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July 7, 2014

Submitted Electronically

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave., NW
Washington, D.C 20551

Re: Federal Reserve Notice of Proposed Rulemaking on Concentration Limits on Large Financial Companies; Docket No. R-1489, RIN 7100 AE 18

Dear Mr. Frierson:

On behalf of certain of our clients, we respectfully submit the following comments to the Board of Governors of the Federal Reserve System (the "Board") regarding proposed Regulation XX (the "Proposed Rule").[1] The Proposed Rule would implement section 14 of the Bank Holding Company Act of 1956 (the "BHCA"), which was added by section 622 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[2] The Proposed Rule generally would establish concentration limits applicable to mergers or consolidations among large financial companies and impose related reporting requirements.

We appreciate this opportunity to comment on the Proposed Rule. While we appreciate the efforts of the Board to implement these required concentration limits, we have concerns about the Proposed Rule, primarily regarding the disproportionate burden it would impose on institutions that currently do not report consolidated financial information to a federal banking agency. For the reasons discussed below, we urge the Board to consult with the Financial Stability Oversight Council ("FSOC") and revisit the Proposed Rule.

Discussion

The Proposed Rule generally would prohibit a financial company from consummating a covered acquisition if the liabilities of the resulting financial company would exceed 10 percent of the financial sector liabilities. In order to calculate the financial sector liabilities, the Proposed

[1] Concentration Limits on Large Financial Companies, 79 Fed. Reg. 27801 (May 15, 2014).
[2] 12 U.S.C. § 1852.

Rule would impose a requirement that financial companies that do not otherwise file consolidated financial statements with a federal banking agency report their consolidated liabilities to the Board on an annual basis. As discussed below, we believe certain aspects of the Proposed Rule warrant further consideration.

A. *The proposed reporting requirement exceeds the Board's statutory authority.*

Proposed section 251.6 provides that, by March 31 of each year, a U.S. financial company that does not otherwise file financial statements with a federal banking agency must report to the Board its consolidated liabilities as of the previous calendar year-end. By requiring that such financial companies report their liabilities to the Board, the Proposed Rule exceeds the Board's statutory authority, which carefully limits the nature of the entities that can be required to report to the Board and the specific circumstances where the Board can require the reporting of "liabilities."

Congress specifically addressed and limited the Board's authority to require reports from financial institutions. Section 11 of the Federal Reserve Act (the "FRA") first sets forth the Board's authority in this respect.[3] The FRA provides the Board with broad discretion to require "statements and reports as it may deem necessary" from the Federal Reserve Banks and member banks.[4] The FRA explicitly contemplates reports of assets and liabilities, but generally requires that, with respect to depository institutions other than member banks, the Board obtains such information through the institution's primary federal or state banking regulator.[5] Section 5(c) of the BHCA also authorizes the Board to require periodic reports, but solely from bank holding companies and their subsidiaries.[6] As the Board acknowledges, subsection 251.6 of the Proposed Rule would require reports to the Board from entities that are not member banks (nor depository institutions of any type), bank holding companies, or subsidiaries of bank holding companies.[7]

Section 5(b) of the BHCA authorizes the Board to "issue such regulations and orders … as may be necessary to enable it to administer and carry out the purposes of this chapter …."[8] While "this chapter" applies to section 14 of the BHCA, in light of other provisions of the BHCA and FRA, section 5(b) does not authorize the Board to impose the proposed reporting requirement. Where Congress has specifically addressed and limited a particular aspect of an agency's power, that determination is not set aside or displaced by a separate, general grant of administrative power. Thus, the broad language in section 5 of the BHCA does not authorize the

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[3] *See id.* § 248(a).
[4] *Id.* § 248(a)(1).
[5] *Id.* § 248(a)(2)(A).
[6] *Id.* § 1844(c).
[7] *See* 79 Fed. Reg. at 27807 (reporting requirements newly imposed on certain savings and loan holding companies that are insurance companies; holding companies of industrial loan companies, limited-purpose credit card banks, and limited-purpose trust banks; and nonbank financial companies supervised by the Board).
[8] 12 U.S.C. § 1844(b).

