

MEMO# 27198

April 24, 2013

Recent Regulatory Developments Concerning Nonbank "SIFIs"

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 12-13
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 10-13
SEC RULES COMMITTEE No. 18-13 RE: RECENT REGULATORY DEVELOPMENTS CONCERNING
NONBANK "SIFIS"

This memorandum briefly describes two recent rulemakings by the Board of Governors of the Federal Reserve System ("Board") to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). Both concern nonbank financial companies that are or could be designated as systemically important financial institutions by the Financial Stability Oversight Council ("FSOC"). [1] More specifically, the Board:

- adopted a final rule (1) establishing the requirements for determining if a company is "predominantly engaged in financial activities" for purposes of Title I of the Dodd-Frank Act and (2) defining the terms "significant nonbank financial company" and "significant bank holding company" for purposes of Title I; [2] and
- proposed a rule to collect assessments from certain bank holding companies and savings and loan holding companies, and from nonbank SIFIs, to cover the Board's expenses for supervising and regulating these companies ("Assessment Proposal"). [3]

Comments on the Assessment Proposal are due to the Board by June 15th. If there are any issues you would like ICI to consider addressing through the comment process, please contact Frances Stadler at frances@ici.org by May 15th.

Final Rule - "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Companies and Bank Holding Companies

Section 102(b) of the Dodd-Frank Act requires the Board to "establish, by regulation, the requirements for determining if a company is predominantly engaged in financial activities." The term "predominantly engaged in financial activities" is relevant to various

provisions in Title I of the Dodd-Frank Act. These provisions include, for example: (1) Section 113, which authorizes the FSOC to designate a “nonbank financial company” as a SIFI in certain circumstances; and (2) Section 120, under which the FSOC can issue recommendations to a primary financial regulatory agency to apply new or heightened standards to a financial activity or practice conducted by nonbank financial companies under that agency’s jurisdiction.

The Dodd-Frank Act defines “nonbank financial company” to mean “a U.S. nonbank financial company or a foreign nonbank financial company.” A required element of the definitions of “U.S. nonbank financial company” and “foreign nonbank financial company” is that the company must be “predominantly engaged in financial activities.” Generally speaking, the Act provides that a company is “predominantly engaged in financial activities” if—

(A) 85 percent or more of the company’s consolidated annual gross revenues are derived from activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956 (“BHC Act”)); or

(B) the company’s consolidated assets related to activities that are financial in nature (as defined in section 4(k) of the BHC Act) represent 85 percent or more of its consolidated assets.

The Board has adopted a final rule that provides additional parameters for determining whether a company is “predominantly engaged in financial activities.” Among other things, the final rule defines “financial activities” for purposes of Title I to include the broad range of activities authorized under section 4(k) of the BHC Act. [\[4\]](#) Of note, in response to comments, the Adopting Release expresses the Board’s belief that “it is clear that open-end investment companies, such as mutual funds including money market funds, as well as closed-end investment companies, engage in financial activities as defined in section 4(k) of the BHC Act.” [\[5\]](#)

As part of the same rulemaking, the Board defined the terms “significant nonbank financial company” and “significant bank holding company” for purposes of Title I, as required by Section 102(a)(7) of the Dodd-Frank Act. These terms are used in two provisions under Title I. First, Section 113 requires the FSOC to consider the relationships of a nonbank financial company with significant nonbank financial companies and significant bank holding companies in determining whether to designate the nonbank financial company as a SIFI. Second, Section 165(d)(2) requires a nonbank SIFI to report to the Board, the FSOC, and the Federal Deposit Insurance Corporation its credit exposures to significant nonbank financial companies and significant bank holding companies (and the credit exposures of such companies to the nonbank SIFI).

As the Board had proposed, the final rule defines “significant nonbank financial company” as (1) any nonbank financial company supervised by the Board (i.e., any nonbank SIFI) and (2) any other nonbank financial company that had \$50 billion or more in total consolidated assets (as determined in accordance with applicable accounting standards) as of the end of its most recently completed fiscal year. [\[6\]](#)

The final rule will become effective on May 6, 2013.

