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April 30, 2012

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

Re: Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies/ RIN 7100-AD-86

Via Federal eRulemaking Portal

We are pleased to respond to the notice of proposed rulemaking issued by the Board of Governors of the Federal Reserve System on January 5, 2012, entitled *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies*, RIN 7100-AD-86, 77 Fed. Reg. 594 (Jan. 5, 2012). Attached are our written comments on the proposed rule.

If you have any questions or would like to discuss these issues further, please do not hesitate to contact me.

Very truly yours,

Michael D. Bopp

I. Introduction

We represent several companies that may be impacted by the proposed rule recently released by the Board of Governors of the Federal Reserve System (the "Board") on January 5, 2012, entitled *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies* (the "Proposal"). We appreciate the opportunity to participate in the regulatory process and we submit this comment letter to help inform the Board about issues relating to the Proposal that may affect the regulated community.

The Dodd-Frank Wall Street Reform and Accountability Act (the "Dodd-Frank Act") was passed with one overriding goal in mind—to promote the financial stability of the United States. Those are the very first words of the legislation and they are repeated nearly fifty times throughout the Act's 849 pages. Central to achieving this goal is the establishment of heightened regulatory requirements for companies that could pose significant systemic risk to the U.S. economy. At the same time, subjecting a company to regulation beyond the amount of regulation necessary to address the amount of risk posed by a company is not an objective of the Dodd-Frank Act and, indeed, would be counterproductive, imposing unwarranted costs at the expense of investment and jobs. We strongly urge the Board, in issuing a final rule and implementing Section 165 of the Dodd-Frank Act, to maintain a focus on establishing prudential standards that appropriately correspond to the amount of risk posed by individual companies and to avoid expanding prudential standards beyond the extent necessary to prevent financial instability. We believe that the current Proposal falls short of achieving this goal, and we offer the following comments for the Board's consideration.

This rulemaking is critical for several reasons, including the fact that designated nonbank financial companies could be subject for the first time to stringent regulatory restrictions and controls that were designed to apply to banks and bank holding companies. Although Congress determined in Section 165 that systemically significant nonbank financial companies should come under the supervision of the Board, it also specified that the Board should tailor any prudential requirements based on the risk posed by the company.[1] Accordingly, the Board must not apply prudential requirements that may be appropriate for banking entities across-the-board to nonbank financial companies whose operations and existing regulatory oversight vary in significant ways. The Proposal recognizes that there are substantial differences between banks and other financial sectors and that tailored prudential standards should be applied to account for these differences. However, the Proposal suggests deferring this analysis until after the rulemaking process is complete and the Board reviews companies on a case-by-case basis.

This approach is faulty for several reasons. First, it denies the regulated community a meaningful opportunity to participate in this rulemaking process and to provide input concerning how the Board will make its tailoring determinations. Rather, the Board will be developing standards and applying them to companies through its individual enforcement efforts rather than through a rulemaking process, thereby establishing Section 165 determinations through an

[1] *See, e.g.*, 12 U.S.C. § 5365(b)(3)(A). As discussed further in Part II.A below, when prescribing prudential standards, the Board must take into account differences among companies, including, the factors listed in Section 113(a) and (b) of the Dodd-Frank Act.

opaque and closed process that lacks transparency and predictability. A proper implementation of Section 165 would develop more definitive standards through the rulemaking process, allowing the Board to benefit from the informed views of commenters in developing appropriate distinctions among different categories of nonbank financial companies. Given the fundamental importance of appropriately tailoring prudential requirements in a transparent and uniform manner, the Board should adopt a rulemaking approach that engages the public and that leads to greater regulatory certainty and clarity.

In addition, given the broad overarching focus on systemic risk reflected in the statutory approach, the Board should not simply apply control principles from the Bank Holding Company Act to this very different regulatory scheme. Overbroad application of control principles may lead to prudential requirements being imposed beyond the appropriate scope of the statute, diverting limited oversight resources and detracting from a regulatory focus on factors that create systemic risk. Control should not be defined and applied in this ad hoc manner that serves to impede rather than fulfill the purposes of Title I of Dodd-Frank. We discuss these and other issues in greater detail below.

