American Bankers Association

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Financial Stability Oversight Council
Attn: Mr. Lance Auer
Office of Domestic Finance
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Financial Stability Oversight Council Second Notice of Proposed Rulemaking and Proposed Interpretative Guidance Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies; RIN 4030-AA00; 76 Federal Register 64264; October 18, 2011

Ladies and Gentlemen:

The American Bankers Association[1] appreciates the opportunity to comment on the Financial Stability Oversight Council's (Council) Second Notice of Proposed Rulemaking and Proposed Interpretative Guidance[2] pursuant to the Dodd-Frank Act (DFA), regarding the Council's authority to require supervision and regulation of certain nonbank financial companies by the Federal Reserve Board (FRB). ABA appreciates that this proposed rule and guidance provide more information on the manner in which the Council intends to apply the statutory considerations, as well as the processes and procedures it intends to follow to make determinations under Section 113 of DFA to require supervision and regulation of certain nonbank financial companies.

To enhance further the transparency and clarity of the determination process, ABA offers the following recommendations for consideration by the Council. We also offer our comments to encourage an integrated and effective implementation process for determining whether a nonbank financial company could pose a threat to the financial stability of the United States.

[1] 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.

[2] Financial Stability Oversight Council Second Notice of Proposed Rulemaking and Proposed Interpretative Guidance Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies. *See* 76 *Fed. Reg*. 64264 (October 18, 2011).

Proposed Rule[3]:

Determinations regarding nonbank financial companies:
ABA recommends that final Council action on this proposed Rule and Guidance include provisions for public notice and an opportunity for comment before the Council makes any subsequent changes to the final determination provisions. This is necessary to ensure maximum possible transparency for these critical determinations of nonbank financial companies.[4] Changes to the nonbank financial company determination provisions could have a significant impact on individual firms and industry sectors.

To further the Council's objective to provide transparency to reduce the likelihood of uncertainty about the Determination process having a negative affect on financial markets, ABA recommends that the Council explicitly include in the final Rule and Guidance a requirement to notify the public of any proposed changes to either the Proposed Rule or Guidance, together with an opportunity for comment as if the Proposed Rule and Guidance were a regulation subject to the Administrative Procedures Act.

Importance of the Council's role in coordinating and integrating DFA provisions:
ABA notes the importance of coordinating and integrating the yet to be proposed DFA section 165 regulatory structure for enhanced Federal Reserve Board supervision and prudential standards for nonbank financial companies with the Council's proposed determination process for nonbank financial companies that will be supervised by the FRB.

The parameters for the FRB regulatory regime for enhanced supervision and regulation of nonbank financial companies is a key interrelated piece of the overall framework for making an accurate determination of any nonbank financial company that would be subject to the enhanced supervision. While the Council will determine the nonbank financial companies that could pose a threat to the financial stability of the United States, it is important also to know, when making that determination for any individual nonbank financial company, what the FRB's substantive prudential standards will be. It is logical and important for a smooth and well-executed

[3] *See* proposed Rule - Part 1310 – Supervision and Regulation of Certain Nonbank Financial Companies, 76 *Fed. Reg.* 64272 - 64277.

[4] *See* 76 *Fed. Reg*. pp. 64267 and 64269, where the Council states: "The Council is committed to fostering transparency with respect to the Determination Process, and the Proposed Rule and Proposed Guidance are intended to address such concerns by providing a detailed description of: (i) The profile of those nonbank financial companies that the Council likely will evaluate for potential determination so as to minimize the uncertainty to which many commenters referred regarding the Determination Process, and (ii) the metrics that the Council intends to use when analyzing companies at various stages of the Determination Process …. ." *See* 76 *Fed. Reg. p*. 64267, middle column. (Emphasis added.)

The Council also notes in the proposal that it developed a three-stage process "[i]n response to the public comments requesting more transparency and clarity regarding the criteria that will inform the Determination Process …." and that a benefit of the thresholds-based approach in proposed Stage 1 is that it "provides the maximum possible transparency to the market, thereby reducing the likelihood that uncertainty about the Determination Process could negatively affect financial markets." *See* 76 *Fed. Reg.* p. 64269, left and middle columns. (Emphasis added.)

transition of a nonbank financial company to regulation by the FRB to coordinate the implementation of the new DFA section 165 regulatory regime with the Council's determination process.

