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December 19, 2011

Mr. Lance Auer
Deputy Assistant Secretary
United States Department of Treasury
Financial Stability Oversight Council
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Notice of Proposed Rulemaking – SIFI Determination Process (RIN 4030–AA00)

Dear Mr. Auer,

Introduction And Overview

American for Financial Reform ("AFR") appreciates this opportunity to comment on the notice of proposed rulemaking by the Financial Stability Oversight Council ("Council ") regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (FSOC-2011-0001-0045, Federal Register/Vol. 76, No. 201, pp. 64264-83) (the "NOPR"). AFR is a coalition of more than 250 organizations who have come together to advocate for reform of the financial sector. Members of the coalition include consumer, civil rights, community based, labor, retiree, faith based and business groups along with prominent economists and other experts.

Section 113 of the Dodd- Frank Wall Street Reform and Consumer Protection Act ("DFA") authorizes the Council to require a nonbank financial company to be supervised by the Board of Governors of the Federal Reserve System ("FRB") and to be subject to heightened prudential standards established in accordance with Title I of the DFA. The proposed rulemaking and interpretive guidance set forth in the NOPR (the "Proposed Rule") establishes a process to identify nonbank financial companies ("NBFCs") that are systemically important and to implement the broader systemic risk and resolution authority mandates of Title 1 of the DFA.

The NOPR is the Council's second notice of proposed rulemaking setting forth standards and procedures by which the Council intends to make determinations as to which NBFCs are to be subject to enhanced FRB supervision and prudential regulation. The Proposed Rule represents a significant elaboration on the first such proposed rule issued in January. The Proposed Rule establishes an appropriate and, in most respects, reasonable process for making the determination of systemic importance.

AFR does believe in general that a rule along the lines proposed here will be sufficiently detailed to allow regulators to proceed with the implementation of Section 113, and urges the Council to do so expeditiously. The Section 113 authority is a crucial part of the DFA and should be implemented as a matter of urgency. The 2008 crisis which gave rise to the DFA was to a significant degree the result of the fact that an enormous "shadow banking" sector was allowed to grow outside of the regulated banking sector. Financial institutions engaged in shadow banking posed grave risks to the entire economy, but there was no mechanism for meaningful oversight of them. Section 113 is a critical provision of Dodd-Frank intended to ensure that this does not happen again. Today, 16 months after the passage of the Dodd-Frank Act, Section 113 has not yet been implemented and no non-banks have been designated as systemically significant. Even institutions which are among the largest financial institutions in the United States and received assistance in 2008 have not been designated for prudential oversight.

The Council has engaged in an extended process of notice-and-comment rulemaking laying out its determination procedures. This allows additional public input into the procedure. AFR appreciates the opportunity to participate, and in the comment that follows we lay out suggested changes that should be incorporated in the final rule. However, it is important to note that the general rulemaking is not the end of the process. It is therefore not necessary to resolve every question that could arise in every designation decision at this stage. Section 113 establishes a procedure for notice, opportunity for hearing, and judicial review of *each* designation individually. This indicates that Congress intended some specific issues arising in particular designations to be determined on a case-by-case basis.

The statutory framework of Section 113 thus plainly calls for an ongoing process which is highly responsive to the specific circumstances of individual firms and the nonbank sector and new regulatory information about such firms and the sector. This makes sense given the rapidly evolving nature of the financial sector, and the current incomplete state of information about it. (For example, agencies do not even have a fully reliable methodology in place for fully identifying the range of legal entities associated with a financial company). The Council should now swiftly complete a final rule, and get started on actual determinations of whether non-bank financial firms are systemically significant.

In developing the final rule, it is important to keep in mind that the text, purpose, and structure of the Dodd-Frank Act require a low threshold for determination. Consideration of the statute shows that Section 113 determination is not intended to be a draconian measure applied only to the riskiest financial companies. Instead, it is meant as a gateway into a discretionary and gradually increasing regime of prudential regulation. Smaller and/or less interconnected companies that are designated for oversight might experience almost no additional requirements beyond observation or reporting.

In light of this, the recommended Stage 1 procedures for consideration must be carefully considered and must not limit the Council's ability to designate financial companies for prudential oversight where there is any possibility of systemic risk. If there is doubt as to whether a company may pose systemic risk, it is more appropriate to move it into oversight and use additional information that is gathered once the determination takes place to decide on the appropriate prudential regime. Given the difficulty of fully assessing financial exposures (in

particular, leverage and liquidity) without company-specific information it is also crucial that the Council can fully utilize its ability to gather company-specific information in the Stage 1 process.

