



# FSOC regulatory framework for nonbank financial companies

November 2023

# Executive Summary

The Financial Stability Oversight Council (FSOC) was established in 2010 under the *Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA)* to provide comprehensive monitoring of the stability of our nation's financial system. FSOC is chaired by the Secretary of Treasury.

**On [November 03, 2023](#), FSOC unanimously approved issuance of final versions of (1) a new analytic framework for financial stability risks and (2) updated guidance on the FSOC's nonbank financial company (NBFC) determinations process:**<sup>1</sup>

1. The final [Analytic Framework](#) describes the approach FSOC expects to take in identifying, assessing, and addressing risks to financial stability, irrespective of their source or the tool FSOC may use to address any risk<sup>2</sup>
2. The final [Guidance](#) describes a new process for designation of nonbank financial companies<sup>3</sup>

The final Guidance on NBFC designation and Analytic Framework are intended to put the designation authority for systemically important financial institutions (SIFIs) on equal footing with FSOC's other authorities going forward.

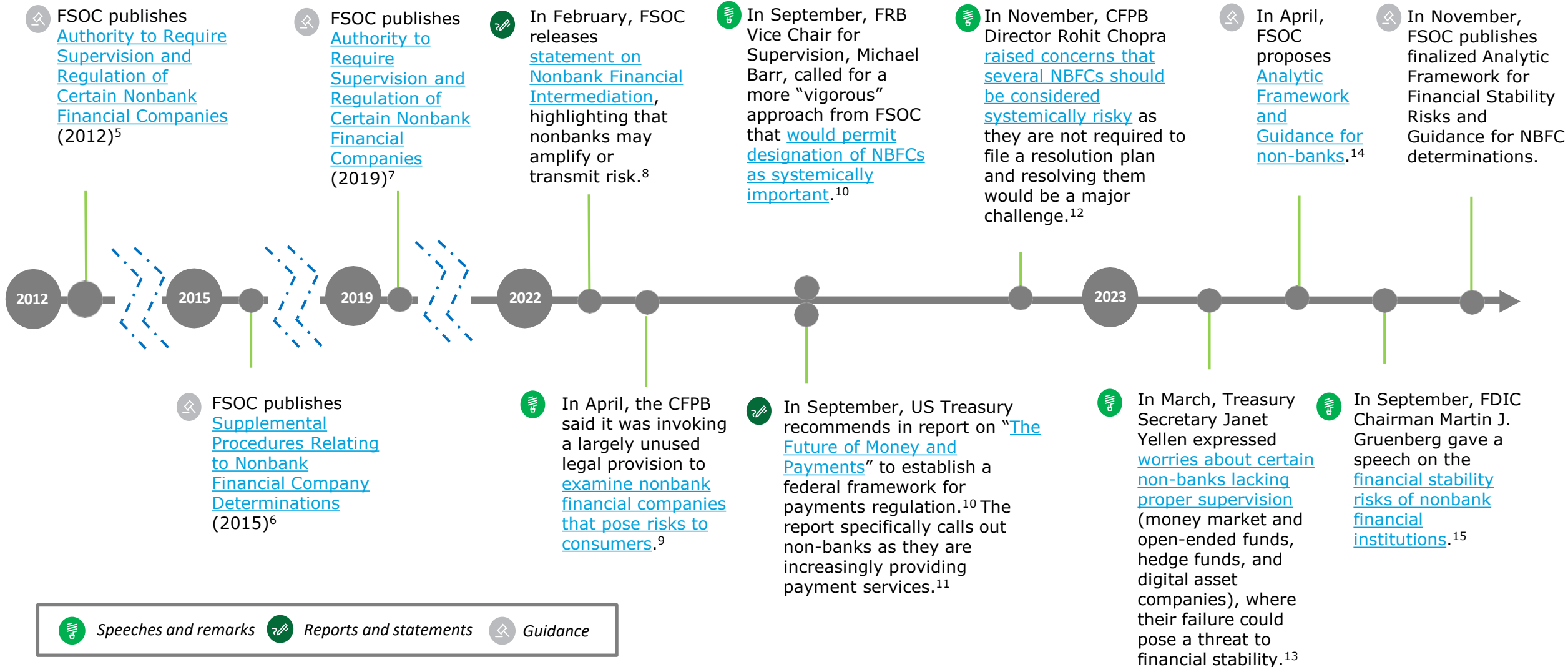
As the new Analytic Framework separates the procedural elements from the Guidance, FSOC may revise the Analytic Framework going forth without public comment, as the procedural elements will no longer be appended to the regulatory authority to designate NBFCs.

