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INSURANCE LAW ALERT

APRIL 2012

Financial Stability Oversight Counsel (FSOC) Approves Final Rule On Criteria Used To Determine Which Financial Companies Will Face New Scrutiny

On April 3, 2012, the Financial Stability Oversight Counsel ("FSOC"), headed by the Secretary of the Treasury, approved a final rule (the "Rule") laying out the criteria to be used to determine which financial companies outside the banking industry will face new scrutiny by the Federal Reserve, as required by the Dodd-Frank Consumer Protection and Wall Street Reform Act of 2010 (the "Dodd-Frank Act"). Large insurers, hedge funds and other financial firms are potentially subject to the systemic designation. Enhanced federal scrutiny is intended to prevent a recurrence of the financial crisis which occurred late in 2008. A systemically important financial institution ("SIFI") is a financial institution deemed systemically important to the economy because its failure has the potential to trigger a global financial crisis.

While the Rule identifies broad measures to be used by the FSOC to determine which companies should be reviewed, unfortunately, it does not provide a precise definition, leaving many large financial institutions in a quandary. Federal oversight will add costs for those regulated, as it will require the maintenance of higher capital reserves, the establishment of a plan for liquidation in the event of failure and other regulatory requirements more fully set forth in the Dodd-Frank Act. In addition to more onerous regulation, companies subject to federal supervision contest the designation on the basis that the Federal Reserve does not have sufficient expertise to oversee industries beyond the banking industry.

The Rule authorizes the FSOC to designate any financial firm for greater oversight, details the types of companies that will be considered and outlines a three-step process for how regulators will evaluate a company. SIFIs are so designated based upon the following process:

Step 1: A six-threshold matrix is applied to all non-bank financial institutions, with the first criterion being total consolidated global assets of $50 billion for U.S. groups and $50 billion of total consolidated U.S. assets for foreign groups.

Step 2: Companies meeting both the asset thresholds plus any one of the five additional thresholds detailed in the Rule would then be subjected to additional testing to evaluate: (i) compliance with GAAP; (ii) their potential risks to the overall financial system; and (iii) their own vulnerability to financial stress. Based upon statutory financial data, as well as other information already available to regulators and the public, the FSOC will consider whether the subject firm may be a SIFI.

For more information about any of the topics covered in this issue of the Insurance Law Alert, please contact:

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> Step 3: The FSOC will notify the company that it is under consideration and will ask for additional information necessary to finalize its determination. Step 3 analysis subjects the company to qualitative and quantitative evaluation, based upon company-specific information collected by the Office of Financial Research or another appropriate regulatory agency.

At the end of Step 3 of the evaluation process, the FSOC can vote to designate a company as "systemically important." The subject company then has the right to request a hearing with the regulators to dispute being selected, after which the FSOC will put a final designation to a vote. While the financial industry asserts that the criteria is still not sufficiently definitive, representatives from the Department of Treasury contend that there are only minor differences between the proposed final Rule and a proposal released in October 2011. See 12 CFR Part 1310, RIN 4030-AA00. The Rule is subject to public comment for a 60-day period.

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