April 30, 2012

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

Submitted electronically via http://www.regulations.gov

RE: Regulation YY – Proposed Rule Regarding Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies (RIN 7100-AD-86)

Dear Ms. Johnson:

The undersigned group of companies[1] appreciates the opportunity to comment on the proposed rule regarding the enhanced prudential standards and early remediation requirements for covered companies ("proposed rule").[2]

The proposed rule "would implement the enhanced Prudential standards required to be established under section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act) and the early remediation requirements established under section 166 of the Act."[3] Sections 165 and 166 of the Dodd-Frank Act require the Board of Governors of the Federal Reserve System (the "Board") to "impose a package of enhanced prudential standards on bank holding companies with total consolidated assets of $50 billion or more and nonbank financial companies the [Financial Stability Oversight] Council has designated, pursuant to section 113 of the Dodd-Frank Act, for supervision by the Board."[4] The Board has submitted almost 100 questions soliciting public input on this proposed rule, and we appreciate the outreach with respect to such an important rulemaking.

In particular, we are pleased to see the Board encourage specific public comment on "alternative approaches for applying the enhanced prudential standards and the early remediation requirements the Dodd-Frank Act requires to nonbank covered companies." In the proposed rule, the Board seems to acknowledge that the proposed standards were "largely developed with large, complex bank holding companies in mind," and that "the types of business models, capital structures, and risk profiles of companies that would be subject to designation by the [Financial Stability Oversight] Council could vary significantly."[5] The Dodd-Frank Act permits the Board, when applying enhanced standards to nonbank financial companies, to take into consideration

[1] General Motors Financial Company, Inc., American Honda Finance Corporation, Nissan Motor Acceptance Corporation, Toyota Financial Services, Volvo Financial Services, a division of VFS US LLC, and VW Credit, Inc.
[2] 77 *Federal Register* 594, January 5, 2012.
[3] *Ibid.*
[4] 77 *Federal Register*, 595.
[5] 77 *Federal Register*, 597.

the differences in "capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors that the Board of Governors deems appropriate"[6] of covered companies. This authority, the Board notes, "will be particularly important in applying the enhanced standards to specific nonbank financial companies designated by the Council that are organized and operated differently from banking organizations."[7]

In the preamble to the proposed rule, the Board recognizes that the Dodd-Frank Act specifically directs it to "take into account differences among bank holding companies covered by the rule and nonbank financial companies supervised by the Board, based on certain considerations."[8] Unfortunately, the proposed rule does not appear to account for distinctions between bank holding companies and certain nonbank financial companies, nor does it recognize legislative intent associated with captive finance companies. While we commend the Board for its solicitation of public input to help inform its deliberations with regards to the imposition of enhanced prudential standards and early remediation requirements on nonbank financial companies, it is difficult to comment on proposed standards that do not attempt to account for the structural, operational, and management differences that inherently distinguish nonbank financial companies, particularly captive finance companies, from bank holding companies. To account for these differences, and to provide potentially affected parties time to comment, we believe the Board should withdraw nonbank financial companies from coverage under the proposed rules and propose separate enhanced prudential and early remediation standards for nonbank financial companies in a separate rulemaking.

While the proposed rule does not account for differences between bank holding companies and nonbank financial companies, it is more important to reiterate that the proposed enhanced prudential standards and early remediation requirements would only apply to nonbank financial companies if they are designated by the Financial Stability Oversight Council, as prescribed in Section 113 of the Dodd-Frank Act. As we have previously commented,[9] captive finance companies, due to their relative size, targeted mix of activities and lack of interconnectedness with other segments of the financial services industry, do not bear any of the characteristics of systemically important financial institutions. Individually and collectively, captive finance companies, pose little risk of transmitting any negative effects from financial distress to other firms or markets or to the financial system as a whole. Congress recognized this fact and clearly indicated that such companies should remain outside of consideration under Section 113. As such, captive finance companies should benefit from a safe harbor from Board supervision, under Section 170 of the Dodd-Frank Act, and thus be exempt from the application of the proposed enhanced prudential standards and early remediation requirements.

