FINANCIAL REGULATION — DODD-FRANK ACT — FSOC DETERMINES GENERAL ELECTRIC SUBSIDIARY NO LONGER A SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTION — FINANCIAL STABILITY OVERSIGHT COUNCIL, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S RESCISSION OF ITS DETERMINATION REGARDING GE CAPITAL GLOBAL HOLDINGS, LLC (2016).

Systemic financial breakdown predictably leads to systemic financial regulation: in nation-states, as in most institutions driven by public accountability, efforts to prevent the recurrence of a problem tend to mirror the size and scope of the problem itself. The 2008 financial crisis was no exception. Its chief legislative effect, the Dodd-Frank Wall Street Reform and Consumer Protection Act,[1] is "the most sweeping reform of the financial system since the Great Depression," a sprawling bill "passed largely on party[ ]line[s]"[2] and with little public scrutiny.[3] In order to better organize macroprudential regulatory oversight, Dodd-Frank established the Financial Stability Oversight Council (FSOC), an apex committee tasked with monitoring the systemic risk of large, nonbank financial firms.[4] In realizing that such firms played a large role in the crisis, Dodd-Frank authorizes FSOC to "determine" or "designate" firms for enhanced prudential supervision.[5] The designation process is complex; it involves tiered stages of review, a multidimensional analysis, and hybrid, interlocking legal and economic considerations. At its heart lies section 113, which empowers FSOC to designate firms as systemically important financial firms (SIFIs) subject to higher capital, leverage, and liquidity requirements, short-term debt limits, and greater public disclosure obligations.[6]

On July 8, 2013, FSOC exercised its section 113 power to designate General Electric Capital Corporation (GECC), the predecessor of what is now GE Capital Global Holdings, LLC (GE Capital).[7] Recently, after GE Capital's parent company, General Electric (GE), went through

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[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of the U.S. Code).

[2] MICHAEL S. BARR ET AL., FINANCIAL REGULATION: LAW AND POLICY 63 (2016).

[3] *See* ROBERT G. KAISER, ACT OF CONGRESS 384–85 (2013).

[4] *See generally* 12 U.S.C. § 5321 (2012).

[5] *Id.* § 5323(a). Upon designation, these firms are subject to enhanced supervision and prudential standards that have not yet been specified by the Federal Reserve. *See id.* § 5325(b).

[6] *See id.* § 5365(b).

[7] *See* FIN. STABILITY OVERSIGHT COUNCIL, BASIS OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S FINAL DETERMINATION REGARDING GENERAL ELECTRIC CAPITAL CORPORATION, INC. (2013) [hereinafter DESIGNATION REPORT], https://www.treasury.gov/initiatives/fsoc/designations/Documents/Basis%20of%20Final%20Determination%20Regarding%20General%20Electric%20Capital%20Corporation,%20Inc.pdf [https://perma.cc/Q2KC-8BY5].

extensive corporate reorganization, FSOC decided to rescind the designation, releasing GE Capital from enhanced supervision.[8] While section 113 and its subsequent interpretation appear to be straightforward, systematic, and precise, actual designation determinations are complex and multifaceted. They reach multiple audiences, send a variety of market signals, and have the potential to generate adverse as well as beneficial consequences. In this light, a sensitivity to the communicative functions of section 113 designation repays attention as much as the short- and medium-term focus on individual firms does; the GECC designation in particular may send a dangerous message to large financial firms closely watching how FSOC operates, encouraging them to try to game the system rather than structure their firms to avoid generating systemic risk.