Definition of "predominantly engaged in financial activities":
A critical part of the definition of both "U.S. nonbank financial company" and "Foreign nonbank financial company" is the term "[p]redominantly engaged in financial activities" as that term is defined in DFA section 102(a)(6), and pursuant to the requirements established by the FRB's implementing regulation.[5]

It is important logically and procedurally that the FRB's proposed rule[6] on the definition of "predominantly engaged in financial activities" be known and understood in order for the Council to promulgate its Rule and Guidance for determinations of nonbank financial companies, since the latter is in significant degree dependent on the former. The proper sequencing of this definition is critical.

Confidentiality/FOIA protections:
ABA recommends that the Council's final rule on confidentiality and Freedom of Information Act (FOIA) protection and procedures clarifications[7] be explicitly incorporated into the final Rule/Guidance on determinations of nonbank financial companies. That is to say that the final Rule and Guidance need to provide confidentiality and all the FOIA protections from disclosure that attach to business information, including trade secrets and proprietary or confidential commercial or financial information.

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[5] *See* 76 *Fed. Reg.* pp. 64272 – 64273, and p. 64274. For example, section 1310.2's proposed definition of "U.S. nonbank financial company" states "The term 'U.S. nonbank financial company' means a company (other than a bank holding company; … that is - (1) Incorporated or organized under the laws of the United States or any State; and (2) 'Predominantly engaged in financial activities,' as that term is defined in section 102(a)(6) of the Dodd-Frank Act …, and pursuant to the requirements for determining if a company is predominantly engaged in financial activities as established by regulation of the Board of Governors pursuant to section 102(b) of the Dodd-Frank Act …."

[6] On February 11, 2011, the FRB issued a proposed rulemaking and request for public comment on proposed amendments to Regulation Y that establish the criteria for determining whether a company is "predominantly engaged in financial activities" at the same time that it also proposed definitions for the terms "significant nonbank financial company" and "significant bank holding company" for purposes of implementing Title I of the DFA. The FRB's proposal specifically stated that "[t]hese terms are relevant to various provisions of Title I of the Dodd-Frank Act, including section 113, which authorizes the Financial Stability Oversight Council ("Council") to designate a nonbank financial company for supervision by the Board if the Council determines that the company could pose a threat to the financial stability of the United States." *See* 76 *Fed. Reg.* 7731 (February 11, 2011), at 7731. This proposed rulemaking has not yet been finalized by the FRB.

[7] *See* 76 *Fed. Reg.* 17038 (March 28, 2011) relating to the Financial Stability Oversight Council's Proposed Rulemaking on Implementation of the Freedom of Information Act to implement the requirements of FOIA by setting forth procedures for requesting access to FSOC records. "Section 112(d)(5)(C) of the [Dodd-Frank] Act provides that the FOIA, 'including the exceptions thereunder, shall apply to data or information submitted under this subsection and subtitle B.' These proposed regulations would implement the requirements of the FOIA as they apply to the Council." *See* p. 17038. Section 1301.10 of the proposed rulemaking relates to requests for business information provided to the Council, including the proposed protections of business information, which would include "trade secrets or commercial or financial information obtained by the Council from a submitter that may be protected from disclosure under Exemption 4." *See* pp. 17043 – 170344.

Also, ABA recommends that the final rule clarify that the DFA section 112(d)(5)(A) requirement to maintain confidentiality also extends to maintaining the confidentiality of any data, information, and reports that the Council collects from Federal, State, and relevant foreign financial regulatory agencies other than the Federal governmental entities specifically designated in the DFA section 112(d)(5)(A) – the Council, the Office of Financial Research (OFR), and other member agencies of the Council. Further, section 1310.20 (a) of the proposed Rule provides that the Council may receive and request submission of data or information from "other Federal and State financial regulatory agencies."[8] However, the privilege and FOIA exception protections provided by the DFA section 112(d)(5)(B) and (C) would not appear to extend to information the Council obtains from Federal, State, and relevant foreign financial regulatory agencies other than the Federal governmental entities specifically designated in the DFA section 112(d) – the Office of Financial Research (OFR), member agencies of the Council, and the Federal Insurance Office (FIO). In this situation, ABA recommends that the final Rule provide a mechanism for maintaining the confidentiality, privilege, and FOIA protections when there is a request for release of, or the Council is considering providing, the information relating to a nonbank financial company that is obtained from any Federal, State, or foreign financial regulatory agency other than the OFR, member agencies, or the FIO.

