July 8, 2014

Robert deV. Frierson, Esq.
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
Docket No. R-1489
RIN 7100 AE18

Re: Notice of Proposed Rulemaking, *Concentration Limits on Large Financial Companies* (79 Fed. Reg. 27801)

Mr. Frierson:

The Clearing House Association L.L.C. ("**The Clearing House**"), joined by the American Bankers Association and The Financial Services Roundtable (collectively, the "**Associations**"),[1] appreciates the opportunity to comment on the notice of proposed rulemaking by the Board of Governors of the Federal Reserve System (the "**Federal Reserve**") entitled *Concentration Limits on Large Financial Companies* (the "**Proposed Rule**").[2] The Proposed Rule would implement Section 622 ("**Section 622**") of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"), which establishes a financial sector concentration limit that generally prohibits a financial company[3] from merging or consolidating with, or acquiring, another company if the resulting company's consolidated liabilities upon consummation would exceed 10% of the aggregate consolidated liabilities of all financial companies as

1 Descriptions of the Associations are provided in Annex A of this letter.

2 79 Fed. Reg. 27801 (May 15, 2014).

3 Under Section 622, a financial company is "(A) an insured depository institution; (B) a bank hoiding company; (C) a savings and loan holding company; (D) a company that controls an insured depository institution; (E) a nonbank financial company supervised by the [Federal Reserve] under Title I of [The Dodd-Frank Act]; and (F) a foreign bank or company that is treated as a bank holding company for purposes of [the Bank Holding Company Act]." 12 U.S.C. § 1852(a)(2).

calculated under Section 622 (the "**622 Concentration Limit**").[4] The Proposed Rule also would incorporate the recommendations made by the Financial Stability Oversight Council (the "**FSOC**") in its 2011 report mandated by Section 622 (the "**FSOC Report**").[5]

The Associations generally support the FSOC's four stated policy rationales for the 622 Concentration Limit: (i) promoting financial stability; (ii) limiting moral hazard; (iii) promoting the efficiency and competitiveness of U.S. financial companies and the U.S. financial market; and (iv) improving the cost and availability of credit and other financial services to households and businesses in the United States.[6] Consistent with these policy rationales, the Associations strongly believe that the 622 Concentration Limit should be implemented and applied in a manner that is transparent, predictable and, most importantly, avoids unnecessary and unintended restrictions on ordinary course business activity that clearly is outside of Section 622's intended scope. In this respect, we believe that the FSOC was quite correct to recommend that the implementation of the 622 Concentration Limit should be undertaken in such a manner as to "mitigat[e] practical difficulties likely to arise in the administration and enforcement of the [622 Concentration Limit], without undermining its effectiveness in limiting excessive concentration among financial companies."[7]

In addition, we note that Section 622 is the third statutory restriction, in addition to basic anti-trust considerations, on growth by large banking organizations through acquisition or merger. First, the Riegle-Nea Interstate Banking Act of 1994 (the "**Riegle-Neal Act**") limits bank holding companies to holding no more than 10% of nationwide deposits.[8] Second, § 604(d) of the Dodd-Frank Act established the so-called "financial stability factor" (the "**Financial Stability Factor**") pursuant to which the Federal Reserve must assess "risk to the stability of the United States banking or financial syste m" against anticipated public benefit in evaluating proposed acquisitions, mergers, or consolidations.[9] As a third

4 12 U.S.C. § 1852(b).

5 Financial Stability Oversight Council, Study and Recommendations Regarding Concentration Limits on Large Financial Companies (January 2011), *available at* http://www.treasury.gov/initiatives/Documents/Study%20on%20Concentration%20Limits%20on%20Large%20Firms%2001-17-11.pdf. The FSOC's recommendations were (i) to measure the liabilities of financial companies not subject to consolidated risk-based capital rules using U.S. generally accepted accounting principles or other applicable accounting standards; (ii) to use a two-year average to calculate aggregate financial sector liabilities and publish annually by July 1 the current aggregate financial sector liabilities applicable to the period of July 1 through June 30 of the following year; and (iii) to extend the "failing bank exception" to apply to the acquisition of any type of insured depository institution in default or in danger of default. FSOC Report at 16-17, 20-21.

6 *Id.* at 14.

7 *Id.* at 14.

8 12 U.S.C. § 1842(d)(2). Because this provision excludes both deposits in U.S. branches of foreign banks and deposit-equivalents such as money market funds, the deposit cap is in fact reduced substantially further.

9 *See* 12 U.S.C. § 1842(c)(7). The Federal Reserve has been applying the financial stability factor to proposed acquisitions in the financial sector for over two years. *See* Federal Reserve Board, Order Approving Capital One's Acquisition of ING Bank, fsb (February 14, 2012) (the "**Capital One Order**"); Federal Reserve Board, Order Approving the Acquisition of RBC Bank (USA) by PNC Bancorp, Inc. (December 23, 2011).

statutory restriction, the 622 Concentration Limit provides yet another layer of protection against the potential concerns with market concentration levels that are addressed by these other restrictions.[10] In light of these multiple systemic safeguards, the Federal Reserve can and should appropriately use the discretion granted to it by the Dodd-Frank Act to develop a workable final rule that places restrictions on transactions that "*substantially* increase" the size of very large, complex financial institutions, but that does not limit their ability to engage in routine and necessary business operations with no meaningful effect on market concentration or financial stability.

With those objectives in mind, the Associations are concerned that, as more fully described below, certain aspects of the Proposed Rule create serious practical difficulties without serving the fundamental policy rationales behind the 622 Concentration Limit. As such, we focus in this letter on comments and recommendations meant to "mitigat[e the] practical difficulties"[11] we believe are associated with the Proposed Rule while still serving the stated purposes of Section 622.

