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Financial Stability Oversight Council (FSOC): Structure and Activities

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Summary

The Financial Stability Oversight Council (FSOC) and its Office of Financial Research (OFR) were established by the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) to address several potential sources of systemic risk. Some observers argue that communication and coordination of financial regulators was insufficient to prevent the financial crisis of 2008. To foster coordination and communication, the FSOC assembles the heads of federal financial regulators, representatives from state regulatory bodies, and an independent insurance expert in a single venue. The OFR supports the FSOC with data collection, research, and analysis.

The FSOC does not generally have direct regulatory authority; its role is to make policy recommendations to member agencies where authority already exists or to Congress where additional authority is needed. However, it is responsible for monitoring financial stability and designating nonbank financial companies and financial market utilities as systemic, which subjects those entities to heightened prudential regulation and the direct regulatory authority of other agencies. The FSOC considers a company to pose a threat to financial stability if a company's financial distress or activities could be transmitted to other firms or markets, causing broader disruptions to financial intermediation or other financial market functions. Three of the many relevant factors used for designation include leverage, interconnectedness with other systemically important nonbank financial institutions (SIFIs), and whether a primary prudential regulator already has responsibility for the SIFI and the activity.

Additional FSOC and OFR responsibilities include

- collection and analysis of financial data,
- issuing nonbinding recommendations to member agencies,
- facilitating the resolution of jurisdictional issues among member agencies,
- issuing a congressionally mandated annual report, and
- reviewing Consumer Financial Protection Bureau (CFPB) rules under some circumstances.

The FSOC is composed of 15 members: 10 voting members and 5 nonvoting members. Voting members include the chair of the FSOC (Treasury Secretary), heads of the banking agencies (Federal Deposit Insurance Corporation, Federal Reserve Board, Office of the Comptroller of the Currency, and the National Credit Union Administration), Securities and Exchange Commission, Commodity Futures Trading Commission, Federal Housing Finance Agency, CFPB, and an independent insurance expert appointed by the President. Nonvoting members include the directors of the OFR and Federal Insurance Office, and state regulatory representatives, one each for insurance, banking, and securities. If an agency is led by a commission or board, the chair is a member, not other commissioners or board members. Additionally, some FSOC actions require a supermajority council vote and an affirmative vote by the chair.

The FSOC also monitors regulatory gaps and overlaps to identify emerging sources of systemic risk. Regulatory gaps and overlaps occur in part because agencies have different policy missions and authorities. The financial regulatory architecture includes agencies that issue and enforce behavioral mandates and bans, balance a set of risky but permissible activities, and administer an emergency program or participate in the financial system similarly to a private firm. These diverse missions continue to create regulatory gaps and overlaps.

In the current Congress, the House has passed the Financial CHOICE Act of 2017 (H.R. 10) to amend the FSOC. The bill would repeal the FSOC's ability to designate entities as systemic; eliminate the OFR; subject the FSOC to the congressional appropriations process; repeal the FSOC's ability to set aside CFPB regulations; and modify council membership, voting procedures, open meeting requirements, and other duties. The Financial Stability Oversight Council Improvement Act of 2017 (H.R. 4061), another bill that has received congressional action, would require FSOC to consider additional factors during its designation process and make a number of other procedural changes to the designation process, including more opportunities for firms to participate in the process. Additionally, the Financial Stability Oversight Council Insurance Member Continuity Act (P.L. 115-61) became law on September 27, 2017, and modified the term of the FSOC's independent insurance member.

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Introduction

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act; P.L. 111-203) created the Financial Stability Oversight Council (FSOC) and the Office of Financial Research (OFR), among other changes, in response to the financial crisis that followed the mortgage boom and bust of the 2000s. The FSOC is a collaborative body that brings together the expertise of federal financial regulators, a presidentially appointed independent insurance expert, and representatives of state financial regulators.

Some observers, including financial regulators, contended that the structure of the federal financial regulatory system contributed to financial instability and systemic risk.[1] To address some of these structural concerns, the FSOC's primary mission includes identifying risks to financial stability emanating from large interconnected financial institutions and utilities, promoting market discipline by eliminating investor expectations of government support to financial institutions' creditors, and responding to emerging threats to financial instability.[2]

The OFR is to support the FSOC in monitoring the financial system, conduct research, provide findings at FSOC meetings, and identify sources of systemic risk. The OFR's permanent researchers and analysts are distinct from researchers and staff at member agencies.

