[ORAL ARGUMENT NOT YET SCHEDULED]
16-5086

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 of the District of Columbia in Case No. 1:15-00045-RMC; Judge Rosemary M. Collyer

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BRIEF OF *AMICUS CURIAE* THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS IN SUPPORT OF PLAINTIFF-APPELLEE

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STATEMENT REGARDING CONSENT TO FILE AND SEPARATE BRIEFING

Pursuant to D.C. Circuit Rule 29(b), undersigned counsel for *amicus curaie* represent that both parties have been sent notice of the filing of this brief and have consented to the filing.[1]

Pursuant to D.C. Circuit Rule 29(d), undersigned counsel for *amicus curiae* certifies that a separate brief is necessary. Amicus is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories. It represents the collective views of state regulators both domestically and internationally and its members form the national system of state-based insurance regulation in the U.S. Amicus and its members have a strong interest in conveying to the Court an accurate presentation related to the critical role state that state insurance regulation plays in monitoring the financial condition of insurers and insurance groups, and preventing, identifying, and reacting to any financial distress with interstate coordination where appropriate. It is critical that the Court understand the regulatory structure already in place as it reviews the designation of MetLife by the Financial Stability Oversight Council ("FSOC").

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[1] Pursuant to Fed. R. App. P. 29(c), *amicus curiae*, states that no counsel for a party authored this brief in whole or in part, and no person other than *amicus curiae* or its counsel made a monetary contribution to its preparation or submission.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, *amicus curiae* states that it is not a publicly-held corporation, does not issue stocks, and has no parent company.

CERTIFICATES AS TO PARTIES, RULINGS, AND RELATED CASES

I. PARTIES AND AMICUS

Except for *Amicus* and any other *Amici* who have not yet entered an appearance in this case as of the filing of Appellant's brief, all parties, intervenors, and amici appearing before the District Court and in this Court are listed in the Brief for Appellant.

II. RULINGS UNDER REVIEW

References to the ruling under review appears in the Brief for Appellant.

III. RELATED CASES

Reference to any related cases pending before this Court appears in the Brief for Appellant.

Dated: August 22, 2016

/s/ Michael Gatje
Michael A. Gatje

Counsel for Amicus Curiae the National Association of Insurance Commissioners

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I. IDENTITY AND INTEREST OF *AMICUS CURIAE*

Founded in 1871, the National Association of Insurance Commissioners ("NAIC") is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate regulatory oversight. NAIC staff supports these efforts, and the NAIC represents the collective views of state regulators domestically and internationally. The NAIC members, together with the centralized resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

The NAIC's purpose is to provide its members with a national forum enabling them to work cooperatively on regulatory matters that transcend the boundaries of their own jurisdictions. This not only allows for consistency in regulating companies that do business in multiple states, but it provides a central point of communication and facilitation for joint initiatives with federal and international regulators. The NAIC also regularly assists federal regulators, federal agencies, members of Congress and the Government Accountability Office by providing information and data related to state insurance regulation, health insurance issues, terrorism insurance, annuities, insurance fraud and many other topics. As founding members of the International Association of Insurance Supervisors, the NAIC and its members remain extensively engaged with international counterparts in developing the elements of a stronger international insurance regulatory framework.

Collectively, the state insurance commissioners work to develop model legislation, rules, regulations, handbooks, white papers and actuarial guidelines that promote and establish uniform regulatory policy. Their overriding objectives are to protect consumers, maintain the financial solvency of insurance companies and the financial stability of the insurance industry as a whole.

Hundreds of state and federal laws assign duties to the NAIC and incorporate NAIC standards, models and other publications. NAIC model laws, regulations and other standards, as implemented by the states, are a critical part of the robust regulatory structure in place to monitor the financial solvency of MetLife and other insurers. In addition, the NAIC manages and coordinates the accreditation review of insurance departments as well as maintains regulatory and financial databases of insurance company financial data.

The interest of the NAIC in this case arises out of the regulatory responsibility vested in each commissioner as part of the state-based system of insurance regulation. The insurance commissioners of the various states are charged with the responsibility of regulating the business of insurance within their respective jurisdictions pursuant to the McCarran-Ferguson Act of 1945, 15 U.S.C. §§ 1011 to 1015 (2012) ("McCarran-Ferguson Act"). The NAIC and its members have an interest in conveying to the Court an accurate presentation related to the critical role state insurance regulation plays in monitoring the financial condition of insurers and insurance groups, and preventing, identifying, and reacting to any financial distress with interstate coordination where appropriate. Just as the Financial Stability Oversight Council (FSOC) is required to consider the degree to which a company is already regulated before it designates a company for enhanced supervision and oversight, it is critical that this Court understand the regulatory structure already in place as it reviews this appeal concerning FSOC's designation of MetLife.