I. Executive Summary

Our principal recommendations for addressing the practical difficulties created by the Proposed Rule are as follows:

- Ordinary course business transactions should be excluded from the definition of "covered acquisition." The Proposed Rule's definition of "covered acquisition" should expressly exclude a wider range of ordinary course business activities that neither meaningfully increase a firm's relative share of financial sector liabilities nor constitute the type of growth transactions that Section 622 is intended to restrict ("**Ordinary Course Business Transactions**"). These include community development investments, investments in small business investment companies ("**SBICs**"), customer-driven hedging positions and several additional categories of routine business transactions detailed below. To the extent that these transactions may, as a technical matter, fall within the Proposed Rule's current definition of "covered acquisition," they should be excluded in view of Section 622's intended scope and purpose so as to avoid, as urged by the

10 Section 163 of the Dodd-Frank Act also amended the Bank Holding Company Act, 12 U.S.C. § 1841 et seq. (the "**BHC Act**"), to require a bank holding company with $50 billion or more in total consolidated assets or a nonbank financial company designated by the FSOC to provide prior written notice to the Federal Reserve of the acquisition of a company with $10 billion or more in total consolidated assets that is engaged in activities described in Section 4(k) of the BHC Act. The standard of review for such transactions under Section 163 is "the extent to which the proposed acquisition would result in greater or more concentrated risks to global or United States financial stability or the United States economy." 12 U.S.C. § 5363(b)(4). Although not focused exclusively on concentration, other provisions of the Dodd-Frank Act include financial stability among the criteria the banking agencies must consider when approving acquisitions. Section 604(e) of the Dodd-Frank Act amends the BHC Act to require the Federal Reserve to consider the stability of the U.S. banking system in its evaluation of a notice by a bank holding company to acquire a company engaged in nonbanking activities, and Section 604(f) imposes a similar requirement for the review of certain transactions under the Bank Merger Act. 12 U.S.C.§ 1843(j)(2); 12 U.S.C. § 1828(c)(5).

11 FSOC Report at 14.

FSOC, the possibility of detrimental effects on the financial sector and the broader economy, including reduced credit "to households and businesses in the United States."[12]

- The Proposed Rule's *de minimis* framework should be adjusted to ensure that it is workable and effective when applied in practice, while simultaneously advancing the policy rationales of Section 622. As such, we recommend the following:
  - The cap on *de minimis* transactions should be set at an increase in liabilities of $5 billion (rather than $2 billion as proposed) on a 12-month rolling basis. A $5 billion cap would have a negligible impact on the total liabilities of the financial company and would not even meaningfully—much less substantially—increase financial sector concentration, yet should provide meaningful flexibility and potential benefits to customers;
  - The Federal Reserve's suggestion to develop an alternative process, such as a pre-approval process, for certain *de minimis* transactions should be implemented. We believe such a process will reduce administrative burden by eliminating the unnecessary review and approval of transactions that do not pose a risk of financial concentration and are subject to broader safeguards of the 12-month rolling *de minimis* cap. By providing for a more efficient and streamlined administrative approach, a pre-approval process will also help ensure that the 622 Concentration Limit does not hinder transactions that are inconsequential in this context because the volume of substantively immaterial requests cannot be processed on a timely basis. To realize these benefits, however, we believe that such a pre-approval mechanism should be implemented for *de minimis* transactions in which $100 million or less in consideration is paid; and
  - The final rule should state that *de minimis* transactions will be reviewed by the Federal Reserve pursuant to an explicit standard of whether the proposed transaction creates a level of concentration in the financial sector that would pose a threat to financial stability.

- The prior notice requirement for certain transactions below the 622 Concentration Limit should be eliminated. The proposed prior notice requirement for covered acquisitions of more than $2 billion by a financial company that, on consummation, would exceed 8% of aggregate financial sector liabilities ("**Financial Sector Liabilities**" or the "**Denominator**") but not the 622 Concentration Limit is unnecessary and is neither mandated by the statute nor recommended by the FSOC, and it therefore should be eliminated.
  - If included, such a notice should take the form, at most, of an after-the-fact notice requirement.
  - At a minimum, the threshold should be appropriately adjusted above 8.0% to 9.5%. Modifying the notice requirement in this way would ensure that only transactions that actually approach the 622 Concentration Limit are subject to a prior notice requirement

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12 FSOC Report at 3.

and, accordingly, avoid unnecessary administrative burden on financial companies and the Federal Reserve.

- The components of the Calculation Methodology should be published, and the methodology adjusted to account for the implementation of Basel III. The precise details of the methodology for calculating Financial Sector Liabilities (the "**Calculation Methodology**") should be published to allow financial companies an opportunity to develop their business strategy based on a more accurate forecast of their share of Financial Sector Liabilities ("**Market Share**") under Section 622. In addition, the Calculation Methodology should be adjusted to take account of the implementation of Basel III to prevent unnecessary shocks and inappropriate distortions in the application of Section 622.

Finally, we request that the Federal Reserve provide additional clarification in the final rule or preamble on certain technical aspects of the rule described in detail in Section VI of this letter.

II. Additional Exclusions to the Definition of "Covered Acquisition" Should Be Incorporated Into the Final Rule

As a financial company approaches the 622 Concentration Limit, the Proposed Rule, as drafted, would prohibit the financial company from engaging in certain routine business transactions that are equivalent (in terms of the volume of liabilities attributable to its balance sheet) to Ordinary Course Business Transactions that, like traditional lending and financing activities, (i) are beneficial to the economy and the general public but (ii) do not in any practical sense affect concentration in the financial sector. To avoid restricting these activities, the Proposed Rule should be modified to exclude additional types of Ordinary Course Business Transactions from the definition of "covered acquisition."

