

**OVERSIGHT OF THE FINANCIAL STABILITY
OVERSIGHT COUNCIL DESIGNATION PROCESS**

HEARING
BEFORE THE
SUBCOMMITTEE ON
SECURITIES, INSURANCE, AND INVESTMENT
OF THE
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
ONE HUNDRED FOURTEENTH CONGRESS
FIRST SESSION
ON
EXAMINING THE FINANCIAL STABILITY OVERSIGHT COUNCIL DESIGNATION PROCESS FOR NONBANK FINANCIAL COMPANIES THAT COULD POSE A THREAT TO THE FINANCIAL STABILITY OF THE UNITED STATES

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JULY 22, 2015
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OVERSIGHT OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL DESIGNATION PROCESS

WEDNESDAY, JULY 22, 2015

U.S. SENATE,
SUBCOMMITTEE ON SECURITIES, INSURANCE, AND
INVESTMENT,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met at 10:17 a.m., in room SD-538, Dirksen Senate Office Building, Hon. Mike Crapo, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. This hearing will come to order.

Today's hearing will focus on the Financial Stability Oversight Council's designation process for nonbank financial companies that could pose a threat to the financial stability of the United States.

Last year, I requested that the Government Accountability Office initiate a study to examine the process that FSOC uses when designating nonbank financial institutions. The report concluded that FSOC's process lacks transparency and accountability, insufficiently tracks data, and does not have a consistent methodology for determinations.

In February, FSOC approved supplementary procedures designed to improve the SIFI designation process. I am interested in learning how this improved the process and what other changes are being considered by FSOC to improve transparency, accountability, and communications.

One of the criticisms that I hear is that while lots of information is being requested and reviewed by FSOC, there is not a lot of meaningful opportunity for companies to correct or contextualize information being evaluated and to contest specific allegations of the threat that a company poses to the financial stability.

In previous hearings, it has been suggested by some witnesses that FSOC needs to pinpoint specific activities that contribute to the company's systemic risk profile and provide a process for a company to eliminate the identified risks before being designated by FSOC.

In the April hearing that Senator Warner and I held, the witnesses agreed that FSOC needed to have an off ramp to allow designated SIFIs to de-risk and shed their designation level. The goal of such reforms is to ensure that FSOC is more transparent during the designation process about which activities, together or sepa-

rately, pose the greatest threat to financial stability so a company has the opportunity to address them.

Understanding that a process that involves nine regulatory heads, an independent member, and five nonvoting members is never simple, it is important to understand the timeline and the details of the designation process and how we can ensure there is sufficient transparency, accountability, and clarity. I look forward to hearing from our witnesses on these issues today.

With that, we have with us today Mr. Patrick Pinschmidt. Mr. Pinschmidt will—excuse me. I am looking for your official title here. He is Deputy Assistant Secretary of the Financial Stability Oversight Council, and he will testify today from the Department of the Treasury, and we appreciate your being here, Mr. Pinschmidt. I know there is a lot of business going on this morning, and so I expect you will see Senators floating in and out. But we appreciate your taking the time here with us, and you may have 5 minutes now to make your presentation. Your entire written presentation will be made a part of the record, and we ask you to try to summarize your comments in 5 minutes so we will have plenty of time for questions. Please proceed.

STATEMENT OF PATRICK PINSCHMIDT, DEPUTY ASSISTANT SECRETARY, FINANCIAL STABILITY OVERSIGHT COUNCIL, DEPARTMENT OF THE TREASURY

Mr. PINSCHMIDT. Thank you very much, Mr. Chairman.

Chairman Crapo, Ranking Member Warner, and Members of the Subcommittee, thank you for inviting me here today to discuss the Financial Stability Oversight Council's nonbank designations process.

The financial crisis taught us that we need a clear accountability for the overall stability of the financial system. Congress created the Council to bring together for the first time the entire financial regulatory community to identify and respond to potential threats to financial stability.

Today the Council convenes regularly to monitor market developments and to take action when needed to protect the American people from potential threats to the financial system.

Our approach from day one has been data-driven and deliberative, while providing the public with considerable information regarding the Council's actions and views. As Secretary Lew has made clear, Council members recognize that the Council should be open to adapting its procedures and engaging broadly with stakeholders. Just since last year, the Council has demonstrated this commitment by enhancing its transparency policy, strengthening its internal governance, approving supplemental procedures to its nonbank financial company designations process, and soliciting public comment on potential risks from asset management products and activities.

You asked me here today to discuss the Council's responsibility to designate nonbank financial companies for enhanced prudential standards and supervision by the Federal Reserve. The Council takes such action if it determines that a company's material financial distress or activities could pose a threat to U.S. financial stability.

This authority addresses a key weakness brought to light by the financial crisis: that the failure of large, complex, and interconnected companies without appropriate supervision could pose risks to financial stability.

Designating a firm is not a decision the Council takes lightly. Before making a final decision, the Council goes through a lengthy, multistage, in-depth analysis. The review covers every aspect of a company, including financial statements, business activities, market dynamics, and existing regulation.

The Council works with the company and its regulators to understand how the firm's financial distress could affect the broader financial system. Most of the companies the Council has considered so far have not met the standard for designation, but in four cases, after considerable and thoughtful deliberation, the Council has found that a firm needs to be held to a higher standard to protect the U.S. financial system.

The Council recently adopted supplemental procedures for its designations process. These changes were informed by extensive outreach with more than 20 stakeholders, including trade groups, companies, and public interest organizations. We also solicited input from each of the three companies then subject to a designation.

Under the new procedures, companies will now know early in the process where they stand, and they will have earlier opportunities to engage with and provide input to the Council. For example, the Council will notify a company when it first comes under active review and provide it with the opportunity to meet with staff, review the Council's primary sources of public information, and provide information relevant to the Council's review.

The Council is also providing companies with a clearer and more robust annual review process. Company representatives are now provided an opportunity to discuss the scope and process for the review, and they can present information regarding any change that may be relevant, including restructurings, regulatory developments, market developments, or other factors.

In addition, the Council will provide each designated company an opportunity for an oral hearing to contest its designation every 5 years. These changes open the door to more engagement with the Council following a designation to make sure there is ample opportunity to discuss and address any issues that a company wants to put before the Council.

Altogether, these and other changes strengthen the Council's process while also addressing many of the suggestions made by stakeholders.

As Congress contemplates additional changes to the designations process, it is important that such changes do not compromise the Council's fundamental ability to conduct its work. We are particularly concerned with legislative proposals that would dramatically lengthen an already long and deliberative designation process, impose insurmountable practical hurdles on the Council's work, and prevent the Council from taking action to address potential threats to financial stability.

As the President and Secretary Lew have both made clear, we will not support legislation that weakens important taxpayer, in-

vestor, and consumer protections by impeding the ability of regulators to identify and respond to threats to financial stability. U.S. markets and financial institutions are constantly evolving, and we must remain alert and responsive to new challenges in order to maintain the safety, soundness, and resiliency of our financial system.

I thank the Subcommittee for the opportunity to discuss the Council's nonbank designations process, and I look forward to answering your questions.

Chairman CRAPO. Thank you very much, Mr. Pinschmidt.

Senator Warner, did you want to make an opening statement?

Senator WARNER. I will defer.

Chairman CRAPO. All right. Thank you. Then we will go right into questions.

Mr. Pinschmidt, the February supplemental procedures appear to be a positive step toward increasing communication between FSOC staff and firms under review. However, while lots of information is being requested and reviewed, the process does not seem to provide clarity to the companies about which activities together or separately pose the greatest threat to financial stability. So a company basically does not have an effective opportunity to address these issues before and after designation.

Can you please explain when in the designation process companies are informed of the risks that FSOC believes they pose?

Mr. PINSCHMIDT. Certainly. So you noted the supplemental procedures that the Council approved in February. Essentially, that opened up the process. Previously, it was a three-stage process. It is still a three-stage process. Stage 1 was purely mechanical based on certain mechanical thresholds. If you trip one of those thresholds, you go into Stage 2.

Previously, Stage 2 was a preliminary internally facing review by the Council internal facing. If it was a public company, the Council would download the 10-K and 10-Q, do a very preliminary analysis to determine if a company should be considered in Stage 3. And Stage 3 was the more robust back-and-forth period with the Council.

As a result of the supplemental procedures approved in February, companies under consideration by the Council will now be informed at the beginning of Stage 2 once an active review commences on that company. So they will have an opportunity on day one, once an active review is commenced, to come in, meet with a Council analytical team, present information to Council member staff, ask questions if they want to ask questions, and also as part of Stage 2, get a sense for the type of materials that the Council is reviewing during Stage 2 as it looks at the company.

So that was an important facet of the supplemental procedures allowing companies to engage earlier in the process, raise questions, and review the type of materials that the Council—

Chairman CRAPO. But in that process as it begins, is there a point at which the FSOC staff inform the company of which factors and which concerns they are having, if they are having any?

Mr. PINSCHMIDT. So, yeah, that is a very important point. I think one thing to keep in mind is this is the beginning of the process. This is the first time the Council member staff are engaging with

a company, so, you know, it is probably not practical to assume that firm views and positions on the risk will be developed in that process. The threshold consideration in Stage 2 is: Are there enough questions here? Is there a there there to advance the company to Stage 3 to do a deeper dive and a drilldown with the company?

But that being said, as part of the new supplemental procedures, to the extent that through Stage 2, through that engagement, through that preliminary review that is conducted by the Council, again, just relying on publicly available information and information from regulators, there is no provision to get nonpublic information from the company in Stage 2. But based on that preliminary information available to the Council, should the Council decide to advance a company to Stage 3 for additional review, the Council will inform the company at the beginning of Stage 3: Hey, this is what we learned in Stage 2; these are the factors we are looking at; this is what we expect to explore in Stage 3; we are going to send you a list of questions asking very detailed questions; these foot to these key concerns.

Chairman CRAPO. So if I understand you right, the point at which you are transitioning from Stage 2 to Stage 3 is the point at which FSOC will tell the company that we have identified these risks, and these risks, taken either together or separately, are what is potentially going to cause a designation?

Mr. PINSCHMIDT. I just want to be careful on that because it is—you know, Stage 2 is preliminary. It does not benefit from the robust back-and-forth that happens during Stage 3. It does not benefit from nonpublic information that the company provides to the Council. So any view at that stage of the process at the end of that preliminary review is a high-level sense of like, well, these are the potential risk areas we want to drill down deeper on. It is not a firm view as to like these are three things we are going after, we are worried about; you know, these are the three threats to financial stability.

Chairman CRAPO. So even at Stage 3, the company is not going to be informed as to what the specific risks are.

Mr. PINSCHMIDT. Well, I guess what I would say, at the beginning of Stage 3, if the company is advanced to Stage 3, there is a rationale for that decision. The Council comes together, evaluates the record in Stage 2. To the extent that there are potential areas that have been highlighted and Council members are concerned about these areas and want to explore them more in Stage 3, those areas will be highlighted to the company at the beginning of Stage 3.

You know, Stage 3 is a lengthy process. It lasts over a year. It will probably last up to a year and a half going forward. So, you know, that gives a company a sense of the areas that the Council is interested in pursuing with the company, and certainly there will be an opportunity for significant engagement throughout Stage 3.

For example, one recent company had over a dozen meetings with the Council staff. They submitted over 20,000 pages of information. There are a lot of conversations. So as the company goes

through Stage 3 those preliminary areas of inquiry will become much more crystallized for the company.

Chairman CRAPO. All right. Thank you.

