American Financial Services Association

April 30, 2012

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

***RE: Regulation YY – Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies***
***Docket No. 1438; RIN 7100-AD-86***

Dear Ms. Johnson:

The American Financial Services Association ("AFSA") welcomes the opportunity to comment on the notice of proposed rulemaking (the "Proposed Rule") issued by the Board of Governors of the Federal Reserve System (the "Board") entitled *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies*.[1] The Proposed Rule seeks public comment on two important provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")[2] applicable to the largest bank holding companies and designated nonbank financial companies identified by the Financial Stability Oversight Council ("Council") for Board supervision (collectively, "Covered Companies"). Specifically, the Proposed Rule establishes (i) enhanced prudential standards for Covered Companies under Section 165 of the Dodd-Frank Act, including risk-based capital and leverage requirements, liquidity standards, requirements for enterprise-wide risk management, single-counterparty credit limits, stress test requirements and debt-to-equity limits; and (ii) early remediation requirements for Covered Companies under Section 166 of the Dodd-Frank Act. We greatly appreciate the opportunity to provide industry insight and comments on this important Proposed Rule and the meaningful financial implications that will result for Covered Companies.

By way of brief background, AFSA represents a broad cross-section of financial companies, including certain large nonbank financial companies with a direct interest in the scope of companies that may be considered Covered Companies under the Board's Proposed Rule.[3] AFSA's members include leading consumer finance companies, automotive lenders and residential mortgage lenders, as well as bank holding companies and their non-depository

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1 77 Fed. Reg. 594 (Jan. 5, 2012) (to be codified at 12 C.F.R. pt. 252 and referred to as Regulation YY). On March 7, 2012, the Board extended the public comment period for the Proposed Rule until April 30, 2012. *See* Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 13,513 (Mar. 7, 2012).

2 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

3 *See* 77 Fed. Reg. 645 (proposed 12 C.F.R. § 252.12(d) defines "covered company" as U.S. nonbank financial companies designated by the Council for Board supervision pursuant to Section 113 of the Dodd-Frank Act and bank holding companies with total consolidated assets in excess of $50 billion).

affiliates. Some members are captive financing arms of larger manufacturing or retail companies, while other members are independent providers of financial products and services.

Following careful review by, and numerous conversations with, our members, AFSA believes that the Proposed Rule fails to provide adequate or sufficient standards for nonbank financial companies designated as Covered Companies. Indeed, the Proposed Rule falls fatally short of providing the necessary level of consideration for the operations, activities, reporting and recordkeeping processes of nonbank financial companies as compared to banking organizations. In fact, as presented, the Proposed Rule does not even facilitate meaningful substantive comment by nonbank financial companies. Throughout the 95 questions and the suggested standards set forth in the Proposed Rule, specific reference is made to standards applicable exclusively to bank holding companies, including existing reporting, recordkeeping and structural requirements. The Proposed Rule fails to recognize the significant differences between bank holding companies and nonbank financial companies.

AFSA believes that separate standards must be established for nonbank financial companies that are designated as Covered Companies by the Council and covered by the Board's regulations for enhanced prudential standards and early remediation. The Proposed Rule states that, upon designation of a nonbank financial company subject to Board supervision, "the Board ***may***, by order or regulation, tailor the application of the enhanced standards to designated nonbank financial companies on an individual basis or by category, as appropriate."[4] Use of the permissive "may" ignores the congressional mandate that the Board "shall" consider differences between nonbank financial companies and bank holding companies when establishing such standards.[5]

Ironically, the Board specifically recognized the need for the Proposed Rule to establish separate and distinct standard for certain entities that are not domestic bank holding companies – namely, foreign banking organizations.[6] "Determining how to apply the enhanced prudential standards and early remediation framework established by the Dodd-Frank Act to foreign banking organizations in a manner consistent with the purposes of the statute and the Board's existing framework for supervising foreign banking organizations is difficult."[7] In doing so, the Proposed Rule follows the Dodd-Frank Act's direction to the Board to "give due regard to the principle of national treatment and equality of competitive opportunity," as justification for presenting separate standards for foreign banking organizations.[8] For similar reasons, the Board should follow the Dodd-Frank Act's instructions and adopt separate standards for nonbank financial companies, rather than merely requiring compliance by reference back to existing standards applicable to bank holding companies.

One example of requirements set forth in the Proposed Rules that are inappropriate for the manner in which nonbank financial companies are organized and operated is contained in the

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[4] 77 Fed. Reg. 597 (emphasis added; footnote omitted).
[5] Dodd-Frank Act § 165(b)(3).
[6] 77 Fed. Reg. 598.
[7] 77 Fed. Reg. 598.
[8] 77 Fed. Reg. 598. *See also* Dodd-Frank Act § 165(b)(2).

proposed liquidity standards.[9] Although nonbank financial companies conduct operations in a manner that attempts to match the liquidity needs of their balance sheets in an efficient and cost-effective manner, liquidity financing for nonbank financial companies is significantly different from bank holding companies. By definition, bank holding companies, through their insured depository subsidiaries, have access to deposits as a relatively stable source of funding to meet liquidity ratios and buffers. Conversely, nonbank financial companies are faced with more limited financing options as sources of liquidity, such as debt issuances and secondary markets.

