IV. MetLife's SIFI Designation and Appeal

A. Introduction

In December of 2014, the Financial Stability Oversight Council ("FSOC") designated MetLife, Inc. ("MetLife")—the nation's largest life insurer—a "systemically important financial institution," or "SIFI."[1] Section 111 of the Dodd-Frank Act created the FSOC, and Section 113 tasked the FSOC with identifying "non-bank financial companies" that could pose a significant threat to the financial stability of the United States, or those institutions commonly referred to as "too-big-to-fail," in an effort to prevent future financial crises like that of 2008.[2] Once the FSOC designates them, the SIFIs must comply with stricter capital requirements, provide additional disclosures to regulators, and submit to closer supervision by the Board of Governors of the Federal Reserve (the "Board").[3]

MetLife is not the first SIFI insurance company, following American International Group ("AIG") and Prudential Financial ("Prudential").[4] MetLife is the first financial company, however, to challenge its SIFI designation as "arbitrary and capricious" in federal court.[5]

This Article outlines the FSOC's basis for designating MetLife a SIFI, as well as MetLife's appeal and its likelihood of success on appeal. Part B discusses the purposes of the Dodd-Frank Act, the role of the FSOC, the standards for SIFI designation, and the consequences of SIFI designation. Part C explains the FSOC's rationale for designating MetLife and the dissenting and minority view arguments in that decision. Part D then discusses MetLife's lawsuit, industry reactions to the lawsuit, and MetLife's likelihood of success in the lawsuit.

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[1] Mary Williams Walsh, *Regulators Deem MetLife a 'Too Big to Fail' Institution*, N.Y. TIMES, Dec. 19, 2014, at B4.

[2] Dodd-Frank Consumer Protection and Wall Street Reform Act (Dodd-Frank) §§ 111(a), 113, 12 U.S.C. §§ 5321(a), 5323 (2012); *see also* Walsh, *supra* note 1.

[3] 12 U.S.C. §§ 5323, 5325(a)-(b); Walsh, *supra* note 1.

[4] Walsh, *supra* note 1.

[5] Mary Williams Walsh, *MetLife Sues Over Being Named Too Big to Fail,* N.Y. TIMES, Jan. 14, 2015, at B1.

B. Background and Context

Section 111 of the Dodd-Frank Act established the FSOC, which is composed of ten voting members including the Secretary of the Treasury, the Chairman of the Board, the Comptroller of the Currency, and several other key financial regulators.[6] Dodd-Frank established the FSOC to identify potential "risks to the financial stability of the United States," to "promote market discipline," and to "respond to emerging threats to the stability of the United States financial system."[7] Most significantly, the Dodd-Frank Act authorizes the FSOC to designate SIFIs and subject them to increased supervision and regulation by the Board.[8] SIFI designation does not mean that an institution is operating hazardously, but rather that if the institution were in "material financial distress," its instability could spread to other institutions and snowball throughout the U.S. economy, thereby harming the entire financial system.[9]

In its interpretive guidance, the FSOC explains its two independent standards for SIFI designation: (1) the "First Determination Standard" is met if "material financial distress at the nonbank financial company could pose a threat to the financial stability of the United States," and (2) the "Second Determination Standard" is met if "the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company could pose a threat to the financial stability of the United States."[10] The FSOC may find a "threat to the financial stability of the United States" exists if "there would be an impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy."[11] Finally, "material financial distress" exists when an institution is "in imminent danger of insolvency or defaulting on its financial obligations."[12]

After the FSOC designates an institution a SIFI, the Board regulates and oversees its operation in order to prevent it from becoming financially distressed, and to prevent its financial distress