AFR is concerned that the Stage 1 process as currently outlined in the rule could inappropriately limit the Council in making systemic risk designations. The final rule should be modified to make it clear that the criteria laid out in the State 1 process provide important guidelines for triggering consideration of systemically important financial institution or "SIFI" determination, but that they must not be used to exclude firms that pose systemic risk, especially as circumstances and market conditions change. Below, we also propose a number of specific ways to make the definitions in Stage 1 more comprehensive, and more likely to take into fuller account the range of sources of risk. AFR also strongly supports the statement in the rule that company specific information may be used in Stage 1. Since reliable assessment even of basic first-stage issues like company debt and liquidity may require firm-specific, non-public information, this statement should be made even stronger. For example, the rule could more clearly state that the Council may use information and apply standards beyond the specific ones set forth in Stage 1 of the Proposed Rule as necessary to fulfill the requirements of Section 113.

The Proposed Rule incorporates a prudent concern regarding liquidity of NBFCs. Categories of risk which can cause damage rapidly through a "run" on a financial institution and thus cannot be easily managed after onset are the ones most likely to have systemic repercussions. However, the liquidity concept used in the proposed rule is too narrow. It concentrates on short-term debt, especially as that debt is measured using solely public information, but will not capture many important forms of short-term liquidity risk. Below are several forms of short-term liquidity exposure that expose a financial institution to a form of creditor run risk, but may not be incorporated in publicly available measures of short-term debt:

- Repurchase agreements financing securities held, whether they are short-term and must be rolled or are longer term and require mark-to-market margining.
- Par put rights of investors in mutual funds requiring liquidation of assets.
- Auction securities investor put rights requiring guaranteed market liquidity at a price.
- Securities lending requiring mark-to-market margining.
- Securities borrowing for the purpose of posting collateral.
- Annuities issued by insurance companies indexed to market value of securities requiring funded reserve based on that value.
- Unfunded margin for over-the-counter derivatives and the related triggering conditions.

Indeed, some of these assets vulnerable to short-term runs – such as par put rights of mutual fund investors – do not show up as debt liabilities at all. To the extent that the Proposed Rule fails to consider these and other aspects of liquidity risk under any of the stages of the proposed

determination process, liquidity will be inaccurately and incompletely measured and companies that present systemic risk may evade FRB supervision and heightened prudential standards. The actual complexity of 'short-term debt' is an excellent example of why the Stage 1 process must be flexible enough to allow the consideration for determination of companies which may not have high levels of leverage using simple, publically available metrics.

Beyond the need to retain a low threshold and sufficient flexibility to capture the range of institutions that may pose a threat to financial stability for determination, and the unsatisfactory treatment of liquidity and leverage, AFR has a number of other concerns with the Proposed Rule. These include the following:

- Care must be taken in implementing the consideration of regulation by other authorities. Such regulation should not impact determination unless there is a specific finding that the regulator has both the mission and the capacity to address all the systemic risks posed by the institution. The experience of the 2008 crisis clearly demonstrates this.

- The frequency and timing of Stage 1 measurements is an important issue that is not addressed in the rule. The Council should perform these measurements frequently and at times not designated in advance, to prevent 'window dressing'.

- NBFCs must explicitly include financial businesses owned in whole or in part by another company that engage in financial transactions unrelated to the business of the owner and that are operated as separate entities. To do otherwise invites gaming the 85/15 rule.

- The measurement of referencing total credit default swap exposure, a valuable metric, should be improved, especially by including index references.

These and various other considerations are discussed in more detail below.

Discussion of the Proposed Rules

The text of Dodd-Frank prescribes low thresholds for Section 113 determination. Section 112(a)(2)(H) of the bill charges the FSOC with designating supervision of non-bank financial companies that may pose a threat to financial stability. Section 113 provides for determination of nonbank financial companies that could pose a threat to financial stability. The operating standard triggering designation is contained in the words "may", "could" and "threat." Words such as may or could mean the possibility or conditional possibility; the unqualified word threat constitutes a low threshold in contrast to other sections of the Act that discuss significant or grave threats.

