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Financial Stability Oversight Council (FSOC) Releases Proposed Criteria For Assessing The Systemic Risk of Nonbank Financial Institutions[1]

On October 11, 2011, FSOC proposed criteria for assessing the systemic risk of nonbank financial institutions.[2] The proposal is open to public comment until December 12, 2011. It will implement a statutory mandate under § 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Under Dodd-Frank, FSOC has considerable authority to require any enterprise, whether it is currently regulated by federal or state oversight, to be supervised by the Federal Reserve in circumstances where FSOC determines that the enterprise poses "a threat to the financial stability of the United States."

Designation of Dodd-Frank's nonbank strategically important financial institutions ("SIFIs") has been a critical aspect of Dodd-Frank implementation which, heretofore, has not been sufficiently clarified. The pending proposal creates a three-step framework for evaluating companies across industry sectors (including insurance), it would also attempt to harmonize FSOC review process through a set of standardized criteria. *Step One* is to identify companies subject to further review using the eleven criteria set forth below. *Step Two* would be for FSOC to conduct an internal review based on information available from public and regulatory sources. Finally, *Step Three* entails the FSOC contacting companies that it believes merit further review to obtain additional information. If, based upon this three-step process, FSOC concludes the company may be an SIFI, the company will be provided the opportunity to submit written materials contesting the determination. At the end of the three-step review process, FSOC will vote on the recommended determination. The company will then have the right to request both a hearing and an additional vote of FSOC at the conclusion of the hearing.

Pursuant to the proposal, FSOC is required to consider eleven statutory considerations when evaluating whether to make a determination of nonbank financial company status, as follows:

1. The extent of the leverage of the company;

2. The extent and nature of the off-balance sheet exposure of the company;

3. The extent and nature of the transactions in relationship to the company with other significant nonbank financial companies and significant bank holdings;

4. The importance of the company as a source of credit for households, business and State and Local Governments and as a source of liquidity for the U.S. financial system;

5. The importance of the company as a source of credit for low-income, minority or under-served communities, and the impact that the failure of such company would have on the availability of credit in such communities;

1 Title I of the Dodd-Frank Act defines a "nonbank financial company" as a domestic or foreign company, other than bank holding companies and certain other types of firms, that is "predominantly engaged in financial activities" in the United States. See 12 U.S.C. 5311(a)(4). The Dodd-Frank Act provides that a company is "predominantly engaged" in financial activities if either: (i) the annual gross revenues derived by the company and all of its subsidiaries from financial activities, as well as from the ownership or control of insured depository institutions, represents 85% or more of the consolidated annual gross revenue of the company; or (ii) the consolidated assets of the company and all of its subsidiaries related to financial activities, as well as related to the ownership or control of insured depository institutions, represents 85% or more of the consolidated assets of the company. The Act requires the Board of Governors to establish the requirements for determining whether a company is "predominantly engaged in financial activities." See 12 U.S.C. 5311(b).

2 Link to the proposed rules.

6. The extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse;

7. The nature, scope, size, scale, concentration, interconnectedness, and the mix of the activities of the company;

8. The degree to which the company is already regulated by one or more primary financial regulatory agencies, such as a state insurance department;

9. The amount and nature of the financial assets of the company;

10. The amount and types of the liabilities of the company, including the degree of reliance on short-term funding; and

11. Any other risk-related factors that FSOC deems appropriate.

Interested persons are invited to comment on the proposed rules, either by electronic submission of comments through the Federal eRulemaking Portal at: http:\\www.regulations.gov or via mail to the Financial Stability Oversight Council, Attention: Lance Auer, 1500 Pennsylvania Avenue, N.W., Washington, D.C. 20220. ■

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

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