## Key aspects of the finalized Analytic Framework and designation Guidance

- The finalized Guidance and Analytic Framework use a **two-stage review process when determining whether a NBFC should be subject to Board of Governors of the Federal Reserve System (FRB) supervision and prudential standards** and adds language that a company under consideration for designation may "act to mitigate any risks to financial stability and thereby potentially avoid becoming subject to a Council determination."
- The Guidance removes three prerequisites for NBFC designation: (1) **prioritization of activity-based regulations** over the designation of specific entities; (2) **cost-benefit analysis** prior to designation; and (3) assessment of the **likelihood of a company's "material financial distress."** A new definition of terms was added for 'financial stability,' and the term 'threat to financial stability' was redefined.
- The Analytic Framework flags **key vulnerabilities and transmission channels** through which risks could **affect the broader financial system** and lays out the full range of tools that the FSOC has to address systemic risks beyond the normal regulatory and supervisory work of the member agencies. This will **enhance the transparency of the FSOC's process for considering financial stability risk.**

# Timeline

FSOC has the authority to designate nonbanks as systemically important and it has previously released documents over the years on the designation process. Given the notable increase in its budget and staff recently, FSOC may take more assertive action going forth.<sup>4</sup> Furthermore, officials at the Treasury Department, FRB, Federal Deposit Insurance Corporation (FDIC), and Consumer Financial Protection Bureau (CFPB) have increasingly expressed concerns about the systemic risk of NBFCs.



# Analytic Framework – summary and key changes

- New, separate narrative description of the approach FSOC expects to take in identifying, assessing, and responding to certain potential risks to US financial stability.

## Broader applicability and transparency

- The Analytic Framework enables FSOC to monitor for potential risks to financial stability which may cover an expansive range of asset classes, institutions, and activities;
  - The Analytic Framework specifically states that **FSOC has the authority, under DFA Title VIII, to designate payment, clearing and settlement activities, and financial market utilities** that are, or are likely to become, systemically important should a potential risk to financial stability be identified.
  - Due to their uniqueness, evaluation of nonbank financial companies will be **firm-specific including assessment of qualitative and quantitative information** that is deemed relevant to the particular financial institution.
- Identifies list of vulnerabilities and transmissions channels, along with quantitative metrics, FSOC will analyze to identify those risks that jeopardize financial stability.
- Addresses potential risks through numerous approaches, including using mitigation tools as needed to: (i) reduce the risk of shock within the financial system, (ii) mitigate financial vulnerability and (iii) improve the resilience of the financial system to shocks.

## New ability to update going forward

- The New Analytic Framework is separated from the designation Guidance and therefore may be changed in the future without public comment as, unlike the Guidance, it is no longer included as an appendix to 12 CFR Part 1310.

## Key Changes from 2019

1. Clarifies that **designation authority is on a co-equal footing with the other tools** available to FSOC
2. FSOC indicated that the Analytic Framework is designed not only in respect of potential nonbank financial company designations but additionally to **payment, clearing, and settlement (PCS) activity and financial market utility (FMU) designations** (subject to Title VIII standards)
3. **New definition for “financial stability”** as used in DFA: “the financial system being resilient to events or conditions that could impair its ability to support economic activity”
4. **Redefines the term “threat to financial stability”** from a threat that “would be sufficient to inflict severe economic damage” to a lower standard of one that “could substantially impair” the financial system.
5. **Adds additional sample quantitative metrics** FSOC may use to assess vulnerabilities (*see slides 7-8*).
6. **Includes further detail on the transmission channels and links vulnerabilities to transmission channels** (*see slide 9*).
7. **Includes additional emphasis on FSOC’s collaboration with primary state and federal financial regulators** to address most risks.

# Designation Guidance – summary and key changes

- Update on FSOC procedures that broaden the approach for identifying, evaluating, and designating NBFC for enhanced prudential structures.

