The Daily Dish

Executive Order on FSOC's Fatal Flaws

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On Saturday Congressional Republicans were told that the House is moving closer to a compromise bill on health care. Speaker Paul Ryan told members that while a deal is coming together there will be no vote on health care until leadership is certain they have the votes to pass the bill through the House. This week Congress is expected to focus on passing a funding bill to keep the government open but Speaker Ryan stated that passing a health care bill remains a top priority.

Last week a new Banking Compliance Index report showed that regulations have substantially slowed during the first quarter of President Trump's term. The report showed that it would take a typical bank or credit union less than one full time employee for banks to comply with financial regulations, which is a substantial reduction from the more than two needed during the last quarter of President Obama's term.

Eakinomics: Executive Order on FSOC's Fatal Flaws

On Friday, the White House issued three Presidential Memoranda, each directing the Department of Treasury to examine a specific subject: one on the burdens of certain tax laws, another on Dodd-Frank's orderly liquidation authority that avoids bankruptcy procedures for failing banks, and the last on the Financial Stability Oversight Council's (FSOC's) ability to place nonbank financial institutions they deem "systemically important" under enhanced supervision.

The last one should be familiar to regular readers of Eakinomics. Recall that last year a federal judge, in her decision striking down FSOC's designation of MetLife, said that "FSOC made critical departures from two of the standards adopted in its Guidance, never explaining such departures or even recognizing them as such. That alone renders FSOC's determination process fatally flawed." And in February of this year, the House Committee on Financial Services, after nearly two years of investigation, published a report finding that "FSOC's nonbank designation process is arbitrary and inconsistent." And such arbitrary and inconsistent decision making, including FSOC's failure to perform a basic cost benefit analysis, ignores even the costs of its macroprudential regulation to consumers of these designated companies' products.

In fact, FSOC's regulatory designation of nonbanks imposes direct costs and risk on the designated institutions. The magnitude of the costs is uncertain, especially given that the specific rules and capital requirements have yet to be determined, but it cannot be presumed negligible. FSOC's two-tiered system will alter the dynamics of competition in the insurance sector, whereas large banks who compete with each other are all under the same regulatory umbrellas.

Considering the above, the executive order makes perfect sense. It directs the Secretary of the Treasury to (i) review the process for designating a nonbank entity as a Systemically Important Financial Institution (SIFI), (2) review the performance of the FSOC itself, and (3) impose a temporary pause in designations of SIFIs. This is a step in the right direction, even if it falls short of removing FSOC's nonbank designation authority altogether or significantly altering its process. But it is a step. Big league.