To pursue its mission, the FSOC is to foster communication among financial regulators, monitor systemic risks in the financial system as evaluated by the OFR, designate systemically important financial institutions (SIFIs) and financial market utilities (FMUs) for enhanced prudential regulation, provide annual reports on emerging risks and current responses, and alert Congress and the President to any unaddressed potential systemic risks. The FSOC and its OFR have a number of additional responsibilities, including making nonbinding recommendations to member agencies, encouraging research in financial stability, and promoting data standards for the financial industry.

This report provides an overview of the FSOC's structure and analyzes FSOC policy-related issues and legislation.

FSOC Structure

Membership

The FSOC has 15 members: 10 voting members and 5 nonvoting members (see **Table 1**). In addition to the Treasury Secretary (chair of the FSOC) and the director of the OFR, nine council members are the heads of federal financial regulatory agencies, one is an insurance expert, and three are state-level financial regulatory representatives. One person from each agency is on the council, even if the agency is led by a board or commission.

The FSOC's voting members include the Treasury Secretary, the heads of the banking agencies (Federal Deposit Insurance Corporation [FDIC], Federal Reserve Board [FRB], Office of the

[1] Testimony of Chairman Mary L. Shapiro, Securities and Exchange Commission, before the Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Securities, Insurance, and Investment, June 22, 2009, at http://www.banking.senate.gov/public/_cache/files/e039fcf3-b152-4abd-80e4-a7fcc14f8051/23C6AE00CC53D93492511CC744028B5E.schapirotestimony62209.pdf.

[2] Dodd-Frank Act, §112(a). Although the council has more responsibilities, it summarized its core mission in its introduction to its 2016 annual report. Financial Stability Oversight Council, *FSOC 2016 Annual Report*, June 2016, p. ii, at https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC%202016%20Annual%20Report.pdf.

Comptroller of the Currency [OCC], and National Credit Union Administration [NCUA]), securities agencies (Securities and Exchange Commission [SEC] and Commodity Futures Trading Commission [CFTC]), Consumer Financial Protection Bureau (CFPB), Federal Housing Finance Agency (FHFA), and an independent insurance expert appointed by the President. Nonvoting members include the directors of the OFR and the Federal Insurance Office (FIO), and one state regulatory representative for each of insurance, banking, and securities. Some FSOC actions require a supermajority council vote and an affirmative vote by the chair.

Table 1. Membership of the FSOC

(head of agency if a federal agency)

Voting	Nonvoting
Treasury Secretary	Federal Insurance Office
Federal Reserve Board	Office of Financial Research
Office of the Comptroller of the Currency	State insurance regulator
Federal Deposit Insurance Corporation	State banking regulator
National Credit Union Administration	State securities regulator
Securities and Exchange Commission	
Commodity Futures Trading Commission	
Federal Housing Finance Agency	
Consumer Financial Protection Bureau	
Independent insurance expert	

Source: P.L. 111-203, Dodd-Frank Wall Street Reform and Consumer Protection Act, §111(b).

Mission and Duties

Section 112(a) of the Dodd-Frank Act specifies the following three primary purposes and duties of the FSOC:

> (A) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace;
>
> (B) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure; and
>
> (C) to respond to emerging threats to the stability of the United States financial system.

To pursue that mission, the Dodd-Frank Act provides for 14 specific duties. The first five duties address financial market monitoring, including domestic and foreign data collection and sharing and support of the council's work by the OFR. Three duties are related to designating systemic financial market firms and utilities for heightened regulation by the Federal Reserve (Fed), with recommendations for heightened prudential standards. Three duties relate to making nonbinding recommendations to primary regulators, including specific reference to accounting principles. Another duty is to provide a forum for regulators to discuss market developments and regulatory jurisdiction issues. FSOC must also identify regulatory gaps that might have systemic significance. The FSOC's final duty is to provide an annual report and testimony to Congress on

council activities, including statements by each member attesting that all reasonable steps to address systemic risk are being taken, or if not, what could be done.

Chairperson

As previously noted, the Treasury Secretary is the chair of the FSOC. The chair has a number of powers and responsibilities concerning FSOC meetings, congressional reports and testimonies, and certain council rulemakings and recommendations. As chair, the Secretary calls FSOC meetings; otherwise, meetings may be called by a majority of the members, but must be held at least quarterly. The Secretary must testify before the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs in conjunction with the release of the annual FSOC report. If any member agencies have notified Congress of deficiencies in systemic risk efforts, the Secretary must address those concerns at the hearing.

