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## FSOC We Hardly Knew Ye

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**November 28, 2016** - As the financial services sector and Republican politicians draft the obituary of the Dodd-Frank Act, it remains to be seen whether that landmark legislation will be survived by the Financial Stability Oversight Council ("FSOC"). Whether FSOC itself survives the advancing wave of deregulation, however, it seems increasingly likely that the FSOC's reasons for existing will not.

Section 111 of the Dodd-Frank Act created the inter-agency FSOC, made up of the heads of eight independent financial regulators and chaired by the Secretary of the Treasury. In general, the FSOC is tasked with identifying and responding to risks to the financial stability of the U.S. financial system and with encouraging discipline in the financial services market. Like the Department of Homeland Security, the FSOC was created to centralize across federal agencies the analysis and response to financial security threats.

In particular, the FSOC was vested with the authority to determine whether a bank or nonbank financial institution with more than \$50 billion in assets is subject to heightened regulation as a "systemically important financial institution" or "SIFI." SIFIs are the latest incarnation of financial institutions that have long been called "too big to fail," because they are critically important to our financial system.

In its short life, the FSOC has voted to designate four nonbank financial companies as systemically important: American International Group, Inc., General Electric Capital Corporation, Inc., Prudential Financial, Inc., and MetLife, Inc. In 2016, the FSOC voted to rescind that designation for GE Capital, since it significantly restructured itself over the past three years. Also in 2016, a D.C. federal district court overturned the FSOC's designation that MetLife – the largest life insurance company in the United States – was a SIFI. The district court concluded that the FSOC's designation was based on "fundamental violations of established administrative law" and therefore was "arbitrary and capricious." That decision is now on appeal. As a result, only two nonbank companies remain in the category "systemically important."

The FSOC also was empowered to designate financial market utilities (or FMUs) as systemically important. The FSOC has designated eight clearing services – such as the Clearing House Payments Company, the Chicago Mercantile Exchange, and the Depository Trust Company – as systemically important FMUs without incident.

House Republicans have criticized the FSOC as a “politicized” structure and part of a “shadow regulatory system” that is both contrary to democratic principles and harmful to the U.S. economy.” Following the November elections, House Financial Services Committee Chair Jeb Hensarling claimed the FSOC is not “adding value to our economy” and as a result it should be tossed “in the trash bin.” “I do not believe any institution in America is too big to fail,” according to Representative Hensarling.

In the 114th Congress, House Republicans introduced legislation that called for:

- limiting when the FSOC can designate a nonbank financial institution for heightened supervision;
- allowing a financial services company to eliminate risk on its own rather than being designated “systemically important”; making the FSOC subject to the traditional congressional budget and appropriation process; and
- replacing the \$50 billion threshold for bank SIFI designations with a multi-factor test.

Earlier this year, Representative Hensarling introduced the “Financial CHOICE Act of 2016,” which passed his Financial Services Committee and goes even further than his Republican colleagues’ other proposals. Among other forms of deregulation, the CHOICE Act would retroactively repeal the FSOC’s authority to designate nonbank financial companies as “systemically important.” Similarly, the CHOICE Act would retroactively repeal Title VIII of the Dodd-Frank Act, which gives the FSOC authority to designate financial market utilities as systemically important. In short, the CHOICE Act would legislate away the FSOC’s most important reasons for existing.

Representative Hensarling is preparing to introduce a revised version of the CHOICE Act (what he calls a “2.0 version”) early in the new Congress. Increasing congressional oversight and neutering the FSOC as a distinct regulator can be expected to be part of the legislation. Republican legislators will need to offer some concessions to Democrats in order to avoid a filibuster, but the regulatory power of the FSOC will hardly be seen as a grenade worth falling on for the Democrats. In spite of its important statutory mandate, the structure and authority of the FSOC is something only a Washington bureaucrat could love. At least for the FSOC, government regulation of institutions that are too big to fail has likely become too big to survive.

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