January 15, 2015

The Honorable Matthew Rutherford
Acting Undersecretary of Domestic Finance
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Mr. Patrick Pinschmidt
Deputy Assistant Secretary,
Financial Stability Oversight Council
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Financial Stability Oversight Council Nonbanks Designation Process Discussion

Dear Acting Undersecretary Rutherford and Deputy Assistant Secretary Pinschmidt:

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 (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. The CCMC welcomes the opportunity to participate in the Financial Stability Oversight Council’s (“FSOC” or “the Council”) consideration of ways make necessary transparency and process reforms to the nonbank designation process. We appreciate the efforts you have made to reach out to all stakeholders including the roundtables you held on November 12th.

The CCMC supports efforts to monitor and address systemic risk. We represent a broad number of financial and non-financial businesses that may be subject to the systemic risk designation process and enhanced regulation under Title I and II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act” or the “Act”). We have been dismayed by the level of transparency surrounding the Systemically Important Financial Institution (“SIFI”) designation process both as to the companies involved in the process and the public generally.
We believe all parties would benefit from efforts to improve the fairness and due process afforded to companies that have or will be designated as SIFIs by the FSOC.¹

CCMC has sought to constructively propose specific steps that would measurably improve the Council’s processes. We would like to reiterate our support for some of the issues raised both in our prior recommendations as well as items discussed during the FSOC Deputies roundtable on November 12th. The FSOC should:

- Establish and disclose FSOC’s jurisdiction over a nonbank company by demonstrating the nonbank company is predominantly engaged in financial activities;
- Give early notice to companies under consideration for designation by FSOC;
- Improve the statutorily required consultation with the primary regulators by standardizing templates for consultation, establishing standards that afford more weight to the views of the primary regulator, incorporating the views of the full agency during the consultation, and providing transparency on the consultation;
- Allow nonbank financial companies the opportunity to eliminate or mitigate risks prior to any preliminary designation;
- Conduct an economic impact analysis of the impact of a nonbank financial company designation and provide that analysis to the targeted company;

¹ On December 4, 2013, the CCMC issued a set of recommendations for FSOC reform which can be found at: http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/2013_Financial-Stability-Oversight-Council-Reform-Agenda.pdf. While we understand that some of those recommendations, such as giving prudential regulators a bigger say in the designation of covered firms or enhancing the composition of FSOC to insure greater internal input for members who are Commissions, are within the realm of Congress and not FSOC, we do believe it is illustrative of a path forward for reform.
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- Incorporate a more robust standard for annual reviews of existing SIFIs;

- Provide additional transparency on how metrics are calculated in Stage 1; and

- Disclose aggregate statistics on the number of nonbank financial companies considered in various stages of designation.

We strongly encourage the FSOC to publish for public comment any changes to the current rules and guidance regarding the designation process and transparency measures similar to the two 2011 Notices of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies.

Additionally, as an overarching and fundamental issue, we believe that it is inappropriate for the Council to designate any nonbank companies without first having policy measures in place as required by Section 165 of the Dodd-Frank Act that make clear what the consequences of designation are on a macro-economic, industry-wide and company basis. Without these regulations in place, it is unclear how the FSOC can determine that designation is the best course of action when set against alternative actions. Moreover, because companies cannot reasonably rebut conclusions underlying an FSOC determination unless they know what prudential requirements will be applied to them, no company should be put in a position of having to argue against designation until the full regulatory regime is in place. Therefore, the Council should cease any further designations until the Board of Governors of the Federal Reserve finalizes rules that will be applied to nonbank SIFIs, and the Council has an opportunity to factor in the consequences of such new prudential regulation while comparing them against other possible courses of action.