As a threshold matter, a target for enhanced prudential supervision under section 113 must be a "U.S. nonbank financial company" — an entity defined under Dodd-Frank as a company incorporated in the United States and "predominantly engaged in financial activities."[9] If a firm passes this threshold and is eligible for designation, FSOC can apply one of two "Determination Standards" to assess the firm's systemic risk. If material financial distress at the firm might "pose a threat to the financial stability of the United States," or, alternatively, if the firm's "nature, scope, size, scale, concentration, interconnectedness, or mix of . . . activities" might pose the same threat, the firm may be designated.[10] Congress has identified ten factors FSOC must consider, including the firm's leverage, liabilities, off-balance-sheet exposures, connection to other nonbank financial companies, asset management, and short-term funding.[11] Congress also included a final catch-all provision, stating that in addition to the ten statutory factors explicitly listed, FSOC must consider "any other risk-related factors that [it] deems appropriate."[12]

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[8] *See* FIN. STABILITY OVERSIGHT COUNCIL, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S RESCISSION OF ITS DETERMINATION REGARDING GE CAPITAL GLOBAL HOLDINGS, LLC (2016) [hereinafter RESCISSION REPORT], https://www.treasury.gov/initiatives/fsoc/designations/Documents/GE%20Capital%20Public%20Rescission%20Basis.pdf [https://perma.cc/MH49-NBDV].

[9] 12 U.S.C. § 5311(a)(4)(B). This predicate can be broken down into two components: what it means to be "predominantly engaged" and what it means to be "financial in nature." The latter is modeled on the Bank Holding Company Act, which lists a series of activities that are "financial in nature." *Id.* § 1843(k)(4). The former is specified by a disjunctive test stating that a firm is "predominantly engaged in financial activities" if either at least 85% of its consolidated annual gross revenues are derived from activities that are financial in nature, or at least 85% of its consolidated assets are derived from activities that are financial in nature. *See id.* § 5311(a)(6).

[10] *Id.* § 5323(a)(1).

[11] *Id.* § 5323(a)(2).

[12] *Id.* § 5323(a)(2)(K).

FSOC supplemented the statutory designation requirements with a final rule detailing how its determination process would be executed.[13] Along with an appendix that sets out how exactly the section 113 designation process will guide FSOC's assessments ("the Guidance"),[14] the rule organizes the ten statutory factors used for assessing material financial distress into six categories, divided into two sets of considerations. The first set looks to a firm's interconnectedness (that is, the degree to which a firm is systemically connected to other large firms), substitutability, and size; its aim is to "assess the potential for spillovers from the firm's distress to the broader financial system or real economy."[15] The second set looks to the firm's "leverage, liquidity risk and maturity mismatch" (that is, the risk that a firm may be unable to meet short-term financial demands based on the practice of holding more short-term liabilities than assets and more long- or medium-term assets than liabilities) "and existing regulatory scrutiny"; here the aim is "to assess how vulnerable a company is to financial distress."[16]

Finally, FSOC specified how a firm might pose a threat to the financial stability of the United States. If material financial distress at the firm may lead to "an impairment of financial intermediation," or to impairment within the financial markets that either through connectedness or contagion effects might inflict "significant economic damage on the broader economy,"[17] the firm may represent systemic risk to the larger U.S. economy. This risk may be conveyed through any of three "transmission channels" — exposure, asset liquidation, or critical function/service — defined in the Guidance.[18]

In July 2013, FSOC applied its section 113 designation analysis to GECC. The first few requirements were easily met: GECC's parent company, GE, is incorporated in New York;[19] "more than 85 percent of GECC's revenues were derived from activities that are financial in nature," and "more than 85 percent of GECC's assets [we]re related to activities that are financial in nature," such as "insurance, lending, un-

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[13] *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 12 C.F.R. pt. 1310 (2016).

[14] *Id.* pt. 1310 app. A.

[15] *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 4555, 4560 (proposed Jan. 26, 2011) (codified at 12 C.F.R. pt. 1310).

[16] *Id.*

[17] Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 64,264, 64,277 (proposed Oct. 18, 2011) (codified at 12 C.F.R. pt. 1310).

