FSOC's New Guidance on Nonbank "SIFI" Designations

BOTTOM-LINE TAKEAWAYS

- ***New Guidance Eliminates Procedural Steps Introduced in Prior Administration.*** On November 3, 2023, the Financial Stability Oversight Council ("FSOC") finalized new procedural guidance for designating nonbank financial companies as "systemically important financial institutions" ("nonbank SIFIs"). Designation as a nonbank SIFI subjects a nonbank company to Federal Reserve supervision and prudential standards.
- ***Significantly Easier to Designate Companies.*** The new guidance removes the heightened procedural protections FSOC adopted in 2019. It will now be significantly easier for FSOC to designate companies as nonbank SIFIs, although it appears to have no immediate plans to do so.

THE DETAILS: KEY CHANGES FSOC MADE TO GUIDANCE

FSOC has:

1. Moved away from approaching entity designation as a "tool of last resort"—thus placing designation authority on "equal footing" with FSOC's other powers.
2. Removed the cost-benefit requirements associated with FSOC's use of its nonbank SIFI designation authority and its policy recommendation authority.
3. Removed the requirement to assess the "likelihood" of a company's material financial distress prior to designation.
4. Liberalized the key designation threshold of "threat to the financial stability of the United States" by introducing a more speculative standard.

LOOKING AHEAD: PRACTICAL IMPLICATIONS

- ***No Apparent Immediate Plans to Begin Designations.*** FSOC stated that the new guidance does not make "designation" FSOC's default method of addressing risks. FSOC expects to address most risks—as is the case today—through its collaboration with primary financial regulators.
- ***New Leverage to Advance Rulemaking and Other Policy Initiatives.*** FSOC's elimination of the procedural steps adopted in 2019 is important, even if FSOC currently has no plans to use the designation authority. A more readily available designation authority provides FSOC member agencies—and their leaders—with an additional lever that they can wield, explicitly or implicitly, to help drive towards desired rulemaking outcomes and other policy goals.
- ***Increased FSOC Resources.*** Treasury Secretary Yellen, who also serves as FSOC's Chair, stated in March 2023 that she "inherited a financial stability apparatus . . . that had been decimated" and one of her top priorities over the past two years has been to "rebuild the financial stability infrastructure at Treasury." The budget and staff resources for FSOC's secretariat function housed within the Treasury Department have more than doubled since Fiscal Year 2021.
- ***Asset Management Industry.*** FSOC and its individual members have over the years shown significant interest in the asset management industry. Secretary Yellen has stated that money market funds, open-end funds and hedge funds are among the current focus areas for FSOC. Additionally, in a September 2023 speech on financial stability more generally, FDIC Chair (and FSOC member) Gruenberg stated his view that the "most effective and balanced way to enhance the stability of the entire financial system" would be the imposition of strong capital requirements for large banks, "complemented by greater transparency, stronger oversight and appropriate prudential requirements for nonbanks" such as various asset management funds and nonbank lenders (*e.g.*, private credit funds).

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