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Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

Docket No. R – 1503

Dear Secretary Frierson:

General Electric Capital Corporation ("*GECC*") is writing to respond to the request for comment by the Board of Governors of the Federal Reserve System (the "*Federal Reserve*") on the Federal Reserve's proposed application to GECC of enhanced prudential standards and reporting requirements (the "*Proposed Order*") under Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "*Dodd-Frank Act*").[1]

GECC recognizes that its status as a nonbank financial company designated by the Financial Stability Oversight Council (the "*FSOC*") to be supervised by the Federal Reserve (a "*nonbank SIFI*") requires the application of enhanced prudential standards, but we respectfully submit that the overall approach is not sufficiently tailored to GECC as is required and that certain provisions of the Proposed Order are ill-suited for GECC and inconsistent with the statutory mandate under the Dodd-Frank Act.

At the outset, we wish to emphasize that GECC supports a robust regulatory regime for financial institutions and is committed to operating in a safe and sound manner. GECC respects the importance of the Federal Reserve's mission and acknowledges the breadth of the Federal Reserve's authority to ensure the safety and stability of the U.S. financial system. Moreover, we understand that nonbank SIFI designation entails

1 Federal Reserve, *Application of Enhanced Prudential Standards and Reporting Requirements to General Electric Capital Corporation*, 79 Fed. Reg. 71768 (Dec. 3, 2014). References to the Proposed Order include the Supplementary Information to the Proposed Order unless indicated otherwise.

certain obligations, such as continuing to enhance our risk management processes, which GECC acknowledges and embraces, as evidenced by the significant investment that GECC is already making to upgrade its enterprise risk management processes and systems. We appreciate that the Federal Reserve's enhanced prudential standards for GECC will necessarily require GECC to adapt and to continue to improve its current practices and to bear additional costs of compliance. We also readily acknowledge the benefits of robust supervision and that GECC has become a better and stronger financial services company since the Federal Reserve became our principal supervisor. Nothing in our comments is intended to suggest otherwise.

At the same time, the Dodd-Frank Act requires that prudential standards devised for Global Systemically Important Banks ("*G-SIBs*") or other systemically important banks not be carried over indiscriminately to GECC as a nonbank SIFI. Rather, the standards for GECC must bear a reasonable relationship to GECC's relative size, relative level of complexity and other relevant circumstances.[2] The standards must also be consistent with other requirements of federal and state law. We respectfully submit that critical aspects of the Proposed Order fail to satisfy these basic tests.

EXECUTIVE SUMMARY

This letter begins by addressing two areas of fundamental concern with respect to the substance of the Proposed Order.

First, the Proposed Order would disregard longstanding and consistent definitions of director "independence" and require that GECC's board of directors add "independent/independent" members. These are individuals who would be not only independent of the management of GECC and its parent General Electric Company ("*GE*"), but who could not even be outside, independent directors of GE. This unprecedented requirement, which the Proposed Order makes little attempt to justify, exceeds the Federal Reserve's authority under Section 165. Directors of a Delaware corporation such as GECC owe fiduciary duties to stockholders and are not permitted to disregard a sole stockholder's interests in favor of other constituencies, as the Proposed Order plainly intends. Nothing in the text or history of Section 165 suggests that Congress intended to empower the Federal Reserve to preempt long-settled state law by promulgating a new definition of "independence" – and, indeed, a new concept of directors' loyalties – with no authorization in any relevant authority, including the Federal Reserve's own regulations. The requirement is also unreasonable in light of the

2 *See* Dodd-Frank Act §§ 165(a)(2), 165(b)(3). This foundational point is emphasized throughout this letter.

complications that it unavoidably creates and unnecessary in light of GECC's governance structure.

Second, although the Federal Reserve asserts that it has not determined to classify GECC as a G-SIB, the Proposed Order nonetheless effectively equates GECC with a G-SIB. The Proposed Order takes this approach notwithstanding that G-SIB designation is reserved for institutions that, by the Federal Reserve's own standards, are far more systemically significant than GECC. In particular, the Proposed Order would require GECC to comply with the Federal Reserve's enhanced supplementary leverage ratio ("*eSLR*"), a requirement specific only to U.S. G-SIBs, even though GECC does not come close to meeting the established criteria for the eSLR. This is not only inappropriate in the context of the Proposed Order, but would also set a troubling precedent. If the Federal Reserve were to subject GECC to future G-SIB requirements in a similar fashion, including additional capital surcharges, the resulting regulatory framework would be out of proportion to GECC's systemic footprint and place GECC at an unjustified competitive disadvantage relative to banking organizations to which it is more closely comparable.

Moreover, even beyond the question of inappropriate G-SIB-like treatment, the Proposed Order broadly applies bank holding company ("*BHC*") rules and ratios on capital, leverage, liquidity and other subjects without sufficient consideration of GECC's specific circumstances. This is also inconsistent with Section 165. The Federal Reserve is required to take into account differences among large BHCs and nonbank SIFIs in developing enhanced prudential standards.[3] The Federal Reserve has repeatedly acknowledged its intention to "tailor" those standards to institutions' respective circumstances, as contemplated by Congress.[4] Furthermore, the Federal Reserve must consider the same factors in establishing enhanced prudential standards for a nonbank SIFI as the FSOC must consider in making a designation, including "the importance of the company as a source of credit for households, businesses, and State and local governments"[5] – and, in the particular case of GECC, our role as a provider of credit to middle-market companies, which the FSOC expressly cited as a source of systemic significance. Tailoring the Proposed Order to GECC also requires the Federal

3 *See id.* § 165(b)(3).

4 *See id.* § 165(a)(2) ("Tailored Application"); *see also* note 73. The uniform application of the G-SIB regulatory regime to GECC would, of course, be the antithesis of a tailored approach. As discussed below, we acknowledge and appreciate that the Proposed Order has been tailored in one significant respect, that is, in the non-application of the so-called "advanced approaches" methodology for calculating regulatory capital under the Federal Reserve's risk-based capital rules.

5 *See* Dodd-Frank Act § 165(b)(3) (requiring consideration of factors enumerated in *id.* § 113).

Reserve to give proper consideration to GECC's decreasing systemic significance since its designation as a nonbank SIFI.

Part I of this letter explores these issues in more detail. Part I-A discusses the multiple defects of an independent/independent director requirement, as well as what GECC believes to be a constructive and demonstrably preferable alternative. Part I-B discusses the Proposed Order's errors in equating GECC with G-SIBs and the general lack of relevant analysis and calibration with respect to the application of BHC capital, leverage, liquidity and other rules.

Part II of this letter provides additional, more specific comments on the details and implementation of the enhanced prudential standards. Part II-A responds to the Federal Reserve's request for comment on particular aspects of the BHC capital and liquidity rules that should be tailored to reflect GECC's circumstances, including by establishing more appropriate transition periods. Part II-B discusses the need for appropriate grandfathering in connection with the Proposed Order's Section 23B-like requirement.

Finally, Part III of this letter addresses the significant due process concerns raised by the Proposed Order.

I. Critical Substantive Flaws in the Proposed Order

A. The requirement to add "independent/independent" directors to the GECC board is inconsistent with settled principles of corporate law; exceeds the Federal Reserve's authority under Section 165; and is counterproductive in light of GECC's robust governance structure.

The Proposed Order would require that 25% of GECC's board (or two directors, whichever is greater) consist of "independent/independent" directors who are independent of the management of GECC and GE and not members of GE's board of directors.[6] GECC's board would also be required to maintain a risk committee at the GECC level chaired by one of these independent/independent directors and including at least one member with expertise in identifying, assessing and managing risk exposures of large, complex financial firms.[7]

The stated purpose of this requirement is to clearly vest the independent/independent directors with a special and different set of responsibilities from other directors, so that,

6 Proposed Order at 71784.

7 *Id.*

according to the Proposed Order, "their attention is focused on the business operations and safety and soundness of GECC itself, *apart from the needs of its parent GE.*"[8] This purpose seemingly proceeds from an unsupported assumption that even independent directors are somehow beset by conflicts of interests from which only independent/independent directors would be free. These positions are directly contrary to governing state law and problematic for multiple other reasons as well.

After a brief summary of the Delaware law governing corporate directors' fiduciary duties, we focus our comments on the numerous legal and other fundamental defects arising from an independent/independent director requirement:

- The independent/independent director requirement unequivocally conflicts with governing state law.
- By displacing settled principles of state corporate law through federal regulation, without any indication in the statutory text or legislative history of Section 165 that the Federal Reserve is authorized to do so, the independent/independent director requirement exceeds the Federal Reserve's authority under Section 165 under well-established legal principles.
- The independent/independent director requirement is inconsistent with the Federal Reserve's own regulatory practices (and those of other U.S. financial regulators), without any explanation or apparent grounds for the discrepancy.
- Even if the Federal Reserve had the requisite authority, an independent/independent director requirement would interfere with a strong and continuously improving framework for enterprise risk management under the leadership of the Risk Committee of the GE Board of Directors (the "*GE Risk Committee*") while ignoring more effective alternatives.
- Other measures to which GECC does not object, most notably a Section 23B-like requirement and capital planning and capital distribution requirements, obviate any ostensible need for independent/independent directors and will suffice to ensure appropriate controls on the relationship between GE and GECC.

We address these points in turn below, concluding with GECC's support for the alternative proposal advanced in a separate letter from the independent directors of

8 *Id.* at 71778 (emphasis added).

GE: If the Federal Reserve believes that special governance standards should apply to GECC, the Federal Reserve should instead require that a majority of GECC's directors be independent under normal standards of independence and that GECC's board be chaired by an independent director.[9]

1. *Delaware corporate law provides a clear framework for the fiduciary duties owed by directors of a wholly-owned subsidiary such as GECC.*

Consideration of the independent/independent director requirement must begin with the legal framework within which directors of a Delaware corporation operate, with particular focus on the duties owed by directors of a wholly-owned subsidiary such as GECC.

Under Delaware law, the "business and affairs" of a corporation "shall be managed by or under the direction of a board of directors" consisting of one or more natural persons.[10] The directors therefore have ultimate responsibility for the management of the corporation. A corporation's directors owe fiduciary duties to the corporation's stockholders, including a duty of care and a duty of loyalty.[11] All directors owe the *same* fiduciary duties, and the owners of a corporation are owed the same duties by *all* directors.[12] These basic principles are no different for directors of a corporation that is a BHC or other depository institution holding company, or a subsidiary of a BHC or other depository institution holding company.[13]

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9 *See* the comment letter on the Proposed Order submitted by the 16 independent directors of the GE Board of Directors (the "*GE Board Letter*") at 4-5.

10 8 Del. C. § 141(a)-(b).

11 *See, e.g., Guth v. Loft, Inc.*, 5 A.2d 503 (Del. 1939); *see also Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) ("[C]orporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders."). The U.S. Supreme Court has recognized that the same or similar duties exist in the law of "almost every, if not every" state. *United States v. Byrum*, 408 U.S. 125, 137 n.11 (1972); *see also, e.g., Irving Trust Co. v. Deutsch*, 73 F.2d 121, 126 (2d Cir. 1934); *Dankoff v. Bowling Proprietors Ass'n*, 331 N.Y.S.2d 109, 112 (N.Y. 1972) (New York corporations); *Orlando Orange Groves Co. v. Hale*, 107 Fla. 304, 313-14 (Fla. 1932) (Florida corporations); Cal. Corp. Code § 309(a) (California corporations).

12 *See, e.g., eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 26 (Del. Ch. 2010) ("*All* directors of Delaware corporations are fiduciaries of the corporations' stockholders.") (emphasis added).

13 *See Gantler v. Stephens*, 965 A.2d 695, 708-10 (Del. 2009) (stockholders of a BHC stated a claim for breach of the duty of loyalty against the BHC's directors and officers); *Arnold v. Soc'y for Sav. Bancorp*, 650 A.2d 1270, 1279-80 (Del. 1994).

These fiduciary duties and other specific obligations under state law have been referred to collectively as a "duty of good management."[14] To fulfill this duty of good management, directors must themselves obey applicable laws and regulations, including the Federal Reserve's, and must supervise the corporation's compliance with laws and regulations.[15] They can be held personally liable for failing to do so.[16] Furthermore, supervision of the corporation's "business and affairs" necessarily extends to ultimate responsibility for wholly-owned subsidiaries, including such subsidiaries' regulatory obligations, both generally and in the course of dealings with the parent.[17] Thus, state law provides a strong, coherent set of incentives for directors to manage the affairs of a corporation and its subsidiaries responsibly and lawfully.

When a corporation has only one stockholder and is a wholly-owned subsidiary, Delaware law clearly explains how the corporation's directors must discharge their fiduciary duties. Specifically, "the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders."[18] Contrary to what the Federal Reserve has proposed, no director of a Delaware corporation can be "independent" of a sole stockholder in the sense of not owing fiduciary duties to the sole stockholder or not being required to consider and represent its interests. Furthermore, there is no conflict under this legal framework if the same individual serves as a director of both a parent corporation and a subsidiary corporation. When directors of a parent corporation serve as directors of a wholly-owned subsidiary, "they have a fiduciary duty, as part of their management

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[14] *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11 (Del. 1983).

[15] *See, e.g.*, *In re Caremark Intern. Inc. Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996); *see also, e.g.*, *In re Massey Energy Co. Derivative & Class Action Litig.*, 2011 Del. Ch. LEXIS 83, 72-74 (Del. Ch. May 31, 2011); *Metro Commun. Corp. BVI v. Advanced Mobilecomm Techs. Inc.*, 854 A.2d 121, 131 (Del. Ch. 2004); *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003).

[16] *See, e.g.*, 8 Del. C. § 102(b)(7) (prohibiting exculpation for breach of a director's duty of loyalty or good faith); *id.* § 174 (establishing directors' liability for unlawful payment of dividends). In the case of regulated financial institutions, directors may also be held liable under banking laws for breaches of corporate fiduciary duties. *See* 12 U.S.C. § 1818(i).

[17] *See, e.g.*, *McPadden v. Sidhu*, 964 A.2d 1262 (Del. Ch. 2008) (directors' breach of duty of care was founded in part on failure to exercise oversight of the corporation's relationship with a wholly-owned subsidiary).

[18] *Anadarko Petroleum Corp. v. Panhandle E. Corp.*, 545 A.2d 1171, 1174 (Del. 1988); *see also* *Sternberg v. O'Neil*, 550 A.2d 1105, 1124 (Del. 1988); *Trenwick Am. Litig. Trust v. Ernst & Young, LLP*, 906 A.2d 168, 173 (Del. Ch. 2006) (it is "established Delaware law" that "[w]holly-owned subsidiary corporations are expected to operate for the benefit of their parent corporations; that is why they are created"), *aff'd sub nom.*, *Trenwick Am. Litig. Trust v. Billett*, 931 A.2d 438 (Del. 2007).

responsibilities, to act in the best interests of the parent and its stockholders."[19] This law is settled and unambiguous.

2. *The independent/independent director requirement unequivocally conflicts with governing state law.*

In light of the foregoing, it is evident that the proposed independent/independent director requirement squarely conflicts with both the spirit and the letter of Delaware law. The Proposed Order provides the following rationale (and only the following rationale) for this requirement: "[T]he [Federal Reserve] believes that it is necessary to ensure that GECC's board of directors includes members who are independent of GE so that their attention is focused on the business operations and safety and soundness of GECC itself, *apart from the needs of its parent GE*."[20] As this passage establishes, the purpose of the independent/independent director requirement is to modify some directors' fiduciary duties and to orient them away from GE as GECC's sole stockholder.

But a director cannot have duties "apart" from the needs of a sole stockholder parent company. If that were the case, some directors would have to disregard, at least in part, the interests of the sole stockholder, and these directors would have different duties from the other directors. Such a departure from settled principles of Delaware corporate law would compromise the essential features of a director's role as a fiduciary of the corporation and its sole stockholder.

GECC is not alone in reaching this conclusion. Experts in Delaware law and corporate governance have also determined that the independent/independent director requirement in the Proposed Order unequivocally conflicts with Delaware law. We have attached supporting letters from **Justice Jack B. Jacobs**, who served on the Delaware Supreme Court from 2003 to 2014 and before that served as Vice Chancellor on the Delaware Court of Chancery since 1985; **Chancellor William B. Chandler III**, who served on the Delaware Court of Chancery from 1989 to 2011 as Vice Chancellor and then Chancellor; and **Professor Jonathan R. Macey**, a preeminent scholar of corporate law and corporate governance, particularly with respect to banking organizations.[21]

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19 *Grace Bros. v. Uniholding Corp.*, 2000 WL 982401, at *12 (Del. Ch. July 12, 2000); *see also Quadrant Structured Products Co. v. Vertin*, 102 A.3d 155, 184 (Del. Ch. 2014); *Hamilton Partners, L.P. v. Englard*, 11 A.3d 1180, 1209 (Del. Ch. 2010).

20 Proposed Order at 71778 (emphasis added).

21 The letters from Justice Jacobs, Chancellor Chandler and Professor Macey are attached as **Annexes A**, **B** and **C**, respectively, to this letter.

It bears emphasis that, as these experts' writings amply demonstrate, an independent/independent director requirement is not merely vaguely or directionally inconsistent with Delaware law. Rather, as Chancellor Chandler concludes, the Federal Reserve's proposed requirement is "out of step with, and invites serious misapprehensions of, the fundamental tenets of Delaware corporate law."[22]

3. *By displacing settled principles of state corporate law through federal regulation, without any indication in the statutory text or legislative history of Section 165 that the Federal Reserve is authorized to do so, the independent/independent director requirement exceeds the Federal Reserve's authority under Section 165 under well-established legal principles.*

Because an independent/independent director requirement conflicts with state law, it can constitute a permissible prudential standard only if Congress manifestly authorized the Federal Reserve to displace state law in this area. Nothing in Section 165 suggests that this is the case.

The Proposed Order states that the Federal Reserve proposes to impose the independent/independent director requirement "under its authority in section 165(h) to impose risk committee and risk management standards and its authority under section 165(b)(1)(B)(iv) to impose other standards that the [Federal Reserve] determines are appropriate."[23]

But neither Section 165(h) nor Section 165(b) confers this authority. Section 165(h) uses language that cannot be interpreted to extend to an independent/independent director requirement. Section 165(b) does not authorize the Federal Reserve to preempt state law.

a. *<u>Section 165(h)</u>.*

The language of Section 165(h) actually contradicts, rather than supports, the standard that has been proposed. Section 165(h) requires that, for nonbank SIFIs or certain BHCs that are "publicly traded compan[ies]," there be a risk committee of the board of

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22 Chandler, Annex B, at 12. *See also* Jacobs, Annex A, at 8 ("[N]o decision of which we are aware . . . suggests that a subsidiary's directors owe no fiduciary duty to the parent, or that the subsidiary's directors may base the discharge of their duties on considerations apart from the needs of the parent – which appears to be the premise of the [Federal Reserve] proposal."); Macey, Annex C, at 4 ("[T]he Proposal radically alters the scope of the fiduciary duties of certain GECC directors . . . . And in doing so, the Proposal directly encroaches upon state law.").

23 Proposed Order at 71778 n.57.

directors that "include[s] such number of independent directors" as the Federal Reserve determines to be appropriate.[24] Nowhere in Section 165 is there any language that authorizes the Federal Reserve to require independent/independent directors as in the Proposed Order.

An "independent" director is universally understood to mean a director who is independent from *management*. The term does not carry, and has never carried, any connotation of independence from a stockholder, including a parent company *board*. *All* the most commonly consulted director independence standards use "independent" in this well-accepted fashion.

Under the rules of the New York Stock Exchange (the "*NYSE*"), for example, "[n]o director qualifies as 'independent' unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company)," but "as the concern is independence from *management*, the [NYSE] does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding."[25]

Similarly, Nasdaq listing standards provide that an independent director is "a person other than an Executive Officer or employee of the Company or any other individual having a relationship which, in the opinion of the Company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director," and likewise note that "Nasdaq does not believe that ownership of Company stock by itself would preclude a board finding of independence."[26]

Under none of these rules would serving on both a parent company board and a subsidiary board create any implication of an absence of independence with respect to service on either board, much less constitute a bar to an independence determination. If a large shareholder can be an independent director, it must follow that an

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[24] Dodd-Frank Act §§ 165(h)(1), 165(h)(3)(B). We also do not believe as a threshold matter that GECC is in fact a "publicly traded company," which is commonly understood to mean a company whose *common stock* is publicly traded; GECC's is not. The Proposed Order cites to the Federal Reserve's own definitions under Regulation YY, which arguably include publicly traded debt and preferred stock such as GECC's, but those definitions do not represent a reasonable interpretation of Section 165(h)(1) as applied to GECC. *See* Proposed Order at 71778 n.57; 12 CFR § 252.21(a) (Regulation YY).

[25] NYSE Listed Company Manual § 303A.02 (emphasis added).

[26] Nasdaq Equity Rules §§ 5605(a)(2), IM-5605.

independent director of a large shareholder can be an independent director of a subsidiary.

Even under the heightened independence standards for audit committee members under Securities and Exchange Commission ("*SEC*") Rule 10A-3, an outside director of a parent company would qualify as an independent audit committee member of a subsidiary; only directors of the parent company who are also employees of the parent company would fail to be independent audit committee members of the subsidiary.[27]

The Federal Reserve's authority under Section 165(h) does not extend to adopting an interpretation of statutory language that departs from unambiguous meaning of that language.[28] "If the intent of Congress is clear, that is the end of the matter."[29] Regulatory agencies are not exempt from this "plain meaning" rule. The term "independent" in Section 165(h) is unambiguous and has a widely understood and accepted meaning.

There is no indication in the statutory language or legislative history of Section 165 that Congress intended to change the conventional definition or permit the Federal Reserve to do so. Rather, Section 165(h) simply provides that the Federal Reserve will determine the *number* of independent directors required to serve on a risk committee.[30] Moreover, even if there were arguably some ambiguity at the margins, the Federal Reserve's interpretation of the term "independent" would still be unreasonable, and hence invalid, because it departs from "accepted ordinary commercial usage" without any indication of congressional intent to do so.[31]

The same argument applies to references in Section 165(h) to "directors." Those references should, consistent with accepted ordinary commercial usage, be construed as referring to individuals who owe customary fiduciary duties established under state law to the corporation's stockholders. An independent/independent director with special duties of the sort articulated in the Supplementary Information to the Proposed Rule would be more akin to a corporate monitor than to a director of a Delaware

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27 *See* 17 CFR § 240.10A-3(e)(1)(iii)(B).

28 *See Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-44 (1984).

29 *Id.* at 842.

30 Dodd-Frank Act § 165(h)(3)(B).

31 *Board of Governors of the Fed. Reserve Sys. v. Dimension Fin. Corp.*, 474 U.S. 361, 373 (1986).

corporation. The Federal Reserve's interpretation of Section 165(h) is therefore doubly incorrect as a matter of plain meaning.[32]

b. Section 165(b).

Section 165(b) provides that the Federal Reserve "may establish additional prudential standards" for nonbank SIFIs "that include . . . such other prudential standards as the [Federal Reserve] . . . determines are appropriate."[33] For the reasons discussed below, this delegation of discretion clearly does not extend to an independent/independent director requirement.

First, as noted above, an independent/independent director requirement can be permissible only if Section 165 clearly authorized the Federal Reserve to preempt state law. It is a cornerstone of U.S. federalism, however, that "there is generally a presumption against pre-emption."[34] Both the judicial and executive branches of the U.S. government have long recognized that federal agencies are not independently empowered to preempt state law in the same way that Congress is.[35] Furthermore,

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32 It is also inappropriate for the Federal Reserve to impose an independent/independent director requirement under Section 165(b), even if it otherwise had the authority to do so, before concluding a rulemaking under Section 165(h) with respect to the risk committee requirements for nonbank SIFIs. Section 165(h) expressly contemplates precisely such a rulemaking. The Federal Reserve cannot circumvent such a specific statutory obligation under Section 165(h) by relying on its generalized power under Section 165(b) to promulgate prudential standards. *See, e.g., D. Ginsberg & Sons v. Popkin*, 285 U.S. 204, 208 (1932) ("General language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment.").

33 Dodd-Frank Act § 165(b)(1)(B).

34 *Pokorny v. Ford Motor Co.*, 902 F.2d 1116, 1122 (3d Cir. 1990); *see also, e.g., Altria Group, Inc. v. Good*, 555 U.S. 70, 77 (2008) ("[W]hen the text of a pre-emption clause is susceptible of more than one plausible reading, courts ordinarily 'accept the reading that disfavors pre-emption.'") (quoting *Bates v. Dow Agrosciences LLC*, 544 U.S. 431, 449 (2005)); *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996) ("[B]ecause the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action.").

35 *See, e.g., Hillsborough Cnty. v. Automated Med. Labs.*, 471 U.S. 707, 717 (1985) ("We are even more reluctant to infer pre-emption from the comprehensiveness of regulations than from the comprehensiveness of statutes."); *Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 908 (2000) (Stevens, J., dissenting) ("While the presumption [against pre-emption] is important in assessing the pre-emptive reach of federal statutes, it becomes crucial when the pre-emptive effect of an administrative regulation is at issue."); Exec. Order No. 13132, *Federalism*, 64 Fed. Reg. 43255, 43257 (Aug. 4, 1999) ("Agencies shall construe, in regulations and otherwise, a Federal statute to preempt State law only where the statute contains an express preemption provision or there is

the presumption against preemption "is heightened in areas traditionally occupied by the states, such as corporate law."[36] The Proposed Order does not address this presumption, let alone attempt to rebut it.