The Secretary has special powers regarding the designation of systemic nonbank firms. Under Section 113(a)(1), a two-thirds vote of the FSOC is required to designate a nonbank as posing systemic risk, thereby subjecting it to Fed supervision. However, one of the affirmative votes must be the Secretary's. In other words, the FSOC chair has an effective veto over the designation of individual firms as systemically important. Similarly, the chair's vote is required to rescind or reevaluate the systemic designation of a firm. In emergencies, the chair's affirmative vote is required as part of the determination that a nonbank not be granted the usual hearing before it is designated as systemic. A two-thirds vote along with the affirmative vote of the chair is also required to designate as systemically important an FMU under Section 804 of the Dodd-Frank Act.

Agency Representation

The heads of the financial regulatory agencies listed in **Table 1** are members of the FSOC. If the agency has a vote, the head of the agency exercises sole discretion over the vote, even if the agency is led by a commission or board, some of which are required to have bipartisan membership. For example, the SEC's director, but not the other SEC commissioners, is on the FSOC and casts the agency's vote. For their own internal agency matters, these agencies often have board or commission votes to issue new rules, initiate investigations, or change policies. The head of the agency may attend official FSOC meetings and staff briefings as a matter of right.

Meetings

Meetings are chaired by the Treasury Secretary and may be open or closed to the public depending on the meeting's agenda.[3] Public meetings may be aired via a live webcast and may also be viewed online afterwards. Additionally, minutes are recorded for FSOC meetings; however, they may be subject to redactions as determined by the chairperson. The Dodd-Frank Act requires regular FSOC meetings, although the FSOC may meet more often to consider emerging threats to financial stability or to make a determination that a financial firm or market utility poses systemic risk. Agency commissioners and board members other than the head may be invited or admitted to FSOC meetings, but cannot attend as a matter of right. Reportedly, nonmember SEC commissioners complained about lack of access to FSOC meetings in 2014.[4] A

[3] FSOC's transparency policy is available at https://www.treasury.gov/initiatives/fsoc/Documents/The%20Council%27s%20Transparency%20Policy.pdf.

[4] Sarah Lynch, "At SEC, Discontent Grows Over Closed U.S. Risk Council Meetings," Reuters, April 2, 2014, at

Member of Congress on the committee of jurisdiction also attempted to attend an FSOC meeting and was denied admittance.[5]

OFR Duties and Responsibilities

Section 153 of the Dodd-Frank Act directs the OFR to "support the Council in fulfilling the purposes and duties of the Council ... and to support member agencies." In practice, this means that when the Dodd-Frank Act instructs the FSOC to monitor the financial system, the FSOC can rely on the OFR to conduct the actual data collection and analysis. Technically, the OFR is housed in the Department of the Treasury, but it is funded by assessments, not by funds appropriated to Treasury. The director of the OFR is to consult with the Treasury Secretary regarding budget, staff, and mission priorities, but the OFR director has an independent term of office and is not a subordinate of the Treasury Secretary.

The OFR director is appointed by the President and confirmed by the Senate, and serves a six-year term. The Dodd-Frank Act instructs the OFR director to "consult with" the Secretary regarding the OFR's budget priorities, staffing, and research agenda. However, Section 152(b)(5) says that the OFR director has sole discretion in the exercise of the duties and responsibilities "described in subtitle A." Thus, the relationship of the OFR to the FSOC is complicated in that the 15-member council does not actually monitor the financial system, but instead relies on the OFR, which has some independence (yet whose director is a member of council and must consult with the council's chair in determining the office's budget and priorities).

The FSOC does have some staff and administrative expenses distinct from the OFR. For FY2017, the FSOC's budget justification proposed $8.8 million, of which $4.4 million was for staff.[6] This includes reimbursement to the FDIC for staff work on rulemaking related to Title II of the Dodd-Frank Act (orderly liquidation authority).[7]

FSOC Activities

Designation of Systemic Nonbank SIFIs and FMUs

Although the FSOC is not a prudential regulator of the financial system, it does designate nonbank financial firms and financial market utilities as systemic. This designation triggers the Fed to apply heightened prudential regulation for those SIFIs. The prudential regulator of systemic FMUs depends upon their function. Certain large bank holding companies (BHCs) are automatically considered SIFIs and subject to heightened prudential regulation independently of FSOC designation.