[18] *See* 12 C.F.R. pt. 1310 app. A.II.a. The transmission channels are understood by FSOC as the vehicles through which the structure of a firm and the composition of its portfolio causally affect the wider economy. They are thus the means by which risk at a target may create, exacerbate, or otherwise intersect with systemic risk. *See id.*

[19] GEN. ELEC. CO., CERTIFICATE OF INCORPORATION, http://www.ge.com/sites/default/files/GE_Certificate_of_Incorporation_Effective_September2016.pdf [https://perma.cc/Z45S-WTLY].

derwriting and dealing, investing and trading activities, and merchant banking."[20]

Applying the First Determination Standard through its own interpretation of the Guidance, FSOC then evaluated GECC's risk of material financial distress. First, along the exposure channel, FSOC considered the positions of market participants directly or indirectly exposed to or contracting with GECC, finding that the firm was "highly dependent on wholesale funding" driven largely by commercial paper (that is, short-term unsecured debt),[21] and that its long-term and securitization debt holdings led to significant exposure for large financial counterparties.[22] For example, GECC was the reference entity (that is, it bore the risk) for credit default swaps totaling nearly $80 billion, in addition to large amounts of off-balance-sheet exposures to other financial institutions.[23] These facts indicated that material financial distress at GECC could lead to systemic risk along both connectedness and contagion dimensions.

Second, along the asset liquidation channel, FSOC considered GECC's leverage, liabilities, and asset portfolio.[24] By the end of 2012, the firm's total consolidated assets, including equity and debt instruments, came to $539 billion;[25] at the same time, it ran a large securitization practice that funded commercial and consumer asset-backed financing and origination valued at $30 billion.[26] Worried that an unexpected need to liquidate could adversely affect comparable assets in the market, FSOC found that this holding structure "could result in reduced credit availability" and "constrain[] economic growth more broadly."[27]

Third, along the critical function/service channel, FSOC examined whether "GECC provides a critical function or service that is relied upon by market participants and for which there are no ready substitutes."[28] Using both publicly available and confidential information, FSOC noted that the firm was a source of credit for households as well as businesses, providing liquidity for both low-income families and large financial institutions, and participating in "middle market com-

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[20] *See* DESIGNATION REPORT, *supra* note 7, at 4.

[21] *Id*. at 6.

[22] *See id.* at 13–14. As of year-end 2012, GECC had liabilities of approximately "$43 billion of commercial paper; $9 billion of other short-term borrowings; $44 billion of current portion of long-term debt; $225 billion of long-term unsecured debt; [and] $30 billion of non-recourse asset-backed securities and collateralized borrowings." *Id.* It had "$46 billion of worldwide deposits." *Id.* at 14.

[23] *See id.*

[24] *See id.* at 7 n.13.

[25] *Id.* at 8.

[26] *Id.* at 13.

[27] *Id.* at 8.

[28] *Id.*

mercial lending and leasing, . . . consumer revolving credit, and . . . aviation financing."[29] FSOC determined that in an adverse economic environment, material financial distress at GECC could have an unmitigated adverse effect in commercial credit markets, for example, if the $50 billion in committed lines of credit GECC maintained with other large financial institutions were to be destabilized.[30]

Three years later, in June 2016, FSOC rescinded its designation decision.[31] Three sets of facts lay behind the de-designation. First, GECC went through a significant corporate reorganization: the firm merged into GE, and all of its assets were transferred to a new, wholly owned intermediate holding company, GE Capital.[32] Second, the firm went through a series of divestitures, selling off approximately $272 billion in bank and nonbank assets,[33] thereby reducing its role in the U.S. financial markets. Finally, it transformed its funding model: its reliance on short-term funding fell by 86%; it decreased its commercial paper holdings by 88%; and it reduced deposit debt by 80% and securitization debt by 90%.[34]

Under each of the Guidance's transmission channels, FSOC found that the new structure, function, and activities of GE Capital allowed it to exit SIFI designation. By reducing its use of short-term funding and commercial paper, the new firm limited both direct and indirect counterparty exposure; by replacing numerous lines of credit with other firms with an exclusive line of credit with GE, it reduced the potential negative effects of material financial distress; by halting the use of brokered deposits (large, consolidated funds traded by banks and brokers) to fund operations, it effectively eliminated deposit liability exposure.[35] It also decreased its financing receivables (which were some of its most illiquid assets) by 74%, from $227 billion in 2012 to $72 billion in 2016.[36] As a proportion of total assets, this reduction meant that

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[29] *Id.* Revolving credit is credit provided on a going basis, with specific contractual conditions, rather than onetime loan disbursements.

