American Financial Services Association

November 5, 2010

Hon. Timothy Geithner, Chairman
Financial Stability Oversight Council
1500 Pennsylvania Avenue, NW
Washington, DC 20220

RE: 12 CFR Chapter XIII – Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (FSOC-2010-0001-0001)

Dear Chairman Geithner:

On behalf of our member organizations who are not part of a bank holding company, the American Financial Services Association ("AFSA") welcomes the opportunity to provide comments on the *Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies* (the "Notice") published by the Financial Stability Oversight Council (the "Council") under Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or the "Act"). We greatly appreciate the Council's interest, as reflected in the Notice, in obtaining industry and public input as to the specific criteria and analytical framework by which the Council will designate nonbank financial companies for enhanced supervision under Section 113 of the Dodd-Frank Act.

Section 113 designations will have significant and far-reaching regulatory implications and costs, both in terms of time and resources, for nonbank financial companies. . . . With this in mind, we encourage the Council to consider proposed and final rules under Section 113 that reflect a careful and measured response to the true issues that contributed to the recent economic crisis and that may prevent future similar crises. We believe that the following comments represent such a measured analysis.

By way of brief background, AFSA represents a broad cross-section of financial companies that provide credit products and services to consumers, many of which do not have a depository institution within their organizational structure. Members of the association include leading consumer finance companies, indirect automotive finance companies and residential mortgage lenders. Some members are captive financing arms of larger manufacturing or retail companies, while other members are independent providers of financial products and services. Given the diversity in the size, scope and complexity of its membership, AFSA is uniquely positioned to provide thoughtful comments to the Notice that are informed through input from various participants in the financial services market with a direct interest in the application of Section 113 and its implications.

Without restating the specific question from the Notice, the numbering below mirrors the numbering used by the Council in the Notice.

1. Metrics adopted for use in making determinations under Section 113 should consider the nature and complexity of a nonbank financial company's financial products and services, market share and barriers to entry.

Metrics adopted by the Council under Section 113 must be flexible to allow for necessary determinations in cases where nonbank financial companies truly present a threat to the stability of the United States financial system and must be sufficiently rigid to provide certainty and clarity to the market. The Council should adopt metrics that focus on anticipated market disruption by a company's failure by taking into account (i) the nature and complexity of the products or services offered by a nonbank financial company; (ii) a nonbank financial company's market share for a given financial product or service; and (iii) the ease with which other firms can enter the market for the nonbank financial company's financial products and services and/or alternative products and services. The variety and complexity of the financial products offered necessarily impacts the number of alternative sources a customer may have for the product. It may be possible that certain finance segments have so little cross-connectedness to the system as to pose little systemic risk. The systemic importance of providers of complex products is relatively higher than providers of more basic products. The concept of product complexity, however, is captured if the Council considers metrics that accurately determine the potential retail market disruption of a company's failure. Those companies that offer more complex products for which the customer has few alternative sources will inherently present a higher potential for retail market disruption than those that offer products for which alternative source are abundant.

The metrics adopted should recognize the systemic significance of those participants in the market whose failure would necessarily result in systemic lack of credit availability, while also recognizing the converse of that principal which is that the failure of a participant whose clients are faced with multiple alternatives for financial products and services has inherently less of a systemic impact. The market share controlled by a nonbank financial company serves as a strong indicator of the importance of a firm with respect to a given geographic region and financial product. Market share should not, however, be used exclusively as a proxy for review of the considerations in Section 113. Even with a significant market share, the ease with which a given nonbank financial company can be replaced or is interchangeable with another firm or company suggests that market share or size are not necessarily a true indicator of the importance of the company.

In addition to market share, a key factor in this analysis should be barriers to entry for competitive providers of financial services. The products offered by nonbank financial companies can also be offered by banks, thrifts or credit unions, but in some cases the converse is not also true and some of the more complicated bank, thrift and credit union products are not offered by nonbank financial companies. As compared to depository institutions that must seek and obtain federal approval under the statutory factors enumerated in Section 6 of the Federal Deposit Insurance Act or Section 201 of the Federal Credit Union Act to accept insured deposits as a key source of funding for credit products, nonbank financial companies face substantially less barriers to entry. Nonbank financial companies offer relatively "simpler" financial products and services and ease to market, often directed at a single product or industry. The likelihood that they will present a risk to retail market disruption is materially less.

2. The Council should focus on key drivers of systemic importance, which may inherently involve consideration of finance industry-specific concentrations. To the extent possible, metrics should be current and forward-looking without regard for historic factors or measurements.

