

CENTER FOR CAPITAL MARKETS COMPETITIVENESS

OF THE

UNITED STATES CHAMBER OF COMMERCE

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December 19, 2011

Financial Stability Oversight Council
Attn: Lance Auer
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Second Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies

Dear Mr. Auer:

The U.S. Chamber of Commerce ("Chamber") is the world's largest business federation, representing over three million companies of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness ("CMCC") to promote a modern and effective regulatory structure for capital markets to fully function in the 21st Century economy. The CMCC welcomes the opportunity to comment on the Second Notice of Proposed Rulemaking and Proposed Guidance ("Re-Proposal") published by the Financial Stability Oversight Council ("Council") on October 18, 2011 regarding its authority to require supervision and regulation of certain nonbank financial companies by the Board of Governors of the Federal Reserve System ("FRB").

The CMCC supports the Council's efforts to monitor and address systemic risk. We appreciate the decision of the Council to issue the Re-Proposal that addresses certain of the comments it received in response to its first notice of Proposed Rulemaking regarding its authority to require supervision and regulation of certain nonbank financial companies by the FRB, published on January 24, 2011 ("First Proposal"). However, we are deeply concerned that many important fundamental questions remain unanswered, and the Re-Proposal remains significantly deficient.

A wide range of comments were submitted in response to both the First Proposal and the advance notice of Proposed Rulemaking ("ANPR") that the Council issued in October 2010. The Re-Proposal, however, does not inform the public of

the Council's views with regard to the vast majority of those comments, and in fact, raise new questions with the Proposed Guidance. Given the significant overhanging effect on nonbank financial companies that may be subject to designation as a systemically important financial institution ("SIFI") and, through them, on the economy as a whole, it is crucial that the Council address these comments during the rulemaking process.

As we discuss in detail below, we believe that the Re-Proposal has a series of important deficiencies that must be addressed. We respectfully request that the Council and its member agencies carefully consider our points and those of other commenters and publish its responses to ensure that the Title I rulemaking process is conducted in a manner that is thorough, open, and transparent. Such rulemaking will avoid unwarranted harm to and burden on the country's economic recovery.

In that regard we note the following points:

- On October 20, 2011 the Chamber submitted a comment to the Council noting that the Re-Proposal neither contained any cost/benefit analysis nor gave any indication that the Council had conducted such an analysis. We noted that this was not in accordance with the mandates of Executive Order 12866 and Executive Order 13563. We requested, among other things, that the Council extend the comment period to 60 days from the date of publication of the cost/benefit analysis on the Re-Proposal. As of the date of this letter we are not aware of any response from the Council. As discussed below, the need for a thorough and transparent cost/benefit analysis is particularly critical in a rulemaking that has the potential to impose significant regulatory requirements and burdens on companies that have not been subject to such requirements and whose operations may be subject to significant disruption. Accordingly, we hereby repeat our request.
- The Re-Proposal does not address important issues regarding the intent, legal status and significance of the Proposed Guidance contained in the Appendix to the Proposed Rule.

- The Re-Proposal does not adequately describe the circumstances in which the Council may find that a company could pose a threat to the financial stability of the United States.
- There is significant ambiguity in the Proposed Guidance, including with regard to the threshold factors that would be used to determine whether a company was subject to evaluation for potential SIFI designation.

Discussion

1. The Re-Proposal Does Not Contain A Cost/Benefit Analysis As Required by Executive Orders

In our February 25, 2011 comment letter to the Council in response to the First Proposal, we noted that the Council did not appear to have conducted any cost/benefit analysis of the rule.

Notwithstanding this comment and those of other commenters, the Re-Proposal does not contain a cost/benefit analysis. The Council has acknowledged in the Re-Proposal that it is subject to Executive Orders 12866 and 13563, which direct agencies to assess costs and benefits of available regulatory alternatives and to make this analysis available for public review and comment during the rulemaking process.¹

The Council, however, has given no indication that it conducted the required cost/benefit analysis, and no such analysis is contained in the Re-Proposal. Just as there is no cost/benefit analysis of the Proposed Rule itself, there is also no indication that a cost/benefit analysis would be conducted when the Council considers whether to designate SIFIs. It is difficult to understand how the Council can assess the costs and benefits of the Proposed Rule or the application of that rule without providing an economic analysis on which the regulated community and participants in the capital markets are able to review and comment. It is essential that such an analysis be

¹ 76 Fed. Reg. 64264, 64272 (Oct. 18, 2011). Under these Executive Orders, if regulation is necessary, an agency is directed to quantify costs and benefits, select regulatory approaches that maximize net benefits and reduce costs, harmonize rules and promote flexibility.

published with respect to the Proposed Rule and that the rule itself specify a process for conducting a robust cost/benefit analysis whenever a company is considered for designation as a SIFI.

