[ORAL ARGUMENT NOT SCHEDULED]

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 APPELLANT

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to D.C. Circuit Rule 28(a)(1), the undersigned counsel certifies as follows:

A. Parties and Amici

Appellee in this Court, who was plaintiff in the district court, is MetLife, Inc.

Appellant in this Court, who was defendant in the district court, is the Financial Stability Oversight Council.

The following amici participated in support of plaintiff-appellee in the district court: National Association of Insurance Commissioners; American Council of Life Insurers; U.S. Chamber of Commerce; and a group of academic experts in financial regulation (Jonathan R. Macey, Tamar Frankel, Keith Sharfman, and Therese M. Vaughan).

The following amici participated in support of defendant-appellant in the district court: Better Markets; a group of economics professors (Viral V. Acharya, Robert Engle, Thomas Philippon, and Matthew P. Richardson); a group of law and finance professors (Kate Andrias, Michael S. Barr, John C. Coffee, Jr., Darrell Duffie, Ronald J. Gilson, Jeffrey N. Gordon, Robert J. Jackson, Jr., Kathryn Judge, Andrew Metrick, Gillian Metzger, Saule T. Omarova, Amiyatosh Purnanandam, Jennifer Taub, Adrian Vermeule, and David Zaring); and a group of insurance regulation scholars (Daniel Schwarcz, Patricia A. McCoy, Joseph M. Belth, Steven L. Schwarcz, Peter N. Swisher, Robert F. Weber, Hazel Beh, Jeffrey W. Stempel, Aviva Abramovsky, John

Patrick Hunt, Jennifer Wriggins, Constance Wagner, Max N. Helveston, and Donald T. Hornstein).

The following amici have indicated that they intend to participate in this appeal on behalf of neither party: William Michael Cunningham.

B. Rulings Under Review

The rulings under review are the Memorandum Opinion and accompanying Order issued by Judge Rosemary M. Collyer on March 30, 2016, docket numbers 105 and 106 [JA 779-813]. The opinion is not yet published.

C. Related Cases

This matter has not previously been before this Court or any other court. We are unaware of any related cases pending in this Court or any other court.

s/ Daniel Tenny
Daniel Tenny

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GLOSSARY

AIG	American International Group
EPA	Environmental Protection Agency

INTRODUCTION

The sudden and unanticipated collapse of companies such as American International Group (AIG) in 2008 had a crippling effect on the U.S. financial system and exposed significant gaps in the existing regulatory structure. In response, Congress created the Financial Stability Oversight Council, whose members include the heads of all the federal financial regulatory agencies, and instructed it to identify nonbank financial companies whose material financial distress could pose a threat to the financial stability of the United States. 12 U.S.C. § 5323(a)(1). Designated companies are subject to additional supervision and regulation. The Council has exercised this authority on four occasions, including its designation of MetLife, Inc.

The district court overturned the collective judgment of the heads of the nation's financial regulatory agencies that material distress at MetLife could pose a threat to the country's financial stability. The court's ruling leaves one of the largest, most complex, and most interconnected financial companies in the country without the regulatory oversight that Congress found essential.

Nothing in the district court's analysis casts any doubt on the reasoning of the Council's 341-page decision. The Council explored in depth the nature of MetLife's assets, which total over $900 billion, as well its liabilities. These include MetLife's issuance of a range of financial products including approximately $35 billion in funding agreement-related liabilities, a securities-lending program that typically

includes outstanding borrowings of approximately $30 billion, and $48 billion in guaranteed investment contracts.

The Council found that MetLife's size, leverage, interconnectedness, potential liquidity risk, and complexity could cause material financial distress at MetLife to threaten the U.S. financial system. The Council explained in detail how, in the event of MetLife's distress, the company could face a significant liquidity shortfall, threatening its ability to satisfy its obligations and creating a risk of fire sales that could severely disrupt market functioning.

The district court set aside the judgment of the nation's federal financial regulators on two grounds.

First, the court held that the Council had departed from the interpretive guidance that the Council had issued in 2012 to explain its decision-making process. The court believed that the guidance required the Council to evaluate the likelihood that a company would experience financial distress, and that the Council had failed to do so. The court also believed that the guidance required the Council to predict the precise course of a future financial crisis, including the amount of losses that other financial institutions would incur as a result of MetLife's distress.

The district court's assessment of the interpretive guidance was profoundly mistaken, even apart from the court's failure to accord any deference to the Council's understanding of its own guidance. The statute lists ten factors the Council must consider in its analysis. None suggests that the Council is required to evaluate the

likelihood that a company will experience material financial distress. And the Council's interpretive guidance makes clear that it is not intended to establish extra-statutory requirements. Instead, it simply "describes the manner in which the Council intends to apply the statutory standards and considerations." 12 C.F.R. pt. 1310, App. A, § I.

