December 19, 2011

Lance Auer
Financial Stability Oversight Council
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 64,264 (RIN 4030–AA00)

Dear Mr. Auer:

The Committee on Capital Markets Regulation (Committee) appreciates the opportunity to comment on the Financial Stability Oversight Council's (FSOC) proposed rule regarding its Authority to Require Supervision and Regulation of Certain Nonbank Companies[1] under § 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[2]

Since 2005, the Committee, composed of 32 members, has been dedicated to improving the regulation of U.S. capital markets. Our research has provided an independent and empirical foundation for public policy. In May 2009, the Committee released a comprehensive report entitled *The Global Financial Crisis: A Plan for Regulatory Reform*, which contains fifty-seven recommendations for making the U.S. financial regulatory structure more integrated, more effective, and more protective of investors in the wake of the financial crisis of 2008.[3] Since then, the Committee has continued to make recommendations for regulatory reform of major areas of the U.S. financial system.

The Dodd-Frank Act allows FSOC to designate nonbank financial companies for supervision by the Federal Reserve if FSOC determines that a company, if met with financial distress, "could pose a threat to the financial stability of the United States."[4] The Committee is pleased that FSOC has proposed to make institution size the initial test for this determination. The Committee has commented extensively on this issue in the past, and has recommended that, although we do not think any institutions should be designated as systemically important, if FSOC is to make such a designation, it should do this through application of an asset threshold. The Committee explained: "This approach would avoid the moral hazard and market uncertainties associated with using a subjective and unpredictable set of criteria. It is less

[1] Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 64,264 (proposed Jan. 26, 2011) [hereinafter Proposed Rules].
[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 113 (a)(1), 124 Stat. 1376 (2010) [hereinafter Dodd-Frank Act].
[3] COMM. ON CAPITAL MKTS. REG., THE GLOBAL FINANCIAL CRISIS: A PLAN FOR REGULATORY REFORM (May 2009), http://www.capmktsreg.org/research.html.
[4] Dodd-Frank Act §113(a)(1).

harmful to use the single, objective, predictable measurement of asset size because it will cause no stigma or signal to be attached to the firm."[5] Designation of a firm based on anything other than a bright-line test would potentially leave the determination open to legal challenge. In its letter to FSOC dated February 22, 2011, the Committee concluded: "[a]sset thresholds are the only sensible method."[6] Regarding the $50 billion in consolidated assets suggested in the Proposed Rules, we would encourage FSOC to further investigate whether total consolidated assets is the appropriate measure for the threshold. For example, FSOC should consider whether certain third-party assets consolidated onto the balance sheet of an investment advisor who manages them should be treated differently for purposes of the FSOC designation than they are under generally accepted accounting principles.

We envision that relatively few non-bank financial institutions will be identified under Stage 1 of FSOC's proposed determination process, meeting both the $50 billion threshold and also one of the leverage or derivative standards. For example, looking solely at firms that reach the $50 billion consolidated asset threshold, we have identified 15 insurance holding companies, 1 hedge fund manager, 6 private equity managers, 14 consumer finance companies, 23 retirement funds, no real estate investment trusts, and no credit unions. We have also identified fewer than 20 mutual funds, including money market mutual funds, with assets over $50 billion.[7] This list will be even shorter after application of the other thresholds.

Even for entities that meet the Stage 1 standard, we believe FSOC should consider whether certain industries should be excluded altogether from further analysis. The Committee previously commented that nonbank financial institutions should be treated on an industry-by-industry basis.[8] That is, no firm should be designated as systemically important unless the firm's industry is also considered systemically important. It is clear that private equity firms should be excluded for this reason.

[5] Letter from the Comm. On Capital Mkts. Reg. to Timothy Geithner 3 (Nov. 5, 2010), http://www.capmktsreg.org/comments.html [hereinafter Nov. 5 letter].

[6] Letter from the Comm. On Capital Mkts. Reg. to Lance Auer 3 (Feb. 22, 2011), http://www.capmktsreg.org/comments.html [hereinafter Feb. 22 letter].

[7] Note that for the hedge fund manager and private equity manager data, these figures reflect total assets under management of the manager (as we were not able to identify individual funds that reached the threshold) and thus may be overinclusive to the extent they represent multiple funds with different investment strategies. Under the Proposed Rules, FSOC says it may aggregate funds if their investments are "identical or highly similar." *See* Proposed Rules at 64,281 n.12. We note any such aggregation may be problematic to the extent it indicates that FSOC would disregard the separate operational, regulatory and governance structures of these legal entities, which could further cloud analyses and regulatory outcomes. Similarly, with respect to retirement fund data, these figures reflect combined assets of all plans associated with the relevant company, which may be overinclusive to the extent they reflect multiple plans with different investment strategies. For data supporting these totals, *see* Standard & Poor's NetAdvantage, http://www.netadvantage.standardandpoors.com/ (insurance holding companies); Absolute Return + Alpha, *Billion Dollar Club* (Oct. 3, 2011) (hedge fund managers); Hoover's Company Profiles, http://www.hoovers.com/products/100000859-1.html (private equity managers); Yahoo! Finance, http://finance.yahoo.com/ (mutual funds and money market funds); S&P Industry Survey: Real Estate Investment Trusts, http://www.netadvantage.standardandpoors.com (real estate investment trusts); Mergent Online, http://www.mergentonline.com/ (consumer finance companies); American Banker, Credit Unions with the Most Assets, 10/26/11, vol. 165, p. 12 (Oct. 26, 2011) (credit unions); and Towers Watson, P&I / TW Top 300 Pension Funds, http://www.towerswatson.com/assets/pdf/5351/TW-PI-300.pdf (retirement fund sponsors).