The Council's failure to publish a cost/benefit analysis for public review is particularly troubling in light of the significant costs that may be incurred by individual companies in the course of the designation process or as a result of their designation as SIFIs. At a minimum, the Council should publish a cost/benefit analysis that compares the costs of review and designation under the Re-Proposal to the cost of the Council making recommendations to the primary financial regulatory agencies for new or heightened standards and safeguards to address the conditions that might be determined to give rise to designation.² The Council has stated that it intends to follow this approach with respect to asset management companies and to consider whether the systemic risks that they may pose "can be mitigated by subjecting such companies to Board of Governors supervision and prudential standards, or whether they are better addressed through other regulatory measures."³ The Council should follow the identical process with respect to all nonbank financial companies and the Council's "numerous authorities and tools to carry out its statutory duty."⁴

Costs also would be imposed on the customers, investors, creditors and counterparties of a company designated as a SIFI flowing from the increased regulation that would be imposed on the designated company. Thus, the Proposed Rule, the existence and application of which will necessarily impact the U.S. financial system, has a significant potential to impose substantial costs through various financial sectors and the broader economy. It is exactly the type of rule that should be subject to a careful and thorough cost/benefit analysis and should have the benefit of public input.

² See 12 U.S.C. § 5322(a)(2)(K).

³ 76 Fed. Reg. at 64269.

⁴ *Id.* at 64267.

We therefore again strongly urge the Council to publish any cost/benefit analysis it has conducted of the Re-Proposal, and if one has not yet been conducted, to do so and to publish the results for comment promptly. In addition, the Council should specify the process for conducting a robust analysis when a company is considered for designation and should provide in any final rule that a copy of its analysis and conclusions will be included in the written notice of proposed or final determination given to a company.

For these reasons, we request that the Council extend the comment period for 60 days from the date of publication of the cost/benefit analysis on the Re-Proposal. Doing so would allow stakeholders, potentially affected entities and participants in the broader capital markets and the public in general adequate time to provide meaningful comment on the entirety of the Proposed Rule in view of the cost/benefit analysis, which would serve the interests of all parties.

2. The Re-Proposal Does Not Explain the Legal Significance of the Proposed Guidance

The Re-Proposal contains an Appendix to the Proposed Rule that is described as Proposed Guidance. The Proposed Guidance generally describes the elements of a three-stage process that the Council would utilize in making determinations whether to designate a company as a SIFI. The critical aspects of the Council's apparent intended decision-making process in regard to SIFI designations are contained in the Proposed Guidance rather than in the Proposed Rule.

The Re-Proposal is inadequate in that it does not explain what legal status and significance the Council intends the Proposed Guidance to have. The absence of any such explanation raises a series of essential legal questions. For example:

- Is the Proposed Guidance intended to be a substantive rule of general applicability that would be binding on the Council and parties that are considered for a SIFI designation?
- Would the Council be required to apply the provisions of the Proposed Guidance whenever it evaluates a particular company for potential

designation, or would it be free to diverge from those provisions in its discretion?

- Does the Council plan to take the position that its actions in accordance with the Proposed Guidance should be given rulemaking deference in the event of a judicial challenge by a company that is designated as a SIFI by the Council pursuant to the Proposed Guidance?
- If the Council wished to amend the terms of the Proposed Guidance, would it be required as a matter of law to publish the proposed amendments for public notice and comment before implementing such changes?

Consistent with the requirements of the Administrative Procedure Act, a clear explanation of the Council's position on the intended legal significance and binding effect of the Proposed Guidance is essential to the public's understanding of the Re-Proposal and the public's ability to provide meaningful comments to the Council. We urge the Council to disclose its position on these points and provide the public with an adequate opportunity to submit comments in response to the Council's position.

3. Standard for Determining that a Company Poses "A Threat to the Financial Stability of the United States"

Sections 113(a)(1) and (b)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA") directs the Council to designate a nonbank financial company as a SIFI if it determines that (i) material financial distress at the company or (ii) 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.

The term "pose a threat to the financial stability of the United States" thus serves a critical role in determining whether a SIFI designation is warranted. The Council has not, however, proposed to define the statutory term in the Proposed Rule. Instead, there is a reference to the term in the Proposed Guidance that indicates that the Council would consider such a threat to exist "if there would be an impairment of

financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy.”⁵

The Proposed Guidance does not provide specific proposed metrics as to what circumstances the Council would view as being sufficiently severe to inflict significant damage on the broader economy. Instead, the Proposed Guidance indicates that the Council has identified three transmission channels as being most likely to facilitate the transmission of the negative effects of a company’s material financial distress or activities to other financial firms and markets. However, an examination of the Council’s discussion of the three transmission channels again shows an absence of a meaningful standard for determining what impact would suffice for a finding that issues relating to a company “would be sufficiently severe to inflict significant damage on the broader economy.”

