

Potential FSOC Scrutiny of “Big Tech” Firms

Following the 2008 financial crisis, Congress created the Financial Stability Oversight Council (“FSOC” or the “Council”) to identify and respond to risks to U.S. financial stability, promote market discipline and respond to emerging threats to the stability of the U.S. financial system. FSOC has various statutory authorities, including the ability to make systemic importance designations in different contexts.

A recent statement by the Director of the Consumer Financial Protection Bureau (“CFPB”) indicates that FSOC is “actively evaluating” the first-ever use of one particular designation authority, which heretofore has been commonly overlooked: FSOC’s authority under Title VIII of the Dodd-Frank Act to designate “payment, clearing or settlement activities” that FSOC determines are, or are likely to become, systemically important. The CFPB Director’s statement indicates that FSOC may be evaluating this designation authority for use with respect to “Big Tech,” such as cloud providers, stablecoin arrangements and/or other payment companies.

The CFPB Director’s statement is noteworthy for a few reasons. Designation under this particular authority would subject a company to risk management standards that may significantly affect its business operations and finances. And more generally, the statement signals that FSOC could be widening its aperture of review of the types of companies and segments of the economy that it monitors as part of its financial stability mandate. Indeed, FSOC may be extending its focus beyond the traditional financial services industry and into technology and other non-financial sectors.

Looking ahead, large technology companies that are involved in, or otherwise support the financial services industry—*e.g.*, certain cloud providers, companies

involved in stablecoin arrangements and payment companies—should monitor this area, particularly statements of FSOC and its individual members. FSOC’s Chair, Treasury Secretary Yellen, is scheduled to testify on FSOC’s activities before the U.S. House Financial Services Committee on February 6, 2024 and may address this particular topic. Other FSOC members may also receive Congressional questions and letters on this topic.

Following is broader background information and context, including additional details concerning the CFPB Director’s statement, as well as information concerning FSOC and its powers, particularly FSOC’s authority under Title VIII to designate certain “payment, clearing or settlement activities.”

STATEMENT OF CFPB DIRECTOR ROHIT CHOPRA

In a December 18, 2023 statement on the issuance of FSOC’s 2023 Annual Report, CFPB Director—and FSOC voting member—Rohit Chopra urged his fellow policymakers to focus and “act” on purported risks that he believes emanate from “Big Tech” firms.¹ Director Chopra stated, in part:

Importantly, we cannot focus solely on large pools of financial assets – we must also face the reality that large pools of data play a growing role in our financial system.

Large technology firms, including Big Tech firms, are leveraging their network effects in new ways. Some of these firms are larger than Wall Street’s most dominant players, and they have been creeping into the financial system by developing networks that move payments and “deposits,” serving as cloud infrastructure players that undergird the digital plumbing of much of the industry, and emerging as foundational models powering new uses of artificial intelligence. It is not enough to draft reports, we must also act.²

FSOC and its individual members have, over the years, highlighted concerns regarding various types of technology companies and individual technologies—including cloud providers, stablecoin arrangements and payment companies. For example:

- In a 2021 report, the President’s Working Group on Financial Markets (“PWG”),³ joined by the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, recommended that (1) Congress act promptly to enact legislation to ensure that payment stablecoins and payment stablecoin arrangements are subject to a federal framework on a consistent and comprehensive basis, and (2) in the absence of legislation, FSOC consider taking action, including potentially designating certain activities conducted within stablecoin arrangements under Title VIII of the Dodd-Frank Act.⁴
- In FSOC’s 2023 Annual Report, the Council highlighted the roles and functions performed by various types of technology companies—such as cloud providers—and their use in the financial system and broader economy, and potential financial stability considerations.⁵

That said, Director Chopra’s December 18 statement is particularly noteworthy because he also mentioned, without specifics, that FSOC is “actively evaluating” the first-ever use of one of its systemic designation authorities. He stated:

[FSOC’s authority under Title I of Dodd-Frank to designate nonbank financial companies as “nonbank systemically important financial institutions”] is not our only tool that has been dormant. The FSOC has two important authorities under Title VIII of the Dodd-Frank Act that could be used to strengthen the resilience of financial market utilities and payment, clearing, and settlement activities. I am pleased that we are actively evaluating the first-ever use of Title VIII authorities to address certain payment, clearing, and settlement activities.

