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Rethinking the Financial Stability Oversight Council

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RETHINKING THE FINANCIAL STABILITY OVERSIGHT COUNCIL

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ABSTRACT

New major existential challenges are threatening the U.S. financial system. Climate change, cyber risk, the evolving role of digital assets, and vulnerabilities in nonbank financial intermediation call for prompt collective responses by financial regulators. However, the existing U.S. financial macroprudential regulatory architecture seems not to be up to the task because of "architectural vulnerabilities" that undermine its proper functioning.

The Financial Stability Oversight Council (FSOC) is a multiagency authority created by the Dodd-Frank Act to mitigate systemic risk by coordinating the actions of U.S. financial regulators. It was envisioned as a macroprudential authority to stabilize the financial system. FSOC was given the power to designate systemically important entities and activities and to trigger a novel back-up regulatory and supervisory authority of the

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Federal Reserve (Fed), what I call the Regulator of Last Resort (ROLR) function.

This Article shows that FSOC, in its current structure, is not up to the challenges facing the U.S. financial system. Offering a novel political economy account to its operations and structure, the Article shows that architectural vulnerabilities in the FSOC design exposes it to political cyclicality—which undermines its operations, deprives the markets of a critical watchdog, and compromises the operation of the Fed as ROLR.

This Article proposes incrementalistic and marginal policy solutions to this problem. Congress should fix the architectural vulnerabilities of the FSOC by adopting a different leadership structure. Building on the comparative experience of the U.K. and the E.U., the Articles proposes two alternative options: upgrading the current leadership of the Council to a Co-Chair role of the Fed Chair and the Treasury Secretary; or alternatively, creating a new Systemic Risk Council withing the Fed as a novel macroprudential authority.

> *"...It is one of the proper functions of academics regularly to reassess and to challenge the legitimacy and value of existing institutional arrangements."*[1]

INTRODUCTION

ON March 31, 2021, during her first remarks as Chair of the Financial Stability Oversight Council ("FSOC" or "Council"), Secretary Janet L. Yellen, addressing the heads of all major federal financial regulators, firmly said that the FSOC's "task is to guard the nation's financial system" and that prompt coordinated actions are needed to address new dangerous challenges faced by the U.S. economy.[2] She then went on to stress the importance of revitalizing the operations of the Council, which underwent a radical downsizing during the Trump administration, and warned that a "collective effort" is needed to address new existential threats to financial stability.[3]

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1 CHARLES A.E. GOODHART, THE CENTRAL BANK AND THE FINANCIAL SYSTEM ix (1995).

2 Janet L. Yellen, U.S. Secretary of the Treasury, Remarks at the Open Session of the Meeting of the Financial Stability Oversight Council (Mar. 31, 2021), https://home.treasury.gov/news/press-releases/jy0092.

3 *Id.*

As of March 2022, the FSOC's agenda reflects this call to action. Acting on President Biden's executive orders on climate-related financial risks[4] and on digital assets,[5] the FSOC has started analyzing the effects of climate-related risk and digital assets on financial stability and exploring possible coordinated regulatory responses to such problems.[6] In addition, the FSOC is investigating two market segments that suffered severe distress during the COVID-19 crisis and required a strong public back-stop: the U.S. Treasury markets and the nonbank financial intermediation sector, what the media generally refers to as "shadow banking,"[7] with a specific focus on money market mutual funds ("MMMF").

So, what is the FSOC and what role does it play in the U.S. financial regulatory architecture? How was it meant to operate in the U.S. financial architecture? Why are policymakers and commentators calling on the FSOC to coordinate the response against the rising risk of cross-sectoral risks in the financial system? And why, despite its current initiatives in resetting a new regulatory agenda, would the FSOC still benefit from being re-envisioned both structurally and procedurally? [8]

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4 Exec. Order No. 14,030, 86 C.F.R. 27967, 27968 (2021) (directing the FSOC to assess the climate-related financial risk to financial stability of the U.S. and to facilitate the sharing of data among federal agencies about climate-related financial risk and to ultimately coordinate the adoption of regulatory measures to address the climate by federal financial regulators).

5 Exec. Order No. 14,067, 87 C.F.R. 14143, 14148 (2022) (directing the FSOC to produce a report outlining the specific financial stability risks and regulatory gaps posed by various types of digital assets and providing recommendations to address such risks).

6 Fin. Stability Oversight Council, Minutes of the Financial Stability Oversight Council (June 11, 2021), https://home.treasury.gov/system/files/261/FSOC_Minutes_6-11-21_1.pdf; Fin. Stability Oversight Council, Minutes of the Financial Stability Oversight Council (Mar. 31, 2021), https://home.treasury.gov/system/files/261/FSOC_Minutes_6-11-21.pdf.

7 Shadow banking generally refers to the unregulated system of credit and financial intermediation occurring outside the formal banking system. Policymakers tend to use the more neutral concept of "nonbank financial intermediation." *See* Tobias Adrian and Bradley Jones, *Shadow Banking and Market Based Finance* 13, *in* INTERNATIONAL MONETARY FUND DEPARTMENT PAPERS (2018); Zoltan Pozsar et al., *Shadow Banking*, 19 FRBNY ECON. POL'Y REV. 1 (2013).

8 Extensive literature has focused on FSOC and on the macroprudential financial architecture built by the Dodd-Frank Act in 2010. For an overview of the literature, see, e.g., Hilary J. Allen, *Putting the "Financial Stability" in Financial Stability Oversight Council*, 76 OHIO ST. L.J. 1087, 1113-1152 (2015) (arguing for the creation of a standalone financial stability regulator); GREGG GELZINIS, CTR. FOR AM. PROGRESS, STRENGTHENING THE REGULATION AND OVERSIGHT OF SHADOW BANKS: REVITALIZING THE FINANCIAL STABILITY OVERSIGHT COUNCIL 33-44 (July 2019) (offering policy proposals to strengthening the FSOC's actions); Jeffrey N. Gordon, *"Dynamic Precaution" in Maintaining Financial Stability: The Importance of FSOC*, *in* TEN YEARS AFTER THE CRASH 144 (Sharyn O'Halloran & Thomas Groll eds., 2019) (highlighting the important role of the FSOC as a systemic risk regulator); Jeremy C. Kress et al., *Regulating Entities and Activities: Complementary*

The Dodd-Frank Wall Street Reform and Consumer Protection Act[9] ("Dodd-Frank" or "the Dodd-Frank Act")—the most extensive piece of financial regulation after the New Deal era reforms—structurally reformed the U.S. financial system and partially re-envisioned the balkanized U.S. regulatory architecture.[10] The 2008 financial crisis revealed how the existing regulatory structure of financial markets, with multiple agencies sharing jurisdiction over overlapping market segments and operating under rigid yet blurred jurisdictional classifications, undermined regulators' capacity to effectively tackle the market and government failures[11] that fueled the building up of systemic risk[12] and encouraged regulatory arbitrage opportunities for financial institutions.[13] Policymakers acknowledged the inadequacy of the existing fragmented and siloed regulatory system in keeping pace with modern finance and the incapacity of individual regulators to fully understand, regulate, and

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Approaches to Nonbank Systemic Risk, 92 S. CAL. L. REV. 1455, 1472-1525 (2019) (offering an insightful analysis of the delicate entity-based versus activity-based approaches to systemic risk); Daniel Schwarcz & David Zaring, *Regulation by Threat: Dodd-Frank and the Nonbank Problem*, 84 U. CHI. L. REV. 1813, 1834-1864 (2017) (providing a novel analysis of the power of the FSOC designation authority); Christina Parajon Skinner, *Regulating Nonbanks: A Plan for SIFI Lite*, 105 GEO. L.J. 1379, 1417-1432 (2017) (arguing for a gradual designation authority for SIFI); Adam J. White, *Too Big for Administrative Law?: FSOC Designations and the Fog of "Systemic Risk"* (The C. Boyden Gray Ctr. for the Study of the Admin. State Working Paper Series, Dec. 9, 2016) (providing an insightful analysis of the evolution of the statutory and regulatory framework of the FSOC); Robert F. Weber, *The FSOC's Designation Program as a Case Study of the New Administrative Law of Financial Supervision*, 36 YALE J. ON REGUL. 359 (2019) (providing an insightful analysis of the administrative process within the FSOC).

9 12 U.S.C. § 5301 *et seq.*

10 U.S. GOV'T ACCOUNTABILITY OFF., GAO-16-175, FINANCIAL REGULATION: COMPLEX AND FRAGMENTED STRUCTURE COULD BE STREAMLINED TO IMPROVE EFFECTIVENESS 9-85 (2016); MARC LABONTE, CONG. RSCH. SERV., R44918, WHO REGULATES WHOM? AN OVERVIEW OF THE U.S. FINANCIAL REGULATORY FRAMEWORK 2-10 (2020).

11 *See, e.g.*, JOHN ARMOUR ET AL., PRINCIPLES OF FINANCIAL REGULATION 445–48 (2016); MICHAEL S. BARR ET AL., FINANCIAL REGULATION: LAW & POLICY 59–62 (2d ed. 2018); KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS, 25–27, 69–75 (2011); Daniel Schwarcz & Steven L. Schwarcz, *Regulating Systemic Risk in Insurance*, 81 U. CHI. L. REV. 1569, 1601 (2014).

12 Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 198–204 (2008) (attempting to define systemic risk). *See also* HAL S. SCOTT, CONNECTEDNESS AND CONTAGION: PROTECTING THE FINANCIAL SYSTEM FROM PANICS 1 (2016) (identifying three main components of systemic risk: connectedness, contagion, and correlation); *see generally* THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL CRISIS IN THE UNITED STATES 27-31 (2011) (exploring the causes of the 2008 crisis).

13 *See, e.g.*, John C. Coffee, Jr., *The Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019, 1057 (2012).

supervise entities and activities that crossed their jurisdictional boundaries.[14] For these reasons, they proceeded to reform the financial architecture. Congress decided to create a new agency, the FSOC, as the systemic and macroprudential financial authority intended to fill the gaps and level the overlaps in the U.S. regulatory framework and to provide a forward-looking and holistic approach to regulating and supervising in the face of rising threats to financial stability.

Structured as a multi-member agency housed within the Treasury Department and chaired by its Secretary,[15] the FSOC was envisioned as a coordinating mechanism for the many federal financial regulators to effectively address systemic and cross-sectoral risks[16] and as a scout for new threats to financial stability.[17] However, in its ten years of existence, the FSOC has been the target of much criticism. On one side, it was dubbed as an activist and over-reaching entity operating under an overbroad administrative delegation and using legally questionable administrative procedures.[18] On the other,

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14 *See* U.S. DEPARTMENT OF THE TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE 3-5 (2008) [hereinafter PAULSON'S REPORT] ; U.S. DEPARTMENT OF THE TREASURY, U.S. TREASURY FINANCIAL REGULATION REFORM – A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 5-6 (2009) [hereinafter GEITHNER'S REPORT]; Elisabeth F. Brown, *Prior Proposals to Consolidate Federal Financial Regulators*, THE VOLCKER ALLIANCE (Apr. 20, 2015), https://perma.cc/8A9E-UQ7W (providing a comprehensive analysis of proposals to consolidate the federal financial regulation since 1915). For academic proposals, see e.g., Howell E. Jackson, *A Pragmatic Approach to the Phased Consolidation of Financial Regulation in the United States* (Harvard Law Sch. Pub. Law & Legal Theory Working Paper Series, Paper No. 09-19, 2008), https://perma.cc/S54N-JXBW.

15 GEITHNER'S REPORT, *supra* note 14. A first initiative to create a forum to coordinate regulators' actions and share information among agencies was the President's Working Group, established to address and evaluate systemic threats to the U.S. markets and economy.

16 *See, e.g.*, Jim Rossi & Jody Freeman, 125 HARV. L. REV. *Agency Coordination in Shared Regulatory Space*, 1131 (2012).

17 Cross-sectoral risks are risk that cannot be contained in a specific market segment and that spills across jurisdictional boundaries. *See Eric J. Pan, Structural Reform of Financial Regulation,* 19 TRANSNAT'L L. & CONTEMP. PROBS. 796, 817 (2011).

18 *See* White, *supra* note 8, at 29-42; *Oversight of the Financial Stability Oversight Council: Due Process and Transparency in Non-Bank SIFI Designations: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Fin. Servs.*, 114th Cong (2015) [hereinafter *FSOC Hearing*] (statement of Jonathan R. Macey) (arguing that the FSOC designation authority can face two types of errors: type one errors—FSOC does not designate as systemically important what actually is systemically important—and type two errors— the FSOC does designate as systemically important what actually is not systemically important); *id.* (statement of Hal S. Scott) (calling for a revision of the nonbank SIFI designation process that provides the public and the potential designee with adequate transparency, including cost-benefit analysis); *id.* (statement of Adam J. White) (analyzing the constitutional claim of the

commentators challenged its inactivism, when, under a different leadership, the Council slowed its operation.[19] Simply, the FSOC has exhibited "architectural vulnerabilities" that undermine its operation, causing what was envisioned as a safehouse against systemic risks to instead function only intermittently and ineffectively. Scholars have written extensively on the U.S. financial regulatory architecture and on the FSOC, but this Article takes a novel perspective on these issues. It argues that even well-intended institutions can collapse if weakened by design flaws. The FSOC is a timely and critical example of how a potentially innovative and reformative institution can fall victim to its own architectural vulnerabilities. This Article analyzes an important yet overlooked strength of the FSOC regulatory framework—the regime of the Board of Governors of the Federal Reserve System ("Fed") as a "regulator of last resort"("ROLR")—but it also shows how weaknesses in the Council's structure—namely its high political cyclicality, which exposed it to volatile leadership[20]—render this potentially innovative regulatory tool vulnerable to instability.[21] The U.S. economy is facing the rise of new risks: climate risk, cyber risks, and the unknown risks connected to digital assets. All of these risks transcend the traditional jurisdictional barriers of financial regulators and demonstrate the shortcomings of the existing financial regulatory architecture. The FSOC could be the solution to the challenges posed by modern finance and the new impelling cross-sectoral risks, but it needs to be reformed to be effective and to support the stability of our financial system. Thus, this Article offers some incrementalistic and marginal policy proposals on how to strengthen this critical player in the U.S. financial regulatory architecture.

Cognizant of the costs associated with the nation's fragmented regulatory architecture—with three bank regulators, two market regulators, and some other federal and state financial regulators—and its magnificent failure to identify the buildup of risk in the financial system in the run-up to the 2008 financial crisis, lawmakers embraced the need to create a regulator to respond

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overbroad delegation of power to the FSOC). *But see id.* (statement of Robert Hockett) (stressing that the FSOC designation process is not an outlier but fits in the Administrative Procedure Act norms).

19 *See e.g.*, BETTER MARKETS, TEN YEARS OF DODD-FRANK AND FINANCIAL REFORM 58-60 (2020), https://perma.cc/7WZF-SZFL.

20 *See infra* Section II.B.; Part III. This Article analyzes and discusses the political cyclicality of the FSOC's structure as an architectural vulnerability that Dodd-Frank failed to properly account for, rather than a feature of the Council as a political entity. This Article also explores the option that the political cyclicality of the FSOC is actually a feature of the Council, that was intended to be a political entity in the U.S. financial architecture, open to political fluctuation depending on the outcome of election cycles.

21 *See infra* Section II.A.2.

to cross-sectoral risk, systemic risk, and regulatory arbitrage. The outcome of the political compromise was the FSOC in its current structure, a multi-member body, housed and led by the Treasury Secretary, responsible for promoting coordination among the multiple existing financial regulators and meant to holistically support financial stability and identify systemic threats.

To fulfill its mission, the FSOC was endowed with three main purposes: (1) identify existing and potential risk in the financial system; (2) promote market discipline; and (3) respond to emerging threats to financial stability.[22] These critical purposes were bound together with a unique regulatory toolkit. The FSOC has a singular designation function, namely, the FSOC can identify systemically important entities or activities that ought to be subject to enhanced regulatory and supervisory standards. This delicate and controversial power[23] transcends and potentially supersedes traditional jurisdictional boundaries of independent agencies.[24] In addition, the FSOC operates as a data-collection coordinator[25] and has the authority to recommend, support, and guide fellow federal regulators' regulatory and supervisory efforts. The FSOC is unique in its forward-looking, holistic and systemic mission; however, it was not given autonomous regulatory and supervisory power. The FSOC relies upon existing federal regulators to meet its goals and has a dialectic relationship with all "primary regulators" and the Fed.