Just quickly, how many companies to date that have been moved into Stage 3 have gone through Stage 3 without ultimately being designated?

Mr. PINSCHMIDT. The Council has considered nine companies in total. Of those nine companies, five were considered in Stage 2, and the decision was made not to advance them to Stage 3. Of the four companies that advanced to Stage 3, the four companies were designated.

Chairman CRAPO. All right. Thank you.

Senator Warner.

Senator WARNER. Thank you, Mr. Chairman. I wonder if I could get an extra minute since I skipped my opening statement. I just want to cite for the record that here we are 5 years later, there are some very good things that have happened in Dodd-Frank. There are things, I think, that still need improvement. But I think if the record was ever written about how this provision came about, let me just assure you that there was robust discussion about whether nonbanks should be SIFI designated.

I think one of the concerns that Senator Crapo, Senator Corker, Senator Warren, and I have all had is that this designation of SIFI should not be a Hotel California where you can never de-designate. And I am going to ask some questions about that. I just want to make a couple of comments.

So, first, I share a lot of my colleagues' concerns about the transparency of the process and how we have moved. I think there has not been enough transparency. I think Secretary Lew's change last year made improvements. I think some of the discussions about how firms are brought in, how much information is shared now are moving in the right direction.

I also think we have seen in the case of—Senator Toomey and I may disagree on this one, but on the money market issues, what happened with the SEC moving and saying that size alone should not be a factor was an interesting process. And one of the things that I continue to believe is that size is not necessarily the guiding factor on a SIFI designation. It should be the underlying activities, not simply the size itself.

Now, we have got an example how this should work out with GE. I would point out we saw the Fed's capital requirements I think on Monday of this week. GE has made the business decision to spin off a number of its GE Capital assets. As a matter of fact, CEO Jeff Immelt said, when he announced that move, "This is exactly what was envisioned by the FSOC process." So you got one of America's leading CEOs saying, you know, by making this choice to bring down the size of his firm rather than falling into the full SIFI designation, you know, he is making a business decision that I think is both appropriate and will lessen the amount of risk in the overall system.

As we look at GE, though, I would like to go through—let me just read off a couple of questions, and then you can respond. What risk would the failure of GE Capital pose today in its current status? As GE Capital spins off some of its assets, how does FSOC plan

to monitor the transfer of those assets throughout the financial system to ensure that they do not end up at another firm that would inadvertently trigger other systemic concerns? To what extent are GE's excessively risky assets moving into any kind of shadow banking system? And if they are in that shadow banking system, how would the FSOC monitor? And do you believe that the FSOC and Federal Reserve have the tools and authority necessary to address any existing concerns that may arise with GE's de-risking process?

Mr. PINSCHMIDT. Thank you very much, Senator.

In terms of GE Capital, as I am sure you can appreciate, it is probably not appropriate for me to get into too much of the details of the company's ongoing restructuring.

Senator WARNER. Well, any particular firm, as you take assets that may be risky, if they could go into the shadow banking, or if they simply moved to other firms, how do you monitor that process?

Mr. PINSCHMIDT. Yeah, I think as a general matter, you know, this has been an area, again, speaking generally in terms of the migration of activities or assets from one space to another space, that the Council is very well positioned to monitor, because the Council brings together regulators from across the regulatory community, looking at different types of institutions, looking at different types of markets, and is in a very good position to understand what is driving this. Are there business issues? Are there competitive issues? Are there regulatory issues? And what are the potential consequences in terms of financial stability?

So, more broadly, this is an issue that the Council continues to monitor. It has highlighted this issue in its Annual Report and this will obviously remain a focus going forward.

I think in terms of GE Capital, I mean, clearly there is a process in place. The company alluded to that in terms of them pursuing their de-designation strategy with the Council. This process was elaborated on in the February supplemental procedures. It is very clear, to the extent a company wants to pursue this strategy, there is an off ramp available, and there is a process that they can engage with at the Council. They can ask questions. They can get responses to those questions and the purpose is to be as transparent as possible to give companies the right information to make decisions.

Senator WARNER. Let me just in my last remaining moments say that another area of great concern has been the whole question around insurance designations—obviously AIG, one of the firms that caused the crisis in 2008. What have you learned from the designation of AIG that helped guide you when you went through the same process with Prudential and MetLife? Obviously, I believe Roy Woodall offered a dissenting opinion on that issue. Could you explain why you disagree with Mr. Woodall's dissent? And just on a more general basis, under what circumstances do you believe an insurance firm could pose systemic risk? And can you see any kind of hypotheticals going forward since this is going to be an area that I know a number of my colleagues have concerns about as well?

Mr. PINSCHMIDT. So I think generally, in terms of the Council's approach to the three insurance companies designated, these were company-specific analyses, you know, that took over a year on each

of them, sometimes as much as 2 years. So, you know, I think each company is different, and each company poses a different set of potential risks, not in their standard operations but should they encounter financial distress in terms of what that impact would be on broader market functioning. That was, of course, the threshold decision by the Council.

I think generally speaking, across the three firms, the Council's analysis—which is outlined on the public bases on the Council's Web site, providing a summary of the rationale for each of the designations. But I think speaking generally, the focus of the Council was on the exposure of broader financial markets directly and indirectly to each company and also the asset liquidation channel in the sense that if the company got into trouble, had to liquidate assets, what would be the consequences of that liquidation on broader market functioning? So I think, you know, generally speaking, because of these companies' size, interconnectedness, not necessarily their vanilla or straightforward insurance operations, but, you know, other operations that are not really in that category, the decision was made to designate them.

Senator WARNER. Thank you, Mr. Chairman. I would just simply close by saying that I know there is great reluctance from the administration about codifying any changes with the process. I understand some of your concerns, but I do think there have been some movements in the right direction on transparency and ensuring that those transparency requirements are going to last into future administrations. I look forward to—if it is not legally codified, how can we ensure that? So that might be for a future round of questions.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Corker.

Senator CORKER. Thank you, Mr. Chairman. I thank you and the Ranking Member for having this hearing, and you, sir, for your testimony.

Look, with FSOC, my sense is we have a number of people in the Senate that would like for FSOC not to designate anybody as a SIFI. There are probably some people, on the other hand, that think FSOC is working just fine the way that it is.

But my guess is there is a pretty large group of folks that would like to see the process be improved, and my guess is even you would like to see the process get better as it moves along.

So I want to ask one long question for you to respond. There are three areas where I think there could be a lot of consensus around improvement. One would be the disclosure prior to designation—I know that you talked a little bit about that in answering Senator Crapo's question—but really being more transparent about the analysis that is given, and give people the opportunity on the front end to more fully understand.

Second, as they are moving into the upper stages, as you alluded to in your comments, giving them a predesignation off ramp so that before they are designated, they can off-ramp, they can just go ahead and share with you, and you can work with them toward that end to make sure in advance of being designated they have the opportunity to off-ramp. My sense is—you alluded to GE just

a minute ago. Maybe there was not that opportunity for them even though it appears that they have certainly done a lot to make sure they are not a SIFI. You can decide whether they have or not.

And then after that, especially Section 113 of Dodd-Frank says that the FSOC will reevaluate each determination at least once a year. It seems to me that if we could work more fully to understand how you could have a post designation off ramp, there would be a lot of consensus on this Committee toward supporting that. And I wonder if you might just lay out whether you agree that some of those types of things would be helpful, and if so, what those things might be that we could come around legislatively.

Mr. PINSCHMIDT. Yes, and, certainly, I think you raise some good questions, and I would like to sort of tick through them, and please interrupt me if I am not addressing it the way you wanted me to address it.

So in terms of disclosure throughout the process and getting companies as much information so they know where they stand as they are going from Stage 2 to Stage 3 and within Stage 3, I would reiterate that this is a very lengthy process. There is a lot of engagement. There is a lot of paper going back and forth. There are a lot of meetings. And that being said, as part of the supplemental procedures we put out in February, we recognize that to the extent the Council has formed views or has questions, that information will be shared with companies sooner in the process. For example, in Stage 2, allowing the company to come in and meet with Council member staff, allowing the company to present anything it wants to present, and basically allowing the company to ask the Council member staff what information are you using in your analysis today. So I think—

Senator CORKER. If I could, just on that point, so when they do that, if Company X says, “Look, I will just unload my entire financial arm. I am a manufacturing operation, an industrial operation. I will just unload my entire financial arm,” which a particular company has done, would you all then say, “OK, well, if you will do that, then forget it, we will not designate you”? Does that kind of process occur?

Mr. PINSCHMIDT. So what I would say is that the Council will always consider any information or requests brought to it by companies under consideration. So of the four companies that the Council has designated, there was never one specific issue that triggered the designation. So there was—

Senator CORKER. But if you are not in the financial business, I would think that would be a pretty big clue that maybe they are not a threat to the financial system. Would that be the case in one particular—and I do not want to drive home one company, but if you are an industrial company, you say I am going to be out of the financial business, would that keep you from being designated as systemically risky to the financial system? I just think it would.

Mr. PINSCHMIDT. I was referring—it was not the industrial company that was designated. It was the sub. And if you look at the basis that was posted publicly for that decision, it was a confluence of different factors that drove that decision. I guess what I am referring to is hypothetically, let us say it is Company X and they have this business that is doing something that is very scary, and

that is the reason they are going to be designated. So if that company wanted to come to the Council and say, look, we have a proposal to deal with this, that is certainly a conversation that can happen within the current process. It just has not happened with the four companies that were previously designated because there was no one factor that triggered it.

Senator CORKER. But there is a clear opportunity for them, though, to present and say, look, if this is of concern to you, it is not worth it to us to be identified in this way, it hurts our investors, so we will do away with this. There is a clear process laid out where they can do that and be off-ramped.

Mr. PINSCHMIDT. Yeah. Certainly, we are talking about a 2-year process from beginning to end for a designation. So that is a lot of time, and there are certainly a lot of opportunities for the company to bring information, the primary regulator to bring information that would be considered by the Council.

Senator CORKER. And the other two issues—I realize I have run over my time, but we will send you a question so you can give us some information about the post-designation off ramp and what you are doing to make sure that companies have a route to be undesignated. And I guess that process exists somewhat today. Yes or no?

Mr. PINSCHMIDT. Yes. I would be happy to discuss it quickly if you wanted me to.

Senator CORKER. Well, I do not know if the Chairman is that lenient today, but thank you.

Chairman CRAPO. Thank you.

Senator Donnelly.

Senator DONNELLY. Mr. Chairman, in the interest of my colleagues' questions, are you in that mood today, sir? Just kidding.

Thank you very much for being here, sir. One of the questions I wanted to ask is: Based on your participation at recent FSOC meetings, one of the other things that you have responsibility for is what are some of the emerging threats that you see in the economies, whether here or overseas, that are most concerning? Obviously, first and foremost I wonder about here. One of the things I have always tried to do is say, OK, what might be out there that might lead toward a similar situation that we had in 2008 and how do we prevent it?

Mr. PINSCHMIDT. Thank you. So that goes to the core of what the Council does. I know a lot of focus is always on—

Senator DONNELLY. I know it goes to the core. I am just asking what are the things you are looking at right now that have you most concerned.

Mr. PINSCHMIDT. So the Council's Annual Report highlights the key risks that the Council believes are in the current financial system and the best recommendations to address those. I think this year's Annual Report, consistent with prior years, highlighted cybersecurity. I think that one remains at the top of everybody's list in terms of fostering greater information sharing between Government and the private sector, making sure that technological capabilities are in place, and just understanding the threat and how it would potentially play out in terms of responding to that threat

and recovering from that threat. So that is a key area of focus for the Council.