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[6] 12 U.S.C. § 5321(a)-(b). The FSOC also includes five non-voting members who merely advise the Council. *Id.* § 5321(b)(2).
[7] *Id.* § 5322(a)(1).
[8] *Id.* § 5323(a).
[9] Walsh, *supra* note 1.
[10] 12 C.F.R. pt. 1310, app. A § II (2014).
[11] *Id.*
[12] *Id.*

from affecting other market participants.[13] The Board can then require the SIFI to meet heightened risk-based capital requirements, liquidity requirements, enhanced public disclosures, and overall risk management requirements.[14]

C. The FSOC Designation and Basis

1. FSOC Rationale

The FSOC evaluated MetLife under the First Determination Standard.[15] The FSOC noted that in addition to leading the U.S. life insurance industry, MetLife provides a variety of other insurance products, annuities, and investment products to individuals and institutions.[16] The FSOC found that MetLife's participation in these activities increases its "complexity and interconnectedness with other market participants."[17] Furthermore, the FSOC evaluated the extent to which material financial distress at MetLife could "transmit risk" to other market participants by examining: (1) MetLife's exposure to other market participants, (2) the market consequences in the event of MetLife's asset liquidation, and (3) the extent to which MetLife provides a critical function or service relied upon by market participants.[18] The FSOC determined that MetLife's material financial distress would threaten U.S. financial stability due primarily to the exposure and asset liquidation channels, with the critical service channel as a fallback justification.[19]

First, the FSOC explained that large financial intermediaries are exposed to MetLife through the products it offers to institutions, including investment products, insurance products, and annuity

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[13] *See* Walsh, *supra* note 1.
[14] Dodd-Frank § 115, 12 U.S.C. § 5325 (2012).
[15] Fin. Stability Oversight Council, *Basis for the Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc.*, U.S. DEP'T OF THE TREASURY 4 (Dec. 18, 2014), http://www.treasury.gov/initiatives/fsoc/designations/Documents/MetLife%20Public%20Basis.pdf [hereinafter *MetLife Basis*], *archived at* http://perma.cc/5EUF-BN4G.
[16] *Id.* at 7.
[17] *Id.* at 18.
[18] *Id.* at 15-26. The FSOC refers to these three considerations as the "risk transmission channels." *Id.* at 5.
[19] *See id.* at 16.

products.[20] Therefore, these exposures could impair the ability of those interconnected firms to provide their services, and result in a substantial "contraction in the supply of financial services" if MetLife were to experience material financial distress.[21]

Second, according to the FSOC, if MetLife became financially distressed and was forced to liquidate its relatively illiquid assets to meet debt obligations, it could disrupt trading in a variety of markets.[22] MetLife's assets could be liquidated very quickly, according to the FSOC, because: (1) many of its investment products could be terminated or not renewed, and (2) most of its insurance-related liabilities could be "withdrawn or surrendered by the contract holder."[23]

Finally, the FSOC explained that MetLife participates mostly in highly competitive insurance markets which could continue to provide those insurance services if MetLife were to become financially distressed.[24] Therefore, the FSOC concluded that MetLife could not transmit a substantial amount of risk through the critical service or function channel.[25]

Next, the FSOC considered the degree to which MetLife is already regulated by other regulators, noting that insurance companies are licensed and regulated by state regulators.[26] The FSOC pointed to weaknesses in the state regulatory framework, explaining that the state regulators have never been tested by the financial distress of a company the size and scope of MetLife, and that the state regulatory system was not capable of "consolidated supervision" over an international company like MetLife.[27]

Based on the above analysis, the FSOC made the "final determination that material financial distress at MetLife could pose a threat to the financial stability of the United States," and that MetLife should therefore be subject to increased regulation by the Board.[28]

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[20] *Id.* at 17.
[21] *Id.* at 18.
[22] *See id.* at 21.
[23] *Id.*
[24] *See id.* at 25.
[25] *Id.*
[26] *Id.* at 26 n.107.
[27] *Id.* at 26-28.
[28] *Id.* at 30.