But not all primary regulators are subject to the same treatment: a novel and grand role was assigned to the Fed. The Fed has seen its jurisdiction substantially expanded to potentially encompass the whole shadow banking system—i.e., nonbank financial intermediaries—and all systemically important financial entities, including the entire system of financial market utilities.[26] This policy approach set the premise to create a *de jure* and *de facto* regulator ROLR

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22 12 U.S.C. § 5322(a)(1).

23 *See FSOC Hearing*, *supra* note 18 (statements of Prof. Jonathan R. Macey, Prof. Hal S. Scott, Mr. Adam J. White, Prof. Robert Hockett).

24 *See, e.g.*, MARSHALL J. BREGER & GARY J. EDLES, INDEPENDENT AGENCIES IN THE UNITED STATES: LAW, STRUCTURE, AND POLITICS (2015); *see also infra* Section II.A.2. (discussing the FSOC designation process and the resulting allocation of regulatory and supervisory responsibilities).

25 The Office of Financial Resources is the designated agency responsible to act as an information hub. *See* 12 U.S.C. §§ 5342-5346.

26 The Fed was not new in serving as the "on call" regulator to address potentially systemic disturbances to the U.S. financial sector and asked to intervene outside the traditional banking sector. In 1998, the Fed Board of Governors and the New York Fed played a central role in concerting the private and industry-funded bailout of Long-Term Capital Management ("LTCM"), a hedge fund with highly leveraged derivatives positions. *See* Michael Fleming & Weiling Liu, *Near Failure of Long-Term Capital Management*, FED. RSRV. HIST. (Sept. 1998), https://www.federalreservehistory.org/essays/ltcm-near-failure#.

for the financial system.[27] In some instances, the Fed has received the ultimate authority to regulate and supervise systemically important nonbank financial entities ("nonbank SIFIs").[28] In other instances, the Fed was granted a role as back-up regulator, with all the interesting and delicate jurisdictional issues that might ensue.[29]

When drafting this new regulatory and supervisory structure for the U.S. financial system, lawmakers—perhaps naively or simply conditioned by the politics and leadership of the time—imagined an active and engaged FSOC. An FSOC that, under the steady leadership of the Treasury Secretary, regularly screened the markets for systemic risk, proactively coordinated the actions of the multiple financial agencies, and promptly designated, where needed, firms and activities as systemically important. The FSOC would then subject them to heightened prudential standards and appropriate oversight procedures.[30] But, lawmakers set overly optimistic expectations for the FSOC. Lawmakers might have underestimated the intrinsic political nature of the Council's leadership and its cyclical operations.[31] The change in the Council's political leadership, coupled with the systematic regulatory fatigue that independent agencies experienced in implementing their Dodd-Frank-delegated competencies,[32] have undermined the Council's productivity, depriving the U.S. financial system of a valuable watchdog.

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27 12 U.S.C. §§ 5325, 5464-5465. *See* Paolo Saguato, *Regulator of Last Resort* (2022) (on file with the author).

28 *Id.* § 5325 (outlining the enhanced supervision and prudential standards for nonbank financial companies supervised by the Board of Governors and certain bank holding companies; the Fed is the primary regulator and supervisor of bank SIFI, *id.* § 5327.

29 12 U.S.C. §§ 5461-5472 (setting the designation process and the enhanced supervisory and regulatory regime for systemically important financial market utilities ("SIFMUs"); *id.* §§ 5464–5465 (outlining the allocation of authority over SIFMUs between the Commodity Futures Trading Commission ("CFTC"), and the Securities Exchange Commission ("SEC") and the Fed; *id.* § 5464(a)(2) (setting the Fed concurring and residual jurisdiction over the supervision of and the setting prudential requirements for SIFMUs); *see* Paolo Saguato, *Systemic Market Utilities: Crypto Infrastructures and The Conundrum of Title VIII* (2022) (on file with the author).

30 *See* 12 U.S.C. §§ 5325, 5464.

31 *See* Christina Parajon Skinner, *Presidential Pendulums in Finance*, 20 COLUM. BUS. L. REV. 532, 534 (2020) (describing the role of the executive branch in deregulating the financial system and the impact on financial cycles); Philip A. Wallach, *The Pendulum is the Pits: Can the United States Make Enduring Regulations?*, BROOKINGS REPORT (2020), perma.cc/6GMM-L4V4 (discussing the costs to regulatory programs and to regulatory stability due to extreme policy partisanship in the administrative state).

32 *See, e.g.*, Sharon B. Jacobs*, The Administrative State's Passive Virtues*, 66 ADMIN. L. REV. 565, 598 (2014) (noting even the European Union's experience with regulatory fatigue in addition to the U.S. sentiments about Dodd-Frank rulemakings).

The institutional approach to the regulation of systemic risk—meant to structurally improve the U.S. financial architecture—relied primarily on the concerted actions of the FSOC, the Fed as a ROLR, and the other primary regulators, primarily the Securities and Exchange Commission ("SEC") and the Commodities Futures Trading Commission ("CFTC"). However, this system fell short of its expectations. If one of the major rationales for creating the FSOC was to identify and tackle sources of systemic risk[33]—particularly in the shadow banking system—and tackle "too-big-to-fail" institutions, then conditioning the Fed's regulatory and supervisory jurisdiction upon the actions of a "weak" agency undercut the reform's added value.[34] In fact, the Fed does not derive its ROLR authority from a direct legislative mandate. It only indirectly derives its ROLR authority as the result of the FSOC exercising its designation power.[35] Hence, the Fed's authority as ROLR depends on the FSOC's effective operations. Likewise, the FSOC's inaction might deprive the markets of the coordination mechanism necessary to address systemic risk and of the Fed's enhanced regulatory and supervisory apparatus.

In its ten years of existence, the FSOC's activities have followed the trend of a sine curve. After the initial uptick in its first years of operation and steady growth from the multiple designation decisions, the FSOC's activities embraced a downward trend that resulted in the Council conducting its bare minimum meetings. Only recently has that trend started to slope upward again.

During the first Obama administration, starting in 2011, the FSOC primarily focused on setting the regulatory foundations for future designations and adopting the necessary guidelines to designate financial firms as "systemically important."[36] During the second Obama administration, the FSOC was highly active. In early 2012, the FSOC designated eight systemically important financial market utilities ("SIFMUs")[37] and four nonbank SIFIs.[38] It

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33 *See* 12 U.S.C. § 5322(a)(1)(A)–(C).

34 *See id.* § 5469 (granting much of the necessary rulemaking to the Fed and the primary regulators, with the FSOC serving supervisory and advisory roles).

35 *See id.*; *see also* 12 U.S.C. § 5464(a)(1).

36 FIN. STABILITY OVERSIGHT COUNCIL, 2011 ANNUAL REPORT, LETTER FROM THE CHAIR (2011). Then-Chair Secretary Timothy Geithner stressed that the leadership in the financial sector needed to "establish and maintain much higher standards of integrity and a more sophisticated understanding of the risk inherent in the business of finance" to maintain a stable financial system. *Id.* at iv.

37 12 U.S.C. § 5326.

38 *See Designations*, U.S. DEP'T OF THE TREASURY, https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc/designations (last visited Mar. 15, 2022); FIN STABILITY OVERSIGHT COUNCIL, 2012 ANNUAL REPORT APPENDIX A (145) (2012), https://perma.cc/Z6CT-T9MW [hereinafter SIFMU Report].

also recommended that the SEC adopt more stringent prudential regulation for MMMFs.

During the Trump administration, the FSOC played a substantially downsized role. First, in early 2016, MetLife successfully challenged its designation as a nonbank SIFI in court.[39] The controversial rescission of the designation of all nonbank SIFIs (particularly AIG and Prudential) and the adoption of a more passive approach to the Council's role followed. The Trump FSOC's most proactive stance was adopting another controversial set of guidelines for the designation of nonbank SIFIs grounded in an activity-based approach.[40]

Finally, as previously mentioned, in Secretary Yellen's first year as Council Chair, the FSOC has undertaken new initiatives to investigate and plan actions against new rising existential threats to financial stability such as climate-related financial risk, risks in the digital assets space, and the longstanding fragilities in the MMMFs and in the Treasury markets. However, based on its 2021 annual report, the FSOC has not taken any formal actions to coordinate responses to existing threats to financial stability.[41]

One of the Dodd-Frank Act's main creations lost momentum because design flaws left it vulnerable to political cycles. In recent years, commentators have called for a new Dodd-Frank Act to complete the unfinished business of regulating systemic risk.[42] However, before lawmakers try to reinvent (or rebuild) the wheel via structural reforms, there is value in examining policy solutions to address the FSOC's design flaws. There are solutions that can be reached via incrementalistic and marginal adjustments to the existing legal foundation, which this Article explores.

This Article provides two main contributions to the literature. First, using a novel political economy account, it shows how architectural vulnerabilities undermine the actions of financial regulators. The FSOC is the ideal case study to apply such a theory. A recently established agency, equipped with an innovative regulatory instrument, the ROLR scheme, lost its effectiveness and legitimacy because of structural flaws in its design that make it a partisan player. Building on these findings, the Article offers incrementalistic and marginal

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39 FIN. STABILITY OVERSIGHT COUNCIL, 2016 ANNUAL REPORT 106-07 (2016).

40 Kress et al., *supra* note 8, 1478-79.

41 FIN. STABILITY OVERSIGHT COUNCIL, 2021 ANNUAL REPORT (2021), https://perma.cc/FZL5-ECU3.

42 Janet Yellen, Webinar: A decade of Dodd-Frank Co-hosted by the Brookings Institution and the Center on Finance, Law & Policy at the University of Michigan (June 30, 2020), https://www.brookings.edu/events/a-decade-of-dodd-frank/.

policy recommendations built upon insights from comparative experiences, in the U.K. and the E.U., to create a more effective FSOC.

This Article proceeds in three parts. Part I lays the foundation by examining the political economy of financial regulation, focusing on the who, why, and how of regulating the dynamic forces of financial markets and institutions. The U.S. financial regulatory architecture is unique in its (complex) structure and has been the target of multiple reform blueprints. Part II examines the existing U.S. regulatory architecture created by the Dodd-Frank Act and develops the FSOC case study. The legislative history shows how,[43] despite being the byproduct of a bipartisan compromise,[44] and within just ten years of existence, the FSOC has been the target of multiple reform attempts. A chronicle of the FSOC's activities shows how the architectural vulnerability in its organizational design has undermined its operations, eroding its effectiveness, accountability, and legitimacy.[45] And finally, this Part dives into an overlooked but critical component of the post-crisis regulatory apparatus, which relies on the proper functioning of the FSOC to fully operate and is weakened by the Council's architectural vulnerabilities: the ROLR scheme[46] and the interesting relationship between the FSOC and the Fed.[47] Part III frames the architectural vulnerabilities of the FSOC between technical expertise and independence, on one side, and political responsiveness, on the other. Part IV develops two alternative policy proposals that can address, with marginal reforms and without a complete overhaul of the system, the architectural vulnerabilities of the FSOC. Reforms are required to create an effective systemic risk regulator. Congress can either stabilize the FSOC by creating a co-chairpersonship of the Council to mitigate its political cyclicality or can re-house the FSOC within the Fed system, as a Systemic Risk Board based on the European model. These policy proposals are contextualized through the comparative experiences of the Financial Policy Committee at the

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43 *See infra* Section I.B.

44 *See* BEN S. BERNANKE, TIMOTHY F. GEITHNER, HENRY M. PAULSON, JR., FIREFIGHTING – THE FINANCIAL CRISIS AND ITS LESSON 115-16 (2019).

> We would have liked to see more restructuring of the antiquated financial regulatory system, a key element of [Paulson]'s original blueprint for reform, with the Fed in charge of monitoring systemic risk and several redundant agencies consolidated to create more consistency and accountability, but the political turf battles were daunting, and this felt like a war of choice rather than a war of necessity. The Fed faced a fierce backlash after the crisis, and Congress had no interest in giving it sweeping power.

45 *See* GELZINIS, *supra* note 8, at 13-22.

46 12 U.S.C. §§ 5325, 5464(a), 5465(a).

47 *Id.*

Bank of England and the European Systemic Risk Board within the European Central Bank.[48] In the end, this Article encourages policymakers to experiment with the existing regime of the ROLR as a possible solution to regulatory arbitrage risk and regulatory inactivity and as a path to achieve regulatory clarity in uncharted regulatory land.

I. UNDERSTANDING THE PROBLEM: DYNAMIC MARKETS IN A RIGID REGULATORY ENVIRONMENT

The 2008 global financial crisis and the turmoil in the financial system caused by the COVID-19 pandemic have revealed the struggle for a rigid financial administrative state in keeping pace with the financial markets' dynamism. On one side, the force of financial innovation has outpaced the capacity of regulators to keep up with the regulated industry.[49] On the other, the incentives of the deregulatory policies that lawmakers rolled out in the 1980s and 1990s fueled industry innovation, creating cross-sectoral markets and instruments.[50] Financial innovation has exploited the opportunities that regulatory gaps and overlaps created in the system to build and serve new markets.[51] New financial contracts were crafted to both manage and transfer risk,[52] and new services and instruments, that crossed the traditional conceptual and jurisdictional divides in the financial system—banking law, securities law, insurance law, and commodities and futures law—were rolled out in the markets.[53]

48 *See infra* Section IV.A.

49 *See, e.g.*, Michael S. Barr, *The Financial Crisis and the Path of Reform*, 29 YALE J. ON REG. 91, 99-100 (2012).

50 *See, e.g.*, Todd J. Zywicki, *An Economic Analysis of the Consumer Bankruptcy Crisis*, 99 NW. U.L. REV. 1463, 1480 (2005).

51 *See, e.g.*, Andrew F. Tuch, *The Remaking of Wall Street*, 7 HARV. BUS. L. REV. 315, 365-66 (2017) (noting that regulators lack sufficient information to oversee nonbank lenders' increasing importance).

52 Henry T. C. Hu, *Disclosure Universes and Modes of Information: Banks, Innovation, and Divergent Regulatory Quests*, 31 YALE J. ON REG. 565, 647 (2014).

53 Dan Awrey, *Regulating Financial Innovation: A More Principles-Based Proposal?*, 5 BROOK. J. CORP. FIN. & COM. L. (2011); Dan Awrey, *Towards a Supply-Side Theory of Financial Innovation*, 41 J. COMP. ECON. (2013).

A. Markets Outpaced Regulators: Regulatory Arbitrage and Systemic Risk

The existing U.S. financial regulatory architecture is the result of the stratification of numerous legislative interventions over the course of our nation's history[54] and is characterized by multiple agencies involved in financial regulation and supervision.[55] Interestingly, the structure of the U.S. financial regulatory system relies on jurisdictional silos—that often reflect the market structure at the time the specific financial agency was created to regulate and supervise the financial systems and its actors.

At the federal level, three different federal banking agencies, the Fed, the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC"), share the primary regulatory and supervisory responsibilities over U.S. financial institutions. And two market regulators overlook the financial markets: the SEC supports the efficient and orderly functioning of the U.S. capital markets, and the CFTC regulates and supervises the U.S. derivatives markets.

Financial regulatory agencies do not simply differ in their sphere of competence, they also have been allocated different authority by Congress. Banking authorities have been tasked (since the beginning) with a microprudential objective: assuring banks' financial resilience. The SEC and CFTC have traditionally and primarily focused on market structure, efficiency, and integrity of the markets, substantially relying on the self-regulation of market intermediaries to set their own prudential and organizational standards.[56]

Starting in the 1990s with the repeal of the famous Glass-Steagall Act[57] and consequent rise of financial conglomerates and the parallel development of the

54 The creation of new components of the U.S. financial architecture can be traced back to specific historical events: the OCC as a byproduct of the Civil War; the Fed as a response of the financial crisis of the early years of the twentieth century; the FDIC and the SEC as central pillars of the New Deal financial reforms to rebuild confidence in the financial system during the Great Depression; and finally, the FSOC and the OFR as results of the 2008 financial crisis and Dodd-Frank creations. *See* MICHAEL BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, FINANCIAL REGULATION LAW AND POLICY 92 (3d ed. 2021).

55 In addition to federal regulators, state financial agencies often provided additional financial regulation and supervision of the same sectors of the markets, and, in the case of the insurance markets, states are the primary regulators.

