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Mr. Lance Auer
Financial Stability Oversight Council
1500 Pennsylvania Avenue, NW
Washington, DC 20220

RE: 12 CFR Part 1310 – Authority to Require Supervision and Regulation of
Certain Nonbank Financial Companies
RIN 4030-AA00; FR Doc. 2011-26783

Dear Mr. Auer:

On behalf of our member organizations who are not part of bank holding companies, the American Financial Services Association (“AFSA”) welcomes the opportunity to provide comments on the second notice of proposed rulemaking and proposed interpretive guidance issued by the Financial Stability Oversight Council (the “Council”), entitled Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (the “Notice”).¹ The Notice represents the Council’s third² solicitation of public comments on the standards and criteria to be used to determine whether certain nonbank financial companies should be subject to enhanced prudential standards and supervision by the Board of Governors of the Federal Reserve System (the “Board”) under Section 113³ of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The National Association of Industrial Bankers (“NAIB”) joins in these comments. We greatly appreciate the opportunity continue to provide industry insight and comment on this proposal.

As noted in response to the Council’s earlier requests for public comment, Section 113 designations will have significant and far-reaching regulatory implications and costs, both in terms of time and resources, for nonbank financial companies. Designation under Section 113 by the Council will, without question, have a tremendous impact on the identified nonbank financial company, from a cost, compliance and operational perspective, including supervision and oversight by the Board, enhanced capital and liquidity standards, enhanced risk management and

¹ 76 Fed. Reg. 64,264 (Oct. 18, 2011). Any term not defined herein is given the meaning set forth in the Notice.

² The prior Council requests for public comment consisted of the Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 75 Fed. Reg. 61,653 (Oct. 6, 2010), and the notice of proposed rulemaking, entitled, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 4,555 (Jan. 26, 2011).

³ 12 U.S.C. § 5323.

concentration limit requirements and development of resolution plans or “living wills.” Also, the resources, time and attention needed to fulfill its obligations for nonbank financial companies so designated will draw heavily on the Board, and must be considered in terms of the appropriate allocation of limited regulatory resources in a manner that most effectively accomplishes statutory mandates. Accordingly, we appreciate the Council’s continued efforts to establish clear and transparent procedures and guidance regarding the process by which nonbank financial companies will be designated under Section 113 and the opportunity to comment on that process. With this in mind, we encourage the Council to develop a final rule and supplemental guidance 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.

By way of brief background, AFSA represents a broad cross-section of financial companies, many of which are nonbank financial companies, that provide credit products and services to consumers. AFSA’s members include leading consumer finance companies, automotive lenders 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. NAIB represents industrial banks, the only class of insured depository institutions that may be owned by non-financial parent companies. Chartered since 1910, they are the best capitalized, most profitable class of banks.

We believe that, consistent with our earlier comments to the Council, the following comments should be considered as a vital part of such a measured final rule and related guidance.

Structure, Timing and Scope of Proposals in Notice

As a threshold matter, the Council should follow the clear intent and direction of Congress and clearly and explicitly exclude nondepository captive finance companies from the scope of the final rule’s coverage.

Congressional intent regarding the scope of the Council’s authority to designate nonbank financial companies under Section 113 of the Dodd-Frank Act is clear, as noted in specific debate on the various provisions of the Dodd-Frank Act setting out the standards the Council is to consider when making such designations. These debates often centered on the scope of the statutory factors the Council would be required to consider in making a determination regarding a nonbank financial company.

As an example of one such debate, a colloquy between Chairman Frank and Representative Kilroy on December 9, 2009 confirms that it was not the intent of the Dodd-

Frank Act to subject nondepository captive finance companies to the strict prudential standards applicable to other nonbank financial companies designated by the Council under Section 113.⁴

Mr. FRANK of Massachusetts. I yield to the gentlewoman from Ohio (Ms. KILROY), who I understand wants to engage in a colloquy.

Ms. KILROY. Thank you, Mr. Chairman. I would like to address the provisions of section 1103, which specifies the criteria to be considered in determining whether a financial company might be subject to stricter standards. It is my understanding that nondepository captive finance companies do not pose the types of risks that warrant such treatment.