It should be noted that the global systemic risk process is following such a sequenced approach for non-bank non-insurance firms. The Financial Stability Board (“FSB”) and International Organization of Securities Commissions (“IOSCO”) are expected to release for comment this month methodologies for non-bank non-insurance firms to determine if they should be subject for consideration as Global SIFIs. It is our understanding that following the finalization of such methodologies that the FSB and IOSCO will then propose an enhanced regulatory system for Global SIFIs and designations will occur thereafter. We believe that this is the proper sequence for such a system to be developed and implemented.
I. Designation Process

Jurisdictional Establishment

Prior to evaluating any nonbank financial company as a SIFI under Section 113 of the Dodd-Frank Act, or any activity under Section 120, the FSOC should clearly establish its jurisdiction. This is a fundamental step that is statutorily required under Section 102 of the Dodd-Frank Act, which provides that a company is subject to such jurisdiction if it is “predominantly engaged in financial activities.” To satisfy this definition, 85% or more of its consolidated revenues or assets must derive from or relate to “activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act [BHC Act]).”

Nonbank financial companies do not necessarily correlate to or easily satisfy this statutorily prescribed test. It takes an asset-by-asset and revenue-by-revenue analysis of its financial statements against Section 4(k) of the BHC Act, which sets forth a list of permissible financial activities that bank affiliates, known as financial holding companies, are permitted to engage in. If FSOC does not have jurisdiction over a company, the company should not have to wait for the entire process to run—and devote the human and financial resources it takes to respond to FSOC during the year long process—before it learns the basis upon which FSOC may assert its jurisdiction over the company.

We propose that the Council establish its jurisdictional authority early in the process and provide the company with a preliminary notice of consideration (“PNC”) that includes:

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3 In comment letters filed with the Federal Reserve on May 25, 2012 and August 6, 2012, the CCMC has expressed serious concerns with the implementation of the predominantly engaged in financial activities section of the Dodd-Frank Act, and the proposed implementing regulation goes well beyond Congressional intent. It should be noted that Senators Vitter and Pryor, the drafters of the Amendment inserting the predominantly engaged section expressed similar concerns in a letter to the Federal Reserve on May 16, 2012 and June 3, 2013.

4 These activities are subject to rules and interpretations of the Federal Reserve Board (“FRB”). Section 4(k) activities are supplemented by the FRB’s Regulation Y. These requirements are further detailed in the FRB’s “Predominantly Engaged in Financial Activities” regulation (also known as Regulation PP).
A detailed statement that breaks down consolidated assets and revenue to specifically demonstrate how the 85% of assets or revenue tests are met;

A description of the regulatory criteria and risks that FSOC believes support consideration of the company, including a statement of how the application of financial regulation by the FRB will mitigate the risks to the stability of the U.S. financial system that it foresees; and

A preliminary opportunity to rebut FSOC jurisdiction and demonstrate how substantive risk concerns are not raised by the company, or how they may be reduced.

Providing a targeted company with such a clear, written notice of the grounds on which FSOC asserts jurisdiction is necessary for the company to evaluate whether FSOC is acting within the bounds of the law. This is of particular concern given the FRB’s determined efforts in its Supplemental Notice of Proposed Rulemaking Regarding Definition of “Predominantly Engaged in Financial Activities” to expand the predominantly engaged standard beyond the statutory limits Congress prescribed in the Dodd-Frank Act. The delivery of a clear and unambiguous PNC would go a long way toward eliminating the mystery and informational abyss that now exists and also indicate whether FSOC was relying on the anti-evasion provisions of Section 113(c) of the Act.

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6 The overly expansive nature of the FRB’s interpretation of “activities that are financial in nature” for purposes of Section 102 are discussed in detail in our May 25, 2012 comments on the FRB’s Supplemental Proposed Rule. A company being subjected to the designation process under Section 113 of the Act based on this unsupportable definition of “activities that are financial in nature” would likely have solid grounds to challenge the FRB’s interpretation and any related FSOC designation.
Timing of the PNC

Once the Council asserts jurisdiction over a nonbank financial company and has provided the company the ability to respond and rebut it, a potential designee should be involved in the process at the *earliest* point feasible to prevent the creation of a one-sided record that becomes more difficult to rebut as the process unfolds\(^7\). That should include access to any data, financial metrics and staff analysis that FSOC is considering in evaluating the company for designation.