56 See JOHN ARMOUR, DAN AWREY, PAUL DAVIES, LUCA ENRIQUES, JEFFREY N. GORDON, COLIN MAYER, AND JENNIFER PAYNE, PRINCIPLES OF FINANCIAL REGULATION 539 (2016).

57 Banking Act of 1933, 48 Stat. 162 (1933).

over-the-counter derivatives markets and structured finance,[58] this regulatory architecture started showing its limits. In 1998, Long-Term Capital Management ("LTCM")—one of the largest hedge funds operating in the U.S. with a massive exposure on derivatives and short-term financing transactions—imploded because of significant failures in its risk management.[59] LTCM's failure showed some early structural vulnerabilities in the U.S. financial architecture. The SEC, LTCM's primary regulator, failed to spot the excessive leverage and off-balance-sheet exposures built up by LTCM.[60] Only too late did the New York Fed realize how interconnected LCTM was to other major financial institutions and how disastrous the effects of its failure would have been on the U.S. financial system. At that point, the only option left to avoid systemic disruption was to organize a private bail out financed by a consortium of creditor financial firms.[61]

The costs associated with systemic risk created by nonbank firms and their activities,[62] which leverage regulatory arbitrage opportunities, presented themselves again in a different format in 2008. In 2008, the burst of the subprime mortgage market bubble triggered the worst financial crisis since 1929. Again, the high jurisdictional fragmentation over the financial system hampered the capacity of regulators to catch the early signs of the crisis. As a result, regulators failed to either act preemptively or to respond promptly.[63]

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58 *See* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1591 (2005) (arguing that "[m]uch of the expansion of federal regulation of financial markets has . . . occur[red] after significant economic turmoil"); Larry Ribstein, *Bubble Laws*, 40 HOUS. L. REV. 77, 77-78 (2003) (describing the "centuries-old cycle of capital market booms followed by busts and regulation"); Stuart Banner, *What Causes New Securities Regulation?*, 300 Years of Evidence, 75 WASH. U. L.Q. 849, 850 (1997) (arguing that market crashes are the major drivers of new securities regulation).

59 Paul L. Lee, A Retrospective on the Demise of Long-Term Capital Management, THE CLS BLUE SKY BLOG (September 10, 2018) https://clsbluesky.law.columbia.edu/2018/09/10/a-retrospective-on-the-demise-of-long-term-capital-management/.

60 The President's Working Group on Financial Markets, Hedge Funds, Leverage, and The Lessons of Long-Term Capital Management 12 (1999).

61 Hedge Fund Operations: Hearing Before the H. Comm. on Banking and Financial Services, 105th Cong. 2 (1998) (statement of Rep. James Leach) (discussing for the first time the doctrine of "too-big-to-fail" applied to nonbank financial firms). *See, e.g.*, RICHARD J. HERRING & ROBERT E. LITAN, FINANCIAL REGULATION IN THE GLOBAL ECONOMY 95-107 (1995) (discussing systemic risk exclusively in the context of banking institutions).

62 Howell E. Jackson, *Regulation in a Multisectored Financial Services Industry: An Exploratory Essay*, 77 WASH. U. L.Q. 319, 333–34 (1999); Heidi Mandanis Schooner, *Regulating Risk Not Function*, 66 U. CIN. L. REV. 441, 442–43 (1998).

63 *See* ALAN S. BLINDER, AFTER THE MUSIC STOPPED – THE FINANCIAL CRISIS, THE RESPONSE, AND THE WORK AHEAD 275 (2013) (identifying the regulatory overlaps, regulatory gaps, and regulatory mismatch as the most pressing problems policymakers had to face in the aftermath of the 2008 crisis).

In February 2009, then-Treasury Secretary Timothy Geithner provided this snapshot of the U.S. financial system:

> Our financial system operated with large gaps in meaningful oversight, and without sufficient constraints to limit risk. Even institutions that were overseen by our complicated, overlapping system of multiple regulators put themselves in a position of extreme vulnerability. These failures helped lay the foundation for the worst economic crisis in generations.[64]

As sharply summarized by then-Treasury Secretary Timothy Geithner, the crisis revealed how financial firms were able to navigate through the gray areas of financial regulation and capitalize on regulatory arbitrage opportunities encouraged by the siloed structure of the federal financial regulatory system. The 2008 crisis revealed governmental and regulatory failures that, over the years, allowed modern finance to grow unchecked, and exposed regulators to the limits of the existing financial administrative state.[65] Regulators were incapable of identifying sources of financial instability and systemic risk and of overseeing the growth of the nonbank financial intermediation system[66]—the so-called shadow banking system.[67]

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64 Timothy Geithner, Treasury Secretary, Introducing the Financial Stability Plan (Feb. 10, 2009), https://www.treasury.gov/press-center/press-releases/Pages/tg18.aspx.

65 *See, e.g.*, FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINANCIAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES (2011). Regulatory failures were not the sole reason for the financial crisis, but it played a substantial role in supporting the shadow banking system's growth.

66 Testimony of Chairman Mary L. Shapiro, Securities and Exchange Commission, before the Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Securities, Insurance, and Investment, June 22, 2009, at http://www.banking.senate.gov/public/_cache/files/e039fcf3-b152-4abd-80e4-a7fcc14f8051/23C6AE00CC53D93492511CC7 44028B5E.schapirotestimony62209.pdf.

67 The shadow banking system is defined as a complex web of transactions and institutions that provide banking-like services through the medium of capital markets, operating outside of the traditional banking sector, and without being subject to prudential banking regulation. Shadow banks, including firms like Lehman Brothers, Bearn Stearns, and AIG engage in the business of maturity transformation like traditional banks but out of the sight of prudential banking supervision or regulators. Because they were intermediaries in the capital markets, they were able to opt into a regulatory and SEC, that proved to be ineffective and inadequate to mitigate and manage risk. Consolidated Supervised Entity ("CSE") Program administered by the SEC. *See* SEC. & EXCH. COMM'N, OFFICE OF THE INSPECTOR GEN, SEC'S OVERSIGHT OF BEAR STERNS AND RELATED ENTITIES: TIE CONSOLIDATED SUPERVISED ENTITY PROGRAM (2008), http://www.sec-oig.gov/Reports/AuditsInspections/2008/446-b.pdf.

Shadow banks were tightly stitched into the fabric of the financial system,[68] but regulators missed that. Because of their tentacular operations,[69] shadow banks and their activities reached all corners of the financial system, linking traditional regulated banks to financial markets and connecting the different segments of the financial system, which, up until the 1990s, were kept strictly separate by defined legislative and regulatory intent. The shadow banking system transformed what was considered sectoral financial risk into cross-sectoral and systemic risk. Correlation and connectedness between capital markets and banks exacerbated the costs of the crisis and caught regulators off-guard.

B. Facing the Realty of an Inadequate Financial Regulatory Architecture

As the 2008 crisis unfolded, policymakers acknowledged the structural flaws in the financial regulatory architecture and its inadequacy at adapting to modern finance. They recognized how the existing siloed approach to financial supervision and regulation fueled regulatory arbitrage opportunities.[70] The financial regulatory state faced the difficulty of instituting a coordinated and effective regulatory and supervisory program to tackle cross-sectoral issues and systemic risk. The complexity of modern financial markets and institutions directly challenged the siloed architecture of financial regulators, proving it not up to the challenges and realities of modern finance.

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68 The Dodd-Frank Act defined shadow banking and shadow banks as "nonbank financial entities and activities." 12 U.S.C. § 5311. The Financial Stability Board, an international standard setting body that that took the lead in supporting a coordinated approach across developed economies to the regulation of financial markets post-2008 crisis, defined shadow banking as with the broader and more neutral term "market-based finance." *See* Financial Stability Board, "Shadow Banking: Strengthening Oversight and Regulation," (Oct. 27, 2011), at 1, https://www.fsb.org/wp-content/uploads/r_111027a.pdf?page_moved=1.

69 Shadow banks were linked to the traditional banking sector and the real economy through different channels. They had a central role in producing mortgage-backed securities and were invested in securitized financial instruments linked to the U.S. real estate market. They operated as primary dealers in derivatives—primarily credit default swaps—which hedge against the very same structure products they originated and were exposed to. Additionally, shadow banks heavily relied on the short-term borrowing market—like commercial paper and repo markets—to finance operations; and had a central role as dealers in the repo market.

70 Regulatory arbitrage is a longstanding dynamic in a broad variety of financial regulatory settings. *See* Dan Awrey, *Complexity, Innovation, and the Regulation of Modern Financial Markets*, 2 HARV. BUS. L. REV. 235, 256 n.104, 265 (2012). For a treatment of regulatory arbitrage, see generally Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 229-30 (2011).

Lawmakers were challenged to reconsider the institutional design of financial regulators. In 2008, the U.S. Department of the Treasury, under Secretary Hank Paulson, published a blueprint for modernizing the financial regulatory structure.[71] This was followed by the Obama administration White Paper on Financial Regulatory Reform in 2009,[72] which substantially converged into the Treasury Department's "Green Paper," put forth under Secretary Timothy Geithner, and was used as a model for the current regime created by the Dodd-Frank Act.[73] Both documents recognized the convergence of the financial services industry and accepted the financial regulatory and supervisory structure's inadequacies in tackling cross-sectoral financial activities and comprehensively assessing complex financial conglomerates.

Paulson's Report[74] and Geithner's Report[75] both call for modernizing and reforming the regulatory structure. Paulson's Report proposed a completely re-envisioned financial regulatory structure built around objectives-based regulators. Specifically, it recommended the creation of a systemic risk or market stability regulator,[76] a prudential financial regulator,[77] and a business conduct regulator.[78] A central role in Paulson's Report was played by the Fed, which would have been a macroprudential regulator, responsible for issues of financial market stability and would have been assigned an enhanced regulatory authority to deal with systemic risk. The Fed as a market stability regulator would have sat at the center of the new financial architecture.[79]

Geithner's Report, which incorporated the Obama administration's regulatory priorities, still envisioned a strong role for the Fed as a systemic risk

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71 PAULSON'S REPORT, *supra* note 14.

72 GEITHNER'S REPORT, *supra* note 14.

73 PAULSON'S REPORT, *supra* note 14. *See e.g.*, John C. Coffee, Jr., *Competition versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation*, 50 BUS. LAW. 447 (1995); Adam J. Levitin, *The Politics of Financial Regulation and the Regulation of Financial Politics*, 127 HARV. L. REV (2014).

74 *See* PAULSON'S REPORT, *supra* note 14.

75 *See* GEITHNER'S REPORT, *supra* note 14.

76 *See* PAULSON'S REPORT, *supra* note 14, at 146-56. The market stability regulator would have been responsible to address overall conditions of financial market stability that could impact the real economy.

77 *Id.* at 157-69. The prudential financial regulator would have been responsible to address issues of limited market discipline caused by government guarantees.

78 *Id.* at 170-82. The business conduct regulator would have been responsible to address standards for business practices.

79 A justification of the Fed-centric regulatory architecture and the central role of the Fed as a systemic risk regulator was justified by the critical role the Fed played as a lender of last resort during the crisis. *See infra* Sections IV.B-D (arguing on similar ground for the expansion of the role of the Fed as a ROLR as a necessary and ancillary role to the lender of last resort).

regulator but with less structural reform of the financial regulatory architecture.[80] The report advocated for the creation of a Financial Services Oversight Council as a multiagency body housed at the Treasury and responsible for playing an advisory role to the Fed, that would have been a systemic risk regulator.

Sheila Bair, then Chairwoman of the Federal Deposit Insurance Corporation, presented her own proposal to create a systemic risk and financial stability regulator. She envisioned a stand-alone systemic risk council, headed by a presidentially appointed individual, and responsible for monitoring and addressing risk in the financial system.[81] This multiagency council also would have been responsible for writing rules for the whole financial system, and these rules would have been the minimum standards upon which primary regulators could have promulgated tougher rules.[82]

All the proposals—albeit in different ways—stressed the importance of establishing an agency tasked with supporting financial market stability and addressing systemic risk.[83] The political process and negotiations that brought about the adoption of the Dodd-Frank Act were long and complex, but a final delicate compromise was reached.[84] Lawmakers attempted to address the conundrum between the traditional siloed approach to regulate and supervise financial phenomena and the increasing cross-sectoral nature of financial entities and activities by setting up a new agency responsible for coordinating the actions of the existing regulators. The next section presents the product of the delicate political compromises reached in 2010: the FSOC.

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80 *See* GEITHNER'S REPORT, *supra* note 14, at 19-42.

81 *See* SHEILA BAIR, BULL BY THE HORNS – FIGHTING TO SAVE MAIN STREET FROM WALL STREET AND WALL STREET FROM ITSELF 337-39 (2012). Bair's idea was strongly opposed by Treasury Secretary Geithner, who favored a stronger role of the Fed. *See* TIMOTHY GEITHNER, STRESS TESTS: REFLECTIONS ON FINANCIAL CRISES 402-03 (2014).

82 *Id.* This systemic risk multiagency council would have adopted its rules with a simple majority vote of its members.

83 *See* Peter Conti-Brown & Brian D. Feinstein, *The Contingent Origins of Financial Regulation,* WASH. L. REV. 145, 201-03, 205-06 (2021) (looking at the legislative history of the FSOC as a macroprudential supervision and systemic risk regulation, and analyzing the temporary cross-sectional political coalitions that supported its creation).

84 *See* BLINDER, *supra* note 63 at 263-319 (providing a comprehensive analysis of the negotiations and political dynamic behind the Dodd-Frank Act).

II. THE FSOC AND THE REGIME OF THE REGULATOR OF LAST RESORT

Dodd-Frank structurally reformed the U.S. financial system by re-writing some of the Wall-Street rulebook.[85] The establishment of the FSOC was the policy response to the need to tackle systemic risk by reinventing the U.S. financial architecture.[86] Lawmakers saw in this novel multiagency body a mechanism (1) to support regulatory and supervisory dialogue and coordination between federal financial regulators and (2) to strengthen regulatory accountability by making individual regulators collectively responsible for identifying, designating, and addressing new sources of systemic risk.[87]

This section unpacks the FSOC, its structure, duties, powers, and jurisdiction. It then discusses the ten years of the Council's operations and identifies four stages of the FSOC's institutional life. These four stages show a political cyclicality in the Council's operations, that might find its roots in the architectural vulnerabilities of the FSOC institutional design.

A. FSOC on the Stage

1. FSOC Structure, Duties, and Powers

The FSOC is a collaborative multi-member coordinating macroprudential agency housed at the Treasury Department and chaired by the Treasury Secretary.[88] The Council is made up of ten voting members and five nonvoting

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85 *See, e.g.*, DAVID SKEEL, THE NEW FINANCIAL DEAL – UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES (2011) (presenting the structural reforms introduced by the Dodd-Frank Act; the sweeping reforms introduced by the Act affect bank capital requirements and resolution, derivatives markets reform, consumer finance, securitization, etc.).

86 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 111, 124 Stat. 1376, 1392 (2010) (creating the FSOC, a council of the heads of the U.S. regulatory agencies, chaired by the Treasury Secretary). Dodd-Frank also established another new agency, the Office of Financial Research ("OFR") and tasked it with a support role to the FSOC. The OFR supports the FSOC in monitoring the financial system in search of systemic risk by conducting research, gathering data from financial regulators, providing findings at FSOC's meetings, and participating in the identification of new sources of systemic risk. 12 U.S.C. § 5342(a).

87 Simon Johnson & Antonio Weiss, *The Financial Stability Oversight Council: An Essential Role for the Evolving US Financial System* 2-3 (Peterson Inst. for Int'l Econ., Policy Brief 17-20, 2017).

88 U.S. DEPARTMENT OF THE TREASURY, "Financial Stability Oversight Council," https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc (last visited Dec. 23, 2020); JEFFREY M. STUPAK, FINANCIAL STABILITY

members. The voting members are: the Secretary of the Treasury, the heads of the banking agencies (Chairperson of the Fed, the Comptroller of the Currency ("OCC"), and the Chairperson of the Federal Deposit Insurance Corporation ("FDIC")); the Director of the Consumer Finance Protection Bureau ("CFPB"); the Chairman of the SEC; the Chairperson of the CFTC; the Director of the Federal Housing Finance Agency ("FHFA"); the Chairperson of the National Credit Union Administration ("NCUA"); and an independent insurance expert appointed by the President and confirmed by the Senate for a six-year term.[89] The nonvoting members, who serve in an advisory capacity, are: the Director of the Office of Financial Research ("OFR"); the Director of the Federal Insurance Office; and three state financial regulators each representing one of the following sectors: banking, securities, and insurance.[90]

As FSOC Chair, the Treasury Secretary has a substantial role in steering the Council's operations. The Chair calls meetings and sets the agenda.[91] In the event of the Chair's inaction, a meeting can be called by a vote of the majority of the members.[92] The FSOC must meet at least quarterly,[93] but this does not prevent the Chair from calling additional meetings to discuss and consider imminent or emerging treats to financial stability and to vote on a "systemically importance" designation.[94] Meetings may be open or closed to the public,

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OVERSIGHT COUNCIL (FSOC): STRUCTURE AND ACTIVITIES, CRS REPORT (2018), https://fas.org/sgp/crs/misc/R45052.pdf.