## Lowering standard for designation

- Eliminates the prioritization—but not the potential use—of activities-based approach and sets designation authority on equal footing with other powers.
- Eliminates the requirement from the 2019 Guidance<sup>16</sup> that FSOC must first rely on federal and state regulators to address risks to financial stability before it considers a NBFC for potential designation.
- Eliminates the need for a cost-benefit analysis and an assessment of the likelihood of a firm’s material financial distress prior to making a determination under Section 113.

## Two-stage process and engagement

- Requires a two-stage process of evaluation and analysis used by FSOC to determine whether a NBFC is deemed “systemically important.”
  - **Preliminary** – identify firm for review and conduct preliminary analysis
  - **In-depth** – select firm for in-depth review and potentially designate as a risk
- NBFCs under review for designation can take action to mitigate risks to financial stability to avoid designation during FSOC’s review process.
- Institutions should do their own independent analysis of their systemic footprint ahead of any potential designation. They should be prepared to answer detailed questions if they are prominent in markets.
- FSOC reevaluates the designation at least annually focusing on any material changes that have taken effect (e.g., changes at the company, in its market or its regulation, in impact of relevant factors) and may rescind the designation as needed.

## Key Changes from 2019

1. **Eliminates three significant prerequisites**, thereby lowering the standard for designating a company as systemically important
2. Reverts to the designation approach taken in the initial FSOC 2012 designation Guidance by **eliminating the emphasis on “prioritization of an activities-based approach”**
3. Unlike prior Guidance, the Finalized Guidance **focuses on the FSOC’s procedures for NBFC designations and does not discuss the substantive analytic factors** used in its assessments of NBFCs (*see Analytic Framework*)
4. **Redefines the term “threat to financial stability”** from a threat that “would be sufficient to inflict severe economic damage” to a lower standard of one that “could substantially impair” the financial system.
5. Provides **further detail on how FSOC expects to identify NBFCs for preliminary evaluation** to assess the risks they could pose to U.S. financial stability.

# How FSOC will monitor institutions and markets for potential financial stability risk





FSOC's broad mandate allows for its expansive monitoring over a range of asset classes, institutions, and activities.<sup>17</sup>









# How FSOC will assess institutions and markets for vulnerabilities (1 of 2)

The Guidance highlights FSOC’s intention to cooperate closely with primary financial regulators when addressing most risks. The Guidance states that the designation of any NBFC will depend on a data-driven analysis, taking into account the unique characteristics of the company, its market, and its current regulation. The metrics below inform this analysis.

Vulnerability	Sample Metrics in <i>Proposed</i> Analytic Framework	Additional Metrics in <i>Final</i> Analytic Framework
 <p><b>Leverage</b> Leverage amplifies risks by reducing market participants’ ability to satisfy obligations and by increasing potential for sudden liquidity strains.</p>	<ul style="list-style-type: none"> <li>• Ratios of assets</li> <li>• Risk-weighted assets</li> <li>• Debt</li> <li>• Derivatives liabilities or exposures</li> <li>• Off-balance sheet obligations to equity</li> </ul>	<ul style="list-style-type: none"> <li>• <i>No additional metrics identified in Final Analytic Framework</i></li> </ul>
 <p><b>Liquidity risk and maturity mismatch</b> Shortfall of sufficient liquidity or reliance on short-term liabilities for long-term assets can lead to rollover or refinancing risk.</p>	<ul style="list-style-type: none"> <li>• Ratio of short-term debt to unencumbered short-term high-quality liquid assets (HQLA)</li> <li>• Funding available to meet unexpected reductions in short-term funding</li> </ul>	<ul style="list-style-type: none"> <li>• Scale of financial obligations that are short-term or can become due in a short period</li> <li>• Amounts of transactions that required additional collateral</li> </ul>
 <p><b>Interconnections</b> Financial interconnections between creditors, counterparties, investors, and borrowers can increase the negative impact of disruptions or financial distress.</p>	<ul style="list-style-type: none"> <li>• Total assets</li> <li>• Off-balance-sheet assets or liabilities</li> <li>• Total debt</li> <li>• Derivatives exposures</li> <li>• Values of securities financing transactions</li> <li>• Size of potential requirements to post margin or collateral</li> <li>• Concentration of holdings of a class of financial assets</li> </ul>	<ul style="list-style-type: none"> <li>• <i>No additional metrics identified in Final Analytic Framework</i></li> </ul>
 <p><b>Concentration</b> Risks are amplified when financial exposures or important services are highly concentrated in a small number of entities.</p>	<ul style="list-style-type: none"> <li>• Market shares in segments of applicable financial markets</li> </ul>	<ul style="list-style-type: none"> <li>• <i>No additional metrics identified in Final Analytic Framework</i></li> </ul>











