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Submitted Electronically via https://www.regulations.gov

Financial Stability Oversight Council
Attn: Eric Froman, Office of the General Counsel
1500 Pennsylvania Avenue, NW
Room 2308
Washington, DC 20220

Re: Request for Comment on Notification of Proposed Interpretive Guidance Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies; Request for Comment on Proposed Analytic Framework for Financial Stability Risk Identification, Assessment, and Response

Dear Mr. Froman:

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to comment on the Financial Stability Oversight Council's ("FSOC" or "Council") proposed interpretive guidance governing the designation of nonbank financial companies for supervision by the Board of Governors of the Federal Reserve System ("Federal Reserve Board") and application of prudential standards ("Proposed Guidance")[2] and proposed analytic framework for identifying, assessing, and responding to potential financial stability risks ("Proposed Framework" and together with the Proposed Guidance, the "Proposals").[3]

The FSOC plays an important role identifying and assessing emerging threats to U.S. financial stability. Fidelity supports the FSOC's mission and a regulatory approach that meets the FSOC's objective of mitigating risks to financial stability through means other than designating individual entities based on size. We appreciate the FSOC's goal with the Proposals of addressing elements of designation that members of the Council view as less effective.[4]

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1 Fidelity is a leading provider of mutual fund management and distribution, securities brokerage, and retirement plan recordkeeping, among other businesses.

2 *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 88 Fed. Reg. 26,234 (Apr. 28, 2023), *available at* https://www.govinfo.gov/content/pkg/FR-2023-04-28/pdf/2023-08964.pdf.

3 *See* Analytic Framework for Financial Stability Risk Identification, Assessment, and Response, 88 Fed. Reg. 26,305 (Apr. 28, 2023), *available at* https://www.govinfo.gov/content/pkg/FR-2023-04-28/pdf/2023-08969.pdf.

4 Remarks by Secretary of the Treasury Janet L. Yellen at Financial Stability Oversight Council Meeting (Apr. 21, 2023), *available at* https://home.treasury.gov/news/press-releases/jy1431.

However, in broadening and accelerating the FSOC's process for identifying and designating certain nonbank financial companies as systemically important, and thus subject to the Federal Reserve Board's prudential standards, the Proposals reinstate elements of the prior flawed approach to systemic risk regulation[5] and exceed the FSOC's statutory mandate from Congress. The Proposals also would risk misapplying bank regulations that are both unnecessary and fundamentally incompatible with nonbank financial companies. In our letter, we outline key issues that the Council should address, including:

1. The renewed emphasis on entity designation over an activities-based approach is not only inefficient and ineffective, but would also harm customers, investors, and markets, while failing to achieve FSOC's desired outcomes.

2. The Proposals overlook the requirement and benefits of relying on primary financial regulators, who specialize in the nonbank business sectors they oversee.

3. By failing to assess the actual likelihood of a nonbank financial company's material financial distress, the Proposals would grant the Federal Reserve Board authority over vast sectors of the economy in a manner that exceeds the statutory authority from Congress.

4. The Proposals' reinterpretation of "threat to the financial stability of the United States" meaningfully lowers the threshold for FSOC designation, creating regulatory uncertainty.

5. The designation process should retain the existing robust cost-benefit analysis requirement, which obligates the FSOC to account for real and potentially damaging consequences of nonbank financial company designations, including the costs borne by customers.

6. The Proposed Framework identifies four transmission channels that are most likely to facilitate transmission of financial stability risks, without the necessary transparency into their application, nor explanation into how they relate to the eight vulnerabilities enumerated in the Proposals.

I. The renewed emphasis on entity designation over an activities-based approach is not only inefficient and ineffective, but would harm customers, investors, and markets, while failing to achieve FSOC's desired outcomes.

The FSOC should continue to prioritize an activities-based approach to addressing risks to financial stability, which leads to better outcomes for nonbank customers, investors, and markets. If the FSOC proceeds with deprioritizing the activities-based approach, it must thoroughly and carefully evaluate the impact of any individual company designation in light of its statutory purpose and authority before proceeding.

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5 *See* Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21,637 (Apr. 11, 2012), *available at* https://www.govinfo.gov/content/pkg/FR-2012-04-11/pdf/2012-8627.pdf.

The activities-based approach better positions the FSOC to identify and address system-wide risks that might impact financial stability and the broader economy. The approach reflects two key priorities: (i) identifying and addressing potential risks and threats to U.S. financial stability on a system-wide basis, and (ii) allowing relevant primary financial regulatory agencies to address potential risks, rather than subjecting companies to new regulatory authorities.[6] By contrast, individual company designations increase costs for U.S. customers and investors, are inefficient and ineffective, distort competitive markets, disadvantage U.S. companies, and misapply bank regulation to nonbank financial companies. By doing so, individual company designations do not effectively identify, assess, and respond to financial stability risks that might be posed by nonbank financial companies.

- **Individual company designations misapply bank regulation to nonbank financial companies.** As an initial matter, the individual company designation scheme established by Section 113 of the Dodd-Frank Act ("Section 113") is ill-suited for, and fundamentally incompatible with, the activities and risks posed by nonbank financial companies, including asset managers, broker-dealers, retirement plan recordkeepers, private funds, insurance companies, and payment providers. The requirements that would be imposed on a designated nonbank financial company—including enhanced capital and leverage requirements, stress testing requirements, liquidity requirements, resolution planning requirements and concentration limits[7]—were developed for banks, which take insured deposits and comply with a regulatory framework centered around safety and soundness to protect customer deposits.[8]

  Unlike banks, nonbank financial companies that engage in capital markets activities, such as asset managers, are regulated and supervised under a wholly different paradigm designed to assess, disclose, mitigate, and monitor the specific risks presented by their respective business models—not one designed to protect investors from appropriate risk-taking. The existing requirements for nonbank financial companies are appropriate for their business models. A prudential framework focused on safety and soundness for banking institutions is fundamentally incompatible with the capital markets where investors knowingly put their capital at risk, subject to a comprehensive investor protection framework established by market regulators like the Securities and Exchange Commission ("SEC"), benefitting businesses, markets, and those investors, in the form of

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6 *See* 2019 Guidance, at 71,744.

