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No. 16-5086

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

METLIFE, INC.,

Plaintiff-Appellee,

v.

FINANCIAL STABILITY OVERSIGHT COUNCIL,

Defendant-Appellant.

On Appeal From The United States District Court
For The District Of Columbia

BRIEF FOR APPELLEE

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to D.C. Circuit Rule 28(a)(1), Plaintiff-Appellee MetLife, Inc. ("MetLife") files the following Certificate as to Parties, Rulings, and Related Cases.

Parties, Intervenors, and *Amici*

Except for the following, all parties, intervenors, and *amici* appearing before the district court and in this Court are listed in the Brief for the Financial Stability Oversight Council ("FSOC"):

1. District Court

The following is a list of parties, intervenors, and *amici* that appeared before the district court.

Intervenor: Better Markets, Inc.

2. Court of Appeals

The following is a list of parties, intervenors, and *amici* that have appeared before this Court.

Amici: The following have appeared as *amici curiae* in support of the Financial Stability Oversight Council: Viral V. Acharya, Robert Engle, Thomas Philippon, Matthew P. Richardson, Better Markets, Inc., Ben S. Bernanke, Paul A. Volcker, Sherrod Brown, Michael E. Capuano, John Conyers, Jr., Elijah Cummings, Christopher J. Dodd, Keith Ellison, Barney Frank, Al Green, Luis V.

Gutierrez, Tom Harkin, Timothy Johnson, Paul E. Kanjorski, Patrick Leahy, Jeff Merkley, Brad Miller, Nancy Pelosi, Jack Reed, Harry Reid, Charles E. Schumer, Elizabeth Warren, Kate Andrias, Michael S. Barr, John C. Coates IV, John C. Coffee, Jr., Peter Conti-Brown, Anna Gelpern, Jeffrey N. Gordon, Erik F. Gerding, Robert J. Jackson, Jr., Kathryn Judge, Prasad Krishnamurthy, Jerry L. Mashaw, Patricia A. McCoy, Nina Mendelson, Andrew Metrick, Gillian Metzger, Saule T. Omarova, Edward Rubin, Kevin Stack, Peter L. Strauss, Jennifer Taub, Adrian Vermeule, Arthur Wilmarth, Aviva Abramovsky, Hazel Beh, Joseph M. Belth, Peter C. Carstensen, John Crawford, Max N. Helveston, Donald T. Hornstein, John Patrick Hunt, Peter Korchenburger, Joseph Lavitt, Kyle D. Logue, Daniel Schwarcz, Steven L. Schwarcz, Jeffrey W. Stempel, Robert F. Weber, Jennifer Wriggins, David Zaring.

The following has appeared as *amicus curiae* in support of neither party: William Michael Cunningham.

Rulings Under Review

The ruling under review is the March 30, 2016, Opinion (D.E. 105; JA779-811) and Order (D.E. 106; JA812-13) of the district court (Collyer, J.) rescinding

FSOC's Final Designation. *See MetLife, Inc. v. Fin. Stability Oversight Council*, ___F. Supp. 3d___, 2016 WL 1391569 (D.D.C. Mar. 30, 2016).

Related Cases

Better Markets, Inc. has appealed to this Court from the district court's Opinion (D.E. 113) and Order (D.E. 114) granting its motion to intervene but denying its application for an order to show cause why the record should not be unsealed: *MetLife, Inc. v. Fin. Stability Oversight Council*, No. 16-5188.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1 and D.C. Circuit Rule 26.1, Appellee MetLife, Inc. makes the following disclosures:

MetLife, Inc. is a publicly traded company (NYSE: MET). MetLife, Inc. has no parent companies, and no other publicly held company owns 10% or more of the stock of MetLife, Inc.

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GLOSSARY

AIG	American International Group, Inc.
APA	Administrative Procedure Act
Board	Board of Governors of the Federal Reserve System
CCAR	Comprehensive Capital Analysis and Review
D.E.	Docket Entry
DDCJA	District Court for the District of Columbia Joint Appendix
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
FDIC	Federal Deposit Insurance Corporation
FSOC	Financial Stability Oversight Council
G-SIB	Global Systemically Important Bank
GECC	General Electric Capital Corporation
GIC	Guaranteed Investment Contract
JA	Joint Appendix
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
Prudential	Prudential Financial, Inc.
RBC	Risk-Based Capital
SEC	Securities and Exchange Commission

INTRODUCTION

When Congress created the Financial Stability Oversight Council ("FSOC"), it did not grant FSOC a roving mandate to designate every large financial company for enhanced federal regulatory oversight. Instead, Congress carefully prescribed eleven statutory factors that the agency must consider when determining whether a company warrants designation as a nonbank systemically important financial institution. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act"). Because the consequences of designation are far-reaching—including the imposition of heightened capital and liquidity requirements, oversight of a company's structure and decision-making processes, and regulatory fees and costs—Congress also expressly authorized companies to challenge their designations as "arbitrary and capricious." 12 U.S.C. § 5323(h). In so doing, Congress made clear that FSOC is bound by the same principles of reasoned decision-making as all other regulatory agencies. FSOC therefore must adhere to both the Dodd-Frank Act and its own regulations, rely on concrete evidence and logical inferences rather than unwarranted speculation and unsubstantiated guesswork, and consider the consequences of its decisions, including whether designation will actually protect the U.S. economy from financial instability.

FSOC violated both the Dodd-Frank Act and fundamental principles of administrative law when it designated MetLife. Having decided to target MetLife for designation, FSOC selectively applied the statutory criteria established by Congress, repeatedly departed from its own regulations in order to overcome MetLife's evidence and analysis, consistently embraced unreasonable assumptions and counterfactual conjecture in the face of contrary historical examples, and disregarded representations by MetLife's state insurance regulators and the views of the two independent Council members with insurance expertise.

Notwithstanding these errors, FSOC accuses the district court of imposing on the agency an unrealistic "requirement to identify with precision the impact that distress would have on the broader [economy]" and of "second-guessing the expert judgment of the nation's federal financial regulators." FSOC Br. 22, 49. Those characterizations are demonstrably false. Far from demanding clairvoyance or overriding FSOC's substantive conclusion about MetLife's alleged systemic importance, the district court simply required that FSOC adhere to its own regulatory standards and the basic precepts of reasoned agency decision-making. Two of FSOC's errors—its failures to consider MetLife's vulnerability to material financial distress and to assess whether the effects of that distress would be "'sufficiently severe to inflict significant damage on the broader economy,'" JA802—were deviations from standards adopted *by FSOC itself* in its regulations implementing

the Dodd-Frank Act. *See* 77 Fed. Reg. 21,637 (Apr. 11, 2012) (codified at 12 C.F.R. pt. 1310, App. A) ("Final Rule and Interpretive Guidance"). And the third ground on which the district court rescinded MetLife's designation—FSOC's failure to consider whether the designation would have effects that would actually undermine the agency's regulatory objectives—reflects a basic tenet of administrative law that every agency must satisfy when taking regulatory action.

The district court did not reach several other flaws in FSOC's designation decision, including its unfounded, counterintuitive assumption that state insurance regulators would *exacerbate* the effects of material financial distress at MetLife, FSOC's disregard for settled risk analysis methodologies applied by other federal agencies, its failure to consider reasonable alternatives to designating MetLife, and FSOC's persistent refusal to provide MetLife with access to the administrative record or its prior designation decisions. Agency "expertise" is not a justification for indulging ahistorical assumptions, spurning well-established risk analysis principles, disregarding viable regulatory alternatives, or withholding record evidence and the agency's most relevant precedents. In each of these respects—as well as those identified by the district court—the Final Designation was arbitrary and capricious and was appropriately rescinded.

STATEMENT OF ISSUES

1. Whether FSOC improperly departed from its Final Rule and Interpretive Guidance and the Dodd-Frank Act by failing to evaluate MetLife's vulnerability to material financial distress.

2. Whether FSOC violated its Final Rule and Interpretive Guidance, the Dodd-Frank Act, and principles of reasoned decision-making when assessing whether material financial distress at MetLife could pose a threat to U.S. financial stability.

3. Whether FSOC acted arbitrarily and capriciously in refusing to consider the effects of designation on MetLife.

4. Whether FSOC acted arbitrarily and capriciously by declining to consider reasonable alternatives to designating MetLife.

5. Whether FSOC's designation procedures violate due process and the separation of powers.

STATUTES AND REGULATIONS

Pertinent statutes and regulations are reproduced in the Addendum to this brief.

STATEMENT OF THE CASE

I. The Statutory and Regulatory Framework for FSOC Designations

The Dodd-Frank Act authorizes FSOC to designate nonbank financial companies as systemically important financial institutions subject to supervision by the Board of Governors of the Federal Reserve System ("Board") where one of two standards is satisfied: (1) "material financial distress at the" company "could pose a threat to the financial stability of the United States" or (2) "the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities" of the company "could pose" such a threat. 12 U.S.C. § 5323(a)(1).

In determining whether one of these designation standards is met, the Dodd-Frank Act directs FSOC to consider eleven statutory factors, including (1) the company's leverage, off-balance sheet exposures, financial assets, and liabilities; (2) its relationships with other significant financial companies; (3) the degree to which the company is already subject to regulation; and (4) "any other risk-related factors [FSOC] deems appropriate." 12 U.S.C. § 5323(a)(2).

FSOC implemented these statutory standards through a Final Rule governing the designation process, which is accompanied by Interpretive Guidance that "describes the manner in which [FSOC] intends to apply the statutory standards and considerations in making determinations" to designate a nonbank financial company. 12 C.F.R. pt. 1310, App. A, § I. The Final Rule and Interpretive Guidance

translates Congress's statutory framework into six designation categories: size, interconnectedness, substitutability, leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny. *See id*. at § II(d)(1). In adopting this framework, FSOC explained that the six categories address two distinct inquiries: The first three categories are intended to assess "the potential impact of a nonbank financial company's financial distress on the broader economy," while the remaining categories "seek to assess the vulnerability of a nonbank financial company to financial distress." *Id.*

FSOC's Final Rule and Interpretive Guidance also identifies three "transmission channels" through which a nonbank financial company's material financial distress could spread to the rest of the U.S. economy. 12 C.F.R. pt. 1310, App. A, § II(a). As relevant here, FSOC's "exposure" transmission inquiry assesses whether counterparties have exposures to the company that would be "significant enough to materially impair" the counterparties "and thereby pose a threat to U.S. financial stability." *Id*. The "asset liquidation" transmission inquiry examines whether the nonbank financial "company holds assets that, if liquidated quickly, would cause a fall in asset prices and thereby significantly disrupt trading or funding in key markets or cause significant losses or funding problems for other firms with similar holdings." *Id*.

FSOC's designations of nonbank financial companies proceed in three stages. At the close of Stage 3, FSOC issues a notice of proposed designation to the company, which can request an oral hearing before FSOC. 12 C.F.R. pt. 1310, App. A, § III(c). If two-thirds of FSOC's ten voting members, including the Secretary of the Treasury, thereafter vote to designate the company, FSOC issues a final designation determination to the company. *See* 12 C.F.R. § 1310.10(b). (A high-level summary of the designation determination is made public.)

Designated companies are subject to extensive regulation by the Board. *See* 12 U.S.C. § 5365. They are required to comply with enhanced capital requirements, leverage limits, and liquidity requirements, *id.* § 5365(b)(1)(A), submit to detailed regulatory oversight of organizational structures, staffing levels, and decision-making processes, *id.* § 5361(b), prepare detailed resolution plans (typically running thousands of pages) designed to facilitate their orderly resolution in the event of material financial distress or failure, *id.* § 5365(d)(1), obtain Board approval for certain large acquisitions, *id.* § 5363(b)(1), and pay assessments to fund the Board's supervision, *id.* § 5345; *see also id.* § 248(s). The Board recently proposed enhanced prudential standards and capital requirements for designated insurers. *See* 81 Fed. Reg. 38,610 (June 14, 2016); 81 Fed. Reg. 38,631 (June 14, 2016).

To date, FSOC has designated four nonbank financial companies, including three insurers, for Board supervision: American International Group, Inc. ("AIG"), General Electric Capital Corporation ("GECC"), Prudential Financial, Inc. ("Prudential"), and MetLife.

II. MetLife's Designation

MetLife is a traditional life insurance group that sells and issues insurance products and invests, holds, and manages the assets required to support its policy liabilities. *See, e.g.*, JA140-43. Life insurance products generate 84% of MetLife's direct premiums, with the remaining premiums attributable to accident, health, home, and automobile coverage. D.D.C. Joint Appendix ("DDCJA") 1623. Unlike banks, which take short-term deposits and invest in long-term assets, MetLife matches its predominantly long-term liabilities with long-term assets in order to satisfy policyholder liabilities. *See* DDCJA862, 867; *see also* JA234-35.

MetLife conducts its business through subsidiary insurance companies that, in accordance with long-standing federal law establishing the primacy of state insurance regulation, 15 U.S.C. §§ 1011-1015, are subject to comprehensive oversight by state regulators. As of June 30, 2013—the reference date for much of FSOC's analysis, DDCJA809—MetLife's insurance subsidiaries owned 98% of MetLife's consolidated assets, owed 96% of its liabilities, and collected 95% of its revenues. DDCJA809; *see also* JA234. Among other state regulatory require-

ments, MetLife's insurance subsidiaries are subject to supervisory reporting and disclosure obligations, on-site examinations, investment restrictions, business plan approval requirements, and risk-based capital ("RBC") requirements. *See* DDCJA1893, 1896-99, 1912-28, 1930. Even during the 2008-2009 financial crisis, MetLife's insurance subsidiaries maintained RBC levels far in excess of required minimums and many times above the level at which regulators would have been required to intervene. DDCJA910, 1893.

On July 16, 2013, FSOC informed MetLife that it was being considered for designation as a nonbank systemically important financial institution. In response, MetLife submitted extensive materials demonstrating that it was unlikely to experience material financial distress and that, if it did, MetLife's distress would not pose a threat to U.S. financial stability. Throughout the designation process, MetLife also made, and FSOC denied, numerous requests for access to the administrative record. FSOC likewise denied MetLife's requests for copies of the nonpublic versions of FSOC's prior decisions designating Prudential and AIG (with appropriate redactions to preserve confidentiality). These nonpublic decisions were FSOC's only precedents regarding the designation of insurance companies. (By contrast, after this litigation was initiated, FSOC promptly made available to its

amici and others a redacted version of its nonpublic decision designating MetLife.)[1]

In September 2014, FSOC issued a notice of proposed determination to MetLife. *See* JA816-1088 ("Proposed Designation"). MetLife thereafter submitted additional materials identifying flaws in FSOC's analysis and requested an oral hearing, which was held on November 3, 2014. *See* JA239-360. On December 18, 2014, FSOC issued its final determination designating MetLife a nonbank systemically important financial institution because, in FSOC's opinion, material financial distress at MetLife could pose a threat to U.S. financial stability. JA361-778 ("Final Designation"). As later confirmed by FSOC during the district court proceedings, FSOC relied on the same staff and principals to investigate MetLife, respond to its requests for access to record materials, prepare the Proposed Designation, review MetLife's submissions, evaluate its challenge to the Proposed Designation, and decide whether to adopt the Final Designation. *See, e.g.*, DDCJA40-42, 48-50; D.E. 108, at 3, 55.

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[1] Even after MetLife filed suit, FSOC continued to deny MetLife access to the complete administrative record, withholding or redacting nearly 2,000 pages from its production. *See* D.E. 17-1. After MetLife raised objections to FSOC, the parties negotiated a Protective Order under which FSOC agreed to disclose a portion of the withheld materials to MetLife's counsel. D.E. 35; D.E. 38. To gain access to approximately 500 pages of the withheld materials, however, MetLife was forced to file a motion to compel, D.E. 93, which the district court granted. *Id*.

Relevant aspects of the Final Designation include the following:

MetLife's Vulnerability to Material Financial Distress. Despite FSOC's commitment in its Final Rule and Interpretive Guidance to consider a company's "vulnerability . . . to financial distress" in conducting its designation analysis, 12 C.F.R. pt. 1310, App. A, § II(d)(1), and representations to state regulators that it would consider MetLife's vulnerability to distress, *see* JA209, FSOC opted "to assume material financial distress at MetLife" without any assessment of whether that distress was "likely to occur," JA389. Rather than acknowledge its about-face, FSOC insisted that "neither the Dodd-Frank Act nor the Interpretive Guidance requires or states that the Council will evaluate the probability or likelihood of material financial distress at a nonbank financial company." JA390. In addition, although the Final Rule and Interpretive Guidance defines "material financial distress" as "imminent danger of insolvency," 12 C.F.R. pt. 1310, App. A, § II(b), FSOC assumed far worse degrees of distress at MetLife—including the simultaneous failure of all of MetLife's insurance subsidiaries and the company's total inability to satisfy its debts—when assessing the possibility of systemic effects. JA608, 663.