2. Dissenting and Minority Views

Only one voting member of the FSOC, Roy Woodall Jr., dissented from the FSOC's final determination.[29] Woodall contended that the FSOC's asset liquidation transmission channel analysis relied on "implausible, contrived scenarios as well as failures to appreciate fundamental aspects of insurance and annuity products, and, importantly, State insurance regulation."[30] Woodall argued that, although it is easy to presume a hypothetical total insolvency and designate MetLife under the First Determination Standard, the FSOC should have analyzed MetLife's specific activities and explained how they contribute to systemic risk.[31] Furthermore, Woodall argued that MetLife's 2013 designation, by the Financial Stability Board ("FSB"), as a "global systemically important financial institution" ("G-SIFI") was a driving force behind the FSOC's designation.[32] In essence, Woodall concluded that the FSOC was merely falling in line with the FSB, and that the FSOC never really critically and independently analyzed whether MetLife poses a threat to U.S. financial stability.[33]

Non-voting member and State Insurance Commissioner Representative Adam Hamm also dissented, echoing Woodall's arguments regarding the FSOC's failure to appropriately evaluate the efficacy of state insurance regulation and the FSOC's misplaced reliance on an unlikely total insolvency scenario.[34] Hamm emphasized the strength and efficacy of the state regulatory system, as well as its significant discretion to exercise a variety of tools to maintain the financial stability of insurance companies.[35] By failing to effectively account for the existing state regulation framework, Hamm argued, the FSOC failed to appreciate that most of its concerns are already addressed by the existing regulatory scheme.[36] Hamm's dissent goes on

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[29] *See generally* Fin. Stability Oversight Council, *Basis for the Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc.—Dissenting and Minority Views*, U.S. DEP'T OF THE TREASURY (Dec. 18, 2014), http://www.treasury.gov/initiatives/fsoc/designations/Documents/Dissenting%20and%20Minority%20Views.pdf, *archived at* http://perma.cc/5DZ9-2YQZ.
[30] *Id.* at 2.
[31] *See id.* at 3.
[32] *Id.* at 4.
[33] *Id.* at 4-5.
[34] *See id.* at 7-11.
[35] *Id.* at 7-9.
[36] *Id.* at 8.

to criticize the FSOC's "merely speculative" outcomes and "unsubstantiated qualitative statements," which omit any thorough analysis to support them.[37] Finally, Hamm called for a specific explanation of the issues the FSOC considered in its decision, arguing that the Board cannot mitigate MetLife's systemic risk without a clear understanding of the factors that the FSOC relied on when making its designation.[38]

3. MetLife's Reaction

MetLife claims that it does not meet the criteria necessary for designation, and further asserts that its designation will harm competition in the insurance market without actually reducing systemic risk, resulting in "higher prices and less choice for consumers."[39] MetLife contends that the prudential regulations prescribed by Dodd-Frank are aimed towards protecting banks, not insurance companies, and that these sorts of regulations are ineffective for maintaining the stability of insurance companies.[40] MetLife's main argument is that prudential requirements can effectively address the problems posed by "bank runs" and "panics"—events which banks are prone to, but not insurance companies.[41] Because life insurance contracts are typically long-term, life insurance companies are not susceptible to "run behavior," and prudential requirements are ineffective at mitigating insurers' threat to the financial system.[42]

D. MetLife Lawsuit

On January 13, 2015, MetLife filed a seventy-nine page complaint in the United States District Court for the District of Columbia challenging its designation, making it the first SIFI to

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[37] *Id.* at 10.
[38] *Id.* at 13.
[39] *See* Press Release, MetLife, Inc., MetLife Statement on Final SIFI Designation (Dec. 18, 2014), *available at* https://www.metlife.com/about/ press-room/index.html?compID=154016, *archived at* https://perma.cc/AZ2M-FHGY.
[40] *See* Press Release, MetLife, Inc., MetLife Statement on Preliminary SIFI Designation (Sept. 4, 2014), *available at* https://www.metlife.com/about/ press-room/index.html?compID=140852, *archived at* https://perma.cc/ 8XUA-LJVC.
[41] Walsh, *supra* note 1.
[42] *See id.*; Press Release, MetLife, Inc., *supra* note 40.