7 See 12 U.S.C. § 5365.

8 See 12 U.S.C. § 1831p-1 (requiring the federal banking agencies to prescribe standards for safety and soundness); see also 12 U.S.C. § 1818(b) (authorizing the federal banking agencies to take enforcement action for unsafe or unsound practices).

higher returns.[9] These requirements reflect the substantial differences between banks and nonbank financial companies.

For example, there are a number of critical differences between asset managers and banks that render the Federal Reserve Board's bank regulatory toolkit a poor fit for asset managers. Most mutual funds cannot become insolvent because they employ little or no leverage. Asset managers similarly employ little or no leverage and face little or no risk of sudden insolvency.[10] Fluctuations in asset values within fund portfolios do not threaten a manager's solvency the way similar fluctuations in the values of a bank's assets can threaten its solvency because asset managers do not bear the credit or market risk of fund portfolios.[11]

Fund managers conduct an agency business in which they manage a fund's assets and provide ongoing services that the fund needs to operate in exchange for fees. Asset management fees are tied to assets under management and are paid by funds out of fund assets. Managers rely on fee-based income rather than "investing on behalf of the firm to obtain the potential for positive performance with high-risk assets."[12]

Asset management is resilient, and managers have proven to be financially stable. Managers with a large amount of assets under management in particular are typically highly diversified with multiple investment products across multiple strategies and their overall results tend not to depend on any particular segment of the market. Steady sources of client assets, such as 401(k) contributions, continue to flow into funds during times of stress, mitigating outflows that may occur during the same conditions. Investors and funds also rebalance their portfolios by periodically buying or selling assets to maintain their desired level of asset allocation, which has a similar countercyclical effect for managers and markets.[13]

The suggestion that applying bank regulation to nonbank financial companies would make the financial system safer is misleading for two reasons. First, as illustrated by the

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9 *See, e.g.*, Chair Mary Jo White, "Chairman's Address at SEC Speaks 2014" (Feb. 21, 2014), *available at* https://www.sec.gov/news/speech/2014-spch022114mjw ("We want to avoid a rigidly uniform regulatory approach solely defined by the safety and soundness standard that may be more appropriate for banking institutions.").

10 *See, e.g.*, Andrew G. Haldane, Exec. Dir. of Fin. Stability, Bank of Eng., Speech: The Age of Asset Management? (Apr. 4, 2014), *available at* https://www.bankofengland.co.uk/-/media/boe/files/speech/2014/the-age-of-asset-management.pdf ("[A]sset managers are essentially unlevered"; and "[a]sset managers are, to a large extent, insolvency-remote.").

11 *Id.* ("As an agency function, asset managers do not bear credit, market and liquidity risk on their portfolios. . . .Fluctuations in asset values do not threaten the insolvency of an asset manager as they would a bank.").

12 *See* Letter from the Investment Company Institute to the Secretariat of the Fin. Stability Bd., A-3 (Apr. 7, 2014), *available at* https://www.ici.org/doc-server/pdf%3A14_ici_fsb_gsifi_ltr.pdf.

13 John Gidman, Chief Info. Officer, Loomis, Sayles & Co., Remarks at the Financial Stability Oversight Council Conference on Asset Management in Washington D.C., 211-212 (May 19, 2014) ("[O]ur experience with sophisticated institutional investors is markedly countercyclical. When we have a good

number of bank failures, including those that occurred recently, and their impact on the larger U.S. economy, bank regulation is not a panacea. Second, because asset managers do not face the risk of failure in the manner that banks face, the application of bank regulation to asset managers is unnecessary and ineffective to achieve the aims for which it was designed, as well as harmful to investors and the vibrancy of the U.S. markets.[14] To the contrary, the financial system is safer with a diverse range of business models, coupled with specialized regulatory agencies applying cross-industry standards appropriately tailored to those models.

- **Individual company designations increase costs and limit choices for customers and investors.** Nonbank financial company designations increase the costs of providing many financial products and services, which in many cases would be borne by their customers and investors. For example, one firm estimated that annual compliance costs alone were between $100 million and $150 million as a result of designation.[15] A nonbank financial company could also respond to the increased costs of designation by exiting certain business lines in an effort to be de-designated, resulting in fewer choices for investors.

- **Individual company designations are inefficient and ineffective.** The steps of evaluating a company for potential designation, making a final determination, resolving any litigation, and designing and applying final regulations takes years. Even after nonbanks were designated under the 2012 Guidance, it took the Federal Reserve Board years longer to design and adopt rules for them. That years-long lag between designation and regulation renders designation inherently ineffective and inefficient during that interim period. Entity-based designation should be a tool of last resort after alternative, less damaging means of mitigating verifiable threats to U.S. financial stability prove unavailing.