Indeed, reflecting the particular force of the strong presumption against preemption here, Congress has time and again declined to displace state regulation of corporate law.[37] Congressional forays into corporate governance have been limited. The Securities Act of 1933 and Securities Exchange Act of 1934 (the "*Exchange Act*") focused on regulating communications of public corporations with investors and securities markets. While the Sarbanes-Oxley Act of 2002 adopted far-reaching substantive rules that addressed particular areas of federal interest in how corporations operate (*i.e.*, accounting oversight and disclosure obligations), the sweeping statute nevertheless left traditional state corporate law largely untouched, including the fiduciary duties of directors. Likewise, the U.S. Supreme Court has routinely rejected regulatory efforts to preempt state corporate law.[38] With regard to corporate directors in particular, the Court has consistently recognized the primacy of

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some other clear evidence that the Congress intended preemption of State law . . . . Any regulatory preemption of State law shall be restricted to the minimum level necessary to achieve the objectives of the statute pursuant to which the regulations are promulgated.").

36 *Freedman v. Redstone*, 753 F.3d 416, 430 (3d Cir. 2014).

37 *See Burks v. Lasker*, 441 U.S. 471, 478 (1979) ("[I]n this field congressional legislation is generally enacted against the background of existing state law; Congress has never indicated that the entire corpus of state corporation law is to be replaced simply because a plaintiff's cause of action is based upon a federal statute."); *Bus. Roundtable v. SEC*, 905 F.2d 406, 412 (D.C. Cir. 1989) (rejecting the SEC's assertion of power to "establish a federal corporate law by using access to national capital markets as its enforcement mechanism" because "[i]t would . . . overturn or at least impinge severely on the tradition of state regulation of corporate law"); Note, *An Historical Survey of Federal Incorporation*, 1 DEL. J. CORP. L. 370, 378-89 (1976) (summarizing failed proposals to federalize corporate law).

38 *See, e.g.*, *United States v. Bestfoods*, 524 U.S. 51 (1998) (CERCLA did not preempt rule that parent of wholly-owned subsidiary may be liable for subsidiary's actions only when corporate veil may be pierced under applicable state law); *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69 (1987) (Indiana anti-takeover statute was not preempted by federal Williams Act and did not violate Commerce Clause); *Burks*, 441 U.S. at 471 (state corporate law governed whether disinterested directors of an investment company could terminate a derivative suit under the federal Investment Company and Investment Advisers Acts of 1940); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977) (refusing to extend Exchange Act Section 10(b) and Rule 10b-5 thereunder to cover breach of state law fiduciary duty by majority stockholders).

state law in defining their rights and duties, declaring that "[c]orporations are creatures of state law, and it is state law which is the font of corporate directors' powers."[39]

Consequently, to "displace traditional state regulation" in an area such as corporate law, "the federal statutory purpose must be *clear and manifest*."[40] Otherwise, "except where federal law *expressly* requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of [a] corporation."[41]

Second, Section 165(b) also cannot reasonably be interpreted to provide the necessary "clear and manifest" evidence that Congress intended to grant the Federal Reserve statutory authority to rewrite core principles of state corporate law. Among other reasons why Section 165(b) cannot be interpreted in this manner, Congress spoke more directly to corporate governance issues in Section 165(h) without granting the Federal Reserve that far-reaching authority.

The language of Section 165(b) provides not even a hint that Congress intended to authorize the Federal Reserve to use its "other prudential standards" authority to displace settled corporate law. The "other prudential standards" clause is the last item in a list, preceded by specific measures that the statute classifies as "additional prudential standards" that the Federal Reserve could impose: "a contingent capital requirement"; "enhanced public disclosures"; and "short-term debt limits."[42] None of those "additional prudential standards" is a requirement concerning the structure, composition or qualifications of a nonbank SIFI's board. Construing the "other prudential standards" clause to encompass an independent/independent director requirement would therefore contradict the settled rule of statutory interpretation that "where general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words."[43]

Under this "rule of construction . . . the residual clause" in this list in Section 165 "should itself be controlled and defined by reference to the enumerated categories" of

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[39] *Burks*, 441 U.S. at 478 (quoting *Cort v. Ash*, 422 U.S. 66, 84 (1975)) (internal quotation marks and citation omitted).

[40] *Bfp v. Resolution Trust Corp.*, 511 U.S. 531, 544 (1994) (internal quotation marks and citations omitted) (emphasis added).

[41] *Santa Fe*, 430 U.S. at 479 (emphasis added).

[42] *See* Dodd-Frank Act § 165(b)(1)(B)(i)-(iii).

[43] *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 114-15 (2001).

enhanced prudential standards "recited just before it." [44] Because the independent/independent director requirement is nothing like a requirement relating to the financial condition of a company or a corresponding disclosure provision, it is not an "other prudential standard" of the sort that the Federal Reserve is authorized to impose.

Moreover, as discussed above, the detailed language of Section 165(h), which specifically pertains to the composition of a nonbank SIFI's risk committee, underscores that Congress did not intend the Federal Reserve to use the far more general language of Section 165(b) to issue prudential standards regarding director independence or other matters of corporate governance.[45] Indeed, it is well-settled that, where Congress speaks directly to an issue in one section of a statute, an agency cannot invoke a general, catch-all provision to expand its authority beyond the limits expressly established by Congress in the more specific section of the statute.

In *California Independent System Operator v. FERC*, for example, the U.S. Court of Appeals for the D.C. Circuit rejected the position of the Federal Energy Regulatory Commission ("*FERC*") that it possessed the authority to "compel a corporation created by state law to employ a governing board chosen in violation of that law."[46] According to FERC, "the composition of the governing board of a utility and the method of its selection [was] a 'practice . . . affecting [a] rate'" within its regulatory authority under 16 U.S.C. § 824e(a).[47] The D.C. Circuit disagreed, emphasizing that another statutory provision, 16 U.S.C. § 825d, gave FERC the "limited authority to regulate conflicts of interest among the directors of public utilities and market actors who deal with such utilities." [48] "Congress's specific and limited enumeration of FERC's power over corporate governance" in 16 U.S.C. § 825d, the D.C. Circuit explained, "is *strong evidence* that [16 U.S.C. § 824e(a)] confers no such authority on FERC."[49] The court

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44 *Id.* at 115.

45 *See, e.g.*, *D. Ginsberg & Sons*, 285 U.S. at 208; *see also Edmond v. United States*, 520 U.S. 651, 657 (1997) ("Ordinarily, where a specific provision conflicts with a general one, the specific governs."); *Busic v. United States*, 446 U.S. 398, 406 (1980) ("[A] more specific statute will be given precedence over a more general one, regardless of their temporal sequence.").

46 372 F.3d 395, 398 (D.C. Cir. 2004).

47 *Id.* at 399.

48 *Id.* at 401.

49 *Id.* (emphasis added).

accordingly vacated FERC's order as an "unprecedented invasion of internal corporate governance" that the agency was not "empower[ed] . . . to make."[50]

That reasoning applies with equal force here. The specific focus of Section 165(h) on director independence in the context of a nonbank SIFI's risk committee is "strong evidence" that Congress did not authorize the Federal Reserve to impose additional corporate governance requirements under the more general provisions of Section 165(b). It is inconceivable that, with respect to corporate governance, Congress would have granted the Federal Reserve carefully enumerated and narrowly circumscribed authority in Section 165(h) while simultaneously granting sweeping and seemingly boundless authority under the generalized provisions of Section 165(b).

4. *The independent/independent director requirement is inconsistent with the Federal Reserve's own regulatory practices (and those of other U.S. financial regulators), without any explanation or apparent grounds for the discrepancy.*

The independent/independent director requirement is also contrary to regulatory practice and to stated policy. The Proposed Order offers no reasoning for departing from that settled practice or for treating GECC differently in this respect.

As BHCs became the prevalent form of banking organization structure in the last half of the twentieth century, the question of the relationship between the holding company and its subsidiary banks became the subject of review and analysis by the regulators and banking organizations alike. To our knowledge, there has never been a requirement in any published rule or policy statement that bank subsidiaries of U.S. depository institution holding companies, let alone corporate subsidiaries, must have independent/independent directors.[51]

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50 *Id.* at 399.

51 Isolated cases in which other regulators have required an insured depository subsidiary to appoint directors who have no affiliation with the depository's corporate affiliates are different from the circumstances presented by GECC and the Proposed Order. Our understanding is that this requirement has been applied to seriously troubled banks or to specialized institutions (such as industrial banks) that were small relative to their parents, significantly relied on the parent for control functions and/or could not realistically be expected to have the type of independent risk management framework that has been installed at GECC under the oversight of the four outside directors who serve on the GE Board's Risk Committee. It is also our understanding that the other regulators have not charged the independent directors with special fiduciary duties that would set them apart from other directors. Indeed, the boards of various subsidiaries of GE Capital include outside directors who are united with the GECC directors by shared fiduciary duties and a common mission of safety and soundness, including the Boards of GE Capital Bank (our Industrial Loan Corporation) and Synchrony Bank.

Nor has the Federal Reserve's Section 165 rulemaking to date included any requirement comparable to independent/independent directors. Of perhaps most relevance is the Federal Reserve's final rule on applying Section 165 to foreign banking organizations ("*FBOs*") with substantial subsidiary operations in the United States. This rule requires these FBOs to establish a U.S. intermediate holding company ("*IHC*"), but does not establish an independent/independent director requirement for the IHC, including its risk committee. Rather, the rule requires that the risk committee of a covered U.S. BHC be chaired by a director who, consistent with the generally accepted definition of "independent," is:

- not an *officer or employee* of the BHC and has not been an officer or employee of the BHC during the previous three years;

- not a member of the immediate family, as defined in the Federal Reserve's Regulation Y, of a person who is, or has been within the last three years, an executive officer of the BHC, as defined in the Federal Reserve's Regulation O; and

- an independent director under Item 407 of SEC Regulation S-K, if the BHC has an outstanding class of securities traded on an exchange registered with the SEC as a national securities exchange, or would qualify as an independent director under the listing standards of a national securities exchange, as demonstrated to the satisfaction of the Federal Reserve, if the BHC does not have an outstanding class of securities traded on a national securities exchange.[52]

Similarly, the rule requires that, where an FBO is required to constitute a U.S. risk committee, the U.S. risk committee must have at least one member who is:

- not an *officer or employee* of the FBO or its affiliates and has not been an officer or employee of the FBO or its affiliates during the previous three years; and

- not a member of the immediate family, as defined in the Federal Reserve's Regulation Y, of a person who is, or has been within the last three years, an executive officer, as defined in the Federal Reserve's Regulation O, of the FBO or its affiliates.[53]

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52 12 CFR § 252.33(a)(4)(ii) (Regulation YY).

53 *Id.* § 252.155(a)(5)(ii).

In no event would these provisions exclude an independent director of the top-level parent company from serving as an independent member of the risk committee (at whatever level of the organization the risk committee was constituted).

The Proposed Order does not provide any basis for treating GECC differently in this respect from a U.S.-based IHC, some of which are quite significant in size.[54] Furthermore, this independence requirement is intended to be consistent with rules of U.S. securities exchanges, which, as discussed above, likewise do not contain any independent/independent director requirement as applied to a subsidiary of a parent company.[55]

The "heightened standards" for certain large national banks recently promulgated by the Office of the Comptroller of the Currency (the "*OCC*") are also instructive and underscore the extent to which the Federal Reserve's proposed independent/independent requirement for GECC is an outlier.[56] The OCC's heightened standards discuss the relationship between a national bank and its parent BHC, and impose a number of new requirements and offer a number of suggestions relating to that relationship, but do not impose a requirement of independent/independent directors at the national bank level. On the contrary, although the heightened standards require a covered national bank to have at least two independent directors to promote effective and independent oversight of the bank, the standards expressly contemplate that independent directors of the parent BHC can satisfy this requirement and instruct such directors on how to satisfy both sets of duties.[57]

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[54] For example, HSBC North America Holdings Inc. has approximately $280 billion in assets, and TD Bank US Holding Company has approximately $240 billion in assets. *See* National Information Center ("*NIC*"), *Holding Companies with Assets Greater Than $10 Billion* (Sept. 30, 2014), *available at* https://www.ffiec.gov/nicpubweb/nicweb/Top50Form.aspx.

[55] *See* Federal Reserve, *Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations; Final Rule*, 79 Fed. Reg. 17240, 17287 (Mar. 27, 2014) (the "*FBO Rule*") (for FBOs, the independence requirement "was adapted from director independence requirements of certain U.S. securities exchanges").

[56] *See* OCC, *Guidelines Establishing Heightened Standards for Certain Large Insured National Banks, Insured Federal Savings Associations, and Insured Federal Branches; Integration of Regulations; Final Rule*, 79 Fed. Reg. 54518 (Sept. 11, 2014).

[57] *See id.* at 54538 ("In the preamble to the proposal, we noted that this would enable the bank's board to provide effective, independent oversight of bank management and, to the extent the bank's independent directors are also members of the parent company's board, the OCC would expect that such directors would consider the safety and soundness of the bank in decisions made by the parent company that impact the bank's risk profile.").

5. *Even if the Federal Reserve had the requisite authority, an independent/independent director requirement would interfere with a strong and continuously improving framework for enterprise risk management under the leadership of the GE Risk Committee while ignoring more effective alternatives.*

Even if the Federal Reserve *could* impose an independent/independent director requirement under Section 165(b) or Section 165(h) under some circumstances, it *should not* do so with respect to GECC. Indeed, GECC currently benefits from extensive oversight from independent directors on GE's Board of Directors that would be weakened by the imposition of an independent/independent director requirement.

Ultimate responsibility for oversight of GECC's enterprise risks is currently vested in the GE Risk Committee, whose principal charter is to provide "independent oversight of the Company's wholly-owned subsidiary, General Electric Capital Corporation (GECC), including the adequacy and effectiveness of its risk management and credit review functions." This is the core of what GECC and GE strongly believe to be a thoughtful and effective protocol for managing GECC's risks while maintaining an informed view of the relationship between GECC and GE.

The GE Risk Committee consists of four eminently qualified and dedicated independent directors who have significant financial services experience and who have successfully led institutions in both the private and public sectors:

- ***W. Geoffrey Beattie.*** Mr. Beattie has been a Director since 2009. He received a law degree from the University of Western Ontario and served as a partner in the Toronto law firm Torys LLP before joining The Woodbridge Company Limited, where he served as chief executive officer from 1998 through December 2012. The Woodbridge Company Limited is a privately held investment holding company for the Thomson family of Canada and the majority shareholder of Thomson Reuters, where Mr. Beattie served as deputy chairman from 2000 through May 2013 and director from 1998 through May 2013. He has served as chief executive officer of Generation Capital, an investment company, since September 2013, and chairman of Relay Ventures since June 2013. He has served as a member of the board of directors of Royal Bank of Canada since 2001 and chaired that board's Risk Committee since 2010.

- ***John J. Brennan.*** Mr. Brennan has been a Director since 2012. He is a graduate of Dartmouth College and earned an MBA from Harvard Business School. He joined Vanguard in 1982, was elected chief financial officer in 1985, president in 1989, and served as chief executive officer from 1996 to

2008 and chairman from 1998 through 2009. He has been chairman emeritus and senior advisor to Vanguard since 2010. Mr. Brennan is a director of Guardian Life Insurance Company of America and LPL Financial Holdings Inc., and lead governor of the Financial Industry Regulatory Authority ("*FINRA*") Board of Governors. Mr. Brennan has also served as a director at The Hanover Insurance Group.

- ***James E. Rohr.*** Mr. Rohr has been a Director since 2013. A graduate of the University of Notre Dame, Mr. Rohr also holds an MBA from The Ohio State University. Mr. Rohr joined The PNC Financial Services Group, Inc. in 1972, and served in various marketing and senior management positions, including as president and vice chair and president and chief operating officer. He became chief executive officer in 2000 and chairman in 2001. He retired as chief executive officer in 2013 and as executive chairman in 2014. Mr. Rohr is also a director at Allegheny Technologies, Inc., EQT Corporation and Marathon Petroleum Corporation and has been a director at BlackRock. He is a former President of the Federal Advisory Council of the Board of Governors of the Federal Reserve System.

- ***Mary L. Schapiro.*** Ms. Schapiro has been a Director since 2013. She is a graduate of Franklin & Marshall College and earned a law degree from George Washington University Law School. She served as the 29th chairman of the SEC from January 2009 through December 2012. From April 2013 to January 2014, she was a managing director and chairman of the Governance and Markets Practice at Promontory Financial Group, and since January 2014 she has served as Vice Chair of the Promontory Advisory Board and as a board member of Promontory Interfinancial Network. Prior to becoming chairman of the SEC, Ms. Schapiro served as chief executive officer of FINRA from 2007 through 2008. She joined that organization in 1996, serving as president of NASD Regulation from 1996 to 2002 and as vice chairman from 2002 to 2006, when she was named chairman. Ms. Schapiro previously served as a commissioner of the SEC from December 1988 to October 1994, and left the SEC when appointed chairman of the CFTC, where she served until 1996. Ms. Schapiro has also served as a director at Kraft Foods and Duke Energy.

These directors have the stature, independence and expertise to exercise objective and effective oversight of GECC consistent with fiduciary requirements and supervisory expectations. Professor Macey examined the background of these directors in light of existing regulations and based on his own work – as published or about to be published in the Federal Reserve Bank of New York's *Economic Policy Review* – concerning the qualifications of bank directors.[58] Professor Macey determined that these directors "have the requisite independence and experience in identifying, assessing, and managing the risk exposures of large, complex financial firms."[59] Professor Macey therefore concluded that each member of the GE Risk Committee is "fully qualified" to serve on such a committee "under any actual or proposed standard for directors' qualifications."[60]

The GE Risk Committee has established a rigorous meeting and engagement process to oversee GECC effectively and independently. Its GECC-focused oversight has steadily intensified since the Committee's formation in 2011, with more frequent and more in-depth meetings and other sessions with GECC management. In 2014, the GE Risk Committee convened more than 20 meetings focused on GECC matters. The GE Risk Committee has added monthly calls with the GECC Chief Risk Officer and senior leadership to allow for more comprehensive risk updates. The annual schedule includes in-depth reviews of each GECC business, site visits to GECC locations and GE Risk Committee exposure to a range of GECC risk and business leaders and other subject matter experts. We anticipate a similar GE Risk Committee schedule during 2015. The meeting schedule is illustrative, but of course captures only a portion of the time that the GE Risk Committee members spend on GECC oversight when also accounting for informal interactions with GECC management, preparation for meetings and review of board reporting and other materials.

Not only do these initiatives of the GE Risk Committee contribute to GECC's safety and soundness, but they also show why an independent/independent director requirement is unnecessary. New outside directors at GECC would not have benefited from the GE Risk Committee's dedicated efforts and knowledge of GECC, its businesses and its risks. Nor can the GE Risk Committee's level of familiarity with GECC be replicated without substantial time and effort. In the same vein, Professor Macey notes that establishing a separate GECC Risk Committee with independent/independent directors would be a less effective means of risk management because overlapping membership between the boards of a parent and a subsidiary "increases operational efficiency, increases the quantity and quality of information flow, and streamlines decision-making."[61] An independent/independent director requirement, in contrast, is

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[58] *See* Jonathan Macey & Maureen O'Hara, *Bank Corporate Governance: A Proposal for the Post-Crisis World*, FRBNY ECON. POL'Y REV. (forthcoming 2015); Jonathan R. Macey & Maureen O'Hara, *The Corporate Governance of Banks*, FRBNY ECON. POL'Y REV. 91 (Apr. 2003).

[59] Macey, Annex C, at 6.

[60] *Id.* at 6, 10.

[61] *Id.* at 10.

"inefficient and inconsistent with both state law and ordinary and customary corporate practice."[62]

The members of the GE Risk Committee all owe the same fiduciary duties and therefore share the same goals, which enables them to work collaboratively and efficiently.[63] This would not be true of a GECC board with independent/independent directors who were required (or even perceived to be required) to have different responsibilities and duties. Practically speaking, the independent/independent directors would find themselves in a virtually impossible situation, with a role and mandate that would inevitably be unclear and confusing. The divergent fiduciary obligations of GECC's independent/independent directors and of GECC's other directors could generate discord and conflict in GECC's boardroom, and undermine the unity, trust and shared sense of a common mission that are essential to any well-functioning board. The GE Board Letter provides additional insights on these considerations that are informed by the authors' wide-reaching and deep collective experience as corporate directors in diverse settings.[64] Chancellor Chandler confirms that, from his unique vantage point, the concerns expressed by the independent directors of GE regarding the dynamics of the GECC Board of Directors are anything but hypothetical or academic: His judgment, based on more than 20 years of "experience on the bench, [is that] the presence of a balkanized board of directors can lead to wasteful litigation, distraction from management of the company's business and affairs, and a possible undoing of the company itself."[65]

The foregoing discussion is central to the validity of the Proposed Order. Apart from the legal deficiencies described in the earlier sections of this part, it is well established that an agency's action is arbitrary and capricious – and therefore fatally deficient – if it does not "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made."[66] The Proposed Order makes no attempt to explain or offer a bona fide analysis of the independent/independent director requirement. Any surmised benefits

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62 *Id.* at 13.

63 As noted above, even ignoring the specific provisions of the GE Risk Committee's charter, the duties of care and good management owed by the members of the GE Risk Committee certainly extend to a material subsidiary of GE such as GECC. Again, state law provides a strong framework that the Proposed Order would not augment, but would actually undermine.

64 *See* GE Board Letter at 3-4.

65 Chandler, Annex B, at 4.

66 *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (internal quotation marks and citations omitted).

of an independent/independent director requirement are inherently speculative and attenuated at best, yet its detriments are, as demonstrated, cognizable and serious. Even when a more detailed explanation is provided, furthermore, it may not rest on "sheer speculation" about how certain actors (such as GECC directors who were or were not independent/independent) would or would not behave.[67] Finally, and of particular pertinence here, an agency may not assume that applicable laws will fail to function as intended, such as to protect the interests of stockholders by providing for oversight from independent directors to ensure that a wholly-owned subsidiary honors its regulatory obligations.[68]

6. *Other measures to which GECC does not object, most notably a Section 23B-like requirement and capital planning and capital distribution requirements, obviate any ostensible need for independent/independent directors and will suffice to ensure appropriate controls on the relationship between GE and GECC.*

To the extent that this relationship between GECC and GE is a source of concern for the Federal Reserve, board composition is not an appropriate, optimal or necessary channel for creating appropriate controls. Three other measures in the Proposed Order more effectively safeguard GECC in its interactions with GE without presenting the same intractable conflicts with state law, practical conflicts for independent/independent directors or risk of disruption.

First, the Proposed Order requires transactions between GECC or its subsidiaries, on the one hand, and GE or its non-GECC subsidiaries, on the other hand, to be conducted on arm's-length terms, as though Section 23B of the Federal Reserve Act applied and GECC were a member bank. Although we comment below on the need for appropriate grandfathering with respect to such a requirement, the imposition of an arm's-length

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67 *See Sorenson Commc'ns Inc. v. FCC*, 755 F.3d 702, 708-09 (D.C. Cir. 2014) ("deference" to an agency's predictive judgments "must be based on some logic and evidence, not sheer speculation") (internal quotation marks and punctuation omitted); *see also City of Centralia v. FERC*, 213 F.3d 742, 749 (D.C. Cir. 2000) (when an agency's "conclusion is based on sheer speculation . . . it cannot be said that there is substantial evidence" supporting challenged action); *McDonnell Douglas Corp. v. U.S. Dep't of the Air Force*, 375 F.3d 1182, 1187 (D.C. Cir. 2004) ("[W]e do not defer to the agency's conclusory or unsupported suppositions.").

68 *See Bus. Roundtable v. SEC*, 647 F.3d 1144, 1151 (D.C. Cir. 2011) (agency's errors included misapprehension of state law); *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178-79 (D.C. Cir. 2010) (agency's cost-benefit analysis was flawed because it failed to account for "baseline level" of key variables "under state law" and was "incomplete" because it "fail[ed] to determine whether, under the existing regime, sufficient protections existed").

requirement substantially mitigates any possible need for an independent/independent director requirement.

Second, extensive capital planning requirements, supervisory and company-run stress tests and related supervisory restrictions on capital distributions will all circumscribe GECC's ability to make distributions to its parent company and ensure that such distributions will not threaten GECC's capital strength.[69] These tools have been referred to by the Federal Reserve itself as the "best example" of "how the strengthening of systems of controls and risk-appetite decision processes can promote achievement of regulatory interests beyond those shared with the owners of firms."[70] The Federal Reserve has used these tools to restrict distributions and impose appropriate sanctions for noncompliance.[71]

Third, the liquidity requirements in the Proposed Order will similarly safeguard GECC, further obviating the need for an extraordinary independent/independent director requirement at GECC.[72]

7. *If the Federal Reserve continues to believe that special governance standards should apply to GECC, the Federal Reserve should instead require that a majority of GECC's directors be independent under normal standards of independence and that GECC's board be chaired by an independent director.*

For the numerous reasons discussed above, an independent/independent director requirement is beyond the Federal Reserve's authority under the Dodd-Frank Act and is ill-advised as a matter of effective corporate governance. If, nonetheless, after consideration of our comments, the Federal Reserve continues to believe that special governance standards should apply to GECC, we support the alternative requirements urged by the independent directors of GE. Under these alternative requirements, a majority of GECC's directors would be required to be independent under normal standards of independence – so that the members of the GE Risk Committee could join

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69 *See, e.g.*, Federal Reserve, *Comprehensive Capital Analysis and Review 2014: Assessment Framework and Results* (Mar. 2014); Federal Reserve, *Dodd-Frank Act Stress Test 2014: Supervisory Stress Test Methodology and Results* (Mar. 2014). We provide additional comments on GECC's transition to full compliance with these requirements in Part II-A of this letter.

