February 25, 2011

Financial Stability Oversight Council
1500 Pennsylvania Avenue, NW
Washington, DC 20220
Attn: Lance Auer

RE: 12 CFR Part 1310 – Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (RIN 4030-AA00)

Dear Mr. Auer:

On behalf of our member organizations who are not part of bank holding companies, the American Financial Services Association ("AFSA") welcomes the opportunity to provide comments on the Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (the "Notice") published by the Financial Stability Oversight Council (the "Council") under Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or the "Act"). AFSA represents a broad cross-section of financial services companies that provide credit products and services to consumers, many of which do not have a depository institution within their organizational structure. Members of the association include leading consumer finance companies, indirect automotive finance companies and residential mortgage lenders. Some members are captive financing arms of larger manufacturing or retail companies, while other members are independent providers of financial products and services. Given the diversity in the size, scope and complexity of its membership, AFSA is uniquely positioned to provide thoughtful comments to the Notice that are informed through input from various participants in the financial services market with direct interests in the application of Section 113 and its implications.

We commend the Council for its attempt to provide direction to nonbank financial companies on the criteria to be used in designating systemically important nonbank financial companies to be supervised by the Board of Governors of the Federal Reserve. We believe there are areas in the proposed rule where the Council should make revisions to provide better guidance to itself and to nonbank financial companies.

AFSA’s recommendations for revisions are set out below. The recommendations require several substantive changes in the proposed rule. The recommendations add significant detail that is not currently in the proposed rule, but which the Council indicates in the supplementary
information contained in the Notice will be used to determine which nonbank financial companies will be designated as systemically important. Without the details being set out in the rule, there is a concern the determination process used by the Council may not be consistent for all nonbank financial companies.

AFSA, therefore, believes incorporating these details into the final rule is critical. Because there has not been an opportunity to review the Council's interpretation of these important details, AFSA strongly recommends the Council reissue for public comment a proposed rule addressing the matters set out in this letter.

With that in mind AFSA offers comments on the following specific parts of the proposed rule:

**Analytical Framework**

In the overview of the proposed rule contained in the Notice, the Council indicates support for the concept of examining the risk profiles of different industry sectors and applying appropriate metrics to each sector. The Notice also sets out six categories (encompassing the statutory criteria) in an analytical framework. AFSA has two comments on these categories. First, none of the categories is carried through to the proposed rule. We urge the Council to do so. Second, in order for the Council to fully carry out its statutory mandate in Section 113 of the Act, the Council should add material financial distress as a seventh category. Specifically, the Council should add to its analytical framework the potential that a company's material financial distress would pose a threat to the financial stability of the United States. The Act requires that a determination by the Council must be based in finding material financial distress at the company, or that the nature, scope, size, scale, concentration, interconnectedness, or mix the company's activities, could pose a threat to the financial stability of the United States. The analytical framework set out in the Notice addresses the nature, scope, size, scale, concentration, interconnectedness and mix of a company's activities. It does not address the impact of a company's material financial distress. Whether a company might be in material financial distress should be a factor for consideration.

Adding material financial distress to the analytical framework would require the Council to define "material financial distress" and "financial stability." In the Notice, the Council states there was broad consensus under the Advance Notice of Proposed Rulemaking that it should define "material financial distress" and "financial stability." The proposed rule does not give guidance on how the Council interprets these terms. A clear understanding of the meaning of the terms is necessary to ensure consistent application of the statutory standard.

The use of "material" with any term suggests that the item is to be measured, for a determination of whether is it material. It is incumbent on the Council to develop metrics for it to determine when a company is in material financial distress and the impact of that material financial distress on the nation's financial stability. Those metrics need to be a part of any final rule, with the opportunity for public comment before incorporation into a rule.
Further, the Council should provide definition and metrics to each category so nonbank financial companies may determine how they are to be judged. Ultimately, the Council must set out how the categories will be applied to each financial industry sector. We suggest the following for consideration as to four of the categories.

**Size**

We agree that the analysis of a company's size should not be limited to the amount of assets held by a company. The metrics adopted should recognize the systemic significance of those participants in the market whose failure would necessarily result in systemic lack of credit availability, while also recognizing the converse of that principal, that the failure of a participant whose clients are faced with multiple alternatives for financial products and services has inherently less of a systemic impact. Size and/or market share should not be used exclusively as a proxy for review of the considerations in Section 113. The ease with which a given nonbank financial company can be replaced or is interchangeable with another firm or company suggests that market share or size are not necessarily an indicator of systemic risk.

**Lack of Substitutes**

In determining the lack of substitutes for financial services and products the Council should adopt metrics that focus on anticipated market disruptions caused by a company’s failure by taking into account the nature and complexity of the products or services offered by a nonbank financial company and the ease with which other firms can enter the market for the nonbank financial company’s financial products and services and/or alternative products and services. The variety and complexity of the financial products offered necessarily impacts the number of alternative sources a customer may have for the product. It may be possible that certain finance segments have so little cross-connectedness to the system as to pose little systemic risk. The systemic importance of providers of complex products is relatively higher than providers of more basic products. The concept of product complexity, however, is captured if the Council considers metrics that accurately determine the potential retail market disruption of a company’s failure. Those companies that offer more complex products for which the customer has few alternative sources will inherently present a higher potential for retail market disruption than those that offer products for which alternative sources are abundant.

