

Proposed FSOC Guidance Could Lead to Bank-like Regulation for Asset Managers, Private Funds, and Non-bank Mortgage Companies – as well as New Federal Regulatory Frameworks for Digital Assets and Payment Activities

Paul Atkins, Keith Noreika, Jill Sommers, Robert Greene

8 May 2023

On 21 April, the Financial Stability Oversight Council (“FSOC”) – a federal multi-regulator council established by the 2010 Dodd-Frank Act – [released](#) for public comment two documents that could set the stage for a dramatic transformation of how the United States’ financial markets are regulated:¹ its proposed Analytic Framework for Financial Stability Risk Identification, Assessment, and Response (the “[Proposed Analytic Framework](#)”),² and its proposed interpretive guidance entitled Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies (the “[Proposed Non-bank Guidance](#)”).³

This proposed interpretive guidance and accompanying analytic framework, if finalized, would have major implications to U.S. financial markets:

- FSOC will be empowered to use sweeping powers to subject an expansive potential list of many different types of non-bank financial firms and a broad range of otherwise regulated financial activities to additional bank-like regulation by the Federal Reserve Board (the “Fed”).
- FSOC will no longer be required to conduct cost-benefit analysis or consider the economy-wide and regulatory costs of subjecting large swaths of the financial sector to bank-like regulation.
- FSOC will no longer be required to establish the likelihood of material financial distress associated with a particular financial firm or activity before determining that expansive Fed bank-like regulation is necessary.
- Over a decade of procedural guardrails on FSOC’s powers applied by the Obama and Trump Administrations will be abandoned.

If the Proposed Analytic Framework and Proposed Non-bank Guidance are finalized, then non-bank financial firms across the United States – including large private funds, asset managers, mortgage companies, payments companies, insurers, and cryptocurrency firms – will need to brace for new Fed-led regulatory regimes.

The Dodd-Frank Act grants FSOC three primary ways to subject non-bank financial firms, market infrastructure, and activities to additional regulation by the Fed. This analysis examines the statutory basis for this authority, how FSOC has used this power in the past, and how the Biden Administration’s Proposed Analytic Framework and Proposed Non-bank Guidance may affect the future exercise of this authority in ways never before used by FSOC.

¹ FSOC, FSOC Issues for Public Comment Proposed Analytic Framework for Financial Stability Risks and Proposed Guidance on Nonbank Financial Company Determinations (Apr. 21, 2023), available at <https://home.treasury.gov/news/press-releases/jy1432>.

² FSOC, Analytic Framework for Financial Stability Risk Identification, Assessment, and Response, 88 FR 26305 (Apr. 28, 2023), <https://home.treasury.gov/system/files/261/FSOC-2023-Risk-Framework.pdf> (*hereinafter* “Proposed Analytic Framework”).

³ FSOC, Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies, 88 FR 26234 (Apr. 28, 2023), <https://home.treasury.gov/system/files/261/FSOC-2023-Proposed-Nonbanks-Guidance.pdf> (*hereinafter* “Proposed Nonbank Guidance”).

I) Reviewing the Statutory Basis for FSOC's Designation Authorities

FSOC is chaired by the Secretary of the Treasury. The other nine voting members are the heads of the Fed, the Securities and Exchange Commission (“SEC”), the Commodity Futures Trading Commission (“CFTC”), the Consumer Financial Protection Bureau (“CFPB”), the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Federal Housing Finance Agency, and the National Credit Union Administration, as well as an independent member with insurance expertise appointed by the President with the consent of the Senate (“Independent Insurance Member”). FSOC’s designation authorities primarily come from Sections 113 and 804 of the Dodd-Frank Act. The Biden Administration’s Proposed Analytic Framework marks the first time FSOC has proposed an analytic framework surrounding how it will use all of the designation authorities granted by these sections.

A) Section 113 non-bank designations

Section 113 of the Dodd-Frank Act allows FSOC, by a two-thirds vote, to designate a non-bank financial firm as a “threat to financial stability of the United States” and subject that firm to Fed supervision and regulation if it determines that either:⁴

- 1) “material financial distress” at the firm “could pose a threat to the financial stability of the United States” (the “First Determination Standard”); or
- 2) the “nature, scope, size, scale, concentration, interconnectedness, or mix” of the firm’s activities could pose a similar threat (the “Second Determination Standard”).