II. Tailoring of Prudential Standards

The Dodd-Frank Act strongly rejects a one-size-fits-all approach towards regulation of systemically significant companies. Through Section 165, Congress instructed the Board to tailor prudential standards to individual companies and categories of companies based on the relative risk they pose to the nation's financial system.[2] The Proposal, while recognizing the "authority under section 165 to tailor the application of the standards, including differentiating among covered companies on an individual basis or by category,"[3] does not carry out in full what the statute requires.

While the Board expresses support for such a tailoring approach, it proposes to develop and apply its tailoring methodology largely outside the framework of notice-and-comment rulemaking. Indeed, the Board would avoid any meaningful examination of tailoring until after the rulemaking process is complete and when it is applying the prudential standards to individual companies. Because tailoring is not robustly addressed in the rulemaking, the Board explicitly recognizes that the "proposal was largely developed with large, complex bank holding companies in mind."[4]

We encourage and support the Board's stated efforts to tailor prudential requirements to individual companies based on systemic risk. But we are concerned that this regulatory regime will be derived almost exclusively at the Board's enforcement discretion and outside of the rulemaking process which is meant to help guide and inform the Board's determinations. The Proposal, for the most part, does not provide any details of the tailoring process and the regulatory text on its face could allow the Board to apply the same bank-centric prudential standards to all companies across-the-board. As described below, we think this approach is

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[2] *Id.*
[3] 77 Fed. Reg. 596.
[4] 77 Fed. Reg. 597.

flawed and that the Board should more fully engage the regulated community and other interested parties through the rulemaking process as it develops standards.

A. Tailoring Is Required by the Statute and Reflects Congressional Intent

Section 165 of the Dodd-Frank Act requires the Board in establishing prudential standards to "take into account differences among nonbank financial companies . . . and bank holding companies" based on the following characteristics:

- The factors described in sections 113(a) and (b) of the Dodd-Frank Act (which are the same factors the Financial Stability Oversight Council (the "Council") must use to identify systemically important nonbank financial companies);
- Whether a company owns an insured depository institution;
- Nonfinancial activities and affiliates of the company; and
- Any other risk-related factors that the Board determines to be appropriate.[5]

There are other provisions within Section 165 that also require tailoring of prudential standards. For nonbank financial companies, the Board is required to adapt prudential standards in light of any predominant line of business of a nonbank financial company for which bank-centric standards may not be appropriate.[6] The Board must also to the extent possible ensure that small changes in the factors listed in section 113(a) and (b) of the Dodd-Frank Act would not cause sharp, discontinuous changes in the prudential standards established by the Board.[7] Finally, the Board is called upon broadly to "differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any of the risk-related factors that the [Board] deems appropriate."[8]

These specific references to tailored prudential standards in Section 165, along with other provisions in Section 165 that relate to tailoring, demonstrate that Congress intended to create a regulatory scheme for systemically significant institutions that would correspond to the level of systemic risk posed by a company or a group of companies. The Proposal, however, leaves the details of how the Board intends to tailor prudential standards largely unspecified and to the Board's near limitless discretion. As noted above, the Proposal does mention in the preamble that tailoring is required.[9] There are also instances where the general concept of tailored

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[5] 12 U.S.C. § 5365(b)(3)(A).

[6] 12 U.S.C. § 5365(b)(3)(D).

[7] 12 U.S.C. § 5365(b)(3)(B). Governor Tarullo has also stated that "it is generally better to avoid cliff effects, whereby significant regulatory consequences ensue based on relatively modest differences among firms." Governor Daniel K. Tarullo, "Regulating Systemically Important Financial Firms," Speech at the Peter G. Peterson Institute for International Economics, Washington, D.C., June 3, 2011.

[8] 12 U.S.C. § 5365(a)(2)(A).

[9] *E.g.*, 77 Fed. Reg. 596 ("In prescribing prudential standards under section 165(b)(1) to covered companies, the Board is required 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."); *id.* ("When differentiating among companies for purposes of applying the standards established under Section 165, the

standards is mentioned in the text of the Proposal. For example, in the section of the Proposal relating to stress testing, the proposed rule text states that stress testing "must be tailored to . . . the covered company's capital structure, risk profile, complexity, activities, size, and any other risk related factors that are appropriate."[10] The sections of the Proposal relating to the liquidity buffer requirements and limits on potential sources of liquidity risk likewise state that the requirements must align with the same list of criteria. But the Proposal mentions tailoring for only a few of the many prudential standards proposed, and even then does not describe with sufficient specificity how tailoring will be applied in practice.

