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March 30, 2011

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

RE: Notice of Proposed Rulemaking: Definitions of "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company [RIN 7100-AD64 and Docket No. R–1405]

Delivered via email to regs.comments@federalreserve.gov and submitted via the FRB eRulemaking Portal at www.regulations.gov

Dear Secretary Johnson:

This letter is submitted on behalf of the American Financial Services Association ("AFSA") and the National Association of Industrial Bankers ("NAIB") to express our joint comments to the Proposed Rule implementing provisions of the Dodd-Frank Act dealing with nonbank financial companies.

Founded in 1916, AFSA is the national trade association for the consumer credit industry protecting access to credit and consumer choice. Our 350 members include consumer and commercial finance companies, auto finance and leasing companies, mortgage lenders, credit card issuers, industrial banks and industry suppliers. A number of AFSA members are commercial companies which own finance companies and FDIC-insured banks that provide a broad array of financial products in support of their parent companies, their affiliates and other consumer and commercial customers.

NAIB represents industrial banks and industrial loan corporations chartered in California, Nevada and Utah. Since 1910, these banks have engaged in consumer and commercial lending on both a secured and unsecured basis. They do not offer demand checking accounts but do accept time deposits, savings deposit money market accounts and deposits that may be withdrawn through negotiable orders for withdrawal ("NOW" accounts). Industrial banks provide a broad array of products and services to customers and small businesses nationwide.

This rulemaking addresses the definition of a term that is central to the implementation of Title I--that of "predominantly engaged in financial activities." The proposed rule adds a new Subpart N to Regulation Y to determine what nonbank financial companies ("NBFCs") are "predominantly engaged in financial activities" and thus potentially subject to designation by the Financial Stability Oversight Council ("FSOC") for enhanced prudential supervision under Title I of The Dodd-Frank Act.

The legislative intent is clear. As stated by then House Financial Services Committee Chairman Frank in a colloquy with Rep. Jim Himes (D-CT) during the debate considering the final legislation, Title I seeks to regulate certain financial activities and companies and not to regulate nonfinancial companies or the nonfinancial activities of companies that have both financial and nonfinancial activities:

> Mr. HIMES. Thank you, Mr. Chairman. My understanding is also that, consistent with the overall intent not to subject commercial firms to financial regulation, section 604 provides that an existing savings and loan holding company with both financial and nonfinancial businesses will cease to be an S&L holding company when it establishes an intermediate holding company under section 626. That company also may have an intermediate holding company under section 167. Am I right that the intent of this legislation is for these sections to be applied in harmony, so that an organization will have a single intermediate holding company that will be both the regulated S&L holding company in the organization and the holding company for implementing the heightened supervision of systemic financial activities under title I?
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> Mr. FRANK of Massachusetts. If the gentleman will yield again, yes, he is exactly right. And just to sum it up, we want regulated some activities and not regulated other activities when you have a hybrid kind of situation, and what the gentleman has described is how you accomplish that. [1]

The policy expressed by Rep. Frank is embedded in the NBFC structure, notably section 113(c) and section 167(b) that were expressly designed to ensure that supervision by the Federal Reserve Board (the "Fed") does not extend to nonfinancial activities. AFSA and NAIB believe that this rulemaking must implement the terms of The Dodd-Frank Act and advance this fundamental policy.

In the Dodd-Frank Act, "financial activities" are defined by reference to section 4(k) of the Bank Holding Company Act ("BHC Act") which encompasses a specified set of activities that are "financial in nature" and related to the ownership or control of an insured depository institution. The clear corollary is that The Dodd-Frank Act definition excludes all assets and revenues from nonfinancial activities. AFSA and NAIB believe it is essential that any final rule expressly provide that no revenues derived from nonfinancial activities and no assets related to nonfinancial activities whatsoever can be counted in the calculation of whether a nonbanking company is "predominantly engaged in financial activities" and thus will be a NBFC under The Dodd-Frank Act.

<u>Only assets and revenues related to or derived from section 4(k) financial activities can be included in the 85% test under The Dodd-Frank Act</u>

The Proposed Rule in § 225.301 (b) and (c) properly incorporates Section 102(a)(6) of the Dodd-Frank Act to provide, for the purposes of the 85% test, revenues must be "derived

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[1] Congressional Record—House (June 30, 2010) at H5226.

from" section 4(k) financial activities and assets must be "related to" section 4(k) financial activities. The mere fact that an asset is financial or that revenues derive from a financial asset is not sufficient, and there is a wide array of financial assets and revenues for nonfinancial companies that do not result from financial activities.

AFSA and NAIB believe that the final rule should confirm that revenues or assets that are neither derived from nor related to a section 4(k) financial activity are excluded when determining whether a nonbank company is "predominantly engaged in financial activities." Moreover, we believe that the treatment of unconsolidated investments in the Proposed Rule must similarly focus on whether they are related to a section 4(k) financial activity (and similarly that resulting revenues are derived from a section 4(k) activity).

There are numerous examples of assets and revenues that fall into this category and thus cannot be counted in the 85% test provided in The Dodd-Frank Act. Among these are the following: (1) cash and financial assets held in connection with general corporate operations; (2) receivables resulting from nonfinancial activities; (3) intangible assets and goodwill; (4) sale proceeds from a nonfinancial transaction; and (5) revenues or assets "incidental" to nonfinancial activities. We will discuss each briefly.