# How FSOC will assess institutions and markets for vulnerabilities (2 of 2)

Vulnerability	Sample Metrics in <i>Proposed</i> Analytic Framework	Additional Metrics in <i>Final</i> Analytic Framework
 <p><b>Operational risk</b> Risks can arise from the impairment or failure of financial market infrastructures, processes, or systems, including due to cybersecurity vulnerabilities.</p>	<ul style="list-style-type: none"> <li>• Statistical measurements on cybersecurity incidents</li> <li>• Scale of critical infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>• <i>No additional metrics identified in Final Analytic Framework</i></li> </ul>
 <p><b>Complexity or opacity</b> A risk may be exacerbated if a market, activity, or firm is complex or opaque resulting in risks that cannot readily be determined.</p>	<ul style="list-style-type: none"> <li>• Number of jurisdictions in which activities are conducted</li> <li>• Number of affiliates</li> </ul>	<ul style="list-style-type: none"> <li>• Extent of intercompany or inter-affiliate dependencies for liquidity, funding, operations, and risk management</li> </ul>
 <p><b>Inadequate risk management</b> A risk may be exacerbated if it is conducted without effective risk-management practices, including the absence of appropriate regulatory authority and requirements.</p>	<ul style="list-style-type: none"> <li>• Amount of capital</li> <li>• Amount of liquidity</li> </ul>	<ul style="list-style-type: none"> <li>• Levels of exposures to particular types of financial instruments or asset classes</li> </ul>
 <p><b>Destabilizing activities</b> Certain activities, particularly those that are sizeable and interconnected, can destabilize markets for financial instruments or impair financial institutions.</p>	<ul style="list-style-type: none"> <li>• Trading practices that substantially increase volatility in one or more financial markets</li> <li>• Activities that involve moral hazard or conflicts of interest</li> </ul>	<ul style="list-style-type: none"> <li>• <i>No additional metrics identified in Final Analytic Framework</i></li> </ul>



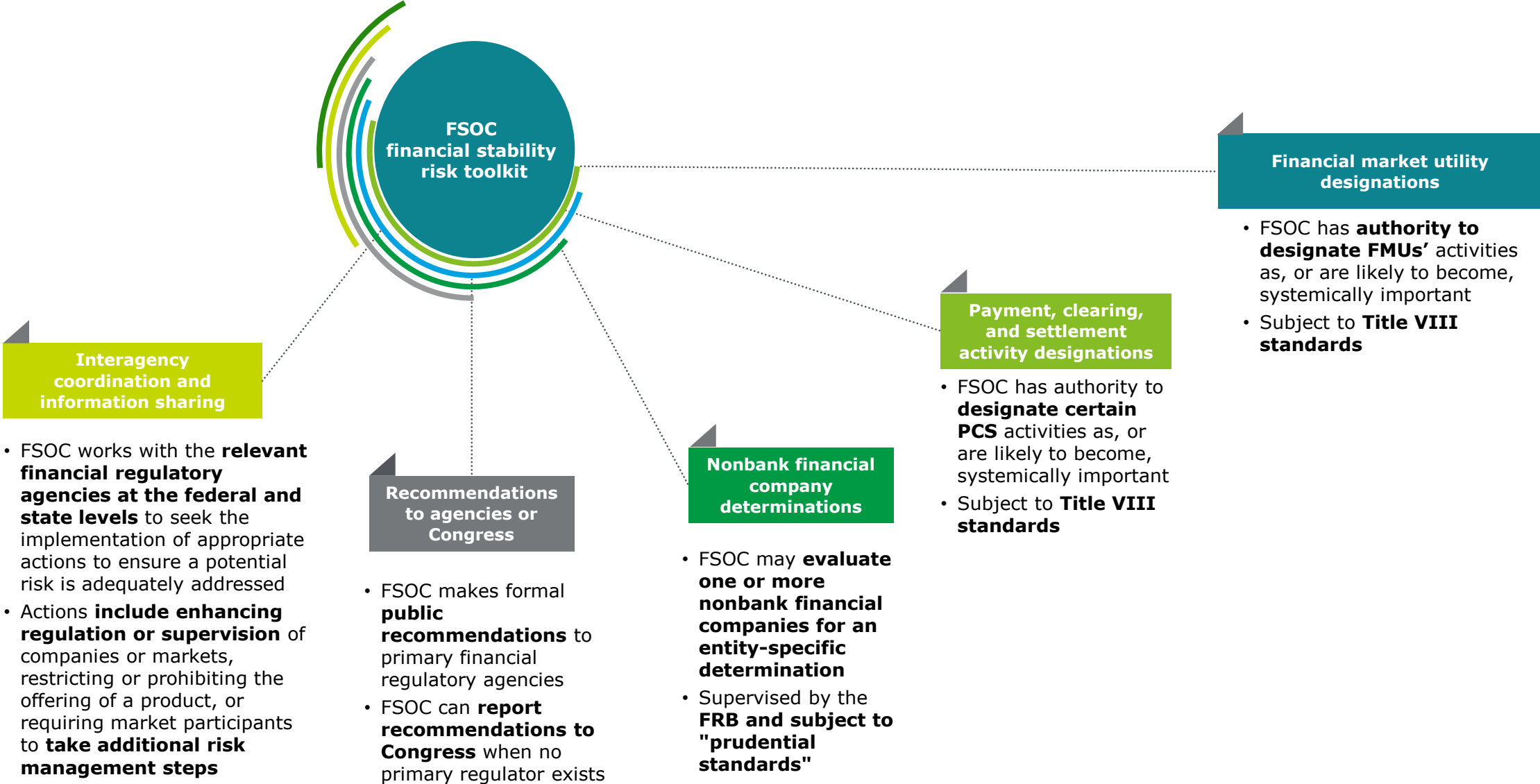
# How FSOC will assess institutions and markets for transmission risk