Similarly, ABA recommends that the final rule clarify that the requirement to maintain the confidentiality of data, information, and reports submitted to the Council under proposed section 1310.20(e) also apply to all Council members, staff, and others who receive, review, maintain, gather or transmit confidential information provided to the Council. In order to ensure that such individuals will maintain confidentiality of this information, ABA recommends that the Council develop and implement policies and procedures, and provide appropriate training for all such individuals of the Council and the OFR, including members and staff, on maintaining the confidentiality of information submitted to the Council.

Finalizing and implementing these data protections during and after the Council determination process are needed to ensure that any confidential or protected information provided by, or concerning, a nonbank financial company that is considered by the Council for a determination for supervision by the FRB, is in place during and after the entire determination process.

FRB Intermediate Holding Company rule:
ABA recommends that the FRB propose and finalize the Intermediate Holding Company (IHC)[9] Rule as an important and necessary precursor to the Council's nonbank financial company determination process. It is important for any such institution to be able to plan for potential enhanced supervision by the FRB.

[8] *See* 76 *Fed. Reg.* 64275.

[9] DFA Section 626 authorizes the FRB to require a grandfathered unitary savings and loan holding company that conducts activities other than financial activities to establish and conduct all or a portion of its financial activities in or through an intermediate holding company, which would be a savings and loan holding company (SLHC), that the FRB would establish by regulation. Likewise, this section authorizes the FRB to require such grandfathered unitary SLHC to establish an IHC if the Board makes a determination that establishment of an IHC is necessary to (1) appropriately supervise activities determined to be financial activities; or (2) ensure that supervision by the FRB does not extend to such company's activities that are not financial activities.

Anti-evasion provision:
ABA recommends that the Council clarify that a financial company's effort to manage its business to avoid crossing the thresholds established by the Council in this proposed Rule and proposed Guidance should not be considered a violation of the anti-evasion provision of the DFA section 113(c) or the Council's proposed Rule, section 1310.12. Moreover, ABA recommends that this should be one factor, rather than the sole factor, for the Council to take into consideration with regard to the anti-evasion standard, especially the provision that "the company is organized or operates in such a manner as to evade the application of Title I of the Dodd-Frank Act … or this part."[10]

The DFA proposed that a company's size, leverage, substitutability, interconnectedness, and liquidity risk could pose a threat to the financial stability of the United States. A nonbank financial company that actively manages its balance sheet to reduce these factors, and thereby falls below the systemic determination thresholds, should be viewed as advancing the protections extended in the DFA and not as evading determinations under Section 1310.12(a)(2) of the proposed rule.

Emergency exception to the section 1310.21 notice and opportunity for an evidentiary hearing relating to proposed and final determinations:
ABA recommends that the term "emergency exception" be defined in the final Rule.

Proposed section 1310.22 would establish an emergency exception that allows the Council to waive or modify the notice and procedural requirements of proposed section 1310.21 relating to the determination of a nonbank financial company that could pose a threat to the financial stability of the U.S. The Council would also be required to provide timely notice of the waiver or modification to the nonbank financial company. However, section 1310.22 does not define the term "emergency" or provide examples of when it would be used by the Council. While the Council may utilize this exception when it makes a determination that such waiver or modification is "necessary or appropriate to prevent or mitigate threats posed by the nonbank financial company to the financial stability of the United States,"[11] the proposed rule is not detailed or clear on the circumstances when the Council may properly exercise this extraordinary power.

ABA recommends that the Council include in its final Rule, a narrow definition of "emergency" to clarify that a waiver or modification of the notice and procedural requirements of section 1310.21 would be used only in exceptional circumstances when other tools available to the Council or regulators would not be a viable alternative. The DFA provides new regulatory tools, in addition to the Council's section 113 determination authority, to address threats to the financial stability of the United States. For example, Title II of the DFA establishes an Orderly Liquidation Authority (OLA) to resolve a large, interconnected financial company upon a determination that its failure and resolution under applicable law would have serious adverse

[10] *See* 76 *Fed. Reg.* 64275.

[11] 76 *Fed. Reg*. at 64276.

effects on the financial stability of the United States and use of the OLA would avoid or mitigate such adverse effects.