The first channel relates to a company’s exposure to other parties. The Council has not indicated the level of exposure that it would consider to be sufficient to pose a threat of inflicting significant damage on the broader economy. In fact, the Council stops far short of such a discussion. It merely informs the public that “[i]n its *initial analysis* . . . with respect to this channel, the Council expects to consider metrics including total consolidated assets, credit default swap outstanding, derivative liabilities, loans and bonds outstanding, and leverage ratio.”⁶ In fact, the Council provides metrics as to each of these topics in Stage 1 of its evaluation process for the purpose of determining initial eligibility for SIFI consideration, but fails to provide such guidance for ultimately finding that a company could inflict significant damage on the broader economy.

The second channel relates to the potential for disruption associated with a company’s liquidation of assets. The Council again has not indicated the level or type of asset liquidation activity that it would consider to be sufficient to pose a threat of inflicting significant damage on the broader economy. Here again, the Council goes no further than referring to the preliminary criteria it would consider in regard to this channel, stating “[i]n its *initial analysis* of . . . companies with respect to this channel,

⁵ 76 Fed. Reg. at 64277.

⁶ *Id.* at 64278 (emphasis added).

the Council expects to consider metrics including total consolidated assets and short-term debt ratio.”⁷ The Council provides these metrics for the purpose of determining initial eligibility for SIFI consideration, but not as a basis for ultimately finding that a company could inflict significant damage on the broader economy.

The third channel relates to the possibility that a company would no longer be able to provide a critical function or service that is relied on by market participants and for which there is no ready substitute. The Council has indicated that it would not offer any type of metric either for initial consideration of a company or with regard to an ultimate determination that a company could pose the threat of inflicting significant damage on the broader economy. It has stated that “[d]ue to the unique ways in which a . . . company may provide a critical function or service to the market, the Council expects to apply company-specific analyses with respect to this channel, rather than applying a broadly applicable quantitative metric.”⁸

Given the significant impact of a SIFI designation on a company and the cumulative impact of multiple SIFI designations on the financial services sector and the economy, we respectfully submit that the approach that the Council has taken to support a determination that a company could pose a threat to the financial stability of the United States is inadequate because it goes no further than to supply general metrics that would be used at a preliminary stage to screen companies for further consideration. Even by the Council’s description of its intended process, these metrics (which are only set forth with regard to two of the channels) plainly would be inadequate to support a final SIFI determination with regard to a particular company.

Thus, the Proposed Guidance leaves potential SIFI designees without meaningful guidance as to the degree or level of the threat to the financial stability of the United States that they must be deemed to pose in order to warrant designation as a SIFI. The lack of specificity in this approach also undermines any support the Proposed Guidance could potentially provide to the Council in the event of a company’s judicial challenge to a SIFI designation.

⁷ *Id.* (emphasis added).

⁸ *Id.*

4. The Re-Proposal Does Not Provide Sufficiently Transparent Guidance Regarding the Screening and Review of Companies for Possible Designation as SIFIs

The Council has undertaken in the Re-Proposal to provide additional guidance, including setting forth certain quantitative thresholds regarding the process by which it would screen companies that may merit additional investigation for possible designation as SIFIs. While the Proposed Guidance provides a general discussion of the factors the Council considers to be relevant to a company's status as a SIFI and sets forth a three-stage process for identifying companies that may be designated as SIFIs, the Re-Proposal fails to explain adequately how the quantitative thresholds or screens in Stage 1 were set and how they would be applied. This partial explanation does not provide the transparency that should be present in agency rulemaking for a rule that will influence market behavior and have so profound an impact on the companies subject to that process and, by extension, the U.S. financial system. In fact, it confuses the public.

4.1 The Re-Proposal largely fails to address the public comments submitted in response to the ANPR and the First Proposal

As noted by the Council itself in the Re-Proposal, the First Proposal was widely criticized for failing to provide sufficient detail and clarity regarding the proposed designation process.⁹ The First Proposal also was criticized for failing to address many of the issues raised in the public comments submitted in response to the ANPR regarding the application of the statutory standards for SIFI designation to various types of financial activities and financial companies. In the Re-Proposal, the Council has stated that it "is committed to fostering transparency with respect to the Determination Process, and the Proposed Rule and Proposed Guidance are intended to address such concerns."¹⁰ Unfortunately, the Re-Proposal does not achieve this objective.

