

May 13, 2019

Financial Stability Oversight Council
Attn: Mark Schlegel
1500 Pennsylvania Avenue, NW
Room 2208B
Washington, D.C. 20220

Re: Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (RIN 4030-AA00)

Dear Members of the Council:

The Investment Company Institute¹ appreciates this opportunity to comment on the Financial Stability Oversight Council's (FSOC or Council) proposal to replace its existing interpretive guidance on nonbank financial company determinations.² We strongly support the Proposal, which thoughtfully outlines the Council's intended use going forward of its various authorities to identify and address potential risks to US financial stability, and we urge its prompt adoption.

Financial stability is a matter of utmost concern to ICI and its members. As major participants in US and global financial markets on behalf of over 100 million American investors, registered funds and their managers have every reason to support policy approaches that promote the robustness, diversity and resiliency of financial markets and market participants.

¹ The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US\$22.6 trillion in the United States, serving more than 100 million US shareholders, and US\$6.6 trillion in assets in other jurisdictions. ICI carries out its international work through [ICI Global](#), with offices in London, Hong Kong, and Washington, DC.

² FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 84 Fed. Reg. 9028 (March 13, 2019) (Proposal), available at <https://home.treasury.gov/system/files/261/Notice-of-Proposed-Interpretive-Guidance.pdf>. The Proposal consists of a preamble explaining the changes that FSOC intends to make (Preamble) and the proposed text (Proposed Guidance) that would replace the Council's existing interpretive guidance on nonbank financial company determinations.

Ten years after the financial crisis, the US financial system clearly is more robust and resilient. But it also is—and will continue to be—complex, diverse and rapidly changing. This dynamism requires that financial regulators stay abreast of developments including new products, new market entrants and technological advances; understand the implications, both positive and negative, of these developments; and evaluate whether, and to what degree, these developments fit within existing—or may require new or adjusted—regulatory guardrails to ensure that the US financial system remains robust and resilient. This is a very tall order.

Congress designed FSOC with these challenges in mind. It chose not to establish a new agency as a systemic risk regulator, nor to elevate an existing financial regulator above all others. Rather, Congress chose to establish FSOC as a council of existing financial regulators, able to bring together different perspectives and expertise from across the spectrum of financial services to consider emerging risks and potential responses to such risks. Indeed, ICI consistently has opined that the convening and coordinating power of FSOC is its greatest strength.³

In the Proposal, which draws extensively on recommendations by the Treasury Department,⁴ the Council rightly seeks to make the most of its coordinating power. The Proposal envisions a collaborative, organic process that will take advantage of the collective resources of the financial regulatory community. It recognizes that a range of regulatory responses may be used depending on the circumstances. As ICI has long urged, the Proposal prioritizes approaches that seek to address risks on the broadest possible basis, with individual regulators making full use of their existing authorities. And the Proposal acknowledges that the Council should be mindful of market dynamics and regulatory costs and burdens as it determines the appropriate regulatory response in each instance.

The Proposal's approach to FSOC's authority to designate nonbank financial companies as systemically important financial institutions (SIFIs) is equally sound. It appropriately reserves SIFI designation—a blunt regulatory tool—for use when a specific company clearly poses significant risks to the financial system that cannot otherwise be adequately addressed through other means. If the Council does vote to consider a company for potential designation, it would follow a process that is more transparent, accountable and

³ See, e.g., Testimony of Paul Schott Stevens, President & CEO, ICI, Before the Committee on Banking, Housing and Urban Affairs, United States Senate, on Financial Stability Oversight Council Nonbank Designations (March 14, 2019) (Stevens 2019 Testimony), available at https://www.ici.org/pdf/19_senfoc.pdf. See also Timothy G. Massad, *It's Time to Strengthen the Regulation of Crypto-Assets*, Economic Studies at Brookings (March 2019) at 55, available at <https://www.brookings.edu/wp-content/uploads/2019/03/Economis-Studies-Timothy-Massad-Cryptocurrency-Paper.pdf> (noting that the Council's "utility is that it brings all financial regulators together and thus provides a forum for looking at issues that cut across regulatory jurisdictions.").

⁴ Department of the Treasury, Financial Stability Oversight Council Designations (Nov. 2017) (Treasury Report), available at <https://www.treasury.gov/press-center/press-releases/documents/pm-fsoc-designations-memo-11-17.pdf>.

rigorous. Further, the Council’s work will benefit from more constructive engagement with the company under consideration and that company’s primary regulator. These improvements should help avoid the risk of inappropriate or unnecessary designations.

We commend the Council for a well-reasoned and thoughtful proposal—one that reflects the “lessons learned” through the Council’s work to date, responds to the criticisms and concerns voiced by ICI and other stakeholders, incorporates principles of “good government” (*e.g.*, increased transparency and accountability), and outlines a workable framework designed to effectuate the Council’s congressionally mandated duties. We likewise commend the Council for its commitment to make any future changes to its interpretive guidance through a public notice and comment process.⁵ This step provides helpful assurances to stakeholders and the public that FSOC will continue to be transparent about how it expects to employ its broad authorities.

Our views on the Proposal are set forth in detail below. In Section I, we discuss our strong support for the proposed activities-based approach and offer some suggestions for improvements. In Section II, we express similar support for the proposed enhancements to the nonbank SIFI designation process. We comment on (1) the analytic framework that will guide FSOC’s evaluation of a nonbank financial company for possible SIFI designation, and (2) other improvements to the process by which FSOC will conduct any such evaluation and, as necessary, any annual reevaluation of a designated company. Our comments include additional recommendations for improvements.

I. Activities-Based Approach

In this section, we begin with a brief overview of the proposed activities-based approach, which the Council explains will enable it “to more effectively identify and address...underlying sources of risks to financial stability, rather than addressing risks only at a particular nonbank financial company that may be designated.”⁶ We discuss why we fully concur with the Council’s assessment. We then offer some suggestions for improvement or clarification in the following areas: how FSOC evaluates whether a particular product, activity or practice poses potential risk to US financial stability; involvement by industry stakeholders in the Council’s review process; and transparency regarding the Council’s concerns, assessments and conclusions.

A. Overview

The Proposal outlines a two-step process intended to guide FSOC’s efforts to identify, assess, and address potential risks and threats to US financial stability. In step one, the

⁵ See FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 84 Fed. Reg. 8958 (March 13, 2019). This new rule requires that the notice and comment process be consistent with the Administrative Procedure Act.

⁶ Proposal at 9029.

Council (in consultation with primary financial regulatory agencies) expects to monitor financial markets and market developments to identify products, activities or practices that could pose risks to financial stability. If the Council’s monitoring identifies a product, activity or practice that could pose a potential risk to US financial stability, the Council (in conjunction with relevant financial regulatory agencies) would evaluate the potential risk to determine whether it merits further review or action. Step one thus would formalize, and expand upon, the work that is already happening within the Council’s Systemic Risk Committee.⁷

Step two of the process focuses on actions to address any potential risk to US financial stability identified in step one. The Council will work with relevant financial regulatory agencies at the federal and state levels to seek implementation of measures to address the identified potential risk. The Proposal acknowledges that “there may be different approaches existing regulators could take, based on their authorities and the urgency of the risk” and that these approaches may involve “modifying their regulation or supervision of companies or markets under their jurisdiction.”⁸

B. General Observations

We strongly support the two-step process articulated by the Council. It promises to provide more certainty to financial markets, market participants and the broader public about how FSOC will approach its work, while retaining necessary flexibility. In step one, the areas to be monitored are broadly envisioned in the Proposal—appropriately, in our view, given the breadth of FSOC’s mandate and the inherent uncertainty of how future risks to financial

⁷ See, e.g., Charter of the Systemic Risk Committee of the Financial Stability Oversight Council at 12-13, available at <https://www.treasury.gov/initiatives/fsoc/governance-documents/Documents/The%20Council%27s%20Committee%20Charters.pdf> (noting that the duties of the Systemic Risk Committee include “monitoring and analyzing financial markets, the financial system and issues relating to financial stability to support the Council’s work to identify and respond to risks and emerging threats to the stability of the United States financial system” and “facilitating information sharing and coordination among staff of Council members and member agencies to help identify and respond to risks to the stability of the United States financial system”); FSOC Annual Report (Dec. 2018) at 103, available at <https://home.treasury.gov/system/files/261/FSOC2018AnnualReport.pdf> (explaining that the Council “regularly examines significant market developments and structural issues within the financial system” and that “[t]his risk monitoring function is facilitated by the Council’s Systemic Risk Committee, whose participants are primarily member agency staff in supervisory, monitoring, examination and policy roles”).