As indicated in the previous section, this notice and access should be provided to companies as early as Stage 1 of the designation process. Currently, a company—if it even knows it is being reviewed—does not know the theories upon which FSOC is considering it and has had no ability to access information being collected and considered. Indeed, under current procedures, the company does not generally receive a comprehensive analysis and rationale for designation until a preliminary designation is effectively made. Thus, the company cannot rebut FSOC’s theories, correct inaccuracies in the information, or fill in any gaps at a stage in the proceedings before judgments (if not determinations) are formed. Both the company and FSOC should have an interest in using accurate, high-quality data and not wasting time and resources proceeding based on misinformation. Fundamental principles of transparency and basic notions of due process also support FSOC sharing the information it is collecting and considering from the outset.

Experience demonstrates that FSOC has not been forthcoming in identifying the factual bases underpinning its conclusions before the latest stage of the proceedings. Time and resources are often wasted responding to issues relating to data or materials that FSOC may or may not be focused on. It is very difficult to correct misunderstandings or to change judgments or biases formed on the basis of defective data. It is especially hard when a company is left to guess what data FSOC is relying upon in its evaluation. Therefore, it is critical that a potential SIFI have access to the data on which FSOC is actually relying and allowed the opportunity to

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\(^7\) The disclosure issue should be manageable if every company over $50 billion in assets is invited into the process. In any event, public disclosure obligations are unlikely to dissuade companies from wanting as much information as early as they can get it.
correct and supplement it as early in and throughout the process as possible. Given the significance of SIFI designation to a company and the economy generally, such basic due process should be a standard practice as a matter of good government, even before legal considerations are factored into the equation.

FSOC should identify specific risks or uncertainties that have prompted its consideration of the company. Notice of the areas of risk and uncertainty that give rise to FSOC’s interest would allow both FSOC and the company to collect facts and develop expert analyses to better inform FSOC’s review. In addition, it will be much easier for FSOC and the company to engage in this dialogue before the Stage 3 process, when FSOC’s review is most likely to become public knowledge due to securities disclosure requirements.

**Stage 3 Consultation**

Under Section 113(g) of the Dodd-Frank Act, the Council is required to consult with the primary regulator of the nonbank company being evaluated for the SIFI designation. The statutory language is vague as to what a consultation means. Congress would not have required such a step unless it was to be a meaningful and substantive consultation which was on the record. In that regard, we propose specific actions that the FSOC should take as part of its consultation.

First, the quality of the primary regulator’s consultation will be hamstrung if it is not provided meaningful facts and analytical data by FSOC. That will require a standard template for such sharing of materials, and a timeline that provides such consulting parties to evaluate them.

Second, because the primary regulator of the company being evaluated is best suited to identify and understand the risks posed by the company, the Council should establish standards that provide for the weight afforded the views of the primary regulator with regard to the rationale for initiating the designation process, the utility of information and data under review, and the vote of its members. More importantly, logic suggests that the Council should require the concurrence of the primary regulator in order to effect a Section 113 designation. It is unfathomable that the Council would proceed with a designation that comes with significant
consequences for a company and its industry if the company’s primary regulator—the agency that is best suited to understand the business, its industry, and the risks it poses—determines that designation is not appropriate.

Third, while the statutory language is vague with respect to specifically who represents the primary regulator, the law must mean that the agency to be consulted is the entire agency. While the head of the agency may sit on the Council, he or she, along with his or her colleagues on a multi-member board or commission, should all be a part of the consultation process. The statute cannot be interpreted to mean that a sitting FSOC member must consult with oneself. This will ensure that all points of view are considered and that political views are limited to the extent possible.

Finally, the Council should make the results of its consultation available to the company at the earliest point, including a description of the precise nature of the consultation, the responses received by FSOC, the extent to which they were considered, and the basis for rejecting any such consultative advice. Doing so on the record will not only provide necessary transparency, but it will also strengthen the designation process by allowing companies the opportunity to correct any misinformation or to fill information gaps that may have led to an erroneous conclusion. To these same ends, materials from each agency, including memoranda analyzing the potential designee and designation, should also be provided to the company.