- **Individual company designations distort competitive markets and disadvantage U.S. companies.** The FSOC has previously recognized that entity-based designations could result in "competitive market distortions" given the variation in treatment of similarly situated firms in highly competitive markets.[16] As the Council has previously discussed, entity designation "forces the council to pick winners and losers from among firms in a competitive industry…[which] may adversely affect the competitive environment in

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quarter, we get redemptions. When we have a bad quarter, we get more inflows. And that really relates to asset allocation decisions made by the end asset owner. They are not runs. They are putting risk on the table and taking risk off the table based on a predetermined asset allocation strategy they have that they're well able to manage and monitor.").

14 *See* Fed. Deposit Ins. Corp., Failed Bank List (last updated May 1, 2023), *available at* https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/.

15 *See* Alistair Gray, *AIG sheds $150m in costs along with Sifi label*, FIN. TIMES (Oct. 1, 2017), *available at* https://www.ft.com/content/31b36b9a-a662-11e7-93c5-648314d2c72c. The compliance costs would be notably higher in 2023 dollars.

16 *See* 2019 Guidance, at 71,742.

unfair and arbitrary ways".[17] The Council should be wary of tilting the competitive landscape among financial services firms through its designation toolkit. Moreover, these distortions are likely to fall disproportionately on U.S. companies because companies outside the U.S. are not subject to a similar designation construct.[18] The FSOC's proposal to deprioritize an activities-based approach to addressing potential risks to U.S. financial stability will unnecessarily reintroduce the possibility of these types of market distortions.

II. The Proposals overlook the requirement and benefits of relying on primary financial regulators, who specialize in the nonbank business sectors they oversee.

In the intervening years since Congress created the FSOC, federal financial regulators have promulgated significant additional rules and regulations that increase regulatory oversight and transparency and decrease the potential for contagion risks that were the objects of the original 2012 guidance.[19] For example, since the financial crisis of 2008, the SEC has revised the risk management requirements relating to open-end funds[20] and money market funds[21] on several occasions. The FSOC had identified risks in these markets[22] and the SEC as the primary

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17 Gonzalez, G. (2017, Oct. 2) Competitive impact, financial market stability debated in AIG SIFI designation hearing. Business Insurance, *available at* https://www.businessinsurance.com/article/20171002/NEWS06/912316251?template=printart

18 *See* Financial Stability Board. (30 July 2015). *Next Steps on the NBNI G-SIFI Assessment Methodologies* [Press release], *available at* https://www.fsb.org/2015/07/next-steps-on-the-nbni-g-sifi-assessment-methodologies/

19 *See* Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21,637 (Apr. 11, 2012), *available at* https://www.govinfo.gov/content/pkg/FR-2012-04-11/pdf/2012-8627.pdf.

20 *See* Investment Company Liquidity Risk Management Programs, Release Nos. 33- 10233; IC- 32315 (Oct. 13, 2016) *available at* https://www.sec.gov/files/rules/final/2016/33-10233.pdf; Investment Company Liquidity Disclosure, Release No. IC-33142 (June 28, 2018) *available at* https://www.sec.gov/files/rules/final/2018/ic-33142.pdf

21 *See* Investment Company Liquidity Risk Management Programs, Release Nos. 33- 10233; IC- 32315 (Oct. 13, 2016); Money Market Fund Reforms; Form PF Reporting Requirements for Large Liquidity Fund Advisers; Technical Amendments to Form N-CSR and Form N-1A, Release Nos. 33-11211; 34-97876; IA-6344; IC-34959; File No. S7-22-21, RIN 3235-AM80 (July 12, 2023), *available at* https://www.sec.gov/rules/final/2023/33-11211.pdf; Money Market Fund Reform; Amendments to Form PF, Release No. 33-9616, IA-3879; IC-31166; FR-84; File No. S7-03-13, RIN 3235-AK61 (July 23, 2014), *available at* https://www.sec.gov/rules/final/2014/33-9616.pdf; *and* Money Market Fund Reform, Release No. IC-29132; File Nos. S7-11-09, S7-20-09, RIN 3235-AK33 (February 23, 2010), *available at* https://www.sec.gov/rules/final/2010/ic-29132.pdf. The three rounds of money market fund reform have included structural improvements that address perceived risk in money funds such as new requirements regarding asset quality and liquidity, a floating net asset value for institutional prime and institutional tax-exempt funds, new requirements for board oversight and new disclosure changes providing investors with more frequent and accessible information.

22 For example, the FSOC identified risks in money market funds and issued for comment certain recommendations to mitigate such risks. Thereafter, the SEC, as the primary regulator and subject matter expert, issued for comments its first round of MMF reforms. *See* Financial Stability Oversight Council

regulator, used its statutory authority and knowledge of the market, to promulgate rules and regulations to address such risks. With the new rules and subsequent rule amendments, the SEC believes it has significantly enhanced the risk management, stability and transparency of open-end and money market funds.[23] In addition, both the SEC and the Commodity Futures Trading Commission have issued multiple rules governing the use and operation of derivatives.[24] While Fidelity does not always agree with everything that these regulators propose, the efforts to improve the risk management of liquidity and derivatives are illustrative of the benefits that can arise when regulators with subject matter expertise regulate on a system-wide basis.

Recognizing the role of strong primary regulators, Congress expressly required the FSOC to consider the "degree to which the company is already regulated by 1 or more primary financial regulatory agencies."[25] Deference to primary financial regulators ensures a balanced approach, in sharp contrast to the one-size-fits-all prudential framework that is ill-equipped to address diverse nonbank business models. The FSOC member agencies each possess specialized knowledge in their respective sectors, putting them in a better position to understand the unique risks and challenges faced by their regulated entities. Primary financial regulators are best equipped to allocate resources efficiently and conduct targeted supervision and risk mitigation efforts, strengthening the FSOC's overall mission by addressing issues before they rise to a systemic level.