II. ARGUMENT

FSOC is empowered to subject a U.S. nonbank financial company to supervision and certain prudential standards if the Council determines that material financial distress at that company could pose a threat to the financial stability of the United States. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 12 U.S.C.A. § 5323(a)(1) (2010). Congress took several steps to ensure that when the company under consideration for designation is an insurance company the views and expertise of state insurance regulators are considered. First, a state insurance commissioner serves as a non-voting member of the Council. *See* 12 U.S.C.A. § 5323(b)(2). Second, an independent member with insurance expertise is one of the voting members. *Id* at § 5323(b)(1). Third, the Council is required to consider "the degree to which the company is already regulated by 1 or more primary financial regulatory agencies." *Id* at § 5323(a)(2)(H). Finally, the Council is required to consult with the primary financial regulatory agencies before making a designation that the company is a systemically important financial institution ("SIFI"). *See* 12 U.S.C.A. § 5323(g).

In spite of all of these requirements and in spite of FSOC's assertion that it "considered the extent to which MetLife is subject to supervision and regulation," it appears FSOC largely ignored or discounted (and in its appellate brief, continues to ignore and discount) the state regulatory system and the views of state regulators and its own insurance expert in favor of speculation, assumptions about consumer and regulatory responses to distress that have no basis in fact or history, and a flawed analysis of the insurance business and its regulation. FSOC, *Explanation of the Basis of the Financial Stability Oversight Council's Final Determination that Material Financial Distress at MetLife Could Pose a Threat to U.S. Financial Stability and that MetLife Should Be Supervised by the Board of Governors of the Federal Reserve System and Be Subject to Prudential Standards*, p. 20 (December 18, 2014) ("Final Designation"). The State Insurance Commissioner Representative on FSOC, Commissioner Adam Hamm from North Dakota, made this point in his public statement on MetLife's designation:

> To effectively assess how regulation mitigates the risks the firm poses to financial stability, the Council should have sought to match the areas of concern to the authorities of existing regulators to address those concerns. The Basis fails to do this. As a result, the Basis fails to acknowledge that most, if not all, of the concerns it identifies (several of which have questionable merit) are addressed by the existing regulatory structure. This omission makes the Council's rationale for its decision fundamentally flawed. Final Designation at 305-306.

Similarly, Roy Woodall, the Council's Independent Member Having Insurance Expertise, dissented from the designation of MetLife and voiced concerns that it "failed to appreciate fundamental aspects of insurance and annuity products, and, importantly, State insurance regulation and the framework of the McCarran-Ferguson Act . . . .The analysis discusses in detail, and is dismissive of, the U.S. State insurance regulatory framework, the panoply of State regulatory authorities, and the willingness of State regulators to act, thereby overstating shortcomings and uncertainties that are inherent in all regulatory frameworks, State or Federal." Final Designation at 299-300. FSOC repeats many of these same mistakes in its appellate brief.

Because FSOC continues to rely on its previous mischaracterizations of the state insurance regulatory system, the NAIC seeks to assist the Court by describing in detail the regulatory scrutiny already applied to MetLife and, in doing so, support MetLife's contention that FSOC acted arbitrarily and capriciously in failing to take existing regulation fully into account.

A. FSOC failed to adequately consider the full range of regulatory tools available to state regulators at the individual entity and group level.

The standard by which entities are subjected to a change in regulation, or deregulated, should be high. We agree with Commissioner Hamm's statement that "suggestions or assertions that a consolidated regulator would more effectively address the identified potential risks should be supported by a description of the tools, how they explicitly address the systemic risks identified, and experience from past financial crises." Final Designation at 307. FSOC has not compared the presumptive advantages of consolidated federal oversight with the existing state-based system, nor has it credited state regulators for their evolved and effective approach to supervision of legal entity insurance companies and holding companies[2]. FSOC continues to argue the lack of "a single interstate regulator with jurisdiction across state boundaries" but fails to explain why a single regulator would be more effective than the timely, coordinated response of the NAIC's

[2] As an initial matter, the NAIC notes that misperception remains about the financial distress experienced by American International Group, Inc. ("AIG") in 2008. To whatever extent state-based insurance regulation might be disregarded because of AIG's failure, it bears repeating that "In September 2008, AIG's international insurance subsidiaries were thriving and profitable, but its Financial Products Division experienced a severe liquidity shortage due to the collapse of the housing market." *Starr Int'l Co. Inc. v. U.S.*, No. 11-779C, 2015 WL 3654465 at *6 (Fed. Cl. June 15, 2015). Strong consumer protection and reserve requirements at the state level were ultimately mitigating factors for AIG, and they would similarly benefit any holding company.

collective members. *See* Brief of Appellant, *MetLife v. Financial Stability Oversight Council*, No. 16-5086 (D.C. Cir. June 16, 2016) at 36.

Each of MetLife's insurance subsidiaries is subject to extensive regulation at the state level, including, but not limited to, investment limits as to type and concentration, risk-based capital (RBC) and reserving requirements, reporting and statutory accounting standards, and "constant and ongoing supervision and examination." Letter from Benjamin M. Lawsky[3], Superintendent, New York Department of Financial Services (DFS) to Jacob Lew, Secretary of the Treasury, p. 3 (July 30, 2014) ("Lawsky Ltr."). These highly regulated insurance subsidiaries account for 98% of MetLife's consolidated assets, 96% of its liabilities, and 95% of its revenues. Complaint at 13, *MetLife, Inc. v. Financial Stability Oversight Council*, No. 15-cv-45, 2015 WL 3422486 (D. D.C. May, 22 2015). The DFS also closely regulates MetLife's derivatives portfolio and securities lending activities. Superintendent Lawsky informed FSOC that MetLife's derivatives program is "well collateralized, conducted almost exclusively for hedging purposes, and not concentrated in any counterparty or group of counterparties…MetLife conducts its securities lending program within its life insurance subsidiaries alone, which in New York means the program is subject to restrictions on size, concentration limits, and counterparty

[3] Superintendent Lawsky has since left the New York Department of Financial Services. Maria T. Vullo is the current Superintendent.

creditworthiness." Lawsky Ltr. at 2. Although mandated by law to consider the degree of existing regulation, FSOC conducted no analysis of the efficacy of the state regulatory system generally or the specific New York laws, regulations, and other standards applicable to MetLife.

