

November 5, 2010

***By electronic delivery to:***

Financial Stability Oversight Council  
Office of Domestic Finance  
United States Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

Re: Financial Stability Oversight Council Advance Notice of Proposed Rulemaking  
Regarding Authority to Require Supervision and Regulation of Certain Nonbank  
Financial Companies

Ladies and Gentlemen:

The American Bankers Association (ABA)<sup>1</sup> appreciates the opportunity to comment on the Financial Stability Oversight Council's (FSOC) Advance Notice of Proposed Rulemaking<sup>2</sup> pursuant to the Dodd-Frank Act<sup>3</sup>(DFA), regarding the FSOC's authority to apply federal systemically-related enhanced supervision and regulation to certain nonbank financial companies.<sup>4</sup> This is one of the key tools that the DFA gives the FSOC in order to mitigate threats to the financial stability of the United States.

Our comments focus on the broad-based systemic risk aspects of the proposed rulemaking that would be helpful to the FSOC as it develops the criteria and analytical framework to designate nonbank financial companies for enhanced supervision under the DFA. The FSOC's Advance Notice of Proposed Rulemaking is a constructive step towards ensuring that all financial companies that are systemically important are subject to comparable prudential standards and supervision.

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<sup>1</sup> The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's \$13 trillion banking industry and its 2 million employees. The majority of ABA's members are banks with less than \$165 million in assets. Learn more at [www.aba.com](http://www.aba.com).

<sup>2</sup> Financial Stability Oversight Council Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies. *See* 75 *Fed. Reg.* 61653 (October 6, 2010).

<sup>3</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (July 21, 2010).

<sup>4</sup> "Nonbank financial company" is defined in Section 102(a)(4) of the DFA. Section 102(a)(4)(C) provides that "[t]he term 'nonbank financial company' means a U.S. nonbank financial company and a foreign nonbank financial company" which are also defined terms in Section 102(a)(4).

We offer the following recommendations:

**Apply comparable prudential standards to systemically important financial companies that engage in similar activities or functions.** The designation criteria should be sufficiently inclusive to ensure that a nonbank financial company will be subject to enhanced prudential standards when the failure of that company would create material risk that a meaningful number of other financial companies would fail, suffer material financial distress that could bring them (or an important activity or function) to the point of non-viability, or be unable to meet their obligations. This generally would be the case when the company is of a critical size and is sufficiently interconnected with other financial companies to justify heightened standards. Interconnectedness could arise, for example, from correlated or directionally consistent exposures or dependencies on activities or functions that are not easily or quickly substitutable. The FSOC should apply its designation criteria in a manner that avoids creating new opportunities for regulatory disparity by applying designation criteria that treat in a comparable manner systemically important financial companies that engage in similar activities or functions.

**Focus on activities/functions and not types of financial companies.** When determining whether a company is sufficiently interconnected to justify its designation as a systemically important financial company, the focus should be on the activities and functions that can create systemic risk. Systemic risk arises from the possibility that financial products or services that are important for a significant portion of our economy will be unavailable or otherwise materially impaired in their operation due to the failure of one or more providers, or that shocks or dislocations in one company or part of the financial system cause grave ripple effects across the system. Consequently, the FSOC's focus on activities and functions could mitigate the negative system-wide impact of the systemic risk posed by financial companies conducting key activities or functions.

Some key activities or functions to consider include:

- Clearing, payment, and settlement;
- Guarantees;
- Credit supply;
- Trading counterparties;
- Significant derivatives exposures; and
- Prime brokerage.

Focusing on these (and other) critical activities or functions could better enable regulators to identify the appropriate actors and tailor the criteria effectively.

**Focus on interconnectedness and risk of contagion.** Systemic risk could arise when a company's failure prevents other companies from meeting their obligations. Counterparty credit risk exposure is one of the most significant risks related to interconnectivity. Related to this is

the risk of contagion, which is the risk that losses in one company will lead to unacceptable losses in a significant number of other companies. Continental Illinois is a good example of a company whose failure, which would have harmed an estimated 2,300 community banks, was deemed to create too great a risk of contagion.<sup>5</sup>

**Size alone is an insufficient proxy for systemic significance.** Clearly size should be considered when determining which companies should be subject to heightened prudential supervision, but size must be considered within the context of several other factors, as outlined herein, as well as the potential for competitors to pick up whatever slack is created by the failure of a company. Determination of market share of the activities and functions discussed above may be a useful additional regulatory tool to evaluate the systemic risk of a particular company.