As the Office of Financial Research (“OFR”) is the research and analysis arm of the Council, OFR information gathering must under Title I of the Act be conducted pursuant to standard metrics and procedures which have been published for comment pursuant to Section 153(a). Any company-specific information or analysis provided to the FSOC should also be provided to the company, and the company should be afforded the opportunity to comment on that information on the record. Past work by the OFR raises legitimate concerns about the quality and the credibility of some of OFR’s analysis. Given the very significant consequences of designation, it is incumbent upon FSOC to follow a process that ensures its conclusions are supported by accurate facts, data, and analysis.

Stage 3 De-Risking

During the Stage 3 process, the company should be given an opportunity to address FSOC’s concerns and make appropriate changes in its operations prior to preliminary designation. It seems logical and consistent with Congressional intent for the Council to identify systemically risky behavior so that companies can voluntarily lessen systemic risk, rather than designating those companies to be subject to government oversight that attempts to lessen systemic risk. Many governmental agencies do just that—they establish markers to assist companies in structuring their activities, so that the choice of how much regulation they want to confront is their own.

In that regard, companies should be given an opportunity to undertake voluntary risk mitigation, such as divestiture, resolution plans, etc. Those actions should be given due weight and discussed on the record, if designation is still determined to be necessary and appropriate. Such a process would accomplish FSOC’s main goal of mitigating risk, including systemic risk. This process may do so much more quickly than designating a company—especially a company in an industry for which enhanced prudential standards have yet to be articulated.

Stage 3 Economic Analysis

The CCMC notes that it appears no economic analysis has been conducted on any SIFI designation or proposed recommendation to date. We believe that the FSOC should require that any designation action under Section 113 or Agency Recommendation under Section 120 include a detailed cost-benefit analysis or economic impact statement that is informed by the company’s responses.

The Council has acknowledged in its 2011 Second Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies that it is subject to Executive Orders 12866 and

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9 We are aware that FSOC may view this as a difficult task. We have endeavored to consider those factors as best we can. However, we are left with the conclusion that if FSOC cannot articulate the precise risk factors or channels that require designation as a SIFI, it is hard to imagine that it can defend the designation in the face of a judicial challenge.
13563, which direct agencies to assess available regulatory alternatives and to make this analysis available for public review and comment during the rulemaking process.\textsuperscript{10} Apart from legal considerations, many of which may ultimately be determined by the courts, it would seem to be a matter of logic and good government that a designation of a SIFI should not be made unless the government officials making such a decision understand the economic significance of their decision. Said another way, we view the law as leaning in the direction of requiring agencies to evaluate the competing economic costs and benefits of a proposal in order to avoid a finding by a court that its decision was arbitrary and capricious.

There have similarly been no economic or traditional analyses accompanying either of the 2011 proposed notices of rulemaking, and no indication that a cost-benefit analysis would be conducted when the Council considers whether to designate SIFIs. A rule establishing the designation process is exactly the type of rule that should be subject to a careful and thorough cost-benefit analysis that has the benefit of public input. It is difficult to understand how the Council can assess the desirability of such important rules without conducting and publishing an economic analysis.

FSOC’s failure to expose its rules concerning the designation process to a cost-benefit analysis on which the public can comment 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.\textsuperscript{11} 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 give rise to designation.\textsuperscript{12} FSOC has stated that it intends to follow this approach with respect to

\textsuperscript{10}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.

\textsuperscript{11}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.

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.” 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.”

The Council should not take any action under Sections 113 or 120 unless the evidence demonstrates that the costs are significantly outweighed by the benefits. In that regard, FSOC should clearly identify and describe to a targeted company the forms of regulation that will be imposed, the financial impact that they will have, and the attendant costs that will be created.

