May 13, 2019

Financial Stability Oversight Council
Attn: Mark Schlegel
1500 Pennsylvania Avenue, NW
Room 2208B
Washington, DC 20220
Via Electronic Filing

Re: Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies; RIN 4030-ZA00

Dear Mr. Schlegel:

The Asset Management Group ("**AMG**")[1] of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide our comments to the Financial Stability Oversight Council ("**FSOC**" or "**Council**") in response to its proposed Interpretive Guidance ("**Proposal**" or "**Proposed Guidance**") relating to the Council's authority to require supervision and regulation of certain nonbank financial companies.[2]

The Proposed Guidance makes key changes to the existing guidance that we strongly support and welcome. These include adopting and prioritizing an activities-based approach, leveraging the data, expertise, and existing regulatory frameworks of primary regulators, and making entity-specific designation a last resort – instead of the only option under current guidance. These significant and positive proposed changes are of critical importance to members of our organization, which represents a broad and substantial spectrum of asset management companies.[3]

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[1] SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS, and private funds such as hedge funds and private equity funds.
[2] 84 Fed.Reg. No. 49 (Mar. 13, 2019), "*Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies.*"
[3] A list of AMG's members is available at: https://www.sifma.org/about/member-directory/.

We have been closely engaged on issues relating to nonbank financial companies since the enactment of the Dodd-Frank Act.[4] During the past several years, we have been actively involved in opposing bank-style prudential regulation of asset management activities and the potential designation of asset managers and investment funds as nonbank systemically important financial institutions ("**SIFIs**") under provisions of the Dodd-Frank Act. Our activities have included letters to FSOC, the U.S. Securities and Exchange Commission ("**SEC**"), and the Financial Stability Board ("**FSB**").[5]

We appreciate the work that the Council and Treasury Department have already accomplished, including appropriate actions to rescind the designations of nonbank SIFIs. We applauded the President's orders directing the Treasury Department to examine how financial laws, treaties, regulations, and guidance comport with certain Core Principles and to issue a separate report mandating a thorough review of the nonbank designation process.[6] We strongly agreed with the Treasury Department's reform recommendations in its 2017 report on FSOC's nonbank SIFI designation process.[7] The Dodd-Frank Act is now nearly a decade old, and we believe these actions have helped to lay the foundation for a more transparent, inclusive, and effective use of the Council's authority.[8]

The Proposed Guidance, and specifically the Council's shift to an activities-based approach, is better suited to accomplishing the Council's mission, which we underscored in our

[4] Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111–203 (July 21, 2010).
[5] *See Appendix A* of our 2017 letter to Treasury, *infra*, n.9, for a list of SIFMA AMG comment letters on these issues. Key positions we have previously articulated include the following: (i) attempts to apply bank-style prudential regulation to asset management entities and capital markets are misguided and flawed; (ii) the design and application of the current SIFI designation guidance suffers from such conceptual flaws, as well as process and legal deficiencies that require reform; and (iii) designation of asset managers or investment funds, in particular, would be ineffective, indefensible, and ultimately destructive to the products, services, and markets that efficiently enable long-term savings by American workers and investments in the firms that employ them and power the U.S. economy.
[6] *See* Exec. Order 13722, *Core Principles for Regulating the United States Financial System*, 82 Fed. Reg. 9,965 (Feb. 8, 2017); Presidential Memorandum for the Secretary of the Treasury, *Financial Stability Oversight Council* (Apr. 21, 2017), available at: https://www.whitehouse.gov/presidential-actions/presidential-memorandum-secretary-treasury/.
[7] *See "Financial Stability Oversight Designations,"* (Nov. 17, 2017), Report to the President of the United States, U.S. Dept. of the Treasury, available at: https://www.treasury.gov/press-center/press-releases/documents/pm-fsoc-designations-memo-11-17.pdf.
[8] *See e.g., Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies*, 77 Fed. Reg. No. 70 (April 11, 2012), available at: https://www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Authority%20to%20Require%20Supervision%20and%20Regulation%20of%20Certain%20Nonbank%20Financial%20Companies.pdf; *Financial Stability Oversight Council Supplemental Procedures Relating to Nonbank Financial Company Designations*, 80 Fed. Reg. No. 28 (Feb. 4, 2015), available at: *https://www.treasury.gov/initiatives/fsoc/designations/Documents/Supplemental%20Procedures%20Related%20to%20Nonbank%20Financial%20Company%20Determinations%20-%20February%202015.pdf.*

most recent letter to the Secretary of the Treasury[9] that emphasized the need to reform the nonbank designation process:[10]

> *First, we support FSOC's core missions to identify risks to the financial stability of the U.S. and to serve as an inter-agency forum that serves to monitor market developments and facilitate information-sharing and regulatory coordination. In our view, these core missions represent FSOC's primary and most valuable functions.*
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> *Second, the Report will serve as an opportunity to review and reform the nonbank designation process to ensure greater transparency, due process, and fairness, including providing for greater involvement by the SEC, the primary regulator of capital markets, including asset management firms. In assessing the nonbank designation process with the benefit of its experience since the enactment of the Dodd-Frank Act, the review affords Treasury the opportunity to examine how the process can be improved and to outline concrete steps that can and should be taken to mitigate FSOC activities that detract from the more critical goals of identifying risks to the financial stability of the U.S. and facilitating information-sharing and regulatory coordination among regulators.*[11]