I think given the current economic backdrop, one recurring theme throughout the report is the reach for yield dynamic. You know, we have had interest rates low for a long time, and it is only natural that some investors and some market participants will reach for yield, whether it is on a looser credit quality, whether it is taking on much more risk for incremental gain, and that is an area for market participants and regulators to be very focused on going forward.

I think two areas that were highlighted in this year's Annual Report that were not highlighted in previous reports. I think central clearinghouses as Dodd-Frank is implemented—and certainly Dodd-Frank anticipated this—clearinghouses are playing a much bigger role in terms of providing transparency and stability to the system. But because of that rule and the more transactions that are going through them, it is important that regulators continue to remain vigilant as to how these entities are being run, how they are being risk-managed. There is certainly a lot going on. There continues to be a lot going on on that front. But it is a very strong focus.

And I think, finally, another new area that was highlighted in the Annual Report was—and this is something we are hearing a lot about lately—emerging market structures across different asset classes. You have seen an increase in electronification. You have seen structural changes in how markets operate and understanding how those changes are impacting market functioning and to the extent that they could pose any potential risks.

Senator DONNELLY. Let me ask you a question I have been asked by folks back home, as well as in other places, and that is, for mutual funds, which many of us have used for 401(k) or for other purposes. So you have a mutual fund that gets in \$1,000 and invests \$1,000 into the market or into bonds or wherever for you, that they are not running margins, that they do not—you know, you give them 10 bucks, they invest 10 bucks, period. Where is the systemic risk in that?

Mr. PINSCHMIDT. So, yeah, I think you are absolutely right when you think about traditional mutual funds. They are a different animal in terms of how they invest and how they operate. They do not have the balance sheet. They do not have the leverage. It is an agency model. They are not investing their own money.

But I think, broadly speaking—and this is why the Council is doing some work on this front. There has been incredible change in that space, and there are certain activities across the industry that there are a lot of legitimate questions on in terms of certain products, for example, ETFs and certain liquidity features of certain products.

The Council right now is not focused on individual companies. The Council is prioritizing a review of industry activities and products, and issued a *Federal Register* notice last December with a series of questions, just trying to get more information from the industry and other stakeholders, including information on some of the issues you are raising.

Senator DONNELLY. So if you have not—and I apologize if you already did make a list of—you mentioned ETFs. If you have put out a list of here are the things we are concerned about so that companies have an idea of what to avoid if they want to avoid being systemically designated.

Mr. PINSCHMIDT. So let me just clarify that. I think it is premature to say the Council is concerned about any one thing right now. What the Council did in December was issue a *Federal Register* notice highlighting four key areas for exploration.

Senator DONNELLY. What I think is important is: How do you know what to avoid if you are not being told here are the things we want you to avoid?

Mr. PINSCHMIDT. So what I would say is the Council has not really—has not finished its process in terms of understanding if there are even legitimate risks there. It is an ongoing process. It is engaging with the industry. The Council is focusing on four areas: liquidity and redemption risk, leverage, operational risk, and resolution. And within each of those four areas, the *Federal Register* notice asked a series of questions, probably eight questions in each section, and points out potential areas of concern to explore. And we are trying to get information, understand the nature of potential risks. And to the extent there are risks, then, there will be a dialogue about those risks. But I think it is premature to point out to any one single feature rising to a certain level at this juncture.

Senator DONNELLY. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Scott.

Senator SCOTT. Thank you, Mr. Chairman. Good morning, Mr. Pinschmidt.

Mr. PINSCHMIDT. Good morning.

Senator SCOTT. I personally think it is highly unlikely that asset managers pose a systemic risk, honestly. But Federal Reserve Governor Tarullo recently suggested that activities-based designation in the asset management industry would be preferred to entity-based designation. Can you please commit that if the FSOC goes down this path with asset management activities, it will revisit the entity-based designation of the insurance SIFIs and consider an activities-based designation for them as well?

Mr. PINSCHMIDT. Thank you for your question. So you are right that for asset management the Council is currently taking an activities-based approach. The Council made a decision back in July of last year, asking staff to prioritize an industry review focused on asset management products and activities. But I think in terms of the larger question here, in terms of entity review versus industry-wide review, it is really not an either/or question.

I think where there are risks at individual firms based on their size, interconnectedness, and the consequences of their failure to the financial system, the Council has taken action. Where there are broad-ranging questions regarding certain activities or products, the Council has also sought to get answers to those.

Neither approach precludes the other option. So to the extent that you are looking at industry activities, it does not mean you cannot look at individual companies. And to the extent you are

looking at individual companies, it does not mean you cannot look at industry activities.

I think, in the case of insurance, certainly in the Annual Report, the Annual Report has talked about areas whether it is captive re-insurance, whether it is the “reach for yield” dynamic I referred to earlier, that there are certainly ongoing questions on an industry-wide basis that the Council needs to explore.

Senator SCOTT. Dodd-Frank turned 5 years old yesterday, and in an interview with the Wall Street Journal with the bill’s author, former House Financial Social Security Committee Chairman Barney Frank said, “I do think there is a tendency for an overreach by the FSOC. I do not think straightforward insurance companies or money managers should be covered and regulated as SIFIs.” Do you agree or do you disagree with Chairman Frank?

Mr. PINSCHMIDT. So I certainly have the utmost respect for Chairman Frank. I guess what I would say is the Council was created 5 years ago to bring together regulators from across the regulatory system with a common responsibility to identify and respond to threats to financial stability. The rationale for that was a recognition that threats evolve over time. Financial institutions and markets are not static and, thus, risks evolve over time.

So to the extent 5 years ago there were certain risks folks were worried about, those risks have changed over the past 5 years, and they will change again over the next 5 to 10 years.

I will say in the case of the Council’s review of insurance companies, it has not been the straightforward dynamics or the vanilla dynamics of the insurance companies that triggered the designation. These were large, highly interconnected companies whose failure could potentially pose a threat to financial stability.

I think his comments also referenced mutual funds. As I just alluded to earlier, the Council has not designated any mutual funds. The Council is focused on products and activities across the industry—engaging with the industry to better understand the nature of potential risks, which are albeit very different from other risks in the financial system.

Senator SCOTT. Thank you.

Senator WARNER. [Presiding]. Senator Toomey.

Senator TOOMEY. Thanks, Mr. Chairman.

[Laughter.]

Senator WARNER. You get used to that.

Senator TOOMEY. Yes, never mind.

[Laughter.]

Senator TOOMEY. I want to pursue this discussion that, well, almost everybody has been talking about. You have acknowledged that there is a focus in the asset management space on activities and products, but you also seem to suggest that that is not to be understood to be an alternative to entity designation. So I just want to be—first of all, let me be clear. Let me ask you, are you telling us today that entity-based designations are still on the table and that it is still entirely possible that individual asset management firms will be designated as SIFIs as such?

Mr. PINSCHMIDT. So I was responding generally to the question on terms of activities versus entity-based reviews.

Senator TOOMEY. Right.

Mr. PINSCHMIDT. I think the Council has been very clear. The Council has been evaluating risks in the asset management space for some time. And after about a year of work in multiple different work streams on that front, across different areas, the Council directed staff to prioritize a review of asset management products and activities. So that certainly is the focus of the Council.

Senator TOOMEY. I understand. That did not even come close to answering my question. My question is: Has the FSOC taken off the table entity-based designations? Or is it still entirely possible that the FSOC will decide to designate asset managers as SIFIs per se?

Mr. PINSCHMIDT. I cannot speak to the Council in terms of what it may decide down the road—

Senator TOOMEY. Wait a minute. You cannot answer the question of whether or not you have taken off the table entity-based designations and substituted exclusively activity-based designation? You cannot tell us whether that is your criteria?

Mr. PINSCHMIDT. What I can say is the Council is firmly focused on products and activities across the industry, and a broad review informed that focus by the Council. So I think the Council is very committed to this. They issued a *Federal Register* notice for comment. They are engaged in a back and forth with the industry and other stakeholders, designed at understanding the risks. And I think what triggered that is a recognition that asset management firms are different. You know, they—

Senator TOOMEY. Yeah, we know that. But I got to tell you, this—you know, the opacity with which the FSOC has been operating is extremely disturbing, and when you come here today and you continue to obfuscate about a very fundamental and basic question, that is extremely problematic.

Senator Donnelly raised the question: How can a firm choose not to be systemically risky if it does not know what activities you consider to be systemically risky? I do not understand how it is defensible not to have a clear, objective, public description of the activities that you think give rise to systemic risk so that a firm could decide to note engage in them and know in advance that thereby it will avoid this designation. How can that be unreasonable?

Mr. PINSCHMIDT. Senator, I think that is completely reasonable. I mean, I—

Senator TOOMEY. Except you do not do it.

Mr. PINSCHMIDT. I guess my point is the Council is in its risk identification phase. It really has not, you know, come to conclusions on risks in the asset management—

Senator TOOMEY. It seems to be pretty far down the path of designating individual firms.

Mr. PINSCHMIDT. Again, I think the Council was very clear a year ago that it is focusing on products and activities rather than individual firms, and to the extent the Council arrives at some decisions in terms of potential risks, those decisions will obviously be shared with the public.

Senator TOOMEY. So can we be assured that no firm will be designated until the Council has reached the decision about what activities give rise to systemic risk?

Mr. PINSCHMIDT. I mean, certainly, the process now is not looking at individual firms. It is looking at activities and products across the industry. And to the extent there are specific activities and products that concern the Council that pose risks, the Council will then obviously engage further in terms of the specific concerns—

Senator TOOMEY. Well, here is another problem we have. If you guys decide a particular activity deserves to be designated, one of the things that is still entirely unclear is how the Fed will choose to regulate a nonbank that gets drawn into this web.

It seems to me that the only way that a firm can make an informed decision about whether or not it wants to exit an activity that is the source of its designation would be to know how that activity is going to be treated. So can we be assured that we will not have any designations until the Fed also comes out and publicly discloses how it intends to regulate these activities?

Mr. PINSCHMIDT. So the role of the Council and the Fed is clearly different here. The Council is responsible for risk identification. The Fed is responsible for addressing that risk with enhanced prudential standards.

What I would say—and, again, I am sort of speaking for the Fed on this. What they have said previously and certainly how they have approached it with some of the prior designations is they recognize each industry is different and the players within industries are different. So their view and their approach has been to tailor the enhanced prudential standards for the risks posed by individual firms. And I think that in order to tailor, you need to understand what the nature of the risk is first, so, therefore, there is kind of a sequencing there.

Senator TOOMEY. Well, and the sequence should include that all of that should be very well known and understood and publicly debated before anyone is subject to this regulation that they had no way to avoid but might well have chosen to avoid.

Thanks, Mr. Chairman.

Chairman CRAPO. [Presiding]. Thank you, Senator Toomey.

Senator Heller.

Senator HELLER. Mr. Chairman, thank you, and to the Ranking Member also. I am not a Member of this Subcommittee, but this is a fascinating discussion, and probably in my home State one of the—probably one of the biggest issues that I get questioned on constantly. This financial downturn did not help the State of Nevada by any means, and most people are very aware of the amount of unemployment. We lost a lot of banking entities in the State. We probably lost more than half of our local banks, community banks, over the last 5 or 6 years, and it has been pretty devastating to the economy. So that is why I am here today, and I want to thank our witness today also for taking time and answering our questions. I know sometimes it is a little uncomfortable, but it does help this process move forward. So thank you for being here today.