[30] *See id.* at 12. Two separate but related points also featured in FSOC's analysis. GECC's extant regulatory supervision by the Federal Reserve could be circumvented, and any resolution process would involve significant cross-border complexities. Both features aggravated the systemic risk analysis.

[31] RESCISSION REPORT, *supra* note 8. The de-designation decision was pursuant to 12 C.F.R. § 1310.23 (2016).

[32] *See* GE CAPITAL, SUMMARY OF GE CAPITAL'S SIFI RESCISSION REQUEST 2 (2016) [hereinafter RESCISSION REQUEST]. As a subsidiary of GE, GE Capital's long-term debt and commercial paper are guaranteed by GE. *Id.*

[33] GE Capital divested $99 billion in commercial lending and leasing, $50 billion in real estate, $24 billion in nonbank consumer financing, $14 billion in non-U.S. bank assets, and ran a successful IPO and share exchange worth $87 billion in assets. *Id.* at 5.

[34] *Id.* at 6.

[35] *See* RESCISSION REPORT, *supra* note 8, at 13–15.

[36] *See* RESCISSION REQUEST, *supra* note 32, at 6.

short-term liabilities would not force the liquidation of illiquid assets, mitigating the risk that material financial risk at GE Capital would impact the U.S. economy at large through the asset liquidation channel.[37] At the same time, GE Capital exited U.S. consumer lending, reduced its activity in the middle-market lending space, narrowed the scope of its foreign banking operations,[38] and honed in on three industrial business spaces (aviation, energy, and industrial financing).[39]

Such measures convinced FSOC that material financial risk at GE Capital was no longer systemically linked to its critical function/service transmission channel.[40] Based on these developments, FSOC concluded that "GE Capital ha[d] fundamentally changed its business" — indeed, as FSOC recognized, the company had reorganized its legal structure altogether — and so had "become a much less significant participant in financial markets and the economy."[41]

FSOC's treatment of GE Capital represents the first full cycle of section 113 designation, providing a convenient opportunity to step back and view the process from a critical perspective. In both its designation and de-designation determinations, FSOC relied heavily on GECC's assets and liabilities, supplemented with facts and figures about counterparty exposure and funding modalities. While this data is critical to understanding GECC's role and function within the U.S. economy, it is not exhaustive of that role or function; more generally, the question whether material financial distress at the firm might pose systemic risk to the larger economy is not one that can be answered merely by listing how much commercial paper it holds, or the extent of its short-term wholesale funding.[42] And while in theory FSOC is aware of this,[43] neither its designation nor de-designation report ventures far beyond broad quantitative observations that can simply be read off of GECC's balance sheet. In so limiting itself, FSOC fails to show much sensitivity to important secondary effects of its designation decisions, namely, the messages it may be sending to other firms, as

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[37] *See* RESCISSION REPORT, *supra* note 8, at 18–19.

[38] *See* RESCISSION REQUEST, *supra* note 32, at 5. GE Capital established a new holding company for its non-U.S. assets and operations, one subject to consolidated supervision by the U.K. under Basel III. RESCISSION REPORT, *supra* note 8, at 20.

[39] *See* RESCISSION REQUEST, *supra* note 32, at 2.

[40] *See* RESCISSION REPORT, *supra* note 8, at 19.

[41] *Id.* at 21.

[42] For example, facts about the firm's business plans, projected growth, corporate culture, hiring and firing practices, and other nonquantitative factors influence its risk appetite and tolerance; this, in turn, affects whether and how risk within the firm may be transferred outside it.