Congress charged the FSOC with "identify[ing] gaps in regulation that could pose risks to the financial stability of the United States,"[26] not layering on duplicative oversight where robust regulation already exists. The Proposals appear to eliminate consideration of this Congressional mandate. Ignoring this requirement could lead to a designation process that circumvents the statute by failing to consider the regulatory ecosystem within which a nonbank financial company operates and the fact that it may already be highly regulated. A diversified, nonbank financial company may be regulated by a host of regulators already such as the SEC, the Commodity Futures Trading Commission, the Department of Labor, the Financial Industry Regulatory Authority (FINRA), insurance regulators and state regulatory authorities, among others. Designation or any additional regulation from an additional regulator would suggest that these many entities have not fulfilled, or will not fulfill, their roles and responsibilities as the principal regulators. In addition, the FSOC's omission of this factor could lead to a designation

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Releases Proposed Recommendations for Money Market Mutual Fund Reform | U.S. Department of the Treasury (Nov. 2012) *available at* https://home.treasury.gov/news/press-releases/tg1764.

23 Following the implementation of the second round of reform, a large majority of the industry is now comprised of government money market funds as well as other funds (i.e., prime funds) that hold substantial amounts of government securities, including Treasury securities and Treasury-backed repurchase agreements. According to Crane Data, as of June 30, 2023, over 75 percent of U.S. money market funds qualify as government funds and over 85 percent of all assets held by U.S. money market funds are government securities.

24 *See, e.g.,* Use of Derivatives by Registered Investment Companies and Business Development Companies, Release No. IC-34084 (Nov. 2, 2020).

25 12 U.S.C. § 5323(a)(2)(H).

26 12 U.S.C. § 5322(a)(2)(G).

process that inappropriately subjects a regulated nonbank financial company to duplicative and unwarranted new regulation, with a prudential framework that is a poor match for the potential risks to be addressed. It would also remove the opportunity for a primary regulatory agency—which generally has greater information and understanding with respect to regulated companies—to address an identified risk prior to a nonbank financial company designation.

Asset managers and their sponsored funds are subject to an extensive regulatory framework that addresses and mitigates virtually all the Proposed Framework's vulnerabilities—including, with respect to mutual funds and money market funds, very low levels of leverage[27] and high levels of liquidity,[28] and with respect to all registered advisers and funds, significant compliance program and risk management requirements as well as regular SEC examination.[29] We also note that the asset management industry is characterized by intense competition with highly substitutable products and highly mobile assets and participants. If the FSOC retains the eight proposed vulnerabilities, it should recognize that they do not apply equally to all nonbank financial companies and should be analyzed in the context of any existing rules and regulations that apply to such nonbank financial companies. The FSOC should also be mindful of ensuring fair and consistent regulation across the industry so as not to inject unfair market dynamics, pick winners and losers, and push customers to competitors who do not bear the costs of prudential oversight.

We recognize the concerns voiced by Secretary Yellen over potential for systemic risks to "emanate from a particular entity—one that might not be within the jurisdiction of a regulator with adequate prudential or supervisory authorities."[30] However, such a scenario should not exempt the FSOC from first considering the degree to which a nonbank financial company is already regulated by one or more primary regulatory agencies as part of any final analytic framework. The mere threat of designation by the FSOC of an already highly regulated entity risks eroding market stability and investors' confidence in the primary financial regulators' capabilities.

III. By failing to assess the actual likelihood of a nonbank financial company's material financial distress, the Proposals would grant the Federal Reserve Board authority over vast sectors of the economy in a manner that exceeds the statutory authority from Congress.

Congress requires the FSOC to assess the likelihood of a nonbank financial company's material financial distress as a part of its designation analysis.[31] We are concerned that the Proposals' changes to the designation assessment would contravene statutory text, depart from

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27 *See* 15 U.S.C. § 80a-18.

28 *See* 57 Fed. Reg. 9828 (Mar. 20, 1992).

29 In addition, investment vehicles not registered with the SEC are often governed by other regulatory regimes such as the Employee Retirement Income Security Act of 1974.

30 Remarks by Secretary of the Treasury Janet L. Yellen at Financial Stability Oversight Council Meeting (Apr. 21, 2023), *available at* https://home.treasury.gov/news/press-releases/jy1431.

31 *See* 5 U.S.C. § 706(2).

prior guidance without adequate explanation, and fail to consider an important aspect of the problem—namely, whether a nonbank financial company would benefit from or be harmed by supervision by the Federal Reserve Board and the application of prudential standards.

Section 113 authorizes the Council to determine whether material financial distress at a nonbank financial company "could pose a threat to the financial stability of the United States."[32] To make that determination, the Council may not consider a hypothetical failure, nor may it presuppose such failure. Instead, it must analyze ten factors enumerated by statute, several of which focus on the company's *actual* likelihood of material financial distress. For example, the Council must analyze "the extent of the leverage of the company"; "the degree to which the company is already regulated" by other agencies; and "the amount and types of the liabilities of the company."[33] As the Council itself previously recognized, those three enumerated factors "seek to assess the vulnerability of a nonbank financial company to financial distress."[34] Other statutorily enumerated factors also speak to the likelihood of material financial distress. For instance, "the extent to which assets are managed rather than owned by the company" can bear not only on the effects in the market of material financial distress, but also the likelihood of such distress occurring in the first place.[35] The statute thus reflects Congress's judgment that the Council must analyze not only the effect of hypothetical material financial distress, but also the likelihood of such distress actually occurring. Ignoring the likelihood of material financial distress thus means ignoring required statutory factors.

