June 27, 2023

Financial Stability Oversight Council
Attn: Eric Froman
1500 Pennsylvania Avenue NW, Room 2308
Washington, DC 20220

VIA ELECTRONIC PORTAL

Re.: *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies - RIN 4030 – [XXXX]*

Dear Sir:

The Committee on Capital Markets Regulation (the "Committee") is grateful for the opportunity to provide comments to the Financial Stability Oversight Council (the "Council") on its proposed framework for financial stability risk identification, assessment, and response (the "Framework")[1] and proposed interpretive guidance on nonbank financial company designations (the "Guidance," and together with the Framework, the "Proposal")[2] under the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[3]

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-seven leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Emeritus Dean, Columbia Business School) and John L. Thornton (Former Chairman, The Brookings Institution) and is led by Hal S. Scott (Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Program on International Financial Systems). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Proposal would make numerous changes to the criteria and process for designation of nonbank financial companies as systemically important financial institutions ("SIFIs"). Our letter focuses on four of the most significant issues the Proposal raises. Specifically, we show that: (i) the designation of nonbanks as SIFIs should occur, if at all, only in narrow and exceptional circumstances, but the Proposal would instead increase the generality and vagueness of the Council's criteria; (ii) an "activities-based approach" to addressing systemic risk is preferable to an entity-by-entity designation approach; (iii) the Proposal's elimination of the cost-benefit analysis requirement for each nonbank SIFI designation is contrary to the law and the most basic

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1 FINANCIAL STABILITY OVERSIGHT COUNCIL ["FSOC"], *Analytic Framework for Financial Stability Risk Identification, Assessment, and Response*, 88 FR 26,305 (Apr. 28, 2023) https://www.federalregister.gov/documents/2023/04/28/2023-08969/analytic-framework-for-financial-stability-risk-identification-assessment-and-response [the "Framework"].

2 FSOC, *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 88 FR 26,234 (Apr. 28, 2023) https://www.federalregister.gov/documents/2023/04/28/2023-08964/authority-to-require-supervision-and-regulation-of-certain-nonbank-financial-companies [the "Guidance"].

3 12 U.S.C. § 5323.

principles of policymaking; and (iv) the Proposal's removal of the assessment of the likelihood of a company's material financial distress in considering nonbank SIFI designation is also contrary to the law and the fundamental goal of the SIFI designation process.

I. Overview of the Proposal

Subpart (1) briefly summarizes the history of the nonbank SIFI designation process and FSOC's current framework for nonbank SIFI designations. Subpart (2) then reviews how the Proposal would change the current framework, focusing on the changes highlighted in the introduction.

1. The current nonbank SIFI designation process

Dodd-Frank directs the Council to identify nonbank financial companies that "may pose risks to the financial stability of the United States in the event of their material financial distress or failure, or because of their activities" and to place those entities under the supervision of the Federal Reserve.[4] If the Council determines that the above standard applies to a nonbank financial company, it must subject the company to Federal Reserve supervision by designating it as a SIFI.

In 2012, the Council published rules that established a procedural framework to determine if a nonbank financial company must be designated as a SIFI ("nonbank SIFI").[5] The rules provide that the Council will designate a nonbank financial company as a SIFI if "(i) material financial distress at the nonbank financial company could pose a threat to the financial stability of the United States" or (ii) "the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company could pose a threat to the financial stability of the United States."[6] For this purpose, a "threat to the financial stability of the United States" means "an impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy."[7]

The 2012 rules identify two groups of three factors that FSOC uses to determine if a nonbank financial company implicates either of the two standards described above:

> Group I factors, which are used to "assess the potential impact of the nonbank financial company's financial distress on the broader economy:"
> - size
> - substitutability
> - interconnectedness
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> Group II factors, which are used to "assess the vulnerability of a nonbank financial company to financial distress:"
> - leverage

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[4] 12 U.S.C. § 5322(a)(2).
[5] FSOC, *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 77 FR 21,637 (Apr. 11, 2012) https://www.federalregister.gov/documents/2012/04/11/2012-8627/authority-to-require-supervision-and-regulation-of-certain-nonbank-financial-companies.
[6] *Id.*
[7] *Id*. at 21,657.

- liquidity risk and maturity mismatch
- existing regulatory scrutiny[8]

The 2012 rules also identify three "channels" that are most likely to facilitate "transmission of the negative effects of a nonbank financial company's material financial distress or activities to other financial firms and markets" such that the nonbank financial company's material financial distress could threaten the overall financial stability of the United States.