89 12 U.S.C. § 5321(b)(1).

90 *Id.* § 5321(b)(2)–(b)(3). The three state regulators representatives are: a state insurance commissioner designated by the state insurance commissioners; a state banking supervisor designated by the state banking supervisors; and a state securities commissioner designated by the state securities commissioners.

91 The Chair must testify before the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs in conjunction with the release of the annual FSOC report, and about the Council's activities and any threats or concerns or recommendations about the status of the U.S. financial system, lawmakers should be apprised of by providing Congress the necessary information to assess if, and how, to intervene. Additionally, if any member agencies have notified Congress of deficiencies in systemic risk efforts, the Treasury Secretary must address those concerns at the hearing. 12 U.S.C. § 5322(2)(N).

92 The FSOC its supported in its activities by multiples committees. The committee structure of the Council promotes shared responsibility among the member agencies, leveraging the expertise that already exists at each agency. Among the Committees, there is a committee for each area of designation authority; a Systemic Risk committee; a Regulation and Resolution committee; and a Data committee. *See About FSOC*, U.S. DEP'T OF THE TREASURY, https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc/about-fsoc (last visited Apr. 11, 2022).

93 *See* 12 U.S.C. § 5321(e).

94 *Id.* (a majority of the Council's members can also call a Council's meeting).

depending on the meeting's agenda,[95] and minutes of the meetings are recorded. Other agency commissioners, or board members other than the head, might be invited to participate in a meeting but do not have voting rights.[96]

Finally, the Chair has a special veto power in designating, rescinding, or reevaluating the systemic designation of nonbank SIFIs[97] and SIFMUs.[98] As discussed later in the section, designation, rescission, and reevaluation decisions require a two-thirds vote of FSOC members and the FSOC Chair must affirmatively vote in support of the resolution.[99]

Section 112(a) of Dodd-Frank identifies three primary purposes and duties of the FSOC:

> (A) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace; (B) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure; and (C) to respond to emerging threats to the stability of the United States financial system.[100]

Lawmakers translated those three main objectives into fourteen specific duties for the FSOC. The first group of duties addresses the information and coordination problem.[101] These duties give the FSOC the responsibility to monitor the financial system and identify and respond to sources of risk or threats to financial;[102] to support data gathering and sharing;[103] and to facilitate dialogue and coordination in both policy and rulemaking among federal

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95 Financial Stability Oversight Council, *Transparency Policy for the Financial Stability Oversight Council*, https://www.treasury.gov/initiatives/fsoc/Documents/The%20Council%27s%20Transparency%20Policy.pdf.

96 For example, the SEC's chairperson, but not the other SEC commissioners, is an FSOC's member and can cast her vote under her sole discretion, without formally consulting with her fellow agency members. The same consideration is true for the CFTC, or the Fed, where the Fed Chair is the only directly involved representative, despite Dodd-Frank having created a new Vice-Chair, formally responsible for financial supervision.

97 12 U.S.C. § 5323 (a)(1).

98 *Id.* § 5463(1).

99 *See infra* Section II.A.2.

100 *See* 12 U.S.C. § 5322(a)(1).

101 *Id.* § 5322(a)(2).

102 *Id.* § 5322 (1)(A), (C), (G).

103 *Id.* § 5322(2)(A)-(B).

regulators.[104] The second group of responsibilities focuses on addressing regulatory gaps and overlaps as well as the risk of regulatory arbitrage opportunities that might undermine financial stability. Lawmakers coupled the duty to monitor with an express duty to identify regulatory gaps that could pose a systemic threat,[105] and a duty to recommend policy approaches and advise Congress and financial regulators on financial lawmaking or rulemaking for systemic risk.[106] This is done to "enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets" and to establish a heightened prudential standard for systemically important entities and activities.[107] The FSOC is also responsible for resolving jurisdictional disputes among financial agencies.[108] The third set of responsibilities focuses on the novel and powerful duty of the FSOC to identify and designate as systemically important: financial firms, market utilities, and activities that pose a risk to the financial stability of the U.S. markets.[109] Such designation power,[110] as discussed in the next Section, triggers the application of enhanced prudential and supervisory standards. Two final responsibilities of the FSOC are: to promote market discipline by eliminating the expectation of a public bail-out[111] and to resolve jurisdictional issues and disputes among its members.[112]

A very interesting and often misstated aspect of the FSOC's structure is the fact that lawmakers did *not* grant the FSOC a formal autonomous rulemaking or supervisory authority over systemically important designated entities, activities, or market utilities or the authority to mitigate major financial sector risks.[113] Instead, Congress created a dialectic regulatory relationship between the FSOC and the primary regulators,[114] built around the FSOC's designation power.[115] In this dialectic relationship, the FSOC is empowered to designate entities and activities that could pose a systemic threat to financial stability as systemically important, and it may make recommendations to the

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104 *Id.* § 5322(2)(C), (E).
105 *Id.* §§ § 5322(2)(G), 5330.
106 12 U.S.C. §§ 5322(2)(D), (F), (I), (H).
107 *Id.* § 5322(2)(K).
108 *Id.* § 5329.
109 *Id.* §§ 5322(2)(H)-(K), 5323, 5324, 5325, 5463, 5464, 5465 (designating systemically important financial market unities). *See* infra Part II.A.2.1.
110 *Id.*
111 12 U.S.C. § 5322(a)(1)(B).
112 *Id.* § 5322(a)(2)(M).
113 *See generally id.* § 5322(a)(2).
114 *Id.* § 5469 (giving rulemaking authority to the Fed's Board of Governors and the other supervisory agencies, while the FSOC plays a more advisory role).
115 The FSOC's mandate also includes the power to propose other ways to mitigate systemic risk. *See* 12 U.S.C. § 5331.

Fed concerning the establishment and refinement of prudential standards.[116] But the actual and ultimate regulatory and supervisory authority is vested either with the existing primary regulators, or, as discussed in the next section, with the Fed, as a ROLR.[117]

2. FSOC Jurisdictions and the Designation of Authority: Title I and Title VIII and the Role of the Fed as ROLR

FSOC jurisdiction over the designation of systemically important entities and activities derives from Title I and Title VIII of the Dodd-Frank Act. Title I—the Financial Stability Act of 2010[118]—envisioned the Council as the institutional response to systemic risk,[119] and equipped it with two innovative tools: (1) the authority to designate nonbank SIFI, and subject them to enhanced regulation and supervision by the Fed (i.e., the *de jure* ROLR);[120] (2) the authority to propose and recommend to regulators—or directly to lawmakers where no existing regulator has authority over a specific entity or activity—new or alternative ways to mitigate major financial sector risks.[121] In addition, structuring the FSOC as a multiagency body with the representation of the federal financial regulators and three state financial regulators' representatives was intended to promote the accountability of the collective decision-making process and strengthen the legitimacy of the product of any FSOC determination.[122]

Title I assigns the FSOC the power to designate nonbank SIFIs.[123] Such designation triggers heightened prudential regulation and supervision by the Fed.[124] The two-tiered structure for addressing systemic risk threats thus requires the following steps: (1) FSOC action and (2) subsequent Fed action to establish heightened prudential standards and to supervise.[125] FSOC designation of an entity or activity as systemically important results from a participatory and complex procedure where the Council receives inputs from multiple stakeholders. If the FSOC, for instance, decides to designate a nonbank financial institution as systemically important, it notifies the firm with

116 12 U.S.C. §§ 5323, 5325, 5463, 5464; *see also* Kress et al., *supra* note 8, at 1463.
117 *See infra* Section II.A.2; 12 U.S.C. §§ 5325, 5464.
118 *See* 12 U.S.C. §§ 5311–5374.
119 *See* Johnson & Weiss, *supra* note 87, at 2-3.
120 12 U.S.C. § 5323(a).
121 *Id.* § 5322(2), 5325.
122 *Id.* § 5321(b).
123 *Id.* § 5323.
124 *Id.*
125 12 U.S.C. §§ 5324, 5325.

an explanation of the basis of the designation. Then the firm may request the opportunity to contest the proposed determination via a written procedure or a hearing.[126] After the final determination is made, the Fed receives the authority to supervise the firm and to subject it to prudential standards.[127] But the designation and the transfer of competence to the Fed does not preclude the right of the designated entity to challenge the determination in court and have it reviewed under the arbitrary and capricious standard.[128]

Being designated as a nonbank SIFI triggers the application of heightened prudential requirements set by the Fed as well as Fed supervision. But, nonbank SIFIs are not granted the opportunity to access Fed accounts[129] or to access discount and borrowing privileges in the absence of unusual or exigent circumstances—i.e., nonbank SIFIs cannot access the services of the Fed as a lender of last resort ("LOLR") under the new 13(3).[130]

Title VIII provides the FSOC with the power to designate SIFMUs.[131] Such designation triggers heightened supervision and prudential and risk management standards by the primary regulators—SEC and CFTC—and residually by the Fed, but the designation and the triggered regulatory costs also come with benefits, including the right to access Fed accounts and liquidity support in case of distress.[132] A peculiar feature of Title VIII is the role given to the Fed. On one side, the Fed acts as primary regulator for SIFMUs; on the other, the Fed is assigned a role as a back-up regulator for SIFMUs and for systemically important clearing, settlements, and payment activities. Simply, the Fed has a back-up supervisory and regulatory authority over SIFMUs. Where the primary regulators do not follow up on the designation of a regulated SIFMU and adopt a heightened prudential standard, then the Fed regulatory regime would be applied as back-up regulation.[133] The Fed's heightened standards for SIFMUs operate as minimum standards for any other designated

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126 *Id.* § 5323(e).

127 *Id.* § 5325(b)(2).

128 *Id.* § 5325(h).

129 *Id.* § 342.

130 12 U.S.C. § 343(3).

131 *See id.* § 804; 12 U.S.C. § 5464; *see also* Posting of Dan Ryan, *Financial Market Utilities: Is the System Safer?*, HARV LAW SCH. F. ON CORP. GOVERNANCE (Feb. 21, 2015), https://corpgov.law.harvard.edu/2015/02/21/financial-market-utilities-is-the-system-safer/; *TITLE VIII: Payment, Clearing, and Settlement Supervision*, GIBSON DUNN, https://www.gibsondunn.com/wp-content/uploads/documents/publications/Dodd-Frank-TitleVIII.pdf.

132 *See, e.g.*, Saguato, *supra* note 29 (analyzing Title VIII regulatory framework and political economy).

133 12 U.S.C. § 5464(a)(1).

SIFMUs.[134] Furthermore, the Fed was granted a very incisive power to challenge primary regulators before the Council in those instances where the Fed determines that the primary regulator's prudential regime is inadequate to address systemic risk—i.e. liquidity, credit, operational, or other risks to the financial markets or to financial stability.[135] In that instance, the primary regulator has the right to respond to the Fed and the Council, which would eventually vote to determine whether or not the prudential standards are adequate to address systemic risk.[136]

Overall, the regime adopted by lawmakers can be described as composed of: (1) an onboarding and offboarding process overseen and managed by the FSOC; and then (2) an "on board" regime where the Fed (or the primary regulator) has prudential and oversight responsibilities over the systemically important entity. What is particularly interesting, however, are the different regimes lawmakers envisioned. There is a regime for nonbank SIFIs, where the Fed has received direct regulatory and supervisory responsibility as ROLR, and there is a separate regime for SIFMUs, where the Fed's regulatory and supervisory authority operates as a back-up authority.[137] These two manifestations of the Fed's authority as a ROLR deserve more attention, and, if properly tuned, can provide effective regulatory and supervisory mechanisms to address systemic risk, jurisdictional vacuum, and regulatory arbitrage situations.

The next section analyzes the FSOC's operations over the years with a threefold purpose: (1) to show what the FSOC achieved in its ten years of activity, (2) to map the cyclicality of its operation, and (3) to highlight the major legislative attempts to reform the Council.

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134 See Regulation HH 12 C.F.R. Part 234.

135 Primary regulators, in the SIFMU's case the CFTC and the SEC, in prescribing their prudential requirements, need to consul the Council and the Fed.

136 12 U.S.C. § 5464(a)(2).

137 This misaligned and unbalanced regime for systemically important nonbanks on one side and SIFMUs on the other creates clear tensions. While all designated shadow banks either litigated or tried to restructure to remove their designation, all designated SIFMUs accepted the designation.

B. The Four Stages of FSOC Existence

1. Stage One 2010-2012: The First Term of the Obama Administration and the FSOC's Full Engagement

In the first two years of its existence, the FSOC began fulfilling its rulemaking mandate and setting its general agenda. It focused its efforts in four distinct areas: (1) the ongoing interaction between the financial system and the economy; (2) the buildup of systemwide leverage and funding mismatches; (3) the ongoing evolution of financial market activity and practices; and (4) the potential opportunities for regulatory arbitrage.[138]

a. Rulemaking Initiatives: Setting the Foundations for the FSOC's Authority

Dodd-Frank delegated to the FSOC the authority to adopt guidelines and rules for setting for its procedures to designate systemically important phenomena, and, generally, to carry out its responsibility as a macroprudential authority.

In July 2011, implementing the Dodd-Frank Title VIII mandate, the FSOC promulgated a final rule that established its authority to designate SIFMUs.[139] This rule sets forth the framework and elements of the two-step designation process for SIFMUs,[140] and defines the considerations and elements the Council would assess and evaluate to determine whether a financial market utility is systemically important.[141]

The rulemaking on SIFMU designation was followed in 2012, by the finalization of the rules outlining the process to designate nonbank SIFIs.[142] In April 2012, the FSOC adopted a final rule and interpretative guidance which

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138 FIN. STABILITY OVERSIGHT COUNCIL, 2011 ANNUAL REPORT, LETTER FROM THE CHAIR (2011). Then-Chair Secretary Timothy Geithner stressed that the leadership in the financial sector needed to "establish and maintain much higher standards of integrity and a more sophisticated understanding of the risk inherent in the business of finance" to maintain a stable financial system. *Id.* at iv.

139 Fin. Stability Oversight Council, Authority to Designate Financial Market Utilities as Systematically Important, 76 Fed. Reg. 44763, 44763 (Jul. 27, 2011) (stressing the rule would only address FMU designation). The rule adopted the same factors to determine "system importance" outlined in 12 U.S.C. §5463(a)(2)(A)–(E), *see* Authority to Designate Financial Market Utilities as Systematically Important, 76 Fed. Reg. at 44764–65 (codified in 12 C.F.R. Part 1320).

140 12 U.S.C. § 1320.

141 *Id.*

142 12 C.F.R. Part 1310 (2012); 12 C.F.R. Part 1320, pp. A (2012).

outlined the three-stage process for evaluating nonbank SIFIs,[143] defined key terms regarding its determination authority, and set forth uniform quantitative thresholds that it uses to identify companies for further evaluation.

b. The First (and "Uncontroversial") "Systemically Important" Designation and the First Formal Recommendation

In 2011, the FSOC's activities largely involved setting up the supervisory framework necessary for designating SIFMUs. The FSOC started the procedure to designate SIFMUs on July 27, 2011 and, one year later, on July 18, 2012, the Council voted unanimously to designate eight FMUs as systemically important.[144] Of the eight SIFMUs, two are payment systems, under the direct supervision of the Fed, Clearinghouse Interbank Payment System and CLS Bank International; two are derivatives clearing organizations under the CFTC jurisdiction, the Chicago Mercantile Exchange Inc. and ICE Clear Credit LLC, and four are clearing agencies that operate in the SEC perimeter, the Depository Trust Company, the Fixed Income Clearing Corporation, the National Securities Clearing Corporation, and The Options Clearing Corporation.[145]

In addition, on November 2012, FSOC exercised its Section 120 authority and issued a set of proposed recommendation regarding MMMFs reforms.[146] The FSOC also conducted a study and made recommendations in its annual report on implementing the Volcker Rule.[147]

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143 12 C.F.R. Part 1310.

