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Financial Stability Oversight Council
Attn: Lance Auer
1500 Pennsylvania Avenue, N.W.
Washington D.C. 20220

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

Ladies and Gentlemen:

The Investment Company Institute[1] appreciates the opportunity to comment on the Financial Stability Oversight Council's ("FSOC" or "Council") revised notice of proposed rulemaking ("Proposed Rule") and proposed interpretive guidance ("Proposed Guidance" and, together with the Proposed Rule, "Release") regarding the designation of certain nonbank financial companies for consolidated supervision and regulation by the Federal Reserve Board.[2] As both issuers of securities and large investors in U.S. and international financial markets, ICI's registered investment company members are keenly interested in the Council's efforts to identify and address potential risks to U.S. financial system stability.

In two prior comment letters, ICI has discussed in detail how the FSOC should use its authority under Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") to designate particular companies as so-called systemically important financial institutions ("SIFIs").[3] Those letters—which continue to reflect ICI's views in this area—emphasized the following:

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[1] The Investment Company Institute (ICI) is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $12.5 trillion and serve over 90 million shareholders.

[2] Financial Stability Oversight Council, *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 76 Fed. Reg. 64264 (Oct. 18, 2011).

[3] *See* Letters from Paul Schott Stevens, President & CEO, Investment Company Institute, to the Financial Stability Oversight Council, dated Nov. 5, 2010 ("ICI November 2010 Letter") and Feb. 25, 2011 ("ICI February 2011 Letter"), available at http://www.ici.org/pdf/24696.pdf and http://www.ici.org/pdf/24994.pdf, respectively.

- The Dodd-Frank Act, by design, provides regulators with an array of new tools to address abuses and excessive risk taking by financial market participants, and to detect new buildups of risk in the financial system. The broad scope of those authorities should allow the FSOC to reserve SIFI designation for those circumstances in which other regulatory actions clearly would be inadequate to address or limit the perceived risks to the financial system.

- The Council's need for flexibility to respond, as circumstances dictate, to new or emerging risks to the financial system must be properly balanced against the needs of financial market participants for clarity regarding the FSOC's use of its SIFI designation authority.

- Registered investment companies ("registered funds") are at the "less risky" end of the spectrum when considering the potential for systemic risk. In addition, a registered fund is a separate legal entity, whose assets are owned *pro rata* by its shareholders. Accordingly, a registered fund's assets should not be attributed to the registered investment adviser that manages those assets.

- SIFI designation is an inappropriate regulatory tool for further strengthening the resilience of money market funds to severe market distress.

In this letter, we provide our views with regard to the Proposed Rule and Proposed Guidance. In particular, we recommend that the Proposed Guidance (once finalized) not be materially changed unless the Council first provides notice and the opportunity for public comment on such changes. We further recommend that the Council strengthen the confidentiality provisions in the Proposed Rule.

The letter also comments on statements in the Release regarding the FSOC's intention to conduct further analysis into what threats to financial stability, if any, arise from asset management companies and how any such threats are best addressed. We urge the Council to make clear that it will refrain from evaluating asset management companies under the Proposed Rule and Proposed Guidance until (1) its further analysis of asset management companies has been completed and (2) the Council provides the public with some indication of its findings and conclusions. It is our belief that this review will lead the FSOC to conclude, at the very least, that neither investment advisers to registered funds, nor the funds themselves, present the risks that SIFI designation was intended to address.

Views on the Proposed Rule and Proposed Guidance

At the outset, we wish to acknowledge the Council's efforts to address the various concerns raised by ICI and other interested parties in the two prior comment periods. Chief among these concerns had been the lack of specificity about how the FSOC would select nonbank financial companies for evaluation and how it would apply the criteria and determination standards set forth in Section 113 of the Dodd Frank Act. In issuing the Release, the Council has provided much needed insight into how it views the Section 113 criteria and standards and how it intends to exercise its SIFI

designation authority. Importantly, the Release also acknowledges that SIFI designation is just one of the tools available to regulators to address potential systemic risk.[4]

Details of the Proposed Designation Process

We are pleased that the Release includes the proposed quantitative thresholds by which the FSOC intends to identify nonbank financial companies for further evaluation, as well as the proposed metrics the FSOC may use in applying the six-category analytical framework to each company selected for evaluation.[5] It is critical for financial market participants to have the opportunity to consider the proposed thresholds and metrics, and provide input to inform the Council as to their appropriateness.[6] As ICI previously has advised, the Council's ability to determine that an individual company poses potential risk to the entire U.S. financial system—and the regulatory oversight and heightened standards that would flow from that determination—is an extraordinarily potent legal authority, and one that should be used with great care. Market participants can and should be called upon to offer their expertise and, in so doing, help the FSOC to properly delineate its SIFI designation process.