Exposure Transmission Channel. MetLife submitted extensive evidence demonstrating that counterparties' exposures to MetLife are not so large as to pose a threat to the counterparties, much less to U.S. financial stability. This evidence

showed that no counterparty that has been designated a global systemically important bank ("G-SIB") or global systemically important insurer would lose more than 2% of its total equity in the event of a hypothetical MetLife insolvency. DDCJA1649-52, 1652-53 (Tbl. II-1). In fact, the largest exposure of a G-SIB to MetLife (corrected for overstatements, including the failure of FSOC to account for collateral, and adjusted for expected recoveries on policyholder liabilities) is $3.2 billion, *see* DDCJA1657, which, even assuming a total loss, is dwarfed by the losses the Board assumes in "stress tests" of banks' resilience, and by the fines and penalties the U.S. government required several G-SIBs to pay in recent mortgage settlements, *id.* Despite FSOC's prior acknowledgment that threats to U.S. financial stability result only from those exposures "significant enough to materially impair" the counterparty, 12 C.F.R. pt. 1310, App. A, § II(a), FSOC cast aside this evidence in favor of unsupported speculation that direct and indirect exposures to MetLife "could cause losses" to market participants, with no attempt to make any "estimate of expected losses to counterparties," JA440 n.381, or to measure the "significan[ce]" of those losses to the counterparties or the U.S. economy, *see, e.g.*, JA373-74, 395-96, 415-29, 459-94.

Asset Liquidation Transmission Channel. To address FSOC's concerns about the possible systemic effects of a sudden asset fire sale, MetLife submitted an analysis by consulting firm Oliver Wyman demonstrating that, even applying

assumptions so extremely adverse as to be implausible, MetLife could liquidate assets to meet increased liquidity demands without causing an impact on market prices that would threaten the U.S. economy. *See* JA1173-1214. FSOC rejected those findings—as well as a comprehensive study (also prepared by Oliver Wyman) confirming that the failure of an insurer has never produced "contagion" effects at other insurers, *see* JA1089-1172—concluding instead that MetLife could threaten U.S. financial stability based on a chain of events it speculated might materialize, with no attempt to assess their plausibility, *see* JA508. Specifically, FSOC assumed, contrary to all historical experience, that (1) policyholders would act against their self-interest and surrender their policies *en masse*, despite substantial contractual and tax penalties, and other disincentives, (2) MetLife would not invoke its contractual deferral rights to restrict or postpone policyholder withdrawals, and (3) state insurance regulators would fail to use their existing authority to impose stays or moratoria on policyholder withdrawals, or, if they did, would "cause a loss of confidence" that could exacerbate distress by prompting a run on other insurers, JA506-07; *see also* JA452-53. In making these assumptions, FSOC ignored numerous submissions from state insurance regulators explaining that they would intervene to stop a policyholder run on MetLife, as they have done effectively during prior insurer failures. JA454-55.

Effects of Designation. MetLife submitted evidence that the increased capital requirements and other regulatory burdens that accompany designation could have severe financial and competitive consequences for the company. Its chief executive officer confidentially disclosed during the oral hearing before FSOC that MetLife had retained a firm to evaluate the possibility of breaking up the company in the event of designation. *See, e.g.*, JA257-59. FSOC ignored all of this evidence on the ground that "[t]here is no requirement under the Dodd-Frank Act or other applicable law for the Council to" consider the consequences of designation for the regulated company. *See* JA391.

The concerns that MetLife raised regarding the potential effects of its designation proved to be well-founded. In January 2016, MetLife announced that it is divesting the vast majority of its U.S. retail insurance operations in response, in part, to its designation. *See* Press Release, MetLife Announces Plan to Pursue Separation of U.S. Retail Business (Jan. 12, 2016), *available at* https://www.metlife.com/about/press-room/index.html?compID=192215.

Alternatives to Designation. MetLife repeatedly requested that, as an alternative to costly company-specific designations of insurers, FSOC consider an activities-based approach that would subject any systemically risky activities undertaken by insurers to regulation on an industry-wide basis. *See, e.g.*, JA98-101. FSOC refused to consider that alternative because it had decided to evaluate Met-

Life on a company-specific basis and "considering an industry-wide, activities-based analysis is not one of the statutory considerations." JA393. FSOC reached this conclusion even though it is currently considering the very same activities-based approach to address risks posed by mutual funds and other large asset managers—many of which have assets under management that vastly exceed MetLife's assets. *See* FSOC, Update on Review of Asset Management Products and Activities (Apr. 18, 2016) ("Asset Mgmt. Update"), *available at* https://www.treasury.gov/initiatives/fsoc/news/Documents/FSOC%20Update%20on%20Review%20of%20Asset%20Management%20Products%20and%20Activities.pdf.

Dissents from Designation. The two independent FSOC members with insurance expertise dissented from the Final Designation. S. Roy Woodall, the statutorily-mandated "independent member" with "insurance expertise," 12 U.S.C. § 5321(b)(1)(J), criticized FSOC for declining to adopt an activities-based approach to insurers and for conducting an asset liquidation analysis based on "implausible, contrived scenarios" rather than "substantial evidence in the record." JA661. He further took issue with FSOC for assuming, as the Final Designation's "central foundation," a "sudden and unforeseen insolvency of unprecedented scale, of unexplained causation, and without effective regulatory responses or safeguards." JA663.

Adam Hamm, FSOC's non-voting State Insurance Commissioner Representative, dissented because FSOC failed "to appropriately consider the efficacy of the state insurance regulatory system." JA666. Hamm also criticized FSOC's asset liquidation and exposure analyses because FSOC made "hypothetical and highly implausible claims of significant policyholder surrenders," JA669-70, and ignored insurance regulators' "authority to impose stays or apply similar powers to manage heightened policyholder surrender activity," JA668.

III. District Court Proceedings

As authorized by Dodd-Frank, 12 U.S.C. § 5323(h), MetLife filed suit challenging the Final Designation as arbitrary and capricious.

On March 30, 2016, the district court rescinded the Final Designation. JA779-813. Although the court determined that MetLife is a nonbank financial company eligible for designation, JA796, it held that, in designating MetLife, FSOC had arbitrarily and capriciously departed from its own Final Rule and Interpretive Guidance in two material respects. First, FSOC failed "to evaluate MetLife's vulnerability to material financial distress" despite its commitment to do so in its Final Rule and Interpretive Guidance, "steadfastly refused . . . to acknowledge that it changed positions," and "never explained why it abandoned the Guidance." JA799, 802. Second, FSOC disregarded its commitment in the Final Rule and Interpretive Guidance to determine whether material financial distress

at a company could pose a threat to U.S. financial stability by evaluating whether "'there would be an impairment of financial intermediation or financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy.'" JA802 (quoting 12 C.F.R. pt. 1310, App. A, § II(a)). In fact, "the Final Determination hardly adhered to any standard when it came to assessing MetLife's threat to U.S. financial stability," as illustrated by FSOC's exposure analysis, which "merely summed gross potential market exposure" without assessing the plausible potential losses from those exposures. JA803. A "summary of exposures and assets," the court emphasized, "is not a prediction." JA804.

In addition, the district court held that FSOC arbitrarily and capriciously refused to consider the effects of designation on MetLife, which are "'an important aspect of the problem when deciding whether regulation is appropriate.'" JA808 (quoting *Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015)). "'[N]o regulation is appropriate,'" the court concluded, "'if it does significantly more harm than good.'" *Id.* (quoting *Michigan*, 135 S. Ct. at 2707).

Because these deficiencies in the Final Designation each required rescission, JA811, the court did not reach MetLife's other arguments, including that FSOC arbitrarily and capriciously assumed the inefficacy of state regulation, ignored settled risk analysis methodologies, failed to consider reasonable alternatives to designation, and violated MetLife's due process rights and separation of powers principles.

SUMMARY OF ARGUMENT

FSOC's designation of MetLife suffers from numerous fatal deficiencies. In addition to repeatedly redefining the ground rules governing the designation process—by selectively disregarding statutory criteria and abandoning its own regulations without acknowledgment or explanation—FSOC consistently disregarded record evidence that undermined its conclusions, ignored long-standing principles of risk analysis and the views of experts on state insurance regulation, relied on unfounded and ever-more-dire speculation about the distress MetLife could experience and the potential effects of that distress, and declared itself indifferent to the consequences of its designation decision. Confronted with the task of defending that manifestly flawed analysis, FSOC repeatedly departs from the reasoning of the Final Designation in favor of arguments that appear nowhere in the decision itself. The district court correctly cast aside FSOC's *post hoc* rationalizations, *see SEC v. Chenery Corp.*, 318 U.S. 80, 93-94 (1943), and identified three serious errors in FSOC's decision to designate MetLife. The Final Designation should be rescinded on each of those independent grounds, as well as on several additional grounds that the district court did not reach.

I. FSOC departed from its Final Rule and Interpretive Guidance when it refused to evaluate MetLife's vulnerability to material financial distress. FSOC unequivocally committed in its Final Rule and Interpretive Guidance "to assess the

vulnerability of a nonbank financial company to financial distress," 12 C.F.R. pt. 1310, App. A, § II(d)(1), by considering a company's leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny. In the Final Designation, however, FSOC simply *assumed* that MetLife would experience material financial distress. FSOC's unacknowledged and unexplained departure from its own regulations was arbitrary and capricious, and also violated the Dodd-Frank Act, which independently requires an assessment of vulnerability as part of the designation inquiry. FSOC then compounded its error by assuming extreme degrees of distress at MetLife that are far more severe than the "imminent danger of insolvency" standard it committed to apply in its Final Rule and Interpretive Guidance.

II. FSOC further stacked the deck in favor of designation by abandoning the standard it adopted in the Final Rule and Interpretive Guidance for determining whether a company's material financial distress could destabilize the U.S. economy. In lieu of that standard—which required establishing that the effects of distress "would be sufficiently severe to inflict significant damage on the broader economy," 12 C.F.R. pt. 1310, App. A, § II(a)—FSOC conducted an amorphous, *ad hoc* inquiry that "hardly adhered to any standard" at all. JA803. Rather than attempt to determine whether MetLife's material financial distress could cause financial harm to other market participants that would rise to the level of threatening U.S. financial stability, FSOC simply tallied other financial institutions' raw expo-

sures to MetLife—without estimating potential losses from these exposures, evaluating the materiality of those estimated losses, or considering collateral and other risk mitigants. As the district court explained, this *sub silentio* departure from the standard FSOC committed to apply in the Final Rule and Interpretive Guidance undermines both its exposure and asset liquidation analyses.

In addition, FSOC ignored accepted principles of risk analysis and reasoned decision-making by refusing to specify plausible, objectively defined scenarios under which to evaluate the risks posed by MetLife, and unreasonably assumed the total inefficacy of the state insurance regulatory system, hypothesizing that intervention by state regulators would actually *aggravate*, rather than quell, economic turmoil—a counterintuitive assumption for which FSOC provided absolutely no support. These flaws provide further grounds for rescinding the Final Designation.

III. Underscoring its single-minded focus on designating MetLife, FSOC refused to consider whether designation might undermine its regulatory objectives by increasing the possibility that MetLife could experience financial distress that might destabilize the U.S. economy. According to FSOC, it had no obligation to consider the consequences of its designation decision and was free to ignore MetLife's representations that designation could actually weaken the company and lead to its break-up. FSOC's utter disregard for the consequences of its designa-

tion decision is incompatible with principles of reasoned decision-making and the Dodd-Frank Act.

IV. FSOC also refused to consider reasonable alternatives to designating MetLife, including the activities-based approach proposed by MetLife, under which FSOC would identify any systemically risky activities undertaken by insurers and recommend to the relevant primary regulator that those activities be regulated on an industry-wide, rather than a company-specific, basis. Although FSOC is currently evaluating an activities-based approach for asset managers, FSOC steadfastly maintained that it need not even consider that approach for MetLife because it had already decided to evaluate MetLife for designation on a company-specific basis and the Dodd-Frank Act does not mandate activities-based regulation.

V. Finally, FSOC violated due process and the separation of powers by denying MetLife access to the administrative record and FSOC's prior designation decisions during the designation proceedings, and subjecting MetLife to an administrative apparatus in which the same principals and staff wrote the rules, built the case against MetLife, considered MetLife's challenge to the Proposed Designation, and made the final decision to designate MetLife. By blending the legislative, investigative, prosecutorial, and adjudicative roles in the same principals and staff—who decided to designate MetLife based on a record and agency precedent that the

company had never seen—FSOC denied MetLife the opportunity to mount a meaningful defense to designation.

For all of these reasons, the Final Designation is impossible to reconcile with fundamental tenets of administrative law, the Dodd-Frank Act, or basic principles of fairness. And because FSOC made clear that "[n]o single consideration [was] dispositive" in its decision to designate MetLife, JA394, each of these errors requires rescission of the Final Designation in its entirety, *see Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 839 (D.C. Cir. 2006).

STANDARD OF REVIEW

This Court reviews a grant of summary judgment "applying the same standards as those that govern the district court's determination." *Alpharma, Inc. v. Leavitt*, 460 F.3d 1, 6 (D.C. Cir. 2006) (internal quotation marks omitted). As the prevailing party, MetLife "may, of course, defend [the] judgment on any ground properly raised below whether or not that ground was relied upon, rejected, or even considered by the District Court." *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 38-39 (1989) (internal quotation marks omitted).

FSOC's designation decisions are subject to arbitrary and capricious review, 12 U.S.C. § 5323(h), which requires FSOC to comply with basic precepts of reasoned decision-making under the Administrative Procedure Act ("APA"), 5 U.S.C. § 706. Agency action is arbitrary and capricious when the agency "entirely

failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Motor Vehicle Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

ARGUMENT

I. The Final Designation Contravened FSOC's Final Rule And Interpretive Guidance And The Dodd-Frank Act By Failing To Consider MetLife's Vulnerability To Material Financial Distress.

The Dodd-Frank Act authorizes FSOC to designate a nonbank financial company if it determines that "material financial distress" at the company could pose a "threat to the financial stability of the United States." 12 U.S.C. § 5323(a)(1). In its Final Rule and Interpretive Guidance, FSOC stated that it will evaluate three categories of criteria "to assess the vulnerability of a nonbank financial company to financial distress." 12 C.F.R. pt. 1310, App. A, § II(d)(1). FSOC's failure to undertake that vulnerability assessment in the Final Designation of MetLife—and its persistent refusal to acknowledge its shift in position—were arbitrary and capricious.

A. The District Court Correctly Concluded That FSOC Violated Its Interpretive Guidance By Refusing To Assess MetLife's Vulnerability To Material Financial Distress.

In its Final Rule and Interpretive Guidance, FSOC distilled Dodd-Frank's statutory designation criteria into six categories that are dedicated to two distinct inquiries. Specifically, "[t]hree of the six categories—size, substitutability, and interconnectedness—seek to assess the potential impact of the nonbank financial company's financial distress on the broader economy." 12 C.F.R. pt. 1310, App. A, § II(d)(1). "The remaining three categories—leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny of the nonbank financial company—seek to assess *the vulnerability of a nonbank financial company to financial distress*." *Id.* (emphasis added). FSOC explained that "companies that are highly leveraged, have a high degree of liquidity risk or maturity mismatch, and are under little or no regulatory scrutiny are more likely to be more vulnerable to financial distress." *Id.* FSOC therefore made an unambiguous commitment in the Final Rule and Interpretive Guidance to undertake a vulnerability assessment that examines the likelihood of a company's experiencing material financial distress. *See id.*

In the Final Designation, however, FSOC refused to consider MetLife's vulnerability to material financial distress. FSOC instead relied on an irrebuttable presumption of material financial distress that, despite serving as the foundation for FSOC's entire evaluation of MetLife, is not mentioned *anywhere* in the Final

Rule and Interpretive Guidance. FSOC declared in the Final Designation that the "three categories" identified in the Final Rule and Interpretive Guidance as relevant to assessing a company's vulnerability to financial distress would be used "to assess *the potential effects* of a company's material financial distress . . . —not to assess the likelihood of the company's material financial distress." JA390-91 (emphasis added). Rather than acknowledge that it was changing its position, FSOC insisted that "neither the Dodd-Frank Act nor the Interpretive Guidance requires or states that the Council will evaluate the probability or likelihood of material financial distress." JA390.