Proposed Guidance:[12]

Council determination authority and proposed framework - "threat to the financial stability of the United States":
ABA recommends that the Council include in the metrics for the proposed channels that are presumed likely to facilitate the transmission of the negative effects of a nonbank financial company's material financial distress or activities to other financial firms or markets, a linkage to the DFA section 113 statutory considerations that the Council will use to determine which nonbank financial companies will be subject to FRB supervision and regulation. Requiring this additional information would provide more transparency during the Council's determination process by tying each Council-proposed metric to the DFA statutorily-mandated considerations that the Council must use when making a determination that a nonbank financial company should be supervised and regulated by the FRB because it could pose a threat to the financial stability of the U.S.

Second determination standard – nature, scope, size, scale, concentration, interconnectedness, or mix of activities that could pose a threat to U.S. financial stability and Stage 1 Determination Process thresholds:
ABA recommends that the Council add an "over a period of time" component to this proposed standard as well as the total consolidated assets threshold and the other key thresholds in proposed Stage 1 of the determination process. It would be a more predictable and more realistic measurement of the thresholds for the Council to use an "over a period of time" measurement, especially for the Stage 1 thresholds of each of the factors, rather than using a less meaningful "at a point in time" threshold measurement that could be a much more volatile measurement more prone to inaccurate conclusions**.**

While there may be various methods for achieving this, one way to do so would be to utilize a model similar in concept to the recent banking agencies' Supervisory Statement[13] that clarified how the Agencies would determine total assets size threshold determinations of insured depository institutions and credit unions for purposes of supervision by the Bureau of Consumer Financial Protection. In that Guidance, the Agencies utilized a method for measuring total asset size, based on the institution's quarterly Call Reports for four consecutive quarters, starting with the June 30, 2011, Call Report. This guidance could form a model, with adaptations, for use by the Council when making determinations of nonbank financial companies for purposes of DFA section 113. For example, if use of a quarterly Call Report would not apply to a nonbank financial company, use of consolidated financial statements or other significant periodic reports

[12] *See* proposed Appendix to Part 1310 – Financial Stability Oversight Council Guidance for Nonbank Financial Company Determinations, 76 *Fed. Reg.* 64277 - 64283.

[13] *See* Supervisory Statement, Determination of Depository Institution and Credit Union Asset Size for Purposes of Section 1025 and 1026 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. http://www.consumerfinance.gov/wp-content/uploads/2011/11/SupervisoryStatement_Nov17.pdf

filed by the nonbank financial company over a period of time could be used to measure the proposed threshold levels proposed by the Council.

Six-category framework:
ABA notes an overarching concern with how the Council will weigh the categories in its proposed six-category framework and what ultimate standard it will use to determine a nonbank financial company's likelihood to pose a threat to the financial stability of the U.S. ABA recommends that the Council clarify which of the many criteria and related metrics will be most critical during the Council's analysis, and whether some of the proposed criteria will be more important than others. These clarifications would provide more transparency and clarity to the determination process.

Size:
ABA recommends that the Council's final Rule (1) include a definition of the term "company", and (2) evaluate separate legal entities in a manner that is consistent with the DFA statutory language and the actual legal structures of the nonbank financial companies considered by the Council.

The Council intends to interpret the term "company" broadly for nonbank financial companies in connection with DFA section 113 to include, among other entities, an association, whether incorporated or unincorporated, or similar organization.[14] This expansive definition appears to exceed the scope and intent of the DFA.

Also, in footnote 12 to the proposed Guidance that relates to the Stage 1 determination process thresholds for size and other Council-listed key criteria, the Council states that when applying the proposed six thresholds to investment funds managed by a nonbank financial company, it "may consider the funds as a single entity if their investments are identical or highly similar."[15] This proposed expansive intent also appears to exceed the intent of the DFA.

Ignoring the distinctions among entities that might have different legal, governance, ownership and regulatory structures during the analytical phase of the process is inadvisable because that approach could materially increase the likelihood of faulty analysis and conclusions during the Council determination process and perhaps inappropriate or unnecessary regulatory outcomes.

Determination process:
Overall recommendations for Stage 1 criteria:
ABA recommends that the Council make publicly available on its website, its data, methodology, and analysis on how it derived the thresholds for each of these quantitative criteria proposed for Stage 1 of the determination process, including the specified dollar levels for each threshold. E.O. 13563 of January 18, 2011, on Improving Regulation and Regulatory Review, provides that agencies should provide such information during the public comments process. [16]

[14] *See* 76 *Fed Reg.* 64265.

[15] *See* 76 *Fed. Reg.* 64281.