We continue to support the Council's core missions and are pleased with the significant improvements set forth in the Proposed Guidance. As an initial observation, we strongly agree with the Council's observations that the Proposed Guidance will better enable the Council to:

* Leverage the expertise of financial regulatory agencies;
* Promote market discipline;
* Maintain competitive dynamics in affected markets;
* Appropriately tailor regulations to cost-effectively minimize burdens; and
* Ensure the Council's designation analyses are rigorous and transparent.[12]

These commendable objectives are reflected in many aspects of the Proposed Guidance. We believe that further refinements – consistent with the Proposal's basic structure – should be made to fulfill these objectives and build a more fulsome, enduring, fair, balanced, transparent, and cost-effective set of guidelines.

Our letter contains two sections. The first section sets forth our comments on the many significant improvements made by the proposed Interpretive Guidance. The second section sets forth our comments on ways that the Proposed Guidance's sound foundation can and should be clarified, enhanced, and improved as the Council moves forward to finalize and implement it.

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[9] Letter from SIFMA AMG to Treasury (Aug. 18, 2017), available at: https://www.sifma.org/wp-content/uploads/2019/03/SIFMA-AMG-FINAL-PDF14.pdf.

[10] *See "Financial Stability Oversight Designations,"* (Nov. 17, 2017), Report to the President of the United States, U.S. Dept. of the Treasury, available at: https://www.treasury.gov/press-center/press-releases/documents/pm-fsoc-designations-memo-11-17.pdf.

[11] *Supra,* n.9, at 2.

[12] Proposal, at 9029.

I. The Proposed Guidance Forms a Much-Improved Foundation for the Council'sAuthority to Identify and Mitigate Threats to U.S. Financial Stability

We commend the Council for including numerous provisions in the Proposal that will greatly enhance the transparency, fairness, and engagement by primary regulators and relevant stakeholders in the Council's processes, as well as the Council's ability to achieve its statutory mandates to identify risks to U.S. financial stability, promote market discipline, and respond to emerging threats.[13] Following are significant positive aspects of the Proposal:

1. FSOC is providing AMG and other parties an opportunity to provide written comments on the Proposal and committing to do so in the future. The notice and comment process set forth in the Administrative Procedure Act is absolutely essential to a fair, inclusive, and transparent process, and it should guide the Council in designing and implementing its new activities-based approach and in exceptional circumstances in which it considers an individual nonbank for potential designation. We also acknowledge the final rule adopted by the Council stating that "the Council shall not amend or rescind the interpretive guidance…without providing the public with notice and an opportunity to comment under the Administrative Procedure Act."[14] Allowing for public comment is a matter of fundamental fairness and essential to providing the Council with appropriate and necessary information when evaluating potential actions pursuant to its statutory authority.

2. The Proposal states that the Council will adopt and prioritize an activities-based approach to identify and, if necessary, regulate systemic risk. We have previously urged the Council to utilize an activities-based approach, as opposed to the current guidance that focuses exclusively on entity-specific nonbank SIFI designations and subjects all companies that exceed arbitrary numerical thresholds to review for potential designation. Thus, we are very pleased that the Proposal states that "[t]he Council will pursue entity-specific determinations under section 113 of the Dodd-Frank Act *only if a potential risk or threat cannot be addressed through an activities-based approach*."[15] The activities-based approach will better position the Council to achieve its mission by monitoring new trends, products, and activities, as well as other broad industry-wide developments that meet the statutory elements of risks and threats to U.S. financial stability. We also note favorably that the Proposal suggests two primary reasons for emphasizing an activities-based approach: "(1) Identifying and addressing, in consultation with relevant financial regulatory agencies, potential risks and emerging threats on a system-wide basis, thereby reducing the potential for competitive distortions among companies and in markets that could arise from entity-specific regulation and supervisions, and (2) allowing relevant financial regulatory agencies, which generally possess greater information and expertise with respect to company, product, and market risks, to address potential risks, rather than subjecting the companies to new regulatory authorities."[16] We strongly agree with both reasons underlying

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[13] 12 U.S.C. § 5322(a)(1).
[14] 84 Fed. Reg. No. 49, at 8959 (March 13, 2019).
[15] Proposal, at 9030 (emphasis added). In order to provide consistency, we suggest that the statement on page 9041 of the Proposed Guidance be amended to provide that "if the potential threat identified by the Council is one that *can only* be addressed by a Council determination" (deleting "could" and replacing it with "can only").
[16] Proposal, at 9030 (footnote omitted).

the proposed activities-based approach and believe it is a vast improvement to the current guidance.