As the district court held, that unexplained and unacknowledged departure from FSOC's prior position on vulnerability was arbitrary and capricious. JA802. "[A]n agency is bound by its own regulations," *Nat'l Envtl. Dev. Ass'n's Clean Air Project v. EPA*, 752 F.3d 999, 1009 (D.C. Cir. 2014) (internal quotation marks omitted), and while "[a]n initial agency interpretation is not instantly carved in stone," *Verizon v. FCC*, 740 F.3d 623, 636 (D.C. Cir. 2014) (internal quotation marks omitted), it is "[o]ne of the core tenets of reasoned decision-making . . . that an agency [when] changing its course . . . is obligated to supply a reasoned analysis for the change." *Republic Airline Inc. v. U.S. Dep't of Transp.*, 669 F.3d 296, 299 (D.C. Cir. 2012) (internal quotation marks omitted); *see also FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (an agency "may not . . . depart from

a prior policy *sub silentio*" and "must show that there are good reasons for the new policy"). FSOC, however, "reversed itself without acknowledgement or explanation" when it refused to assess whether MetLife is vulnerable to experiencing material financial distress. JA796 (capitalization omitted).

FSOC persists in its revisionism in this Court, arguing that leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny inform "how the company may respond in the event of material financial distress," which, in turn, "may affect other market participants." FSOC Br. 29. But that assessment of effects on "other market participants" is no different from the assessment that the Final Rule and Interpretive Guidance said FSOC would perform using the three *other* categories of its six-category framework—size, substitutability, and interconnectedness—which "seek to assess the potential impact of the nonbank financial company's financial distress on the broader economy." 12 C.F.R. pt. 1310, App. A, § II(d)(1). FSOC's commitment to consider leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny was thus plainly intended to evaluate something *other* than the effects of a company's material financial distress on other market participants and the broader economy.

As the Final Rule and Interpretive Guidance makes clear—and as FSOC told state regulators when soliciting information about MetLife—those three categories are intended to "assess the vulnerability" of a nonbank financial company to expe-

riencing financial distress. 12 C.F.R. pt. 1310, App. A, § II(d)(1); *see also* JA209 (communication from FSOC informing state regulators that it would "assess the vulnerability of a company to financial distress"). FSOC's made-for-litigation interpretation would extinguish its own basic dichotomy between the two distinct inquiries identified in the Final Rule and Interpretive Guidance.

FSOC's lengthy discussion of the Final Designation's evaluation of leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny is thus entirely beside the point because FSOC concedes that it considered these categories to determine whether there would be systemic effects in the event that MetLife experienced material financial distress, without considering the likelihood that MetLife would experience such distress. *See* FSOC Br. 30-37. Regarding liquidity risk, for example, FSOC highlights the Final Designation's conclusion that "*in the event of MetLife's distress*, the company could be forced to sell securities or other assets." *Id.* at 30 (emphasis added). And, with respect to leverage, FSOC emphasizes the Final Designation's statement that, although MetLife's securities lending and funding agreement obligations "'may be considered low risk during normal market conditions, the risks posed by these activities can be amplified *during periods of financial distress*.'" *Id.* at 34-35 (quoting JA559) (emphasis added). FSOC's analysis of the effects of MetLife's hypothetical material financial distress does not satisfy FSOC's obligation under the Final Rule and Interpretive Guidance

to assess MetLife's vulnerability to financial distress in the first place. *See, e.g.*, 12 C.F.R. pt. 1310, App. A, § II(d)(2) ("Leverage amplifies *a company's risk of financial distress*.") (emphasis added).

FSOC's reliance on the public versions of its three prior designation decisions is equally unavailing. FSOC Br. 38. Nowhere in those decisions did FSOC acknowledge that it was departing from its commitment to undertake a vulnerability assessment or explain why it was changing its position, and FSOC steadfastly refused to provide MetLife with the *nonpublic* versions of those documents. The fact that FSOC's prior public designations "depart[ed] . . . *sub silentio*" from its Final Rule and Interpretive Guidance did not give FSOC license to continue to flout its own regulations when designating MetLife. *Fox Television*, 556 U.S. at 515.

In sum, FSOC's Final Designation and briefs in this Court take as their starting point an irrebuttable presumption about material financial distress at MetLife that is mentioned nowhere in the agency's Final Rule and Interpretive Guidance, and that contradicts what FSOC said in that document and in communications to state regulators. The district court correctly concluded that FSOC never made a "'conscious change in course'" regarding vulnerability and "never explained why it abandoned the Guidance." JA802 (quoting *Fox Television*, 556 U.S. at 515).

That unacknowledged departure from FSOC's prior position was arbitrary and capricious.[2]

B. Section 113(a)(2) Of The Dodd-Frank Act Also Requires Consideration Of A Company's Vulnerability To Material Financial Distress.

FSOC was also independently obligated by the Dodd-Frank Act to undertake an assessment of MetLife's vulnerability to material financial distress. Section 113(a)(1) of the Dodd-Frank Act directs FSOC to determine whether material financial distress at a company "could pose a threat to the financial stability of the United States," 12 U.S.C. § 5323(a)(1), by evaluating eleven statutory criteria, *id.* § 5323(a)(2), three of which are the same criteria that FSOC construed in its Final Rule and Interpretive Guidance as relevant to an assessment of vulnerability.

Specifically, Section 113(a)(2) directs FSOC to consider "the extent of the leverage of the company," 12 U.S.C. § 5323(a)(2)(A), "the degree to which the

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[2] In a footnote, FSOC suggests that the district court erred by treating the Final Rule and Interpretive Guidance as a "formal rulemaking." FSOC Br. 29-30 n.9. But FSOC codified the Final Rule and Interpretive Guidance in the Code of Federal Regulations, 12 C.F.R. pt. 1310, App. A; *see also Brock v. Cathedral Bluffs Shale Oil Co.*, 796 F.2d 533, 539 (D.C. Cir. 1986), and has never disputed that it intended to adhere to the Interpretive Guidance, which FSOC promulgated to "promote an accountability that benefits the public and the nonbank financial companies subject to evaluation," 77 Fed. Reg. 21,637, 21,647 (Apr. 11, 2012). Thus, regardless how the Interpretive Guidance is classified, FSOC was required to adhere to the Guidance when designating MetLife or, if it chose to depart from the Guidance, to acknowledge and explain that departure. *See Fox Television*, 556 U.S. at 515.

company is already regulated by 1 or more primary financial regulatory agencies," *id.* § 5323(a)(2)(H), and "the amount and types of the liabilities of the company, including the degree of reliance on short-term funding," *id*. § 5323(a)(2)(J). FSOC is therefore incorrect when it asserts that "[n]othing in the . . . list of required considerations contemplates an assessment of the likelihood of a company's financial distress." FSOC Br. 24. As FSOC explained in the Final Rule and Interpretive Guidance, these three statutory factors bear directly on that assessment because companies that are "highly leveraged," "have a high degree of liquidity risk or maturity mismatch," and are not closely regulated "are more likely to be more vulnerable to financial distress." 12 C.F.R. pt. 1310, App. A, § II(d)(1).

In addition, FSOC was required to consider vulnerability as an "appropriate" "risk-related factor" under Section 113(a)(2)(K) because it would be unreasonable for FSOC to subject a company to the costs and burdens of enhanced federal oversight in the absence of a plausible risk that the company will actually experience material financial distress. *See ALLTEL Corp. v. FCC*, 838 F.2d 551, 561 (D.C. Cir. 1988) ("a regulation perfectly reasonable and appropriate in the face of a given problem may be highly capricious if that problem does not exist") (internal quotation marks omitted). Congress enacted the Dodd-Frank Act to safeguard the U.S. economy against systemic threats, not to burden companies with unnecessary protections against illusory risks.

FSOC's insistence that a vulnerability assessment is not required because assessing the likelihood of distress is impossible (FSOC Br. 24-26) must be rejected because FSOC did not offer this reasoning in the Final Designation. *See Chenery Corp.*, 318 U.S. at 93-94. Furthermore, the suggestion that vulnerabilities are impossible to assess is wholly inconsistent with Dodd-Frank's supervisory framework. A central premise of Dodd-Frank's designation and stress-testing provisions is that federal regulators can identify a company's weaknesses, determine if those weaknesses could have systemic effects, and mitigate the risk of such effects by fortifying the company against distress. *See, e.g.*, 81 Fed. Reg. at 38,621 (stating that the Board's proposed prudential standards for designated insurers would "reduce the likelihood that . . . [they] would fail or experience material financial distress"). FSOC's professed inability to assess vulnerabilities flies in the face of Dodd-Frank's design and purpose.

C. FSOC Improperly Assumed Distress At MetLife That Was More Severe Than The Definition Of "Material Financial Distress" In Its Final Rule And Interpretive Guidance.

FSOC compounded its error by abandoning the definition of "material financial distress" adopted in its Final Rule and Interpretive Guidance in favor of an inquiry in which FSOC arrogated to itself unfettered discretion to hypothesize any level of distress it deemed necessary to generate systemic effects.

FSOC defined "material financial distress" in its Final Rule and Interpretive Guidance as "imminent danger of insolvency." 12 C.F.R. pt. 1310, App. A, § II(b). In the Final Designation, however, it assumed states of distress that were far more desperate, including—in the words of dissenting FSOC member Roy Woodall—a "massive and total insolvency" of "unprecedented scale, of unexplained causation, and without effective regulatory responses." JA662, 663 (Woodall Dissent); *see also, e.g.*, JA454 (noting that the aggregate general account shortfall would be approximately $63 billion under a "deep insolvency" scenario); JA608 (assuming the simultaneous failure of all of MetLife's insurance subsidiaries).

FSOC's abandonment of its own definition of "material financial distress" served as a linchpin of the entire designation analysis, liberating FSOC to assume whatever extreme and unprecedented conditions at MetLife it thought necessary to justify designation, regardless of the existing regulatory framework and other factors that would effectively make it impossible for these conditions to materialize. In this manner, FSOC continually moved the goalposts in response to MetLife's evidence and arguments, dismissing them as irrelevant or nonresponsive to the increasingly dire circumstances FSOC could conjure, and denied MetLife a meaningful opportunity to defend itself.

II. The Final Designation's Exposure And Asset Liquidation Analyses Defied The Final Rule And Interpretive Guidance, The Dodd-Frank Act, And Principles Of Reasoned Decision-making.

As the district court held, the Final Designation also violated FSOC's Final Rule and Interpretive Guidance by failing to establish that "material financial distress" at MetLife could lead to systemic effects that "'would be sufficiently severe to inflict significant damage on the broader economy.'" JA802 (quoting 12 C.F.R. pt. 1310, App. A, § II(a)). In that respect—and several others not reached by the district court—FSOC's exposure and asset liquidation analyses were arbitrary and capricious.

A. The District Court Correctly Concluded That FSOC's Exposure And Asset Liquidation Analyses Violated The Final Rule And Interpretive Guidance By Failing To Establish How MetLife's Material Financial Distress Could Pose A Systemic Threat.

In the Final Rule and Interpretive Guidance, FSOC explained that material financial distress at a nonbank financial company could pose a systemic risk to U.S. financial stability only "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." 12 C.F.R. pt. 1310, App. A, § II(a). In the Final Designation, however, FSOC abandoned that analytical standard by simply tallying raw exposures and total assets while refusing to assess potential losses from those exposures, and by relying on unjustified assumptions and guesswork, rather than evidence-based judgments, about the likely impact of Met-

Life's material financial distress on the U.S. economy. That "change in policy"—which FSOC "neither acknowledged nor explained"—was "arbitrary and capricious," and endorsed a mode of speculation-based decision-making that is flatly at odds with the APA. JA805.

FSOC's exposure analysis was riddled with blatant departures from the Final Rule and Interpretive Guidance and the requirements of reasoned agency decision-making. For example, FSOC emphasized in its Final Rule and Interpretive Guidance that not every type of counterparty "exposure" to a nonbank financial company would support designation, and that only those exposures "significant enough *to materially impair*" counterparties could "pose a threat to U.S. financial stability" in the event of material financial distress at a nonbank financial company. 12 C.F.R. pt. 1310, App. A, § II(a) (emphasis added).

In designating MetLife, however, FSOC dispensed with that material-impairment standard and instead simply tallied counterparties' "exposure" and asserted that MetLife's failure "could cause losses," JA440 n.381, 443-44, 461-62, 488-90, without defining whether "could" meant a 10%, 1%, or 0.1% likelihood and with no indication of how material that loss would be to the counterparty, much less to U.S. financial stability. Nowhere in the Final Designation did FSOC project which counterparties could realistically experience losses or estimate the magnitude or impact of those losses. *See* JA802-03. FSOC's *post hoc* insistence

in its brief that MetLife's failure "could impair" its counterparties, FSOC Br. 40, 44, is sheer revisionism that cannot salvage the agency's decision. *See Chenery Corp.*, 318 U.S. at 93-94.[3]

Furthermore, FSOC disregarded MetLife's evidence that, even in the highly implausible event that counterparties lost their full exposures to MetLife, those counterparties would not be materially impaired and the losses would not produce systemic effects. For example, MetLife established that the largest dollar exposure that an individual G-SIB has to MetLife is $3.2 billion (based on the exposure amount corrected for overstatements, including the failure of FSOC to account for collateral, and adjusted for expected recoveries on policyholder liabilities), *see* DDCJA1657, an amount far lower than the fines and settlement amounts the government compelled several G-SIBs to pay in connection with recent mortgage settlements (JPMorgan Chase & Co. at $13 billion and Bank of America Corporation at $16.65 billion). *Id*. Even though none of these fines caused material financial distress at any G-SIB, *see id.*, FSOC completely ignored this evidence in the Final Designation—an omission that cannot be rectified before this Court.

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[3] Similarly, FSOC's assertion that MetLife conceded there could be $90 billion in "direct losses" from its capital markets activities, FSOC Br. 49, again conflates losses—which FSOC refused to estimate—with aggregate exposures, *see* JA77 ¶ 118.

FSOC also failed to address MetLife's evidence that the Board's Comprehensive Capital Analysis and Review ("CCAR") testing—which assesses banks' ability to withstand losses during extreme market disruptions—shows quantitatively that the U.S. G-SIBs' exposures to MetLife would not materially impair them. That evidence was highly relevant to FSOC's exposure analysis—which hinged on the exposures of large financial firms to MetLife, *see, e.g.*, JA366-67—and demonstrated that, if the eight U.S. G-SIBs were to lose the full value of their exposures to MetLife (adjusted for expected recovery on policyholder liabilities), the resulting reduction in those banks' capital would be only a *tiny fraction* of the reduction they would suffer under the Board's "severely adverse" CCAR testing scenario, DDCJA1656-57 (Tbl. II-3). Because all of the U.S. G-SIBs passed the quantitative component of their 2014 CCAR examinations, the Board necessarily concluded that they could withstand economic conditions far more severe than MetLife's failure. In the face of this evidence, FSOC nevertheless "summarily deemed" each counterparty's exposure to MetLife "grave enough to damage the economy." JA803.

FSOC then further departed from its previously announced material-impairment standard by speculating that third parties that do not even conduct business with MetLife might be "uncertain" about the extent of losses by MetLife's counterparties, causing them to "pull back from a range of firms and mar-

kets, in order to reduce [their own] exposures, thereby increasing the potential for destabilization." JA446, 498. These indirect and highly speculative consequences—in which a company is deemed a threat not because it is one, but because some other "uncertain," uninformed company worries it might be—were never identified in the Final Rule and Interpretive Guidance as relevant to the exposure analysis. And for good reason: This type of "sheer speculation" about the consequences of financial distress at MetLife—unmoored from any "logic and evidence" indicating that the hypothesized events might actually come to pass—is manifestly insufficient to satisfy the requirements of reasoned decision-making. *Sorenson Commc'ns Inc. v. FCC*, 755 F.3d 702, 708 (D.C. Cir. 2014) (internal quotation marks omitted).[4]

FSOC's contention that the Final Designation "explained that designation would be appropriate even if it were to accept MetLife's preferred [exposure]

[4] While FSOC contends that preventing this type of "contagion effect" prompted the federal government to intervene to prevent AIG's failure in 2008, FSOC Br. 43, it ignores that AIG's difficulties were caused by non-insurance activities conducted by a non-insurance subsidiary; MetLife has nothing comparable, *see* DDCJA1024. As one of MetLife's primary regulators has made clear, "[t]he risks associated with non-traditional non-insurance activities that felled AIG . . . are decidedly diminished in the case of MetLife," whose "activities are more closely tethered to the business of insurance *qua* insurance." JA235. FSOC pointed to no historical examples where third parties had "pull[ed] back" from counterparties of a traditional life insurer such as MetLife out of concern that those counterparties would be exposed to losses in the event of the insurer's failure.

methodology" is specious. FSOC Br. 48. That "expla[nation]" amounts to no more than a few conclusory passages in which FSOC acknowledged the different estimates of raw exposures and then summarily declared that "even exposures at the lower ends of these estimates" could pose a systemic threat. JA444; *see also* JA494-95. FSOC provided no explanation or evidentiary support for that *ipse dixit* and never assessed the potential losses arising from those raw exposures or demonstrated that any such losses satisfied the material-impairment standard adopted in the Final Rule and Interpretive Guidance.