To that end, the interpretive guidance groups the ten statutory factors into six categories and explains that three of those categories—a company's leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny—seek to assess a company's vulnerability to distress. As the guidance explains, these three categories assist the Council in assessing the effects that distress could have on the company, which in turn affects how the company's distress could be transmitted to other firms and markets. The guidance does not suggest, much less require, that the Council will consider the likelihood of a company's failure.

Nor does the statute or the interpretive guidance indicate that the Council will estimate specific counterparty losses or produce quantitative projections of the harm that would result from a company's distress. The 2008-2009 financial crisis demonstrated that the sudden, unforeseen failures of large financial companies can have sweeping, unpredictable ramifications. The Council did not set itself the impossible task of predicting the precise impact of a company's distress on its counterparties and the broader market.

Second, the district court erred in holding that the Council was compelled to assess the costs of designation to MetLife. The ten statutory factors that the Council must consider in making a designation include neither cost nor any other effect of designation on the company. The statutory authority to take into account considerations beyond those enumerated in the statute is limited to "other risk-related factors" that the Council, in its discretion, "deems appropriate." 12 U.S.C. § 5323(a)(2)(K). Recognizing that limitation, the district court declared that the cost of designation to MetLife was a "risk-related factor"—a conclusion without basis in the statute or common sense. The factors set out in the statute guide the Council's evaluation of whether material financial distress at a company could have a destabilizing effect on the U.S. financial system. Congress allowed the Council to take similar risk-related factors into consideration as it deems appropriate. It did not direct the Council to second-guess Congress's determination that supervision and regulation are warranted when a company's distress could threaten financial stability.

In sum, the Council properly exercised its expert judgment in faithfully applying the governing statute and its own interpretive guidance. The designation of MetLife should be upheld.

STATEMENT OF JURISDICTION

MetLife, Inc. invoked the jurisdiction of the district court pursuant to 28 U.S.C. § 1331. The district court entered judgment on March 30, 2016. Order [JA 812]. The

government filed a timely notice of appeal on April 8, 2016. Notice of Appeal [JA 814]. This Court has jurisdiction pursuant to 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES

1. Whether the Council conducted its analysis consistent with its interpretive guidance in determining that material financial distress at MetLife could pose a threat to the financial stability of the United States.

2. Whether the Council was required to consider the potential cost to MetLife of being designated for Federal Reserve supervision and enhanced prudential standards.

PERTINENT STATUTES AND REGULATIONS

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

STATEMENT OF THE CASE

A. Statutory Background

Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), in direct "response to the financial crisis that nearly crippled the U.S. economy beginning in 2008." S. Rep. No. 111-176, at 2 (2010). As the Senate Banking Committee report explained, during the 2008-2009 financial crisis, many "major market participants, such as AIG, were not subject to meaningful oversight by federal regulators." *Id.* at 43. Furthermore, "no financial regulator was responsible for assessing the impact the failure of a single firm might have on the state of the financial system." *Id.* Dodd-Frank was designed to

help close those regulatory gaps by, among other things, creating a better system for monitoring the risks that particular financial institutions could pose to the U.S. economy. *Id.*

To help achieve this objective, Congress provided that bank holding companies (*i.e.*, companies that own a bank) with more than $50 billion in assets would be subject to enhanced prudential standards established by the Federal Reserve's Board of Governors. *See* 12 U.S.C. § 5365.

Drawing on the lessons learned from the collapse of the insurance giant AIG during the 2008-2009 crisis, Congress also sought to strengthen oversight of certain "nonbank financial companies," defined as companies that do not own a bank but are nevertheless "predominantly engaged in financial activities." 12 U.S.C. § 5311(a). Rather than establishing a simple quantitative threshold for identifying these companies, as it had for bank holding companies, Congress authorized federal regulators to exercise their expert judgment in determining whether a nonbank financial company should be subject to supervision by the Federal Reserve and enhanced prudential standards.

Congress vested responsibility for designating these nonbank financial companies in a newly created Financial Stability Oversight Council. 12 U.S.C. §§ 5321, 5322(a)(1)(A); *see also* S. Rep. No. 111-176, at 2 (recognizing that designating nonbank financial companies is one of the main purposes of the Council).