As noted in our response to comment 1, the Council should focus its attention under Section 113 on anticipated market disruption by a company's failure by taking into account (i) the nature and complexity of the products or services offered by a nonbank financial company; (ii) a nonbank financial company's market share for a given product or service; and (iii) the ease with which other firms can enter the market for the nonbank financial company's financial products and services. It is possible that a nonbank financial company could obtain a market concentration within a given industry or product such that its failure would be systemically important for that industry; however, absent such an occurrence which could pose a threat to the financial stability of the United States as a whole, we are not aware of any meaningful assessment that is needed on an industry basis. We note, however, the vast majority of our members that offer consumer or retail products hold a relatively small market share, even on an industry-basis; thus, there are likely to be very few companies whose market share would warrant designation under Section 113.

In terms of time as a component of designations, we firmly support analyses that focus exclusively, if not entirely, on current as opposed to historic figures. In light of the rapid and dynamic shifts in the financial services markets over the past several years, market share, concentrations and other measurements of systemic importance require utilization of the most recent historical data.

3. When companies appropriately differentiate internally among domestic and foreign operations, the Council should respect that separateness.

Given the fact that the Council is tasked with monitoring risks to the United States financial system, the Council's review of nonbank financial companies should focus on a given company's United States operations and, to the extent appropriate, foreign operations that are not separated from United States operations and pose risks to systemically important domestic operations. Based on input from our membership, we believe foreign financial operations of nonbank financial companies are much less prevalent and generally more segregated from domestic financial operations when compared to foreign operations of depository institutions and bank holding companies. In fact, many nonbank financial companies that offer products overseas do so through separately formed foreign affiliates that are regulated and authorized by the appropriate foreign authorities. In most cases, these separate affiliates do not operate in the United States and the domestic entities do not operate internationally. This organizational distinction between banks and nonbanks is meaningful for purposes of the Council's determinations under Section 113. We believe that, absent unique circumstances that dictate to the contrary, only the domestic operations of a nonbank financial company should be considered in determining market share and other analyses under Section 113.

4. Simple metrics and bright line thresholds should be avoided by the Council in determining which nonbank financial companies should be considered under Section 113.

The Council's mandate under the Dodd-Frank Act and the Act's statutory objectives deal with inherently complex issues. Unless the Council is seeking to discourage companies from growing in size until they are "too big to fail," the Council should avoid using simple metrics to designate companies under Section 113. Congress adopted a purportedly simple metric in the Dodd-Frank Act for bank holding companies when it established the $50 billion in asset size threshold for significant bank holding companies. Congress adopted an alternative, less rigid approach for nonbank financial companies under Section 113 which does not include an asset size threshold. We would assert that this difference was intentional, and it was not the intent of Congress to apply a simple asset size threshold for nonbank financial companies.

5. Determinations regarding the scope, size, and scale of nonbank financial companies should consider the complexity of a firm's products, off-balance sheet transactions and level of interconnectedness with other significant companies in the United States.

The Council should measure the scope, size and scale of a nonbank financial company by reviewing the company's assets and the complexity of the products offered. The scope and scale should also consider the amount of off-balance sheet financing and transactions the company has engaged in and the level of interconnectedness with other systemically important financial institutions.

Nonbank financial companies do not have capital requirements, federally insured deposits or depositors to protect and as a result, they do not risk-weight their assets. While complex, banks and bank holding companies have a limited number of permissible investments and activities. As such, the balance sheet of a bank holding company is more consistent with its peers than the balance sheet of a nonbank financial company is with its peers. This relative consistency among bank holding companies is conducive to risk weighting of assets. Conversely, the lack of consistency among nonbank financial companies would either make risk weighting unmanageably complicated or result in outcomes that do not offer an accurate measurement for the Council's purposes.

6. The Council should measure market concentration and market share in a manner that assesses the impact a nonbank financial company has on the financial stability of the United States.

In making a determination under Section 113, the Council should focus on the market concentration of a particular nonbank financial company as a primary consideration. Market definitions and the concentration or share of a properly defined market will provide the Council with the most direct information and insight into those institutions that should be designated under Section 113. The Council should also take into account that nonbank financial companies designated under Section 113 for heightened supervision and increased regulatory oversight should be those posing a systemic threat to the United States financial system. The larger the firm, the more financial products the firm offers in the United States and the complexity of those products should all be among Section 113 considerations.

In terms of product markets, as noted n our response to comment 1, it is relevant to assess others that can and will offer the same or similar product to consumers if the subject company were to fail. Complexity of products often dictates fewer providers which would also dictate a heightened significance for the provider.

From a geographic market perspective, the explicit objective of the Dodd-Frank Act - to identify risks to the financial stability of the United States, to eliminate market expectations for Federal government intervention, and to identify and respond to emerging threats to the stability of the United States financial system[1] - confirm that the Council's focus must be national in scope. The loss of a bank or nonbank financial company with a significant market share in a specific county, metropolitan statistical area or even state is not likely to have systemic consequences for the United States financial system. As such, the Act has effectively defined the market to be a national one.

Further, as previously discussed, the importance of market share should also be assessed in the context of the ease with which a given nonbank financial company can be replaced or is interchangeable with another firm or company.