FSOC also refused to "reduce exposure estimates by an expected recovery rate" in order to account for financial recoveries that would mitigate losses. JA805. Most significantly, FSOC irrationally discounted MetLife's evidence that actual counterparty losses would be largely offset by collateral, which federal regulatory agencies recognize as a "fundamental" risk-reduction measure. OCC, FDIC, Fed. Reserve Bd. & OTS, *Interagency Supervisory Guidance on Counterparty Credit Risk Management* 14 (June 29, 2011), *attachment to Interagency Counterparty Credit Risk Management Guidance* (July 5, 2011) (SR 11-10). In fact, FSOC itself has conceded elsewhere that posting collateral reduces risks to counterparties, including in the securities lending context. *See* Asset Mgmt. Update, *supra*, at 18, 25. But, in the Final Designation, FSOC *excluded* collateral from its assessment of counterparty exposures. JA495; *see also* JA803.

As the district court recognized, FSOC's back-of-the-hand treatment of collateral also undermined its asset liquidation analysis. JA804. To excuse its failure to consider collateral as part of the exposure analysis, FSOC hypothesized that collateralization could actually exacerbate MetLife's systemic risk under the asset liquidation channel because "liquidations [of collateral] could place downward pressure on the prices of the assets involved." JA495. But, as with its failure to convert raw exposures into expected losses, FSOC refused to "quantif[y]" this "impact." JA804. Its asset liquidation analysis does not evaluate the assets held as collateral or the pressures, if any, that liquidation would have on market prices. FSOC thus departed from its commitment in the Final Rule and Interpretive Guidance to "determine" whether the effects of a company's material financial distress would be "sufficiently severe to inflict significant damage on the broader economy." 12 C.F.R. pt. 1310, App. A, § II(a).

In addition to ignoring the effectiveness of collateral, FSOC disregarded new risk-reducing measures the SEC had adopted for money market mutual funds four months before the Final Designation. The SEC rules authorized money market mutual funds to impose liquidity fees and redemption gates to limit investor redemptions during times of market stress, concluding that the measures would reduce the likelihood of a "run" that could force a fund to "break the buck" by reducing its stable share price below $1.00. *See* Money Market Fund Reform (Final

Rule), 79 Fed. Reg. 47,736, 47,747-49 (Aug. 14, 2014). The SEC also withdrew permission for institutional funds to maintain a stable $1.00 share price, thus eliminating the possibility of those funds' "breaking the buck." *See id.* at 47,774-75. The Final Designation nevertheless continued to posit that, were MetLife to fail, as many as 65 money market mutual funds that hold MetLife funding-agreement backed securities could "break the buck"—an assertion that inexplicably assumed that the SEC reforms would be wholly ineffectual and ignored that only two U.S. money market funds had ever "broken the buck." DDCJA1676-81.

Against this pattern of unsubstantiated speculation and standardless decision-making, FSOC's repeated refrain that the Final Designation constitutes an "expert judgment" (FSOC Br. 4, 6, 21, 45, 49) rings hollow. FSOC's designation of MetLife is remarkable for the degree to which it spurned expertise, including the federal government's treatment elsewhere of collateral, G-SIBs' financial resilience as measured by the Board's stress testing, and the expertise of state insurance regulators—two of whom Congress placed on FSOC specifically to inform its analysis of insurance companies, but whose judgments FSOC's other members ignored in favor of their own baseless speculation. FSOC has not cited a single case deferring to agency "expertise" in such circumstances, nor when an agency repeatedly ignored relevant evidence in the record, substituted conjecture for empirical analysis, and failed to adhere to its own regulatory standards.

FSOC accuses the district court of demanding that FSOC "predict the specific causes and effects of the next financial crisis." FSOC Br. 46. In reality, the district court simply required FSOC to undertake an assessment that was consistent with its own regulations, the evidence in the administrative record, and the principles of reasoned decision-making to which all agencies must adhere. JA804-05. The court did not demand "precision"—only meaningful analysis. Because FSOC failed to establish in either its exposure or its asset liquidation analyses that material financial distress at MetLife could "inflict significant damage on the broader economy," 12 C.F.R. pt. 1310, App. A, § II(a)—and therefore failed to abide by the designation standard it adopted in its Final Rule and Interpretive Guidance—the Final Designation is arbitrary and capricious.

B. FSOC's Exposure And Asset Liquidation Analyses Are Flawed In Other Critical Respects.

In addition to the shortcomings identified by the district court, there are other critical flaws in FSOC's analysis of the exposure and asset liquidation transmission channels. In particular, FSOC ignored settled principles of risk analysis when assessing the effects of MetLife's potential material financial distress and arbitrarily assumed the utter ineffectiveness of state regulation to avert systemic effects. These errors provide two additional grounds for rescission.

1. FSOC Departed From Accepted Principles Of Risk Analysis And Reasoned Decision-making.

In purporting to examine the risk that material financial distress at MetLife could pose to the broader U.S. economy, FSOC ignored settled risk analysis principles by failing to utilize plausible risk scenarios based on objective economic indicia and historical experience.

Both FSOC and the federal agencies that are represented on the Council have repeatedly stressed the importance of reasoned risk analysis. For example, in evaluating the systemic importance of the asset management industry, FSOC has explained that "adequate risk management planning" entails testing companies' "abilities to meet redemptions" by counterparties "under a variety of *extreme but plausible* stressed market conditions." Asset Mgmt. Update, *supra*, at 12 (emphasis added). Similarly, the Board has directed banks performing stress tests to use "well designed scenarios" and "well-documented assumptions." Fed. Reserve Bd., FDIC, OCC, Supervisory Guidance on Stress Testing for Banking Organizations with More than $10 Billion in Total Consolidated Assets, 77 Fed. Reg. 29,458, 29,465 (May 17, 2012) (SR 12-7).

Despite the widespread acceptance that reasoned risk analysis requires well-defined scenarios and plausible conditions, the Final Designation did not objectively define *any* scenario—plausible or otherwise—against which to evaluate the effects of MetLife's material financial distress. While FSOC purported to describe

events stemming from "material financial distress" at MetLife "in the context of a period of overall stress in the financial services industry and in a weak macroeconomic environment," 12 C.F.R. pt. 1310, App. A, § II(b), it never assigned a concrete meaning to "overall stress" or "weak macroeconomic environment." Instead, it repeated those undefined phrases to justify its unsupported assertions that MetLife could transmit risks through the exposure and asset liquidation channels. FSOC offered only the conclusory reassurance that it had "address[ed] a range of outcomes that are possible but vary in likelihood," JA371, without disclosing any of those scenarios or identifying the economic assumptions on which they were based.

FSOC's error on this point is all the more flagrant because it had a clear alternative. The Board's CCAR testing examines the resilience of bank holding companies by subjecting them to a series of hypothetical "stress scenarios," ranging from a "baseline" scenario to "adverse" and "severely adverse" economic conditions with quantitative assumptions for each. *See, e.g.*, Fed. Reserve Bd., *2014 Supervisory Scenarios for Annual Stress Tests Required Under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule* (2013), *available at* http://www.federalreserve.gov/bankinforeg/bcreg20131101a1.pdf. These scenarios assign values to 28 variables, including unemployment, exchange rates, prices, incomes, and interest rates. *Id.* at 1. Ambiguous concepts—such as "severe reces-

sion" and a "sharp slowdown in economic activity"—are thus given concrete meaning because they are associated with the values of those variables. *Id.* at 3, 4. Similarly, the rule on resolution planning promulgated by the Board and FDIC directs banks and nonbank systemically important financial institutions to apply the same three stress scenarios when developing a resolution plan—an activity directly analogous to FSOC's evaluation of the effects of a nonbank financial company's material financial distress on financial stability. 12 C.F.R. § 381.4(a)(4)(i). It plainly would have been feasible for FSOC to identify scenarios with similarly quantitative, objective definitions of "material financial distress" and "weak macroeconomic environment." FSOC not only failed to do so, but also neglected to offer any explanation for jettisoning the accepted risk-assessment principles applied by the very agency that oversees the companies FSOC designates. *Id.*

FSOC exacerbated this error by premising its evaluation of whether MetLife could pose a threat to U.S. financial stability on illusory risks that have no footing in reality. For example, FSOC's asset liquidation analysis rests on the far-fetched supposition that, on learning of MetLife's presumed material financial distress, retail policyholders would terminate their coverage *en masse*, triggering an asset fire sale by MetLife in order to fund policyholders' redemptions. JA504-07, 526-28.

In positing that "run" on MetLife, FSOC ignored MetLife's evidence that policyholders have historically maintained their policies in times of financial dis-

tress. DDCJA917-19 (Tbl. III-20 & Charts III-21 & 22). Nor did FSOC offer any response to MetLife's showing that it would be irrational for the average policyholder to terminate early because doing so could trigger penalties and taxes, and because a terminating policyholder might not be able to obtain replacement coverage. JA165, 1052-53 (Huff Dissent). FSOC likewise had no response to MetLife's demonstration that its assumptions about retail customer behavior contradicted the premises of two recent rulemakings by agencies whose heads are FSOC members. *See* 79 Fed. Reg. at 47,743, 47,794 (permitting retail money market funds to continue to maintain a stable $1.00 share price because "retail investors historically have behaved differently from institutional investors," including by being "slower moving"); 79 Fed. Reg. 61,440, 61,497 (Final Rule) (Oct. 10, 2014) (wholesale counterparties are assumed to withdraw their deposits at higher rates because they "are generally more sophisticated than retail counterparties").

FSOC further assumed that MetLife would not invoke its contractual deferral right to limit or postpone policyholder terminations in the event it experienced material financial distress, JA507, flatly disregarding MetLife's *own* statements that, in situations as dire as those posited, the company would exercise its deferral rights to limit outflows, *see* DDCJA1760-61, 1763, and may even have a fiduciary obligation to do so, DDCJA1782-83. FSOC's counterfactual, illogical assessment of risk is incompatible with the requirements of reasoned agency decision-making.

See Appalachian Power Co. v. EPA, 249 F.3d 1032, 1054 (D.C. Cir. 2001) (per curiam) (rebuking agency for "what appear[ed] to be stark disparities between its projections and real world observations").

2. FSOC Ignored The Efficacy Of The State Insurance Regulatory System, Relying Instead On Baseless Speculation That Contradicted Record Evidence And The Expertise Of State Insurance Regulators.

In violation of its obligation under the Dodd-Frank Act to consider existing regulatory oversight, 12 U.S.C. § 5323(a)(2)(H), FSOC also disregarded the rigorous, time-tested state regulatory system that governs MetLife's operations and that has protected policyholders and the broader economy from prior life insurer failures. FSOC instead embraced the implausible assumption that, in the event of material financial distress at MetLife, state regulatory intervention would actually *intensify* rather than mitigate market turmoil.

These flaws are most apparent in FSOC's asset liquidation analysis, which rests predominantly on the assumption that MetLife's policyholders would terminate their policies *en masse*. *See* JA522-54 (devoting 25 pages of asset liquidation analysis to insurance liabilities). FSOC assumed that state regulators would not intervene to stop a policyholder "run" on MetLife and that, if state regulators did exercise their authority to impose a stay on withdrawals, their intervention would make matters worse by stoking a "crisis of confidence" at other insurers and throughout the broader economy. *See* JA452-53, 500, 506-07; *see also* JA498.

FSOC identified no evidence, however, that state regulators had ever failed to intervene or that their intervention had ever backfired in such a counterintuitive manner. Nor did FSOC explain why an SEC-authorized "redemption gate" suspending withdrawals from money market mutual funds is an effective risk *mitigant*, 79 Fed. Reg. at 47,747, but a state-imposed stay on withdrawals from insurers is a risk *accelerant*. FSOC likewise never explained why a stay by States would spark panic, whereas a principal benefit of "systemic" designation is the Board's authority to "requir[e] [a] company to terminate one or more of its activities" or product offerings. JA613.

In fact, the record showed that a suspension of surrenders is a commonly invoked regulatory tool that would shield MetLife from FSOC's theoretical fire sale without fomenting economy-wide panic. *See* DDCJA1264-65 (study finding that regulators placed moratoria on withdrawals in the majority of insurer failures and that regulatory intervention did not cause policyholder contagion). Submissions from MetLife's state regulators confirmed the efficacy of existing state regulatory tools to manage policyholder surrenders and alleviate liquidity strain. JA104-05, 142, 184-95, 202, 236; *see also* JA108 (Louisiana Insurance Commissioner explaining that state regulators are *legally* obligated "to intervene . . . long before . . . hypothetical distress levels would be reached").

FSOC refused to address that evidence, as well as FSOC Member Hamm's conclusion in dissent that the broad array of state regulatory tools provides "substantial means to quell panic" and that FSOC need not be concerned about a stay at one company leading to contagion at other companies because "insurance regulators have extensive authorities to intervene to protect policyholders at these other firms as well." JA668; *see also BellSouth Telecomms., Inc. v. FCC*, 469 F.3d 1052, 1060 (D.C. Cir. 2006) (agencies have "no license to ignore the past when the past relates directly to the question at issue"). These glaring omissions are sufficient standing alone to undermine FSOC's entire asset liquidation analysis because a hypothetical unrestrained policyholder run on MetLife was an essential premise of that analysis. *See, e.g.*, JA510-54; *see also Am. Gas Ass'n v. FERC*, 593 F.3d 14, 16 (D.C. Cir. 2010) (agencies must respond to dissenting members' reasonable concerns).[5]

FSOC now tries to evade its reliance on policyholder surrenders by arguing that other potential sources of liquidity strain could independently cause a fire sale

[5] FSOC misleadingly contends that MetLife "conceded" that examining "systemic risks" is not within the "role" of state regulators. FSOC Br. 35-36. The statements FSOC selectively quotes from the oral hearing did not address the efficacy of state regulators in mitigating systemic risk or resolving failed insurers, which was addressed at length elsewhere at that hearing, JA268-78, and in the numerous submissions to FSOC by MetLife and state regulators, *see, e.g.*, JA108, 166-70, 181-95, 235-37.

of MetLife's assets. *See* FSOC Br. 32-33. But those "*post hoc* rationalizations" are "inadequate" to save its asset liquidation analysis. *Alpharma, Inc.*, 460 F.3d at 6. In any event, MetLife submitted an analysis by Oliver Wyman demonstrating that, even if all of its policyholders surrendered all surrenderable policies and state regulators implausibly failed to intervene, MetLife's asset sales would generate liquidity sufficient to satisfy *all* relevant demands, including *other* surrenderable liabilities, without causing price impacts that would significantly disrupt financial markets. DDCJA1008-16, 1735, 1756, 1791 & n.162. In response, FSOC asserted that the Oliver Wyman analysis was flawed because it assumed that MetLife would sell its most liquid assets first. In FSOC's view, it was more appropriate to employ a "Monte Carlo" simulation that assumed that MetLife would sell its assets in *random order*, JA583-84, despite fiduciary duties requiring the company to liquidate assets in a manner that minimizes losses and despite this Court's admonition that it is arbitrary and capricious for an agency to assume action contrary to board members' fiduciary duties. *See Bus. Roundtable v. SEC*, 647 F.3d 1144, 1150 (D.C. Cir. 2011).

FSOC's insistence that the state regulatory framework is inadequate because it does not provide for "consolidated supervision" of MetLife is also misplaced. JA599; *see also* FSOC Br. 36. Unlike the statutory framework for evaluating *foreign* financial companies, Dodd-Frank does not identify the existence of consoli-

dated supervision as a relevant consideration in evaluating a U.S. nonbank financial company for designation. *Compare* 12 U.S.C. § 5323(b)(2)(H) (directing FSOC, in evaluating foreign companies, to consider "the extent to which" that company "is subject to prudential standards on a consolidated basis"), *with id.* § 5323(a)(2)(H) (directing FSOC to consider whether a U.S. nonbank financial company is subject to regulation by "1 or more primary financial regulatory agencies"). Consolidated supervision was not a trump card that FSOC could pull to discount the state insurance regulatory system regardless of the record evidence of its effectiveness.

FSOC's failure to understand the state insurance regulatory system also pervades numerous other aspects of the Final Designation, including its assessment of the risks posed by MetLife's "captive reinsurance" activities and guaranteed investment contracts ("GICs"), and the effect of hypothetical distress at MetLife on state Guaranty Associations:

- ***Captive Reinsurance***: Although FSOC asserts that "[t]he use of captive reinsurance subsidiaries . . . 'creates a greater risk that MetLife could be required to engage in asset sales,'" FSOC Br. 37 (quoting JA369), the Delaware insurance regulator made clear to FSOC that "captive reinsurance arrangements are closely monitored by state regulators" and "facilitate lower prices and more life insurance capacity without substantially increasing insolvency risk." JA154; *see also, e.g.*, N.Y. Ins. Law § 1501(7); Conn. Gen. Stat. § 38a-135(f); Del. Code Ann. tit. 18, § 5004(l).

