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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FINANCIAL STABILITY OVERSIGHT COUNCIL

12 CFR Part 1310

RIN 4030-ZA00

Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies

AGENCY: Financial Stability Oversight Council.

ACTION: Notification of proposed interpretive guidance; request for public comment.

SUMMARY: This proposed interpretive guidance, which would replace the Financial Stability Oversight Council's existing interpretive guidance on nonbank financial company determinations, describes the approach the Council intends to take in prioritizing its work to identify and address potential risks to U.S. financial stability using an activities-based approach, and enhancing the analytical rigor and transparency in the processes the Council intends to follow if it were to consider making a determination to subject a nonbank financial company to supervision by the Federal Reserve.

DATES: *Comment due date:* May 13, 2019.

ADDRESSES: You may submit comments by either of the following methods. All submissions must refer to the document title and RIN 4030-AA00.

Electronic Submission of Comments: You may submit comments electronically through the Federal eRulemaking Portal at <http://www.regulations.gov>. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt, and enables the Council to make them available to the public. Comments submitted electronically through the <http://www.regulations.gov> website can be viewed by other commenters and interested members of the public. Commenters should follow the

instructions provided on that site to submit comments electronically.

Mail: Send comments to Financial Stability Oversight Council, Attn: Mark Schlegel, 1500 Pennsylvania Avenue NW, Room 2208B, Washington, DC 20220.

All properly submitted comments will be available for inspection and downloading at <http://www.regulations.gov>.

In general, comments received, including attachments and other supporting materials, are part of the public record and are available to the public. Do not submit any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

FOR FURTHER INFORMATION CONTACT: Bimal Patel, Office of Domestic Finance, Treasury, at (202) 622-2850; Eric Froman, Office of the General Counsel, Treasury, at (202) 622-1942; or Mark Schlegel, Office of the General Counsel, Treasury, at (202) 622-1027.

SUPPLEMENTARY INFORMATION:

I. Background

The statutory purposes of the Financial Stability Oversight Council (the "Council") are to identify risks to U.S. financial stability, promote market discipline, and respond to emerging threats to the stability of the U.S. financial system. The Council's authorities to accomplish these statutory purposes include authorities to facilitate information sharing and coordination among regulators, monitor the financial services marketplace, make recommendations to regulators, and require supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve") for nonbank financial companies that may pose risks to U.S. financial stability.

Section 111 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5321) (the "Dodd-Frank Act") established the Council. The purposes of the Council under section 112 of the Dodd-Frank Act (12 U.S.C. 5322) are (A) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace; (B) to promote market discipline, by

eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure; and (C) to respond to emerging threats to the stability of the United States financial system.

As a threshold matter, the Council emphasizes the importance of market discipline, rather than government intervention, as a mechanism for addressing potential risks to U.S. financial stability posed by financial companies. The Dodd-Frank Act gives the Council broad discretion to determine how to respond to potential threats to U.S. financial stability. The Council's duties under section 112 of the Dodd-Frank Act include monitoring the financial services marketplace in order to identify potential threats to U.S. financial stability, and recommending to the Council member agencies general supervisory priorities and principles reflecting the outcome of discussions among the member agencies. The Council's duties under section 112 also include making recommendations to primary financial regulatory agencies¹ to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks of significant liquidity, credit, or other problems spreading among financial companies and markets. The Council intends to seek to identify, assess, and address potential risks and emerging threats on a system-wide basis by taking an activities-based approach to its work, as further explained below.

The Dodd-Frank Act also authorizes the Council to determine that certain nonbank financial companies will be subject to supervision by the Federal Reserve and prudential standards. The Federal Reserve is responsible for establishing the prudential standards that will be applicable, under section 165 of the Dodd-Frank Act, to nonbank financial companies subject to a Council designation² under section 113 of the Dodd-Frank Act. The Council has previously issued rules, guidance, and other public statements regarding its

¹ "Primary financial regulatory agency" is defined in section 2(12) of the Dodd-Frank Act, 12 U.S.C. 5301(12).

² Section 113 of the Dodd-Frank Act, 12 U.S.C. 5323, refers to a Council "determination" regarding a nonbank financial company. This proposal refers to "determination" and "designation" interchangeably for ease of reading.

process for evaluating nonbank financial companies for a potential designation. On April 11, 2012, the Council issued interpretive guidance (the “2012 Interpretive Guidance”) regarding the manner in which the Council makes designations under section 113 of the Dodd-Frank Act, as an appendix to a final rule (together, the “2012 Final Rule and Interpretive Guidance”).³ On May 22, 2012, the Council approved hearing procedures relating to the conduct of hearings before the Council in connection with proposed determinations regarding nonbank financial companies and financial market utilities and related emergency waivers or modifications under sections 113 and 804 of the Dodd-Frank Act.⁴ The hearing procedures were amended in 2013,⁵ and again in 2018.⁶ On February 4, 2015, the Council adopted supplemental procedures (the “2015 Supplemental Procedures”) to the 2012 Final Rule and Interpretive Guidance.⁷ In June 2015, the Council published staff guidance with details regarding the methodologies used in Stage 1 thresholds in connection with the determination process under section 113.⁸ On November 17, 2017, the Department of the Treasury issued a report to the President in response to a Presidential Memorandum directing the Secretary of the Treasury to conduct a thorough review of the determination and designation processes of the Council.⁹ The Council is proposing this interpretive guidance (the “Proposed

Guidance”), which incorporates certain provisions of the 2015 Supplemental Procedures, to revise and update the 2012 Interpretive Guidance. The Proposed Guidance is intended to enhance the Council’s transparency, analytical rigor, and public engagement. If the Council issues final interpretive guidance based on this proposal, the final interpretive guidance will replace the 2012 Interpretive Guidance, the 2015 Supplemental Procedures, and the 2015 staff guidance regarding the Stage 1 thresholds; the Council’s hearing procedures will remain in effect.

The Council expects that the Proposed Guidance will better enable the Council to:

- Leverage the expertise of financial regulatory agencies;
- Promote market discipline;
- Maintain competitive dynamics in affected markets;
- Appropriately tailor regulations to cost-effectively minimize burdens; and
- Ensure the Council’s designation analyses are rigorous and transparent.

II. Overview of Proposed Guidance

The Proposed Guidance would revise the 2012 Interpretive Guidance in order to ensure that the Council’s work is clear, transparent and analytically rigorous, and to enhance the Council’s engagement with companies, regulators, and other stakeholders. By issuing clear and transparent guidance, the Council seeks to provide the public with sufficient information to understand the Council’s concerns regarding risks to financial stability, while appropriately protecting information submitted by companies and regulators to the Council.

A. Key Changes From 2012 Interpretive Guidance

The Proposed Guidance would substantially transform the Council’s existing procedures. Following are high-level descriptions of several of the most important changes, which are explained in greater detail below.

First, under the Proposed Guidance, the Council will prioritize its efforts to identify, assess, and address potential risks and threats to U.S. financial stability through a process that emphasizes an activities-based approach. This approach is consistent with the Council’s priorities of identifying and addressing potential risks and emerging threats on a system-wide basis, in order to reduce the potential for competitive market distortions that could arise from entity-specific determinations, and allow primary financial regulatory agencies to address identified potential risks. The

Council will pursue entity-specific determinations under section 113 of the Dodd-Frank Act only if a potential risk or threat cannot be addressed through an activities-based approach. This approach will enable the Council to more effectively identify and address the underlying sources of risks to financial stability, rather than addressing risks only at a particular nonbank financial company that may be designated.

Second, in the event the Council considers a nonbank financial company for a potential determination under section 113, the Proposed Guidance includes a new proposal that the Council perform a cost-benefit analysis prior to making a determination. The Council will make a determination under section 113 only if the expected benefits to financial stability from the determination justify the expected costs that the determination would impose.

Third, under the Proposed Guidance, the Council will assess the likelihood of a nonbank financial company’s material financial distress when evaluating the firm for a potential designation, in order to evaluate the extent to which a designation may promote U.S. financial stability.

Fourth, the Proposed Guidance condenses the current three-stage process for a determination under section 113 into two stages, by eliminating current stage 1 (as established by the 2012 Interpretive Guidance). Under current stage 1, a set of uniform quantitative metrics is applied to a broad group of nonbank financial companies in order to identify nonbank financial companies for further evaluation and to provide clarity for other nonbank financial companies that likely will not be subject to evaluation for a potential designation. The Proposed Guidance eliminates current stage 1, because it generated confusion among firms and members of the public and is not compatible with the proposal to prioritize an activities-based approach.

Fifth, the Proposed Guidance further enhances the new, two-stage determination process by making numerous procedural improvements and incorporating several provisions of the 2015 Supplemental Procedures, which were intended to facilitate the Council’s engagement and transparency. The Proposed Guidance would increase the Council’s engagement with companies and their existing regulators during the designation process. One of the goals of this enhanced engagement is to provide the company with greater visibility into the aspects of its business that may pose risks to U.S. financial

³ The 2012 Final Rule and Interpretive Guidance added a new part 1310 to title 12 of the Code of Federal Regulations, consisting of final rules (12 CFR 1310.1–1310.23) and interpretive guidance (Appendix A to Part 1310—Financial Stability Oversight Council Guidance for Nonbank Financial Company Designations). See 12 CFR part 1310, app. A (2012). The Proposed Guidance proposes to modify appendix A, but does not propose to modify the final rules added to title 12 by the 2012 Final Rule and Interpretive Guidance.

⁴ 12 U.S.C. 5323, 5463; 77 FR 31855 (May 30, 2012).

⁵ 78 FR 22546 (April 16, 2013).

⁶ 83 FR 12010 (March 19, 2018).

⁷ Financial Stability Oversight Council Supplemental Procedures Relating to Nonbank Financial Company Determinations (February 4, 2015), available at <https://www.treasury.gov/initiatives/fsoc/designations/Documents/Supplemental%20Procedures%20Related%20to%20Nonbank%20Financial%20Company%20Determinations%20-%20February%202015.pdf>.

⁸ See Council, Staff Guidance Methodologies Relating to Stage 1 Thresholds (June 8, 2015), available at <https://www.treasury.gov/initiatives/fsoc/designations/Documents/FSOC%20Staff%20Guidance%20-%20Stage%201%20Thresholds.pdf>.

⁹ Treasury, Report to the President of the United States in Response to the Presidential Memorandum Issued April 21, 2017: Financial Stability Oversight Council Designations (November 17, 2017), available at <https://www.treasury.gov/press-center/press-releases/documents/pm-fsoc-designations-memo-11-17.pdf>.

stability. Enhanced engagement will also allow a company under review to provide the Council with relevant information, which will help to ensure that the Council is making decisions based on a diverse array of data and rigorous analysis. By making a company aware early in the review process of the potential risks the Council has identified, the Council seeks to give the company more information and tools to mitigate those risks prior to any Council designation, thereby providing a potential pre-designation “off-ramp.”

The Proposed Guidance also includes procedures intended to clarify the post-designation “off-ramp.” The Proposed Guidance provides that in the event the Council makes a final determination regarding a company, the Council intends to encourage the company or its regulators to take steps to mitigate the potential risks identified in the Council’s written explanation of the basis for its final determination. Except in cases where new material risks arise over time, if a company adequately addresses the potential risks identified in writing by the Council at the time of the final determination and in subsequent reevaluations, the Council should generally be expected to rescind its determination regarding the company. By clarifying the “off-ramp” to rescission, and taking other steps to promote designated nonbank financial companies’ ability to reduce the risks they could pose to financial stability, the Council seeks to both protect the U.S. financial system and reduce the regulatory burden on the companies.

Sixth, the Proposed Guidance eliminates the six-category framework described in the 2012 Interpretive Guidance. As noted in the 2012 Interpretive Guidance, the Dodd-Frank Act requires the Council to take into account 10 considerations when evaluating a company for a potential designation, and authorizes the Council to consider “any other risk-related factors that the Council deems appropriate.”¹⁰ The 2012 Interpretive Guidance established an analytic framework that groups all relevant factors, including the 10 statutory considerations¹¹ and any additional risk-related factors, into six categories (size, interconnectedness, substitutability, leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny). The six-category framework has not proven useful in guiding the Council’s evaluations, and

unnecessarily complicates the framework for the Council’s analysis. As a result, the Proposed Guidance eliminates this six-category framework.

The following sections provide detailed descriptions of (1) the proposed activities-based approach (section B); (2) the proposed analytic framework for the Council’s evaluation of nonbank financial companies for a potential designation under section 113 of the Dodd-Frank Act (section C); and (3) the process that the Council will generally follow when determining whether to designate, or rescind the designation of, a nonbank financial company (section D).

B. Activities-Based Approach

Under the Proposed Guidance, the Council would prioritize its efforts to identify, assess, and address potential risks and threats to U.S. financial stability through a process that emphasizes an activities-based approach. The Council will pursue entity-specific determinations under section 113 of the Dodd-Frank Act only if a potential risk or threat cannot be addressed through an activities-based approach. This approach reflects two priorities: (1) Identifying and addressing, in consultation with relevant financial regulatory agencies,¹² potential risks and emerging threats on a system-wide basis, thereby reducing the potential for competitive distortions among companies and in markets that could arise from entity-specific regulation and supervision, and (2) allowing relevant financial regulatory agencies, which generally possess greater information and expertise with respect to company, product, and market risks, to address potential risks, rather than subjecting the companies to new regulatory authorities. The 2012 Final Rule and Interpretive Guidance did not address the concept of an activities-based approach.

The Dodd-Frank Act gives the Council broad discretion to determine how to respond to potential threats to U.S. financial stability. As part of its activities-based approach, the Council will examine a diverse range of financial products, activities, and practices that could pose risks to financial stability. The types of activities the Council will evaluate are often identified in the Council’s annual reports, and include activities related to the extension of credit, maturity and liquidity

transformation, market making and trading, and other key functions critical to support the functioning of financial markets.¹³

The Proposed Guidance establishes a two-step process for the Council’s activities-based approach. In the first step, in an effort to identify potential risks to U.S. financial stability, the Council intends to monitor diverse financial markets and market developments, in consultation with relevant financial regulatory agencies, to identify products, activities, or practices that could pose risks to financial stability.¹⁴ The Council intends to continue to monitor a broad scope of financial markets and market developments, which may include corporate and sovereign debt and loan markets, equity markets, new or evolving financial products, activities, and practices, and developments affecting the resiliency of financial market participants. If the Council’s monitoring of markets and market developments identifies a product, activity, or practice that could pose a potential risk to U.S. financial stability, the Council, in consultation with the relevant financial regulatory agencies, will evaluate the potential risk to determine whether it merits further review or action. The Proposed Guidance defines a “risk to financial stability” as a risk of an event or development that could impair financial intermediation or financial market functioning to a degree that would be sufficient to inflict significant damage on the broader economy.¹⁵

In its analysis in the first step of the activities-based approach, the Council will evaluate the extent to which certain characteristics could amplify potential risks to U.S. financial stability arising from products, activities, or practices. While these characteristics may not themselves present risks to U.S. financial stability, the Council will consider whether the combination or prominence of such characteristics in the products, activities, or practices under evaluation, warrants further scrutiny. Such characteristics include asset valuation risk or credit risk;

¹³ For example, the Council’s 2018 annual report noted risks such as cybersecurity events associated with the increased use of information technology, the concentrations of activities and exposures in central counterparties, and transition issues related to the move away from LIBOR to an alternative, sustainable reference rate.