I do have a few questions, and, again, it is along the line of everybody else, but I think this is important to the banking industry and the nonbanking industry to get clarification on some of these questions.

I guess my first question is: Is it your belief that no firm should ever be undesignated as a SIFI?

Mr. PINSCHMIDT. Oh, certainly not, no. There is a clear process in place. If a company decides to pursue a de-designation strategy, that is available to that company.

Senator HELLER. See, that is the argument. The argument is that there is not a clear process, and so that is why I asked you that question. This is what these entities are coming to me saying, OK, if there is a designation, how can we avoid it? Again, this is the same question everybody else is asking, but I guess we are really trying to get down to the basic answers on this.

You are saying that there is a clear path—a clear path—that a company can come to you and be told specifically what it takes or an off ramp if, in fact, a SIFI designation were to occur?

Mr. PINSCHMIDT. Yes. So, look, I will walk you through that. So after a designation is made, the Council subjects every company to an annual review process, and the basic—the process there is to evaluate what has changed at that company since the designation, and to the extent there have been changes, are those material that would warrant a potential rescission of the designation?

As part of the supplemental procedures we put out in February, we put some more meat on the bone on this in terms of kind of letting companies know what their rights are and how we would expect to conduct the process, because bear in mind we have not really gone through this process a lot because we just had the first round of designations just 2 years ago.

But the way it is set up now at the beginning of the process we will send a letter out to the company inviting them to come in, meet with Council member staff, and that is their opportunity to raise any questions they have, to highlight any changes in their business. Our view is that each company that has been designated, they receive a 200-, 300-page document from the Council outlining the key factors as to why they are designated. So our view is companies know why they are designated and what risks the Council is concerned with.

But to the extent that they have questions on that, to the extent they have—well, you cited these factors, if we did this to that, what would that mean? This is a forum to allow that sort of dialogue.

Senator HELLER. Help me understand—I am sorry to interrupt because I do not have a lot of time, but help me understand what it means when you say that you are still going through the risk identification phase. Does that impact a company's ability to exit a SIFI designation?

Mr. PINSCHMIDT. So I think the risk identification phase, what you are referring to, is in Stage 2, and that is kind of at the preliminary—the beginning of the process—

Senator HELLER. But you are still saying you are going through this process?

Mr. PINSCHMIDT. Not in terms of the annual reevaluation. So the annual reevaluation reflects—comes after the designation. It comes after the company receives a lengthy 200-, 300-page document from the Council outlining the key risks and the concerns of the Council. So the company, in that position, comes into that meeting post their designation with a long document outlining the risks, and

this is an opportunity for the company to talk to Council staff and say, look, this is what we are thinking, this is what we have been doing, these are potential other ideas. What were you thinking when you said this? What were you thinking about this? And just have that dialogue, because we feel it is important, to the extent a company wants to pursue an off ramp, there are many different ways to go about doing it. And the company is in the best position, the management team is in the best position to assess the relative pros and cons of those options, and we want to provide as much information.

Senator HELLER. Let me add one thing. I guess the confusion and the comments that I am receiving—there is a lot of dialogue. There is a lot of dialogue. But what they do fear is that there is not enough action. In other words, they talk and talk and talk, and very rarely are there instances where decisions are actually made. I do not know how you change that, but that is a concern and a reflection right now of what the Council is doing.

Mr. PINSCHMIDT. So what I would say is, again, we have not been through this process a lot yet because just for the timeline in terms of when companies were designated. But, I think dialogue is a precursor to action, and to the extent a company is motivated to pursue a de-designation strategy, there is a pathway forward to do that. There is a mechanism and a process to allow it. And to the extent a company wants to contest their designation, if the Council votes not to rescind that designation, the Council will respond in writing, giving a rationale and reasons. And that is very valuable information to the company, and ultimately if a company—again, this is part of our supplemental procedures. If a company feels that they are still not being heard, there is an opportunity for an oral hearing with the entire Council regarding that designation.

Senator HELLER. Mr. Pinschmidt, thank you.

Mr. Chairman, thank you for allowing me to be here today.

Chairman CRAPO. You are welcome. Thank you.

We will do one more round for those who want to ask questions. We are going to try to wrap up here by half past the hour. I think we can do that.

Mr. Pinschmidt, as you can see, there is some frustration up here, and the frustration, the way I would describe it is that we consistently hear that there just does not seem to be a way to get specifics from the FSOC process when a company is being evaluated so that the company can know what specific activities it or are they that are creating the risk concern that could result in a designation. And as you give your answers, I do not seem to see the answer to that question.

There is obviously a lot of document production. There are opportunities to get together and sit down between the FSOC staff and the staff of the company that is being evaluated. But in that process, is there ever a time at which the FSOC says these are the activities that this company is engaging in that we believe present potential risk to the system?

Mr. PINSCHMIDT. Yes, I would say there is, and I think obviously it is an analytical process. The information and the Council's understanding and views of the risks evolve over time as there is more information, particularly in Stage 3 when you are dealing

with nonpublic information and you are actually having meetings with the management team on a regular basis.

But what I would say is that the new process, when we did the supplemental procedures in February, we talked to a lot of people. We talked to the companies that were previously designated. We talked to industry groups. We talked to the GAO. We talked to congressional staff. And we heard a lot of different things, and it made sense for us to assess what improvements we can make in the process that allow for that engagement, allow for that back and forth. And that is what precipitated the 17 changes in February. One of those areas, again, to your point in terms of knowing earlier in the process where they stand, Stage 2 is no longer an internal FSO process. It is open to the company. The company is notified. They have the opportunity to come and present. They have the opportunity to ask what information the Council is considering. And at the end of that process, should the company—and, again, this is just based on preliminary information, publicly available information. At the end of Stage 2, if the Council should decide to move a company to Stage 3, the Council will let that company know, well, hey, these are the factors we are kind of looking in on, you can expect questions on this, questions on that, this is what we want to explore and drill down with you in the next year as we do a Stage 3 evaluation. And then as we move through Stage 3, if there is a decision to make a proposed designation to a company, so before a final vote by the Council, the company under consideration—again, before a final vote on designation—they are given a 200-, 300-page basis for a proposed determination which outlines in very specific detail the Council's view, the Council's concerns, and the rationale for a proposed decision on designation.

Chairman CRAPO. And at that point, do you agree that there should be an opportunity for an off ramp? In other words, if at that point when the decision apparently has been made and the risks have been identified, the activities have been identified, should not the company at that point have an opportunity to evaluate its business model and structure and determine whether to adjust it?

Mr. PINSCHMIDT. Well, what I would say is if there was one specific area that the Council was focusing on, they would know long before that proposed designation document was given to the company. So, I mean, there would be an opportunity for dialogue. But, again, there has not ever been in the cases of the four companies designated where there was one specific thing that could be addressed in sort of an expedited manner.

Chairman CRAPO. Well, let us take a case of one of the four companies or a hypothetical fifth company that does get designated. So the process is finished. The company is designated. Should there be an off ramp?

Mr. PINSCHMIDT. Absolutely, absolutely. And that is why the supplemental procedures made it very clear that, to the extent companies have questions, to the extent a company is determined to pursue an off-ramp strategy, there is a path there. And it is, you know, not a simple endeavor, because as I noted before, there is never really one or two things or there has not been in the past—

Chairman CRAPO. But in that case—and I am interrupting because we are running a long time, but in that case, should not the

FSOC have a responsibility to work with the company to help them identify what the proper elements of an off ramp should be?

Mr. PINSCHMIDT. Absolutely. I think it is very important that companies—I mean, this is a big decision for a company. They need to have the best information. There are pros and cons to weigh. The key point here is there is an off ramp; there are multiple different lanes. The company should be able to choose which lane they want to pursue based on the best available information. We have a process in place to allow companies to do that.

Chairman CRAPO. All right. Thank you.

Senator Warner.

Senator WARNER. Well, thank you, Mr. Chairman, and I want to, frankly, continue this line of questioning.

The Chairman and I work very closely together. We may not come at this from exactly the same direction. I actually think FSOC has improved its performance. I think there clearly are cases of nonbank financials who are systemically important. But I really urge, Mr. Pinschmidt, that you kind of be more collaborative with us because there does still seem to be this transparency issue.

One of the things just this week with the Fed setting some of these new capital rules, having a company being able to more fully evaluate the cost of designation is important. So that is a step in the right direction as well. And I think all of us will be watching very closely GE's process to see whether the off ramp works.

But what I do not hear is a disagreement that predesignation, at some point along the way, there ought to be enough clarity for a company to make the decision to spin off whatever component of its business that causes the systemic risk.

Senator Corker and I worked deeply on Title 5 years ago, and we always envisioned that there would be this off ramp. And I guess what my question is, we need your help working through this, or I think you are going to end up seeing Congress without the full amount of information and experience that you have gone through, learning this process in 5 years, potentially take action, and that might not be the right—this would be much better done collaboratively. I do not think there is a difference of opinion that there ought to be an off ramp predesignation and there ought to be even after designation, then the ability on the annual review to have an off ramp. If we want to send the signal that for those on the Committee on both sides who think we have not ended too big to fail in whatever connotation, bank or nonbank, I think we would like nothing more than the ability to show, now, look, this is the way out.

Can you just speak to that a little bit? And why can't we get to a common place here that either is codified in law or codified in rules? Because who can predict what the next Secretary—I think Secretary Lew has moved appropriately and aggressively to try to work through this, and I think the process has improved. But if it is all left with this lack of clarity, a future Secretary from either party could veer dramatically off the course that has been set.

Mr. PINSCHMIDT. Thank you. I guess what I would say is I think it is important to allow the supplemental process changes that the Council approved in February to work through. I mean, we are just

now beginning the first round of annual reevaluations post the supplemental procedures.

But that being said, in terms of kind of the predesignation off ramp that you were referring to, the Council will consider any proposal from any company at any stage of the process. So while it is not formally in the current process for designations before a decision is made on designations, that is not to preclude down the road a company presenting a proposal, a regulator presenting a proposal, and having a mechanism to discuss that within the Council.

So what I would say in terms of, I think, the legislation before this Committee, what it creates is it effectively creates a situation that would essentially double the length of a designation.

Senator WARNER. I do not support that component.

Mr. PINSCHMIDT. OK. So we go from 2 years to 4 years, and I think when you are thinking about a 4-year analysis, that essentially becomes unworkable, and it would just basically hamper the Council's ability to identify and respond to risks. But I think, certainly to the extent that there are other proposals out there that work within our current process, if we can do a better job sort of making clear how this will work, we are certainly happy to do that and work with you.

Senator WARNER. Let me just interrupt you for 1 second because, again, I want to be sensitive and let Senator Donnelly get his question in. I simply want to say it has gotten better since some of the changes, but when we hear company after company say we are not being told how to get off, what to do, and you understand when we say we have to continue to protect the confidentiality of the process, we are only getting one side of the story. And that is troubling.

Mr. PINSCHMIDT. If I could just answer that question real quickly, I think one thing to keep in mind here is that these—the supplemental procedures were approved in February. We have not really entered in the post-supplemental procedures annual reevaluation phase yet. So I think some of what you may be hearing is based on the view of the process previously. We have made some changes. I think they are very good changes, and they are going to dramatically improve the level of engagement and I think get the information to companies that they need to make decisions regarding a potential off ramp. And I think we need time to let that work out, and then to the extent that there are concerns or things to address, we are very happy to do that.

Chairman CRAPO. Senator Donnelly.