3. The Proposal, if adopted, will eliminate current Stage 1 of the designation process (as set forth in FSOC's 2012 Interpretive Guidance) and instead will condense the current three-stage process into a two-stage process. We agree that this is a sensible approach. In particular, we are pleased that, by eliminating the current Stage 1, the Council will discard the arbitrary numerical criteria that were never shown to be indicative of systemic risk and will no longer subject any company to automatic review for potential SIFI designation; rather, SIFI designation will be a last resort to consider if regulation is required and the alternatives are insufficient or impracticable. We are also pleased that the Council intends to consult with relevant financial regulatory agencies during the first step and that the Council will consult with relevant financial regulatory agencies during the second step to "seek the implementation of actions to address the identified potential risk."[17] These actions may range from informal information-sharing among regulators to more formal actions, such as recommendations to the private sector, regulators, or Congress. Subject to modifications that we recommend below, we find that these steps outline a thoughtful and reasonable framework for the proposed activities-based approach.

4. The Proposal allows for regular consultation with the primary financial regulators, both under the activities-based approach, as well as in the more remote case of considering an entity-specific designation under section 113 of the Dodd-Frank Act. The Council was created to leverage the expertise, data, resources, and regulatory frameworks of the primary regulators – not to supplant or duplicate them. Accordingly, we have repeatedly urged the Council to engage with and rely upon primary financial regulators in monitoring the financial system for potential threats and in evaluating potential private sector, regulatory, and legislative responses.[18] Engagement with the primary regulators will illuminate the probability and magnitude of an alleged risk, the viability of potential responses and their impacts on existing regulations, and the costs and benefits of such action on the company in question as well as its customers, counterparties, and competitors. It is essential to engage the primary financial regulator early and often and to make the financial regulator's recommendations key components of both the risk assessment and evaluation of potential policy responses.

5. The Proposal envisions engagement by an affected nonbank financial company at an early stage of the designation process. Engaging a company is critical to understanding its business as part of the risk assessment, as well as the cost-benefit analysis, because it may be subjected to an entirely new, different, and burdensome regulatory scheme. Full and transparent engagement is crucial to ensure due process and fundamental fairness. Engagement includes: notice to the nonbank financial company at an early stage, sharing information with the nonbank financial company that underlies the potential designation, allowing full access to FSOC staff and the nonbank financial company's primary financial regulator to discuss relevant issues, requiring an affirmative finding by the nonbank financial company's primary regulator, and providing for both a pre-designation and post-designation off-ramp.

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[17] Proposal, at 9031 (footnote omitted).
[18] *Supra,* n.9, at 4.

6. The Proposed Guidance states that "[a]s required by statute, the Council will consider the extent to which assets are managed rather than owned by the company and the extent to which ownership of assets under management is diffuse; this recognizes the distinct nature of exposure risks when the company is acting as an agent rather than as principal. In particular, in the case of a nonbank financial company that manages assets on behalf of customers or other third parties, the third parties' direct financial exposures are often to the issuers of the managed assets, rather than to the nonbank financial company managing those assets."[19] We agree with this important statement underscoring the fact that managed assets differ from balance sheet assets.

7. The Proposal will require the Council to conduct a cost-benefit analysis of any nonbank financial company designation. This is consistent with our prior recommendations and is absolutely essential to ensure an appropriate outcome. We strongly agree that the Council can and should engage in a meaningful cost-benefit analysis with respect to any entity-based designation, and as described below, should also perform such analysis as part of the activities-based approach.

8. The Proposal allows for an off-ramp for potentially affected nonbank financial companies prior to any designation by FSOC. This is consistent with our previous suggestions to the Treasury Department where we stated that a pre-designation off-ramp should be explicitly included in the Council's designation procedures and that it should provide "affected companies and their primary regulator with any relevant information and data supporting a potential designation and then time to consider available options to eliminate or mitigate any concerns and thereby render SIFI designation unnecessary."[20]

9. The Proposal clarifies the off-ramp for designated nonbank financial companies by allowing them to work with the Council and their primary regulator to describe factors that mitigate the final determination. This is consistent with the Treasury Department's 2017 recommendations. We agree with these recommendations and reiterate our strong agreement with the Proposed Guidance that a nonbank SIFI designation will be a last regulatory resort. The Council should be required to assess all available options, including recommendations for private action, new regulation by the primary regulator or a group of regulators, and legislation, before considering any entity-specific designations.

10. We support the Proposed Guidance's statements that the *likelihood* of risks, including the likelihood of a company's material financial distress, will be considered if and when the Council considers a section 113 designation. For example, the Proposed Guidance states that: "Consistent with sound risk regulation, the Council will consider not only the impact of an identifiable risk, but also the likelihood that the risk will be realized. The Council will therefore assess the likelihood of a company's material financial distress, applying qualitative and quantitative factors, when evaluating the overall impact of a Council designation for any company under review under the First Determination Standard."[21] We agree that the likelihood

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[19] Proposal, at 9042.
[20] *Supra,* n.9, at 7.
[21] Proposal, at 9035. The Proposal includes numerous references indicating that the likelihood of risk will be considered in conjunction with a section 113 designation.

of risk is a key factor that should be considered when the Council evaluates *any potential risk* as well as when it exercises its designation authority.