The examination authority referenced by Superintendent Lawsky and other state regulators who submitted information to FSOC is crucial to the demonstrated success of state-based insurance regulation. Pursuant to the NAIC Model Law on Examinations ("Examination Law"), all insurance commissioners have the authority to examine companies whenever deemed necessary and must examine all domestic insurers no less frequently than every five years. *See* NAIC *Model Laws, Regulations and Guidelines*, 390-1 to 390-8, 20XX WL 8342885 (1991, amended 1999), *Accreditation Program Manual*, NAIC, pg. 125 (January 1, 2015).[4] In order to create best practices and promote consistency in financial regulation for each state's domiciled insurers, the NAIC continuously updates the *Financial Condition Examiners' Handbook*, which is the standard referenced in all states'

[4] The NAIC's accreditation program establishes and maintains standards to promote sound insurance company financial solvency regulation. Regulation of multi-state insurance companies is enhanced and adequately monitored with emphasis on adequate solvency laws and regulations, financial analysis and examination processes, appropriate organizational and personnel practices in each accredited state, and effective and efficient review of organization, licensing and change of control. The NAIC reviews each state's laws, regulations and department practices to determine compliance with Accreditation Standards. All U.S. states, the District of Columbia and Puerto Rico are currently accredited.

laws. *See id.* The NAIC's Risk-Focused Surveillance Working Group regularly reviews the effectiveness of financial analysis and examination functions, and it provides a forum for peer review among state departments of insurance.

While effective oversight of insurance companies that are part of larger holding company systems is undoubtedly more complicated, the NAIC and its members have been enhancing this authority since the initial adoption of the Insurance Holding Company System Regulatory Act in 1969 ("Holding Company Act"). *See* NAIC *Model Laws, Regulations and Guidelines*, 440-1 to 440-38, 20XX WL 8342889 (1969, amended 2014). The Holding Company Act requires the insurer to file annual reports detailing material intercompany contract terms and relationships. The commissioner is also empowered to review and approve cost-sharing agreements, material management agreements, major reinsurance agreements, material transactions and requests for extraordinary dividends. This reporting, and regulatory review and approval of intercompany transactions, helps ensure the insurer's assets, expenses and affiliate relationships are closely monitored.

FSOC claims that "state insurance regulators generally do not have direct authority to require a non-mutual holding company of a state-licensed insurer or any non-insurance company subsidiary to take or not take actions outside of the insurer for the purpose of safety and soundness of the insurer." Final Designation at 242. FSOC continues to invoke purportedly limited state authority over MetLife's parent and non-insurance subsidiaries as a deficiency in present state regulatory oversight. *See* Appellant's Brief at 36. This myopic view discounts the value of state regulatory authority to order production of books and records in the possession of the insurer's affiliates, including its ultimate controlling person, a power that exists under state laws based on the Examination Law and the Holding Company Act. It also dismisses the benefits of coordinated monitoring and response among state regulators and assumes regulators would ignore the presence of actionable information and other warning signs. Instead, FSOC – an entity formed because of the presumed benefit of gathering the collective expertise of various federal regulators – suggests that there must be a single regulator where an insurance company is involved despite the strong track record of the existing system of coordinated insurance regulation.

In addition to ongoing regulatory coordination and cooperation, state insurance regulators continue to incorporate enhancements into the existing system. Through recent amendments to the Holding Company Act, the authority to conduct group supervision was significantly expanded and is also now required for each state's continued accreditation. The revised Holding Company Act requires the ultimate controlling person of the insurer to file an annual enterprise risk report that will "identify the material risks within the insurance holding company system that could pose enterprise risk to the insurer." NAIC *Model Laws, Regulations and Guidelines*, 440-7 and 440-18, 20XX WL 8342889 (1969, 2014). In addition, the commissioner also has the power to examine any insurer authorized to do business in that state and which is a member of an insurance holding company system, *and its affiliates*, "to ascertain the financial condition of the insurer, including the enterprise risk to the insurer by the ultimate controlling party, or by any entity or combination of entities within the insurance holding company system, or by the insurance holding company system on a consolidated basis." NAIC *Model Laws, Regulations and Guidelines*, 440-24, 20XX WL 8342889 (1969, 2014).