B. The Board Must Provide Additional Guidance and Clarity

A proper agency rulemaking must adequately inform the regulated community of the proposed regulatory approach to afford interested parties a reasonable and meaningful opportunity to participate in the rulemaking process.[11] The Proposal fails to meet this standard because it does not provide a description of how standards will be tailored, other than listing broad criteria that may be considered. This approach leaves many important questions unanswered and does not inform the public of the Board's approach with regard to precisely how prudential standards will be tailored.

For example, Section 165 requires that the Board consider the same factors in applying prudential standards as it does to determine if a company should be designated as systemically significant under Section 113. The Proposal, however, does not explain whether the Board will interpret and apply these factors in the same manner as proposed by the Council. There is also no indication in the Proposal of whether the Board will emphasize or place more weight on certain of these factors over others. Section 165 also grants the Board authority to develop its own factors based on risk. The Proposal does not indicate, however, whether the Board expects to develop such factors or how any such factors would be used to tailor the prudential standards.

Without a clear articulation of these important details, the public is at a loss to ascertain how the Board will approach tailoring determinations (including what criteria it will apply and the relative weight to be accorded each factor). The rule, as proposed, simply does not give the regulated community assurance that the Board will apply a robust tailoring analysis in all cases, as required by statute. This does not meet the standards for notice-and-comment rulemaking and, as discussed below, compels a reproposal of the rule that articulates clearly, and at a level of detail sufficient to allow meaningful comment, the necessary details of how tailoring determinations will be made. Absent such an articulation, regulated entities and other interested parties are not afforded a meaningful opportunity to participate in the rulemaking process as required by the Administrative Procedure Act ("APA").[12]

Board may consider the companies' size, capital structure, riskiness, complexity, financial activities, and any other risk-related factor the Board deems appropriate.").

[10] 77 Fed. Reg. 647.

[11] *Chrysler Corp. v. Dept. of Transp.*, 515 F.2d 1053, 1061 (6th Cir. 1975).

[12] *Forester v. Consumer Product Safety Commission*, 559 F.2d 774, 787 (D.C. Cir. 1977) (explaining that the APA requires notice that "affords interested parties a reasonable opportunity to participate in the rulemaking process").

C. Untailored Standards Could Impose Disproportionate Harm on Companies that Pose the Least Threat

Standards that are not tailored to address the degree of risk posed by individual or groups of covered companies could lead to unnecessary and harmful regulatory burdens on companies that pose minimal risk to the U.S. financial system—a result that would be contrary to the intended statutory framework. To avoid disruptions in their business operations, companies that anticipate or suspect that the Council may designate them as systemically significant under Section 113 will begin preparing to meet the Section 165 prudential standards before a possible designation is made final. Moreover, without sufficient clarity from the Board about how prudential standards will be tailored, companies will not be able to determine whether or how particular standards will apply to them. Out of an abundance of caution, companies might well assume that the most stringent level of standards will apply and prepare accordingly. Severe negative consequences could occur from unnecessary preparation for compliance that may not ultimately be required. Such preparation may require significant restructurings engendering increased costs, diminished services, and impaired market competitiveness compared to other, similarly situated companies that are not likely to be designated as systemic. As a result, customers and potential customers, as well as employees and other stakeholders of a covered company could all be affected in the form of higher prices and as a result of restructurings that, ultimately, may not reduce systemic risk.

These effects would be magnified if the Board in its implementation efforts fails to make tailoring determinations for individual companies in an appropriate manner based on systemic risk to the financial system. In addition, inadequately tailored prudential standards could lead to the misallocation of regulatory resources. Covered companies that pose the least amount of systemic risk could come under greater regulatory scrutiny, without much, if any, benefit to the stability and soundness of the financial system. In the process, limited resources would be diverted from regulating the most systemic companies. Therefore, a robust tailoring regime is absolutely critical to fulfilling the statutory purpose of rooting out systemic risks to the financial system without unduly harming companies through the imposition of unnecessary regulation.