II. Suggested Enhancements to the Proposed Guidance

While the Proposal offers a much-improved framework for exercising the Council's authorities with respect to monitoring activities for potential threats to financial stability, leveraging the primary regulators, and delineating the exceptional circumstances in which it would consider designating a company under section 113, we offer the following comments and suggestions to enhance, clarify, and refine the strong foundation set forth in the Proposal:

1. As noted above, we strongly support the activities-based approach outlined in the Proposed Guidance. However, we respectfully suggest that the Proposed Guidance should be clarified to provide a more detailed road map of the process the Council will use when conducting an activities-based approach, and, in particular, the process it must follow if and when it decides to abandon the preferred activities-based approach and to instead pursue a section 113 designation. We suggest that the Proposed Guidance should be amended: (a) to require the Council to make a written finding stating that it is moving from an activities-based approach to a process of potential section 113 designation; (b) to require a statement from the primary regulator, supported by written findings, indicating it cannot adequately address an identified risk or threat to U.S. financial stability; and (c) to require a two-thirds vote of the Council supporting such statements, including a positive vote by the primary regulator. The Proposed Guidance should be revised to provide that a potential threat is one that "can only be adequately addressed" by a section 113 designation (instead of the current language stating that the potential threat "could" be addressed by such a designation).[22] These recommendations are consistent with the Proposed Guidance's statement that: "[t]he Council will prioritize its efforts to identify, assess, and address potential risks and threats to U.S. financial stability through a process that emphasizes an activities-based approach, and will pursue entity-specific determinations under section 113 of the Dodd-Frank Act *only if a potential risk or threat cannot be addressed through an activities-based approach*."[23] We believe this statement clearly expresses the appropriate preference for an activities-based approach (particularly considering the well-documented drawbacks of entity-specific designations). Providing a clear and explicit process for moving from an activities-based approach to a potential section 113 designation will enhance the Proposed Guidance, consistent with principles of due process, clarity, and fundamental fairness.

2. We strongly suggest that the Proposed Guidance should more clearly state that an activity that triggers any action by the Council should be based, at a minimum, on a *reasonably foreseeable and likely* set of facts and circumstances rather than situations or conditions that are simply *possible* to imagine or *could* happen. For example, although the four framing questions set forth in the Proposed Guidance are directionally correct,[24] each should be amended to ask

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[22] Proposal, at 9032 and 9041.
[23] Proposal, at 9039 (emphasis added).
[24] Proposal, at 9040.

how likely the risk is to be triggered, how likely it is to be transmitted to markets and their participants, and how likely it is to have adverse effects on the financial system and the U.S. economy. As currently written, the questions merely ask whether any of these events "could" happen. Some level of reasonable probability and magnitude, based on empirical data, needs to guide the Council's analysis of activities that rise to the level of potential threats to the stability of the U.S. financial system. It is certainly possible to speculate about all manner of activities that could present some type of risk or threat. But the Proposed Guidance should make it absolutely clear that the Council will be focused on activities that present a likely or reasonably foreseeable threat to the stability of the U.S. economy. In the section of the Proposal discussing designations, the Council articulates the correct principle that: "[c]onsistent with sound risk regulation, the Council will consider not only the impact of an identifiable risk, but also the likelihood that a risk will be realized."[25] We recommend that the Council amend the framing questions and other key elements of its new guidance to incorporate expressly that concept of likelihood.

3. We respectfully suggest that the Proposed Guidance should note that an activities-based action by the Council under sections 112 and 120 of the Dodd-Frank Act implicates significant facts that clearly underscore the need for action based on risks or threats to the financial stability of the U.S. – and that recognize the breadth and range of the U.S. financial system. This is not to be confused with our strong opposition to monetary or numerical thresholds, such as those set forth in the Council's current guidance.[26] Instead, we suggest the Proposed Guidance could and should be strengthened by referencing some level of scope and scale that equates to financial risks or threats to the financial stability of the U.S. For example, as the world's leading economy, U.S. GDP in 2018 was $20,494,100 million – representing an increase of $1,008,700 million above 2017.[27] An activity that threatens the financial stability of the U.S. needs to be such that it involves a truly substantial disruption.

In overturning the Council's designation of MetLife as a nonbank SIFI, the D.C. Circuit Court made similar findings:

> Indeed, the Final Determination hardly adhered to any standard when it came to assessing MetLife's threat to U.S. financial stability. The Exposure channel analysis merely summed gross potential market exposures, without regard to collateral or other mitigating factors. For example: "In the event that MetLife were to experience material financial distress, the holders of its $30.6 billion in [Funding Agreement Backed Securities (FABS)], including investment funds and large banking organizations, could sustain losses." From that point, FSOC assumed that any such losses would affect the market in a manner that "would be sufficiently severe to inflict significant damage on the broader economy." These kinds of assumptions pervade the analysis; every possible effect of MetLife's imminent insolvency was summarily deemed grave enough to damage the economy. For example, FSOC posited that "contagion can result when relatively modest

[25] Proposal, at 9035.
[26] *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, Financial Stability Oversight Council, 77 Fed. Reg. N0. 70 (Apr. 11, 2012), at 21643.
[27] *See:* https://countryeconomy.com/gdp/usa.