- ***Guaranteed Investment Contracts***: FSOC's contention that there is a "history of defaults" on GICs (FSOC Br. 41 (citing JA558 n.941)) re-

lies on a footnote in the Final Designation attempting to derive insight from insurer defaults in the early 1990s. Those defaults were caused not by the insurers' GICs, but by investment portfolios that were over-concentrated in high-risk assets. *See* DDCJA1019-28. In the ensuing decades, many new tools have been adopted to prevent or address insurers' financial distress, including risk-based capital and investment diversification requirements, *see* JA142, 184-95, which FSOC simply assumes away.

- ***State Guaranty Associations***: FSOC's conclusion that "MetLife's financial distress could . . . destabilize the state-based guaranty associations," FSOC Br. 43 (citing JA456), was premised solely on MetLife's size and ignored evidence regarding the funding capacity of the Guaranty Associations and their success in resolving complex multi-state insurance companies. JA179-80, 184-95; *see also* DDCJA1922-28, 1271-78, 1832-38.

In all of these respects, FSOC's designation of MetLife arbitrarily and capriciously ignored record evidence, disregarded historical experience, embraced unfettered speculation and unreasonable assumptions, and offered explanations that were "so implausible that [they] could not be . . . the product of agency expertise." *State Farm*, 463 U.S. at 43.

III. The District Court Correctly Concluded That FSOC Improperly Failed To Consider The Effects Of Designation On MetLife.

The district court concluded that, because "[n]o regulation is 'appropriate' if it does significantly more harm than good," JA808 (internal quotation marks omitted), it was arbitrary and capricious for FSOC not to consider the effects of designation on MetLife, including whether designating the company could actually make it more vulnerable to material financial distress and more susceptible to

transmitting that distress to the rest of the economy. The district court's conclusion is consistent with well-settled principles of agency decision-making, the language of the Dodd-Frank Act, and controlling Supreme Court precedent.

It is arbitrary and capricious for an agency to ignore the consequences of its actions because an agency cannot discharge its regulatory mandate if it is oblivious to whether its actions will further, or actually undermine, its regulatory objectives. *See, e.g.*, *North Carolina v. EPA*, 531 F.3d 896, 907 (D.C. Cir. 2008) (per curiam) (vacating EPA rule where the agency could not show that it "achieve[d] something measurable toward the goal" the agency sought to further). The consequences of regulatory action are plainly "an important aspect of the problem" that every agency must consider before deciding on a course of action. *State Farm*, 463 U.S. at 43.

The Dodd-Frank Act tasks FSOC with "identify[ing] risks to the financial stability of the United States that could arise from the material financial distress or failure" of nonbank financial companies and designating systemically important companies for Board supervision to avert those risks. 12 U.S.C. § 5322(a)(1)(A); *see also id.* § 5322(a)(2)(H). An indisputably "important aspect of the problem" of preventing the transmission of systemic risk is considering whether the costs and burdens accompanying federal regulatory oversight will in fact weaken the designated company, making it more vulnerable to material financial distress and more

likely to transmit distress to the rest of the economy. Yet, FSOC steadfastly refused to consider the effects of designation on MetLife, JA391, and therefore failed to evaluate whether designating the company would advance, or undermine, its statutory mandate. That "come what may" attitude is the height of arbitrary and capricious decision-making. Indeed, it is extraordinary to hear a regulator insist that it can take regulatory action with no consideration of the consequences.

The fact that the Board has not yet finalized enhanced prudential standards and capital requirements for insurers did not excuse FSOC from considering the consequences of designation. FSOC Br. 54-55. FSOC did not rely on that rationale in the Final Designation and cannot invoke it for the first time in litigation. *See Chenery Corp.*, 318 U.S. at 93-94. Moreover, during the designation process, MetLife informed FSOC of specific steps that it might be required to take in response to designation, including withdrawing from certain lines of business where it could no longer compete effectively due to the enhanced capital requirements that would accompany designation. MetLife's chief executive officer even informed FSOC that MetLife was evaluating the possibility of dismantling itself in the event of designation—a possibility that in fact came to pass when, after being designated, MetLife decided to divest the majority of its U.S. retail insurance business. DDCJA1603-04, 1929-34; *see also* Press Release, *supra*. Designation also led General Electric to divest most of the assets of GECC (which was subsequently

de-designated by FSOC). *See* Ted Mann & Joann S. Lublin, *Why General Electric Is Unwinding Its Finance Arm*, Wall St. J. (Oct. 13, 2015). FSOC was obligated to consider these potential consequences in assessing whether designating MetLife was an appropriate means of safeguarding U.S. financial stability.

This conclusion is reinforced by the Supreme Court's decision in *Michigan v. EPA*, where the Court reiterated that "reasonable regulation ordinarily requires paying attention to the advantages and the disadvantages of agency decisions." 135 S. Ct. at 2707 (emphasis omitted). Relying on this principle, the Court construed a provision of the Clean Air Act that permitted the EPA to regulate power plants only if "regulation is appropriate and necessary," 42 U.S.C. § 7412(n)(1)(A), to require a consideration of the costs of regulation, *Michigan*, 135 S. Ct. at 2707.

Like the Clean Air Act, the Dodd-Frank Act requires FSOC to consider other "appropriate" "risk-related factors." 12 U.S.C. § 5323(a)(2)(K). If designation imposes costs that weaken the designated company—or make the transmission of the company's material financial distress more likely—that is undeniably a "risk-related factor[ ]" that is relevant to FSOC's designation inquiry.

FSOC gains nothing from contending that the relevant "risk-related factors" under the Dodd-Frank Act are those relating to "the risk that the company's material financial distress could pose to the country's financial stability." FSOC Br. 51.

FSOC failed to undertake that precise inquiry when designating MetLife: It refused to consider whether designating MetLife could weaken the company and make it more likely to transmit material financial distress to the rest of the economy.

Nor does the language in Dodd-Frank directing FSOC to consider only those "risk-related factors" that "the Council deems appropriate" provide FSOC unfettered discretion to ignore the consequences of its actions. 12 U.S.C. § 5323(a)(2)(K); *see also* FSOC Br. 51-54. Interpreting analogous language in *Michigan*, the Supreme Court made clear that, while the term "appropriate" "leaves agencies with flexibility, an agency may not 'entirely fail[ ] to consider an important aspect of the problem' when deciding whether regulation is appropriate." 135 S. Ct. at 2707 (quoting *State Farm*, 463 U.S. at 43). In any event, even if Dodd-Frank's "risk-related factors" provision were inapplicable here, FSOC would still be required to consider the consequences of its designation determinations because that obligation flows directly from basic principles of administrative law. *See State Farm*, 463 U.S. at 43. FSOC's reliance on *Webster v. Doe*, 486 U.S. 592, 600 (1988), to excuse its failure to consider the consequences of designating MetLife is thus entirely misplaced, FSOC Br. 52, because, in interpreting a provision of the National Security Act, that decision did not purport to alter the requirements of reasoned agency decision-making, which necessarily encompasses consideration

of whether agency action will advance, or undermine, the agency's regulatory objectives.

FSOC also contends that, because Congress expressly referred to consideration of costs and benefits in other provisions of Dodd-Frank, the absence of an express reference to "costs" in Section 113(a)(2) excuses FSOC from considering the consequences of its actions. *See* FSOC Br. 52 (citing 12 U.S.C. § 5512(b)(2)). But other provisions of the Clean Air Act likewise refer to a consideration of costs, *see, e.g.*, 42 U.S.C. §§ 7412(d)(2), 7412(d)(8)(A)(i), 7412(f)(2)(A), and the Supreme Court nevertheless concluded that an assessment of costs was required to determine whether the power-plant regulation was "appropriate," *see Michigan*, 135 S. Ct. at 2709. Moreover, MetLife is not contending—and the district court did not find—that FSOC is required to undertake the type of formal cost-benefit analysis that Congress has expressly imposed on some agencies in specific regulatory settings. The court instead concluded that FSOC is required to consider the consequences of its decisions and whether the action it is taking is consistent with its statutory mandate. Nothing in Dodd-Frank grants FSOC a special dispensation to ignore this requirement of reasoned decision-making applicable to all other agencies.

IV. FSOC Failed To Give Meaningful Consideration To Reasonable Alternatives To Designation.

One reason agencies consider the consequences of their actions—and why, in this case, it was improper for FSOC to ignore the potentially severe effects of designation on MetLife—is that consideration of consequences informs an agency's assessment of alternatives that are available to it. An agency must consider alternatives that are "neither frivolous nor out of bounds." *Chamber of Commerce of U.S. v. SEC*, 412 F.3d 133, 144-45 (D.C. Cir. 2005). In light of the far-reaching consequences of designation, MetLife urged FSOC to consider and adopt an "activities-based approach" to regulating insurers—which would subject any systemically risky aspects of insurers' operations to enhanced regulatory oversight on an industry-wide basis—as an alternative to designating MetLife for enhanced supervision on a company-specific basis. *See, e.g.*, JA98-101. FSOC's persistent refusal to consider that alternative was arbitrary and capricious, and provides an additional ground for rescinding the Final Designation.

FSOC insisted that it need not consider an activities-based approach because it had already decided to designate MetLife on a company-specific basis and thus "an industry-wide evaluation of activities is not necessary or appropriate in the case of MetLife." JA393. That reasoning is wholly circular. An agency cannot ignore alternatives simply because it has selected one regulatory option without considering others. FSOC also emphasized that the Dodd-Frank Act does not *re-*

quire it to regulate insurers using that industry-wide approach. *See* JA392-93. Of course, nothing in the statute *precludes* such an alternative either, and FSOC possesses regulatory tools under Dodd-Frank to implement activities-based regulation of insurers. *See, e.g.*, 12 U.S.C. § 5322(a)(2)(K) (authorizing FSOC to "make recommendations to [the company's] primary financial regulatory agenc[y] to apply new or heightened standards and safeguards for financial activities or practices that could create or increase [systemic] risks"). At the very least, FSOC was "obligat[ed] to consider" the activities-based alternative and to explain its decision not to adopt it. *Chamber of Commerce*, 412 F.3d at 144.

FSOC's refusal to consider an activities-based approach in designating MetLife was particularly arbitrary because it is currently pursuing that approach for asset managers. *See* Asset Mgmt. Update, *supra*, at 18, 25. Many of the largest mutual funds have assets under management that vastly exceed MetLife's assets, and their liquidation could have a substantially larger impact on market prices than the liquidation of an insurer like MetLife. *See* DDCJA1789 n.159. FSOC's "artificial narrowing of options is antithetical to reasoned decisionmaking." *Int'l Ladies' Garment Workers' Union v. Donovan*, 722 F.2d 795, 817 (D.C. Cir. 1983) (internal quotation marks omitted); *see also Laclede Gas Co. v. FERC*, 873 F.2d 1494, 1498 (D.C. Cir. 1989) (agency must consider alternatives even where those alternatives fall under a different statutory provision).

V. FSOC's Structure And Designation Procedure Violate Due Process And The Separation Of Powers.

FSOC's designation of MetLife also departed from the requirements of due process and the separation of powers. These constitutional deficiencies—which the district court did not reach—likewise require rescission.

A. FSOC Deprived MetLife Of Due Process By Denying It Access To The Record, Introducing New Evidence And Analysis In The Final Designation, And Relying On Vague Standards That Enabled It To Repeatedly Shift The Requirements For Designation.

Throughout the designation process, FSOC violated due process by denying MetLife's repeated requests for access to the administrative record and applying vague and protean standards for designation that deprived MetLife of a meaningful opportunity to present its case against designation.

The "fundamental norm of due process" requires "that *before* the government can constitutionally deprive a person of the protected liberty or property interest, it must afford him notice and hearing," including the record upon which the agency intends to rely. *Nat'l Council of Resistance of Iran v. Dep't of State*, 251 F.3d 192, 205, 209 (D.C. Cir. 2001). Applying that principle, this Court has held that before the Secretary of State designates an entity a "foreign terrorist organization," the Secretary must provide the entity with "notice of those unclassified items upon which he [or she] proposes to rely" and an "opportunity to present" evidence "rebut[ting] the administrative record." *Id.* Similarly, "as soon as" FSOC had

"reached a tentative determination that the designation [was] impending," it was required to provide MetLife with notice of those items upon which it "propose[d] to rely" and an opportunity to respond. *Id.* Yet, FSOC rejected MetLife's repeated requests for access to the administrative record throughout the designation proceedings—including after it had issued a notice of proposed determination indicating it had tentatively decided to designate MetLife. *Id.* FSOC also refused to disclose to MetLife the nonpublic versions of its prior designation decisions, despite MetLife's numerous requests for those highly relevant precedents and FSOC's subsequent eagerness to share a redacted version of MetLife's nonpublic designation with its *amici* and others in this litigation.

Without access to the record on which FSOC based its designation inquiry or the most relevant precedents, MetLife lacked a meaningful opportunity to respond to FSOC's evidentiary showing "at a meaningful time"—*i.e.*, *before* it was designated. *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976) (internal quotation marks omitted); *see also Ralls Corp. v. Comm. on Foreign Inv. in U.S.*, 758 F.3d 296, 318-19 (D.C. Cir. 2014) (due process was violated where an agency failed to provide access to record evidence prior to prohibiting a commercial transaction). FSOC's refusal to provide access to the record concretely prejudiced MetLife by concealing evidence on which MetLife could have relied in opposing designation. For example, MetLife could have pointed to FSOC's representations to state regu-

lators that it would consider MetLife's vulnerability to material financial distress, JA209, [redacted]. But MetLife had no idea that those materials were part of the record until *after* it had been designated (and then only after the district court compelled FSOC to produce them).

FSOC exacerbated this prejudice by relying on new evidence and analysis for the first time in the Final Designation and applying unconstitutionally vague standards for designation.

For example, FSOC introduced in the Final Designation a "Monte Carlo" simulation as part of its asset liquidation analysis, which assumed that MetLife's management would irrationally sell assets in a random order. JA571, 583-84. Had MetLife known that FSOC was considering a Monte Carlo simulation, it could have demonstrated that the simulation is unreasonable in this context. *See supra* p. 49. Due process required FSOC to provide MetLife with the opportunity to review and respond to that evidence *before* the agency had finalized its designation decision.

In addition, FSOC failed to identify with any specificity the thresholds it would apply to designate MetLife, how the designation factors would be weighed

against one another, the cause of MetLife's assumed material financial distress, the dimensions of that distress, and the broader macroeconomic environment in which the assumed distress occurred. When coupled with FSOC's refusal to provide MetLife its designation precedents, this standardless approach enabled FSOC to continuously shift its designation criteria in response to MetLife's evidence and denied MetLife its due process right to fair notice of the standards against which it was being judged. *See Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972) (due process requires "a reasonable opportunity to know" what the law is); *see also Gen. Elec. Co. v. EPA*, 53 F.3d 1324, 1329 (D.C. Cir. 1995).

B. FSOC Deprived MetLife Of Due Process And Violated Separation Of Powers Principles By Blending Legislative, Investigative, Prosecutorial, And Adjudicative Authority In The Same Staff And Decision-makers.

FSOC's designation of MetLife also violated separation of powers principles and denied MetLife due process because the same agency staff and principals who ultimately decided to designate MetLife also developed FSOC's regulations governing the designation process, selected MetLife for consideration and amassed and assessed the evidence against it, and evaluated MetLife's arguments in response to the Proposed Designation. *See* D.E. 70, at 9, 67-70; D.E. 71, at 33-35.

This blending of functions deprives regulated parties of due process and violates the separation of powers. *See Amos Treat & Co. v. SEC*, 306 F.2d 260, 265 (D.C. Cir. 1962) ("the investigative as well as the prosecuting arm of the agency

must be kept separate from the decisional function"). FSOC's conflation of the roles of legislator, investigator, prosecutor, and adjudicator stands in stark contrast to other agency structures where these functions are separated into distinct offices. *See FTC v. Atl. Richfield Co.*, 567 F.2d 96, 102 (D.C. Cir. 1977) (The FTC "and the other regulatory agencies have two separate functions to perform, investigative and adjudicative. It is also recognized that the regulatory agencies have an obligation to keep those roles separate insofar as is possible, in order to insure the judicial fairness of adjudicative proceedings."). Indeed, in those cases in which the Supreme Court has upheld hybridized structures against legal challenge, it has emphasized that the prosecutorial and judicial functions were performed by *different* individuals, *see Withrow v. Larkin*, 421 U.S. 35, 54 & n.20 (1975), and that the adjudicator "neither [ ] advised nor g[ave] consultation" on any matter "which [wa]s a basis for the hearing," *Schweiker v. McClure*, 456 U.S. 188, 190-91, 197 n.11 (1982).