144 Fin. Stability Oversight Council, Minutes of the Financial Stability Oversight Council (July 18, 2012), https://www.treasury.gov/initiatives/fsoc/Documents/July%2018%20FSOC%20Meeting%20Minutes.pdf.

145 *See* SIFMU Report, *supra* note 38, at 146-56 (providing a comprehensive analysis of the SIFMUs business and the rationale that supported their designation).

146 *See* 12 U.S.C. § 5330; Fin. Stability Oversight Council, Proposed Recommendations Regarding Money Market Mutual Reform (Nov. 19, 2012), https://www.govinfo.gov/content/pkg/FR-2012-11-19/pdf/2012-28041.pdf.

147 *See* FIN. STABILITY OVERSIGHT COUNCIL, 2013 ANNUAL REPORT 129 (2013), https://www.treasury.gov/initiatives/fsoc/Documents/FSOC%202013%20Annual%20Report.pdf.

2. Stage Two 2013-2016: The Second Term of the Obama Administration and a Split Congress

During the Obama administration's second term, the FSOC's rulemaking activity slowed down,[148] and the Council focused on working on the analysis of the risk in the nonbank financial sector.

a. The Designations of Four Nonbank SIFIs

Between 2013 and 2014, the FSOC designated four nonbank SIFIs, three insurance firms—American International Group, Inc. ("AIG"), Prudential Financial, Inc. ("Prudential"), and MetLife, Inc—and one nonbank lender, General Electric Capital Corporation, Inc. ("GE").[149]

The first nonbank SIFIs designations came on July 8, 2013. The Council voted to officially designate AIG[150] and GE[151] as potential risks to the stability of the U.S. financial system. In its official statements, the Council determined that the level of involvement in financial markets by both of these companies warranted heightened prudential standards and oversight by the Fed. On similar grounds, the Council voted to designate Prudential, on September 19, 2013,[152] and MetLife, on December 18, 2014.[153]

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148 Two bills were passed by Congress during this term, amending minor features of the Council. The Freedom of Information Improvement Act of 2016, PL 114-185 changed the procedures for citizens to request and obtain public records held by federal agencies, and amended the FOIA request procedure and limitations for FSOC. *See* FOIA Improvement Act, Pub. L. No. 114-185 (codified at 5 U.S.C. § 552) (2016). And the Financial Stability Oversight Council Insurance Member Continuity Act of 2017 allowed the insurance member to continue serving on the Council for up to eighteen months after their six-year term had expired while searching for their replacement. *See* Financial Stability Oversight Council Insurance Member Continuity Act, PL 115-61 (Sept. 2017).

149 *See* FIN. STABILITY OVERSIGHT COUNCIL, 2015 ANNUAL REPORT 101 (2015) https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/2015%20FSOC%20Annual%20Report.pdf.

150 *See* Fin. Stability Oversight Council, Basis of the Financial Stability Oversight Council's Final Determination Regarding American International Group, Inc. (July 8, 2013), https://perma.cc/6V27-GUMP.

151 *See* Fin. Stability Oversight Council, Basis of the Financial Stability Oversight Council's Final Determination Regarding General Electric Capital Corporation, Inc (July 8, 2013), https://perma.cc/M6ZZ-4WAU.

152 *See* Fin. Stability Oversight Council, Basis for the Financial Stability Oversight Council's Final Determination Regarding Prudential Financial, Inc. (Sept. 19, 2013), https://perma.cc/AH5E-4WDQ.

153 *See* Fin. Stability Oversight Council, Basis for the Financial Stability Oversight Council's Final Determination Regarding Metlife Inc. (Dec. 18, 2014), https://perma.cc/5249-ZJD7.

Three years after its designation, the Council voted to rescind GE's designation, stating that "the company executed significant divestitures, transformed its funding model, and implemented a corporate reorganization," thus reducing its systemic importance.[154] Such changes made GE Capital a "much less significant participant in U.S. financial markets and the economy."[155]

3. Stage Three 2017-2020: The Trump Administration and the Reassessment of the FSOC Role

a. Final Rules Promulgated During This Stage

The most important and controversial rulemaking of the Trump administration,[156] was the FSOC decision to amend the Council's final interpretative guidance for nonbank SIFI determination.[157] In December 2019, the FSOC promulgated its final new guidelines.[158] The rule revised the FSOC's 2012 guidance by embracing an activities-based approach to identify, assess, and address potential risks and threats to U.S. financial stability. The new guidelines did not exclude the previously embraced entity-based approach, but it would reserve its back-up role only in the case of potential risk or threat that could not be adequately addressed through an activity-based approach.[159]

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154 *See* Fin. Stability Oversight Council, Basis for the Financial Stability Oversight Council's Rescission of Its Determination Regarding GE Capital Global Holdings, LLC (June 28, 2016), https://perma.cc/3FVF-5J35; FIN STABILITY OVERSIGHT COUNCIL, 2017 ANNUAL REPORT 120 (2017), https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC_2017_Annual_Report.pdf.

155 *Id.* (stressing the changes "significantly reduced the potential for GE Capital's material financial distress to threaten U.S. financial security").

156 *See, e.g.*, Kress et al., *supra* note 8.

157 *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 84 Fed. Reg. 8958 (Mar. 13, 2019) (codified in 12 C.F.R. Part 1310). The proposed rule would require the FSOC to adopt "an activities-based approach as FSOC's preferred method of identifying and addressing potential risks to U.S. financial stability in the first instance, and enhance the analytical rigor and transparency of FSOC's process for designating nonbank SIFIs in the event the activities-based approach proves incapable of addressing systemic risk in particular cases." Covington & Burling, "FSOC Proposes Activities-Based Approach to Regulating Systemic Risk," (Mar. 13, 2019).

158 Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies, 84 Fed. Reg. 71740, 71742 (2019), available at https://home.treasury.gov/system/files/261/Authority-to-Require-Supervision-and-Regulation-of-Certain-Nonbank-Financial-Companies.pdf; 12 C.F.R. Part 1310; 12 C.F.R. Part 1320.

159 Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies, 84 Fed. Reg. 71740, 71742 (2020).

Additionally, the interpretative guidance tasked the FSOC with finding whether the primary financial regulatory agency is expected to perform a cost-benefit analysis of the actions taken in response to the FSOC's contemplated recommendation.[160]

b. Recission of Designations

During the Trump administration, the FSOC rescinded the designations of the remaining three nonbank SIFIs. In 2017, the FSOC rescinded its designation regarding AIG. "Both direct and indirect capital markets exposures to AIG [had] decreased substantially and the company ha[d], through divestures, exited certain important markets."[161] Like with GE Capital in 2017, in 2018, the FSOC rescinded its designation that material financial distress at Prudential would pose a threat to U.S. financial stability.[162] "The [FSOC's] decision to rescind the determination was based on extensive analysis that indicated that there [was] not a significant risk that the company [would] pose a threat to financial stability."[163] Finally, after MetLife successfully challenged its designation as systemically important as arbitrary and capricious before the U.S. District Court of the District of Columbia,[164] and Treasury Secretary Steven Mnuchin decided not to appeal, even MetLife's designation lapsed.[165]

c. Two Legislative Attempts to Reform the FSOC

During the four years of the Trump administration, Congress tried to amend the structure and operation of the Council. The delicate political compromise upon which the FSOC was created faded away, and lawmakers

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160 Fin. Stability Oversight Council, Notice and Explanation of the Basis for the Financial Stability Oversight Council's Rescission of Its Determination Regarding American International Group, Inc. (AIG) (June 28, 2016), https://perma.cc/W3CA-9TWS.

161 *Id.* at 5-6 (noting that "additional analyses conducted during [an] annual reevaluation indicated that there [was] not a significant risk that a forced asset liquidation by AIG would [have] disrupt[ed] market functioning").

162 Fin. Stability Oversight Council, Notice and Explanation of the Basis for the Financial Stability Oversight Council's Rescission of Its Determination Regarding Prudential Financial, Inc. (Prudential) (October 16, 2018), https://perma.cc/NP3Y-YPED.

163 *Id.* at 6-7.

164 MetLife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219 (D.D.C. 2016).

165 *See e.g.* Kress et al., *supra* note 8, at 1482-87 (analyzing MetLife decision and the impact on systemically impact designation); *see also*, REPUBLICAN STAFF OF THE COMM. ON FIN. SERVS., U.S. HOUSE OF REPS., 115TH CONG., THE ARBITRARY AND INCONSISTENT FSOC NONBANK DESIGNATION PROCESS (2017) https://perma.cc/J9NS-RKYY (discussing the vulnerabilities in FSOC's designation process).

expressed strong criticisms regarding the Council's operations and its potentially overbearing or far-reaching designation authority.[166] The presidential agenda regarding the FSOC was set at the beginning of the Trump administration. In a memorandum addressed to the Treasury Secretary, the President directed the Treasury Secretary to review the designation process for systemically important entities and to assess the legitimacy of the process and the efficacy of its outcome.[167]

The first (ultimately unsuccessful) attempted structural changes to the FSOC were introduced during the 115th Congress by Republican members, and primarily targeted the duties of the Council.[168] The Financial Stability Oversight Council Improvement Act of 2017, introduced and referred to the House Financial Services Committee by Rep. Dennis Ross (R-FL) in October 2017, sought to substantially restrict the designation authority of the FSOC by modifying the procedural frameworks used to make determinations.[169] The bill would have required the FSOC to consider in its designation determination "the appropriateness of the imposition of prudential standards as opposed to other forms of regulation to mitigate the identified risks."[170] The bill would have also amended the annual reevaluation process for each designation determination, making it a dialectic and participatory process between the FSOC and the designated entity,[171] and would have created a new procedure for the designation of systemically important entities.[172] The committee's minority (Democratic) members primarily objected to the proposed bill on the grounds that the amendments would have significantly slowed down the Council's designation capacity, undermining its effectiveness.[173] The bill passed

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166 Weber, *supra* note 8, at 370.

167 Presidential Memorandum for the Secretary of the Treasury, Subject: Financial Stability Oversight Council (April 21, 2017), https://perma.cc/MU5S-BWK7. *See* Peter J. Wallison, *The Trump Treasury's Disturbing Regulatory Turn*, WALL ST. J. (Dec. 6, 2017), https://perma.cc/43MR-XL4U; John Crawford, *Lesson Unlearned?: Regulatory Reform and Financial Stability in the Trump Administration*, 117 COLUM. L. REV. ONLINE 127, 137-138 (2017).

168 *See* STAFF OF H. COMM. ON FIN. SERVS., 113TH CONG., FAILING TO END: TOO BIG TO FAIL": AN ASSESSMENT OF THE DODD-FRANK ACT FOUR YEARS LATER 26-58 (2014), https://perma.cc/EM52-64CR.

169 *See* H.R. 4061, 115th Cong. (2018) [hereinafter Financial Stability Oversight Council Improvement Act]; H.R. Rep. No. 115-592, at 2 (2017), https://perma.cc/F5EA-D28H.

170 *See* Financial Stability Oversight Council Improvement Act, Sec. 2 (introducing a new Title I of Dodd-Frank § 113(a)(K)).

171 *See id.* (introducing a new Title I of Dodd-Frank § 113(d)).

172 *See id.* (introducing a new Title I of Dodd-Frank § 113(e)).

173 *See id.* at 26-27.

the House in early 2018 and was referred to the Senate Banking Committee, where it languished and died.[174]

A more structural challenge to the FSOC architecture and authority came with the Financial CHOICE Act of 2017, introduced in the 115th Congress by Rep. Jeb Hensarling (R-TX).[175] Referred to as the CHOICE Act 2.0, this bill sought to radically reform Title I and VIII of Dodd-Frank, and repeal FSOC's authority to designate a firm as a nonbank SIFI,[176] or SIFMU.[177] The bill would have significantly altered the structure of the FSOC. All members of a multi-member commission, agency or board would have been members of the FSOC. Nevertheless, each agency would have had only one vote. And the multi-member commission, agency or board would have determined its vote by its normal voting processes, meaning that the Chair would have not independently cast her vote on the Council, but she would have been bound by the outcome of the collective vote of all members of the commission, agency or board.[178] To add transparency to the FSOC meetings, meetings would be open to attendance by members of the House Financial Services and Senate Banking Committees; and they would be subject to government oversight via the Sunshine Act.[179] Finally, the FSOC would receive a set amount of congressionally authorized funding each fiscal year, rather than being funded by assessing nonbank SIFIs and bank SIFIs. This bill passed the House on June 8, 2017, but died in the Senate.

Finally, during the 116th Congress, Democratic members—Rep. Jesús García (IL) and Rep. Katie Porter (CA)—introduced the Systemic Risk Mitigation Act.[180] The Act would have: expanded each FSOC's members' mission to include a financial stability mandate; introduced automatic designation for certain large nonbank SIFIs; imposed minimum staffing and funding levels for the Council; expanded the transparency obligation by

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174 An additional small bill introduced by Rep. Tom Emmer, the Financial Stability Oversight Council Reform Act, intending to change the funding structure of the FSOC subjecting the budgets of FSOC and OFR to Congressional appropriation and to more transparency. *See* H.R. 1459, 115th Cong. (2017).

175 *See* H.R. 10, 115th Cong. (2017); Rept. 115-153 – Financial CHOICE Act of 2017, 115th Cong. (2017); *see also generally* REGULATING WALL-STREET: CHOICE ACT V. DODD-FRANK (Matthew P. Richardson et al., eds., 2017), https://perma.cc/4WFL-9UWJ (offering a comparison of the two acts); *see also* MARC LABONTE ET AL., CONG. RSCH. SERV., R44839, THE FINANCIAL CHOICE ACT IN THE 115TH CONGRESS: SELECTED POLICY ISSUES (2017).

176 *See* H.R. 10, 115th Cong. (2017) Title I §151. The CHOICE Act intended to repeal the vast majority of Title I of Dodd Frank, The Financial Stability Act of 2010.

177 *See* H.R. 10, 115th Cong. (2017), Title I §141.

178 *See* H.R. 10, 115th Cong. (2017), Title I §151.

179 *Id.*

180 *See* H.R. 6501, 116th Cong. (2020).

requiring the Council to meet at least six times a year and imposing on all members an obligation to testify before the House Financial Services and Senate Banking, Housing, and Urban Affairs Committees; and it would have created a new and permanent Climate Change Committee within the FSOC. An interesting proposal of the Systemic Risk Mitigation Act was the creation of a novel back-up regulatory authority on the Council in case of designation of a systemically important activity. In case of a primary regulator's inaction in setting new rules for a designated systemically important activity, the FSOC would have been empowered to initiate a rulemaking on the issues.[181] This provision would have established an interesting rulemaking process that would have partially resembled the existing regime of the Fed role as a ROLR, with a stronger regulatory authority assigned to the Council.[182]

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181 *Id.* Sec. 125. Council Regulation of the Systemically Risky Activities:

> (a) Authority Of The Council.—[T]he Council shall issue such rules as may be required to regulate an activity or practice if the Council determines that the conduct, scope, nature, size, scale, concentration, or interconnectedness of such activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies, financial markets of the United States, or low-income, minority, or under-served communities.
>
> (b) Council Delegation To The Primary Regulator. —With respect to an activity or practice that the council determines meets the standard outlined in subsection (a)—
>
>> (1) the Council shall issue recommendations to the primary regulator for a rulemaking to address the risk posed by the activity, and provide the primary regulator with a 12-month period to issue a final rule to address such risk; and
>>
>> (2) if the primary regulator does not issue such a final rule within the period described under paragraph (1) or the Council determines that such final rule is insufficient to address the risk, the Council may—
>>
>>> (a) terminate such final rule, if applicable; and
>>>
>>> (b) issue a rule to address the risk.
>>>
>>> (c) Backup Authority Of The Council For Member Agency Rulemakings.—With respect to any rulemaking required of a member agency by Federal statute, if the member agency does not issue the rule within the time frame required by such Federal statute, the Council may issue such rule in place of the member agency. . . .

182 *See infra* Section IV.D (proposing a novel regime for the Fed's ROLR role); *see also*, Saguato, *supra* note 27.