¹⁴ The Council has a statutory duty to monitor the financial services marketplace in order to identify potential threats to U.S. financial stability. See Dodd-Frank Act section 112(a)(2)(C), 12 U.S.C. 5322(a)(2)(C).

¹⁵ The 2012 Final Rule and Interpretive Guidance did not define “risk to financial stability.”

¹⁰ See Dodd-Frank Act section 113(a)(2), 12 U.S.C. 5323(a)(2).

¹¹ See section C(1) below for a list of the 10 statutory considerations.

¹² References in this preamble and guidance to “relevant financial regulatory agencies” may encompass a broader range of regulators than those included in the statutory definition of “primary financial regulatory agency.” See Dodd-Frank Act section 2(12), 12 U.S.C. 5301(12).

leverage, including leverage arising from debt, derivatives, off-balance sheet obligations, and other arrangements; and the transparency of financial markets, such as growth in financial transactions occurring outside of regulated sectors, among others. When evaluating the potential risks associated with a product, activity, or practice, the Council will take into account these characteristics and various other factors that may exacerbate or mitigate the risks. For example, activities may pose greater risks if they are complex or opaque, are conducted without effective risk-management practices, are significantly correlated with other financial products, or are either highly concentrated or significant and widespread. A trading activity in a market subject to a significant amount of asset valuation risk, for instance, may pose a greater threat to financial stability if the activity is also complex. In contrast, regulatory requirements or market practices may mitigate risks by, for example, limiting exposures or leverage, enhancing risk-management practices, or restricting excessive risk-taking. Regulatory requirements associated with a lending activity, such as an asset concentration limit or repayment test, may reduce the potential risk to financial stability stemming from the activity. Council members can, at their discretion, raise potential risks for consideration by the Council, including with respect to risks that are, or are migrating, outside a particular regulator's jurisdiction.

The Council's analysis in the first step of the activities-based approach will generally focus on four framing questions, which analyze: (1) Triggers of potential risks (for example, sharp reductions in the valuation of particular classes of financial assets or significant credit losses); (2) how adverse effects of the potential risk may be transmitted to financial markets or market participants (for example, through direct or indirect exposures in financial markets to the potential risk or funding or trading pressures that may result from associated declines in asset prices); (3) the effects the potential risk could have on the financial system (for example, the scale and magnitude of adverse effects on other companies and markets, and whether such effects could be concentrated or diffused among market participants); and (4) whether the adverse effects of the potential risk could impair the financial system in a manner that could harm the non-financial sector of the U.S. economy (for example, through curtailed or interrupted provision of credit to non-

financial companies). As part of this analysis, the Council will engage in a collaborative discussion with relevant regulators.

If the Council identifies a potential risk to U.S. financial stability in step one of the activities-based approach, then in the second step, the Council will work with the relevant financial regulatory agencies at the federal and state levels to seek the implementation of actions to address the identified potential risk.¹⁶ The Council will coordinate among its members and member agencies and will follow up on supervisory or regulatory actions to ensure the potential risk is adequately addressed. The goal of this step is for existing regulators to take appropriate action, such as modifying their regulation or supervision of companies or markets under their jurisdiction in order to mitigate potential risks to U.S. financial stability identified by the Council. Measures that existing regulators can take to address a particular risk may vary widely, based on their authorities and the urgency of the risk. The Council would seek to take advantage of existing regulators' expertise and regulatory authorities to address the potential risk identified by the Council.

The Council anticipates that appropriate measures it may take to address an identified potential risk will typically take the form of relatively informal actions, such as information sharing among regulators, but as deemed appropriate could also include more formal measures, such as the Council's public issuance of recommendations to regulators or the public. Such recommendations could be made in the Council's annual report, which includes the Council's recommendations to enhance the integrity, efficiency, competitiveness, and stability of U.S. financial markets, to promote market discipline, and to maintain investor confidence.

Alternatively, if after engaging with relevant financial regulatory agencies, the Council finds that those regulators' actions are insufficient to address the identified potential risk to U.S. financial

¹⁶ The Council has a statutory duty to "recommend to the member agencies general supervisory priorities and principles reflecting the outcome of discussions among the member agencies" and to "make recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks of significant liquidity, credit, or other problems spreading among bank holding companies, nonbank financial companies, and United States financial markets." See Dodd-Frank Act section 112(a)(2)(F), (K), 12 U.S.C. 5322(a)(2)(F), (K).

stability, the Council has authority under section 120 of the Dodd-Frank Act to "provide for more stringent regulation of a financial activity" by publicly issuing nonbinding recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for a financial activity or practice conducted by bank holding companies or nonbank financial companies under their jurisdictions.¹⁷ This transparent process includes consultation with the primary financial regulatory agency and public notice inviting comments. The Council intends to make recommendations under section 120 of the Dodd-Frank Act only to the extent that its recommendations are consistent with the statutory mandate of the relevant primary financial regulatory agency.

The Council expects that much of its initial identification and assessment of risks, and engagement with regulators, will be informal and nonpublic in nature. The staffs of Council members and member agencies will likely be responsible for much of the market monitoring, risk identification, information sharing, and analysis in the activities-based approach. This engagement may yield a range of diverse outcomes, including the sharing of data, research, and analysis among the Council and regulators, or the public issuance of recommendations by the Council in its annual report. Potential risks that merit further attention may be raised at meetings of the Council members or with other stakeholders, and, as appropriate, may result in public statements or recommendations by the Council, as described above.

Questions for Comment on Activities-Based Approach:

General Questions:

1. Does the Council's proposal described above to prioritize its efforts to identify, assess, and address potential risks and threats to U.S. financial stability through a process that emphasizes an activities-based approach allow the Council to achieve its statutory purposes? Should the Council's proposed approach to the activities-based approach be modified for other considerations?

2. When undertaking the activities-based approach, are there specific categories of risks to U.S. financial stability that should be examined by the Council?

Step One of Activities-Based Approach: Identifying Potential Risks

¹⁷ Dodd-Frank Act section 120(a), 12 U.S.C. 5330(a).

from Products, Activities, or Practices (Appendix, s. II(a)):

3. Are the proposed financial markets and market developments examples (including corporate and sovereign debt and loan markets, equity markets, markets for other financial products, including structured products and derivatives, and short-term funding markets) for identifying products, activities, or practices that could pose risks to financial stability appropriate?

4. What specific, consistent analyses should the Council perform to monitor markets generally or specific types of markets?

5. The Proposed Guidance identifies certain characteristics that may amplify potential risks to U.S. financial stability arising from products, activities, or practices. Are the proposed characteristic examples (including asset valuation risk or credit risk, leverage, and liquidity risk or maturity mismatch) appropriate? Are there additional characteristics that the Council should consider, or are any of the identified criteria inappropriately specified?

6. Are the four framing questions described in the Proposed Guidance for evaluating potential risks appropriate?

Step Two of Activities-Based Approach: Working with Regulators to Address Identified Risks (Appendix, s. II(b)):

7. Should the Council make any changes to step two of the activities-based approach, as described in the Proposed Guidance?

C. Analytic Framework for Nonbank Financial Company Determinations

The Council expects to advance beyond the activities-based approach, and evaluate a nonbank financial company for a potential determination under section 113 of the Dodd-Frank Act, only in a limited set of circumstances—namely, if (1) the Council’s collaboration and engagement with the relevant financial regulatory agencies does not adequately address the potential risk identified by the Council, or if the potential threat to U.S. financial stability is outside the jurisdiction or authority of financial regulatory agencies, and (2) the potential threat identified by the Council is one that could be addressed by a Council determination regarding one or more companies. Following is a description of the substantive analysis the Council would undertake regarding any nonbank financial company under review for a potential determination.

1. Statutory Standards and Considerations

Title I of the Dodd-Frank Act defines a “nonbank financial company” as a domestic or foreign company that is “predominantly engaged” in “financial activities,” other than bank holding companies and certain other types of firms.¹⁸ The Dodd-Frank Act provides that a company is “predominantly engaged” in financial activities if either (1) the annual gross revenues derived by the company and all of its subsidiaries from financial activities, as well as from the ownership or control of insured depository institutions, represent 85 percent or more of the consolidated annual gross revenues of the company; or (2) the consolidated assets of the company and all of its subsidiaries related to financial activities, as well as related to the ownership or control of insured depository institutions, represent 85 percent or more of the consolidated assets of the company.¹⁹ The Dodd-Frank Act requires the Federal Reserve to establish the requirements for determining whether a company is “predominantly engaged in financial activities” for this purpose.²⁰

Section 113 of the Dodd-Frank Act authorizes the Council to subject a nonbank financial company to supervision by the Federal Reserve and prudential standards if the Council determines that (1) material financial distress at the nonbank financial company could pose a threat to U.S. financial stability (the “First Determination Standard”), or (2) the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company could pose a threat to U.S. financial stability (the “Second Determination Standard”). The analytic framework in the Proposed Guidance focuses primarily on the First Determination Standard, because risks to financial stability (such as asset fire sales or financial market disruptions) are most commonly propagated through a nonbank financial company when it is in distress.

The Council is statutorily required to take into account the following considerations in making a

¹⁸ See Dodd-Frank Act section 102(a)(4), 12 U.S.C. 5311(a)(4).

¹⁹ See Dodd-Frank Act section 102(a)(6), 12 U.S.C. 5311(a)(6).

²⁰ See Dodd-Frank Act section 102(b), 12 U.S.C. 5311(b). The Federal Reserve published a final rule in April 2013 establishing the requirements for determining if a company is “predominantly engaged in financial activities.” See 12 CFR 242.3.

determination under section 113 of the Dodd-Frank Act:²¹

- The extent of the leverage of the company;
- The extent and nature of the off-balance-sheet exposures of the company;
- The extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;
- The importance of the company as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the U.S. financial system;
- The importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities;
- The extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse;
- The nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;
- The degree to which the company is already regulated by one or more primary financial regulatory agencies;
- The amount and nature of the financial assets of the company;
- The amount and types of the liabilities of the company, including the degree of reliance on short-term funding; and
- Any other risk-related factors that the Council deems appropriate.

The Proposed Guidance clarifies several terms used in the Determination Standards that are not defined in the Dodd-Frank Act, including “company,” “material financial distress,” and “threat to the financial stability of the United States.” The Proposed Guidance would define “threat to the financial stability of the United States” by reference to the potential for “severe damage on the broader economy,” in contrast to the definition in the 2012 Interpretive Guidance, which refers to “significant” damage.

2. Transmission Channels

The Proposed Guidance explains that the Council’s evaluation of a nonbank financial company for a potential designation will focus primarily on how

²¹ See Dodd-Frank Act section 113(a)(2), 12 U.S.C. 5323(a)(2). This list reflects the statutory considerations applicable to a determination with respect to a U.S. nonbank financial company. The Council is required to consider corresponding factors in making a determination with respect to a foreign nonbank financial company.

the negative effects of the company's material financial distress, or of the nature, scope, size, concentration, interconnectedness, or mix of the company's activities, could be transmitted to or affect other firms or markets, thereby causing a broader impairment of financial intermediation or of financial market functioning. The Council has identified three transmission channels as most likely to facilitate the transmission of these negative effects. These transmission channels are: (1) The exposure transmission channel; (2) the asset liquidation transmission channel; and (3) the critical function or service transmission channel. While these transmission channels were also described in the 2012 Interpretive Guidance, the Proposed Guidance would substantially enhance and clarify the Council's analyses under these three channels.

a. Exposure Transmission Channel

Under the exposure transmission channel, the Council will evaluate whether a nonbank financial company's creditors, counterparties, investors, or other market participants have direct or indirect exposure to the nonbank financial company that is significant enough to materially and adversely affect those or other creditors, counterparties, investors, or other market participants and thereby pose a threat to U.S. financial stability. Among other factors, the Council expects to evaluate the amounts of exposures, the degree of protection for the counterparty under the terms of transactions, whether the largest counterparties include large financial institutions, and the company's leverage and size. The Council will also consider the exposures that counterparties and other market participants have to a nonbank financial company arising from the company's capital markets activities. The Council expects to consider a variety of factors in connection with this analysis, such as the amount and nature of, and counterparties to, the company's outstanding debt (regardless of term) and other liabilities, derivatives transactions (which may be measured on the basis of gross notional amount, net fair value, or potential future exposures), and securities financing transactions, among others. The Council will also consider factors that mitigate the potential risks posed by exposures to the nonbank financial company, such as whether exposures of a company's counterparties arising from capital markets activities are collateralized by high-quality, highly liquid securities. The Proposed Guidance notes that the

Council will consider the extent to which assets are managed rather than owned by the company, in recognition of the distinct nature of exposure risks when the company is acting as an agent rather than as principal. In particular, in the case of a nonbank financial company that manages assets on behalf of customers or other third parties, the third parties' direct financial exposures are often to the issuers of the managed assets, rather than to the nonbank financial company managing those assets. Finally, the Council will evaluate the potential for contagion in conjunction with other factors summarized above when evaluating risk under this channel. As part of this assessment, the Council will consider relevant industry-specific historical examples, the scope of the company's interconnectedness with large financial institutions, and market-based or regulatory factors that may mitigate the risk of contagion, among other factors.

b. Asset Liquidation Transmission Channel

Under the asset liquidation transmission channel, the Council will consider whether a nonbank financial company holds assets that, if liquidated quickly, could cause a fall in asset prices and thereby significantly disrupt trading or funding in key markets or cause significant losses or funding problems for other firms with similar holdings. The Council may also consider whether a deterioration in asset pricing or market functioning could pressure other financial firms to sell their holdings of affected assets in order to maintain adequate capital and liquidity, which, in turn, could produce a cycle of asset sales that could lead to further market disruptions. The Council's analysis of the asset liquidation transmission channel will focus on three central factors: (1) Liquidity of the company's liabilities; (2) liquidity of the company's assets; and (3) potential fire sale impacts.