D. Suggestions for Tailoring Prudential Standards

As the Board continues with its implementation efforts of Section 165, it must ensure that the tailoring of prudential requirements takes into account the different business characteristics of covered companies. As part of those efforts, the Board should avoid imposing bank-centric regulations on nonbank financial companies. The Proposal contains many untailored prudential requirements and would apparently reserve any tailoring determinations to the Board's sole discretion at the enforcement stage. As stated above, the Board should provide greater clarity through the notice-and-comment process about how tailoring determinations will be made. We offer the following suggestions that should be included as part of those efforts.

While we believe that the regulatory approach itself should be redesigned, we also note that the application of certain prudential requirements to nonbank financial institutions could impose severe and unjustified financial harm. For example, such harm could follow if the Board were to require nonbank financial companies to meet the same capital requirements as banks. The regulatory capital requirements that may be appropriate for banks are not necessarily appropriate for nonbank companies. Nonbank financial companies have a greater degree of variation in their operations and capital structures than do banks. Moreover, a covered nonbank company may have insufficient capital to meet the proposed capital standards because its organizational form, statutory or regulatory restrictions, or long-standing business or operating considerations prevent it from raising the capital needed to comply with new requirements, even though holding more capital might not be needed to mitigate systemic risk.

In addition, the use of banking capital and leverage rules, as proposed in Section 252.13, is inappropriate as applied to insurers. Insurance companies are required to adhere to strict Risk Based Capital ("RBC") rules that can be adjusted as conditions warrant. The methodology for applying existing RBC standards is thoroughly documented and well understood by insurance regulators and insurers, and has proven effective in helping to maintain the soundness and stability of insurance companies. The Board can and should readily adopt prudential standards based on the current RBC rules for insurers. Because there is no evidence to suggest that insurance companies are a primary source of systemic risk to the financial system, it would be inefficient and harmful to impose bank-centric capital and leverage requirements on insurance companies where RBC-based standards, which already exist, are more appropriately tailored for the industry and adequately manage risk.

The Proposal also specifies that the Board intends to issue separate rulemakings in the future that would apply Basel III requirements to covered companies. However, application of these incomplete bank-centric, quantitative liquidity requirements to insurance companies would only exacerbate the harm from the aforementioned burdensome and unnecessary regulatory requirements. Accordingly, the Board should clarify that any future use of the Basel III requirements would be limited to banks.

The proposed timeframe for compliance with these standards is also problematic and would exacerbate the harm to the regulated community. The Proposal would require within 180 days following designation by the Council that the nonbank financial company be subject to risk-based capital and leverage requirements. This is wholly unreasonable as applied to insurance companies. Most covered nonbank financial companies, including insurance companies, are not currently subject to bank regulatory capital definitions, regulatory accounting practices, or bank regulatory examination practices related to capital adequacy, and would have to drastically modify their operations to come into compliance. Moreover, insurers typically do not have the same credit facilities as banks or other types of financial companies because it is rarely, if ever, the case that they need to access those sources of capital to fund their operations and obligations. Imposing this 180-day compliance regime could cause insurers to incur the additional cost of having such facilities in place as a preventative measure, which would increase costs and reduce services to customers while achieving no appreciable reduction in systemic risk. Additionally, insurers not currently publicly-traded, such as mutual insurance companies, may not be able to, or may have structural or other impediments against, issuing stock or other securities.

In addition, Section 252.91 of the Proposal, which requires compliance with the single counterparty exposure limits on the first day of the fifth quarter following the date on which a company becomes a covered company, would also be inappropriate for insurance companies due to similar implementation barriers. The need to possibly unwind certain contractual obligations and replace them with new funding facilities could take much longer than five quarters, particularly given the different funding structures associated with insurers compared to banks.

These various examples demonstrate the substantial harm from applying the proposed prudential requirements in an untailored manner to nonbank financial companies. As an alternative to this bank-centric focus, entities and industries that pose relatively less systemic risk should be grouped together and subjected to less stringent prudential standards. For example, insurance companies are heavily regulated by state regulatory agencies, are not highly leveraged, and have strong balance sheets. Accordingly, the rule implementing Section 165 prudential standards for any covered insurance companies should be tailored to reflect this reality.