4. Stage Four 2021-Present: The Biden Administration and the Re-Evaluation of the Role of the FSOC

As soon as President Biden took office in January 2021 and Secretary Yellen was confirmed on January 25, 2021, the Biden administration publicly acknowledged the critical role that the FSOC was going to play in the four years to come. Senior officials, including Secretary Yellen herself, identified the FSOC as the key player in tackling the rising existential threats to financial stability and as the mechanism to coordinate the actions of the multiple financial regulators involved in addressing cross-sectoral financial risk. Specifically, Secretary Yellen planned to use the FSOC to overcome traditional regulators' inaction in delicate and risky segments of the financial system.

As of April 2022, FSOC's agenda reflects such a call for action.[183] Acting on President Biden's executive order on climate-related financial risks,[184] the FSOC has started analyzing the effects of climate-related risk on financial stability and exploring possible coordinated regulatory responses to such problems.[185] In October 2021, the FSOC published a Report on Climate-Related Financial Risk.[186] The Report acknowledges that climate change is an emerging threat to the financial stability of the United States,[187] recommends the creation of specialized committees within the FSOC to address climate related financial risk,[188] and recommends and relies on FSOC members to act on this pressing systemic issues.[189] The Council has also been investigating two market segments that suffered severe distress during the COVID-19 crisis and required a strong public back-stop: the U.S. Treasury markets and the nonbank financial intermediation sector, in particular, MMMFs.[190] Finally, acting on

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183 FIN. STABILITY OVERSIGHT COUNCIL, 2021 ANNUAL REPORT, https://perma.cc/6VP4-MZQZ.

184 Exec. Order No. 14,030, 86 C.F.R. 27967, 27968 (2021) (directing FSOC to produce a report outlining the specific financial stability risks and regulatory gaps posed by various types of digital assets and providing recommendations to address such risks).

185 FIN. STABILITY OVERSIGHT COUNCIL, 2021 ANNUAL REPORT, *supra* note 183, at 137-40, 157; Fin. Stability Oversight Council, Minutes of the Financial Stability Oversight Council (June 11, 2021), https://home.treasury.gov/system/files/261/FSOC_Minutes_6-11-21_1.pdf; Fin. Stability Oversight Council, Minutes of the Financial Stability Oversight Council (Mar. 31, 2021), https://home.treasury.gov/system/files/261/FSOC_Minutes_6-11-21.pdf.

186 FIN. STABILITY OVERSIGHT COUNCIL, REPORT ON CLIMATE-RELATED FINANCIAL RISK (2021), https://perma.cc/C93T-FREG.

187 *Id.* at 11.

188 *Id.* at 5-6

189 *Id.* at 6-8.

190 FIN. STABILITY OVERSIGHT COUNCIL, 2021 ANNUAL REPORT, *supra* note 183, at 157-72.

President Biden's executive order on digital assets,[191] the Council has begun to investigate financial innovation, specifically the risks stablecoins might pose to U.S. financial stability.[192] Interesting, with regards to both the recommendations on MMMF and digital assets and stablecoins, the FSOC's actions were preceded by two public reports—one on MMMFs[193] and the other on stablecoins[194]—issued by the President's Working Group on Financial Markets. The stablecoin report, recommended that, in the absence of congressional action, the FSOC consider all steps available to address the risks connected to stablecoin arrangements, including the designation of certain activities conducted within a stablecoin arrangement as, or as likely to become, systemically important payment, clearing, and settlement activities.[195]

III. THE ARCHITECTURAL VULNERABILITY IN FSOC DESIGN: BALANCING EXPERTISE AND POLITICAL RESPONSIVENESS

In its ten years of operation, the FSOC has revealed two architectural vulnerabilities. First, the political cyclicality of the Council's activities due to its institutional design undermined both its operation and its mission as a macroprudential authority tasked to mitigate systemic risk. Second, the lack of an effective operating mechanism to promptly trigger the Fed's back-up regulatory authority as ROLR, or a primary regulator's direct jurisdiction, allowed financial risk to build up unchecked in the system.

The first problem is what can be defined as the "hostage" problem. Lawmakers were or should have been aware of the consequences of placing the FSOC within and under the leadership of the Treasury. The Treasury Secretary has full authority to tune up or tune down the operation of the FSOC.[196] The Secretary responds to the President and implements his political agenda. In other words, the FSOC Chair's strong political bent affects the Council's

191 Exec. Order No. 14,067, 87 C.F.R. 14143, 14148-14149 (2022) (directing FSOC to assess the climate-related financial risk to financial stability of the US and to facilitate the sharing of data among federal agency about climate-related financial risk and to ultimately coordinate the adoption of regulatory measures to address climate by federal financial regulators).

192 *Id.* at 171-75.

193 PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS, OVERVIEW OF RECENT EVENTS AND POTENTIAL REFORM OPTIONS FOR MONEY MARKET FUNDS (2020), https://perma.cc/HRJ5-B99D.

194 PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS, THE FEDERAL DEPOSIT INSURANCE CORPORATION, AND THE OFFICE OF THE COMPTROLLER OF THE CURRENCY, REPORT ON STABLECOINS (2021), https://perma.cc/3FS8-S5Z6.

195 *Id* at 3.

196 *See* 12 U.S.C. § 5321(b)(1)(A).

architecture and the Fed's authority as a ROLR.[197] When drafting the new regulatory and supervisory structure for the U.S. financial system, lawmakers—perhaps naively or simply conditioned by the political context and leadership of the time—imagined an active and engaged FSOC under the steady leadership of the Treasury Secretary. As a commentor posited "[t]he FSOC was structure around a *tacit* view [*rectius* assumption, *sic!*] that regulators committed to the council's mission would always be in place . . . ."[198] Lawmakers pictured the FSOC screening the markets for systemic risk, proactively coordinating the actions of multiple financial agencies and when needed, promptly designating firms and activities as systemically important, thus causing them to be subject to heightened prudential standards and appropriate oversight procedures.

However, lawmakers set too optimistic operational assumptions for the FSOC, possibly underestimating the intrinsic political natural of the agency's chairperson and its cyclical operations.[199] The change in the Council's political leadership, coupled with the systematic regulatory fatigue that independent financial agencies experienced in implementing their Dodd-Frank delegated competencies, have undermined the Council's productivity.[200]

Thus, the institutional approach to regulate systemic risk, which was meant to be a structural improvement in the U.S. financial architecture, relied primarily on a concerted action of the FSOC and the Fed as ROLRs but fell short of expectations. If one of the major rationales for creating the FSOC was to reduce systemic risk—particularly in the shadow banking system—and to tackle "too-big-to-fail" institutions, conditioning the Fed's regulatory and supervisory jurisdiction on a "weak" agency's actions undercut the reform's added value.[201] In fact, the Fed does not derive its ROLR authority from a direct legislative mandate. Rather, the Fed's ROLR authority arises only *indirectly*

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197 Roberta Romano, *Does Agency Structure Affect Agency Decision-making: Implications of the CFPB's Design for Administrative Guidance*, 36 YALE J. ON REG. (2019).

198 *See* GELZENIS, *supra* note 8, at 2 (emphasis added)

199 Allen, *supra* note 8, at 1090 ("The FSOC, as the only regulatory body with a statutory direction to address threats to financial stability, should therefore be designed in a way that insulates it as much as possible from this political economy cycle. Unfortunately, both the FSOC's structure and its mandate are flawed in ways that increase the susceptibility of financial stability regulation to the vagaries of political economy.").

200 Stavros Gadinis, *From Independence to Politics in Financial Regulation* 101 CAL. L. REV. 327 (2013); Steven A. Ramirez, *Depoliticizing Financial Regulation*, 41 WM. & MARY L. REV. 503 (2000).

201 Gillian E. Metzger, *Through the Looking Glass to a Shared Reflection: The Evolving Relation-ship Between Administrative Law and Financial Regulation*, 78 L. & CONTEMP. PROBS. 129 (2015); Michael S. Barr, *Comment: Accountability and Independence in Financial Regulation: Checks and Balances, Public Engagement, and Other Innovations*, 78 L. & CONTEMP. PROBS. 119-28 (2015).

under and after the FSOC's inputs. Hence, as previously discussed,[202] the Fed's power as ROLR depends on the FSOC's effective operations. Therefore, FSOC's inaction deprives the markets of both the enhanced regulatory and supervisory apparatus envisioned for systemically important firms and the coordination necessary to address systemic risk.

The existing structure and leadership of the FSOC, decoupled from any of the designation authority or power assigned to the FSOC by Title I and Title VIII, makes the Council resemble the Presidential Working Group on Financial Markets ("PWG").[203] Since its creation in 1988,[204] the PWG has assisted the President in assessing and identifying the priorities in the financial regulatory agenda and in supporting inter-agency coordination of financial regulatory policies. The PWG is, like the FSOC, a forum of high-level financial agency officials—the Secretary of the Treasury (who acts as Chair), Chairperson of the Fed, Chairperson of SEC, and Chairperson of the CFTC—that support the executive's policy making initiatives by leveraging their expertise.[205] If lawmakers wanted to create a political systemic risk and macroprudential regulator, they could have simply stabilized and modernized the existing

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202 *See supra* Section II.A.2.

203 U.S. GOV'T ACCOUNTABILITY OFF., GAO/GGD-00-46 FINANCIAL REGULATORY COORDINATION: THE ROLE AND FUNCTIONING OF THE PRESIDENT'S WORKING GROUP (2000).

204 Exec. Order No. 12,631, 85 Fed. Reg. 35171 (1988). President Ronald Reagan established the Working Group on Financial Marker and assigned it three purposes and functions:

> (a) Recognizing the goals of enhancing the integrity, efficiency, orderliness, and competitiveness of our Nation's financial markets and maintaining investor confidence, the Working Group shall identify and consider:
>
>> (1) the major issues raised by the numerous studies on the events in the financial markets surrounding October 19, 1987, and any of those recommendations that have the potential to achieve the goals noted above; and
>>
>> (2) the actions, including governmental actions under existing laws and regulations (such as policy coordination and contingency planning), that are appropriate to carry out these recommendations.
>
> (b) The Working Group shall consult, as appropriate, with representatives of the various exchanges, clearinghouses, self-regulatory bodies, and with major market participants to determine private sector solutions wherever possible.
>
> (c) The Working Group shall report to the President initially within 60 days (and periodically thereafter) on its progress and, if appropriate, its views on any recommended legislative changes.

205 *See* PAULSON'S REPORT, *supra* note 14 (analyzing the role history and evolution of the role PWG as inter-agency mechanism to facilitate coordination and communication among financial regulation).

structure of the PWG, reinforcing its purpose—as proposed in the Paulson Report.[206]

Another option: create a new standalone independent agency—i.e., a fully staffed, sufficiently funded or even self-funded, empowered regulatory and supervisory authority with a presidentially appointed chair—while widely discussed and still supported by some commentators,[207] was not able (and has not been able) to garner enough support among lawmakers.

And, since the world of financial regulatory politics is a world of compromises and second bests, the solution that was ultimately found was a watered-down version of the Geithner Report's proposed "Financial Services Oversight Council."[208] The byproduct of a time-constrained legislative process and necessary political compromise, the FSOC's institutional design is fragile. And, the existing tandem approach to systemic risk and financial stability—with the FSOC and the Fed acting as engaged and dialectic players—looks, in reality, like a jigsaw puzzle where some pieces have gone missing.

The FSOC's political leadership impacts its operations and has been seen both as a feature and a bug of the Council.[209] Housing the FSOC in the

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206 Paulson's Blueprint recommended creating a stronger and more modern PWG with a larger membership base that would have included the OCC, the Chairperson of the FDIC. *Id* at 76. Paulson's Report, however, did not consider the institutionalization of the PWG via legislation, but simply through a new presidential executive order. *Id* at 76. In addition, the new PWG would have had a clear mandate to promote coordination and communication for financial policy for the financial system, and it should focus on four main missions: mitigating systemic risk to the financial system, enhancing financial market integrity, promoting consumer and investor protection, and supporting capital markets efficiency and competitiveness. And in doing so the PWG should be given the ability to engage in consultations, issue reports or other documents. *Id.* at 77. The PWG that Paulson's Report had in mind is very similar to the existing structure and purpose of the FSOC.

207 *See* BAIR, *supra* note 81, at 338; Allen, *supra* note 8, at 1138-52.

208 *See* GEITHNER'S REPORT, *supra* note 14, at 20-21. The Treasury Report envisioned a Council with the same members of the current FSOC that would have replaced the PWG on financial markets. *Id.* at 21. An interesting feature of the report, which was substantially watered down in the final text of the Dodd-Frank Act, was the allocation to the Fed of the role as ROLR of all systemically important firms, including all systemically important payment, clearing and settlement systems, and activities of financial firms; *see id* at 23-27, 54.

209 This Article claims that the political leadership of the FSOC undermines its operations and weakens the post-crisis Lawmakers' intent to create a stable FSOC. However, the very composition of the Council, in light of the recent Supreme Court decisions on Seila Law and PHPA, might become quintessentially political, transforming the FSOC's institutional design as a political agency. The full political representativeness of the FSOC membership would be met by the presence of the Treasury Secretary as the FSOC chair, and the chairs of the independent agencies, whose chairs could now be removed at will by the President. *See infra* note 264.

Treasury Department and making it chaired by the Treasury Secretary was the result of a delicate political compromise, but it can be interpreted as both a strength and a flaw in its institutional design. Since the Treasury Secretary is the FSOC Chair, depending on the policy priority of the administration, she will run the FSOC according to the President's policy agenda. The FSOC chair may, therefore, run the Council at high speed, requiring the agency to thoroughly and timely screen the markets for systemic threats and proceed to designate entities and activities as systemically important and then eventually trigger the intervention of the Fed as ROLR. Conversely, the administration's politics may substantially influence the operation of the FSOC in the opposite direction, weakening its role as a financial stability regulator. These outcomes would, in some way, reflect a true democratic and political accountability of an "executive" agency, and they can be achieved without Congress, thereby depriving the market of a critical watchdog against systemic risk. Nevertheless, it should not have surprised commentators that in the existing polarized political environment, the Council's operations would have likely swung between engagement and disengagement. The FSOC has operated as a pendulum, like many other independent or executive administrative agencies, [210] adjusting and moving depending on the change in administrations.

The political cyclicality of the FSOC operations is intrinsic in its institutional design. The FSOC does not operate *motu proprio* but needs the Treasury Secretary's political leadership. FSOC funding comes from assessments on nonbank SIFIs and systemically important banks. Thus, the FSOC is not subject to appropriations procedure and direct congressional oversight. Although subject to the Administrative Procedure Act, the FSOC operates in a *sui generis* administrative law status and within a unique framework. In fact, the designation process is primarily delegated.[211] Congress delegated ample authority to the FSOC to set its own guidelines to define what constitutes systemic risk and guidelines to interpret the requirements for designating a nonbank SIFIs.[212] In doing so, the FSOC granted the potential designee the right to formal notice, to an administrative hearing, and required mandatory periodic reevaluation of all eventual designations. However, rather

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210 *See* 12 U.S.C. § 5321(b) (the presidential appointment power over the chair of the voting member agencies can heavily influence what issues, actions, and direction the FSOC takes under any Presidential administration).

211 *See* Weber, *supra* note 8, at 382-387; *see* White, *supra* note 8, at 17-20.

212 12 U.S.C. § 5323(a)(1).

than a participatory system—where other interested stakeholders are involved—lawmakers and the FSOC effectively adopted an adversarial one.[213]

Because of this multiagency structure and the representation mechanisms (i.e., only the head of the agencies are represented), the FSOC differs from many other multi-member independent agencies (SEC, CFTC). The FSOC is a monochromatic agency where the sitting president can potentially appoint all members (or at least the largest majority of them), with the exception of the Fed Chair.[214]

IV. RETHINKING THE FSOC: FSOC 2.0; THE SYSTEMIC RISK BOARD; AND A NOVEL ROLR REGIME

Since its creation, the FSOC has been the target of criticism from both sides of the aisle. Some commentators and policymakers have questioned the merits of the FSOC's own existence and raised concerns about the Council's accountability and the legitimacy of its administrative power.[215] They have argued to foster transparency in its operations and designation processes,[216] and they introduced legislative proposals to carve out and limit the FSOC's authority.[217] Others who see the role of the FSOC as a systemic risk authority, express concerns regarding the existing institutional design of the Council, and have argued for strengthening the Council itself in a multitude of ways: spanning structural reforms to making it a stand-alone financial agency,[218] or via more marginal reforms that tweak its leadership structure and the transparency of its operations vis-à-vis the public.[219]

The current status of the Council's institutional design leaves the system in a dubious limbo. Lawmakers' creation of a coordinating body for overseeing cross-sectoral financial phenomena and entities was a reasonable and

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213 *See* Weber, *supra* note 8, at 388-94 (analyzing the three stages of the nonbank SIFI designation process under § 5323); *see* White, *supra* note 8, at 15-17.