Under Section 251.2(f) of the Proposed Rule, a "covered acquisition" generally includes a "transaction in which a company merges or consolidates with, acquires all or substantially all of the assets of, or otherwise acquires control of another company, and the resulting company is a financial company."[13] Because many Ordinary Course Business Transactions are technically structured as investments in companies, the Proposed Rule may limit, or perhaps eliminate altogether for larger financial companies, the ability to engage in such transactions even though economically equivalent transactions that would also raise the financial company's liabilities are permitted. For example, acquisitions of loans may, as a technical legal matter, be structured as investments in companies for a variety of legitimate reasons. These investments are economically indistinguishable from direct lending or financing activities undertaken by the financial company as part of its ordinary business.

The Proposed Rule excludes from the definition of "covered acquisition" several types of Ordinary Course Business Transactions, including the acquisition of shares in the ordinary course of collecting a debt previously contracted, in a fiduciary capacity, in connection with underwriting or market making, as part of a financial company's merchant or investment banking activities, or as part of an interna corporate reorganization.[14] In light of the concerns noted above, this list of exempt

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13 *See* Section 251.2(f) of the Proposed Rule, citing 12 U.S.C. § 1841(a)(2).

14 *See Id*.

transactions should be expanded to include additional categories of Ordinary Course Business Transactions and other beneficial activities described below. Although most of the transactions discussed below should not give rise to concerns regarding evasion, we note that an appropriately crafted anti-evasion provision would address any such concern.

A. Community Development Investments

Many banking organizations engage in a wide range of community development investments as permitted and encouraged under applicable law and regulation.[15] These investments generally involve making equity and debt investments in corporations or projects designed to promote community welfare. In fact, many community development investments by banking organizations are structured as equity investments in corporations that would constitute "control" under the Federal Reserve's definition of the term and, as such, could technically be "covered acquisitions" under the proposed definition. One of the primary purposes of Section 622 was to "improve . . . the cost and availability of credit and other financial services to households and business in the United States."[16] However, if activities like community development investments are considered "covered acquisitions," a major existing source of credit to small businesses and individual consumers would potentially be greatly curtailed, contrary to one of the primary purposes of Section 622.[17]

The federal banking agencies have long supported and encouraged the participation of financial institutions in community development investments. The Federal Reserve included community development investments among the activities determined to be closely related to banking "in order to permit bank holding companies to fulfill their civic responsibilities" and "to take an active role in the quest for solutions to the Nation's social problems."[18] Community development investments by banks may qualify as community development investments for purposes of the Community Reinvestment Act (the "**CRA**").[19] Congress recognized the public policy importance of community development investments in the Dodd-Frank Act, as reflected by their exemption from the prohibitions in the Volcker Rule.[20] Because these investments are focused on community welfare, such as economic rehabilitation

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15 12 C.F.R. 208.22 (state member banks); 12 C.F.R. 225.22 through 225.28 and 225.127 (bank holding companies); 12 C.F.R. 225.81 and 225.87 (financial holding companies); 12 C.F.R. 24.1 through 24.7 (national banks); and 12 C.F.R. 159.4 and 159.5 (federal savings associations).

16 FSOC Report at 14.

17 The FSOC Report states, "Historical trends . . . indicate that growth of the largest financial institutions has taken place largely through acquisitions and mergers." FSOC Report at 8. However, the categories of transactions that we believe should be excluded from the definition of "covered acquisition" are not the types of transactions that drive significant growth or concentration in a large financial company or make a financial company "harder to manage" and thus should not be the focus of rules adopted pursuant to Section 622. *Id.* at 9.

18 12 C.F.R. 225.127.

19 12 U.S.C. §§ 2901 *et seq.*; *see* 12 C.F.R. 228.12.

20 *See* 12 U.S.C. § 1851(d)(1)(E).

and development of ow-income areas,[21] community development investments would not appear to lead to the risks associated with financial sector concentration that Section 622 was designed to address.

The consequence of the 622 Concentration Limit on community development investments falling within the scope of the 622 Concentration Limit could be significant. For many banking organizations, a significant portion of these activities are structured as investments in companies. If these investments are included in the definition of "covered acquisitions," community development investments will be significantly reduced for institutions at or approaching the 622 Concentration Limit even with Section 622's *de minimis* exception because the volume of such investments, as currently engaged in by the largest financial companies, would very likely cause them to approach the *de minimis* aggregate rolling cap within only a few months after the beginning of each cycle. If this investment activity is effectively curtailed, the bank subsidiaries of financial companies that approach the 622 Concentration Limit will face significant challenges in achieving satisfactory ratings on their CRA performance evaluations, especially the investment test portion of the evaluation.

B. Small Business Investment Companies

Banking organizations also routinely make investments in SBICs[22] with the encouragement of the federal banking agencies. Investments in SBICs meet the definition of "qualified investments" under the CRA.[23] As with community development investments, SBICs are specifically excluded from the Volcker Rule.[24] Further, as noted above, improving the availability of credit to businesses in the United States is a primary purpose of Section 622.[25] Excluding such investments from the definition of "covered acquisition" would allow all financial companies (including banking organizations) to continue to make these investments, which are an important source of funding to small businesses, without undermining the purpose of Section 622 and the Proposed Rule. In addition, these investments are quite similar in nature and purpose to merchant banking investments, which are excluded from the definition of "covered acquisition" under the Proposed Rule.

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21 12 C.F.R. 225.28.

22 SBICs are investment funds licensed and regulated by the U.S. Small Business Administration that are eligible for certain benefits if they comply with certain regulatory restrictions. Banks (and by extension bank holding companies) have the authority under the Small Business Investment Act of 1958 to invest in SBICs, subject to certain quantitative limits and as investments designed primarily to promote the public welfare under 12 § USC 24(Eleventh). Federal savings associations have limited authority to make investments that are permitted for national banks under 12 C.F.R. 24.