Senator DONNELLY. Thank you, Mr. Chairman.

I used to serve in the House. I served on the House Financial Services Committee, and Barney Frank was my Chairman. I was there during the time that Dodd-Frank passed, and Chairman Frank helped write the bill. And, I do not want to put words in Barney's mouth. I am just following what he was quoted as saying. His quote was—Frank did not believe that asset managers or insurance companies that just sell insurance are systemically important and should not be labeled as systemically important financial institutions. And when Mr. Scott asked you about that, you said, well, that was 5 years ago, and so we have to determine what threats have evolved over time in that space.

So if you could tell me what threats have evolved in insurance companies who just sell insurance or something like a mutual fund that just gets in a dollar and sends out a dollar, I would like to know what those additional threats are.

Mr. PINSCHMIDT. Yeah, so let me clarify my comment. I was not—the Council has not designated any companies based on—any insurance companies based on straightforward insurance products.

Senator DONNELLY. Barney was the Chairman of the Committee that helped write the legislation.

Mr. PINSCHMIDT. Yeah, but what I would say, you know, pointing to the three designations for insurance companies, none of those designations were made based on straightforward insurance activities.

Senator DONNELLY. OK. I am just saying when you look at this, the hard part to understand is: How can you avoid a systemically important designation, how can you make sure you do not wind up with that if they do not know what the rules are, if you do not know what the judgment is going to be of how these are determined? And so if you are running a business, you cannot make decisions unless you know what the rules of the road are. And for the FSOC not to let them know, it just makes no sense to me.

Mr. PINSCHMIDT. Look, I agree with you that it is very important to let companies and let industries know how they are being evaluated. And I think certainly the nonbank designations rulemaking that was done in 2012 reflected three rounds of public comment, including comments by industry folks about the standards the Council is looking at in Stage 1, Stage 2, and Stage 3. And that process worked for the companies the Council designated, but it was only natural to sort of step back and say, well, look, we have gone through this process with a few companies, there are areas to improve it, to improve the information flow from the Council to companies, and that is why the Council—

Senator DONNELLY. I just want to make two other points. This is not just about mutual fund companies or insurance companies. What happens is so you run a small business, and you set up a 401(k), and you send your money to the mutual fund company, and you hope that you get a decent return so you can retire and you can have a nice little condo, have a chance to go fishing on the dock, and enjoy life and see your grandkids. Your annual return is going to be less each year if a portion of the money you send in to that mutual fund company has to be set aside because they have been designated as systemically important, and all of a sudden there is less money. This is about the ultimate family at the end of the day. It is not so much just about the mutual fund company. It is about their customers, the millions and millions and millions of Americans that our job is not make it so that their return winds up to be lower at the end of the day. If it is just as safe and they can get a higher return, what are we doing?

Mr. PINSCHMIDT. So I think two things on that point. The Council is not focused on individual mutual funds in terms of the designation, and I think there is also—I do not think anybody would want to see, if there was an issue with a designation, that bank-like standards would be imposed on certain nonbank companies that do not have bank characteristics. So I think some of the stud-

ies out there that sort of hypothesize as to what the consequences of designation would be are based on faulty data and I think, frankly, just do not reflect the record in terms of where the Council is focusing. They are focusing on products and activities, not individual entities within the mutual fund space.

Senator DONNELLY. And then the last question I will ask is this: If you are company and you do not know what the rules are, and then the rules finally come out and you get told, OK, you are now going to be designated as systemically important, do they have a grace period to try and get a fix so that the areas that you do not want them in they can get out of?

Mr. PINSCHMIDT. So I think—

Senator DONNELLY. Because if you do not know the rules and then you are told, well, this part is what does not work for us, if I was running a business, I would say, OK, give me a month or two, let me get that squared away so I will not be in it anymore.

Mr. PINSCHMIDT. Look, the Council endeavors to be very transparent regarding the factors that it is looking at. I mean, a lot of it is spelled out in terms of the nonbanks process, and it has been improved upon by the supplemental procedures in February.

To the extent companies are not aware of what they are being looked at, there is an opportunity for them to engage in a dialogue and answer questions.

Senator DONNELLY. But wouldn't it also be incumbent on you to let them know these are the areas we are looking at, to make it public to everybody?

Mr. PINSCHMIDT. There should be no surprises in terms of what the factors are and how the Council is looking at individual industries or more generally specific companies. But the framework for that—a lot of that is public.

Senator DONNELLY. OK. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you, Senator Donnelly, and thank you for being here with us, Mr. Pinschmidt. As you can see, there is a lot of interest on the Committee about getting this right, and I know you have given us a lot of assurances that the process needs to be given a chance to play out and see how it works, that we will be focusing on it very carefully.

It just seems to me that at Stage 2, which is now open and publicly engaged in, we ought to be able to very quickly see the companies and the FSOC be able to come to an understanding of what the issues and activities and risks are that are being evaluated and be able to engage in analysis and discussion about how to deal—first of all, how to analyze those risks and those activities to determine whether there is a systemic risk; and, B, understand what the FSOC's conclusions are as they move along so that options for addressing it can be engaged in. It seems to me that would be a much more positive outcome for the economy, for the ultimate consumer, and, frankly, for the country and the individual companies.

So I encourage you to take these concerns back to the FSOC folks and let them know that there really is a high level of concern here about whether we have got it right. And most importantly, we want to get to the transparency and to the right outcomes. And if it takes more legislation to do that, then we want to know how to get it right.

In any event, we appreciate you taking the time to be here with us today. I am sure there will be follow-up from Members of the Committee. I would appreciate it if you and your office would respond promptly if there are follow-up questions.

Mr. PINSCHMIDT. Absolutely. Thank you.

Chairman CRAPO. Thank you. This hearing is adjourned.

[Whereupon, at 11:28 a.m., the hearing was adjourned.]

[Prepared statement supplied for the record follows:]

PREPARED STATEMENT OF PATRICK PINSCHMIDT
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Chairman Crapo, Ranking Member Warner, and Members of the Subcommittee, thank you for inviting me here today to discuss the Financial Stability Oversight Council's (Council) process for nonbank financial company designations.

The financial crisis taught us that we need clear accountability for the overall stability of the financial system. Five years ago this month, Congress responded with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Wall Street Reform), which established the Council. The creation of the Council brought together, for the first time, the entire financial regulatory community with a collective responsibility to work together to identify and respond to potential threats to financial stability. This new mission required regulators to break out of their silos to strengthen the stability of the U.S. financial system.

Over the past 5 years, the Council has demonstrated a sustained commitment to working collaboratively to fulfill its statutory mission in a transparent and accountable manner. We built a new organization and developed strong working relationships among Council members and their staffs to provide a forum for candid conversations; share confidential, market-sensitive information; and ask tough questions that will help make our financial system safer.

Today, the Council convenes regularly to monitor market developments, to consider a wide range of potential risks to financial stability, and, when necessary, to take action to protect the American people against potential threats to the financial system. Our approach from day one has been data-driven and deliberative, while providing the public with considerable information regarding the Council's actions and views. The Council fosters interagency engagement on a daily basis, including through staff-level committees that discuss financial market developments, regulatory policy developments, and emerging risk topics. The Council has published five annual reports that describe its past work and future priorities in great detail; regularly opened its meetings to the public; published minutes of all of its meetings that include a record of every vote the Council has ever taken; and solicited public input both on areas of potential risk and on its procedures for evaluating potential risks.

As Secretary Lew has made clear, Council members recognize that the Council should be open to adapting its procedures when stakeholders raise good ideas. Just since last year, the Council has demonstrated this commitment by enhancing its transparency policy, strengthening its internal governance, adopting supplemental procedures to its nonbank financial company designations process, and soliciting public comment on potential risks from asset management products and activities.

One of the duties Wall Street Reform gave to the Council is to designate a nonbank financial company for enhanced prudential standards and supervision by the Board of Governors of the Federal Reserve System (Federal Reserve), if the Council determines that the company's material financial distress or activities could pose a threat to U.S. financial stability. The Council's nonbank designations address a key weakness brought to light by the financial crisis: that large, complex, and interconnected nonbank financial companies, without appropriate supervision, could contribute to bringing our financial system to a halt.

Since Wall Street Reform was enacted, the Council has designated four nonbank financial companies following a thorough, rigorous, and fact-based process with extensive engagement directly with each company and its regulators. Before considering any company for designation, the Council voluntarily adopted a rule and interpretive guidance in 2012, after soliciting three separate rounds of public comment, to provide as much transparency as possible regarding how the Council would evaluate companies. That guidance explains both the process that the Council follows for designations and the substantive framework for how it assesses risks.

As a result of these efforts, each designated company had extensive opportunities to engage with the Council and its staff during the process and the opportunity to understand and respond to the factors underpinning the Council's analysis before the Council's vote on a final designation. These designated companies are now subject to consolidated supervision by the Federal Reserve, which is currently working to develop enhanced prudential standards for these companies, taking into account their specific businesses, risks, and existing regulation.

Designating a firm is not a decision the Council takes lightly. Before making a final decision about any designation, the Council goes through a lengthy, multistage, in-depth analysis, during which it reviews every aspect of a company—including a company's financial statements, business activities, market dynamics, and existing

regulation—and works with the company and its regulators to understand how the firm's financial distress could affect the broader financial system. The most recent designation followed a year and a half of engagement with the company. Most of the companies the Council has considered so far have not met the standard for designation. But in four cases, after considerable and thoughtful deliberation, the Council has found that a firm needs to be held to a higher standard to protect the U.S. financial system. Of the four firms the Council has designated, none were designated for a single reason—they are all large, interconnected, and complex firms.

The Council's recent adoption of changes to the nonbank financial company designations process is a prime example of the way the Council should go about supplementing its processes without compromising its fundamental ability to conduct its work. Last year, before making any changes, the Council conducted extensive outreach with a wide range of stakeholders. The Council's Deputies Committee—senior staff who coordinate the Council's activities—hosted a series of meetings in November with more than 20 trade groups, companies, consumer advocates, and public interest organizations. The Council also solicited input from each of the three companies then subject to a designation. The Council discussed the findings from this outreach and proposed changes during a public meeting in January before subsequently adopting the procedures in February. Having the administrative flexibility for the Council to adapt its own procedures allowed us to respond quickly to stakeholder feedback.

The supplemental procedures address the areas that stakeholders were most interested in and formalize a number of existing Council practices regarding engagement with companies. Under the new procedures, companies will now know early in the process where they stand, and they will have earlier opportunities to engage with and provide input to the Council. For example, the Council will notify a company when it first comes under active review and provide it with the opportunity to meet with staff, review the Council's primary sources of public information regarding the company, and provide information relevant to the Council's review. If a company advances to the next stage of review, staff will meet with the company to explain the evaluation process and the framework for the Council's analysis, as well as any specific issues identified.

Regarding transparency, the changes will provide the public with more information about the process, while still allowing the Council to meet its obligation to protect sensitive, nonpublic company information. First, if a company publicly announces that it is under review by the Council, the Council intends, upon the request of a third party, to confirm the status of the company's review. Second, the Council will continue its recent practice of including more information in its public bases for designations, to provide the public with a deeper understanding of the Council's analysis. Third, the Council has started to publish more information in its annual reports about its designations work, including the numbers of companies in each stage of the review process. And fourth, the Council last month published further details explaining how staff calculate the quantitative thresholds that the Council applies as a screening mechanism to identify companies for consideration.