⁹ *Id.* at 64266 n.3.

¹⁰ *Id.* at 64267.

The Council has stated that the Re-Proposal addresses only *certain* comments it received in response to the ANPR and the First Proposal and that it expects to respond to comments it receives in response to the Re-Proposal in its notice of final rulemaking.¹¹ This suggests that *previously filed* comments to which the Council chose not to respond in the Re-Proposal will not be addressed in the final rule. For example, several substantive comments were submitted regarding the “bank-centric” nature of many of the statutory standards and their inapplicability to the business model of insurance companies, investment advisers and certain types of investment funds. The Re-Proposal leaves unaddressed these fundamental issues regarding *who* or *what* the Council should designate as systemically important and offers instead a discussion of *how* the Council will screen and review companies and activities that arguably should not be subject to review under those standards in the first place. It is one thing for the Council to defer making a final decision regarding some aspect of a final rule in order to allow debate on the issue to proceed and develop through the public notice and comment process. It is quite another for the Council to demur on the very appropriateness of its screening and review process. To remedy this situation, the Council should respond to these points in its notice of final rulemaking and address them appropriately in the text of the final rule and guidance.

4.2 The Re-Proposal applies an impermissibly broad concept of “company”

The Re-Proposal also raises many issues regarding how the screening and review procedures would be applied. One of the most fundamental of these issues concerns the scope of the term “company.” The Council has stated in the Re-Proposal that it intends to interpret the term broadly to include “any corporation, limited liability company, partnership, business trust, association (incorporated or unincorporated), or similar organization.”¹² The Council also has stated that, when applying the proposed quantitative screens to investment funds managed by a nonbank financial company, it “may consider the funds as a single entity, if their investments are identical or highly similar.”¹³ However, the Council has not explained

¹¹ *Id.* at 64275-6.

¹² *Id.* at 64265.

¹³ *Id.* at 64281 n.12.

what authority or rationale it has to interpret the term “company” in so broad a manner.

The DFA authorizes the Council to determine that a “U.S. nonbank financial company” or a “foreign nonbank financial company” shall be supervised by the FRB and be subject to heightened supervision.¹⁴ A “U.S. nonbank financial company” is defined, with additional qualifications, as a company that is “incorporated or organized under the laws of the United States or any State.”¹⁵ This reference to the laws of incorporation or organization restricts the meaning of the term “company” to a formally organized business entity. Directly to this point, while the DFA incorporates by reference several definitions found in the Federal Deposit Insurance Act (“FDI Act”), it does not incorporate the definition of “company.”¹⁶ By this singular omission, the Congress chose not to adopt the type of broad definition that the Council now proposes.¹⁷ Therefore, the text of the DFA argues for the precise opposite of the Council’s proposed broad interpretation of the term “company,” and the Council has presented no other explanation in the Re-Proposal of its authority or its reasons for its interpretation. Based on this record, the Council may not in its rulemaking or in the review or designation of companies as SIFIs ignore corporate structures, aggregate the assets of individual companies or otherwise treat individual companies as an informal “association.” The Council should explain what statutory authority supports its position in this regard.

4.3 The Re-Proposal does not adequately explain how the asset size screen was selected or would be applied for the Stage 1 review

¹⁴ 12 U.S.C. § 5323(a)(1) and (b)(1).

¹⁵ 12 U.S.C. § 5311(a)(4)(B)(i). Similarly, a “foreign nonbank financial company” is defined, with additional qualifications, as a company that is “incorporated or organized in a country other than the United States.” 12 U.S.C. § 5311(a)(4)(A)(i).

¹⁶ See 12 U.S.C. § 5301(18)(A).

¹⁷ The definition of “company” in the FDI Act references the meaning of the term in the Bank Holding Company Act. 12 U.S.C. § 1813(w)(7). That definition includes an “association.” 12 U.S.C. § 1841(b).

Under the Re-Proposal, the Council would apply a set of quantitative screens in Stage 1 of the review process to identify companies that may merit further review for the purpose of possible designation as SIFIs. The primary quantitative screen would be an asset size test of \$50 billion of global total consolidated assets (or, in the case of foreign nonbank financial companies, \$50 billion of U.S. total consolidated assets).¹⁸ The Re-Proposal states that “[t]his threshold is consistent with the Dodd-Frank Act threshold of \$50 billion in assets for subjecting bank holding companies to enhanced prudential standards.”¹⁹ No other explanation for the use of this asset size screen has been provided.