A key factor in the analysis of a lack of substitutes should be barriers to entry for competitive providers of financial services. The products offered by nonbank financial companies can also be offered by banks, thrifts or credit unions, but in some cases the converse is not also true. Some of the more complicated bank, thrift and credit union products are not offered by nonbank financial companies. As compared to depository institutions that must seek and obtain federal approval under the statutory factors enumerated in Section 6 of the Federal Deposit Insurance Act or Section 201 of the Federal Credit Union Act to accept insured deposits as a key source of funding for credit products, nonbank financial companies face substantially fewer
barriers to entry. Nonbank financial companies offer relatively “simpler” financial products and services and ease to market, often directed at a single product or industry. The likelihood that they will present a risk to retail market disruption is materially less.

**Interconnectedness**

The level and measurement of interconnectedness of a nonbank financial company should focus on the level of interrelationships the company maintains with respect to the financial products and services it offers. It may be assessed by the Council in terms of institutional disruption that would arise upon a given nonbank financial company’s failure.

In general terms, the measurement should assess whether failure of the subject nonbank financial company enhances or threatens the financial condition and competitive position of other significant financial companies. AFSA’s members, similar to most nonbank financial companies, are primarily of the type whose failure or decision to terminate a specific product offering would arguably enhance the position of other participants in the market. It is our expectation that the same statement may not hold true for complex financial services firms on which other financial firms rely as sources of funding or risk mitigation.

Absent a specific focus on interconnectedness among systemically important firms, an inventory of relationships among various bank and nonbank financial companies in the market would not facilitate the designation of nonbank financial companies that present a significant risk of institutional disruption (i.e., interconnectedness). We believe interconnectedness among systemically important firms is relevant for purposes of the Act, but interconnectedness among others financial firms is not.

Other considerations the Council should bear in mind are the timing (current versus contingent) and nature or scope of the relationships. We would also recommend that the Council take into consideration factors which may mitigate the risk and exposure of relationships among banks and nonbank financial companies, such as whether collateral exists to cover obligations and the dilution of risk across multiple institutions.

**Existing Regulatory Scrutiny**

The existing regulatory scrutiny category should not be limited to supervision at the federal level. Any nonbank financial company that may be subject to this Notice must already comply with the requirements of multiple state and federal laws. For state law purposes, a nonbank financial company is often registered with or licensed by one or more state agencies to offer financial products and services. Although the level of examination and supervision provided by state agencies may differ from jurisdiction to jurisdiction and from license-type to license-type, each shares the underlying goal of ensuring that operational safeguards established by state law are followed and that a company is under prudent management. Generally speaking, a state’s focus is on the protection of residents through the enforcement of compliance obligations on licensed providers of financial services in its state.
State financial services examiners regularly assess a nonbank financial company for compliance with federal consumer protection laws, including the Truth in Lending Act, the Fair Credit Reporting Act and the Equal Credit Opportunity Act. State-licensed members of AFSA must also abide by consumer protection statutes enacted in all of the states in which they do business. It is also true that many states require confirmation of a stated level of capital, bonding requirements and/or an assessment of management’s financial standing and background in order to issue a license to a nonbank financial company.

Nonbank financial companies have been successful in providing needed credit and other financial products and services in the communities in which they operate in part because of the oversight of state regulators who have a familiarity with local and regional situations and issues faced by lenders. This knowledge, along with their geographic proximity to a given lender and financial market, means that state regulators are often the first to identify emerging issues, practices or products that may need further investigation or may pose additional risk to the financial industry. Though the state system has not been perfect, no one can argue that states have not aggressively fought abusive lending. Over the past three years, states have taken thousands of enforcement actions. The Dodd-Frank Act further reinforces reliance on state regulators by re-working the mechanics for federal preemption offered to federally chartered banks and calling for a coordination of efforts among state and federal regulators in identifying and addressing future issues in the financial system before they lead to systemic crises.

Primary Financial Regulatory Agency

The proposed rule provides a definition of "primary financial regulatory agency." Conspicuously absent from the list of entities being primary financial regulatory agencies are the Federal Trade Commission and the state agencies regulating finance companies. Both of these supervise nonbank financial companies.

State regulators regularly review the activities of their licensed, non-bank lenders. These reviews include the nonbank's compliance with state and federal consumer protection laws. In addition, the state regulators request substantial information, generally on an annual basis, regarding the nonbank's portfolio and volumes and its management structure, including personal financial data and fingerprints. The New York State Banking Department, for instance, engages in detailed examination of the nonbank's overall operations, including information technology practices, risk management guidelines, auditing practices and related governance. The state regulator may revoke or suspend the nonbank's lending license if it finds any aspect of the nonbank's practices deficient. The Federal Trade Commission has broad powers to regulate nonbank practices through its enforcement of section 5 of the Federal Trade Commission Act and its specific rules regarding unfair and deceptive trade practices. Many of the Federal Trade Commission's current rules are fundamental to nonbank lending practices (e.g., The Perseveration of Claims and Defenses and the Credit Practices Rule). Additionally, the Federal Trade Commission's expedited rule-making authority over automobile dealers, as granted by the Dodd-Frank Act, could result in significant regulation of automotive financing.
practices, for those nonbanks in that industry. Given the scope of these agencies regulatory
designation for supervision. It is because of these significant consequences that AFSA again urges the Council to reissue, for public comment, a proposed
rule that incorporates the suggestions made in this letter.
AFSA appreciates the opportunity to comment on this Notice of Proposed Rulemaking. Please feel free to contact me with any questions at 202-296-5544, ext. 616 or bhimler@afsamail.org.

Respectfully submitted,

Bill Himpler
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American Financial Services Association