214 *See, e.g.*, PETER CONTI-BROWN, THE POWER AND INDEPENDENCE OF THE FEDERAL RESERVE (2016); SARAH BINDER & MARK SPINDEL, THE MYTH OF INDEPENDENCE—HOW CONGRESS GOVERNS THE FEDERAL RESERVE (2017).

215 *See* PETER J. WALLISON, AM. ENTER. INST., RISKY BUSINESS: CASTING THE FED AS A SYSTEMIC RISK REGULATOR (2009); PETER J. WALLISON, MAGICAL THINKING: THE LATEST REGULATION FROM THE FINANCIAL STABILITY OVERSIGHT COUNCIL (2011).

216 *See* White, *supra* note 8.

217 *See* REGULATING WALL STREET: CHOICE ACT VS. DODD-FRANK 17-18, 93-98 (2017), https://perma.cc/J5PA-LYFB.

218 *See* Allen, *supra* note 8.

219 *See* Gelzenis, *supra* note 8; Glenn Hubbard et al., *Chapter 8: Regulatory Structure and Process*, *in* BROOKING TASK FORCE ON FINANCIAL STABILITY 102-15 (2021), https://perma.cc/D6PW-NHMS [hereinafter BROOKING REPORT].

appropriate response to the expansion in breadth of the financial system. It was a response to the structural weakness of the existing siloed financial regulatory architecture and a mechanism to potentially fill the regulatory gaps, reduce the risk of arbitrage opportunities, and support a more resilient financial system. However, its architectural vulnerabilities make the FSOC prone to cyclical political trends, that undermine the Council's operations, destabilize the activity of its "on/off boarding" designation process, and expose the Council to mission creep criticisms.[220] This ultimately destabilizes the operability of the "on board" ROLR regime for systemically important financial phenomena,[221] either by disengaging the Council or over-delegating to it. Both scenarios erode the FSOC's legitimacy.

Reforms are needed to rebalance the FSOC's institutional design and retune its operations as a coordinating forum and supporting authority for financial agencies as well as its role as a designator of systemically important entities or activities. The financial system's dynamism and evolution have posed new challenges to the existing regulatory architecture. A revitalized and updated FSOC—which would account for its proneness to political cyclicality and would address the flaws in its administrative procedure—could be a testing ground for institutional design options. These design options would tackle the current partisan polarization of the administrative state and would offer different alternatives to the regulation and supervision of the financial system. Additionally, lawmakers should experiment with the Fed's partially-existing role as ROLR as a regulatory mechanism to address regulatory gaps and create regulatory clarity. Lawmakers should build a more effective jurisdictional allocation mechanism between the Fed and primary regulators. This would account for the principles of subsidiarity and proportionality in allotting responsibilities over the system.[222]

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220 *See supra* Section II.A.2.

221 *See* Saguato, *supra* at 29.

222 Subsidiarity and proportionality are the cardinal principles of the functioning of the E.U. along with the allocation of legislative and administrative competencies between the E.U. and its members states. Nevertheless, their application could be used in any multi-jurisdiction context where different authorities share in total or partially the jurisdiction over a specific market or phenomenon. In the E.U. context, the subsidiarity principle safeguards the ability of the Member States to take decisions and actions, and authorizes intervention by the E.U. when the objectives of an action cannot be sufficiently achieved by the Member States, but can be better achieved at Union level, "by reason of the scale and effects of the proposed action." *See The Principle of Subsidiarity*, EUR. UNION, https://www.europarl.europa.eu/factsheets/en/sheet/7/the-principle-of-subsidiarity.
Under the proportionality principle, on the other hand, the E.U., when it decides to intervene, must take only those actions that are necessary to achieve the objectives of the Treaties. Simply put, the E.U. must act within its boundaries, and the content and form of

This Article presents two alternative policy options to create a more accountable, legitimate, and effective FSOC. This is in the best interest of the markets, economy, and society. If value-adding public institutions are created to endure; bipartisan support is of the essence. Incremental and practical, the first proposal builds on the existing regime and tweaks some institutional and procedural aspects of the FSOC on the margins. This option would make the Council's activities more reliable and its operations more resistant to political pressure. Financial stability is, and should be, a bipartisan issue. The second proposal builds on the Fed-centric ideas to reform the U.S. financial architecture in the aftermath of the financial crisis, expands on the Fed's role as a regulator, lender, and dealer of last resort in the U.S. financial system;[223] and draws on the comparative experience of the U.K. and the E.U. This proposal reimagines a Fed-centric system of micro- and macroprudential regulation with a new coordinating body within the Fed: the Fed Systemic Risk Board ("SRB"), responsible for identifying systemic risk threats and designating systemically important entities and activities.

This section is structured as follows. A comparative view on how other jurisdictions, in this case the U.K. and the E.U., have addressed the issues of regulating systemic risk, can inform the policy discourse on how to strengthen the U.S. regulatory architecture. In both peer jurisdictions, post-crisis reforms granted central banks a more direct authority over financial stability, and the proposals presented in the next section envision the Fed having a more prominent systemic responsibility. After the comparative overview, this section presents two policy solutions to address the architectural vulnerabilities of the current FSOC structures aimed at strengthening the capacity of the Council to operate by adjusting its leadership. It then concludes by expanding the idea and regime of the Fed as a ROLR, an effective regime for regulating and supervising systemically important designated phenomena.

A. A Comparative Perspective

To inform policymakers' actions, it is worth examining the comparative experience of two jurisdictions whose financial systems are strongly connected with the U.S. and also faced severe distress during the 2008 financial crisis: the E.U. and the U.K.[224] Neither jurisdiction opted to create a stand-alone systemic

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its action must be in keeping with the aim pursued. *See Proportionality Principle*, EUR. UNION, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM:proportionality.

223 *See, e.g.*, GEITHNER'S REPORT, *supra* note 14; PAULSON'S REPORT, *supra* note 14.

224 For a comparative analysis of the different regulatory approaches to the regulation of financial markets, see Jacopo Carmassi & Richard J. Herring, *The Structure of Cross-Sector*

risk regulator nor has adopted an equivalent to the FSOC, but each adopted alternative mechanisms and arrangements to address systemic risk threats.

1. The E.U. Experience: The ECB and the Systemic Risk Board

The 2008 crisis revealed the lack of effective mechanisms or institutions for system oversight and macroprudential review. This assessment drove E.U. policymakers to reconsider the European architecture of financial supervisors and regulators. The E.U. Commission tasked a High-Level Group of experts, chaired by Jacques de Larosière, to consider options for strengthening the E.U. financial architecture. The Report published by the Group, the so-called de Larosière Report, recommended the creation of a sound macro-prudential system built around central banks,[225] and the establishment of the European Systemic Risk Council (ESRC) as a part of the European Central Bank (ECB), chaired by the ECB Chair and operating in the ECB perimeter; and responsible for overseeing risk in the financial system, monitoring the macroprudential conditions of the E.U., issuing macroprudential risk warnings, recommendations, and observations on macroprudential policies.[226] The Report envisioned the ESRC as an ECB appendage responsible for macroprudential oversight that would be a part of a novel European System of Financial Supervisors (ESFS), tasked with coordinating microprudential supervision of financial markets and institutions.[227]

Financial Supervision, (Wharton School of Bus. Fin. Inst. Working Papers, 2007); Jeroen J.M. Kremers et al., *Cross-Sector Supervision: Which Model?*, (Brookings-Wharton Papers on Fin. Serv., 2003); Richard K. Abrams & Michael W. Taylor*, Issues in the Unification of Financial Sector Supervision*, (Int'l Monetary Fund Working Papers, Paper No. 00/213, 2000); Giorgio Di Giorgio and Carmine Di Noia, *Financial Regulation and Supervision in the Euro Area: A Four-Peak Proposal* (Wharton School of Bus. Fin. Inst. Working Papers, 2001); U.S. GOV'T ACCOUNTABILITY OFF., GAO-05-61, FINANCIAL REGULATION: INDUSTRY CHANGES PROMPT NEED TO RECONSIDER U.S, REGULATORY STRUCTURE (2004); and U.S. GOV'T ACCOUNTABILITY OFF., GAO-08-31, FINANCIAL REGULATION: INDUSTRY TRENDS CONTINUE TO CHALLENGE THE GENERAL REGULATORY STRUCTURE (2007).

225 THE DE LAROSIÈRE GROUP, THE HIGH-LEVEL GROUP ON FINANCIAL SUPERVISION IN THE EU REPORT 44-5 (Feb. 25, 2009), https://perma.cc/LZD6-ZQCT.

226 *Id.* at 46. The responsibility for implemented macroprudential policies remained allocated to the competent authorities of each E.U. member state.

227 *Id.* at 47-48.

In 2010, European legislators building on the de Larosière Report recommendations,[228] established the European Systemic Risk Board (ESRB)[229] as a new E.U. body, formally separated from the ECB,[230] and part of the ESFS.[231] The ESRB was given a macroprudential mandate among financial regulators and is responsible for the macroprudential oversight and supervision of the E.U. financial system and monitoring, assessing, preventing, and mitigating systemic risk.[232]

The ESRB has a broad jurisdiction over the whole E.U. financial system, covering banks, insurers, asset managers, shadow banks, financial market infrastructures, and other financial institutions and markets. In pursuing its mission, the ESRB has multiple tasks: (1) determining and/or collecting and analyzing all the relevant and necessary information to perform its macroprudential supervision responsibilities;[233] (2) identifying and prioritizing systemic risks; (3) issuing warnings, and where appropriate, recommendations to the competent authority for remedial actions to systemic risks in response to the risks identified (including, when appropriate, legislative initiatives);[234] (4)

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228 Fabio Recine & Pedro Gustavo Teixeira, *The New Financial Stability Architecture in the EU* 15-19 (Paolo Baffi Centre Research Paper No. 2009-62, 2009), http://dx.doi.org/10.2139/ssrn.1509304.

229 *See* Regulation (EU) No 1092/2010 on European Parliament and of the Council of 24 November 2010 on the European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, 2010 O.J. (L 331) 1; 2019 O.J. (L 334) 146 (amending (EU) No 1092/2010) [hereinafter ESRB Regulation]; NIAMH MOLONEY, EU SECURITIES AND FINANCIAL MARKETS REGULATION 1013-23 (3d ed. 2014) (offering a comprehensive analysis of the ESRB role in the EU financial architecture); LUCA AMORELLO, MACROPRUDENTIAL BANKING SUPERVISION & MONETARY POLICY – LEGAL INTERACTION IN THE EUROPEAN UNION 65-81, 314-27 (2018); Brigitte Haar, *Organizing Regional Systems – The EU Example*, *in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION 157, 174-78 (Niamh Moloney et al., eds., 2015).

230 Recital 15 ESRB Regulation. The institutional decision for a formal separation of the ESRB from the ECB, and the creation of the ESRB as an independent body, was primarily due to the fact that not all E.U. member states are euro-zone members, and the ESRB's actioned needed to cover all E.U. members states.

231 *See The European System of Financial Supervision*, EUR. COMM'N, https://perma.cc/3WRW-FRSB. The European Parliament and the Council issued five regulations to set the pillars of the ESFS. The E.U. established three new microprudential authorities, the European Banking Authority, the European Insurance and Occupational Pension Authority, and the European Securities and Markets Authority, and one macroprudential supervisory body, the ESRB.

232 Art. 3(1) ESRB Regulation.

233 Art 15 ESRB Regulation.

234 Art 16 ESRB Regulation; warnings and recommendations can be address to one or more of the national supervisor authorities, to the Members States, or to the E.U. Commission, where the issues required a Union legislation. Anytime the ESRB issue any warnings or recommendation, under strict rules of confidentiality, the ESRB must transmit them to the

cooperating closely with all the other parties to the ESFS; (5) coordinating its actions with those of international financial organizations, particularly the International Monetary Fund and the Financial Stability Board as well as the relevant bodies in third countries on matters related to macroprudential oversight.[235]

The ESRB was envisioned to have real influence in shaping fiscal, financial, regulatory, and supervisory policy and its organization reflects the balance lawmakers had to find between expertise and accountability. The ESRB is housed and staffed at the ECB,[236] chaired by the President of the ECB,[237] composed of a broad membership base (among the members there are national central banks, E.U. financial regulators, and a representative of the European Commission),[238] and operated with multiple committees. While the size of the ESRB's membership can pose a logistical challenge at times, it ensures that all the relevant stakeholders are properly involved and that the ESRB's assessment of systemic risk is based on a wide range of views and a broad set of information.[239] The ESRB must meet at least four times a year,[240] and decisions are generally taken with a simple majority vote, or with a two-thirds majority when the General Board votes to adopt a recommendation or to make a warning or recommendation public.[241] ESRB warnings and recommendations are soft law and not enforceable,[242] but the ESRB monitors compliance with its recommendations using "act or explain" mechanisms. Furthermore, in case of inaction, the ESRB can escalate to other European Supervisory Authorities

European Parliament, Council, Commission, and to the European Supervisory Authorities ("ESAs").

235 Art. 3(2) ESRB Regulation.

236 *See* Council Regulation 1096, 2010 O.J. (L 331) 1626 (conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board). The ECB provides analytical, statistical, administrative and logistical support to the ESRB, drawing also on the technical advice from national central banks and supervisors.

237 Art. 5 ESRB Regulation.

238 The General Board is the decision-making body of the ESRB and is chaired by the President of the ECB. It has 65 members (37 voting and 28 non-voting). The voting members include: the President and Vice-President of the ECB; the governors of the national central banks of the EU Member States; the Chairs of the three ESAs; a member of the European Commission; the Chair and the two Vice-Chairs of the ASC; and the Chair of the ATC. The non-voting members are: the President of the Economic and Financial Committee and one high-level representative per E.U. Member State from the competent national supervisory authorities. *See* EUR. SYSTEMIC RISK BD., ANNUAL REPORT 14 (2011).

239 EUR. SYSTEMIC RISK BD., ANNUAL REPORT 14 (2011).

240 Art. 9 ESRB Regulation.

241 Art. 10 ESRB Regulation.

242 Ellis Ferran, Ellis & Kern Alexander, *Can soft law bodies be effective? The special case of the European systemic risk board*, 37 EUR. L. R. 751, 753-58 (2011).

(ESA) or E.U. institutions the failure of the addressee to comply; and it may even make the warning or recommendation public. [243]

Different from the FSOC, the ESRB does not have the authority to designate a specific entity or activity as systemically important, nevertheless in its ten years of operations, the ESRB issued recommendations in relations to money-market funds, on funding sources of credit institutions, on strengthening macroprudential policies and on cross-border coordination of macroprudential policies, and liquidity and leverage risk in investment funds, etc.[244] In addition, another structural difference with the FSOC and the U.S. financial architecture, is the formal role the ESRB has in supporting the ESA in their duty to promote financial stability and contain systemic risk.[245].

2. The U.K. Experience: The Bank of England and the Financial Policy Committee

After the financial crisis, the U.K. radically reformed its regulatory system's structure, strengthening the financial stability mission of the Bank of England and placing all systemic risk regulation responsibilities within the Bank of England's purview.[246] The Financial Services Act of 2012 created a new committee in the Bank of England, the Financial Policy Committee ("FPC"),[247] and assigned it a macroprudential responsibility: overseeing and mitigating systemic risk and supporting financial stability.[248] The FPC works together with the Monetary Policy Committee and the Prudential Regulation Committee, which is responsible for the microprudential regulation of banks, insurance companies, and complex investment firms.[249]

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243 *See* MOLONEY, *supra* note 229, at 1014.

244 *See Recommendations*, EUR. SYSTEMIC RISK BD., https://www.esrb.europa.eu/mppa/recommendations/html/index.en.html.

245 *See* MOLONEY, *supra* note 229, at 1015-19 (discussing the role of the ESRB in financial markets); *see e.g.*, Arts. 22-24, European Parliament and Council Regulation 1095, 2010 O.J. (L 331) 84. The ESAs are the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA). They all have a financial stability mandate—an overarching obligation to duly consider systemic risk and to address any risks of disruption in financial services—and are all individually required to collaborate with the ESRB to develop a framework to address systemic risk.

