115TH CONGRESS 2d Session | HOUSE OF REPRESENTATIVES | REPORT 115–601

ALLEVIATING STRESS TEST BURDENS TO HELP INVESTORS ACT

MARCH 15, 2018.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. HENSARLING, from the Committee on Financial Services, submitted the following

R E P O R T

together with

MINORITY VIEWS

[To accompany H.R. 4566]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 4566) to amend the Dodd-Frank Wall Street Reform and Consumer Protection Act to provide relief to nonbanks from certain stress test requirements under such Act, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Alleviating Stress Test Burdens to Help Investors Act".

SEC. 2. STRESS TEST RELIEF FOR NONBANKS.

Section 165(i) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5365(i)) is amended—

(1) in paragraph (1)(B)(ii), by striking "and nonbank financial companies"; and

(2) in paragraph (2)—

(A) in subparagraph (A), by striking "are regulated by a primary Federal financial regulatory agency" and inserting: "whose primary financial regulatory agency is a Federal banking agency or the Federal Housing Finance Agency";

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(B) in subparagraph (C), by striking "Each Federal primary financial regulatory agency" and inserting "Each Federal banking agency and the Federal Housing Finance Agency"; and

(C) by adding at the end the following:

"(D) SEC AND CFTC.—The Securities and Exchange Commission and the Commodity Futures Trading Commission may each issue regulations requiring financial companies with respect to which they are the primary financial regulatory agency and that have total consolidated assets of more than $10,000,000,000 to conduct periodic analyses of the financial condition, including available liquidity, of such companies under adverse economic conditions.".

SEC. 3. RULE OF CONSTRUCTION.

Nothing in this Act shall be construed to limit the authority of the Financial Stability Oversight Council under section 120 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5330).

PURPOSE AND SUMMARY

On December 6, 2017, Representative Bruce Poliquin introduced H.R. 4566, the "Alleviating Stress Test Burdens to Help Investors Act", which amends Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to exempt nonbank financial institutions not under the supervision by the Board of Governors of the Federal Reserve System (Federal Reserve) from the Dodd-Frank Act's stress-testing requirements. Additionally, the bill allows the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) to issue regulations to require entities subject to their respective jurisdictions, referred to as "financial companies" in Title I of the Dodd-Frank Act, that have total consolidated assets of more than $10 billion to conduct periodic analysis of the financial condition of such entities under adverse economic conditions.

BACKGROUND AND NEED FOR LEGISLATION

The goal of H.R. 4566 is to eliminate burdensome costs for nonbank financial companies by eliminating stress testing requirements that are structured and designed for banks and do not appropriately reflect risks to nonbanks. Ultimately, these stress testing requirements impose high costs on nonbanks, which would include the asset management industry that ultimately will be borne by investors.

The financial crisis led to questions—domestically and internationally—about how to address financial stability and create a regulatory framework to mitigate systemic risk. Section 165 of the Dodd-Frank Act confers a host of powerful new supervisory tools upon the Federal Reserve to oversee the activities of bank holding companies with total consolidated assets of $50 billion or more and nonbank financial companies designated by the Financial Stability Oversight Council for heightened prudential supervision by the Federal Reserve. Two of these new authorities—living wills and stress tests—have been particularly controversial. First, Living wills and stress tests effectively put government bureaucrats in the position to dictate the business models and operational objectives of private businesses. Second, the Federal Reserve failed to implement its Section 165 statutory authorities with complete transparency and the Federal Reserve did not provide clear guidance about the conduct of the stress tests to market participants.

With respect to stress tests, under Section 165(i)(1)(A) of the Dodd-Frank Act, requires the Federal Reserve to conduct annual stress tests of large bank holding companies and nonbank systemically important financial institutions (SIFIs). By statute, the purpose of these tests is to allow the Federal Reserve to evaluate "whether such companies have the capital necessary to absorb losses as a result of adverse economic conditions." Section 165(i)(1)(B)(ii) gives the Federal Reserve Board full discretion to require the same tests as nonbank financial companies that are not systemically important, which thus could include registered funds and investment advisers.

In addition to bank holding companies, Section 165(i)(2) of the Dodd-Frank Act requires "financial companies" with total consolidated assets of more than $10 billion, and that have a primary federal financial regulatory agency, to conduct annual stress tests in accordance with regulations issued by the relevant agency. The term "financial company" is defined broadly and sweeps in registered investment companies (e.g., mutual funds) and registered investment advisers. According to information provided by the Investment Company Institute, more than 400 funds had $10 billion in assets or more as of July 31, 2017.