[16] *See* http://www.whitehouse.gov/sites/default/files/omb/inforeg/eo12866/eo13563_01182011.pdf.

Stage 1 of the determination process - quantitative thresholds for additional criteria of credit default swaps outstanding:
The proposed threshold level and criterion of "gross notional credit default swaps ("CDS") outstanding" does not appear to be an appropriate measure of the risk posed, since it often does not reflect the actual financial risk involved. ABA requests that the Council publicly disclose specifically how it devised this proposed threshold (data, methodology, and analysis) in order to determine whether this criterion and the threshold dollar levels are appropriate measures of risk relating to the nonbank financial company. At a minimum, the following examples should be considered:

1. An entity may effectively be performing a dealer function by selling $10 of notional CDS protection on a bond issued by a financial company and immediately buying identical protection from another organization. In this case, there is $20 of notional outstanding though the practical exposure is $10.

2. A financial company issues $100 of collateralized debt, such as a RMBS or covered loan. Holders of the related security buy CDS protection on $10 notional amount. The actual exposure to the credit risk of the financial company is significantly less than the notional amount (and may often be zero) because of the collateral. In most situations, the credit rating of the RMBS is based on the underlying collateral and not on the credit of the firm.

3. An entity that has acquired $10 of notional protection through a CDS may desire to close out its position. Due to inefficiencies in the market, it may be more cost effective to sell $10 of similar, but not identical, protection as opposed to selling the position currently held. In this case, there will be $20 of notional exposure, though the actual exposure is $10.

This may also occur if other instruments are used to protect against credit risk instead of utilizing a CDS. For example, an option to enter into a CDS may create (or alleviate) the same exposure.

Derivative Liabilities:
ABA recommends that the Council clarify the proposed threshold netting criterion to make clear that the affected nonbank financial company could measure the derivative liabilities in accordance with the GAAP netting concept per the Accounting Standards Codification (ASC) 815, whether or not the nonbank financial company elected.

More specifically, ABA recommends making the following revisions on page 64281, column 3, of the proposed Guidance relating to Derivative Liabilities:

- Delete "In accordance with" and insert "Per".
- Add the following new sentence after the first sentence: "Derivative liabilities will be measured in accordance with this methodology whether elected or not."

ABA agrees that a net basis of accounting is appropriate in analyzing actual derivative exposure. While it is common for banks to apply ASC 815 on a net basis, nonbank financial companies do not necessarily operate in a regulatory structure that would encourage a net basis of accounting.

Therefore, the net derivative liability exposure for nonbank financial companies that do not elect to report on a net basis may be derived from adjustments detailed in footnote disclosures to the financial statements.

Stage 2 of the determination process:
ABA recommends that there should be more clarity and specificity in the proposed Guidance Stage 2 data analysis (*e.g.* what the Council looked at) and the key factors it relied upon in making its decision that a nonbank financial company merits further evaluation in Stage 3.

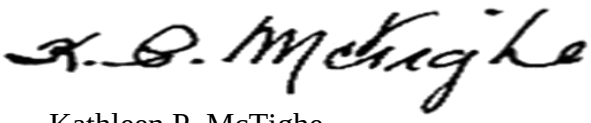
Stage 3 of the determination process:
Comparative analysis:
ABA recommends that the Council incorporate a comparative analysis of the tools available to the Council to mitigate an identified risk explicitly as part of the Stage 3 Determination Process. The Council should provide this analysis in writing to the affected financial company and explain why the final determination under DFA section 113 is the best and most appropriate tool available to the Council to mitigate risk of the nonbank financial company to the financial stability of the U.S., and why it is superior to all other tools available.

Opportunity for a nonbank financial company to contest orally a proposed determination:
ABA recommends that the Council include in the final Rule or Guidance, a provision that provides the opportunity for a nonbank financial company to request and provide oral testimony and oral argument to contest a proposed determination, prior to any Council final determination. Notwithstanding that section 113 (e)(2) of the DFA provides the Council the sole authority to determine if there will be an opportunity to contest orally the proposed determination, a nonbank financial company should have the opportunity due to the profound impact of being determined a nonbank financial company to present orally its position and rationale to the Council prior to a final determination.

Requirement for the FSOC to explain the determination:
ABA also recommends that the Council be required to provide a detailed confidential written explanation to the nonbank financial company on the determination process used and the Council's full explanation of the basis for making its determination.

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

Sincerely,



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