Statement of

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Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for the opportunity to discuss the Discussion Draft of the Financial Stability and Improvement Act. We support many of its key initiatives, but also have significant concerns about certain provisions, and we are continuing to review the Draft in detail to provide additional comments to the Committee. Let me briefly comment here on four key parts of the Discussion Draft.

First, we believe the Financial Services Oversight Council established by the Discussion Draft has appropriate roles and responsibilities. The Council would be well positioned to monitor and address developments that threaten the financial system; identify regulatory gaps and arbitrage opportunities; and make formal recommendations to individual regulators. The Council would also have the responsibility, which is appropriate, for identifying those financial companies and financial activities that require heightened prudential supervision and stricter prudential standards.

Second, the Discussion Draft expands the role of the Federal Reserve in two fundamental ways: as consolidated supervisor and standard-setter for all systemically significant <u>financial firms</u>, and as the standard-setter for <u>financial activities</u> that pose systemic risk. We support extending the Federal Reserve's consolidated supervisor authority beyond bank holding companies to any other type of financial company that the Council identifies as posing systemic risk. The lack of such authority over such nonbanking companies as AIG, Bear Stearns, and Lehman Brothers was a key contributor to the financial crisis, and it is imperative to eliminate this supervisory gap.

In terms of setting and implementing standards for these companies, the Discussion Draft is an improvement over the Administration's bill in terms of the role played by primary supervisors in the process. While the Federal Reserve would have authority to establish such standards for holding companies and their subsidiaries, the primary supervisors of the functionally regulated subsidiaries, if they disagreed with such standards, would have the authority to explain publicly why they believed imposing such standards would be inappropriate and should not apply. As a practical matter, this will provide primary supervisors like the OCC with the opportunity to provide meaningful input into design of the standards. This is appropriate given that, in many cases, primary supervisors will have more expertise with respect to the impact of particular standards on the firms they directly supervise than will the Federal Reserve.

We are very concerned, however, about the separate authority provided to the Federal Reserve to establish standards for any <u>financial activity</u> that the Council deems to present systemic risk. There the Federal Reserve's authority is unilateral, as there would be <u>no</u> opportunity for input by any other supervisor. In addition, the Federal Reserve would also have broad authority to impose and enforce such standards on banks and other regulated firms engaging in such activities, even where the firms' primary federal regulator objected. We believe this expansion of authority is far too broad, and also have concerns about unilateral Fed authority to act on divestitures or acquisitions affecting the bank and about continuing gaps in supervision of non-bank holding company affiliates.

Third, we support the agency consolidation provisions of the Discussion Draft. These would transfer the bulk of the functions of the Office of Thrift Supervision into the OCC, while providing a framework in which the federal thrift charter is preserved. The mechanics of the proposed transfer appear to be sensible and workable, and fair and equitable to employees of both agencies. There are, however, important technical areas, including assessments, transfer of property and personnel, and clarification of the agency's independence, where we will have additional comments.

Finally, the Discussion Draft includes important new measures to address the so-called "too-big-to-fail" problem. It would establish a new regime primarily administered by the FDIC to facilitate the orderly resolution of failing, systemically important financial firms. As it has with failing banks, the FDIC would have the authority to operate the financial firm, enforce or repudiate its contracts, and pay its claims. It could also provide the firm with emergency assistance in the form of loans, guarantees, or asset purchases, but only with the concurrence of the Secretary and only after determining such assistance is necessary to preserve financial stability.

In doing so, however, there would be a strong presumption that the FDIC, as receiver, would remove senior management. Even more important, shareholders, subordinated creditors, and any other provider of regulatory capital to the firm could never be protected. Instead, they would <u>always</u> absorb first losses in the resolution to the same extent as such stakeholders would in an ordinary bankruptcy. This mandatory exposure to first loss by shareholders and creditors is a substantial change from the Administration's original proposal. It is an appropriate and effective way to maintain market discipline and address the too-big-to-fail problem, while protecting systemic stability.