In making this determination, FSOC is required to consider a number of factors, including leverage, off-balance sheet exposures, importance of the company to underserved communities, and transactions and relationships with other significant banks or non-bank financial firms, as well as “any other risk-related factors” that FSOC “deems appropriate.”⁵

Section 113(e) of the Dodd-Frank Act requires that before any Section 113 designation, a non-bank financial company being considered for designation be provided with a written notice of a proposed FSOC determination, including an explanation of the basis for the proposed determination, and the opportunity for a hearing to contest the proposed determination no later than 30 days after the receipt of the written notice.⁶ It also requires that no later than 60 days after such a hearing, FSOC decide whether to designate the non-bank financial company and notify it accordingly, providing a statement of the basis for any decision to designate a non-bank financial firm.⁷ However, these Section 113(e) procedural requirements can be waived or modified by a two-thirds majority vote under Section 113(f) if FSOC determines “that such waiver or modification is necessary or appropriate to mitigate threats posed by the nonbank financial company to the financial stability of the United States.”⁸

FSOC can by a two-thirds majority vote to rescind designations, and importantly, is required to reevaluate Section 113 designations on an annual basis.⁹

⁴ H.R.4173, *Dodd-Frank Wall Street Reform and Consumer Protection Act*, 111th Congress, (Jul. 21, 2010), Sec. 113, <https://www.congress.gov/bill/111th-congress/house-bill/4173/text> (*hereinafter* “Dodd-Frank Act”).

⁵ *Id.*, Sec. 113(a)-(b).

⁶ *Id.*, Sec. 113(e).

⁷ *Id.*

⁸ *Id.*, Sec. 113(f).

⁹ *Id.*, Sec. 113(d).

B) Section 804 entity-specific and activity designations

Section 804 of the Dodd-Frank Act allows FSOC, by a two-thirds vote, to designate so-called “financial market utilities” (“FMUs”) that it “determines are, or are likely to become, systemically important.”¹⁰ The Dodd-Frank Act defines FMUs as entities that manage or operate multilateral systems “for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person.”¹¹ Designated FMUs are to be subject to Fed regulation, or in certain cases, heightened SEC and/or CFTC regulation developed in consultation with FSOC and the Fed.¹²

Section 804 also allows FSOC, by a two-thirds vote, to designate a “payment, clearing, or settlement activity” (“PCS Activity”) as systemically important or likely to become systemically important, and thus subject to either Fed regulation or SEC and/or CFTC regulation developed in consultation with FSOC and the Fed.¹³ Upon designation, the Fed shall prescribe regulations governing the conduct of PCS Activities by financial institutions, unless the CFTC or SEC is the supervisory authority for such financial institutions, in which case the appropriate supervisory authority would prescribe regulations in consultation with the Fed and FSOC.¹⁴ If the Fed ultimately determined that that these regulations were insufficient, there is a statutory pathway whereby it could gain authority to prescribe superseding regulations by a two-thirds FSOC vote.¹⁵

When determining whether to designate a FMU or PCS Activity as “systemically important,” the Dodd-Frank Act requires FSOC to consider: 1) the aggregate monetary value of transactions processed by a FMU or through a particular PCS Activity; 2) aggregate exposure of a FMU or a financial institution engaged in a PCS Activity to counterparties; 3) relationship, interdependencies, or other interactions of the FMU or PCS Activity with other FMUs or PCS Activities; 4) the effect that failure or disruption of the FMU or PCS Activity would have on “critical markets, financial institutions, or the broader financial system”; and 5) any other factors that the FSOC determines are appropriate.¹⁶

Unlike for Section 113 designations, in advance of determining that a FMU or PCS Activity is “systemically important,” FSOC is required to provide a FMU set for designation or financial institutions engaged in a PCS Activity set for designation with advance notice by publishing a notice in the Federal Register.¹⁷ The FMU or a financial firm engaged in such a PCS Activity can request a hearing to demonstrate that a proposed designation is not supported by substantial evidence, although FSOC can determine by a two-thirds vote to waive or modify this process if it determines that a “waiver or modification” is necessary to “prevent or mitigate an immediate threat to the financial system.”¹⁸

Once a FMU or PCS Activity is designated as “systemically important,” it remains so until a two-thirds vote to rescind such designation.¹⁹

¹⁰ *Id.*, Sec. 804.

¹¹ *Id.*, Sec. 803.

¹² *Id.*, Sec. 805(a)

¹³ *Id.*, Sec. 804

¹⁴ *Id.*, Sec. 805(a)

¹⁵ *Id.*

¹⁶ *Id.*, Sec. 804(a).

