Financial Stability Oversight Council

Staff Guidance

Methodologies Relating to Stage 1 Thresholds

June 8, 2015

Stage 1 Overview

Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) authorizes the Financial Stability Oversight Council (the Council) to determine that a nonbank financial company shall be supervised by the Board of Governors of the Federal Reserve System and be subject to enhanced prudential standards if the Council determines that material financial distress at the company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company, could pose a threat to the financial stability of the United States.[1] The Council has issued a rule and interpretive guidance (Rule and Guidance) regarding its determinations authority.[2] The Rule and Guidance provide a detailed description of the analysis that the Council intends to conduct, and the processes and procedures that the Council intends to follow, during its review of nonbank financial companies. The Council has also adopted supplemental procedures related to nonbank financial company determinations that supplement the Rule and Guidance (Supplemental Procedures).[3]

In the Rule and Guidance, the Council created a three-stage process for identifying and analyzing companies for a potential determination. Each stage of the process involves an analysis based on an increasing amount of information to determine whether a company meets one of the statutory standards for a determination. In the first stage of the process (Stage 1), the Council applies six quantitative thresholds to a broad group of nonbank financial companies to identify a set of companies that merit further evaluation. The six thresholds are described below. A nonbank financial company identified for further evaluation in Stage 1 may be subject to active review in Stage 2. The Council will notify a company if the Council commences an active review of the company in Stage 2. Subsequent steps of the process are described in the Rule and Guidance and Supplemental Procedures.

Stage 1 provides a mechanism for the Council, nonbank financial companies, market participants, and other members of the public to assess whether a nonbank financial company may be subject to further evaluation by the Council. In Stage 1, the Council relies solely on information available through existing public and regulatory sources. A fundamental purpose of Stage 1 is to narrow the universe of nonbank financial companies that may be subject to active review in Stage 2. The Stage 1 thresholds are designed to be uniform, transparent, and readily calculable by the Council, nonbank financial companies, market participants, and other members of the public.

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[1] 12 U.S.C. § 5323.

[2] Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 12 C.F.R. part 1310.

[3] Supplemental Procedures Relating to Nonbank Financial Company Determinations (February 4, 2015), available at fsoc.gov.

The Council applies the Stage 1 thresholds to all types of nonbank financial companies, to the extent that the relevant data are available. The Council retains the discretion to consider in Stage 2 a nonbank financial company not identified by the Stage 1 thresholds if further analysis is warranted to determine if the company could pose a threat to U.S. financial stability.

As announced in the Council's Supplemental Procedures, below are additional details explaining how the Stage 1 thresholds are calculated. [4]

Methodologies for Calculating Stage 1 Thresholds

1. **Components of thresholds.** The six Stage 1 thresholds are described below. A nonbank financial company that meets both the total consolidated assets threshold and any one of the other thresholds is in Stage 2 and may become subject to active review by the Council.

   - *$50 billion in total consolidated assets*
     - For a U.S. nonbank financial company, the global assets of the company and its consolidated subsidiaries are included in the calculation of this threshold. For a foreign nonbank financial company, only the U.S. assets of the company and its consolidated subsidiaries are included.
   - *$30 billion in gross notional credit default swaps (CDS) outstanding for which a nonbank financial company is the reference entity*
     - Gross notional value equals the sum of CDS contracts bought (or equivalently sold) for all contracts in the aggregate. This value is calculated on a per-trade basis to avoid double-counting that would arise from including both the purchase and sale of the same contract.
     - If a nonbank financial company has a subsidiary that is the reference entity for CDS, the CDS referencing that subsidiary are included in the calculation of this threshold with respect to the parent nonbank financial company.
     - With respect to a foreign nonbank financial company, only CDS for which the company's U.S. subsidiaries are the reference entities are included in the calculation.
     - With respect to a U.S. nonbank financial company that is the subsidiary of a parent company that is not a nonbank financial company, any CDS for which the parent company is the reference entity are not included in the calculation.
     - The data used for this threshold are as of the last week of the quarter for which the threshold is being calculated.
   - *$3.5 billion of derivative liabilities*
     - Derivative liabilities are calculated including embedded derivative liabilities, and are net of master netting agreements and cash collateral held with the same

[4] The calculation of the Stage 1 thresholds may be adjusted as appropriate in the event of idiosyncratic accounting issues or other circumstances in a particular nonbank financial company's financial reporting.

counterparty (this netting reduces the calculated derivative liabilities). Derivative liabilities are not calculated net of securities collateral.

    - For nonbank financial companies that do not disclose these net effects, derivative liabilities equal the fair value of derivative contracts in a negative position.

- *$20 billion in total debt outstanding*
    - Total debt outstanding is broadly defined to include, regardless of maturity, loans (whether secured or unsecured), bonds, repurchase agreements, commercial paper, securities lending arrangements, surplus notes (for insurance companies), and other forms of indebtedness.
    - For repurchase agreements and securities lending arrangements, the liability associated with cash borrowings is considered to be debt.
    - Advances from a Federal Home Loan Bank and capital lease obligations are included in total debt.
    - Deposit liabilities (to the extent separately disclosed) are not included in total debt.