When analyzing the liquidity of the company's liabilities, the Council will assess the company's liquidity risk by reviewing factors such as the company's short-term financial obligations, financial arrangements that can be terminated by counterparties and therefore become short-term, and long-term liabilities that may come due in a short-term period, among other factors. The Council will also evaluate the company's leverage (for example, by assessing total assets and total debt measured relative to total equity, and derivatives liabilities and off-balance sheet obligations relative to total equity), as well as the company's short-

term debt ratio. When analyzing the liquidity of the company's assets, the Council will consider which assets the company could rapidly liquidate, if necessary, to satisfy its obligations. The Council expects to focus on the size and liquidity characteristics of the company's investment portfolio, grouping the assets into categories based on liquidity. Finally, when analyzing potential fire sale impacts, the Council will consider the potential effects of the company's asset liquidation on markets and market participants. The Council will apply quantitative models to assess how the company could satisfy the identified range of potential liquidity needs, identified in the previous step of the Council's analysis, by rapidly selling its identified liquid assets.

c. Critical Function or Service Transmission Channel

Finally, under the critical function or service transmission channel, the Council will consider the potential for a nonbank financial company to become unable or unwilling to provide a critical function or service that is relied upon by market participants and for which there are no ready substitutes. This analysis considers the extent to which other firms could provide similar financial services in a timely manner at a similar price and quantity if a nonbank financial company withdraws from a particular market, a factor commonly known as "substitutability." Substitutability also captures situations in which a nonbank financial company is the primary or dominant provider of services in a market that the Council determines to be essential to U.S. financial stability. When evaluating this transmission channel, the Council may consider the nonbank financial company's activities and critical functions and the importance of those activities and functions to the U.S. financial system, including how those activities and functions would be performed by the company or other market participants in the event of the company's material financial distress; the competitive landscape for markets in which a nonbank financial company participates and for the services it provides; the company's market share in specific product lines; and the ability of substitutes to replace a service or function provided by the company, among other factors.

In addition to the three transmission channels, the Proposed Guidance explains that the Council also intends to consider a nonbank financial company's complexity, opacity, and resolvability when evaluating whether the company poses a risk to U.S. financial stability.

As part of this analysis, the Council may assess the complexity of the nonbank financial company's legal, funding, and operational structure, and any obstacles to the rapid and orderly resolution of the company. In addition, consistent with section 113 of the Dodd-Frank Act, the Proposed Guidance explains that the Council will consider the degree to which a nonbank financial company is already regulated by one or more primary financial regulatory agencies. When considering existing regulatory scrutiny, the Council may weigh factors such as the extent to which the company's primary financial regulator has imposed risk-management standards as relevant to the type of company, as well as regulators' processes for inter-regulator coordination.

Questions for Comment on Analytic Framework for Nonbank Financial Company Determinations:

General Questions:

8. The Proposed Guidance describes a uniform analytic framework for determinations that would be applied across industries; are there industry-specific factors that should be addressed in the Proposed Guidance?

9. The Proposed Guidance defines "material financial distress" as a nonbank financial company being in imminent danger of insolvency or defaulting on its financial obligations. Should the Council consider alternative interpretations of this term or apply additional metrics or criteria when interpreting this term?

10. The Proposed Guidance defines "threat to the financial stability of the United States" as the threat of an impairment of financial intermediation or of financial market functioning that would be sufficient to inflict severe damage on the broader economy. What criteria or metrics should the Council consider when evaluating whether a threat is sufficient to inflict "severe" damage on the broader economy?

11. Are the Council's proposed three transmission channels (appendix, s. III(b)) appropriate for evaluating whether a nonbank financial company under section 113 of the Dodd-Frank Act meets one of the Determination Standards?

a. Do the three transmission channels capture the ways in which the negative effects described in the Determination Standards could be transmitted to or affect other firms or markets?

b. Are there ways in which the three transmission channels (or the three factors that the Council will focus on in the asset liquidation channel) may interact that would compound the negative effects of a single channel?

Exposure Transmission Channel (Appendix, s. III(b)):

12. The Council may consider various types of exposures that counterparties and other market participants have to a nonbank financial company, which the Proposed Guidance notes are highly dependent on the nature of the company's business. Are there other unique types of exposures that such parties may have to a nonbank financial company, or factors that may mitigate the risks posed by these exposures? How should the Council take into account any such mitigating factors in its analysis?

Asset Liquidation Transmission Channel (Appendix, s. III(b)):

13. The Council may consider a company's liquidity risk, based on a set of proposed factors (short-term financial obligations, financial arrangements that can be terminated by counterparties and therefore become short-term, etc.) when evaluating the asset liquidation channel. Are there other factors the Council should consider, in addition to those proposed? Is there an appropriate time period during which the Council should evaluate a company's liquidity risk, tailored for specific types of financial products?

14. The Council may also evaluate a company's leverage when evaluating this transmission channel, based on a set of proposed factors (including total assets and total debt measured relative to total equity, and derivatives liabilities and off-balance sheet obligations relative to total equity). Are there other factors the Council should consider, in addition to those proposed? How should the Council assess the effects of a company's leverage in this channel?

15. When evaluating potential fire sale impacts as part of this channel, what quantitative models should the Council consider?

Critical Function or Service Transmission Channel (Appendix, s. III(b)):

16. Are there relevant quantitative metrics for measuring risks under the critical function or service transmission channel? Should the Council consider additional factors under this channel when evaluating the activities and functions of a company in order to measure its substitutability?

17. What metrics can be used to measure whether a service or function is critical to financial stability?

Complexity and Resolvability; Existing Regulatory Scrutiny (Appendix, s. III(c)-(d)):

18. Is the Council's proposed framework appropriate for assessing the complexity and resolvability of a nonbank financial company and its

existing regulatory scrutiny (appendix, s. III(c)-(d)) when considering a potential designation?

3. Other Considerations

Under the Proposed Guidance, the Council will perform a cost-benefit analysis before making any designation under section 113. The Council proposes to make a designation under section 113 only if the expected benefits justify the expected costs that the determination would impose.²² The key elements of regulatory analysis include (1) a statement of the need for the proposed action, (2) an examination of alternative approaches, and (3) an evaluation of the benefits and costs of the proposed action and the main alternatives.²³ The Council will quantify reasonable estimable benefits and costs (using ranges, as appropriate), and will also consider non-quantified benefits and costs, in assessing the net benefits of a designation. The Council will conduct this analysis only in cases where the Council is concluding that the company meets one of the standards for a determination by the Council under section 113 of the Dodd-Frank Act, because in other cases doing so would not affect the outcome of the Council's analysis.

The Council will consider the benefits of a designation to the U.S. financial system, the U.S. economy, and the nonbank financial company due to additional regulatory and supervisory requirements resulting from the determination, including the benefits of the prudential standards adopted by the Federal Reserve under section 165 of the Dodd-Frank Act. When evaluating potential benefits to the U.S. financial system and the U.S. economy arising from a designation, the Council may consider whether the designation enhances financial stability and improves the functioning of markets by reducing the likelihood or severity of a potential financial crisis, among other factors. With respect to company-specific benefits, a company subject to a designation may derive benefits from anticipated new or increased requirements, including, for example, a lower cost of capital or higher credit ratings upon meeting its post-designation regulatory and supervisory requirements.

When evaluating the costs of a designation, the Council will consider

²² See *MetLife, Inc. v. Financial Stability Oversight Council*, 177 F. Supp.3d 219, 242 (D.D.C. 2016) (quoting 12 U.S.C. 5323(a)(2)(K) and *Michigan v. Environmental Protection Agency*, 135 S. Ct. 2699, 2707 (2015)).

²³ See Office of Management and Budget Circular A-4 (Sept. 17, 2003).

not only the cost to the nonbank financial company from anticipated new or increased regulatory requirements in connection with a designation, but also costs to the U.S. economy. Relevant costs to the company will likely include costs related to risk-management requirements, supervision and examination, and liquidity requirements. When evaluating the costs of a determination to the U.S. economy, the Council will assess the impact of the determination on the availability and cost of credit or financial products in relevant U.S. markets, among other factors.

Consistent with sound risk regulation, the Council will consider not only the impact of an identifiable risk, but also the likelihood that the risk will be realized. The Council will therefore assess the likelihood of a company's material financial distress, applying qualitative and quantitative factors, when evaluating the overall impact of a Council designation for any company under review under the First Determination Standard. To assess the risk of material financial distress, the Council may consider a range of factors, including market-based measures (e.g., distance-to-default measures), accounting-based measures (e.g., statistical models using capital adequacy), and market- and accounting-based measures (e.g., academic models). The Council's analysis of the likelihood of a nonbank financial company's material financial distress will be conducted taking into account a period of overall stress in the financial services industry and a weak macroeconomic environment. When possible, the Council will attempt to quantify the likelihood of material financial distress; as an alternative, when doing so is not possible with respect to a specific firm, the Council will generally consider quantitative and qualitative factors related to the types of market-based or accounting-based measures noted above, and historical examples regarding the characteristics of financial companies that have experienced financial distress.

As noted below, the Council will consult with the company's primary financial regulatory agency (if any) when assessing the company, including regarding the company's resolvability, complexity, and the likelihood of its material financial distress.

Questions for Comment on Other Considerations (Benefits and Costs of Determination; Likelihood of Material Financial Distress):

Benefits and Costs of Determination (Appendix, s. III(e)):

19. Is the proposed framework for assessing the benefits and costs of a

potential determination appropriate? How should the Council assess benefits and costs that are difficult to monetize or quantify?

20. Should the Council consider other benefits or costs than those proposed in section III.e of the Proposed Guidance?

21. How should the Council estimate the costs of any new regulatory requirements that would result from the Council's designation? What sources should the Council rely upon when estimating such costs?

22. Should the Council consider additional factors when considering the benefits or costs of a designation to the U.S. economy?

23. Should the Council consider any additional benefits to the company subject to a designation, or additional benefits to the U.S. financial system and the U.S. economy arising from a Council designation other than those listed in section III.e of the Proposed Guidance? How should the Council quantify any such benefits? What sources should the Council rely upon when estimating such benefits?

24. How should the Council address uncertainty (for example, using alternate baselines or sensitivity analyses)?

25. Are there additional approaches the Council should consider when measuring potential threats to financial stability in order to assess any improvement in financial stability following a determination?

26. Should the Council interpret its authority under section 113 of the Dodd-Frank Act in a manner that is consistent with the opinion of the U.S. District Court for the District of Columbia in *MetLife, Inc. v. Financial Stability Oversight Council*?²⁴

Likelihood of Material Financial Distress (Appendix, s. III(e)):

27. Is the proposed framework for assessing the likelihood of material financial distress when evaluating the impact of a potential determination appropriate?

28. What metrics or factors should the Council consider when attempting to quantify the likelihood of a company's material financial distress? If such quantification is not possible with respect to a specific company, what additional factors should the Council consider? What are the appropriate methodologies or models (including appropriate time horizons and assumptions) to assess the likelihood of a nonbank financial company's material financial distress?

29. After the Council assesses the likelihood of a company's material financial distress, what should be the

threshold for the Council taking further action regarding a potential determination with respect to the company?

D. Determination and Annual Reevaluation Process

As noted above, the Council will prioritize an activities-based approach for identifying, assessing, and addressing potential risks to financial stability. The Council, may, however, subject a nonbank financial company to review for an entity-specific determination under section 113 of the Dodd-Frank Act if the activities-based approach would not adequately address potential risks to U.S. financial stability.²⁵

The Proposed Guidance condenses the current three-stage determination process into two stages by eliminating current stage 1, makes other procedural improvements, and incorporates certain provisions of the 2015 Supplemental Procedures.²⁶ Following is a description of the processes set forth in the Proposed Guidance for the Council's evaluation of a nonbank financial company for a potential determination under section 113 and the Council's annual reevaluations of any such determinations.

1. Stage 1: Preliminary Evaluation of Nonbank Financial Companies

In the first stage of the determination process, the Council will notify nonbank financial companies identified as potentially posing risks to U.S. financial stability. The Council or its Deputies Committee will vote to commence review of a nonbank financial company in Stage 1. Under the Proposed Guidance, the Council would engage extensively with the relevant company and its existing financial regulators during Stage 1.

The Council's preliminary analysis will be based on quantitative and qualitative information available to the Council primarily through public and regulatory sources. In addition, a company under review in Stage 1 may voluntarily submit to the Council any information it deems relevant to the Council's evaluation and may, upon request, meet with staff on the Council's analytical team. In order to reduce the burdens of review on the company, the

²⁵ The Council would be most likely to consider a determination under section 113 only in rare instances such as an emergency situation or if a potential threat to U.S. financial stability is outside the jurisdiction or authority of financial regulatory agencies.

²⁶ As discussed in section II(A) above, the Proposed Guidance eliminates the six-category framework described in the 2012 Interpretive Guidance.

Council will not require the company to submit information during Stage 1. The Council may consider the company and its subsidiaries together, to enable the Council to consider potential risks arising across the consolidated organization.

For any company under review in Stage 1 that is regulated by a primary financial regulatory agency or home country supervisor, the Council will consult with the regulator, as appropriate, before the Council votes on whether to advance the company to Stage 2. In consideration of the benefits that the Council will derive from extensive engagement with a company's primary financial regulatory agency, the Council will actively solicit the regulator's views regarding risks at the company and potential means to mitigate those risks, and will share its preliminary views regarding potential risks at the company with the regulator. The Council will continue to encourage the regulator to address relevant risks using the regulator's existing authorities.

Enhanced engagement in Stage 1 is intended to allow a company under review to provide the Council with relevant information, which will help to ensure that the Council is making decisions based on a diverse array of data and rigorous analysis, and to provide the company with greater visibility into the aspects of its business that may pose risks to U.S. financial stability. Another goal of the enhanced engagement in Stage 1 is to enable the company to take actions in response to the Council's concerns, thereby providing a pre-designation "off-ramp," while not burdening a company with the relatively higher costs that may be incurred during a Stage 2 evaluation. By making a company aware of the potential risks the Council has identified during its preliminary review, the Council seeks to give the company more information and tools to mitigate those risks prior to any Council designation. Following the preliminary evaluation in Stage 1, the Council may decide not to evaluate the company further, or it may begin a more detailed analysis of the company by advancing it to Stage 2.

2. Stage 2: In-Depth Evaluation

In Stage 2, the Council will conduct an in-depth evaluation of any company that the Council has determined in Stage 1 merits additional review. Under the Proposed Guidance, the Council would continue in Stage 2 to engage extensively with the relevant company and its existing regulators.

In Stage 2, the Council will request that the company provide information that the Council deems relevant to its evaluation, which will involve both qualitative and quantitative data. The Council will take certain preliminary steps before requiring the submission of reports from any nonbank financial company that is regulated by a Council member agency or any primary financial regulatory agency; acting through the Office of Financial Research (OFR), the Council will coordinate with these agencies and, whenever possible, rely on information available from the OFR or these agencies.

The Council will also take steps to facilitate a transparent review process with the company during Stage 2. During Stage 2, the company may submit any other information that it deems relevant to the Council's evaluation, and the Council will make staff on the Council's analytical team available to meet with the representatives of the company, to explain the evaluation process and the framework for the Council's analysis. If the analysis in Stage 1 has identified specific aspects of the company's operations or activities as the primary focus for the evaluation, staff will notify the company of those issues. The Proposed Guidance also provides for the Council's Deputies Committee to meet with a company in Stage 2, to allow the company to present any information or arguments it deems relevant to the Council's evaluation. In addition, the Council will seek to continue its consultation with the company's primary financial regulatory agency or home country supervisor in a timely manner before the Council makes any proposed or final determination, encouraging the relevant regulator to address relevant risks using the regulator's existing authorities. The Council will notify the company when the Council believes that the evidentiary record regarding the company is complete, before the Council makes any proposed determination regarding the company, or alternatively notifies the company that it is no longer being considered for a designation at that time.