⁸ Proposal at 9040.

stability may materialize.⁹ Step two rightly enhances the role of individual financial regulators that have the “front line” expertise.¹⁰

One can look to current work of the Council for an example as to how the proposed activities-based approach might work in practice. In late 2017, FSOC established a working group on digital assets and distributed ledger technology. Readouts from Council meetings in June and December 2018 indicate that the working group briefed FSOC principals on their work. In addition, the Council’s 2018 annual report, also issued in December, provides some insight into the Council’s concerns and current assessment in these areas. The annual report explains that the working group was formed to foster collaboration among relevant agencies, has sought to identify and address potential risks, and has conducted outreach to state regulators and law enforcement.¹¹ The report further explains the Council’s preliminary conclusion that digital assets do not appear to raise financial stability risks at present, and that the Council will continue to monitor for potential risks as these markets evolve.¹²

The example above illustrates another helpful aspect of the Proposal. The Council observes that the monitoring, risk identification, information sharing and analysis that will occur through the activities-based approach “may yield a range of diverse outcomes” depending upon the circumstances, from “relatively informal actions” (such as information sharing among regulators) to “more formal measures” (such as Council recommendations issued publicly).¹³ This statement makes clear that the Council intends to utilize the full range of its authorities under Title I of the Dodd-Frank Wall Street Reform and Consumer

⁹ The Proposal indicates that the Council’s monitoring may include, for example: corporate and sovereign debt and loan markets; equity markets; markets for other financial products, including structured products and derivatives; short-term funding markets; payment, clearance and settlement functions; new or evolving financial products, activities, and practices; and developments affecting the resiliency of financial market participants. *Id.*

¹⁰ *See, e.g.*, Statement from NAIC President and FSOC Member Eric Cioppa, Superintendent, Maine Bureau of Insurance (March 6, 2019) (observing that the best approach to addressing financial stability risks is for FSOC to work with existing regulators; “mitigation is best handled by the regulators with authorities to address them in the first instance”). The statement is available at https://www.naic.org/newsroom_statement_190306_fsoc_proposed_change.htm.

¹¹ FSOC Annual Report at 103-04.

¹² *Id.* at 89.

¹³ Given the importance of these observations, we strongly recommend that the Council incorporate them into the Proposed Guidance. At present, they are stated only in the Preamble.

Protection Act (Dodd-Frank Act) and its inherent authority as a collaborative body as appropriate to mitigate potential risks to US financial stability.¹⁴

The fact that the Council does not have direct regulatory authority will not undermine the effectiveness of the proposed activities-based approach. The US financial system is far too diverse for “one size fits all” regulation. Moreover, as noted earlier in this letter, Congress did not design FSOC to be a systemic risk regulator.¹⁵ It chose instead to structure FSOC in a manner intended to foster coordinated action by the range of financial regulators.

There may be cases in which an activities-based approach is less straightforward—for example, in areas where there are overlaps in regulatory jurisdiction or there are gaps in the federal regulatory system. The fact that an activities-based approach may not produce an optimal solution in each instance does not mean that the proposed approach is flawed. In fact, the greater degree of collaboration envisioned under the Council’s two-step approach is worthwhile in and of itself.¹⁶ It also may help to foster more consistency among regulatory outcomes in cases of jurisdictional overlap. Should an activities review by the Council reveal potential threats to US financial stability for which no regulatory solution is apparent, FSOC can highlight this gap for Congress, as intended by the Dodd-Frank Act.¹⁷

¹⁴ See, e.g., Remarks by Mary Miller at *Functions and Firms: Using Activity and Entity-based Regulation to Strengthen the Financial System*, conference co-sponsored by the Office of Financial Research and the University of Michigan Center on Finance, Law and Policy (Nov. 15-16, 2018, Washington DC) (Functions and Firms Conference) (“I don’t think FSOC [involvement] always has to lead to regulation. I think if it’s really strong oversight and . . . the power to convene and to bring people in and put them on the spot and to shine a spotlight on emerging risks in the system, I think that’s an excellent use of their time as well.”), available at <http://financelawpolicy.umich.edu/conferences/functions-and-firms-using-activity-and-entity-based>, at video for day 2, panel 6 at approximately 48:05 to 48:27.

¹⁵ The initial discussion draft of the Restoring American Financial Stability Act, proposed by then-Senate Banking Chairman Christopher Dodd (D-CT) in November 2009, called for the creation of an independent systemic risk regulator. By the time that legislation was reported out of committee in April 2010, however, the independent agency concept had been replaced with language to create a council of financial regulators. Both versions of that Act are available at <https://www.llsdc.org/dodd-frank-legislative-history>.

¹⁶ See, e.g., Claire Williams, *As Nonbank Lending Rises, Clayton Says SEC Keeping Eye on CLOs*, Morning Consult (May 2, 2019), available at <https://morningconsult.com/2019/05/02/as-nonbank-lending-rises-clayton-says-sec-keeping-eye-on-clos/> (detailing an interview of SEC Chair Jay Clayton by ICI President Paul Stevens at ICI’s recent General Membership Meeting, at which Clayton observed of the Council, “Even if we conclude that the growth in CLOs is not something that poses a systemic risk, having those discussions among market regulators and banking regulators is a really big thing.”).

¹⁷ See Secs. 112(a)(2)(G) of the Dodd-Frank Act (Council shall “identify gaps in regulation that could pose risks to the financial stability of the United States”) and 112(a)(2)(N) (Council shall annually report to and testify to Congress on a variety of topics, including the activities of the Council, potential emerging threats to financial stability, and recommendations to enhance the stability of US financial markets).

C. Evaluation of Particular Products, Activities or Practices

As noted above, the areas for monitoring and evaluation are broadly envisioned. It thus will be important for the Council to be deliberate in making choices about how to focus its attention and resources in these reviews.

The Council proposes four framing questions for evaluating a product, activity or practice to determine if it could pose potential risks to US financial stability. Briefly summarized, the questions concern how a potential risk could be triggered, how its adverse effects might be transmitted to financial markets/market participants, its possible impact on the financial system, and the potential for harm to the non-financial sector of the US economy.¹⁸ We believe that these questions generally are the right ones to ask, but strongly recommend that the Council consider adding a fifth—what is the likelihood, or plausibility, of the potential risk being triggered? This question, in our view, is highly relevant to the Council’s determination as to whether the potential risk “merits further review or action.”¹⁹

Just as the Proposal envisions an analytically rigorous evaluation of any individual company for potential SIFI designation, so too should an activities-based review include such analytical rigor. This is particularly important as the Council looks at triggers of potential risk and the transmission of adverse effects to financial markets or market participants. It likewise is highly relevant to the Council’s consideration of factors that may amplify—or may mitigate—the potential risk from a product, activity or practice that is being evaluated by the Council.²⁰

D. Greater Involvement by Industry Stakeholders in Activities Reviews

In its monitoring of markets and market developments, the Council intends to rely on data, research and analysis from a range of sources, including industry participants. If the Council’s monitoring identifies a product, activity or practice that could pose a risk to US financial stability, the Council’s evaluation of that potential risk “may” include engagement with industry participants and other members of the public.

¹⁸ Proposal at 9040.

¹⁹ *Id.*

²⁰ We find the current discussion of “characteristics [that] could amplify potential risks to US financial system stability arising from products, activities, or practices” and “various factors [that] may exacerbate or mitigate each of these types of risks” to be confusing. *See id.* For example, the list of “characteristics” is in fact largely a list of risks (*e.g.*, asset valuation risk, credit risk, counterparty risk), so it is difficult to determine whether the reference to “factors that may exacerbate or mitigate risks” is intended to relate to the product, activity or practice risk that is under evaluation by the Council or to the “characteristics” that are risks. We accordingly recommend that the Council consider streamlining this discussion so that it refers more generally to “factors that may amplify or mitigate” the potential risk from a product, activity or practice that is being evaluated by the Council. This would avoid any unneeded delineation between “characteristics” and “factors,” and keep the focus on the potential risk (from a product, activity or practice) that is being evaluated by the Council.