The Council is also providing companies with a clearer and more robust annual review process. Company representatives are now provided an opportunity to discuss the scope and process for the review, and they can present information regarding any change that may be relevant, including a company restructuring, regulatory developments, market changes, or other factors.

If a company contests its designation in an annual review, the Council will vote and provide the company with a written explanation of any decision not to rescind the designation. In addition, the Council will provide each designated company an opportunity for an oral hearing to contest its designation every 5 years. These changes open the door to more engagement with the Council following a designation to make sure there is ample opportunity to discuss and address any issues that a company wants to put before the Council.

Altogether, the changes that the Council has made strengthen the Council while also addressing many of the suggestions made by stakeholders.

As Congress contemplates additional changes to the designations process, it is important that such changes do not compromise the Council's fundamental ability to conduct its work. We are particularly concerned with legislative proposals that would dramatically lengthen an already long and deliberative designation process, impose insurmountable practical hurdles on the Council's work, and prevent the Council from taking action to address potential threats to financial stability that it has identified. Such proposals ignore the lessons of the financial crisis and would impede the Council's ability to fulfill the duties Congress gave it. As the President and Secretary Lew have made clear, we will not support legislation that weakens the important taxpayer, investor, and consumer protections by impeding the ability

of regulators to identify and respond to threats to financial stability. U.S. markets and financial institutions are constantly evolving, and we must remain alert and responsive to new challenges in our dynamic system, toward the ultimate goal of maintaining the safety, soundness, and resiliency of our financial system.

I thank the Subcommittee for the opportunity to discuss the Council's process for nonbank financial company designations and look forward to answering your questions.

APPENDIX

1. Financial Stability Oversight Council Supplemental Procedures Relating to Nonbank Financial Company Determinations - February 4, 2015

<http://www.treasury.gov/initiatives/fsoc/designations/Documents/Supplemental%20Procedures%20Related%20to%20Nonbank%20Financial%20Company%20Determinations%20-%20February%202015.pdf>

2. Financial Stability Oversight Council (FSOC) Nonbank Financial Company Designations Frequently Asked Questions

<http://www.treasury.gov/initiatives/fsoc/designations/Documents/Supplemental%20Procedures%20Related%20to%20Nonbank%20Financial%20Company%20Determinations%20-%20February%202015.pdf>

Financial Stability Oversight Council
Supplemental Procedures
Relating to Nonbank Financial Company Determinations
February 4, 2015

Background

Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) authorizes the Financial Stability Oversight Council (the Council) to determine that a nonbank financial company shall be supervised by the Board of Governors of the Federal Reserve System and be subject to enhanced prudential standards if the Council determines that material financial distress at the company, or 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.

Over the last several months, as part of the Council's ongoing evaluation of how it conducts its work, the Council has reviewed its practices related to the evaluation of nonbank financial companies under section 113 of the Dodd-Frank Act. This review included engagement with financial companies, trade associations, nonbank financial companies subject to previous Council determinations, public interest groups, and Congressional stakeholders.

Based on this review, the Council has adopted the following procedures that the Council intends to use for determinations in non-emergency situations, to supplement its rule and interpretive guidance regarding nonbank financial company determinations (Rule and Guidance).¹ The Council will continue to work to identify and evaluate additional potential changes to its practices and procedures that would promote active engagement with companies under consideration for a determination and transparency to the public.

The Rule and Guidance provide a detailed description of the analysis that the Council intends to conduct, and the processes and procedures that the Council intends to follow, during its review of nonbank financial companies. In the Rule and Guidance, the Council created a three-stage process for identifying companies for determinations. Each stage of the process involves an analysis based on an increasing amount of information to determine whether a company meets one of the statutory standards for a determination. In the first stage of the process (Stage 1), the Council applies six quantitative thresholds (described in the Rule and Guidance) to a broad group of nonbank financial companies to identify a set of companies that merit further evaluation. In Stage 2, the Council conducts a preliminary analysis of the potential for the companies identified in Stage 1 to pose a threat to U.S. financial stability. Based on the analysis conducted during Stage 2, the Council identifies companies that merit further review in Stage 3, which builds on

¹ Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 12 C.F.R. part 1310 (2013).

the Stage 2 analysis with additional quantitative and qualitative analyses. The Council may make a proposed determination regarding a company based on the results of the analyses conducted during this three-stage review. If the Council makes a proposed determination, the Council provides the company with notice and an explanation of the basis of the proposed determination. The company may request a hearing to contest the proposed determination. After any hearing, the Council may make a final determination regarding the company.

The Council's evaluation of nonbank financial companies is supported by the staff-level Nonbank Financial Company Designations Committee (Nonbank Designations Committee). The Nonbank Designations Committee is overseen by the Council's Deputies Committee, which is composed of one representative from the staff of each Council member or member agency.

The procedures described below supplement the Rule and Guidance, and are organized into three categories: engagement during evaluations for potential determinations; engagement during annual reevaluations of determinations; and transparency to the public.

Engagement During Evaluations for Potential Determinations

Engagement with Companies

- The Council's practice has been to notify a nonbank financial company under evaluation only if the company is advanced to Stage 3. The Council now will notify a nonbank financial company within 30 days after the Deputies Committee instructs the Nonbank Designations Committee to form an analytical team to commence an active review of the company in Stage 2. Prior to approving a company for active review, the Deputies Committee will consider any preliminary information gathered by the Nonbank Designations Committee.
- A company under active review in Stage 2 may submit to the Council any information it deems relevant to the Council's evaluation and may, upon request, meet with analytical team staff. In addition, analytical team staff will, upon request, provide the company with a list of the primary public sources of information being considered during the Stage 2 analysis, so that the company has an opportunity to understand the information the Council may rely upon during Stage 2.
- If the Council votes to not advance a company from Stage 2 to Stage 3, the Council will notify the company in writing of the Council's decision. The notice will clarify that a vote not to advance the company from Stage 2 to Stage 3 at that time does not preclude the Council from notifying the company in the future that it is again under active consideration in Stage 2.
- If the Council votes to advance a company from Stage 2 to Stage 3, the Council's current practice is to provide the company with an opportunity to submit written materials to the Council to contest the Council's consideration of the nonbank financial company for a

proposed determination. In addition, analytical team staff will now meet with the company's representatives at the start of Stage 3 to explain the evaluation process and the framework for the Council's analysis. If the analysis in Stage 2 has identified specific aspects of the company's operations or activities as the primary focus for the evaluation, staff will notify the company of those issues, although the issues will be subject to change based on the ongoing analysis. After this meeting, the Council will provide the company with a request for information that will generally indicate how the requested items relate to the Council's framework for analyzing potential risks described in the Rule and Guidance.

- Consistent with the Council's current practice, during Stage 3, a company may submit to the Council any information it deems relevant to the Council's evaluation and may request meetings with analytical team staff regarding any issue the company deems appropriate.
- The Council's Deputies Committee will grant a request to meet with a company in Stage 3 on a mutually agreed-upon date, subject to receiving the request at least 30 days prior to the proposed meeting, to allow the company to present any information or arguments it deems relevant to the Council's evaluation.
- Pursuant to the Dodd-Frank Act, the Council can, in its sole discretion, determine whether to grant a request for an oral hearing for any company subject to a proposed determination. The Council intends to grant any timely request for an oral hearing from a company subject to a proposed determination, and for any such hearing to be conducted by the Council members.

Engagement with Existing Regulators

Under the Dodd-Frank Act, the Council must consult with the primary financial regulatory agency, if any, for each nonbank financial company or subsidiary of a nonbank financial company that is being considered for a determination before the Council makes any final determination with respect to such company. The Council's practice has generally been to begin the consultation process in Stage 2 with the primary financial regulatory agencies or home country supervisors, as appropriate, and to consult in Stage 3 with such regulators in a timely manner before the Council makes any final determination with respect to the company.

- For any company under active review in Stage 2 that is regulated by a primary financial regulatory agency or home country supervisor, the Council will notify such regulator or supervisor that the company is under active review no later than such time as the company is notified. The Council will seek to begin the consultation process with such regulator or supervisor during Stage 2, before the Council votes on whether to advance the company to Stage 3.

- In addition, if the Council votes to advance a company to Stage 3, the Council will seek to continue its consultation with such regulator or supervisor during Stage 3, before voting on whether to make a proposed determination regarding the company.
- Further, for any company regulated by a primary financial regulatory agency or home country supervisor, promptly after the Council votes to make a proposed or final determination regarding the company, the Council will provide such regulator or supervisor with the nonpublic written explanation of the basis of the Council's proposed or final determination.

Engagement During Annual Reevaluations of Determinations

- The Council reevaluates each of its determinations not less than annually and will rescind a determination if it determines that the company no longer meets the statutory standards for a determination. Before the Council's annual reevaluation of a nonbank financial company subject to a Council determination, the company will be provided an opportunity to meet with staff on the Nonbank Designations Committee to discuss the scope and process for the review and to present information regarding any change that may be relevant to the threat the company could pose to financial stability, including a company restructuring, regulatory developments, market changes, or other factors.
- If a company contests its determination during the Council's annual reevaluation, the Council intends to vote on whether to rescind the determination and provide the company, its primary financial regulatory agency, and the primary financial regulatory agency of its significant subsidiaries with a notice explaining the primary basis for any decision not to rescind the determination. The notice will address the material factors raised by the company in its submissions to the Council contesting the determination during the annual reevaluation.
- The Council will provide each company subject to a determination an opportunity for an oral hearing before the Council once every five years at which the company can contest the determination.

Transparency to the Public

- The Council's practice has been not to publicly announce the name of any nonbank financial company that is under evaluation for a determination prior to a final determination with respect to such company. However, if a company that is under active review in Stage 2 or that has been advanced to Stage 3 publicly announces the status of its review by the Council, the Council now intends, upon the request of a third party, to confirm the status of a company's review.

- When the Council makes a final determination, it provides the company with a detailed statement of the basis for the Council's decision and publicly releases a written explanation of the basis for the final determination. The Council is subject to statutory and regulatory requirements to maintain the confidentiality of certain information submitted to it by a nonbank financial company under review for a potential determination.² As a result, the Council's public basis cannot include confidential information that was submitted by a company to the Council in connection with the Council's evaluation of the company. Nevertheless, the Council is committed to continuing to set forth sufficient information in its public bases to provide the public with an understanding of the Council's analysis while protecting sensitive, confidential information submitted by the company to the Council.
- The Council also will publish in its annual reports the numbers of nonbank financial companies that, since the publication of the Council's prior annual report, (1) the Council voted to advance to Stage 3, (2) the Council voted not to advance to Stage 3, (3) became subject to a proposed or final determination, and (4) in the aggregate are subject to a final determination at that time.
- In addition, the Council will in the coming months publish on its website further details explaining how the Stage 1 thresholds are calculated, which may address issues such as how the Council evaluates the use of various accounting standards for purposes of Stage 1; components of the six Stage 1 thresholds; and practices for calculating the thresholds when incomplete data regarding a company are available.

² See Dodd-Frank Act section 112(d)(5), 12 U.S.C. § 5322(d)(5); 12 C.F.R. part 1310.20(e).

**Financial Stability Oversight Council (FSOC)
Nonbank Financial Company Designations
Frequently Asked Questions**

Last updated on February 4, 2015.

1. What is the FSOC and who are its members?

The FSOC was established in 2010 by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to bring together federal and state financial regulators to look across the financial system to identify risks to financial stability, promote market discipline, and respond to emerging threats to the stability of the U.S. financial system.