Background on Captive Finance Companies

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[6] *See* 12 U.S.C. 5365(a)(2)(A).
[7] 77 *Federal Register*, 597.
[8] 77 *Federal Register*, 596.
[9] See comment letter (December 19, 2011) available at: *http://www.regulations.gov/#!documentDetail;D=FSOC-2011-0001-0086.*

In general, a captive finance company is a wholly-owned subsidiary whose purpose is to provide financing and leasing for products manufactured or distributed by its parent company. In other words, the captive finance company plays a useful role by serving as an extension of the distribution and manufacturing activities of its parent but is not otherwise providing a unique product or service. And although there are many examples of captive finance companies, the most well-known are those captive finance companies associated with motor vehicle and equipment manufacturers.

Captive finance companies and their affiliates differ significantly from many other depository and nondepository institutions in terms of their primary purpose, which is to assist their parent companies in selling their branded products. Making a profit is not the only objective of captive finance companies. The financial products offered by these companies are important to the on-going success of their affiliated manufacturing entities, but other financial institutions provide similar (and competitive) products. Captive finance companies, by definition, maintain a narrower business focus than competitors that are engaged in the larger consumer and commercial credit markets in addition to motor vehicle and equipment financing. Captive finance companies, thus, are not highly complex firms that engage in very disparate activities; instead, captive finance companies are often engaged in asset-based lending, viewed as a relatively safe form of lending. Furthermore, the motor vehicle and equipment financing market was not a contributing factor to the recent financial crisis; in fact, both markets experienced continued positive performance. Notably, a captive finance company's overarching mission is to provide a reliable source of financing, thereby creating a long-term customer relationship resulting in parent brand loyalty.

Congress Intended to Exclude Captive Finance Companies from Consideration under Section 113

As mentioned above, captive finance companies differ from other nondepository and depository institutions that offer motor vehicle and equipment financing. Captive finance companies: (i) engage predominantly in financing activities; (ii) provide financing to dealers and to customers who sell, purchase and lease the parent's or affiliate's products; (iii) lend on depreciating assets or collateral; and (iv) are predominately serving the needs of households and businesses. We maintain that such institutions should not be considered for designation under Section 113 because these firms lack the scope, scale, size and interconnectedness to pose a threat to other financial intermediaries or the U.S. financial system at large.

During the enactment of Dodd-Frank, Congresswoman Mary Jo Kilroy (D-OH) clarified Congressional intent that "nondepository captive finance companies are not the types of finance companies that should be subject to stricter standards." In a House floor colloquy with Financial Services Committee Chairman, Barney Frank,[10] Congresswoman Kilroy stated that,

> "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.

[10] Representatives Kilroy (OH) and Frank (MA). "Wall Street Reform and Consumer Protection Act." *Congressional Record* 155:184 (December 9, 2009) p. H14431.

> 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 subject to stricter standards…is that correct?"

In response to her inquiry, Chairman Frank replied,

> "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.
>
> It is again inconceivable to me that somehow they [captive finance companies] would rise to the level of risk that would justify the Systemic Risk Council stepping in."[11]

As such, even if the regulators are not able to carve out a blanket exemption for captive finance companies, it appears that, given the Congressional intent to exclude captive finance companies from Section 113 and other regulations, as discussed above, that any assets accumulated by the company in the pursuit of captive finance activities, should be excluded from consideration when determining whether the finance company meets the systemic risk designation thresholds. Such an approach acknowledges Congress's appreciation for the level of risk posed by captive finance companies as well as the inherent differences between captive finance companies and their competitors.

Congress Further Recognized the Unique Role of Captive Finance Companies by Excluding Them from Other Prudential Regulation Provisions in Dodd-Frank

Congress further acknowledged that captive finance companies pose little risk to major financial institutions or to the financial system in its treatment of such companies in other parts of the Dodd-Frank Act. For example, Congress recognized that they use financial instruments, including derivatives, primarily to hedge legitimate business risk,[12] and granted captive finance companies, as defined in the Dodd-Frank Act,[13] an exemption from the definition of "major swap participant," regardless of the size of their hedge positions. Congress also exempted captive finance companies from the definition of "financial entity" and from the mandatory clearing and exchange trading requirements contained in Title VII. Although the definition of captive finance companies, often referred to as the "90/90" language, requires further clarification to reflect the

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[11] *Ibid.*

[12] While end users in general account for no more than one-seventh of total derivatives' notional value, captives comprise just a fraction of this. According to our estimates, combined captive finance companies' notional derivative amount is less than $300 billion in the overall $600 trillion derivatives market. That is just 0.05 percent of the overall market and far less than the amount of many large derivative users.