ICI strongly urges the Council to involve industry stakeholders to a greater degree in its reviews of products, activities and practices. Such involvement can help deepen FSOC's understanding of particular issues and broaden its perspective. Input from industry stakeholders may be helpful, for example, as the Council considers factors that may amplify or mitigate a particular risk arising from a product, activity or practice—a line of inquiry that is important yet also may be amorphous and more susceptible to eliciting theoretical (rather than actual) concerns. A “real world” perspective likewise could prove valuable to any evaluation involving new products or technologies.²¹

At last fall's Office of Financial Research conference on regulatory approaches to strengthen the financial system, former Treasury official Mary Miller voiced support for greater industry involvement in the Council's work. During a discussion of leveraged lending, for example, she commented that the Council

perhaps [should be] inviting in members of industry to talk about the risks in the system because I think there should be a more regular exchange from markets to regulators about this; it shouldn't just be regulators observing. I think there should be some responsibility on the part of the market to come in and explain what they're up to and what they're doing, so that would put a little bit more real time into the exchange.²²

There are several possible ways for the Council to engage with industry stakeholders (and other interested parties) as part of an activities review. For example:

- The Council could begin exploring a broad topic or area with a public conference and then use the information learned to narrow the Council's focus. As appropriate, the Council could follow up with a request for public comment. FSOC utilized this sort of two-step inquiry as part of its consideration of potential risks in asset management.²³
- Similar steps could be employed in reverse order: the Council could issue a request for public comment on a broad topic and then use the feedback it receives to identify areas for a “deeper dive.” The Council could do this through one or more

²¹ The Council's 2018 annual report, for example, observes that an increasing number of financial institutions are exploring potential applications of distributed ledger technology. FSOC Annual Report at 88. Engagement with those institutions presumably would advance the thinking of the Council's digital assets working group, mentioned above.

²² See Remarks by Mary Miller at *Functions and Firms*, *supra* note 14, at approximately 47:40 to 48:07.

²³ In May 2014, the Council hosted a half-day conference consisting of three panels. In December 2014, it issued a request for public comment in several areas that had been discussed at the conference. FSOC issued a public statement on its findings to date in April 2016 and has commented on asset management issues in each of its subsequent annual reports.

roundtables or meetings with various stakeholders. Requesting comment first can help FSOC sharpen its focus and invite the right participants.

- For some issues, the Council may wish to conduct more extensive outreach to solicit a broader range of public input. It could do so by holding a series of public hearings or roundtables in different parts of the country—an approach that regulators such as the Securities and Exchange Commission and Treasury’s Financial Crimes Enforcement Network have used.²⁴

Regardless of the approach it chooses for any given review, the Council would retain flexibility to determine how to structure its engagement with industry stakeholders, including the extent and timing of such engagement, depending upon the specifics of the particular inquiry. This should help to ensure that the engagement is useful to the Council’s purposes and does not delay its work.

E. Greater Transparency as to FSOC Concerns, Assessments and Conclusions

Pursuing an activities-based approach by building on the work FSOC’s Systemic Risk Committee already conducts is both logical and sensible. But the Committee’s work has one shortcoming that should not be carried over to the new approach—a noteworthy lack of transparency. To date, the Committee’s work has taken place largely behind the scenes, with little public visibility as to which staff members are involved in any given project, which Council members or member agencies they represent, and what they are considering. The Committee roster is not public. According to its charter, the Committee meets at least quarterly, but the Committee does not announce its meetings or release its agendas. Nor does it issue a readout or other summary of its discussions.

Indications are that FSOC anticipates proceeding in a similar manner. For example, the Preamble states that much of the Council’s initial identification and assessment of risks “will be informal and nonpublic in nature.”²⁵ As to broader engagement on potential risks that merit further attention, the Proposed Guidance is ambivalent, stating only that such matters “*may* be raised at meetings...with other stakeholders.”²⁶

ICI recognizes that there is a time and place for regulators to meet behind closed doors to encourage and allow for candid discussion of potentially sensitive topics. In addition, there can be valid reasons to avoid releasing information too early in the course of an analysis.

²⁴ See, e.g., *SEC Chairman Clayton Invites Main Street Investors to ‘Tell Us’ About Their Investor Experience* (press release, June 29, 2018), available at <https://www.sec.gov/news/press-release/2018-125>; *Summary of Public Hearing: Advance Notice of Proposed Rulemaking on Customer Due Diligence* (July 31, 2012), available at <http://www.regulations.gov/#!documentDetail;D=FINCEN-2012-0001-0094>.

²⁵ Proposal at 9031.

²⁶ *Id.*

But in our view, providing as much public transparency as possible into this work is essential to serve the Council's stated goal of promoting market discipline as a mechanism for addressing potential risks to US financial stability.²⁷

Consistent with statutory requirements²⁸ and FSOC's transparency policy,²⁹ we recommend that the Council commit to report publicly on its activity reviews and incorporate a requirement to do so into the interpretive guidance. Such reporting should be a regular part of each annual report issued by the Council. We suggest that FSOC report on, for example: the status of its reviews of financial products, activities, or practices; any empirical work that has been or will be conducted; how FSOC is interpreting relevant data; and any conclusions that a particular product, activity, or practice does not presently pose financial stability risks. If circumstances warrant, the Council also could issue one or more interim updates.³⁰ This might be appropriate, for example, to allay market concerns about a particular review or if the review involves issues that are time sensitive.

II. Enhanced Nonbank SIFI Designation Process

In this section, we discuss proposed changes to the Council's process for considering the designation of a nonbank financial company as a SIFI. We begin with several general observations before addressing, in turn: (1) threshold considerations governing the decision to commence a review of an individual nonbank financial company; (2) the analytic framework that FSOC will apply to evaluations of individual companies; and

²⁷ A recent empirical study of Federal Reserve Board communications regarding monetary policy illustrates this principle. See Kevin L. Kliesen, Brian Levine, and Christopher J. Waller, "Gauging Market Responses to Monetary Policy Communication," Federal Reserve Bank of St. Louis *Review*, Second Quarter 2019, pp. 69-91, available at <https://research.stlouisfed.org/publications/review/2019/02/14/gauging-market-responses-to-monetary-policy-communication/>. The article notes that the primary methods used by the Federal Reserve to communicate its policies, procedures, and policy expectations to the public include the policy statement released at the end of each regularly scheduled meeting of the Federal Open Markets Committee (FOMC), the minutes released three weeks after each of the eight regularly scheduled FOMC meetings, the Chair's quarterly press conference, as well as speeches, testimonies, and media interviews by Board governors and Reserve Bank presidents. Based on their findings, the authors conclude that "[c]lear and concise communication of monetary policy helps the [Federal Reserve Board] achieve its congressionally mandated goals of price stability, maximum employment, and stable long-term interest rates. It does so by helping to reduce uncertainty about the future direction of policy. This helps to reduce distortions in market pricing, thereby improving the efficient allocation of resources by firms, households, and governments."

²⁸ See *supra* note 17.

²⁹ Transparency Policy for the Financial Stability Oversight Council, available at <https://www.treasury.gov/initiatives/fsoc/Documents/The%20Council%27s%20Transparency%20Policy.pdf>.

³⁰ See, e.g., Remarks by Mary Miller, *supra* note 14, at 40:28 to 40:54 ("we need to be more in the moment of looking at systemic risk and I think reports that come out annually that are identifying risks are very useful but they are necessarily somewhat backward looking and I think I'd like to see us push toward a more dynamic reporting out").

(3) procedural reforms to the nonbank SIFI designation process (and the process for reevaluating on an annual basis any such designation).

A. General Observations

ICI strongly supports the reforms FSOC proposes to make to its nonbank SIFI designation process. We recognize that since first adopting interpretive guidance outlining a three-stage designation process in 2012, FSOC already has made some enhancements.³¹ These changes responded to calls for reform from industry stakeholders, the Government Accountability Office, and members of Congress, among others, but also reflected the Council's own recognition of shortcomings in its process.