We believe the Proposed Guidance misreads the statute, interpreting the statutory language as permitting the FSOC to designate a company that "could" pose a threat to U.S. financial stability as allowing the FSOC to "presuppose[] a company's material financial distress, and then evaluate[] what consequences could follow for U.S. financial stability."[36] The statutory term "could" invites the FSOC to determine whether a company's material financial distress would result in a real likelihood of widespread financial instability, but it does not invite the FSOC to "presuppose" material financial distress to skip to the next step of the analysis. The legislative history supports this plain reading of the statute.[37] It is not enough to presuppose material financial distress because the contours of the systemic threat posed by an institution can only be fully known once the company is displaying indicia of potential financial distress.

Finally, a designation conducted without considering a company's likelihood of material financial distress would violate the Administrative Procedure Act ("APA") because it would

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32 12 U.S.C. § 5323(a)(1).

33 *Id.* § 5323(a)(2)(A), (H), (J).

34 2012 Interpretive Guidance, at 21,658.

35 12 U.S.C. § 5323(a)(2)(F).

36 Proposed Guidance, at 26,239.

37 *See, e.g.*, 156 Cong. Rec. at 5903 (daily ed. July 15, 2010) (statement of Senator Kerry) (emphasizing that the FSOC should focus on specific risk factors in "making such a determination" that material financial distress at a nonbank financial company could pose a threat to the financial stability of the United States).

ignore an "important aspect[] of the problem,"[38] which agencies are required to consider. In deciding whether a nonbank financial company requires additional oversight, the likelihood that the company actually experiences material financial distress is plainly an "important aspect[] of the problem." As the FSOC recognized in the 2019 Guidance, such an assessment is "[c]onsistent with sound risk regulation" and an "important part of the Council's assessment of the extent to which a determination may promote U.S. financial stability."[39] Implicit in this acknowledgement is the fact that it could actually *decrease* financial stability to designate a nonbank financial company under Section 113 if the FSOC believed that company was unlikely to experience material financial distress. Moreover, it would be irrational to impose an onerous regulatory burden on a company regardless of whether its chances of experiencing material financial distress are substantial or minimal.[40]

IV. The Proposals' reinterpretation of "threat to the financial stability of the United States" meaningfully lowers the threshold for FSOC designation, creating regulatory uncertainty.

The Proposals' reinterpretation of the phrase "threat to the financial stability of the United States" is a significant departure from previous approaches to designation. This shift in framework leaves institutions without the procedural transparency needed to make informed business decisions, including how to voluntarily de-risk their activities or financial profile.

The FSOC has the authority to designate a nonbank financial company for supervision by the Federal Reserve Board and apply prudential standards if the FSOC determines that one of two designation standards is met: (i) material financial distress at the company could pose a threat to the financial stability of the United States, or (ii) the nature, scope, size, scale, concentration, interconnectedness, or mix of activities of the company could pose a threat to the financial stability of the United States.[41] Under both designation standards, a determination regarding what constitutes a "threat to the financial stability of the United States" is critical. As part of the FSOC's proposed analytic approach, the Proposed Guidance and the Proposed Framework would significantly reinterpret this phrase in a manner that would depart from all prior guidance. Although the FSOC characterizes this change as "limited to the Council's procedures—rather than substantive analyses—related to nonbank financial company designations,"[42] it would have substantial and substantive implications for nonbank financial

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[38] Department of Homeland Security v. Regents of the University of California, 140 S. Ct. 1891 at 1910.

[39] 2019 Guidance, at 71,754.

[40] *Cf. Home Box Office, Inc.* v. *FCC*, 567 F.2d 9, 36 (D.C. Cir. 1977) ("[A] regulation perfectly reasonable and appropriate in the face of a given problem may be highly capricious if that problem does not exist.") (internal quotation marks omitted).

[41] *See* 12 U.S.C. § 5323.

[42] Proposed Guidance, at 26,235.

companies by meaningfully lowering the threshold for FSOC designation, which would be inconsistent with the statute Congress enacted.[43]

First, the Proposed Guidance suggests that the term "threat to the financial stability of the United States" should cover any risk that "*could*" pose such a threat.[44] This standard is so broad as to be self-fulfilling. Mere public identification (or rumor) by the FSOC of a company that "could" pose a threat instantly elevates that firm to a potential systemic risk, even if the financial condition or activities of the firm did not pose a systemic risk before FSOC evaluation. The Proposals create an inevitable outcome of systemic risk for any financial institution that finds itself in the FSOC's scope. By contrast, under both the 2019 Guidance and the 2012 Guidance, the definition of "threat to the financial stability of the United States" covered only a risk that "*would*" pose such a threat.[45] As part of its process to finalize the 2012 Guidance, the FSOC rejected suggestions from commenters to modify this definition, arguing that it "accurately reflect[s] the statutory requirements and the nature of the threat that the Council's authority under section 113 of the Dodd-Frank Act seeks to mitigate."[46] The FSOC's proposal to radically shift its interpretation of the statute after more than ten years and eliminate a key finding could enable it to premise nonbank financial company designations on hypotheticals, speculation and assumptions. Moreover, neither the Proposed Guidance nor the Proposed Framework provides any indication of how the FSOC would determine that a risk "*could*" pose a threat to U.S. financial stability. This approach deprives nonbank financial companies being considered for designation, as well as their customers and counterparties, of critical due process protections.