- *15 to 1 leverage ratio*
    - The leverage ratio is calculated as the ratio of total consolidated assets (excluding separate account assets) to total equity.
    - Total equity for this calculation includes non-controlling interests in subsidiaries and redeemable interests of consolidated funds.

- *10 percent short-term debt ratio*
    - The short-term debt ratio is calculated as the ratio of total debt outstanding (as defined above) with a maturity of less than 12 months to total consolidated assets (excluding separate account assets).
    - Commercial paper, repurchase agreements, and securities lending liabilities are included as short-term debt unless their remaining duration as of the measurement date is 365 days or more.
    - Deposit liabilities (to the extent separately disclosed) are not included in short-term debt.

2. **Application of accounting standards.** The Council generally applies the Stage 1 thresholds using generally accepted accounting principles in the United States (GAAP) when such information is available. If GAAP information with respect to a nonbank financial company is not available, the Council may rely on data reported under state statutory accounting principles (SAP), data based on international financial reporting standards, or other such data as are available to the Council. As discussed below, when calculating Stage 1 thresholds for insurance companies that report financial statements solely under SAP, those financial statements are adjusted to improve their comparability with financial statements reported under GAAP to promote consistency and uniformity in the application of the Stage 1 thresholds.

- When using SAP, the following adjustments are made:

    - Under SAP, certain assets that are not included for purposes of calculating regulatory capital are reported separately as "non-admitted." For purposes of calculating total consolidated assets, both admitted and non-admitted assets are included. In addition, the company's carrying value of investments in direct U.S. insurance subsidiaries is deducted from the calculation of total consolidated assets as a consolidating adjustment because the assets of the subsidiaries are separately aggregated.

    - SAP requires surplus notes to be recorded as a separate component of surplus (equity), while GAAP requires surplus notes to be reported as long-term debt. As a result, considering surplus notes to be long-term debt provides a figure more comparable to GAAP. Therefore, for purposes of calculating total debt outstanding, surplus notes are included, and for purposes of calculating short-term debt, surplus notes are excluded.
    - Short-term debt is not provided in SAP filings; therefore, it is assumed that short-term debt is equivalent to total SAP debt.
    - For purposes of calculating the leverage ratio, total equity is calculated as the sum of statutory capital and surplus, non-admitted assets, and asset valuation reserve and interest maintenance reserve accounts, less surplus notes. In addition, the company's carrying value of investments in direct U.S. insurance subsidiaries is deducted from the calculation of total equity as a consolidating adjustment because the equity of the subsidiaries is separately aggregated.

3. **Data sources; practices when incomplete data are available**

- Data sources used for calculating the Stage 1 thresholds include filings with the Securities and Exchange Commission, filings with the National Association of Insurance Commissioners (NAIC), credit union call reports provided by National Credit Union Administration, certain private-sector data vendors, and the Trade Information Warehouse, which is operated by a subsidiary of the Depository Trust & Clearing Corporation (with respect to CDS data).
- In some cases, consolidated financial statements for a company are not available. In that circumstance, the data for those subsidiaries for which data are available are aggregated to calculate the thresholds.
- When data are not reported quarterly, data from the most recent available period are used.
- The NAIC provides the Council with SAP data collected for each insurance group for which data are requested in Stage 1.

4. **Entities included in calculations**

- For U.S. nonbank financial companies, the Stage 1 thresholds are calculated based on the global assets, liabilities, and operations of the company and its consolidated subsidiaries. For foreign nonbank financial companies, the Stage 1 thresholds are calculated based solely on the U.S. assets, liabilities, and operations of the foreign nonbank financial company and its consolidated subsidiaries.

- When evaluating a particular nonbank financial company for a potential determination, the Council considers the company and its subsidiaries. If a nonbank financial company that is a subsidiary of another nonbank financial company meets the Stage 1 thresholds, the Council may evaluate the parent nonbank financial company and all of its subsidiaries, even if the parent company or another individual subsidiary does not meet the Stage 1 thresholds. This approach enables the Council to consider potential risks arising across the consolidated organization, while retaining the ability to make a determination regarding either the parent or an individual nonbank financial company subsidiary (or neither), depending on which entity the Council determines could pose a threat to financial stability.

5. **Frequency of calculations**

- The Stage 1 thresholds are calculated quarterly using the most recently available data.

6. **Periodic review of Stage 1 thresholds**

- The Council has stated that it retains the ability to revisit the Stage 1 thresholds and to develop additional thresholds. The Council has also stated that it intends to review the appropriateness of both the current Stage 1 thresholds and the levels of the thresholds that are specified in dollars as needed, but at least every five years, and to adjust the thresholds and levels as the Council may deem advisable.