The DFA in fact provides no support for the proposed asset size screen. In contrast to the treatment of bank holding companies, the DFA treats the size of a financial company as only one of several criteria, all of equal rank, to be considered when making a SIFI designation. No single criterion, including size, must be satisfied. Indeed, the size of a financial company is so ill-defined a concept in the DFA that the statute does not even indicate how size should be measured.²⁰ If Congress wanted to establish \$50 billion of assets as an appropriate threshold for designating financial companies as SIFIs, it could have done so easily by adopting the same standard it used to identify large bank holding companies. Instead, Congress adopted a very different analytical approach. The Council’s decision to adopt the proposed standard may *coincide* with Congress’ treatment of large bank holding companies, but it is not *consistent* with Congress’ intent for the designation of SIFIs.²¹

In the absence of support in the DFA, the Council must provide support for the particular asset size screen it has proposed. The Council should explain, without

¹⁸ 76 Fed. Reg. at 64281.

¹⁹ *Id.*

²⁰ 12 U.S.C. § 5323(a)(G) and (b)(G).

²¹ The Council also has failed to explain (i) why the asset size screen for large bank holding companies, which is applied in the DFA to bank and bank-related assets, is applicable without any modification to the diverse financial and commercial assets that are held by various nonbank financial holding companies and (ii) how the separate thresholds that the Council proposes to apply to U.S. and foreign nonbank financial companies are consistent with the single threshold applied in the DFA to all U.S. and foreign bank holding companies.

reference to the treatment of bank holding companies in the DFA, (i) why size is the single most important standard for screening companies for possible SIFI designation and (ii) why \$50 billion is the most appropriate size for the proposed screen.

The Council also should clarify how it intends to apply its proposed asset size screen in its review of asset managers. In our comments on the ANPR and the First Proposal, we pointed out to the Council that assets under management do not raise the same issues with regard to systemic financial stability as do assets on the balance sheet of a financial company. Consistent with these points, the Council has stated in the Proposed Guidance that it intends to apply the proposed asset size screen to a company's "total consolidated assets." This would exclude assets under management because they do not appear on an asset manager's own balance sheet.

The Re-Proposal can, however, be read to create some ambiguity as to how the Council intends to apply the screen to asset management companies. The Council has stated in the preamble of the Re-Proposal that asset management companies, among others, "may pose risks that are not well-measured by the quantitative thresholds approach."²² In addition, the Proposed Guidance states that the metrics that may be used to assess size include "the extent to which assets are managed rather than owned by a nonbank financial company and the extent to which the ownership of assets under management is diffuse."²³ We request that the Council in any final rule make clear that the Stage 1 asset size screen is limited to balance sheet assets and does not include assets under management.²⁴

²² 76 Fed. Reg. at 64269.

²³ *Id.* at 64280.

²⁴ The asset size screen and any other consideration of asset size in the Re-Proposal also should exclude assets under management in certain circumstances when they are consolidated with the asset manager under GAAP. Currently, asset managers may be required under GAAP to consolidate the assets of a limited partnership they manage with their own assets when the limited partners lack certain rights. This accounting treatment is under review. In such cases, the ability of the asset manager to purchase, sell, lend or borrow on the basis of the managed assets are substantially the same as in other arrangements to manage other investors' assets and are substantially different from the ability of the asset manager to deal with its own assets. Conflating managed assets that are on-balance-sheet under GAAP with an asset manager's other assets would substantially overstate the size of the asset manager and present an inaccurate and misleading picture of the asset manager's systemic importance.

4.4 The Re-Proposal does not adequately explain how the other proposed Stage 1 quantitative screens were selected or would be applied

The Council also should explain how the other five Stage 1 quantitative screens set forth in the Re-Proposal were selected. The Re-Proposal does not discuss what alternative measures might be used to apply the Council's six-category framework for considering whether a company is systemically important.²⁵ For example, the proposed screen of \$30 billion of gross notional credit default swaps ("CDS") outstanding for which a nonbank financial company is the reference entity is intended to reflect the credit exposure of counterparties to the company.²⁶ However, the notional amount of CDS outstanding would appear to be subject to significant background "noise" and volatility arising from general economic and market conditions and speculative activity unrelated to the reference entity's actual economic activity. The Re-Proposal also does not explain when or over what period of time the CDS outstanding would be measured, which parameter could significantly affect the volatility of the measured activity. The Council also should explain how it would acquire the data required to measure CDS outstanding for a specific reference entity, when the reference entity is not a party to the transactions.