Nondepository captive finance companies typically provide financing on a nonrevolving basis only to customers and to dealers who sell and lease the products of their parent or affiliate. As such, they are involved in only a narrow scope of financial activity.

Equally important, their loans are made on a depreciating asset, a fact taken into account when the loans are entered into. If they are not a depository institution, they therefore have no access to the Federal deposit insurance safety net. It is my understanding that it is the intent of the committee that nondepository captive finance companies are not the types of finance companies that should be subjected to stricter standards under section 1103 of this legislation; is that correct?

Mr. FRANK of Massachusetts. The gentlewoman is correct. She has been very diligent in trying to protect this very important type of financing. Financing companies are not depository institutions. They provide financing for the sale of that particular product in that company.

It is again inconceivable to me that somehow they would rise to the level of risk that would justify the Systemic Risk Council stepping in.

Ms. KILROY. Thank you, Mr. Chairman.⁵

As noted in the discussion by Representative Kilroy, “nondepository captive finance companies do not pose the types of risks that warrant” such heightened prudential standards. It

⁴ See 155 Cong. Rec. H14431 (daily ed. Dec. 9, 2009) (colloquy between Chairman Barney Frank and Rep. Mary Jo Kilroy regarding the scope of coverage for criteria the Council was to consider under H.R. 4173).

⁵ Id.

was understood to be “the intent of the committee that nondepository captive finance companies are not the types of finance companies that should be subject to stricter standards[.]”⁶ Although many reasons support this conclusion, those stated by Representative Kilory include that nondepository captive finance companies (i) are only involved in a narrow scope of financial activity, primarily financing the sale or lease of products of their parent or affiliates; (ii) generally provide financing on a depreciating asset, which is taken into consideration at the time the financing is entered into; and (iii) as nondepositories, do not enjoy Federal deposit insurance.⁷ In recognition of, and in direct response to, these points, Chairman Frank stated that it would be “inconceivable to [him] that somehow [nondepository captive finance companies] would rise to the level of risk that would justify the Systemic Risk Council stepping in.”⁸

Given this declaration of congressional intent, the Council should ensure that nondepository captive finance companies are clearly excluded from the scope of coverage within the language of the final rule.

The Council should ensure that the final rule and proposed guidance is not finalized prior to the adoption of relevant definitions and other related regulatory initiatives are completed by the Board, Council and other federal agencies, and in no event should the Council begin the designation process until such other regulations are finalized.

AFSA and NAIB appreciate the Council’s stated intent to establish clear and transparent standards and processes that provide a meaningful roadmap to the financial industry and other markets regarding how nonbank financial companies will be designated under Section 113 of the Dodd-Frank Act. The Dodd-Frank Act’s overhaul of financial industry regulation and oversight contained multiple overlapping provisions within its various Titles, one of the most significant of which is the Council’s designation of certain nonbank financial companies for supervision by the Board under Section 113. Many of the definitions used throughout the Dodd-Frank Act, as well as the jurisdictional and rulemaking requirements for such provisions, have considerable overlap with each other. The combined impact of each of these overlapping issues must be carefully considered as related rulemakings are proposed and, in particular, before the Council issues a final rule under Section 113.

In recognition of this, the Council’s Notice contains discussion in the preamble and proposed regulatory language referencing a number of other definitions that are being developed through the Dodd-Frank Act’s rulemaking processes of other agencies, but which have yet to be finalized. In order for the financial industry, as well as various stakeholders in related markets, to fully understand the implications of the Notice it is necessary to give the other agencies an opportunity to complete their respective rulemaking process before the Council finalizes the rules and guidance proposed in the Notice.

⁶ Id. (emphasis added).

⁷ See id.

⁸ Id.

By way of example of an important rulemaking with significant implications for the proposals set forth in the Notice, the Board is required to define, through amendments to Regulation Y, when a company is a “significant nonbank financial company” that is “predominantly engaged in financial activities.”⁹ Although the Board has taken initial steps to provide regulatory definitions in this area, final definitions are not yet available. The Notice incorporates the Board’s proposed definitions within the definitions section contained in the text of the proposed rule.¹⁰ It is therefore inevitable that, in order to develop a full and complete analysis of the Council’s Notice, commenters must assume that the Board’s final amendments to Regulation Y will conform to the proposed definitions currently available. If that assumption proves false, comments to the Notice may not fully and accurately reflect the views of commenters to the Notice.