I support the publication of this year’s annual report, as it describes some of these risks in more detail and highlights our plans for greater focus on digital technologies in 2024.⁶

As explained further below, the Council’s designation authority under Title VIII of the Dodd-Frank Act is broad in scope and, depending on how aggressively FSOC wishes to proceed, could potentially be used on a wide range of companies—including those that have ordinarily been viewed to be outside of the traditional financial services sector.

FSOC: BACKGROUND AND CONTEXT

The Dodd-Frank Act created FSOC to identify risks to U.S. financial stability, promote market discipline and respond to emerging threats to the stability of the U.S. financial system. By statute, FSOC is chaired by the Secretary of the Treasury and consists of 10 voting members (including the CFPB Director and the heads of the other federal financial regulatory agencies) and five non-voting members.⁷

The Dodd-Frank Act assigned FSOC with numerous duties, including: (1) monitoring the financial services marketplace for potential threats to U.S. financial stability, (2) identifying gaps in regulation that could pose risks to U.S. financial stability, (3) issuing formal public (but not binding) recommendations to primary financial regulatory agencies concerning new or heightened standards and safeguards and (4) reporting annually to Congress on FSOC’s activities and potential emerging threats to U.S. financial stability, among other things.

Dodd-Frank also provided FSOC with designation authorities:

- The first—FSOC’s authority under Title I of Dodd-Frank to designate nonbank financial companies as nonbank “systemically important financial institutions” (“Nonbank SIFIs”) (FSOC’s “Nonbank SIFI Designation Authority”)⁸—has been the subject of extensive focus and debate.
- The second and third—FSOC’s authorities under Title VIII of Dodd-Frank to designate “financial market utilities” (“FMUs”) or “payment, clearing or settlement activities” (“PCS activities”) that FSOC determines are, or are likely to become, systemically important (respectively, FSOC’s “FMU Designation Authority” and “PCS Activities Designation Authority,” and together FSOC’s “Title VIII Designation Authorities”)⁹—are commonly overlooked and, in fact, the PCS Activities Designation Authority has yet to be used.

FSOC’S NONBANK SIFI DESIGNATION AUTHORITY

FSOC’s approach to and use of its Nonbank SIFI Designation Authority has been the subject of ongoing debate and controversy—and continues to evolve. In 2012, FSOC issued a final rule and interpretive guidance describing its procedures and approach to nonbank SIFI designations.¹⁰ In 2013 and 2014, FSOC designated four Nonbank SIFIs. Between 2016 and 2018, FSOC rescinded three of these designations, and a federal district court rescinded the other. No companies are currently designated as Nonbank SIFIs.

In November 2023, FSOC finalized new procedural guidance concerning its use of the Nonbank SIFI Designation Authority.¹¹ In so doing, FSOC removed heightened procedural protections FSOC adopted in 2019, thus making it easier for FSOC to designate companies as Nonbank SIFIs.

FSOC’S TITLE VIII DESIGNATION AUTHORITIES: FRAMEWORK

By contrast, FSOC’s approach to its Title VIII Designation Authorities has over the years been less contentious.

As noted, Title VIII of the Dodd-Frank Act gives FSOC authority to designate “FMUs” and “PCS

activities” that FSOC determines are, or are likely to become, “systemically important.”¹²

The statute applies the following definitions:

- “FMU”: Any person that manages or operates a multilateral system for the purpose of transferring, clearing or settling payments, securities or other financial transactions among financial institutions or between financial institutions and the person (subject to exclusions for certain regulated financial institutions’ activities).¹³
- “PCS activities”: Any activity carried out by one or more “financial institutions” to facilitate the completion of “financial transactions” (excluding certain common securities transaction activities).¹⁴
- “Financial institutions”: Defined to include (1) traditionally regulated financial institutions (*e.g.*, banks and broker-dealers) and (2) “any company engaged in activities that are financial in nature or incidental to a financial activity.”¹⁵
- “Financial transactions”: Defined to include, among other things: (1) funds transfers, (2) securities contracts, (3) derivatives and (4) “any similar transaction” that FSOC determines to be a financial transaction.¹⁶ Title VIII states that this may include a wide range of services and functions to support financial transactions, such as the (a) movement of funds, (b) calculation and communication of unsettled financial transactions between counterparties, (c) management of risks and activities associated with continuing financial transactions and (d) any other “similar functions” that FSOC may determine.¹⁷