Second, the Proposed Framework notes that financial stability "can be defined as the financial system being resilient to events or conditions that could impair its ability to support economic activity, such as by intermediating financial transactions, facilitating payments, allocating resources, and managing risks."[47] By contrast, the 2019 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."[48] Similarly, the 2012 Guidance defined "threat to the financial stability of the United States" as "impairment of financial intermediation or of financial

43 *See, e.g.*, 156 Cong. Rec. at 5903 (daily ed. July 15, 2010) (statement of Chairman Dodd) ("The Banking Committee intends that only a limited number of high-risk, nonbank financial companies would join large bank holding companies in being regulated and supervised by the Federal Reserve.").

44 Proposed Guidance, at 26,236 (emphasis added). Unlike the 2019 Guidance and the 2012 Guidance, however, the Proposed Guidance does not provide a definition of the term, but rather provides that "[f]or purposes of analyses under section 113, the Council would expect to evaluate a 'threat to the financial stability of the United States' with reference to the description of financial stability provided in the [Proposed Framework]." *Id*.

45 2019 Guidance, at 71,763; 2012 Guidance, at 21,657 (emphasis added).

46 2012 Guidance, at 21,640.

47 Proposed Framework, at 26,306. Again, the Proposed Framework does not define this term under the FSOC's regulations.

48 2019 Guidance, at 71,763 (emphasis added).

market functioning that would be *sufficiently severe to inflict significant damage* on the broader economy."[49]

By notably lowering the threshold from "severe damage" or "sufficiently severe to inflict significant damage" to "resilien[ce]" to events or conditions that "impair its ability to support economic activity," the Proposed Framework would authorize the FSOC to determine that nearly any institution or activity should be subject to enhanced supervision or regulation when in fact such institutions or activities pose no threat to the actual financial stability of the United States, in contravention of the statute. The definition of "financial stability" under the Proposed Framework is also at odds with international standard-setting bodies, including the Financial Stability Board ("FSB"), which defines the term with reference to time variation, cross-sectoral and other limiting factors.[50] The definitions provided by the FSB and other standard-setting bodies are more in line with the 2012 Guidance and 2019 Guidance.

Clear and consistent designation frameworks have broad benefits to investors, customers, and markets, enabling nonbank financial companies to proactively identify and address potential risks through targeted measures, while minimizing disruptions to firm operations and the broader financial system. Tackling risks in their early stages, with guidance from the primary financial regulator with depth of expertise in the nonbank financial company's business model, contributes to the overall stability of the financial system in furtherance of FSOC's mission.

V. The designation process should retain the existing robust cost-benefit analysis requirement, which obligates the FSOC to account for real and potentially damaging consequences of nonbank financial company designations, including the costs borne by customers.

The potential benefits of designation—namely the incremental reduction in risks of failure by a nonbank—should be carefully weighed against the significant costs of misplaced designation. Nonbank financial companies like Fidelity operate in highly competitive markets. As the costs of providing financial products and services increase, so do the costs to customers, often paired with fewer options from decreased competition. The FSOC should consider the real costs to investors and customers of diverted investment in technology, product improvements, operations, and human resources against any incremental benefit from duplicative oversight from the Federal Reserve Board.

Congress specifically required the Council to consider the costs to a designated company of regulatory compliance.[51] In deciding whether to designate a nonbank financial company under Section 113, Congress specified that the Council "shall" consider "any other risk-related

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[49] 2012 Guidance, at 21,657 (emphasis added).

[50] *See* Fin. Stability Bd. *FSB Financial Stability Surveillance Framework* (Sept. 30, 2021), *available at* https://www.fsb.org/wp-content/uploads/P300921.pdf ("The time horizon over which vulnerabilities materialise is important for policy.").

[51] *See* 5 U.S.C. § 706(2)(A) (forbidding agency action that is "not in accordance with law").

factors that the Council deems appropriate."[52] The Proposed Guidance contends that the Council need not conduct a cost-benefit analysis because the consideration of costs is not "appropriate" within the meaning of the statute.[53] That argument is inconsistent with the Supreme Court's decision in *Michigan* v. *EPA*, which held that a statutory requirement that an agency determine whether "regulation is appropriate and necessary" is not "an invitation to ignore cost."[54] On the contrary, the Court recognized that "the phrase 'appropriate and necessary' requires at least some attention to cost."[55] As the *MetLife* court correctly recognized, "[t]he same textual hook in 12 U.S.C. § 5323(a)(2)(K) ('appropriate') would thus require FSOC to consider the cost of designating a company for enhanced supervision, provided that cost is a 'risk-related' factor."[56] As the court went on to hold, the cost to a designated company is plainly a "risk-related factor," because requiring a company to shoulder the costs associated with designation could itself increase the risk of the company's material financial distress.[57] A designation would impose extraordinary and likely unexpected costs on a firm, including material legal and compliance costs, costs relating to restructuring and/or divesting business lines, personnel costs, and reputational costs. For many companies, these costs could increase the risk of distress.

A designation conducted without regard to costs would further violate the APA because it would ignore an "important aspect[] of the problem" the FSOC is tasked with solving, and agencies are required to consider the "advantages *and* the disadvantages of agency decisions."[58] Here, the costs to a designated company are an especially important aspect of the problem the FSOC has to solve, because the costs of regulatory compliance could actually make the company *more* vulnerable to distress.[59] Any theoretical advantages to designation must be assessed against the known disadvantages of increasing operating costs, diminishing returns, and harming customers, investors and the market as a whole.

For these reasons, the FSOC should preserve its prior position that a cost-benefit analysis is required. In doing so, it should clearly explain what prudential standards it would apply as part of its assessment of costs to give fair notice to nonbank financial companies as to the agency's decision-making process.

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52 12 U.S.C. § 5323(a)(2)(K).

53 *See* Proposed Guidance at 26,238.

54 *Michigan* v. *EPA*, 576 U.S. 743, 753 (2015).