It also is unclear how the proposed screen of "\$20 billion of outstanding loans borrowed and bonds issued" would be applied. These liabilities are intended "to serve as a proxy for interconnectedness."²⁷ The Council should clarify several issues related to the application of this test, including how commercial paper, loan commitments, margin loans, securities lending and borrowing and repurchase and reverse repurchase agreements would be treated, and when or over what period of time borrowing would be measured. It also appears that \$20 billion may be too low a threshold or that the threshold should be stated as a percentage of a company's total liabilities and shareholders' equity. For example, for a company with \$50 billion of total consolidated assets, if "outstanding loans borrowed and bonds issued" were

²⁵ *Id.* at 64279-81.

²⁶ *Id.* at 64281.

²⁷ *Id.*

defined broadly, then as much as 60 percent of the company's total funding would have to consist of equity in order for the company not to exceed the liabilities screen. A company with \$100 billion of total consolidated assets would have to obtain as much as 80 percent of its total funding from equity. These equity requirements are excessive and would indiscriminately capture large numbers of companies, thereby rendering the liabilities screen meaningless.

Moreover, in general with regard to all the proposed quantitative screens, the Council should explain how it intends to obtain the appropriate data and should propose and submit for public comment mechanisms to index and adjust the thresholds over time to reflect changes in price levels and economic activity as well as the growth of the U.S. economy.²⁸

4.5 The Council should clarify how Stage 2 of the preliminary review process would proceed

In Stage 2 of the preliminary review process, the Council would conduct a more robust analysis of the companies identified in Stage 1 for further evaluation to determine whether they pose a potential threat to U.S. financial stability. Based on the results of this analysis, the Council would contact those companies that the Council believes merit further evaluation.²⁹ In general, this analysis would be based on information available to the Council through public and regulatory sources, but it also may contain information obtained from a company voluntarily.³⁰ There is no provision for a company to be informed by the Council that it is the subject of a Stage 2 review.

The Council should revise the Proposed Guidance to provide notice to a company that it is undergoing Stage 2 review. A company with knowledge of its

²⁸ The Council should clarify whether GAAP, international accounting standards or industry-specific accounting principles, such as those mandated by state insurance commissioners, would be applied. The Re-Proposal also is silent regarding whether the proposed quantitative screens (other than the asset size screen) would apply to U.S. or global activities. The Council should clarify that these screens would apply only to U.S. activities.

²⁹ *Id.* at 64282.

³⁰ *Id.* at 64269.

status may determine that it should disclose that fact under federal securities laws, and it would be inappropriate for this decision to be made on the basis of information incidentally acquired.

The Council also should establish, subject to public notice and comment, a timetable and deadline for the performance of the Stage 2 review. Related to the issue of public disclosure, discussed above, an extended and open-ended period of Stage 2 review may subject a company to rumor, partial disclosure or “leaks” and unfounded speculation regarding the results of the review or possible actions by a company that may be contemplated or underway to avoid further review and possible designation. A publicly announced timetable and deadline for review would help to minimize these disruptive events.

4.6 The Council should adopt more detailed procedures for the annual review and rescission of a SIFI designation

Section 113 of the DFA requires the Council to re-evaluate each SIFI designation it makes no less frequently than on an annual basis. It further provides that the Council shall rescind its designation of a company if two-thirds of the voting members then serving, including the chairperson, determine that the company no longer meets the statutory criteria for designation.³¹ The Council in the Re-Proposal has restated these requirements with essentially no elaboration.³²

These provisions for review and rescission are inadequate. Companies that are designated as SIFIs may reasonably be expected to undertake efforts to terminate their status and thus be released from FRB supervision and avoid enhanced prudential requirements, including heightened capital requirements. These companies also may undertake efforts to reduce or eliminate their systemic importance in connection with the review of their so-called “living wills” by the FRB and the Federal Deposit Insurance Corporation (“FDIC”).³³ The Council’s proposed procedures for annual

³¹ 12 U.S.C. § 5323(d).

³² 76 Fed. Reg. at 64277.

³³ See Resolution Plans Required, 76 Fed. Reg. 67323 (Nov. 1, 2011).

review and rescission, however, do not indicate how, or in what manner, or at what time the Council's review will take place. The Council should adopt procedures for review, both on an automatic basis and on request, that address, among other things, the applicable evidentiary standards, the opportunity to present written information and oral testimony and the requirements and timing to request a review.

5. The FRB Should Adopt "Safe Harbor" Regulations to Exempt Certain Types or Classes of Nonbank Financial Companies from Enhanced Supervision

The DFA requires the FRB to adopt regulations for exempting certain types or classes of nonbank financial companies that are designated as SIFIs from enhanced supervision by the FRB. In developing these exemptions, the FRB is required to take into consideration the criteria for the Council's designation of SIFIs under Section of the DFA.³⁴

While the FRB, and not the Council, is the agency responsible for adopting these "safe harbor" regulations, the safe harbor regulations should logically be the predicate to the Council's own SIFI designation rule. To the extent that the FRB, in consultation with the Council, would exempt certain companies from enhanced supervision, the application of the SIFI designation rule to those companies would be unnecessary. Such a clarifying action would reduce the uncertainty regarding supervision that overhangs numerous companies and would allow the Council to better focus its resources.