¹⁷ *Id.*, Sec. 804(c).

¹⁸ *Id.*

¹⁹ *Id.*, Sec. 804(b).

II) Past is Prologue: An Overview of Past FSOC Designations

FSOC’s Section 804 activity-based designation authority has never been used. On the other hand, eight FMUs were unanimously designated under FSOC’s Section 804 authority in July 2012, less than two months after the FSOC proposed designating these entities.²⁰ No hearings were held, as no designated FMU ever requested a hearing to disagree with the FSOC’s proposed designations or findings of fact.²¹ These designations took place less than a year after FSOC finalized a rule outlining the criteria, processes, and procedures for FMU designation.²² This rule is still in effect, as are the eight FMU designations. The Fed is the primary supervisory agency for two of these FMUs, while the SEC is the primary supervisory agency for four FMUs and the CFTC is the primary supervisory agency for two FMUs.²³

Past efforts to designate non-bank entities under FSOC’s Section 113 authority were much more controversial. FSOC successfully used its Section 113 authority four times during the Obama Administration, but due to designation rescissions and successful legal challenges, no non-bank firms are currently designated by FSOC under Section 113.

A) Understanding the Obama Administration’s successful and attempted Section 113 designations

The Obama Administration’s four Section 113 designations were enabled by April 2012 Treasury Department guidance regarding FSOC’s use of Section 113 authorities (“2012 Non-bank Guidance”).²⁴ About one year later, in July 2013, FSOC designated American International Group, Inc. (“AIG”) and General Electric Capital Corporation, Inc. (“GECC”) under the First Determination Standard.²⁵ Insurers Prudential Financial, Inc. (“Prudential”) and MetLife, Inc. (“MetLife”) were similarly designated in September 2013 and December 2014, respectively, under the First Determination Standard.²⁶

FSOC attempted to designate large asset managers in 2014 under Section 113, but after months of advocacy work by these firms, this effort did not materialize.²⁷ FSOC also targeted money market funds (“MMFs”) offered by these firms, and used its Dodd-Frank Act Section 120 authority to propose non-

²⁰ FSOC, *Designations*, <https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc/designations> (accessed May 4, 2023).

²¹ FSOC, 2012 ANNUAL REPORT 145-146, <https://home.treasury.gov/system/files/261/here.pdf>.

²² FSOC, Authority To Designate Financial Market Utilities as Systemically Important, 76 F.R. 44763 (Jul. 27, 2011), <https://home.treasury.gov/system/files/261/Final-Rule-on-Authority-to-Designate-Financial-Market-Utilities-as-Systemically-Important.pdf>.

²³ Fed, *Designated Financial Market Utilities* (Jan. 29, 2015), https://www.federalreserve.gov/paymentsystems/designated_fmu_about.htm.

²⁴ FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 F.R. 21637 (Apr. 11, 2012),

<https://home.treasury.gov/system/files/261/Authority%20to%20Require%20Supervision%20and%20Regulation%20of%20Certain%20Nonbank%20Financial%20Companies.pdf> (*hereinafter* “2012 Non-bank Guidance”).

²⁵ FSOC, *Basis of the Financial Stability Oversight Council’s Final Determination Regarding American International Group, Inc.* (Jul. 8, 2013), <https://home.treasury.gov/system/files/261/American%20International%20Group%2C%20Inc.pdf> (*hereinafter* “AIG Designation Report”); FSOC, *Basis of the Financial Stability Oversight Council’s Final Determination Regarding General Electric Capital Corporation, Inc.* (Jul. 8, 2013),

<https://home.treasury.gov/system/files/261/General%20Electric%20Capital%20Corporation%2C%20Inc.pdf> (*hereinafter* “GECC Designation Report”).

²⁶ FSOC, *Basis for the Financial Stability Oversight Council’s Final Determination Regarding Prudential Financial, Inc.* (Sep. 19, 2013), <https://home.treasury.gov/system/files/261/Prudential%20Financial%20Inc.pdf> (*hereinafter* “Prudential Designation Report”); FSOC, *Basis for the Financial Stability Oversight Council’s Final Determination Regarding Metlife, Inc.* (Dec. 18, 2014), <https://home.treasury.gov/system/files/261/MetLife%2C%20Inc..pdf> (*hereinafter* “MetLife Designation Report”).

