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FSOC: “Too Big to Fail” Has Failed

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Insurance and Investment Firms Breathe Easier

On December 4, 2019, the Financial Stability Oversight Council adopted final interpretive guidance on addressing systemic threats to the financial system that prioritizes the identification and regulation of risky “activities” rather than risky companies.

Pursuant to the Dodd-Frank Act, the FSOC initially adopted standards for designating systemically important nonbank financial institutions (SIFIs) that relied heavily on the size of the institution, among other considerations. SIFIs — often referred to as “too big to fail” — are deemed to expose the U.S. financial system to such significant risks that, under Dodd-Frank, they are subjected to special prudential regulation by the Federal Reserve Board.

Following Dodd-Frank’s enactment, very large insurance, mutual fund, and money management firms (among others) were concerned that they might be designated as SIFIs, and several large insurance companies did in fact receive such designations. The prudential regulation to which these insurance companies were subjected proved burdensome and arguably unnecessary, given the nature of their activities and the state insurance and other regulation to which they already were subject.

Based on such considerations, the FSOC has, for a number of years, been placing more emphasis on (a) identifying activities that pose significant risks to the financial system and (b) appropriately addressing such risks across a spectrum of different-sized companies engaged in those activities, rather than seeking to assign the SIFI label to individual companies that, by themselves, pose systemic risks. The FSOC’s December 4 final interpretive guidance is the most recent and definitive articulation of this approach.

Under the final interpretive guidance, the FSOC will, among other things, give priority to identifying activities that present systemic risks and seeking to adequately control those risks by making nonbinding recommendations to the primary regulators of the companies engaged in those activities. It is hoped that an institution’s primary regulators — e.g., state insurance regulators, the SEC, the CFTC, etc. — will be better able than the Federal Reserve Board to tailor appropriate constraints on that institution’s risky activities.

For that and other reasons, insurance companies and money managers have generally welcomed the FSOC’s migration away from “too big to fail” that has now culminated in the final interpretive guidance; and the FSOC has not recently designated any such firms as SIFIs. Nevertheless, if the FSOC does not believe that measures imposed by an institution’s primary regulators can or do adequately address systemic risks presented by that institution, the FSOC and the Federal Reserve Board still retain a variety of other remedial options, including, in appropriate cases, designating and regulating the institution as a SIFI.

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