The revised Holding Company Act provides for submission of financial statements of the entire holding company system (including non-regulated entities) and unrestricted access to information in the possession of the insurer, the parent or any other entity within the system including non-regulated entities.[5] It also includes fit and proper requirements, rights of inspection and approval and intervention powers for certain transactions involving insurers. *See* Letter from

[5] A related initiative in this area is the NAIC Risk Management and Own Risk and Solvency Assessment Model Act ("ORSA"), which requires an insurer or insurance group to maintain a risk management framework commensurate with the nature, scale and complexity of the insurer or group. Topics for the filing include an assessment of risk exposure and group assessment of risk capital and prospective solvency. This model act is scheduled to become an accreditation standard in the next few years. *See* NAIC *Model Laws, Regulations and Guidelines*, 505-1 to 505-6, 20XX WL 11615902 (2012).

Thomas B. Leonardi[6], Commissioner, Connecticut Insurance Department to Jacob Lew, Secretary of the Treasury, Schedule A, p. 6 et. seq. (October 24, 2014) ("Leonardi Ltr."). The revised version of the Holding Company Act has been adopted by 52 jurisdictions, including states such as New York and Connecticut with primary regulatory authority over MetLife. *See* NAIC, Implementation of 2010 Revisions to Model #440, Insurance Holding Company System Regulatory Act [status as of January 13, 2016], www.naic.org/documents/committees_e_related_smi_dashboard.pdf.

The 2010 revisions also granted to the commissioner the explicit authority to initiate a supervisory college for any domestic insurer that is part of an insurance holding company system with international operations. A supervisory college may be convened as a temporary or permanent forum to assess the insurer's business strategy, financial position, legal and regulatory position, risk exposure, risk management and governance processes. FSOC quickly disregarded supervisory colleges as "not equivalent" to the supervisory structure under a potential SIFI designation. Final Designation at 242. There is no comparative analysis in this statement, nor is there a meaningful description of what a supervisory college is empowered to do.

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[6] Commissioner Leonardi has since left the Connecticut Insurance Department. Katharine L. Wade is the current Commissioner.

The powers associated with college participation include clarifying the functions and roles of participating supervisors, establishing the group-wide supervisor, coordinating ongoing college activities, and establishing a crisis management plan.[7] The New York State Department of Financial Services, which supervises MetLife's largest insurance subsidiary and serves as the lead insurance regulator for the MetLife group of companies, hosts an annual supervisory college for MetLife and also holds "telephonic meetings in the interim to facilitate collaboration, cooperation and coordination among supervisors." Lawsky Ltr. at 3. As the Connecticut Insurance Commissioner told FSOC, "the college greatly enhances and facilitates both the sharing of information about MetLife's financial performance and in the understanding of its global risk management processes. Most importantly, the college provides for comprehensive, coordinated regulation of MetLife." Leonardi Ltr. at 3.

In addition to the statutory authority to initiate and participate in a supervisory college, state insurance regulators have participated in the development of national and international protocols concerning the operation of

[7] The NAIC continues its forward-looking approach with expanded authority in the Holding Company Act. In 2014, the model was amended to provide a group-wide supervisor of internationally active insurance groups with authority to assess enterprise risk, request sufficient information from the group to do so, and compel development and implementation of reasonable measures to mitigate such risk. *See* NAIC *Model Laws, Regulations and Guidelines*, 440-26 and 440-29, 20XX WL 8342889 (1969, 2014).

supervisory colleges. The NAIC's *Financial Analysis Handbook* provides guidance and best practices for state insurance regulators participating in colleges. This guidance notes that "one of the key functions of the college is to create the means to facilitate communication," while acknowledging that "[i]t is important for all participants in a Supervisory College to have a clear understanding of the regulatory mission of each of the regulatory bodies which are being considered for any Supervisory College." 2 NAIC *Financial Analysis Handbook*, 2-209 (2016). The International Association of Insurance Supervisors, of which the NAIC and state insurance regulators are members, promulgated similar guidance through an application paper. *See* IAIS, *Application Paper on Supervisory Colleges* (2014).

In continuing to rely on its conclusory assertions about the authorities apparently lacking in the current system of supervision, FSOC fails to do what supervisory college participants actually do: cooperate, communicate, understand and act. Focusing on consolidated supervision for its own sake ignores what can and is achieved through a functioning supervisory college system of "comprehensive, coordinated regulation."

In its Final Designation, FSOC focuses only on its view that supervision of MetLife by state regulatory authorities does not include direct authority over every entity in a holding company system. However, in doing so, FSOC fails to adequately consider the totality of the state regulatory system and, as

Commissioner Hamm noted, fails to identify what additional regulatory tools could address the risks FSOC identifies. FSOC's analysis did not account for the state's authority to enforce compliance with the Holding Company Act. Under state adoptions of that law, state insurance regulators have extensive authority with respect to the ultimate controlling person, including a parent holding company, of an insurance company. Material transactions involving the insurer and any of its affiliates, including its parent, are subject to prior approval under standards of reasonableness and fairness. Dividends and other distributions must be reported to the insurance commissioner, and extraordinary dividends require prior approval. Also, every director or officer of an insurance holding company system is subject to civil fines for knowingly violating, participating in, assenting to, or permitting improper reporting of transactions or investments, and any officer, director, or employee of an insurance holding company system is subject to imprisonment, civil fines, or both for willfully and knowingly subscribing to or making or causing false statements or reports to be made with the intent of deceiving the commissioner.