Further example of the unworkable disconnect between the Proposed Rule's treatment of nonbanking financial companies by references to bank holding company standards is contained in proposed Section 252.13(b) regarding enhanced capital requirements. This section provides that a "nonbank covered company" must calculate its risk-based capital ratios to determine its compliance with the proposed enhanced regulatory capital requirements "as if [the nonbank financial company] were a bank holding company in accordance with any minimum capital requirements established by the Board for bank holding companies[.]"[10] Nonbank financial companies employ a number of unique, proprietary and distinct capital and risk management systems. These systems are generally different from the Board's rules on risk-weighted assets and capital adequacy standards for bank holding companies. One reason for this structural difference is that bank holding companies are statutorily required to serve as sources of strength for their depository institution subsidiaries – a requirement incurred as part of the decision to own and control depository institutions and not imposed on nonbank financial companies. Reference in the Proposed Rule to risk-weighted assets and capital requirements incorrectly assumes that nonbank financial companies currently use a risk-weighting system for capital management or are sufficiently familiar with such systems to provide meaningful comment on the standards identified in the Proposed Rule. Again, such standards expressly ignore the statutory mandate to consider the significant differences between bank holding companies and nonbank financial companies.

A proposal with separate nonbank financial company standards will provide appropriate tailored prudential regulatory standards and remediation proposals on which nonbank financial companies may provide insightful and meaningful comments. More importantly, however, doing so will follow the congressional mandate of the text of the Dodd-Frank Act for the Board to consider such structural, regulatory and practical differences between bank holding companies and nonbank financial companies in establishing the enhanced standards.

Creating specifically tailored enhanced prudential standards for nonbank financial companies, as compared to bank holding companies, is consistent with the important policy decisions made by Congress in the Dodd-Frank Act. For example, a colloquy between Chairman Frank and Representative Kilroy on December 9, 2009 explicitly and directly confirms that it

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[9] 77 Fed. Reg. 647 – 48 (to be codified at 12 C.F.R. § 252.56 – 252.57).
[10] 77 Fed. Reg. 645 (to be codified at 12 C.F.R. § 252.13(b)(1)).

was not Congress' intent that the Dodd-Frank Act subject nondepository captive finance companies to the strict prudential standards applicable to systemically important depositories.[11]

> Mr. FRANK of Massachusetts. I yield to the gentlewoman from Ohio (Ms. KILROY), who I understand wants to engage in a colloquy.
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> Ms. KILROY. Thank you, Mr. Chairman. I would like to address the provisions of section 1103, which specifies the criteria to be considered in determining whether a financial company might be subject to stricter standards. ***It is my understanding that nondepository captive finance companies do not pose the types of risks that warrant such treatment.***
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> Nondepository captive finance companies typically provide financing on a nonrevolving basis only to customers and to dealers who sell and lease the products of their parent or affiliate. As such, they are involved in only a narrow scope of financial activity.
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> Equally important, their loans are made on a depreciating asset, a fact taken into account when the loans are entered into. If they are not a depository institution, they therefore have no access to the Federal deposit insurance safety net. ***It is my understanding that it is the intent of the committee that nondepository captive finance companies are not the types of finance companies that should be subjected to stricter standards*** under section 1103 of this legislation; is that correct?
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> Mr. FRANK of Massachusetts. ***The gentlewoman is correct.*** She has been very diligent in trying to protect this very important type of financing. Financing companies are not depository institutions. They provide financing for the sale of that particular product in that company.
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> ***It is again inconceivable to me that somehow they would rise to the level of risk that would justify the Systemic Risk Council stepping in.***
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> Ms. KILROY. Thank you, Mr. Chairman.[12]

As noted in the discussion by Representative Kilroy, "nondepository captive finance companies do not pose the types of risks that warrant" being subject to heightened prudential

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[11] *See* 155 Cong. Rec. H14431 (daily ed. Dec. 9, 2009) (colloquy between Chairman Barney Frank and Rep. Mary Jo Kilroy regarding the scope of coverage for criteria the Council was to consider under H.R. 4173).

[12] *Id.* (emphasis added).

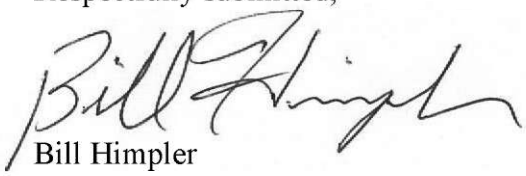
standards. Similarly, the important distinctions between bank holding companies and nonbank financial companies more generally, should also be taken into account as the Board establishes enhanced prudential standards for nonbank financial companies. Failure to take such factors into account will result in standards that are not tailored to address the different risks posed by such companies.

For the reasons set forth in this letter, AFSA cannot provide meaningful or useful comment to the substantive portions of the Proposed Rule. The Proposed Rule should be revised to apply solely to bank holding companies. The Board should establish separate and distinct standards to be used by nonbank financial companies that are specifically tailored to their operations and the risks they pose to the financial stability of the U.S. – just as the Board is proposing separate rules for foreign banking organizations – and submit the second proposal on nonbank financial companies for public comment. Such a secondary proposal will permit significant and meaningful input from nonbank financial companies to whom such standards may apply.

***Conclusion***

AFSA appreciates the opportunity to comment on the Proposed Rule and welcomes the opportunity to discuss further any of the issues addressed in this response letter. If you have any questions or if we can provide any additional information, please feel free to contact me at (202) 296-5544, ext. 616 or bhimpler@afsamail.org.

Respectfully submitted,



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