December 15, 2011

By electronic submission to www.regulations.gov

Financial Stability Oversight Council
c/o United States Department of the Treasury
Office of Domestic Finance
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Docket number FSOC-2011-0001-0045
Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] thanks the Financial Stability Oversight Council (the "**Council**") for the opportunity to provide our views in connection with the Council's second notice of proposed rulemaking and proposed interpretive guidance (**"Proposal"**) regarding the criteria that should inform the Council's designation of nonbank financial companies for supervision by the Board of Governors of the Federal Reserve System (the "**Federal Reserve**") under Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").[2]

SIFMA acknowledges that the Council has taken into consideration public comments on its previous proposals and we appreciate that the Council has attempted to address some of our earlier comments. With regard to the Proposal, we have the following main concerns:

- The uniform quantitative thresholds are overly broad and not clearly specified;

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

[2] All section references in this comment letter are to sections of the Dodd-Frank Act.

- There is insufficient clarity on when Stage 2 begins and ends;
- Firms should be given sufficient time to provide information to the Council in Stage 3;
- The Council should make every effort to ensure the confidentiality of information provided to it by firms and should clearly articulate the procedures it intends to adopt in order to achieve this;
- The Council should consider alternative approaches to addressing systemic risk posed by firms and the cost and benefit of each;
- The Council should consider home country supervision prior to designating a foreign nonbank financial company;
- The Council should not disregard legal entity distinctions or imply incorporation or organization when none exists in connection with its determination process; and
- Actual determination decisions should await finalization of several other related Dodd-Frank rulemakings.

Determining whether a nonbank financial company should be subject to Federal Reserve supervision is a responsibility that has significant impact, affecting the Federal Reserve, which will take on major new supervisory responsibilities; designated firms, which will face new, more restrictive standards and considerable compliance costs; and the U.S. economy as a whole. SIFMA believes these outcomes could result in negative or unintended consequences the risks of which have been reflected only partially in the Proposal. We encourage the Council to make further modifications to the Proposal, as described in this letter.

While the designation of nonbank financial companies may be one of the Council's biggest challenges, it is by no means the only one. We continue to encourage the Council to form an industry Advisory Council to provide perspective and input on significant policy decisions. An Advisory Council would be able to provide helpful and practical input into issues such as the process and criteria for systemic designation, among others.

Proposed Criteria

SIFMA believes the Council should adopt an approach that combines transparent benchmarks with a process that affords the Council the time and opportunity to carefully consider less quantifiable, but equally important, factors that reflect the extent of systemic risk a firm poses to the financial system. The framework of indicators the Council uses to evaluate nonbank financial companies for potential designation as systemically significant should be transparent to the public, and more information should be available on the qualitative criteria the Council intends to use.

Stage 1. In Stage 1 of the three-stage process set forth in the Proposal, six uniform thresholds are applied to a broad group of nonbank financial companies. We would like to see more justification as to why the thresholds and their values were chosen. They either lack adequate

rationale, or are based on high-level assertions without back-up. The designation decision has significant impact and it is critical that it be undertaken thoughtfully and based on well-understood, scholarly analysis.

The stated intent of the uniform quantitative thresholds is to identify nonbank financial companies for further evaluation and to provide clarity for those companies that are not likely to be subject to further evaluation. SIFMA agrees with the underlying intent, but is concerned that the proposed thresholds do not offer such clarity, in two respects.

- First, the thresholds appear to include many nonbank financial companies that will not be designated systemically important. For example:
    - The $50 billion consolidated assets test is not required by the Dodd-Frank Act, and not indicative of systemic risk. It ignores differences in the composition of assets, certain of which should be excluded due to their *prima facie* non-systemic qualities. These assets include, but are not limited to:
        - Cash and cash equivalents;
        - Government and federal agency obligations;
        - Customer-segregated assets;
        - Municipal securities;
        - Goodwill; and
        - Property and equipment.
    - In addition, the $3.5 billion in derivatives liabilities threshold is far too low to be a realistic proxy for systemic interconnectedness. Evaluating the threshold of $3.5 billion in derivatives liabilities is difficult given the widely-varying definitions of reported derivatives exposures. However, one measure that provides reasonable context to this proposed threshold is from the OCC's Quarterly Report on Derivatives,[3] which states that the total net current credit exposure of U.S. bank holding companies is around $350 billion. The figure of $3.5 billion, at 1/100th of this amount, is clearly significantly below any level of systemic concern.

  While we appreciate that the purpose of the metrics is to act as an initial filter, and that some of the above issues could be addressed in Stage 2, if the application of the Stage 1 thresholds identifies a large number of companies that are not systemically significant, then those companies and their stakeholders may needlessly enter a potentially prolonged period of uncertainty. The Council risks unintended consequences on the broader economy if companies modify their decisions and/or their corporate structures in response to these thresholds, or face market pressure because investors presume they will be designated as systemic. SIFMA urges the Council to adjust the Stage 1 metrics to

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[3] See http://occ.treas.gov/topics/capital-markets/financial-markets/trading/derivatives/dq211.pdf.

include only those firms that appear to be sufficiently large and complex to require further consideration of their systemic importance. This would streamline the Council's process, provide clarity to more firms and the markets, and limit unintended consequences.

