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House Committee Passes Critical Changes to SIFI Designation Process

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Legislation Would Enhance Transparency and Provide FSOC Additional Tools to Mitigate Systemic Risk

Washington, DC, November 4, 2015—The House Committee on Financial Services today passed bipartisan legislation to give the Financial Stability Oversight Council (FSOC) additional options for addressing potential risks to the financial system while also making the FSOC process more accountable and transparent. The FSOC Improvement Act, H.R. 1550, would also ensure that a nonbank entity would be designated as a systemically important financial institution (SIFI) only when systemic risk cannot be addressed more effectively by an entity's primary regulator or by an action of the entity itself.

"Five years after passage of the Dodd-Frank Act, it is time to update and improve FSOC's process," said Investment Company Institute President and CEO Paul Schott Stevens. "Under current law, the primary tool FSOC has to address systemic risk is SIFI designation, which leads to bank-like regulation and supervision by the Federal Reserve Board."

"Designation is not an end in itself," Stevens stated. "FSOC's goal should be to reduce systemic risk, not simply to designate ever more nonbank financial companies as SIFIs for the Federal Reserve to regulate. This bipartisan bill would enhance FSOC's ability to mitigate systemic risk while also ensuring that nonbank SIFI designations are reserved for the limited cases where FSOC concludes that Federal Reserve oversight is more appropriate than alternative regulatory tools or action by the financial entity to address identified risks."

Important Reforms for FSOC Process

H.R. 1550 would make the following important changes to the FSOC process:

- Codify into law the “supplemental procedures” that FSOC adopted earlier this year to provide more transparency to its nonbank SIFI designation process. Incorporating these procedures in law would prevent FSOC from changing them at any time, without public input, as currently could happen.
- Require FSOC to identify the reasons it believes that an entity poses systemic risk.
- Encourage de-risking by an entity prior to SIFI designation by allowing its primary regulator to address identified systemic risks broadly, rather than by designating it. The legislation also allows an entity that FSOC has proposed to designate as a SIFI the opportunity to make changes to its structure or business practices to address identified systemic risks prior to designation. Allowing an entity the opportunity to change its business model or practices may be the most effective way to address the identified risks.
- Encourage de-risking after SIFI designation by requiring FSOC to conduct a more robust review process every five years. Under H.R. 1550, FSOC would be required to vote on whether to rescind a company’s designation every five years. At that time, the company would also be allowed to present FSOC with a plan on how it could de-risk and shed its SIFI designation by changing its business structure or practices.

Registered Funds Do Not Pose Systemic Risks

ICI opposes SIFI designation of registered funds or their managers because, unlike some other types of financial institutions, they do not pose systemic risks.

- Unlike other financial institutions, fund managers act as agents. Fund investors—not fund managers—bear the risks of any portfolio losses and the benefits of any gains.
- Funds have regulatory limits on leverage, so they typically have little or none of it.
- Registered funds do not fail like other financial institutions do—investment losses are absorbed by fund investors, so there’s no need for a government bailout.

“The consequences of SIFI designation—bank-style capital requirements and prudential supervision by the Federal Reserve—not only are unnecessary, but are altogether inappropriate in the case of registered funds and their managers,” said Stevens. “SIFI designation for registered funds and their managers would result in significant costs for investors and reduce their investment returns, harming retirement savers. In addition, it would distort the fund marketplace, given that some funds or managers would be designated while others engaging in the exact same practices would not be. Designation would impede the important role that funds play as a vital source of funding in our capital markets.”

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