Statutory Factors

The Dodd-Frank Act does not define financial instability or systemic risk in the context of designation. However, the act directs the FSOC to consider 11 factors in designations, which

http://www.reuters.com/article/us-sec-risks-complaints-idUSBREA3124320140402.

[5] Office of Representative Scott Garrett, press release, April 3, 2014, at https://garrett.house.gov/media-center/press-releases/garrett-denied-access-to-fsoc-meeting-introduces-legislation-to-bring.

[6] FSOC budget documents can be found at https://www.treasury.gov/initiatives/fsoc/governance-documents/Documents/FSOC_Budget_Information_for_Fiscal_Year_2017.pdf.

[7] For more information regarding the orderly liquidation authority, refer to CRS In Focus IF10716, *Orderly Liquidation Authority*, by David W. Perkins and Raj Gnanarajah.

include the extent of leverage, relationship to other SIFIs, and whether the entity is already subject to prudential regulation (see **Table 2**). Each of these factors may include several components. For example, factor 7 directs the FSOC to consider the candidate's consequences of material distress, taking into account the nature, scope, size, scale, concentration, interconnectedness, and mix of its activities.

Table 2. Statutory Factors in SIFI Designation

(1) The extent of the leverage of the company;
(2) The extent and nature of the off–balance-sheet exposures of the company;
(3) The extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;
(4) The importance of the company as a source of credit for households, businesses, and state and local governments and as a source of liquidity for the U.S. financial system;
(5) The importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities;
(6) The extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse;
(7) The nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;
(8) The degree to which the company is already regulated by one or more primary financial regulatory agencies;
(9) The amount and nature of the financial assets of the company;
(10) The amount and types of the liabilities of the company, including the degree of reliance on short-term funding; and
(11) Any other risk-related factors that the council deems appropriate.

Source: P.L. 111-203, Dodd-Frank Wall Street Reform and Consumer Protection Act, §113.

FSOC Implementation of Designation Process

Although the Dodd-Frank Act did not define financial instability or systemic risk in this context, in a final rule the FSOC delineated when a firm threatens the financial stability of the United States. Many of the rule's elements reflect statutory factors to be considered.[8] The FSOC published the following simplified summary of how it determines if a SIFI threatens the financial stability of the United States:[9]

> The FSOC considers a "threat to the financial stability of the United States" to exist if a nonbank financial company's material financial distress or activities could be transmitted to, or otherwise affect, other firms or markets, thereby causing a broader impairment of financial intermediation or of financial market functioning. An impairment of financial intermediation and financial market functioning can occur through several channels, including:
>
> • Exposure. A nonbank financial company's creditors, counterparties, investors, or other market participants have exposure to the nonbank financial company that is significant enough to materially impair those creditors, counterparties, investors, or other market participants and thereby pose a threat to U.S. financial stability.

[8] Ibid.

[9] FSOC, *Nonbank Designations - FAQs*, last updated February 4, 2015, at https://www.treasury.gov/initiatives/fsoc/designations/Pages/nonbank-faq.aspx.

> • Asset liquidation. A nonbank financial company holds assets that, if liquidated quickly, would cause a fall in asset prices and thereby significantly disrupt trading or funding in key markets or cause significant losses or funding problems for other firms with similar holdings.
>
> • Critical function or service. A nonbank financial company is no longer able or willing to provide a critical function or service that is relied upon by market participants and for which there are no ready substitutes.[10]

The final rule created a three-stage evaluation process.[11] During stage 1, the FSOC reviews (through the OFR) existing public and financial regulatory information. Nonbanks proceed to stage 2 only if they have at least $50 billion in total consolidated assets and meet or exceed any one of five additional factors. These factors are (1) $30 billion in credit default swaps for which the company is the reference entity, (2) $3.5 billion in derivative liabilities, (3) $20 billion in total debt outstanding, (4) a 15-to-1 leverage ratio, and (5) a 10% short-term debt-to-asset ratio.

During stage 2, the FSOC (through the OFR) utilizes any information provided by the designated firm and any existing public and financial regulatory information. The rule provides the firm, upon request, a meeting with the analytical team and access to any data being considered, including a list of the primary public sources of information.

Firms placed in stage 3 are notified immediately, and a meeting is scheduled to explain the process. The FSOC no longer relies only on public and regulatory records. The FSOC issues a formal request for firm information along with an explanation of issues that contributed to the stage 3 designation. However, as the FSOC gathers more information, the scope of issues of concern is subject to change with ongoing analysis. The FSOC works with the firm's primary regulator or home country supervisor, if it has one. The firm is asked to submit any additional information that relates to the designation process.