70 Governor Daniel K. Tarullo, *Corporate Governance and Prudential Regulation* (speech June 9, 2014).

71 *See, e.g.*, Written Agreement by and between Santander Holdings USA, Inc. and Federal Reserve Bank of Boston (Sept. 15, 2014).

72 *See, e.g.*, Proposed Order at 71784 ("Liquidity Requirements").

the GECC board in satisfaction of this requirement – and GECC's board would be chaired by an independent director.

Furthermore, to the extent that GECC's board must establish a risk committee, the members of the GE Risk Committee are, by far, the best candidates to serve on that committee. Such an arrangement would be fully consistent with (and, indeed, provide for more independent directors than) the risk committee structure contemplated by Section 165(h) and would do far more to promote and maintain strong corporate governance at GECC than would an independent/independent director requirement.

B. The Federal Reserve should not treat GECC in the same manner as significantly larger, more complex and more systemically significant G-SIBs, and should also engage in further analysis and calibration with respect to the application of BHC-style regulation to GECC.

Congress developed a carefully structured approach for nonbank financial institutions that are deemed to be systemically important. In the first instance, Congress decided that these institutions would be subject to regulation, under an enhanced regulatory scheme, by a federal regulator, the Federal Reserve. At the same time, Congress recognized that nonbank financial institutions are different from BHCs. Congress therefore instructed the Federal Reserve to differentiate in its regulatory scheme between bank and nonbank SIFIs.

Indeed, as noted above, representatives of the Federal Reserve have repeatedly acknowledged and emphasized the Federal Reserve's responsibility to tailor the application of enhanced prudential standards to specific firms.[73] This process has been described as requiring "a thoughtful and iterative analysis of each designated company over time."[74]

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[73] *See, e.g.*, Semiannual Monetary Policy Report to the Congress before the House Committee on Financial Services, 113th Congress (statement of Chairman Ben S. Bernanke) (July 17, 2013) ("We are developing a supervisory and regulatory framework that can be tailored to each firm's business mix, risk profile, and systemic footprint."); Dodd-Frank Implementation before the Senate Committee on Banking, Housing and Urban Affairs, 112th Congress (statement of Governor Daniel K. Tarullo) (June 6, 2012) ("[T]he Federal Reserve expects to tailor the application of the enhanced standards to different companies individually or by category, taking into consideration each company's capital structure, riskiness, complexity, financial activities, size, and any other risk-related factors that the Federal Reserve deems appropriate.").

[74] Statement of Michael S. Gibson before the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial Services, 112th Cong. (May 16, 2012).

The Proposed Order does provide that GECC will not be required to calculate regulatory capital under the so-called "advanced approaches" methodology.[75] We agree with and appreciate this adaptation of the BHC regulatory regime to GECC. For the most part, however, the rest of the Proposed Order does not show the same level of consideration of GECC's circumstances and the ways in which GECC differs from BHCs, particularly the very largest BHCs. For example, although the Proposed Order purports not to "automatically" treat GECC as a G-SIB, it nonetheless proposes to subject GECC to the most notable requirement of U.S. G-SIB regulation adopted to date, the eSLR; often compares GECC to the very largest U.S. BHCs; and states that the Federal Reserve will evaluate GECC for inclusion in future G-SIB-related initiatives.[76] This treatment is premised on a false equivalency between nonbank SIFIs and G-SIBs.

1. *GECC is notably smaller, less complex and less systemically significant than G-SIBs, including the largest U.S. banking organizations.*

G-SIBs are identified under the international framework developed by the Financial Stability Board (the "*FSB*").[77] Eight U.S. banking organizations have been identified as G-SIBs. These U.S. G-SIBs can be grouped into three categories: universal banks, investment banks and custodian banks. GECC is none of these; its profile is much closer to that of a larger regional BHC (although it is also different from those in significant respects). Figure 1 shows how GECC's profile, based on core categories of total assets, loans and leases and capital markets activity, contrasts with the eight U.S. G-SIBs and is comparable to the three largest regional banks, Capital One Financial Corporation, PNC Financial Services Group and U.S. Bancorp.

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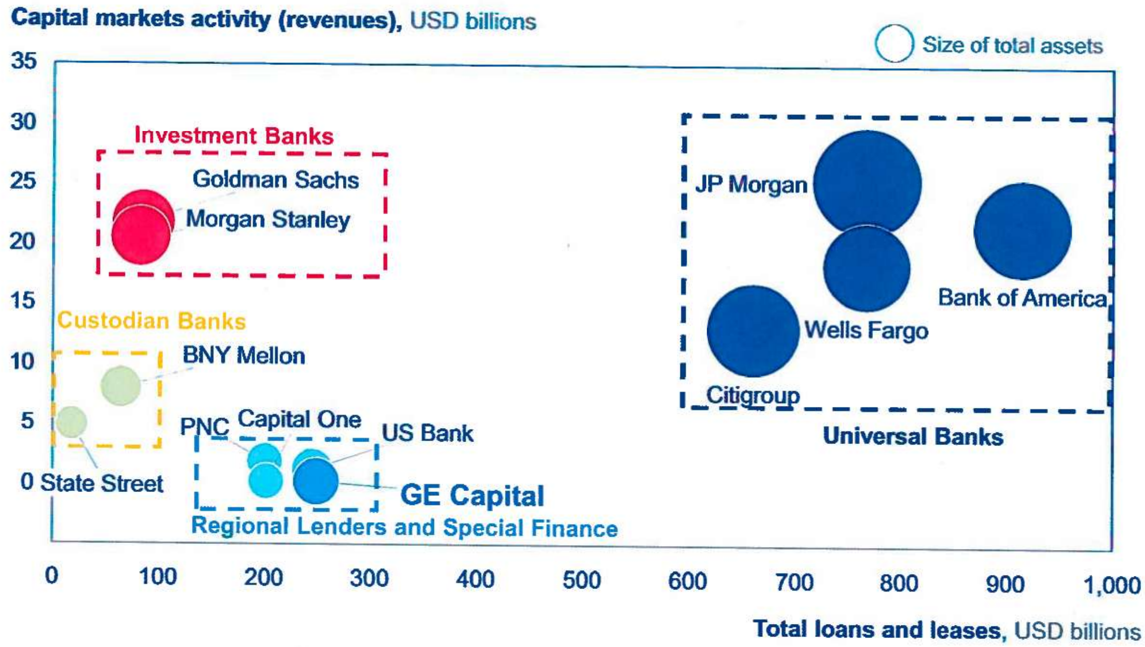
75 Proposed Order at 71784.

76 *Id.* at 71773.

77 *See* Basel Committee on Banking Supervision (the "*BCBS*"), *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement* (July 2013) (the "*G-SIB Assessment Methodology*").

Figure 1: Mix of Total Assets, Loans and Leases and Capital Markets Activity for Selected Institutions[78]



Under the FSB's framework, G-SIBs are identified under an approach in which certain categories of "indicators" – related to size, interconnectedness, substitutability, complexity and cross-jurisdictional activity – "are chosen to reflect the different aspects of what generates negative externalities and makes a bank critical for the stability of the financial system."[79] In the Federal Reserve's recent proposal for a G-SIB capital surcharge, which adopted a similar approach to identifying G-SIBs, the Federal Reserve described these indicators as "good proxies for, and correlated with, systemic importance."[80]

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[78] **Source:** Federal Reserve Form Y-9C as of September 30, 2014 for the indicated institutions. Loans and leases are net of unearned income as specified on Schedule HC of Form Y-9C. Capital markets revenues are from Schedule HI of Form Y-9C and include trading, brokerage, investment banking, advisory, underwriting, venture capital, net securitization income and fiduciary activities.

[79] G-SIB Assessment Methodology at 5.

[80] Federal Reserve, *Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies*, 79 Fed. Reg. 75473, 75475 (Dec. 18, 2014) (the "*G-SIB Capital Surcharge Proposal*").

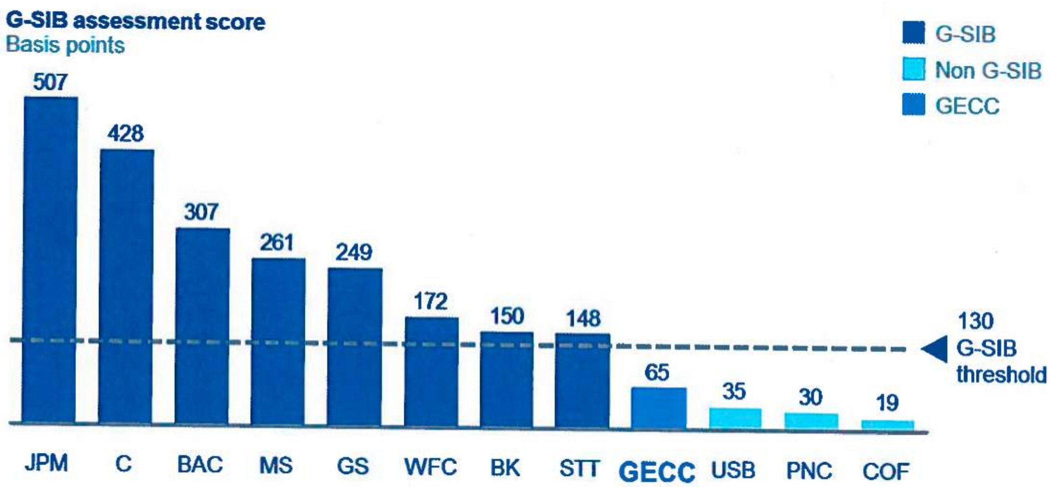
Under both the G-SIB Assessment Methodology and the G-SIB Capital Surcharge Proposal, "[b]anks that have a score produced by the indicator-based measurement approach that exceeds a cutoff level . . . will be classified as G-SIBs."[81] The most recently published cutoff score, based on year-end 2013 data, was 130.[82] By contrast, GECC estimates that its score of approximately 65 would be *less than half* of that of the *lowest-scoring* G-SIB and far below the cutoff.[83] Figure 2 shows how GECC's estimated score contrasts with those of the eight U.S. G-SIBs and is again far more comparable to the three largest regional banks.

81 G-SIB Assessment Methodology at 8.

82 *See* BCBS, *The G-SIB assessment methodology – score calculation* 4 (Nov. 2014); *see also* G-SIB Capital Surcharge Proposal at 75478.

83 We note that, although GECC is, at present, a grandfathered unitary savings and loan holding company ("*SLHC*") and controls two relatively small U.S. depository institutions, it is not a BHC and would not be considered a "bank" under the G-SIB Assessment Methodology. Similarly, the G-SIB Capital Surcharge Proposal would apply only to BHCs. In comparing GECC to G-SIBs and estimating GECC's scores on G-SIB measurement scales, we assume that GECC is considered to be a BHC solely for those purposes, but otherwise had the same balance sheet and activities as it actually does.

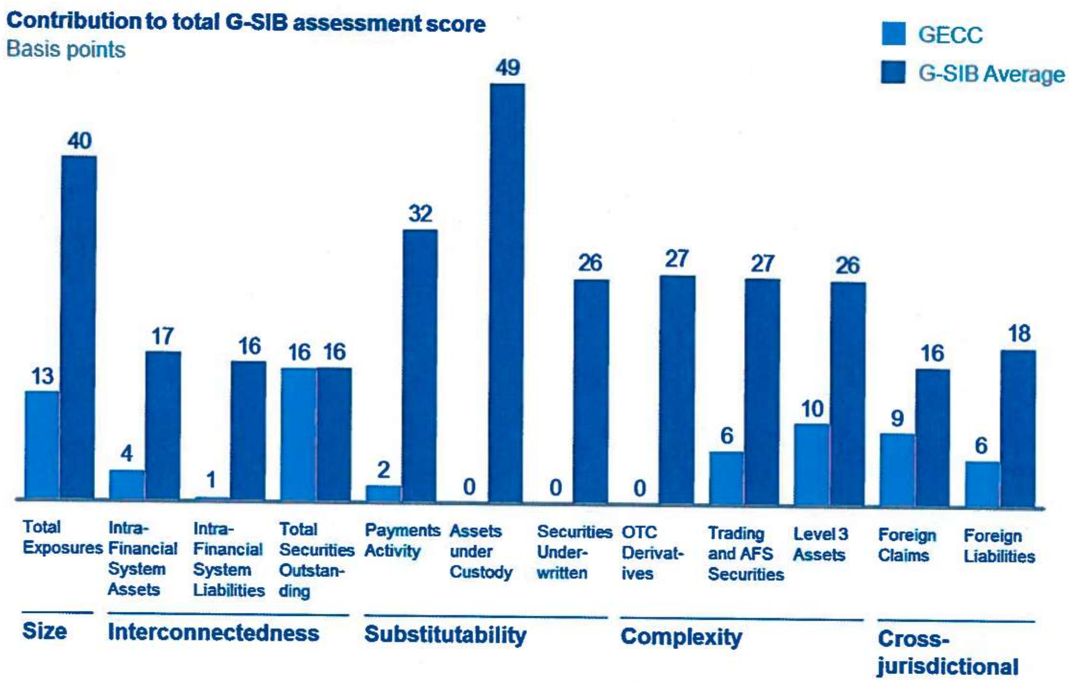
Figure 2: Estimated GECC Composite Score on G-SIB Indicator Scale versus U.S. G-SIBs and Regional Banks[84]



This sharp differentiation is reflected in nearly every sub-score for the 12 components as well as in the total score. Figure 3 shows GECC's estimated sub-scores relative to the estimated average for U.S. G-SIBs.

84 **Source:** Federal Reserve Form Y-15 as of December 31, 2013 for the indicated institutions other than GECC; GECC internal data from the third quarter of 2013 and the first quarter of 2014. Scores are calculated in accordance with "Method 1" under the G-SIB Capital Surcharge Proposal (that is, based on BCBS, note 82, with a cap of 100 basis points on the substitutability component).

Figure 3: GECC versus U.S. G-SIB Average on Each G-SIB Sub-Score[85]



As the chart shows, GECC's score for many indicators is either negligible or very low relative to the U.S. G-SIB average. Of the 12 indicators, GECC scores lower than 10% of the U.S. G-SIB average on five, lower than 25% on an additional two and less than 33% on an additional two. The only indicator on which GECC may be close to the U.S. G-SIB average is securities outstanding. GECC's volume of securities outstanding reflects the fact that it is fundamentally different from BHCs, which rely on shorter-term deposit funding to a far greater extent than GECC. Yet, because the G-SIB Assessment Methodology was designed for BHCs, it does not fully capture the strengths of GECC's funding profile or account for the numerous steps that GECC has taken to reduce its potential funding risks.

For example, GECC has significantly reduced its reliance on commercial paper (*"CP"*) since the financial crisis and still further since its designation as a nonbank SIFI. Today, CP makes up only 7% of GECC's total funding, and the liquidity risk of CP issuances is offset by approximately three times as much in cash and cash equivalents held on GECC's balance sheet, as shown in Figure 4.

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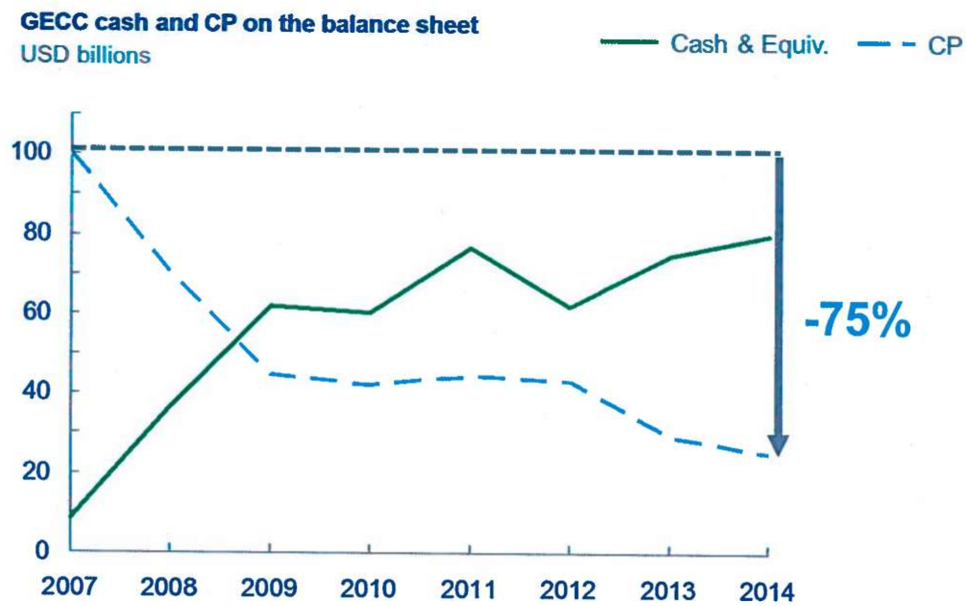
[85] **Source:** Same as Figure 2; the cap of 100 basis points on the substitutability component applies only to the total substitutability score (not shown).

Figure 4: GECC's Cash and Commercial Paper, 2007 – Present[86]



More broadly, GECC's current level of cash and cash equivalents substantially mitigates any short-term liquidity concerns: the $80 billion in liquidity noted in Figure 4 is enough to cover 116% of a *full year* of short-term borrowings, which total $69 billion when including CP, the current portion of long-term debt and other components of short-term funding such as GE Interest Plus notes.[87] Because of the highly liquid nature of these cash equivalents, there is minimal risk that their sale to meet liquidity needs would cause market pricing disruptions.

Match funding is also a relative source of strength for GECC. Unlike a BHC, which tends to have predominantly long-term assets and short-term liabilities in the form of deposits (and, often, very short-term wholesale funding), GECC's assets are actually of shorter average term than its debt: the weighted-average term of GECC's assets is 3.3 years, while that of its debt is 5.9 years.[88] This greatly reduces the inherent maturity transformation risk associated with lending businesses.

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86 **Source:** SNL Financial.

87 *See* GECC, Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2014.

88 These calculations are based on GECC's internal analysis.

In any event, securities outstanding do not raise GECC's estimated composite score to anywhere near the cutoff for G-SIB classification.

As additional context for these estimated scores, we emphasize that GECC is fundamentally unlike G-SIBs under each of the five categories of indicators in the G-SIB Assessment Methodology:

- ***Size – GECC is significantly smaller than almost all G-SIBs.*** Although the Proposed Order relies heavily on the overall size of GECC, there is no real effort to compare GECC's size to that of the very largest U.S. banking organizations or to G-SIBs more generally.[89] GECC is only a fraction of the size of the largest U.S. banking organizations. By assets, GECC is 20% of the size of JPMorgan Chase, 24% the size of Bank of America, 27% the size of Citigroup and 31% the size of Wells Fargo.[90] Although the remaining U.S. G-SIBs are closer in asset size to GECC, each has large volumes of other sources of systemic significance that are not present at GECC. The Bank of New York Mellon and State Street Corporation each have over $20 trillion in custodial assets.[91] Goldman Sachs, which is 69% larger than GECC in terms of assets, underwrote $371 billion in securities in 2013, and Morgan Stanley, which is 58% larger than GECC in terms of assets, underwrote $331 billion in securities in 2013.[92] By contrast, GECC does not have any custodial assets and does not underwrite securities.

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89 The FSB identifies size as "a key measure of systemic importance" because "[a] bank's distress or failure is more likely to damage the global economy or financial markets if its activities comprise a large share of global activity." G-SIB Assessment Methodology at 7. *See also* G-SIB Capital Surcharge Proposal at 75484. As discussed below, the Proposed Order also fails to take into account reductions in GECC's size or further planned reductions.

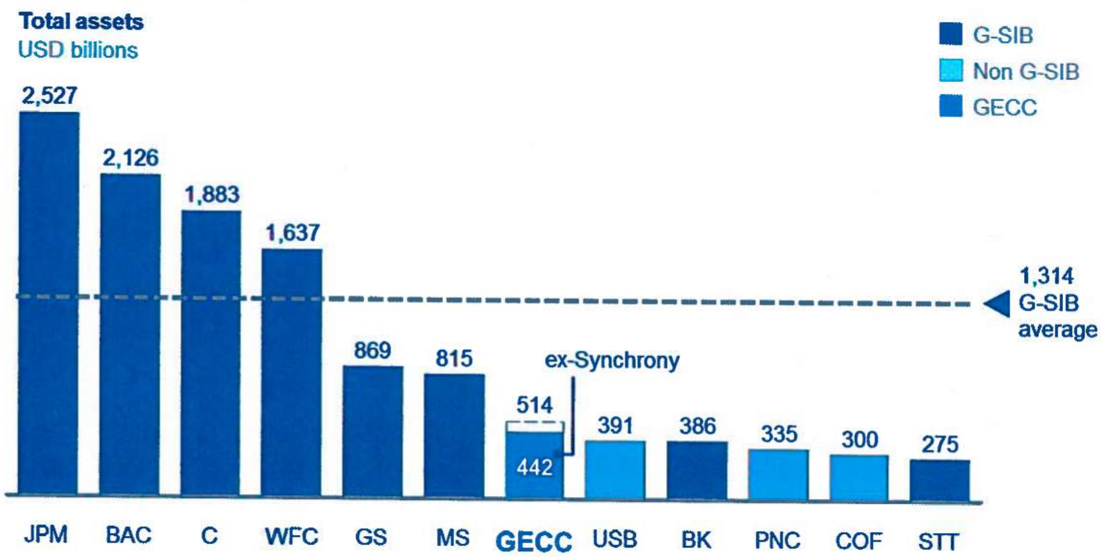
90 *See* NIC, note 54.

91 *See* Schedule C, Line 3 of Federal Reserve Form FR Y-15 submitted as of December 31, 2013 by The Bank of New York Mellon Corporation and State Street Corporation. The Federal Reserve has noted that "[t]he collapse of a GSIB that holds assets on behalf of customers, particularly other financial firms, could severely disrupt financial markets and have serious consequences for the domestic and global economies." G-SIB Capital Surcharge Proposal at 75485.

92 *See* Schedule C, Line 6 of Federal Reserve Form FR Y-15 submitted as of December 31, 2013 by The Goldman Sachs Group, Inc. and Morgan Stanley. Similarly, "[t]he failure of a GSIB with a large share of debt and equity underwriting could impede new securities issuances and potentially increase the cost of debt and capital." G-SIB Capital Surcharge Proposal at 75485.

Figure 5 shows how GECC's size compares to the U.S. G-SIBs and the largest regional banks.

Figure 5: Total Assets of GECC versus U.S. G-SIBs and Regional Banks[93]



As shown in Figure 5, the average U.S. G-SIB has approximately $1.3 trillion in total assets. Looking at both U.S. and international G-SIBs, the average G-SIB has approximately $1.6 trillion in total assets.[94] This is more than *three* times as large as GECC. GECC had $514 billion in total consolidated assets as of September 30, 2014, which we currently expect to reduce to approximately $442 billion after the completion of GECC's split-off of Synchrony Financial in 2015.[95] GECC is smaller than 28 out of 30 G-SIBs worldwide, and, as mentioned,

93 **Source:** NIC, note 54. "GECC ex-Synchrony" is an approximate internal pro forma showing the effect of completion of the planned split-off of Synchrony Financial (disregarding loans between GECC and Synchrony that would be reported as third-party receivables/borrowings for GECC and Synchrony, respectively).

94 *See* Thomas M. Hoenig, *Global Capital Index* (Sept. 5, 2014), *available at* https://www.fdic.gov/about/learn/board/hoenig/capitalizationratios2q14.pdf (data as of June 30, 2014).

95 In August and September of 2014, GECC completed an initial public offering of common stock of Synchrony Financial. Following the offering, GECC owns approximately 85% of Synchrony Financial.

the systemic significance of those two smaller G-SIBs (The Bank of New York Mellon Corporation and State Street Corporation) results from their critical roles in asset custody and payment and transaction processing, activities in which GECC does not engage to any meaningful extent.[96] Moreover, we estimate that there are more than 20 banking organizations that are larger than GECC, but have not been designated as G-SIBs.[97]

- ***Interconnectedness – GECC's funding profile is strong, and GECC has few intra-financial system assets or liabilities relative to G-SIBs.*** GECC has far less than G-SIBs in the way of "intra-financial system assets and liabilities" as measured under the G-SIB Assessment Methodology, which have been identified as a potential source of systemic risk.[98] As shown in Figure 3, GECC's intra-financial system assets are only 20% of the average for U.S. G-SIBs, and its intra-financial system liabilities are only 4% of the average.

- ***Substitutability – GECC is not an active participant in financial institution "infrastructure" activities.*** Most, possibly even all, G-SIBs engage actively in one or more of what might be referred to as "infrastructure" activities for financial services companies. These activities, which include custody, payment and transaction processing, clearing and asset management, create substantial interconnectedness and "closed loop" exposures.[99] Many G-SIBs

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96 *See* Hoenig, note 94 (information for The Bank of New York Mellon Corporation and State Street Corporation).

