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FINANCIAL STABILITY OVERSIGHT COUNCIL RELEASES PROPOSED FRAMEWORK TO DESIGNATE FINANCIAL COMPANIES AS SYSTEMICALLY SIGNIFICANT UNDER THE DODD-FRANK ACT

To Our Clients and Friends:

On January 18, 2011, the Financial Stability Oversight Council (the "Council") released a [notice of proposed rulemaking](#) ("NPR") that sets forth the proposed criteria and analytical framework for the Council to designate an entity as a nonbank financial company under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "DFA").

Pursuant to the DFA, the Council has the authority to require that the Federal Reserve Board supervise a designated nonbank financial company and that the company be subject to prudential standards in accordance with Title I of the DFA. Under the DFA, the Council will designate a systemically significant entity as a covered nonbank financial company if the Council determines that material financial distress at such an entity, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the entity, could pose a threat to the financial stability of the United States.

The NPR comment period will be for 30 days after the release is published in the Federal Register in the near future. In the NPR, the Council stated that it expects to begin assessing the systemic importance of nonbank financial companies under the proposed framework shortly after adopting a final rule.

As described in our previous Alert, "[The Dodd-Frank Act: Application of Heightened Bank-Like Supervision and Regulation to Systemically Significant Financial Companies](#)," the DFA provides a nonexclusive list of statutory factors the Council must consider in making such a determination. Through the NPR, the Council is requesting public comment on the specific criteria and framework that should be used to apply the statutory factors. The NPR also evaluates the comments that were submitted on the October 6, 2010 advance notice of proposed rulemaking on this topic.

Analytical Framework for Assessing Systemic Importance

The NPR's proposed analytical framework is organized around six broad categories. Per the NPR, "Each of the proposed categories reflects a different dimension of a firm's potential to experience material financial distress, as well as the nature, scope, size, scale, concentration, interconnectedness and mix of the company's activities." Each of the statutory factors or other discretionary factors selected is relevant to, and would be considered as part of, one or more categories within this analytical framework.

The six systemically important categories are:

1. Size;
2. Lack of substitutes for the financial services and products the company provides;

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3. Interconnectedness with other financial firms;
4. Leverage;
5. Liquidity risk and maturity mismatch; and
6. Existing regulatory scrutiny.

The criteria in the first three categories seek to assess the potential for spillovers from the firm's distress to the broader financial system or real economy. The criteria in the second three categories seek to assess how vulnerable a company is to financial distress. The Council, using its judgment, would evaluate nonbank financial companies in each of the six categories, using quantitative metrics where possible.

Thus, this approach incorporates both quantitative measures and qualitative judgments. Per the NPR, "[A]s part of the qualitative judgment, the Council would consider potential spillovers that could occur from financial distress or failure of the company in normal times, as well as those that could occur in times of widespread financial stress."

By way of illustration of the framework, the table below provided in the NPR sets forth the statutory factors for assessing a U.S. nonbank financial company and then aligns them with one or more of the six analytical categories in the framework.

Statutory factors:	Category or categories in which this factor would be considered:
(A) the extent of the leverage of the company;	Leverage
(B) the extent and nature of the off-balance-sheet exposures of the company;	Size; Interconnectedness
(C) the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;	Interconnectedness
(D) 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 United States financial system;	Size; Lack of substitutes
(E) the importance of the company as a	Lack of substitutes

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;	
(F) 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;	Size; Interconnectedness
(G) the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;	Size; Lack of substitutes; Interconnectedness
(H) the degree to which the company is already regulated by 1 or more primary financial regulatory agencies;	Existing regulatory scrutiny
(I) the amount and nature of the financial assets of the company;	Size; Interconnectedness
(J) the amount and types of the liabilities of the company, including the degree of reliance on short-term funding;	Liquidity risk and maturity mismatch; Size; Interconnectedness
(K) any other risk-related factors that the Council deems appropriate.	Appropriate category or categories based on the nature of the additional risk-related factor

Importantly, determinations using this analytical framework are to be based on whether the firm could pose a threat to the financial stability of the United States in accordance with the DFA. Thus, if a firm would not pose such a threat, then implicating a statutory factor or category should not be sufficient for a firm to be designated a covered nonbank financial company.

For example, take the case of a firm that is a highly significant entity in the United States with respect to the statutory factor of "the importance of the company as a source of credit for low-income, minority, or underserved communities," and assume that the failure of such company would have a significant effect on the availability of credit in such communities because of a lack of substitutes. Nonetheless, this would not be sufficient for the firm to be designated a covered nonbank financial company if it did not otherwise pose a threat of systemic risk to the financial stability of the United States.

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The Council also recognized that the application of the framework should be adapted for the risks presented by a particular industry sector and the business models present in each sector. Thus, any metrics that are utilized will be industry specific and "likely will differ across industry sectors." Accordingly, the most important determinants or metrics for a company and its industry remain to be developed as part of the determination process and the implementation of the standards established under the DFA. The Council is also required to review these metrics on a periodic basis and revise them as appropriate.



Gibson, Dunn & Crutcher lawyers are available to assist in addressing any questions you may have regarding the issues discussed above. Please contact [Christopher J. Bellini](mailto:cbellini@gibsondunn.com) (202-887-3693, cbellini@gibsondunn.com) in the firm's Washington, D.C. office, the Gibson Dunn attorney with whom you work, or any member of the firm's Financial Institutions Practice Group.

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