23 *See* 12 C.F.R. 228.12.

24 *See* 12 U.S.C. § 1851(d)(1)(E).

25 FSOC Report at 14.

C. Transactions Involving Banking Organizations' Traditional Lending and Customer-Driven Activities

The definition of "covered acquisition" has the potential to subject many Ordinary Course Business Transactions and transactions that support such activities, such as lending activity, investments by funds of which a financial company subsidiary serves as general partner, and *bona fide* hedging transactions, to the 622 Concentration Limit. Because these activities relate to a financial company's traditional customer-driven services and organic growth, which Section 622 is not designed to limit,[26] they should appropriately be excluded from the definition of "covered acquisition."

This encroachment on ordinary business activity could arise because, for example, the acquisition of certain assets, such as a loan portfolio, may be structured as a legal matter as an acquisition of a special purpose vehicle instead of a purchase of the underlying assets themselves. This is, in fact, a very common acquisition structure for loans, as well as many other types of financial assets such as debt securities and leases. Similarly, a banking organization may acquire substantially all of the assets of a company (*e.g.*, all of the loans held by a company) even though it is not acquiring the company as a going concern. Certain leasing activity that serves as the functional equivalent of financing is typically structured as an investment in a company and therefore may raise the same concern. It would be illogical and serve no public policy objective to treat the same underlying economic transaction (*e.g.*, a loan) differently for purposes of the 622 Concentration Limit based on the form of legal transaction structure being utilized. Therefore, purchases of loan portfolios and special purchase vehicles holding only loans and similar financial assets should be excluded from the definition of "covered acquisition."

In addition, because of the broad definition of "control" under the BHC Act,[27] *bona fide* hedging activity (*e.g.*, in connection with customer-driven derivatives transactions or the issuance of structured notes the performance of which may be linked to the performance of various reference assets) could give rise to a "covered acquisition." For example, as a technical matter, under the Proposed Rule, the types of hedging transactions that may give rise to a "covered acquisition" may include scenarios where:

- the financial company issues notes linked to a reference asset and buys over 25% of the reference asset as a hedge in connection with the offering;
- the reference asset acquired as a hedge of risk is an individual's equity in a closely held corporation that constitutes over 25% of that class of equity in the corporation;
- the reference asset acquired as a hedge of risk is 25% or more of the equity in a special purpose vehicle that owns a portfolio of loans or debt securities;

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[26] 79 Fed. Reg. 27801, at 27802; FSOC Report at 11.

[27] The definition of "control" under the BHC Act—which Section 622 amended to include the 622 Concentration Limit as a new Section 14—includes the ownership or control of 25 percent or more of any class of voting securities of a company, control in any manner over the election of a majority of directors, and the power to exercise a controlling influence. 12 U.S.C. § 1841(a)(2).

- the reference assets are loans, which are purchased from a special purpose vehicle, and the loans represent all or substantially all of the assets of that special purpose vehicle;

- the reference assets acquired as a hedge of risk are 25% or more of outstanding debt securities of a variable interest entity, and the senior noteholders have voting power to hire and fire the trustee;

- the reference assets acquired as a hedge of risk are the residual equity tranches of a variable interest entity that represent 100% of the equity and voting control of the entity; and

- the reference asset acquired as a hedge of risk is less than 10% of the total equity of a publicly traded issuer but other indicia of "control" are present, such as the financial company having a director on the issuer's board of directors or the right to appoint a member to the board of directors stemming from the financial company's holdings in a separate class of equity.

Because *bona fide* hedging is an activity that promotes stability within the financial sector and should create no net increase in liabilities for a financial company, this activity should be excluded from Section 622.

The BHC Act "control" definition also could restrict investments by a financial company's controlled fund managed and operated for, and in the best interests of, its clients.[28] A similar issue also may arise in the context of a financial company providing the seed capital for a fund (to the extent permitted under the Volcker Rule for financial companies subject to its restrictions). While the investment may otherwise present a promising investment opportunity, there may be tensions between the fund manager's fiduciary duties to the fund's investors and the need for the parent financial company to abide by the restrictions of Section 622.

In implementing other regulatory requirements under the BHC Act, the Federal Reserve has recognized that banking organizations may seek to achieve organic growth through various means including through transactions that are structured as asset purchases from third parties. For example, under Regulation Y, no prior Federal Reserve approval is required for an acquisition of the assets of a company acquired in the ordinary course of business (subject to the provisions of 12 C.F.R. § 225.132) if the assets relate to activities in which the acquiring company has previously received Federal Reserve

[28] For example, a controlled subsidiary of a financial company may serve as the general partner of (and thus control for BHC Act purposes) a fund for third party investors that invest in loans, loan portfolios, or other debt, including in entities that hold such assets, and may make investments that exceed 24.9% of such an entity. As a result, a general partner of such a fund may have to force the fund to cap its investments in such entities at 24.9%, which may be inconsistent with the best interests of the fund's investors and the general partner's duties or contractual requirements. As another example, a controlled fund may invest in a third party-managed sub-fund, which primarily makes community development or public welfare investments. If these investments include equity investments, the controlled fund may choose not to invest—or potentially could be prohibited from investing—in these types of sub-funds solely because the investments would be included in the calculation of the parent financial company's liabilities.

approval under this regulation to engage.[29] The guidance provided in 12 C.F.R. § 225.132 focuses on whether the asset acquisition "constitutes the acquisition, in whole or in part, of a going concern" (*i.e.*, a focus on the fundamental purpose of the transaction). Although the approach in 12 C.F.R. § 225.132 could not be used to address all of the scenarios that may arise under the 622 Concentration Limit because it does not specifically contemplate, for example, the use of special purpose vehicles to facilitate asset acquisitions, the concepts underpinning the exception to the prior approval requirement for ordinary course asset acquisitions and the guidance are equally relevant here. An exception for Ordinary Course Business Transactions—whether they involve direct investments in acquisition vehicles, hedging activity, or acquisition of all or substantially all of the assets of a company—that do not constitute the acquisition of a going concern would appropriately limit the scope of the 622 Concentration Limit. Moreover, an appropriately crafted anti-evasion provision together with existing supervisory authority should be sufficient to address any potential concerns regarding such an exemption subverting the fundamental requirements of Section 622.

