SYSTEMIC RISK

The Dodd-Frank Wall Street Reform and Consumer Protection Act created the Financial Stability Oversight Council, composed of 10 voting members with diverse areas of expertise, to comprehensively monitor and mitigate threats to the U.S. financial system as well as ensure greater coordination among the array of financial regulators.

In its formative years, the FSOC made a number of decisions that were not without controversy and arguably supplanted robust economic analysis for arbitrary political decisions. One of the primary concerns was a regulatory approach that was bank-centric and disregarded important distinctions in capital markets activities. In recent years, important updates to processes and procedures have been implemented that will improve the FSOC's competence for identifying and addressing systemic risk.

The FSOC can improve financial regulation and the efficient operation of the capital markets if it adheres to the principles of transparency, accountability, and due process.

FSOC: IMPLEMENT ACTIVITIES-BASED APPROACH FOR SYSTEMIC RISK

In December 2019, the FSOC finalized guidance improving the transparency and due process of its activities. Importantly, the guidance established an activities-based approach for the council's efforts to identify, assess, and address potential risks and threats to U.S. financial stability. This guidance formalizes work started in the previous administration, where the FSOC directed staff to "undertake a more focused analysis of industry-wide products and activities to assess potential risks" as it related to the asset management industry. In 2020, the U.S. House of Representatives favorably reported legislation with report language expressing support for FSOC's guidance and a preference for an activities-based approach, rather than individual entity designations, for addressing potential risks.

ACTION: The FSOC should exclusively use an activities-based approach for assessing and addressing systemic risk in the financial system in accordance with its December 2019 guidance.

CONGRESS: DIRECT FSOC TO USE AN ACTIVITIES-BASED APPROACH FOR SYSTEMIC RISK

The Dodd-Frank Act created the FSOC, chaired by the secretary of the Treasury, and provided it with the authority to designate a nonbank financial entity as a Systemically Important Financial Institution (SIFI). This designation by FSOC would have the FRB impose bank-like regulations that are inappropriately tailored for these entities without necessarily providing them adequate opportunity to first address the risks identified by regulators. Designation as an SIFI should be informed by a transparent, evidence-based process with clear rules of the road. Action by Congress would provide more certainty to nonbank financial entities that their business model will not be arbitrarily called into question by the FSOC.

ACTION: Congress should enact the Financial Stability Oversight Council Improvement Act (S. 603/H.R. 3561–116th), which would require closer coordination with an entity's primary regulator by FSOC and an opportunity for entities to "de-risk" by modifying their business, structure, and operations prior to a designation as a SIFI.

CONGRESS: IMPLEMENT THE ALLEVIATING STRESS TEST BURDENS TO HELP INVESTORS ACT

The Dodd-Frank Act calls for enhanced supervision and prudential standards for bank holding companies with greater than $50 billion in assets and certain nonbank financial entities supervised by the FRB including the application of an annual stress test. A stress test created by the FRB, a bank regulator, would be inherently inappropriate for a nonbank financial entity, such as an asset manager, and disregard the significant differences between the two.

The Alleviating Stress Test Burdens to Help Investors Act (H.R. 3987–116th) would amend the stress test requirements under the Dodd-Frank Act by removing the authority for the FRB to conduct stress tests and instead provide new authority to the SEC and CFTC to conduct periodic analyses of financial conditions, including the availability of liquidity under adverse economic conditions.

ACTION: Congress should enact the Alleviating Stress Test Burdens to Help Investors Act (H.R. 3987–116th).