Despite the progress that has been made, there is still ample room for further improvement, as detailed in the Treasury Report and recent ICI Congressional testimony.³² The changes reflected in the Proposed Guidance represent a giant step forward. Most significantly, they provide for:

- More analytical rigor and attention to actual experience;
- Evaluation of benefits and costs and assessment of the likelihood of a company's material financial distress;
- Earlier and more extensive engagement with a company being considered for possible designation;
- Enhanced engagement with the company's primary financial regulatory agency;
- A clear "off-ramp" for designated companies; and
- Greater transparency and accountability.

Grounded in the Council's experience with the designation process and engagement with stakeholders, these reforms respond to long-standing criticisms—including by incorporating enhancements from FSOC's 2015 Supplemental Procedures. As a result of the changes, in those cases when FSOC concludes that evaluation of a nonbank financial

³¹ See, e.g., FSOC, Supplemental Procedures Relating to Nonbank Financial Company Determinations (Feb. 4, 2015) (2015 Supplemental Procedures), available at <https://www.treasury.gov/initiatives/fsoc/designations/Documents/Supplemental%20Procedures%20Related%20to%20Nonbank%20Financial%20Company%20Determinations%20-%20February%202015.pdf>. The 2015 Supplemental Procedures were designed to improve the Council's engagement with companies and other regulators and increase transparency to the public.

³² See Treasury Report at 28-34; Stevens 2019 Testimony.

company for possible SIFI designation is warranted, such an evaluation is more likely to be focused and efficient.

Moreover, the revised process seeks to encourage mitigation of identified risks in a variety of ways—including through action by the company itself or by the primary regulator. Consistent with the idea that FSOC’s primary goal should be to reduce systemic risk, it makes sense to keep all potential solutions on the table.

The process improvements in the Proposed Guidance offer at least two additional benefits. First, to the extent they reflect some practices in which FSOC already engages, it is appropriate to formalize those informal good practices. Doing so provides assurance that these protections will endure—unless and until they undergo changes through a public notice and comment process.³³ Second, and related to the first benefit, all guidance relating to SIFI designations will be in one place.³⁴ In addition to reducing complexity and inconvenience, consolidating the guidance in this manner will promote the transparency of FSOC’s SIFI designation process to nonbank financial companies and the public.

Under the Proposed Guidance, FSOC would retain control over the timing of the designation process. And the proposed enhancements to the designation process would not affect FSOC’s emergency powers under Section 113(f) of the Dodd-Frank Act.

B. Threshold Considerations for Commencing SIFI Review

Consistent with the Treasury recommendations, and as ICI has long urged, the Proposed Guidance makes clear that SIFI designation will be reserved for use in rare circumstances. More specifically, the Proposed Guidance states that the Council may evaluate one or more nonbank financial companies for potential SIFI designation if (1) the Council’s collaboration and engagement with the relevant financial regulatory agencies does not adequately address a potential threat identified by the Council or (2) a potential threat to US financial stability is outside the jurisdiction or authority of financial regulatory agencies.³⁵ The Proposed Guidance further specifies that the identified potential threat must be “one that could be addressed by [SIFI designation].”³⁶

It is appropriate for the Proposed Guidance to set forth these threshold considerations for deciding to evaluate an individual company for potential SIFI designation. In so doing, it

³³ See *supra* note 5.

³⁴ Currently, getting a complete picture of the SIFI designation process requires referencing multiple sources, including the 2012 interpretive guidance, the 2015 Supplemental Procedures, Frequently Asked Questions issued by FSOC, and FSOC staff guidance on methodologies relating to the Stage 1 thresholds.

³⁵ Proposal at 9041. The Proposed Guidance similarly indicates that FSOC would be most likely to consider designation “only in rare instances such as an emergency situation or if a potential threat to US financial stability is outside the jurisdiction or authority of financial regulatory agencies.” *Id.* at 9045, n. 21.

³⁶ *Id.* at 9041.

establishes parameters for the Council’s choice of regulatory approaches and provides welcome transparency to nonbank financial companies and the public about those parameters.

Importantly, by requiring that the identified potential threat must be one that could be addressed by SIFI designation, the Proposed Guidance makes clear that FSOC affirmatively must consider whether designation is the right tool for the job at hand. There is good reason for the Council to do so. For example, as we have indicated previously, the “remedies” that flow from SIFI designation—enhanced prudential standards and Federal Reserve Board supervision—at their core are designed to address bank-like risks.³⁷ While there is some flexibility for tailoring the enhanced prudential standards to be applied to a nonbank SIFI, the potential remains high for some degree of mismatch between the identified risk and the application of bank-oriented policy measures to address it.³⁸ We agree that SIFI designation should not be a “default” regulatory approach without regard to whether it would be appropriate in the specific circumstances.

C. Proposed SIFI Analytic Framework

During the course of our engagement in financial stability policy discussions, ICI has urged that a regulatory determination as consequential as SIFI designation should be based on rigorous, empirically based analysis that is thorough and objective and considers historical experience, among other factors.³⁹ We also have cautioned that designation decisions should not be based on pre-judgment, conjecture, or implausible scenarios.⁴⁰

Unfortunately, in the past, FSOC’s designation analyses have fallen short of these standards—as demonstrated, for example, by the Council’s stated basis for designating Prudential Financial, Inc. as a SIFI. The independent member with insurance expertise on the Council at the time, Roy Woodall, dissented from the Council’s decision, observing that FSOC’s “underlying analysis utilizes scenarios that are antithetical to a fundamental

³⁷ See, e.g., Testimony of Paul Schott Stevens, President & CEO, ICI, Before the Committee on Banking, Housing and Urban Affairs, United States Senate, on FSOC Accountability: Nonbank Designations (March 25, 2015) (Stevens 2015 Testimony), available at https://www.ici.org/pdf/15_senate_fsoc.pdf.

³⁸ We note, for example, that the Federal Reserve Board was reluctant to tailor capital standards for SIFI-designated insurance companies absent legislative clarification. Congress passed the Insurance Capital Standards Clarification Act of 2014 for this purpose. See *Fed confirms to Maloney that pending legislation would allow tailoring of capital standards for insurance companies* (press release issued by Rep. Carolyn Maloney (D-NY), July 15, 2014), available at <https://maloney.house.gov/media-center/press-releases/fed-confirms-to-maloney-that-pending-legislation-would-allow-tailoring>.

³⁹ See, e.g., Stevens 2019 Testimony.

⁴⁰ The Treasury Report similarly observed that “[d]esignations have serious implications for affected entities, the industries in which they operate, and the economy at large. It is therefore imperative that the Council’s analyses be rigorous, transparent, and consistent.” Treasury Report at 23.

and seasoned understanding of the business of insurance, the regulatory environment, and the state of insurance company resolution and guaranty fund systems.”⁴¹

Similarly, the Treasury Report noted that comments from stakeholders have in common the following underlying concern: “that before designating a nonbank financial company, the Council should more specifically identify the *plausible* scenarios in which the company could pose a threat to U.S. financial stability.”⁴² Treasury recommended changes aimed at addressing this concern and in response, the Proposed Guidance includes changes to increase the transparency and analytical rigor of the Council’s designation analyses.

Generally speaking, to be supportable as a basis for designation, FSOC’s analysis must give due regard to institutional details that are relevant to the analysis (*e.g.*, structural and regulatory characteristics, investor behavior patterns and their underlying causes), avoid introducing improper bias (*e.g.*, viewing nonbank financial companies through a bank regulatory lens); and strive for a high degree of accuracy (*e.g.*, by steering clear of metrics or models relying on assumptions that are not supported, or are contradicted, by evidence).

Below, we comment on selected elements of the proposed analytic framework, in order of appearance: transmission channels (exposure, asset liquidation, and critical function or service); complexity and resolvability; existing regulatory scrutiny; benefits and costs of determination; and likelihood of material financial distress.

1. Transmission Channels

The Proposed Guidance provides that the Council will assess how the negative effects of a company’s material financial distress, or of the nature, scope, size, scale, concentration, interconnectedness, or mix of the company’s activities, could be transmitted to or affect other firms or markets, thereby causing a broader impairment of financial intermediation or of financial market functioning.⁴³ It identifies the same three “transmission channels” as the current guidance as the most likely mechanisms: exposure; asset liquidation; and

⁴¹ See “Views of the Council’s Independent Member Having Insurance Expertise” (Sept. 19, 2013), available at <https://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/September%2019%202013%20Notational%20Vote.pdf>.