FSOC violated these bedrock principles by designating MetLife in an adjudicative proceeding where the principals and staff who voted and advised on the decision were the same individuals who drafted the relevant regulations and developed the record to support MetLife's designation—a fact that FSOC has never denied, even in response to questioning from the district court. *See* D.E. 108, at 29-37. Because the decision whether to designate MetLife rested with the same agen-

cy officials who wielded legislative, investigative, and prosecutorial powers over the designation process, and who sat in judgment of their own efforts, FSOC's decision to designate MetLife was preordained from the outset. The Constitution and fundamental fairness require far more.

CONCLUSION

For the foregoing reasons, the district court's judgment should be affirmed.

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Respectfully submitted,

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ADDENDUM

ADDENDUM: STATUTORY AND REGULATORY PROVISIONS

Table Of Contents

12 U.S.C. § 5311. Definitions

(a) In general

For purposes of this subchapter, unless the context otherwise requires, the following definitions shall apply:

(1) Bank holding company

The term "bank holding company" has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841). A foreign bank or company that is treated as a bank holding company for purposes of the Bank Holding Company Act of 1956 [12 U.S.C. 1841 et seq.], pursuant to section 3106(a) of this title, shall be treated as a bank holding company for purposes of this subchapter.

. . .

(4) Nonbank financial company definitions

. . .

(B) U.S. nonbank financial company

The term "U.S. nonbank financial company" means a company (other than a bank holding company, a Farm Credit System institution chartered and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.), or a national securities exchange (or parent thereof), clearing agency (or parent thereof, unless the parent is a bank holding company), security-based swap execution facility, or security-based swap data repository registered with the Commission, or a board of trade designated as a contract market (or parent thereof), or a derivatives clearing organization (or parent thereof, unless the parent is a bank holding company), swap execution facility or a swap data repository registered with the Commodity Futures Trading Commission), that is—

(i) incorporated or organized under the laws of the United States or any State; and

(ii) predominantly engaged in financial activities, as defined in paragraph (6).

(C) Nonbank financial company

The term "nonbank financial company" means a U.S. nonbank financial company and a foreign nonbank financial company.

(D) Nonbank financial company supervised by the Board of Governors

The term "nonbank financial company supervised by the Board of Governors" means a nonbank financial company that the Council has determined under section 5323 of this title shall be supervised by the Board of Governors.

. . .

12 U.S.C. § 5321. Financial Stability Oversight Council established

(a) Establishment

Effective on July 21, 2010, there is established the Financial Stability Oversight Council.

(b) Membership

The Council shall consist of the following members:

(1) Voting members

The voting members, who shall each have 1 vote on the Council shall be—

(A) the Secretary of the Treasury, who shall serve as Chairperson of the Council;

(B) the Chairman of the Board of Governors;

(C) the Comptroller of the Currency;

(D) the Director of the Bureau;

(E) the Chairman of the Commission;

(F) the Chairperson of the Corporation;

(G) the Chairperson of the Commodity Futures Trading Commission;

(H) the Director of the Federal Housing Finance Agency;

(I) the Chairman of the National Credit Union Administration Board; and

(J) an independent member appointed by the President, by and with the advice and consent of the Senate, having insurance expertise.

(2) Nonvoting members

The nonvoting members, who shall serve in an advisory capacity as a nonvoting member of the Council, shall be—

(A) the Director of the Office of Financial Research;

(B) the Director of the Federal Insurance Office;

(C) a State insurance commissioner, to be designated by a selection process determined by the State insurance commissioners;

(D) a State banking supervisor, to be designated by a selection process determined by the State banking supervisors; and

(E) a State securities commissioner (or an officer performing like functions), to be designated by a selection process determined by such State securities commissioners.

. . .

12 U.S.C. § 5322. Council authority

(a) Purposes and duties of the Council

(1) In general

The purposes of the Council are—

(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.

(2) Duties

The Council shall, in accordance with this subchapter—

(A) collect information from member agencies, other Federal and State financial regulatory agencies, the Federal Insurance Office and, if necessary to assess risks to the United States financial system, direct the Office of Financial Research to collect information from bank holding companies and nonbank financial companies;

(B) provide direction to, and request data and analyses from, the Office of Financial Research to support the work of the Council;

(C) monitor the financial services marketplace in order to identify potential threats to the financial stability of the United States;

. . .

(H) require supervision by the Board of Governors for nonbank financial companies that may pose risks to the financial stability of the United States in the event of their material financial distress or failure, or because of their activities pursuant to section 5323 of this title;

. . .

(K) make recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks of significant liquidity, credit, or

other problems spreading among bank holding companies, nonbank financial companies, and United States financial markets;

. . .

12 U.S.C. § 5323. Authority to require supervision and regulation of certain nonbank financial companies

(a) U.S. nonbank financial companies supervised by the Board of Governors

(1) Determination

The Council, on a nondelegable basis and by a vote of not fewer than ⅔ of the voting members then serving, including an affirmative vote by the Chairperson, may determine that a U.S. nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards, in accordance with this subchapter, if the Council determines that material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States.

(2) Considerations

In making a determination under paragraph (1), the Council shall consider—

(A) the extent of the leverage of the company;

(B) the extent and nature of the off-balance-sheet exposures of the company;

(C) the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;

(D) the importance of the company as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the United States financial system;

(E) the importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities;

(F) the extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse;

(G) the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;

(H) the degree to which the company is already regulated by 1 or more primary financial regulatory agencies;

(I) the amount and nature of the financial assets of the company;

(J) the amount and types of the liabilities of the company, including the degree of reliance on short-term funding; and

(K) any other risk-related factors that the Council deems appropriate.

(b) Foreign nonbank financial companies supervised by the Board of Governors

(1) Determination

The Council, on a nondelegable basis and by a vote of not fewer than ⅔ of the voting members then serving, including an affirmative vote by the Chairperson, may determine that a foreign nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards, in accordance with this subchapter, if the Council determines that material financial distress at the foreign nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the foreign nonbank financial company, could pose a threat to the financial stability of the United States.

(2) Considerations

In making a determination under paragraph (1), the Council shall consider—

(A) the extent of the leverage of the company;

(B) the extent and nature of the United States related off-balance-sheet exposures of the company;

(C) the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;

(D) the importance of the company as a source of credit for United States households, businesses, and State and local governments and as a source of liquidity for the United States financial system;

(E) the importance of the company as a source of credit for low-income, minority, or underserved communities in the United States, and the impact that the failure of such company would have on the availability of credit in such communities;

(F) the extent to which assets are managed rather than owned by the company and the extent to which ownership of assets under management is diffuse;

(G) the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;

(H) the extent to which the company is subject to prudential standards on a consolidated basis in its home country that are administered and enforced by a comparable foreign supervisory authority;

(I) the amount and nature of the United States financial assets of the company;

(J) the amount and nature of the liabilities of the company used to fund activities and operations in the United States, including the degree of reliance on short-term funding; and

(K) any other risk-related factors that the Council deems appropriate.

. . .

(e) Notice and opportunity for hearing and final determination

(1) In general

The Council shall provide to a nonbank financial company written notice of a proposed determination of the Council, including an explanation of the basis of the proposed determination of the Council, that a nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards in accordance with this subchapter.

(2) Hearing

Not later than 30 days after the date of receipt of any notice of a proposed determination under paragraph (1), the nonbank financial company may request, in writing, an opportunity for a written or oral hearing before the Council to contest the proposed determination. Upon receipt of a timely request, the Council shall fix a time (not later than 30 days after the date of receipt of the request) and place at which such company may appear, personally or through counsel, to submit written materials (or, at the sole discretion of the Council, oral testimony and oral argument).

(3) Final determination

Not later than 60 days after the date of a hearing under paragraph (2), the Council shall notify the nonbank financial company of the final determination of the Council, which shall contain a statement of the basis for the decision of the Council.

(4) No hearing requested

If a nonbank financial company does not make a timely request for a hearing, the Council shall notify the nonbank financial company, in writing, of the final determination of the Council under subsection (a) or (b), as applicable, not

later than 10 days after the date by which the company may request a hearing under paragraph (2).

. . .

(h) Judicial review

If the Council makes a final determination under this section with respect to a nonbank financial company, such nonbank financial company may, not later than 30 days after the date of receipt of the notice of final determination under subsection (d)(2), (e)(3), or (f)(5), bring an action in the United States district court for the judicial district in which the home office of such nonbank financial company is located, or in the United States District Court for the District of Columbia, for an order requiring that the final determination be rescinded, and the court shall, upon review, dismiss such action or direct the final determination to be rescinded. Review of such an action shall be limited to whether the final determination made under this section was arbitrary and capricious.

. . .

12 U.S.C. § 5325. Enhanced supervision and prudential standards for nonbank financial companies supervised by the Board of Governors and certain bank holding companies

(a) In general

(1) Purpose

In order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress, failure, or ongoing activities of large, interconnected financial institutions, the Council may make recommendations to the Board of Governors concerning the establishment and refinement of prudential standards and reporting and disclosure requirements applicable to nonbank financial companies supervised by the Board of Governors and large, interconnected bank holding companies, that—

(A) are more stringent than those applicable to other nonbank financial companies and bank holding companies that do not present similar risks to the financial stability of the United States; and

(B) increase in stringency, based on the considerations identified in subsection (b)(3).

(2) Recommended application of required standards

In making recommendations under this section, the Council may—

(A) differentiate among companies that are subject to heightened standards on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors that the Council deems appropriate; or

(B) recommend an asset threshold that is higher than $50,000,000,000 for the application of any standard described in subsections (c) through (g).

(b) Development of prudential standards

(1) In general

The recommendations of the Council under subsection (a) may include—

(A) risk-based capital requirements;

(B) leverage limits;

(C) liquidity requirements;

(D) resolution plan and credit exposure report requirements;

(E) concentration limits;

(F) a contingent capital requirement;

(G) enhanced public disclosures;

(H) short-term debt limits; and

(I) overall risk management requirements.

. . .

12 U.S.C. § 5365. Enhanced supervision and prudential standards for nonbank financial companies supervised by the Board of Governors and certain bank holding companies

(a) In general

(1) Purpose

In order to prevent or mitigate 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 financial institutions, the Board of Governors shall, on its own or pursuant to recommendations by the Council under section 5325 of this title, establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies with total consolidated assets equal to or greater than $50,000,000,000 that—

(A) are more stringent than the standards and requirements applicable to nonbank financial companies and bank holding companies that do not present similar risks to the financial stability of the United States; and

(B) increase in stringency, based on the considerations identified in subsection (b)(3).

. . .

(b) Development of prudential standards

(1) In general

(A) Required standards

The Board of Governors shall establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), that shall include—

(i) risk-based capital requirements and leverage limits, unless the Board of Governors, in consultation with the Council, determines that such requirements are not appropriate for a company subject to more stringent prudential standards because of the activities of such company (such as investment company activities or assets under management) or structure, in which case, the Board of Governors shall apply other standards that result in similarly stringent risk controls;

(ii) liquidity requirements;

(iii) overall risk management requirements;

(iv) resolution plan and credit exposure report requirements; and

(v) concentration limits.

(B) Additional standards authorized

The Board of Governors may establish additional prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), that include—

(i) a contingent capital requirement;

(ii) enhanced public disclosures;

(iii) short-term debt limits; and

(iv) such other prudential standards as the Board or Governors, on its own or pursuant to a recommendation made by the Council in accordance with section 5325 of this title, determines are appropriate.

. . .

(d) Resolution plan and credit exposure reports

(1) Resolution plan

The Board of Governors shall require each nonbank financial company supervised by the Board of Governors and bank holding companies described in subsection (a) to report periodically to the Board of Governors, the Council, and the Corporation the plan of such company for rapid and orderly resolution in the event of material financial distress or failure, which shall include—

(A) information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company;

(B) full descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company;

(C) identification of the cross-guarantees tied to different securities, identification of major counterparties, and a process for determining to whom the collateral of the company is pledged; and

(D) any other information that the Board of Governors and the Corporation jointly require by rule or order.

. . .

12 C.F.R. pt. 1310

APPENDIX A TO PART 1310—FINANCIAL STABILITY OVERSIGHT COUNCIL GUIDANCE FOR NONBANK FINANCIAL COMPANY DETERMINATIONS

I. INTRODUCTION

Section 113 of the Dodd–Frank Wall Street Reform and Consumer Protection Act (the "Dodd–Frank Act")[1] authorizes the Financial Stability Oversight Council (the "Council") to determine that a nonbank financial company will be supervised by the Board of Governors of the Federal Reserve System (the "Board of Governors") and be subject to prudential standards in accordance with title I of the Dodd–Frank Act if either of two standards is met. Under the first standard, the Council may subject a nonbank financial company to supervision by the Board of Governors and prudential standards if the Council determines that "material financial distress" at the nonbank financial company could pose a threat to the financial stability of the United States. Under the second standard, the Council may determine that a nonbank financial company will be supervised by the Board of Governors and subject to prudential standards if the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company could pose a threat to U.S. financial stability. Section 113 of the Dodd–Frank Act also lists 10 considerations that the Council must take into account in making a determination.[2]

Section II of this document describes the manner in which the Council intends to apply the statutory standards and considerations in making determinations under section 113 of the Dodd–Frank Act. First, section II defines "threat to the financial stability of the United States" and describes channels through which a nonbank financial company could pose such a threat. Second, it discusses each of the two statutory standards for determination. Third, it describes the six-category framework that the Council intends to use to evaluate nonbank financial companies under each of the 10 statutory considerations. Section II also includes lists of sample metrics that may be used to evaluate individual nonbank financial companies under each of the six categories.

Section III of this document outlines the process that the Council intends to follow in non-emergency situations when determining whether to subject a non-

[1] *See* 12 U.S.C. 5323.

[2] In addition to these considerations, the Council may consider any other risk-related factors that the Council deems appropriate. 12 U.S.C. 5323(a)(2)(K) and (b)(2)(K).

bank financial company to Board of Governors supervision and prudential standards. Section III also provides a detailed description of the analysis that the Council intends to conduct during each stage of its review. In the first stage of the process, the Council will apply six uniform quantitative thresholds to nonbank financial companies to identify those nonbank financial companies that will be subject to further evaluation by the Council. Because the Council is relying in the first stage on quantitative thresholds using information available through existing public and regulatory sources, nonbank financial companies should be able to assess whether they will be subject to further evaluation by the Council. During the second stage of the evaluation process, the Council will analyze the identified nonbank financial companies using a broad range of information available to the Council primarily through existing public and regulatory sources. The third stage of the process will involve a comprehensive analysis of those nonbank financial companies using information collected directly from the nonbank financial company, as well as the information used in the first two stages.

II. Council Determination Authority and Framework

As noted above, the Council may determine that a nonbank financial company will be supervised by the Board of Governors and be subject to prudential standards if the Council determines that (i) material financial distress at the nonbank financial company could pose a threat to the financial stability of the United States (the "First Determination Standard") or (ii) 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 (the "Second Determination Standard," and, together with the First Determination Standard, the "Determination Standards").

The Council intends to interpret the term "company" broadly with respect to nonbank financial companies and other companies in connection with section 113 of the Dodd–Frank Act, to include any corporation, limited liability company, partnership, business trust, association, or similar organization.

This section provides definitions of the terms "threat to the financial stability of the United States" and "material financial distress" and describes how the Council expects to apply the Determination Standards.

a. Threat to the Financial Stability of the United States

The Determination Standards require the Council to determine whether a nonbank financial company could pose a threat to the financial stability of the United States. The Council will consider a "threat to the financial stability of the United States" to exist 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.

In evaluating a nonbank financial company under one of the Determination Standards, the Council intends to assess how a nonbank financial company's material financial distress or activities could be transmitted to, or otherwise affect, other firms or markets, thereby causing a broader impairment of financial intermediation or of financial market functioning. An impairment of financial intermediation and financial market functioning can occur through several channels. The Council has identified the following channels as most likely to facilitate the transmission of the negative effects of a nonbank financial company's material financial distress or activities to other financial firms and markets:

• *Exposure*. A nonbank financial company's creditors, counterparties, investors, or other market participants have exposure to the nonbank financial company that is significant enough to materially impair those creditors, counterparties, investors, or other market participants and thereby pose a threat to U.S. financial stability. In its initial analysis of nonbank financial companies with respect to this channel, the Council expects to consider metrics including total consolidated assets, credit default swaps outstanding, derivative liabilities, total debt outstanding, and leverage ratio.

• *Asset liquidation*. A nonbank financial company holds assets that, if liquidated quickly, would cause a fall in asset prices and thereby significantly disrupt trading or funding in key markets or cause significant losses or funding problems for other firms with similar holdings. This channel would likely be most relevant for a nonbank financial company whose funding and liquid asset profile makes it likely that it would be forced to liquidate assets quickly when it comes under financial pressure. For example, this could be the case if a large nonbank financial company relies heavily on short-term funding. In its initial analysis of nonbank financial companies with respect to this channel, the Council expects to consider metrics including total consolidated assets and short-term debt ratio.

