Impending Financial Stability Oversight Council Rule Changes

regulatory   risk management   industry update

Summary: Amidst a handful of bank collapses and ongoing economic uncertainty, the Financial Stability Oversight Council has proposed rule changes that would make it easier to regulate and classify non-bank organizations as systemically risky.

By testing samples of a person's saliva, blood, or inner cheek cells, doctors can now determine through genetic testing whether or not someone is at risk of developing a certain condition or is a carrier of certain genetic disorders or cancers. In cases where concerning genes are identified, many people can choose to take preventative measures to reduce their risk of developing cancer or disease, from changes in diet or lifestyle to the removal of certain organs or glands that may be affected in the future.

Just as doctors can determine which patients are most at risk for future illnesses, the Financial Stability Oversight Council (FSOC) is hoping to step up the measures it uses to determine the overall health of non-bank organizations.

Quicker Classification

The FSOC has put out a proposal for new rules that would significantly reduce the amount of time it takes to classify non-bank institutions as being systemically important. The new rules would essentially eliminate previous rules that made the classification process extremely cumbersome and time-consuming.

Under the existing rules, which were put in place in 2019, it can take up to six years for the FSOC to make such classifications. But following the collapses of Silicon Valley Bank (SVB), Signature Bank, and First Republic Bank, regulators are stepping up oversight of financial institutions across the board.

US Treasury Secretary Janet Yellen recently flagged concerns regarding non-bank financial institutions in particular: organizations including pension funds, insurance funds, mutual funds, microloan businesses, venture capital firms, hedge funds, and even pawn shops. There is currently little regulatory oversight of such businesses, yet the potential for organizational failures within these non-bank financial institutions could have major ramifications on the economy.

The FSOC's proposed rules would eliminate the requirement to apply cost-benefit analysis before a non-bank organization can be designated systemically important, which includes the need to determine that the benefits of a systemically important designation outweigh the costs of such a designation. The changes would also replace the current definition of "threat to the financial stability of the United States" from something that "would" be a big enough risk to significantly damage the overall economy, to something that "could" lead to such damage.

A Two-Stage Process

Instead, a two-stage process would be used to assess non-bank organizations. Under the first stage, the FSOC would use a combination of public information and data from regulators — both qualitative and quantitative —

to analyze organizations. Non-bank organizations would also have the ability to supply additional information of their own at this point.

If the initial review suggests that an organization fits the criteria of being systemically important, the second stage will involve a more in-depth assessment of the company, which could include supervisory requirements. At this point, companies would be able to request a hearing, and the FSOC would suggest that the organization and applicable regulators begin steps to reduce any risks identified. Designations are reviewed at least once every 12 months and can be removed if the FSOC believes material risks have been diminished or eliminated.

These proposed rule changes indicate that the FSOC still has a keen eye on non-bank entities, especially given the recent financial institution failures and ongoing economic uncertainty, and will be casting a wider net beyond traditional financial institutions. Passage of the rules would be an important step toward achieving a balanced approach regarding assessing and handling potential risks.

It should also serve as a reminder for community financial institutions (CFIs) that a robust risk assessment framework is essential for any institution that has the potential for a significant economic impact. CFIs would do well to identify any weaknesses within their own organization to ensure that they, too, are keeping an eye on their own financial stability.

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ECONOMY & RATES

Rates As Of: 07/20/2023 02:18PM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.49	0.06	1.07
6M	5.52	0.05	0.76
1Y	5.32	-0.07	0.62
2Y	4.82	-0.08	0.39
5Y	4.10	-0.05	0.10
10Y	3.85	0.02	-0.02
30Y	3.91	0.05	-0.06

FF Market	FF Disc	IORB
5.08	5.25	5.15
SOFR	**Prime**	**OBFR**
5.05	8.25	5.07