ICI is aware of concerns that many details of the proposed designation process are set forth in the Proposed Guidance rather than in the Proposed Rule, leaving open the possibility that the FSOC could change the guidance without prior notice and the opportunity for public comment. For example, according to the Release, the FSOC expects to review the proposed quantitative thresholds as appropriate in light of evolving reporting requirements and the availability of new data regarding certain industries and nonbank financial companies. The Release does not indicate, however, what process the FSOC might follow in making changes to those thresholds. We recommend that the Council address these concerns by indicating, in any release finalizing the Proposed Rule, that it would seek comment from market participants and the broader public before making any material changes to the Proposed Guidance (once finalized). We believe that taking this approach would not constrain the FSOC's ability to respond quickly to immediate threats to financial stability because, as the Release makes clear, the determination process outlined in the Proposed Guidance is intended for non-emergency situations.

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[4] Release, *supra* note 2, at 64267. Treasury Secretary Geithner made similar observations at the October 11, 2011 Council meeting approving the issuance of the Proposed Rule and Proposed Guidance. In providing examples of other available regulatory tools, he mentioned that the Securities and Exchange Commission ("SEC") "has authority over money market funds as a large part of the [financial] system." We note that the SEC, in close coordination with the FSOC, continues to evaluate possible structural reforms to money market funds that would "reduc[e] money market funds' susceptibility to runs and provid[e] for a greater cushion in the case of a poor credit decision or decrease in short-term liquidity." *See* Mary L. Schapiro, Chairman, SEC, *Remarks at SIFMA's 2011 Annual Meeting*, Nov. 7, 2011, available at http://www.sec.gov/news/speech/2011/spch110711mls.htm.

[5] For a summary of ICI's views on the proposed six-category framework, *see* ICI February 2011 Letter, *supra* note 3.

[6] *See, e.g.*, Letter from Gus Sauter, Managing Director and Chief Investment Officer, and John Hollyer, Principal and Head of Risk Management and Strategy Analysis, Vanguard, dated Dec. 19, 2011 (recommending that, in calculating net derivative liability under its "Stage 1" analysis, the Council take into account not just cash collateral but also collateral consisting of cash-equivalents, such as Treasuries and other U.S. government agency securities).

Information Collection and Confidentiality Provisions

The Proposed Rule contains provisions addressing the Council's collection of information and its obligation to maintain the confidentiality of such information, largely reflecting the statutory language in Section 112(d) of the Dodd-Frank Act. ICI believes it is critically important for the FSOC to give the highest priority to protecting the confidentiality of information concerning a nonbank financial company in connection with an evaluation under the proposed SIFI designation process. To that end, we recommend several changes and clarifications intended to strengthen these provisions of the Proposed Rule.

Information requested by the Council. Section 1310.20(b) of the Proposed Rule covers information collection from nonbank financial companies. Specifically, it refers to "periodic and other reports" that the Council may direct the Office of Financial Research ("OFR") to require from a nonbank financial company, including one being considered for possible SIFI designation. According to the Release, the Council is likely to request information, perhaps including confidential business information, from any nonbank financial company to be comprehensively evaluated in "Stage 3" of the proposed designation process.[7] We recommend the Council clarify that the reference to "reports" in Section 1310.20(b) covers *any* information or data that is reported by a company.[8]

Information voluntarily provided by a nonbank financial company. According to the Release, the Council's "Stage 2" analysis of a nonbank financial company would include, among other things, consideration of information that is provided by the company voluntarily. Section 1310.20(b) of the Proposed Rule, however, does not mention data, information, or reports that nonbank financial companies may provide on their own initiative. Moreover, subsections (b) and (e) of Section 1310.20 refer to data, information or reports "submitted under this part," which presumably means the Proposed Rule and may not include the Proposed Guidance. As a result, it is unclear as a technical matter whether the confidentiality provision would extend to such material provided voluntarily. We recommend that Section 1310.20 of the Proposed Rule be revised to (1) include a specific reference to the Proposed Guidance (once finalized) and (2) encompass expressly any data, information or reports submitted voluntarily by a nonbank financial company.