⁴² Treasury Report at 23 (emphasis added).

⁴³ This statement refers to the two alternative designation standards outlined in Section 113 of the Dodd-Frank Act. The Proposed Guidance indicates, however, that the analytic framework focuses primarily on the first standard because “threats to financial stability...are most commonly propagated through a nonbank financial company when it is in distress.” Proposal at 9041. On this basis, we recommend that the Council delete the reference to the second standard (*i.e.*, “the nature, scope, size, scale, concentration, interconnectedness, or mix of the company’s activities.”). Should the Council determine in the future to analyze a nonbank financial company under that second standard, it must first consider whether a different analytic framework may be needed.

critical function or service. The Proposed Guidance describes the three transmission channels and provides examples of the factors FSOC will analyze under each one.

It is difficult to overstate the significance of this part of FSOC's analysis. A nonbank financial company cannot pose risk to the stability of the financial system if there is no plausible mechanism for transmitting risk of a nature and magnitude that would have the potential to destabilize the US financial system. Given its central importance, it is essential that FSOC conduct this part of its analysis in a transparent manner designed to maximize the accuracy and integrity of any results. The Council likewise must articulate a clear and defensible understanding of how a particular risk, once triggered, would be transmitted to other market participants, other markets, and the economy.

Consistent with these goals, the Treasury Report recommended changes to improve FSOC's ability to identify plausible risks through its analysis of the exposure and asset liquidation transmission channels. Treasury's recommendations called for more exacting analysis of mitigants to exposures and more rigorous quantitative assessments of asset liquidation risks.

a. Exposure Transmission Channel

The Proposed Guidance states that the Council will evaluate whether a nonbank financial company's creditors, counterparties, investors, or other market participants have direct or indirect exposure to the nonbank financial company that is significant enough to materially and adversely affect those or other creditors, counterparties, investors, or other market participants and thereby pose a threat to US financial stability. It indicates that considerations will include a company's leverage (which "can amplify the risks posed by exposures") and size.⁴⁴

Like the current guidance (and as required by statute), the Proposed Guidance states that in gauging size, FSOC will consider the extent to which assets are managed rather than owned and ownership of assets under management is diffuse. Importantly, the Proposed Guidance observes that "this recognizes the distinct nature of exposure risks when the company is acting as an agent rather than principal." It further explains that "in the case of a nonbank financial company that manages assets on behalf of customers or other third parties, the third parties' direct financial exposures are often to the issuers of the managed assets, rather than to the nonbank financial company managing those assets." This example aptly describes the situation of managers of regulated funds.

The Proposed Guidance indicates that the potential risk arising under this transmission channel depends, in part, on "the importance of [the] nonbank financial company to its counterparties and the extent to which the counterparties are interconnected with other financial firms, the financial system, and the broader economy. Therefore, the Council will

⁴⁴ All quoted language in this subsection appears in the Proposal on page 9042.

focus on exposures of large financial institutions to the nonbank financial company under review.” We note that interconnectedness with the financial system in and of itself does not raise financial stability concerns.⁴⁵

The Proposed Guidance recognizes that “[t]he amount and types of other exposures that counterparties and other market participants have to a nonbank financial company is highly dependent on the nature of the company’s business” and specifies that the Council’s analysis of counterparty exposures will take “these and other fact-specific considerations” into account. This element of the Proposed Guidance seems to contemplate giving due attention to institutional details, a welcome improvement. We suggest that FSOC clarify that such considerations will apply broadly to the Council’s analysis, not just reviews of “other exposures.” In this way, FSOC can more readily dispense with exposures that should not raise financial stability concerns.

Consistent with Treasury’s recommendations, the Proposed Guidance states that FSOC will consider risk-mitigating factors, such as the collateralization of a company’s counterparty exposures. We support making explicit that risk-mitigating factors will enter into the Council’s analysis, as such considerations are necessary to help FSOC identify accurately any plausible risks. We suggest that FSOC consider adding more examples of risk-mitigating factors relevant to the exposure channel, including regulatory changes implemented since the financial crisis and whether a nonbank financial company is a creditor or bearer of counterparty exposure.

In its analysis of the potential for a company’s exposures to lead to contagion among financial institutions and financial markets more broadly, the Proposed Guidance provides that the Council will seek evidence regarding the potential for contagion, “including relevant industry-specific historical examples.” This is a useful reference to the need for the Council’s analysis to rely on actual evidence, such as pertinent historical experience, rather than assumptions or conjecture. It is equally important for the Council to give appropriate weight to evidence (including “relevant industry-specific historical examples”) regarding the *lack* of potential for contagion, and we suggest that the Proposed Guidance so indicate. The Proposed Guidance further notes that “[v]arious market-based or regulatory factors can strongly mitigate the risk of contagion.” We view this observation as a worthwhile addition to the guidance.

b. Asset Liquidation Transmission Channel

The Proposed Guidance states that the Council will evaluate “whether a nonbank financial company holds assets that, if liquidated quickly, could cause a fall in asset prices and thereby significantly disrupt trading or funding in key markets or cause significant losses

⁴⁵ Consider, for example, regulated funds’ relationships with banks. Funds interact with banks through the payment system, but as long as the payment system is sound, this “interconnection” on its own does not pose financial stability risk. Custody banks hold fund assets, but those assets do not pose risks to the bank because they are not on the bank’s balance sheet.

or funding problems for other firms with similar holdings.” Further, the Council also may consider “whether a deterioration in asset pricing or market functioning could pressure other financial firms to sell their holdings of affected assets in order to maintain adequate capital and liquidity which, in turn, could produce a cycle of asset sales that could lead to further market disruptions.”⁴⁶

The Council expects its analysis will focus on three central factors: liquidity of the company’s liabilities; liquidity of the company’s assets; and potential fire sale impacts.

- The Council will consider the amount and nature of the company’s liabilities that are, or could become, short term in nature. It expects to “quantitatively identify the scale of potential liquidity needs that could plausibly arise,” including by considering counterparty and customer withdrawal rates based on historical examples. Other considerations cited by the Council include the ability of the company or its regulators to impose stays on counterparty terminations or withdrawals and the company’s leverage and short-term debt ratios.
- The Council will conduct an analysis of the assets that the company could rapidly liquidate, if necessary, to satisfy its obligations. The assessment will focus on the size and liquidity characteristics of the company’s investment portfolio, including whether the company “holds cash instruments or readily marketable securities that could reasonably be expected to have a liquid market in times of broader market stress.”
- To assess potential fire sale impacts, the Council expects to “apply quantitative models to assess how the company could satisfy the identified range of potential liquidity needs by rapidly selling its identified liquid assets.” It also acknowledges that a company might be incentivized to sell some of its less-liquid assets first (*e.g.*, to maintain compliance with risk-based capital ratios or other requirements or because, “in the event of a significant market disruption, there could be a meaningful first-mover advantage to selling less-liquid assets first”).

The Council’s description of the asset liquidation channel, while detailed, is noteworthy for its omission of what should be a key element of the analysis. Challenging as it may be, the Council must establish a valid basis for concluding that a decline in asset prices and any resulting trading or funding disruptions, or losses or other problems experienced by other market participants, poses a potential threat to US financial stability.⁴⁷ For the sake

⁴⁶ All quoted language in this subsection appears in the Proposal on pages 9042-43.

⁴⁷ The Council’s description of the exposure transmission channel is clear on this point. It indicates that the Council “will evaluate whether nonbank financial company’s creditors, counterparties, investors, or other market participants have direct or indirect exposure to [the company] that is significant enough to materially and adversely affect those or other creditors, counterparties, investors, or other market participants *and thereby pose a threat to U.S. financial stability.*” Proposal at 9042 (emphasis added).

of clarity, we recommend that the Council incorporate the prospect of a financial stability threat into its description of the asset liquidation channel.