[43] 12 C.F.R. pt. 1310 app. A (2016) ("In contrast to the application of uniform quantitative thresholds to a broad group of nonbank financial companies . . . [FSOC] intends to evaluate the risk profile and characteristics of each individual nonbank financial company . . . based on a wide range of quantitative and qualitative industry-specific and company-specific factors.").

well as to the market at large. This signaling is a crucial aspect of section 113 SIFI classification, and one FSOC cannot afford to ignore.

Recent work in both the theory and empirics of legal decisionmaking reveals that the expressive content of a statute, case, or agency ruling is just as important as its substantive holding.[44] Specifically, law impacts behavior only when certain conditions are met: when an articulable proposition is sufficiently public, mutually salient, and actually received.[45] An institutional actor cannot perfectly control how others interpret its actions; behavior in reaction to any public action is influenced by expressions that create focal points, conscious or subconscious.[46] In this context, it is worth asking what proposition FSOC's designation decisions are communicating, what their focal points are, and how they contrast with the actual text of the section 113 statute and the Guidance.

From a market participant perspective, section 113 designation offers firms like GECC a rather stark choice: either accept additional prudential supervision or reorganize and petition for de-designation.[47] Neither choice is attractive. Designation subjects firms to prudential oversight under the Federal Reserve, but no one knows what exactly this requires, and firms are justifiably wary of agreeing to an institutional label with an undetermined price tag.[48] On the other hand, de-designation seems to require drastic corporate, legal, and economic overhaul — GE Capital achieved it only after "the most sweeping transformation in the company's 124-year history."[49] If firms want to avoid designation, the message FSOC's treatment of GECC sends is that despite its claims to holistic analysis,[50] what FSOC really cares about is a target's balance sheet. It makes determinations based on the funding models a firm uses, and how leveraged the firm is;[51] it assesses potential financial distress by measuring exposure and identifying how large the counterparties are;[52] it repeatedly emphasizes liquid-

[44] *See generally* RICHARD H. MCADAMS, THE EXPRESSIVE POWERS OF LAW (2015); LAWRENCE M. FRIEDMAN, IMPACT: HOW LAW AFFECTS BEHAVIOR (2016).

[45] *See* MCADAMS, *supra* note 44, at 179–80; *see also* Recent Book, *Richard H. McAdams,* The Expressive Powers of Law *(2015)*, 129 HARV. L. REV. 1160, 1163 (2016).

[46] *See* MCADAMS, *supra* note 44, at 22, 44–45.

[47] Of course, a firm can also choose to contest the designation, a decision that carries an entirely separate set of costs and considerations. *See generally* Metlife, Inc. v. Fin. Stability Oversight Council, No. 15-0045, 2016 WL 1391569 (D.D.C. Mar. 30, 2016).

[48] *See* RANA FOROOHAR, MAKERS AND TAKERS: THE RISE OF FINANCE AND THE FALL OF AMERICAN BUSINESS (2016) (describing how GE Capital's top priority was to exit the SIFI designation).

[49] Rick Clough, *GE Says Too-Big-to-Fail Exit Puts Stamp of Approval on Overhaul*, BLOOMBERG (June 29, 2016, 1:57 PM), http://www.bloomberg.com/news/articles/2016-06-29/ge-wins-regulatory-approval-to-shed-too-big-to-fail-designation [https://perma.cc/NWQ4-RUVC].

[50] *See* 12 C.F.R. pt. 1310 app. A (2016).

[51] *See* DESIGNATION REPORT, *supra* note 7, at 6.

[52] *Id.* at 7.

ity risks[53] and lines of credit,[54] while glossing over nonquantitative considerations almost entirely.

With respect to GECC in particular, FSOC reports that it considered all ten of the statutory factors Congress mandated it examine — but it seems to have stopped there.[55] In contrast to the language in both section 113 and its own Guidance — language insisting that FSOC's decisions in any given case will not be formulaic[56] — its actual analysis focuses almost exclusively on quantitative figures. Unsurprisingly, then, the focal points created by the designation and de-designation reports will turn on these figures, reducing analysis of systemic risk to the question whether a firm has *X* amount of commercial paper, or *Y* reliance on short-term wholesale funding.[57] Given how salient (not to mention concrete) this focus is, the takeaway for firms reacting to FSOC decisions (and contemplating how to avoid their own SIFI designation) will revolve heavily if not exclusively around quantitative metrics. The lesson they will learn from the GECC designation is that at the end of the day, what FSOC really cares about — what it thinks important enough to base its designation decisions on — are threshold figures for commercial paper holdings, or short-term borrowing; in order to avoid designation, firms will aim to structure their balance sheets in a way that mimics GE Capital, rather than GECC.