Instead of conducting any analysis of the efficacy of coordinated regulation at the state level, FSOC dismissed it. FSOC substituted its perceptions about the state regulatory system for the facts about how state insurance regulators already supervise large insurance groups, including these regulators' cooperation with international counterparts and coordination among the states. Inserting the Federal Reserve into the supervisory process through designation will not alter the need for supervisors of a large insurance group to work together. Given the success of the NAIC's members in effectively regulating MetLife, expanding available state regulatory tools after the financial crises, and coordinating regulatory activities among themselves and with international counterparts, the designation of MetLife as a SIFI might fairly be called a fix in search of a problem.

B. FSOC failed to assess the risk of asset liquidation against existing regulatory authority to actively prevent a "run on the bank" scenario, including early warning through risk-based capital requirements and stays on surrender activity.

In its Final Designation, FSOC raised the specter of a "run" on a large insurer by policyholders, which could throw a troubled company (and apparently the life insurance industry) into full-blown insolvency seemingly overnight. *See* Final Designation at 138. As Commissioner Hamm pointed out:

> Fears of surrenders leading to mass asset liquidation are thus unfounded, as insurance regulators have the ability and, moreover, the responsibility to take action in such an event…It is worth noting that our authorities are flexible and provide us substantial means to quell panic. Final Designation at 306.

The practical aspects of insurance products, particularly in the area of life insurance, simply do not support these fears. The very process of underwriting for life insurance policies demonstrates the overall predictability of payouts. Actuarial forecasting allows life insurers to anticipate their liability with an enviable amount of specificity, relative to other industries. Furthermore, life insurance and annuity products are valued by consumers for the long-term savings buildup. Unlike countless banking products, insurance products are not designed to allow access to funds on demand and often contain deterrents such as the policy limitations or penalties for early withdrawal.

In its letter to FSOC, the National Organization of Life and Health Insurance Guaranty Associations ("NOLHGA") agreed that a "run on the bank" is not only unlikely, but would in fact "defeat the very purpose for which insurance contracts were acquired." Letter from Peter G. Gallanis, President, NOLHGA to Jacob Lew, Secretary of the Treasury, p. 3 (October 14, 2014) ("NOLHGA Ltr."). NOLHGA noted that "instances of surrender and withdrawal activity by insurance consumers have traditionally been low, even in cases where a specific insurer is the subject of publicized financial difficulties." *Id.* Despite this historical trend, FSOC continues to imagine a consumer-fueled liquidation of insurance assets as part of its basis for designation. FSOC's asset liquidation analysis, relying as it does on policyholders to sabotage their own financial interest *en masse*, shows a tortured reasoning.

In addition to inadequately considering the nature of insurance and annuity products and likely responses from insurers and insurance consumers, FSOC also failed to adequately consider the many tools state insurance regulators have available to ensure that adequate resources are maintained to meet insurer obligations and to step in if financial distress occurs. State insurance commissioners are consistent in mandating certain capital standards because of accreditation requirements based on the NAIC's Risk-Based Capital for Insurers Model Act ("RBC Act"). *See* NAIC *Model Laws, Regulations and Guidelines*, 312-1 to 312-14, 20XX WL 8342873 (1993, amended 2011). The RBC Act was adopted in 1993 to require capital levels to correspond with the risk factors of the policy type:

> The Act's main purpose is to ensure that insurers' risk-capital levels reflect a rational relationship with the riskiness of the policies that are insured. The Act provides "trigger points" by which regulatory bodies can gauge the strength of insurers and assess the need for state regulatory intervention. Conrad D. Brooks, *Risk-Based Capital: Provide for the Computation of Risk-Based Capital Levels for Insurers and the Submission of Risk-Based Capital Reports by Insurers; Provide for the Authority of the Commissioner of Insurance to Take Action; Provide Immunity from Civil Action to Receivers*, 13 Ga. St. U. L. Rev. 212, 213 (1996).

Under the RBC Act, every domestic insurer reports its RBC levels on an annual basis in accordance with NAIC-issued RBC instructions. The instructions contain a formula that was developed (and is regularly updated) as an additional tool to assist regulators in the financial analysis of insurance companies. The purpose of the formula is to establish a minimum capital requirement based on the types of risks to which a company is exposed. Separate RBC models have been developed for each of the primary insurance types: Life, Property/Casualty, Health and Fraternal. This reflects the differences in the economic environments for these products. The formula is calibrated to consider additional factors within these groups. For example, life and annuity reserves are evaluated differently depending on cash flow testing and withdrawal provisions. Interest rate risk and market risk, in particular, can have a significant impact on annuities. The formula emphasizes these conditions as well.

After RBC filings are submitted, the NAIC conducts quality assurance by cross checking the RBC information against the remainder of the company's annual financial reporting. Data validation failures are reported back to the company for an opportunity to resolve the inconsistency, after which any unresolved validation issues are reported to the domiciliary regulator.

Under the RBC system, regulators have the authority and statutory mandate to take preventive and corrective measures that vary depending on the capital deficiency indicated by the RBC result. If the total capital level is not sufficient in light of attendant risks, the commissioner has the authority to order specific corrective action. *See* NAIC *Model Laws, Regulations and Guidelines*, 312-7 to 312-9 20XX WL 8342873 (1993, amended 2011). These preventive and corrective measures are designed to provide for early regulatory intervention to correct problems before insolvencies become inevitable, thereby minimizing the number and adverse impact of insolvencies.