The Board also has yet to finalize its regulations and guidance regarding enhanced prudential standards under Section 165 of the Dodd-Frank Act. These definitions are also material for purposes of the Notice.¹¹ Additionally, the operation of Sections 113, 115 and 165, among other provisions of Title I of the Dodd-Frank Act, are directly related to one another and must be considered jointly by the Council. For example, Section 165 directs the Board to establish enhanced prudential standards for designated companies that are proportional to the systemic risk posed by the nonbank financial company. These standards may also be tailored at a company or industry level. At the same time, Section 115 of the Dodd-Frank Act grants the Council with authority to provide recommendations to the Board regarding the enhanced prudential standards. Accordingly, we would recommend issuance of the rules required under Section 165 and recommendations under Section 115 prior to the Council’s finalizing rules under Section 113.

Other ongoing regulatory changes that impact the ability to fully analyze the Notice include the proposed rules issued by the Securities and Exchange Commission and the Commodities Futures Trading Commission to define “major swap participant.” Again, without additional clarity and definitive outcomes on these definitional rulemakings, it is impossible for market participants to fully understand and quantify the likely implications of the Notice’s proposed language.

Similarly, the Board has not developed the regulations required for the creation of intermediate holding companies by certain grandfathered unitary savings and loan holding companies engaged in commercial and financial activities. The interrelationship between Section 113 and Section 626 was specifically considered and addressed by Congress and the final rule should reflect the express intent to allow grandfathered unitary savings and loan holding companies to establish an intermediate holding company prior to being considered for

⁹ See, Dodd-Frank Act, Section 102(b); see also, Definitions of “Predominantly Engaged in Financial Activities” and “Significant” Nonbank Financial Company and Bank Holding Company, 76 Fed. Reg. 7,731 (Feb. 11, 2011) (amending Regulation Y, 12 C.F.R. Part 225, to define these terms).

¹⁰ 76 Fed. Reg. 64,274.

¹¹ Id.

designation by the Council under Section 113.¹² Section 626 of the Dodd-Frank Act provides that the Board shall require a unitary savings and loan holding company to establish an intermediate holding company if necessary to ensure (i) the company's financial activities are adequately supervised; and (ii) to ensure that the Board's supervision does not extend to commercial activities. Under Section 626, the parent of an intermediate holding company is subject to limited supervision by the Board and financial activities conducted by the grandfathered unitary savings and loan holding company are transferred to the intermediate holding company. The clear import of this provision is that Board supervision is not intended to extend to commercial activities of a grandfathered unitary savings and loan holding company, but rather to the financial activities of the intermediate holding company. Accordingly, the final rule should also clarify that the Council will only consider the extent to which the financial activities conducted by the intermediate holding company pose a threat to the financial stability of the United States. The Council should necessarily delay any potential designation of a grandfathered unitary savings and loan holding company until the Board has adopted the rules and regulations required by Section 626.

Furthermore, timing of final rules under the Notice should be delayed until the Council has adopted final rules to protect the proprietary commercial information that will likely be collected with respect to nonbank financial companies in the Council's review process under Section 113. In March, the Council proposed rules¹³ for treatment of information considered confidential and exempt from public disclosure under the Freedom of Information Act ("FOIA").¹⁴ Although the Notice appropriately indicates that information collected by the Council in making a determination under Section 113 will be afforded confidential treatment under FOIA,¹⁵ the specific processes and requirements for potential filers' to seek confidential treatment will be meaningful as they assess the individual costs and burdens associated with the Section 113 process generally and may impact their respective views on comments to the Notice. Thus, a final rule under the Notice should be delayed until the Council has finalized rules for the confidential treatment of collected information.

The Council should provide a procedural mechanism for nonbank financial companies to correct, supplement and explain information gathered by the Council from third parties as part of the Stage 2 review process.