That is, if there is a realistic chance that a firm could cause a threat to the financial stability of the United States on account of its current or possible size, activities, or interconnectedness, then it should be designated for supervision by the Federal Reserve.[1] Inverting the question, FSOC should

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[1] The Supreme Court has considered the meaning of the word could as it pertains to a regulatory prerogative, and its analysis controls here. In Federal Energy Regulatory Comm'n v. Martin Exploration Management Co., 486 U.S. 204, 209–10 (1988), the Court upheld the plain meaning of "could", overruling a lower court's attempt to translate it into the unconditional "will" in a natural gas pricing test. In this case, the Supreme Court specifically rejected the approach of responding ad hoc to current market realities. It held that the term "could" required a *per se* rule based

consider what non-bank financial firms it can confidently say could not pose a threat to broader financial stability. Other firms should be designated.

The DFA's overall structure and purpose reinforce the plain meaning of Section 113. First, the Act makes clear that determination is not—and should not become—a draconian measure that applies only to the riskiest nonbank financial companies. Designation as a nonbank SIFI should not be a scarlet letter. This is demonstrated by the mandate in Section 115(b)(3)(B) of the DFA that regulators ensure that small changes in a firm do not result in "sharp, discontinuous changes" in the prudential standards established under section165. If firms are not designated until they already pose substantial risk, then designation will trigger heightened prudential standards that would have to be "sharp and discontinuous" in contrast to the firm's immediate prior standards.

Other provisions of Dodd-Frank also demonstrate that determination under Section 113 should serve as a low-level, simple gateway into a broader regime of supervision and prudential regulation. Determination places a firm into a discretionary regime of progressive regulation, supervision and prudential standards that increase as a firm grows in size, complexity, interconnectedness, or other factors. The Federal Reserve is given very broad discretion to determine exactly how these prudential requirements change according to the characteristics of each individual firm. Such broad discretion is not logical unless the authors of the legislation envisioned a wide range of companies being placed under supervision, including those that might be smaller and posed a potential threat as opposed to a major or immediate threat.

Further, if firms are designated only after they already pose a threat, then it may be too late for early remediation. Designation qualifies firms for a range of other key authorities, such early remediation. Section 166 of the Dodd-Frank Act shows that early remediation – as opposed to haphazard, late-stage emergency intervention – is an important goal of the overall DFA regulatory framework. Early remediation cannot occur unless firms are designated for some type of prudential oversight or monitoring before they actually pose an immediate risk.

Scope of Proposed Rules – 'Predominantly Engaged In Financial Activities'

The Proposed Rule applies to NBFCs that are predominantly engaged in financial activities, as those terms are defined in the DFA. This formulation requires substantial clarification if the process is to function properly.

Foremost is the need to address financial enterprises that are owned, in whole or in part, by non-financial companies. The final rule should not distinguish between a NBFC owned by shareholders and a similar business owned by a multi-national conglomerate, each of which would be a systemically important NBFC under Council rules. If that distinction were allowed, the 85/15 rule for designating non-financial companies could create an incentive for establishing combinations of financial and non-financial businesses that would escape the process provided in the NOPR.

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on what was merely possible, not what was currently true. In this context, Martin requires FSOC to designate firms that could, hypothetically, pose a threat to financial stability—not just firms that will do so or are likely to do so.

The definition of NBFCs should explicitly include financial businesses owned in whole or in part by another company that are operated as separate financial enterprises unrelated to the business of the owner and are effectively separate enterprises.

Analytical Framework for Statutory Considerations

Consistent with the statute, the Proposed Rule identifies two categories of determination. One consists of NBFCs in "material financial distress" – that is, in imminent danger of insolvency or defaulting on their financial obligations where their insolvency, default or failure could pose a threat to U.S. financial stability. The second includes NBFCs where the nature, scope, size, scale, concentration, interconnectedness, or mix of their activities could pose a threat to U.S. financial stability.

Section 113 of the DFA directs the Council to consider 10 specified factors in making its determination whether a NBFC is to be classified as systemically important. In the Proposed Rule, these factors are grouped into six categories, which are discussed below.

Interconnectedness: This category focuses on "linkages between financial companies that may be conduits for the transmission of the effects resulting from a nonbank financial company's material financial distress or activities."[2] The Proposed Rule sets forth seven metrics that may be used to assess interconnectedness. While these metrics are generally appropriate, two should be expanded (CDS exposure and Sources of Funding) and additional metrics should be included.