Of the three transmission channels proposed by the Council, analyzing the transmission of risk through the “asset liquidation” channel will be the most challenging. It is unlike an analysis under the exposure channel, where the Council could attempt to map a company’s exposures to other market participants by examining its financial contracts. And it is unlike an analysis under the critical function or service channel, where the Council can evaluate the company’s market share for particular services and the ability of substitutes to perform those services. Instead, an analysis under the asset liquidation channel will be heavily dependent upon the assumptions and models used. Further, if the Council’s assumptions are not grounded in historical experience and do not reflect the “institutional details” of the company being evaluated, the credibility of the analysis may be compromised.

To illustrate these challenges, we draw on our work relating to similar “asset liquidation” analyses in the regulated fund context.

In mid-2017, the Bank of England (BoE) published a paper detailing results from a simulation model intended to stress-test open-end investment funds.⁴⁸ It suggested that under “severe but plausible” assumptions, investors could redeem so heavily from such funds during a period of market stress that they could *cause* “dislocations” in corporate bond markets. The BoE solicited feedback on its analysis, which it acknowledged was a pilot step and “incomplete exercise.” In reviewing the paper, ICI economists noted that the simulation model appears to have assumed that bond fund flows cause bond market returns to move, effectively driving its results. It is true that bond fund flows are *correlated* with bond market returns, but correlation and causation are not the same. In this case, the assumption of causation is not supported by empirical evidence. And, a range of other papers have suggested that the correlation between bond fund flows and bond market returns arises primarily from investors’ reaction to bond returns, rather than vice versa. ICI recommended that the BoE examine how the results of its simulation would change using this new assumption.⁴⁹

As the Council will recall, ICI raised similar concerns about the assumption underlying the Council’s statements in 2016 that outflows from mutual funds, particularly those invested

⁴⁸ Yuliya Baranova, Jamie Coen, Pippa Lowe, Joseph Noss and Laura Silvestri, *Simulating stress across the financial system: the resilience of corporate bond markets and the role of investment funds*, Financial Stability Paper No. 42, Bank of England (July 2017), available at <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-paper/2017/simulating-stress-across-the-financial-system-resilience-of-corporate-bond-markets>.

⁴⁹ For a more fulsome explanation, see Sean Collins, *Simulating a Crisis*, ICI Viewpoints (Aug. 15, 2017), available at https://www.ici.org/viewpoints/view_17_boe.

in less liquid assets, could “cause fund distress, *and hence* broader stress.”⁵⁰ To underscore the importance of rigorous empirical analysis, ICI undertook a case study to explore FSOC’s concerns about the prospect of destabilizing redemptions from mutual funds invested in less liquid assets. Using publicly available data about high-yield bond funds and their experience from early 2014 to early 2016 (a period that included significant stress in the high-yield bond market), ICI’s chief economist tested the predictions about destabilizing redemptions that had been suggested by the Council and by other policymakers and academics. Contrary to those predictions, the data show that investors were purchasing (as well as selling) shares in high-yield bond funds, and in the underlying bonds, during this period of market stress. Moreover, on a net basis, trading volumes of high-yield bonds actually *rose* when the high-yield bond market was under the greatest degree of stress. We submitted this analysis to the Council and urged it to reexamine its hypotheses about mutual funds in accordance with ICI’s findings.⁵¹

In a more recent analysis, the Council appeared to put greater weight on empirical evidence, a development we were pleased to see. In its 2017 decision to rescind the designation of American Insurance Group (AIG), the Council re-examined its theory that if AIG ever came under financial distress, “there could be a forced, rapid liquidation of a significant portion of AIG’s assets as a result of [insurance] policyholder surrenders or withdrawals that could cause significant disruptions to key markets, including corporate debt and asset-backed securities markets.” In determining to rescind AIG’s designation, the Council reconsidered that view. Based upon “additional consideration of incentives and disincentives for retail policyholders to surrender policies, including analysis of historical evidence of retail and institutional investor behavior,” the Council determined that there was “not a significant risk that asset liquidation by AIG would disrupt trading in key markets or cause significant losses or funding problems for other firms with similar holdings.”⁵²

The decision to rescind AIG’s designation was a matter of some controversy. Regrettably, that controversy distracted attention from the Council’s willingness to refine—and improve—its analysis. The result is much more defensible from an analytical perspective.

⁵⁰ FSOC, Update on Review of Asset Management Products and Activities (April 18, 2016) at 7 (emphasis added), available at:

<https://www.treasury.gov/initiatives/fsoc/news/Documents/FSOC%20Update%20on%20Review%20of%20Asset%20Management%20Products%20and%20Activities.pdf>.

⁵¹ See Letter from Paul Schott Stevens, President & CEO, ICI, to FSOC, dated July 18, 2016 (commenting on FSOC Update on Review of Asset Management Products and Activities), and accompanying analysis in Appendix B to the letter, available at https://www.ici.org/pdf/16_ici_fsoc_ltr.pdf.

⁵² See Notice and Explanation of the Basis for the Financial Stability Oversight Council’s Rescission of its Determination Regarding American International Group, Inc. (Sept. 29, 2017), available at <https://www.treasury.gov/initiatives/fsoc/news/Documents/American%20International%20Group%20Inc%20Rescission.pdf>. For further detail, see Sean Collins, *Applying Evidence to Theories on Regulated Funds*, ICI Viewpoints (Oct. 12, 2017), available at https://www.ici.org/viewpoints/view_17_fsoc_aig.

This is very important, because precise and accurate analysis is essential to sound policy outcomes.

As a “takeaway” from the improved AIG analysis, and consistent with Treasury’s recommendations, we suggest that FSOC incorporate into its analysis of fire sale risk consideration of the likelihood that fire sales would occur, taking into account potential mitigating factors such as daily marking to market of the company’s assets, the prospect of capital gains taxes, the characteristics and behavior patterns of the company’s customer base, and historical precedent. Relatedly, the Council must take care in its analysis not to conflate market risk with systemic risk. For example, asset sales could cause prices to fall, and some market participants might suffer losses as a result, but that would not necessarily raise financial stability concerns. Our recommendation above should help avoid this problem by focusing the Council on the bottom line issue—*i.e.*, whether risks that plausibly could materialize through the asset liquidation channel, if any, pose a financial stability threat.

As additional ways to help foster credible analysis—specifically with regard to the asset liquidation channel but also more generally—the Council should consider the following.

- Ensure a key or leading role for staff of the primary regulator on the analytical team, to help ensure that the analysis of the company reflects relevant historical experience and correct institutional details.
- Similar to the engagement that led to the process reforms issued in early 2015,⁵³ FSOC or staff could solicit input from economists and analysts in industry and academia on how to best to conduct these types of analyses. A forum where views, analyses, and results can be openly shared and discussed likely would be most helpful.

c. Critical Function or Service Transmission Channel

The Proposed Guidance describes the Council’s approach to evaluating the potential for a nonbank financial company “to become unwilling or unable to provide a critical function or service that is relied upon by market participants and for which there are no ready substitutes.”⁵⁴ It explains that “substitutability” is intended to capture both (1) “the extent to which other firms could provide similar financial services in a timely manner at a similar price and quantity” if the company withdraws from a particular market and (2) situations in which the company is “the primary or dominant provider of services in a market that the Council determines to be essential to U.S. financial stability.”

⁵³ See *supra* note 23.

⁵⁴ All quoted language in this subsection appears in the Proposal on pages 9043-44.

ICI concurs that substitutability issues are worthy of regulatory attention, because of the potential impact of a service disruption on market participants or market functioning. The Council should be careful, however, not to conflate market disruption with systemic risk. As with the other channels, the Council must establish a valid basis for concluding that the company's non-provision of a critical function or service poses a potential threat to US financial stability.⁵⁵ Accordingly, the Council's description of the critical function or service transmission channel should incorporate the prospect of a financial stability threat.

2. *Complexity and Resolvability*

The Proposed Guidance includes an expanded discussion of the potential relevance of a nonbank financial company's complexity, opacity, or resolvability when FSOC is evaluating whether the company could pose a threat to US financial stability. While focusing primarily on the possibility that these characteristics could aggravate risks, the Proposed Guidance also appropriately acknowledges that these characteristics (or lack thereof) could *mitigate* the potential for the company to pose a financial stability threat. Further, it describes specific factors that FSOC may consider in assessing (1) the complexity of a nonbank financial company's legal, funding, and operational structure, and (2) any obstacles to the company's rapid and orderly resolution.