**Preserve flexibility to act as needed.** While it is important that similar criteria be applied across all systemically important nonbank financial companies, the government will need flexibility. That said, the FSOC should avoid as much as possible a “togglng” of companies into and out of the status as a systemically important financial company. Moreover, given the new tools under DFA to identify systemic risks as they develop, it would be very unlikely that a failing company would create a surprise systemic risk, justifying a “deathbed conversion” of the firm to inclusion in the systemically significant category just as it verges on failure.

**Recognize existing regulation of nonbank financial companies if it is sufficiently robust.** The FSOC should take into consideration whether a sufficiently robust system of supervision and regulation already exists for a nonbank financial company or its activities or functions when making a determination of systemic importance.<sup>6</sup> However, the mere existence of a supervisory regime should not end the analysis; the FSOC should consider the adequacy of supervision and regulation in light of the full scope of the company’s activities and functions and its role in the U.S. markets and economy. This approach would avoid unnecessary regulatory overlap while ensuring that large, important segments of the financial system do not operate pursuant to standards that permit destabilizing regulatory disparities.

**Appropriate focus on the role of foreign firms.** We urge the FSOC to provide for appropriate focus on the role that a foreign nonbank systemically important financial company would play in the U.S. financial system, rather than relying upon identifying types of, or size thresholds for, such companies.

We also urge the FSOC to consider principles of national treatment in designing a scheme that would cover foreign companies and avoid creating disparities of treatment. That does not mean that the FSOC should not take into consideration specific features of foreign regulatory regimes,

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<sup>5</sup> See Federal Reserve Bank of Cleveland Policy Discussion Paper Number 27, August 2009, *On Systemically Important Financial Institutions and Progressive Systemic Mitigation*.

<sup>6</sup> A system of supervision and regulation may be domestic (e.g., the U.S. Securities and Exchange Commission) or foreign (e.g., the U.K. and Japanese Financial Services Authorities).

market structure, and national infrastructures, in addition to company-specific qualities, in considering whether a foreign company should be designated a systemically important financial company, as all relevant factors should be accorded adequate weight.

**Avoid determinations based on presence of Government intervention.** Government assistance, by itself, should not be dispositive in deciding whether a given company is systemically important, as government assistance can be provided for a variety of policy reasons, related or not to the systemic significance of a firm.

Furthermore, using government assistance as a trigger for heightened prudential supervision would discourage companies from participating in programs that may otherwise be beneficial for the economy or that are designed to meet other governmental policy goals. To avoid this unintended consequence, the FSOC should evaluate a company according to criteria that in and of themselves are indicative of systemic significance.

**Develop principles relating to “material financial distress” and “financial stability.”** The statute gives the FSOC authority to require a nonbank financial company to be regulated by the Federal Reserve Board if, among other things, the FSOC determines that “material financial distress” at the firm could pose a threat to the “financial stability” of the United States.<sup>7</sup> ABA encourages the FSOC to consider a principles-based approach to determining what constitutes “material financial distress” and “financial stability,” rather than developing hard definitions of these terms. Crises can arise from unforeseen events. A principles-based approach would provide the FSOC with the needed flexibility to adapt principles to different sources and impacts of financial distress over time, while providing guidance and transparency to market participants.

**Create an advisory council.** While the issue of advisory councils was not raised by the ANPR, we urge the FSOC to create such a council and appoint representatives of the banking industry who can consult with and advise the FSOC on all matters within the FSOC’s jurisdiction. Such councils are used by other regulators (*see, e.g.*, the Federal Advisory Council and the Thrift Institutions Advisory Council created by the Federal Reserve Board and the FDIC Advisory Committee on Community Banking). They provide a very helpful opportunity for the agencies to gain perspectives about various issues while providing a vehicle for industry views to be heard.

The statute clearly contemplates the use of such councils. Section 111(d) of the DFA states that the FSOC “may appoint such special advisory, technical, or professional committees as may be useful in carrying out the functions of the [FSOC]. . . .”<sup>8</sup> Given the enormous scope of issues that the FSOC will consider over the coming years, we believe that such councils, coupled with other communications with financial institutions on a less formal basis, would be very useful in helping the FSOC and its constituent members address issues in the most appropriate and robust fashion.

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<sup>7</sup> See Section 113 of the Dodd-Frank Act.

<sup>8</sup> Section 152(e) provides comparable authority to the Office of Financial Research.

ABA appreciates the opportunity to comment on this proposed rulemaking. Please contact the undersigned at (202) 663-5331 or kmctighe@aba.com, if you have any questions. Thank you for considering our comments and recommendations.

Sincerely,

A handwritten signature in black ink that reads "K. P. McTighe". The signature is written in a cursive style with a large, stylized initial "K".

Kathleen P. McTighe  
Senior Counsel