E. The Board Should Repropose the Rule

As discussed above, we believe that the Proposal has numerous significant deficiencies that must be addressed. We respectfully request that the Board consider our points and those of other commenters, provide the additional clarity suggested, and re-propose the rule for additional public comment to ensure that this rulemaking process is conducted in a manner that is thorough, open, and transparent.

Re-proposal comports with the Board's obligations under the APA. The APA does not permit agencies "to promulgate mush and then give it concrete form only through subsequent less formal 'interpretations.'"[13] Such an approach is prohibited because overly vague rule proposals do not provide an adequate basis for public comment. But, as noted above, the preamble to the Proposal leaves open the possibility that the Board will take just such an approach with respect to how it applies prudential standards. The preamble notes that "[t]he 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."[14] If the Board proceeds to tailor Section 165 prudential standards by order in the future, then the current Proposal, which lacks any meaningful discussion of how tailoring might occur, would be the only opportunity for broad based public comment on the issue. The Board should reject such an insular process that does not comport with APA requirements.

Re-proposing the Proposal or portions thereof to increase the Proposal's specificity and clarity would comport with the rulemaking approach taken by the Council in October, 2011 when it re-proposed its regulations implementing Section 113 of the Dodd-Frank Act. The Council issued a re-proposal in response to similar concerns from commenters that the Council's original notice of proposed rulemaking failed to provide adequate clarity and guidance to the regulated community. In that situation, the first NPRM did little more than restate the criteria listed in Section 113 of the Dodd-Frank Act. Likewise, this Proposal does little more than restate the statutory criteria and requirements for standards to be tailored. The Proposal is deficient in much the same way as the Council's first rule proposal under Section 113. The Board should follow the same approach as the Council and re-propose this important rule for public comment. As discussed above, failure to re-propose and the adoption of a final rule that does not provide

[13] *Paralyzed Veterans of Am. v. D.C. Arena L.P.*, 117 F.3d 579, 584 (D.C. Cir. 1997).

[14] 77 Fed. Reg. 597.

additional clarity about how prudential standards will be tailored would cause significant harm to companies and their stakeholders.

III. Application of Control Principles

Applying control principles in a careful and nuanced manner to avoid the imposition of prudential standards that have little or no bearing on systemic risk is critical to this rulemaking. This important goal will require deviating from prior regulatory applications of control, particularly under the Bank Holding Company Act ("BHCA"). However, we are concerned that the Board fails to apply such a control analysis to all aspects of the Proposal.

The Board explained in the preamble of the Proposal that terms used in the Proposal "are generally given the same meaning as their definitions under other regulations issued by the Board."[15] However, the Proposal adopted a modified definition of control with respect to certain proposed prudential requirements: "Control would have a different meaning under the proposed rules concerning single-counterparty credit limits."[16] In setting permitted counterparty credit exposure limits for a company and its subsidiaries, the Proposal sets forth a "simpler, more objective definition of control,"[17] than is contained in the BHCA. Notably, under the Proposal, control would exist if (a) the ownership or voting interest that a company holds in another entity equals or exceeds 25%, or (b) if a company and another entity prepare consolidated financial statements for financial reporting purposes.[18] We agree with this approach and urge the Board to more fully recognize that the definition of "control" should be tailored to the specific situations in which it is used in the Dodd-Frank Act instead of defaulting to the BHCA definition. Unfortunately, the Board's tailored approach to control appears limited to counterparty credit limits, as the Proposal would seemingly apply the BCHA control regime to other aspects of the proposed rule, including liquidity-based prudential requirements.

We think this approach is misguided. The definition of "control" contained in the BHCA is overbroad for the purpose of determining whether a company "controls" another company under Section 165. Using a distinct definition of "control"—such as the proposed definition applicable to counterparty credit limits—to all aspects of Section 165 and in other sections of the Dodd-Frank Act would allow the Board to focus more precisely on those elements of the financial system that could endanger others and to avoid inefficiently expending resources to regulate entities that do not warrant heightened regulatory standards. We expound on these points in greater detail below.

A. Control Applied Under Section 165 Should be Distinct from the BHCA

Regarding "control," the BHCA provides that a company "has control over a bank or over any company if—

[15] 77 Fed. Reg. 602.
[16] 77 Fed. Reg. 602, n. 47.
[17] 77 Fed. Reg. 614.
[18] 77 Fed. Reg. 649 (proposed rule § 252.92(i)).