97 *See* SNL Financial, *Largest 100 banks in the world* (Dec. 23, 2013) (data as of Dec. 12, 2013); FSB, *2014 update of list of global systemically important banks (G-SIBs)* Annex I (Nov. 6, 2014). This list includes, for example, China Construction Bank Corp., Lloyds Banking Group, Rabobank Group, Intesa Sanpaolo and Toronto-Dominion Bank.

98 *See* G-SIB Assessment Methodology at 7 ("Financial distress at one institution can materially increase the likelihood of distress at other institutions given the network of contractual obligations in which these firms operate. A bank's systemic impact is likely to be positively related to its interconnectedness vis-à-vis other financial institutions."). Intra-financial system liabilities are separate from securities outstanding and include deposits due to financial institutions and over-the-counter derivatives with financial institutions that have a net negative fair value. *See* Federal Reserve, *Instructions for Preparation of Banking Organization Systemic Risk Report – Reporting Form FR Y-15* (Dec. 2013) at "Schedule B – Interconnectedness Indicators."

99 In addition to the risks associated with custody activities, the Federal Reserve has noted that "[t]he collapse of a GSIB that processes a large volume of payments is likely to affect a large number of customers, including financial, non-financial, and retail customers." G-SIB Capital Surcharge Proposal at 75485.

rank among the world's largest asset managers.[100] In contrast, GECC does not engage in any of these activities in any meaningful way.

- ***Complexity – GECC does not engage in significant capital markets or trading activities, and GECC's derivatives activities are far smaller, and of a fundamentally different type, than those of the G-SIBs.*** The BCBS notes that G-SIBs tend to be characterized by "greater emphasis on trading and capital markets-related activities."[101] In total contrast, GECC has no emphasis whatsoever on these complex and often volatile activities. Its trading, underwriting and market-making activities are virtually nonexistent.

  Furthermore, as the financial crisis demonstrated, a substantial derivatives business can create risk to the financial system in two ways. First, because derivatives' pricing can be so volatile, financial institutions engaged in that business are exposed to risk. Second, these businesses can also create substantial interdependencies among financial institutions.

  It is therefore unsurprising that most of the U.S. G-SIBs have very large, often huge, derivatives businesses. As shown in Figure 6, as of September 30, 2014, the U.S. G-SIBs had an average of \$35.3 trillion in notional value of over-the-counter derivatives.[102] This is over 100 times the \$311 billion in notional value for GECC. The U.S. G-SIB with the smallest derivative exposure still has about four times GECC's exposure.

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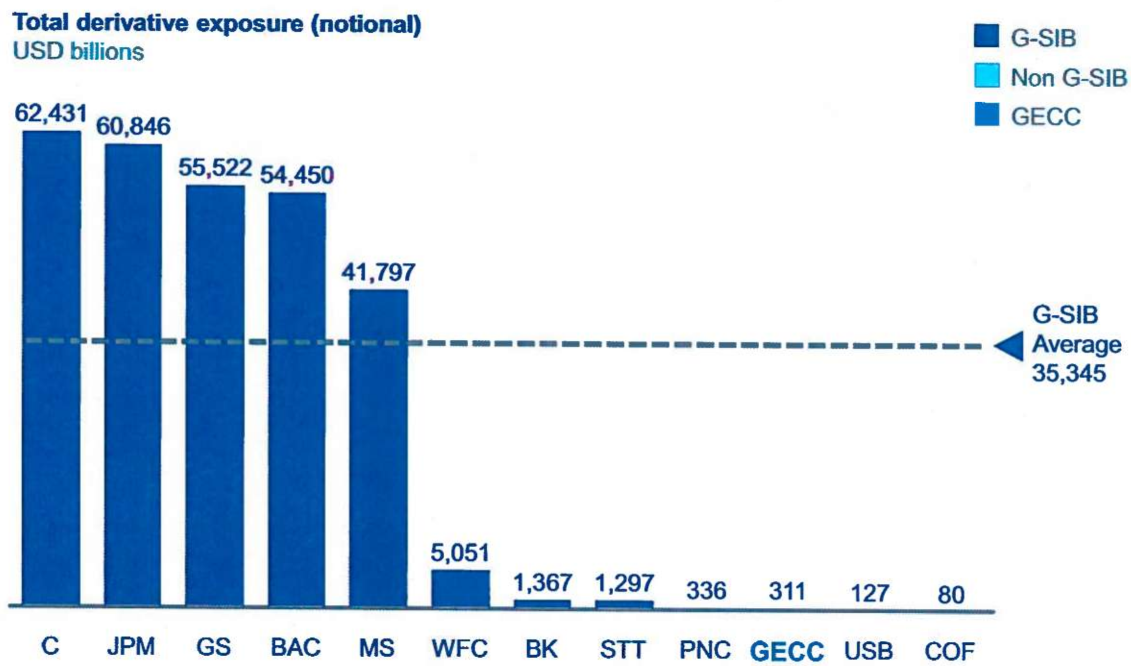
[100] *See* Office of Financial Research, *Asset Management and Financial Stability* 5-6 (Sept. 2013) (listing four U.S. G-SIBs and four non-U.S. G-SIBs as owning one of the world's 20 largest asset managers, with worldwide assets under management ranging from \$634 billion to \$2.1 trillion as of December 31, 2012).

[101] G-SIB Assessment Methodology at 3. In addition to the risks associated with underwriting businesses, the Federal Reserve has noted that "[a] banking organization's trading and [available-for-sale] securities can cause a market disturbance through mark-to-market losses and fire sales of assets in times of distress." G-SIB Capital Surcharge Proposal at 75486.

[102] The ability of the major U.S. banks to continue to conduct a major derivatives business was recently enhanced by the amendment to the so-called "push-out" provisions of Section 716 of the Dodd-Frank Act. *See* H.R. 83 § 630.

Figure 6: Total Derivative Exposure (Notional) of GECC versus U.S. G-SIBs and Regional Banks[103]



GECC's use of derivatives is also simpler and of a manifestly different character than that of the G-SIBs. GECC primarily uses "plain vanilla" interest rate and foreign exchange derivatives for simple and straightforward deal-by-deal hedging. In contrast, G-SIBs often use more complicated swaps and more complicated hedging strategies and use derivatives for profit-seeking capital markets activities. The derivatives books of seven of the eight U.S. G-SIBs are at least 98% held for trading, while GECC's derivatives book is 98% *not* held for trading.[104]

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[103] **Source:** SNL Financial.

[104] *See* Federal Reserve Form FR Y-9C as of September 30, 2014, Schedule HC-L, items 12 and 13, for the indicated institutions. The derivatives book of the eighth U.S. G-SIB, Wells Fargo, is 92% held for trading.

- ***Cross-Jurisdictional Activity – GECC is less international in scope than most G-SIBs.*** The significant majority of GECC's international activities take place within the European Union, with relatively minimal activity in Asia and negligible legacy operations in Latin America.[105] GECC has reduced its international footprint through recent dispositions in Russia, Latvia, Switzerland, the Nordics, Taiwan and Thailand and plans in due course to pursue orderly dispositions of its overseas retail banking operations in other foreign jurisdictions (as recently announced in Hungary, for example). GECC estimates that its cross-jurisdictional assets and liabilities are less than half the U.S. G-SIB average and a far smaller fraction of those of more internationally active G-SIBs such as JPMorgan Chase and Citigroup. GECC's cross-jurisdictional assets and liabilities will continue to fall with subsequent dispositions.

In summary, by every metric and every category of business operations, GECC is far different from every G-SIB. These differences have become only more pronounced since GECC's designation as a nonbank SIFI and will become only even more pronounced as GECC continues to exit from its retail financial businesses in the United States, Europe and Asia.

2. *The Proposed Order should not adopt a default view – implicitly or explicitly – that G-SIB regulations should apply to GECC.*

Because GECC is so different from every G-SIB, a proposed regulatory scheme for GECC with little or no differentiation from the regulatory treatment of G-SIBs is difficult to justify. Yet the Proposed Order would apply the eSLR (the only finalized regulation that currently applies to G-SIBs) to GECC without articulating any meaningful rationale for doing so.

Indeed, the Proposed Order acknowledges that GECC does not meet the Federal Reserve's own established criteria for the eSLR – $700 billion in total consolidated assets or $10 trillion in assets under custody – but reasons that nonbank SIFI designation is an independently sufficient criterion, without any analysis or detail to support this conclusion.[106] Moreover, even if it were the case that GECC merited *an* eSLR requirement, it does not necessarily follow that it would be appropriate for it to

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[105] Cross-jurisdictional activity is included in the G-SIB Assessment Methodology on the premise that "the international impact of a bank's distress or failure would vary in line with its share of cross-jurisdictional assets and liabilities." G-SIB Assessment Methodology at 7.

[106] Proposed Order at 71773. The G-SIB Capital Surcharge Proposal would remove these criteria and provide instead that the eSLR would simply apply to G-SIBs. Yet, as detailed above, GECC does not come close to qualifying as a G-SIB. *See* G-SIB Capital Surcharge Proposal at 75489.

have the *same* eSLR requirement as the U.S. G-SIBs, especially when, again, GECC does not meet the criteria for that requirement. Yet the Proposed Order does not appear to give any consideration to tailoring of eSLR ratios (or any other ratios).

This default treatment of GECC in the same manner as the largest, most complex banking organizations, without establishing that GECC poses comparable risks or supervisory challenges, is not appropriate or consistent with the nonbank SIFI regulatory framework as established by Congress. That a nonbank SIFI is not categorically (or even generally) equivalent to a G-SIB is established beyond any doubt by the respective structures and purposes of Section 165 and the G-SIB framework. The standards for designation of nonbank SIFIs, which are set forth in Section 113 of the Dodd-Frank Act and implemented by the FSOC, are oriented solely toward U.S. financial stability.[107] The standards for designation of G-SIBs, by contrast, are designed primarily to impose heightened regulation on banks that are deemed to be so large or systemically significant that they produce "wide spillover risk" and "cross-border negative externalities" to such an extent that already-enhanced regulatory and supervisory regimes may not be sufficient to protect global financial stability.[108] This is a much higher bar, and one that GECC plainly does not meet.

The designation outcomes to date reinforce this distinction. In the United States, Section 165 treats as a SIFI both a nonbank SIFI designated by the FSOC and a BHC with $50 billion or more in total consolidated assets.[109] Of over 30 U.S.-based BHCs that are SIFIs, however, only eight have been designated as G-SIBs.[110] Globally, there is a similar pattern. As of 2014, of the approximately 55 banking organizations in the world with at least $500 billion in total assets, only 28 have been designated as G-SIBs, including six of the eight such organizations headquartered in the United States.[111]

Stated differently, G-SIB-specific regulations such as the eSLR are essentially intended to inhibit and disincentivize a degree of size and complexity that, as amply

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[107] *See* Dodd-Frank Act § 113(a) (providing for designation if "the [FSOC] determines that material financial distress at [a] U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company, could pose a threat to the financial stability *of the United States*") (emphasis added); FSOC, *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 77 Fed. Reg. 21637 (Apr. 11, 2012).

[108] G-SIB Assessment Methodology at 2-3.

[109] Dodd-Frank Act § 165(a)(1).

[110] *See* NIC, note 54.

[111] SNL Financial, note 97; FSB, note 97.

demonstrated, GECC simply does not have in the first place. The eSLR requirement should therefore be categorically inapplicable to GECC. At a minimum, the Federal Reserve cannot apply the eSLR or similar G-SIB-specific requirements to GECC – and certainly not in exactly the same manner – without a more comprehensive analysis of whether they are truly warranted by GECC's size, complexity, risk profile and other relevant considerations.

The application of the eSLR to GECC could also have the unfair and unwarranted effect of creating a presumption that future G-SIB requirements, such as the Federal Reserve's proposed G-SIB capital surcharge or the Total Loss Absorbing Capacity ("*TLAC*") requirement recently published for comment by the FSB, should apply to GECC solely because of its nonbank SIFI designation.[112]

At a minimum, even if the Federal Reserve were to determine to impose a G-SIB-like capital surcharge or a TLAC requirement for GECC, it would need to do so on the basis of far more thorough and transparent analysis, particularly in explaining why GECC should be subject to a requirement previously judged to be warranted only for larger and more complex banking organizations. GECC would, of course, be entitled to review and comment on that analysis before a final order is adopted. Furthermore, even assuming that a G-SIB-like capital surcharge or a TLAC requirement on GECC could be legitimately considered, GECC should not automatically be subject to the same measurement scales and quantitative requirements as G-SIBs unless the Federal Reserve can specifically demonstrate why such treatment is appropriate after considering and discussing alternative means of tailoring the requirements.

To be consistent with its own articulated policies and procedures, the Federal Reserve should also conduct a cost-benefit analysis in connection with its consideration of imposing the eSLR (and other requirements) on GECC. In 1979, the Federal Reserve asserted that "[i]n every case, at a minimum," it will conduct a "regulatory analysis" that "will discuss the need for and purposes of the regulation, set forth the various options available, discuss, where appropriate, their possible economic implications, evaluate their compliance, recordkeeping and reporting burdens, and recommend the best course of action based on an evaluation of the alternatives."[113]

More recently, the Federal Reserve has affirmed that, in implementing the Dodd-Frank Act, "regulatory efforts should be designed to minimize regulatory burden consistent

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112 *See* FSB, *Adequacy of loss-absorbing capacity of global systemically important banks in resolution: Consultative Document* (Nov. 10, 2014).

113 Federal Reserve, *Statement of policy regarding expanded rulemaking procedures*, 44 Fed. Reg. 3957, 3958 (Jan. 15, 1979).

with the effective implementation of our statutory responsibilities."[114] Noting that Executive Order 13563, which speaks to the role of cost-benefit analysis in federal regulation, "does not apply to independent agencies such as the Federal Reserve," the Federal Reserve stated that it "nonetheless . . . abides by the principles described in the Executive Order."[115] Similarly, the General Counsel of the Federal Reserve has stated that the Federal Reserve "seek[s] to abide by the spirit of OMB benefit-cost guidance," and that "existing Federal Reserve regulatory policies closely mirror key aspects of Executive Order 13563."[116]

The Proposed Order constitutes the implementation of a Dodd-Frank Act provision, yet the Federal Reserve has not assessed costs versus benefits or, to use former Chairman Bernanke's phrase, sought to "minimize regulatory burden." Nor does the Proposed Order explain why the Federal Reserve has departed from its practice of cost-benefit analysis.

3. *Beyond the question of G-SIB treatment, the Federal Reserve should consider the calibration of capital, leverage, liquidity and other rules that will apply to GECC and study the Proposed Order's likely effect on key constituencies such as middle-market borrowers.*

The previous section of this letter emphasized the special importance of not automatically grouping GECC with much larger and more complex G-SIBs. Part II-A of this letter focuses on how certain aspects of the Federal Reserve's existing Section 165 regulations for BHCs should be tailored to GECC's particular circumstances, including with respect to appropriate transition periods. There is a fundamental threshold question as to the extent to which GECC should, in principle, be regulated in the same manner – and subject to the same quantitative requirements such as risk-based capital and liquidity ratios – as even a BHC SIFI that is not a G-SIB.

Under Section 165, enhanced prudential standards for both BHC and nonbank SIFIs must generally include risk-based capital, leverage and liquidity requirements, among other things.[117] It does not follow, however, that the requirements for BHC SIFIs should

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114 Letter from Ben S. Bernanke, Chairman, to Cass R. Sunstein, OIRA Administrator, at 4 (Nov. 8, 2011).

115 *Id.*; *see also* Exec. Order No. 13563, *Improving Regulation and Regulatory Review*, 76 Fed. Reg. 3821 (Jan. 18, 2011) ("[E]ach agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible.").

116 Letter from Scott Alvarez, General Counsel of the Federal Reserve, to Nicole Clowers, Director of Financial Markets and Community Investment, GAO (Oct. 24, 2011) (citing 1979 statement).

117 Dodd-Frank Act § 165(b)(1)(A).

automatically be mapped onto a particular nonbank SIFI such as GECC. Indeed, Congress explicitly instructed the Federal Reserve that, in formulating enhanced prudential standards, the Federal Reserve must "take into account differences among" nonbank SIFIs and large BHCs.[118] GECC should be subject to, for example, quantitative risk-based capital requirements, but it is not necessarily the case that the ratios for BHCs – even non-G-SIB BHCs – are the right ones for GECC.

With the exception of the dispensation on "advanced approaches" calculations, however, the Proposed Order does not reflect meaningful consideration of how the BHC regulatory regime should be evaluated for fit with GECC in light of its financial condition, businesses, risks, asset and liability maturity profiles and other factors. The rationales provided throughout the Proposed Order, if they are provided at all, are brief and not specific. For example, the Federal Reserve supports its decision to apply various regulatory requirements to GECC by concluding in summary fashion that "GECC's activities and balance sheet are similar to those of a large bank holding company" and that the requirements applicable to large BHCs should therefore apply.[119]

Furthermore, as noted above, the Federal Reserve must consider the same factors in establishing enhanced prudential standards for a nonbank SIFI as the FSOC must consider in making a designation, including "the importance of the company as a source of credit for households, businesses, and State and local governments."[120] In its final order designating GECC as a nonbank SIFI, the FSOC identified ways in which it believed that material financial distress at GECC, if it were to occur, could threaten U.S. financial stability. In particular, noting that GECC "provides credit to a wide range of middle-market companies that are significant components of the broader economy," the FSOC maintained that "[m]aterial financial distress at GECC that limits its ability to

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118 *Id.* § 165(b)(3)(A).

119 *See* Proposed Order at 71772 (application of capital requirements), 71774 (application of capital planning requirements), 71775 (application of stress-testing requirements), 71778 (application of risk-management standards). In referring to the BHC regulatory regime, furthermore, the Proposed Order also frequently shifts between phrases such as "large [BHCs]," "the largest [BHCs]" and "the largest, most complex banking organizations" for reasons that are not always clear from context, creating confusion about whether distinctions between these descriptions are intended and, if so, how those distinctions relate to the conclusions in the Proposed Order. *See, e.g.*, *id.* at 7177.

120 *See* Dodd-Frank Act § 165(b)(3) (requiring consideration of factors enumerated in *id.* § 113).

continue to provide credit to middle-market companies . . . could have an adverse effect on middle-market borrowers."[121]

GECC disagrees that this outcome, if it occurred, would pose a threat to U.S. financial stability. Nonetheless, inasmuch as the FSOC identified GECC's importance as a source of credit for a particular group as a source of systemic significance that contributed to GECC's nonbank SIFI designation, it is incumbent upon the Federal Reserve to consider the ripple effects of particular regulatory capital, leverage, liquidity and other ratios for GECC and ensure that the enhanced prudential standards do not exceed what is necessary for GECC to remain safe and sound. Disproportionate requirements would unnecessarily increase GECC's cost of capital and potentially limit GECC's flexibility to extend credit to middle-market companies on competitive terms. Yet the Proposed Order does not discuss, and it is not evident whether the Federal Reserve has considered, the contours of this problem or the repercussions of the proposed enhanced prudential standards for middle-market borrowers.

The Federal Reserve, like the FSB, has frequently undertaken quantitative impact studies to analyze the impact of various aspects of regulatory frameworks for which it is responsible. Enhanced prudential standards for a nonbank SIFI such as GECC should be no different. Consequently, before finalizing enhanced prudential standards for GECC, it is incumbent on the Federal Reserve to rigorously analyze the effect of the proposed BHC-like capital, leverage, liquidity and other rules on GECC and its customers, as well as the relative impact of different required ratios that could potentially be established. We stand ready to provide whatever information or other assistance is required to facilitate such an effort, and to comment on any such analysis before it is incorporated into a final order.

4. *GECC's enhanced prudential standards should also reflect a thorough consideration of GECC's significant improvements in many key metrics viewed as indicators of impact on U.S. financial stability.*

Finally, given that many substantive requirements of enhanced prudential standards under Section 165 will phase in over the next several years, an individual institution's trajectory with respect to systemic importance should be highly relevant to determining the regulatory regime and initial requirements that will apply to that institution.

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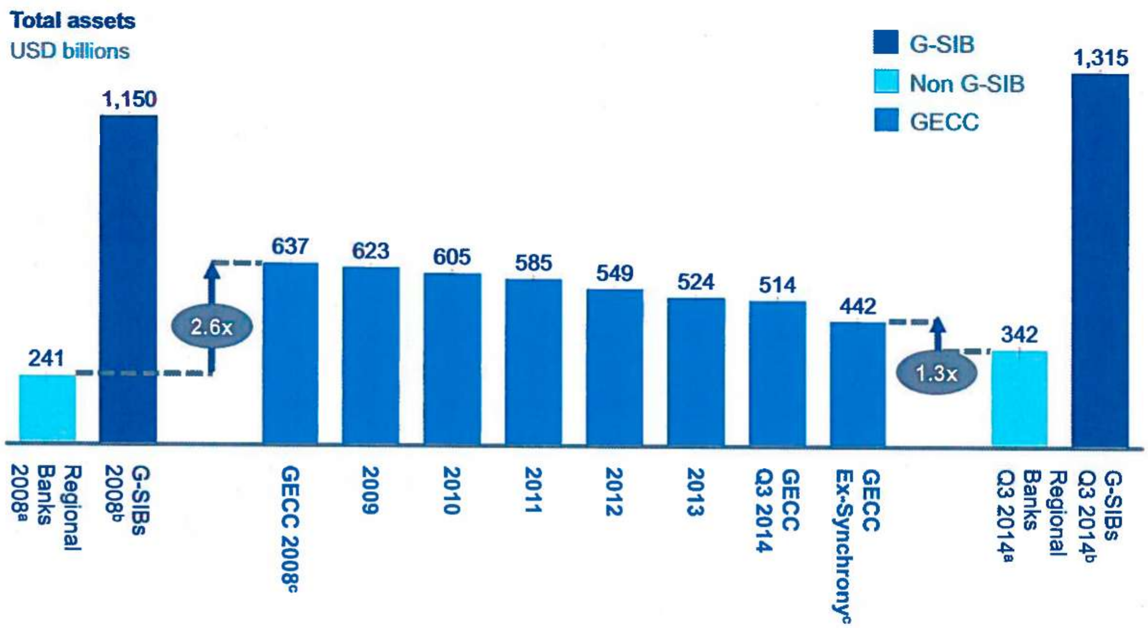
[121] FSOC, *Basis of the Financial Stability Oversight Council's Final Determination Regarding General Electric Capital Corporation, Inc.* 3 (July 8, 2013).

Over the past several years, GECC has significantly reduced the size of its balance sheet, significantly increased its levels of cash, highly liquid instruments and other sources of liquidity, significantly reduced its reliance on CP and generally increased the term of its liabilities. Even since being designated as a nonbank SIFI, GECC has undergone balance sheet changes that have further reduced its systemic importance. In addition to decreases in total assets (down 23% since 2008 and 6% since 2012) and CP (down 65% since 2008 and 42% since 2012), GECC's total third-party debt has also continued to decline (30% since 2008 and 10% since 2012), and its total equity has continued to increase (60% since 2008 and 8% since 2012).

As these data indisputably illustrate, GECC has become sharply less systemically significant since 2008, and even more so since 2012. While both the U.S. G-SIBs and the regional banks have actually grown substantially since 2008 (14% and 42%, respectively), GECC has reduced its assets significantly. Indeed, GECC has shrunk from being more than 2.6 times the size of the large regional banks in 2008, to only 1.3 times larger (considered on a pro forma basis ex-Synchrony) in 2014. Figure 7 shows GECC's total assets from 2008 to 2014 and highlights GECC's movement further away from the U.S. G-SIBs and further toward the regional banks.

Figure 7: GECC's Total Assets from 2008 to 2014, Compared to U.S. G-SIBs and Regional Banks[122]



The consequence is that today, compared solely on the basis of size, GECC is very close to the regional bank average and only a small fraction of the size of the U.S. G-SIBs.

In addition, GECC is in the process of implementing a substantial restructuring, principally the split-off of Synchrony Financial and prospective divestitures of GECC's international retail finance businesses, which will reduce its systemic significance further still. An even smaller and more simplified GECC will pose an even lesser systemic risk. At some point in the relatively near future, these changes are likely to present squarely the issue of whether GECC should continue to be designated as a nonbank SIFI.[123]

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122 **Source:** (a) Regional Banks (Average of Capital One, PNC and U.S. Bancorp) – SNL Financial and Form Y-9C; (b) U.S. G-SIBs – SNL Financial, Form 10-K and Form Y-9C; (c) GECC – SNL Financial, Form Y-9C. As above, "GECC ex-Synchrony" is an approximate internal pro forma showing the effect of completion of the planned split-off of Synchrony Financial (disregarding loans between GECC and Synchrony that would be reported as third-party receivables/borrowings for GECC and Synchrony, respectively).

123 *See* Dodd-Frank Act § 113(d) (providing for rescission of nonbank SIFI designation for companies that no longer meet the designation criteria).

In short, GECC is less like a nonbank SIFI – let alone a G-SIB – than ever before. Grouping GECC with the largest and most complex BHCs and relying on that grouping as a basis for applying regulatory requirements would not only be unjustified today, but would be likely to result in progressively worse regulatory mismatches in the future. We believe that the Federal Reserve should give greater weight to GECC's downward trajectory of systemic importance in formulating GECC's enhanced prudential standards and in calibrating its required capital, leverage, liquidity and other ratios, and explain how GECC's decreased systemic importance and trajectory affected those requirements.[124]

II. ADDITIONAL COMMENTS ON DETAILS AND IMPLEMENTATION OF ENHANCED PRUDENTIAL STANDARDS

A. Certain aspects of BHC capital and liquidity rules should be modified to reflect GECC's specific circumstances.

The previous section of this letter addressed what we view as critical, high-level problems with the substance and philosophy of the Proposed Order. The Proposed Order also solicited comment on whether the Federal Reserve should further tailor the capital and liquidity rules proposed for GECC.[125] For the reasons described below, we believe that a number of adjustments are warranted on the basis of GECC's circumstances and relevant differences in those circumstances from those of BHCs.