3. Proposed Determination; Hearing

The procedural steps related to the Council's proposed determinations, subsequent hearings, and final determinations are largely specified in section 113 of the Dodd-Frank Act. The Proposed Guidance reflects and expands on those mandatory procedures.

A nonbank financial company may be considered for a proposed determination based on the analysis

performed in Stage 2. In the event the Council votes to make a proposed determination, the Council will issue a written notice and explanation of the proposed determination to the company, and will also provide the company's primary financial regulatory agency or home country supervisor (subject to appropriate protections for confidential information) with the nonpublic written explanation of the basis for the proposed determination. In accordance with section 113(e) of the Dodd-Frank Act, a nonbank financial company that is subject to a proposed determination may request a nonpublic hearing before the Council to contest the proposed determination.

4. Final Determination

After making a proposed determination and holding any requested written or oral hearing, the Council may make a final determination in accordance with the Dodd-Frank Act that the company will be subject to supervision by the Federal Reserve and prudential standards. If the Council makes a final determination regarding the company, the Council will provide the company with a written notice of the Council's final determination, including an explanation of the basis for the Council's decision, and will also provide the company's primary financial regulatory agency or home country supervisor with the nonpublic written explanation of the basis of the Council's final determination, subject to appropriate protections for confidential information. Under the Proposed Guidance, the Council expects that its explanation of the final basis for any determination will highlight the key risks that led to the determination and include clear guidance regarding the factors that were most important in the Council's determination. The final determination process also incorporates several procedural steps in the 2015 Supplemental Procedures. For example, the Council will provide each designated nonbank financial company with an opportunity for an oral hearing before the Council once every five years at which the company can contest the designation.

Consistent with the 2012 Interpretive Guidance, when practicable and consistent with the purposes of the determination process, the Council will provide a nonbank financial company with a notice of a final determination at least one business day before publicly announcing the determination. As a result, the Council generally would not issue any public notice regarding its determination vote on the day of the vote; instead, to enable the company

adequately to prepare its public disclosures regarding the Council's determination, the first public announcement by the Council will generally be the day after the Council's vote.

5. Annual Reevaluations of Nonbank Financial Company Determinations

For any nonbank financial company that is subject to a final determination, the Council is required by statute to reevaluate the determination at least annually, and to rescind the determination if the Council determines that the company no longer meets the statutory standards for a designation. The Proposed Guidance proposes to incorporate a number of additional procedural steps for annual reevaluations to enhance engagement with companies and their regulators, and to increase transparency. One of the goals of these changes is to clarify the "off-ramp" process for a designated company, which would enable the company to identify changes it could consider making to address the potential threat to financial stability identified by the Council, and receive feedback regarding whether those changes may address the Council's concerns. The Council intends that this process should be flexible and tailored to the risks posed by designated companies, rather than hard-wired or overly prescriptive. The process is intended to incentivize designated companies to address the key factors that led to designation, which would promote the Council's goal of reducing risks to U.S. financial stability.

As an example, the Proposed Guidance provides that in the event the Council makes a final determination regarding a company, the Council intends to encourage the company and, if appropriate, its regulators to take steps to mitigate the potential risks identified in the Council's written explanation of the basis for its final determination. Except in cases where new material risks arise over time, if a company adequately addresses the potential risks identified in writing by the Council at the time of the final determination and in subsequent reevaluations, the Council should generally be expected to rescind its determination regarding the company. To facilitate this process, companies are encouraged during annual reevaluations to submit information regarding any changes related to the company's risk profile that mitigate the potential risks identified in the Council's final determination of the company and in reevaluations of the determination. If the company explains in detail potential

changes it could make to its business to address the potential risks previously identified by the Council, staff of Council members and Council member agencies will endeavor to provide their feedback on the extent to which those changes may address the potential risks.

The Proposed Guidance also underscores that the Council applies the same standards of review in its annual reevaluations as the standard for an initial determination regarding a nonbank financial company: Either the company's material financial distress, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the company's activities, could pose a threat to U.S. financial stability. If the Council determines that the company no longer meets those standards, the Council will rescind its determination. The Proposed Guidance also stresses that, while the Council's annual reevaluation of a company subject to a final determination will generally focus on changes since the Council's previous review, the ultimate question the Council will seek to assess is whether changes in the aggregate since the company's designation have caused the company to cease meeting the Determination Standards.²⁷

Questions for Comment on Determination Process and Annual Reevaluations:

General Questions:

30. Do the proposed changes to the determination and reevaluation process achieve the intended purposes of improving the Council's engagement with companies, regulators, and other stakeholders and incorporating various due process and other procedural improvements designed to foster a fair, more transparent, and more robust engagement with companies under review?

31. In certain circumstances, a company's regulator may be willing to share confidential information with the Council only if the Council commits, to the extent permissible under applicable law, to maintain the confidentiality of the information and not to share the information with the subject company. How should the Council balance regulators' need for confidentiality with the need to be transparent with companies under review?

Stage 1: Preliminary Evaluation of Nonbank Financial Companies (Appendix, s. IV(a)):

²⁷ In a reevaluation of a determination, the Council may choose to consider only one Determination Standard, because changes that address the potential risks previously identified by the Council under one Determination Standard may also address potential risks relevant to the other Determination Standard.

32. Are there specific factors or considerations that the Council should discuss with a primary financial regulatory agency or home country supervisor of a company under review in Stage 1? What types of information should the Council solicit from the agency or supervisor?

Stage 2: In-Depth Evaluation (Appendix, s. IV(b)):

33. Should the Council follow additional procedural steps or steps for outreach to a company that has entered Stage 2?

34. Should the Council take additional steps to work with the primary financial regulatory agency or home country supervisor of a company that has entered Stage 2 before making a designation?

Annual Reevaluations of Nonbank Financial Company Determinations (Appendix, s. V):

35. Is the Council's proposed process for annual reevaluations of nonbank financial company determinations appropriate?

36. Should the Council follow additional procedural steps, or provide additional opportunities for a company to provide information to the Council, before the Council conducts its annual reevaluation of the company?

37. How should the Council narrow the amount of information evaluated during the annual reevaluation process, given the compressed timeframe for annual reviews? What issues should the Council focus on, given this compressed timing?

38. If the Council does not rescind a determination with respect to a company, should the Council provide additional explanation to the company, or additional procedural steps for the company to respond to the Council's decision?

III. Legal Authority of Council and Status of the Proposed Guidance

The Council has numerous authorities and tools under the Dodd-Frank Act to carry out its statutory purposes.²⁸ The Council expects that its response to any potential risk or threat to U.S. financial stability will be based on an assessment of the circumstances. As the agency charged by Congress with broad-ranging responsibilities under sections 112 and 113 of the Dodd-Frank Act, the Council has the inherent authority to promulgate interpretive guidance under those provisions that explains and interprets the statutory factors that the Council will consider when employing the

²⁸ See, for example, Dodd-Frank Act sections 112(a)(2), 113, 115, 120, 804, 12 U.S.C. 5322(a)(2), 5323, 5325, 5330, 5463.

activities-based approach and undertaking the determination process.²⁹ The Council also has authority to issue procedural rules³⁰ and policy statements.³¹ The Proposed Guidance describes the Council's interpretation of the statutory factors and provides transparency to the public as to how the Council intends to exercise its statutory grant of discretionary authority. Except to the extent that the Proposed Guidance sets forth rules of agency organization, procedure, or practice, the Council has concluded that the Proposed Guidance does not have binding effect; does not impose duties on, or alter the rights or interests of, any person; does not change the statutory standards for the Council's decision making; and does not relieve the Council of the need to make entity-specific determinations in accordance with section 113 of the Dodd-Frank Act. The Proposed Guidance also does not limit the ability of the Council to take emergency action under section 113(f) of the Dodd-Frank Act if the Council determines that such action is necessary or appropriate to prevent or mitigate threats posed by a nonbank financial company to U.S. financial stability. As a result, the Council has concluded that the notice and comment requirements of the Administrative Procedure Act do not apply.³² Nonetheless, the Council invites interested persons to submit comments regarding the Proposed Guidance. Furthermore, contemporaneous with the publication of this proposed interpretive guidance, the Council is separately publishing, elsewhere in this issue of the **Federal Register**, a final rule, RIN 4030-AA03, stating that the Council shall not amend or rescind its interpretive guidance on nonbank financial company determinations without providing the public with notice and an opportunity to comment under the Administrative Procedure Act.

²⁹ Courts have recognized that "an agency charged with a duty to enforce or administer a statute has inherent authority to issue interpretive rules informing the public of the procedures and standards it intends to apply in exercising its discretion." See, for example, *Production Tool v. Employment & Training Administration*, 688 F.2d 1161, 1166 (7th Cir. 1982). The Supreme Court has acknowledged that "whether or not they enjoy any express delegation of authority on a particular question, agencies charged with applying a statute necessarily make all sorts of interpretive choices." See *U.S. v. Mead*, 533 U.S. 218, 227 (2001).

³⁰ See Dodd-Frank Act section 111(e)(2), 12 U.S.C. 5321(e)(2).

³¹ See *Association of Flight Attendants-CWA, AFL-CIO v. Huerta*, 785 F.3d 710 (D.C. Cir. 2015).

³² See 5 U.S.C. 553(b)(A).

IV. Paperwork Reduction Act

The collection of information contained in the Proposed Guidance has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control 1505-0244. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

The collection of information under the Proposed Guidance is found in 12 CFR 1310.20-1310.23, which were added pursuant to the 2012 Final Rule and Interpretive Guidance.³³

The hours and costs associated with preparing data, information, and reports for submission to the Council constitute reporting and cost burdens imposed by the collection of information. The estimated total annual reporting burden associated with the collection of information in the Proposed Guidance is 20 hours, based on an estimate of one respondent. We estimate the cost associated with this information collection to be \$9,000. These estimates are significantly lower than those in the Paperwork Reduction Act discussion in the 2012 Final Rule and Interpretive Guidance, because the Council expects that, notwithstanding any additional reporting burden that financial companies participating in the activities-based approach may incur, the aggregate reporting burden on companies will be significantly reduced as a result of the Council's proposal to pursue entity-specific determinations under section 113 of the Dodd-Frank Act only if a potential risk or threat cannot be addressed through an activities-based approach.

In making this estimate, the Council estimates that due to the nature of the information likely to be requested, approximately 75 percent of the burden in hours will be carried by financial companies internally at an average cost of \$400 per hour, and the remainder will be carried by outside professionals retained by financial companies at an average cost of \$600 per hour. In addition, in determining these estimates, the Council considered its obligation under 12 CFR 1310.20(b) to, whenever possible, rely on information available from the OFR or any Council member agency or primary financial regulatory agency that regulates a nonbank financial company before requiring the submission of reports from

³³ See note 3 above.

such nonbank financial company. The Council expects that its collection of information under the Proposed Guidance would be performed in a manner that attempts to minimize burdens for affected financial companies. The aggregate burden will be subject to the number of financial companies that participate in the activities-based approach or are evaluated in the determination process, the extent of information regarding such companies that is available to the Council through existing public and regulatory sources, and the amount and types of information that financial companies provide to the Council.

Interested persons are invited to submit comments regarding the estimates provided in this section. Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Financial Stability Oversight Council, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to Samantha MacInnis, Department of the Treasury, Washington, DC 20220. Comments on the collection of information must be received by May 13, 2019.

Comments are specifically requested concerning:

(1) Whether the proposed collection of information is necessary for the proper performance of the functions of the Council, including whether the information will have practical utility;

(2) The accuracy of the estimated burden associated with the proposed collection of information;

(3) How the quality, utility, and clarity of the information to be collected may be enhanced;

(4) How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

(5) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

V. Executive Orders 12866 and 13563

Executive Orders 12866 and 13563 direct certain agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules,

and of promoting flexibility. The Office of Information and Regulatory Affairs within the Office of Management and Budget has designated this interpretive guidance as a “significant regulatory action” under section 3(f) of Executive Order 12866.

List of Subjects in 12 CFR Part 1310

Brokers, Investments, Securities.

The Financial Stability Oversight Council proposes to amend 12 CFR part 1310 as follows:

PART 1310—AUTHORITY TO REQUIRE SUPERVISION AND REGULATION OF CERTAIN NONBANK FINANCIAL COMPANIES

■ 1. The authority citation for part 1310 continues to read as follows:

Authority: 12 U.S.C. 5321; 12 U.S.C. 5322; 12 U.S.C. 5323.

■ 2. Appendix A is revised to read as follows:

Appendix A to Part 1310—Financial Stability Oversight Council Guidance for Nonbank Financial Company Determinations

I. Introduction

Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”)¹ authorizes the Financial Stability Oversight Council (the “Council”) to determine that a nonbank financial company will be supervised by the Board of Governors of the Federal Reserve System (the “Federal Reserve”) and be subject to prudential standards in accordance with Title I of the Dodd-Frank Act if either of two standards is met. Under the first standard, the Council may subject a nonbank financial company to supervision by the Federal Reserve and prudential standards if the Council determines that material financial distress at the nonbank financial company could pose a threat to the financial stability of the United States. Under the second standard, the Council may determine that a nonbank financial company will be supervised by the Federal Reserve and subject to prudential standards if the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company could pose a threat to U.S. financial stability. Section 113 of the Dodd-Frank Act also lists considerations that the Council must take into account in making a determination.

Section II of this document describes the approach the Council intends to take in prioritizing its work to identify and address potential risks to U.S. financial stability using an activities-based approach. This approach reflects the Council’s priorities of identifying potential risks on a system-wide basis, reducing the potential for competitive distortions that could arise from entity-specific determinations, and allowing

primary financial regulatory agencies² to address identified potential risks. First, the Council will monitor markets to identify potential risks to U.S. financial stability and to assess those risks on a system-wide basis. Second, the Council will then work with relevant regulators to seek the implementation of actions intended to address identified potential risks to financial stability.

Section III of this appendix describes the manner in which the Council intends to apply the statutory standards and considerations in making determinations under section 113 of the Dodd-Frank Act, if the Council determines that potential risks to U.S. financial stability are not adequately addressed through the activities-based approach. Section III defines key terms used in the statute, including “threat to the financial stability of the United States.” Section III also includes a detailed description of the analysis that the Council intends to conduct during its reviews, including a discussion of channels through which risks from a company may be transmitted to other companies or markets, and the Council’s assessment of the likelihood of the company’s material financial distress and the benefits and costs of a determination.

Section IV of this appendix outlines a two-stage process that the Council will follow in non-emergency situations when determining whether to subject a nonbank financial company to Federal Reserve supervision and prudential standards. In the first stage of the process, the Council will notify the company and its primary financial regulatory agency and conduct a preliminary analysis to determine whether the company should be subject to further evaluation by the Council. During the second stage of the evaluation process, the Council will conduct an in-depth evaluation if it determines in the first stage that the nonbank financial company merits additional review.