The Dodd-Frank Act's red tape does not stop there, but it also requires the primary financial regulatory agency—in this case, the SEC—to issue implementing regulations for the financial companies under its jurisdiction. To fulfill this requirement, the SEC must coordinate with the Federal Reserve and Federal Insurance Office and issue regulations that are "consistent and comparable" with those the Federal Reserve and other banking regulators have adopted for banking organizations. As with bank stress tests, the methodologies the SEC establishes must include three sets of conditions: (1) baseline, (2) adverse, and (3) severely adverse scenarios. Results are required to be reported to both the SEC and the Federal Reserve, and the company is required to publish a summary of the results. To date, though, the SEC has yet to propose a stress-testing rule under Section 165(i)(2).

The statutory requirement for stress tests of large investment advisers and mutual funds came about, in part, because of the success of the initial supervisory stress test exercise led by the Federal Reserve for the largest bank holding companies in the midst of the financial crisis. Stress testing in the context of banking organizations is designed to test for capital adequacy in stressed conditions. The concept of "capital adequacy" is entirely appropriate in the banking context. If a bank does not have adequate capital, it risks being unable to meet its obligations to depositors. In times of market stress, inadequate bank capital could have broader implications for financial stability.

But in reality the concept of capital adequacy does not have the same application when it comes to nonbanks. For example, asset management is an agency-based business model, as opposed to the principal-based business model of banks. This means that asset managers manage funds on behalf of clients, but they do not generally own the investments themselves. Furthermore, asset managers are legally separated from the funds—e.g., the assets and liabilities of the manager are distinct from assets and liabilities of the funds. On the other hand, the bank business model directly subjects the bank to the risks and obligations of its assets and liabilities. In short, to the extent that systemic risks arise from the asset management industry, prudential regulation of asset management is unlikely to be the most effective regulatory approach for mitigating these risks.

After all, asset managers and investment funds, in contrast to banks, generally are not highly leveraged and do not engage in maturity and liquidity transformation to the same degree that banks do through the use of bank deposits and other forms of credit. Any decline in the value of a fund's assets results is a corresponding reduction in the investor's investment, whereas a bank's obligation to its depositors and creditors remains the same even if the bank suffers losses on its asset exposures. For example, registered funds do not guarantee any return to investors or even promise that investors will see the return of their principal. Fund investors know that any gains or losses belong to them on a pro rata basis. Further, fund assets are not on the adviser's balance sheet. Gains or losses are borne solely by funds or other client accounts and do not flow through to the adviser. These characteristics of both registered funds and advisers hold true in both normal and stress periods. They help explain why, even in times of severe market stress, registered stock and bond funds and fund advisers routinely exit the market in an orderly fashion, with no effect on the broader financial system or need for government intervention.

Not only does the prudential stress-testing regime fail to fit the nonbank model, prudential stress testing for asset management raises significant implementation challenges, including how to engage in such testing when fluctuations in asset values are passed through to fund investors by design. While the SEC has implemented stress testing rules for some situations, these are tailored to the specific industry. In 2016, then-SEC Chief Economist Mark Flannery stated that the Dodd-Frank Act requires stress tests for large banks, but there is a "false parallel" for stress testing asset managers: "The parallel to bank stress tests is really extremely misleading. It's as if Dodd-Frank said 'stress test the big banks, and, oh, you might as well go ahead and do the asset management companies.'"

In its Asset Management and Insurance Report issued on November 15, 2017 pursuant in response to President Trump's February 3, 2017 Executive Order 13772 on "Core Principles for Regulating the United States Financial System", the U.S. Department of Treasury said that:

> entity-based systemic risk evaluations of asset managers or their funds are generally not the best approach for mitigating risks arising from asset management. Instead, primary federal regulators should focus on potential systemic risks arising from asset management products and activities, and on implementing regulations that strengthen the asset management industry as a whole.

Further, the Treasury Department's November 15, 2017 report supports legislative action to eliminate the stress-testing requirement for investment advisers and investment companies:

> Treasury rejects the need for stress testing of asset management firms. Stress testing is a regulatory tool that can be a

> part of systemic risk evaluation. Treasury recognizes the possibility of liquidity risk that may arise during mutual fund redemptions, but believes a strong liquidity risk management framework is a more effective approach to addressing the concern."

The misapplication of the stress-testing regime to non-SIFI nonbanks is important because the U.S. asset management industry is the global leader in promoting vibrant capital markets and diverse investment and savings opportunities for investors and businesses. An asset manager manages assets on behalf of investors, businesses, and other institutions using different types of funds and other investment structures. U.S. asset managers range in size from a few million dollars to over five trillion dollars in assets under management. In the United States alone, registered investment companies, a type of investment fund, held almost $20 trillion of assets under management, representing the investments of more than 95 million individuals.

While assets under management have risen, so have costs. One of the largest drivers of rising costs is the cost of compliance with the increased regulatory burden since the financial crisis. For example, in a recent study of global asset managers, banks, and brokers, participants highlighted perceptions that regulations are increasing costs and that compliance spending at a typical firm is expected to double over the next five years. Many of these costs are passed along to individual retail investors in the form of expenses higher than they would be if compliance costs had been the same.