[8] Nov. 5 letter at 3.

In addition, there is no evidence to suggest that mutual funds in general (other than possibly money market mutual funds) created any systemic risk during the financial crisis or would do so in the future.[9] With respect to money market mutual funds, we do not believe that designating them as systemically important and subjecting them to heightened supervision by the Federal Reserve will mitigate the systemic risks they may pose. Rather, to prevent future runs on money market funds, the focus should be on other regulatory measures already being considered. Federal Reserve Governor Daniel Tarullo stated:

> [T]o a considerable extent, potential contagion effects are best contained by directly addressing them, rather than by trying to indirectly address them through designating large numbers of nonbank-affiliated institutions under section 113 of the Dodd-Frank Act. This direct approach would, I believe, yield maximum financial stability benefits at the lowest cost to financial intermediation, financial firms, and financial supervisors.[10]

Similarly, retirement funds may fall within the definition of "major swap participant," which would bring oversight and regulation by the SEC and Commodity Futures Trading Commission.

In addition, we believe FSOC should exclude traditional insurance companies. We note that the traditional insurance industry fared well relative to banks during the financial crisis, and that numerous features of traditional insurers support the idea they do not pose systemic risk (for example, high level of substitutability, self-funding through insurance premiums, and lack of leverage or reliance on short-term funding).[11]

We also believe that entities that are already subject to supervision by the Federal Reserve should be excluded from FSOC's determination process. Instead, the Federal Reserve should make any determinations about the systemic importance of entities it governs, and the FSOC should make the same determination for all other entities that are not already subject to Federal Reserve oversight. We note that under the Dodd-Frank Act, the standards to be imposed on institutions identified as systemically important under FSOC's determination process will apply automatically to bank holding companies with more than $50 billion in assets (large BHCs), which are currently supervised by the Federal Reserve.[12] We do not believe these rules should apply automatically to large BHCs, because not every large BHC is systemically important. Again, we believe the Federal Reserve should make any determinations about the systemic importance of any institution it already supervises on a case-by-case basis. We urge Congress to change this requirement by amending the Dodd-Frank Act.

[9] Written Testimony of René M. Stulz before the Subcomm. on Capital Mkts. and Gov't Sponsored Entities, U.S. House of Representatives 3 (June 24, 2011).
[10] Daniel K. Tarullo, Governor, Fed. Reserve Bd., Remarks at the 2001 Credit Markets Symposium: Regulating Systemic Risk 3 (Mar. 31, 2011).
[11] THE GENEVA ASSOCIATION, SYSTEMIC RISK IN INSURANCE – AN ANALYSIS OF INSURANCE AND FINANCIAL STABILITY, SPECIAL REPORT OF THE GENEVA ASSOCIATION SYSTEMIC RISK WORKING GROUP 4 (Mar. 2010), http://www.genevaassociation.org/PDF/BookandMonographs/Geneva_Association_Systemic_Risk_in_Insurance_Report_March2010.pdf.
[12] Dodd-Frank Act § 165(a)(1).

Finally, we wish to reiterate a point the Committee has raised in its prior letters regarding the sequence in which FSOC's rules on determination and the Federal Reserve's rules on supervision are both finalized. The Committee asserted: "It is difficult to create a plan to designate certain firms for a solution when the solution itself is undertermined."[13] We once again recommend that a final designation should not occur until the Federal Reserve has developed a proposed supervisory plan and FSOC has compared it to other available regulatory responses and analyzed the effectiveness and efficiency of each.[14] This analysis should be included in the "written notice of the Proposed Determination" that will be provided to any company FSOC proposes to designate.[15]

With respect to cost-benefit analysis,FSOC states that the Proposed Rules have been reviewed by the Office of Management and Budget (OMB).[16] However, the Office of Information and Regulatory Affairs (OIRA) within OMB has determined that the Proposed Rules are not "economically significant"[17] and thus OIRA has not performed any substantive review. This determination by OIRA seems on its face somewhat implausible, given the consequence of SIFI designation to the regulation of important financial institutions, so we would encourage OMB to explain how such a conclusion was reached. Furthermore, we would encourage FSOC to perform a cost-benefit analysis, whatever review of this analysis may or not be done by OIRA.

Thank you for considering our comments. Please do not hesitate to contact us at (617) 384-5364 if we can be of any further assistance.

Respectfully submitted,

Robert Glenn Hubbard

R. Glenn Hubbard
CO-CHAIR

John L. Thornton
CO-CHAIR

Hal S. Scott
DIRECTOR

[13] Feb. 22 letter at 3.
[14] FSOC acknowledged in the Proposed Rules that it "has numerous authorities and tools to carry out its statutory duty to monitor the financial stability of the United States." *See* Proposed Rules at 64,267.
[15] Proposed rules, p. 67.
[16] Proposed Rules, 76 Fed. Reg. at 64,272.
[17] *See* Office of Information and Reg. Affairs, *Exec. Order Reviews Completed Between Jan 1, 2011 to Nov. 30, 2011*, http://www.reginfo.gov/public/do/eoHistoricReport.