

MEMO# 24901

January 21, 2011

FSOC Proposal Regarding Designation Of Non-Bank Firms For Heightened Supervision; Conference Call On January 27

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 6-11
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 4-11
SEC RULES COMMITTEE No. 8-11 RE: FSOC PROPOSAL REGARDING DESIGNATION OF NON-BANK FIRMS FOR HEIGHTENED SUPERVISION; CONFERENCE CALL ON JANUARY 27

On January 18, 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). [\[1\]](#) The proposed rule is briefly summarized below.

We will hold a conference call to discuss the proposal on Thursday, January 27 at 3:00 pm ET. The dial-in number for the call is 888-566-6168 and the passcode is 75707. If you plan to participate, please RSVP to Gwen Kelly (gwen.kelly@ici.org) by noon on January 27. If you cannot participate, please provide any comments to Frances Stadler (202/326-5822 or frances@ici.org) or Rachel Graham (202/326-5819 or rgraham@ici.org), preferably before the conference call. Comments must be filed with the FSOC no later than 30 days after the proposal's publication in the Federal Register.

By way of background, the FSOC may designate a nonbank financial company for heightened supervision and regulation by determining that material financial distress at the company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the company's activities, could pose a threat to U.S. financial stability. The FSOC must consider certain factors specified in the Dodd-Frank Act and any other risk-related factor that it deems appropriate. Last fall, the FSOC issued an advance notice of proposed rulemaking (ANPR) in which it sought information to help it develop "a robust and disciplined framework" for making these designations. In its comment letter on the ANPR, ICI provided

its views on how the FSOC should consider certain factors, including in evaluating funds and investment advisers, and asserted that funds are at the “less risky” end of the spectrum when considering the potential for systemic risk. [2]

The Notice begins by summarizing the comment letters received in response to the ANPR. It notes several areas of agreement among commenters, including that: (1) in making its designations, the FSOC should give significant weight to company size, leverage, dependence on short-term funding, substitutability, degree of existing regulation, and interconnectedness; (2) size alone does not fully reflect a company’s ability to pose systemic risk; (3) the FSOC should focus its attention on unregulated firms and activities; and (4) different metrics are needed for different industries.

In a section entitled “Statutory and Analytical Framework for Designations,” the Notice sets forth the list of factors from the Dodd-Frank Act that the FSOC must consider. The Notice then describes how these statutory factors would be considered as part of a framework for assessing systemic importance that is organized around six broad categories:

- Size
- Lack of substitutes for the financial services and products the company provides
- Interconnectedness with other financial firms
- Leverage
- Liquidity risk and maturity mismatch
- Existing regulatory scrutiny

The Notice explains that the first three categories seek to assess the potential for spillovers from the company’s distress to the broader financial system, and the last three categories seek to assess how vulnerable a company is to financial distress. It states that the FSOC would evaluate companies in each of these categories, using quantitative metrics where possible, and that the FSOC “expects to use its judgment, informed by data on the six categories” to determine whether a company should be designated for heightened supervision and regulation. The Notice observes that application of the framework would be adapted for the risks presented by a particular industry sector and the business models within that sector.

The details of this framework and how it would be used by the FSOC are not reflected in the text of the proposed rule. Instead, the rule text essentially tracks the statutory language in the Dodd-Frank Act.

According to the Notice, the FSOC expects to begin assessing the systemic importance of nonbank financial companies shortly after adopting a final rule.

Rachel H. Graham
Senior Associate Counsel

endnotes

[1] Financial Stability Oversight Council, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, available at <http://www.treasury.gov/initiatives/Documents/Nonbank%20NPR%20final%2001%2013%2011%20formatted%20for%20FR.pdf> (“Notice”). The proposed rule also outlines the processes and procedures applicable to such designations.

[2] See Institute [Memorandum](#) 24696, dated November 10, 2010 (summarizing ICI's comment letter).

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