direct, individual losses cause financial institutions with widely dispersed exposures to actively manage their balance sheets in a way that destabilizes markets." But FSOC never projected *what* the losses would be, *which* financial institutions would have to actively manage their balance sheets, or *how* that market would destabilize as a result. This Court cannot affirm a finding that MetLife's distress would cause severe impairment of financial intermediation or of financial market functioning – even on arbitrary-and-capricious review – when FSOC refused to undertake that analysis itself. Predictive judgment must be based on reasoned predictions; a summary of exposures and assets is not a prediction.[28]

Accordingly, we urge the Council to amend the Proposed Guidance to ensure that any new regulation of activities or entity designations under sections 112, 113, or 120 of the Dodd-Frank Act include sufficient facts and analysis relating to the reasonable likelihood that financial distress will occur, and that it is reasonably likely to impair financial intermediation or financial market functioning that would inflict severe damage on the U.S. economy as a whole.[29] We encourage the Council to define these terms more clearly prior to recommending new regulation of either an activity or an entity.

4. We strongly recommend that the role of the primary financial regulator should be strengthened further and articulated more specifically in the final guidance adopted by the Council. In the first step of the activities-based approach set forth in the Proposed Guidance, the Council would be required to monitor the financial services marketplace "in consultation with primary financial regulatory agencies."[30] We respectfully suggest that the Proposed Guidance be strengthened and clarified to be consistent with our prior recommendations to the Treasury Department[31] and as recommended in the final Treasury Department report.[32] Accordingly, we urge that the Proposed Guidance be amended to reflect the active and leading role that primary financial regulators should play during every stage of the contemplated activities-based approach, including a statement that a presumption exists supporting the primary regulator's findings. We note that the SEC recently took steps to designate senior staff "to manage and coordinate the agency's efforts to identify, monitor and respond to market risks—including activities-based risks—affecting the U.S. capital markets."[33] This proactive step underscores the

[28] *MetLife, Inc. v. Financial Stability Oversight Council*, 177 F. Supp. 3d 219 (D.D.C. 2016) (footnotes and related citations omitted).

[29] This is the definition of "threat to the financial stability of the United States" set forth in the Proposal (at 9041).

[30] Proposal, at 9040. Further, if a product, activity or practice is identified, the Council must evaluate the potential risk "in consultation with relevant financial regulatory agencies."

[31] *Supra,* n.9, at 4.

[32] *Supra,* n.10, at 32. "In order to achieve these benefits, Treasury recommends that the Council undertake greater engagement with a company's regulator during the Council's evaluation of the company for potential designation. In particular, the Council should actively solicit the regulator's views regarding risks at the company and potential mitigants. In order to enable the regulator to provide relevant information, the Council should share its preliminary views regarding potential risks at the company, and request that the regulator provide information regarding those specific risks, including whether the risks are adequately mitigated by factors such as existing regulation or the company's business practices. Finally, during the designation process, the Council should continue to encourage the regulator to address any risks to U.S. financial stability using the regulator's existing authorities."

[33] *SEC Names Jeffrey Dinwoodie Senior Counsel and Policy Advisor for Market and Activities-Based Risk,* SEC press release (Mar. 25, 2019), available at: https://www.sec.gov/news/press-release/2019-41.

expertise and resources primary regulators can provide to these endeavors and the need for the Council to engage fully with them when taking action under the Proposed Guidance.

5. We suggest that the Proposal be revised to articulate more clearly that the Council expects to engage with industry and to gather reliable data and solicit input from subject matter experts as it conducts any analysis under the activities-based approach. Accordingly, we would expect that the focus of the Council's initial analysis – in close consultation with primary financial regulators and market participants – will concentrate on new products, activities, and services, as well as fundamental changes to current products, activities, and services, cross-jurisdictional risks over which regulatory authority may be shared or unclear, and historic or well-known sources of financial instability that may meet the statutory threshold under section 112 of the Dodd-Frank Act. While we understand and appreciate the difficulty of the Council's task, we also believe that the Proposed Guidance should reflect the fact that concentrating efforts on well-regulated and transparent products, activities, and services – about which there will be more information available – would not be the best use of limited resources.

6. The activities-based approach in the Proposed Guidance (pursuant to sections 112 and 120 of the Dodd-Frank Act) is far superior to the entity-based, company-specific SIFI designation process that the Council has pursued to date (under section 113 of the Dodd-Frank Act). It is simply a matter of record that the Department of Treasury, securities regulators, members of Congress, the Government Accountability Office, academics, industry groups, courts, and others have all roundly criticized the current nonbank SIFI designation process and analyses supporting it.[34] Accordingly, we believe it would be beneficial for the Proposed Guidance to reflect the shortcomings of the prior guidance and entity-based designations in order to acknowledge why an activities-based approach will present a far better approach and to mark a clear break from past practices and processes. The Proposed Guidance should include explicit statements that recognize the benefits of asset management and nonbank market-based activities, reject imposition of macro-prudential banking-style regulation of asset management firms and capital markets, and affirmatively confirm that there is no historical evidence demonstrating that traditional asset management activities have threatened the financial stability of the U.S.