²⁷ See Andrew Ackerman & Ryan Tracy, *Asset Managers Notch an ‘Important’ Win* (Jul. 31, 2014), *The Wall Street Journal*, <https://www.wsj.com/articles/asset-managers-may-avoid-more-oversight-by-fsoc-1406828103>.

binding recommendations for the SEC to act on MMFs.²⁸ This effort was likewise met with fierce industry resistance,²⁹ but significantly influenced new SEC MMF regulations adopted in 2014.³⁰

The four firm-specific Section 113 designation processes that FSOC did successfully carry out during the Obama Administration were criticized for analytical brevity and opacity, in part because the process was viewed by many as working towards a pre-determined outcome due to a global group of regulators called the Financial Stability Board (“FSB”) – discussed in greater depth below – labeling MetLife, AIG, and Prudential as “systemically important” months before FSOC did so similarly.³¹ Indeed, the designations of AIG, Prudential, and GECC were accompanied by perfunctory reports of just twelve to fourteen pages. MetLife’s designation report was somewhat longer, but FSOC’s own Independent Insurance Member voted against both the MetLife and the Prudential designations on the grounds that the reports utilized unrealistic scenarios and assumptions.³² None of the designation reports considered the costs of designation.

B) The aftermath of Obama Administration Section 113 designations

Ultimately, the costs were very significant. The GECC designation effectively resulted in the elimination of many of GECC’s business lines and reportedly drove its asset size to decrease by 50 percent.³³ The Obama Administration rescinded its designation in 2016, noting that GECC engaged in a series of divestitures, a corporate reorganization, and a transformation of its funding model.³⁴ Then during the Trump Administration, AIG’s and Prudential’s designations were rescinded as part of the annual re-evaluation process – each of the respective rescission reports detailed how these firms sold off businesses, restructured operations, exited certain markets, and/or reduced footprints.³⁵ Prior to rescission, the compliance costs related to FSOC’s designation of AIG were reportedly \$150 million per year.³⁶

²⁸ FSOC, Proposed Recommendations Regarding Money Market Mutual Fund Reform, 77 F. R. 69455 (Nov. 19, 2012), <https://www.govinfo.gov/content/pkg/FR-2012-11-19/pdf/2012-28041.pdf>.

²⁹ See, e.g., Investment Company Institute, *Comment Letter of the Investment Company Institute on Financial Stability Oversight Council Proposed Recommendations Regarding Money Market Mutual Fund Reform* (Jan. 24, 2013), https://www.ici.org/doc-server/pdf%3A13_fsoc_mmf_recs.pdf.

³⁰ See SEC, Money Market Fund Reform; Amendments to Form PF, 79 F.R. 47736 (Aug. 14, 2014), <https://www.govinfo.gov/content/pkg/FR-2014-08-14/pdf/2014-17747.pdf>.

³¹ See, e.g., Letter from John M. Huff et al., National Association of Insurance Commissioners, to Rep. Lynn Westmoreland and Rep. David Scott (Feb. 25, 2016),

https://content.naic.org/sites/default/files/naic_archive/government_relations_160225_letter_fsoc_des_rev_act.pdf; Peter Wallison, American Enterprise Institute, *Statement before the House Committee on Financial Services On “Examining the Dangers of the FSOC’s Designation Process and its Impact on the U.S. Financial System* (May 20, 2014), <https://docs.house.gov/meetings/BA/BA00/20140520/102244/HHRG-113-BA00-Wstate-WallisonP-20140520.pdf>; Speech by SEC Commissioner Daniel Gallagher at the 2015 Virginia Law and Business Review Symposium (Apr. 10, 2015), <https://www.sec.gov/news/speech/041015-spch-cdmg>.

³² See Hester Peirce, *Insurance Regulation in the Dodd-Frank Era* (Policy Brief, Networks Financial Institute at Indiana State University, Mar. 2015), https://www.indstate.edu/business/sites/business.indstate.edu/files/Docs/2015-PB-02_Peirce.pdf.

³³ See Ted Mann & Ryan Tracy, *GE Capital Sheds ‘Systemically Important’ Label*, Wall Street Journal (Jun. 29, 2016), <https://www.wsj.com/articles/ge-capital-sheds-systemically-important-label-for-too-big-to-fail-firms-1467205963>.

³⁴ FSOC, Basis for the Financial Stability Oversight Council’s Rescission of Its Determination Regarding GE Capital Global Holdings, LLC (Jun. 28, 2016), <https://home.treasury.gov/system/files/261/GE%20Capital%20Global%20Holdings%20LLC%20%28Rescission%29.pdf>.