Board to impose the reporting requirement in proposed section 251.6 In addition, section 11 of the FRA itself confirms that a provision such as section 5(b) of the BHCA cannot expand Congress' specific limit on the Board's power to require reports. Section 11 of the FRA itself includes a very similar general rulemaking power, which Congress clearly intended not to displace the limit on the Board's authority set out in section 11(a).[9]

Finally, the other authorities invoked by the Board either confirm the limits on its rulemaking authority or clearly fail to empower the Board to impose proposed section 251.6's reporting obligation. The Board claims authority from section 1852 itself, but that provision carefully limits the Board's authority by providing that "[t]he Board shall issue regulations implementing this section in accordance with the recommendations of the Council under subsection (e), including the definition of terms, as necessary."[10] "This section" omits any mention of reporting requirements, and, therefore, the power to "implement[this section" does not extend to imposing novel reporting requirements not addressed in the section. That result provides a further basis to conclude that Congress intended to limit the Board's exercise of such authority. The Board also invokes the FSOC report,[11] but that report provides no recommendation or other basis to impose reporting requirements (even assuming that any such FSOC recommendation could in some manner displace Congress's prior determination of this issue). The other statutes cited as authority by the Board also provide no basis for the Board to impose a reporting requirement under proposed section 251.6.[12]

B. *The proposed reporting requirement is unduly burdensome.*

If the Board determines that it has the statutory authority to impose the reporting obligation, section 11 of the FRA requires the Board to "endeavor to avoid the imposition of unnecessary burdens on reporting institutions . . . "[13] Accordingly, the Board should not impose such a requirement without considering the associated burden on the reporting financial companies. Imposing a new reporting obligation on, by the Board's estimate, 80 companies that currently do not submit financial reports for any bank regulatory purpose would result in a measurable burden to those institutions.

The Board estimates that preparation of the proposed report will require between 30 minutes and one hour.[14] The Board's estimate is low even if applied narrowly to the time it

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[9] *See id.* § 248(i).
[10] *See id.* § 1852(e).
[11] Study and Recommendations Regarding Concentration Limits on Large Financial Companies (Jan. 2011), *available at*: http://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/Study%20on%20Concentration%20Limits%20on%20Large%20Firms%2001-17-11.pdf
[12] *See* 12 C.F.R. § 251. (proposed) (citing 12 U.S.C. § 1818 and the International Banking Act of 1978).
[13] 12 U.S.C. § 248(a)(2).
[14] We note a discrepancy between the Board's estimate of the reporting burden noted in the Proposed Rule and in the draft reporting form on the Board's website. The former estimates 30 minutes, while the latter estimates hour.

would take someone to review the reporting instructions and complete and file the form. The Board's estimate completely ignores the time and resources invested in preparing and ensuring that the underlying financial statements conform to the methodology in the Proposed Rule; processing the form through the appropriate corporate review and approval channels; and drafting, approving and submitting the associated request for confidential treatment. Accordingly, we believe the burden associated with the report is much greater.

In the supplementary information to the Proposed Rule, the Board indicates an intention to use information already reported by financial companies "to the maximum extent possible."[15] To that end, the Board proposes to extrapolate the amount of consolidated liabilities for small bank holding companies based on existing reports filed by those institutions (which do not include a line item for liabilities).[16] For the vast majority of financial companies subject to the Proposed Rule, the Board's proposal imposes no new reporting obligations. Accordingly, the Proposed Rule imposes a disproportionate burden on the approximately 80 companies that currently do not report consolidated financial information to a federal banking agency.[17]

C. *Accordingly, the scope of the Proposed Rule should be narrowed.*

We urge the Board to consider, and consult with the FSOC as necessary regarding, whether the inclusion of these 80 companies in the scope of the Proposed Rule is even appropriate. While we appreciate that the statute broadly defines a "financial company" to include all companies that control insured depository institutions, the statute also grants broad authority to the FSOC to make recommendations regarding modifications that would more effectively implement the statutory intent. We suggest that the FSOC's review process can be, and should be, an iterative one, in which the Board provides suggestions based on public comment, which the FSOC takes under further consideration.