- Second, the thresholds lack sufficient detail to be applied by stakeholders. It is not sufficiently clear how and over what time period the metrics are calculated. Terms should be defined more precisely; in particular the Council should clarify that the thresholds will be calculated based on the accounting method companies use to report their financial results. Regarding the time period, a four-quarter fixed or rolling average would be more appropriate, to account for normal cyclical variations, than a point-in-time approach, where one-time "tripping" of the thresholds could result in a company moving into Stage 2.

Stage 2. The Proposal indicates that if a company meets the uniform quantitative thresholds, it moves into Stage 2. Given the inability to apply these thresholds without further specification, a firm will not know if and when it moves into Stage 2. Even if sufficient specification is provided, however, the Proposal does not clarify when the Council will begin the Stage 2 deliberation. Although the Proposal mentions that firms may provide information to the Council voluntarily during Stage 2, it is not clear at what point the firm could provide such information. SIFMA believes that the Council should inform firms regarding the timing of its Stage 2 review of a firm, as well as the point at which the firm is no longer under consideration. Otherwise, there could be lingering uncertainty about the firm for an extended time.

Stage 3. The Proposal is clear that Stage 3 begins when a firm receives a Notice of Consideration. At that point the firm may provide information to the Council, or the Council may request information. The Proposal states that the timeframe for submission is up to the Council. Given the many facets of the determination decision laid out in the Proposal, SIFMA supports providing a firm at least 90 days to provide information, including non-public information, and supporting internal analysis to the Council once informed of its consideration for a proposed determination. To ensure a timely and relevant submission, SIFMA also recommends the Council provide an explanation of the basis for its consideration in this notice. Without some indication of the basis for consideration, firms may find it difficult to present helpful and pertinent information to aid the Council's decision. Given the potential enormity of the consequences to a nonbank financial company of being subject to Federal Reserve supervision, companies may err on the side of providing extraneous information, rather than risk omitting something of importance. Such an approach may be counterproductive.

The Proposal also states that the Council will consider the firm's resolvability before deciding whether or not to designate the firm for Federal Reserve supervision. This statement requires significantly more clarification so firms can provide any necessary information to the Council.

Under the Dodd-Frank Act, designated firms are required to prepare a resolution plan, as implemented by the joint final rule of the Federal Reserve and FDIC.[4] While we assume a full resolution plan would not be required prior to designation, it is not at all clear how much data and analysis would be needed in order for a firm to demonstrate its resolvability.

Finally, in the event of a designation, we ask that the Council give advance notice to a firm before announcing that firm's designation to the market in order to allow it a reasonable period to prepare public communications and any required disclosures.

Additional Areas of Comment

Cost-Benefit Analysis. The Proposal estimates a total annual reporting burden of 1,000 hours and invites comments on the accuracy of this estimate. However, the Council's failure to identify any of the assumptions underlying its estimate makes it extremely difficult for the public to comment on the accuracy of the estimate. Along those lines, while noting that the OMB reviewed the proposed rule because it constitutes a "significant regulatory action," the Council neither shares the results of OMB's review nor provides any discussion of the costs – or benefits – associated with the Proposal itself or its application.

More generally, this failure to include any discussion of the costs and benefits associated with a Council determination may undermine the credibility of the Council's otherwise laudable statements recognizing that its determination authority is just one available tool among many to safeguard U.S. financial stability and that its responses to identified threats will be based on an "assessment of the circumstances."[5] In keeping with these statements, the Council should rely on a robust cost-benefit analysis when considering whether to exercise its determination authority with respect to an individual firm. This analysis should compare the costs and benefits of possible determination to other available tools and authorities in order to enable the Council to select the tool that most effectively and efficiently mitigates the risk it has identified. The Council should revise the Proposal to explicitly provide that this analysis will be included in its Stage 3 process and in the written Notice of Consideration.

As a threshold matter, the Council should provide a clear discussion of the costs and benefits associated with the determination authority, including the underlying assumptions, on which the public may comment. Such transparency would provide the public greater insight into the

[4] Board of Governors of the Federal Reserve System and Federal Deposit Insurance Corporation, *Resolution Plans Required*, 76 *Fed. Reg.* 67323 (Nov. 1, 2011) (to be codified at 12 C.F.R. pts. 243 & 381).

[5] Financial Stability Oversight Council, *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 76 *Fed. Reg.* 64264 (Oct. 18, 2011), at 64267.

Council's decision process as well as produce a more effective methodology for determining which tool or authority the Council will use in any given scenario.

International Considerations. While the Dodd-Frank Act permits the Council to designate a foreign nonbank financial company as systemically important, there are certain mitigating factors that the Council, as a statutory matter, must take into account in making that designation. These factors limit the scope of the Council's review to mainly the U.S. operations of the company, require the Council to avoid duplicative regulation, and require the Council to consult with the foreign supervisor to the extent appropriate before making such designation. The Council should consider the extent to which the foreign nonbank financial company is subject to and meets the comprehensive, consolidated supervision standards by its home country regulator.