6. The FRB Should Complete Its Rulemaking to Determine When a Company Is "Predominantly Engaged in Financial Activities"

The DFA requires the FRB to adopt regulations that set forth the requirements for a company to be determined to be "predominantly engaged in financial activities."³⁵ If a company is not predominantly engaged in financial activities, it is not a

³⁴ 12 U.S.C. § 5370(a) and (b).

³⁵ 12 U.S.C. § 5311(b).

nonbank financial company and is not eligible for designation as a SIFI.³⁶ This phrase is partially described in the DFA, but additional detailed regulations are required to complete its definition.³⁷ The FRB has issued a Notice of Proposed Rulemaking to adopt these regulations, but the public comment period for the proposal closed over eight months ago, and no further action has been taken.³⁸ It is necessary that the FRB complete this rulemaking in order that the Council, when considering whether to designate a company as a SIFI, may determine the extent and nature of the company's transactions and relationships with other significant nonbank financial companies and significant bank holding companies.³⁹ In order that the Council's review of companies for possible SIFI designation may proceed on a sound administrative basis, the FRB should proceed promptly with its rulemaking.

7. The Council and the FRB Should Require the Establishment of an IHC Prior to a SIFI Designation Being Applied to a Lower-Tier Company of a Parent Company Not Predominantly Engaged in Financial Activities

Congress has made it clear in the DFA that it did not intend for the nonfinancial activities of a group or organization to be subject to supervision by the FRB. To facilitate this separation, both Title I and Title VI of the DFA provide for the establishment of an intermediate holding company ("IHC") to engage in financial activities and be supervised by the FRB, thereby leaving higher-tier and lateral affiliates free to engage in nonfinancial activities without FRB supervision. Under Title VI, the FRB is directed to require a grandfathered unitary savings and loan holding company to establish an IHC in which to conduct all or a portion of its financial activities if the FRB determines that the establishment of an IHC is necessary to appropriately supervise those activities or to ensure that the FRB's

³⁶ See 12 U.S.C. § 5311(a)(4).

³⁷ See 12 U.S.C. § 5311(a)(6).

³⁸ 76 Fed. Reg. 7731 (Feb. 11, 2011). We filed timely comments in that rulemaking, both supporting in part and criticizing in part the FRB's proposed regulation.

³⁹ 12 U.S.C. § 5323(a)(2)(C) and (b)(2)(C). See also 76 Fed. Reg. at 7732.

supervision does not extend to the company's nonfinancial activities.⁴⁰ A company shall not be deemed to be a savings and loan holding company solely by virtue of its control of an IHC.⁴¹ Similarly, under Title I, the FRB is directed to require a company that is designated as a SIFI to establish an IHC in which to conduct all or a portion of its activities that are determined to be financial in nature or incidental thereto under Section 4(k) of the Bank Holding Company Act ("BHC Act") if the FRB determines that the establishment of an IHC is necessary to appropriately supervise those activities or to ensure that the FRB's supervision does not extend to the company's commercial activities.⁴²

Based on the text of the DFA, it logically follows that for companies engaged in both financial and nonfinancial activities, the IHC structure is essential to limit the financial regulation to only to the financial activities. Without an IHC structure, the Council and the Board run the risk that financial services oriented regulations may extend to the nonfinancial activities. Therefore, we request that for companies where the top-tier holding company is not predominately engaged in financial activities, but a lower-tier company is predominately engaged in financial activities, an IHC is a condition precedent to a SIFI designation.

8. The Re-Proposal Does Not Comply with the Paperwork Reduction Act

Under the Paperwork Reduction Act, the Council must set forth in the Re-Proposal a description of the likely respondents to the information collection activities under the Re-Proposal and an estimate of the burden that would result from the collection of information.⁴³ The Council, however, has not provided any estimate of the type or number of likely respondents and has merely estimated the total annual

⁴⁰ 12 U.S.C. § 1467b(b)(1)(B).

⁴¹ 12 U.S.C. § 1467a(a)(1)(D)(ii)(III).

⁴² 12 U.S.C. § 5367(b)(1)(B).

⁴³ 44 U.S.C. § 3507(a)(1)(D)(i)(IV) and (V).

reporting burden for all respondents to be 1,000 hours.⁴⁴ It is inappropriate for the Council to require the public to speculate as to the type or number of companies that would be affected by the Re-Proposal and to provide so little information regarding the likely burden on the affected companies.