The Council’s practices set forth in this guidance to address potential risks to U.S. financial stability are intended to comply with its statutory purposes: (1) To identify risks to U.S. financial stability that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace; (2) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the government will shield them from losses in the event of failure; and (3) to respond to emerging threats to the stability of the U.S. financial system.³ Council actions seek to foster transparency and to avoid any government intervention that could create competitive distortions in markets for financial services and products. Further, nonbank financial companies should not

benefit from an implicit federal financial safety net. Therefore, the Council emphasizes the importance of market discipline as a mechanism for addressing potential risks to U.S. financial stability posed by financial companies.

This interpretive guidance is not a binding rule, except to the extent that it sets forth rules of agency organization, procedure, or practice. This guidance is intended to assist financial companies and other market participants in understanding how the Council expects to exercise certain of its authorities under Title I of the Dodd-Frank Act. The Council retains discretion, subject to applicable statutory requirements, to consider factors relevant to the assessment of a potential risk or threat to U.S. financial stability on a case-by-case basis. If the Council were to depart from the interpretive guidance, it would need to provide a reasoned explanation for its action, which would ordinarily require acknowledging the change in position.⁴

II. Activities-Based Approach

The Dodd-Frank Act gives the Council broad discretion in determining how to respond to potential threats to U.S. financial stability. A determination to subject a nonbank financial company to Federal Reserve supervision and prudential standards under section 113 of the Dodd-Frank Act is only one of several Council authorities for responding to potential risks to U.S. financial stability.⁵ The Council will prioritize its efforts to identify, assess, and address potential risks and threats to U.S. financial stability through a process that emphasizes an activities-based approach, and will pursue entity-specific determinations under section 113 of the Dodd-Frank Act only if a potential risk or threat cannot be addressed through an activities-based approach. This approach reflects two priorities: (1) Identifying and addressing, in consultation with relevant financial regulatory agencies,⁶ potential risks and emerging threats on a system-wide basis and to reduce the potential for competitive distortions among companies and in markets that could arise from entity-specific regulation and supervision, and (2) allowing

⁴ See *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009).

⁵ For example, the Council has authority to make recommendations to the Federal Reserve concerning the establishment and refinement of prudential standards and reporting and disclosure requirements applicable to nonbank financial companies supervised by the Federal Reserve; make recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for a financial activity or practice conducted by certain financial companies if the Council determines that such activity or practice could create or increase certain risks; and designate financial market utilities and payment, clearing, and settlement activities that the Council determines are, or are likely to become, systemically important. Dodd-Frank Act sections 115, 120, 804, 12 U.S.C. 5325, 5330, 5463.

⁶ References in this appendix to “relevant financial regulatory agencies” may encompass a broader range of regulators than those included in the statutory definition of “primary financial regulatory agency.” See Dodd-Frank Act section 2(12), 12 U.S.C. 5301(12).

² “Primary financial regulatory agency” is defined in section 2(12) of the Dodd-Frank Act, 12 U.S.C. 5301(12).

³ Dodd-Frank Act section 112(a)(1), 12 U.S.C. 5322(a)(1).

¹ See Dodd-Frank Act section 113, 12 U.S.C. 5323.

relevant financial regulatory agencies, which generally possess greater information and expertise with respect to company, product, and market risks, to address potential risks, rather than subjecting the companies to new regulatory authorities.

As part of its activities-based approach, the Council will examine a range of financial products, activities, or practices that could pose risks to U.S. financial stability. These types of activities are often identified in the Council's annual reports, such as activities related to (1) the extension of credit, (2) the use of leverage or short-term funding, (3) the provision of guarantees of financial performance, and (4) other key functions critical to support the functioning of financial markets. The Council considers a risk to financial stability to mean a risk of an event or development that could impair financial intermediation or financial market functioning to a degree that would be sufficient to inflict significant damage on the broader economy. The Council's activities-based approach is intended to identify and address risks to financial stability using a two-step approach, described below.

a. Step One of Activities-Based Approach: Identifying Potential Risks From Products, Activities, or Practices

Monitoring Markets

The Council has a statutory duty to monitor the financial services marketplace in order to identify potential threats to U.S. financial stability.⁷ In the first step of the activities-based approach, to enable the Council to identify potential risks to U.S. financial stability, the Council, in consultation with primary financial regulatory agencies, intends to monitor diverse financial markets and market developments to identify products, activities, or practices that could pose risks to financial stability. When monitoring potential risks to financial stability, the Council intends to consider the linkages across products, activities, and practices, and their interconnectedness across firms and markets.

For example, the Council's monitoring may include:

- Corporate and sovereign debt and loan markets;
- equity markets;
- markets for other financial products, including structured products and derivatives;
- short-term funding markets;
- payment, clearing, and settlement functions;
- new or evolving financial products, activities, and practices; and
- developments affecting the resiliency of financial market participants.

To monitor markets and market developments, the Council will review information such as historical data, research regarding the behavior of financial market participants, and new developments that arise in evolving marketplaces. The Council will regularly rely on data, research, and analysis from Council member agencies, the Office of Financial Research, industry

participants, and other public sources. Consistent with its statutory obligations, the Council will, whenever possible, rely on information available from primary financial regulatory agencies.⁸

Evaluating Potential Risks

If the Council's monitoring of markets and market developments identifies a product, activity, or practice that could pose a potential risk to U.S. financial stability, the Council, in consultation with relevant financial regulatory agencies, will evaluate the potential risk to determine whether it merits further review or action. The Council's work in this step may include efforts such as sharing data, research, and analysis among Council members and member agencies and their staffs; consultations with regulators and other experts regarding the scope of potential risks and factors that may mitigate those risks; and the collaborative development of analyses for consideration by the Council. As part of this work, the Council may also engage with industry participants and other members of the public as it assesses potential risks.

The Council will assess the extent to which characteristics such as the following could amplify potential risks to U.S. financial stability arising from products, activities, or practices:

- Asset valuation risk or credit risk;
- leverage, including leverage arising from debt, derivatives, off-balance sheet obligations, and other arrangements;
- liquidity risk or maturity mismatch, such as reliance on funding sources that could be susceptible to dislocations;
- counterparty risk and interconnectedness among financial market participants;
- the transparency of financial markets, such as growth in financial transactions occurring outside of regulated sectors;
- operational risks, such as cybersecurity and operational resilience; or
- the risk of destabilizing markets for particular types of financial instruments, such as trading practices that substantially increase volatility in key markets.

Various factors may exacerbate or mitigate each of these types of risks. For example, activities may pose greater risks if they are complex or opaque, are conducted without effective risk-management practices, are significantly correlated with other financial products, and are either highly concentrated or significant and widespread. In contrast, regulatory requirements or market practices may mitigate risks by, for example, limiting exposures or leverage, enhancing risk-management practices, or restricting excessive risk-taking.

While the contours of the Council's initial evaluation of any potential risk will depend on the type and scope of analysis relevant to the particular risk, the Council's analyses will generally focus on four framing questions:

1. How could the potential risk be triggered? For example, could it be triggered by sharp reductions in the valuation of particular classes of financial assets?

2. How could the adverse effects of the potential risk be transmitted to financial markets or market participants? For example, what are the direct or indirect exposures in financial markets to the potential risk?

3. What impact could the potential risk have on the financial system? For example, what could be the scale of its adverse effects on other companies and markets, and would its effects be concentrated or distributed broadly among market participants? This analysis should take into account factors such as existing regulatory requirements or market practices that mitigate potential risks.

4. Could the adverse effects of the potential risk impair the financial system in a manner that could harm the non-financial sector of the U.S. economy?

If a product, activity, or practice creating a potential risk to financial stability is identified, the Council will work with regulators to address the identified risk, as described in section II.b of this appendix.

b. Step Two of Activities-Based Approach: Working With Regulators To Address Identified Risks

If the Council identifies a potential risk to U.S. financial stability in step one of the activities-based approach, the Council will work with the relevant financial regulatory agencies at the federal and state levels to seek the implementation of actions to address the identified potential risk. The Council will coordinate among its members and member agencies and will follow up on supervisory or regulatory actions to ensure the potential risk is adequately addressed. The goal of this step would be for existing regulators to take appropriate action, such as modifying their regulation or supervision of companies or markets under their jurisdiction in order to mitigate potential risks to U.S. financial stability identified by the Council.⁹ If a potential risk identified by the Council relates to a product, activity, or practice arising at a limited number of individual financial companies, the Council nonetheless will prioritize a remedy that addresses the underlying risk across all companies that engage in the relevant activity. If the Council finds that a particular type of financial product could present risks to U.S. financial stability, there may be different approaches existing regulators could take, based on their authorities and the urgency of the risk, such as restricting or prohibiting the offering of that product, or requiring market participants to take additional risk-management steps that address the risks.

If, after engaging with relevant financial regulatory agencies, the Council believes those regulators' actions are insufficient to

⁹ The Dodd-Frank Act provides that the Council's duties include to recommend to the member agencies general supervisory priorities and principles reflecting the outcome of discussions among the member agencies and to make recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks of significant liquidity, credit, or other problems spreading among bank holding companies, nonbank financial companies, and United States financial markets. Dodd-Frank Act sections 112(a)(2)(F), (K), 12 U.S.C. 5322(a)(2)(F), (K).

⁷ Dodd-Frank Act section 112(a)(2), 12 U.S.C. 5322(a)(2).

⁸ Dodd-Frank Act section 112(d)(3), 12 U.S.C. 5322(d)(3).

address the identified potential risk to U.S. financial stability, the Council has authority to make formal public recommendations to primary financial regulatory agencies under section 120 of the Dodd-Frank Act. Under section 120, the Council may provide for more stringent regulation of a financial activity by issuing nonbinding recommendations, following consultation with the primary financial regulatory agency and public notice inviting comments, to the primary financial regulatory agency to apply new or heightened standards or safeguards for a financial activity or practice conducted by bank holding companies or nonbank financial companies under their jurisdiction.¹⁰ In addition, in any case in which no primary financial regulatory agency exists for the company conducting financial activities or practices identified by the Council as posing risks, the Council can consider reporting to Congress on recommendations for legislation that would prevent such activities or practices from threatening U.S. financial stability. The Council intends to make recommendations under section 120 of the Dodd-Frank Act only to the extent that its recommendations are consistent with the statutory mandate of the primary financial regulatory agency to which the Council is making the recommendation.

III. Analytic Framework for Nonbank Financial Company Determinations

If the Council's collaboration and engagement with the relevant financial regulatory agencies does not adequately address a potential threat identified by the Council—or if a potential threat to U.S. financial stability is outside the jurisdiction or authority of financial regulatory agencies—and if the potential threat identified by the Council is one that could be addressed by a Council determination regarding one or more companies, the Council may evaluate one or more nonbank financial companies for an entity-specific determination under section 113 of the Dodd-Frank Act, applying the analytic framework described below. This section describes the analysis the Council will conduct in general regarding individual nonbank financial companies that are considered for a potential determination, and section IV of this appendix describes the Council's process for those reviews.

a. Statutory Standards and Considerations

The Council may determine, by a vote of not fewer than two-thirds of the voting members of the Council then serving, including an affirmative vote by the Chairperson of the Council, that a nonbank financial company will be supervised by the Federal Reserve and be subject to prudential standards if the Council determines that (1) material financial distress at the nonbank financial company could pose a threat to the financial stability of the United States (the "First Determination Standard") or (2) the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company could pose a

threat to the financial stability of the United States (the "Second Determination Standard," and, together with the First Determination Standard, the "Determination Standards").¹¹ The analytic framework described below focuses primarily on the First Determination Standard because threats to financial stability (such as asset fire sales or financial market disruptions) are most commonly propagated through a nonbank financial company when it is in distress.

Several terms used in the Determination Standards are not defined in the Dodd-Frank Act. The Council intends to interpret the term "company" to include any corporation, limited liability company, partnership, business trust, association, or similar organization.¹² In addition, the Council intends to interpret "nonbank financial company" as including any successor of a company that is subject to a final determination of the Council. The Council intends to interpret the term "material financial distress" as a nonbank financial company being in imminent danger of insolvency or defaulting on its financial obligations. The Council intends to interpret the term "threat to the financial stability of the United States" as meaning the threat of an impairment of financial intermediation or of financial market functioning that would be sufficient to inflict severe damage on the broader economy. For purposes of considering whether a nonbank financial company could pose a threat to U.S. financial stability under either Determination Standard, the Council intends to assess the company in the context of a period of overall stress in the financial services industry and in a weak macroeconomic environment, with market developments such as increased counterparty defaults, decreased funding availability, and decreased asset prices. The Council believes this is appropriate because in such a context, the risks posed by a nonbank financial company may have a greater effect on U.S. financial stability.

The Dodd-Frank Act requires the Council to consider 10 specific considerations when determining whether a nonbank financial company satisfies either of the Determination Standards. These statutory considerations help the Council to evaluate whether one of the Determination Standards has been met:¹³

¹¹ If the Council is unable to determine whether the financial activities of a U.S. nonbank financial company pose a threat to the financial stability of the United States based on certain information, the Council may request the Federal Reserve to conduct an examination of the U.S. nonbank financial company for the sole purpose of determining whether the company should be supervised by the Federal Reserve for purposes of Title I of the Dodd-Frank Act. Dodd-Frank Act section 112(d)(4), 12 U.S.C. 5322(d)(4).

¹² The statutory definition of "nonbank financial company" excludes bank holding companies and certain other types of companies. Dodd-Frank Act section 102(a)(4), 12 U.S.C. 5311(a)(4).

¹³ Dodd-Frank Act section 113(a)(2), 12 U.S.C. 5323(a)(2). This list of considerations is applicable to U.S. nonbank financial companies. With respect to foreign nonbank financial companies, the Council is required to take into account a similar list of considerations, in some cases limited to the companies' U.S. business or activities. See Dodd-Frank Act section 113(b)(2), 12 U.S.C. 5323(b)(2).

- The extent of the leverage of the company;
- the extent and nature of the off-balance-sheet exposures of the company;
- the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;
- the importance of the company as a source of credit for households, businesses, and state and local governments and as a source of liquidity for the U.S. financial system;
- the importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities;
- the extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse;
- the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;
- the degree to which the company is already regulated by one or more primary financial regulatory agencies;
- the amount and nature of the financial assets of the company; and
- the amount and types of the liabilities of the company, including the degree of reliance on short-term funding.

The statute also requires the Council to take into account any other risk-related factors that the Council deems appropriate. Any determination by the Council will be made based on a company-specific evaluation and an application of the standards and considerations set forth in section 113 of the Dodd-Frank Act, and taking into account qualitative and quantitative information the Council deems relevant to a particular nonbank financial company. The Council anticipates that the information relevant to an in-depth analysis of a nonbank financial company may vary based on the nonbank financial company's business.