At the end of stage 3 analysis, the FSOC meets and votes on the firm's designation. Designation requires a two-thirds vote, and the FSOC chair must be one of the affirmative votes for designation.

The FSOC issued its final rule for designations of FMUs in 2011[12] and SIFIs in 2012.[13] Since then, the FSOC has designated four nonbank SIFIs (American International Group, Inc., General Electric Capital Corporation, Inc., Prudential Financial, Inc., and MetLife, Inc.) and eight nonbank FMUs (The Clearing House Payments Company L.L.C., CLS Bank International, Chicago Mercantile Exchange, Inc., The Depository Trust Company, Fixed Income Clearing Corporation, ICE Clear Credit LLC, National Securities Clearing Corporation, and the Options Clearing Corporation).

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[10] Ibid., Question 4.

[11] FSOC, "Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies," 77 *Federal Register* 21637, April 11, 2012, pp. 21641-21647, at https://www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Authority%20to%20Require%20Supervision%20and%20Regulation%20of%20Certain%20Nonbank%20Financial%20Companies.pdf.

[12] Financial Stability Oversight Council, "Authority to Designate Financial Market Utilities as Systemically Important," 76 *Federal Register* 44763, July 27, 2011, at https://www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Final%20Rule%20on%20Authority%20to%20Designate%20Financial%20Market%20Utilities%20as%20Systemically%20Important.pdf.

[13] Financial Stability Oversight Council, "Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies," 77 *Federal Register* 21637, April 11, 2012, at https://www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Authority%20to%20Require%20Supervision%20and%20Regulation%20of%20Certain%20Nonbank%20Financial%20Companies.pdf.

The FSOC is required statutorily to review designations no less than annually. The FSOC has voted to rescind the designation of two SIFIs, GE Capital and American International Group, Inc., after the firms made changes to their structure and activities that addressed the FSOC's systemic concerns.

Challenges to Designation

Following the final designation of a firm by the FSOC, the firm has 30 days to bring an action in district court to challenge its designation. The Dodd-Frank Act directs the court to use the arbitrary and capricious standard, which is generally considered deferential. Although one firm (MetLife) has challenged its designation in court, and won one lower court decision, not all possibilities of appeal have been exhausted. See CRS Legal Sidebar WSLG1554, *Trial Judge Scraps FSOC's MetLife SiFi Designation: Appeal to Follow*, by M. Maureen Murphy.

Reports

The FSOC and the OFR issue reports related to financial stability and systemic risk. The FSOC is required to issue an annual report to update and make recommendations to Congress where statutory changes are required. The FSOC annual report has a number of statutorily required elements. Specifically, these are[14]

> i. the activities of the Council;
>
> ii. significant financial market and regulatory developments, including insurance and accounting regulations and standards, along with an assessment of those developments on the stability of the financial system;
>
> iii. potential emerging threats to the financial stability of the United States;
>
> iv. all determinations made under Section 113 or Title VIII, and the basis for such determinations;
>
> v. all recommendations made under Section 119 and the result of such recommendations; and
>
> vi. recommendations—
>
> > I. to enhance the integrity, efficiency, competitiveness, and stability of United States financial markets;
> >
> > II. to promote market discipline; and
> >
> > III. to maintain investor confidence.

The most recent FSOC report was issued in December 2017.[15] The report included numerous recommendations including the formation of a private sector council to collaborate with regulators regarding cybersecurity threats to financial stability, the completion of a plan by the Alternative Reference Rates Committee to transition from interbank lending reference rates, such as LIBOR, to the Secured Overnight Financing rate, efforts to encourage private capital to play a larger role in the housing finance system, and that regulatory agencies continue to monitor and assess the effectiveness of their regulations in promoting financial stability.

[14] P.L. 111-203, Dodd-Frank Wall Street Reform and Consumer Protection Act, §112(a).

[15] Financial Stability Oversight Council, *FSOC 2017 Annual Report*, December 2017, at https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC_2017_Annual_Report.pdf.

Alongside the annual report released by the FSOC, all voting members of the FSOC are required to either state that the FSOC, the government, and the private sector are taking all reasonable steps to ensure financial stability and to mitigate systemic risk that would negatively affect the economy, or if they don't agree with those statements, they must submit a statement indicating what actions they believe should be taken to ensure financial stability and the mitigation of systemic risk.[16] No FSOC member has submitted a negative statement, as of this writing. Rather, all members have signed an affirmative joint statement alongside each annual report.