- *Exposure* – i.e., the extent of third-party exposure to the nonbank financial company as measured by total consolidated assets, credit default swaps outstanding, derivative liabilities, total debt outstanding, and leverage ratio.
- *Asset liquidation* – i.e., the type of assets held by the nonbank financial company and whether their quick liquidation would cause a fall in asset prices.
- *Critical function or service* – i.e., the importance of the nonbank financial company's role in the market and the number of possible substitutes for it.[9]

Furthermore, the 2012 rules establish a three-stage assessment procedure:

- In Stage 1, the Council uses information from existing public and regulatory sources to identify nonbank financial companies for further evaluation.[10]
- In Stage 2, the Council analyzes the companies identified in Stage 1 "on a wide range of quantitative and qualitative information available to [FSOC] through public and regulatory sources" and consults "with the primary financial regulatory agencies" to determine if a company should be subject to additional review.[11]
- In Stage 3, companies selected for additional review are notified for the first time that they are being considered for SIFI designation and are subjected to "in-depth evaluation" using "information collected directly from the nonbank financial company."[12]

If the Council designates a nonbank company as a SIFI, the company may then request a hearing before the Council to challenge the determination.[13] If the Council declines to change its determination following such a hearing, Dodd-Frank then allows the company to challenge its designation in court.[14]

In 2019, the Council made discrete updates to the 2012 rules.[15] Most notably, the 2019 reforms adopted an "activities-based approach" and committed the Council to conducting a cost-benefit analysis before designating a nonbank financial company as a SIFI.[16] Under the activities-based

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[8] *Id*. at 21,658-60.
[9] *Id*. at 21,657.
[10] *Id*. at 21,660.
[11] *Id.*
[12] *Id.*
[13] *Id*. at 21,662.
[14] *Id.*
[15] FSOC, *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 88 FR 71,7140 (Dec. 30, 2019) https://www.federalregister.gov/documents/2019/12/30/2019-27108/authority-to-require-supervision-and-regulation-of-certain-nonbank-financial-companies.
[16] *Id*. at 71,742.

approach, the Council first seeks to address a potential risk to financial stability through generally applicable regulation of the activity and will only pursue a nonbank SIFI designation if such activity-based regulation cannot address the potential risk.[17] The Council also changed the determination process itself in 2019, eliminating the first stage and "increas[ing] the Council's engagement with companies and their existing regulators during the determination process."[18]

2. How the Proposal would change the nonbank SIFI designation rules

The Proposal would significantly amend the Council's rules for determining if a nonbank financial company should be designated as a SIFI in a manner that would make it more likely that the Council would designate nonbanks as SIFIs.

First, the Proposal would eliminate the requirement that FSOC determine that the "economy would be severely damaged" in order to designate a financial company as a SIFI.[19] Second, the Proposal would eliminate the "activities-based approach" whereby the Council seeks to address potential systemic risks posed by nonbank financial institutions through general activity-wide regulation before considering whether to designate an institution as a SIFI.[20] Third, the Proposal would eliminate consideration of the likelihood of a nonbank financial institution's financial distress.[21] And fourth, the Proposal would eliminate the requirement that the Council conduct a cost-benefit analysis before designating a nonbank financial company as a SIFI.[22]

Finally, the Proposal would also amend the procedure for nonbank SIFI designation. The Council would only notify a company that it is under consideration in the first stage 60 days before the Council votes on whether to proceed to the second stage.[23] The company would be permitted to submit information and documentation to the Council, but the Council may request a page-limited summary of the company's submissions.[24]

[17] *Id*. at 71,761.
[18] *Id*. at 71,742.
[19] Guidance at 26,236.
[20] *Id.* at 26,237.
[21] *Id.* at 26,238-39.
[22] *Id.* at 26,238.
[23] *Id.* at 26,242.
[24] *Id.*

II. Analysis of the Proposal

In Part II, we identify four significant issues with the Proposal's reforms and set forth certain recommendations to address our concerns.

1. SIFI designation of nonbank financial companies should only occur, if at all, in exceptional and narrowly defined circumstances – but the Proposal establishes criteria that are vague and generalized.

As the Committee has explained in several previous letters,[25] designating individual nonbanks as SIFIs is unlikely to benefit financial stability, for several reasons.