The discussion below describes how the Council will apply the Determination Standards in its evaluation of a nonbank financial company, including how the Council will take into account the statutory considerations, and other risk-related factors that the Council will take into account. Due to the unique threat that each nonbank financial company could pose to U.S. financial stability and the nature of the inquiry required by the statutory considerations, the Council expects that its evaluations of nonbank financial companies will be firm-specific and may include quantitative and qualitative information that the Council deems relevant to a particular nonbank financial company. The transmission channels, sample metrics, and other factors set forth below are not exhaustive and may not apply to all nonbank financial companies under evaluation.

b. Transmission Channels

The Council's evaluation of any nonbank financial company under section 113 of the Dodd-Frank Act will seek to determine whether a nonbank financial company meets

¹⁰ Dodd-Frank Act section 120(a), 12 U.S.C. 5330(a).

one of the Determination Standards described above. In its analysis of a nonbank financial company, the Council will assess how the negative effects of the company's material financial distress, or of the nature, scope, size, scale, concentration, interconnectedness, or mix of the company's activities, could be transmitted to or affect other firms or markets, thereby causing a broader impairment of financial intermediation or of financial market functioning. Such a transmission of risk can occur through various mechanisms, or channels. The Council has identified three transmission channels as most likely to facilitate the transmission of the negative effects of a nonbank financial company's material financial distress, or of the nature, scope, size, scale, concentration, interconnectedness, or mix of the company's activities, to other financial firms and markets: Exposure; asset liquidation; and critical function or service. These three transmission channels are described below. The Council may also consider other relevant channels through which risks could be transmitted from a particular nonbank financial company and thereby pose a threat to U.S. financial stability. The Council will take into account the 10 statutory considerations as part of its evaluation of a nonbank financial company under the three transmission channels and the other factors described below.

Exposure Transmission Channel

Under this transmission channel, the Council will evaluate whether a nonbank financial company's creditors, counterparties, investors, or other market participants have direct or indirect exposure to the nonbank financial company that is significant enough to materially and adversely affect those or other creditors, counterparties, investors, or other market participants and thereby pose a threat to U.S. financial stability.

The Council expects that its analyses under the exposure transmission channel will generally include the factors described below. The potential threat to U.S. financial stability will generally be greater if the amounts of the exposures are larger; if the terms of the transactions provide less protection for the counterparty; and if the largest counterparties include large financial institutions. The Council also will consider a company's leverage and size. A company's leverage can amplify the risks posed by exposures, including off-balance sheet exposures, by reducing the company's ability to satisfy its obligations to creditors in the event of its material financial distress. Size is relevant to this analysis, as material financial distress at a larger nonbank financial company would generally transmit risk on a larger scale than distress at a smaller company. Size may be measured by the assets, liabilities, and capital of the firm. As required by statute, the Council will consider the extent to which assets are managed rather than owned by the company and the extent to which ownership of assets under management is diffuse; this recognizes the distinct nature of exposure risks when the company is acting as an agent rather than

as principal.¹⁴ In particular, in the case of a nonbank financial company that manages assets on behalf of customers or other third parties, the third parties' direct financial exposures are often to the issuers of the managed assets, rather than to the nonbank financial company managing those assets.

The Council will consider the exposures that counterparties and other market participants have to a nonbank financial company arising from the company's capital markets activities. This assessment includes an evaluation of the company's relationships with other significant nonbank financial companies and significant bank holding companies. In most cases, the Council will consider factors such as the amount and nature of, and counterparties to, the company's:

- Outstanding debt (regardless of term) and other liabilities (such as guaranteed investment contracts issued by an insurance company or Federal Home Loan Bank loans).
- Derivatives transactions (which may be measured on the basis of gross notional amount, net fair value, or potential future exposures).
- Securities financing transactions (*i.e.*, repurchase agreements and securities lending transactions).
- Lines of credit.
- Credit-default swaps outstanding for which the company or an affiliate is the reference entity (generally focusing on single-name credit-default swaps).

Relevant metrics may include the number, size, and financial strength of a nonbank financial company's counterparties, including the proportion of its counterparties' exposure to the nonbank financial company relative to the counterparties' capital. The potential risk arising under this transmission channel depends not only on the number of counterparties that a nonbank financial company has, but also on the importance of that nonbank financial company to its counterparties and the extent to which the counterparties are interconnected with other financial firms, the financial system, and the broader economy. Therefore, the Council will focus on exposures of large financial institutions to the nonbank financial company under review. This analysis will take into account both individual counterparty exposures as well as aggregate exposures of other financial institutions to the company under review. The amount and types of other exposures that counterparties and other market participants have to a nonbank financial company is highly dependent on the nature of the company's business. The Council's analysis will take these other fact-specific considerations into account.

The Council also will consider factors that mitigate the potential risks posed by exposures to the nonbank financial company. For example, exposures of a company's counterparties arising from capital markets activities may be collateralized by high-quality, highly liquid securities, such as U.S. Treasury securities, which reduces the

potential for the exposure to serve as a channel for the transmission of risk.

Contagion. The negative effects of the material financial distress of a large, interconnected nonbank financial company are not necessarily limited to the amount of direct losses suffered by the firm's creditors, counterparties, investors, or other market participants. In general, the wider and more interconnected a company's network of financial counterparties, the greater the potential negative effect of the material financial distress of the company. Aggregate exposures to a nonbank financial company can create a potential threat to U.S. financial stability if they lead to contagion among financial institutions and financial markets more broadly. Contagion has the potential to spread distress quickly and seemingly unexpectedly. Such transmission is associated with opaque balance sheets, closely correlated markets, and coordination failures among investors. In such circumstances, fire sales by a highly leveraged and interconnected nonbank financial company may result in a loss of confidence in other financial companies that are perceived to have similar characteristics. The Council will seek evidence regarding the potential for contagion, including relevant industry-specific historical examples and the scope of the company's interconnectedness with large financial institutions, among other factors. Various market-based or regulatory factors can strongly mitigate the risk of contagion. Contagion should be viewed in conjunction with other factors described above when evaluating risk under the exposure transmission channel.

Asset Liquidation Transmission Channel

Under this transmission channel, the Council will consider whether a nonbank financial company holds assets that, if liquidated quickly, could cause a fall in asset prices and thereby significantly disrupt trading or funding in key markets or cause significant losses or funding problems for other firms with similar holdings. This channel would likely be most relevant for a nonbank financial company that could be forced to liquidate assets quickly due to its funding and liquid asset profile. For example, this could be the case if a nonbank financial company relies heavily on short-term funding. The Council may also consider whether a deterioration in asset pricing or market functioning could pressure other financial firms to sell their holdings of affected assets in order to maintain adequate capital and liquidity, which, in turn, could produce a cycle of asset sales that could lead to further market disruptions. This analysis includes an assessment of any maturity mismatch at the company—the difference between the maturities of the company's assets and liabilities. A company's reliance on short-term funding to finance longer-term positions can subject the company to rollover or refinancing risk that may force it to sell assets rapidly at low market prices.

The Council's analyses of the asset liquidation transmission channel will focus on three central factors, described below.

Liquidity of the company's liabilities. The first factor in the Council's assessment under

¹⁴Dodd-Frank Act section 113(a)(2)(F), 12 U.S.C. 5323(a)(2)(F).

this transmission channel is the amount and nature of the company's liabilities that are, or could become, short-term in nature. This analysis involves an assessment of the company's liquidity risk. Liquidity risk generally refers to the risk that a company may not have sufficient funding to satisfy its short-term needs. For example, relevant factors may include:

- The company's short-term financial obligations (including outstanding commercial paper).
- Financial arrangements that can be terminated by counterparties and therefore become short-term (including callable debt, derivatives, securities lending, repurchase agreements, and off-balance-sheet exposures).
- Long-term liabilities that may come due in a short-term period.
- Financial transactions that may require the company to provide additional margin or collateral to the counterparty.
- Products that allow customers rapidly to withdraw funds from the company.
- Liabilities related to other collateralized borrowings and deposits.

The Council will quantitatively identify the scale of potential liquidity needs that could plausibly arise at the company. As part of this analysis, the Council will apply counterparty and customer withdrawal rates based on historical examples and other relevant models to assess the scope of plausible withdrawals. In addition, any ability of the company or its financial regulators to impose stays on counterparty terminations or withdrawals is relevant, because it may reduce the company's liquidity needs in an event of material financial distress. The Council also will consider the company's internal estimates of potential liquidity needs in a context of material financial distress.

The company's leverage and short-term debt ratios are relevant to this analysis, as high leverage and reliance on short-term funding can increase the potential for a company to be subject to sudden liquidity strains that force it rapidly to sell assets. Leverage can be measured by the ratio of assets to capital or as a measure of economic risk relative to capital. The latter measurement can better capture the effect of derivatives and other products with embedded leverage on the risk undertaken by a nonbank financial company. Comparisons of leverage to peer financial institutions can help indicate the level of risk at the company. Metrics that may be used to assess leverage include:

- Total assets and total debt measured relative to total equity, which measures financial leverage.
- Derivatives liabilities and off-balance sheet obligations relative to total equity, which may show how much off-balance sheet leverage a nonbank financial company may have.
- Securities financing transactions and funding agreements that provide alternative sources of liquidity or operating income, which indicate the use of operating leverage.
- Changes in leverage ratios, which may indicate that a nonbank financial company is increasing or decreasing its risk profile.

Liquidity of the company's assets. The second factor under the asset liquidation

transmission channel is an analysis of the company's assets that the company could rapidly liquidate, if necessary, to satisfy its obligations. In particular, the Council expects that this assessment will focus on the size and liquidity characteristics of the company's investment portfolio. The Council will assess the company's assets, grouped into categories such as highly liquid (for example, cash, U.S. Treasury securities, and U.S. agency mortgage-backed securities) and less-liquid (for example, corporate bonds, non-agency mortgage-backed securities, and mortgages and other loans) to determine if it holds cash instruments or readily marketable securities that could reasonably be expected to have a liquid market in times of broader market stress. To the extent that the company's assets are encumbered, those assets would generally not be considered to be available to satisfy short-term obligations.

Potential fire sale impacts. The third factor in the asset liquidation transmission channel analysis is the potential effects of the company's asset liquidation on markets and market participants. As described above, the Council will assess the scale of potential liquidity needs that could plausibly arise at the company and the amount and nature of financial assets the company could sell to satisfy its obligations. In this step of the asset liquidation transmission channel analysis, the Council will apply quantitative models to assess how the company could satisfy the identified range of potential liquidity needs by rapidly selling its identified liquid assets. To assess this factor, the Council will compare the volume of the company's potential liquidation of particular categories of financial instruments with the average daily trading volume in the United States of those types of instruments. In general, a rapid liquidation of a significant amount of relatively illiquid financial instruments, or instruments that are widely held by other market participants, will have a greater effect on the market than a liquidation of the same amount of highly liquid instruments or instruments that are not widely held. The Council may also conduct an analysis to assess the relative impact of negative shocks to the equity or assets of certain financial institutions on other financial institutions. The Council expects that its analysis will generally focus on potential asset liquidation periods of 30 to 90 days.

The order in which a nonbank financial company may liquidate assets is a factor in the extent of any fire sale risk, but is subject to considerable uncertainties. A company could liquidate a significant portion of its highly liquid assets first, in order to reduce the likelihood that the company would be forced to liquidate illiquid assets in the event of its material financial distress. However, in the event of the company's material financial distress, a company may also be expected to seek to maintain compliance with any applicable risk-based capital ratios and other requirements. Doing so might require a company to sell a mix of assets across a number of asset classes, rather than proceed with the sale of assets in order from most liquid to least liquid. Further, in the event of a significant market disruption, there could be a meaningful first-mover advantage to

selling less-liquid assets first. For example, markets for less-liquid assets, such as private and public corporate bonds and asset-backed securities, could be prone to disruption in the event that a seller liquidated a large portion of its portfolio of those assets. Given these potential discounts, in some circumstances a company may be incentivized to sell a portion of its less-liquid assets first and to hold U.S. government securities and agency mortgage-backed securities, which tend to increase in value during a period of market turmoil. To the extent that a company's highly liquid assets are encumbered (for example, under securities financing transactions or as collateral for loans), the company would also need to sell less-liquid assets to satisfy its liquidity needs. Further, a company's holdings of liquid assets could be reduced before the company enters material financial distress. As a result, the Council may take into account company-specific factors in assessing the order in which the company might liquidate assets. One approach the Council may take is to assess the potential effects if the company sells pro rata portions of the more-liquid segments of its investment portfolio (such as cash and highly liquid instruments, U.S. agency securities, investment-grade public corporate debt securities, publicly traded equity securities, and asset backed-securities).

Critical Function or Service Transmission Channel

Under this transmission channel, the Council will consider the potential for a nonbank financial company to become unable or unwilling to provide a critical function or service that is relied upon by market participants and for which there are no ready substitutes. This factor is commonly referred to as "substitutability." Substitutability captures the extent to which other firms could provide similar financial services in a timely manner at a similar price and quantity if a nonbank financial company withdraws from a particular market. Substitutability also captures situations in which a nonbank financial company is the primary or dominant provider of services in a market that the Council determines to be essential to U.S. financial stability. A risk under this transmission channel may be identified if a company provides a critical function or service that may not easily be substitutable.

Concern about a potential lack of substitutability could be greater if a nonbank financial company and its competitors are likely to experience stress at the same time because they are exposed to the same risks. The Council may also analyze the nonbank financial company's activities and critical functions and the importance of those activities and functions to the U.S. financial system and assess how those activities and functions would be performed by the nonbank financial company or other market participants in the event of the nonbank financial company's material financial distress. The Council also will consider substitutability with respect to any nonbank financial company with global operations to identify the substitutability of critical market

functions that the company provides in the United States in the event of material financial distress of a foreign parent company.

The analysis of this channel incorporates a review of the competitive landscape for markets in which a nonbank financial company participates and for the services it provides (including the provision of liquidity to the U.S. financial system, the provision of credit to low-income, minority, or underserved communities, or the provision of credit to households, businesses and state and local governments), the ability of other firms to replace those services, and the nonbank financial company's market share. This analysis may focus on the company's market share in specific product lines and the ability of substitutes to replace a service or function provided by the company. The Council's evaluation of a nonbank financial company's market share regarding a particular product or service may include assessments of the ability of the nonbank financial company's competitors to expand to meet market needs during a period of overall stress in the financial services industry or in a weak macroeconomic environment; the costs that market participants would incur if forced to switch providers; the timeframe within which a disruption in the provision of the product or service would materially affect market participants or market functioning; and the economic implications of such a disruption.

c. Complexity and Resolvability

The potential threat a nonbank financial company could pose to U.S. financial stability may be mitigated or aggravated by the company's complexity, opacity, or resolvability. In particular, a risk may be aggravated if a nonbank financial company's resolution under ordinary insolvency regimes could disrupt key markets or have a material adverse impact on other financial firms or markets. An evaluation of a nonbank financial company's complexity and resolvability entails an assessment of (1) the complexity of the nonbank financial company's legal, funding, and operational structure, and (2) any obstacles to the rapid and orderly resolution of the nonbank financial company:

- Legal structure factors may include the number of jurisdictions the company operates in, the number of subsidiaries, and the organizational structure.
- Funding structure factors may include the degree of interaffiliate dependency for liquidity and funding (such as intercompany loans or other affiliate support arrangements), payment operation (such as treasury operations), and risk-management.
- Operational structure factors may include the number of employees, the number of U.S. and non-U.S. locations, and the degree of inter-company dependency in regard to financial guarantees and support arrangements, the ability to separate functions and spin off services or business lines, the complexity and resiliency of intercompany and outsourced services and arrangements in resolution, and the likelihood of preserving franchise value in a recovery or resolution scenario.