In addition, Section 112(a)(2)(B) of the Dodd-Frank Act specifies that the FSOC is to provide direction to, and request data and analyses from, the OFR to support the council's work. Recall that the chair of the FSOC is the Treasury Secretary, and that the director of the OFR is to consult with the Secretary in determining the OFR's budget and research priorities. The OFR is to assist the FSOC in researching and compiling its required yearly report to Congress. In addition, the OFR typically issues an annual report near the end of each year. The Dodd-Frank Act also directs the OFR to publish occasional topical reports and otherwise promote research on financial stability topics.

Review CFPB Rules

The FSOC has a unique relationship with CFPB in that its purview regarding the agency's rulemaking extends beyond offering nonbinding recommendations. Section 1023 of the Dodd-Frank Act provides a procedure for CFPB rules to be evaluated for systemic risk implications. Upon an FSOC two-thirds vote, a CFPB-issued rule can be subject to a stay or set aside. To date, no CFPB rules have been subject to a vote, stayed, or set aside by the FSOC.

Identifying Regulatory Gaps and Overlaps that Could Cause Financial Instability

The FSOC is supposed to help coordinate member agencies within a complex regulatory architecture.[17] In this context, the regulatory architecture refers to the array of regulatory agencies, the scope of their authorities, and their relation to each other.[18] There may be regulatory gaps and overlaps in the coverage of regulatory authority, where either multiple regulatory agencies claim they have jurisdiction over a certain financial firm, activity or product, or no agency feels they have the authority to regulate. Dodd-Frank created formal processes for the FSOC to help resolve these situations. The FSOC generally does not have superior authority over its member agencies; instead, it generally serves as a nonbinding facilitator of agency communication and potential cooperation.

Section 119 of the Dodd-Frank Act established a formal process for jurisdictional dispute resolutions among FSOC member agencies. If two or more member agencies have a dispute regarding which agency is responsible for regulating a particular bank holding company, nonbank financial company, or a financial activity or product, they can request the FSOC to produce a written recommendation for how the agencies should proceed. These recommendations from FSOC are nonbinding and must be approved by two-thirds of voting members.

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[16] P.L. 111-203, Dodd-Frank Wall Street Reform and Consumer Protection Act, §112(b).

[17] Department of the Treasury, *Financial Regulatory Reform: A New Foundation*, October 2009, at https://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

[18] CRS Report R44918, *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework*, by Marc Labonte.

In addition, Section 120 of the Dodd-Frank Act established a formal process for FSOC to recommend additional regulation of financial activities, if the activities may increase the risk of financial instability. If FSOC determines a primary regulatory agency already has the authority to regulate the financial activity, FSOC can work with that regulatory agency to develop recommendations for new or heightened regulatory standards and safeguards to prevent the financial activity from increasing the risk of financial instability. Alternatively, if no regulatory agency currently has the authority to regulate the financial activity, FSOC can prepare and submit recommendations for legislation that would prevent the financial activity from increasing the risk of financial instability.

Policy Issues in Selected FSOC-Related Legislation

A number of bills have been introduced to alter the FSOC's structure and general mission, or to abolish the council altogether. This section analyzes policy issues in lead legislation in the House and Senate, as defined by bills receiving committee or floor action.[19] The Financial CHOICE Act of 2017 (H.R. 10) was passed by the House on June 8, 2017, and would make numerous changes to the FSOC and the OFR. It would rescind the FSOC's authority to designate firms as systemically important, eliminate the OFR, subject the FSOC to the congressional appropriations process, alter council membership, remove the ability to stay CFPB rules, and alter voting procedures and open meeting requirements, as well as implement broader regulatory changes. An alternative bill moving through the House, the Financial Stability Oversight Council Improvement Act of 2017 (H.R. 4061), would require FSOC to consider additional factors during its designation process and make a number of other procedural changes to the designation process, including more opportunities for firms to participate in the process. A narrower proposal, the Financial Stability Oversight Council Insurance Member Continuity Act (P.L. 115-61), became law on September 27, 2017, and modified the FSOC's independent insurance member's term to allow the current member to continue to serve in the event of a delay in the naming of a successor by the end of the member's six-year term.