First, systemic risk in capital markets is not confined to or concentrated in a few discrete entities. Rather, it shifts with capital flows, which themselves are driven by investor preferences and other market dynamics. Therefore, by singling out particular companies, the Council will merely allow the risks posed by those companies to shift elsewhere, including to less regulated sectors. Indeed, as the Committee has explained before, a portion of the heightened compliance costs associated with SIFI designation is likely to be passed on to customers of the nonbank SIFI. Instead of bearing these costs, investors could simply shift their capital to other financial institutions that hold similar assets without the regulatory restrictions imposed on SIFIs.[26] This is particularly true when the nonbank SIFI is part of a highly competitive industry, since investors will have ample choice among service providers, making it easier for them to shift their capital to entities not supervised by the Federal Reserve. Thus, regulating any systemic risks posed by capital markets requires a focus on market infrastructure and on activities and products, rather than individual entities, as discussed further below.

Second, shoehorning a multiplicity of entities ranging from mutual funds to broker dealers to venture capital firms into a regulatory schema implemented by the Federal Reserve may lead to

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[25] *See, e.g.*, Letter from the Comm. on Capital Mkts. Reg. to Christopher Dodd, Chairman, Richard Shelby, Ranking Member, S. Comm. on Banking, Hous. & Urban Affairs and Blanche Lincoln, Chairman, Saxby Chambliss, Ranking Member, S. Comm. on Ag., Nutrition & Forestry (Apr. 26, 2010); Memo from Hal S. Scott, Director Comm. on Capital Mkts. Reg. to Christopher Dodd, Chairman, Richard Shelby, Ranking Member, S. Comm. on Banking, Hous. & Urban Affairs (May 4, 2010); Letter from the Comm. on Capital Mkts. Reg. to Timothy F. Geithner, Chairman, Fin. Stability Oversight Council (Nov. 5, 2010); Letter from the Comm. on Capital Mkts. Reg. to Lance Auer, Fin. Stability Oversight Council (Feb. 22, 2011); Letter from the Comm. on Capital Mkts. Reg. to Lance Auer, Fin. Stability Oversight Council (Dec. 19, 2011); Letter from Comm. on Capital Mkts. Reg. to Neal S. Wolin, Acting Chairman, Fin. Stability Oversight Council (Feb. 15, 2013); Letter from Comm. on Capital Mkts. Reg. to Fin. Stability Oversight Council (Mar. 16, 2015); *Due Process and Transparency in Non-Bank SIFI Designations, Hearing before the Subcomm. on Oversight and Investigations of the H. Comm. on Fin. Services*, 114th Cong. (Nov. 19, 2015) (written testimony of Hal S. Scott, Director, Comm. on Capital Mkts. Reg.) ["Scott Testimony"]; COMM. ON CAPITAL MKTS. REG., ROADMAP FOR REGULATORY REFORM (May 2017), https://www.capmktsreg.org/wpcontent/uploads/2018/10/Roadmap-for-Regulatory-Reform.pdf ["Roadmap"]; Letter from the Comm. on Capital Mkts. Reg. to Mark Schlegel, Attorney-Advisor to U.S. Dep't of Treasury (Apr. 25, 2019). *See also* Letter from the Comm. on Capital Mkts. Reg. to the Secretariat, Fin. Stability Bd. (Apr. 7, 2014); Letter from the Comm. on Capital Mkts. Reg. to the Secretariat, Fin. Stability Bd. (Sept. 21, 2016).

[26] Letter from the Comm. on Capital Mkts. Reg. to Secretariat, Fin. Stability Bd. (May 29, 2015). Comm. on Capital Mkts. Reg., Data on Why SIFI Designation Is Not the Answer to Possible Herding Behavior by Asset Managers (May 17, 2014), https://capmktsreg.org/why-sifi-designation-is-not-the-answer-to-possible-herding-behavior-by-asset-managers/.

suboptimal regulatory outcomes, particularly where those entities already have a primary regulator with greater expertise and experience at addressing their risks than the Federal Reserve.