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[7] *See* Release, *supra* note 2, at 64282 ("Information requests likely will involve both qualitative and quantitative data. Information relevant to the Council's analysis may include confidential business information such as internal assessments, internal risk management procedures, funding details, counterparty exposure or position data, strategic plans, resolvability, potential acquisitions or dispositions, and other anticipated changes to the nonbank financial company's business or structure that could affect the threat to U.S. financial stability posed by the nonbank financial company.")

[8] We note that whereas the confidentiality provision in Section 1310.10(e) of the Proposed Rule applies to "data, information or reports," Section 1310.10(b) refers only to "reports" and Section 2010.10(e)(3) (regarding the Freedom of Information Act) mentions only "data and information." We recommend that the FSOC use consistent terminology throughout the rule and make clear its intent to provide confidential treatment to all types of information, regardless of its form or source.

Information obtained by OFR or FSOC Member Agencies. The confidentiality provision in the Proposed Rule would obligate the Council—and *only* the Council—to maintain the confidentiality of data, information and reports submitted under the rule. By contrast, Section 112(d)(5) of the Dodd-Frank Act imposes confidentiality obligations not only on the Council, but also on OFR and the FSOC's member agencies. To ensure appropriate protection of nonpublic information and greater consistency with the statute, we recommend that Section 1310.20(e)(1) be broadened to impose confidentiality obligations on OFR and the FSOC's member agencies, in addition to the Council.

We offer two examples to illustrate why such a change is important. First, as noted above, the Proposed Rule provides that the Council may direct OFR to require the submission of reports by a nonbank financial company. The Proposed Rule also requires the Council, acting through OFR, to coordinate with its member agencies or primary financial regulatory agencies and, whenever possible, to rely on information available from OFR or such agencies. In either case, it appears that OFR would act as a conduit, providing information it receives from companies or obtains from regulatory agencies to the FSOC.

Second, consistent with Section 112(d)(4) of the Dodd-Frank Act, the Proposed Rule authorizes the Federal Reserve Board to conduct a "back-up" examination of a U.S. nonbank financial company if the Council is unable to determine whether that company's financial activities pose a threat to U.S. financial stability.[9] Nonpublic information made available to the Federal Reserve Board in connection with such an examination should be protected to the fullest extent under the Proposed Rule.

Application of the Freedom of Information Act. Section 1310.20(e)(3) of the Proposed Rule states that the Freedom of Information Act ("FOIA"), including the exemptions thereunder, shall apply to any data or information submitted under the Proposed Rule. How the Council administers this provision will be of critical importance to any nonbank financial company subject to a Stage 3 evaluation, given the likelihood that the company will be asked to provide confidential business information to the Council in connection with that evaluation.[10] We accordingly recommend that the Council send a clear signal, in any release adopting the Proposed Rule, that it expects such confidential business information to be subject to withholding under exemptions 4 and 8 of FOIA.[11] A statement

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[9] *See* Section 1310.10(c)(1) of the Proposed Rule. Indeed, the Proposed Rule goes beyond the statute in authorizing the Federal Reserve Board to conduct an examination of a U.S. nonbank financial company "*and its subsidiaries*" for this purpose. (Emphasis added.)

[10] The Council's administration of proposed Section 1310.20(e)(3) also may be important to any nonbank financial company that voluntarily provides information to the Council.