The effect is felt on Main Street because registered funds are the investment vehicles of choice for millions of Americans seeking to buy a home, pay for college, or plan for financial security in retirement. Application of unnecessary, ill-suited stress-testing requirements to registered funds and advisers will increase costs for these funds and advisers—and hence, investors—without providing any corresponding benefits. As discussed above, such stress testing requirements would do nothing to promote public policy goals, such as financial stability or investor protection, because their underlying purpose is pegged to the business model, operations, and risks of banks and is at odds with the distinct, defining attributes of registered funds and advisers.

In short, H.R. 4566 would eliminate ineffectual costs for nonbank financial institutions that have not been designated as systemically important by removing Dodd Frank's bank-centric, mandatory stress test requirement, which does not make sense for the asset management industry and only adds costs that will ultimately be borne by investors who rely on these funds. Additionally, to the extent stress tests might be useful in certain contexts, rather than apply the Federal Reserve's bank-centric stress tests, H.R. 4566 provides that the SEC and CFTC may issue regulations requiring financial companies for which they are the primary financial regulatory agency and have total assets of more than $10 billion to conduct periodic stress tests.

Hearings

The Committee on Financial Services held a hearing examining matters relating to H.R. 4566 on April 26, 2017, and April 28, 2017.

Committee Consideration

The Committee on Financial Services met in open session on January 17, 2018, and January 18, 2018, and ordered H.R. 4566 to be reported favorably by a recorded vote of 47 yeas to 8 nays (Record vote no. FC–147), a quorum being present. Before the motion to report was offered, an amendment in the nature of a substitute offered by Mr. Poliquin was agreed to by a voice vote and an amendment to the amendment in the nature of a substitute offered by Mrs. Maloney was agreed to by a voice vote.

Committee Votes

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole recorded vote was on a motion by Chairman Hensarling to report the bill favorably to the House as amended. The motion was agreed to by a recorded vote of 47 yeas to 8 nays (Record vote no. FC–147), a quorum being present.

Record vote no. FC-147

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling	X			Ms. Maxine Waters (CA)		X	
Mr. McHenry				Mrs. Carolyn B. Maloney (NY)	X		
Mr. King				Ms. Velázquez	X		
Mr. Royce (CA)	X			Mr. Sherman	X		
Mr. Lucas	X			Mr. Meeks	X		
Mr. Pearce	X			Mr. Capuano	X		
Mr. Posey	X			Mr. Clay			
Mr. Luetkemeyer	X			Mr. Lynch		X	
Mr. Huizenga	X			Mr. David Scott (GA)	X		
Mr. Duffy	X			Mr. Al Green (TX)		X	
Mr. Stivers				Mr. Cleaver		X	
Mr. Hultgren	X			Ms. Moore	X		
Mr. Ross	X			Mr. Ellison		X	
Mr. Pittenger	X			Mr. Perlmutter		X	
Mrs. Wagner	X			Mr. Himes	X		
Mr. Barr	X			Mr. Foster	X		
Mr. Rothfus	X			Mr. Kildee	X		
Mr. Messer				Mr. Delaney	X		
Mr. Tipton	X			Ms. Sinema	X		
Mr. Williams	X			Mrs. Beatty		X	
Mr. Poliquin	X			Mr. Heck	X		
Mrs. Love	X			Mr. Vargas	X		
Mr. Hill	X			Mr. Gottheimer	X		
Mr. Emmer	X			Mr. Gonzalez (TX)		X	
Mr. Zeldin	X			Mr. Crist	X		
Mr. Trott	X			Mr. Kihuen	X		
Mr. Loudermilk	X						
Mr. Mooney (WV)	X						
Mr. MacArthur	X						
Mr. Davidson	X						
Mr. Budd	X						
Mr. Kustoff (TN)	X						
Ms. Tenney	X						
Mr. Hollingsworth	X						

Committee Oversight Findings

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the Committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

Performance Goals and Objectives

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 4566 will reduce burdensome regulatory costs on nonbank financial companies, that are ultimately passed down to investors, by eliminating the requirement that they comply with the Dodd-Frank Act stress testing requirements.

New Budget Authority, Entitlement Authority, and Tax Expenditures

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

Congressional Budget Office Estimates

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. Congress,
Congressional Budget Office,
Washington, DC, March 14, 2018.

Hon. Jeb Hensarling,
Chairman, Committee on Financial Services,
House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 4566, the Alleviating Stress Test Burdens to Help Investors Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Nathaniel Frentz.

Sincerely,

Keith Hall,
Director.

Enclosure.

H.R. 4566—Alleviating Stress Test Burdens to Help Investors Act

H.R. 4566 would exempt certain nonbank financial firms from requirements to conduct assessments of their ability to withstand financial stress. It would also remove the Federal Reserve's authority to conduct stress tests at nonbank financial companies more often than once per year.