The final rule should provide a mechanism for a nonbank financial company to correct the accuracy and veracity of any information collected by the Council in the Stage 2 analysis prior to the final review in Stage 3. Publicly available information filed by the nonbank financial company with the Securities and Exchange Commission or with other federal regulatory agencies must be assumed to be accurate and present a fair and reasonable depiction of the nonbank financial company. However, other publicly available information, such as credit ratings, analyses prepared by third party analysts and other nonpublic reference materials

¹² See 156 Cong. Rec. H5223 (daily ed. June 30, 2010) (colloquy between Chairman Barney Frank and Rep. Himes).

¹³ Implementation of the Freedom of Information Act, 76 Fed. Reg. 17,038 (Mar. 28, 2011).

¹⁴ 5 U.S.C. §§ 551 et seq.

¹⁵ See 76 Fed. Reg. 64,275 – 276.

provided by parties external to the nonbank financial company such as counterparties or competitors may include factually incorrect information or be presented in a misleading manner. To the extent that the Council intends to rely on such third-party information, the Council should clearly define the types of information on which it will rely and ascribe the process it will follow to confirm the completeness and accuracy of such information. Further, the nonbank financial company under review should be permitted, by rule, to review, correct and or provide supplemental data to explain such information.

The Council's steps and criteria for designating nonbank financial companies should be included as part of the text of the final rule itself, and not as a supplement or appendix.

We believe that the Council should set forth the specific steps and criteria standards for Section 113 designation in the text of the final rule. Although we recognize that official commentary, agency guidance and standards included as appendices or supplements to parts of the Code of Federal Regulations may typically only be revised or amended in accordance with the procedures of the Administrative Procedure Act,¹⁶ placing such important decision-making criteria and standards within a supplement and appendix mitigates the importance of these standards. In addition to the potential "optics" of including such an important regulatory promulgation outside the rule text, there is the very real issue of the level of deference that such guidance or interpretive material is afforded in the event of dispute or appeal of a determination. Placing the substance of this guidance within the text of the rule mitigates the likelihood of differing levels of market deference afforded to the Council's guidance.

AFSA and NAIB understand and appreciate the clarity provided by inclusion of a narrative discussion as an appendix, and support the retention of this guidance in this form in addition to including definitive rules incorporating the substance of these steps and criteria within the rule text itself consistent with, for example, the approach used by federal banking agencies in setting forth the capital requirements for banks and bank holding companies. The procedural steps to be followed by the Council in making the determination generally lend themselves to inclusion in the final rule of the text, in that they are definitive processes capable of summary and easily referenced to the appendix for additional information in narrative form for clarification or illustrative examples. Similarly, the quantitative and substantive criteria set forth in Stage 1 of the Council's determination process are sufficiently specific to be included in the text of the rule, again with reference back to the appropriate narrative in the appendix for interpretative guidance or context.

¹⁶ 5 U.S.C. §§ 500 et seq.

The Determination Standards and Relationship to Stage Criteria and Metrics

The Council should more clearly define the metrics used, and factors considered, in determining whether a nonbank financial company poses a threat to the financial stability of the United States.

The proposed guidance in the Notice provides that the “Council will consider a ‘threat to the financial stability of the United States’ to exist if there would be an impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy.”¹⁷ The Council continues by identifying several “channels” likely to facilitate or exacerbate “the negative effects of a nonbank financial company’s material financial distress or activities to other financial firms and markets” and provides a brief discussion of each channel.¹⁸ These brief discussions set forth an analysis of the metrics the Council “expects” to consider in its initial review of nonbank financial companies within each channel. Each of these metrics should be more clearly discussed and, to the extent appropriate, specifically weighted to demonstrate to the market the perceived importance of each metric within the channel. Congress established an extremely high threshold for designation under Section 113 when it limited designation to those nonbank financial companies that pose a threat to the financial stability of the United States. The Council should ensure that its final rules emphasize the stringency of this standard and explain how the chosen metrics have a demonstrated nexus to this high threshold.

Under the “exposure” channel, for example, the Council notes that a nonbank financial company may pose a threat to financial stability if its stakeholders, including creditors, counterparties, investors and other market participants, are exposed to such an extent that the material financial distress of the nonbank financial company would have a material impact on the financial condition of such stakeholders. Factors listed by the Council to make this determination include the nonbank financial company’s (i) total consolidated assets; (ii) credit default swaps (“CDS”) outstanding; (iii) derivative liabilities; (iv) loans and bonds outstanding; and (v) leverage ratio.¹⁹ Accordingly, the Council has prepared the Stage 1 standards to set thresholds beyond which a nonbank financial company is presumably deemed to pose a threat to the financial stability of the United States through the exposure channel.