³⁵ FSOC, Notice and Explanation of the Basis for the Financial Stability Oversight Council’s Rescission of Its Determination Regarding Prudential Financial, Inc. (Prudential) (Oct. 16, 2018), <https://home.treasury.gov/system/files/261/Prudential%20Financial%20Inc%20Rescission.pdf>; FSOC, Notice and Explanation of the Basis for the Financial Stability Oversight Council’s Rescission of Its Determination Regarding American International Group, Inc. (AIG) (Sep. 29, 2017), <https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc/designations>.

³⁶ See Alistair Gray, *AIG sheds \$150m in costs along with Sifi label*, Financial Times (Oct. 1, 2017), <https://www.ft.com/content/31b36b9a-a662-11e7-93c5-648314d2c72c>.

Notably, MetLife’s designation was never formally rescinded, but was thrown out by a 2016 U.S. District Court ruling, which noted that FSOC’s designation was “unreasonable” in that it “focused exclusively on the presumed benefits of its designation and ignored the attendant costs.”³⁷ This decision was appealed by the Treasury Department and ultimately culminated in a 2018 settlement agreement whereby the designation did not move forward.³⁸ About two years later, the Trump Administration finalized revisions to the 2012 Non-bank Guidance which established new procedural steps for Section 113 designations (the “2019 Non-bank Guidance”).³⁹

III) How the Proposed Analytic Framework and Proposed Non-bank Guidance would turbocharge FSOC

The Proposed Analytic Framework and Proposed Non-bank Guidance proposed by the Biden Administration on 21 April 2023 retain some important procedural steps for Section 113 designations from the 2019 Non-bank Guidance, including a two-stage process for non-bank Section 113 designations. Under this approach, FSOC first determines whether to pursue designation of a non-bank financial firm by reviewing public and regulatory information and through FSOC staff dialogue with the firm.⁴⁰ Then, if FSOC determines a particular non-bank indeed potentially warrants Section 113 designation, an in-depth examination is carried out, culminating in a vote to propose designation, which in turn culminates in a hearing before a designation is finalized.⁴¹

But for the most part, the Proposed Analytic Framework and Proposed Non-bank Guidance appear designed to enable FSOC to behave much more actively than the FSOC of the Obama and Trump Administrations. These documents will do away with various important procedural steps surrounding the use of Section 113 authorities set forth in existing guidance and seem designed to facilitate a broader range of non-bank designations than which took place during the Obama Administration. The Proposed Analytic Framework and Proposed Non-bank Guidance are also clearly crafted in a way that aims to avoid legal challenges that culminated in the MetLife designation being thrown out. Additionally, the Proposed Analytic Framework indicates that FSOC is preparing to use its Section 804 authority to designate PCS Activities for the first time. Described below are three significant ways in which the Proposed Analytic Framework and Proposed Non-bank Guidance seem poised to accelerate FSOC designations.

A) Dramatically eases the ability of FSOC to use its Section 113 authority in a way that aims to avoid future legal challenges

The Proposed Non-bank Guidance would remove several important procedural steps established by the 2019 Non-bank Guidance to govern FSOC’s use of Section 113.⁴² First, the Proposed Non-bank Guidance would remove a requirement that FSOC, before pursuing a Section 113 designation, first consider using its Section 120 authority to make recommendations to relevant financial regulators to implement regulatory changes for financial activities or practices that FSOC finds could create or increase significant liquidity, credit, or other problems spreading across the financial system.⁴³ Second, the 2023 Proposed

³⁷ MetLife, Inc. v. Financial Stability Oversight Council, 177 F. Supp. 3d 219 (D.D.C. 2016), available at <https://casetext.com/case/metlife-inc-v-fin-stability-oversight-council-3>.

³⁸ See Pete Schroeder, *MetLife, U.S. Regulators Agree to Set Aside Legal Fight*, Reuters (Jan. 18, 2018), <https://www.reuters.com/article/us-usa-metlife-fsoc-idUKKBN1F8064>.

³⁹ FSOC, Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 84 F.R. 71740, (Dec. 30, 2019), <https://www.govinfo.gov/content/pkg/FR-2019-12-30/pdf/2019-27108.pdf> (*hereinafter* “2019 Non-bank Guidance”).

⁴⁰ See *id.*; Proposed Analytic Framework, *supra* note 2; Proposed Nonbank Guidance, *supra* note 3.