While there are undoubtedly benefits to this effect (after all, in its expert opinion FSOC determined that GE Capital should no longer be deemed a SIFI), it dangerously oversimplifies the realities of financial regulation. As multiple scholars have argued, the interaction between financial regulation and its targets is recursive: the system that generates financial regulation is constitutive of the patterns of response to it, the adaptation of arbitrage it generates, and the interplay between these forces.[58] One upshot is that financial regulation is not an exact science, or a formulaic enterprise; as FSOC itself has argued, it is not

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[53] *Id.* at 8.

[54] *Id.*

[55] *Id.* at 11–14.

[56] *See* FSOC Rules for Nonbank Financial Companies, 12 C.F.R. pt. 1310 app. A ("[FSOC's] ultimate determination decision regarding a nonbank financial company will not be based on a formulaic application of the . . . categories.").

[57] On this note, many of the statutory considerations as applied to the GECC designation are redundant. The extent to which GECC was a "source of credit for households, businesses, and State and local governments," DESIGNATION REPORT, *supra* note 7, at 12, and the extent to which other firms held its commercial paper and long-term debt, *id.* at 13, are both a function of its assets and liabilities.

[58] *See, e.g.*, Jeffrey N. Gordon, *The Empty Call for Benefit-Cost Analysis in Financial Regulation*, 43 J. LEGAL STUD. S351, S352 (2014) ("For the financial sector, the system that generates costs and benefits is not a natural system but rather a system constructed by the pattern of financial regulation itself and by the subsequent processes of adaptation and regulatory arbitrage.").

easy to predict "whether and exactly how a specific company might fail," or specify causes, effects, or downstream consequences of various financial market structures and practices.[59] Care must therefore be taken so that the message relayed by section 113 designations is not oversimplified, or interpreted as a set of mechanical processes that, if mimicked, will insulate against systemic risk. It is crucial to avoid the appearance or suggestion that there is a magic set of numbers (a leverage ratio, capital cushion, commercial paper ceiling) below which a firm will be deemed safe and above which it will be designated a SIFI;[60] safe harbors are a serious worry, analogous to a negligence rather than a strict liability punishment regime that incentivizes rational actors to take just enough care, but no more.[61] In this vein, an analysis that focuses too much on a list of statutory considerations sublimated into transmission channels risks not only overconfidence and oversimplification, but also over- and under-inclusivity. For example, erecting regulatory perimeters generally serves a necessary demarcating function, but if left unqualified, doing so can also engender regulatory arbitrage by incentivizing firms to build up concentrations of the riskiest assets within the asset class closest to the perimeter without actually tipping over.[62]

To mitigate these effects and ensure the correct signals are being sent by its designation decisions, FSOC ought to address nonquantitative regulatory factors more explicitly. This is a key requirement of contemporary financial regulation, perhaps best expressed by a key architect of Dodd-Frank itself, Paul Volcker. Discussing the need to cut back on risky banking activity, Volcker writes that financial regulation "is not only, or perhaps most importantly, a matter of immediate market risks involved. It is the seemingly inevitable implication for the *culture* of the [financial] institutions involved . . . ."[63] As industry experts have argued, financial economists over the past twenty years have come to recognize the way that orga-

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[59] Brief for Appellant at 24, MetLife, Inc. v. Fin. Stability Oversight Council, No. 16-5086 (D.C. Cir. June 16, 2016).