The RBC system operates as a tripwire that gives regulators clear legal authority to intervene in the business affairs of an insurer upon the occurrence of one of the action levels specified in the RBC law. RBC alerts regulators to undercapitalized companies while there is still time for the regulators to react quickly and effectively to minimize the overall costs associated with insolvency. RBC provides a baseline of objective standards and regular reporting without diminishing a commissioner's flexibility to obtain and consider additional information under more general authority granted by a state's insurance code.

In addition to this objective, uniform, maintenance-focused RBC standard, state insurance regulators also have a variety of tools in the case of a specific troubled company, including the longstanding authority to impose stays on policyholder surrenders. The NAIC's Accreditation Program includes a standard for adequate receivership laws that may be met by the Insurer Receivership Model Act. Under this model act, a rehabilitation plan for a life insurer "may also propose imposition of a moratorium upon loan and cash surrender rights under policies, for a period not to exceed one year from the entry of the order approving the rehabilitation plan, unless the receivership court, for good cause shown, shall extend the moratorium." NAIC *Model Laws, Regulations and Guidelines*, 555-38, 20XX WL 8342898 (1936, amended 2007).

Once again, the statutory language demonstrates broad, flexible discretionary authority for insurance commissioners to act. A commissioner can even consider need-based exceptions for release of funds on a case-by-case basis. FSOC acknowledged this explicit power, stating that a state regulator may issue a stay "at its discretion to preserve assets or to calm fears that the insurer will be unable to meet its obligations to policyholders". Final Designation at 21. Where FSOC strayed from reality was in assessing the impact of such measures. NOLHGA asserts there is no evidence that imposition of moratoriums in significant receivership cases resulted in increased surrender and withdrawal activity[8]. NOLHGA Ltr. at 12-13. FSOC's scenario of mass surrenders and withdrawals by MetLife policyholders assumes, with no evidence or historic precedent, that state regulators would not act to prevent the financial distress of an insurer and then would sit idly by as these unprecedented events occurred.

In its designation, FSOC managed to create a scenario where declining to issue a stay or deciding to issue a stay would have equally disastrous consequences, suggesting that "the imposition of a stay on discretionary withdrawals could cause a loss of confidence, particularly if other insurers are

[8] "I attach particular significance to the fact that no material increases in surrenders or withdrawals were occurring at major life insurers whose holding companies' publicly traded stock prices were declining materially in value in early 2009 – at a time when there had been no public indication that TARP funds or other forms of extraordinary Federal financial support would ever be made available to insurance companies or groups." NOLHGA Ltr. at 12-13.

simultaneously experiencing some level of financial distress." Final Designation at 144-145. Again, FSOC's asset liquidation analysis is stripped of meaning when it assumes any decision a state regulator might make to be too little, too much, too soon or too late.

Aside from the authority to issue stays, insurance commissioners also have the benefit of central organization, communication and administrative support through the NAIC to manage the resolution of a large, complex holding company. The NAIC and its members have a tremendous amount of experience in coordinating multistate regulation, including examinations, investigations, and dealing with troubled companies, as well as multiple appropriate forums for such a response. Starting with early detection of distress, state regulators work together through the NAIC's Financial Analysis Working Group ("FAWG") to analyze nationally significant insurers and groups that exhibit characteristics of being financially troubled.[9] FAWG allows regulators to confer on appropriate regulatory actions and strategies that will prevent further deterioration. FAWG continuously monitors nationally significant insurers in receivership. Supervisory colleges,

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[9] NOLHGA's March 27, 2014 statement to FSOC notes on p. 4 that "the solvency regulators from across the country, working through the NAIC's highly successful Financial Analysis Working Group (FAWG), have, since FAWG;s establishment in the mid-1990s, helped to ensure that a company's domiciliary regulator receives early notice, analysis, and peer support for taking the necessary regulatory measures."

implemented through the Holding Company Act and discussed above, can also be called in order to coordinate a response among nations where necessary[10].

These resources and the record of success for coordinated responses clearly demonstrate that the fear of "contagion" resulting from a run on insurer assets is greatly overstated. The Council expresses concern that state regulatory authorities "have never been tested by an event of the material financial distress of an insurance company of the size, scope, and complexity of MetLife's large insurance subsidiaries." Final Designation at 22. The Council fails to continue this assertion to its logical conclusion - state authorities have not been so tested because the existing regulatory structure, applied with strong statutory authority and effective means for cooperation, have not allowed a comparable insurance failure.

C. FSOC failed to assess the risk of MetLife's ultimate failure against the deliberate, incremental process that applies to troubled companies supervised by state insurance commissioners.