The Analytic Framework maintains the proposed four "transmission channels" which are most likely to spread the negative impacts of a risk to financial stability. It further identifies relevant vulnerabilities for each channel and includes detailed discussions and analyses. Importantly, the Analytic Framework differentiates between risks from third-party managed assets and those owned by the company.

	Proposal Description	Description Changes in Final Analytic Framework	Identified Vulnerabilities
<b>1 Exposures</b>	<ul style="list-style-type: none"> <li>Direct and indirect exposures of market participants to creditors, counterparties, and investors</li> </ul>	<ul style="list-style-type: none"> <li><b>Adds</b> description of financial instruments or asset class (equity, debt, derivatives, or securities financing transactions)</li> <li><b>Adds</b> risks arising from exposures to managed assets on behalf of third parties distinct from exposures to assets owned by, or liabilities issued by, the company itself</li> </ul>	<ul style="list-style-type: none"> <li> <b>Leverage</b></li> <li> <b>Interconnections</b></li> <li> <b>Concentration</b></li> </ul>
<b>2 Asset liquidation</b>	<ul style="list-style-type: none"> <li>Rapid liquidation of financial assets</li> </ul>	<ul style="list-style-type: none"> <li><b>Adds</b> description of amounts/types of short-term liabilities, amounts of assets that could rapidly liquidated, and potential effects of rapid asset liquidation on markets and market participants</li> <li><b>Adds</b> description of potential actions taken by market participants or financial regulators to impose stays on counterparty terminations or withdrawals</li> </ul>	<ul style="list-style-type: none"> <li> <b>Leverage</b></li> <li> <b>Liquidity risk and maturity mismatch</b></li> </ul>
<b>3 Critical function or service</b>	<ul style="list-style-type: none"> <li>Disruption of a critical function or service that is relied upon by market participants and for which there are no ready substitutes that could provide the function or service at a similar price and quantity</li> </ul>	<ul style="list-style-type: none"> <li><b>Adds</b> description of scenario where a small number of entities are dominant providers of critical services that are essential to US financial stability</li> <li><b>Adds</b> description of scenario where providers of a critical function or service are likely to experience stress at the same time because they are exposed to the same risks, and the increased concern about a potential lack of substitutability</li> </ul>	<ul style="list-style-type: none"> <li> <b>Interconnections</b></li> <li> <b>Operational Risk</b></li> <li> <b>Concentration</b></li> </ul>
<b>4 Contagion</b>	<ul style="list-style-type: none"> <li>Rapid spread of systemic (credit, price, liquidity) stress, from a perception of common vulnerabilities or exposures, such as business models or asset holdings that are similar or highly concentrated</li> </ul>	<ul style="list-style-type: none"> <li><b>No additional details</b> in final Analytical Framework</li> </ul>	<ul style="list-style-type: none"> <li> <b>Interconnections</b></li> <li> <b>Complexity or opacity</b></li> </ul>