- Amount of gross notional credit default swaps outstanding for which an NBFC is the referenced entity. This metric is problematic in two ways.
    - ***First, indexed credit default swaps that include the NBFC in the index market basket should be included pro rata with the weighing of the index.*** These instruments are functionally disaggregated in the event of a default by the NBFC so that the practical effect on market participants is the same as with a CDS referencing the NBFC.[3]
    - ***Second, credit default swap exposure should be considered in aggregate with counterparty exposure to the NBFC (a separate metric in the Proposed Rule) as well as separately.*** For purposes of interconnectedness, the consequences to other market participants of a credit event affecting the NBFC are the relevant issue, not whether the consequences are a result of the market participant being a counterparty. The consequences *via* counterparty relationships and CDS are of the same type, so they must be measured in aggregate as well as separately.
- ***The metric on NBFC's sources of funding should be expanded beyond loans borrowed and bonds issued to include all funding sources, including commercial paper, repurchase agreements, cash derived from securities lending and securities borrowed***

[2] Proposed Rules, Appendix, 76 FR page 64279.

[3] See ICE Clear Credit Petition on "Enhanced Margin Methodology ("Decomp Model") available at http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul112511icecc001.pdf.

for use as collateral for other purposes.

- ***The extent to which the NBFC constitutes a source of funding to other market participants is an important conduit for transmission of the effects of NBFC distress or activity that should be expressly included as a metric.***

- A major conduit for transmission of the consequences of NBFC distress or default is the financing of assets. The system depends on the continuous ability to finance these assets through collateralized borrowing. This process can be disrupted if the value of the assets drops precipitously as a result of market events or a "fire sale" by the NBFC or another market participant. ***The concentration of assets financed with short-term debt in particular classes and their price volatility and liquidity should be reflected in the metrics for interconnectedness.*** The final rules should consider concentration, measured by price correlation, in the assets held by single NBFCs and held widely by market participants.

- Another important class of conduits is the set of markets in which the NBFC participates. Distress or default can create volatility and illiquidity and can adversely affect the market infrastructure providers such as clearing houses. ***The markets an NBFC participates in and the potential for disruption should be included as factors in the metrics for interconnectedness.***

Substitutability: Substitutability is defined too narrowly. In the Proposed Rule, this concept is defined, in part, as follows: "Substitutability also captures situations in which a nonbank financial company is the primary or dominant provider of services in a market that the Council determines to be essential to U.S. financial stability."[4]

First, being the primary or dominant provider of a service fails to capture other circumstances, such as a situation in which the NBFC is a part of a dominant and interconnected oligopoly. Further, establishing a standard in which the market is essential to financial stability is far too restrictive. ***The standard should be changed to encompass circumstances in which an NBFC provides services that, if lost, would materially and adversely affect a market so as to threaten financial stability.*** If that circumstance exists, the NBFCs substitutability would be low.

Leverage: The Proposed Rule reflects a conventional approach to evaluation of leverage in terms of ratios. Included in the example metrics is the gross notional exposure of derivatives and off-balance sheet obligations. Because of the historically demonstrated threat of margin calls to the viability of financial companies, more specificity should be added. "Out-of-the-moniness" for which margin is conditionally forborne is a serious and distinct form of leverage. These obligations must be measured and evaluated. ***The leverage metrics should explicitly include the amount of unfunded margin and the terms under which such margin can be called by counterparties (the triggering conditions).***

[4] Proposed Rules, Appendix, 76 FR, page 64279.

Liquidity Risk and Asset Mismatch: Categories of risk which can cause damage rapidly and therefore cannot be easily managed after onset are most likely to have systemic repercussions. The liquidity concept used in describing this category is, however, far too narrow. It concentrates on short-term debt, which is indeed important. Yet, NBFCs have a number of characteristics that involve potentially creditor run risks that are virtually the same as short-term debt, including the following:

- Counterparty put rights that subject the NBFC to liquidity risk;
- Obligations indexed to market values of securities; and
- Volatility and illiquidity of assets financed with short-term debt or debt requiring margining.

To include short-term debt in the criteria, but to ignore put rights, liquidity and volatility of financial assets and cash margining or reserve requirements, will result in an incomplete measure of liquidity risk. Short-term put rights for equity holders, such as exist for money market funds, are not even classified as debt at all and will certainly be missed. Furthermore, the Federal guarantee for the entire money market fund sector that followed the 2008 failure of a single money market fund (The Reserve Primary Fund) shows the systemic sensitivity of this sector.