Third, asset managers—including mutual funds, hedge funds, and private equity funds, as well as traditional insurers— do not pose systemic risk.[27] For example, as reflected in our earlier comment letters, an asset management firm's assets under management are not indicative of the systemic risk posed by the firm, because these assets are owned by clients, are segregated, and are held by a custodian.[28] This means that asset management firms assume no balance sheet risk for the performance of those client assets and client assets would not be drawn into the liquidation or bankruptcy of an asset management firm. If an asset management firm fails, custodianship and segregation ensure that the resolution process is straightforward from the perspective of investors and involves the reassignment or transfer of their assets to another management firm or fund. Simply stated, the failure of a large asset manager or its constituent funds would not pose systemic risk, because it "would not set off a chain reaction of financial institution failures."[29] As the Committee has also previously explained,[30] traditional insurance companies do not pose a systemic risk because their liabilities are long-term in nature, particularly as compared with the liabilities of other nonbank financial institutions. The systemic risk posed by AIG in the 2008 financial crisis was not from its traditional life and property insurance activities. Rather, AIG's large losses and liquidity crisis were due to the credit protection that AIG Financial Products sold on collateralized debt obligations that were exposed to U.S. subprime mortgages and reinvestment of cash collateral in mortgage-backed securities by AIG's securities-lending subsidiary. These are activities that are not part of the traditional insurance business and have since been addressed by Dodd-Frank reforms to securitizations and state regulation of insurance companies' capital requirements.[31]

In view of the foregoing, the criteria for designation of nonbank financial companies as SIFIs should be tailored to apply only in the most exceptional and narrowly defined circumstances. In particular, a nonbank financial company should only be designated as a SIFI if, at a minimum, (1) there is no primary regulator of the entity at either the federal or state level, *and* (2) the entity belongs to a class of institutions that perform a critical function for financial stability. In the case of asset managers and insurance companies, as we have previously explained, neither of these criteria are present.

The Proposal, however, would fail to establish criteria consistent with the above principles. Instead, the Proposal would continue to apply criteria that are so general and vague that they could

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[27] *See* Letter to Neal S. Wolin dated Feb. 15, 2013, *supra* note 25, at 1-2.
[28] Letter to Secretariat, Fin. Stability Bd., *supra* note 26, at 3.
[29] *Id.* at 2.
[30] CCMR, Comment Letter Re. Non-Bank SIFI Designation (Feb. 15, 2013), https://capmktsreg.org/wp-content/uploads/2013/02/Comment-Letters-to-FSOC-on-the-Designation-of-Non-Bank-Systemically-Important-Financial-Institutions-and-FSOCs-Recommendation-that-the-SEC-Adopt-a-Floating-Net-Asset-Value.pdf; CCMR, Comment Letter Re. Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (Dec. 19, 2011), https://capmktsreg.org/wp-content/uploads/2011/12/The-Committee-submits-comment-letter-to-the-FSOC-regarding-its-Authority-to-Require-Supervision-and-Regulation-of-Certain-Nonbank-Financial-Companies.pdf.
[31] *See, e.g.*, David S. Huntington, *et al.*, PAUL WEISS, "Client Memorandum: Securitization Reform under the Dodd-Frank Act" (Aug. 5, 2010), https://www.paulweiss.com/media/103242/5Aug10DF.pdf; NAIC, "Statutory Minimum Capital and Surplus Requirements" (Mar. 24, 2023), https://content.naic.org/industry_ucaa_chart_statutory_minimum_capital_and_surplus_requirements.htm.

conceivably apply to any nonbank financial company. For example, the Proposal identifies the following vulnerabilities that are relevant to the Council's determination: leverage, liquidity risk and maturity mismatch, interconnections, operational risks, complexity or opacity, inadequate risk management, concentration, destabilizing activities.[32] These criteria fail to add any meaningful specificity to the statutory language of Dodd-Frank and do not provide nonbank financial companies with any ability to predict whether they are susceptible to classification as a SIFI. Perhaps most importantly, the Proposal would remove the requirement that the Council determine that the "economy would be severely damaged" by a nonbank financial company's failure before designating the company as a SIFI.[33] The Proposal is thus likely to exacerbate the problems associated with designation of nonbank financial companies as SIFIs by further broadening the criteria for SIFI designation and making it impossible for market participants to anticipate how such a determination will be made.

Furthermore, by leaving too much discretion to the Council, the vagueness of the Proposal's criteria will make the Council susceptible to legal challenges. The Committee previously warned of this risk,[34] which was borne out by MetLife, Inc.'s successful legal challenge to its designation as a nonbank SIFI.[35]

2. <u>The Proposal's elimination of the requirement that the Council first consider an activities-based approach to addressing systemic risk is a mistake</u>.

