Financial Stability Oversight Council Process

Two paths FSOC could take to reform MMMFs:

1. **Recommend that the SEC under Section 120 of Dodd-Frank adopt heightened prudential standards for MMMFs.**
2. **Designate large MMMFs or their sponsors as Systemically Important Financial Institutions (SIFIs).**

PATH 1 — Recommend that the SEC under Section 120 of Dodd-Frank adopt heightened prudential standards for MMMFs.

FSOC can make recommendations to primary financial regulatory agencies, such as the SEC, to apply new or heightened standards and safeguards for financial activities or practices conducted by a bank holding company (BHC) or a nonbank financial company.

STEP 1 — Determine that the conduct, scope, nature, size, scale, concentration, or interconnectedness creates or increases the risk of liquidity, credit, or other problems in banks, nonbank financials, and the broader financial markets.

STEP 2 — Determine that a MMMF is a nonbank financial company.

A nonbank financial company is one that is predominantly engaged in financial activities.
A company predominantly engaged in financial activities derives 85% of its annual gross revenues from financial activities according to Section 4(k) of the Bank Holding Company Act and attributes 85% of its assets to financial activities.

Given that rules are not yet final, it is still unclear whether MMMFs are considered to be predominantly engaged in financial activities.

When the rules are final, if the MMMF is considered predominantly engaged in financial activities, FSOC could move forward. If the MMMF is not predominantly engaged in financial activities, FSOC could not use this path.

If FSOC moves forward ...

STEP 3 — Consult with the SEC as it drafts the recommendations.

STEP 4 — Take into account any costs to long-term economic growth.

STEP 5 — Publish recommendations for public comment.

STEP 6 — Provide recommendations to the SEC.

SEC has 3 choices:

1. Impose the recommended standards to a rulemaking, subject to notice and comment.
2. Impose similar standards to a rulemaking, subject to notice and comment.
3. Comment back to FSOC (within 90 days) with explanation why recommendations are not implemented.

Possible Recommendations: Prescribe the conduct of the activity or practice (i.e., limit the scope of investments, and/or require particular capital or risk management practices) or prohibit the activity.

STEP 7 — Report back to Congress.

PATH 2 — Designate large MMMFs or their sponsors as SIFIs.

STEP 1

Evaluating Companies

To be evaluated, companies must have at least $50 billion in consolidated assets and at least one of the following:

- $30 billion in gross notional credit default swaps
- $3.5 billion in derivatives liabilities
- $20 billion in total debt outstanding
- Leverage ratio of 15:1 or greater
- Short-term debt in excess of 10% of total assets

However, FSOC reserves the right to subject any nonbank financial company to further review if it believes that additional analysis is needed.

Evaluating Funds

Designation at the fund level:

- May be able to aggregate the funds that are managed by the same adviser.
- Would be subject to the terms of the final rule on the definition of primarily engaged in financial activities; final rule could also impact whether sponsors are nonbank financial companies.

STEP 2 — Consult with the SEC as it drafts the recommendations.

STEP 3 — FSOC requests information from the company and gives the company the opportunity to explain why it should not be designated as a SIFI. *FSOC does not explain why a company is considered.*

STEP 4 — FSOC decides to end consideration or issue preliminary SIFI designation, including the basis of determination.

- 4.1: Company has the opportunity for a hearing before FSOC.
- 4.2: FSOC makes final designation.

IF DESIGNATED ➤ Subject to the Federal Reserve Board's enhanced prudential standard regulations:

- Capital requirements
- Liquidity requirements
- Single counterparty credit exposure limitations
- Stress testing
- Resolution plan requirements
- Early remediation requirements

STATUS: The Fed's Definition of Predominantly Engaged in Financial Activities

- Rule proposed in February 2011.
- In the April 2012 revision to the proposal to define financial activities under Section 4(k) of the Bank Holding Company Act, "organizing, sponsoring, and managing a mutual fund" is interpreted to be a financial activity.
- **Rule is not yet final.**

STATUS: The Fed's Enhanced Prudential Standards Rule

- Rule proposed in January 2012.
- Oriented to large BHCs, not SIFIs.
- The Fed suggested it would tailor the rule on a case-by-case basis for designated companies.
- **Rule is not yet final.**

Key Terms

FSOC–Financial Stability Oversight Council

BHC–Bank Holding Company

SEC–Securities and Exchange Commission

MMMF–Money Market Mutual Fund

SIFI–Systemically Important Financial Institution