The Daily Dish

Last Man Standing – FSOC Edition

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Eakinomics: Last Man Standing – FSOC Edition

This morning, the Financial Stability Oversight Council (FSOC) will meet to discuss, among other things, its designation of Prudential as a non-bank systemically important financial institution (SIFI). As a SIFI, Prudential is subject to costly enhanced oversight and regulation, with little to no guidance on what it can do to escape its SIFI designation. Recall that just a month ago FSOC filed a motion to drop its appeal in its case against MetLife in which the United States District Court for the District of Columbia court ruled MetLife's SIFI designation arbitrary and capricious. As a result, Prudential is now the only entity designated by FSOC as a non-bank SIFI. The meeting this morning will almost certainly not free Prudential from its designation, but it could be a first step in doing so.

There are three important considerations at play in today's meeting. First, in filing its joint motion to drop the appeal in the MetLife case, FSOC asked MetLife to file another separate joint motion that would vacate one portion and uphold the rest of the District Court's decision. The vacated portion would have required FSOC to perform a perfunctory cost-benefit analysis before any future designations. As a result of the vacated portion, FSOC can technically go ahead with a designation process (or de-designation process) without a cost-benefit analysis of the designation on the company and on taxpayers. This outcome is bad and contradicts the literature and FSOC-specific reports coming out of Treasury during this administration.

Second, there's nothing particularly unique about Prudential's business model that should force it to remain the only non-bank entity still designated as a SIFI. The court determined MetLife's designation to be arbitrary and capricious, and FSOC itself determined that AIG and GE Capital no longer qualified as SIFIs. FSOC, though still not transparent, seemed to indicate that it dropped GE and AIG's SIFI designations because they made their structures and asset makeups less risky, which indicates a shift toward an activities-based approach.

This move is good, as AAF has long argued, and, if that is the case, a close look at Prudential's activities and not just its size should allow for shedding the SIFI title.

Third, in response to an executive order, Treasury issued earlier this year its report on FSOC that included a number of non-binding policy recommendations for FSOC. Specifically, it says that, instead of focusing only on the size of entities and taking an entity-based systemic risk approach, "insurance regulators should focus on potential risks arising from insurance products and activities, and on implementing regulations that strengthen the insurance industry as a whole." It goes on to say that "while the FSOC maintains primary responsibility for identifying, evaluating, and addressing systemic risks in the U.S. financial system, the states are the primary regulators of the insurance industry in the United States, and insurance regulation at the federal level should be conducted in coordination with the states." As FSOC considers Prudential's designation and begins to implement Treasury's recommendation to work with the state insurance regulators, it should consider that Prudential's primary state regulator, New Jersey, is one of the most (if not the most) stringent state insurance regulators. The additional regulations from FSOC are simply redundant and costly.

I have been on record advocating for the elimination of FSOC. However, in lieu of a complete abolishment of yet another of Dodd-Frank's burdensome creations, this administration should prioritize ensuring that FSOC is executing good policy. When it comes to its SIFI designations, this means performing proper cost benefit analyses, using an activities-based approach, and being as transparent as possible with these companies both during and after the designation process, with guidance on how to shed their SIFI labels. It's in the best interest of both taxpayers and the companies.