- “Systemically important”: A situation where the failure of or a disruption to the functioning of an FMU or the conduct of a PCS activity could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system.¹⁸ In making this determination, the statute requires FSOC to consider several enumerated factors, such as (1) the aggregate monetary value of transactions processed by the FMU or carried out through the PCS activity, (2) the relationships, interdependencies or other interactions of the FMU or PCS activity with other FMUs or PCS activities and (3) the effect that the failure of or a disruption of the FMU or PCS activity would have on critical markets, financial institutions or the broader financial system.¹⁹

FSOC’S TITLE VIII DESIGNATION AUTHORITIES: EFFECTS OF DESIGNATION

An FSOC designation under Title VIII subjects the designated FMU or financial institution conducting a designated PCS activity (the “Designated Entity”), among other things, to:

- **Enhanced Risk Management Standards.** Developed and prescribed by the Federal Reserve (or the SEC or CFTC, if either have primary regulatory jurisdiction over the Designated Entity) concerning the Designated Entity’s operations and conduct. These standards may include: (1) capital and financial resource requirements, (2) risk management policies and procedures and (3) margin and collateral requirements, among other things.²⁰
- **Examinations and Enforcement.** Federal Reserve (and, as applicable, SEC or CFTC) examination and enforcement authority over the Designated Entity.²¹

Notably, for the PCS Designation Authority, Designated Entities could be *any and all* financial institutions that engage in the designated PCS activity (unless the agencies prescribe a minimum threshold). Moreover, as noted above, “financial institutions” can include a broad range of companies that engage in financial activities—not just banking organizations. Thus, Director Chopra may be contemplating that technology companies engaging in certain financial activities—among many other

activities—could become Designated Entities to the extent those companies engage in designated PCS activities.

FSOC’S TITLE VIII DESIGNATION AUTHORITIES: HISTORY OF USE AND PROCESS CONSIDERATIONS

In 2011, FSOC finalized a rule describing the criteria, processes and procedures for FSOC’s FMU Designation Authority.²² In July 2012, FSOC designated eight FMUs as systemically important: (1) The Clearing House Payments Company L.L.C. (on the basis of its role as operator of the Clearing House Interbank Payments System), (2) CLS Bank International, (3) Chicago Mercantile Exchange, Inc., (4) The Depository Trust Company, (5) Fixed Income Clearing Corporation, (6) ICE Clear Credit LLC, (7) National Securities Clearing Corporation and (8) The Options Clearing Corporation. Those designations remain in place.

FSOC has not used the PCS Designation Authority, nor has it published rules or guidance concerning its approach to the use of such authority. In the absence of published rules or guidance, the statutory provisions under Title VIII of Dodd-Frank would be the primary standards governing FSOC’s exercise of this authority. Title VIII states that:

- Before designating a PCS activity, the Council must consult with certain regulatory agencies and provide financial institutions with advance notice of the proposed designation by Federal Register publication.²³
- A financial institution engaged in a PCS activity may request an opportunity for a hearing before the Council to demonstrate that the proposed designation is not supported by substantial evidence.²⁴
- For a designation to occur, there must be an affirmative vote by at least two-thirds of the FSOC members then serving, which must include an affirmative vote by the FSOC Chair (the Treasury Secretary).²⁵
- Following any designation, the appropriate regulator would establish risk management standards governing the conduct of the Designated Entities.²⁶