The Proposal would eliminate the "activities-based approach" that the Council adopted in 2019.[36] Under the activities-based approach, the Council first seeks to address potential risks to financial stability through generally applicable regulation and only considers designating an individual entity as a nonbank SIFI if such regulation cannot address the risk. The Committee opposes the elimination of the activities-based approach.

As the Committee explained in prior letters, the activities-based approach is preferable from a policy perspective for several reasons.[37]

First, a focus on systemically risky activities and products, assessed through reliance on risk-based metrics, is the preferable line of inquiry if the objective is to reduce systemic risk. An activities-based approach can more readily identify and address a widespread systemically risk activity or product involving a large number of market participants that an entity-by-entity designation approach could fail to identify and address. Such a broad-based approach has already been employed with respect to the regulation of, for example, derivatives trading (e.g., central clearing

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32 Framework at 26,307-08.

33 Guidance at 26,236.

34 *See, e.g.*, Letter to Timothy F. Geithner dated Nov. 5, 2010, *supra* note 25, at 2-3.

35 *See generally MetLife, Inc. v. Fin. Stability Oversight Council*, 177 F. Supp. 3d 219 (D.D.C. 2016).

36 Guidance at 26,235.

37 *See* Letter to Mark Schlegel dated Apr. 25, 2019, *supra* note 25; Letter to Neal S. Wolin dated Feb. 15, 2013, *supra* note 25 ("[W]e recommend that FSOC (i) carefully assess any identified risk, including the firms, activities, or industries that may present it, and the tools available to mitigate it, (ii) conclude that designation is the most appropriate tool to mitigate the risk presented by a company, and (iii) provide a rationale for that conclusion before it makes any designation determination."). *See also* Letter to the Secretariat, Fin. Stability Bd. dated Apr. 7, 2014, *supra* note 25, at 7-8.

and minimum margin requirements).[38] Indeed, the SEC has recently employed a similar approach to addressing risk posed by the U.S. Treasury markets by proposing the mandatory clearing and enhanced transparency of trading in U.S. Treasuries.[39]

Second, an activities-based approach is more effective than an entity-specific approach at accurately communicating to markets the sources and extent of systemic risks. The activities of individual entities, as well as the relative size and importance of individual entities, change over time, such that an entity-specific classification can become increasingly irrelevant over time. By identifying activities and products that can create systemic risks, an activities-based approach is less susceptible to these changes. As a result, market participants will be in a better position to evaluate the risks and benefits of such activities and products, thus doing more to reduce overall risk in the system than merely designating a few large nonbank financial companies as sources of systemic risk.

3. <u>A cost-benefit analysis is both legally required and crucial as a policy matter</u>.

The Proposal removes the requirement that the Council conduct a cost-benefit analysis before designating a nonbank financial company as a SIFI.[40] The Proposal argues that Dodd-Frank does not require a cost-benefit analysis and that even if it did, the Council "does not believe that prescribing a cost-benefit analysis prior to determination under Section 113 [of Dodd-Frank] is useful or appropriate."[41] The Committee disagrees with this position. First, a cost-benefit analysis is in fact legally required under Dodd-Frank, as the *MetLife* decision shows. Second, a cost-benefit analysis is crucial as a policy matter.

In the *MetLife* case, the court confirmed that Dodd-Frank requires a cost-benefit analysis before the Council makes a nonbank SIFI designation.[42] More specifically, the court found that the Council is required "to consider the cost of designating a company for enhanced supervision, provided that cost is a 'risk-related' factor,"[43] which includes the potentially "billions of dollars in costs" that a designation would involve.[44] Further, the court held that the Council must consider not only the cost of designation itself but also that "of the ensuing prudential standards."[45]

Furthermore, a cost-benefit analysis is crucial as a policy matter.[46] If the costs of SIFI designation to the company and its customers outweigh the benefits to market participants in the form of

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[38] *See, e.g.*, FINANCIAL STABILITY BOARD, "Derivatives markets and central counterparties" (June 7, 2022), https://www.fsb.org/work-of-the-fsb/market-and-institutional-resilience/derivatives-markets-and-central-counterparties-2/; 12 C.F.R. § 349.

[39] SECURITIES AND EXCHANGE COMMISSION, *Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With Respect to U.S. Treasury Securities*, 87 FR 64,610 (Oct. 25, 2022), https://www.federalregister.gov/documents/2022/10/25/2022-20288/standards-for-covered-clearing-agencies-for-us-treasury-securities-and-application-of-the.

[40] Guidance at 26,238.

[41] *Id.*

[42] *MetLife*, 177 F. Supp. 3d at 239-42.