AFSA and NAIB believe that the relationship between certain criteria, including total consolidated assets and CDS outstanding, and the exposure such a firm presents to the financial stability of the United States should be more clearly set out in the Council’s guidance. Additionally, under the exposure channel, it would appear that certain thresholds should be weighted more heavily within the Council’s determinative process and that such weighting should more clearly show the relationship between the criteria and the concern addressed. For example, to the extent that the Council uses a CDS threshold as a factor in the determinative process, the relationship between this threshold and the manner in which such threshold

¹⁷ 76 Fed. Reg. 64,277.

¹⁸ 76 Fed. Reg. 64,278.

¹⁹ Id.

represents an indicator of the risk the nonbank financial company poses to the financial stability of the United States should be expressly stated. As discussed more fully below, to the extent that nonbank financial companies operate in different markets and provide different financial products and services, they will have different balance sheet mixes and present unique risks which are intended to be captured by the Council's criteria. As a result, the Council should more clearly indicate the weight given to the applicable criteria across such unique business lines.

Another channel identified by the Council is the "asset liquidation" channel. This channel would deem a nonbank financial company to pose a threat to financial stability if the quick liquidation of the company's assets would disrupt trading or funding in key markets or cause significant losses or funding issues for other firms with similar balance sheets, due to falling asset prices.²⁰ The Notice states that metrics indicative of important nonbank financial companies within this channel are (i) total consolidated assets; and (ii) short-term debt ratio (to determine whether the company relies heavily on short-term funding).²¹ Again, AFSA and NAIB request additional guidance and clarity regarding the process by which such metrics will be analyzed and, as appropriate, weighted by the Council in making its determination under Section 113.

The final channel used to determine if a nonbank financial company poses a threat to financial stability in the United States is whether the nonbank financial company provides a critical function or service that would cease to be provided or for which there are no ready substitutes in the event the company ceases to provide the function or service. Because of the unique nature of this channel, the Council will review the market to determine the level of competition in which the company operates and will perform a company-specific analysis, rather than set forth a "broadly applicable quantitative metric."²² AFSA and NAIB respectfully request additional clarity on the types and nature of activities the Council is referring to under this channel. Unlike the other channels identified, this channel lends itself to the least amount of market clarity and, for this reason, should be more carefully described in the Council's guidance. Further, the existence of other service providers is not, in itself, indicative of a reduced risk to market stability presented by a given company. A lack of barriers to entry or the ability for substitute providers to quickly fill a void created by a company's absence are very important counterbalancing factors that must be acknowledged. Otherwise, designation under Section 113 due to a lack of competition could effectively stifle innovation and new product or service offerings or existing efforts to protect "first-to-market" advantages through a fear that such outcome will result in Council designation under Section 113.

Guidance from the Council should also more clearly delineate the ways in which the criteria are applied across business types, for example, investment banks, investment companies, insurance companies and nondepository lenders. Financial companies are subject to vastly different accounting and reporting requirements, statutory and regulatory standards and industry or market realities that drive certain asset concentrations or market positions that would appear to

²⁰ See *id.*

²¹ *Id.*

²² *Id.*

elevate likelihood of a Section 113 designation. Selecting criteria with a single standard for all nonbank financial companies with differing reporting, recordkeeping and accounting standards will necessarily result in different outcomes when applied across industries. Accordingly, the Council should refine its guidance to more clearly show how criteria will be weighted against the various types of businesses and operations to whom it intends to apply such metrics.²³

The Council's Determination Standards are intended to focus on detecting those nonbank financial companies that pose a "threat to the financial stability of the United States," as required under the Dodd-Frank Act. However, the Notice fails to demonstrate how the Council believes certain bright-line criteria will achieve this objective and may capture companies that are not of the type intended to be covered by Section 113.