Finally, we urge the Federal Reserve to reserve authority in the final rule to exclude additional traditional banking functions similar to those described in this section from the definition of "covered acquisition" if the Federal Reserve determines—when presented with a unique type of transaction or set of facts—that such activities are outside the scope of transactions and activities that the 622 Concentration Limit was intended to restrict.[30]

III. The *De Minimis* Exception

It is important that the *de minimis* exception that Congress envisioned be workable, transparently administered, and sufficient to provide a financial company with appropriate flexibility to make an acquisition that, while not an Ordinary Course Business Transaction, would offer important benefits to the company but still have no meaningful impact on the company's Market Share. Financial companies of course must plan and manage their business to comply with the 622 Concentration Limit. Not all eventualities can be anticipated, however, and a *de minimis* exception without sufficient flexibility may ultimately prohibit financial companies from engaging in small, immaterial transactions that pose no risk to financial stability but offer significant benefits (e.g., by spurring innovation or allowing financia companies' customers to benefit from technological advancements).

With these objectives in mind, we have three significant concerns with the Proposed Rule's implementation of the statutory *de minimis* exception. First, as currently designed, the Proposed Rule may not, as a practical matter, allow financial companies to carry out certain *de minimis* transactions that would be wholly consistent with the spirit and purpose of the 622 Concentration Limit. In particular, the *de minimis* cap is set too low to provide meaningful flexibility to pursue the types of transactions that may enhance the services provided to customers, improve a financial company's

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[29] 12 C.F.R. § 225.22.

[30] We note that Section 622 explicitly authorizes the Federal Reserve to issue interpretations or guidance regarding the application of Section 622 to an individual financial company or to financial companies in general. *See* Section 622(d) of the Proposed Rule.

competitiveness and minimize technological risks.[31] Second, we are concerned that, as structured, the prior-approval requirement in the Proposed Rule may make the *de minimis* exception largely unusable. Third, the final rule should enunciate a specific standard for review and approval of *de minimis* transactions, which should be based on whether the transaction would result in financial sector concentration that would pose a risk to financial stability.

A. The *De Minimis* Cap is Too Low

We urge the Federal Reserve to increase the cap on *de minimis* transactions to permit an increase in liabilities of up to $5 billion, rather than $2 billion, on a 12-month rolling basis. As described below, a $5 billion *de minimis* cap is unlikely to raise financial stability concerns, would result in only a *de minimis* increase in the liabilities of large financial companies, and would be consistent with the spirit and purpose of the 622 Concentration Limit.

As an initial matter, we note that the $2 billion cap for *de minimis* acquisitions in the Proposed Rule represents a negligible proportion of the liabilities of the largest U.S. financial companies. For a financial company at the 622 Concentration Limit of $1.8 trillion in liabilities (assuming a Denominator of $18 trillion),[32] the $2 billion cap over a 12-month period would mean that the aggregate acquisitions during that period could not result in an increase of more than approximately 1/10th of 1% of the subject institution's "liabilities," as defined by reference to risk-weighted assets under Section 622 and the Proposed Rule. As support for the $2 billion cap, the preamble to the Proposed Rules (the "**Proposing Release**") points only to the Capita One Order[33] in which the Federal Reserve, applying the Financial Stability Factor, states that acquisitions under $2 billion in assets "may be presumed not to raise financial stability concerns" absent extenuating factors.[34] The Capital One Order, however, used the $2 billion threshold solely as an example of a transaction that should not raise financial stability concerns and, at that, in the context of only a single acquisition. The Proposed Rule, by contrast, would use the same $2 billion threshold for all acquisitions by a financial company over a 12-month period. Accordingly, the use of a higher threshold than that in the Capital One Order in the context of an aggregate 12-month limit is entirely appropriate and not inconsistent with the example in the Capital One Order of acquisitions that presumptively raise no financial stability concerns.

As noted, we believe that the *de minimis* exception is important to allow financia companies to accommodate the unknown and participate in and encourage innovation, especially in areas, such as

[31] In addition, to the extent Ordinary Course Business Transactions as described above are not excluded from the definition of "covered acquisition," the ability to rely on the *de minimis* exception becomes even more important, though we note that even the higher de minimis threshold we propose in this letter would not be sufficient, as a practical matter, to permit major financial firms to conduct Ordinary Course Business Transactions at norma levels of routine banking and related business.

[32] In the Proposing Release, the Federal Reserve estimated that Financial Sector Liabilities were approximately $18 trillion as of December 31, 2013, based on publicly available regulatory reports, such as, for bank holding companies, FR Y-9C.

[33] *Capital One Financial Corporation*, Federal Reserve Order No. 2012-2 (Feb. 14, 2012).

[34] 79 Fed. Reg. 27801, at 27809, citing the Capital One Order, at 30.

technological advances, that potentially provide significant benefits to financial companies and their customers. Acquisitions that may lead to benefits for consumers or increase the safety and soundness of a financial company but which may be unavailable to financial companies close to or at the limit under the Proposed Rule include, for example, investments in lending platforms that would expand customers' access to online services, which may improve a financial company's ability to reach a wider range of customers. Similarly, investments in technology consortia that are developing methods to reduce financial companies' exposure to information technology risks benefit both customers and the financial company. The increase in technological offerings to consumers has become an increasingly important factor in financial companies' competitiveness. An increase in the *de minimis* cap should help provide financial companies additional needed flexibility to pursue these types of transactions.