Because the Federal Reserve currently does not conduct stress tests on nonbank financial firms, enacting the bill would have a negligible effect on its spending in the near term. Although some types of stress testing may begin under current law at some point over the 2018–2027 period, CBO anticipates that those activities probably would not be affected by the restrictions in this bill. In addition, based on information from the Federal Reserve, CBO estimates that provisions in the bill that may exempt some financial companies from certain capital planning requirements would have no significant effect on the operating costs of the Federal Reserve. As a result, CBO estimates that implementing the bill would have no significant effect on Federal Reserve remittances to the U.S. Treasury, which are recorded in the budget as revenues.

Because enacting H.R. 4566 would affect revenues, pay-as-you-go procedures apply. Enacting the bill would not affect direct spending.

CBO estimates that enacting H.R. 4566 would not significantly increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2028.

H.R. 4566 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act.

The CBO staff contact for this estimate is Nathaniel Frentz. The estimate was approved by John McClelland, Assistant Director for Tax Analysis, and Theresa Gullo, Assistant Director for Budget Analysis.

FEDERAL MANDATES STATEMENT

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995.

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

EARMARK IDENTIFICATION

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

Duplication of Federal Programs

In compliance with clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95–220, as amended by Pub. L. No. 98–169).

Disclosure of Directed Rulemaking

Pursuant to section 3(i) of H. Res. 5, (115th Congress), the following statement is made concerning directed rulemakings: The Committee estimates that the bill requires no directed rulemakings within the meaning of such section.

Section-by-Section Analysis of the Legislation

Section 1. Short title

This section cites H.R. 4566 as the "Alleviating Stress Test Burdens to Help Investors Act."

Section 2. Stress test relief for nonbanks

This section amends section 165(i) of the Dodd-Frank Wall Street Reform and Consumer Protection Act to exempt nonbank financial institutions that are not under the supervision by the Federal Reserve from the Dodd-Frank Act's stress testing requirements. Additionally, this section allows the Securities and Exchange Commission and the Commodity Futures Trading Commission to issue regulations to require financial companies that have total consolidated assets of more than $10 billion to conduct periodic analysis of the financial condition of such companies under adverse economic conditions.

Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

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TITLE I—FINANCIAL STABILITY

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Subtitle C—Additional Board of Governors Authority for Certain Nonbank Financial Companies and Bank Holding Companies

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SEC. 165. ENHANCED SUPERVISION AND PRUDENTIAL STANDARDS FOR NONBANK FINANCIAL COMPANIES SUPERVISED BY THE BOARD OF GOVERNORS AND CERTAIN BANK HOLDING COMPANIES.

(a) IN GENERAL.—

(1) PURPOSE.—In order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions, the Board of Governors shall, on its own or pursuant to recommendations by the Council under section 115, establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies with total consolidated assets equal to or greater than $50,000,000,000 that—

(A) are more stringent than the standards and requirements applicable to nonbank financial companies and bank holding companies that do not present similar risks to the financial stability of the United States; and

(B) increase in stringency, based on the considerations identified in subsection (b)(3).

(2) TAILORED APPLICATION.—

(A) IN GENERAL.—In prescribing more stringent prudential standards under this section, the Board of Governors may, on its own or pursuant to a recommendation by the Council in accordance with section 115, differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors that the Board of Governors deems appropriate.

(B) ADJUSTMENT OF THRESHOLD FOR APPLICATION OF CERTAIN STANDARDS.—The Board of Governors may, pursuant to a recommendation by the Council in accordance with section 115, establish an asset threshold above $50,000,000,000 for the application of any standard established under subsections (c) through (g).

(b) DEVELOPMENT OF PRUDENTIAL STANDARDS.—

(1) IN GENERAL.—

(A) REQUIRED STANDARDS.—The Board of Governors shall establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), that shall include—

(i) risk-based capital requirements and leverage limits, unless the Board of Governors, in consultation with the Council, determines that such requirements are not appropriate for a company subject to more stringent prudential standards because of the activities of such company (such as investment company activities or assets under management) or structure, in which case, the Board of Governors shall apply other standards that result in similarly stringent risk controls;

(ii) liquidity requirements;

(iii) overall risk management requirements;

(iv) resolution plan and credit exposure report requirements; and

(v) concentration limits.

(B) ADDITIONAL STANDARDS AUTHORIZED.—The Board of Governors may establish additional prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), that include—

(i) a contingent capital requirement;

(ii) enhanced public disclosures;

(iii) short-term debt limits; and

(iv) such other prudential standards as the Board or Governors, on its own or pursuant to a recommendation made by the Council in accordance with section 115, determines are appropriate.