As noted above, the Council's guidance in the proposed appendix spends a great deal of time generally discussing the manner in which the Council has broken down the Dodd-Frank Act's statutory considerations for designating nonbank financial companies as systemically important to the financial stability of the United States under Section 113. The next part of the guidance then attempts to clearly articulate the standards, procedures and factors the Council will consider in making a determination regarding specific nonbank financial companies. AFSA and NAIB recognize and appreciate the market certainty created by establishing clear, bright-line thresholds regarding the size and scope of firms potentially subject to designation under Section 113, particularly as a part of initial review process during Stage 1.

However, bright-line thresholds necessarily have limits in their utility. To this end, it seems that the Council has attempted to mitigate the potential limits by providing itself two additional steps in Stage 2 and Stage 3 to develop and analyze information in a more subjective and less defined fashion. The preamble to the Notice states that "the Council reserves the right, in its discretion, to subject any nonbank financial company, irrespective of whether such company was identified in Stage 1, to further review, if the Council believes that further analysis of the company is warranted[.]"²⁴ Such a right seems antithetical to the notion that the bright-line thresholds in Stage 1 are intended to provide market certainty. It is difficult to imagine a scenario in which a company that does not meet the criteria of Stage 1 is, nonetheless, a company for which Section 113 designation is warranted. Thus, the cited discretion afforded to the Council in the preamble should be affirmatively rejected in any final rule.

A bright-line test based on consolidated asset size creates a disincentive for growth and expansionary activities and should, at a minimum, be subject to automatic adjustment

²³ See, e.g., 156 Cong. Rec. S5902 (daily ed. July 15, 2010) (statements of Sen. Collins and Sen. Dodd regarding factors to be considered by the Council in designating nonbanking financial companies and suggesting that industry-specific factors should be included in the Council's deliberative process); and Letter from Rep. Barney Frank, Ranking Member, House Committee on Financial Services, to Raj Date, Acting Director, Consumer Financial Protection Bureau (Oct. 26, 2011) (suggesting that regulatory agencies should consider the risk associated with different classes of assets in setting regulatory criteria and factors for meeting objectives for which agency was established).

²⁴ 76 Fed. Reg. 64,270.

tied to an inflationary index and be further subject to the Council's periodic review and amendment.

The Notice states that a nonbank financial company will be subject to continued review under Stage 2 of the determination process if it has total consolidated assets of \$50 billion and meets one of the other enumerated thresholds.²⁵ In doing so, the Council weighs total consolidated assets more strongly than the other criteria and simultaneously creates an artificial restraint on market growth or expansion. Such a restraint should be carefully reviewed to determine the overall economic impact of the threshold.

AFSA and NAIB are mindful that asset size is an important, but not determinative, criterion in making a determination under Section 113. The final rule should not assign a specific asset size threshold for nonbank financial companies or, at a minimum, should ensure that any asset threshold is referenced to an inflation index to take into account economic changes that impact such a bright-line. Moreover, any final rule should further provide for periodic, substantive review by the Council to determine if a revision to such a threshold, if adopted, is necessary to more accurately capture the scope of nonbank financial companies that should be subject to review and determination under Section 113.

Although Congress established a \$50 billion standard for subjecting large bank holding companies to enhanced prudential standards and supervision,²⁶ such a provision may not be an applicable starting point for nonbank financial companies – particularly where such a threshold may have material economic impact on the growth and operations of such companies and where nonbank financial companies, by law, often have more complex and diversified balance sheets than bank holding companies that are, by statute, limited in the types of investments and assets they may hold. If Congress intended for nonbank financial company coverage under Section 113 to be triggered by the same defined asset benchmark, it could have easily included similar language in Section 113 as was included in Section 165 for bank holding company coverage. It did not, and the Council should not, by regulation, adopt thresholds that were rejected by Congress and are inconsistent with congressional intent.

The proposed criteria in the Stage 1 analysis are not related to systemic risk posed by such a nonbank financial company and should be weighted appropriately in the Stage 1 review process.

AFSA and NAIB believe that the Council should carefully review the criteria established for the Stage 1 review (and any standards to be used in Stages 2 or 3) to ensure that such thresholds truly capture those firms and companies intended to be covered by the scope of Section 113. For example, after meeting the asset threshold test in Stage 1, any company would be subject to additional Stage 2 scrutiny by the Council if such company was a reference entity for more than \$30 billion in gross notional CDS.²⁷

²⁵ Id. at 64,281.