Confidentiality. SIFMA supports the inclusion of section 1310.20(e) of the Proposal, implementing the confidentiality requirements of Section 112(d)(5) of the Dodd-Frank Act. However, the Council should clarify explicitly (as part of the final rule rather than in the guidance) that it will also maintain the confidentiality of any non-public information submitted by firms voluntarily (during Stages 2 and 3). Without such clarification, firms may be reluctant to submit information until or unless the Council specifically requests it in Stage 3. Moreover, the final rule should expressly acknowledge that information submitted by firms in connection with the determination process – whether voluntarily or at the request of the Council or OFR – has been created for the "use of" the Council in the examination or supervision process and will, therefore, be treated as confidential supervisory information. The Council should also include a more detailed explanation of how it intends to apply the exceptions to the Freedom of Information Act to maintain the confidentiality of the non-public information it collects during the process.

Interpretation of "Company." The Council proposes to interpret the term "company" broadly to include, among other things, an "association (incorporated or unincorporated), or similar organization." The Council further notes that it may consider investment funds with identical or highly similar investments managed by the same company as a single entity for purposes of applying the Stage 1 thresholds. While SIFMA understands the Council's desire for flexibility, we believe such a broad interpretation is neither authorized nor appropriate under the Dodd-Frank Act. Even if such an interpretation were authorized by the statute, we believe that it would be inadvisable for the Council to disregard the legal separation between entities that might have different governance, ownership, and regulatory structures. Aggregating separate companies for analytical purposes would present an inaccurate picture of the companies involved and increase the probability of flawed analyses going into the determination decision.

Thoughtful and Deliberative Approach. Finally, we would like to emphasize that the designation decision is a significant one that should be made with great care. Moreover, it is

only one tool in the Council's toolbox to deal with potential systemic risk of firms or financial activities. While we appreciate the importance of moving ahead with the monitoring of systemic risk, the fact is that there are a number of interrelated mandates within the Dodd-Frank Act that should be considered when making the designation decision. We strongly believe that the Council should integrate its rulemaking process with related provisions of the Dodd-Frank Act. These include:

- The Federal Reserve should finalize its rule defining "predominately engaged in financial activities," "significant nonbank financial company" and "significant bank holding company" prior to beginning the designation process. As a threshold matter, a company must first be predominantly engaged in financial activities to be considered a nonbank financial company, much less designated by the Council under Section 113. The Dodd-Frank Act also requires the Council to consider a company's transactions and relationships with other "significant nonbank financial companies" and "significant bank holding companies" in making its determination. Designating a company before the universe of nonbank financial companies is known or one of the statutory factors understood would be premature.

- Section 120 of the Dodd-Frank Act gives the Council the authority to designate a financial activity or practice as systemically important if it finds that the activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading throughout the financial system.[6] Such a designation would result in heightened standards for the activity or practice, which could be relevant in determining whether designation of an entity is appropriate. For example, application of heightened prudential standards to an activity could well affect the leverage and/or liquidity of a firm engaging in this activity; leverage and liquidity are among the proposed criteria for Council designation. In addition, designation of an activity or practice would necessarily affect the degree of existing regulatory scrutiny, another criterion which the Council has said it will consider under Section 113.

- The Federal Reserve, under Section 165, is mandated to require enhanced supervision and prudential standards for nonbank financial companies subject to Federal Reserve supervision. Without the existence of these standards – and without knowing the contours of the Federal Reserve's supervision program that will apply to designated firms – the Council would be unable to know the practical consequences of subjecting the firms to Federal Reserve supervision, including the costs and benefits. Similarly, the application of the Volcker Rule to nonbanks has not yet been proposed.

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[6] Under Title VIII the Council can also designate payment, clearing, and settlement activities as systemically important. *See* Section 804.

- Under Section 170, the Federal Reserve is to promulgate a regulation on behalf of the Council setting forth criteria exempting certain classes or types of nonbank financial institutions from Federal Reserve supervision. Determining – with the benefit of public comment – the characteristics of nonbank financial companies that ***will not*** be designated as systemic seems to be an integral part of deciding what the characteristics are of nonbank financial institutions that ***will*** be designated.

Regardless of when the Council finalizes the Proposal, we urge a cautious approach that fully recognizes the impact on the regulators, firms, and markets of designating a nonbank financial company for Federal Reserve supervision and heightened standards, and considers the other tools the Council has to address systemic risk.

Conclusion

We appreciate the Council issuing a second Notice of Proposed Rulemaking on this complex Dodd-Frank mandate. SIFMA stands ready to assist the Council in any way that we can to achieve an optimal, workable outcome for the supervisors, firms, and the financial system. If you have any questions, please do not hesitate to call me at 202-962-7400 or SIFMA's regulatory advisor, Susan Krause Bell, Promontory Financial Group, at 202-384-1151.

Sincerely,

Kenneth E. Bentsen, Jr.
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Securities Industry and Financial Markets Association