(2) STANDARDS FOR FOREIGN FINANCIAL COMPANIES.—In applying the standards set forth in paragraph (1) to any foreign nonbank financial company supervised by the Board of Governors or foreign-based bank holding company, the Board of Governors shall—

(A) give due regard to the principle of national treatment and equality of competitive opportunity; and

(B) take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.

(3) CONSIDERATIONS.—In prescribing prudential standards under paragraph (1), the Board of Governors shall—

(A) take into account differences among nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), based on—

(i) the factors described in subsections (a) and (b) of section 113;

(ii) whether the company owns an insured depository institution;

(iii) nonfinancial activities and affiliations of the company; and

(iv) any other risk-related factors that the Board of Governors determines appropriate;

(B) to the extent possible, ensure that small changes in the factors listed in subsections (a) and (b) of section 113 would not result in sharp, discontinuous changes in the prudential standards established under paragraph (1) of this subsection;

(C) take into account any recommendations of the Council under section 115; and

(D) adapt the required standards as appropriate in light of any predominant line of business of such company, including assets under management or other activities for which particular standards may not be appropriate.

(4) CONSULTATION.—Before imposing prudential standards or any other requirements pursuant to this section, including notices of deficiencies in resolution plans and more stringent requirements or divestiture orders resulting from such notices, that are likely to have a significant impact on a functionally regulated subsidiary or depository institution subsidiary of a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), the Board of Governors shall consult with each Council member that primarily supervises any such subsidiary with respect to any such standard or requirement.

(5) REPORT.—The Board of Governors shall submit an annual report to Congress regarding the implementation of the prudential standards required pursuant to paragraph (1), including the use of such standards to mitigate risks to the financial stability of the United States.

(c) CONTINGENT CAPITAL.—

(1) IN GENERAL.—Subsequent to submission by the Council of a report to Congress under section 115(c), the Board of Governors may issue regulations that require each nonbank financial company supervised by the Board of Governors and bank holding companies described in subsection (a) to maintain a minimum amount of contingent capital that is convertible to equity in times of financial stress.

(2) FACTORS TO CONSIDER.—In issuing regulations under this subsection, the Board of Governors shall consider—

(A) the results of the study undertaken by the Council, and any recommendations of the Council, under section 115(c);

(B) an appropriate transition period for implementation of contingent capital under this subsection;

(C) the factors described in subsection (b)(3)(A);

(D) capital requirements applicable to the nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), and subsidiaries thereof; and

(E) any other factor that the Board of Governors deems appropriate.

(d) RESOLUTION PLAN AND CREDIT EXPOSURE REPORTS.—

(1) RESOLUTION PLAN.—The Board of Governors shall require each nonbank financial company supervised by the Board of Governors and bank holding companies described in subsection

(a) to report periodically to the Board of Governors, the Council, and the Corporation the plan of such company for rapid and orderly resolution in the event of material financial distress or failure, which shall include—

(A) information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company;

(B) full descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company;

(C) identification of the cross-guarantees tied to different securities, identification of major counterparties, and a process for determining to whom the collateral of the company is pledged; and

(D) any other information that the Board of Governors and the Corporation jointly require by rule or order.

(2) CREDIT EXPOSURE REPORT.—The Board of Governors shall require each nonbank financial company supervised by the Board of Governors and bank holding companies described in subsection (a) to report periodically to the Board of Governors, the Council, and the Corporation on—

(A) the nature and extent to which the company has credit exposure to other significant nonbank financial companies and significant bank holding companies; and

(B) the nature and extent to which other significant nonbank financial companies and significant bank holding companies have credit exposure to that company.

(3) REVIEW.—The Board of Governors and the Corporation shall review the information provided in accordance with this subsection by each nonbank financial company supervised by the Board of Governors and bank holding company described in subsection (a).

(4) NOTICE OF DEFICIENCIES.—If the Board of Governors and the Corporation jointly determine, based on their review under paragraph (3), that the resolution plan of a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a) is not credible or would not facilitate an orderly resolution of the company under title 11, United States Code—

(A) the Board of Governors and the Corporation shall notify the company of the deficiencies in the resolution plan; and

(B) the company shall resubmit the resolution plan within a timeframe determined by the Board of Governors and the Corporation, with revisions demonstrating that the plan is credible and would result in an orderly resolution under title 11, United States Code, including any proposed changes in business operations and corporate structure to facilitate implementation of the plan.

(5) FAILURE TO RESUBMIT CREDIBLE PLAN.—

(A) IN GENERAL.—If a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a) fails to timely resubmit the resolution plan as required under paragraph (4), with such revisions as are required under subparagraph (B), the

Board of Governors and the Corporation may jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on the growth, activities, or operations of the company, or any subsidiary thereof, until such time as the company resubmits a plan that remedies the deficiencies.