⁴¹ See *id.*; Proposed Analytic Framework, *supra* note 2; 2019 Non-bank Guidance, *supra* note 39.

⁴² Proposed Nonbank Guidance, *supra* note 3.

⁴³ *Id.*, at 26235 & 26237.

Non-bank Guidance would eliminate a formal step established by the 2019 Non-bank Guidance of first relying upon federal and state regulators to address financial stability risks presented by a particular non-bank before FSOC considers a Section 113 entity-based designation.⁴⁴ Third, the Proposed Non-bank Guidance removes the requirement that a cost-benefit analysis be conducted and that the “likelihood of material financial distress” be assessed.⁴⁵ Interestingly, it cites the recent failure of Silicon Valley Bank as underscoring the Biden Administration’s view that having to assess the “likelihood of material financial distress” is not practical because there may not be enough time to conduct such an assessment.⁴⁶

With regards to cost-benefit analysis, the 2023 Proposed Non-bank Guidance indicates that the Biden Administration believes that the 2016 U.S. District Court MetLife decision to throw out MetLife’s designation does not require FSOC to consider the potential costs of a non-bank’s FSOC designation and resulting regulation. In a footnote, it states that this decision “held that [FSOC] should have considered the potential costs of designation before designating MetLife, Inc. under section 113, but the Court’s reasoning assumes that a company’s likelihood of material financial distress is itself a required consideration under the Council’s guidance in effect at that time.”⁴⁷ The footnote and accompanying text suggest that the Biden Administration believes that FSOC is not required to consider the costs incurred by a particular firm as a result of FSOC designation and Fed regulation because, among other things: 1) the Proposed Non-bank Guidance makes clear that FSOC believes it is not required to consider a non-bank’s likelihood of material financial distress, and 2) in the final 2018 MetLife settlement agreement, “MetLife expressly waived any right to argue that the cost-benefit portion of the district court’s opinion had any preclusive effect in any future proceeding before the Council or in any subsequent litigation.”⁴⁸

Importantly, FSOC strongly emphasizes in the 2023 Proposed Non-bank Guidance that the guidance would “not have binding effect,” and if finalized, FSOC would not need to follow the guidance were it to determine that Dodd-Frank Act Section 113(f) emergency actions were necessary.⁴⁹ In doing so, it notes that FSOC has concluded that its designation process is not subject to notice and comment requirements under the Administrative Procedure Act.⁵⁰ Finally, it is noteworthy that the 2023 Proposed Non-bank Guidance leaves out quantitative thresholds for Section 113 non-bank designation, such as those that were in the Obama Administration’s 2012 Non-bank Guidance.⁵¹ This may be the case in order to ensure that FSOC has the ability to designate a broad range of non-banks under Section 113 – including those that may fall below a particular threshold.

B) Definitional shifts set the stage for FSOC to identity a wide range of activities and institutions as risks to “financial stability”

Obama-era 2012 Non-bank Guidance on FSOC’s Section 113 authority did not define “risk to financial stability.”⁵² The existing 2019 Non-bank Guidance, however, defines it as “risk of an event or development that could impair financial intermediation or financial market functioning to a degree that would be sufficient to inflict significant damage on the broader economy.”⁵³ The Proposed Non-bank

⁴⁴ *Id.*, 26235.

⁴⁵ *Id.*

⁴⁶ *Id.*, 26239. In April 2023, the Fed published a report observing that in the lead-up to Silicon Valley Bank’s failure, the bank’s “foundational problems were well known,” but that Fed supervisors “underappreciated important [issues].” Fed, Review of the Federal Reserve’s Supervision and Regulation of Silicon Valley Bank 5 (Apr. 2023), <https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf>.

⁴⁷ *Id.*, 26238 note 16.

⁴⁸ *Id.* See also Bank Reg Blog, *FSOC’s New Proposals* (Apr. 23, 2023), <https://bankregblog.substack.com/p/fsocs-new-proposals>.

⁴⁹ Proposed Nonbank Guidance, *supra* note 3, 26239.

⁵⁰ *Id.*, 26240.

⁵¹ *Id.*, 26237.

⁵² 2012 Non-bank Guidance, *supra* note 24.

⁵³ 2019 Non-bank Guidance, *supra* note 39, 71745.