FSOC Membership for Agencies Led by Commissions and Boards

Currently, if an agency is led by a board or commission, instead of by a single director, the chair of the agency is a member of the FSOC. In other contexts, these agencies may require a board or commission vote for some agency actions. H.R. 10 would make all board members or commissioners members of the FSOC, and the agency's vote would be a single vote determined by the board or commission collectively. The agency's voting rule would be consistent with its voting method for its own activities.

Expanding FSOC membership to all board members or commission members would arguably broaden the perspectives represented on the FSOC. This may weaken an individual's influence, because one would conceivably present the board's or commission's perspective rather than one's own. This may be particularly true for boards and commissions that have bipartisan requirements, such as the SEC and the CFTC.

[19] The Senate has yet to act on legislation regarding the FSOC and the OFR in the 115th Congress; however, S. 1484, considered in the 114th Congress, would have made broad changes to these agencies.

OFR Existence

The OFR provides the FSOC with a permanent staff to monitor the financial system as a whole, including available data sources from all regulators and directly from market participants.

H.R. 10 would eliminate the OFR. Many financial regulatory agencies perform their own research and analysis regarding the financial system, and as such, some observers consider that OFR research efforts may be duplicative. Additionally, some observers see research produced by the private sector as better able to identify risks to financial stability. The OFR is charged with conducting broad-ranging research that surveys the entire financial system, whereas most agencies are tasked with relatively discrete areas of regulation. The OFR's research, some say, may therefore be more adept at identifying broader systemic issues than that of individual regulatory agencies.

FSOC and OFR Funding

The FSOC and the OFR are funded by assessment fees on designated SIFIs and by bank holding companies with total consolidated assets greater than $50 billion, not by annual congressional appropriations. As member salaries and offices are covered by their own agencies, the FSOC's direct funding needs are modest compared with those of other financial agencies. However, the OFR has salary and administrative requirements for professional researchers similar to those of other economic data collection and monitoring bureaus.

H.R. 10 would eliminate the OFR and make the FSOC's funding subject to the annual appropriations process. Some executive agencies are funded outside of the congressional appropriations process to insulate them from political considerations and provide additional independence, as politically unpopular decisions would be less likely to affect their funding. As such, the current funding structure for the FSOC and the OFR likely grants them additional independence from Congress, like many other regulatory agencies. Alternatively, subjecting them to the annual appropriations process would give Congress additional oversight and influence over the agencies.

FSOC Systemic Designations

Currently, BHCs meeting certain requirements are automatically subject to enhanced prudential regulation. This includes certain firms that received Troubled Asset Relief Program (TARP) funds and are not allowed to cease being SIFIs even if they change their structure (so-called Hotel California firms). Alternatively, the FSOC can designate a nonbank or a financial market utility as systemic with a two-thirds majority vote, directing regulatory agencies to apply prudential regulations.

H.R. 10 would eliminate the FSOC's authority to make systemic designations of SIFIs and FMUs. It would also retroactively rescind the designation of currently designated entities, including banks that had received funding under TARP and therefore were required to remain subjected to enhanced prudential regulation under Dodd-Frank.

The inability to designate financial firms as systemically important would eliminate the additional prudential regulations placed on those firms. If the FSOC is capable of correctly identifying systemically important financial firms and these prudential regulations make financial firms less susceptible to failure, then eliminating the FSOC's systemic designations may increase the risk of financial instability. Alternatively, if the FSOC's systemic designations act as a signal that those designated firms are "too big to fail" and therefore would likely be bailed out by the government

in the event of failure, the designations may result in riskier behavior by those firms. This may make failures more likely if enhanced prudential regulation cannot mitigate the risky behavior.

Alternative legislation (H.R. 4061) was marked up and ordered to be reported by the House Financial Services Committee on January 18, 2018. H.R. 4061 would modify FSOC's consideration criteria for designating firms as systemic. In addition to the current criteria FSOC considers when designating a nonbank financial company laid out in the "Statutory Factors" above, the bill would require FSOC to consider the "the appropriateness of the imposition of prudential standards as opposed to other forms of regulation to mitigate the identified risks."

The bill would make changes to the evaluation process, providing for more contact between companies under consideration and FSOC. The evaluation process would be modified to allow for more input from the company under consideration throughout the process, providing for numerous opportunities for the firm to provide materials to FSOC and opportunities for in-person hearings. Additionally, FSOC would be required to provide written notice to the company at each stage of the evaluation process, including when a company is initially identified for evaluation, following a proposed determination by FSOC, and after the final determination. The bill would give companies under evaluation by FSOC an opportunity to present a plan to FSOC to alter their business, structure, or operations with a specified implementation period. FSOC can approve the plan with a two-thirds vote including the chairperson, and after implementation FSOC votes again regarding final designation of the company.