In determining whether nonbank financial companies should be supervised by the Federal Reserve and subject to enhanced prudential standards, the Council brings to bear the expertise of the Secretary of the Treasury, who serves as its chair, and the leaders of eight other federal financial regulatory agencies.[1] The Council may designate a company if it "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." 12 U.S.C. § 5323(a)(1). Designation requires a two-thirds vote of the Council's voting members then serving, including the affirmative vote of the Secretary of the Treasury. *Id.*

The statute sets out ten factors that the Council "shall consider" in determining whether a company should be designated:

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

[1] The other voting members of the Council represent the Federal Reserve Board, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, the Commodity Futures Trading Commission, the Federal Housing Finance Agency, and the National Credit Union Administration Board. In addition to the nine agency heads, the Council includes a tenth voting member with insurance expertise appointed by the President. 12 U.S.C. § 5321(b)(1). The Council also includes five nonvoting members. *Id.* § 5321(b)(2).

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

12 U.S.C. § 5323(a)(2). Congress also directed the Council to consider "any other risk-related factors that [it] deems appropriate." *Id.* § 5323(a)(2)(K).

Before designating a nonbank financial company, the Council is required to notify the company that it is under review, provide the company with a written notice and explanation of its "proposed determination," and give the company an opportunity for a hearing. 12 U.S.C. § 5323(e).

B. The Council's Interpretive Guidance

After three rounds of notice and comment, the Council promulgated regulations that govern its process for designating nonbank financial companies. *See* 12 C.F.R. § 1310. The regulations contain an appendix, which was also the subject of notice and comment, that provides "Financial Stability Oversight Council Guidance For Nonbank Financial Company Determinations." 12 C.F.R. pt. 1310, App. A.

This interpretive guidance "simply describes the Council's interpretation of the statutory factors and provides transparency to the public as to how the Council intend[ed] to exercise its statutory grant of discretionary authority." Final Rule and Interpretive Guidance, 77 Fed. Reg. 21,637, 21,647 (Apr. 11, 2012). The Council emphasized that its guidance did not supersede or alter the statutory inquiry: the "ultimate assessment of whether a nonbank financial company meets a statutory standard for determination will be based on an evaluation of each of the statutory considerations, taking into account facts and circumstances relevant to each nonbank financial company." *Id.* at 21,639. The Council also made clear that the guidance "does not impose duties on, or alter the rights or interests of, any company." *Id.* at 21,647. Instead, the guidance was designed merely to "explain and interpret the statutory factors that the Council will consider in the Determination Process." *Id.*

The Council noted that the statute authorized it to designate a company if it determined that "material financial distress" at the company could pose a threat to U.S. financial stability. *See* 12 U.S.C. § 5323(a)(1). The Council explained that under

this "First Determination Standard," it "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." 12 C.F.R. pt. 1310, App. A, § II(b). The Council applied this First Determination Standard in its analysis of MetLife.[2]

The interpretive guidance noted that the Council would consider the ten factors set out by the statute to guide its determination, and it grouped those factors into six categories. These categories were designed to "assist the Council in assessing the extent to which the transmission of material financial distress is likely to occur." 12 C.F.R. pt. 1310, App. A, § III(c). Three 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." *Id.* § II(d)(1). The Council observed that "[m]aterial financial distress at nonbank financial companies

[2] Under the statute's Second Determination Standard, designation would also be appropriate if the Council determined 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. 12 U.S.C. § 5323(a). The interpretive guidance made clear that this second standard can be met if a company would pose a threat even without experiencing financial distress. 12 C.F.R. § 1310, App. A, § II(c). It further stated that the Council "expect[ed] 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 many firms that would satisfy the second standard could also pose a threat if they were to experience material financial distress and would therefore also satisfy the first standard. *Id.*

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." *Id.*

The guidance noted that "[t]he 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." 12 C.F.R. pt. 1310, App. A, § II(d)(1). The Council explained that high leverage "increas[es] a company's exposure relative to capital," and thus "raises the likelihood that a company will suffer losses exceeding its capital." *Id.* § II(d)(2). High leverage also "raises a company's dependence on its creditors' willingness and ability to fund its balance sheet" and can "increas[e] the size of any asset liquidation that the company is forced to undertake as it comes under financial pressure." *Id.* "Liquidity risk generally refers to the risk that a company may not have sufficient funding to satisfy its short-term needs," and the related concept of "maturity mismatch" refers to the possibility that a company's liabilities will come due before its assets mature, which could force the company to sell assets at below-market prices. *Id.*

The Council emphasized that its decisions would "not be based on a formulaic application of the six categories," but that it would, instead, "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." 12 C.F.R. pt. 1310, App. A, § II(d)(1).