ICI agrees that considerations related to a company's complexity, opacity, and resolvability belong in the mix of FSOC's areas of analysis—and should be viewed from both sides (*i.e.*, as potential risk-mitigating or risk-aggravating factors). We also welcome the increased transparency the Proposed Guidance provides around the factors that may inform FSOC's evaluation.

The Preamble indicates that “the Council will consult with the company's primary financial regulatory agency (if any) when assessing the company, including regarding the company's resolvability, complexity, and the likelihood of its material financial distress.”⁵⁶ Such consultation makes good sense, as the primary regulator likely can provide relevant expertise and useful perspective, including on the importance (or lack thereof) of specific factors to the analysis in the context of a particular company. We recommend, therefore, that FSOC make explicit in the guidance its intention to consult the primary regulator on these matters.

3. *Existing Regulatory Scrutiny*

FSOC's current guidance provides in part that the Council “will consider the extent to which nonbank financial companies are already subject to regulation, including the consistency of that regulation across nonbank financial companies within a sector, across different sectors, and providing similar services, and the statutory authority of those

⁵⁵ See *supra* note 47 and accompanying text.

⁵⁶ Proposal at 9035.

regulators.”⁵⁷ The Proposed Guidance revises the description of what FSOC will consider, helpfully clarifying that FSOC’s focus will be on “the extent to which existing regulation of the company has mitigated the potential risks to financial stability identified by the Council.”⁵⁸

The examples of factors to be considered reflect useful refinements that should lead to appropriately targeted analysis. For instance, the Council will consider “[t]he extent to which the company’s primary financial regulator *has imposed* risk-management standards such as capital, liquidity, and reporting requirements, *as relevant to the type of company*.”⁵⁹ These changes will help direct FSOC’s attention toward pertinent regulatory considerations. Importantly, it also contemplates that FSOC’s analysis needs to take into account differences among different types of nonbank financial companies.

4. *Benefits and Costs of Determination*

ICI strongly supports the addition to FSOC’s analytic framework of a new section contemplating that FSOC will evaluate the expected benefits and costs of a nonbank SIFI designation. The Treasury Report recommended that FSOC add consideration of benefits and costs to its analysis, while harboring no illusions about the challenges involved.⁶⁰ Treasury offered two compelling reasons why FSOC should conduct such analysis, despite its challenges:

- The analytical discipline of weighing costs against benefits—and quantifying those impacts to the extent feasible—improves the quality of administrative decision-making and ensures that agencies take account of the relevant trade-offs and alternatives; and
- Agency action is appropriate only if it does more good than harm, and there can be no confidence on that point unless the Council weighs the costs and benefits of its actions.⁶¹

⁵⁷ 77 Fed. Reg. 21660.

⁵⁸ Proposal at 9044.

⁵⁹ *Id.* (emphasis added). Under FSOC’s existing guidance, the Council reviews “whether existing regulators have the ability to impose detailed and timely reporting obligations, capital and liquidity requirements.” FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21637, 21660.

⁶⁰ Treasury Report at 27 (stating that “[f]inancial stability benefits may be difficult to quantify, and some of the costs may be difficult to forecast with precision.”). The Proposed Guidance likewise acknowledges these and other likely challenges and limitations.

⁶¹ *Id.*

We think these points are unassailable.⁶² They reflect principles for a sound regulatory process that both Republican and Democratic presidential administrations have embraced. For example, in a 1993 executive order on regulatory planning and review directed to federal agencies, the Clinton Administration stated as part of its regulatory philosophy that:

In deciding whether and how to regulate, agencies should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating. Costs and benefits shall be understood to include both quantifiable measures (to the fullest extent that these can be usefully estimated) and qualitative measures of costs and benefits that are difficult to quantify, but nevertheless essential to consider.⁶³

The executive order also directed federal agencies to adhere to certain principles (to the extent permitted by law and where applicable), including: “Each agency shall assess both the costs and the benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs.”⁶⁴

In a similar vein, we concur with the Council’s observation that determining whether the expected benefits of designation justify the expected costs “is necessary to ensure that the Council’s actions are expected to provide a net benefit to U.S. financial stability and are consistent with thoughtful decision making.”⁶⁵ For these reasons, it is entirely appropriate for the Council to commit that it will designate a nonbank financial company as a SIFI “only if the expected benefits to financial stability from Federal Reserve supervision and prudential standards justify the expected costs that the determination would impose.”⁶⁶

⁶² They align closely with views ICI has expressed on previous occasions. *See, e.g.*, Stevens 2015 Testimony (indicating that consideration of costs and benefits of designation would put FSOC decision making on a par with Administrative Procedure Act requirements for significant rulemakings and Obama Administration executive orders regarding rulemaking processes). *See also* Letter to Elizabeth Murphy, Secretary, Securities and Exchange Commission from Paul Schott Stevens, President & CEO, ICI, dated Oct. 6, 2011, at 5-6, available at <https://www.ici.org/pdf/25545.pdf>. That letter discusses cost-benefit analysis as a component of retrospective reviews of regulation, as called for by Executive Order 13579, *Regulation and Independent Regulatory Agencies* (July 11, 2011), 76 Fed. Reg. 41585 (July 14, 2011).

⁶³ Executive Order 12866, *Regulatory Planning and Review* (Sept. 30, 1993), 58 Fed. Reg. 51735 (October 4, 1993).

⁶⁴ *Id.* *See also* Executive Order 13563, *Improving Regulation and Regulatory Review* (Jan. 18, 2011), 76 Fed. Reg. 3821 (Jan. 21, 2011) (supplementing and reaffirming the principles set forth in Executive Order 12866); Executive Order 13772, *Core Principles for Regulating the United States Financial System* (Feb. 3, 2017), 82 Fed. Reg. 9965 (Feb. 8, 2017) (calling for “more rigorous regulatory impact analysis” and for “mak[ing] regulation efficient, effective, and appropriately tailored”).

⁶⁵ Proposal at 9044 (citation omitted).

⁶⁶ *Id.*

Like Treasury and the Council, ICI recognizes that evaluating the expected benefits and costs of designation will not be easy.⁶⁷ FSOC will need to assess benefits and costs not only to the company under review but also to the financial system and the economy. Yet, if conducted in good faith using the most accurate and reliable inputs available (and with transparency about limitations), this analysis will make a positive contribution to the soundness of FSOC's process.

5. *Likelihood of Material Financial Distress*

ICI also supports clarifying that FSOC's analysis will include assessing the likelihood of a nonbank financial company's material financial distress. The Treasury Report noted uncertainty among stakeholders regarding whether the Council intended, under its current guidance, to assess this factor. Treasury recommended revising the guidance to provide clearly for such assessment as part of the analytic framework for designations, commenting that "[s]ound risk regulation requires consideration of not only the impact of an identifiable risk, but also the likelihood that the risk will be realized."⁶⁸ Treasury further observed that "[m]aterial financial distress at a nonbank financial company does not pose a threat to U.S. financial stability if the company will not experience material financial distress."⁶⁹

Citing this same premise, the Proposed Guidance provides that as part of the assessment of the overall impact of a Council determination for any company under review under the First Determination Standard,⁷⁰ the Council will assess the likelihood of the company's material financial distress. The Proposed Guidance provides examples of quantitative and qualitative factors the Council may consider. It acknowledges the difficulty of accurately forecasting firm failures and describes how the Council will conduct the assessment in cases in which it is not possible to quantify the likelihood of material financial distress.

ICI recognizes that accurately assessing the likelihood of a nonbank financial company's material financial distress involves challenges. As with consideration of benefits and costs, however, this exercise will add value to FSOC's analysis. We agree with Treasury's observation that even though FSOC already looks at some factors that relate to the likelihood of distress, "a distinct evaluation of the factors that may lead to a firm's failure—and factors that mitigate those risks—will make the designation process more

⁶⁷ We note that just because some benefits and costs do not lend themselves to precise quantification does not mean they are negligible. A thorough assessment of qualitative benefits and costs—even if just through a discussion—will be necessary for FSOC principals to understand the full net impact of a proposed designation.

⁶⁸ Treasury Report at 26 (citation omitted).

⁶⁹ *Id.* at 27.

⁷⁰ *See supra* note 43.

empirically grounded and focused on realizable risks.”⁷¹ Accordingly, we view this assessment as a procedural improvement, not a procedural barrier.