Corporations hold a variety of financial assets in connection with their general corporate activities, including cash, liquidity instruments, hedging positions, treasury investments and other similar assets. These plainly are not a distinct "activity " of the company, nor are derived from or related to a financial activity. Companies hold these types of assets in the normal course of their business functions and there is no basis in Section 4(k) to suggest that they are part of an "financial activity."

It is not uncommon for the sales of a nonfinancial product to result in a receivable on the books of the company. Such receivables would be a financial asset, but they plainly derive from a nonfinancial activity, e.g., the sale of a manufactured product.

A corporate transaction may result in the inclusion of an intangible asset on the books of the company, such as goodwill. When any such intangible assets derive from a nonfinancial transaction, such as the purchase or sale of a nonfinancial subsidiary, they are correspondingly nonfinancial for purposes of the 85% test. Again, sales of nonfinancial entities is not a Section 4(f) financial activity, and intangible assets resulting from such sales are excluded.

Similarly, all proceeds from the sale of a nonfinancial subsidiary are excluded. When the sale of a nonfinancial subsidiary results in cash or other financial assets for the selling company, these also are not assets "related to" financial activities, and revenues from such an asset are not "derived from" financial activities. Correspondingly, when such proceeds are deployed into an new or expanded activity, an asset held for investment, or a new subsidiary, the revenues and assets related to such a deployment would then be considered for inclusion in the 85% calculation if they are related to or derived from a Section 4(k) activity.

As the foregoing suggest, a nonbanking company will hold on its balance sheet numerous types of financial assets and will derive revenues from activities and functions that are plainly not within the scope of Section 4(k) financial activities. We believe that any final rule should recognize that such companies may hold assets or derive revenues that are “incidental” to nonfinancial activities and thus not "financial" for purposes of section 102(a)(6) of the Dodd-Frank Act or calculations under it. The rationale for such a provision would parallel one long recognized in the context of the BHC Act -- that a BHC may provide a service or function that may itself not be closely related to banking under section 4(c)(8) if necessary for the permissible activity and thus "incidental" to it.

In parallel fashion, financial assets that are integral to a nonfinancial line of business or activity or generated as an element or a feature of a nonfinancial transaction and necessary for the completion of that transaction are related to a nonfinancial activity and revenues from holding that asset likewise are derived from a nonfinancial activity. For example, in order to effect a particular sales transaction for one of its products a manufacturing company may need to provide seller financing specific to that transaction, without involvement of its “captive finance” division or subsidiary, if it has one. [2] Such seller financing would result in a loan or financing asset on the seller’s books, but it is not related to a financial activity. Such revenues or assets are "incidental" to the nonfinancial activity, and thus not "financial" under the terms of section 102(a)(6) of the Dodd-Frank Act.

The same analysis applies to minority investments held by a nonbanking company—if the company holds equity investments in a non-consolidated company that is not a subsidiary of the investing company that investing itself does not constitute an “activity” and it can be treated as a financial activity only if the investment is held in connection with a section 4(k) activity such as underwriting, dealing, market-making, insurance or merchant banking. Thus, when an investment is not held in connection with one of these specified section 4(k) activities, the investment does not relate to a section 4(k) activity and the related assets or revenues cannot be counted in the 85% calculation.

For this reason, AFSA and NAIB question the inclusion of section 4(c)(6)-(7) investments under Proposed Rule § 225.301(d)(2). These statutory provisions allow BHCs to make equity investments in nonbanking and nonfinancial companies. That authority was adopted long before the enactment of section 4(k). Any investment that meets the terms of section 4(c)(6)-(7) thus should be excluded, even if the entity invested in might engage in Section 4(k) financial activities specified under 12 C.F.R. § 225.86 (a)-(c) or (e). Equity investments under section 4(c)(6)-(7) are not a distinct activity and, we believe, it would not be consistent with the terms of The Dodd-Frank Act to include any such investment in the calculation of “predominantly engaged in financial activities.” [3]

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[2] If the company has a division or subsidiary that regularly provides financing for the sale of the company’s nonfinancial products – a captive finance activity,-- then its assets would be related to a financial activity of the company. We also note that the Section 113(c) “evasion” provisions of The Dodd-Frank Act empower the FSOC and Fed to address the structure and activities of any particular company to ensure that Title I applies as Congress intended.

[3] In addition, to ensure that only Section 4(k) activities are encompassed by any final rule, AFSA suggests that it should expressly provide that activities permissible under BHC Act section 4(c)(1)-(4) are excluded. These services, liquidation, DPC workout, and fiduciary activities are distinct from activities permissible under section 4(c)(8). While Section 4(k)

AFSA and NAIB appreciate the opportunity to share our views and would be pleased to discuss any of them further at your convenience. Please feel free to contact the undersigned with any questions.

Sincerely,

American Financial Services Association

National Association of Industrial Bankers

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incorporates section 4(c)(8) activities by reference, it plainly makes no incorporation by reference of such section 4(c)(1)-(4) activities.