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- 1 See CFPB, “Prepared Statement of CFPB Director Rohit Chopra on the Financial Stability Oversight Council’s 2023 Annual Report” (Dec. 18, 2023), available at <https://www.consumerfinance.gov/about-us/newsroom/prepared-statement-of-cfpb-director-rohit-chopra-on-the-financial-stability-oversight-councils-2023-annual-report/>.
 - 2 *Id.*
 - 3 The PWG is comprised of the Secretary of the Treasury and the Chairmen of the Federal Reserve Board, U.S. Securities and Exchange Commission (“SEC”) and Commodity Futures Trading Commission (“CFTC”).
 - 4 See PWG, “Report on Stablecoins” (Nov. 1, 2021), available at https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.
 - 5 See, e.g., FSOC, “Annual Report 2023” (Dec. 14, 2023) at 95 (“The Council has identified the financial services sector’s reliance on third-party service providers, such as cloud service providers (CSPs), as a potential risk to financial stability because of the significant role these entities serve in the financial sector.”) and 44 (“In the 2021 PWG Report, the PWG, FDIC, and OCC noted that the failure of stablecoins to maintain a stable value could expose stablecoin users to unexpected losses and lead to stablecoin runs that damage financial stability.”), available at <https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf>.
 - 6 CFPB, *supra* note 1.
 - 7 FSOC’s voting members consist of the Secretary of the Treasury (who also serves as FSOC’s Chair), the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Director of the CFPB, the Chairman of the SEC, the Chairman of the Federal Deposit Insurance Corporation, the Chairman of the CFTC, the Director of the Federal Housing Finance Agency, the Chairman of the National Credit Union Administration and an independent member having insurance expertise who is appointed by the President and confirmed by the Senate for a six-year term. FSOC’s non-voting members, who serve in an advisory capacity, are the Director of the Office of Financial Research, the Director of the Federal Insurance Office, a state insurance commissioner designated by the state banking supervisors and a state securities commissioner (or officer performing like functions) designated by the state securities commissioners.
 - 8 See 12 U.S.C. § 5323(a)(1).
 - 9 See 12 U.S.C. § 5463(a)(1).
 - 10 See “Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies” 77 Fed. Reg. 21637 (Apr. 11, 2012), available at <https://home.treasury.gov/system/files/261/Authority%20to%20Require%20Supervision%20and%20Regulation%20of%20Certain%20Nonbank%20Financial%20Companies%20%28April%2011%2C%202012%29.pdf>.
 - 11 See “Guidance on Nonbank Financial Company Determinations” 88 Fed. Reg. 80110 (Nov. 17, 2023), available at <https://home.treasury.gov/system/files/261/Interpretive-Guidance-Regarding-Authority-to-Require-Supervision-and-Regulation-of-Certain-Nonbank-Financial-Companies.pdf>.
 - 12 See 12 U.S.C. § 5463(a)(1).
 - 13 12 U.S.C. § 5462(6)(A)-(B).
 - 14 12 U.S.C. § 5462(7)(A).
 - 15 12 U.S.C. § 5462(5)(A)-(B).
 - 16 12 U.S.C. § 5462(7)(B).
 - 17 12 U.S.C. § 5462(7)(C).
 - 18 12 U.S.C. § 5462(9).
 - 19 12 U.S.C. § 5463(a)(2).
 - 20 12 U.S.C. § 5464(a).
 - 21 12 U.S.C. § 5466. Title VIII also imposes additional requirements on Designated FMUs. See, e.g., Dodd-Frank Section 806.
 - 22 See “Authority To Designate Financial Market Utilities as Systemically Important” 76 Fed. Reg. 44763 (Jul. 27, 2011), available at <https://www.govinfo.gov/content/pkg/FR-2011-07-27/pdf/2011-18948.pdf>.
 - 23 See 12 U.S.C. § 5463(c)(1), (2)(B).
 - 24 See 12 U.S.C. § 5463(c)(2)(C).
 - 25 See 12 U.S.C. § 5463(a)(1).
 - 26 See 12 U.S.C. § 5464(a)(1).

NEW YORK

David J. Kappos
+1-212-474-1168
dkappos@cravath.com

D. Scott Bennett
+1-212-474-1132
sbennett@cravath.com

Nicholas A. Dorsey
+1-212-474-1764
ndorsey@cravath.com

Sasha Rosenthal-Larrea
+1-212-474-1957
srosenthal-larrea@cravath.com

Matthew M. Kelly
+1-212-474-1318
mkelly@cravath.com

WASHINGTON, D.C.

Jelena McWilliams
+1-202-869-7710
jmcwilliams@cravath.com

Noah Joshua Phillips
+1-202-869-7740
nphillips@cravath.com

Elad Roisman
+1-202-869-7720
eroisman@cravath.com

Jeffrey T. Dinwoodie
+1-202-869-7744
jdinwoodie@cravath.com

Will C. Giles
+1-202-869-7728
wgiles@cravath.com

CRAVATH, SWAINE & MOORE LLP**NEW YORK**

Worldwide Plaza
825 Eighth Avenue
New York, NY 10019-7475
+1-212-474-1000

LONDON

CityPoint
One Ropemaker Street
London EC2Y 9HR
+44-20-7453-1000

WASHINGTON, D.C.

1601 K Street NW
Washington, D.C. 20006-1682
+1-202-869-7700

cravath.com

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