²⁶ See Dodd-Frank Act, § 165(a)(1).

²⁷ See 76 Fed. Reg. 64,281.

AFSA and NAIB recognize that the notional amount of CDS for which a nonbank financial company serves as the reference entity could be seen as a proxy for identifying the extent to which a particular reference entity is interconnected or the degree to which the failure of such company could impact the stability of the financial system in general. However, companies can generally not control whether or not they are a reference entity in a given CDS transaction. [Further, some CDS transactions may reference a nonbank financial company for purely speculative reasons that have no basis in the underlying exposure or interconnectedness of the reference entity with any other company or firm.] Heightened prudential standards and increasing supervision for a company and is not indicative of the company's market impact. For these reasons, the Council should eliminate this factor or lessen the weight afforded to this criterion in its Stage 1 analysis.

AFSA and NAIB believe that other metrics and criteria set forth in the Stage 1 review process should also be revised prior to the Council's issuance of the final rule. Reference to ratios of past failed institutions like Lehman Brothers or Bear Stearns may give context for why a threshold was selected by the Council. However, such examples fail to demonstrate how or why such a threshold identifies companies for Section 113 designation in such a way as to prevent future crises and failures. Given the number of various unique facts and circumstances of these prior firms, they do not serve as a reasonable basis for projections going forward. Establishing thresholds for the short-term debt ratio, leverage ratio and balance sheet composition based on examples of prior failures is inappropriate. The standards and mechanics for calculation of such thresholds should be clearly and specifically set forth by the Council and rely on how the thresholds support Section 113 designation, not how other firms that exceeded these thresholds fared.

In particular, the short-term debt ratio has limited utility as a stated percentage threshold. Instead the focus should be on a specific nonbank financial company's use of short-term debt and should review the different types of short-term debt used by the company to match short-term debt with a company's short-term assets. Where the use of short-term funding available in the repurchase market may be inappropriate for long-term assets, it may perfectly appropriate for other short-term assets. The Council should establish criteria which identify the potential for mismatched funding and liquidity on a nonbank financial company's balance sheet as a more useful criteria for determining the overall risk posed to the financial stability of the United States. Additionally, the calculation of the short-term debt ratio should exclude any related-party debt otherwise required to be reported by the nonbank financial company in accordance with generally accepted accounting principles, reporting standards or other regulatory requirements. While appropriately reported in certain circumstances, related-party debt fails to demonstrate the threat the nonbank financial company poses to the financial stability of the United States because it does not show increased third party exposure or increased levels of interconnectedness. Finally, the Council should clearly distinguish securitizations from other types of short-term debt that are not match funded. Other provisions of the Dodd-Frank Act are intended to mitigate the risks associated by asset securitizations within the financial market.²⁸

²⁸ See, e.g., Dodd-Frank Act, § 941 (requiring credit risk retention in certain asset-backed securitizations).

Two other metrics proposed by the Council in the Stage 1 review are potentially duplicative with each other or other thresholds established elsewhere. The Council should consider the fact that any firm with \$50 billion or more in total consolidated assets (which is a threshold currently proposed in the Notice) will, in almost all cases, have more than \$20 billion in loans outstanding and bonds issued. Thus, the metrics imposed by the Council would necessarily result in all nonbank financial companies with total consolidated assets of \$50 billion being subject to Stage 2 review by virtue of meeting the loans and bonds outstanding threshold. The loans and bonds outstanding criterion also becomes irrelevant if the Council is also using a leverage ratio as a factor in the Stage 1 review process. Accordingly, the Council should eliminate the loans and bonds outstanding threshold or increase the dollar value of total consolidated asset threshold or the loans and bonds outstanding threshold to avoid such a result.

Clarity Needed on Time Period Reviewed and Application of Emergency Exception

The Council should provide a timeframe under which it will review nonbank financial companies to determine designation under Section 113 of the Dodd-Frank Act, as well as the timing for defining and calculating thresholds.