55 *Id*. at 752.

56 *MetLife, Inc.*, 177 F. Supp. 3d at 241.

57 *Id.* at 242 (holding that "risk" under 12 U.S.C. § 5323(a)(2)(K) "must refer to both the risk of destabilizing the market and the risk of distress in the first place").

58 *Regents of the Univ. of Cal.*, 140 S. Ct. at 1910 (citation omitted); *Michigan*, 576 U.S. at 753.

59 *See MetLife*, 177 F. Supp. 3d at 241 (quoting *Michigan*, 576 U.S. at 752) (explaining that the Council "imposing billions of dollars in cost could actually make MetLife more vulnerable to distress" and holding that "[b]ecause FSOC refused to consider cost as part of its calculus, it is impossible to know whether its designation 'does significantly more harm than good'").

VI. The Proposed Framework identifies four transmission channels that are most likely to facilitate transmission of financial stability risks, without the necessary transparency into their application, nor explanation into how they relate to the eight proposed vulnerabilities.

Although the Proposed Framework identifies transmission channels that are similar to prior FSOC guidance,[60] it (i) eliminates much of the substance around its analyses of the transmission channels; (ii) eliminates consideration of any factors that may limit the risk of transmission; and (iii) broadens the definition of transmission to channels "most likely to facilitate the transmission of the negative effects of a risk to financial stability."[61] The Proposed Framework's discussion of the transmission channels fails to achieve the FSOC's stated goal of increasing transparency.[62]

- **Discussion of the proposed transmission channels is vague, overly broad, and insufficiently detailed.** Although the Proposed Framework is "intended to help market participants, stakeholders, and other members of the public better understand how the Council expects to perform certain of its duties,"[63] the proposed transmission channels are too vague and overly broad, significantly undermining this objective. For example, the Proposed Framework does not specify whether the FSOC views exposures to all financial instruments or asset classes equally or whether it would distinguish among financial instruments or asset classes in analyzing this transmission channel. The FSOC's existing framework provides a detailed explanation of how it would apply the transmission channels for exposures, asset liquidation, and critical function or service.[64] These details provide nonbank financial companies with adequate notice of the relevant standards under which they could be designated. By contrast, the Proposed Framework provides virtually no details on how the FSOC would apply the transmission channels in practice, which would result in a nonbank financial company designation process that deprives companies of adequate notice of the relevant standards by which they may be designated. This opacity contravenes Secretary Yellen's statement that the Proposed Framework is intended to provide "new public transparency into how the Council does its

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60 *See* Proposed Framework, at 26,308. The transmission channels in the Proposed Framework are (i) exposures; (ii) asset liquidation; (iii) critical function or service; and (iv) contagion.

61 *Id*.

62 In addition to the lack of transparency regarding the application of the four proposed transmission channels and the eight proposed vulnerabilities, which are discussed below, the Proposed Framework increases opacity by failing to explain how the FSOC would apply its analytic approach differentially with respect to individual nonbank financial company designations under Section 113, activities-based recommendations under Section 120, and financial market utility and payment, clearing, and settlement designations under Section 804, each of which has a different statutory standard. This lack of transparency harms market participants and their customers who rely on the FSOC's guidance.

63 *Id.* at 26,307.

64 2019 Guidance, at 71,763. Contagion is not currently treated as a separate transmission channel but is analyzed under the exposures transmission channel.

work."[65] The lack of clarity also makes it difficult to know whether the designation process would be consistent with the FSOC's historical view of financial stability and whether the application of these transmission channels is consistent with the statute. Additionally, firms cannot evaluate how FSOC would view the systemic risk footprint of their businesses and respond proactively. The FSOC should retain the analysis in the prior guidance and, in the event the FSOC finds it necessary or appropriate to make changes to such analysis, it should include a robust explanation of such changes with an adequate notice and comment period before finalizing them.

- **The Proposed Framework ignores factors that may limit transmission of risk.** The existing framework affirms that the FSOC will "consider applicable factors that may limit the transmission of risk, such as existing regulatory requirements, collateralization, bankruptcy-remote structures, or guarantee funds that reduce counterparties' exposures to the nonbank financial company or mitigate incentives for customers or counterparties to withdraw funding or assets."[66] The Proposed Framework, without explanation, eliminates these considerations. For example, the Proposed Framework suggests that all liquidations of financial assets could threaten financial stability. This ignores the fact that mutual funds and other regulated investment vehicles are subject to extensive rules and regulations regarding portfolio liquidity and shareholder redemptions. In extreme cases, these funds would "resolve" themselves through orderly liquidation, which prompts funds to liquidate or merge in a manner that ordinarily has not presented systemic risks.[67] The FSOC should retain the discussion of mitigating factors and expressly acknowledge that the transmission channels do not apply equally to all nonbank financial companies.

- **The Proposed Framework broadens the definition of transmission**. The Proposed Framework broadens the definition of transmission to include channels "most likely to facilitate the transmission of the negative effects of a risk to financial stability."[68] This

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65 Remarks by Secretary of the Treasury Janet L. Yellen at Financial Stability Oversight Council Meeting (Apr. 21, 2023), *available at* https://home.treasury.gov/news/press-releases/jy1431.

66 2019 Guidance, at 71,763.