1. *The Federal Reserve should provide limited extensions of transition periods for certain enhanced prudential standards.*

The Federal Reserve requested comment on whether any of the standards in the Proposed Order should be subject to longer transition periods.[126] As explained below, we submit that limited extensions of transition periods for certain requirements are justified to treat GECC equitably relative to BHCs.

We preface this section by reiterating that GECC has already been sparing no expense or effort to strengthen its enterprise risk management and internal controls. We are committed to becoming a robust financial services company and, as part of this

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124 We also note that this positive trend makes it all the more questionable that sharp changes in corporate governance, such as would be necessitated by an independent/independent director requirement, could possibly be warranted for GECC.

125 Proposed Order at 71773 (Question 3), 71777 (Question 8).

126 *Id.* at 71783 (Question 15).

commitment, to meeting whatever enhanced prudential standards are ultimately established for GECC. To this end, we have already been revamping our risk processes; upgrading our control functions, especially Risk, Compliance and Internal Audit; and overhauling our capital planning and stress testing functions.

We also acknowledge that much work remains to be done. GECC is making significant investments to improve our data and information management systems, internal controls and capabilities in reporting, valuations, allowances for loan and lease losses, model risk management and other critical areas. We have recruited thousands of new domain experts to GECC and are investing hundreds of millions of dollars in "Getting to Strong," our framework for this transformation. But, as one might expect, changes of this magnitude necessarily require a reasonable period of time to be implemented and then to take hold.

Unlike nonbank SIFIs, BHCs have been subject to formal risk-based regulatory capital requirements and reporting at the holding company level for many years. BHCs will generally have had considerably greater experience in dealing with complex and data-intensive regulatory frameworks and reporting requirements. BHCs have also had the advantage of preparing for new requirements under the Dodd-Frank Act on a more sequential basis than is proposed for GECC in the Proposed Order.

Despite this prior experience with regulatory capital requirements, the Dodd-Frank Act has created significant implementation challenges for BHCs.[127] A nonbank SIFI like GECC coming into full compliance with multiple requirements at the same time faces even greater operational and technological challenges. Coming into full compliance is necessarily a multi-year process that requires changing numerous finance and risk data systems and ledgers while implementing enhanced data governance and validation practices and procedures. In GECC's case, institutional resources are being reallocated not only among these tasks, but also in response to the cumulative impact of making a full transition to Federal Reserve regulation and supervision, which began

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[127] *See, e.g.*, Letter from The Clearing House Association L.L.C. et al. regarding the Federal Reserve's proposed implementation of the Basel III liquidity coverage ratio ("*LCR*") 63-64 (Jan. 31, 2014) ("The demands placed on Covered Banks' IT resources have been increasing exponentially in recent years . . . . In the near term, very substantial IT resources are required to accommodate the [a]gencies' recently adopted new capital rules . . . changes to stress testing data gathering and related requirements . . . data gathering necessary to prepare Dodd-Frank required resolution plans, data gathering required as part of the development of compliance plans for the final Volcker Rule . . . anticipated rules to implement other sections of Dodd-Frank (*e.g.*, the single counterparty credit limit rules), and incremental reporting required under the Federal Reserve's '5G' proposal.").

in 2011 and includes numerous independent requirements related to reporting, data and controls, governance and many other things.[128]

Recognizing these general principles, the U.S. banking agencies have in the past provided significant transition accommodations for non-BHCs (or for companies with less experience in a particular regulatory context generally).[129] Such an approach is warranted here as well. The timing challenges presented by the Proposed Order contrast markedly with the generally longer compliance schedules to which BHCs have been subject. If the Proposed Order were finalized in its present form in the first or second quarter of 2015, GECC would be afforded only three or four months to achieve compliance with the Proposed Order's risk-based regulatory capital requirements – a far shorter time horizon than has applied to BHCs subject to comparable requirements.[130]

Accordingly, GECC requests the following limited adjustments to the timing implied by the Proposed Order:

- ***Capital planning and stress testing requirements.*** The Proposed Order would apply the Federal Reserve's capital planning and stress testing requirements to GECC commencing with the capital plan cycles that begin on January 1, 2016 and January 1, 2017, respectively, with the first filings being due on April 5, 2016 and April 5, 2017, respectively. The Proposed Order notes that "GECC likely will need time to build and implement the

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[128] As a consequence of its becoming a regulated institution supervised by the Federal Reserve, GECC has initiated dozens of highly critical projects that require substantial IT and other resources, ranging from a last calendar day close, to ongoing information-collection activities for FR Y-10 reports, to the preparation of capital, recovery and resolution plans. BHCs have generally not been required to initiate all such projects at the same time and in many cases have had many such capabilities in place for years.

[129] *See, e.g.*, Final Capital Rules at 62028 (recognizing that "advanced approaches banking organizations have the sophistication, infrastructure, and capital markets access to implement the final [capital] rule earlier than . . . covered SLHCs that have not previously been subject to consolidated capital requirements").

[130] We also note that, even if the Proposed Order's independent/independent director requirement were replaced with a requirement that a majority of GECC's directors be independent, complying with the governance requirements in the Proposed Order in 90 days or less would not be feasible. The committee structure of both the GE and GECC boards would need to be reorganized, new policies and procedures would need to be developed and – if the independent/independent director requirement is retained – new directors would need to be located, interviewed and engaged. Any final order should accordingly provide more lead time with respect to any corporate governance requirements.

internal systems necessary to fully meet the requirements of the capital plan rule and the CCAR process."[131] We agree and appreciate the delayed application of these requirements relative to the rest of the Proposed Order.

To establish appropriate parity with BHCs, however, we submit that GECC should be afforded an additional year to continue to build the internal systems and infrastructure necessary to comply with the CCAR process. Specifically, we request that capital planning and stress test requirements become effective for the capital plan cycles that begin on January 1, 2017 and January 1, 2018, with a first capital plan filing due on April 5, 2017 and a first stress test filing on April 5, 2018. We note that April 5, 2016 is likely to be only about 12 months from when the Proposed Order would likely be finalized. During those 12 months, GECC would also have to make an accelerated transition to Basel III risk-based capital rules. U.S. BHCs have generally not been required to implement both of these major initiatives at the same time. Certain FBOs must do so, but will have more than three years to formally comply with capital planning requirements.[132]

- ***Daily averaging of on-balance-sheet exposures.*** To the extent that GECC becomes subject to a supplementary leverage ratio requirement, we request that GECC be permitted to phase in the daily averaging of on-balance-sheet exposures. GECC proposes that it be permitted to use a month-end average until July 1, 2017. Beginning on July 1, 2017, GECC proposes to switch to daily averaging for at least half of its portfolio and to switch the remainder of its portfolio to daily averaging by no later than July 1, 2018.[133] We believe that this schedule will allow the time necessary to implement all of the operational challenges necessary to complete daily averaging.[134]

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[131] Proposed Order at 71774.

[132] *See* FBO Rule at 17304-05.

[133] We also request that GECC be permitted to apply this phase-in proposal to other reporting requirements presenting daily or weekly averaging issues, such as Schedule HC-K of Form FR Y-9C.

[134] We note that the Federal Reserve has acknowledged the operational burdens associated with calculating the supplementary leverage ratio in the past. The supplementary leverage ratio, as adopted in the Final Capital Rules, included the onerous requirement that the denominator of the supplementary leverage ratio be calculated as the total leverage exposure calculated daily, minus applicable deductions. *See* OCC and Federal Reserve, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital*

GECC's balance sheet is generally composed of relatively stable longer-term assets such as loans and leases, which are not as vulnerable to fluctuations in value as many assets typically held by large BHCs, particularly those with significant capital markets activities. Daily averaging of exposures has therefore historically not been a priority for GECC. GECC has launched an initiative to implement daily averaging, but building the proper infrastructure will likely require a substantial investment and additional time beyond the July 2016 deadline posited in the Proposed Order.

- ***Intraday liquidity monitoring requirements.*** The Proposed Order applies the liquidity risk-management requirements applicable to BHC SIFIs under the Federal Reserve's Regulation YY to GECC without adjustment, including the intraday liquidity risk monitoring requirements.[135] GECC embraces the need for liquidity risk monitoring, but believes that any intraday monitoring requirement should be applied only after a more thorough evaluation of whether such a requirement is necessary in light of GECC's liquidity risk profile and the costs required to develop and maintain such a monitoring system.

  In formulating the enhanced prudential standards for BHCs, the Federal Reserve emphasized the importance of liquidity risk management for institutions "engaged in significant payment, settlement, and clearing activities" and the need to develop procedures "to reflect in stringency and complexity, the scope of operations of the company."[136] GECC engages in none of the activities mentioned. Instead, GECC relies on other, larger financial institutions to provide payment, settlement and clearing services for itself and its clients. With its limited exposure to clearing, GECC is isolated from the daily volatility of businesses closely tied to market fluctuations. In addition, unlike larger banking organizations that house large broker-dealer

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Rule; Final Rule, 78 Fed. Reg. 62018, 62169, 62171 (Oct. 11, 2013) (the *"Final Capital Rules"*). Recognizing the operational challenges and limited benefits of this calculation method, the Federal Reserve modified this requirement so that total leverage exposure is now calculated as the mean of the on-balance-sheet assets calculated as of each day of the reporting quarter, plus the mean of the off-balance-sheet exposures calculated as of the last day of each of the most recent three months, minus applicable deductions. *See* OCC, Federal Reserve and FDIC, *Regulatory Capital Rules: Regulatory Capital, Revisions to the Supplementary Leverage Ratio*, 79 Fed. Reg. at 57725 (Sept. 26, 2014).

[135] 12 CFR § 252.34(h) (Regulation YY).

[136] Federal Reserve, *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies; Proposed Rule*, 77 Fed. Reg. 594, at 612 (Jan. 5, 2012).

operations, GECC participates in minimal market-making and securities trading businesses.

- ***Liquidity reporting on Form 2052a.*** Over the course of the last two years, GECC has begun the process of developing the infrastructure necessary to support automated liquidity data collection, analytics and reporting. Among other initiatives, GECC is currently working on piloting a reporting template comparable to Form 2052b. Our work to implement the appropriate systems has highlighted the significant restructuring necessary to develop capabilities required to comply with Form 2052a reporting requirements (including the calculation and monitoring of the LCR), such as changes to finance and risk data systems and ledgers and enhancements to data governance and validation practices and procedures.

  If finalized, the Federal Reserve's recent proposal on Form 2052a reporting would require GECC, as a covered company subject to the LCR with between $250 billion and $700 billion in total assets, to make reports on Form 2052a on a monthly basis starting July 2015 and a daily basis starting July 2016.[137] GECC has not previously been subject to the Federal Reserve's "3G" or "4G" liquidity reporting requirements and therefore has not previously developed a baseline system for monthly or daily monitoring. In comparison, BHCs that are larger than or comparable in size to GECC will have a substantial head start in transitioning to Form 2052a.

  Consequently, we request that the liquidity reporting requirements be subject to incremental implementation on a timeline that is reasonable in light of these operational challenges. Specifically, we request that GECC be permitted to phase in the daily reporting of on-balance-sheet and off-balance-sheet exposures. GECC proposes that it be permitted to use month-end exposures until July 1, 2017. Beginning July 1, 2017, GECC proposes to switch to daily exposures for at least half of its portfolio and to switch the remainder of its portfolio to daily exposures by no later than July 1, 2018. Furthermore, we request that GECC be allowed to submit the Form 2052a 15 business days after the close of the business cycle for the period during which GECC will be subject to monthly reporting. GECC believes that this schedule will allow the time necessary to implement all of the operational challenges necessary to complete daily reporting of liquidity exposures.

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137 Federal Reserve, *Proposed Agency Information Collection Activities; Comment Request*, 79 Fed. Reg. 71416, 71420 (Dec. 2, 2014).

2. *GECC should be allowed to continue to apply the AOCI filter to investment securities held by its legacy insurance businesses.*

With limited exceptions for smaller BHCs, the Federal Reserve's capital rules generally eliminate the AOCI (accumulated other comprehensive income) filter. The AOCI filter allowed banking organizations to disregard fair-value adjustments in shareholders' equity (which were often temporary) required by generally accepted accounting principles when calculating regulatory capital.[138]

GECC oversees three legacy U.S. insurance businesses with total assets of $36 billion as of December 31, 2014.[139] These businesses are in wind-down, with no new business written since 2006. All assets of these businesses are held to support future payments under outstanding insurance contracts or to meet state regulatory capital requirements. The assets include investment securities, which are generally high-quality corporate and sovereign debt investments, but which, given their typically long duration (to match long-term liabilities), are sensitive to interest rate and credit spread movements. Natural fluctuations in these underlying securities cause volatility in AOCI, which causes volatility in calculations of regulatory capital when the AOCI filter is removed, notwithstanding that in many cases the insurance businesses generally hold these securities for long-term purposes.

Congress recently passed the Insurance Capital Standards Clarification Act of 2014, which gives the Federal Reserve flexibility in applying leverage and risk-based capital requirements to insurance companies.[140] In doing so, Congress recognized that insurance assets are very different from traditional banking assets and therefore warrant different capital treatment. We request that the Federal Reserve use the flexibility afforded by the Act to permit GECC to maintain the AOCI filter for assets in its legacy insurance businesses. We believe that doing so would be an appropriate tailoring to GECC's circumstances in terms of businesses in runoff and would not pose any threat to GECC's safety and soundness.

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138 *See* Final Capital Rules at 62027.

139 GECC's North America Life and Health business unit is composed of Employers Reassurance Corporation, its subsidiary Union Fidelity Life Insurance Company, and its subsidiary Heritage Casualty Insurance Company. All are Kansas-domiciled insurance companies, regulated primarily by the Kansas Insurance Department, and are self-funded entities relying on insurance premium payments and investment cash flows to fund business operations.

140 *See* Pub. L. No. 113-279.

3. *GECC's calculation of the LCR should be tailored to reflect GECC's inability to hold significant Federal Reserve Bank balances, a key source of Level 1 HQLA available to BHCs.*

Under the Federal Reserve's implementation of the LCR, Level 1 HQLA, which is included in the numerator, includes "Reserve Bank balances," defined as balances of certain master and "excess balance" accounts at one of the Federal Reserve Banks.[141] Federal Reserve Bank balances are one of only a very limited number of assets that qualify as Level 1 HQLA.

As a nonbank SIFI, GECC does not focus on retail banking or retail deposit-taking to the extent of BHCs subject to the LCR. As a consequence, GECC naturally keeps far less of its liquidity in affiliated depository institutions that are eligible to make deposits with a Federal Reserve Bank, and therefore has limited access to a key source of Level 1 HQLA.[142] Instead, GECC maintains a greater proportion of its cash liquidity in third-party commercial bank deposits, which are not credited as HQLA and are subject to a 75% cap on net inflows.[143] As a result, GECC is at a significant disadvantage as compared to traditional BHCs. This is a subject on which GECC has previously commented to the Federal Reserve and other U.S. regulators.[144]

The Federal Reserve has previously stated that, in applying the LCR to a nonbank SIFI, the Federal Reserve "intends to assess the business model, capital structure, and risk profile of the designated company . . . and if appropriate, would tailor application of the LCR by order or rule to that nonbank financial company or to a category of nonbank financial companies."[145] In the Proposed Order, however, which would apply the LCR to GECC "without change," the Federal Reserve appears to suggest that the LCR is

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[141] *See* 12 CFR §§ 249.3, 249.20(a)(1).

[142] All large BHCs with $250 billion or more in total consolidated assets have substantial depository institution subsidiaries, meaning that, first, they are more likely to manage a greater proportion of their liquidity within the depository institution subsidiaries themselves, and, second, the depository institution subsidiaries are more capable of accepting significant deposits from a parent BHC and then depositing those funds in a Federal Reserve Bank. Conversely, GECC's relatively small industrial bank subsidiary would not be permitted to accept demand deposits from GECC, and its relatively small federal savings bank subsidiary's balance sheet would be greatly distorted by significant deposits from GECC.

[143] *See* 12 CFR § 249.30(a).

[144] *See* Letter from GECC to the OCC, Federal Reserve and FDIC re: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards and Monitoring (Jan. 31, 2014).

[145] OCC, Federal Reserve and FDIC, *Liquidity Coverage Ratio: Liquidity Risk Measurement Standards; Final Rule*, 79 Fed. Reg. 61440, 61446 (Oct. 10, 2014).

essentially self-tailoring because it applies different inflow and outflow rates to different types of assets and liabilities.[146]

We respectfully submit that this analysis does not adequately account for the key differences between GECC and BHCs in terms of HQLA access. We believe that HQLA eligibility presents an opportunity to tailor the enhanced prudential standards to reflect GECC's circumstances, including its funding profile and business model. To this end, we reiterate our earlier request that the LCR as applied to GECC be tailored so that GECC's deposits in third-party commercial banks are counted as inflows in the denominator of the LCR, but are not subject to the 75% cap on net inflows if: (i) the third-party commercial banks or their holding companies are themselves subject to the full (and not merely the modified) LCR or a foreign equivalent; and (ii) the deposits are not concentrated in any one affiliated group of banks.[147] These requirements will ensure that qualifying deposits remain with the safest and most comprehensively supervised institutions, which will be required to specifically account for outflows to GECC in their own liquidity risk planning.[148] Alternatively, GECC could be permitted to include such qualifying overnight deposits in Level 1 HQLA, subject to a haircut established as part of the supervisory process.

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[146] Proposed Order at 71777 ("Because the LCR applies outflow and inflow rates that are based on a covered bank holding company's particular risk profile and activities, the LCR requirements would be tailored to GECC's activities, balance sheet, and risk profile.").

[147] This calculation could be accomplished by determining net outflows without taking into account these qualifying deposits, then subtracting the amount of the qualifying deposits from the net outflows. To ensure that this does not result in a minimal HQLA requirement, an overall cap on such inflows from qualifying deposits could be determined and monitored as part of the supervisory process.

[148] Deposits at creditworthy third-party commercial banks have also been treated equivalently to central bank deposits in at least one other liquidity-related regulation under the Dodd-Frank Act. *See* 17 CFR § 39.33(c)(3) (qualifying liquidity resources of systemically important derivatives clearing organizations, including cash "held either at the central bank of issue or at a creditworthy commercial bank"); *see also* Commodity Futures Trading Commission, *Derivatives Clearing Organizations and International Standards*, 78 Fed. Reg. 72476, 72490 (Dec. 2, 2013).

B. The Proposed Order should be further tailored to grandfather historical Section 23B transactions.

The Proposed Order requires transactions between GECC or its subsidiaries and GE or its non-GECC subsidiaries to be conducted on arm's-length terms, as though Section 23B of the Federal Reserve Act applied and GECC were a member bank.[149] We agree that this requirement is appropriate prospectively. But we do not believe (and the Federal Reserve has not established) that it is necessary to apply the proposed Section 23B-like requirement retroactively.

Accordingly, we request that historical transactions and contractual relationships established before the date of the Proposed Order be grandfathered. A review of prior transactions and existing contractual relationships would be time-consuming, costly and of limited benefit. GECC should not be required to undertake such a review in the absence of any evidence that a particular transaction or category of transactions has been inconsistent with the safety and soundness of GECC or poses a material conflict of interest. Moreover, applying the requirement on a prospective basis would not limit the Federal Reserve's general authority to consider the safety and soundness of historical transactions and contractual relationships.

III. Significant Due Process Concerns

As currently framed, the Proposed Order:

- fails to provide a sufficient justification for the proposed standards;
- fails to examine the propriety of the proposed standards under the tailoring requirements of Section 165; and
- fails to assess the alternatives available to the Federal Reserve.

The Federal Reserve must do far more than it has done in the Proposed Order to explain the grounds for imposing its proposed enhanced prudential standards. Under the Administrative Procedure Act ("*APA*"), agency action is unlawful if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" or is not

[149] Proposed Order at 71779. Section 23B is intended to protect insured depository institutions by preventing these institutions from engaging in transactions with affiliates on terms that are unfavorable and not in their interest.

the product of "reasoned decisionmaking."[150] Agency action will not be upheld under these standards simply because the agency is addressing a topic of acknowledged importance or deems its actions to be warranted. Courts have time and again rejected an agency's mere *ipse dixit* as a permissible basis for agency action.[151] The Federal Reserve must therefore explain in detail the reasoning that underpins its proposed prudential standards. Anything less is a violation of both basic principles of administrative law under the APA and "elementary fairness."[152]

Accordingly, the Federal Reserve must provide a thorough, reasoned explanation for each of its proposed prudential standards. In addition, it must "evaluate . . . significant and viable alternatives" to those standards.[153] GECC has identified several alternative prudential standards in this letter and stands ready to identify further alternatives that will address the Federal Reserve's regulatory objectives without unduly impairing GECC's corporate governance and day-to-day operations.

The Dodd-Frank Act itself also requires that enhanced prudential standards prescribed for a nonbank SIFI "take into account differences among [nonbank SIFIs] . . . and [BHC

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150 5 U.S.C. § 706(2); *Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 839 (D.C. Cir. 2006) ("The APA 'establishes a scheme of 'reasoned decisionmaking'.") (quoting *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 374 (1998)).

151 *See, e.g., Bus. Roundtable v. SEC*, 647 F.3d 1144, 1155 (D.C. Cir. 2011) (rejecting "the [SEC's] assertion that confidentiality agreements could meaningfully reduce costs" as "an *ipse dixit*, without any evidentiary support and unresponsive" to the contrary, substantiated position of petitioners): *Prof'l Airways Sys. Specialists v. FLRA*, 809 F.2d 855, 859-60 (D.C. Cir. 1987) (rejecting the assertion that an agency's precedents were "evolving in a reasonable manner" as mere "*ipse dixit*" inadequate to explain departure from the agency's prior ruling).

152 *Maxcell Telecom Plus, Inc. v. FCC*, 815 F.2d 1551, 1558 (D.C. Cir. 1987) ("It is beyond dispute that an applicant should not be placed in the position of going forward with an application [for a license] without knowledge of requirements established by the Commission, and elementary fairness requires clarity of standards sufficient to apprise an applicant of what is expected."); *see also, e.g., BNSF Ry. Co. v. Surface Transp. Bd.*, 741 F.3d 163, 167-68 (D.C. Cir. 2014) ("[T]he APA requires that [an agency] 'examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'") (quoting *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43).

153 *Shieldalloy Metallurgical Corp. v. NRC*, 624 F.3d 489, 493 (D.C. Cir. 2010) "[A]gencies must evaluate parties' proposals of 'significant and viable' alternatives.") (quoting *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1511 n.54 (D.C. Cir. 1984)); *see also Am. Radio Relay League, Inc. v. FCC*, 524 F.3d 227, 242 (D.C. Cir. 2008) ("An agency is required 'to consider responsible alternatives to its chosen policy and to give a reasoned explanation for its rejection of such alternatives.'") (quoting *City of Brookings Mun. Tel. Co. v. FCC*, 822 F.2d 1153, 1169 (D.C. Cir. 1987)); *Chamber of Commerce of U.S. v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005) (holding that the SEC's "failure to consider the [facially viable] alternative violated the APA").

SIFIs], based on," among other things, the ten "factors described" in Section 113 of the Dodd-Frank Act, and further requires that the Federal Reserve "adapt the required standards as appropriate in light of any predominant line of business of such company, including assets under management or other activities for which particular standards may not be appropriate."[154] The clear import of these requirements is that enhanced prudential standards for a particular nonbank SIFI must be justified by reference to the differences between that nonbank SIFI and BHC SIFIs, with the Federal Reserve undertaking a reasoned elaboration of those differences in its order imposing the enhanced standards.

The Proposed Order fails to meet these tests. Despite the length of the Supplementary Information to the Proposed Order, there is little analysis of GECC and little explanation of departures from the Federal Reserve's own regulations and practices. For example, neither the Proposed Order nor the Supplementary Information discusses how GECC differs from, for example, a greater-than-$250 billion U.S. IHC subsidiary of a G-SIB (such as HSBC) so that the "independent/independent" director requirement may be justified in GECC's case, but not in the case of HSBC's U.S. IHC. The Proposed Order likewise fails to discuss how GECC differs from large regional banks such as Capital One Financial Corporation, PNC Financial Services Group and U.S. Bancorp so as to justify the eSLR requirement for GECC, but not for those regional banks.

At a minimum, if the Federal Reserve wishes to stand by the aspects of the Proposed Order that we have addressed in this letter, the Federal Reserve must supply further justification and analysis and afford GECC an opportunity to comment on the Federal Reserve's additional rationale. The transparency that would be afforded by reasoned explanations for the proposals and a reasoned rejection of alternatives is necessary for the Federal Reserve to establish that its actions are reasonable, especially compared to alternatives that would be equally effective and far less burdensome.

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[154] *See* Dodd-Frank Act § 165(b)(3) (cross-referencing *id.* § 113(a)-(b)).