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[34] *Supra,* n.9, at 10 ("The Council's authority to designate nonbank financial companies is a blunt instrument for addressing potential risks to financial stability. Treasury recommends that the Council prioritize its efforts to address risks to financial stability through a process that emphasizes an activities-based or industry-wide approach."); *Financial Stability Oversight Council: Further Actions Could Improve the Nonbank Designation Process,* GAO-15-51 (Nov. 2014), available at: https://www.gao.gov/assets/670/667096.pdf; letter from Daniel M. Gallagher, Commissioner, to SEC, (May 15, 2014), available at: https://www.sec.gov/comments/am-1/am1-52.pdf ("Exponentially compounding the mistakes of fact and poor substantive analysis contained in the OFR Report was OFR's brazen refusal to consider the comments and input of experts from the SEC, the very agency charged by Congress with regulating asset managers"; letter from Darrell Issa and Jim Jordan, Chairmen, to Hon. Jacob J. Lew, Secretary, Dept. of the Treasury, at 4-5 (Apr. 7, 2014), available at: https://oversight.house.gov/wp-content/uploads/2014/04/2014-04-07-DEI-Jordan-to-Lew-Treas-FSOC-due-4-21.pdf ("OFR ultimately ignored or dismissed core criticisms from the career, non-partisan regulatory experts at the SEC, strongly suggesting that, as observers have alleged, OFR produced the report as simply a pretext for further action to designate asset managers as systemically important, and not as an unbiased and objective review of the industry"); *MetLife, Inc. v. Financial Stability Oversight Council*, 177 F. Supp. 3d 219 (D.D.C. 2016).

7. As noted above, we strongly support the cost-benefit analysis requirement set forth in the Proposed Guidance and reiterate our prior comments to the Treasury Department.[35] As an initial recommendation, we believe the Proposed Guidance should explicitly state that the cost-benefit analysis requirement applies to *both* recommendations for increased regulation under the activities-based approach, as well as entity-based designations (our reading is that the Proposed Guidance refers only to entity-based designations).

A robust cost-benefit analysis is clearly needed before imposing new regulatory requirements – particularly prudential or other regulatory requirements that historically have applied to banks rather than asset management firms. In the *MetLife* decision overturning that designation, the court notes that "[t]here is no doubt that FSOC refused to consider the costs of its Final Determination to MetLife, and purposefully so."[36] The district court decision concluded that FSOC's refusal to consider any costs related to its designation of MetLife rendered the designation arbitrary and capricious: "[FSOC's] decision intentionally refused to consider the cost of regulation, a consideration that is essential to reasoned rulemaking…FSOC's position is at odds with the law and its designation on MetLife must be rescinded."[37]

We suggest that the Proposed Guidance be amended to provide that the cost-benefit analysis will be based on empirical or historical data, not on mere assumptions. The Council can calculate certain direct costs of supervision regulation based on its historic experience with previous nonbank SIFIs, bank SIFIs, and the Federal Reserve Bank's regulatory plan for nonbanks. The Council should only estimate indirect costs of regulation (which should also be considered in addition to direct costs). For indirect costs, the Proposed Guidance should include costs to the U.S. economy, costs to the company's shareholders and counterparties, and costs of market distortions. We recommend that primary regulators be consulted when conducting a cost-benefit analysis for purposes of evaluating an activities-based approach or entity-based designation. We also suggest that the Proposed Guidance be amended to provide that the Council will decline to designate a company until the Federal Reserve Bank identifies the regulations it would adopt for that company; otherwise, any potential costs and benefits are simply unknown or illusory. The Council cannot simply assume that a section 113 designation will be effective or prevent another financial crisis. It must have some empirical basis for assessing the intended benefits. Finally, we suggest that the Proposed Guidance be revised to provide that the Council should follow the GAO's 2012 recommendation and create a framework

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[35] *Supra,* n.9, at 8 (footnote omitted). "In amending the Designation Regulations, we urge Treasury to conduct a thorough and robust cost-benefit analysis. In this regard, we believe it would be instructive for Treasury and FSOC to consider the guidance provided to the rulewriting staff at the SEC. As noted in the SEC guidance, court decisions, statements from Members of Congress, GAO reports, and others have raised questions about and/or recommended improvements to various components of the Commission's economic analysis in its rulemaking, including: (1) identifying the need for the rulemaking and explaining how the proposed rule will meet that need; (2) articulating the appropriate economic baseline against which to measure the proposed rule's likely economic impact (in terms of potential benefits and costs, including effects on efficiency, competition, and capital formation in the market(s) the rule would affect); (3) identifying and evaluating reasonable alternatives to the proposed regulatory approach; and (4) assessing the potential economic impact of the proposed rule and reasonable alternatives by seeking and considering the best available evidence of the likely quantitative and qualitative costs and benefits of each. We believe the same improvements can and should be made to FSOC's designation process."
[36] *Supra,* n.27.
[37] *Id.*

for assessing the impacts of its designation determinations and review results annually prior to making any section 113 designation. Such a framework should be completed before a designation is made to enable the Council to take a baseline reading and then measure changes annually.