There are a number of specific examples of circumstances that must be considered alongside short-term debt in assessing liquidity risk. In each case it is the value of assets that is the principal concern.

- Repurchase agreements financing securities held, whether they are short term and must be rolled or require mark-to-market margining.
- Par put rights of investors in mutual funds requiring liquidation of assets.
- Auction securities investor put rights requiring guaranteed market liquidity at a price.
- Securities lending requiring mark-to-market margining.
- Securities borrowing for the purpose of posting collateral.
- Annuities issued by insurance companies indexed to market value of securities requiring funded reserve based on that value.

The Proposed Rule states that the Council may examine a NBFC's assets to determine if it possesses cash or readily marketable securities, but this is not an element of the metrics that are outlined.

The rules must evaluate liquidity and maturity mismatches using an expansive concept of liquid liabilities (for example, encompassing puts and margin funding) and an analysis of the liquidity and volatility of the assets that are related to debt and other short-term liabilities.

Existing Regulatory Structure. The Proposed Rules establish a category responsive to the statutory consideration: "the degree to which the company is already regulated by 1 or more primary financial regulatory agencies…." The Council should be judicious in its approach to this consideration. The events of 2008 provide a clear example of the ineffectiveness of Federal and state regulation in identifying and mitigating grave risks from complex transactions. In particular, consideration of state regulation opens the door to the issue of regulatory jurisdiction

shopping in which financial firms such as insurance companies seek out jurisdictions that with the least effective regulatory authorities.

The issues raised by the other considerations require a level of expertise and targeted analytical capability that can only be achieved through a dedicated regulatory effort. ***At a minimum, the final rule should require consideration of whether existing regulatory oversight addresses potential systemic risks identified in the determination analysis, and of the capability of current regulators entities to analyze and monitor the data that is contemplated by the Proposed Rules.***

The Three-Stage Determination Process

The Proposed Rule establishes a three-stage review process for implementation of the analytical framework for consideration. Each stage successively involves an increasingly focused examination of sources and data, moving from publicly sourced data to regulator-sourced data to proprietary-sourced data. The metrics are based on a series of thresholds that relate to the analytical framework described above. The approach taken in the Proposed Rule is inadequate because the thresholds are static. ***The final rule should establish a process for revising the thresholds to evolve with changing circumstances and financial market conditions.***

Stage 1: The Stage 1 process is far from trivial. The Council is to rely primarily on publicly available information in establishing the pool of potential systemically important NBFCs. Some NBFCs may be missed or omitted because the screens using publicly available data are inevitably far less accurate than data specifically requested. As a result, the Council must maintain a level of flexibility in this area. AFR strongly supports the statement on page 64282 that the Council "may…initially evaluate nonbank financial companies in Stage 1 based on other firm-specific qualitative or quantitative factors. ***The final rules should additionally state clearly that the Council reserves the right to gather any additional data from individual firms necessary for implementing Stage 1 metrics, and reserves the option of designating individual NBFCs as subject to Stage 2 analysis even if the general Stage 1 thresholds are not met, based on circumstances specific to that NBFC.***

Additional clarity is needed on one structural issue. The NOPR provides no guidance as to the ongoing implementation of Stage 1. It is obvious that the set of NBFCs that meet the Stage 1 thresholds will change over time. The thresholds must be applied to companies on some periodic basis. However the NOPR does not specify the timing or frequency of metric measurement. Infrequent measurement of the metrics and application of the thresholds undercuts the purpose of Section 113 of the DFA and invites imprudent systemic risks. It also can result inappropriate burdens and advantages that impair competition among NBFCs.

Furthermore, application of the Stage 1 thresholds at predictable times (such as quarterly) invites NBFCs to engage in "window dressing." In making the determination, the Council should avoid relying solely upon quarter-end snap shots provided in publicly available financial statements to the extent that these often reflect window-dressing, whereby debt and liquidity levels can be masked. ***In implementing Stage 1, the Council should check the various metrics no less frequently than quarterly, and should check the measurements and apply the thresholds at indeterminate and unpredictable intervals.***

Consolidated Asset Threshold: Although the $50 billion consolidated asset bright line the measure is easy to apply to certain NBFCs, more detail is required. The scope of the consolidated asset calculation is important. Affiliates inside corporate structures often have interconnected relationships, and a fund adviser might suffer problems that infect a variety of funds it manages. A "run" on a managed fund could easily metastasize into a run on its other business (in the form of margin demands and loss of access to short-term funding, for instance); and the process could obviously work in reverse. This internal "interconnectedness" must be addressed in the Stage 1 threshold to avoid an under-inclusive process. ***Pools such as money market funds, hedge funds and mutual funds managed or controlled by the NBFC or any affiliate of the NBFC should be included among consolidated assets.***