CONCLUSION

GECC strongly believes that the Proposed Order requires substantial modification both in its substance and in its approach. We fully embrace the goal of continually improving GECC's safety and soundness and believe that properly formulated enhanced prudential standards under Section 165 will help us work toward that goal. But those standards must be a reasonable fit for GECC. We respectfully request that the final order for GECC reflect the strong and independent oversight of GECC's enterprise risks that is already in place and not contain an independent/independent director requirement. The Federal Reserve should also reject the equation of U.S. nonbank SIFI designation with G-SIB status, carefully consider the calibration of the capital, leverage, liquidity and other rules that will apply to GECC and recognize the material reductions in GECC's systemic footprint.

We appreciate the opportunity to provide our comments and hope that you will find them constructive.

Sincerely,

Keith S. Sherin
Vice Chairman, General Electric Company
Chairman & CEO, GE Capital

Annex A: Letter from Justice Jack B. Jacobs

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January 29, 2015

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Re: Docket No. R-1503, Application of Enhanced Prudential Standards and Reporting Requirements to General Electric Capital Corporation <u>79 Fed Reg. 71, 768 (Dec. 3, 2014)</u>

Dear Sir:

You have asked us to opine on a single issue of Delaware law, namely, whether the directors of a wholly-owned subsidiary that is incorporated in Delaware, owe any fiduciary duty to any person or entity other than the sole stockholder parent company. On the basis of, and subject to, the facts, assumptions and analysis set forth in this letter, we are of the opinion that a court of competent jurisdiction would conclude that under Delaware law, the directors of a wholly-owned subsidiary that is incorporated in Delaware and is solvent, owe no fiduciary duty other than to the subsidiary's sole stockholder parent. The reasoning that leads us to so conclude, and the facts and legal authorities upon which we rely, are set forth below.

This opinion is subject to certain limitations that we express at the outset. First, this letter is rendered solely to and for the benefit of the addressee listed above, and may not be quoted to or relied upon by, and this letter or copies hereof may not be delivered to, any other person. Nor may this letter be used for any other purpose, without our prior written consent; <u>provided</u>, however, that you may show this letter to, or file it with, any regulatory authority having jurisdiction over your company. Second, we opine only as to Delaware law. Although we cite authorities from other jurisdictions, those citations should not be regarded as our firm's opinion regarding the law of any cited non-Delaware jurisdiction. Finally, the facts that underlie the Delaware law issue on which we do specifically opine are based on information you have furnished. We assume the accuracy and completeness of those facts without having verified them independently.

I. Facts

General Electric Capital Corporation ("GECC") is a solvent nonbank financial company that is incorporated in Delaware and is one of the largest depository institution holding companies in the United States. GECC is wholly-owned by General Electric Company ("GE"), which is also a Delaware corporation.

As GECC's sole shareholder, GE elects all members of the GECC board of directors. None of the GECC board members is independent of (*i.e.*, not affiliated with) the management of GE.

The board of directors of GE has a dedicated risk committee ("Risk Committee") that oversees the risk management of both GE and GECC. Four of the Risk Committee members are independent of the management of GE.

On July 8, 2013, the Financial Stability Oversight Council, under Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"),[1] determined that GECC was a nonbank financial company that should be supervised by the Board of Governors of the Federal Reserve System ("FRSB"). As a consequence of that determination, GECC will be subject to enhanced prudential standards established by the FRSB for the purpose of preventing or mitigating risks to U.S. financial stability that could arise from the material financial distress, or failure, or ongoing activities of, nonbank financial companies such as GECC.

On November 25, 2014, the FRSB issued a formal request for public comment on a proposed order that would, among other things, apply four categories of enhanced prudential standards to GECC. Those categories include:

[1] 12 U.S.C. § 5365.

(1) capital requirements, (2) capital-planning and stress-testing requirements, (3) liquidity requirements, and (4) risk-management requirements. As part of category (4), the FRSB is proposing, in addition, to apply certain enhanced prudential standards that would include "additional independence requirements for GECC's board of directors."

Of the foregoing proposed standards, the only one that is relevant to, and a subject of, this letter relates to the "additional independence requirements for GECC's board of directors." On this specific point, the order that the FRSB proposes to issue would relevantly provide as follows:

Risk Management

1. Beginning on July 1, 2015, GECC shall comply with the risk-management standards under section 252.33 of the Board's Regulation YY as though it were a bank holding company with $50 billion or more in total consolidated assets.

    a. In addition, beginning on July 1, 2015, GECC is required to maintain a board of directors that has the greater of 25 percent of directors or two directors who are independent of General Electric Company's management and board of directors and GECC's management, one of whom may satisfy the independent director requirement under section 252.33(a)(4) of Regulation YY; and

    b. GECC shall ensure that the chair of the risk committee established at GECC pursuant to Regulation YY is among the directors who are independent of General Electric Company's management and board of directors and GECC's management....[2]

****

The FRSB's stated rationale for imposing these additional independence requirements for GECC's board of directors is "that it is necessary to ensure that GECC's board of directors includes members who are independent of GE so that

[2] Citations omitted.

their attention is focused on the business operations and safety and soundness of GECC itself, apart from the needs of its parent, GE." 79 Fed. Reg. at 71, 778.

GE and GECC have objected to certain of the proposed enhanced standards. The objections that are relevant to, and treated in, this letter concern the risk management governance proposals quoted above. To repeat, those proposals would: (i) require GECC to establish a separate risk committee independent of GE's existing Risk Committee, and (ii) require that the greater of 25% of the GECC board, or two directors, as well as the chair of the GECC risk committee, be so-called "independent/independent" directors—that is, directors who are independent of the management of both GE and GECC, and also independent of GE's board of directors.

II. Analysis

It is long-settled Delaware law that "in a parent and wholly-owned subsidiary context, the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders." *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*, 545 A.2d 1171, 1174 (Del. 1988); *Sternberg v. O'Neil*, 550 A.2d 1105, 1124 (Del. 1988). As the Delaware Court of Chancery recently stated, the rationale underlying this principle is that:

> When a controller owns 100% of a corporation's equity and the subsidiary is solvent, the interests of the corporation and its fiduciaries are fully aligned with those of the controller. The fiduciary duties of the directors and officers require that the subsidiary be managed for the benefit of the controller, and the fiduciary duties imposed on the controller self-referentially require the same thing.

Quadrant Structured Products Co. v. Vertin, 102 A.3d 155, 184 (Del. Ch. 2014); *accord, Grace Bros. v. Uniholding Corp.*, 2000 WL 982401, at *12 (Del. Ch. July 12, 2000) ("It is by no means a novel concept of corporate law that a wholly-owned subsidiary functions to benefit its parent. To the extent that members of the parent board are on the subsidiary board ... they have a fiduciary duty, as part of their management responsibilities, to act in the best interests of the parent and its stockholders."); *Hamilton Partners, L.P. v. Englard,* 11 A.3d 1180, 1209 (Del. Ch. 2010). The sole exception to this principle arises where the subsidiary is insolvent, in which case the subsidiary board's fiduciary obligation is to manage the subsidiary for the benefit of its creditors. *Trenwick Am. Litig. Trust v. Enrst & Young, LLP*, 906 A.2d 168, 201 n.96, *aff'd sub nom Trenwick Am. Litig. Trust v. Billett*, 931 A.2d 438 (Del. 2007).

From this principle it follows that "Delaware law does not embrace the concept that a director of a wholly-owned subsidiary owes a duty to second-guess the business judgment of its parent corporation, when following and supporting the parent's strategy would not violate any legal obligation the subsidiary owes to another." *Trenwick*, 906 A.2d at 201.[3]

Although not material to our conclusion expressed in this letter, it is noteworthy that, on this issue, the case law of several non-Delaware jurisdictions appears consistent with the law of Delaware. Those jurisdictions include New York,[4] New Jersey,[5] Massachusetts,[6] Indiana,[7] Texas,[8] Kentucky,[9] and Minnesota.[10]

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[3] The qualifying phrase in *Trenwick*—"when following and supporting the parent's strategy would not violate any legal obligation the subsidiary owes to another[]"—is intended to capture a scenario not presented here, *i.e.*, the fiduciary obligation owed by the subsidiary's board to manage the subsidiary for the benefit of its creditors when the subsidiary is insolvent. *See, e.g., Production Res. Grp., LLC v. NCT Grp., Inc.*, 863 A. 2d 772, 791-92 (Del. Ch. 2004); *Trenwick*, 906 A.2d at 201 n.96 (equating "legal obligations" with an insolvent subsidiary's obligations to creditors). Certain bankruptcy court decisions have read *Anadarko* narrowly, and hold that a wholly-owned subsidiary board's fiduciary duty runs to the subsidiary and its creditors and not solely to the parent. To that extent, those decisions misapprehend the *Anadarko* doctrine, which applies to solvent, not insolvent, corporations. *See, e.g., Williams v. McGreevey (In re Touch America Holdings, Inc.)*, 401 B.R. 107, 129 (Bankr. D. Del. 2009); *In re SW Supermarkets, LLC*, 376 B.R. 281, 285 (Bankr. D. Ariz. 2007); *Claybrook v. Morris (In re Scott Acquisition Corp.)*, 344 B.R. 283, 290 (Bankr. D. Del. 2006). To the extent those bankruptcy court cases may be read to apply to solvent corporations, they are incorrect and also non-authoritative statements of Delaware law.

[4] *Aviall, Inc. v. Ryder Sys., Inc.*, 913 F. Supp. 826, 832 (S.D.N.Y. 1996) (applying New York law and citing *Anadarko*) ("When one company wholly owns another, the directors of the parent and the subsidiary are obligated to manage the affairs of the subsidiary in the best interests only of the parent and its shareholders."), *aff'd*, 110 F.3d 892, 896 (2d Cir. 1997); *RSL Commc'ns PLC v. Bildirici*, 649 F. Supp. 2d 184, 212 (S.D.N.Y. 2009) (applying New York law and holding that directors of a wholly-owned subsidiary owed a fiduciary duty only to the parent company and its

shareholders, and that because the subsidiary was not yet insolvent, its board did not owe a duty to creditors, citing *Trenwick*), *aff'd sub nom RSL Communications PLC ex rel. Jervis v. Fisher*, 412 F. App'x 337 (2d Cir. 2011); *see also In re MF Global Holdings Ltd. Inv. Litig.*, 998 F. Supp. 2d 157, 181 n.15 (S.D.N.Y. 2014), and *Texas Int'l Corp. v. Gimbel*, 2014 WL 7177972, at **11-12 (S.D.N.Y. Dec. 17, 2014) (both cases applying New York law).

[5] *VFB LLC v. Campbell Soup Co.*, 482 F.3d 624, 635 (3d Cir. 2007) (applying New Jersey law) ("Corporate duties should be as broad as their purpose requires, but it makes no sense to impose a duty on the director of a solvent, wholly-owned subsidiary to be loyal to the subsidiary as against the parent company."); *Bresnick v. Franklin Capital Corp.*, 10 N.J. Super 234, 241, 77 A.2d 53, 56 (App. Div. 1950) ("The [corporation] owns all the stock of the [subsidiary] and chooses all the directors of that company. In transactions between the two companies, the directors are concerned primarily to serve the company that appoints them and that owns all the stock of the other."), *aff'd sub nom Bresnick v. Franklin Capital Corp.*, 7 N.J. 184, 81 A.2d 6 (N.J. 1951).

[6] *General Electric Co. v. Lines*, 2009 WL 2393935, at *6 (Mass. Super. Aug. 3, 2009) (stating corollary principle that "the weight of authority holds that a parent corporation does not owe a fiduciary duty to a wholly-owned subsidiary, which is created solely to be operated for the benefit of the parent and its shareholders, because there is only one substantive interest to be protected and no divided loyalty requiring special scrutiny of the actions by those in control." (internal citations omitted)).

[7] *Abrams v. McGuireWoods LLP*, 518 B.R. 491, 501-02 (N.D. Ind. 2014) (citing *Trenwick* and holding that under Indiana law, a wholly-owned subsidiary has no cognizable claim against its managers for aiding and abetting a breach of fiduciary duty, because the managers owe a fiduciary duty only to the parent).

[8] *Raytheon Co. v. Boccard USA Corp.*, 369 S.W. 3d 626, 634 (Tex. App. 2012) (citing *Anadarko* and *Trenwick*, and stating that "[u]sually, the fiduciary duties of the directors of a wholly-owned subsidiary corporation run to the parent corporation, not to the subsidiary itself"), *review denied* (Oct. 5, 2012); *Resolution Trust Corp. v. Bonner*, 1993 WL 414679, at *3 (S.D. Tex. June 3, 1993) (applying Texas law and citing *Anadarko* for its corollary proposition that "[t]he cause of action for breach of fiduciary duty against [parent companies] must be dismissed because a parent corporation owes no duties to its wholly-owned subsidiary").

[9] *Westlake Vinyls, Inc. v. Goodrich Corp.*, 518 F. Supp. 2d 902, 917 (W.D. Ky. 2007) (applying Kentucky law and collecting cases, including *Anadarko*, and stating *Anadarko's* corollary proposition that "[t]he weight of authority holds that a parent corporation owes no fiduciary duties to its wholly-owned subsidiary").

We conclude our analysis—solely for completeness—by addressing two non-Delaware decisions that interpret Delaware law to be that the directors of a wholly-owned subsidiary owe fiduciary duties to the subsidiary as well as to the parent. *See First Am. Corp. v. Al-Nahyan*, 17 F. Supp. 2d 10, 26 (D.D.C. 1998) (distinguishing *Anadarko* and holding that under Delaware law a wholly-owned subsidiary had standing to sue its directors for breach of fiduciary duty, because the directors "owe the [subsidiary] corporation fiduciary duties just as they would any would any other corporation"); *Wooley v. Lucksinger*, 61 So. 2d 507, 589-92 (La. 2011) (applying Texas law) (same). Neither decision constitutes an authoritative ruling of Delaware law and both interpret Delaware law erroneously.

The *Al-Nahyan* court, in concluding that the subsidiary's directors "owe the corporation fiduciary duties just as they would any other corporation," relied on *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A. 2d 34, 43 (Del. 1994). But, *QVC* does not and cannot be read to stand for that construction, because *QVC* did not involve a wholly-owned subsidiary or any fiduciary claim against a wholly-owned subsidiary board. Rather, *QVC* involved a challenge to an effort by a corporation (Viacom) to acquire a totally independent corporation (Paramount) that was not even a Viacom subsidiary, let alone one that was wholly-owned. Therefore, no issue was (or could have been) presented regarding whether Paramount's directors owed a fiduciary duty solely to Paramount's (non-existent) parent. It is our view that a Delaware court would conclude that *Al-Nahyan* misconstrued Delaware law.

Wooley is equally erroneous insofar as it attempts to construe Delaware law, although for different reasons. There, the Louisiana Supreme Court was called upon to apply Texas law, not Delaware law, and discussed the latter only as an element informing its effort to predict Texas law. For that reason, *Wooley* is doubly non-authoritative, not only because it is not a decision by a Delaware court, but also because it does not purport to apply Delaware law. As such, *Wooley* amounts to dictum folded into dictum. Moreover, because the wholly-owned corporation before the court in *Wooley* was insolvent, the Louisiana court's holding is more reasonably read as limited to insolvent corporations.

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[10] *Household Reinsurance Co. v. Travelers Ins. Co.*, 1992 WL 222220, at *3 (N.D. Ill. Jan. 31, 1992) ("Under Minnesota law, a 100% shareholder does not owe a fiduciary duty to the wholly-owned corporation." (citing *Anderson v. Benson,* 394 N.W. 2d 171, 175 (Minn. App. 1986))).

We note, finally, that no decision of which we are aware (including *Al-Nahyan* and *Wooley*) suggests that a subsidiary's directors owe no fiduciary duty to the parent, or that the subsidiary's directors may base the discharge of their duties on considerations apart from the needs of the parent—which appears to be the premise of the FRSB proposal.

III. Conclusion

On the basis of, and subject to, the facts, assumptions and analysis set forth above, our opinion is that a court of competent jurisdiction would conclude that, under Delaware law, the directors of a wholly-owned subsidiary that is incorporated in Delaware and is solvent, owe no fiduciary duty other than to the subsidiary's sole stockholder parent.

We hope that the views expressed in this letter are responsive to your inquiry. Should you need further information or explication, please do not hesitate to contact us.

Sidley Austin LLP

By: Jack B. Jacobs

Jack B. Jacobs
Senior Counsel

JBJ:sjs

Annex B: Letter from Chancellor William B. Chandler III

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February 2, 2015

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Re: The "Independent Director Requirement" Proposed by the Board of Governors of the Federal Reserve System

Dear Mr. Alvarez and Mr. Gibson:

I have been asked by General Electric Capital Corporation, a Delaware corporation ("GECC"), to provide an analysis of the "Independent/Independent Director Requirement" (defined below) proposed by the Board of Governors of the Federal Reserve System (the "Federal Reserve") for the board of directors of GECC (the "GECC Board"), in light of the obligations imposed on directors of Delaware corporations under Delaware law. That analysis follows. In sum, certain implications of the Independent/Independent Director Requirement are inconsistent with, and in some respects violate, the long-standing statutory and common law fiduciary duties that apply to every director of a Delaware corporation.

1. Personal Background

I am a partner at Wilson Sonsini Goodrich & Rosati, P.C., where I advise both public and private clients in connection with Delaware corporate governance matters, special committee assignments, internal investigations, and merger and acquisition transactions. I joined the firm after retiring from the Delaware Court of Chancery, the nation's leading court for corporate law cases. I served on the Court of Chancery for over two decades, having been appointed Vice Chancellor in 1989 and then, in 1997, as Chancellor. During my tenure, I issued more than a thousand opinions and presided over some of the most contentious and high-profile corporate law disputes in the country, including those involving The Walt Disney Company, Yahoo, Microsoft, Hewlett-Packard, eBay, Citigroup, Dow Chemical, and, most recently, the Air Products/Airgas dispute. Before my appointment to the Court of Chancery, I served as resident judge of the Delaware Superior Court from 1985 to 1989. I previously was an associate with Morris, Nichols, Arsht & Tunnell LLP and served as legal counsel to Pete duPont, the former governor of Delaware. I received a B.A. in Philosophy and Political Science from the University of Delaware in 1973, a J.D. degree from the University of South Carolina School of Law in 1976, and an LL.M. from Yale Law School in 1979. Earlier in my career, I taught commercial law, legislative process, and remedies at the University of Alabama School of Law, and I have recently taught law courses in Advanced Corporations at the University of Chicago, Vanderbilt, Ohio State, Washington University, and the University of Georgia.

In February 2014, I was appointed by Delaware Governor Jack Markell to chair the Judicial Nominating Commission, a task force responsible for screening and recommending candidates to fill judicial vacancies on the Delaware bench. I am a member of the American Law Institute and a Trustee of the Yale Center for Corporate Governance, the University of Delaware, and the Weinberg Center for Corporate Governance.

2. <u>Factual Background</u>

The Federal Reserve issued a proposed order to GECC on November 25, 2014 (the "Proposed Order") setting forth the Federal Reserve's proposed enhanced prudential standards under Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Proposed Order includes, among other things, a requirement (the "Independent/Independent Director Requirement") that, beginning July 1, 2015, the GECC Board include the greater of 25 percent of the GECC Board or two directors who (1) do not serve on the board of directors (the "GE Board") of General Electric Company, a New York corporation ("GE"), and (2) are independent of GE's and GECC's management (the "Independent/Independent Directors").

I understand that the independent directors on the GE Board are submitting a comment letter in response to the Proposed Order that includes, among other things, a proposal that would result in the directors currently serving on the Risk Committee of the GE Board (the "Risk Committee") joining the GECC Board and a majority of the members of the GECC Board being independent from management of GE or GECC. The Risk Committee is composed of four members of the GE Board, all of whom qualify as independent under NYSE listing standards. The members of the Risk Committee are an impressive group, including in their ranks a former Chairman of the U.S. Securities and Exchange Commission, a Chairman Emeritus of the Vanguard Group, the CEO of

Generation Capital, Toronto, Canada, and a former Chairman and CEO of PNC Financial Services.[1] Further, these directors serve as directors, chairs, and trustees of numerous companies and organizations ranging from Fortune 100 companies to higher education institutions to charitable and special interest organizations. It is patently clear that the independent directors currently serving on the Risk Committee are highly qualified, extraordinarily successful individuals with exceptional careers and reputations.

3. <u>Directors of a Wholly Owned Solvent Delaware Subsidiary Must Serve the Interests of the Parent</u>

It is axiomatic under Delaware law that directors of a wholly owned solvent subsidiary have a duty to serve the interests of the parent stockholder.[2] Generally, directors stand in a fiduciary relationship with the stockholder(s) and the corporation and, where there are multiple stockholders, directors are expected to use their own business judgment rather than act simply as "thermometers, existing to register the ever-changing sentiments of stockholders."[3] However, it is a long settled rule of law in Delaware that wholly owned subsidiaries are "to be operated for the benefit of its parent"[4] and the "directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders."[5] Here, GE is the sole stockholder of GECC. Thus, the GECC Board's duties run to GE as GECC's parent.[6] Directors of a wholly owned subsidiary are

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[1] Full biographies of each of the independent directors serving on the Risk Committee and proposed to be added to the GECC Board, as they appear on GE's website, are attached hereto as **Appendix A**.

[2] *See, e.g.*, *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 200 (Del. Ch. 2006).

[3] *In re Lear Corp. S'holder Litig.*, 967 A.2d 640, 655 (Del. Ch. 2008); *see generally*, *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998) (citing *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939)).

[4] *Trenwick*, 906 A.2d at 174; *Grace Bros. v. UniHolding Corp.*, 2000 Del. Ch. LEXIS 101, at *40 (Del. Ch. July 12, 2000).

[5] *Trenwick*, 906 A.2d at 200 (quoting *Anadarko Petroleum Corp. v. Panhandle E. Corp.*, 545 A.2d 1171, 1174 (Del. 1987)); *Shaev v. Wyly*, 1998 Del. Ch. LEXIS 2, at *7 (Del. Ch. Jan. 6, 1998).

[6] *Trenwick*, 906 A.2d at 200 ("To the extent that Trenwick America was a wholly-owned solvent subsidiary of Trenwick, the fiduciary duties owed by the Trenwick America board ran to Trenwick."); *Grace Bros.*, 2000 Del. Ch. LEXIS 101, at *40 ("To the extent that members of the parent board are on the subsidiary board or have knowledge of proposed action at the subsidiary level that is detrimental to the parent, they have a fiduciary duty, as part of their management responsibilities, to act in the best interests of the parent and its stockholders.").

"free to take action in aid of its parent's business strategy" absent any indication they would be causing the subsidiary to violate legal obligations that the subsidiary owes to others.[7]

Thus, it is abundantly clear under Delaware law that the directors of GECC owe their fiduciary duties to GE. In contrast, the Federal Reserve's proposed Independent/Independent Director Requirement seems to have as its premise that the Independent/Independent Directors would be untethered from GE and GE's interests. In the wholly owned subsidiary context, however, the directors of the wholly owned subsidiary—GECC—are required to serve the interests of the parent—GE—and were they to do otherwise, they risk violating their fiduciary duties. If the Federal Reserve's Independent/Independent Director Requirement contemplates a duty of those directors being something other than a duty to serve the interests of GE and its stockholders, it is not clear how those untethered duties could be articulated and implemented without running afoul of well-established principles of Delaware fiduciary duty law. Further, the Independent/Independent Directors, attempting to ascribe meaning or a perceived mandate to the Proposed Order, would be lost at sea trying to determine what exactly their duties are, how they differ from the duties of the other directors, and how to comply with those untethered duties and with their duties under Delaware law.[8] Although the presence of independent directors (*e.g.*, the members of the Risk Committee to be added to the GECC Board) may encourage healthy deliberation in the boardroom to further the interests of the stockholder(s), Delaware corporate law discourages fostering an environment among directors where some believe their duties are different from those of others, as the existence of divided loyalties in the boardroom could quickly devolve into discord and deadlock among the board members attempting to further their own agendas. In my experience on the bench, the presence of a balkanized board of directors can lead to wasteful litigation, distraction from management of the company's business and affairs, and a possible undoing of the company itself.[9]

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[7] *Trenwick*, 906 A.2d at 201 ("[T]he law is that the Trenwick America directors were obligated to manage Trenwick America with loyalty to Trenwick, the company's sole stockholder. To the extent that the Trenwick America directors acceded to their parent's wishes and lent support to its business strategy, there is no basis to fault them.").

[8] Similarly, if Independent/Independent Directors are purportedly added to further different interests, the GECC directors who are not Independent/Independent Directors may view the Independent/Independent Directors as taking on an adversarial posture, potentially creating an atmosphere of contention that pushes the other directors to take on an opposing viewpoint. This is not appropriate for the boardroom of a Delaware corporation. *Cf. In re Nine Sys. Corp. S'holders Litig.*, 2014 Del. Ch. LEXIS 171, at *107–08 (Del. Ch. Sept. 14, 2014) (finding that directors "fail[ed] to understand the nature of [their] duties" in part because they misunderstood the role of an independent director on the board).