Guidance takes issue with this definition, stating that requiring FSOC “to determine that the economy ‘would’ be severely damaged, contrasts sharply with the statutory standard under section 113 of the Dodd-Frank Act, which calls on the Council to determine whether there ‘could’ be a threat to financial stability.”⁵⁴

Accordingly, the 2023 Proposed Framework cuts any definition of “risk to financial stability,” instead proposing to define “financial stability” 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.”⁵⁵ In other words, by removing the definition of “risk to financial stability” and adding a new, broader, and more conjectural definition of “financial stability,” the proposed framework sets the stage for FSOC to identify a wide range of activities and institutions as risks to “financial stability.”

C) Proposed Analytic Framework identifies particular asset classes, institutions, and activities that FSOC may monitor, and sets forth a broad range of financial risk transmission channels and vulnerabilities

To work toward this goal of identifying risks to financial stability, the Proposed Analytic Framework – unlike Obama and Trump Administration FSOC guidance documents – sets forth a broad list of “asset classes, institutions, and activities” that FSOC “may” monitor for systemic risks.⁵⁶ The list is prefaced by an emphasis on FSOC’s “broad statutory framework” and includes: markets for debt, loans, short-term funds, equity securities, commodities, digital assets, derivatives, and other institutional and consumer financial products and services; broker-dealers; asset managers; investment companies; insurance companies; mortgage originators and servicers; specialty finance companies; new or evolving financial products and practices; cybersecurity; and climate-related financial risks.⁵⁷

This wide-ranging list – as well as repeated admonitions that the analytic framework would be non-binding on FSOC⁵⁸ – is a clear signal that the Biden Administration intends for FSOC to take advantage of loosened procedural guardrails to examine designating a broad range of non-banks and PCS Activities under Section 113 and Section 804 authorities.

Indeed, while the financial risk transmission channels and vulnerabilities emphasized in the Proposed Analytic Framework resemble those in Obama-era FSOC guidance, there are notable differences in emphasis and scope which seem to set the stage for broad actions by FSOC. Both Obama-era guidance and the 2023 Proposed Analytic Framework emphasize size, interconnectedness/interconnections, leverage, and liquidity risk and maturity mismatch, but the 2023 Proposed Framework seems to place a much greater emphasis on “operational risks,” “concentration,” “complexity,” and “opacity.”⁵⁹ Also, unlike the Obama-era FSOC guidance, the 2023 Proposed Analytic Framework explicitly discusses “contagion,” noting that “[c]ontagion can . . . arise when there is a loss of confidence in financial instruments that are treated as substitutes for money” – seemingly a reference to perceived risks regarding MMFs and/or stablecoins.⁶⁰

⁵⁴ Proposed Nonbank Guidance, *supra* note 3, 26236.

⁵⁵ Proposed Analytic Framework, *supra* note 2, 26306.

⁵⁶ *Id.*, 26307.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ Compare Proposed Analytic Framework, *supra* note 2, with 2012 Non-bank Guidance, *supra* note 24.

⁶⁰ Proposed Analytic Framework, *supra* note 2, 26308.

Also, unlike prior FSOC guidance, the Proposed Analytic Framework sets forth how PCS Activities and FMUs could be designated.⁶¹ This indicates a desire by the Biden Administration to use Section 804 authorities, which also helps explain why the 2023 Proposed Analytic Framework is a broad, separate document – a departure from the Obama and Trump Administrations’ approach of identifying substantive analytic factors within their respective non-bank designation guidance documents for FSOC to consider when determining whether a non-bank should be designated for Fed regulation under Section 113 of Dodd-Frank.

IV) How Public Policy and Compliance Professionals Can Prepare

For the last two years, the Biden Administration has clearly telegraphed where FSOC will focus its efforts through both FSOC reports and statements regarding the priorities of international bodies such as the FSB.

FSOC’s 2022 Annual Report affirmatively stated that the following entities and forms of financial intermediation presented various types of “risks to financial stability”: hedge funds, open-end mutual funds, collective investment funds, and MMFs.⁶² It also identified the following entities and activities as presenting potential risks to financial stability: commercial real estate, residential real estate, nonfinancial corporate credit, short-term wholesale funding markets, non-bank mortgage companies, activities impacted by changing climates, and digital assets.⁶³ Statements by SEC Chairman Gary Gensler and CFPB Director Rohit Chopra released concurrently with the Proposed Framework and Proposed Non-bank Guidance indicate that each of these FSOC members believe certain hedge funds and non-bank mortgage companies pose systemic risks.⁶⁴ Also, under the Biden Administration, FSOC has already established task forces to monitor hedge fund-related risks and non-bank mortgage company risks.⁶⁵