• *Critical function or service*. A nonbank financial company is no longer able or willing to provide a critical function or service that is relied upon by market participants and for which there are no ready substitutes. The analysis of this channel will incorporate a review of the competitive landscape for markets in which a nonbank financial company participates and for the services it provides (including the provision of liquidity to the U.S. financial system, the provision of credit to low-income, minority, or underserved communities, or the provision of credit to households, businesses and state and local governments), the nonbank financial company's market share, and the ability of other firms to replace those services. Due to the unique ways in which a nonbank financial company may

provide a critical function or service to the market, the Council expects to apply company-specific analyses with respect to this channel, rather than applying a broadly applicable quantitative metric.

The Council believes that the threat a nonbank financial company may pose to U.S. financial stability through the impairment of financial intermediation and financial market functioning is likely to be exacerbated if the nonbank financial company is sufficiently complex, opaque, or difficult to resolve in bankruptcy such that its resolution in bankruptcy would disrupt key markets or have a material adverse impact on other financial firms or markets.

The Council intends to continue to evaluate additional transmission channels and may, at its discretion, consider other channels through which a nonbank financial company may transmit the negative effects of its material financial distress or activities and thereby pose a threat to U.S. financial stability.

b. First Determination Standard: Material Financial Distress

Under the First Determination Standard, the Council may subject a nonbank financial company to supervision by the Board of Governors and prudential standards if the Council determines that "material financial distress" at the nonbank financial company could pose a threat to U.S. financial stability. The Council believes that material financial distress exists when a nonbank financial company is in imminent danger of insolvency or defaulting on its financial obligations.

For purposes of considering whether a nonbank financial company could pose a threat to U.S. financial stability under this Determination Standard, the Council intends to assess the impact of the nonbank financial company's material financial distress in the context of a period of overall stress in the financial services industry and in a weak macroeconomic environment. The Council believes this is appropriate because in such a context, a nonbank financial company's distress may have a greater effect on U.S. financial stability.

c. Second Determination Standard: Nature, Scope, Size, Scale, Concentration, Interconnectedness, or Mix of Activities

Under the Second Determination Standard, the Council may subject a nonbank financial company to supervision by the Board of Governors and prudential standards if the Council determines that the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company could pose a threat to U.S. financial stability. The Council believes that this Determination Standard will be met if the Council determines that the nature of a nonbank financial company's business practices, conduct, or operations could pose a threat to U.S. financial stability, regardless of whether the nonbank finan-

cial company is experiencing financial distress. The Council expects that there likely will be significant overlap between the outcome of an assessment of a nonbank financial company under the First and Second Determination Standards, because, in many cases, a nonbank financial company that could pose a threat to U.S. financial stability because of the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities could also pose a threat to U.S. financial stability if it were to experience material financial distress.

d. Analytic Framework for Statutory Considerations

As required by section 113 of the Dodd–Frank Act, the Council's determination will be based on its judgment that a firm meets one of the Determination Standards described above. In evaluating whether a firm meets one of the Determination Standards, the Council will consider each of the statutory considerations. The discussion below outlines the analytic framework that the Council intends to use to organize its evaluation of a nonbank financial company under the statutory considerations and provides additional detail on the key data and analyses that the Council intends to use to assess the considerations.

1. Grouping of Statutory Considerations Into Six-Category Framework

The Dodd–Frank Act requires the Council to consider 10 considerations (described below) when evaluating the potential of a nonbank financial company to pose a threat to U.S. financial stability. The statute also authorizes the Council to consider "any other risk-related factors that the Council deems appropriate." These statutory considerations will help the Council to evaluate whether one of the Determination Standards, as described in sections II.b and II.c above, has been met. The Council has developed an analytic framework that groups all relevant factors, including the 10 statutory considerations and any additional risk-related factors, into six categories: size, interconnectedness, substitutability, leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny. The Council expects to use these six categories to guide its evaluation of whether a particular nonbank financial company meets either Determination Standard. However, the Council's ultimate determination decision regarding a nonbank financial company will not be based on a formulaic application of the six categories. Rather, the Council intends to analyze a nonbank financial company using quantitative and qualitative data relevant to each of the six categories, as the Council determines is appropriate with respect to the particular nonbank financial company.

Each of the six categories reflects a different dimension of a nonbank financial company's potential to pose a threat to U.S. financial stability. Three of the six categories—size, substitutability, and interconnectedness—seek to assess the po-

tential impact of the nonbank financial company's financial distress on the broader economy. Material financial distress at nonbank financial companies that are large, provide critical financial services for which there are few substitutes, or are highly interconnected with other financial firms or markets are more likely to have a financial or operational impact on other companies, markets, and consumers that could pose a threat to the financial stability of the United States. The remaining three categories—leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny of the nonbank financial company—seek to assess the vulnerability of a nonbank financial company to financial distress. Nonbank financial companies that are highly leveraged, have a high degree of liquidity risk or maturity mismatch, and are under little or no regulatory scrutiny are more likely to be more vulnerable to financial distress.

Each of the statutory considerations in sections 113(a)(2) and (b)(2) of the Dodd–Frank Act would be considered as part of one or more of the six categories. This is reflected in the following table, using the considerations relevant to a U.S. nonbank financial company for illustrative purposes.[3]

Statutory considerations:	Category or categories in which this consideration would be addressed:
(A) The extent of the leverage of the company	Leverage.
(B) The extent and nature of the off-balance-sheet exposures of the company	Size; interconnectedness.
(C) The extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies.	Interconnectedness.
(D) The importance of the company as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the United States financial system.	Size; substitutability.

[3] The corresponding statutory considerations for a foreign nonbank financial company would be considered under the relevant categories indicated in the table.

(E) The importance of the company as a source of credit for low-income, minority, or under-served communities, and the impact that the failure of such company would have on the availability of credit in such communities.	Substitutability.
(F) The extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse.	Size; interconnectedness; substitutability.
(G) The nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company.	Size; interconnectedness; substitutability.
(H) The degree to which the company is already regulated by 1 or more primary financial regulatory agencies.	Existing regulatory scrutiny.
(I) The amount and nature of the financial assets of the company	Size; interconnectedness.
(J) The amount and types of the liabilities of the company, including the degree of reliance on short-term funding.	Liquidity risk and maturity mismatch; size; interconnectedness.
(K) Any other risk-related factors that the Council deems appropriate	Appropriate category or categories based on the nature of the additional risk-related factor.

2. Six–Category Framework

The discussion below describes each of the six categories and how these categories relate to a firm's likelihood to pose a threat to financial stability. The sample metrics set forth below under each category are representative, not exhaustive, and may not apply to all nonbank financial companies under evaluation. The Council may apply the sample metrics in the context of stressed market conditions.

Interconnectedness

Interconnectedness captures direct or indirect linkages between financial companies that may be conduits for the transmission of the effects resulting from a nonbank financial company's material financial distress or activities. Examples of the key conduits through which the effects may travel are a nonbank financial

company's direct or indirect exposures to counterparties (including creditors, trading and derivatives counterparties, investors, borrowers, and other participants in the financial markets). Interconnectedness depends not only on the number of counterparties that a nonbank financial company has, but also on the importance of that nonbank financial company to its counterparties and the extent to which the counterparties are interconnected with other financial firms, the financial system and the broader economy. The Council's assessment of interconnectedness is intended to determine whether a nonbank financial company's exposure to its counterparties would pose a threat to U.S. financial stability if that company encountered material financial distress.

For example, metrics that may be used to assess interconnectedness include:

• Counterparties' exposures to a nonbank financial company, including derivatives, reinsurance, loans, securities borrowing and lending, and lines of credit that facilitate settlement and clearing activities.

• Number, size, and financial strength of a nonbank financial company's counterparties, including the proportion of its counterparties' exposure to the nonbank financial company relative to the counterparties' capital.

• Identity of a nonbank financial company's principal contractual counterparties, which reflects the concentration of the nonbank financial company's assets financed by particular firms and the importance of the nonbank financial company's counterparties to the market.

• Aggregate amounts of a nonbank financial company's gross or net derivatives exposures and the number of its derivatives counterparties.

• The amount of gross notional credit default swaps outstanding for which a nonbank financial company or its parent is the reference entity.

• Total debt outstanding, which captures a nonbank financial company's sources of funding.

• Reinsurance obligations, which measure the reinsurance risk assumed from non-affiliates net of retrocession.

Substitutability

Substitutability captures the extent to which other firms could provide similar financial services in a timely manner at a similar price and quantity if a nonbank financial company withdraws from a particular market. Substitutability also captures situations in which a nonbank financial company is the primary or dominant provider of services in a market that the Council determines to be essential to U.S. financial stability. An example of the manner in which the Council may

determine a nonbank financial company's substitutability is to consider its market share. The Council's evaluation of a nonbank financial company's market share regarding a particular product or service will include assessments of the ability of the nonbank financial company's competitors to expand to meet market needs; the costs that market participants would incur if forced to switch providers; the timeframe within which a disruption in the provision of the product or service would materially affect market participants or market functioning; and the economic implications of such a disruption. Concern about a potential lack of substitutability could be greater if a nonbank financial company and its competitors are likely to experience stress at the same time because they are exposed to the same risks. The Council may also analyze a nonbank financial company's core operations and critical functions and the importance of those operations and functions to the U.S. financial system and assess how those operations and functions would be performed by the nonbank financial company or other market participants in the event of the nonbank financial company's material financial distress. The Council also intends to consider substitutability with respect to any nonbank financial company with global operations to identify the substitutability of critical market functions that the company provides in the United States in the event of material financial distress of a foreign parent company.

For example, metrics that may be used to assess substitutability include:

• The market share, using the appropriate quantitative measure (such as loans originated, loans outstanding, and notional transaction volume) of a nonbank financial company and its competitors in the market under consideration.

• The stability of market share across the firms in the market over time.

• The market share of the company and its competitors for products or services that serve a substantially similar economic function as the primary market under consideration.

Size

Size captures the amount of financial services or financial intermediation that a nonbank financial company provides. Size also may affect the extent to which the effects of a nonbank financial company's financial distress are transmitted to other firms and to the financial system. For example, financial distress at an extremely large nonbank financial company that is highly interconnected likely would transmit risk on a larger scale than would financial distress at a smaller nonbank financial company that is similarly interconnected. Size is conventionally measured by the assets, liabilities and capital of the firm. However, such measures of size may not provide complete or accurate assessments of the scale of a nonbank financial company's risk potential. Thus, the Council also intends to take into ac-

count off-balance sheet assets and liabilities and assets under management in a manner that recognizes the unique and distinct nature of these classes. Other measures of size, such as numbers of customers and counterparties, may also be relevant.

For example, metrics that may be used to assess size include:

• Total consolidated assets or liabilities, as determined under generally accepted accounting principles in the United States ("GAAP") or the nonbank financial company's applicable financial reporting standards, depending on the availability of data and the stage of the determination process.

• Total risk-weighted assets, as appropriate for different industry sectors.

• Off-balance sheet exposures where a nonbank financial company has a risk of loss, including, for example, lines of credit. For foreign nonbank financial companies, this would be evaluated based on the extent and nature of U.S.-related off-balance sheet exposures.

• The extent to which assets are managed rather than owned by a nonbank financial company and the extent to which ownership of assets under management is diffuse.

• Direct written premiums, as reported by insurance companies. This is the aggregate of direct written premiums reported by insurance entities under all lines of business and serves as a proxy for the amount of insurance underwritten by the insurance entities.

• Risk in force, which is the aggregate risk exposure from risk underwritten in insurance related to certain financial risks, such as mortgage insurance.

• Total loan originations, by loan type, in number and dollar amount.

Leverage

Leverage captures a company's exposure or risk in relation to its equity capital. Leverage amplifies a company's risk of financial distress in two ways. First, by increasing a company's exposure relative to capital, leverage raises the likelihood that a company will suffer losses exceeding its capital. Second, by increasing the size of a company's liabilities, leverage raises a company's dependence on its creditors' willingness and ability to fund its balance sheet. Leverage can also amplify the impact of a company's distress on other companies, both directly, by increasing the amount of exposure that other firms have to the company, and indirectly, by increasing the size of any asset liquidation that the company is forced to undertake as it comes under financial pressure. Leverage can be measured by the ratio of assets to capital, but it can also be defined in terms of risk, as a measure of economic risk

relative to capital. The latter measurement can better capture the effect of derivatives and other products with embedded leverage on the risk undertaken by a nonbank financial company.

For example, metrics that may be used to assess leverage include:

• Total assets and total debt measured relative to total equity, which is intended to measure financial leverage.

• Gross notional exposure of derivatives and off-balance sheet obligations relative to total equity or to net assets under management, which is intended to show how much off-balance sheet leverage a nonbank financial company may have.

• The ratio of risk to statutory capital, which is relevant to certain insurance companies and is intended to show how much risk exposure a nonbank financial company has in relation to its ability to absorb loss.

• Changes in leverage ratios, which may indicate that a nonbank financial company is rapidly increasing its risk profile.

Liquidity Risk and Maturity Mismatch

Liquidity risk generally refers to the risk that a company may not have sufficient funding to satisfy its short-term needs, either through its cash flows, maturing assets, or assets salable at prices equivalent to book value, or through its ability to access funding markets. For example, if a company holds assets that are illiquid or that are subject to significant decreases in market value during times of market stress, the company may be unable to liquidate its assets effectively in response to a loss of funding. In order to assess liquidity, the Council may examine a nonbank financial company's assets to determine if it possesses cash instruments or readily marketable securities, such as Treasury securities, which could reasonably be expected to have a liquid market in times of distress. The Council may also review a nonbank financial company's debt profile to determine if it has adequate long-term funding, or can otherwise mitigate liquidity risk. Liquidity problems also can arise from a company's inability to roll maturing debt or to satisfy margin calls, and from demands for additional collateral, depositor withdrawals, draws on committed lines, and other potential draws on liquidity.

A maturity mismatch generally refers to the difference between the maturities of a company's assets and liabilities. A maturity mismatch affects a company's ability to survive a period of stress that may limit its access to funding and to withstand shocks in the yield curve. For example, if a company relies on short-term funding to finance longer-term positions, it will be subject to significant refunding risk that may force it to sell assets at low market prices or potentially suffer through significant margin pressure. However, maturity mismatches are not

confined to the use of short-term liabilities and can exist at any point in the maturity schedule of a nonbank financial company's assets and liabilities. For example, in the case of a life insurance company, liabilities may have maturities of 30 years or more, whereas the market availability of equivalently long-term assets may be limited, exposing the company to interest rate fluctuations and reinvestment risk.

For example, metrics that may be used to assess liquidity and maturity mismatch include:

• Fraction of assets that are classified as level 2 and level 3 under applicable accounting standards, as a measure of how much of a nonbank financial company's balance sheet is composed of hard-to-value and potentially illiquid securities.

• Liquid asset ratios, which are intended to indicate a nonbank financial company's ability to repay its short-term debt.

• The ratio of unencumbered and highly liquid assets to the net cash outflows that a nonbank financial company could encounter in a short-term stress scenario.

• Callable debt as a fraction of total debt, which provides one measure of a nonbank financial company's ability to manage its funding position in response to changes in interest rates.

• Asset-backed funding versus other funding, to determine a nonbank financial company's susceptibility to distress in particular credit markets.

• Asset-liability duration and gap analysis, which is intended to indicate how well a nonbank financial company is matching the re-pricing and maturity of the nonbank financial company's assets and liabilities.

• Short-term debt as a percentage of total debt and as a percentage of total assets, which indicates a nonbank financial company's reliance on short-term debt markets.

Existing Regulatory Scrutiny

The Council will consider the extent to which nonbank financial companies are already subject to regulation, including the consistency of that regulation across nonbank financial companies within a sector, across different sectors, and providing similar services, and the statutory authority of those regulators.

For example, metrics that may be used to assess existing regulatory scrutiny include:

• The extent of state or federal regulatory scrutiny, including processes or systems for peer review; inter-regulatory coordination and cooperation; and whether existing regulators have the ability to impose detailed and timely reporting obliga-

tions, capital and liquidity requirements, and enforcement actions, and to resolve the company.

• Existence and effectiveness of consolidated supervision, and a determination of whether and how non-regulated entities and groups within a nonbank financial company are supervised on a group-wide basis.

• For entities based outside the United States, the extent to which a nonbank financial company is subject to prudential standards on a consolidated basis in its home country that are administered and enforced by a comparable foreign supervisory authority.

III. THE DETERMINATION PROCESS

The Council expects generally to follow a three-stage process of increasingly in-depth evaluation and analysis leading up to a proposed determination (a "Proposed Determination") that a nonbank financial company could pose a threat to the financial stability of the United States. Quantitative metrics, together with qualitative analysis, will inform the judgment of the Council when it is evaluating a nonbank financial company for a Proposed Determination. The purpose of this process is to help determine whether a nonbank financial company could pose a threat to the financial stability of the United States.