8. We believe the Proposed Guidance should be amended to provide explicitly that the Council bears the burden of proof in taking any action based on either an activities-based approach or entity-specific designation. Given the dramatic consequences of any such action, it is imperative that the Council be responsible for meeting the standards delineating the Council's authority under sections 112 or 113 of the Dodd-Frank Act and that action is needed to ameliorate severe repercussions to the U.S. economy. As then-Federal Reserve Governor Powell has noted: "In my view, the Fed and other prudential and market regulators should resist interfering with the role of markets in allocating capital to issuers and risk to investors unless the case for doing so is strong and the available tools can achieve the objective in a targeted manner and with a high degree of confidence."[38] Accordingly, the Council should bear the burden of proof in demonstrating that actions taken under the Proposed Guidance are necessary and appropriate.

9. We respectfully suggest that the Proposed Guidance's discussion concerning "transmission channels" could be bolstered by referencing existing regulations or policies that relate to potential risks to the stability of the U.S. economy. For example, the SEC's current regulations requiring mutual funds to implement liquidity risk management programs are instructive in considering potential risks related to liquidity.[39] Another example is the Macroprudential Initiative being undertaken by the National Association of Insurance Commissioners, including the development of a regulatory liquidity stress testing framework.[40] And the Proposal could also acknowledge work that has been done by international bodies that relate to issues set forth in the discussion about transmission channels. One example is IOSCO's Consultation Paper on Leverage.[41] Another is the Financial Stability Board's proposed holistic framework for the assessment and mitigation of systemic risk in the insurance sector and implications for the identification of G-SIIs and for G-SII policy measures.[42] In a similar vein, we appreciate the fact that the Proposed Guidance includes references to substitutability. We recommend, however, that it be amended further to state what the historical record has demonstrated, *i.e.*, that the asset management industry is highly substitutable. In the asset management industry, it simply is not at all unusual for competing firms to be hired and replaced

[38] Remarks by Jerome H. Powell, Member, Board of Governors of the Federal Reserve System at Stern School of Business, New York University (Feb. 18, 2015), available at: https://www.federalreserve.gov/newsevents/speech/files/powell20150218a.pdf.

[39] *Investment Company Liquidity Risk Management Programs*, 17 CFR Parts 210, 270, 274, Release Nos. 33-10233; IC- 32315; File No. S7-16-15, RIN 3235-AL61 (Oct. 13, 2016), available at: https://www.sec.gov/rules/final/2016/33-10233.pdf.

[40] *Macroprudential Initiative (MPI)*, National Association of Insurance Commissioners (Mar. 6, 2019), available at:https://www.naic.org/cipr_topics/topic_macro.htm.

[41] *IOSCO Report: Leverage, Consultation Paper (Nov. 2018)*, available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD615.pdf.

[42] *Release of IAIS proposed holistic framework for the assessment and mitigation of systemic risk in the insurance sector and implications for the identification of G-SIIs and for G-SII policy measures*, Financial Stability Board (Nov. 14, 2018), available at: http://www.fsb.org/wp-content/uploads/P141118-2.pdf.

by investor clients. In such cases, the client's assets are unaffected (due to the fact that they are held at a third-party custodian) and there is simply no resulting systemic threat to the financial stability of the U.S.[43] In fact, designating an asset management firm as a nonbank SIFI and thus regulating it differently from its competitors creates the perverse result that clients will be driven to other competitors that are regulated differently. In sum, we urge the Council to consider enhancing the discussion relating to transmission channels by referencing existing regulations, international policies, and historical data rather than attempting to reinvent the wheel. Again, we urge the Council to consider clarifying the Proposal to focus on activities that are new, untested, and risky, or that represent fundamental changes to current products, markets or activities (or to key service providers or market participants), cross-jurisdictional risks that may result in products or activities that are not adequately monitored or regulated, and historical sources of financial instabilities, while recognizing the very different activities that are transparent, well-established, enduring, and subject to extensive regulations and oversight.

10. With respect to the two-stage designation process set forth in the Proposed Guidance, we recommend that the final guidance should specify more formalized procedures, including the following: (a) requiring an affirmative vote by a majority of FSOC principals before proceeding to Stage 2; (b) stating clearly that any company being considered will have the opportunity to meet with FSOC principals at any stage in the process; and (c) requiring the Council to give any company being considered access to documents considered prior to any final determination (including adequate time to review and assess such documents). In addition, we suggest that the interpretation of "nonbank financial company" be revised.[44] The proposed interpretation is overbroad. Under such an interpretation, affiliates or businesses comprising a portion of designated companies, to be spun off or sold as part of a nonbank financial company's strategy to limit risk or to fund payments to creditors, could be designated companies. This designation would make the business or affiliate less valuable in light of the additional supervision and prudential standards applicable to designated companies and could act as a poison pill, rendering any sale or other mergers-and-acquisitions-type-transaction unviable. A specific example of the unintended consequences that might arise from this interpretation is that it could have required all of American International Group's businesses or affiliates to carry such a designation. This interpretation would have damaged multiple key stakeholders including creditors and employees, which significantly benefited from mergers and acquisitions transactions. Accordingly, we request that the interpretation be removed. Alternatively, we suggest that it be revised to read as follows: "In addition, the Council intends to interpret 'nonbank financial company' as including a successor of a company that is subject to a final determination of the Council if such successor entity succeeds to substantially all of the assets and liabilities of the designated company." Finally, we recommend that the Proposed Guidance's discussion of the two-stage designation process elaborate further on how the Council will treat confidential information.[45] We suggest

[43] We also urge the Council to request the FRB to use its authority under Section 170 of the Dodd-Frank Act by exempting "types or classes of U.S. [or foreign] nonbank financial companies" that do not exhibit the required risk factors listed in Section 113, which should include nonbank financial companies that are in substitutable sectors where designation will result in shifting risk to other similar entities.