- Cross-border operational factors may include size and complexity of the company's cross-border operations and impact of potential ring-fencing on an orderly resolution.

Factors that would tend to increase the risk associated with a company's complexity and resolvability include large size or scope of activities; a complex legal or operational structure; multi-jurisdictional operations and regulatory regimes; complex funding structures; the potential impact of a loss of key personnel; and shared services among affiliates.

d. Existing Regulatory Scrutiny

As noted above, one of the considerations the Council is statutorily required to take into account in making a determination under section 113 of the Dodd-Frank Act is the degree to which the nonbank financial company is already regulated by one or more primary financial regulatory agencies.¹⁵ In its analysis of this statutory consideration, the Council will focus on the extent to which existing regulation of the company has mitigated the potential risks to financial stability identified by the Council. For example, factors that may be used to assess existing regulatory scrutiny include:

- The extent to which the company's primary financial regulator has imposed risk-management standards such as capital, liquidity, and reporting requirements, as relevant to the type of company, and has authority to supervise, examine, and bring enforcement actions, with respect to the company and its affiliates, including non-U.S. entities.
- Regulators' processes for inter-regulator coordination.
- For non-U.S. entities, the extent to which the company is supervised and subject to prudential standards on a consolidated basis in its home country that are administered and enforced by a comparable foreign supervisory authority.

e. Benefits and Costs of Determination; Likelihood of Material Financial Distress

Determining whether the expected benefits of a potential Council determination justify the expected costs is necessary to ensure that the Council's actions are expected to provide a net benefit to U.S. financial stability and are consistent with thoughtful decisionmaking.¹⁶ Financial stability benefits may be difficult to quantify, and some of the costs may be difficult to forecast with precision, but the Council will make a determination under section 113 only if the expected benefits to financial stability from Federal Reserve supervision and prudential standards justify the expected costs that the determination would impose. As part of this analysis, the Council will assess the likelihood of a firm's material financial distress, in order to assess the extent to

which a determination may promote U.S. financial stability.

The key elements of regulatory analysis include (1) a statement of the need for the proposed action, (2) an examination of alternative approaches, and (3) an evaluation of the benefits and costs (quantitative and qualitative) of the proposed action and the main alternatives.¹⁷ The Council will quantify reasonable estimable benefits and costs (using ranges, as appropriate).¹⁸ The Council will conduct this analysis only in cases where the Council is concluding that the company meets one of the standards for a determination by the Council under section 113 of the Dodd-Frank Act, because in other cases doing so would not affect the outcome of the Council's analysis.

Benefits. With respect to the benefits of a Council determination, the Council will consider the benefits of the determination itself, both to (1) the U.S. financial system and the U.S. economy and (2) the nonbank financial company due to additional regulatory requirements resulting from the determination, particularly the prudential standards adopted by the Federal Reserve under section 165 of the Dodd-Frank Act.

One of the Council's statutory purposes is to respond to emerging threats to the stability of the U.S. financial system.¹⁹ The primary intended benefit of a determination under section 113 of the Dodd-Frank Act is a reduction in the likelihood or severity of a financial crisis. Therefore, the Council will consider potential benefits to the U.S. financial system and the U.S. economy arising from a Council determination. To the extent that a Council determination reduces the likelihood or severity of a potential financial crisis, the determination could enhance financial stability and improve the functioning of financial markets. The Council may use various measures of systemic risk to assess any improvement in financial stability. Such measures include S-Risk (which attempts to quantify the amount of capital a financial firm would need to raise in order to function normally in the event of a severe financial crisis), conditional value at risk, and certain estimates of fire sale risk, among others. To assess the benefit to the U.S. financial system and the U.S. economy from a determination, the Council may also consider historical analogues to the nonbank under review. In addition, the Council may compare the risks to financial stability posed by a particular nonbank to the risks posed by large bank holding companies, in order to produce an assessment of the relative risks the company may pose. Further, the loss of any implicit "too big to fail" or similar subsidy would be considered a benefit to the economy, even if it increases the nonbank financial company's cost of capital.

Analysis of the benefits of a determination for the relevant nonbank financial company may include those arising directly from the

¹⁷ See Office of Management and Budget Circular A-4 (Sept. 17, 2003).

¹⁸ The Council will also consider non-quantified benefits and costs. See Office of Management and Budget Circular A-4 (Sept. 17, 2003), section (E)(Developing Benefit and Cost Estimates)(7).

¹⁹ Dodd-Frank Act section 112(a)(1)(C), 12 U.S.C. 5322(a)(1)(C).

¹⁵ Dodd-Frank Act section 113(a)(2)(H), 12 U.S.C. 5323(a)(2)(H).

¹⁶ See *MetLife, Inc. v. Financial Stability Oversight Council*, 177 F. Supp.3d 219, 242 (D.D.C. 2016) (quoting 12 U.S.C. 5323(a)(2)(K) and *Michigan v. Environmental Protection Agency*, 135 S. Ct. 2699, 2707 (2015)).

Council's determination as well as any benefits arising from anticipated new or increased requirements resulting from the determination, such as additional supervision and enhanced capital, liquidity, or risk-management requirements. For example, a nonbank financial company subject to a Council determination may benefit from a lower cost of capital or higher credit ratings upon meeting its post-determination regulatory requirements.

Costs. With respect to the costs of a Council determination, the Council will consider the costs of the determination itself, both to (1) the nonbank financial company due to additional regulatory requirements resulting from the determination, including the costs of the prudential standards adopted by the Federal Reserve under section 165 of the Dodd Frank Act; and (2) the U.S. economy.

The Council will consider costs to the company arising from anticipated new or increased regulatory requirements resulting from the determination related to:

- Risk-management requirements, such as the costs of capital planning and stress testing.
- Supervision and examination, such as compliance costs to the firm of additional examination and supervision.
- Increased capital requirements, after accounting for offsetting benefits to taxpayers and to the holders of the firm's other liabilities.
- Liquidity requirements, such as the opportunity cost from any requirement to hold additional high-quality liquid assets, relative to the company's current investment portfolio.

Because the Federal Reserve is required to tailor prudential standards to a nonbank financial company subject to a Council determination after the Council has made a determination regarding the company, the new regulatory requirements that result from the Council's determination will not be known to the Council during its analysis of the company. In cases where the nonbank financial company under review primarily engages in bank-like activities, the Council may consider, as a proxy, the costs that would be imposed on the nonbank if the Federal Reserve imposed prudential standards similar to those imposed on bank holding companies with at least \$250 billion in total consolidated assets under section 165 of the Dodd-Frank Act.²⁰

The Council also will consider the cost of a determination under section 113 of the Dodd-Frank Act to the U.S. economy by assessing the impact of the determination on the availability and cost of credit or financial products in relevant U.S. markets. To the extent that the markets in which the relevant nonbank participates have low concentration, the impact that the determination regarding one firm would have on credit conditions would generally be immaterial. However, if the relevant markets are concentrated, a Council determination regarding a significant market participant could have a material impact on credit conditions in that market. As part of this analysis, the Council may also

consider the extent to which any reduction in financial services provided by the nonbank financial company under review would be offset by other market participants.

Likelihood of Material Financial Distress. As part of the assessment of the overall impact of a Council determination for any company under review under the First Determination Standard, the Council will assess the likelihood of the company's material financial distress, applying quantitative and qualitative factors. There are a number of widely known measures for assessing the risk of default of financial institutions. These include market-based measures (e.g., distance-to-default measures, default probabilities implied by credit-default swap prices); accounting-based measures (e.g., statistical models using capital adequacy, portfolio quality, profitability and other institution-specific characteristics to predict failure); and market- and accounting-based measures (e.g., academic models, credit ratings). In addition, the Council may evaluate a nonbank financial company's resiliency to asset or capital shocks. The Council's analysis of the likelihood of a nonbank financial company's material financial distress will be conducted taking into account a period of overall stress in the financial services industry and a weak macroeconomic environment. The Council may also consider the results of any stress tests that have previously been conducted by the company or by its primary financial regulatory agency.

Nonetheless, the Council recognizes the difficulty of accurately forecasting firm failures, particularly for any period beyond a very short time horizon. Therefore, the assessment of likelihood may not be based on any individual model, and the Council may not seek to produce a quantitative estimate of the probability of a company's material financial distress. The Council will attempt to quantify the likelihood of material financial distress where doing so is possible. If doing so is not possible with respect to a specific firm, as an alternative, the Council will generally take into account quantitative and qualitative factors related to (1) the types of market-based or accounting-based measures described above and (2) historical examples regarding the characteristics of financial companies that have experienced financial distress. In particular, relevant factors in this analysis may include the company's leverage; its liquidity risk (including reliance on short-term funding) or maturity mismatch; its risk-management practices; its existing regulation; and any rapid growth in its business (which may indicate a concentration in high-risk activities).

IV. The Determination Process

As described in section II of this appendix, the Council will prioritize an activities-based approach for identifying, assessing, and addressing potential risks to financial stability. However, if a potential risk or threat to U.S. financial stability cannot be addressed through an activities-based approach,²¹ the Council may subject a

nonbank financial company to review for an entity-specific determination under section 113 of the Dodd-Frank Act. The Council expects generally to follow a two-stage process of evaluation and analysis for determinations under section 113.

In the first stage of the process ("Stage 1"), nonbank financial companies identified as potentially posing risks to U.S. financial stability will be notified and subject to a preliminary analysis, based on quantitative and qualitative information available to the Council primarily through public and regulatory sources. During Stage 1, the Council will permit, but not require, the company to submit relevant information. The Council will also consult with the primary financial regulatory agency or home country supervisor, as appropriate. This approach will enable the Council to fulfill its statutory obligation to rely whenever possible on information available through the Office of Financial Research (the "OFR"), Council member agencies, or the nonbank financial company's primary financial regulatory agencies before requiring the submission of reports from any nonbank financial company.²²

Following Stage 1, nonbank financial companies that are selected for additional review will receive notice that they are being considered for a proposed determination that the company could pose a threat to U.S. financial stability (a "Proposed Determination") and will be subject to in-depth evaluation during the second stage of review ("Stage 2"). Stage 2 will involve the evaluation of additional information collected directly from the nonbank financial company. At the end of Stage 2, the Council may consider whether to make a Proposed Determination with respect to the nonbank financial company. If a Proposed Determination is made by the Council, the nonbank financial company may request a hearing in accordance with section 113(e) of the Dodd-Frank Act and § 1310.21(c) of the Council's rule.²³ After making a Proposed Determination and holding any written or oral hearing if requested, the Council may vote to make a final determination.

a. Stage 1: Preliminary Evaluation of Nonbank Financial Companies

Stage 1 involves a preliminary analysis of nonbank financial companies to assess the risks they could pose to U.S. financial stability.

Identification of Company for Review in Stage 1

If, as described in section II, the Council's consultation with and any recommendations to a nonbank financial company's primary financial regulatory agency do not adequately address a potential risk identified by the Council, the Council may evaluate one or more individual nonbank financial companies for an entity-specific

instances such as an emergency situation or if a potential threat to U.S. financial stability is outside the jurisdiction or authority of financial regulatory agencies.

²² See Dodd-Frank Act section 112(d)(3), 12 U.S.C. 5322(d)(3).

²³ See 12 CFR 1310.21(c).

²⁰ Dodd-Frank Act section 165, 12 U.S.C. 5365.

²¹ The Council would be most likely to consider a determination under section 113 only in rare

determination under section 113 of the Dodd-Frank Act. The Council or its Deputies Committee²⁴ will vote to commence review of a nonbank financial company in Stage 1. When evaluating the potential risks associated with a nonbank financial company, the Council may consider the company and its subsidiaries together. This approach enables the Council to consider potential risks arising across the consolidated organization, while retaining the ability to make a determination regarding either the parent or any individual nonbank financial company subsidiary (or neither), depending on which entity the Council determines could pose a threat to financial stability.

Engagement With Company and Regulators in Stage 1

The Council will provide a notice to any nonbank financial company under review in Stage 1. In Stage 1, the Council will consider available public and regulatory information; in addition, a company under review in Stage 1 may submit to the Council any information it deems relevant to the Council's evaluation and may, upon request, meet with staff on the Council's analytical team. In order to reduce the burdens of review on the company, the Council will not require the company to submit information during Stage 1. In addition, staff on the analytical team will, upon request, provide the company with a list of the primary public sources of information being considered during the Stage 1 analysis, so that the company has an opportunity to understand the information the Council may rely upon during Stage 1.

During the discussions in Stage 1 with the company, the Council intends for staff of Council members and member agencies to explain to the company the key risks that have been identified in the analysis. Because the review of the company is preliminary and continues to change until the Council makes a final determination, these identified risks may shift over time.

The Council will also consider in Stage 1 information available from relevant existing regulators of the company. Under the Dodd-Frank Act, the Council is required to consult with the primary financial regulatory agency, if any, for each nonbank financial company or subsidiary of a nonbank financial company that is being considered for a determination before the Council makes any final determination with respect to such company.²⁵ For any company under review in Stage 1 that is regulated by a primary financial regulatory agency or home country supervisor, the Council will notify the regulator or supervisor that the company is under review no later than such time as the company is notified. As part of that consultation process, the Council will consult with the primary financial regulatory agency, if any, of each significant subsidiary of the nonbank financial company, to the extent the Council deems appropriate in

Stage 1, before the Council votes on whether to advance the company to Stage 2. The Council will actively solicit the regulator's views regarding risks at the company and potential mitigants. In order to enable the regulator to provide relevant information, the Council will share its preliminary views regarding potential risks at the company, and request that the regulator provide information regarding those specific risks, including whether the risks are adequately mitigated by factors such as existing regulation or the company's business practices. During the determination process, the Council will continue to encourage the regulator to address any risks to U.S. financial stability using the regulator's existing authorities; if the Council believes the regulator's actions adequately address the potential risks to U.S. financial stability the Council has identified, the Council may discontinue its consideration of the firm for a potential determination under section 113 of the Dodd-Frank Act.

Based on the preliminary evaluation in Stage 1, the Council may begin a more detailed analysis of the company by advancing the company to Stage 2, or it may decide not to evaluate the company further. If the Council determines not to advance a company that has been reviewed in Stage 1 to Stage 2, the Council will notify the company in writing of the Council's decision. The notice will clarify that a vote not to advance the company from Stage 1 to Stage 2 at that time does not preclude the Council from reinitiating review of the company in Stage 1. For example, the Council may reinitiate review of the company if material changes affecting the firm merit further evaluation.

b. Stage 2: In-Depth Evaluation

Stage 2 involves an in-depth evaluation of any company that the Council has determined merits additional review.