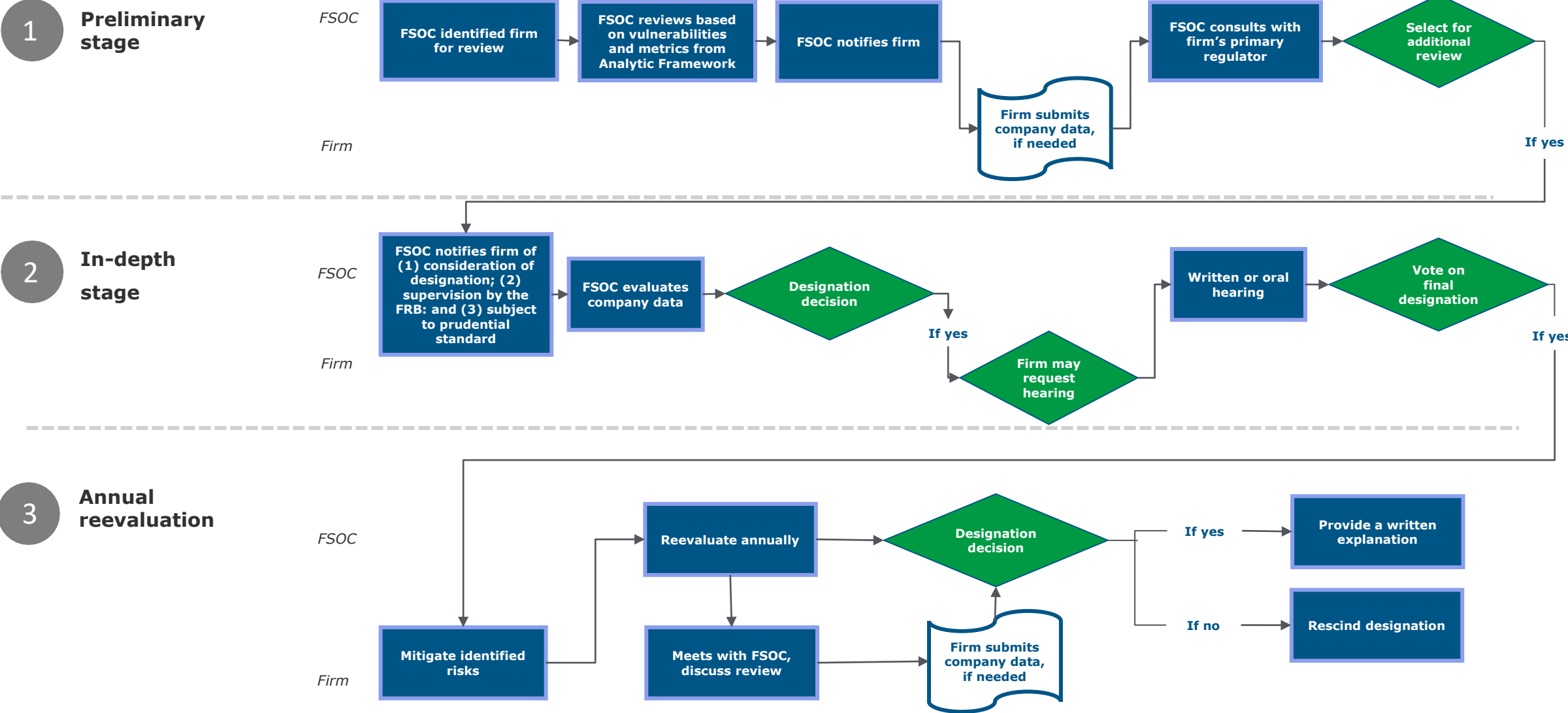
# How FSOC can address financial stability risk

Once a risk has been identified, FSOC may take different approaches to respond and may use multiple tools to mitigate a risk, depending on the circumstances.



