The Financial Stability Oversight Council Improvement Act

Summary

ICI supports bipartisan legislation to reform the Financial Stability Oversight Council's (FSOC) ability to designate nonbank financial companies as systemically important financial institutions (SIFI). The President Trump FSOC should engage in rulemaking undoing the Biden FSOC's flawed risk assessment framework and designation guidance governing the SIFI designation process for nonbank financial institutions. Both actions would ensure a SIFI designation is a last resort, not a first recourse, and let American businesses succeed without a governmental sword of Damocles hanging over their head.

Background

Nonbanks include a wide range of financial intermediaries, from regulated funds to public pensions to alternative lenders. In the wake of the 2008 financial crisis, the FSOC, a council of regulators, was given the broad-reaching ability to designate nonbanks as SIFIs—meaning the failure of these specific companies could risk larger economic collapse—a label entailing an onerous regulatory burden and resulting from a murky decision-making process.

In late 2023, the FSOC approved an analytic framework for identifying and dealing with systemic risk, as well as new guidance on SIFI determinations. In doing so, the FSOC expanded its regulatory powers, shrouded its decision-making, eliminated the flexibility needed to react to complex financial markets, and cast a wider net to capture more nonbanks as SIFIs.

The FSOC's move away from conducting a cost-benefit analysis does not lend itself to thoughtful decision-making based on empirical evidence and is in conflict with the 2016 D.C. District Court's opinion in the successful MetLife challenge to its designation. The FSOC's Designation Guidance of 2023 singles out individual firms instead of taking a holistic assessment of systemic risk. For these reasons, the guidance should be reversed.

The Financial Stability Oversight Council Improvement Act will ensure that, prior to voting on a proposed SIFI designation, the FSOC determines whether the potential threat posed by a nonbank financial intermediary could be mitigated through other means, including a different action by the company's primary regulator or action by the company itself.

Why It Matters

The Biden FSOC appeared determined to designate additional nonbanks as SIFIs supposedly in the name of financial stability.

However, a SIFI designation has broad-reaching negative consequences for nonbanks, including:

- Increased regulatory scrutiny and additional costs that can fundamentally change the way nonbanks do business; and
- Remedies that are designed to moderate bank-like risks (e.g. a run) and are therefore ill-suited to registered funds and their managers.

What's more, the FSOC's designation process overlooks the fact that risks are often not centralized in a single entity but in a type of financial activity. Its flawed risk assessment framework, which moves away from an activities-based approach and toward making it easier to label a company as *systemically important*, lacks justification. The Administration should support this legislation.