D. Other Process Improvements: SIFI Determinations and Annual Reevaluations

Below, we discuss certain procedural elements of the Council’s processes for considering the designation of a nonbank financial company as a SIFI, as well as reevaluating on an annual basis any such designation. We highlight the benefits of changes FSOC proposes and make recommendations for further improvements. Our comments address the following topics in turn: identification of a company for review; enhanced engagement with the company; enhanced engagement with regulators; hearing procedures; and the annual reevaluation process.

1. *Identification of a Company for Review*

The Proposed Guidance would eliminate from FSOC’s process current “Stage 1,” which entails the application of a set of uniform quantitative metrics as an initial screening mechanism to help identify nonbank financial companies for review.⁷² We agree that this change is consistent with the decision to prioritize an activities-based approach.

The Proposed Guidance specifies that a decision to commence review of an individual company will be the subject of a vote of the Council or its Deputies Committee. A vote requirement at this pivotal juncture is appropriate to ensure accountability. Further, the decision will be governed by the threshold considerations set forth in the Proposed Guidance.⁷³ We recommend that, consistent with the spirit of the Proposed Guidance and the highly consequential nature of any such decision for the company at issue, the Proposed Guidance require a vote by FSOC principals.

2. *Enhanced Engagement with the Company*

The Proposed Guidance appropriately contemplates extensive engagement with a company under review in Stage 1. To begin this engagement, consistent with the 2015 Supplemental Procedures, the Council will provide a notice to any nonbank financial company under review in Stage 1. We support codifying this step and recommend that the Proposed Guidance further indicate that the notice will specify why the company was selected for review. This information could foster more productive discussions between the Council and the company from the start, including discussions in which staff of Council members and member agencies explain the key risks they have identified.

⁷¹ *Id.*

⁷² As a result, the Proposed Guidance would condense the current three-stage process into two stages.

⁷³ *See supra* notes 35-36 and accompanying text.

In addition, the company will need to know why it was selected for review if it intends to take advantage early on of the opportunity to “submit to the Council any information it deems relevant to the Council’s evaluation.”⁷⁴ Our recommendation would better position the company to provide relevant information, consistent with the goal of helping ensure that the Council makes decisions “based on a diverse array of data and rigorous analysis.”⁷⁵

The Proposed Guidance describes opportunities for a company under review to meet with Council staff at various points in the process. We recommend that the Proposed Guidance clarify that nothing would prohibit Council members from accepting a request to meet with a company during the course of a review. We believe that there should be no confusion, as has been the case in the past, about the appropriateness or propriety of such meetings.

The Preamble cites another important benefit of making the company aware of the potential risks the Council has identified during its preliminary review. Such engagement is intended to give the company more information and tools to mitigate those risks prior to any Council designation, thus providing a pre-designation off-ramp in Stage 1 before subjecting the company to more detailed analysis in Stage 2. We suggest that FSOC incorporate the pre-designation off-ramp concept into the Proposed Guidance. The Council could draw from the more detailed descriptions in both the Preamble and the Proposed Guidance of the post-designation off-ramp opportunity the Council intends to provide during the annual reevaluation process.⁷⁶ In addition, the Proposed Guidance should make clear that a pre-designation off-ramp opportunity might also be appropriate for Stage 2 (when the company will have notice of any specific aspects of its operations or activities that are the primary focus of the evaluation).

It bears emphasizing that with these recommendations we are not calling for additional, more time-consuming “process.” We simply are encouraging the Council to make even more explicit its willingness to entertain all paths to mitigating systemic risk concerns.

3. *Enhanced Engagement with Regulators*

The Proposed Guidance contains helpful discussion of expected interactions between the Council and a company’s primary regulator during Stage 1, including the Council’s plan to “actively solicit the regulator’s views regarding risks at the company and potential mitigants.”⁷⁷ We agree with Treasury’s assessment that such engagement “can help the Council understand the plausibility of theoretical risks at the company.”⁷⁸

⁷⁴ Proposal at 9046.

⁷⁵ *Id.* at 9036.

⁷⁶ *See* discussion of the annual reevaluation process below.

⁷⁷ Proposal at 9046.

⁷⁸ Treasury Report at 32.

As mentioned above in the discussion of the asset liquidation transmission channel, we suggest that FSOC consider indicating in the guidance that staff of the company's primary regulator will serve in a key or leading role on the analytical team. Assigning such a role to staff of the primary regulator will help ensure that FSOC benefits as much as possible from the primary regulator's experience and expertise.

The Proposed Guidance indicates that FSOC will continue to encourage the regulator to address risks while the Council is evaluating the company. This underscores that the process is a dynamic one and that all regulatory solutions are being explored.

4. *Hearing Procedures*

As indicated in the Proposed Guidance, the Dodd-Frank Act entitles a nonbank financial company to request a hearing to contest a proposed designation. The procedures for such hearings also are the subject of a Council rule and hearing procedures the Council has published on its website.

The Proposed Guidance states that “[i]n light of the short statutory timeframe for conducting a hearing, and the fact that the purpose of the hearing is to benefit the company, if a company requests that the Council waive the statutory deadline for conducting the hearing, the Council may do so in appropriate circumstances.”⁷⁹ We welcome the addition of this policy, which could help foster more meaningful engagement between the company and FSOC principals during the hearing process. As the Treasury Report observed, “additional time would give the company a better opportunity to understand and respond to the Council's written analysis in the proposed designation.”⁸⁰

We recommend that the Council also incorporate in the Proposed Guidance two changes to its hearing procedures based on the 2015 Supplemental Procedures—thus codifying current practice. First, the Proposed Guidance should indicate that the Council intends to grant a company's timely request for an oral hearing.⁸¹ Second, the Proposed Guidance should specify that the Council intends to grant a company's timely request that such oral hearing be conducted by the members of the Council (rather than staff).⁸²

⁷⁹ Proposal at 9047.

⁸⁰ Treasury Report at 30.

⁸¹ The hearing procedures indicate that the decision to grant an oral hearing is at the Council's sole discretion. FSOC, Hearing Procedures for Proceedings Under Title I or Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, available at <https://www.treasury.gov/initiatives/fsoc/designations/Documents/Hearing%20Procedures%20for%20Proceedings%20under%20Title%20I%20or%20Title%20VIII%20of%20DFA.pdf>, at 3.

⁸² The hearing procedures provide that the Council may delegate this function to “representatives.” *Id.* at 5.

5. *Annual Reevaluation Process*

FSOC’s 2012 interpretive guidance does not address the annual reevaluation process. The 2015 Supplemental Procedures include some information about engagement with nonbank financial companies during annual reevaluations but the Proposed Guidance, in line with Treasury’s recommendations, helpfully provides an expanded discussion of this topic.⁸³ Among other things, the Proposed Guidance describes how a company undergoing an annual reevaluation can expect to engage with the Council and its staff regarding a possible off-ramp from designation. For example, the company will be encouraged to submit information about changes it has made, or could make, to its business to address potential risks previously identified by the Council—and will receive feedback on the extent to which those changes may address the potential risks.

The Preamble states that the Council “intends that [the off-ramp] process should be flexible and tailored to the risks posed by designated companies, rather than hard-wired or overly prescriptive.”⁸⁴ Further, the process is “intended to incentivize designated companies to address the key factors that led to designation, which would promote the Council’s goal of reducing” financial stability risks.⁸⁵ We are optimistic about the positive impact the proposed changes could have on mitigation of potential financial stability risks.

* * * *

Thank you once again for considering our views. If you have any questions regarding our comments or would like additional information, please contact me at (202) 326-5901 or paul.stevens@ici.org; Susan M. Olson, General Counsel, at (202) 326-5813 or solson@ici.org; Frances M. Stadler, Associate General Counsel and Corporate Secretary, at (202) 326-5822 or frances@ici.org; or Rachel H. Graham, Associate General Counsel, at (202) 326-5819 or rgraham@ici.org.

Sincerely,

/s/ Paul Schott Stevens

Paul Schott Stevens
President & CEO
Investment Company Institute

⁸³ See Treasury Report at 36; Proposal at 9047-48.

⁸⁴ Proposal at 9037.

⁸⁵ *Id.*