(B) DIVESTITURE.—The Board of Governors and the Corporation, in consultation with the Council, may jointly direct a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), by order, to divest certain assets or operations identified by the Board of Governors and the Corporation, to facilitate an orderly resolution of such company under title 11, United States Code, in the event of the failure of such company, in any case in which—

(i) the Board of Governors and the Corporation have jointly imposed more stringent requirements on the company pursuant to subparagraph (A); and

(ii) the company has failed, within the 2-year period beginning on the date of the imposition of such requirements under subparagraph (A), to resubmit the resolution plan with such revisions as were required under paragraph (4)(B).

(6) NO LIMITING EFFECT.—A resolution plan submitted in accordance with this subsection shall not be binding on a bankruptcy court, a receiver appointed under title II, or any other authority that is authorized or required to resolve the nonbank financial company supervised by the Board, any bank holding company, or any subsidiary or affiliate of the foregoing.

(7) NO PRIVATE RIGHT OF ACTION.—No private right of action may be based on any resolution plan submitted in accordance with this subsection.

(8) RULES.—Not later than 18 months after the date of enactment of this Act, the Board of Governors and the Corporation shall jointly issue final rules implementing this subsection.

(e) CONCENTRATION LIMITS.—

(1) STANDARDS.—In order to limit the risks that the failure of any individual company could pose to a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), the Board of Governors, by regulation, shall prescribe standards that limit such risks.

(2) LIMITATION ON CREDIT EXPOSURE.—The regulations prescribed by the Board of Governors under paragraph (1) shall prohibit each nonbank financial company supervised by the Board of Governors and bank holding company described in subsection (a) from having credit exposure to any unaffiliated company that exceeds 25 percent of the capital stock and surplus (or such lower amount as the Board of Governors may determine by regulation to be necessary to mitigate risks to the financial stability of the United States) of the company.

(3) CREDIT EXPOSURE.—For purposes of paragraph (2), "credit exposure" to a company means—

(A) all extensions of credit to the company, including loans, deposits, and lines of credit;

(B) all repurchase agreements and reverse repurchase agreements with the company, and all securities borrowing and lending transactions with the company, to the extent that such transactions create credit exposure for the nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a);

(C) all guarantees, acceptances, or letters of credit (including endorsement or standby letters of credit) issued on behalf of the company;

(D) all purchases of or investment in securities issued by the company;

(E) counterparty credit exposure to the company in connection with a derivative transaction between the nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a) and the company; and

(F) any other similar transactions that the Board of Governors, by regulation, determines to be a credit exposure for purposes of this section.

(4) ATTRIBUTION RULE.—For purposes of this subsection, any transaction by a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a) with any person is a transaction with a company, to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that company.

(5) RULEMAKING.—The Board of Governors may issue such regulations and orders, including definitions consistent with this section, as may be necessary to administer and carry out this subsection.

(6) EXEMPTIONS.—This subsection shall not apply to any Federal home loan bank. The Board of Governors may, by regulation or order, exempt transactions, in whole or in part, from the definition of the term "credit exposure" for purposes of this subsection, if the Board of Governors finds that the exemption is in the public interest and is consistent with the purpose of this subsection.

(7) TRANSITION PERIOD.—

(A) IN GENERAL.—This subsection and any regulations and orders of the Board of Governors under this subsection shall not be effective until 3 years after the date of enactment of this Act.

(B) EXTENSION AUTHORIZED.—The Board of Governors may extend the period specified in subparagraph (A) for not longer than an additional 2 years.

(f) ENHANCED PUBLIC DISCLOSURES.—The Board of Governors may prescribe, by regulation, periodic public disclosures by nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a) in order to support market evaluation of the risk profile, capital adequacy, and risk management capabilities thereof.

(g) SHORT-TERM DEBT LIMITS.—

(1) IN GENERAL.—In order to mitigate the risks that an over-accumulation of short-term debt could pose to financial companies and to the stability of the United States financial system, the Board of Governors may, by regulation, prescribe a limit on the amount of short-term debt, including off-balance sheet exposures, that may be accumulated by any bank holding company described in subsection (a) and any nonbank financial company supervised by the Board of Governors.

(2) BASIS OF LIMIT.—Any limit prescribed under paragraph (1) shall be based on the short-term debt of the company described in paragraph (1) as a percentage of capital stock and surplus of the company or on such other measure as the Board of Governors considers appropriate.

(3) SHORT-TERM DEBT DEFINED.—For purposes of this subsection, the term "short-term debt" means such liabilities with short-dated maturity that the Board of Governors identifies, by regulation, except that such term does not include insured deposits.

(4) RULEMAKING AUTHORITY.—In addition to prescribing regulations under paragraphs (1) and (3), the Board of Governors may prescribe such regulations, including definitions consistent with this subsection, and issue such orders, as may be necessary to carry out this subsection.

(5) AUTHORITY TO ISSUE EXEMPTIONS AND ADJUSTMENTS.—Notwithstanding the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.), the Board of Governors may, if it determines such action is necessary to ensure appropriate heightened prudential supervision, with respect to a company described in paragraph (1) that does not control an insured depository institution, issue to such company an exemption from or adjustment to the limit prescribed under paragraph (1).