By statute, the FSOC is composed of 10 voting members and 5 nonvoting members. The voting members are the Secretary of the Treasury (who serves as the Chairperson of the FSOC), the Chair of the Board of Governors of the Federal Reserve System (Federal Reserve), the Comptroller of the Currency, the Director of the Consumer Financial Protection Bureau, the Chair of the Securities and Exchange Commission, the Chairman of the Federal Deposit Insurance Corporation, the Chairman of the Commodity Futures Trading Commission, the Director of the Federal Housing Finance Agency, the Chairman of the National Credit Union Administration, and an independent member with insurance expertise who is appointed by the President, by and with the advice and consent of the Senate. The five nonvoting members are the Director of the Office of Financial Research, the Director of the Federal Insurance Office, and state insurance, banking, and securities regulators.

The FSOC is supported by several committees composed of staff of each FSOC member and member agency that engage in ongoing discussions regarding financial market developments, potential risks, and the FSOC's activities. An overview of the staff committees is available [here](#).

2. What tools are available to the FSOC to address company or industry risks?

The FSOC has a number of tools available to address risks to U.S. financial stability it identifies, including:

- highlighting potential emerging threats in the FSOC's annual reports to Congress;
- making recommendations to existing primary regulators to apply heightened standards and safeguards;
- designating certain nonbank financial companies and financial market utilities for heightened supervision and prudential standards, and

- collecting and facilitating the sharing of information to assess threats to U.S. financial stability.

3. What is the purpose of the FSOC's authority to designate nonbank financial companies?

The recent financial crisis demonstrated that financial distress at nonbank financial companies can contribute to a broad seizing up of markets and stress at other institutions. The FSOC's designations are intended to reduce the risk that a company will pose a threat to U.S. financial stability in this way by subjecting each designated company to enhanced prudential standards and consolidated supervision by the Federal Reserve.

Under the Dodd-Frank Act, if the FSOC determines that a nonbank financial company's material financial distress, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company, could pose a threat to U.S. financial stability, the FSOC can designate the company for consolidated supervision by the Federal Reserve and enhanced prudential standards. Factors the FSOC must consider include, among others, the company's leverage, size, interconnectedness, and existing regulatory scrutiny.

4. How does the FSOC determine if a company could pose a threat to financial stability?

In the context of nonbank financial company designations, the FSOC considers a "threat to the financial stability of the United States" to exist if a nonbank financial company's material financial distress or activities could be transmitted to, or otherwise affect, other firms or markets, thereby causing a broader impairment of financial intermediation or of financial market functioning. An impairment of financial intermediation and financial market functioning can occur through several channels, including:

- *Exposure.* A nonbank financial company's creditors, counterparties, investors, or other market participants have exposure to the nonbank financial company that is significant enough to materially impair those creditors, counterparties, investors, or other market participants and thereby pose a threat to U.S. financial stability.
- *Asset liquidation.* A nonbank financial company holds assets that, if liquidated quickly, would cause a fall in asset prices and thereby significantly disrupt trading or funding in key markets or cause significant losses or funding problems for other firms with similar holdings.
- *Critical function or service.* A nonbank financial company is no longer able or willing to provide a critical function or service that is relied upon by market participants and for which there are no ready substitutes.

The FSOC's interpretive guidance, available [here](#), provides additional detail regarding these transmission channels and associated metrics that the FSOC may consider during its evaluation.

5. How did the FSOC develop its process for reviewing nonbank financial companies for potential designation?

The FSOC's process for reviewing nonbank financial companies for potential designation is described in its final rule and interpretive guidance, published in 2012 and available [here](#), and in its supplemental procedures, published in 2015 and available [here](#). These documents explain each step of the designations process.

Before adopting its rule and interpretive guidance on nonbank financial company designations, the FSOC voluntarily solicited public comment three times over an 18-month period. This notice and comment process benefited from input from companies and trade organizations representing a broad array of financial sectors, as well as academics and public interest groups. For example, the FSOC considered public comments in developing its three-stage process for review of nonbank financial companies and the sample metrics used in the FSOC's analysis. On February 4, 2015, after several months of engagement with industry and interested parties, the Council adopted supplemental procedures related to the Council's engagement with companies under review and to increase public transparency.

The FSOC has published explanations of its reasons for each of its final designations of nonbank financial companies, available [here](#).

6. What is the FSOC's process for identifying and reviewing firms for designation?

The FSOC's interpretive guidance, available [here](#), establishes a three-stage process for the FSOC to identify, evaluate, and communicate with nonbank financial companies under review in non-emergency situations. The FSOC has also published supplemental procedures, available [here](#), regarding its process. In the first stage of the process (Stage 1), the FSOC applies six quantitative thresholds to a broad group of nonbank financial companies to identify a set of companies that merit further evaluation. In Stage 2, the FSOC notifies a company that comes under active review, and reviews existing public and regulatory information and information submitted by the company. If the Council decides to evaluate the company further, it notifies the company and begins Stage 3, a detailed, in-depth analysis that includes a review of confidential information provided by the company.

Stage 1

Stage 1 of the process involves a quarterly review of public and regulatory data to identify nonbank financial companies that meet or exceed at least two of six uniform quantitative thresholds identified and discussed in the FSOC's interpretive guidance [here](#). This initial step helps the FSOC identify nonbank financial companies that might merit further review. This information is gathered from public and regulatory sources by the Office of Financial Research on behalf of staff of Council members and member agencies. The publication of the thresholds was also intended to help a nonbank financial company determine for itself if it meets or exceeds the thresholds. Specifically, a nonbank financial company will be reviewed further if it has at least \$50 billion in total consolidated assets and also meets or exceeds any of these five thresholds, which are described in the guidance:

- \$30 billion in credit default swaps for which the company is the reference entity
- \$3.5 billion in derivative liabilities
- \$20 billion in total debt outstanding
- 15 to 1 leverage ratio
- 10% short-term debt-to-asset ratio

Stage 2

If the FSOC begins an active review of a nonbank financial company in Stage 2, it will notify the company and its primary financial regulatory agency or home country supervisor within 30 days. During active review in Stage 2, the FSOC conducts a preliminary assessment of companies, based primarily on existing public and regulatory information. In addition, a company under active review in Stage 2 may submit to the FSOC any information it deems relevant to the FSOC's evaluation and may, upon request, meet with staff on the analytical team. In addition, staff on the analytical team will, upon request, provide the company with a list of the primary public sources of information being considered during the Stage 2 analysis, so that the company has an opportunity to understand the information the FSOC may rely upon during Stage 2. The FSOC will also consider in Stage 2 information available from the company's primary financial regulatory agency or home country supervisor, as appropriate. Based on this initial evaluation, the FSOC may vote to begin a detailed analysis of the company by advancing the company to Stage 3, or it may decide not to evaluate the company further. If the FSOC votes to not advance a company from Stage 2 to Stage 3, the FSOC will notify the company in writing of the FSOC's decision. The notice will clarify that a vote not to advance the company from Stage 2 to Stage 3 at that time does not preclude the Council from reinitiating active review and notifying the company in the future that it is again under active consideration in Stage 2.

In addition, as stated in the Council's interpretive guidance, because the uniform quantitative thresholds may not capture all types of nonbank financial companies and all of the potential ways in which a nonbank financial company could pose a threat to financial stability, the Council may conduct a Stage 2 analysis of a nonbank financial company based on other firm-specific factors, irrespective of whether such company meets or exceeds the thresholds in Stage 1. A company that comes under active review in Stage 2 in this manner will generally be reviewed under the process described above.

Stage 3

If the FSOC advances the company to Stage 3, the FSOC immediately informs the company that it is in Stage 3. Staff on the analytical team will meet with the company's representatives at the start of Stage 3 to explain the evaluation process and the framework for the FSOC's analysis. If the analysis in Stage 2 has identified specific aspects of the company's operations or activities as the primary focus for the evaluation, staff will notify the company of those issues, although the issues will be subject to change based on the ongoing analysis. After this meeting, the FSOC will provide the company with a request for information that will generally indicate how the requested items relate to the FSOC's framework for analyzing potential risks. The FSOC will also seek to continue its consultation with the company's primary financial regulatory agency or home country supervisor during Stage 3. The Council or staff of Council members or member agencies determine what information to request from the company or a primary financial regulatory agency, and the Office of Financial Research gathers the information on behalf of the Council. During Stage 3, the FSOC also invites the company to submit any other information that the company believes is pertinent.

The Council's Deputies Committee will also grant a request to meet with a company in Stage 3 on a mutually agreed-upon date, subject to receiving the request at least 30 days prior to the proposed meeting, to allow the company to present any information or arguments it deems relevant to the Council's evaluation. Information considered by the FSOC includes details regarding the company's financial activities, legal structure, liabilities, counterparty exposures, resolvability, and existing regulatory oversight. While there is no specified timeline for this process, the Stage 3 analysis has typically lasted between seven and fourteen months.

At the end of Stage 3, the FSOC may vote to make a proposed designation, as described in question 16 below.

7. Does the FSOC publicly discuss firms that are under review for potential designation or publicly share its analyses supporting its designations?

If a company that is under active review in Stage 2 or that has been advanced to Stage 3 publicly announces the status of its review by the FSOC, the FSOC intends, upon the request of a third party, to confirm the status of the company's review.

When the FSOC makes a final designation, it provides the company with a detailed statement of the basis for the FSOC's decision and publicly releases a written explanation of the basis for the final designation. The Council is subject to statutory and regulatory requirements to maintain the confidentiality of certain information submitted to it by a nonbank financial company under review for a potential designation. As a result, the FSOC's public basis cannot include confidential information that was submitted by a company or its regulators to the FSOC in connection with the FSOC's evaluation of the company. Nevertheless, the FSOC is committed to continuing to set forth sufficient information in its public bases to provide the public with an understanding of the FSOC's analysis while protecting sensitive, confidential information submitted by companies to the FSOC.

The Council also will publish in its annual reports the numbers of nonbank financial companies that, since the publication of the FSOC's prior annual report, (1) the FSOC voted to advance to Stage 3, (2) the FSOC voted not to advance to Stage 3, (3) became subject to a proposed or final designation, and (4) in the aggregate are subject to a final designation at that time.

8. Do companies have an opportunity to interact with the FSOC before a designation?

Yes. If the FSOC begins an active review of a nonbank financial company in Stage 2, it will notify the company and its primary financial regulatory agency or home country supervisor within 30 days. The company may, upon request, meet with staff on the FSOC's analytical team. In addition, staff on the analytical team will, upon request, provide the company with a list of the primary public sources of information being considered during the Stage 2 analysis, so that the company has an opportunity to understand the information the FSOC may rely upon during Stage 2.

If the FSOC advances the company to Stage 3, the FSOC immediately informs the company that it is in Stage 3. Staff on the analytical team will meet with the company's representatives at the start of Stage 3 to explain the evaluation process and the framework for the FSOC's analysis. If the analysis in Stage 2 has identified specific aspects of the company's operations or activities as the primary focus for the evaluation, staff will notify the company of those issues, although the issues will be subject to change based on the ongoing analysis. After this meeting, the FSOC will provide the company with a request for information that will generally indicate how the requested items relate to the

FSOC's framework for analyzing potential risks. During Stage 3, the FSOC also invites the company to submit any other information that the company believes is pertinent. The Council's Deputies Committee will also grant a request to meet with a company in Stage 3, on a mutually agreed-upon date, subject to receiving the request at least 30 days prior to the proposed meeting, to allow the company to present any information or arguments it deems relevant to the Council's evaluation.