Capital requirements, investment limitations, reserving methods, risk-focused surveillance, and regular financial examination are similar to preventative

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[10] The NAIC offers this discussion of collaborative action in part as a rebuttal to the *amici* Scholars of Insurance Regulation's claim that state insurance regulators are frequently not able to coordinate effectively among themselves. *See* Brief of Scholars of Insurance Regulation, *MetLife v. Financial Stability Oversight Council*, No. 16-5086 (D.C. Cir. June 23, 2016) at 26. The Scholars speculate that "there is good reason to believe that regulators could face difficulties in attempting to halt a run" during a financial crisis, buttressing their analysis with unsubstantiated generalizations rivaled only by the Council's own. *Id.*

medicine. Regulators' vigilance in these matters reduces the likelihood of serious infirmity in the future. In those cases where surveillance indicates a company's financial health could become a hazard to policyholders, creditors or the general public, state insurance regulators have direct authority to immediately order corrective action. Insurance commissioners have flexibility here, as "each legal entity insurer has unique characteristics and writes different products…accordingly, each insurance entity would react to stress differently and its regulator would appropriately respond differently to those specific circumstances." Final Designation at 307.

The authority to determine whether continued operation of an insurer might be hazardous to policyholders is provided in the NAIC's Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition (#385). NAIC *Model Laws, Regulations and Guidelines*, 385-1 to 385-5, 20XX WL 8342884 (1985, amended 2008). First, under Section 3, the model regulation lays out conditions which may, either on their own or in combination with each other, be considered by the commissioner to make the determination. Such conditions include but are not limited to: adverse findings from financial condition or market conduct examinations; false or misleading financial statements; availability of cash flow; proportion of operating loss to the insurer's remaining surplus; sufficiency and ability of reinsurers; and competence and fitness of management.

In addition, the model regulation allows the commissioner to consider whether any entity in the holding company system is insolvent, delinquent or threatened with insolvency. It is important to note these conditions may come to the attention of state regulators in many ways. They are not necessarily tied to scheduled financial examinations or annual reporting. This demonstrates not only the flexibility of state authority in this area, but the scope.

Next, Section 4B of the model regulation turns to the actions a commissioner may order once he or she has determined that continued operation of the insurer may be hazardous. The actions include, but are not limited to: reducing the volume of business being accepted; increasing capital and surplus; suspending the payment of dividends; limiting or withdrawing from certain investments; and correcting corporate governance practice deficiencies.

Each state is required to maintain language similar to Sections 3 and 4B of the model regulation. *See Accreditation Program Manual* at 130. The model regulation, initially passed in 1985, was amended to strengthen this regulatory discretion and authority in 2008. Robust state laws and regulations based on NAIC model language allow for early detection of financial distress and swift remedial action to prevent harm to policyholders and minimize the impact of financial distress.

A troubled company, once identified by state regulatory authorities, is not necessarily bound for insolvency proceedings. As early detection has improved, some insurers may be helped by alternative mechanisms including run-off or restructuring. *See Alternative Mechanisms for Troubled Insurance Companies*, NAIC white paper, p. 1 (2009). In a run-off situation, "the insurer ceases writing new business on all lines of business, but continues collecting premium and paying claims as they come due on existing business." *Id.* at 5. Ultimately, operations will close while the company is still solvent. Voluntary restructuring, meanwhile, allows a court to approve and implement an agreement with all creditors in order to accelerate the run-off. *Id.* at 11. These alternatives are made possible by experienced regulators coordinating across state lines and with state guaranty funds.

NAIC guidance recommends early involvement of guaranty associations to allow for a smooth transition of claims and an effective plan for potential liquidation. *See Communication and Coordination Among Regulators, Receivers, and Guaranty Associations: an Approach to a National State Based System,* NAIC white paper (2004). Guaranty associations can also assist with "fact gathering, investigation and the identification of potential guaranty association-covered liabilities." *Id.* at 6. This early coordination may help to avoid an outright liquidation. As NOLHGA states, "Sometimes regulators commence such consultations with the guaranty system even before a rehabilitation proceeding has begun. The NAIC recognizes that such consultation is a prudent practice and encourages it." NOLHGA Ltr. at 5.

Should these alternative mechanisms not be appropriate for the insurer, progression to the insolvency phase is highly structured. As described in detail in the Insurance Receivership Model Act (#555), a commissioner continues to have a great deal of flexibility to determine the degree of intervention required. *See* 1 NAIC *Model Laws, Regulations and Guidelines*, 555-1 to 555-101, 20XX WL 8342898 (1936, amended 2007). Some situations may be addressed by rehabilitation or conservation. However, when a company is in more serious financial distress, the inquiry will proceed to liquidation:

> A typical liquidation order will: cancel all insurance policies issued by the insolvent insurer; stay all actions pending against the insolvent insurer; forbid the insolvent insurer from continuing to defend its policyholders; and temporarily stay all actions against the policyholders to afford the receiver sufficient time to arrange for their defenses. Francine L. Semaya & Lenore S. Marema, *An Overview of the State Insurance Receivership System*, 27 Brief 12, 13 (Fall, 1997).

The insolvency of an insurance company is separate and distinct from a traditional bankruptcy process for a very important reason: the protection of the policyholders whose premiums have financed the company's course of business.

Actions that proceed under the federal bankruptcy code will be subject to the requirement that the cost of administration and government claims are the first to be paid in full. The insolvency approach is different:

> Costs of administration usually receive top priority, followed by wage claims of the insurer's former employees, usually up to a specified dollar amount. A high preference is then afforded to a group consisting of policyholders, beneficiaries, insureds, third-party liability claimants, and guaranty funds, while general creditors are placed in a priority at or close to the bottom of the list, often immediately above those with ownership interests in the insolvent insurer. Claims of government entities for taxes, fines, and other amounts past due are also given a relatively low priority by contrast to the federal bankruptcy system. *Id*. *See also* NAIC *Model Laws, Regulations and Guidelines*, 555
> § 801, 20XX WL 8342898 (2007).