The extent to which a nonbank financial company serves as an important source of credit for low-income, minority and underserved communities is among (though not entirely dispositive of) the factors that should be given weight by the Council under Section 113. Given the purpose of Section 113 to allow the Council to identify those nonbank financial companies posing a risk to the financial stability of the United States, the geographic market for assessing concentrations in low-income, minority and underserved community projects should be reflected on a national basis.

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[1] Dodd-Frank Act, § 111.

7. The measurement of the interconnectedness of a nonbank financial company should focus on counterparty risks associated with financial products and services.

The level and measurement of interconnectedness of a nonbank financial company should focus on the level of interrelationships the company maintains with respect to the financial products and services it offers. It may be assessed by the Council in terms of institutional disruption that would arise upon a given nonbank financial company's failure, as discussed in the response to comment 1.

In general terms, the measurement should assess whether failure of the subject nonbank financial company enhances or threatens the financial condition and competitive position of other significant financial companies. AFSA's members, similar to most nonbank financial companies, are primarily of the type whose failure or decision to terminate a specific product offering would arguably enhance the position of other participants it the market. It is our expectation that the same statement may not hold true for complex financial services firms on which other financial firms rely as sources of funding or risk mitigation.

Absent a specific focus on interconnectedness among systemically important firms, an inventory of relationships among various bank and nonbank financial companies in the market would not facilitate the designation of nonbank financial companies that present a significant risk of institutional disruption (*i.e.*, interconnectedness). We believe interconnectedness among systemically important firms is relevant for purposes of the Act, but interconnectedness among others financial firms is not.

Other considerations the Council should bear in mind are the timing (current versus contingent) and nature or scope of the relationships. We would also recommend that the Council take into consideration factors which may mitigate the risk and exposure of relationships among banks and nonbank financial companies, such as whether collateral exists to cover obligations and the dilution of risk across multiple institutions.

10. The Council should place significant weight on existing regulatory compliance obligations that nonbank financial companies undergo.

A nonbank financial company must often simultaneously operate in compliance with the requirements of multiple state and federal laws. For state law purposes, a nonbank financial company is often registered with or licensed by one or more state agencies to offer financial products and services. Although the level of examination and supervision provided by state agencies may differ from jurisdiction to jurisdiction and from license-type to license-type, each shares the underlying goal of ensuring that operational safeguards established by state law are followed and that a company is under prudent management. Generally speaking, a state's focus in on the protection of residents through the enforcement of compliance obligations on licensed providers of financial services in its state.

State financial services examiners regularly assess a nonbank financial company for compliance with federal consumer protection laws, including the Truth in Lending Act, the Fair Credit Reporting Act and the Equal Credit Opportunity Act. State-licensed members of AFSA must also abide by consumer protection statutes enacted in all of the states in which they do business. It is also true that many states require confirmation of a stated level of capital, bonding requirements and/or an assessment of management's financial standing and background in order to issue a license to a nonbank financial company.

Nonbank financial companies have been successful in providing needed credit and other financial products and services in the communities in which they operate in part because of the oversight of state regulators who have a familiarity with local and regional situations and issues faced by lenders. This knowledge, along with their geographic proximity to a given lender and financial market, means that state regulators are often the first to identify emerging issues, practices or products that may need further investigation or may pose additional risk to the financial industry. Though the state system has not been perfect, no one can argue that states have not aggressively fought abusive lending. Over the past three years, states have taken thousands and thousands of enforcement actions. The Dodd-Frank Act further reinforces reliance on state regulators by re-working the mechanics for federal preemption offered to federally chartered banks and calling for a coordination of efforts among state and federal regulators in identifying and addressing future issues in the financial system before they lead to systemic crises.

11. Public disclosures, transparency and internal valuation or risk management practices should be used by the Council.

Asset valuations, public disclosures, risk management practices and operational transparency should, when and where available, be considered by the Council in making an assessment under Section 113. It is likely that periodic reports filed with the Securities and Exchange Commission by nonbank financial companies could serve as a significant source of information. For purposes of the Dodd-Frank Act and the Council's duties under Section 113, we understand that the Council will only be looking at those nonbank financial companies that are predominantly engaged in financial activities as defined by Section 102(a)(6) of the Act in order to determine which warrant designation under Section 113.

These reports are also indicative of the type of methodologies and reporting that is currently undertaken by nonbank financial companies. In an effort to avoid duplication and redundancies for designated companies, we ask that the Council consider utilizing reporting formats and procedures that follow those already performed by nonbank financial companies and reflected in publicly available information.

Conclusion

AFSA appreciates the opportunity to comment on this Advanced Notice of Proposed Rulemaking. Please feel free to contact me with any questions at 202-296-5544, ext. 616 or bhimpler@afsamail.org.

Respectfully submitted,

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