



Solution

Reform Principles for FSOC Designation Process (Cont'd)

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The decision this week by MetLife to [challenge a federal regulatory designation](#) refocuses the spotlight on the Financial Stability Oversight Council (FSOC) and its systemically important designation authority (“designation”).

With the new Congress just now underway, look for the House Financial Services Committee (as well as the Senate Banking Committee and possibly others) to put the FSOC’s authority and process under a spotlight, with changes in the offing if the policymakers are unhappy with what they find. Thus it is in the interest of even supporters of the FSOC’s activities and the broader Dodd-Frank Title I provisions to consider reforms to the Council, lest broader legal and legislative fixes are imposed, possibly undoing much of its authority.

In addition to [a prior set of recommendations](#), FSOC could undertake the following steps to improve the designation process and increase confidence in their activities.

- **Regular meetings with experts and stakeholders**

Dodd-Frank, which created FSOC, contains no guidance on how the Council should conduct meetings, beyond convening “[no less than quarterly](#).” Beyond necessary meetings to conduct formal votes related to designation, FSOC should prioritize meetings to discuss relevant issues with outside experts. Keep in mind, these meetings need not (always) be structured around Council members, but can very much revolve around deputy and policy advisor level staff at both FSOC and its attendant Office of Financial Research.

There is some recent precedent here. In November 2014, the Council held a series of meetings with outside policy experts and industry representatives to discuss ways to improve transparency. Private reports from those in attendance said the meetings (which were invitation-only) had good turnout from deputy-level folks and were marked by a generally constructive tone. Whether the meeting will result in positive substantive changes in process is unknown, but FSOC would do well to continue down this path.

As FSOC considers different potential systemic threats, and firm types, and as the overall financial economy environment changes (especially as one anticipates eventual policy rate increases from the Fed), continually gathering input and advice from outside experts will be increasingly important. This is especially true before a specific firm is being examined for designation.

- **Involve the primary regulator**

All relevant financial regulators are involved in the Council as voting members, with Treasury acting as the effective chair. But of course each has different expertise and experience. When a firm (or sector) is under initial consideration as a subject of FSOC proceedings, that firm’s primary regulator should be given additional responsibility and a wider berth or shepherd the process and offer input.

It may be the case that the primary regulator is initially skeptical of designation that would ultimately remove the firm from its supervision and place it in the Fed's, but it's important to acknowledge the disparate expertise of the Council members. Though each member is given an equal vote in the end, the inherent differences can be exploited by giving primary regulators a presumptive enhanced role in early deliberations; this includes giving the primary regulator formal opportunities to respond to inquiries and council resolutions.[1]

- **Stage II improvements**

As a firm moves from the initial Stage I consideration to Stage II, the Council should endeavor to operate less as an adversary and more as an active and open regulator. This doesn't mean they should allow the firm to co-opt the designation process, but by extending certain courtesies, they may end up better informed and avoid acrimonious and litigious responses.

- o Give firms earlier formal notice that they have progressed to Stage II consideration. In at least one case, a firm only learned of the progress of the process after it was reported by the media.
- o Give firms access to the specific data used in the decision. This could be done in conjunction with a request for additional or missing data from the firm and industry groups. Note that nothing here is meant to be binding, but merely to facilitate the productive exchange of information.[2]
- o Provide publicly a checklist of the findings regarding the firm along the six criteria categories codified in Dodd-Frank.[3]

- **Give a final summary rundown**

If a firm does in fact make it through Stage III and is designated, provide a public documenting of the process as well as an explanation of the final decision. This decision should include some mention of alternatives to designation that were offered for consideration by the firm, industry groups, or the primary regulator, and why those alternatives were insufficient to mitigate systemic risks. If there is specific activity or a subsidiary of the firm that posed an acute threat, this summary should explicitly mention that.

Above all, the final decision (and really the entire process) should not be viewed as resulting in one side "winning" and the other "losing." Rather, the shared goal of minimizing systemic threats to the economy ought to be the ultimate outcome, and thus whatever path achieves that goal at the lowest cost is the best way forward.

[1] A bill introduced in the House last year goes to this point:

http://dennisross.house.gov/uploadedfiles/fsoc_bill_text.pdf. As an example, upon affirmative vote by FSOC to consider a nonbank financial company for designation consideration, the primary regulator would be given 180 days to pursue (if they wish) a variety of options, including: issuing new regulations which address the potential risks identified; further investigate the issue and report back to the full Council; notify the nonbank financial company of the consideration and gather additional data from them, etc.