[43] *Id.* at 241.

[44] *Id.*

[45] *Id.*

[46] *See, e.g.*, Scott Testimony, *supra* note 25, at 4 (urging the Council to correct the inadequacy of failing to conduct a cost-benefit analysis under the 2012 Interpretive Guidance).

increased financial stability, then SIFI designation serves no valid policy purpose. It is thus crucial that the Council perform a cost-benefit analysis prior to designating a nonbank financial institution as a SIFI. The Committee therefore calls on the Council to reinstate the requirement that the Council conduct a cost-benefit analysis before designating a nonbank company as a SIFI.

4. <u>An assessment of the likelihood of material financial distress is legally required and crucial as a policy matter.</u>

As part of its 2019 amendments to the initial 2012 rules, the Council stated that "the Council will assess the likelihood of a nonbank financial company's material financial distress when evaluating the firm for a potential determination, in order to assess the extent to which a determination may promote U.S. financial stability."[47] The Proposal removes this language as "the Council does not believe the assessment of the likelihood of a company's material financial distress is required or appropriate."[48] The Proposal claims that according to Dodd-Frank, "the Council presupposes a company's material financial distress, and then evaluates what consequences could follow for U.S. financial stability."[49] The Proposal then argues that this interpretation is appropriate because "to be most effective, [designations] must be in place well before material financial distress appears to be likely" and that an assessment of the likelihood of material financial distress and a subsequent designation "could create a run on the company by its creditors and counterparties."[50]

The Committee believes that the assessment of the likelihood of material distress is indeed legally required by Dodd-Frank and crucial as a policy matter.

First, in *MetLife*, the court found that in requiring the Council to consider leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny the 2012 rules required the Council to assess not only the consequences of a company's financial distress, but the actual "vulnerability of a nonbank financial company to financial distress."[51] In our view, while the Proposal would eliminate several of the factors that the court cited as necessitating consideration of the likelihood of distress, the underlying statutory language on which these criteria were based remain in place. Specifically, and as noted earlier, Dodd-Frank continues to direct the Council to consider "the extent of the leverage of the company,"[52] "the amount and types of the liabilities of the company, including the degree of reliance on short-term funding,"[53] and "the degree to which the company is already regulated by 1 or more primary financial regulatory agencies."[54] These are nearly word-for-word equivalents of the criteria that the *MetLife* court held required an assessment of the likelihood of financial distress. The Council cannot simply sidestep the holding of the *MetLife* court by eliminating criteria from its guidelines when the statutory language itself requires consideration of those criteria. Furthermore, the Proposal would continue to require the Council to

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[47] 88 FR 71,7140 at 71,742.
[48] Guidance at 26,238.
[49] *Id.* at 26,239.
[50] *Id.*
[51] 77 FR 21,637 at 21,641.
[52] 12 U.S.C. § 5323(a)(2)(A).
[53] 12 U.S.C. § 5323(a)(2)(J).
[54] 12 U.S.C. § 5323(a)(2)H).

assess two factors — namely "leverage" and "liquidity risk and maturity mismatch"[55]—that the *MetLife* court determined requires an assessment of the likelihood of material distress.

Second, the elimination of this criterion conflicts with the ultimate aim of SIFI designation, which is not simply to identify important institutions, but to reduce the likelihood of the failure of an institution that would threaten overall financial stability where existing regulation is insufficient to do so. If a company is not at risk of material financial distress, designating the company as a SIFI amounts to the imposition of substantial compliance costs for the purpose of eliminating a risk that does not exist. There is no marginal benefit to designating the company as a SIFI in such a scenario. As such, without consideration of the actual likelihood of the financial distress of a company, the nonbank SIFI designation framework is not rationally related to the purpose it is designed to serve. The Committee therefore calls on the Council to reinstate the criterion requiring the Council to assess the actual likelihood of a nonbank company experiencing material financial distress.

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Thank you very much for your consideration of the Committee's position. Should you have any questions or concerns, please do not hesitate to contact the Committee's President, Professor Hal S. Scott (hscott@law.harvard.edu), or its Executive Director, John Gulliver (jgulliver@capmktsreg.org), at your convenience.

Respectfully submitted,

		Robert Glenn Hubbard
John L. Thornton	Hal S. Scott	R. Glenn Hubbard
Co-CHAIR	PRESIDENT	Co-CHAIR

[55] Framework at 26,307.