[44] The Proposal states that the Council intends to interpret the term nonbank financial company "as including any successor of a company that is subject to a final determination of the Council." Proposal, at 9041.

[45] With respect to information requested by and provided to the Council during a Stage 2 evaluation, the Proposal currently provides that: "Council members and their agencies and staffs will maintain the confidentiality of such information in accordance with applicable law." Proposal, at 9046.

that the Proposal be amended to include provisions that: (1) FSOC will pursue all legal and procedural steps to ensure that privileged, confidential, and/or trade secret information shared with the Council by the nonbank financial company's regulators or directly by the company will be treated as confidential and not be shared with parties other than FSOC, such regulators, and the company; and (2) such confidential treatment will be provided to all Council, regulator, or company work product that incorporates such confidential information, including any written explanations or responses or challenges to proposed or final determinations or reevaluations. We respectfully suggest that these statements will encourage the necessary free flow of relevant qualitative and quantitative information from the nonbank financial company to the Council and other regulators. They also would support the extensive collaboration and engagement of the company, Council, and existing regulators, and help ensure that the Council has the type and level of information in the evidentiary record needed to make a fair and appropriate assessment and, when designation is being considered, sufficient information for the FSOC to provide the company with clear guidance on pre- and post-designation off-ramps.

11. A nonbank SIFI designation should not be made by the same officials who conducted the investigation or proposed designation. Similarly, it is patently unfair and contrary to administrative law to have the same officials making a determination and then considering an appeal from their determination. Some separation of functions between the investigative and prosecutorial staffs and adjudicative bodies is necessary to ensure an impartial and unbiased consideration of relevant issues.

12. Finally, we have previously recommended that the Council take a more proactive role with non-U.S. and international organizations in an effort to ensure closer coordination, information-sharing, and consistency among regulators and policymakers around the globe.[46] We believe these recommendations are of continued relevance and importance. Accordingly, we urge the Council to acknowledge its leadership role to work closely with non-U.S. and international policymakers to promote greater coordination in order to achieve greater consistency with respect to laws, regulations, and policies that affect the asset management industry. Moreover, the Proposed Guidance should be amended to provide that the Council will not agree to any international designation effort for any U.S. company that has not already been designated under Section 113.

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FSOC has now had years of experience in dealing with the important issues relating to nonbank financial companies that have led to the shift away from entity-specific designations and toward a more constructive and holistic view of financial activities.[47] We acknowledge

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[46] *Supra,* n. 9, at 5-6.

[47] *See The Financial Stability Board in 2019*, remarks by Randal K. Quarles, Vice Chair for Supervision and Chair, FSB (Mar. 28, 2019): "Nonbank financial intermediation (the artist formerly known as 'shadow banking') provides a valuable alternative to bank financing and helps to support real economic activity." We have long advocated an end to the usage of the misleading and inaccurate term, "shadow banking," when referencing nonbank companies, particularly asset management firms, and hope Gov. Quarles' statement is the final word on eliminating use of this improper term.

initial steps FSOC has taken during the past few years to consider improvements to the nonbank designation process[48] and, as noted in the first section of this letter, commend the Council for the many significant improvements made in the Proposed Guidance. The Proposed Guidance creates the framework for more appropriate, transparent, and reasonable action by the Council. Building on this framework, we urge the Council to adopt the enhancements, suggestions, and recommendations set forth in section two of this letter in order to complete the job and to realize more fulsome and meaningful reforms. As outlined above, we strongly support the many changes in the Proposal. We respectfully suggest that incorporating the clarifications and refinements outlined in this letter are consistent with the framework set forth in the Proposal. We urge prompt action by the Council and stand ready to provide any assistance or to address any questions regarding our recommendations.

We truly appreciate the opportunity to work with you to support FSOC's core missions and to ensure a high level of transparency, due process, and fairness in matters involving the asset management industry and market regulation. We would welcome the opportunity to discuss our specific concerns with you and trust that you will not hesitate to contact Tim Cameron (202.962.7447) or Lindsey Keljo (202.962.7312) if you have any questions or need any additional information.

Sincerely,

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Asset Management Group – Head
Securities Industry and Financial Markets Association

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Managing Director and Associate General Counsel
Asset Management Group
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cc: Kenneth Bentsen, Jr., President, SIFMA

[48] *See Financial Stability Oversight Council Supplemental Procedures Relating to Nonbank Financial Company Designations* (Feb. 4, 2015), available at: https://www.treasury.gov/initiatives/fsoc/designations/Documents/Supplemental%20Procedures%20Related%20to%20Nonbank%20Financial%20Company%20Determinations%20-%20February%202015.pdf.