Establishing a higher cap is clearly within the Federal Reserve's authority. Paragraph (3)(c) of Section 622 does not impose a specific cap on *de minimis* transactions, leaving the determination to the discretion of the Federal Reserve. Similarly, the FSOC Report provides only that "in establishing a threshold for the *de minimis* exception, [the Federal Reserve] should ensure that the threshold does not permit transactions that would be inconsistent with the spirit and purpose of the concentration limit."[35] A cap of $5 billion, which would constitute less than 0.3% of the liabilities of a financial company at the 622 Concentration Limit of $1.8 trillion in liabilities (assuming a Denominator of $18 trillion), would not conflict with the spirit and purpose of the 622 Concentration Limit because it would provide financial companies with the ability to engage in transactions that may provide significant benefits to financial companies, its customers, and the broader economy. Importantly, the risk of doing so is minimal. Any material transaction within the scope of even an enlarged *de minimis* exception would continue to require the Federal Reserve's prior consent. As a result, the Federal Reserve will have the opportunity to review transactions to ensure that they are consistent with the purposes of Section 622 and the *de minimis* exception.

B. <u>The Approval Process for Transactions That Qualify for the *De Minimis* Exception Needs to Be Workable and Administered in a Transparent Manner</u>

As formulated in the Proposed Rule, the requirement that a financial company seeking to rely on the *de minimis* exception must receive the Federal Reserve's prior written consent may result in significant administrative burden that could significantly reduce or eliminate the usefulness of the exception.[36] We are concerned that, depending on the approval requirements included in the final rule, the volume of written requests for *de minimis* transactions may strain the ability of the Federal Reserve to process the requests on a timely basis.

To help alleviate these issues, we support the Federal Reserve's suggestion in the Proposing Release of an alternative approval mechanism for certain categories of transactions, although we

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35 FSOC Report at 7, n. 15.

36 Although the Proposing Release provides guidance regarding the prior-notice process for *de minimis* transactions, the Proposed Rule itself does not describe the timing requirements and approval process for transactions that qualify for exceptions to the 622 Concentration Limit under Section 622(c) of the Dodd-Frank Act.

believe that the suggested threshold of $25 million is too low. Accordingly, we recommend that the Federal Reserve include in the final rule its general consent for a financial company to engage in any transaction for which the consideration paid is $100 million or less, and for which the associated increase in liabilities is within the *de minimis* cap, with only an after-the-fact notice on Form FR Y-10 (or similar notice for financial companies not required to file the FR Y-10). The $100 million proposed transaction value cap is a far simpler, more transparent and practical measure for a financial company to use when planning transactions and would be likely to have, at worst, a negligible impact on liabilities. A more predictable measure may also reduce the number of notices that are filed on a purely cautionary basis because a financial company may not know early in the process what the ultimate effect on liabilities will be. Of course, a financial company would still be subject to the cap on *de minimis* transactions over a 12-month period, calculated on the basis of the increase in liabilities, which means that as a financial company approaches the *de minimis* cap, it will need to monitor both the consideration to be paid and the increase in liabilities relative to the cap to ensure it would remain in compliance with the *de minimis* exception across all of its transactions. Finally, from a practical perspective, a provision in the final rule granting a general consent for a limited universe of truly *de minimis* transactions would save the Federal Reserve the significant administrative burden associated with reviewing and acting on notices that should not in fact raise concerns about concentration in the financial sector.

If a financial company needs to rely on the *de minimis* exception for any Ordinary Course Business Transactions (*i.e.*, if the Proposed Rule is not modified as recommended in Part II above), we would also recommend that such transactions be pre-approved *as a category* with only after-the-fact notice required (provided that the cap on *de minimis* transactions would apply). Because they are Ordinary Course Business Transactions and not strategic in nature, they are wholly unlikely to result in the types of increases in firm size or systemic concentration that the 622 Concentration Limit is intended to restrict.

C. Approval of *De Minimis* Transactions Should Be Based on their Impact on Financial Stability

As a further enhancement to the proposed framework's transparency, we strongly suggest that the final rule specify the standard the Federal Reserve will use to evaluate the transactions that require prior approval under the *de minimis* exception. The statutory exclusion of *de minimis* transactions from restrictions of the 622 Concentration Limit indicates that such transactions do not raise financial stability concerns. Therefore, we believe the Federal Reserve should evaluate requests under the *de minimis* exception against a standard that is clearly consistent with this statutory approach – *i.e.*, whether the consummation of the transaction would create a level of concentration in the financial sector that would pose a threat to financial stability. This standard would be similar to the standards that Congress provided in the prior-consent requirements included in Section 163 (covering certain nonbank acquisitions) and Section 604 (covering certain bank acquisitions) of the Dodd-Frank Act, while also reflecting Section 622's clear statutory direction that any transaction that meets the *de minimis* threshold should be approved absent unusual circumstances. Because the Proposed Rule does not provide *any* guidance on the process, timing, or standards for applications under the *de minimis* exception, however, we strongly suggest that Federal Reserve do so in its final rule.