In Stage 2, the Council will review the relevant company using information collected directly from the nonbank financial company, as well as public and regulatory information. The review will focus on whether the nonbank financial company could pose a threat to U.S. financial stability because of the company's material financial distress or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company. The Council expects that the transmission channels discussed above, and other appropriate factors, will be used to evaluate a nonbank financial company's potential to pose a threat to U.S. financial stability.

Engagement With Company and Regulators in Stage 2

Each nonbank financial company to be evaluated in Stage 2 will receive a notice (a "Notice of Consideration") that the nonbank financial company is under consideration for a Proposed Determination. The Council also will submit to the company a request that the company provide information that the Council deems relevant to the Council's evaluation, and the nonbank financial company will be provided an opportunity to

submit written materials to the Council.²⁶ This information will generally be collected by the OFR. Before requiring the submission of reports from any nonbank financial company that is regulated by a Council member agency or any primary financial regulatory agency, the Council, acting through the OFR, will coordinate with such agencies and will, whenever possible, rely on information available from the OFR or such agencies. Council members and their agencies and staffs will maintain the confidentiality of such information in accordance with applicable law. During Stage 2, the company may also submit any other information that it deems relevant to the Council's evaluation. Information considered by the Council includes details regarding the company's financial activities, legal structure, liabilities, counterparty exposures, resolvability, and existing regulatory oversight.

Information requests likely will involve both qualitative and quantitative data. Information relevant to the Council's analysis may include confidential business information such as detailed information regarding financial assets, terms of funding arrangements, counterparty exposure or position data, strategic plans, and interaffiliate transactions.

The Council will make staff on the Council's analytical team available to meet with the representatives of any company that enters Stage 2, to explain the evaluation process and the framework for the Council's analysis. If the analysis in Stage 1 has identified specific aspects of the company's operations or activities as the primary focus for the evaluation, staff will notify the company of those issues, although the issues will be subject to change based on the ongoing analysis. In addition, the Council expects that its Deputies Committee will grant a request to meet with a company in Stage 2 to allow the company to present any information or arguments it deems relevant to the Council's evaluation.

During Stage 2 the Council will also seek to continue its consultation with the company's primary financial regulatory agency or home country supervisor in a timely manner before the Council makes any proposed or final determination with respect to such nonbank financial company. The Council will continue to encourage the regulator during the determination process to address any risks to U.S. financial stability using the regulator's existing authorities; as noted above, if the Council believes the regulator's actions adequately address the potential risks to U.S. financial stability the Council has identified, the Council may discontinue its consideration of the firm for a potential determination under section 113 of the Dodd-Frank Act.

Before making a Proposed Determination regarding a nonbank financial company, the Council will notify the company when the Council believes that the evidentiary record regarding such nonbank financial company is complete. The Council will notify any nonbank financial company in Stage 2 if the nonbank financial company ceases to be

²⁴ The Council's Deputies Committee is composed of senior officials from each Council member and member agency. It coordinates and oversees the work of the Council's other interagency staff committees.

²⁵ Dodd-Frank Act section 113(g), 12 U.S.C. 5323(g).

²⁶ See 12 CFR 1310.21(a).

considered for a determination. Any nonbank financial company that ceases to be considered at any time in the Council's determination process may be considered for a Proposed Determination in the future at the Council's discretion, consistent with the processes described above.

c. Proposed and Final Determination

Proposed Determination

Based on the analysis performed in Stage 2, a nonbank financial company may be considered for a Proposed Determination. A proposed determination requires a vote of two-thirds of the voting members of the Council then serving, including an affirmative vote by the Chairperson of the Council.²⁷ Following a Proposed Determination, the Council will issue a written notice of the Proposed Determination to the nonbank financial company, which will include an explanation of the basis of the Proposed Determination.²⁸ Promptly after the Council votes to make a proposed determination regarding a company, the Council will provide the company's primary financial regulatory agency or home country supervisor (subject to appropriate protections for confidential information) with the nonpublic written explanation of the basis of the Council's proposed or final determination. The Council also will publish the explanation of the basis of the Proposed Determination, subject to redactions to protect confidential information from the company or its regulators.

Hearing

A nonbank financial company that is subject to a Proposed Determination may request a nonpublic hearing to contest the Proposed Determination in accordance with section 113(e) of the Dodd-Frank Act. If the nonbank financial company requests a hearing in accordance with the procedures set forth in § 1310.21(c) of the Council's rule,²⁹ the Council will set a time and place for such hearing. The Council has published hearing procedures on its website.³⁰ In light of the short statutory timeframe for conducting a hearing, and the fact that the purpose of the hearing is to benefit the company, if a company requests that the Council waive the statutory deadline for conducting the hearing, the Council may do so in appropriate circumstances.

Final Determination

After making a Proposed Determination and holding any requested written or oral hearing, the Council may, by a vote of not fewer than two-thirds of the voting members of the Council then serving (including an affirmative vote by the Chairperson of the Council), make a final determination that the company will be subject to supervision by

the Federal Reserve and prudential standards. If the Council makes a final determination, it will provide the company with a written notice of the Council's final determination, including an explanation of the basis for the Council's decision.³¹ The Council will also provide the company's primary financial regulatory agency or home country supervisor (subject to appropriate protections for confidential information) with the nonpublic written explanation of the basis of the Council's final determination. The Council expects that its explanation of the final basis for any determination will highlight the key risks that led to the determination and include clear guidance regarding the factors that were most important in the Council's determination. When practicable and consistent with the purposes of the determination process, the Council will provide a nonbank financial company with a notice of a final determination at least one business day before publicly announcing the determination pursuant to § 1310.21(d)(3), § 1310.21(e)(3), or § 1310.22(d)(3) of the Council's rule.³² In accordance with section 113(h) of the Dodd-Frank Act, a nonbank financial company that is subject to a final determination may bring an action in U.S. district court for an order requiring that the determination be rescinded.

The Council does not intend to publicly announce the name of any nonbank financial company that is under evaluation prior to a final determination with respect to such company. However, if a company that is under review in Stage 1 or Stage 2 publicly announces the status of its review by the Council, the Council intends, upon the request of a third party, to confirm the status of the company's review. In addition, the Council will publicly release the explanation of the Council's basis for any nonbank financial company determination or rescission of a determination. The Council is subject to statutory and regulatory requirements to maintain the confidentiality of certain information submitted to it by a nonbank financial company or its regulators.³³ In light of these confidentiality obligations, such confidential information will be redacted from the materials that the Council makes publicly available.

V. Annual Reevaluations of Nonbank Financial Company Determinations

After the Council makes a final determination regarding a company, the Council intends to encourage the company or its regulators to take steps to mitigate the potential risks identified in the Council's written explanation of the basis for its final determination. Except in cases where new material risks arise over time, if a company adequately addresses the potential risks identified in writing by the Council at the time of the final determination and in subsequent reevaluations, the Council should

generally be expected to rescind its determination regarding the company.

For any nonbank financial company that is subject to a final determination, the Council is required to reevaluate the determination at least annually, and to rescind the determination if the Council determines that the company no longer meets the statutory standards for a determination. The Council may also consider a request from a company for a reevaluation before the next required annual reevaluation, in the case of an extraordinary change that materially decreases the threat the nonbank financial company could pose to U.S. financial stability.

The Council applies the same standards of review in its annual reevaluations as the standard for an initial determination regarding a nonbank financial company: either the company's material financial distress, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the company's activities, could pose a threat to U.S. financial stability. If the Council determines that the company no longer meets those standards, the Council will rescind its determination.

The Council's annual reevaluations generally assess whether any material changes since the previous reevaluation and since the determination justify a rescission of the determination, based on the same transmission channels and other factors that are considered during a determination decision. The Council expects that its reevaluation process will focus on whether any material changes—including changes at the company, changes in its markets or its regulation, changes in the Council's own analysis, or otherwise—result in the company no longer meeting the standard for a determination. In light of the frequent reevaluations, the Council's analyses will generally focus on changes since the Council's previous review, but the ultimate question the Council will seek to assess is whether changes in the aggregate since the Council's determination regarding the company have caused the company to cease meeting the Determination Standards. The Council expects that its analysis in its annual reevaluations will generally be organized around the three transmission channels described above as well as existing regulatory scrutiny and the company's complexity and resolvability.

Before the Council's annual reevaluation of a determination regarding a nonbank financial company, the Council will provide the company with an opportunity to meet with staff of Council members and member agencies to discuss the scope and process for the review and to present information regarding any change that may be relevant to the threat the company could pose to financial stability. Staff of Council members and member agencies will also be available to meet with the company during the annual reevaluation, at the company's request. In addition, during an annual reevaluation, a company may submit any written information to the Council the company considers relevant to the Council's analysis. During annual reevaluations, companies are encouraged to submit information regarding

²⁷ 12 CFR 1310.10(b).

²⁸ Dodd-Frank Act section 113(e)(1), 12 U.S.C. 5323(e)(1).

²⁹ See 12 CFR 1310.21(c).

³⁰ Financial Stability Oversight Council Hearing Procedures for Proceedings Under Title I or Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, available at <https://www.treasury.gov/initiatives/fsoc/designations/Pages/Hearing-Procedures.aspx>.

³¹ Dodd-Frank Act section 113(e)(3), 12 U.S.C. 5323(e)(3); see also 12 CFR 1310.21(d)(2) and (e)(2).

³² See 12 CFR 1310.21(d)(3) and (e)(3) and 1310.22(d)(3).

³³ See Dodd-Frank Act section 112(d)(5), 12 U.S.C. 5322(d)(5); see also 12 CFR 1310.20(e).

any changes related to the company's risk profile that mitigate the potential risks previously identified by the Council. Such changes could include updates regarding company restructurings, regulatory developments, market changes, or other factors. If the company has taken steps to address the potential risks previously identified by the Council, the Council will assess whether those risks have been adequately mitigated to merit a rescission of the determination regarding the company. If the company explains in detail potential changes it could make to its business to address the potential risks previously identified by the Council, staff of Council members and member agencies will endeavor to provide their feedback on the extent to which those changes may address the potential risks.

If a company contests the Council's determination during the Council's annual reevaluation, the Council will vote on whether to rescind the determination and provide the company, its primary financial regulatory agency, and the primary financial regulatory agency of its significant subsidiaries with a notice explaining the primary basis for any decision not to rescind the determination. If the Council does not rescind the determination, the written notice provided to the company will address each of the material factors raised by the company in its submissions to the Council contesting the determination during the annual reevaluation. The written notice from the Council will also explain in detail why the Council did not find that the company no longer met the standard for a determination under section 113 of the Dodd-Frank Act. In general, due to the sensitive nature of its analyses in annual reevaluations, the Council may not in all cases publicly release the written findings that it provides to the company.

Finally, the Council will provide each nonbank financial company subject to a Council determination with an opportunity for an oral hearing before the Council once every five years at which the company can contest the determination.

Dated: March 6, 2019.

Bimal Patel,

Deputy Assistant Secretary for the Financial Stability Oversight Council, Department of the Treasury.

[FR Doc. 2019-04488 Filed 3-12-19; 8:45 am]

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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 71

[Docket No. FAA-2019-0124; Airspace Docket No. 18-ASO-18]

Proposed Establishment and Amendment of Area Navigation (RNAV) Routes; Southeastern United States

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: This action proposes to establish 2 new low altitude RNAV routes T-239, and T-258, and modify 3 existing RNAV routes T-290, T-292, and T-294 in the southeastern United States. The proposal would expand the availability of RNAV routing in support of transitioning the National Airspace System (NAS) from ground-based to satellite-based navigation.

DATES: Comments must be received on or before April 29, 2019.

ADDRESSES: Send comments on this proposal to the U.S. Department of Transportation, Docket Operations, 1200 New Jersey Avenue SE, West Building Ground Floor, Room W12-140, Washington, DC 20590; telephone: 1 (800) 647-5527 or (202) 366-9826. You must identify FAA Docket No. FAA-2019-0124; Airspace Docket No. 18-ASO-18 at the beginning of your comments. You may also submit comments through the internet at <http://www.regulations.gov>.

FAA Order 7400.11C, Airspace Designations and Reporting Points, and subsequent amendments can be viewed online at http://www.faa.gov/air_traffic/publications/. For further information, you can contact the Airspace Policy Group, Federal Aviation Administration, 800 Independence Avenue SW, Washington, DC 20591; telephone: (202) 267-8783. The Order is also available for inspection at the National Archives and Records Administration (NARA). For information on the availability of FAA Order 7400.11C at NARA, call (202) 741-6030, or go to <http://www.archives.gov/federal-register/cfr/ibr-locations.html>.

FAA Order 7400.11, Airspace Designations and Reporting Points, is published yearly and effective on September 15.

FOR FURTHER INFORMATION CONTACT: Paul Gallant, Airspace Policy Group, Office of Airspace Services, Federal Aviation Administration, 800 Independence Avenue SW, Washington, DC 20591; telephone: (202) 267-8783.

SUPPLEMENTARY INFORMATION:

Authority for This Rulemaking

The FAA's authority to issue rules regarding aviation safety is found in Title 49 of the United States Code. Subtitle I, Section 106 describes the authority of the FAA Administrator. Subtitle VII, Aviation Programs, describes in more detail the scope of the agency's authority. This rulemaking is promulgated under the authority

described in Subtitle VII, Part A, Subpart I, Section 40103. Under that section, the FAA is charged with prescribing regulations to assign the use of the airspace necessary to ensure the safety of aircraft and the efficient use of airspace. This regulation is within the scope of that authority as it would expand the availability of RNAV in the eastern United States to improve the efficiency of the NAS by lessening the dependency on ground-based navigation.

Comments Invited

Interested parties are invited to participate in this proposed rulemaking by submitting such written data, views, or arguments as they may desire. Comments that provide the factual basis supporting the views and suggestions presented are particularly helpful in developing reasoned regulatory decisions on the proposal. Comments are specifically invited on the overall regulatory, aeronautical, economic, environmental, and energy-related aspects of the proposal.

Communications should identify both docket numbers (FAA Docket No. FAA-2019-0124; Airspace Docket No. 18-ASO-18) and be submitted in triplicate to the Docket Management Facility (see **ADDRESSES** section for address and phone number). You may also submit comments through the internet at <http://www.regulations.gov>.

Commenters wishing the FAA to acknowledge receipt of their comments on this action must submit with those comments a self-addressed, stamped postcard on which the following statement is made: "Comments to FAA Docket No. FAA-2019-0124; Airspace Docket No. 18-ASO-18." The postcard will be date/time stamped and returned to the commenter.

All communications received on or before the specified comment closing date will be considered before taking action on the proposed rule. The proposal contained in this action may be changed in light of comments received. A report summarizing each substantive public contact with FAA personnel concerned with this rulemaking will be filed in the docket.

Availability of NPRM's

An electronic copy of this document may be downloaded through the internet at <http://www.regulations.gov>. Recently published rulemaking documents can also be accessed through the FAA's web page at http://www.faa.gov/air_traffic/publications/airspace_amendments/.

You may review the public docket containing the proposal, any comments