The Notice does not indicate a timeframe in which information will be gathered and then used in applying the metrics to determine whether a given nonbank financial company poses a threat to the financial stability of the United States for purposes of Section 113. Large, complex companies are likely to remain large and complex through any stated review period. However, given the Council's reliance on channels for determining the threat posed by such a company to financial stability, it is possible that the profile of a firm could change from time to time through a number of factors both inside and outside of the company's control.

Examples of such changes could include the divestiture of a particular business line, the entrance of competitors in a particular market where the company was once considered to be the sole provider of an essential function or service or the dilution of the level of interconnectedness associated with the nonbank financial company through the actions of its various stakeholders, counterparties and competitors. Nonbank financial companies must understand the timeframe the Council is reviewing for Section 113 designation. For clarity and efficiency, annual reviews would be workable, provided the Council provide sufficient guidance regarding the information or filing to be used as a "triggering" event for such annual review. Moreover, the final rule should clarify that the Council's review will involve the same steps and permit the same level of participation by the nonbank financial company during the reevaluation process as was provided in the initial designation. Finally, provision should be made for permitting designated nonbank financial companies to petition the Council for reevaluation based on changed circumstances before the next review would have been scheduled to occur.

In addition to clarity regarding the triggering event and timing of the Council designation process, additional clarity is necessary regarding the timing for calculation of assets, liabilities or other values necessary for the Council and the nonbank financial company to determine if a threshold has been met. For example, when the Board issued its final rule regarding the requirement that bank holding companies with total consolidated assets in excess of \$50 billion

develop and submit comprehensive capital plans, it set forth the relevant timing for such calculation as the average of total consolidated assets over the previous four quarters.²⁹ The Board's choice to use an average value reflects the economic reality that, over a period of time, such values fluctuate and that the bright-line test should be flexible to capture these fluctuations. The Council should similarly consider clarifying the timing and, if appropriate, the use of averages over a period of time, by which it and nonbank financial companies calculate the given values necessary to determine if a threshold has been met.

The Council must provide additional clarity regarding the scope and intended use of the emergency exception to the procedures set forth in the Notice for making a designation under Section 113 of the Dodd-Frank Act.

The Notice provides that the Council may waive or modify various notice and other procedural requirements for identifying a nonbank financial company under Section 113 in certain emergency situations.³⁰ This provision further provides for limited or truncated notice and an evidentiary hearing;³¹ however, nothing in the Notice or proposed rule provides sufficient guidance on what factors or circumstances would need to exist for the Council to exercise such emergency authority. In fact, the provision only requires that the Council determine "that such waiver or modification is necessary to prevent or mitigate threats posed by the nonbank financial company to the financial stability of the United States[.]"³² AFSA and NAIB believe that such a broad statement goes to the very essence of the proposal contained in the Notice and that absent discussion regarding the exigent circumstances that would trigger such a finding, the provision could operate to eliminate the larger, more fulsome, process established for designation. For example, we assume any trigger for emergency designation would need to be institution-specific and not the result of broader economic conditions that cause entire groups or segments of companies to fall within the scope of Section 113; however, that is not clear in the Notice. AFSA and NAIB believe that additional clarity and guidance on this point is required in order to reduce the potential for arbitrary or capricious use of this authority to truncate the decision-making process or, alternatively, the broad flexibility afforded by the emergency exception should be eliminated in any final rule.

²⁹ See Capital Plans, 76 Fed. Reg. 74,633.

³⁰ 76 Fed. Reg. 64,276.

³¹ Id. at 64,277.

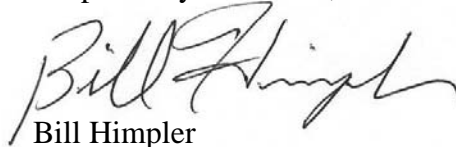
³² Id.

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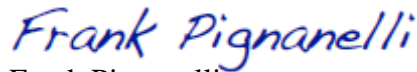
Conclusion

AFSA and NAIB appreciate the opportunity to comment on the Notice and welcome the opportunity to discuss further any of the issues addressed in this response letter. If you have any questions, or if we can provide any additional information, please feel free to contact Bill Himpler at 202-296-5544, ext. 616 or bhimpler@afsamail.org and Frank Pignanelli at 801-355-9188 or frank@fputah.com.

Respectfully submitted,



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