IV. The Notification Requirement for Covered Acquisitions Below the 622 Concentration Limit As Proposed Is Unnecessary and Unduly Broad

The requirement that certain financial companies provide prior notice of covered acquisitions that do not cause a breach of the 622 Concentration Limit is unnecessary, unduly broad, and not mandated by Section 622. According to the Proposing Release, the purpose of the prior-notice requirement for a financial company with liabilities as low as 8% of Financial Sector Liabilities pursuing a covered acquisition that would increase its liabilities by over $2 billion (a "**Reportable Transaction**") is to "allow the [Federal Reserve] to monitor compliance with the statute."[37] However, a financial company holding only 8% of Financial Sector Liabilities is, in practical terms, not close to exceeding the 622 Concentration Limit, and certainly not with an acquisition (or series of acquisitions over a 12-month period) that adds $2 billion (or the proposed $5 billion) to its liabilities. With an appropriately transparent Calculation Methodology, as discussed in Part V, below, financial companies will be well-placed to monitor their own compliance with the limit and will have every incentive to consult with the Federal Reserve should any transaction put the company at risk of exceeding it. The imposition of such a prior notice requirement would add significant burden and would create administrative difficulties for financial companies and the Federal Reserve alike without a corresponding benefit.[38] Accordingly, a Reportable Transaction should be required on an after-the-fact basis only. This approach would limit the administrative burden while preserving the Federal Reserve's ability to "monitor" compliance with Section 622.

If a prior notice requirement is retained, at a minimum, the thresholds should be adjusted. There simply is no compelling reason to require notification of transactions that do not bring a financial company remotely close to the 622 Concentration Limit. If it is determined that such a notice is required, it should be triggered only when, upon consummation of a transaction, a financial company exceeds 9.5% of Financial Sector Liabilities. This threshold would still ensure that the Federal Reserve has ample notice before a financial company approaches the 622 Concentration Limit.[39]

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37 79 Fed. Reg. 27801, at 27808.

38 We note that in other contexts, the BHC Act sets the threshold for a reportable transaction at a level well above $2 billion. For example, Section 163 of the Dodd-Frank Act requires prior notice for the acquisition of a nonbank company engaged in activities that are financial in nature only when the company to be acquired has total consolidated assets of $10 billion or more. 12 U.S.C. § 1843(k)(6). This suggests that in Congress' view prior review by the Federal Reserve of financial holding company transactions below the $10 billion threshold is unnecessary as these transactions should presumptively raise no financial stability concerns. It is also noteworthy that in the context of 12 U.S.C. § 1843(k)(6), Congress —in the statute itself—provided for the prior notification requirement. The fact that Congress did not include a prior notification requirement in Section 622 suggests that it did not view additional information about transactions that did not cause a financial company to exceed the 622 Concentration Limit to be necessary or useful from a financial stability perspective.

39 We note that a financial company holding 9.5% of Financial Sector Liabilities before a transaction would have to make an acquisition of over $9 billion in order to breach the 622 Concentration Limit if one assumes a Denominator of $18 trillion.

Furthermore, if retained, the timing of any prior notice needs to be adjusted to provide sufficient flexibility for financial companies to pursue transactions that are permissible under the 622 Concentration Limit. Adjustment of the timing of the requirement is particularly important if all Ordinary Course Business Transactions are not excluded from the definition of "covered acquisition."

As proposed, a financial company must notify the Federal Reserve of a Reportable Transaction at the earlier of 60 days before the consummation of the Reportable Transaction or 10 days after execution of the transaction agreement.[40] An example of a potential timing issue that arises is in the context of transactions conducted via an auction process, which is common for loan portfolio sales. In the auction process, the winning bidder generally will not know it is the winning bidder until shortly before execution of the agreement specifying the terms of the transaction. If the time period between execution and consummation of an agreement that constitutes a covered acquisition is short, it may not be possible for a financial company to provide notice "at the earlier of 60 days before the consummation of the covered acquisition [and] ten days after execution of the transaction agreement." To enable financial companies to continue to participate in transactions, such as loan portfolio auctions, that involve short periods between execution of the agreement and consummation of the transaction, this provision should be revised to allow notice at the "later of 60 days before the consummation of the covered acquisition and 10 days after execution of the transaction agreement."

Finally, we note that there may be circumstances where it is impractical for a financial company to provide prior notice and recommend that the Federal Reserve provide the ability in the final rule to grant waivers for immaterial and/or inadvertent covered acquisitions that otherwise would be reportable under the rule.[41]

V. Calculation Methodology

We have concerns regarding certain technical aspects of the methodology for calculating a financial company's Market Share under the Proposed Rule. First, in order to allow financial companies to forecast more accurately their share of Financial Sector Liabilities and properly evaluate potential acquisitions accordingly, we encourage the Federal Reserve to publish the technical methodology used

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40 *See* Section 251.6(b) of the Proposed Rule.

41 A financial company could acquire inadvertent "control" of a company as a result of events that are not related to the financial company's economic interest in the entity. For example, securitization trusts often have provisions that grant holders of debt certain rights (*e.g.*, a director on the board of directors) upon the occurrence of certain events. Such a right may be triggered without advance notice to the financial company. Additionally, a financial company often is not aware of what other assets are held by the seller in an acquisition, so it may unknowingly purchase "substantially all" of the assets of a seller and thus inadvertently participate in a covered acquisition. If the Federal Reserve does not grant a waiver in this scenario, a financial company should be able to cure the failure to obtain prior approval if it informs the Federal Reserve of its inadvertent control position or inadvertent covered acquisition within 10 days of the occurrence of the triggering event.

More broadly, we encourage the Federal Reserve to reserve authority to grant waivers to the prior notice requirements as well as other waivers that are consistent with Section 622. Flexibility, to the extent consistent with Section 622, could be an especially important tool during times of severe financial distress.

in calculating Financial Sector Liabilities, including which line items from FRY-9C reports are included. Second, the Calculation Methodology should provide a mechanism to "stabilize" the calculation of Financial Sector Liabilities as Basel iII comes into effect.