The FSOC interacts extensively with each nonbank financial company that advances to Stage 3 during its company-specific analysis. For example, for one of the companies that has been designated, the FSOC spent almost a year and half conducting its analysis after beginning its engagement with the company. The Council considered more than 21,000 pages of materials submitted by the company, and staff of FSOC members and member agencies met with representatives of the company 13 times. The FSOC's evaluation, which considered the company's views and information, culminated in a detailed and lengthy analysis (over 300 pages) that the FSOC shared with the company following the proposed designation and before a vote on a final designation. In addition, any company subject to a proposed designation can request a written or oral hearing before the FSOC to contest the proposed designation. The Council intends to grant any timely request for an oral hearing from a company subject to a proposed designation, and for any such hearing to be conducted by the Council members.

9. Does the FSOC's review of a particular company imply that it will be designated?

No. The FSOC's review is company-specific, and the consideration of a particular firm never has a predetermined outcome. There are many possible results of the FSOC's evaluation of a particular company. Depending on its review and the nature of any risks the FSOC identifies, it could decide to designate a firm, to take no action at that time, or to employ one of its other authorities under the Dodd-Frank Act. A number of companies that have been considered in Stage 2 have not been advanced to Stage 3.

10. Does designation mean that a company is considered "too big to fail"?

No. A designation means that the FSOC has determined that the company's material financial distress, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company could pose a threat to U.S. financial stability. A designation does not mean that the company is currently experiencing material financial distress. Rather, it means that material financial distress at the company, if it were to occur, could pose a threat to U.S. financial stability. Designated companies are subject to enhanced prudential standards and consolidated supervision by the Federal Reserve intended to reduce the risks the company could pose to financial stability. Additionally, each designated company is required to provide regulators with a resolution plan (or "living will") to demonstrate how the firm could be resolved in a rapid and orderly manner in the event of the firm's financial distress or failure. A designation by the FSOC

does not provide the nonbank financial company with any new access to government liquidity sources or create any authority for the government to bail out the company if it fails. To the contrary, the Dodd-Frank Act seeks to eliminate taxpayer-funded bailouts of failing companies.

11. If international entities such as the Financial Stability Board (FSB) identify a U.S. firm as systemically important, does that mean that the FSOC will do the same?

No. While the FSB and the FSOC are both focused on strengthening financial stability, their processes are distinct. Decisions reached in the FSB do not determine decisions made by the FSOC. In fact, the FSOC is under no obligation to even consider a firm identified by the FSB for designation.

The FSB's identification of a firm as a global systemically important financial institution does not have legal effect in the United States or any other country. In the United States, the FSOC is the only entity that can designate nonbank financial companies for enhanced prudential standards and Federal Reserve supervision. FSOC designations can be made only pursuant to a super-majority vote of its 10 voting members based solely on the standards and processes set forth in U.S. federal law, after a robust analysis that reflects extensive interaction with the company.

12. Are companies aware when they are being considered for designation?

Yes. First, the quantitative thresholds used in Stage 1 are public; companies should generally be able to determine whether they meet or exceed the thresholds and will be reviewed in Stage 2. Further, a company is notified soon after the FSOC begins an active review of the company in Stage 2. In addition, the FSOC notifies any company that is advanced to Stage 3.

13. How long does the full designation process take?

For each of the four nonbank financial companies it has designated, the Council and staff of Council members and member agencies spent at least three months reviewing the firm in Stage 2, and, after notifying the company that it was under review, spent between seven and fourteen months conducting each analysis in Stage 3. After a proposed designation, based on deadlines established in the Dodd-Frank Act, the FSOC's review may continue for up to four additional months, if the company requests a hearing. Thus, the entire process for reviewing a firm that is ultimately designated typically takes over one year.

14. Before the FSOC makes a final decision to designate a company, does the company know why it may be designated and have an opportunity to rebut those arguments?

Yes. If the FSOC advances the company to Stage 3, the FSOC immediately informs the company. Staff on the analytical team will meet with the company's representatives at the start of Stage 3 to explain the evaluation process and the framework for the FSOC's analysis. If the analysis in Stage 2 has identified specific aspects of the company's operations or activities as the primary focus for the evaluation, staff will notify the company of those issues, although the issues will be subject to change based on the ongoing analysis. After this meeting, the FSOC will provide the company with a request for information that will generally indicate how the requested items relate to the FSOC's framework for analyzing potential risks. The Council's Deputies Committee will also grant a request to meet with a company in Stage 3, on a mutually agreed-upon date, subject to receiving the request at least 30 days prior to the proposed meeting, to allow the company to present any information or arguments it deems relevant to the Council's evaluation.

If the FSOC makes a proposed designation of a nonbank financial company, it provides the company a detailed, company-specific explanation, setting forth the FSOC's basis for the proposed designation. These company-specific bases can be hundreds of pages in length. Pursuant to the Dodd-Frank Act, any company subject to a proposed designation can request a hearing before the FSOC to contest the proposed designation and submit additional information in support of its position. In addition, before any proposed designation, a company under review has the opportunity to submit arguments and information as to why it should not be designated and has other extensive opportunities to engage with and provide information to staff of FSOC members and member agencies.

Finally, when the FSOC makes a final designation, it provides the company with a detailed statement of the basis for the FSOC's decision.

15. Is a firm entitled to a hearing? Do FSOC members attend?

Pursuant to the Dodd-Frank Act, any company subject to a proposed designation can request a hearing before the FSOC to contest the proposed designation. A company has a right to a written hearing, in which it submits information and arguments to the FSOC. In addition, the Council has stated that it intends to grant any timely request for an oral hearing from a company subject to a proposed designation, and for any such hearing to be conducted by the Council members. For the two firms so far that have requested oral hearings, the FSOC granted their requests, and the Council heard directly from the companies' representatives. The FSOC voluntarily published hearing procedures explaining the process for hearings, available [here](#).

16. How many FSOC members must agree in order to designate a company?

After a detailed evaluation of a company using the three-stage process described above, the FSOC may make a proposed designation only upon an affirmative super-majority vote of at least two-thirds of its voting members then serving, including an affirmative vote by the Treasury Secretary in his capacity as Chairperson of the FSOC. The FSOC will then hold a second vote on a final designation, which must also be approved by two-thirds of the voting FSOC members then serving, including an affirmative vote by the FSOC Chairperson.

17. What happens to nonbank financial companies after they are designated by the FSOC?

Following a final designation, the company is subject to consolidated supervision by the Federal Reserve and enhanced prudential standards, which the Federal Reserve has stated that it intends to tailor, as appropriate, based on the specific business structures, activities, and other factors that may distinguish the designated companies from bank holding companies and foreign banking organizations.

Pursuant to the Dodd-Frank Act, the FSOC annually reevaluates each of its previous designations to consider whether to rescind the designation, as described below.

18. If a firm divests certain businesses or ceases certain risky activities, can the designation be reversed? How soon after designation?

The FSOC recognizes that circumstances can change for a company. For each company that has been designated, the FSOC is required by statute to reevaluate the designation annually, and the FSOC's reevaluation process considers whether any material changes at the company justify a rescission of the designation. As explained in its final rule and interpretive guidance, the FSOC may also consider a request from a company for a reevaluation before the next required annual reevaluation in the case of an extraordinary change that materially decreases the threat the nonbank financial company could pose to U.S. financial stability.

As part of each reevaluation, the company is provided an opportunity to meet with FSOC staff to discuss the scope and process for the review and to present information regarding any change that may be relevant to the threat the company could pose to financial stability, including a company restructuring, regulatory developments, market changes, or other factors. If a company contests its designation during the FSOC's annual reevaluation, the FSOC intends to vote on whether to rescind the designation and provide the company, its primary financial regulatory agency, and the primary financial regulatory agency of its significant subsidiaries with a notice explaining the primary basis for any decision not to rescind the designation. The notice will address the material

factors raised by the company in its submissions to the FSOC contesting the designation during the annual reevaluation.

In addition, the FSOC will provide each company subject to a designation an opportunity for an oral hearing before the Council once every five years at which the company can contest the designation.

19. Are all of the FSOC members involved during the designations process?

Yes. The FSOC was created to bring together expertise from across the federal and state financial regulatory agencies, and the views of all of the FSOC members are important to evaluate any nonbank financial company. Members with expertise relevant to a particular company often provide important insights, and they work together with other FSOC members to reach decisions regarding designations. All of the voting and non-voting members of the FSOC can participate in the evaluation of all nonbank financial companies. Analytical teams composed of staff of FSOC members and member agencies work closely with each company under review in Stage 3. As part of their work, these teams have numerous meetings with company representatives over a period of many months. These analyses are guided by the FSOC's Deputies Committee and Nonbank Financial Company Designations Committee, both of which include representatives of all the FSOC members. Ultimately, proposed and final designations are made by the voting members of the FSOC.

20. What standards or metrics does the FSOC use to determine if a company should be designated?

The Dodd-Frank Act establishes the standards for whether the FSOC may designate a nonbank financial company, and also includes a list of factors that the FSOC must consider in its designations. Under the statute, the FSOC may designate a nonbank financial company only if the FSOC determines that the firm's material financial distress, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company, could pose a threat to U.S. financial stability. Factors the FSOC must consider include, among others, leverage, size, interconnectedness, and existing regulatory scrutiny.

In 2012, after soliciting public comment three separate times, the FSOC published its final rule and interpretive guidance on nonbank designations, available [here](#). The guidance describes how the FSOC intends to apply the statutory standards and considerations and lists examples of the types of metrics that the FSOC would assess as part of its analysis.

In light of the nature, size, and complexity of companies under consideration and as directed by the Dodd-Frank Act, the FSOC conducts its analysis on a company-by-

company basis in order to take into account the potential risks and mitigating factors that are unique to each company. Given the diversity of nonbank financial companies, applying identical analyses to all firms would not be an effective approach.

21. What role does the primary financial regulator for a firm play during FSOC's analysis?

As required by the Dodd-Frank Act, the FSOC consults with the primary financial regulatory agency, if any, for each nonbank financial company or subsidiary of a nonbank financial company that is being considered for designation, before the FSOC makes any final designation. For any company under active review in Stage 2 that is regulated by a primary financial regulatory agency or home country supervisor, the Council will notify such regulator or supervisor that the company is under active review no later than such time as the company is notified. The Council will seek to begin the consultation process with the regulator or supervisor during Stage 2, before the Council votes on whether to advance the company to Stage 3. In addition, if the Council votes to advance a company to Stage 3, the Council will seek to continue its consultation with the regulator or supervisor during Stage 3, before voting on whether to make a proposed designation regarding the company. For example, for the three insurance companies that the FSOC has designated, the FSOC consulted with multiple state insurance regulators of the companies' insurance subsidiaries. Further, for any company regulated by a primary financial regulatory agency or home country supervisor, the FSOC will provide the regulator or supervisor with the nonpublic written explanation of the basis of the FSOC's proposed or final designation.

22. Does the FSOC consider a company at the subsidiary or the holding company level?

When evaluating a particular nonbank financial company for potential designation, the Council considers the company and its subsidiaries. If a nonbank financial company that is a subsidiary of another nonbank financial company meets or exceeds the Stage 1 thresholds described above, the Council may evaluate the parent nonbank financial company and all of its subsidiaries, even if the parent company or another individual subsidiary does not meet or exceed the Stage 1 thresholds. This approach enables the Council to consider potential risks arising across the consolidated organization, while retaining the ability to designate either the parent or an individual nonbank financial company subsidiary (or neither), depending on which entity the Council determines could pose a threat to financial stability.