(A) the company directly or indirectly or acting through one or more other persons, owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank or company;

(B) the company controls in any manner the election of a majority of the directors or trustees of the bank or company; or

(C) the Board determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company."[19]

In lieu of the "controlling influence" test under subparagraph (C), the Proposal as it applies to counterparty credit limits would instead assess whether one company "consolidates the [other] company for financial reporting purposes."[20] But for other control determinations made under the Proposal, the BHCA's framework would apply. As described in Part III.B below, the "simpler, more objective definition of control" for counterparty credit limits[21] should apply to the other aspects of the Proposal as well rather than the overbroad controlling influence test.[22]

As a general matter, it is important to recognize that the purpose behind the BHCA's definition of control differs from the purpose of Section 165 and other sections of the Dodd-Frank Act. The purpose of the BHCA is to identify and supervise commercial operations that control banks. The concept of "control" is central to the BHCA because the BHCA defines "bank holding company" as a company that controls a bank.[23] Likewise, the purpose of Regulation Y, which implements the BHCA's control provision, is to "[r]egulate the acquisition of control of banks by companies and individuals."[24] The BHCA is meant to cast a wide net to ensure adequate regulation of all entities that may have control over a bank.

In contrast, the purpose of Title I of the Dodd-Frank Act is to provide for heightened regulation of entities that could pose a significant threat to U.S. financial stability. The

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[19] 12 U.S.C. § 1841(a)(2).

[20] 77 Fed. Reg. 649 (proposed rule § 252.92(i)).

[21] 77 Fed. Reg. 614.

[22] Regarding subparagraph (C), the BHCA establishes "a presumption that any company which directly or indirectly owns, controls, or has power to vote less than 5 per centum of any class of voting securities of a given bank or company does not have control over that bank or company." 12 U.S.C. § 1841(a)(3). If the Board decides to continue using the BHCA control framework in connection with this rule, it should at least give full effect to the statutory presumption against finding a control relationship where there is less than a 5% ownership or voting interest. This presumption should be read to impose a heightened standard on parallel criteria that could otherwise lead to a control finding.

Indeed, this presumption should be applied vigorously in keeping with the underlying purpose of Section 165; namely, to prevent systemically significant risks to the U.S. financial system. Therefore, in applying control principles, the Board should override the presumption of no control only with a clear and compelling basis. A finding of control that results in any consolidation of entities for Section 165 purposes should require a finding that such a control determination is necessary to prevent a potential risk to the U.S. financial system.

[23] BHCA, § 2(a)(1) ("Except as provided in paragraph (5) of this subsection, 'bank holding company' means any company which has control over any bank or over any company that is or becomes a bank holding company by virtue of this Act.").

[24] Regulation Y, § 225.1(b)(1).

provisions that relate to the definition of "control" are not meant to cast a wide net to capture all entities that may create some amount of systemic risk. Instead, the purpose is to capture *only* those limited number of entities that pose a genuine and significant threat to the stability of the U.S. financial system. Likewise, Section 165 is meant to impose only those prudential requirements that are actually necessary to prevent threats to the financial system.[25] Using the broad BHCA definition of "control" would thus be inappropriate in the Dodd-Frank Act context because it could capture more entities than just those entities that pose a significant threat. We urge the Board in implementing Section 165 to promulgate rules that more broadly reflect these different purposes.

B. Control Determinations Should Be Nuanced

Instead of the BHCA's controlling influence test, the Board should develop and apply control principles for the specific purpose of calibrating the appropriate level of regulation to the risk posed by an entity. Financial regulators have developed and applied several alternatives to the BHCA control framework that bear consideration here.

As noted above, the Proposal contains a tailored control definition for credit counterparty standards. Under this definition, control would exist if (a) the ownership or voting interest that a company holds in another entity equals or exceeds 25% or (b) if a company and another entity prepare consolidated financial statements for reporting purposes. The Board should apply this framework to all prudential requirements under the Proposal, including liquidity-based requirements. This control definition is better suited for Section 165's general purposes than the BHCA definition. It would allow business entities to be aggregated for regulatory purposes where there is potential for significant influence from one company to the other, either because one controls at least 25% of the other, or because the companies' operations are substantially intertwined, as reflected by the preparation of consolidated financial statements.