(h) RISK COMMITTEE.—

(1) NONBANK FINANCIAL COMPANIES SUPERVISED BY THE BOARD OF GOVERNORS.—The Board of Governors shall require each nonbank financial company supervised by the Board of Governors that is a publicly traded company to establish a risk committee, as set forth in paragraph (3), not later than 1 year after the date of receipt of a notice of final determination under section 113(e)(3) with respect to such nonbank financial company supervised by the Board of Governors.

(2) CERTAIN BANK HOLDING COMPANIES.—

(A) MANDATORY REGULATIONS.—The Board of Governors shall issue regulations requiring each bank holding company that is a publicly traded company and that has total consolidated assets of not less than $10,000,000,000 to establish a risk committee, as set forth in paragraph (3).

(B) PERMISSIVE REGULATIONS.—The Board of Governors may require each bank holding company that is a publicly traded company and that has total consolidated assets of less than $10,000,000,000 to establish a risk committee, as set forth in paragraph (3), as determined necessary or appropriate by the Board of Governors to promote sound risk management practices.

(3) RISK COMMITTEE.—A risk committee required by this subsection shall—

(A) be responsible for the oversight of the enterprise-wide risk management practices of the nonbank financial company supervised by the Board of Governors or bank holding company described in subsection (a), as applicable;

(B) include such number of independent directors as the Board of Governors may determine appropriate, based on the nature of operations, size of assets, and other appropriate criteria related to the nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), as applicable; and

(C) include at least 1 risk management expert having experience in identifying, assessing, and managing risk exposures of large, complex firms.

(4) RULEMAKING.—The Board of Governors shall issue final rules to carry out this subsection, not later than 1 year after the transfer date, to take effect not later than 15 months after the transfer date.

(i) STRESS TESTS.—

(1) BY THE BOARD OF GOVERNORS.—

(A) ANNUAL TESTS REQUIRED.—The Board of Governors, in coordination with the appropriate primary financial regulatory agencies and the Federal Insurance Office, shall conduct annual analyses in which nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a) are subject to evaluation of whether such companies have the capital, on a total consolidated basis, necessary to absorb losses as a result of adverse economic conditions.

(B) TEST PARAMETERS AND CONSEQUENCES.—The Board of Governors—

(i) shall provide for at least 3 different sets of conditions under which the evaluation required by this subsection shall be conducted, including baseline, adverse, and severely adverse;

(ii) may require the tests described in subparagraph (A) at bank holding companies [and nonbank financial companies], in addition to those for which annual tests are required under subparagraph (A);

(iii) may develop and apply such other analytic techniques as are necessary to identify, measure, and monitor risks to the financial stability of the United States;

(iv) shall require the companies described in subparagraph (A) to update their resolution plans required under subsection (d)(1), as the Board of Governors determines appropriate, based on the results of the analyses; and

(v) shall publish a summary of the results of the tests required under subparagraph (A) or clause (ii) of this subparagraph.

(2) BY THE COMPANY.—

(A) REQUIREMENT.—A nonbank financial company supervised by the Board of Governors and a bank holding company described in subsection (a) shall conduct semiannual stress tests. All other financial companies that have total consolidated assets of more than $10,000,000,000 and [are regulated by a primary Federal financial regulatory agency] *whose primary financial regulatory agency is a Federal banking agency or the Federal Housing Finance Agency* shall conduct annual stress tests. The tests required under this subparagraph shall be conducted in accordance with the regulations prescribed under subparagraph (C).

(B) REPORT.—A company required to conduct stress tests under subparagraph (A) shall submit a report to the Board of Governors and to its primary financial regulatory agency at such time, in such form, and containing such information as the primary financial regulatory agency shall require.

(C) REGULATIONS.—[Each Federal primary financial regulatory agency] *Each Federal banking agency and the Federal Housing Finance Agency*, in coordination with the Board of Governors and the Federal Insurance Office, shall issue consistent and comparable regulations to implement this paragraph that shall—

(i) define the term "stress test" for purposes of this paragraph;

(ii) establish methodologies for the conduct of stress tests required by this paragraph that shall provide for at least 3 different sets of conditions, including baseline, adverse, and severely adverse;

(iii) establish the form and content of the report required by subparagraph (B); and

(iv) require companies subject to this paragraph to publish a summary of the results of the required stress tests.

(D) SEC AND CFTC.—The Securities and Exchange Commission and the Commodity Futures Trading Commission may each issue regulations requiring financial companies with respect to which they are the primary financial regulatory agency and that have total consolidated assets of more than $10,000,000,000 to conduct periodic analyses of the financial condition, including available liquidity, of such companies under adverse economic conditions.