67 *See, e.g.*, Securities and Exchange Commission, *U.S. Credit Markets: Interconnectedness and the Effects of the COVID-19 Economic Shock* (Oct. 2020), *available at* https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf ("...though many observers have been concerned about bond funds' ability to meet redemption requests during periods of market stress, these concerns did not materialize during the period of market turmoil in March [2020]. Commission staff estimate that bond mutual funds experienced $255 billion of net outflows during March 2020, with another $21 billion from bond ETFs. However, total trading volume in the corporate bond market during the same period was more than triple the level of bond fund outflows, totaling $1.08 trillion in March 2020, or $49.2 billion per day."); *see also* Fin. Stability Bd. & Int'l Org. of Sec. Comm'ns, *Consultative Document: Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions*, 30 n.38 (Jan. 8, 2014), *available at* http://www.financialstabilityboard.org/wp-content/uploads/r_140108.pdf ("[E]ven when viewed in the aggregate, no mutual fund liquidations led to a systemic market impact throughout the [2000-2012] observation period. Part of the explanation may be that many US investors hold mutual fund shares for retirement purposes. As such, these investors' investment horizon could be long-term, whereby they would prefer to remain invested rather than cash-out during a market downturn.").

68 Proposed Framework, at 26,308.

definition is more expansive than the definitions under the 2019 Guidance, which included channels "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" and channels "through which risks could be transmitted from a particular nonbank financial company and thereby pose a threat to U.S. financial stability."[69] By loosening the standard for transmission to channels that facilitate the "negative effects of a risk to financial stability," the Proposed Framework would provide the FSOC with unlimited discretion to find that even minor vulnerabilities could pose a risk to financial stability. The FSOC does not explain its rationale for broadening the definition of transmission or explain how the proposed definition would be applied in practice.

The Proposed Framework identifies eight proposed vulnerabilities that it argues "most commonly contribute to risk to financial stability,"[70] but separates these proposed vulnerabilities from the proposed transmission channels in a manner that limits their usefulness. First, the mere fact that a "vulnerability" may exist in some fashion implies neither that an actual *threat* to financial stability exists nor that such a drastic regulatory response as designation is warranted. Markets rise and fall. Investors in U.S. equities and fixed income securities are vulnerable to losses if there is a downturn in the economy while investors in international equities and fixed income are vulnerable to changes in foreign exchange rates. The FSOC cannot presume that each supposed "vulnerability" automatically constitutes an actual threat to financial stability that requires designation of all firms involved in those markets. Second, as with the proposed transmission channels, the proposed vulnerabilities fail to provide sufficient details regarding how they would be applied in practice. In addition, the breadth of the proposed vulnerabilities would seemingly enable the FSOC to designate *any* nonbank financial company, which could result in a designation process that is inconsistent with the statute.[71] For example, the proposed "destabilizing activities" vulnerability refers circularly to that which the FSOC sets out to prove (*i.e.*, that an activity poses a threat to financial *stability*).[72] The FSOC should not adopt this vulnerability as part of any final analytic framework because it could allow the FSOC to base

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69 2019 Guidance, at 71,763.

70 *See* Proposed Framework, at 26,306. The vulnerabilities in the Proposed Framework are (i) leverage; (ii) liquidity risk and maturity mismatch; (iii) interconnections; (iv) operational risks; (v) complexity or opacity; (vi) inadequate risk management; (vii) concentration; and (viii) destabilizing activities.

71 *See, e.g.*, 156 Cong. Rec. at 5903 (daily ed. July 15, 2010) (colloquy between Senator Kerry and Chairman Dodd) ("The fact that a company is large or is significantly involved in financial services does not mean that it poses significant risks to the financial stability of the United States. There are large companies providing financial services that are in fact traditionally low-risk businesses, such as mutual funds and mutual fund advisers. We do not envision nonbank financial companies that pose little risk to the stability of the financial system to be supervised by the Federal Reserve. Does the chairman of the Banking Committee share my understanding of this provision?" "The Senator from Massachusetts is correct. Size and involvement in providing credit or liquidity alone should not be determining factors.").

72 *Cf. District of Columbia* v. *USDA*, 444 F. Supp. 3d 1, 23 (D.D.C. 2020) ("[The agency's] logic is arbitrary because it is circular.").

nonbank financial company designations on extreme hypotheticals, speculation, and assumptions.

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Fidelity is willing to provide further information, participate in any direct outreach efforts the Council undertakes, or respond to questions the Council may have about our comments.

Sincerely,

Jonathan Chiel

cc: The Honorable Janet L. Yellen, Secretary of the Treasury
Chairperson, Financial Stability Oversight Council
The Honorable Jerome H. Powell, Chair, Board of Governors of the Federal Reserve System
Michael J. Hsu, Acting Comptroller of the Currency, Office of the Comptroller of the Currency
The Honorable Rohit Chopra, Director, Consumer Financial Protection Bureau
The Honorable Gary Gensler, Chair, Securities and Exchange Commission
The Honorable Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation
The Honorable Rostin Behnam, Chair, Commodity Futures Trading Commission
The Honorable Sandra L. Thompson, Director, Federal Housing Finance Agency
The Honorable Todd M. Harper, Chairman, National Credit Union Association
Thomas E. Workman, Independent Member Having Insurance Expertise, Financial Stability Oversight Council

James Martin, Acting Director, Office of Financial Research, Department of the Treasury
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Elizabeth K. Dwyer, Superintendent of Financial Services, Rhode Island Department of Business Regulation
Adrienne Harris, Superintendent, New York State Department of Financial Services
Melanie Lubin, Securities Commissioner, Maryland Office of the Attorney General, Securities Division

The Honorable Hester M. Pierce, Commissioner, Securities and Exchange Commission
The Honorable Caroline A. Crenshaw, Commissioner, Securities and Exchange Commission
The Honorable Mark T. Uyeda, Commissioner, Securities and Exchange Commission
The Honorable Jaime Lizárraga, Commissioner, Securities and Exchange Commission

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