The impetus for FSOC to act on MMFs and open-end funds in particular is also driven by the Biden Administration’s close relationship with the FSB, an international group of regulators from twenty countries. The United States is not treaty-bound to any FSB decision and Congress has never formally approved membership of any U.S. regulator in this group.⁶⁶ Nevertheless, Secretary Yellen recently suggested that she believes that the United States has “international commitments” related to MMF regulation stemming from the Treasury Department’s work with the FSB on this issue.⁶⁷ She also stated that Treasury is working with FSB to develop recommendations on open-end fund regulation.⁶⁸ Similarly, late last year the White House embraced FSB’s call for significant regulation of digital asset markets under the pretext of “same activity, same risk, same regulation,” signaling that it could be appropriate for

⁶¹ *Id.*, 26310 (indicating that the Proposed Analytic Framework applies to FSOC’s Section 804 PCS Activity designation authority).

⁶² FSOC, 2022 Annual Report 42 (2022), <https://home.treasury.gov/system/files/261/FSOC2022AnnualReport.pdf>.

⁶³ *Id.* at 8, 9, 23, 26 & 84.

⁶⁴ Gary Gensler, Remarks before the Financial Stability Oversight Council Financial Stability Risks & Guidance on Nonbank Determinations (Apr. 21, 2023), <https://www.sec.gov/news/speech/gensler-remarks-fsoc-042123>; Rohit Chopra, Statement of CFPB Director Rohit Chopra on the Proposed Restoration of the Financial Stability Oversight Council’s Authority and Regulatory Credibility (Apr. 21, 2023), <https://www.consumerfinance.gov/about-us/newsroom/statement-of-cfpb-director-rohit-chopra-on-proposed-restoration-of-financial-stability-oversight-council-authority-regulatory-credibility/>.

⁶⁵ FSOC, *supra* note 62, at 12.

⁶⁶ See David Wessel, Panel at the Brookings Institution on Questioning the Legality and Legitimacy of Responses to the 2008 Financial Crisis (Apr. 6, 2015), https://www.brookings.edu/wp-content/uploads/2015/03/20150406_2008_financial_crisis_transcript.pdf (noting that a former Bank of England Deputy Governor observed that the FSB was not established by a treaty and there is no recourse to its decision-making); Rep. Jeff Hensarling, Press Release: Chairman Hensarling Once Again Calls on FSOC to “Cease and Desist” Too-Big-To-Fail Designations Until Questions Are Answered (May 2014), <https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=380567>.

⁶⁷ Remarks by Secretary of the Treasury Janet L. Yellen at the National Association for Business Economics 39th Annual Economic Policy Conference (Mar. 30, 2023), <https://home.treasury.gov/news/press-releases/jy1376>.

⁶⁸ *Id.*

certain stablecoin arrangements to be labeled “systemically important” by FSOC.⁶⁹ As mentioned above, during the Obama Administration, FSOC seemingly took direction from FSB when using its Section 113 designation authorities against insurers and attempting to designate asset managers.⁷⁰

In conclusion, if the Proposed Framework and the Proposed Non-bank Guidance are finalized in their current form with little opposition, FSOC will be empowered to begin designating a broad range of entities and activities related to hedge funds, non-bank mortgage finance, open-end funds, MMFs, and digital assets, as well as other areas of non-bank finance. The result would be Fed bank-like regulation applied to broad swaths of the financial sector that are unprepared for such a regulatory approach. The business models of insurers, asset managers, private funds, and other non-bank firms could be fundamentally altered by Fed supervision and regulation, as was the case for non-banks designated during the Obama Administration.

Patomak is prepared to advise executives, investors, compliance professionals, and public policy professionals seeking to understand and prepare for the potential costs and compliance considerations that would be brought about by future FSOC non-bank financial institution and PCS Activity designations. Patomak has deep experience advising non-bank financial firms on the FSOC designation process, responding to the FSOC designation process, and managing the compliance challenges that such designations bring about.

⁶⁹ The White House, G20 Bali Leaders’ Declaration (Nov. 16, 2022), <https://www.whitehouse.gov/briefing-room/statements-releases/2022/11/16/g20-bali-leaders-declaration/>. Indeed, in 2021, the Biden Administration endorsed FSOC using its Section 804 authority to designate certain stablecoin arrangements in the absence of Congressional action on stablecoins. President’s Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, Report on Stablecoins 18 (Nov. 2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

⁷⁰ See *supra* note 31 and accompanying text.