# Process for designating a non-bank as a risk to financial stability

Under the finalized Guidance, FSOC would generally expect to follow a two-stage process of evaluation and analysis when determining whether a NBFC should be subject to FRB supervision and prudential standards.<sup>18</sup>



# Potential impacts of designation | Required capability uplift

To the extent that bank-like risk management functions and capabilities are not present or not yet sufficiently operational, NBFCs would need to work towards building out the necessary capabilities based upon their business profile, operational interconnectedness, and client base.<sup>19</sup> Below is a high-level view of the key capabilities that regulators would expect from a designated NBFC. FSO could expect the following capabilities at an enterprise or holding company level, not just at the operating company level (e.g., fund companies).

Capabilities	Illustrative Incremental Requirements
<b>Governance</b>	<ul style="list-style-type: none"> <li>• Develop an effective corporate governance framework including policies, procedures, trainings, and communications to establish and maintain the firm’s culture, incentives, structure, and processes that promote its compliance with laws, regulations, and supervisory guidance.</li> <li>• Document roles and responsibilities across the three lines of defense.</li> </ul>
<b>Compliance</b>	<ul style="list-style-type: none"> <li>• Establish a (firmwide) compliance risk management program to manage compliance risk at an organization level and have an aggregate view of the organization’s compliance risk exposure and an integrated approach to managing those risks.</li> <li>• Establish controls that effectively identify and address compliance risks that transcend business lines, legal entities, and jurisdictions of operation.</li> </ul>
<b>Risk Management Framework</b>	<ul style="list-style-type: none"> <li>• Establish the components of the risk management framework including risk governance, risk appetite, risk limits, risk management process, risk monitoring and reporting, risk documentation, and ongoing maintenance.</li> <li>• Assess ability to manage fiduciary risk dimensions which is a key area of enterprise capability.</li> </ul>
<b>Financial Risk Management</b>	<ul style="list-style-type: none"> <li>• Establish processes to monitor, identify, measure, assess and report financial risks including credit risk, market risk, liquidity risk, interest rate risk.</li> <li>• Develop capability to conduct regular internal stress tests.</li> </ul>
<b>Non-Financial Risk Management</b>	<ul style="list-style-type: none"> <li>• Establish processes to monitor, identify, measure, assess and report non-financial risks.</li> <li>• Develop a risk and control self-assessments (RCSA) framework for the identification, analysis, and management of operational or non-financial risks.</li> </ul>
<b>Treasury</b>	<ul style="list-style-type: none"> <li>• Establish an asset and liability management (ALM) framework including policies, procedures and processes (including forecasting and stress testing capabilities, liquidity monitoring tools, asset liability management policy and processes) to maintain strong liquidity positions commensurate with the organization’s unique risks under normal and stressful conditions.</li> <li>• Establish process for setting liquidity goals that are approved by the Board of Directors.</li> <li>• Maintain sound liquidity risk measurement and modeling capabilities, supported by data collection and analysis, independent validation, and effective governance, policies, and controls.</li> <li>• Establish a capital framework across regulated/non-regulated entities/associated management information systems (MIS).</li> <li>• Potential for capital requirements (e.g., leverage limitations, stress testing, and other enhanced prudential standards).</li> </ul>
<b>Finance &amp; Reporting</b>	<ul style="list-style-type: none"> <li>• Potential for regulatory reporting considerations on a consolidated level.</li> <li>• Draft financial MIS that provides business, legal entity, and consolidated views – highlighting intercompany flows, regulated and non-regulated entities, and capital requirements.</li> <li>• Draft process for monitoring of applicable reports as well as maintaining on regulatory reporting inventory.</li> </ul>

# NBFCs to be subject to similar expectations from Title VIII of the DFA

Title VIII of the DFA was enacted to mitigate systemic risk in the financial system and to promote financial stability, in part, through enhanced supervision of FMUs designated as systemically important by the FSOC.<sup>20</sup> Federal regulators have significant authorities over designated NBFCs, which would increase supervisory oversight and interaction.