In the supplementary information to the Proposed Rule, the Board acknowledges that financial companies that are not affiliated with an insured depository institution, such as stand-alone broker-dealers or insurance companies, are not subject to the Proposed Rule unless they have been designated by the FSOC for supervision by the Board.[18] However, many of these approximately 80 companies that would be subject to the new reporting requirement are also broker-dealers, asset management companies, and insurance companies that, for all intents and

79 Fed. Reg. at 27811; draft FR Y-17, *available at*: http://federalreserve.gov/reportforms/formsreview/FRY17_20140515_f.pdf

[15] 79 Fed. Reg. at 27804.

[16] *Id.*

[17] Until the reporting requirements are implemented, the Board proposes to rely on publicly available information in order to estimate the total consolidated liabilities of financial companies that do not file financial reports with a federal banking agency. *Id.* at 27805. We encourage the Board to consider whether it can eliminate the reporting burden by continuing to extrapolate the necessary information from other sources.

[18] *Id.* at 27802.

purposes, are no different than those stand-alone financial companies excluded from the scope of the concentration limit. Others are not financial companies at all and, instead, are retailers or manufacturing companies. Many of these 80 companies control limited-purpose depository institutions, such as trust companies, which provide services only to affiliated customers. These institutions are not in the business of accepting deposits from the general public and, often, their only deposit is a minimal deposit (*i.e.*, $500,000) from an affiliate, which is necessary to maintain deposit insurance. These institutions represent a mere fraction of the overall assets and liabilities of the consolidated company. They do not rely on, and do not present a risk to, the federal Deposit Insurance Fund.

We suggest that the Board and FSOC consider excluding these 80 institutions from the scope of the Proposed Rule entirely, to align treatment of these institutions with that of their stand-alone competitors.[19] If the Board and FSOC determine to retain the broad scope of the Proposed Rule, as an alternative, we suggest the inclusion of a *de minimis* exception to the definition of a financial company (or, at a minimum, the calculation of financial sector liabilities) which would exclude a holding company and its nonbank subsidiaries if all of the insured depository institution subsidiaries of such holding company accept deposits solely from affiliated companies and do not accept any deposits from third parties.

D. *<u>In the alternative, form FR Y-17 should be published for public comment.</u>*

In the event the Board determines that additional reporting by these 80 companies is necessary and appropriate, the scope and format of such reporting obligation should be subject to public notice and comment as part of the Proposed Rule. The supplementary information to the Proposed Rule mentions the creation of a new reporting form, the FR Y-17.[20] However, the reporting form was not part of the Proposed Rule. We suggest that the reporting form is an important aspect of the proposal and should have been published for simultaneous public comment.[21] Accordingly, the proposed form should be published for public comment and the period for public comment on the Proposed Rule should be extended to allow interested parties an opportunity to review and comment on both simultaneously.

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[19] This approach also would better align the Board's rule with the statutory intent of section 14 of the BHCA by capturing banks and bank-like institutions while avoiding inclusion of companies not involved in financial intermediation.
[20] 79 Fed. Reg. at 27807.
[21] The Administrative Procedures Act generally requires federal agencies to provide public notice and an opportunity for comment on any proposed rule. 5 U.S.C. § 533. The definition of "rule" is broad enough to cover forms required as part of a proposal, and the proposed form does not fall within any of the exemptions from publication.