Proposed Rule - Supervision and Regulation Assessments

Section 318 of the Dodd-Frank Act requires the Board to collect from nonbank SIFIs and certain other companies [7] assessments, fees, or other charges equal to the total expenses the Board estimates are necessary or appropriate to carry out its supervisory and regulatory responsibilities with respect to all such companies. [8] The proposed rule would implement this provision through annual assessments on “assessed companies” that would be apportioned based on the company’s size. The proposed rule provides a formula for calculating each company’s assessment, which includes a “base amount” of \$50,000:

$$\$50,000 + (\text{Total Assessable Assets} \times \text{Assessment Rate}) = \text{Assessment}$$

For nonbank SIFIs that are U.S. companies, “total assessable assets” would be defined as the average of the company’s total consolidated assets as reported for the assessment period [9] on such regulatory or other reports as are applicable to the nonbank financial company determined by the Board. The “assessment rate” would be determined according to the following formula:

$$\text{Assessment Rate} = \frac{\text{Assessment Basis} - (\text{Number of Assessed Companies} \times \$50,000)}{\text{Total Assessable Assets of All Assessed Companies}}$$

The “assessment basis” would be the Board’s estimate of the total expenses necessary or appropriate to carry out its supervisory and regulatory responsibilities with respect to the population of assessed companies, based on an average of estimated expenses over the current and prior two assessment periods.; Under the proposal, the Board would send a notice to each assessed company no later than July 15 of each year following the assessment period and payments would be due by September 30 of that year. The proposed rule also would allow an assessed company 30 days from July 15 to appeal the Board’s determination (1) that it is an assessed company or (2) of its total assessable assets. The Board proposes to initiate the assessment program with the 2012 assessment period. [10]

The Board requests comment on all aspects of the proposed rule and poses several specific questions, including:

- What, if any, alternatives to a total consolidated assets measure should the Board consider for apportioning the assessment basis among assessed companies and why?
- What alternatives should the Board consider for differentiating assessments among assessed companies (for example, a tiered fee structure), and why?

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endnotes

[1] This memorandum refers to nonbank financial companies that are so designated as “nonbank SIFIs.”

[2] See Board of Governors of the Federal Reserve System, Definitions of “Predominantly Engaged in Financial Activities” and “Significant” Nonbank Financial Company and Bank Holding Company, 78 Fed. Reg. 20756 (April 5, 2013)(“Adopting Release”), available at <http://www.gpo.gov/fdsys/pkg/FR-2013-04-05/pdf/2013-07688.pdf>.

[3] See Board of Governors of the Federal Reserve System, Supervision and Regulation Assessments for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of \$50 Billion or More and Nonbank Financial Companies Supervised by the Federal Reserve, 78 Fed. Reg. 23162 (April 18, 2013), available at <http://www.gpo.gov/fdsys/pkg/FR-2013-04-18/pdf/2013-09061.pdf>.

[4] An appendix to the final rule lists these activities. The Board eliminated some conditions that apply to bank holding companies engaging in certain of these activities; it deemed those conditions irrelevant to determining whether particular activities are financial in nature for purposes of determining whether a company is predominantly engaged in financial activities.

[5] Adopting Release at 20761. The Adopting Release also cites statements made by members of Congress and statutory provisions that, in the Board’s view, indicate that Congress believed that the activities of investment companies are financial activities. *Id.* at 20759.

[6] “Significant bank holding company” is defined as a bank holding company or foreign bank subject to the BHC Act that has \$50 billion or more in total consolidated assets.

[7] The other companies are bank holding companies with at least \$50 billion in total consolidated assets and savings and loan holding companies with at least \$50 billion in total consolidated assets.

[8] Under Section 113 of the Dodd-Frank Act, designation as a SIFI subjects a nonbank financial company to consolidated supervision and heightened prudential regulation by the Board.

[9] “Assessment period” is defined as January 1 through December 31 of each calendar year. “Assessed companies” would be determined based on their status on December 31 of the assessment period.

[10] The Board notes that to date, the FSOC has not designated any nonbank financial company as a SIFI.