A. The Federal Reserve Should Publish the Details of Its Calculation Methodology to Allow Financial Companies to Ensure Their Activities Will Comply with Section 622

Additional detail is necessary with respect to the Federal Reserve's proposed Calculation Methodology to assist financial companies in their compliance with the 622 Concentration Limit. Publication of the specific methodology for calculating the Denominator, similar to the level of detail provided in the calculation of a financial company's share of nationwide deposits under the Riegle-Neal Act,[42] would be helpful for financial companies approaching the 622 Concentration Limit. Greater specificity would enable them to more accurately project their Market Share as they consider their business plans.

At a minimum, the description of the Calculation Methodology would include the source of the information on which the calculation is based—that is, not only the reporting forms from which the information may be drawn but also the specific line items, from which the values are taken (for example, whether accounting adjustments in lines 4 (Accumulated Other Comprehensive Income) and 7B (Debt Valuation Adjustment) of the FR Y-9C's schedule HC-R are considered deductions subject to the add-back requirement). In addition, for financial companies that are not currently required to publicly report the information necessary for the Federal Reserve to calculate Financial Sector Liabilities, the description should identify the specific source of the information the Federal Reserve has relied on to perform the calculation. The description also should provide sufficient detail regarding the methodology for calculating the liabilities of foreign banking organizations and specify the sources of the information relied on for the calculation.

We note as well that we support the Federal Reserve's use of the institution-specific approach to risk-weighting exposures that must be deducted from regulatory capital. As noted in the Proposing Release, this approach would provide a more precise methodology for converting a capital deduction to a risk-weighted asset amount without changing the total capital ratio of the institution and more accurately reflect liabilities in an "institution-specific manner."[43]

B. The Federal Reserve Should "Stabilize" the Calculation of Financial Sector Liabilities as the Basel III Regulatory Capital Regime and Other Similar Regulatory Changes Take Effect

Changes to the regulatory system that affect the calculation of the Denominator, such as the implementation of the Basel III regulatory capital regime, reflect a change only to how the inputs to the

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42 *See, e.g.*, Federal Reserve System, Order Approving the Merger of Bank of America Corporation and FleetBoston Financial Corporation, at 59-60, March 8, 2004, *available at* http://www.federalreserve.gov/boarddocs/press/orders/2004/20040308/attachment.pdf.

43 79 Fed Reg. 27801, at 27803-4.

Calculation Methodology are measured and not the underlying liabilities, risk or concentration in the financial sector. For this reason, we support the Federal Reserve's proposal in the Proposing Release to calculate Financial Sector Liabilities as of the previous calendar year-end rather than the average of the previous two year-ends for a transition period through full implementation of the Basel III regulatory capital regime. This methodology would be consistent with the general approach of the FSOC in making recommendations regarding implementation of Section 622, which was to calculate Financial Sector Liabilities so as to prevent "unnecessary volatility" in the application of the 622 Concentration Limit.[44] Using the previous calendar year rather than the previous two years would prevent "unnecessary volatility" resulting purely from the implementation of new rules rather than in the actual aggregate liabilities and concentration in the financial sector. We also urge the Federal Reserve to reserve authority to adjust the Calculation Methodology in this manner in the event that other future regulatory changes, whether anticipated or not, threaten to have a similar destabilizing or distortive impact on the calculation of Market Shares.

VI. Further Clarifications Regarding the Scope of "Covered Acquisitions"

In order to avoid any potential for confusion, we strongly suggest that the Federal Reserve explicitly confirm in its final rule what we believe is implicit in the language and structure of the Proposed Rule – namely, that securities repurchase financing and securities borrowing and lending transactions are not "covered acquisitions." These transactions are critical to the functioning of financial markets and are not the type of expansionary acquisition to which the 622 Concentration Limit is meant to apply. In many cases, a financial company engaging in this activity is performing a market making function, which is specifically excluded from the definition of Covered Acquisition under the Proposed Rule. Overall, these transactions provide little, if any, opportunity for evasion of the limit, nor should they lead to a long-term, sustained increase in a financial company's liabilities.

- *Securities repurchase financing transactions*. Securities repurchase financing transactions are a form of short-term financing relied on by a wide range of financial market participants. The ability of financial companies to continue to engage in these transactions at current levels is critical to financial companies and the markets they serve. These transactions should not increase concentration at particular financial companies because the arrangements are short-term, and financial companies would not have an incentive to accumulate these holdings because they offer relatively low interest rates in comparison to other lending products. In the Proposing Release, the discussion of the exception for "ordinary business transactions" referred specifically to the fact that shares in those types of transactions generally are held for a limited time period.[45] We believe this rationale applies equally to securities repurchase financing transactions and that they should therefore be excluded from the definition of "covered acquisition."

- *Securities borrowing and lending transactions*. Securities borrowing and lending transactions are similar to securities repurchase financing transactions and serve a similar role in markets. In

44 FSOC Report at 21.

45 79 Fed. Reg. 27801, at 27809.

these transactions, a financial company acquires shares, generally on a short-term basis, for resale and does not exert managerial control over the underlying companies. Once again, the short-term nature of these transactions supports their exclusion from the final rule.

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The Associations appreciate the opportunity to provide comments on the Proposed Rule. Should you have any questions or need further information, please contact Sloan Hatfield at 202-649-4602 (email: sloan.hatfield@theclearinghouse.org) or Gregg Rozansky at 212-612-9220 (email: gregg.rozansky@theclearinghouse.org).

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Board of Governors of the Federal Reserve System

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Annex A

The Clearing House. Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing – through regulatory comment letters, amicus briefs and white papers – the interests of its owner banks on a variety of important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily which represents nearly half of the automated clearing-house, funds transfer, and check-image payments made in the United States. *See* The Clearing House's web page at www.theclearinghouse.org.

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