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FSOC Issues Two Studies and One Proposed Rule

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On January 18, the Financial Stability Oversight Council (FSOC) took three actions to satisfy statutory obligations imposed on it under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

1. Study on Implementation of the Volcker Rule

FSOC released the study on how best to comprehensively implement the Volcker Rule in a manner that constrains risk-taking by, and promotes the safety and soundness of, banking entities that is required under Section 619 of the Dodd-Frank Act. The study included the following key recommendations by the FSOC that seek to identify and eliminate prohibited proprietary trading activities and investments in or sponsorships of hedge funds and private equity funds by banking entities:

- Prohibit banking entities from investing in or sponsoring any hedge fund or private equity fund, except with respect to bona fide trust, fiduciary or investment advisory customers
- Prohibit banking entities from engaging in transactions that would allow them to bail out a hedge fund or private equity fund
- Identify similar funds that should be brought within the scope of the Volcker Rule prohibitions in order to prevent evasion of the intent of the rule
- Require banking entities to publicly disclose permitted exposure to hedge funds and private equity funds
- Require banking entities to perform quantitative analysis to detect potentially impermissible proprietary trading without provisions for safe harbors
- Perform supervisory review of trading activity to distinguish permitted activities from impermissible proprietary trading
- Require divestiture of impermissible proprietary trading positions and impose penalties when warranted
- Require banking entities to sell or wind down all impermissible proprietary trading desks

The study emphasizes the creation of rules and a supervisory framework that can effectively prohibit proprietary trading activities throughout a banking entity and that appropriately distinguish prohibited proprietary trading from permitted activities (such as market making, hedging and underwriting) as an essential part of implementing the Volcker Rule.

To read the U.S. Treasury Department press release, click here.
To read the Volcker Rule study, click here.

2. Study on Concentration Limits

FSOC also released the study on concentration limits for large financial companies required by Section 622 of the Dodd-Frank Act. Section 622 generally prohibits a financial company from merging or consolidating with another company if the liabilities of the resulting company would exceed 10% of the aggregate consolidated liabilities of all financial companies. The study includes three recommendations for modifications to the statutory concentration limit that the council has determined would more effectively implement the intent of the limits, and the recommendations are open for comment for 30 days. The study notes in passing that the concentration limit "is likely to prohibit acquisitions by only a small number of financial companies."

To read the concentration limit study, click here.

3. Notice of Proposed Rulemaking on Designation of Systemically Important Nonbank Financial Companies

FSOC has proposed a new rule setting forth the standards and procedures that will govern the authority of the FSOC to determine when and if a nonbank financial company must be supervised by the Federal Reserve Board because the company could pose a threat to the financial stability of the United States. The rule does not add a great deal to the substance of Sections 111, 112 and 113 of the Dodd-Frank Act, but the accompanying release includes an extensive discussion of comments received as a result of the related Advance Notice of Proposed Rulemaking issued in October. Comments on the new rule will be due 30 days after it is published in the Federal Register.

To read the new rule, click here.

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