NATIONAL ASSOCIATION OF Manufacturers

Carolyn Lee

Senior Director, Tax Policy

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Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Regulation Y; Docket No. R-1405
RIN 7100-AD64
Definition of "Predominantly Engaged In Financial Activities."

Attention Mr. Robert deV. Frierson
Deputy Secretary of the Board

Dear Mr. deV. Frierson:

The National Association of Manufacturers (NAM)— the largest industrial trade association in the United States, representing over 11,000 small, medium and large manufacturers in all 50 states—appreciates the opportunity to provide comments on the Board of Governor's supplemental notice of proposed rulemaking and request for comment in the above referenced docket. Manufacturing employs nearly 12 million workers, contributes more than $1.6 trillion to the U.S. economy annually, is the largest driver of economic growth in the nation and accounts for the lion's share of private sector research and development.

Overview

NAM members recognize the importance of preventing systemic risk that occurred during the financial crisis starting in 2008. We appreciate the efforts of the Federal Reserve to combat crises that harm not only the financial sector, but also the thousands of nonfinancial businesses, employees and their families represented by NAM member companiesNevertheless, we have serious concerns that the proposed rule cited above diverges from both the language and intent of the Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank"). In so doing, it poses the threat of inappropriate, financial-style regulation on American companies that had nothing to do with the financial crisis.

Background

Under Title 1 of Dodd Frank, a nonbank financial company, i.e., a company "predominantly engaged in financial activities" generally can be designated for Board supervision by the Financial Stability Oversight Council (FSOC) under certain conditions. A company "predominantly engaged in financial activities" is defined in section 102(a)(6) as a company deriving 85 percent or more of its revenues or assets from "activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956) and, if applicable, from the ownership or control of one or more depository institutions." Section 102(b) further provides that "The Board of Governors shall establish, by regulation, the requirements for determining if a company is predominantly engaged in financial activities, as defined in subsection (a)(6).”

This framework, in part, reflects concerns that NAM and other commercial businesses expressed during the legislative debate on Dodd Frank. Senators Mark Pryor (D-AR) and David Vitter (R-LA) introduced an amendment incorporating the Bank Holding Company Act’s well defined “predominance” and “financial activities” tests into the bill. The amendment was adopted by the Senate and included in the final law.

The purpose of the Pryor-Vitter Amendment was to ensure that companies that may engage in some level of financial activity, but are not primarily financial enterprises would not become subject to the systemic risk oversight regime created by the law. Even for companies not ultimately subjected to the bank-style regulatory regime created for nonbank financial companies, the threat of potentially becoming the object of the FSOC review process itself could require significant expenditures, as well as cause an adverse effect in the capital markets. The Pryor-Vitter amendment was designed to clearly limit the FSOC’s oversight to companies predominantly engaged in financial activities, as that term was defined in the Bank Holding Company Act and Federal Reserve Regulation Y at the time of enactment of the law.

The Board’s Authority Under Section 102

Unfortunately, the proposed rule fundamentally alters and blurs the delineation between financial and nonfinancial activities contrary to the purpose of the Pryor-Vitter amendment. This is contrary to Congress’ intent to protect commercial enterprises from unwarranted prudential regulation.

Specifically, the Board’s proposed rule appears to invert the framework outlined in Section 102. Under Section 102(b), the Board is charged with establishing “the requirements for determining if a company is predominantly engaged in financial activities, as defined in subsection (a)(6).” Subsection (a)(6) in turn defines “financial activities” by reference to section 4(k) of the Bank Holding Company Act. Neither Section 102(a)(6) or Section 102(b) directs that the Board will define “financial activities” for purposes of Title I. These activities have already been defined under Regulation Y, a fact that was understood by Congress when it enacted Dodd Frank. If that were not the case, the prohibition on FSOC regulation of primarily commercial companies intended by the Pryor-Vitter amendment would be of no effect since the Board could simply define any activity as “financial” under these new authorities, and submit any company in America to FSOC oversight. Section 102(b) is clearly intended to direct the Board to determine how a company’s “financial activities,” as defined in the Bank Holding Company Act, are to be calculated for purposes of assessing whether or not the company meets the 85 percent test. Nowhere does it suggest, much less direct, that the Board fundamentally revise previously defined terms.

In fact, Section 4(k) of the Bank Holding Company Act contains a detailed procedure for the Board to determine whether an activity is “financial in nature.” This procedure involves, among other things, consultation with the Secretary of the Treasury and consideration of various statutory factors (see, e.g., Section 4(k)(2) and (3)). It makes no sense to presume that Congress intended a less rigorous rulemaking process with regard to financial activities under Section 102(b) than the one it explicitly created in the section of the Bank Holding Company Act on which 102(b) relies.

Manufacturers' Concerns with the Proposed Rule

NAM members are particularly concerned with the expansion of activities that are financial in nature as proposed by the Board since it will create regulatory risk for companies that no one would reasonably consider to be financial. For instance, in paragraph 13(ii)(B) and (C) of the Appendix to Subpart N "financial activities" include-

(ii) Investing and trading activities. Engaging as principal in:

. . . . .

> (B) Forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on any rate, price, financial asset (including gold, silver, platinum, palladium, copper, or any other metal), nonfinancial asset, or group of assets.
> (C) Forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on an index of a rate, a price, or the value of any financial asset, nonfinancial asset, or group of assets.[1]

This language materially departs from the existing language contained in Regulation Y, which goes to great lengths to distinguish between contracts that are physically settled and those that are cash settled (see 12 CFR 225.28(b)(8)). Understandably, Regulation Y's current characterization is directed at financial contracts. The proposed rule, however, completely overrides this distinction and extends the definition of "financial activity" to routine commercial transactions.

Many American manufacturers use physical forwards and options as an integral part of the manufacturing process. Such transactions are essential for long-term planning and cost management. Forwards and options on commercial inputs are routinely used as an essential part of the manufacturing process. The recognition of this fact was expressly acknowledged elsewhere in Dodd Frank, where Congress chose to exempt from the "swap" definition "any sale of a nonfinancial commodity . . . for deferred shipment or delivery, so long as the contract is intended to be physically settled." This was in keeping with the longstanding forward contract exclusion under the Commodity Exchange Act (see section 1a(27) and (47)(B)(ii)). Physical forwards and options are not financial contracts and are critical to the everyday commercial operations of virtually every manufacturer, producer, energy or natural resources company, and other nonfinancial business.

Conclusion

NAM members believe the Board's proposed rule does not reflect the language and intent of Dodd Frank by expanding the list of "activities that are financial in nature" to include transactions routinely engaged in by America's manufacturers and commercial companies. Our members are concerned that, in so doing, the Board is subjecting these companies to regulatory risk that can have a materially adverse impact on capital formation and growth. The Pryor-Vitter Amendment was designed to prevent precisely this adverse outcome.

The Board should clearly indicate that the activities listed in Section 4(k) and Regulation Y, as of the date of enactment of Dodd Frank, are those activities which are "financial in nature" as contemplated by Congress. If the Board instead chooses to retain 13(ii)(B) and (C) in the

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[1] *Code of Federal Regulations*, Banks and Banking, title 12, sec. 225.28

Appendix to Subpart N, those provisions should at the very least be amended to clearly exclude activities except those which are related or ancillary to the operations of a commercial enterprise.

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Thank you in advance for considering our comments. If you have any questions, please feel free to contact me at 202-637-3079.

Sincerely,

Carolyn Lee

Carolyn Lee
Senior Director, Tax Policy