Credit Default Swap Threshold: The Proposed Rule establishes a threshold of $30 billion in gross notional amount of credit default swaps outstanding for which the NBFC is a referenced entity. As discussed above, this is inadequate as long as credit default swaps do not include references in CDS indexes. In addition, ***the threshold should include indexed credit default swaps that include the NBFC in the index market basket and should be included pro rata with the weighing of the index.*** The consequences of an NBFC credit event to market participants are indistinguishable and index CDS exposures must not be ignored.

It is important to note that the fact that the NBFC cannot control the volume of credit default swap exposure to the market is subject to is completely irrelevant. The Council is charged with evaluating potential systemic risk and the source of the exposure does not factor into that effort.

Derivatives Liability Threshold: The Council establishes a threshold of $3.5 billion in fair value of derivatives liability. The expressed intent is to provide a partial measure of interconnectedness. While this is an appropriate goal, the use of fair value is not adequate. Interconnectedness is a function of risk. Two derivatives contracts might have the same fair value, but derivative A may expose a counterparty to twice the risk on the occurrence of default as derivative B. Derivative A involves far greater consequences in terms of interconnectedness.

The NOPR recognizes that fair value is inadequate, but defers the use of a risk metric until the collection of swap data by swap data repositories under Title VII of DFA has commenced. "Current derivatives exposure" is to be considered until that time, but not "potential future derivatives exposure." Presumably the latter refers to price volatility risk from the most recent mark-to-market that may be experienced in a liquidation or replacement of the positions. This is typically measured by VaR and is an analog to initial margin in clearing. Despite the characterization in the NOPR, this is a real exposure that is current and not a potential future exposure. Every NBFC must measure and monitor it, so the NBFC has access to the values and should disclose it. It is the best measure of direct derivatives risk and must be incorporated. ***The derivatives liability threshold should be based on risk, as measured by VaR using reasonable assumptions, rather than fair value.***

Loans and Bonds Outstanding: The $20 billion threshold established by the Proposed Rules is conceptually appropriate.

Leverage Ratio: The Proposed Rule establishes a threshold ratio of consolidated assets (excluding separate accounts) to total equity of 15 to 1. The Proposed Rule states that separate accounts are excluded because they are not available to the claims of creditors. However, there

is no definition of "separate accounts." The assertion regarding creditor claims is not stated as part of the definition but merely asserted as a fact. ***The final rules should state that the exclusion is for accounts that are not subject to the claims of creditors.***

Short-Term Debt Ratios. The Council adopts a threshold ratio of debt with a maturity of less than 12 months to consolidated assets (excluding separate accounts) of 10 percent. As discussed above, the notion of "debt" is inadequate. Puts requiring liquidation, margin forbearance arrangements under which margin funding can be triggered, repurchase agreements, securities lending agreements and other structures are common and can have the same, or more likely worse, liquidity consequences as short-term debt. ***The final rule should include arrangements that can create immediate liquidity demands, beyond those encompassed within the concept of short- term debt.***

Stage 2. Stage 2 of the review process involves an analytical simplification of the ten statutory considerations of the degree to which NBFCs not excluded in Stage 1 might pose a threat to national financial stability into six categories, as described above.

The Proposed Rule provides that the standards and metrics to be used in implementing the analytical framework for statutory consideration will be specific to the NBFC's financial sub-industry. This is a useful innovation that avoids the potential under-inclusiveness of a one-size-fits-all macro-industrial approach.

The Proposed Rule references the Office of Financial Research ("OFR"). OFR should be intimately connected with the quantitative analysis involved in the analytical framework for statutory consideration in Stage 2 as well as Stage 3. The analysis should be thorough and adaptable to changing conditions. Systems should be put in place to make certain that the analysis is consistent and comparable. OFR should either do the analysis based on data gathered from other sources (the preferable alternative), or at least make certain that the in-house systems of the NBFCs and regulatory agencies are accurate and comparable across NBFCs. The NOPR is, at best, vague regarding the role of OFR. ***The role of OFR should be made clear and it should be a priority to develop OFR capacity to contribute to the analytical effort.***

Stage 3. Stage 3 does not include any bright-line tests or categories for inclusion or exclusion but adds a layer of firm-specific considerations such as internal risk management procedures; funding details, counterparty exposure or position data; and strategic, resolution, acquisition or other plans or contingencies that could affect the threat to U.S. financial stability posed by the NBFC. It is important that these considerations do not become extenuating circumstances or other pretexts for exclusion.