[13] The exemptions for captive finance companies apply only to entities whose primary business is providing financing and that use derivatives to hedge interest rate and foreign currency exposures 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the entity's parent company or another subsidiary of the parent company.

operating realities of some captive finance companies,[14] Congress clearly intended to exclude captive finance companies from certain prudential regulation in recognition of their unique and crucial role in America's manufacturing sector, as well as the de minimis risk they pose to the financial stability of the United States.

Characteristics Inherent in Captive Finance Companies' Business Models Ensure They Do Not Present Systemic Market Risk

A captive finance company failure is extremely unlikely to have a systemic effect and does not pose a threat to the financial stability of the United States financial system. Financial distress at a captive finance company would not materially impact new or existing customers because its affiliates maintain a vested interest in the financial relationship with the customer, while other lending sources in the market would be capable of meeting the credit needs of those customers. As a result, the market for motor vehicle and equipment financing lacks concentration and has many competitors that offer similar financing options; thus, captive finance companies should not be considered a risk to the motor vehicle and equipment financing market. Focusing financing activities to promote the sale of a parent's product and to create brand loyalty mitigate the likelihood of a significant market disruption.

This focus on providing financing that promotes the parent company's brand is central to the purpose of a captive finance company, and customer satisfaction and retention are key factors that enhance that loyalty. To achieve these objectives, captive finance companies extend and promote their customer service activities beyond the initial sale of the underlying product. As a result, captive finance companies take a more long-term approach to the provision of their financial products than other financial service providers that offer similar products because they want to ensure customer satisfaction throughout the life of the loan and beyond. In turn, captive finance companies prudently manage their assets and liabilities, and often have backup committed credit facilities to soundly manage liquidity risk in order to continue to make credit available. This contrasts with other providers, whose interests may fluctuate with changing economic conditions. The proposed standards and requirements do not account for this business model, and therefore, should not be applicable to captive finance companies.

Captives Should Benefit from a Safe Harbor from Board Supervision, and Thus be Exempt from the Application of the Proposed Enhanced Prudential Standards and Early Remediation Requirements

In further recognition of the fact that not all nonbank financial companies pose systemic risks, the Dodd-Frank Act provides a safe harbor from Board supervision for institutions that meet certain criteria. Section 170 of the Dodd-Frank Act directs the Board to "promulgate regulations on behalf of, and in consultation with, the Council setting forth the criteria for exempting certain types or classes of U.S. nonbank financial companies or foreign nonbank financial companies from supervision by the Board of Governors."[15] It is our view that a nonbank financial company that significantly supports the sale or lease of products that are manufactured by the parent

[14] See comment letter (February 22, 2011) available at: comments.cftc.gov/PublicComments/ViewComment.aspx?id=30517
[15] *See* 12 U.S.C. 5370(a).

company or another subsidiary of the parent company through its financing activities should not be considered for designation under Section 113 or be subject to the application of enhanced prudential standards or early remediation requirements under Sections 165 and 166. With the characteristics intrinsic to captive finance companies' business models, we would like to reiterate that such entities do not meet the Section 113 factors for consideration, and therefore, should be eligible for a Section 170 safe harbor from supervision by the Board.

Conclusion

In conclusion, the undersigned group of captive finance companies appreciates the opportunity to comment on the proposed rule relating to the enhanced prudential standards and early remediation requirements for covered companies. The Board's application of these standards and requirements are predicated on a determination by the Financial Stability Oversight Council that a nonbank financial company requires additional supervision and regulation. We respectfully submit that Congress recognized the unique role of captive finance companies, and subsequently, intended to exclude captive finance companies from designation under Section 113 of the Dodd-Frank Act. Evidence of this Congressional intent includes not only a statement from former House Financial Services Committee Chairman and current Ranking Member, Barney Frank, that it is "inconceivable" that captive finance companies would "rise to the level of risk" that would justify designation, but also the explicit statutory exemptions Congress provided for captive finance companies from other prudential regulation, particularly related to derivatives. Therefore, we contend that the Financial Stability Oversight Council shall not consider captive finance companies for additional regulation and supervision by the Board, and subsequently, the Board should not apply enhanced prudential standards or early remediation requirements to such entities, but should instead, provide a safe harbor under Section 170 of the Dodd-Frank Act.

We thank you for your consideration of our comments, and we are available to answer any questions you might have about the issues addressed in this letter.

Sincerely,

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