Impacts	Description
<b>Risk Management Standards</b>	<ul style="list-style-type: none"> <li>• FRB may prescribe risk-management standards for designated FMUs for which the FRB or another federal banking agency is the supervisory agency governing the operations related to the payment, clearing, and settlement activities of designated FMUs; and the conduct of designated activities by financial institutions.</li> <li>• The objectives and principles for the risk management standards is to (1) promote risk management; (2) promote safety and soundness; (3) reduce systemic risks; and (4) support the stability of the broader financial system.</li> </ul>
<b>Examinations and Enforcement Actions</b>	<ul style="list-style-type: none"> <li>• Be subject to examinations at least once annually focusing on the following:               <ul style="list-style-type: none"> <li>○ The nature of the operations of, and the risks borne by, the designated FMU;</li> <li>○ The financial and operational risks presented to financial institutions, critical markets, or the broader financial system;</li> <li>○ The resources and capabilities of the designated FMU to monitor and control such risks;</li> <li>○ The safety and soundness of the designated FMU; and</li> <li>○ The designated financial market utility's compliance with the rules prescribed in the DFA.</li> </ul> </li> <li>○ Be subject to any enforcement actions taken against designated FMUs.</li> </ul>
<b>Changes to Rules, Procedures or Operations</b>	<ul style="list-style-type: none"> <li>• A designated FMU shall provide notice 60 days in advance to its supervisory agency of any proposed change to its rules, procedures, or operations that could materially affect, the nature or level of risks it presents.</li> <li>• The notice of a proposed change shall describe:               <ul style="list-style-type: none"> <li>○ The nature of the change and expected effects on risks to the designated FMU, its participants, or the market; and</li> <li>○ How the designated FMU plans to manage any identified risks.</li> </ul> </li> <li>• The supervisory agency may require a designated FMU to provide any information necessary to assess the effect the proposed change would have on the nature or level of risks associated with the designated FMU's payment, clearing, or settlement activities and the sufficiency of any proposed risk management techniques.</li> <li>• The supervisory agency might object to the changes and a designated FMU shall not implement those changes.</li> <li>• A designated FMU may implement a change that will otherwise require advance notice if it determines that an emergency exists; such changes would require a notice within 24 hours and describe the nature of the emergency.</li> </ul>
<b>Federal Reserve Account and services</b>	<ul style="list-style-type: none"> <li>• A Federal Reserve Bank may be authorized to establish and maintain an account for a designated FMU and provide certain services to the designated FMU.</li> </ul>
<b>Earnings on Federal Reserve Balances</b>	<ul style="list-style-type: none"> <li>• A Federal Reserve Bank may be authorized to pay earnings on balances maintained by, or on behalf of, a designated FMU in the same manner and to the same extent as the Reserve Bank may pay earnings to a depository institution.</li> </ul>
<b>Service Providers</b>	<ul style="list-style-type: none"> <li>• Whenever a service integral to the operation of a designated FMU is performed by another entity, whether an affiliate or non-affiliate and whether on or off the premises, the supervisory agency may examine whether the provision of that service is in compliance with applicable law, rules, orders, and standards to the same extent as if the designated FMU were performing the service on its own premises.</li> </ul>

# Next steps

***Firms which will be subject to an FSOC NBFC designation should consider and be prepared for an overall enterprise risk, compliance, and risk management review, including:***

- Preparation for **sharp scrutiny by examiners through their safety and soundness” lens with emphasis on financial stability and interconnectedness.**
- Ability to defend the **size and nature of the activities** in relation to vulnerabilities and transmission channels FSOC identified.
- **Simplification of complex legal structures**, especially for large size or scope of activities, intricate legal or operational structures, activities or entities governed by multiple regulators, and complex funding arrangements.
- **Extent of intercompany or inter-affiliate dependencies** for liquidity, funding, operations, and risk management.
- Ability to explain and document **critical function or service** that is relied upon by market participants and what alternate measures are in place to manage disruptions.
- Ability to articulate and explain how **enterprise risk management, firm-wide compliance and governance are currently functioning within the organization.**
  - Explain what controls and risk mitigating measures are in place, especially in case activities result in financial interconnections between creditors, counterparties, investors, and borrowers or intercompany/inter-affiliate dependencies.
  - Ability to identify, measure, assess and report financial and non-financial risks including credit risk, market risk, liquidity risk, and interest rate risk.
  - Sound ALM framework and liquidity risk measurement and modeling capabilities.
  - Accounting policies at a level of detail that covers roles and responsibilities across financial reporting process, as well as process for monitoring of applicable reports and maintaining of regulatory reporting inventory.

**Appendix**





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