To further clarify the Council's analytic approach, the guidance described three "channels" that were "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." 12 C.F.R. pt. 1310, App. A, § II(a). The first, known as the "exposure channel," relates to the degree to which the "company's creditors, counterparties, investors, or other market participants have exposure to the nonbank financial company." *Id.* The second, known as the "asset liquidation channel," relates to whether the "company holds assets that, if liquidated quickly," could "significantly disrupt trading or funding in key markets." *Id.* The final channel, not at issue here, relates to a nonbank financial company's inability or unwillingness "to provide a critical function or service that is relied upon by market participants and for which there are no ready substitutes." *Id.*

In 2013, consistent with this interpretive guidance, the Council designated three nonbank companies: Prudential, AIG, and GE Capital. Summaries of the Council's analyses were made available to the public. *See generally* Basis for the Financial Stability Oversight Council's Final Determination Regarding Prudential Financial, Inc. (Sept.

19, 2013) ("Final Determination Regarding Prudential")[3]; Basis of the Financial Stability Oversight Council's Final Determination Regarding General Electric Capital Corporation, Inc. (July 8, 2013) ("Final Determination Regarding GE Capital")[4]; Basis of the Financial Stability Oversight Council's Final Determination Regarding American International Group, Inc. (July 8, 2013) ("Final Determination Regarding AIG").[5]

C. MetLife's Designation

1. MetLife is the largest publicly traded insurance company in the country, and one of the largest financial services companies of any kind, with over $900 billion in total consolidated assets. Final Determination 43 [JA 405]; Public Statement of Basis 7 [JA 710].[6] The company controls ten percent of the admitted assets of the entire U.S. life insurance industry, with a market share of 16.6 percent. Final Determination

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[3] https://www.treasury.gov/initiatives/fsoc/designations/Documents/Prudential%20Financial%20Inc.pdf

[4] https://www.treasury.gov/initiatives/fsoc/designations/Documents/Basis%20of%20Final%20Determination%20Regarding%20General%20Electric%20Capital%20Corporation,%20Inc.pdf

[5] https://www.treasury.gov/initiatives/fsoc/designations/Documents/Basis%20of%20Final%20Determination%20Regarding%20American%20International%20Group,%20Inc.pdf

[6] The Council's Final Determination regarding MetLife contains certain proprietary information that was filed under seal in the district court. A public version of the Final Determination, with redactions of all sealed material, is included in Volume 2 of the Joint Appendix. A sealed version of the Final Determination, without redactions, is included in Volume 4 of the Joint Appendix, with the same pagination as the public version. This brief contains only public information.

136-37 [JA 498-99]. Until 2013, MetLife also owned a bank—and was therefore subject to enhanced Federal Reserve supervision as a bank holding company. *See* Final Determination 20 [JA 382]; 12 U.S.C. § 5365(a). After it sold its bank subsidiary, however, it was no longer subject to oversight by federal regulators.

Shortly after MetLife deregistered as a bank holding company, the Council commenced an extensive analysis of the company to determine whether it should be subject to heightened oversight under Dodd-Frank. Based on that analysis, which lasted seventeen months and included frequent communications with senior MetLife officials, the Council concluded that material financial distress at MetLife could pose a threat to U.S. financial stability. The Council set forth the basis for its decision in its 341-page Final Determination, which focused on the potential for MetLife's material financial distress to be transmitted to other firms and markets, primarily via the exposure and asset liquidation channels identified in the interpretive guidance.

The Council highlighted MetLife's institutional products and capital market activities—including its funding agreements, securities-lending program, and guaranteed investment contracts—that could, during a period of unforeseen financial turmoil, cause the company's material financial distress to threaten U.S. financial stability. Final Determination 48-61 [JA 410-23]. During such a period, the Council explained, MetLife could find itself unable to satisfy its obligations arising from these activities, thereby exposing its investors and counterparties to significant losses. *Id.* The fact that a significant number of MetLife's counterparties "are other large

financial institutions that are interconnected with one another and the rest of the financial sector" increases the risk that MetLife's material financial distress could destabilize the financial system. *See id.* at 78 [JA 440]. In addition, losses by money market funds that hold MetLife's securities could trigger "a broader run on [money market funds] . . . , such as that which occurred in September 2008 after the collapse of Lehman Brothers." *Id.* at 110 [JA 472]. The company's distress could also expose some of its 90 million insurance policyholders and contract holders to significant losses. *Id.* at 76 [JA 438].