The absence of a description of likely respondents not only limits the public's ability to comment meaningfully on the breadth of the Re-Proposal's impact; it also handicaps the public in commenting on the estimated total annual reporting burden. For example, it is likely that a relatively large group of companies may be reviewed under Stages 1 through 3, which companies would be subject to a relatively small reporting burden, and that a relatively small group of companies may be required to respond to a notice of proposed designation and to participate in a designation hearing, which companies would be subject to a relatively large reporting burden. At a minimum, the Council's should provide a separate estimate of the annual reporting burden per company at each step of the review and designation process.

9. The Re-Proposal Should Specifically Provide Confidential Treatment under the FOIA and Other Provisions of Law to All Documents Submitted to the Council

The Re-Proposal provides that the Council shall maintain the confidentiality of any information submitted to it and that the Freedom of Information Act ("FOIA"), including the exemptions therein, shall apply to such information.⁴⁵

Under Exemption 4 of the FOIA, a company may request confidential treatment for any information it submits that is a trade secret or commercial or financial information that is privileged or confidential.⁴⁶ The Re-Proposal and Exemption 4 provide no assurance how the varied and possibly voluminous information that a company may submit regarding its systemic importance will be treated. Many elements of this information, however, including detailed descriptions

⁴⁴ 76 Fed. Reg. at 64272.

⁴⁵ *Id.* at 64276.

⁴⁶ 12 U.S.C. § 552(b)(4).

of a company's liabilities, other funding sources, major counterparties and external transactions and relationships, are among the most sensitive commercial and financial information in a company's possession. The Re-Proposal does not give sufficient attention to the importance of protecting this information.

Exemption 8 of the FOIA protects matters that are "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions."⁴⁷ The courts have broadly interpreted the scope of Exemption 8.⁴⁸ The information that may be submitted to the Council under the Re-Proposal to assist it to discharge its responsibilities under Section 113 of the DFA falls squarely under the "broad, all-inclusive scope" of Exemption 8. We therefore respectfully request that the Re-Proposal be revised to provide protection to all information submitted to the Council thereunder as "confidential supervisory material" under Exemption 8 of the FOIA. We further request, if the Council has any concerns regarding its ability to provide confidential treatment to the information described above, that it discuss those concerns in detail in the final rulemaking notice and that it request Congress to take appropriate legislative action to address such concerns.

Stage 1 and Stage 2 of the Proposed Guidance provide for the Council to gather information regarding nonbank financial companies from governmental and private sources. The information may include data obtained from a variety of state and federal authorities that are not subject to a uniform set of confidentiality provisions. The Re-Proposal should be revised to make clear that all information obtained by the Council from third parties in connection with its review of a company for possible designation as a SIFI or the actual designation of a company as a SIFI that is subject to confidential treatment under applicable law shall be treated as confidential supervisory information under Exemption 8 of the FOIA.

⁴⁷ 12 U.S.C. § 552(b)(8).

⁴⁸ See *Abrams v. Dep't of Treasury*, 2007 U.S. App. LEXIS 13695 (5th Cir. 2007); *Consumers Union of the U.S. Inc. v. Heimann*, 589 F.2d 531, 533 (D.C. Cir. 1978); *Pentagon Fed. Credit Union v. Nat'l Credit Union Admin.*, No. 95-1475, 1996 U.S. District LEXIS 22841, at 11 (E.D. Va. June 7, 1996).

The Proposed Rule also does not contain adequate safeguards regarding the distribution of information gathered by the Council to its voting and nonvoting members or to any other person. Broad access to this information by a range of parties runs the risk of unauthorized disclosure of sensitive business and supervisory information. If this were to occur, it could harm the affected companies and undermine the integrity of the designation process itself. The Re-Proposal should be revised to include transparent standards governing the distribution, possession, handling, use and disclosure of information provided by the Council to its voting and nonvoting members and to third parties, including for purposes of responding to subpoenas and other requests by financial and nonfinancial supervisory agencies, law enforcement authorities and litigants.⁴⁹

* * *

For the reasons described above, we respectfully request that the Council revise and re-issue the Re-Proposal in order to address and correct the serious deficiencies in it that are discussed above, to protect nonbank financial companies from unduly burdensome and nonproductive regulatory requirements and to provide the public with a meaningful opportunity to provide comment on the Council's rulemaking. We appreciate the opportunity to submit these comments.

Sincerely,



David Hirschmann

⁴⁹ See, e.g., 12 C.F.R. Part 261, Subpart C (FRB); 12 C.F.R. § 310.10(b)(7) (FDIC).