challenge its designation in court.[43] MetLife asserts that the FSOC's designation was "arbitrary and capricious" and that the FSOC made many "critical errors" in its analysis, and that as a result of those errors the designation must be set aside.[44] MetLife claims that the FSOC (1) failed to understand the state insurance regulatory scheme, (2) fixated on MetLife's size and "interconnections" with other financial companies while ignoring other statutory considerations, (3) relied on "vague standards" and "unsubstantiated speculation," and (4) denied MetLife access to the materials necessary to respond to its designation.[45] MetLife argues that, as a result of these errors, the district court should vacate the FSOC's designation.[46] Finally, MetLife argues that the FSOC's extremely "opaque" designation process violated MetLife's due process rights, as well as constitutional separation of powers principles.[47]

In order for MetLife to win its challenge, it must show that the FSOC's designation was "arbitrary and capricious."[48] While industry observers generally believe that the court will not overturn the designation, the unprecedented nature of this challenge presents some uncertainty, which could increase MetLife's chances of succeeding in the suit.[49] Additionally, Eugene Scalia, counsel for MetLife, remains confident, telling reporters that "courts routinely invalidate government agencies' decisions under the [arbitrary and capricious] standard in instances where [the] decision was based on 'sheer speculation' or is 'totally at odds with' the evidence."[50]

Most observers, however, believe that MetLife's suit is unlikely to succeed.[51] The U.S. Treasury Department has publicly supported the FSOC's determination, issuing a statement that it is "confident in the council's work."[52] Moody's, a large credit rating

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[43] Complaint at 1-3, MetLife, Inc. v. Financial Stability Oversight Council, No. 15-45 (D.D.C. Jan. 13, 2015); Walsh, *supra* note 5.
[44] Complaint, *supra* note 43, at 2-3.
[45] *Id.*
[46] *Id.* at 3.
[47] *Id.* at 6-7.
[48] Jeff Sistrunk, *MetLife's SIFI Designation Challenge will be Uphill Battle*, LAW360 (Jan. 13, 2015, 8:22 PM), http://www.law360.com/articles/611093/metlife-s-sifi-designation-challenge-will-be-uphill-battle.
[49] *See id.*
[50] *Id.*
[51] *See id.*
[52] *Id.* (citation omitted).

agency, has also expressed its doubts, calling the lawsuit an "'uphill battle' that 'could serve as a distraction to MetLife's management resources.'"[53] Financial policy advocate at Public Citizen, Bart Naylor, stated that, "regulators—experienced in financial services supervision, veterans of a financial crash—deliberated with care, equipped with experts and extensive data," and that, "[t]o claim their decision was arbitrary and capricious, amounting to a flip of a coin, will be difficult to prove."[54]

E. Conclusion

In December of 2014, the FSOC designated MetLife, the nation's largest life insurer, a SIFI.[55] The FSOC relied on MetLife's massive exposure to other market participants, as well as the market consequences that would result from MetLife's rapid asset liquidation, to determine that MetLife's material financial distress would threaten the financial stability of the U.S.[56] The FSOC's decision has been met with a fair amount of opposition, and dissenters, including MetLife, continue to argue that the designation was unwarranted.[57] As the first company to challenge its designation in court, MetLife faces an uphill battle in overturning the designation.[58] The ultimate outcome of MetLife's suit will undoubtedly have massive consequences for the future of MetLife, Dodd-Frank, and the life insurance industry.

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[53] Walsh, *supra* note 5.
[54] Sistrunk, *supra* note 48 (citation omitted) (internal quotation marks omitted).
[55] Walsh, *supra* note 1.
[56] *See supra* text accompanying notes 15-28.
[57] *See supra* text accompanying notes 29-42.
[58] *See supra* text accompanying notes 43-54.
[59] Student, Boston University School of Law (J.D. 2016).