[9] For example, I presided over the judicial dissolution of Genitrix, LLC, a Delaware limited liability company with a limited liability company agreement that eliminated the members' fiduciary duties by

Finally, to the extent the Federal Reserve believes any of the directors could or should consider matters other than the interests of GE[10] as ends in themselves, this approach would offend Delaware law, which only allows directors to consider the interests of other constituencies *to the extent those other constituencies are incidental to, or in furtherance of, the interests of stockholders.*[11]

4. <u>The Members of the Risk Committee to be Added to the GECC Board Are Independent</u>

The independent directors currently serving on the Risk Committee (and who may be added to the GECC Board), notwithstanding that they are members of the GE Board, are already well-positioned to serve as independent and disinterested voices on GECC matters. To comply with Delaware law when considering a board decision, a director must bring "his or her own informed business judgment to bear with specificity upon the corporate merits of the issues without regard for

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contract so that members were free to pursue their own interests. *Fisk Ventures, LLC v. Segal*, 2009 Del. Ch. LEXIS 7, at *20 (Del. Ch. Jan. 13, 2009); *see also Fisk Ventures, LLC v. Segal*, 2008 Del. Ch. LEXIS 84, at *4 (Del. Ch. July 3, 2008) (finding that the limited liability company agreement expressly eliminated fiduciary duties). The result was expensive litigation yielding a determination that the board was hopelessly deadlocked and unable to continue the operation of the company. *Fisk Ventures*, 2009 Del Ch. LEXIS 7, at *20. Although Delaware limited liability companies are free to contractually modify or eliminate fiduciary duties, Delaware corporations do not enjoy that same latitude. 8 *Del. C.* § 102(b)(7) (allowing a corporation to only limit or eliminate money damages for breach of the duty of care, and not allowing any limits on the duty of loyalty); *Emerald Partners v. Berlin*, 787 A.2d 85, 92 (Del. 2001) (holding that 8 *Del. C.* § 102(b)(7) does not defeat the validity of a claim for breach of the duty of care, and only operates to defeat the ability to recover money damages); *Sutherland v. Sutherland*, 2009 Del. Ch. LEXIS 46, at *14 (Del. Ch. Mar. 23, 2009) (holding that, unlike the Delaware Limited Liability Company Act and the Delaware Revised Uniform Limited Partnership Act, the Delaware General Corporation Law does not allow parties to modify the fiduciary duty of loyalty in a corporation's certificate of incorporation).

[10] *See* Proposed Order, at 42 ("[T]he Board believes that it is necessary to ensure that GECC's board of directors includes members who are independent of GE so that their attention is focused on the business operations and safety and soundness of GECC itself, *apart from the needs of its parent GE.*") (emphasis added).

[11] *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 33 (Del. Ch. 2010) ("Promoting, protecting, or pursuing non-stockholder considerations must lead at some point to value for stockholders"; directors who failed to establish how their actions would lead to shareholder value "failed to prove . . . that they acted in the good faith pursuit of a proper corporate purpose"); Leo E. Strine, Jr., *Lecture and Commentary on the Social Responsibility of Corporate Entities: The Social Responsibility of Boards of Directors and Stockholders in Change of Control Transactions: Is There Any "There" There?*, 75 S. Cal. L. Rev. 1169, 1170 (2002) ("[C]orporations exist primarily to generate stockholder wealth, and . . . the interests of other constituencies are incidental and subordinate to that primary concern.").

or succumbing to influences which convert an otherwise valid business decision into a faithless act."[12] The Supreme Court of Delaware has specifically held that "it is not enough to charge that a director was nominated by or elected at the behest of those controlling the outcome of a corporate election"; instead, to establish that a director lacks independence, there must be facts demonstrating "that through personal or other relationships the directors are *beholden* to the controlling person."[13] Examples of a "beholden" director may include a director who depends on the director office or related position for his or her livelihood when that office or position is at stake,[14] or, with respect to a controlling entity, "when the entity has the direct or indirect unilateral power to decide whether the director continues to receive a benefit upon which the director is so dependent or is of such subjective material importance that its threatened loss might create a reason to question whether the director is able to consider the corporate merits of the challenged transaction objectively."[15] Absent factors such as these, which may provide a director with an incentive to depart from his or her duties in some circumstances, Delaware courts treat directors as capable of bringing their own business judgment to bear when considering matters before the board, and thus as independent.

The non-management directors GE proposes to add to the GECC Board are disinterested when it comes to matters implicating GE's interests and are not "beholden" to GE, as their only connection to GE is their service on the GE Board and committees thereof, and by agreeing to serve on the GECC Board at the request of GE.[16] Delaware case law clearly supports the conclusion that simply serving on the GE Board, without more, does not make those directors beholden to GE such that they could not bring their own independent business judgment to bear on issues presented to the

[12] *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1983).

[13] *Id.* at 815 (emphasis added).

[14] *Rales v. Blasband*, 634 A.2d 927, 937 (Del. 1993); *Mizel v. Connelly*, 1999 Del. Ch. LEXIS 157, at *8–11 (Del. Ch. July 22, 1999).

[15] *Telxon Corp. v. Meyerson*, 802 A.2d 257, 264 (Del. 2002). *See also Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 177 (Del. Ch. 2005) ("This Court will not find a director beholden unless the purported controlling person has 'unilateral' power to substantially affect the director.") (citing *Telxon Corp.*).

[16] This second attribute, agreeing to serve on the GECC Board at the request of GE, would also be shared by any Independent/Independent Director as well as the current directors serving on the GECC Board, since Delaware gives stockholders the power to elect and remove directors, and if the Proposed Order is adopted, GE would need to locate and convince new director candidates to serve on the GECC Board. *See, e.g.*, 8 *Del. C.* § 211(b); 141(k) (describing stockholder power to elect and remove directors). Of course, whether or not the director is an Independent/Independent Director, Delaware generally does not treat this common attribute of all directors of wholly owned subsidiaries as generating a conflict. *See In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 996 (Del. Ch. 2014) ("It is well-settled Delaware law that a director's independence is not compromised simply by virtue of being nominated to a board by an interested stockholder.").

GECC Board.[17] The independent directors serving on the Risk Committee, with successful careers and reputations separate and apart from their affiliation with GE, have every reason to ensure GE and GECC are run only in a responsible way, in accordance with their own independent business judgment, and have no reason to violate their fiduciary duties, risking those careers and reputations simply because they may have a seat on the GE Board.[18] Put another way, these directors are generally considered to be independent when serving on the GE Board, as, in the ordinary case, the implication is that they are well-suited to act in the best interests of the company and would not be tempted to carry out disloyal acts for the benefit of company management or anyone else. These attributes apply equally when the focus is shifted to GECC, with the directors' independence as it relates to GE remaining unchanged.

When an individual is a director of both a parent and a subsidiary, the director owes "the same duty of good management to both corporations" and the "duty is to be exercised in light of what is best for both corporations."[19] Although Delaware case law recognizes potential difficulties for a director serving as a "dual fiduciary" for two separate entities, the circumstances here are quite different from those driving that concern in the case law. First, as a legal matter, there is no conflict between GE and GECC that gives rise to the so-called "dual fiduciary problem."[20] Second, as a factual and realistic matter, the entities' interests are in harmony. That is, GE derives a significant portion of its net earnings from GECC,[21] and thus clearly has a significant interest in the success of GECC. GE would face great reputational risk, and that significant asset would be imperiled, if it

[17] *See, e.g.*, *Beam v. Stewart*, 845 A.2d 1040, 1050–51 (Del. 2004) (rejecting a "structural bias" argument that "presupposes that the professional and social relationships that naturally develop among members of a board impede independent decision-making" and finding that only relationships of a "bias-producing nature," such as professional or personal relationships that are so strong as to "border on or even exceed familial loyalty and closeness," raise doubts about a director's independence); *Crescent/Mach I Partners, L.P.*, 846 A.2d 963, 980 (Del. Ch. 2000) (holding that an allegation of a long-standing 15-year professional and personal relationship was not sufficient to raise reasonable doubt as to the director's independence); *In re MFW S'holders Litig.*, 67 A.3d 496, 509 (Del. Ch. 2013) (noting that Delaware "law is clear that mere allegations that directors are friendly with, travel in the same social circles, or have past business relationships with the proponent of a transaction or the person they are investigating, are not enough to rebut the presumption of independence").

[18] *Id.*

[19] *Weinberger v. UOP*, 457 A.2d 701, 710–11 (Del. 1981); *In re Digex S'holders Litig.*, 789 A.2d 1176, 1206 (Del. Ch. 2000).

[20] *See* Section 3 of this Memorandum, *supra* (describing that a subsidiary should serve the interests of a parent); *In re Trados, Inc. S'holder Litig.*, 73 A.3d 17, 46–47 (Del. Ch. 2013) ("If the interests of the beneficiaries to whom the dual fiduciary owes duties are aligned, then there is no conflict.").

[21] *See* Proposed Order, at 8 n.9.

allowed GECC to be inappropriately managed, to take unreasonable risk, or to fail as a company. For both of these reasons, an independent director can feel comfortable serving on both boards of directors without a realistic fear of being placed in a conflict position.

Because all GECC directors owe their fiduciary duties to GE and its stockholders, and because the independent members of the Risk Committee will bring their own independent business judgment to bear when considering GECC and are not "beholden" to anyone (including GE), I do not see the Independent/Independent Director Requirement serving a viable purpose from a Delaware fiduciary duty perspective. The Risk Committee members who would serve on both boards of directors and any Independent/Independent Director would be obligated and incentivized to approach their role in the same way and would have the same fiduciary obligations—unless, of course, the Federal Reserve purported to require the Independent/Independent Directors to act in the interests of someone other than GECC's sole stockholder, GE, which would be flatly inconsistent with Delaware law.

5. <u>Delaware Law Inherently Places Checks on Directors, Including Directors of Wholly Owned Subsidiaries</u>

To the extent any concern remains as to the manner in which the members of the GECC Board will fulfill their fiduciary duties, Delaware law inherently places several checks on directors that should put any such concerns to rest and further preclude the need for mandating Independent/Independent Directors. For example, if a corporation becomes insolvent, creditors have standing to bring derivative claims against directors for breaches of fiduciary duties,[22] an important check on directors.[23] When a corporation is insolvent, directors are to act in the best interests of the corporate enterprise as a whole, and creditors, as residual claimants who stand to benefit from any increased value of the corporation, are the principal constituency injured by breaches of fiduciary duties and therefore have the same incentive to pursue valid derivative claims as stockholders have

[22] *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007); *Quadrant Structured Prod. Co., Ltd. v. Vertin*, 102 A.3d 155, 176 (Del. Ch. 2014), *reh'g denied*, 2014 Del. Ch. LEXIS 214 (Del. Ch. Oct. 28, 2014).

[23] *See, e.g., Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1036 (Del. 2004) ("The derivative suit has been generally described as 'one of the most interesting and ingenious of accountability mechanisms for large formal organizations.'" (citation omitted)); *Agostino v. Hicks*, 845 A.2d 1110, 1117 (Del. Ch. 2004) ("The prerequisites to a derivative action, developed over time, have attempted to balance the Delaware prerogative that directors manage the affairs of a corporation with the realization that shareholder policing, via derivative actions, is a necessary check on the behavior of directors that serve in a fiduciary capacity to shareholders.").

when a corporation is solvent.[24] I understand that GECC is far from insolvency.[25] Should GECC become insolvent, however, sufficient protection exists against any potential conflict or tension that may arise between the interests of GE and GECC by the enforcement rights of all of GECC's creditors, who have outside interests in holding the members of the GECC Board to account. This is a powerful check that directors must keep in mind: if a subsidiary becomes distressed, creditors gain standing under Delaware law to challenge transactions that occurred between the parent and subsidiary, even those that occurred prior to insolvency, rather than being limited to enforcing any contractual rights they may have negotiated with respect to the company's operations.[26]

The Delaware General Corporation Law also protects against a subsidiary funneling money up to its parent when the subsidiary is insolvent or when doing so would drive the subsidiary into insolvency. Directors are personally liable for willfully or negligently declaring dividends in violation of Delaware law,[27] which allows directors to declare dividends only out of the corporation's surplus or, if there is none, out of the corporation's net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.[28] In addition, the Delaware Court of Chancery has emphasized that, under the common law, directors may not approve distributions to stockholders that would cause the corporation to become insolvent, which occurs either when a corporation's "liabilities exceed its assets, or when it is unable to pay its debts as they come due."[29] Importantly, corporations cannot limit or eliminate directors' personal liability for unlawful dividends[30] and Delaware provides for a six-year statute of limitations period to challenge unlawful

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[24] *See Quadrant*, 102 A.3d at 172 (citations and internal quotations omitted) ("When a corporation is insolvent, its creditors become the beneficiaries of any initial increase in the corporation's value. The stockholders remain residual claimants, but they can benefit from increases in the corporation's value only after the more senior claims of the corporation's creditors have been satisfied. . . . Because the creditors of an insolvent corporation join the class of residual claimants, equitable considerations give creditors standing to pursue derivative claims against the directors of an insolvent corporation."); *see generally Gheewalla*, 930 A.2d at 101–02; *Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.*, 863 A.2d 772, 794 n.67 (Del. Ch. 2004).

[25] *See* General Electric Capital Corporation, Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (Form 10-Q), at 6 (Nov. 4, 2014) (identifying more than $89 billion in book value of net surplus for GECC as of September 30, 2014).

[26] *Quadrant*, 102 A.3d at 180; *Trenwick*, 906 A.2d at 173.

[27] 8 *Del. C.* §§ 173, 174.

[28] 8 *Del. C.* § 170(a).

[29] *SV Investment Partners, LLC v. ThoughtWorks, Inc.*, 7 A.3d 973, 987 (Del. Ch. 2010).

[30] 8 *Del. C.* § 102(b)(7) (explicitly precluding a corporation from limiting or eliminating directors' personal liability pursuant to 8 *Del. C.* § 174).

distributions.[31] Because they would risk being held personally liable, the members of the Risk Committee to be added to the GECC Board are quite unlikely to risk funneling money up to GE in the form of dividends or other distributions if GECC somehow becomes distressed or would be put in such a situation as a result of the act. They simply do not have sufficient incentive, based solely on their director positions, to take such a significant personal risk.

Finally, all directors of Delaware corporations have an obligation to act in good faith[32] and to comply with the law.[33] This includes all laws and regulations promulgated by the Federal Reserve, which, even without the Proposed Order, I understand contain significant protections for the public and the United States financial system. Thus, even if a sole stockholder requested a board of a wholly owned subsidiary to break the law (which I certainly would not expect to occur here in any case), the subsidiary's directors would violate Delaware law if they so acted.[34] Further, the

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[31] 8 *Del. C.* § 174(a).

[32] *Aronson*, 473 A.2d at 812 (articulating the business judgment rule as a "presumption that in making a business decision the directors of a corporation acted on an informed basis, *in good faith* and in the honest belief that the action was taken in the best interest of the company.") (emphasis added); *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971) ("[I]nequitable action does not become permissible simply because it is legally possible."); 8 *Del. C.* § 102(b)(7)(ii) (providing that a corporation cannot limit or eliminate the personal liability of directors for "acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law").

[33] 8 *Del. C.* § 101(b) ("A corporation may be incorporated or organized under this chapter to conduct or promote any *lawful business or purposes*, except as may otherwise be provided by the Constitution or other law of this State.") (emphasis added); 8 *Del. C.* § 102(a)(3) ("It shall be sufficient to state . . . that the purpose of the corporation is to engage in any *lawful act or activity* for which corporations may be organized under the General Corporation Law of Delaware, and by such statement all *lawful acts and activities* shall be within the purposes of the corporation . . .") (emphasis added); 8 *Del. C.* § 102(b)(7)(ii); *Metro Commun. Corp. BVI v. Advanced Mobilecomm Techs. Inc.*, 854 A.2d 121, 131 (Del. Ch. 2004) ("Under Delaware law, a fiduciary may not choose to manage an entity in an illegal fashion, even if the fiduciary believes that the illegal activity will result in profits for the entity."); *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) (describing a director's obligation not to "caus[e] the corporation to violate the positive laws it is obliged to obey" as an "obvious component of the duty of loyalty" (citing 8 *Del. C.* § 102(b)(7)(ii))); *TW Servs., Inc. v. SWT Acquisition Corp.*, No. CIV.A. 10298, 1989 WL 20290, 14 Del. J. Corp. L. 1169, at *1183 (Del. Ch. Mar. 2, 1989) ("[D]irectors may be said to owe a duty to shareholders as a class to manage the corporation *within the law*, with due care and in a way intended to maximize the long run interests of shareholders.") (emphasis added).

[34] *See In re Massey Energy Co. Derivative & Class Action Litig.*, 2011 Del. Ch. LEXIS 83, at *72–74 (Del. Ch. May 31, 2011) ("[A] fiduciary of a Delaware corporation cannot be loyal to a Delaware corporation by knowingly causing it to . . . violat[e] the law."); 8 *Del. C.* § 102(b)(7)(i) & (ii) (prohibiting the exculpation

independent directors proposed to be added from the Risk Committee to the GECC Board have their own reputations and careers—which are separate and apart from GE and its interests—and so they are not susceptible to any extraneous influences as they carry out their duties. They have no incentive not to act in good faith, in accordance with all of their fiduciary duties and with all applicable laws and regulations, regardless of the fact that they also serve on the GE Board. The imposition of mandatory Independent/Independent Directors—directors who clearly would have the exact same duties and obligations as the current GECC directors (unless the Federal Reserve purported to override existing Delaware corporate-governance law, thus confusing the issue)—would serve no purpose and yield no real benefit not already achieved by the directors of what is already a highly regulated and protected business, particularly if the members of the Risk Committee, who are not "beholden" to GE, as that term is used above, are added to the GECC Board. The Federal Reserve's Independent/Independent Director Requirement is not required by Delaware law; nor does it make practical sense in light of the fiduciary requirements imposed upon directors of Delaware corporations by the extensive statutory and common law regime governing directors' conduct.

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of a director's personal monetary liability for breach of the duty of loyalty or for acts or omissions not in good faith).

For the foregoing reasons, I respectfully disagree with the Federal Reserve's proposed Independent/Independent Director Requirement, as I find that it is out of step with, and invites serious misapprehensions of, the fundamental tenets of Delaware corporate law. I appreciate this opportunity to comment on the proposal.

Very truly yours,

William B. Chandler III

William B. Chandler III

APPENDIX A

The following are biographies of the independent directors serving on the Risk Committee and proposed to be added to the GECC Board:[35]

W. Geoffrey Beattie

Mr. Beattie received a law degree from the University of Western Ontario and served as a partner in the Toronto law firm Torys LLP before joining The Woodbridge Company Limited, where he served as president from 1998 through December 2012. The Woodbridge Company Limited is a privately held investment holding company for the Thomson family of Canada and the majority shareholder of Thomson Reuters, where Mr. Beattie served as deputy chairman from 2000 through May 2013 and director from 1998 through May 2013. He has served as chief executive officer of Generation Capital since September 2013, and he has served as chairman of Relay Ventures since June 2013. He also serves as a member of the board of directors of Royal Bank of Canada (where he serves as the chairman of the Risk Committee) and Maple Leaf Foods Inc. In addition to his public company board memberships, Mr. Beattie is a trustee of the University Health Network in Toronto.

John J. Brennan

Mr. Brennan is a graduate of Dartmouth College and earned an MBA from Harvard Business School. He joined Vanguard in 1982, was elected chief financial officer in 1985, president in 1989, and served as chief executive officer from 1996 to 2008 and chairman from 1998 through 2009. He has been chairman emeritus and senior advisor to Vanguard since 2010. Mr. Brennan is a director of Guardian Life Insurance Company of America and LPL Financial Holdings Inc., and lead governor of the FINRA Board of Governors. He is a trustee of The Vanguard Charitable Endowment Program and the University of Notre Dame and served as chairman of the Financial Accounting Foundation. Mr. Brennan also served as a director at The Hanover Insurance Group during the last five years.

James E. Rohr

A graduate of the University of Notre Dame, Mr. Rohr also holds an MBA from The Ohio State University. Mr. Rohr joined The PNC Financial Services Group, Inc. in 1972, and served in various marketing and management positions, including as president and vice chair and president and chief operating officer. He became chief executive officer in 2000 and chairman in 2001. He retired as chief executive officer in 2013, and as executive chairman in April 2014. Mr. Rohr is also a director at Allegheny Technologies, Inc., EQT Corporation and Marathon Petroleum Corporation, and is a trustee of Carnegie Mellon University and the University of

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[35] GE Board of Directors, *available at* http://www.ge.com/about-us/leadership/board-of-directors (last visited Jan. 23, 2015).

Notre Dame. He is a former President of the Federal Advisory Council of the Board of Governors of the Federal Reserve System and a former director at BlackRock, Inc.

Mary R. Shapiro

Ms. Schapiro is a graduate of Franklin & Marshall College and earned a law degree from George Washington University Law School. She served as the 29th chairman of the SEC from January 2009 through December 2012. From April 2013 to January 2014, she was a managing director and chairman of the Governance and Markets Practice at Promontory Financial Group, and since January 2014 she has served as Vice Chair of the Promontory Advisory Board and as a board member of Promontory Interfinancial Network. Prior to becoming chairman of the SEC, Ms. Schapiro served as chief executive officer of FINRA from 2006 through 2008. She joined that organization in 1996, serving as president of NASD Regulation from 1996 to 2002 and as vice chairman from 2002 to 2006, when she was named chairman. Ms. Schapiro previously served as a commissioner of the SEC from December 1988 to October 1994, and left the SEC when appointed chairman of the CFTC, where she served until 1996.

Annex C: Letter from Professor Jonathan R. Macey

Yale Law School

JONATHAN R. MACEY
Sam Harris Professor of Corporate Law, Corporate Finance, and Securities Law

February 2, 2015

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, Northwest
Washington, DC 20551

Re: R–1503- Request for public comment on the application of enhanced prudential standards and reporting requirements to General Electric Capital Corporation

Dear Sir or Madam:

I respectfully submit this letter at the request of General Electric Capital Corporation (GECC) in response to the request for comments made by the Board of Governors of the Federal Reserve (Board) in the above-referenced release. The release proposes the application of enhanced prudential standards and reporting requirements to GECC, a wholly owned subsidiary of General Electric Company (GE).

Section 165 of the Dodd-Frank Act directs the Board to establish enhanced prudential standards for bank holding companies with total consolidated assets of $50 billion or more and for nonbank financial companies that the Financial Stability Oversight Council (Council) has determined warrant supervision by the Board "in order to prevent or mitigate risks to U.S. financial stability." On July 8, 2013, the Council determined that GECC, a nonbank financial company, should be supervised by the Board and be subject to enhanced prudential standards. On December 3, 2014, the Board invited public Comment on its Proposed Application of Enhanced Prudential Standards (Proposal) to GECC.

In its Proposal, the Board proposes several changes to the corporate governance of GECC.[1] The particular changes on which this letter focuses are the proposed risk-management and risk-committee requirements.

In connection with its supervisory authority over bank holding companies, the Board has promulgated Regulation YY, which imposes certain requirements on bank holding companies aimed at managing risk. Section 252.33 of Regulation YY requires all bank holding companies with $50 billion or more in total consolidated assets to establish a risk committee that is independent of the company's management; is chaired

[1] Federal Register, Vol. 79, No. 232 at 71768 (December 3, 2014).

by an independent director; and includes at least one member who has experience in identifying, assessing and managing risk exposures of large, complex financial firms.

While in its Proposal the Board seeks to require GECC to adopt a risk-management framework that is "consistent with the supervisory expectations established for bank holding companies of a similar size,"[2] the Proposal imposes additional requirements beyond those that pertain to bank holding companies. In particular, the Board would require that the GECC board of directors have the greater of 25% or two directors that are independent of both GE's and GECC's management and GE's board in order "to ensure that GECC's board of directors includes members who are independent of GE so that their attention is focused on the business operations and safety and soundness of GECC itself, *apart from the needs of its parent GE.*"[3] One of these independent/independent directors (i.e. independent from both GECC's parent company, GE, as well as independent from GECC) must chair the risk committee of GECC.[4]

In this Comment Letter, I focus on the corporate governance and public policy implications of these proposed Risk-Management and Risk-Committee Requirements.

I. Summary of Qualifications

I am the Sam Harris Professor of Corporate Law, Corporate Finance and Securities Law at Yale University, and Professor in the Yale School of Management. I am a member of the Board of Directors of the Yale Law School Center for the Study of Corporate Governance and a member of the Faculty Advisory Group of Yale's Millstein Center for Corporate Governance and Performance. I am Chairman of the Yale University Advisory Committee on Investor Responsibility. I have served previously as the J. DuPratt White Professor of Law at Cornell University Law School, and I have held academic positions at numerous universities including the University of Chicago, Harvard University and the University of Virginia. I have provided Continuing Education to the judiciary of the State of Delaware and to the Fourth Circuit Judicial Conference on topics related to corporate finance, law and economics, and corporate law.

My teaching and research has focused on the law of financial institutions, corporate responsibility, contractual obligations, and corporate governance.

I have published approximately one hundred and fifty articles in leading legal and economics journals and nine books including: "Corporate Governance: Promises Kept, Promises Broken" (Princeton University Press 2008); "Macey on Corporation Law," (Aspen Law & Business 2008); "Corporations: Including Partnerships and Limited Liability Companies" (Thomson West 2006); and "Banking Law and Regulation" (Aspen Law & Business 2003). Significant portions of my research, teaching, and consulting have focused on corporate governance in a variety of contexts.

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[2] Federal Register, Vol. 79, No. 232 at 71778.
[3] *Id.*
[4] *Id.*

I currently serve as a member of the Economic Advisory Council of the Financial Industry Regulatory Authority ("FINRA," formerly the National Association of Securities Dealers ("NASD")).

I served a full term, concluding in 2011, on FINRA's National Adjudicatory Council ("NAC"). The NAC is the national committee that adjudicates disciplinary, membership, and other proceedings, as well as applications for relief from statutory disqualifications rendered in FINRA disciplinary and membership proceedings.