[60] "During a crisis, systemic risk spreads not only through actual counterparty exposures, but also through uncertainty about and perception of exposures." Brief of Professor Viral V. Acharya et al. as Amici Curiae in Support of Appellant at 24, *MetLife*, No. 16-5086 (D.C. Cir. June 23, 2016).

[61] *See* Ahson T. Azmat, *What Mistake of Law Just Might Be: Legal Moralism, Liberal Positivism, and the Mistake of Law Doctrine*, 18 NEW CRIM. L. REV. 369, 391 (2015).

[62] *See* AMAR BHIDÉ, A CALL FOR JUDGMENT: SENSIBLE FINANCE FOR A DYNAMIC ECONOMY 276 (2010) (noting how regulations based on mechanical assumptions about risk "encourage financial institutions to load up on the supposedly low-risk category with the riskiest assets they can find in that category").

[63] Paul Volcker, Commentary on the Restrictions on Proprietary Trading by Insured Depositary Institutions 2 (Feb. 13, 2012) (emphasis added), https://online.wsj.com/public/resources/documents/Volcker_Rule_Essay_2-13-12.pdf [https://perma.cc/Q5YH-SJ7T].

nizations can generate first-order effects in the capital markets, including by how they screen for and manage employees, and also through the values and incentives they create. Paying attention to organizational culture — and giving it voice in its reports — is a helpful way to avoid the appearance that SIFI designation is merely a function of a firm's portfolio or funding model.[64]

Moreover, a wider focus on corporate culture pushes away from oversimplified and potentially misleading top-down regulation.[65] Agencies can work with target firms on a going basis, asking for quarterly reports, for example, and then making recommendations based on risk metrics, rather than one-off designation decisions that are reviewed annually. FSOC can look into adopting a more supervisory rather than regulatory approach to section 113 designation, examining targets in a more fine-grained, incremental, and tailored way.[66] It can employ tools gleaned from now well-established findings in behavioral law and economics to encourage effective internal regulation.[67] If agencies adopt a more tentative, collaborative stance toward their targets, the enterprise of systemic risk mitigation can be conceived in a less adversarial and more collaborative light.

Ultimately, if the goal of financial regulation is to control for negative externalities rather than levy punishments on firms, FSOC must pay attention to the expressive and communicative content of its decisions. It ought to be sensitive to the detrimental effects of an overreliance on quantitative analysis, and supplement its examination of a target firm's balance sheet with more explicit consideration of qualitative factors. Doing so will prevent sending the wrong message to market participants, and may even prove to be a pathway to a more effective, dialogic approach to financial regulation.

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[64] As the Financial Crisis Inquiry Commission noted, the 2008 recession was driven in large part not by the mere *existence* of complex securities holdings at banks, but rather the culture of subprime lending that made the securitization of such toxic assets possible. *See* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT, xvii (2011).

[65] *See, e.g.*, SEBASTIAN MALLABY, MORE MONEY THAN GOD: HEDGE FUNDS AND THE MAKING OF A NEW ELITE 333 (2010). As Sebastian Mallaby notes, in the period leading up to the 2008 crisis, capital requirements became a crutch for banks; rather than running their books with rigorous analysis, banks benchmarked their safety to capital requirements, as though the two completely overlapped and, thus, were a perfect substitute for risk regulation. In contrast, because hedge funds were in the practice of making their own, internal risk decisions, they were not distracted by external regulations or ratings.

[66] For example, the actual figures regarding a firm's assets may not be very informative; as both economists and experts in financial regulation have argued, quantitative factors such as flat capital requirements or asset holding sizes can often be gamed. *See* Thomas M. Hoenig, *Creating a Responsive, Accountable, Market-Driven Financial System*, *in* PERSPECTIVES ON DODD-FRANK AND FINANCE 43, 53 (Paul H. Schultz ed., 2014).

[67] *See, e.g.*, Cass R. Sunstein, *Nudges.gov: Behaviorally Informed Regulation*, *in* THE OXFORD HANDBOOK OF BEHAVIORAL ECONOMICS AND THE LAW 719 (Eyal Zamir & Doron Teichman eds., 2014).