

MEMO# 26036

April 10, 2012

FSOC Adopts Final Rule and Interpretive Guidance Regarding "SIFI" Designations

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TO: BOARD OF GOVERNORS No. 3-12
CLOSED-END INVESTMENT COMPANY MEMBERS No. 19-12
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 20-12
SEC RULES MEMBERS No. 29-12 RE: FSOC ADOPTS FINAL RULE AND INTERPRETIVE
GUIDANCE REGARDING "SIFI" DESIGNATIONS

The Financial Stability Oversight Council ("FSOC") has adopted a final rule ("Rule") and related interpretive guidance ("Guidance" and, together with the Rule, "Release") regarding the designation of certain nonbank financial companies for consolidated supervision and regulation by the Federal Reserve Board. [\[1\]](#) The Rule and Guidance, which will be effective 30 days after publication in the Federal Register, are very similar to FSOC's proposed rule and guidance issued in October 2011. [\[2\]](#)

Among other things, the Release outlines the process by which the FSOC intends to analyze whether particular companies should be designated as so-called systemically important financial institutions ("SIFIs"). Like the October 2011 Proposal, the Release indicates that the FSOC is continuing to consider how to analyze potential threats to U.S. financial stability, if any, arising from asset management companies. The Release states, however, that for now the FSOC intends to evaluate asset managers under the Guidance as adopted. A brief summary is provided below.

Background

The FSOC may designate a nonbank financial company for heightened supervision and regulation by determining that (1) material financial distress at the company, or (2) the nature, scope, size, scale, concentration, interconnectedness, or mix of the company's activities, could pose a threat to U.S. financial stability (the "Determination Standards"). [\[3\]](#) The FSOC must consider certain factors specified in the Dodd-Frank Act and any other risk-related factor that it deems appropriate.

In prior comment letters, ICI provided its views on how the FSOC should consider certain

factors, including in evaluating registered investment companies (“funds”) and investment advisers, and asserted that funds are at the “less risky” end of the spectrum when considering the potential for systemic risk. [4] ICI also argued that SIFI designation is an inappropriate tool for further strengthening the resilience of money market funds to severe market distress. Most recently, in commenting on the October 2011 Proposal, ICI reiterated these and other arguments from its prior letters. [5] In addition, ICI recommended that the FSOC: (1) indicate in any release finalizing its proposal that it will seek public comment before making any material changes to the interpretive guidance; (2) strengthen the confidentiality provisions in the proposed rule; and (3) refrain from evaluating asset management companies until its further analysis of asset management companies has been completed and it has provided the public with some indication of its findings and conclusions.

Rule

Like the October 2011 Proposal, the Rule reiterates the language in Section 113 of the Dodd-Frank Act regarding the FSOC’s authority to designate nonbank financial companies for consolidated supervision and regulation by the Federal Reserve Board upon a finding that the company satisfies one of the Determination Standards. The list of factors that the FSOC must consider is taken directly from the statute. In addition, the Rule outlines many of the processes and procedures applicable to SIFI designations. Consistent with ICI’s comments, the FSOC strengthened the provisions related to protecting the confidentiality of information concerning a nonbank financial company in connection with an evaluation under the SIFI designation process.

Guidance

As in the October 2011 Proposal, the Guidance is presented as an appendix to the Rule. Noting concerns expressed by commenters, the Release states that if the FSOC revises the Guidance in the future, the FSOC “may provide the public with notice and an opportunity to comment on those changes, as the [FSOC] determines appropriate.”

The Guidance defines the terms “threat to U.S. financial stability” and “material financial distress,” which are referenced in the Determination Standards. It also details the three-stage process by which the FSOC proposes to determine—in non-emergency situations—whether a nonbank financial company should be subject to SIFI designation. The three stages, which reflect only minor changes from the October 2011 Proposal, are briefly outlined in Appendix A to this memorandum.

Application to Asset Management Companies and “Funds”

Similar to the October 2011 Proposal, the Release specifically mentions asset management companies several times. For example, the Release notes that certain types of nonbank financial companies, including asset management companies, “may pose risks that are not well-measured by the quantitative thresholds approach.”

The Release indicates that the FSOC, its member agencies, and the Office of Financial Research

. . . are analyzing the extent to which there are potential threats to U.S. financial stability arising from asset management companies. This analysis is considering what threats exist, if any, and whether such threats can be mitigated by subjecting such companies to [Federal Reserve Board] supervision and prudential standards, or whether they are better addressed through other regulatory measures. The Council may develop additional guidance [\[6\]](#) regarding potential metrics and thresholds relevant to determinations regarding asset managers, as appropriate. . . . While the [FSOC] intends to address such issues at a later date, consistent with the intention described above not to provide exemptions under section 113 of the Dodd-Frank Act for any type of nonbank financial company, the [FSOC] intends to evaluate asset managers under the current interpretive guidance.

Both the Release and the Guidance addresses application of the Stage 1 thresholds to “funds.” The Release states that, in applying each of the thresholds to funds, “whether or not they are registered investment companies,” the FSOC “may consider the aggregate risks posed by separate funds that are managed by the same adviser, particularly if the funds’ investments are identical or highly similar.” By contrast, the text of the Guidance does not include this specific reference to registered investment companies. The Guidance states:

While the [FSOC] expects that its determinations under section 113 of the Dodd-Frank Act will be with respect to individual legal entities, the [FSOC] has authority to assess nonbank financial companies, and their relationships with other nonbank financial companies and market participants, in a manner that addresses the statutory considerations and such other factors as the [FSOC] deems appropriate. For example, for purposes of applying the six thresholds to investment funds (including private equity firms and hedge funds), the [FSOC] may consider the aggregate risks posed by separate funds that are managed by the same adviser, particularly if the funds’ investments are identical or highly similar. In performing this analysis, the [FSOC] may use data reported on Form PF with the Securities and Exchange Commission or the Commodity Futures Trading Commission.

In addition, consistent with ICI’s comments, the Release states that when applying the Stage 1 thresholds to an asset manager, the FSOC’s analysis “will appropriately reflect the distinct nature of assets under management compared to the asset manager’s own assets.”

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[Attachment](#)

endnotes

[\[1\]](#) FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (Apr. 3, 2012), available at

<http://www.treasury.gov/initiatives/fsoc/Documents/Nonbank%20Designations%20-%20Final%20Rule%20and%20Guidance.pdf>.

[2] FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 64264 (Oct. 18, 2011) (“October 2011 Proposal”), available at <http://www.federalregister.gov/articles/2011/10/18/2011-26783/authority-to-require-supervision-and-regulation-of-certain-nonbank-financial-companies>. See Institute Memorandum 25583, dated Oct. 28, 2011. The October 2011 Proposal superseded a less detailed proposal issued by the FSOC in January 2011 (“Initial Rule Proposal”). Before the Initial Rule Proposal, the FSOC invited public comment via an Advance Notice of Proposed Rulemaking.

[3] Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).

[4] See Institute Memoranda 24696 and 24994, dated Nov. 10, 2010 and Feb. 25, 2011, respectively (summarizing ICI’s comment letters on the FSOC’s advance notice of proposed rulemaking and the Initial Rule Proposal).

[5] See Institute Memorandum 25729, dated Dec. 20, 2011 (summarizing ICI’s comment letter on the October 2011 Proposal).

[6] In a similar sentence in the October 2011 Proposal, the FSOC stated that it “may issue additional guidance for public comment” (rather than simply “may develop additional guidance”). The Release does not explain the deletion of the reference to issuing additional guidance for public comment.