[11] Exemption 4 protects "trade secrets and commercial or financial information obtained from a person [that is] privileged or confidential." *See Discretionary Disclosure and Waiver*, Dep't of Justice Guide to the Freedom of Information Act, available at http://www.justice.gov/oip/foia_guide09/disclosure-waiver.pdf (explaining that the Trade Secrets Act, a criminal statute, prohibits the unauthorized disclosure of most information falling within Exemption 4, thus constraining an agency's ability to make a "discretionary disclosure" of Exemption 4 information absent an agency regulation, based on federal statute, that expressly authorizes disclosure). Exemption 8 protects information that is "contained in or related to

of this kind would provide assurances that the Council intends to protect the confidentiality of a company's business information to the greatest extent possible under law.[12]

We note that a recent rulemaking by the Federal Reserve Board and the Federal Deposit Insurance Corporation ("FDIC") followed a similar approach. Specifically, in their releases adopting the "living will" requirements in Section 165(d) of the Dodd-Frank Act, the agencies noted that they "will assess the confidentiality of resolution plans and related material in accordance with applicable exemptions under FOIA" and "certainly expect that large portions of the submissions will contain or consist of . . . information [that] is subject to withholding under exemptions 4 and 8 of the FOIA.[13]

Further Analysis of Asset Management Companies

It is clear from the Release that the Council is not satisfied with how the proposed quantitative thresholds would apply to asset management companies, including registered investment advisers. Several of the proposed thresholds appear to have been carefully designed to capture the particular types of nonbank financial companies whose financial distress raised systemic concerns during the 2008 financial crisis. These companies, according to the Release, include Bear Stearns, Countrywide, Lehman Brothers, and IndyMac Bancorp.

As ICI and others have explained in previous letters to the FSOC, registered investment advisers typically have risk profiles that are very different from those of the companies identified above and from banking institutions generally.[14] There are several reasons for this, but most fundamental is the nature of an investment adviser's business, *i.e.,* managing assets on behalf of clients. Investment advisers manage client assets according to the investment objectives and time horizon of each client. An

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examination, operating, or condition reports prepared by, or on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions."

[12] For the same reason, corresponding changes are needed to the Council's pending proposal to implement FOIA, particularly proposed Section 1.10, which addresses the treatment of requests for business information provided to the Council. *See* FSOC, *Implementation of the Freedom of Information Act*, 76 Fed. Reg. 17038 (March 28, 2011) ("FOIA Proposal"). *See also* Letter from Mark R. Thresher, Executive VP and Chief Financial Officer, Nationwide, to the Financial Stability Oversight Council, dated May 23, 2011 (recommending changes to the FOIA Proposal in order to limit the unnecessary disclosure of sensitive business and individual personal information).

[13] *See* Federal Reserve System and FDIC, *Resolution Plans Required*, 76 Fed. Reg. 67323 (Nov. 1, 2011), available at http://frwebgate1.access.gpo.gov/cgi-bin/PDFgate.cgi?WAISdocID=x3ns5w/0/2/0&WAISaction=retrieve. Importantly, the obligation to maintain confidentiality and the application of FOIA and its exemptions, as outlined in Section 112(d) of the Dodd-Frank Act, apply equally to information received by the Council in the exercise of its SIFI designation authority and to information received by the Federal Reserve Board and the FDIC in connection with resolution plans required by Section 165(d) of the Dodd-Frank Act.

[14] *See, e.g.*, ICI November 2010 Letter, *supra* note 3; Letter from Scott C. Goebel, SVP and General Counsel, Fidelity Management & Research Co., dated Nov. 5, 2010; Letter from Gus Sauter, Managing Director and Chief Investment Officer, and John Hollyer, Principal and Head of Risk Management and Strategy Analysis, Vanguard, dated Nov. 5, 2010; Letter from Barbara G. Novick, Vice Chairman, and Robert P. Connolly, Senior Managing Director and General Counsel, BlackRock, dated Feb. 25, 2011.

investment adviser does not own those assets and it may not use the assets of any client to benefit itself or any other client. Also important is the fact that investment gains and losses from a client account are solely attributable to that account, and do not flow through to the investment adviser.[15]

Other considerations further distinguish the risk profile of an investment adviser whose clients are registered funds. For example:

- A registered fund is organized as a corporation or business trust under state law, and as such is a separate legal entity from its investment adviser. The assets of a registered fund are separate and distinct from those of the adviser and of any other client that receives investment management services from the same adviser. Further, the assets of a registered fund are not available to claims by general creditors of the adviser.

