

**FINANCIAL STABILITY OVERSIGHT COUNCIL RELEASES NOTICE OF
PROPOSED RULEMAKING REGARDING SUPERVISORY AUTHORITY OVER
CERTAIN NONBANK FINANCIAL COMPANIES**

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) was enacted. The comprehensive legislation granted the newly created Financial Stability Oversight Council (“FSOC”) the authority to require certain United States and foreign nonbank financial companies to be regulated and supervised by the Board of Governors of the Federal Reserve System (the “Federal Reserve”).¹ FSOC can make such a determination when it concludes that if a particular nonbank company that is predominantly engaged in financial activities experiences material financial distress, that company could pose a threat to the financial stability of the United States.²

Since the passage of the Dodd-Frank Act, many interested parties have expressed concern that the legislation does not provide enough quantitative detail regarding the analytical process that FSOC will rely upon in designating nonbank financial companies for additional supervision and regulation by the Federal Reserve. On October 6, 2010, FSOC issued an advance notice of proposed rulemaking seeking public input on a variety of questions relating to FSOC’s effort to develop a workable regulatory framework to implement Section 113 of the Dodd-Frank Act. After receiving more than 50 comment letters, on January 18, 2011, FSOC released its notice of proposed rulemaking (the “Release”), which purports to further develop the analytical framework that it will use to assess nonbank financial companies.³

Sections 113(a)(2) and (b)(2) of the Dodd-Frank Act provide a broad framework that FSOC must consider in making a determination as to whether a nonbank financial company should be supervised by the Federal Reserve and become subject to its prudential standards. Although FSOC acknowledges in the Release that many commenters expressed their concerns regarding the need for clear, quantitative standards to make those determinations, FSOC declined to adopt that approach in the Release. Instead, FSOC proposes to build upon the Dodd-Frank Act’s

¹ Section 113 of the Dodd-Frank Act.

² Under section 102(a)(6) of the Dodd-Frank Act, a company is “predominantly engaged in financial activities” if (1) the annual gross revenues derived by the company and all of its subsidiaries from activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act) and, if applicable, from the ownership or control of one or more insured depository institutions represent 85 percent or more of the consolidated annual revenues of the company or (2) the consolidated assets of the company and all of its subsidiaries related to activities that are financial in nature and, if applicable, related to the ownership or control of one or more insured depository institutions represent 85 percent or more of the consolidated assets of the company.

³ In the Release, FSOC states that it intends to begin assessing nonbank financial companies shortly after adopting a final rule.

statutory framework by applying six broad qualitative categories to evaluate the systemic importance of a nonbank financial company:

1. size;
2. lack of substitutes for the financial services and products the company provides;
3. interconnectedness (or mix of activities) with other financial firms;
4. leverage;
5. liquidity risk and maturity mismatch; and
6. existing regulatory scrutiny.

FSOC argues that these six categories successfully implement all of the statutory criteria required to make an assessment of a nonbank financial company under Sections 113(a)(2) and (b)(2). The first three proposed categories are designed to help FSOC assess the likelihood that a particular nonbank financial company's distress would negatively impact the broader financial system or real economy. The other three proposed categories are intended to assess the vulnerability of a nonbank financial company to financial distress. FSOC would apply these six categories to all nonbank financial companies across different industry sectors, but the framework would be adapted for the specific risks presented by specific industry sectors.⁴ Critical details regarding exactly how FSOC will adapt and apply the proposed framework to particular industry sectors remain unclear, including what quantitative factors will be used, when such quantitative factors will be developed, and what weight will be given to each of the six categories.

The Release does not include concrete, quantitative metrics or state whether quantitative metrics will be adopted by FSOC or will be made available to the public before the adoption of a final rule. The Release does not answer many of the questions originally raised by industry observers following the passage of the Dodd-Frank Act. Consequently, nonbank financial companies will continue to have difficulty evaluating the likelihood that FSOC will designate them for supervision and regulation by the Federal Reserve.

If you have any questions regarding this memorandum, please contact David S. Katz (202-303-1149 or dkatz@willkie.com), Scott R. Tkacz (202-303-1145 or stkacz@willkie.com) or the Willkie attorney with whom you regularly work.

⁴ The proposed framework is virtually identical in application to U.S. nonbank financial companies and foreign nonbank financial companies, except that in the case of foreign nonbank financial companies, the proposed assessment categories focus only on the U.S. operations of such companies.

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