The Proposed Rule indicates that Stage 3 analysis will include an evaluation of the firm's "resolvability," with a view to "any obstacles to the rapid and orderly resolution of a nonbank financial company in a manner that would mitigate the risk that the nonbank financial company's failure would have a material adverse effect on financial stability."[5] Presumably, perceived difficulties in resolving a firm through conventional means such as bankruptcy would *incline* the Council to determine that an NBFC is a systemically important NBFC. ***The final rule should make it clear that this is the import of the evaluation.***

[5] Proposed Rules, Appendix 76 FR, page 64282.

The Proposed Rule contemplates the evaluation of internal risk procedures and quality of management in Stage 3. This is completely inappropriate, at least at least insofar as it is used as a mitigating factor. As set forth in the DFA, the purpose for establishing the process is to determine whether the distress or activities of the NBFC "*could pose a threat* to the financial stability of the United States." The quality of internal systems and management is not relevant to this purpose. Indeed, the statutory considerations do not authorize the Council to give any "credit" for the quality of systems or management (though poor systems and management may be a "risk" that the Council considers under the eleventh, generic consideration). These are matters for the regulators overseeing a systemically important NBFC to evaluate and monitor. A failure to determine that a company posed systemic risk and required prudential oversight simply due to a decision that management was of high quality would open the door to favoritism and inequitable application of the law. ***The quality of internal risk systems and management should not be considered in Stage 2 or 3 unless it is so inadequate that it poses a separate systemic risk.***

Determination Notice, Appeal and Review

The Proposed Rules describe the determination hearing process.[6] It is notable that there is no public input into the process. The only feature of the process that the public is informed about is the outcome – that an entity is now to be subject to heightened FRB standards. The public would never know, for example, if the Council has considered a firm for determination or the basis for its exclusion.

The Council should establish greater transparency in the process. While a degree of confidentiality is required, public confidence in the reliability of the process is crucial. ***The final rule should include publication of the list of Stage 2 and Stage 3 NBFCs and determinations that individual NBFCs will not be designated as a systemically important NBFC, as well as the basis for the determination. The determination process should also include the opportunity for public comment.***

Hedge Funds and Private Equity Firms

While the Council will apply the Stage 1 thresholds to hedge funds and private equity firms and their advisers, the Council indicates that there is less data publicly available for these types of entities. It states that "financial guarantors, asset management companies, private equity firms, and hedge funds … may pose risks that are not well-measured" under the proposed quantitative thresholds" so the Council "may issue additional guidance … regarding potential additional metrics and thresholds relevant to asset manager determinations."[7]

The NOPR further notes that, starting next year, advisers to hedge funds and private equity firms as well as commodity pool operators and commodity trading advisors will be required to file proposed Form PF with the SEC or CFTC. Using data collected on proposed Form PF, as well as other data, the Council is to consider whether it is necessary to establish additional thresholds in Stage 1 that would be tailored specifically to hedge funds and private equity firms and their advisers. ***Evaluation of hedge funds, private equity funds, financial guarantors and asset***

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[6] Proposed Rules, Section 1310.21.
[7] NOPR, 76 FR page 64269.

management companies is crucially important, and the additional standards should be developed and made public as soon as possible.

Anti-Evasion

The Proposed Rule includes important provisions to address evasion. However, the ability of the regulators to supervise financial activities as a result of evasion is limited.[8] If the Council makes an anti-evasion determination, the FRB should have no such limitation. ***The final rules should permit the supervision of internal financial activities of an NBFC that has been the subject of a Council determination under its anti-evasion authority.***

Conclusion

We appreciate the opportunity to comment on the Proposed Rules and hope that our comments are helpful in your deliberations. If you have any questions, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672.

Sincerely,

Americans for Financial Reform

[8] Proposed Rules, Section 1310.12(b)(3).

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- Americans for Democratic Action, Inc
- American Income Life Insurance
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Information Press

- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Council of Women's Organizations
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now

- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Signers

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA

- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA

- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET