LETTERS TO THE EDITOR & RESPONSES

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FSOC’s Proposals Would Promote Financial Stability, Not Undermine It

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By Paul Schott Stevens

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Washington watchers often seem to have only one scale for measuring the regulations that govern our markets and economy: more versus less.

Lately, observers and some participants have branded any regulatory change as either “re-regulation” or “deregulation.” These labels are designed to provide convenient magnetic poles for partisans to align their opinions.

But there’s a better scale for measuring regulation: effective or inordinate. And it’s a far more useful scale for those who want to know whether a new rule or interpretation is going to advance or retard the goals of the underlying policy. Rules are valuable when they achieve their purpose with a minimum of economic distortion and added costs. In other words, when they do enough, but no more.

On that scale, the process reforms proposed recently by the Financial Stability Oversight Council provide an outstanding example of how to achieve an overarching goal by enhancing the stability of our financial system in a far more effective fashion.

Ten years after the financial crisis, the FSOC is applying the lessons it has learned to reshape its rules. The resulting framework will be both less burdensome and more likely to succeed in dampening risks and strengthening financial institutions.

The FSOC’s new proposal achieves that goal because it relies on four key changes. First, the proposal focuses on an activities-based approach for addressing any potential systemic risks raised by nonbank financial companies—not on designating those individual companies as systemically important financial institutions, or SIFIs.

As the FSOC observed in its proposed guidance, addressing financial activities, products or practices that could undermine the US financial stability would more directly and effectively address underlying sources of systemic risk. SIFI designation, by contrast, is a blunt regulatory instrument that threatens to impose bank-like regulation that would be ill-suited outside of banking.

Second, the FSOC's new guidance enhances the role of the primary regulators—the agencies that have front-line expertise. These regulators have their own regulatory and supervisory tools tailored to the activities and firms they oversee. Drawing on those strengths could help address risks industrywide.

Focusing on an activities-based approach capitalizes on the FSOC's greatest strength: bringing together diverse perspectives and expertise from across the spectrum of financial regulators. These convening and coordinating powers leverage the collective resources of the financial regulatory community.

Third, the proposal makes clear that SIFI designation is reserved for use in rare circumstance, such as when a potential threat falls outside the jurisdiction or authority of regulators; or when the FSOC's collaboration and engagement with the relevant regulators does not adequately address a potential threat. The proposal also makes clear that the council retains its emergency designation authority. These parameters help provide more transparency to financial companies and the public about the FSOC's work.

Finally, the proposal envisions that the FSOC will engage in more rigorous analysis and follow an enhanced process when evaluating an individual company for possible SIFI designation. For instance, it adds a new section to the analytic framework that requires the council to consider the expected benefits and costs of a nonbank SIFI designation. Rigorous cost-benefit analysis isn't easy. But it is key to improving the FSOC's decision making and is consistent with a sound regulatory process.

Rigorous analysis will also make the FSOC's decisions more likely to stand up in court. The council's "express refusal to consider cost" was a crucial factor in a federal judge's decision to overturn its designation of MetLife Inc. as a SIFI.

Taken together, the reforms in the FSOC's proposed guidance will help regulators identify and address areas of potential systemic risk, while strengthening the resiliency of the financial system and US capital markets.

The registered funds represented by the Investment Company Institute are major participants in US and global financial markets on behalf of more than 100 million American investors. These funds and their managers have every reason to support policy approaches that promote the robustness, diversity and resiliency of financial markets and market participants in the most effective way possible.

We strongly encourage the FSOC to adopt and implement this proposed guidance.

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