A draft FR Y-17 located elsewhere on the Board's website appears to require just a single entry of the reporting company's total consolidated liabilities.[22] To the extent that the Board retains the FR Y-17 form, we encourage the Board to retain the narrow scope of the form. The single line item is sufficient to address the Board's needs, if it is unable to estimate financial sector liabilities though other sources.

E. *Form FR Y-17 should be treated as confidential.*

As the Board recognizes, many of the newly defined financial companies currently do not report consolidated financial information to the Board or other federal banking agencies.[23] At least some of those are privately held and also do not report financial information to the U.S. Securities and Exchange Commission or otherwise publicly release their financial information. Notwithstanding that fact, the Proposed Rule would require such companies to report to the Board their total consolidated liabilities and, as the default position, would make such reports publicly available. While the supplementary information to the Proposed Rule states that financial companies would be permitted to request confidential treatment of the information reported pursuant to the rule, the instructions to the Board's draft form FR Y-17 suggest that the Board would apply a nearly impossible standard.

As a threshold matter, the instructions mandate electronic submission of the form and require that a written request for confidential treatment be submitted to the Board separate from, and in advance of, such electronic submission. This requirement is inconsistent with section 261.15(a) of the Board's regulations which permits "any submitter of information to the Board" to request confidential treatment pursuant to 5 U.S.C. § 552(b)(4) and 12 C.F.R. § 261.14(a)(4) "at the time the information is submitted or a reasonable time after submission."[24] While such a requirement for a pre-filing request might be appropriate for a form like the FR Y-9C, where the submitter is well aware of its holding company status and reporting obligation, it is not appropriate to apply the same standard to the form FR Y-17 reporting population—companies that are not otherwise subject to the Board's supervision and regulation.

In addition, the instructions suggest that the Board would be unreceptive to a financial company's request for confidential treatment. The instructions caution that such a request "must discuss in writing the justification for which confidentiality is requested and must demonstrate the specific nature to the harm that would result from public release of the information. Merely stating that competitive harm would result . . . is not sufficient."[25] In our experience, this standard is higher than the Board historically has applied in practice with respect to various

[22] Draft FR Y-17 *available at:* http://federalreserve.gov/reportformsreview/FRY17_20140515_f.pdf; Instructions *available at:* http://federalreserve.gov/reportformsreview/FRY17_20140515_i.pdf
[23] 79 Fed. Reg. at 27807.
[24] 12 C.F.R § 261.15(a).
[25] Instructions, *supra* note 21, at 3.

applications to, and filings made with, the Board. The instructions further warn that, notwithstanding the company's effort, the information may be released by the Board anyway, if the Board determines that the disclosure of the information is in the public interest. We maintain that where information is collected for an aggregate purpose, there can be no public interest that could justify the release of the information in disaggregated form.

Accordingly, we urge the Board to revisit the confidentiality of form FR Y-17. Given that at least some of the projected reporters are not otherwise subject to the Board's oversight and reporting obligations, and that a subset of them do not release any public financial information, requiring <u>any</u> public disclosure of their financial information would undermine the reporter's status as a private company, would subject the reporter to unwarranted public scrutiny, and could result in substantial competitive harm by allowing the reporter's competitors to discover otherwise confidential financial information about the reporter.

Instead, we suggest that form FR Y-17 be treated as automatically confidential, similar to the following forms: (i) FR Y-8, BHC Report of Insured Depository Institutions Section 23A Transactions with Affiliates; (ii) FR Y-12A, Annual Report of Merchant Banking Investments Held for an Extended Period; (iii) FR Y-14A, 14M, and 14Q, Capital Assessments and Stress Testing Information Collection; (iv) FR Y-16, Annual Company-Run Stress Test Report for State Member Banks, BHCs, SLHCs; and (v) FR Y-20, Financial Statements for a Bank Holding Company Subsidiary Engaged in Bank-Ineligible Securities Underwriting and Dealing.