The Board notes that this tailored definition is "similar to that" found in Appendix G of the BHCA's Regulation Y,[26] which addresses capital adequacy guidelines. As that provision demonstrates, even within the context of the BHCA regulatory structure, the Board acknowledges that different control definitions are necessary for achieving different purposes. For the purpose of the capital adequacy provisions, the Board applied a simpler, more objective control definition because there was no basis to apply the entire BHCA framework. That same principle applies here and cautions against wholesale incorporation of the BHCA control framework to determinations made under Section 165.

In addition, the FDIC, in issuing a proposed rule implementing Section 210 of the Dodd-Frank Act, deviated from the BHCA definition, declaring that "[p]arts of the Bank Holding Company Act definition of 'control' are inapposite to the context" of the provision at hand.[27]

[25] The Board recognizes that Section 165 "requires that the enhanced standards established pursuant to that section increase in stringency based on the systemic footprint and risk characteristics of individual covered companies." 77 Fed. Reg. 596. *See also* 12 U.S.C. 5365(a)(1)(B) (requiring enhanced standards to increase in stringency based on various risk-based criteria).

[26] 77 Fed. Reg. 614.

[27] 77 Fed. Reg. 18127, 18132 (Mar. 27, 2012).

The FDIC's modification of the BHCA control analysis was in full accordance with the Dodd-Frank Act, which states that the BHCA definition is to be used "except as the context otherwise requires."[28] Specifically, the FDIC excised the controlling influence test from the BHCA's control framework, focusing only on whether the company has a 25% ownership or voting interest in another company, or that the company controls the election of a majority of the directors of the other company. The Board should also use its authority and modify the BHCA control framework to fit within the context of Section 165.

Finally, even if the Board is inclined to continue to apply the BHCA "control" definition, we ask the Board to look beyond ownership percentages or thresholds for determining when control of voting stock would constitute "control" of a company. There may be cases where ownership would not reflect true control. By way of hypothetical example, Corporation A owns 100% of Corporation B. Corporation B, while having no ownership interest in Corporation C, has contractual obligations with respect to a significant aspect of the management of that corporation. Simple reliance on the BHCA's delineated criteria would suggest that Corporation A controls Corporation C (through Corporation B). But Corporation B's obligations with respect to Corporation C could be circumscribed by agreements between the two corporations; agreements that Corporation A is powerless to change. In that context, Corporation A could have an ownership interest in Corporation B but no effective "control" over Corporation C. We thus urge the Board to weigh carefully factors that, in substance, may be better indicators of control than the BHCA criteria.

C. Defining Control Properly is Essential to a Well-Functioning Regulatory Regime

Properly defining issues of control is important because of the severe consequences that could occur from improperly adjusted Section 165 prudential standards. Such standards would harm a company itself and its many stakeholders that would have to bear the burdens of unnecessary prudential regulatory requirements. As noted previously, an ill-conceived standard could require restructurings of a company, increased costs, diminished services, and impaired market competitiveness with other similarly situated companies that avoided designation.

Property and casualty insurers, in particular, do not pose a systemic threat to the U.S. financial system. There are several ongoing efforts by existing insurance regulators[29] to recalibrate solvency standards in light of the financial crisis. While P&C insurers weathered the financial crisis relatively well, these ongoing efforts may further reinforce the existing soundness of the industry. The Board should wait to issue a final rule implementing Section 165 (or at least wait to apply any Section 165 provisions to any insurance companies) until these efforts are complete.

Imposing prudential regulations on a company that does not genuinely correspond to the level of systemic risk that it poses may result in inappropriate allocation of limited regulatory resources. Imposing the same requirements on companies that do not have the same system-

[28] 12 U.S.C. § 5301.

[29] The list includes the National Association of Insurance Commissioners, European Union, and International Association of Insurance Supervisors.

wide impact could cause resources to be diverted away from regulating the most systemically risky companies. In other words, over-regulation of less systemically-risky companies could lead to under-regulation of greater threats to overall financial instability and could produce adverse consequences for the system as a whole. Instead of further diverting already scarce resources by imposing regulatory pressure on companies that do not pose as large a threat, the Board should focus its activities on entities that have the highest likelihood of adversely affecting our financial system.