- The Investment Company Act of 1940 and related SEC rules recognize the separate legal identities of registered funds and their investment advisers. Of particular note is the requirement that each registered fund have a board of directors with at least a majority of independent members who must, among other duties, annually review and approve the registered fund's contract with the investment adviser.

- The Investment Company Act requires registered funds to maintain strict custody of fund assets—which are owned *pro rata* by the fund's shareholders—separate from the assets of the fund adviser. Nearly all registered funds use a bank custodian, and a registered fund's custody agreement with a bank is typically far more elaborate than the arrangements used for other bank clients. The custodian's services generally include, among other things, safekeeping and accounting for the registered fund's assets, settling securities transactions, receiving dividends and interest, reporting failed trades, reporting cash transactions, and tracing loaned securities.[16]

The clear legal separation of a registered fund and its investment adviser, together with the risk-limiting provisions of the Investment Company Act, further compel a conclusion that an investment adviser could not pose a threat to U.S. financial system stability merely because it provides investment services to one or more large registered funds.

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[15] In its annual report to Congress, the FSOC observed that "[i]n separately managed accounts, investment losses fall solely on the account owner, so these accounts generally do not raise direct financial stability concerns." Financial Stability Oversight Council, 2011 Annual Report, at 65. This statement is equally true for registered funds.

[16] For a more complete description, see 2011 Investment Company Fact Book at 208-09, which is available at http://www.icifactbook.org/.

The Release states that the FSOC, its member agencies and the OFR will undertake a further analysis to consider what threats to financial stability—if any—arise from asset management companies and whether such threats can be mitigated by SIFI regulation or better addressed through other regulatory measures. We welcome this development, as it suggests that the FSOC recognizes the different risk profile of asset management companies and is committed to exercising its SIFI designation authority in a careful and thoughtful manner. In addition, we believe this review will lead the FSOC to conclude, at the very least, that neither investment advisers to registered funds, nor the funds themselves, present the risks that SIFI designation was intended to address.

We urge the Council to make clear that it will refrain from evaluating asset management companies under the Proposed Rule and Proposed Guidance until (1) its further analysis of asset management companies has been completed and (2) the Council provides the public with some indication of its findings and conclusions.[17] Our recommendation is based on the fact that, for asset management companies, the Release raises more questions than it answers about the determination process. These include such fundamental questions as how the FSOC would apply the total consolidated assets threshold in "Stage 1" to an asset manager and what is meant by the FSOC's intention to "take into account . . . assets under management in a manner that recognizes [their] unique and distinct nature."[18] As to the former question, ICI reiterates its view that a registered fund's assets should not be attributed to that fund's investment adviser.[19] Until the FSOC fully answers these questions, however, the financial markets and market participants are left with exactly the sort of uncertainty that the Council intended the Release to minimize. Moreover, leaving these issues open to speculation is at odds with the FSOC's stated "commit[ment] to fostering transparency with respect to the Designation Process." ICI and its members stand ready to assist the Council in its further work on this rulemaking.

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[17] If the Council determines to issue additional guidance, it should provide the public with notice and the opportunity to comment.

[18] Another area of uncertainty involves the FSOC's statements in footnote 12 of the Release regarding application of the uniform thresholds to investment funds managed by a nonbank financial company. According to footnote 12, the FSOC may consider two or more funds as a single entity if their investments are identical or highly similar. The footnote is silent, however, as to whether the FSOC would be considering the funds themselves or the funds' adviser for possible SIFI designation. In either case, we do not believe it makes sense to view two or more investment funds in the aggregate if each is a separate legal entity and the assets of each fund are owned by the fund's shareholders/investors. Finally, we find the statements in footnote 12 to be puzzling given that the FSOC is proposing to exclude separate account assets when calculating a company's leverage ratio and short-term debt ratio for "Stage 1" purposes. In our view, the argument for excluding managed assets from these calculations is even more compelling for separate legal entities such as registered funds.

[19] *See* ICI November 2010 Letter, *supra* note 3.

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If you have any questions regarding our comments or would like additional information, please feel free to contact me (202/326-5901), ICI General Counsel Karrie McMillan (202/326-5815), or ICI Chief Economist Brian Reid (202/326-5917). Thank you for your consideration of these comments.

Sincerely,

/s/

Paul Schott Stevens
President & CEO
Investment Company Institute