Financial Stability Oversight Council
c/o Eric Froman, Assistant General Counsel for Banking and Finance
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Re: Proposed Designation of Nonbank Financial Company for Supervision by the Board of Governors of the Federal Reserve System

Mr. Froman:

We write to express strong support for the recent rule proposed by the Financial Stability Oversight Council (FSOC) concerning the designation of nonbank financial companies for Federal Reserve supervision. We commend the proposal to return to a framework that focuses on systemic vulnerability rather than specific activities, as it recognizes the evolving nature of the financial industry and the importance of adaptability in ensuring financial stability. Restoring this focus will fulfill the purpose of the authorizing legislation: the Dodd–Frank Wall Street Reform and Consumer Protection Act. Dodd-Frank was written in response to the global financial crisis of 2008, a crisis driven in part by the extraordinary and undersupervised risk taking of nonbank financial firms. The designation of systemically important nonbank financial firms for supervision by the Federal Reserve is at the core of the law's purpose to prevent another similar financial crisis. The current designation process under the 2019 rule is too restrictive and out of step with the original design of the law and the best understanding of risk in financial markets.

Today, nonbank financial firms are even more intertwined with global financial markets than when the law was written, so it is more important than ever to ensure that these firms are subject to appropriate oversight and regulation. The proposed rule makes it much harder for these firms to engage in regulatory arbitrage by engaging in convoluted activities to avoid the narrow band of triggers for Federal Reserve supervision under the 2019 guidance. Instead, the proposed framework and guidance would–after giving these firms every opportunity to justify their exclusion from this regulatory standard–ensure the Federal Reserve timely access to information and the ability to conduct supervision of these firms and the markets in which they operate.

The 2019 rule, which emphasized specific activities for designation, ostensibly written in response to the 2016 U.S. District Court for the District of Columbia's decision[1] to invalidate MetLife's designation. By targeting activities known to be risky, the 2019 standards attempted to impose a cost-benefit standard for designation, however, it is crucial to acknowledge that financial innovation often alters the very nature and labeling of activities,

[1] MetLife, Inc v. Financial Stability Oversight Council, 177 F. Supp. 3d 219 (D.D.C. 2016)

rendering a rigid activity-based approach insufficient to capture systemic risks effectively. The proposed rule's focus on systemic vulnerability aligns with the dynamic and interconnected nature of the financial system, allowing for a more comprehensive assessment of risks and potential threats to financial stability. We commend the decision to clarify this area of legal confusion.

Industry opponents of this rule have argued that "it could treat an entity with a 1% chance of impacting financial stability the same as an entity with a 99% chance.[2]" This claim appears to miss the entire point of this proposal: that enhanced federal supervision exists to the occurrence of rare and extreme events that have a low probability of happening but can have catastrophic consequences. This is called long tail risk. Financial crises, while rare, have created costs well beyond one or two standard deviations off of the normal profit distributions of the firms at their heart. To mitigate the dangers of long tail risks, it is essential to adopt a proactive and comprehensive risk management approach. This includes identifying and assessing potential long tail risks, developing robust contingency plans, maintaining adequate reserves, fostering a culture of risk awareness, and promoting resilience in systems and processes. In addition, in any consideration of costs to industry, the well-documented evidence of sizable funding cost subsidies[3] to designated firms should be kept in mind. Ultimately, we believe that the costs to these firms are well-worth the benefits to the integrity of the financial system.

By shifting the focus to systemic vulnerability, FSOC's proposed rule recognizes that risks can emerge from various sources within nonbank entities, including their interconnectedness, size, leverage, and complexity. This approach allows for a more holistic understanding of systemic risks, ensuring that potential threats are identified and addressed in a timely manner, regardless of specific activities.

Moreover, the proposed rule's consideration of systemic factors like market importance and interconnectedness demonstrates FSOC's commitment to promoting financial innovation while safeguarding the stability of the financial system. Recognizing that innovation can drive positive change, it strikes a delicate balance between fostering innovation and managing potential risks. This approach encourages responsible innovation by nonbank entities, while also ensuring that appropriate oversight measures are in place to prevent the emergence of systemic vulnerabilities that could harm the broader financial ecosystem.

In conclusion, we wholeheartedly support FSOC's rule for the designation of nonbank entities for Federal Reserve supervision, which focuses on systemic vulnerability rather than specific activities. This shift in approach is a commendable step forward in adapting

[2] Letter from Alternative Credit Council et al. May 22, 2023

[3] see KW Ueda and BW Di Mauro, *Quantifying structural subsidy values for systemically important financial institutions*, Journal of Banking & Finance, 2013

regulatory frameworks to the evolving nature of the financial industry. By embracing the fact that while financial innovation has the potential to ease intermediation and more efficiently allocate capital, it is not the same absolute economic good as innovation in the real economy, FSOC's proposed rule will help maintain a resilient and stable financial system.

Sincerely,
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