FACT SHEET: The Financial Stability Oversight Council's Proposed Analytic Framework for Financial Stability Risk Identification, Assessment, and Response

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The Financial Stability Oversight Council (Council) today released for public comment a new proposed analytic framework for financial stability risks.

The proposed analytic framework describes the approach the Council expects to take in identifying, assessing, and responding to potential risks to U.S. financial stability, regardless of whether those risks arise from activities, individual firms, or otherwise. It is intended to help market participants, stakeholders, and other members of the public better understand how the Council expects to perform certain of its duties. The proposed analytic framework would provide the public with new insight into how the Council evaluates potential risks to financial stability. It does not impose obligations on any entity.

Identifying Potential Risks. The Council, in consultation with relevant financial regulators, monitors financial markets, entities, and market developments to identify potential risks to U.S. financial stability. Under the proposal, the Council's monitoring for potential risks to financial stability may cover a broad range of asset classes, institutions, and activities, such as:

- markets for debt, loans, short-term funds, equity securities, commodities, digital assets, derivatives, and other institutional and consumer financial products and services;
- central counterparties and payment, clearing, and settlement activities;
- financial entities, including banking organizations, broker-dealers, asset managers, investment companies, insurance companies, mortgage originators and servicers, and specialty finance companies;
- new or evolving financial products and practices; and
- developments affecting the resiliency of the financial system, such as cybersecurity and climate-related financial risks.

Assessing Potential Risks. The Council works with relevant financial regulatory agencies to evaluate potential risks to financial stability to determine whether they merit further review or action. The evaluation of any potential risk to financial stability will be highly fact-specific, but the proposed analytic framework identifies certain vulnerabilities that most commonly contribute to such risks.

- *Vulnerabilities.* The proposed analytic framework specifies certain vulnerabilities that the Council expects to consider in evaluating potential risks to financial stability – regardless of whether those vulnerabilities arise from activities, firms, or otherwise. The identified vulnerabilities include leverage, liquidity risk and maturity mismatch, interconnections, operational risks, complexity or opacity, inadequate risk management, concentration, and destabilizing activities. The proposal describes each of these vulnerabilities and identifies specific quantitative metrics that may be useful in assessing these vulnerabilities. The presence of any of these vulnerabilities may increase the potential for risks to be transmitted to financial markets or market participants.

- *Transmission channels.* The Council considers how the adverse effects of potential risks could be transmitted to financial markets or market participants and what impact the potential risk could have on the financial system. Such a transmission of risk can occur through various mechanisms, or channels. The proposed analytic framework describes four channels that are most likely to facilitate the transmission of the negative effects of a risk to financial stability, and which the Council might apply in its analyses: exposures, asset liquidation, critical function or service, and contagion.

Addressing Potential Risks. The actions the Council may take to address a risk to financial stability depend on the nature of the vulnerability; for example, vulnerabilities originating from activities that may be widely conducted in a particular sector or market over which a regulator has adequate existing authority may be addressed through an activity-based or industry-wide response; in contrast, in cases where the financial system relies on the ongoing financial activities of a small number of entities, such that the impairment of one of the entities could threaten financial stability, or where a particular financial company's material financial distress or activities could pose a threat to financial stability, an entity-based action may be appropriate. The Council may take different approaches or use multiple tools to mitigate an identified risk to financial stability, depending on the circumstances.

When a potential risk to financial stability is identified, the Council may consider the utility of any of the Council's authorities to respond to risks to U.S. financial stability, including:

- *Interagency coordination and information sharing*. The proposed analytic framework notes that in many cases, the Council works with relevant federal and state financial regulatory agencies to seek the implementation of appropriate actions to ensure a potential risk is adequately addressed. If existing regulators can address a risk to financial stability in a sufficient and timely way, the Council generally encourages those regulators to do so.

- *Recommendations to agencies or Congress.* Section 120 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) gives the Council authority to make recommendations to financial regulators to apply new or heightened standards and safeguards for a financial activity or practice. Prior to issuing a recommendation under section 120, the Council will consult with the relevant primary financial regulatory agency and provide the public with an opportunity to comment on the proposed recommendations. Where no primary financial regulatory agency exists for the markets or companies conducting financial activities or practices identified by the Council as posing risks, the Council can consider reporting to Congress on recommendations for legislation that would prevent such activities or practices from threatening U.S. financial stability.

- *Nonbank financial company determinations*. In certain cases, the Council may evaluate a nonbank financial company to determine whether to designate the company for Federal Reserve supervision and prudential standards. Such determinations would follow the process described in the Council's proposed interpretive guidance on nonbank financial company designations, which the Council also released today for public comment.

- *Financial market utility designation*. Under Title VIII of the Dodd-Frank Act, the Council has authority to designate financial market utilities that are, or are likely to become, systemically important.

- *Payment, clearing, and settlement activity designation.* Under Title VIII of the Dodd-Frank Act, the Council has authority to designate payment, clearing, and settlement activities that are, or are likely to become, systemically important.

The full text of the proposed analytic framework can be found here.