The Financial Stability Oversight Council Factsheet: Saving Taxpayers from the Next AIG and the Next Crisis

What is the Financial Stability Oversight Council?

The Financial Stability Oversight Council (FSOC) was established in 2010 under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The FSOC is a council of federal and state financial regulators chaired by the Secretary of the Treasury, and its mission is to identify and respond to risks that threaten the financial stability of the United States.

Why was the FSOC created?

The financial crisis demonstrated that there were parts of the financial system beyond the responsibility of any single financial regulator, such as the risk posed by the international insurance company AIG that radiated across the financial system to banks and broker-dealers. The financial crisis also demonstrated that there were systemic risks that cut across the jurisdictions of many financial regulators, such that none of the regulators had a complete understanding of the risks that were building up within and across the financial system.

In the immediate aftermath of the crisis, regulatory experts, academics, and financial market participants pointed out that we needed a single financial regulator or body responsible for policing systemic risk. In fact, politicians and financial industry participants alike testified that one way to prevent such a crisis from happening again was to create such a systemic risk regulator:

- "We must create a systemic risk regulator to monitor the stability of the markets and to restrain or end any activity at any financial firm that threatens the broader market."
  – Henry Paulson, former **Secretary of the Treasury**[1]

- "One of the reasons this crisis could take place is that while many agencies and regulators were responsible for overseeing individual financial firms and their subsidiaries, no one was responsible for protecting the whole system from the kinds of risks that tied these firms to one another."
  – Robert S. Nichols, President and Chief Operating Officer, **Financial Services Forum**[2]

- **"**I believe an interagency council with a strong authority in a focused area, in this case monitoring and directing the response to risks that threaten overall financial stability, could, like the [National Security Council], serve the Nation well in addressing complex and multifaceted risks."
  – Paul Schott Stevens, President and CEO, **Investment Company Institute**[3]

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1 How to Watch the Banks: New York Times OP-ED (Feb. 15, 2010).
2 Testimony at House Financial services Committee (July 17, 2009).
3 Testimony at Senate Banking Committee hearing (July 23, 2009).

- "A systemic risk regulator that has access to information about any systemically important financial institution – whether a bank, broker-dealer, insurance company, hedge fund or private equity fund – could have the necessary perspective to ensure firms are not exploiting the gaps between functional regulators, or posing a risk to the larger system."
  – Randolph C. Snook, Executive Vice President, **Securities Industry and Financial Markets Association (SIFMA)**[4]

- "The ABA strongly supports the creation of a systemic regulator. In retrospect, it is inexplicable that we have not had a regulator that has the explicit mandate and the needed authority to anticipate, identify, and correct, where appropriate, systemic problems. To use a simple analogy, think of the systemic regulator as sitting on top of Mount Olympus looking out over all the land. From that highest point the regulator is charged with surveying the land, looking for fires. Instead, we have had a number of regulators, each of which sits on top of a smaller mountain and only sees its part of the land. Even worse, no one is effectively looking over some areas. This needs to be addressed."
  – Edward L. Yingling, then President and Chief Executive Officer, **American Bankers Association**[5]

Who are the Members of the FSOC?
The FSOC is designed as a council to facilitate discussion among regulators and to ensure that its information gathering and oversight ability covers all financial markets. Of the FSOC's fifteen members, ten may vote in FSOC proceedings. The FSOC's voting members are:

- the Treasury Secretary, who Chairs the Council;
- the Chair of the Federal Reserve Board of Governors;
- the Comptroller of the Currency;
- the Director of the Consumer Financial Protection Bureau;
- the Chair of the Securities and Exchange Commission;
- the Chair of the Federal Deposit Insurance Corporation;
- the Chair of the Commodity Futures Trading Commission;
- the Director of the Federal Housing Finance Agency;
- the Chair of the National Credit Union Administration Board; and
- an insurance expert appointed by the President and confirmed by the Senate.

The voting members are aided by the non-voting members, who either provide state-level perspectives or conduct research on the issues that the FSOC considers. These non-voting members are, by law, not to be excluded from FSOC meetings, discussions, and deliberations, except when necessary to safeguard supervisory information. They are:

- the Director of the Office of Financial Research;
- the Director of the Federal Insurance Office;
- a state insurance commissioner selected by the various state insurance commissioners;
- a state banking supervisor selected by the various state banking supervisors; and
- a state securities commissioner selected by the various state securities commissioners.

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4 Testimony at House Financial Services Committee (July 17, 2009).

5 Testimony at House Financial Services Committee (Mar. 17, 2009).

6 Financial Stability Oversight Council, *Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies*, 77 Fed. Reg. 21637 (Apr. 11, 2012).

How Does the FSOC Carry out Its Mission?
FSOC was given a number of tools to carry out its mission including:

- Designating systemically important nonbanks or financial market utilities for supervision by the Federal Reserve;
- Making policy and enforcement recommendations to primary financial regulators and the Federal Reserve;
- Collecting information through the Office of Financial Research; and
- Publishing annual reports about systemic risks to the financial system.

In combination, these tools help to ensure that our regulators can monitor, understand, and respond to risks in the financial system, whether those risks revolve around a specific firm or specific product or activity. The most significant of these tools is the ability to designate firms as systemically important.

What is the Designation Process?
Under Section 113 of the Dodd-Frank Act, the FSOC has the authority to designate a nonbank financial company as a nonbank "Systemically Important Financial Institution" (SIFI) if the FSOC finds that "material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States." Before making such a designation, the FSOC is required to consider ten specific factors, plus any other risk-related factors that the FSOC finds appropriate.

To provide a standard method for considering these designations, in 2012 the FSOC released a final rule and interpretive guidance implementing a three-stage process for designating non-bank SIFIs.[6]

- In Stage 1, the FSOC "narrow[s] the universe of nonbank financial companies to a smaller set" by evaluating the size, interconnectedness, leverage, and liquidity risk and maturity mismatch of nonbanks.

- In Stage 2 the FSOC then "conduct[s] a robust analysis of the potential threat that each of those nonbank financial companies could pose to U.S. financial stability," drawing on data from existing public and regulatory sources.

- In Stage 3, the FSOC conducts a more detailed review using information obtained directly from the nonbank financial company. At this point, the FSOC, by a two-thirds vote, may make a Proposed Determination for a nonbank financial company. A firm subject to a Proposed Determination may request a hearing to contest the determination. After the hearing, the FSOC may vote, again by two-thirds, to make a Final Determination.

On February 4, 2015, in response to concerns from Better Markets and others, the FSOC adopted several improvements to its designation process that increased its transparency and public accountability, including providing more information to firms under review earlier in the process.

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