

MEMO# 24994

February 25, 2011

ICI Letter on FSOC Proposal Regarding Designation of Nonbank Financial Companies for Heightened Supervision

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TO: BOARD OF GOVERNORS No. 1-11
CLOSED-END INVESTMENT COMPANY MEMBERS No. 27-11
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 12-11
SEC RULES MEMBERS No. 40-11 RE: ICI LETTER ON FSOC PROPOSAL REGARDING
DESIGNATION OF NONBANK FINANCIAL COMPANIES FOR HEIGHTENED SUPERVISION

As previously indicated, the Financial Stability Oversight Council (FSOC) issued a proposed rule regarding the criteria it will consider in designating certain nonbank financial companies for consolidated supervision and regulation by the Federal Reserve Board, as authorized by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). [\[1\]](#) ICI has filed a comment letter on the proposal, which is attached and briefly summarized below.

The letter expresses disappointment that the proposed rule does not specify how the FSOC intends to apply the criteria set forth in Section 113 of the Dodd-Frank Act when analyzing a particular company. It notes that while the proposed rule does little more than recite the statutory text, the Release proposes an analytical framework that provides some insight into the FSOC's interpretation of the Section 113 criteria. The letter points out that ICI's November 2010 letter to the FSOC discussed the Section 113 criteria in a way that largely tracks the six broad categories that form the foundation of the proposed analytical framework outlined in the Release. [\[2\]](#)

The letter states that the FSOC's proposed analytical framework provides for a more focused inquiry than would result from simply ticking through each of the criteria listed in the Dodd-Frank Act, and that the framework provides companies and markets with a

somewhat better understanding of how the FSOC intends to approach its analysis. The letter recommends that the FSOC formally adopt its proposed framework, either by incorporation into the text of the final rule or through an explicit discussion of the framework in the rule's adopting release.

The letter refers to the considerable uncertainty and concern among financial market participants about how the FSOC will apply the Section 113 criteria in making its determinations and suggests that this rulemaking provides an opportunity for the FSOC to make known some of its policy judgments about those criteria, without unduly constraining its flexibility. It suggests that a logical place to start would be with areas of general consensus among those who commented on the FSOC's Advance Notice of Proposed Rulemaking. The letter recommends that the adopting release discuss, to the greatest extent possible, the FSOC's views on the Section 113 criteria.

The letter reiterates ICI's recommendation that the FSOC should use its Section 113 designation authority with care, and reserve its application for those circumstances when the FSOC has determined that a specific company poses significant risks to the financial system that cannot otherwise be adequately addressed through enhancements to existing financial regulation and/or other regulatory authorities provided by the Dodd-Frank Act. It states in particular that

[t]he Dodd-Frank Act, by design, provides an array of new regulatory tools, in addition to the FSOC's SIFI designation authority. Moreover, it empowers the FSOC to influence oversight of risks to the financial system through its interactions with primary regulators. Ultimately this may prove to be one of the FSOC's most significant roles. In our view, the broad scope of these other authorities should allow the FSOC to reserve SIFI designation for those circumstances in which the risks to the financial system as a whole are both large and quite plain, and nothing less than designation will suffice to address them.

The letter observes that this view of the Section 113 designation authority is consistent with legislative intent as articulated by former Senate Banking Committee Chairman Christopher S. Dodd and with comments made by Federal Reserve Board Chairman Ben Bernanke. It further recommends that the FSOC state in the adopting release that it intends to use its Section 113 designation authority in this manner.

Finally, the letter addresses the suggestion by some commenters that certain (presumably larger) money market funds should be designated for heightened supervision pursuant to Section 113. After discussing the risk-limiting characteristics of money market funds, it states that

[t]o the extent there is a desire to bolster yet further the resilience of money market funds to severe market stress, designating each of the 652 money market funds or even each of the 277 prime money market funds offered in the U.S. market as a SIFI and subjecting each to ongoing prudential supervision by the Federal Reserve Board is not the way to accomplish this. Nor does it make sense to pick and choose among money market funds or complexes for this purpose, or to designate a fund adviser solely on the basis of its money market fund activities.

The letter instead urges the FSOC to evaluate money market funds under the separate path outlined in the report on money market fund reform options by the President's Working

Group on Financial Markets (PWG Report). It explains that, after examining the reform options outlined in the PWG Report, ICI concluded that creating a private emergency facility to serve as a backup source of liquidity for all prime money market funds is the best way to strengthen money market funds and mitigate any remaining risks these funds pose to the U.S. financial system with the least negative consequences.

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[Attachment](#)

endnotes

[\[1\]](#) See ICI Memorandum No. 24901, dated January 21, 2011; Financial Stability Oversight Council, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 4555 (Jan. 26, 2011) (Release).

[\[2\]](#) See ICI [Memorandum](#) No. 24696, dated November 10, 2010 (summarizing ICI's response to the FSOC's Advance Notice of Proposed Rulemaking). For convenience, the attached letter briefly summarizes ICI's primary observations about those categories, both in general terms and how they should apply specifically to registered investment companies and their investment advisers.