The bill would alter the annual reevaluation process and implement a five-year periodic reevaluation process for companies designated as systemic. During the annual reevaluation process, FSOC must provide written notice to companies being reevaluated, allow company representatives to meet with FSOC, and if the determination is not rescinded, FSOC must provide notice to the company explaining its reasoning. The bill would also implement a process for reevaluation at the company's request five years after the initial designation. During the reevaluation, the company would present a plan to alter its business, structure, or operations where upon implementation and approval by FSOC, through a two-thirds vote including the chairperson, the designation would be rescinded.

The additional criteria for evaluation imposed by H.R. 4061 is likely intended to prevent the imposition of redundant or more burdensome than necessary regulations on nonbank financial companies. However, the inclusion of this additional criterion may send a signal to regulators that the imposition of prudential regulation should be eschewed in favor of alternative regulations, even if prudential regulations may be more appropriate. Additionally, FSOC may not have the authority to apply the alternative regulation, leaving it dependent on the appropriate member agencies to implement them. The changes within the evaluation process would likely also increase the transparency and accessibility of FSOC by requiring additional written correspondence and in-person meetings between FSOC and nonbank financial companies. However, the additional steps and requirements established by the bill may increase the risk of regulatory capture and may slow the evaluation process by FSOC, resulting in longer lag times between identifying sources of financial instability and implementing prudential regulation to reduce the risk of financial stability.

FSOC Accessibility to Congress

FSOC meetings are generally open to the public, and, when public, the meetings may be made available via webcast; however, either the chairperson or a majority vote by voting members of the council can close a meeting or a portion of a meeting to the public. Meetings may be closed to the public for a number of reasons, as the FSOC often discusses confidential or market sensitive

information.[20] Agency commissioners and board members other than the head may be invited or admitted to FSOC meetings, but cannot attend as a matter of right. In 2017, as of this writing, FSOC has met at least seven times; two of these meetings were made available to the public via webcast.

H.R. 10 would make a number of changes to increase congressional access to FSOC meetings and actions. The bill would allow Members of Congress on committees of jurisdiction to attend the council's public meetings. The bill would also require the FSOC to create and preserve transcripts for all nonpublic meetings. Additionally, the FSOC's chairperson would be required to provide confidential briefings to the House Financial Services Committee and the Senate Banking, Housing, and Urban Affairs Committee at least once per year.

The changes introduced in H.R. 10 would generally allow for increased congressional oversight of the FSOC. Increased congressional oversight can ensure greater accountability of the FSOC. At the same time, increased oversight by Congress likely reduces the FSOC's independence from Congress and from political considerations, which may affect regulatory decisions.

FSOC and CFPB Rules

FSOC members can vote to put a stay on CFPB rules if they believe that the rules would put the safety and soundness of the banking system or financial stability at risk. H.R. 10 would remove this FSOC power, in addition to making other significant changes to the CFPB.[21] FSOC recommendations to other agencies are nonbinding.

Some have argued that unlike other financial regulators, who are charged with balancing consumer protection and financial stability, the CFPB is only charged with protecting consumers and therefore is not as concerned with potential tradeoffs between consumer protection and financial stability. As such, it may be beneficial for the FSOC to have the power to stay rules if there is a threat to financial stability. The CFPB is the one agency subject to this additional check from the FSOC, and repealing this FSOC authority would put the CFPB on par with other regulators.

FSOC and the Federal Insurance Office

Currently, most property, casualty, and life insurances are regulated at the state level. Both the Department of the Treasury's Federal Insurance Office (FIO) and an independent insurance expert serve on the FSOC. The independent insurance expert is a voting member; Treasury's FIO is not. The Treasury office can serve as a single negotiator in harmonizing regulation of insurance internationally. H.R. 10 would combine the Treasury office and the office of the independent insurance expert into one office distinct from Treasury.

[20] For more information regarding the current transparency policy for the FSOC, refer to https://www.treasury.gov/initiatives/fsoc/Documents/The%20Council%27s%20Transparency%20Policy.pdf.

[21] For more information regarding H.R. 10 and its impact on the CFPB, refer to CRS Report R44839, *The Financial CHOICE Act in the 115th Congress: Selected Policy Issues*, by Marc Labonte et al.

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