(j) LEVERAGE LIMITATION.—

(1) REQUIREMENT.—The Board of Governors shall require a bank holding company with total consolidated assets equal to or greater than $50,000,000,000 or a nonbank financial company supervised by the Board of Governors to maintain a debt to equity ratio of no more than 15 to 1, upon a determination by the Council that such company poses a grave threat to the financial stability of the United States and that the imposition of such requirement is necessary to mitigate the risk that such company poses to the financial stability of the United States. Nothing in this paragraph shall apply to a Federal home loan bank.

(2) CONSIDERATIONS.—In making a determination under this subsection, the Council shall consider the factors described in subsections (a) and (b) of section 113 and any other risk-related factors that the Council deems appropriate.

(3) REGULATIONS.—The Board of Governors shall promulgate regulations to establish procedures and timelines for complying with the requirements of this subsection.

(k) INCLUSION OF OFF-BALANCE-SHEET ACTIVITIES IN COMPUTING CAPITAL REQUIREMENTS.—

(1) IN GENERAL.—In the case of any bank holding company described in subsection (a) or nonbank financial company supervised by the Board of Governors, the computation of capital for purposes of meeting capital requirements shall take into account any off-balance-sheet activities of the company.

(2) EXEMPTIONS.—If the Board of Governors determines that an exemption from the requirement under paragraph (1) is appropriate, the Board of Governors may exempt a company, or any transaction or transactions engaged in by such company, from the requirements of paragraph (1).

(3) OFF-BALANCE-SHEET ACTIVITIES DEFINED.—For purposes of this subsection, the term "off-balance-sheet activities" means an existing liability of a company that is not currently a balance sheet liability, but may become one upon the happening of some future event, including the following transactions, to the extent that they may create a liability:

(A) Direct credit substitutes in which a bank substitutes its own credit for a third party, including standby letters of credit.

(B) Irrevocable letters of credit that guarantee repayment of commercial paper or tax-exempt securities.

(C) Risk participations in bankers' acceptances.

(D) Sale and repurchase agreements.

(E) Asset sales with recourse against the seller.

(F) Interest rate swaps.

(G) Credit swaps.

(H) Commodities contracts.

(I) Forward contracts.

(J) Securities contracts.

(K) Such other activities or transactions as the Board of Governors may, by rule, define.

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MINORITY VIEWS

H.R. 4566, the so-called "Alleviating Stress Test Burdens to Help Investors Act" would unwisely eliminate a commonsense tool that gives financial companies and regulators an opportunity to identify and correct problems before they could lead to another financial crisis. Specifically, the bill, as amended, would eliminate the Federal Reserve's discretion under Dodd Frank to stress test any nonbank financial company that the Financial Stability Oversight Council ("FSOC") may be in the process of designating as systemically important. As amended, H.R. 4566 would also weaken the mandate in Dodd-Frank that large firms regulated by the Securities and Exchange Commission ("SEC") and Commodity Futures Trading Commission ("CFTC") conduct annual company stress tests. The bill would thus undermine a valuable early warning system for our nation's economy.

One of the major policy achievements following the 2008 financial crisis was to require rigorous stress tests of the nation's largest financial institutions. Importantly, the Dodd-Frank stress testing regime allows regulators to reach beyond banks to better monitor risks and vulnerabilities in other parts of the financial system. If stress testing had been conducted on firms like Lehman Brothers on an annual basis in the years between 2006 through 2008, it might have revealed significant problems before the failure of these institutions led to the near-collapse of the global financial system.

As former SEC Chair Mary Jo White stated in a December 2014 speech, "stress testing is an important tool routinely used by banking regulators. Implementing this new mandate in asset management, while relatively novel, will help market participants and the Commission better understand the potential impact of stress events." Members of the asset management industry have also recognized that stress testing is critical to effectively managing risk. In a 2015 letter to the SEC, the Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA AMG"), whose members manage more than $30 trillion in assets, wrote, "Stress testing is one part of an effective and coherent risk management process for asset managers . . . ." Moreover, in a 2015 survey of SIFMA AMG members, nearly two-thirds (62%) of the asset managers surveyed reported that they already stress test their funds.

Nevertheless, H.R. 4566 would eliminate the Dodd-Frank requirement that large financial institutions under the SEC's purview that manage trillions of dollars of hardworking Americans' retirement funds and other savings conduct an internal evaluation of how the firm would fair in a stressed economy. As stated by Americans for Financial Reform in a letter to the Committee opposing H.R. 4566, "large asset managers such as Blackrock manage trillions of dollars and their risk management procedures are essential to the health of the financial markets. Such entities should be subject to stress testing . . . .”

H.R. 4566 would make it harder for the Federal Reserve to identify and mitigate future systemic risks before they have catastrophic effects on our financial stability and would remove the requirement that firms like asset managers conduct annual stress tests.

For these reasons, we oppose H.R. 4566.

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