I previously served as a member of the Economic Advisory Committee of the NASD (currently the Financial Institutions Regulatory Council), which advised the NASD on matters of capital market structure. I also served as a member of the Legal Advisory Committee to the Board of Directors of the New York Stock Exchange ("NYSE"), which advised the NYSE's board on corporate governance issues within the Exchange itself and for its listed companies.

I am on the Board of Editors of numerous leading legal and economics journals including the Journal of Banking and Finance and the Journal of Banking Law. I have testified before Congress and/or served as a governmental expert on the savings and loan crisis, the credit rating agencies' role in the collapse of Enron, and the corporate governance and organizational structure of commercial banks.

I also served as a Law Clerk to the Honorable Henry J. Friendly, United States Court of Appeals, Second Circuit.

My corporate positions include serving as an independent director of Telxon Corporation (NASD) prior to its acquisition by Symbol Technologies, and on the board of directors (audit committee, and corporate governance and nominating committee) of WCI Communities, Inc. (NYSE). I also served on the board of directors of Shred-It Connecticut (private company) from 2006-2010, on the board of Advisors of Kardea, LLC.

I have been named as a nominee for the board of directors of public companies in several proxy contests initiated by activist investors interested in increasing the accountability of the incumbent boards of directors of these companies. In each of these proxy contests I was interviewed and vetted by advisors to the proxy contest sponsor in order to confirm the fact that I am qualified to serve on the board of directors of a public company. Generally, the professional search firm or law firm in charge of the search for such slates of directors looks for what have been described as "Grade A directors."[5]

The proxy contests in which I have participated include:

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[5] Reed Abelson, "A New Proxy Strategy: Upgrading the Dissident Slate," The New York Times, December 10, 1996, http://www.nytimes.com/1996/12/10/business/a-new-proxy-strategy-upgrading-the-dissident-slate.html (describing the process by which director-nominees were selected to run for the board of Rexene Corporation).

- The Sandell Asset Management, Corp. proxy contest for Sybase Inc. (2007);[6]
- The Astellas Pharma Inc. proxy contest for OSI Pharmaceuticals Inc. (2010);[7] and
- The Roche Holding Ltd (through its indirect wholly owned subsidiary, CKH Acquisition Corporation) proxy contest for Illumina, Inc. (alternate nominee) (2012).[8]
- The Elliott International L.P. proxy contest for Hess, Inc. (2014)[9]
- The Elliott International L.P. proxy contest for Family Dollar Stores, Inc. (2015)[10]

I have served on a number of boards of directors of a number of not-for-profit corporations, and I currently serve on the boards of directors of the St. Thomas's School and the Yale Youth Hockey Association.

II. Summary of My Comments and Opinions

The Proposal would fundamentally alter corporate law and force GECC directors to manage and govern GECC differently than the directors of other companies manage those companies. Prior to this proposal, it was universally the case that corporate directors managed corporations for the benefit of the company's residual claimants, the shareholders, subject to the limiting constraint that all such profit maximizing activities must be fully compliant with all applicable rules and regulations governing the company's activities. The Proposal would alter the deeply embedded fealty obligation to maximize shareholder value because it requires directors to abandon the profit maximization paradigm. In doing so, the Proposal radically alters the scope of the fiduciary duties of certain GECC directors by requiring that the Federal Reserve's poorly-defined general interests, above and beyond the basic obligation to comply with specific regulations and requirements, be taken into account by these GECC directors. And in doing so, the Proposal directly encroaches upon state law.

The Proposal also would alter fundamentally the allocation of rule-making power between the states and the federal government. Among the most important features of constitutional federalism is the delineation of rulemaking authority between the states and the federal government regarding issues of corporate governance in general and the internal affairs of corporations in particular. Certain issues, including those related to the regulation of "independent directors, independent audit committees, shareholder

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[6] http://www.sec.gov/Archives/edgar/data/768262/000090266407003650/0000902664-07-003650.txt
[7] http://sec.gov/Archives/edgar/data/729922/000119312510058402/dex99a5f.htm
[8] http://google.brand.edgar-online.com/EFX_dll/EDGARpro.dll?FetchFilingHTML1?ID=8460185&SessionID=V6CDFWLVFyw-EU7
[9] http://www.sec.gov/Archives/edgar/data/4447/000104746913003863/a2214221zdefc14a.htm
[10] http://www.sec.gov/Archives/edgar/data/34408/000101359414000708/family13d-121114.htm

quorums, [and] shareholder approval for certain major corporate transactions" are "major issues traditionally governed by state law."[11]

The Proposal's provisions setting qualifications standards and independence standards for directors are inconsistent with state law, which regulates director qualifications, and, as such, represent an improper intrusion onto state law. In particular, the Proposal's prohibition on GECC's independent/independent directors' serving simultaneously on both parent and subsidiary boards is inconsistent with both state law (pursuant to which simultaneous service on parent and subsidiary boards is very common) and with best corporate governance practices. Indeed, the notion of expanding duties beyond shareholders has been debated and rejected in Delaware.

U.S. corporate law reflects the fundamental principle that each member of a board of directors owes undivided fiduciary duties of care and of loyalty to the shareholders of the companies on whose boards they serve. Maximizing value for shareholders simultaneously maximizes the value of the company. But by requiring that GECC's independent/independent directors focus their attention "apart from the needs of its parent GE," the Proposal explicitly seeks to shift directors' focus from GECC's shareholder.[12]

The reason that fiduciary duties require undivided loyalty is based on the facts that (i) agents cannot serve two masters and (ii) duties to multiple principals result in duties to no one. Thus, in order for fiduciary duties to serve their core purpose of providing protection for shareholders' equity interests against agency problems, fiduciary duties must be exclusive—they cannot be shared.[13]

The Proposal's provisions regarding qualifications for directors are inconsistent with the fundamental exclusivity principle of state corporate law. In particular, the risk-management and risk-committee requirements dictate that 25% (or two) of GECC's directors be independent of GE's and GECC's management, and not be members of GE's board, "so that their attention is focused on the business operations and safety and soundness of GECC itself apart from the needs of its parent GE"[14] In addition, one of these independent directors must chair GECC's risk committee established under Regulation YY.

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[11] *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990) (holding that it is impermissible for the SEC to promulgate a rule that "directly controls the substantive allocation of powers among classes of shareholders," which is normally in the purview of state corporate law).
[12] Federal Register, Vol. 79, No. 232 at 71778.
[13] The American Bar Association Committee on Corporate Laws, "Other Constituency Statutes: Potential for Confusion," 45 BUSINESS LAWYER 2253-2271 (1990) ("courts have consistently avowed the legal primacy of shareholder interests when management and directors make decision" (p. 2255). *See also* the American Law Institute Project on Principles of Corporate Governance (directors duties are to enhance corporate profit and shareholder gain, except that, whether or not corporate profit and shareholder gain are thereby enhanced, the corporation, in the conduct of its business: (a) is obliged, to the same extent as a natural person, to act within the boundaries set by law; (b) may take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business; and (c) may devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.
[14] Federal Register, Vol. 79, No. 232 at 71778.

Such provisions conflict directly with well-settled state law norms and rules in Delaware. In particular, the Proposal's prohibition against GECC's independent/independent directors' serving parent and sub simultaneously is inefficient, intrusive, and inconsistent with both state law and ordinary and customary corporate practice. This new independent/independent requirement departs from established corporate governance standards and industry norms, and imposes a more onerous burden on GECC than is imposed on either bank holding companies or on other nonbank financial companies.

Further, undivided fiduciary duties are a crucial part of the contract that shareholders receive when they invest in a company. Therefore, to diverge from this long established principle would upset well-settled investment-backed expectations.

In light of the Proposal, I have examined the backgrounds of the directors of GECC that are being considered to serve on GECC's risk committee, and I have determined that each is fully qualified for these roles. In particular, applying my own scholarly work on qualifications of bank directors[15] along with existing regulations, I have determined that all of the prospective members of the GECC Risk Committee have the requisite independence and experience in identifying, assessing, and managing the risk exposures of large, complex financial firms.

III. Comments and Opinions

The Proposal is fundamentally inconsistent with directors' fiduciary (a) duty of care and (b) duty against having divided loyalties as defined by state law because, *inter alia*, the Board is re-defining the scope of directors' fiduciary duties. It is well-settled that both U.S. law and public policy reflect a clear shareholder-centric paradigm of corporate governance. Specifically, in the U.S., corporations and their directors "owe fiduciary duties to shareholders and to shareholders alone."[16] They do not owe duties to creditors or to regulators.

This bedrock principle has defined the Anglo-American model of corporate governance: the exclusive focus of corporate governance should be to maximize shareholder value. This distinguishes our system from the Franco-German approach, which considers corporations to be "industrial partnerships" in which the interests of long-term stakeholders—particularly banks and employee groups—should be accorded at least the same amount of respect as those of shareholders.[17]

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[15] Jonathan Macey and Maureen O'Hara, "Bank Corporate Governance: A Proposal for the Post-Crisis World," FRBNY Economic Policy Review (forthcoming, 2015); Jonathan R. Macey and Maureen O'Hara, The Corporate Governance of Banks, FRBNY Economic Policy Review 91 (April 2003).

[16] Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties,* 21 STETSON L. REV. 23, 23 (1991).

[17] Jonathan R. Macey and Maureen O'Hara, *The Corporate Governance of Banks*, 2003. (citing Ziegler, J. N. 2000. "Corporate Governance and the Politics of Property Rights in Germany," 2 Politics and Society 28 (June): 195.).

A shareholder who buys stock in a corporation has certain legitimate and universally recognized investment-backed expectations. Foremost among these investment-backed expectations is that the shareholders are the sole beneficiaries of directors' and officers' fiduciary duties. Parent companies such as GE, which own subsidiaries, have the same expectations of the subsidiary's directors as other shareholders have of the directors of companies in which they own shares. The proposed restriction on who is eligible to serve on subsidiary boards of directors and on the risk committees of such subsidiaries reduces shareholder value and thwarts the well-understood investment-backed expectations of investors. Thus, by requiring GECC directors to take on additional duties beyond those owed to its shareholder, the Proposal would redefine the scope of directors' responsibilities and fundamentally change the corporate contract that exists between shareholders and the corporations in which they own shares. These expectations have been part of the corporate contract for decades, and are no less valid and reasonable now than they were in 1919, when *Dodge v. Ford Motor Co.* famously held that "[a] business corporation is organized and carried on primarily for the profit of the stockholders."[18]

GE shareholders are significantly affected by the performance of GECC. Investors in GE stock are investing in a company that owns GECC on the assumption that the directors of GECC owe strict and undivided fiduciary duties to GE. These characteristics—undivided loyalty enforced by strict fiduciary duties—are important determinants of shareholders' value. By removing the requirement of undivided loyalty to GE, the Proposal seeks to create a corporate governance structure with a parent board of directors that owes duties to its shareholders on top of a subsidiary board that has divided loyalties.

The Fed's proposed expansion of directors' duties beyond shareholders has been considered, debated and then categorically rejected in state law generally and specifically in Delaware, which is where GECC is incorporated. Under Delaware law, directors are charged with the responsibility of managing and supervising the business and affairs of the corporation. "In discharging this function, the directors owe fiduciary duties to . . . its shareholders."[19] Shareholders are the exclusive beneficiary of undivided duties, subject to the stricture that companies comply with all applicable regulations, including prudential safety regulation, minimum capital requirements, etc. In the U.S., corporations are organized and carried on "for the profit of the stockholders" and "[t]he powers of the directors are to be employed for that end."[20] Consequently, the Proposal represents an improper intrusion on state law.

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[18] Dodge v. Ford Motor Co., 204 Mich. 459, 502 (Mich. 1919).

[19] *See* Varallo and Herring (1999), citing Mills Acquisition Co. v Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1989). By serving shareholders, directors simultaneously maximize corporate value.

[20] Dodge v. Ford Motor Co., 170 N.W. 459, 507 (Mich. 1919). Along these lines, federal securities laws have likewise stayed away from excessive interference with corporate governance, which had long been left to state laws. In *Santa Fe Industries, Inc. v. Green*, the Supreme Court drew the line between state corporation laws and the federal securities law by rejecting the notion that the securities laws "federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden." 430 U.S. 464, 479 (1977).

Over the years, a clear demarcation between the proper scope of federal law and the proper scope of state law has emerged.[21] Corporate governance, which includes the duty of loyalty and the fiduciary duty of care, is the province of state law. For example, when courts have interpreted regulations promulgated pursuant to the Securities and Exchange Act of 1934, they have been clear that regulatory agencies may not "interfere with the management of the affairs of an issuer."[22] This is because state law is responsible for promulgating "requirements for independent directors, independent audit committees, shareholder quorums, shareholder approval for certain major corporate transactions, and other major issues."[23] The Proposal, if implemented, would cause an unprecedented change in the oversight of GECC, by imposing new director qualification requirements, changes in the nature and scope of fiduciary duties and limitations on parent-subsidiary overlaps.

Regulatory agencies such as the Federal Reserve lack the authority to establish a federal corporate law.[24] They lack the authority "to overturn" or to "impinge severely on the tradition of state regulation of corporate law."[25] This is because "[c]orporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation."[26]

Therefore, state corporate law—not federal law—is the proper source of regulation of the distribution of powers among the various players in the process of corporate governance. This would include the distribution of powers between corporations and their subsidiaries.[27]

From a policy perspective, the exclusive and shareholder-centric nature of fiduciary duties is a direct implication of the basic concept that servants cannot faithfully serve two masters. As Chief Justice Stone declared in 1934, the fiduciary principle of undivided loyalty is "the precept as old as Holy Writ, that 'a man cannot serve two masters.' More than a century ago equity gave a hospitable reception to that principle and the common law was not slow to follow in giving it recognition. No thinking man can believe that an economy built upon a business foundation can long endure without loyalty to that principle."[28]

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[21] *See* Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990).
[22] H.R. Conf Rep. No. 1838, 73d Cong., 2d Sess. 35 (1934) (deleting as unnecessary section 13(d) of the bill that would become the Securities and Exchange Act, which made explicit that the Commission could not "interfere with the management of the affairs of an issuer").
[23] Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990).
[24] *Id.*
[25] *Id.*
[26] *Id.* (citing Santa Fe Industries v. Green, 430 U.S. at 479, 97 S.Ct. at 1304 (emphasis in original, quoting Cort v. Ash, 422 U.S. 66, 84, 95 S.Ct. 2080, 2090-91, 45 L.Ed.2d 26 (1975))).
[27] Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990).
[28] Bayer v. Beran, 49 N.Y.S.2d 2, 5 (N.Y. App. Div. 1944) (quoting Harlan F. Stone, The Public Influence of the Bar, 48 HARV. L. REV. 1, 8-9 (1934)), as cited in Stephen M. Bainbridge, In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green, 50 Washington and Lee Law Review 1423, 1447 (1993).

Duties and obligations to creditors or regulators on top of traditional fiduciary duties to shareholders diminish the value of those fiduciary duties. In the corporate context, serving multiple masters reduces the disciplinary effects of fiduciary duties. As the Committee on Corporate Laws of the American Bar Association's Section on Business Law has explained in an important white paper, if directors must serve constituencies other than shareholders,

> [t]he confusion of... trying to ... require directors to balance the interests of various constituencies without according primacy to shareholder interests[] would be profoundly troubling. Even under existing law, particularly where directors must act quickly, it is often difficult for directors acting in good faith to divine what is in the best interests of shareholders and the corporation. If directors are required to consider other interests as well, the decision making process will become a balancing act or search for compromise. When directors must not only decide what their duty of loyalty mandates, but also to whom their duty of loyalty runs (and in what proportions), poorer decisions can be expected.[29]

Academic scholars likewise support this paradigm, arguing that since shareholders are residual claimants, they have the greatest incentive to maximize corporate value:

> As the residual claimants, the shareholders are the group with the appropriate incentives ... to make discretionary decisions. The firm should invest in new products, plants, etc., until the gains and costs are identical at the margin. Yet all of the actors, except the shareholders, lack the appropriate incentives. Those with fixed claims on the income stream may receive only a tiny benefit (in increased security) from the undertaking of a new project. The shareholders receive most of the marginal gains and incur most of the marginal costs. They therefore have the right incentives to exercise discretion.[30]

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[29] ABA Comm. on Corporate Laws, *Other Constituencies Statutes: Potential for Confusion,* 45 BUS. L J. 2253, 2269 (1990).
[30] Easterbrook and Fischel, "Voting in Corporate Law," 26 J. OF LAW & ECON. 395, 402-4 (1983).

In this way, undivided fiduciary duties are a crucial part of the contract that shareholders receive when they invest in a company. To remove this would upset well-settled investment-backed expectations. Put another way, the fiduciary duties owed by directors to shareholders are valuable assets to the corporation that benefit all stakeholders, including non-shareholder constituencies by lowering agency costs and increasing enterprise value.[31]

Under existing corporate law norms as well as state law, companies such as GE are free to populate their subsidiary boards from among the ranks of the directors and officers of the parent. Such overlap is exceedingly common, both in general and in financial companies in particular. Such overlap increases operational efficiency, increases the quantity and quality of information flow, and streamlines decision-making.

Currently, Dodd-Frank requires that at least one of the members of the risk committees of BHCs and nonbank SIFIs have risk management experience commensurate with the firm's capital structure, risk profile, complexity, size and activities.[32] The Sarbanes-Oxley Act explicitly sets standards for members of audit committees by requiring that all members of such committees be independent and that at least one member to be a "financial expert" as defined by SEC rules.[33] One of the motivations behind Sarbanes-Oxley was to strengthen audit committees to "avoid future auditing breakdowns," which were contributing to a loss of confidence in the integrity of U.S. companies and markets.[34]

In previous scholarship, I have discussed the benefits of demanding that members of boards of directors of financial institutions in general, and members of the risk committees of the boards of such financial institutions in particular, meet even more stringent professional standards than currently required by regulation.

I have analyzed the qualifications and experience of the individuals who, I am told, are being considered to serve on GECC's risk committee under any actual or proposed standard for directors' qualifications. Each has acquired, through

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[31] Jonathan R. Macey and Geoffrey P. Miller, *Corporate Stakeholders: A Contractual Perspective*, Yale Law School Faculty Scholarship Series (1993), available at http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=2610&context=fss_papers.

[32] Macey and O'Hara, at 45.

[33] An "audit committee financial expert" is defined as a person who has the following attributes: (i) an understanding of generally accepted accounting principles and financial statements; (ii) the ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves; (iii) experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities; (iv) an understanding of internal controls and procedures for financial reporting; and (v) an understanding of audit committee functions." See Lawrence J. Trautman, "Who Qualifies as an Audit Committee Financial Expert Under SEC Regulations and NYSE Rules?", DEPAUL BUS. & COM. L. J., 11, Winter 2013.

[34] See Senate Report No.107-205 (cited in Stephanie Tsacoumis, Stephanie Bess, and Bryn Sappington, "The Sarbanes-Oxley Act: Rewriting Audit Committee Governance," 3 BUS. L. INTERNATIONAL 212 (2003)).

experience and education, the skills needed to monitor the risk management functions of GECC.

With regard to the skill-level appropriate for members of the GECC Risk Committee, such directors should be sufficiently familiar with the company's business to enable them to make informed judgments about whether the information reporting systems in place at a company are appropriate for that particular company. Risk Committee members also should be sufficiently knowledgeable about corporate finance to enable them to understand and to challenge the advice and recommendations they receive from management and from outside experts and advisers.

Beyond this, the financial skills required for members of different boards will differ from company to company depending on the precise nature of the business activities for which risk monitoring is required. In some financial firms, directors may be required to have an understanding of leverage, portfolio theory and the role of Value at Risk (VaR) models. In an extremely complex firm such as a large, full-service investment bank, members of the risk committee should be required to understand the valuation of complex derivatives, synthetic asset replication, and hedging strategies.

The prospective candidates for the GECC Risk Committee whose qualifications I have evaluated are:

- W. Geoffrey Beattie: Mr. Beattie received a law degree from the University of Western Ontario and served as a partner in the Toronto law firm Torys LLP before joining The Woodbridge Company Limited, where he served as president from 1998 through December 2012. The Woodbridge Company Limited is a privately held investment holding company for the Thomson family of Canada and the majority shareholder of Thomson Reuters, where Mr. Beattie served as deputy chairman from 2000 through May 2013 and director from 1998 through May 2013. He has served as chief executive officer of Generation Capital since September 2013, and he has served as chairman of Relay Ventures since June 2013. He also serves as a member of the board of directors of Royal Bank of Canada (where he serves as the chairman of the Risk Committee) and Maple Leaf Foods Inc. In addition to his public company board memberships, Mr. Beattie is a trustee of the University Health Network in Toronto.[35]

Mr. Beattie's legal training, leadership of multiple financial services companies, and extensive board experience make him a well-qualified candidate.

[35] GE Board of Directors, website: http://www.ge.com/about-us/leadership/profiles/w-geoffrey-beattie.

- John J. Brennan: Mr. Brennan is a graduate of Dartmouth College and earned an MBA from Harvard Business School. He joined Vanguard in 1982, was elected chief financial officer in 1985, president in 1989, and served as chief executive officer from 1996 to 2008 and chairman from 1998 through 2009. He has been chairman emeritus and senior advisor to Vanguard since 2010. Mr. Brennan is a director of Guardian Life Insurance Company of America and LPL Financial Holdings Inc., and lead governor of the FINRA Board of Governors. He is a trustee of The Vanguard Charitable Endowment Program and the University of Notre Dame and served as chairman of the Financial Accounting Foundation. Mr. Brennan also served as a director at The Hanover Insurance Group during the last five years.[36]

Mr. Brennan's business education, leadership of a premier financial services company, and extensive board experience make him a well-qualified candidate.

- Mary L. Schapiro: Ms. Schapiro is a graduate of Franklin & Marshall College and earned a law degree from George Washington University Law School. She served as the 29th chairman of the SEC from January 2009 through December 2012. From April 2013 to January 2014, she was a managing director and chairman of the Governance and Markets Practice at Promontory Financial Group, and since January 2014 she has served as Vice Chair of the Promontory Advisory Board and as a board member of Promontory Interfinancial Network. Prior to becoming chairman of the SEC, Ms. Schapiro served as chief executive officer of FINRA from 2007 through 2008. She joined that organization in 1996, serving as president of NASD Regulation from 1996 to 2002 and as vice chairman from 2002 to 2006, when she was named chairman. Ms. Schapiro previously served as a commissioner of the SEC from December 1988 to October 1994, and left the SEC when appointed chairman of the CFTC, where she served until 1996.[37]

Ms. Schapiro's legal education, leadership at multiple regulatory agencies as well as in private industry, and board experience make her a well-qualified candidate.

[36] *Id.* at http://www.ge.com/about-us/leadership/profiles/john-j-brennan.
[37] *Id.* at http://www.ge.com/about-us/leadership/profiles/mary-l-schapiro.

- James E. Rohr. Mr. Rohr is a graduate of Notre Dame and earned an MBA from The Ohio State University. Mr. Rohr joined The PNC Financial Services Group, Inc. in 1972, and served in various marketing and management positions, including as president and vice chair and president and chief operating officer. He became chief executive officer in 2000 and chairman in 2001. He retired as chief executive officer in 2013, and as executive chairman in April 2014. Mr. Rohr is also a director at Allegheny Technologies, Inc., EQT Corporation and Marathon Petroleum Corporation, and is a trustee of Carnegie Mellon University and the University of Notre Dame. He is a former President of the Federal Advisory Council of the Board of Governors of the Federal Reserve System and a former director at BlackRock, Inc.[38]

Mr. Rohr's business education, leadership at a premier financial services corporation, and extensive board experience make him a well-qualified candidate.

Each of the candidates being considered has an excellent background that makes him or her well qualified for GECC's risk committee. To attempt to disqualify these individuals as independent based on their connections to GE—connections that are quite valuable toward maximizing shareholder value—would fly in the face of industry norms and harm the shareholders. In this way, the Proposal's "independent-independent" requirement is inefficient and inconsistent with both state law and ordinary and customary corporate practice.

IV. Conclusion

Shareholders are entitled under Delaware law, and basic principles of corporate governance, to the undivided loyalty and attention of their directors. This is just as true for shareholders such as parent corporations, who own 100% of a subsidiary, as it is for individual shareholders in public companies.

From the perspective of shareholders, it is a matter of indifference whether directors' attention is diverted for reasons of sloth, or greed, or because their loyalty and attention are divided. Accordingly, the Office of the Comptroller of the Currency, which regulates national banks, long has made clear that directors of bank subsidiaries of bank holding companies should display a "willingness to put the interests of the bank ahead of personal interests," as well as a "willingness to avoid conflicts of interest."[39]

In Delaware courts, the "rigorous application of the shareholder wealth maximization norm" is the standard of judicial review, particularly in contexts in which there is the possibility of a conflict between directors' interests and those of the

[38] *Id.* at http://www.ge.com/about-us/leadership/profiles/james-e-rohr.
[39] See OCC, The Directors Book 4 (2010).

shareholders. Specifically, as the Delaware Supreme Court held in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[40] directors may not protect non-shareholder interests such as employees or governments at the expense of shareholder interests.[41] Management decisions must benefit shareholders. Focusing on other goals violates the board's fiduciary duties.[42]

Respectfully Submitted,

Jonathan R Macey
February 2, 2015

[40] 506 A.2d 173 (Del. 1986).
[41] *Id.* at 182.
[42] *Id.* at 185.