246 The Financial Conduct Authority (FCA) operates parallel to the Bank of England and is the conduct regulator for 56,000 financial services firms and financial markets in the U.K. and the prudential regulator for over 24,000 of those firms." *See* www.fca.org.uk/about/the-fca.

247 *See* Bank of England Act, c. 11, Part 1A Financial Stability, s. 9B.

248 *See* Bank of England Act, c. 11, Part 1A Financial Stability, s. 9C.

249 "The Prudential Regulation Committee has three statutory objectives: 1. a general objective to promote the safety and soundness of the firms it regulates; 2. an objective specific to insurance firms, to contribute to the securing of an appropriate degree of protection for

The FPC's primary responsibility is the macroprudential oversight of the financial system and the enhancement of the stability of the U.K. financial system through identifying, monitoring, and acting to remove or eliminate systemic risks.[250] The FPC's secondary objective is to support the economic policies of the Government, which is charged with ensuring the safety and soundness of the entire financial system.[251]

The FPC is chaired by the Governor of the Bank of England, and its composition is central bank-centric. Of the thirteen members, six are Bank of England staff,[252] five are independent experts appointed by the Chancellor of the Exchequer based on their experience and expertise in financial services, the head of the Financial Conduct Authority (the other financial regulator in the U.K.), and a representative of the Treasury.[253] Despite being a Bank of England Committee, the Treasury has the right to make written recommendations to the FPC about its financial stability and systemic risk oversight objectives, and the FPC is required to respond to such recommendations.[254]

In performing its functions,[255] the FPC reaches its decisions by consensus, whenever possible. When consensus cannot be achieved, the FPC decides by majority vote and the record of the meeting should reflect all arguments advanced for each position.[256] The FPC was assigned the authority to mandate actions to other microprudential regulators and to issue broader recommendations to other regulatory agencies.[257] The FPC has the power to

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those who are or may become insurance policyholders; and 3. a secondary objective to facilitate effective competition." *See Prudential Regulation*, BANK OF ENGLAND, www.bankofengland.co.uk/pra/pages/default.aspx.

250 *See* Bank of England Act, c. 11, Part 1A Financial Stability, s. 9C(1)(a), 9C(2).

251 *See* Bank of England Act, c. 11, Part 1A Financial Stability, s. 9C(1)(b), 9D.

252 In addition to the Governor, the Bank of England is represented by four Deputy Governors – the Deputy Governor for financial stability, the Deputy Governor for markets and banking, the Deputy Governor for monetary policy, the Deputy Governor for prudential regulation, and by the Executive Director for Financial Stability Strategy and Risk – and by the Executive Director for Financial Stability Strategy and Risk, appointed by the Governor of the Bank after consultation with the Chancellor of the Exchequer; see https://www.bankofengland.co.uk/about/people/financial-policy-committee.

253 *See* Bank of England Act, c. 11, Part 1A Financial Stability, s. 9B.

254 *See* Bank of England Act, c. 11, Part 1A Financial Stability, s. 9E.

255 *See* Bank of England Act, c. 11, Part 1A Financial Stability, s. 9G.

256 *See* FPC, *Communications guidance for FPC members* (Feb. 2020), https://perma.cc/NVC4-T72K.

257 *See* Paul Tucker et al., *Macroprudential Policy at the Bank of England*, BANK OF ENGL. Q. BULLETIN Q3, 2013, at 192–200, www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2013/qb130301.pdf. ("The FPC has a distinct set of powers to give Directions to the PRA and FCA to deploy specific macroprudential tools that are prescribed by HM Treasury, and approved by Parliament, for these purposes." And "The FPC can also make Recommendations to the PRA and FCA on a 'comply or explain' basis—in which

give binding directions and instructions to the Prudential Regulatory Authority ("PRA") and the Financial Conduct Authority ("FCA") with respect to macroprudential matters,[258] and the power to make recommendations to the PRA and FCA, to the Bank itself, to the Treasury, or more broadly to anyone to reduce risks to financial stability.[259] Finally, it is required to prepare financial stability reports.[260] As of today, the FPC has exercised its direct power to set countercyclical capital buffers for banks, sectoral capital requirements for U.K. firms, and leverage ratio requirements for U.K. financial institutions.

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Looking at how peer jurisdictions have tackled the need to create a macroprudential authority can inform the domestic debate on how to strengthen and stabilize the FSOC's structure and its operations. Both the E.U. and the U.K. have unique regulatory architecture, and both opted for a macroprudential authority with a strong central bank presence. Both jurisdictions provided their macroprudential authorities with unique toolkits that are substantially different from the FSOC's powers. The next sections draw from the E.U. and U.K. experiences to present some policy proposals on how to reform the FSOC.

B. FSOC 2.0: A New Leadership and a More Effective Structure

The existing leadership structure of the Council (and its membership) attempts to balance democratic accountability and responsiveness with expertise. The FSOC structurally resembles an executive agency that relies on interagency coordination and action to properly function. However, as witnessed over the past decade, the position in which the Treasury Secretary can find herself is peculiar. As a Cabinet member, she responds to the President and implements the short and long-term policy priorities of the administration's agenda. But additionally, as a chair of the FSOC, an authority with a financial stability mission and a duty to actively screen the system for

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case, the regulators are required to act as soon as reasonably practical. If one of these regulators were to decide not to implement a Recommendation, it must explain the reasons for not doing so.").

258 *See* Bank of England Act, c. 11, Part 1A Financial Stability, s. 9H.

259 *See* Bank of England Act, c. 11, Part 1A Financial Stability, s. 9O-9R.

260 *See* Bank of England Act, c. 11, Part 1A Financial Stability, s. 9W.

sources of systemic risk, the Treasury Secretary might find herself in conflict with the administration's financial regulatory and economic priorities.[261]

An improvement to the FSOC's leadership structure that would balance democratic responsiveness with expertise and strengthen the operation of the Council could be achieved with the creation of two Co-Chairs for the FSOC: the Treasury Secretary and the Fed Chair. The Co-chairs would share the same powers, and each would exercise their power autonomously. Each Chair would have the power to the call FSOC meetings, and both Chairs would be required to testify before the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs in conjunction with the release of the annual FSOC report. For designation, rescission, or evaluation of nonbank SIFIs, SIFMUs, or systemically important clearing, settlements, or payment activities, the affirmative vote of one of the two Co-Chairs would be required for the decision to be approved.

In addition, a novel role could be assigned to the Fed Vice Chair for Supervision. The Vice Chair for Supervision "[is] responsible [for] developing policy recommendation[s] for the Board regarding the supervision and regulation of depository institution holding companies and other financial firms supervised by the Board and shall oversee the supervision and regulation of such firms."[262] Because of the Vice-Chair for Supervision's responsibility over financial regulation and supervision (which would also encompass the regulation and supervision of designated nonbank SIFIs, as well as SIFMUs and systemically important clearing, settlements, or payment activities), the Vice-Chair would support the Fed Chair in her FSOC leadership position. Also, at the Chair's discretion, the Vice-Chair for Supervision would have the authority to represent the Fed on the FSOC and act with the authority as Co-Chair, including the authority to call and lead FSOC meetings, to vote at the meetings, and to testify before Congress on matters relating to financial stability.

The FSOC's co-leadership could partially stabilize the operations of the Council, balancing democratic accountability and technical expertise, thus rendering the Council less vulnerable to political cyclicality, but preserving the political responsiveness of the FSOC.[263] Changes in congressional political

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261 *See* BROOKING REPORT, *supra* note 219, at 104.

262 *See* 12 U.S.C. § 242.

263 A recent report by the Brookings Institute recommends changes in the leadership structure of the FSOC, too. The report recommends the creation of a new position within the Treasury Department, the Under Secretary for Financial Stability. The Under Secretary office would be supported by sufficient staff to support the Treasury Department in leading the FSOC. And, at the discretion of the Treasury Secretary, the Under Secretary would have

majorities and administrations are a feature of our constitutional democracy, and the effects of a change in administration should impact financial policies. Nevertheless, some heads of independent agencies can have longer terms than presidential administrations, and can only be removed for cause.[264] The proposed new composition of the FSOC would preserve the President's authority to appoint a majority of FSOC members, and its Chair, so that the Council can respond to her policy priorities. However, having the Fed Chair as the Council's Co-Chair could give continuity to the operations of the Council and preserve some longer-term institutional priorities and financial stability goals, given her removability by the President only for cause.[265] The proposed new FSOC leadership should balance political responsiveness with the need for a forward-looking and long-term financial stability mission to monitor and reduce systemic risk. Striking the right balance between these two aspects would boost the FSOC's accountability and stabilize its operations. In addition, to further mitigate the political cyclicality of the Council, the FSOC membership should be extended to all members or commissioners of any existing FSOC multi-member agency. For instance, all SEC and CFTC commissioners would become FSOC members; however, each multi-member agency would only be entitled to a single vote in the Council—a vote that would represent the majority opinion among all of that particular agency's commissioners.

The FSOC 2.0 proposal has the benefit of incrementalism and practicality yet would still require congressional action. The marginal changes that this proposal advances, which would affect the FSOC's voting structure and membership, would have a potentially higher likelihood of enactment in Congress than a complete reform of the FSOC to make it a stand-alone independent agency with independent rulemaking authority over systemic risk

full authority to take any actions that the Treasury Secretary is authorized to take as chair of the FSOC, including leading FSOC meetings, voting at those meetings, and testifying before Congress on matters relating to financial stability. *See* BROOKING REPORT, *supra* note 219, at 110.

264 *See, e.g.*, Free Enter. Fund v. Pub. Co. Account. Oversight Bd., 561 U.S. 477, 486–87 (2010) (stating that independent agencies have some insulation from Presidential influence because of for-cause removal); Humphrey's Executor v. United States, 295 U.S. 602, 622–23 (1935) (noting the fixed terms, political insulation, and congressional intent as reasons from distinguishing independent agencies from executive departments); *but see also* Seila Law LLC v. CFPB, 140 S. Ct. 2183, 2197 (2020) (holding unconstitutional the statutory provision authorizing the President to remove the CFPB Director only for "inefficiency, neglect, or malfeasance"); *see also* Collins v. Yellen, 141 S. Ct. 1761, 1796 (2021).

265 *See* Peter Conti-Brown, *What Happens if Trump Tries to Fire Fed Chair Jerome Powell?*, BROOKINGS INST. (Sept. 9, 2019) https://www.brookings.edu/opinions/who-has-to-leave-the-federal-reserve-next/.

and macroprudential issues. Such proposals would not only require high political capital and implementation costs, but they would also create risky and delicate jurisdictional conflicts and overlaps between the FSOC as an independent agency and primary regulators, conflicts that the existing ROLR would attenuate substantially, as discussed later in this section.

C. The Systemic Risk Board

As previously discussed, the current FSOC structure is the outcome of political compromise, which watered-down more radical plans for the creation of a systemic risk regulator. In the aftermath of the crisis, some Democratic and Republican politicians and regulators, including Paul Volcker and Hank Paulson, discussed the idea of creating a more Fed-centric financial regulatory system. This would have formally and legally assigned the Fed a financial stability mandate. This would be giving the Fed all the ancillary power necessary to manage systemic risk sources in the financial system.

An alternative solution to the current FSOC, or even to FSOC 2.0, builds on the more Fed-centric proposals advanced in the aftermath of the financial crisis and on the experience of the U.K. and the E.U. A new Systemic Risk Board ("SRB") should take the place of the FSOC and should be integrated within the Fed. The SRB would act as a coordination and designation mechanism, leveraging the staff and resources of the Fed. The SRB could have two possible membership structures. One could resemble the current membership structure of the FSOC, where the voting members are the federal financial regulators, plus the independent insurance expert. Alternatively, the SRB members could formally be the multi-members agencies. All commissioners or members of any FSOC members would be entitled to participate in the FSOC's meetings,[266] but, at time of voting, each FSOC institutional member would have only one vote.[267] Finally, the Fed Chair would chair the SRB, with the authority to delegate to the Fed Vice-Chair for Supervision the authority to represent the Fed on the SRB and lead it.

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266 Adding the agency and all its members as FSOC members and not simply the chair would reduce the political responsiveness and cyclicality of the SRB. In fact, for instance, SEC, CFTC, and NCUA chairs, while they have removal protection as commissioners, they can be removed as chair with or without cause, making them political actor that might contribute to the political fluctuations in the operations of the Council.

267 The Brookings Financial Stability Task Force recently proposed to create in each FSOC member an internal Office of Financial Stability and Resilience to support the agencies actions as FSOC's member. *See* BROOKING REPORT, *supra* note 219, at 109.

The SRB should be built on the FSOC organizational structure and formed as a multiagency agency. The SRB should have six main duties: (1) continuing and enhancing the data collection and sharing activities that the FSOC started; (2) providing a forum to coordinate regulatory actions, particularly in areas of concurring competence between primary regulators, and *ex ante* assessing and solving any cross-sectorial and overlapping issues in regulating market dynamics; (3) designating systemically important nonbank entities and activities requiring enhanced regulation and supervision; (4) identifying a lead primary regulator to adopt adequate framework for systemically important nonbank financial entities and activities; (5) assigning the Fed the role of ROLR to intervene if the primary regulators do not act; and (6) solving jurisdictional conflicts among member agencies. The SRB would be subject to the same transparency regime as the FSOC and be required to produce an Annual Report, and the Fed Chair, or alternatively the Vice-Chair for Supervision when authorized to act as SRB Chair, would be required to testify at least annually *qua* SRB Chair in front of Congress.

D. The Next Step: A Novel ROLR Regime?

As previously discussed, Dodd-Frank envisioned a role for the Fed as a ROLR for nonbank SIFIs, SIFMUs, and systemically important clearing, settlements, and payment activities. But to operate as an effective ROLR, the Fed must rely on the operations and inputs of a functioning FSOC. Lawmakers, in fact, did not grant the Fed direct authority as ROLR, but only indirectly following the designation of systemic importance by the FSOC. However, as this Article unpacked, the existing architectural vulnerabilities in the FSOC design have undermined its on-boarding role into the ROLR regime. The Fed ROLR role is fully conditioned on the prompt actions of the FSOC, whose inactions might deprive the markets of the enhanced regulatory and supervisory apparatus and coordination envisioned by Dodd-Frank.

This Article claims that either a newly refurbished FSOC, with co-chairpersonship by the Secretary of the Treasury and by the Fed Chair, or a novel SRB within the Fed, would reduce the political cyclicality that the FSOC experienced in its ten-year existence and could create a more stable institution. Creating a more balanced FSOC is a necessary condition to consider what role the ROLR regime can play in the U.S. financial system. Analyzing and envisioning a novel and expanded role of the Fed as a ROLR is outside the scope of this Article, but it is an essential element of a larger research agenda.[268]

CONCLUSION

During its ten-year existence, the FSOC has received much criticism about its accountability and legitimacy. Its leadership structure exposed the Council to political cyclicality, that, has undermined its legitimacy and role as technical and expert agency.

Reforms are needed to rebalance the FSOC's institutional design, to retune its operations as a coordinating forum and supporting authority for regulatory agencies, and to refine it as designator of systemically important entities or activities. Without a properly functioning FSOC, the regulatory architecture created by Dodd-Frank to supervise macroprudential risk and to regulate systemic risk would not be able to operate. It is in the best interest of the markets, economy, and society if value-adding public institutions are created to endure. To do so, bipartisan support is of the essence.

Incremental and practical, the first proposal builds on the existing regime and fixes, at the margins, the FSOC's architectural vulnerabilities by tweaking its leadership structure and envisioning a co-chair role for the Treasury Secretary and for the Fed Chairperson. The dual-chair role might make the Council's activities more stable and reliable and its operations more resistant to political pressure. The second proposal builds on a more central role of the Fed as a leading macroprudential authority and advances the dismantling of the FSOC, and supports its replacement with the creation of a new Systemic Risk Board within the Fed—responsible for identifying systemic risk threats and triggering enhanced holistic regulation. The SRB would provide a more direct link between the Fed as a host of the SRC, the Fed as a ROLR, and the Fed as a LOLR.

Systemic risk and macroprudential concerns over the regulation of the financial system are, and should continue to be, priorities for policymakers. Rethinking the current structure of the FSOC could be the first step in creating a more effective regulatory architecture for the U.S. financial system.

268 *See* Saguato, *supra* note 27 (discussing the political economy implications of creating fully embracing the Fed as the ROLR of the financial system).