In the first stage of the process ("Stage 1"), a set of uniform quantitative metrics will be applied to a broad group of nonbank financial companies in order to identify nonbank financial companies for further evaluation and to provide clarity for nonbank financial companies that likely will not be subject to further evaluation. In Stage 1, the Council will rely solely on information available through existing public and regulatory sources. The purpose of Stage 1 is to enable the Council to identify a group of nonbank financial companies that are most likely to satisfy one of the Determination Standards.

In the second stage ("Stage 2"), the nonbank financial companies identified in Stage 1 will be analyzed and prioritized, based on a wide range of quantitative and qualitative information available to the Council primarily through public and regulatory sources. The Council will also begin the consultation process with the primary financial regulatory agencies or home country supervisors, as appropriate. As part of that consultation process, the Council intends to consult with the primary financial regulatory agency, if any, of each significant subsidiary of the nonbank financial company, to the extent the Council deems appropriate. The Council also intends to fulfill its statutory obligation to rely whenever possible on information available through the Office of Financial Research (the "OFR"), member agencies, or the nonbank financial company's primary financial regula-

tory agencies before requiring the submission of reports from any nonbank financial company.[4]

Following Stage 2, nonbank financial companies that are selected for additional review will receive notice that they are being considered for a Proposed Determination and will be subject to in-depth evaluation during the third stage of review ("Stage 3"). Stage 3 will involve the evaluation of information collected directly from the nonbank financial company, in addition to the information considered during Stages 1 and 2. At the end of Stage 3, the Council may consider whether to make a Proposed Determination with respect to the nonbank financial company. If a Proposed Determination is made by the Council, the nonbank financial company may request a hearing in accordance with section 113(e) of the Dodd–Frank Act and § 1310.21(c) of the Council's rule.[5]

The Council expects to follow this three-stage process and to consider the categories, metrics, thresholds, and channels described in this guidance to assess a nonbank financial company's potential to pose a threat to U.S. financial stability. In addition to the information described herein that the Council generally expects to consider, the Council also will consider quantitative and qualitative information that it deems relevant to a particular nonbank financial company, as each determination will be made on a company-specific basis. The Council may consider any nonbank financial company for a Proposed Determination at any point in the three-stage evaluation process described in this guidance if the Council believes such company could pose a threat to U.S. financial stability.

a. Stage 1: Initial Identification of Nonbank Financial Companies for Evaluation

In Stage 1, the Council will seek to identify a set of nonbank financial companies that merit company-specific evaluation. In this stage, the Council intends to apply quantitative thresholds to a broad group of nonbank financial companies. A nonbank financial company that is selected for further evaluation during Stage 1 will be assessed during Stage 2. During the Stage 1 process, the Council will evaluate nonbank financial companies using only data available to the Council, such as publicly available information and information member agencies possess in their supervisory capacities.

In the Stage 1 quantitative analysis, the Council intends to apply thresholds that relate to the framework categories of size, interconnectedness, leverage, and liquidity risk and maturity mismatch. These thresholds were selected based on

[4] *See* 12 U.S.C. 5323(d)(3).
[5] *See* 13 C.F.R. 1310.21(c).

(1) their applicability to nonbank financial companies that operate in different types of financial markets and industries, (2) the meaningful initial assessment that such thresholds provide regarding the potential for a nonbank financial company to pose a threat to financial stability in diverse financial markets, and (3) the current availability of data. These thresholds are intended to measure both the susceptibility of a nonbank financial company to financial distress and the potential for that nonbank financial company's financial distress to spread throughout the financial system. A nonbank financial company will be evaluated further in Stage 2 if it meets both the total consolidated assets threshold and any one of the other thresholds.[6] The thresholds are:

• *Total Consolidated Assets*. The Council intends to apply a size threshold of $50 billion in total consolidated assets. This threshold is consistent with the Dodd–Frank Act threshold of $50 billion in assets for subjecting bank holding companies to enhanced prudential standards.

• *Credit Default Swaps Outstanding*. The Council intends to apply a threshold of $30 billion in gross notional credit default swaps ("CDS") outstanding for which a nonbank financial company is the reference entity. Gross notional value equals the sum of CDS contracts bought (or equivalently sold). If the amount of CDS sold on a particular nonbank financial company is greater than $30 billion, this indicates that a large number of institutions may be exposed to that nonbank financial company and that if the nonbank financial company fails, a significant number of financial market participants may be affected. This threshold was selected based on an analysis of the distribution of outstanding CDS data for nonbank financial companies included in a list of the top 1,000 CDS reference entities.

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[6] While the Council expects that its determinations under section 113 of the Dodd-Frank Act will be with respect to individual legal entities, the Council has authority to assess nonbank financial companies, and their relationships with other nonbank financial companies and market participants, in a manner that addresses the statutory considerations and such other factors as the Council deems appropriate. For example, for purposes of applying the six thresholds to investment funds (including private equity firms and hedge funds), the Council may consider the aggregate risks posed by separate funds that are managed by the same adviser, particularly if the funds' investments are identical or highly similar. In performing this analysis, the Council may use data reported on Form PF with the Securities and Exchange Commission or the Commodity Futures Trading Commission.

• *Derivative Liabilities*. The Council intends to apply a threshold of $3.5 billion of derivative liabilities. Derivative liabilities equal the fair value of derivative contracts in a negative position. For nonbank financial companies that disclose the effects of master netting agreements and cash collateral held with the same counterparty on a net basis, the Council intends to calculate derivative liabilities after taking into account the effects of these arrangements. This threshold serves as a proxy for interconnectedness, as a nonbank financial company that has a greater level of derivative liabilities would have higher counterparty exposure throughout the financial system.

• *Total Debt Outstanding*. The Council intends to apply a threshold of $20 billion in total debt outstanding. The Council will define total debt outstanding broadly and regardless of maturity to include loans (whether secured or unsecured), bonds, repurchase agreements, commercial paper, securities lending arrangements, surplus notes (for insurance companies), and other forms of indebtedness. This threshold serves as a proxy for interconnectedness, as nonbank financial companies with a large amount of outstanding debt are generally more interconnected with the broader financial system, in part because financial institutions hold a large proportion of outstanding debt. An analysis of the distribution of debt outstanding for a sample of nonbank financial companies was performed to determine the $20 billion threshold. Historical testing of this threshold demonstrated that it would have captured many of the nonbank financial companies that encountered material financial distress during the financial crisis in 2007–2008, including Bear Stearns, Countrywide, and Lehman Brothers.

• *Leverage Ratio*. The Council intends to apply a threshold leverage ratio of total consolidated assets (excluding separate accounts) to total equity of 15 to 1. The Council intends to exclude separate accounts from this calculation because separate accounts are not available to claims by general creditors of a nonbank financial company. Measuring leverage in this manner benefits from simplicity, availability and comparability across industries. An analysis of the distribution of the historical leverage ratios of large financial institutions was used to identify the 15 to 1 threshold. Historical testing of this threshold demonstrated that it would have captured the major nonbank financial companies that encountered material financial distress and posed a threat to U.S. financial stability during the financial crisis, including Bear Stearns, Countrywide, IndyMac Bancorp, and Lehman Brothers.

• *Short–Term Debt Ratio*. The Council intends to apply a threshold ratio of total debt outstanding (as defined above) with a maturity of less than 12 months to total consolidated assets (excluding separate accounts) of 10 percent. An analysis of the historical distribution of the short-term debt ratios of large financial institutions

was used to determine the 10 percent threshold. Historical testing of this threshold demonstrated that it would have captured a number of the nonbank financial companies that faced short-term funding issues during the financial crisis, including Bear Stearns and Lehman Brothers.

The Council intends generally to apply the Stage 1 thresholds using GAAP when such information is available. If GAAP information with respect to a nonbank financial company is not available, the Council may rely on data reported under statutory accounting principles, international financial reporting standards, or such other data as are available to the Council.

For purposes of evaluating any U.S. nonbank financial company, the Council intends to apply each of the Stage 1 thresholds based on the global assets, liabilities and operations of the company and its subsidiaries. In contrast, for purposes of evaluating any foreign nonbank financial company, the Council intends to calculate the Stage 1 thresholds based solely on the U.S. assets, liabilities and operations of the foreign nonbank financial company and its subsidiaries.

The Council intends to reapply the Stage 1 thresholds to nonbank financial companies using the most recently available data on a quarterly basis, or less frequently for nonbank financial companies with respect to which quarterly data are unavailable.

The Council intends to review the appropriateness of both the Stage 1 thresholds and the levels of the thresholds that are specified in dollars as needed, but at least every five years, and to adjust the thresholds and levels as the Council may deem advisable.

The Stage 1 thresholds are intended to identify nonbank financial companies for further evaluation by the Council and to help a nonbank financial company predict whether such company will be subject to additional review. Because the uniform quantitative thresholds may not capture all types of nonbank financial companies and all of the potential ways in which a nonbank financial company could pose a threat to financial stability, the Council may initially evaluate any nonbank financial company based on other firm-specific qualitative or quantitative factors, irrespective of whether such company meets the thresholds in Stage 1.

A nonbank financial company that is identified for further evaluation in Stage 1 would be further assessed during Stage 2 (the "Stage 2 Pool").

b. Stage 2: Review and Prioritization of Stage 2 Pool

After the Stage 2 Pool has been identified, the Council intends to conduct a robust analysis of the potential threat that each of those nonbank financial companies could pose to U.S. financial stability. In general, this analysis will be based

on information already available to the Council through existing public and regulatory sources, including information possessed by the company's primary financial regulatory agency or home country supervisor, as appropriate, and information voluntarily submitted by the company. In contrast to the application of uniform quantitative thresholds to a broad group of nonbank financial companies in Stage 1, the Council intends to evaluate the risk profile and characteristics of each individual nonbank financial company in the Stage 2 Pool based on a wide range of quantitative and qualitative industry-specific and company-specific factors. This analysis will use the six-category analytic framework described in section II.d above. In addition, the Stage 2 evaluation will include a review, based on available data, of qualitative factors, including whether the resolution of a nonbank financial company, as described below, could pose a threat to U.S. financial stability, and the extent to which the nonbank financial company is subject to regulation.

Based on this analysis, the Council intends to contact those nonbank financial companies that the Council believes merit further evaluation in Stage 3 (the "Stage 3 Pool").

c. Stage 3: Review of Stage 3 Pool

In Stage 3, the Council, working with the OFR, will conduct a review of each nonbank financial company in the Stage 3 Pool using information collected directly from the nonbank financial company, as well as the information used in the first two stages. The review will focus on whether the nonbank financial company could pose a threat to U.S. financial stability because of the company's material financial distress or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company. The transmission channels discussed above, and other appropriate factors, will be used to evaluate a nonbank financial company's potential to pose a threat to U.S. financial stability. The analytic framework consisting of the six categories set forth above, and the metrics used to measure each of the six categories, will assist the Council in assessing the extent to which the transmission of material financial distress is likely to occur.

Each nonbank financial company in the Stage 3 Pool will receive a notice (a "Notice of Consideration") that the nonbank financial company is under consideration for a Proposed Determination. The Notice of Consideration likely will include a request that the nonbank financial company provide information that the Council deems relevant to the Council's evaluation, and the nonbank financial company will be provided an opportunity to submit written materials to the Coun-

cil.[7] This information will generally be collected by the OFR.[8] Before requiring the submission of reports from any nonbank financial company that is regulated by a member agency or any primary financial regulatory agency, the Council, acting through the OFR, will coordinate with such agencies and will, whenever possible, rely on information available from the OFR or such agencies. Council members and their agencies and staffs will maintain the confidentiality of such information in accordance with applicable law.

Information requests likely will involve both qualitative and quantitative data. Information relevant to the Council's analysis may include confidential business information such as internal assessments, internal risk management procedures, funding details, counterparty exposure or position data, strategic plans, resolvability, potential acquisitions or dispositions, and other anticipated changes to the nonbank financial company's business or structure that could affect the threat to U.S. financial stability posed by the nonbank financial company.

In evaluating qualitative factors during Stage 3, the Council expects to have access, to a greater degree than during earlier stages of review, to information relating to factors that are not easily quantifiable or that may not directly cause a company to pose a threat to financial stability, but could mitigate or aggravate the potential of a nonbank financial company to pose a threat to the United States. Such factors may include the opacity of the nonbank financial company's operations, its complexity, and the extent to which it is subject to existing regulatory scrutiny and the nature of such scrutiny.

The Stage 3 analysis will also include an evaluation of a nonbank financial company's resolvability, which may mitigate or aggravate the potential of a nonbank financial company to pose a threat to U.S. financial stability. An evaluation of a nonbank financial company's resolvability entails an assessment of the complexity of the nonbank financial company's legal, funding, and operational structure, and any obstacles to the rapid and orderly resolution of the nonbank financial company in a manner that would mitigate the risk that the nonbank financial company's failure would have a material adverse effect on financial stability. In addition to the factors described above, a nonbank financial company's resolvability is

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[7] *See* section 1310.21(a) of the rule.

[8] Under section 112(d) of the Dodd-Frank Act, if the Council is unable to determine whether a U.S. nonbank financial company poses a threat to U.S. financial stability based on such information, the Council may request that the Board of Governors conduct an examination of the nonbank financial company to determine whether it should be supervised by the Board of Governors.

also a function of legal entity and cross-border operations issues. These factors include the ability to separate functions and spin off services or business lines; the likelihood of preserving franchise value in a recovery or resolution scenario, and of maintaining continuity of critical services within the existing or in a new legal entity or structure; the degree of the nonbank financial company's intra-group dependency for liquidity and funding, payment operation, and risk management needs; and the size and nature of the nonbank financial company's intra-group transactions.

The Council anticipates that the information necessary to conduct an in-depth analysis of a particular nonbank financial company may vary significantly based on the nonbank financial company's business and activities and the information already available to the Council from existing public sources and domestic or foreign regulatory authorities. The Council will also consult with the primary financial regulatory agency, if any, for each nonbank financial company or subsidiary of a nonbank financial company under consideration in a timely manner before the Council makes any final determination with respect to such nonbank financial company, and with appropriate foreign regulatory authorities, to the extent appropriate.

Before making a Proposed Determination, the Council intends to notify each nonbank financial company in the Stage 3 Pool when the Council believes that the evidentiary record regarding such nonbank financial company is complete.

Based on the analysis performed in Stages 2 and 3, a nonbank financial company will be considered for a Proposed Determination. Before a vote of the Council with respect to a particular nonbank financial company, the Council members will review information relevant to the consideration of the nonbank financial company for a Proposed Determination. After this review, the Council may, by a vote of two-thirds of its members (including an affirmative vote of the Council Chairperson), make a Proposed Determination with respect to the nonbank financial company. Following a Proposed Determination, the Council intends to issue a written notice of the Proposed Determination to the nonbank financial company, which will include an explanation of the basis of the Proposed Determination. The Council expects to notify any nonbank financial company in the Stage 3 Pool if the nonbank financial company, either before or after a Proposed Determination of such nonbank financial company, ceases to be considered for determination. Any nonbank financial company that ceases to be considered at any time in the Council's determination process may be considered for a Proposed Determination in the future at the Council's discretion.

A nonbank financial company that is subject to a Proposed Determination may request a nonpublic hearing to contest the Proposed Determination in accordance

with section 113(e) of the Dodd–Frank Act. If the nonbank financial company requests a hearing in accordance with the procedures set forth in § 1310.21(c) of the Council's rule,[9] the Council will set a time and place for such hearing. The Council will (after a hearing, if a hearing is requested), determine by a vote of two-thirds of the voting members of the Council (including the affirmative vote of the Chairperson) whether to subject such company to supervision by the Board of Governors and prudential standards. The Council will provide the nonbank financial company with written notice of the Council's final determination, including an explanation of the basis for the Council's decision. When practicable and consistent with the purposes of the determination process, the Council intends to provide a nonbank financial company with a notice of a final determination at least one business day before publicly announcing the determination pursuant to § 1310.21(d)(3), § 1310.21(e)(3) or § 1310.22(d)(3) of the Council's rule.[10] The Council does not intend to publicly announce the name of any nonbank financial company that is under evaluation for a determination prior to a final determination with respect to such company. In accordance with section 113(h) of the Dodd–Frank Act, a nonbank financial company that is subject to a final determination may bring an action in U.S. district court for an order requiring that the determination be rescinded.

[9] *See* 12 CFR 1310.21(c).
[10] *See* 12 CFR 1310.21(d)(3), 1310.21(e)(3) and 1310.22(d)(3).

CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of August, 2016, I filed the foregoing Public Copy of the Brief of Appellee with the Clerk of the Court for the United States Court of Appeals for the District of Columbia Circuit via the Court's appellate CM/ECF system. I also hereby certify that I caused eight paper copies to be delivered to the Clerk's Office. Service was accomplished on the following using the Court's CM/ECF system:

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