II. Annual Reviews

FSOC has adopted little, if any, rules or “Guidance” with regard to the annual reevaluation required by Section 113 (d) of Title I. In considering a more formal process for its annual review, the Council should propose additional Guidance for public comment that incorporates the following elements:

- Establishes a methodology for annual reevaluation by proposing standards and metrics;
- Considers the benefits of an abbreviated rather than a de novo analysis;
- Adopts time limitations on the process not to exceed 60 days;
- Establishes a standard and associated burden of proof for a rebuttable presumption that designation should be discontinued;

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14 Id. at 64267.
• Provides for full participation and comment by the company on the record;

• Communicates meaningful financial, examination, risk analysis and related materials (including OFR reports & written reports provided by the primary regulator and any other members of FSOC) to the company;

• Takes full consideration of:

  (i) Enhancements of regulation which reduce the risk to US financial stability;

  (ii) Voluntary de-risking achieved by the company;

  (iii) Changes in the assumptions, analysis, or in any of the other factors that supported the initial designation; and

  (iv) Responsive materials submitted by the company concerning any changed facts or circumstances that were relevant to the initial designation.

Perhaps as important should be the establishment of targets or goals for a SIFI to work toward at the time of its designation so that it can eliminate the risks that caused it to be designated. FSOC must be able to articulate the principal risks that led to designation, and in doing so, the SIFI would be provided a roadmap of steps that can be taken to increase its chances of being “undesignated.” Basic fairness suggests that the company should be told as best as possible how it came to be designated so it can work toward reversing the process. We would think that such a result would be viewed by FSOC as lessening overall systemic risk, consistent with its raison d’être.
III. Transparency to Public

Transparency on Metrics

Consideration for designation includes meeting a $50 billion asset threshold and triggering of one of five metrics set by Congress, which have been incorporated by the Council as part of the Stage 1 process. However, it is unclear how FSOC calculates, measures, or otherwise determines whether a potential designee has triggered any of the five metrics. There are instances where a company finds out that it is in Stage 2 of the designation process, when it clearly does not meet the threshold requirements set in Stage 1. Therefore, we recommend that FSOC provide on its website, or through other means, guidance clarifying the methodology it uses to determine whether any of the five metrics have warranted FSOC advancing a company to Stage 2 of the designation process. Additionally, it should clarify to a targeted company where it gets its data (Annual Reports, other SEC filings, OFR, etc.) so that the company, FSOC, and others are on the same page. \(^\text{15}\)

We believe that such metrics, regarding non-proprietary data are important for both investor protection and efficient capital markets. The corporate disclosure regime is designed to provide investors with decision useful data, as well as promoting competition and capital formation. By accessing decision useful data, investors can decide if they should or should not invest in a company. Similarly, such a set of metrics will help markets better price in potential designations assisting capital market efficiency. Therefore, a set of metrics, of non-proprietary data, is in line with existing corporate disclosures.

Aggregate Data

To better inform the public of the activities of the Council, it should release timely, up-to-date statistics and data on how many companies are in each stage of designation and how many companies have been actively considered but not

\(^{15}\) This should not supersede OFR’s responsibility to establish metrics and propose them for comment pursuant to Section 153 of the Act.
advanced to Stage 3. Doing so will increase transparency of activities of FSOC and allow the public to better understand the breadth of the universe from which the Council is monitoring.

**Conclusion**

The CCMC recognizes that the need to balance financial stability with economic growth is a challenging task the FSOC continues to juggle. We appreciate that the FSOC is seeking input to help develop a fair but effective process for systemic risk designation and ongoing regulation. We look forward to a continuing partnership with the Council as it works toward enhancing the transparency of and public confidence in the designation process.

Sincerely,

David Hirschmann

cc: The Honorable Jacob Lew, U.S. Department of the Treasury
The Honorable Mary Jo White, U.S. Securities and Exchange Commission
The Honorable Janet Yellen, Board of Governors of the Federal Reserve System
The Honorable Timothy Massad, Commodity Futures Trading Commission
The Honorable Martin Gruenberg, Federal Deposit Insurance Corporation
The Honorable Melvin Watt, Federal Housing Finance Agency
The Honorable Thomas J. Curry, Comptroller of the Currency
The Honorable S. Roy Woodall, Jr, Financial Stability Oversight Council
The Honorable Debbie Matz, National Credit Union Administration
The Honorable Richard Cordray, Consumer Financial Protection Bureau

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16 We note that similar information has been published by the Government Accountability Office. Such releases of information are not real time and do nothing to inform companies about the process as it is happening. If the information is public, there should be no issue as to the timing of its release.