If the Board requires an affirmative request for confidential treatment from FR Y-17 reporters, it should permit companies to make a one-time request rather than to justify confidential treatment on an annual basis. In addition, the Board should issue staff commentary explaining in greater detail how a company can secure confidential treatment for its responses to the FR Y-17, including the circumstances in which the Board would determine that disclosure is in the public interest and ways in which a financial company can successfully demonstrate the "specific nature of the harm" likely to result from disclosure.

F. <u>*The Board should either delete or expand the exclusion from "covered acquisition" for acquisitions in a fiduciary capacity.*</u>

Proposed section 251.2(f) defines a "covered acquisition" as "a transaction in which a company . . . acquires control of another company . . . ." Proposed subsection 251.2(f)(2) provides that a covered acquisition does not include the "acquisition of securities or other assets in good faith in a fiduciary capacity if the securities or assets are held in the ordinary course of business and not acquired for the benefit of the company or its shareholders, employees, or subsidiaries."

The Board's inclusion of this exception is puzzling because securities or other assets held in a fiduciary capacity typically would not be treated as balance sheet assets.[26] An acquisition of assets in a fiduciary capacity should not result in any change to the acquirer's liabilities and should not impact application of the concentration limit.

Since the supplementary information to the Proposed Rule does not discuss the application of the fiduciary exception, including what it means to acquire shares in a fiduciary capacity, the Board's inclusion of the fiduciary capacity exception could provide the basis for an argument that some acquisitions on behalf of customers are subject to the concentration limit in proposed section 251.3 and the transaction reporting requirements in proposed section 251.6(b). Proposed section 251.2(d) provides that "control" has the same meaning as in 12 C.F.R. § 225.2(e). Among other things, that definition provides that control includes the ownership, control or power to vote 25% or more of the outstanding shares of a class of voting securities of a company, or the power to exercise a controlling influence over the management or policies of the company. In other contexts, the Board has held that the power to exercise a controlling influence over the management or policies of a company is presumed to exist (subject to rebuttal) upon the acquisition of 10% or more of the outstanding shares of a class of voting securities of the company, if the issuer has publicly traded securities or no other shareholder will hold a greater percentage of the shares in that class.[27] Under Regulation Y, a company that acquires securities in a fiduciary capacity, but has sole discretionary authority to vote the securities, is treated as controlling those securities for purposes of the 10% and 25% thresholds outlined above.[28] Thus, without further clarification, one could argue that an acquisition of securities by an investment manager for a customer's account could be treated as a covered acquisition if the investment manager has sole discretionary voting authority over the securities. We assume this would be an unintended result, and we do not believe such an application would be supported by the statute. Accordingly, the fiduciary capacity exception should be deleted entirely or clarified so that it applies without regard to voting capacity.

If the Board retains the fiduciary capacity exception, it also should be broadened to include any acquisition by a financial company for the account of, or on behalf of, a customer, regardless of whether the acquisition meets a "fiduciary capacity" test. To limit the exception to acquisitions made in a fiduciary capacity creates a negative inference that assets acquired on behalf of customers in other capacities are covered acquisitions. However, there is no practical distinction between assets acquired in a fiduciary capacity and assets acquired in other non-

[26] *See* Instructions for Preparation of Consolidated Reports of Condition and Income (FFIEC 031 and 041) at 9 *available at*: https://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_201403_i.pdf.
[27] *See* 12 C.F.R. § 225.41(c)(2).
[28] *See id.* § 225.12(a)(1).

principal capacities, such as custodian, investment manager or investment advisor.[29] Assets acquired in any of these capacities should be excluded from the "covered acquisition" definition.

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Again, we appreciate the opportunity to comment on the Proposed Rule. If you have any questions, please do not hesitate to contact me at (202) 736-8267 or Amber Tofilon at (202) 736-8939.

Very truly yours,

William S. Eckland

[29] *See* Instructions for Preparation of Consolidated Reports of Condition and Income (FFIEC 03 and 041), Schedule RC-T – Fiduciary and Related Services *available at*: https://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_201403_i.pdf