While regulators and guaranty associations gather the relevant information for coverage, insolvency statutes set out priority of claims and identify the applicable state court with jurisdiction over the insolvency proceedings. This process is intended to advance at the state level, with judicial oversight during the transition. As has been pointed out to FSOC by state regulators throughout its designation process, "the nature of the fundamental insurance promise... makes insurance companies considerably easier to resolve than banks." Lawsky Ltr. at 2. Life insurance company insolvencies are slow moving and can be deliberately managed by regulators, working with the state guaranty funds to keep policyholder losses to a minimum. This was demonstrated in the late 1980s and early 1990s, when a misplaced reliance on junk bonds caused several large life insurers to become impaired and, in some cases, insolvent:

> State insurance regulators placed a number of large insurers into rehabilitation and liquidation proceedings and imposed moratoriums on policy surrenders, policy loans, and cash withdrawals, subject to certain hardship exceptions. These actions, in combination with participation by Life Guaranty Associations, permitted the companies to either transfer blocks of business to other insurers or restructure policy obligations and to restructure investment holdings in a reasonable manner. Letter from Dave Jones, Commissioner, California Department of Insurance, to Jacob Lew, Secretary of the Treasury, p. 3 (October 27, 2014).

As Commissioner Jones noted, this kind of supervision and restructuring effectively manages withdrawals and prevents a "run on the bank".

Historical trends and outside insolvency experts confirm the effectiveness of this process. As NOLHGA President Peter Gallanis noted, "Practices and institutions requiring stringent regulatory attention to large, national insurers…cause me to conclude that none of the nation's largest life insurers would be permitted to deteriorate to the point where assets could not fully support all liabilities to policyholders." NOLHGA Ltr. at p. 13.

FSOC theorizes that MetLife's size and the potential obstacles to a "rapid and orderly resolution" favor designation. Though FSOC's definition of "rapid and orderly" acknowledges that winding down an insurer's estate "may take several years to accomplish," it nevertheless emphasizes speed, thereby ignoring its own definition and the state-based tools that may actually achieve the orderly resolution FSOC appears to want. Final Designation at 252, n. 1190. This lack of internal clarity illustrates a fundamental misunderstanding of insurance company resolutions and the policyholder obligations they are designed to protect, thus favoring "rapid" over effective.

FSOC's mischaracterization of existing regulatory authority, and the circumstances under which it would be applied, permeates every stage of its postulated failure of MetLife. FSOC does not account for any state regulatory intervention as it hypothesizes an accelerating MetLife failure careening through regular financial examination, stringent RBC and other requirements, undetected under any hazardous financial condition standard, and liquidated in a haphazard and uncoordinated manner.

III. CONCLUSION

The size of MetLife is invoked over and over again by the Council in its basis for determination. State regulators and the NAIC do not dispute that MetLife is a large, complex company. But FSOC's analysis cannot stop at size. FSOC is also required to consider the robust system of regulation already in place for this large, complex company and should have analyzed how this system serves to mitigate the risks FSOC identifies. As this brief demonstrates, state regulators have a vast arsenal of tools and statutory power to regulate for solvency and policyholder protection at the legal entity level, coordinate supervision at the group level, obtain early warning that a company may be troubled, take action if financial distress occurs, and proceed with orderly resolution if insolvency occurs.

Merely stating that the company is large and complex is not a cogent analysis of existing regulatory scrutiny. It appears that even if FSOC acknowledged the rigorous authority recounted here - the carefully applied capital standards, the ongoing financial examination and analysis, the expansion of group supervision authority, and the stringent, orderly progression of insolvency – FSOC's final word on the matter would be that MetLife is large and complex. Many insurance holding companies are large. Will each designation, when addressing Dodd-Frank's existing regulatory structure provision of § 5323(a)(2)(H), be identical? Other than conclusory statements, FSOC conducted no analysis to demonstrate that supervision by the Federal Reserve, under enhanced prudential standards that have yet to be fully determined, would do more to mitigate the alleged threat MetLife poses to financial stability in the U.S. than the existing robust system of state-based regulation. The NAIC urges the Court to consider what FSOC is required to consider and what FSOC was told by its own voting insurance expert, the non-voting state insurance representative, and every state regulator who was consulted by or presented information to it: MetLife is a highly regulated company and the existing regulation has served the company and its policyholders well. Simply put, FSOC acted in an arbitrary and capricious manner when it misunderstood, misconstrued, and dismissed the state regulatory system.

Dated: August 22, 2016

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CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B), because it contains 7,248 Words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

I further certify that the attached amicus brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6), because it has been prepared in a proportionally spaced typeface using Microsoft Word 2010 14-point Times New Roman font.

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CERTIFICATE OF SERVICE

I hereby certify that on this 22nd day of August 2016, I electronically filed the foregoing with the Clerk of Court for the United States Court of Appeals for the District of Columbia Circuit using the appellate CM/ECF system. Counsel for all parties to the case are registered CM/ECF users and will be served by the appellate CM/ECF system.

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