The Council also found that MetLife's distress created a risk that the company could be forced to sell its assets at fire-sale prices, which could disrupt key financial markets. The Council found that MetLife offers a number of financial products that allow its customers and counterparties to demand cash or other assets from MetLife, and that in the event of its distress, MetLife could be forced to rapidly liquidate assets to satisfy these obligations. Final Determination 144 [JA 506]. The Council assessed the markets for the types of assets MetLife could be forced to sell in the event of sudden liquidity demands, including government securities, corporate debt securities, mutual funds and equity securities, asset-backed securities, mortgage-backed securities, and real estate. *See id.* at 142-48, 329-40 [JA 504-10, 691-702]. The Council determined that some of those markets could face significant disruptions in the event that a distressed MetLife were forced to sell assets, given the company's large holdings of less-liquid assets. *See id.* at 147 [JA 509].

The Council explained that regulation of MetLife's insurance subsidiaries by state insurance regulators—who generally focus on protecting the policyholders of specific entities within their jurisdictions, rather than the stability of the financial system as a whole—was insufficient to address all of the risks posed by MetLife. *See* Final Determination 240-46 [JA 602-08]. The efficacy of state regulation is further undermined by MetLife's use of "captive reinsurance," transactions that move risk between the company's various subsidiaries while the parent company continues to bear the ultimate economic risk. *Id.* at 61 [JA 423]. These arrangements "reduce the transparency of the organization's potential risks" and also lower the amount of capital that state regulators require MetLife to keep on hand. *Id.* at 63 [JA 425].

The Council engaged extensively with MetLife before issuing its Final Determination. Its member agencies and staff reviewed over 21,000 pages of materials submitted by MetLife and met with company representatives on at least a dozen occasions. Final Determination 3 [JA 365]. The Council also provided MetLife with an extensive, 270-page proposed determination, after which it gave MetLife an opportunity to make an oral presentation to the full Council. *Id.* In addition, the staff representing the Council met five times with two state insurance regulatory authorities with jurisdiction over certain of MetLife's insurance subsidiaries. *Id.*

After this extensive process, the Council voted 9 to 1 to designate MetLife and issued its Final Determination in December 2014. Final Determination 3 [JA 365].

The Council's independent member dissented from the Council's determination. Final Determination 298 [JA 660]. While "shar[ing] concerns about some of MetLife's activities," that member disagreed with some of the Council's findings about the likely effects of material financial distress, and the ability of existing state regulators to respond to MetLife's distress. *Id.* at 299 [JA 661]. The dissenting opinion suggested that the Council should have considered the other statutory standard for designation: whether 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, regardless of whether the company were experiencing material financial distress." *Id.* (emphasis omitted). A nonvoting member of the Council, the State Insurance Commissioner Representative, expressed "serious concerns" with the designation, primarily based on the Council's purported "fail[ure] to appropriately consider the efficacy of the state insurance regulatory system." *Id.* at 304 [JA 666]. The Director of the Federal Insurance Office, another nonvoting member of the Council, did not express concerns with the designation.

2. The Council also explained why it had rejected several of MetLife's additional arguments, including two arguments that were subsequently addressed by the district court.

First, the Council concluded that MetLife was mistaken in asserting that the Council was compelled to consider "potential costs to the company that could result

from a Council determination." Final Determination 29 [JA 391]. The Council noted that "[a]s stated in the preamble to the Final Rule and the Interpretive Guidance, the relative cost and benefit of a Council determination is not one of the statutory considerations" established by Congress. *Id.* (citing 77 Fed. Reg. at 21,640).

The Council also rejected MetLife's contention that the company was not "predominantly engaged in financial activities," as the statute defines that term, and was therefore ineligible for designation. 12 U.S.C. § 5311(a)(4)(B). In particular, the Council declined to adopt MetLife's position that its insurance activities outside the United States should not be considered financial activities. Final Determination 39 [JA 401].

D. District Court Proceedings

On cross-motions for summary judgment, the district court rejected MetLife's threshold assertion that the company was not eligible for designation on the theory that it was not "predominantly engaged in financial activities." 12 U.S.C. § 5311(a)(4)(B); *see* Op. 16-18 [JA 794-96]. The court concluded, however, that it would set aside the determination of the nation's financial regulators. The court held that the Council had acted inconsistently with its guidance in two respects, and that the Council's action was therefore arbitrary and capricious. The court also concluded that the Council had impermissibly declined to consider potential costs to MetLife of designation.

In discussing the two purported departures from the guidance, the district court did not suggest that the Council had failed to apply the terms of the statute or any implementing regulations. The cited errors consisted entirely of the failure (as perceived by the district court) to adhere to the Council's interpretive guidance.

First, the court accepted MetLife's contention "that [the Council] violated its own Guidance by failing to assess MetLife's vulnerability to material financial distress before addressing the potential effect of that distress." Op. 19 [JA 797]. As noted above, and as discussed in more detail below, *see infra* Part I.B, the Council carefully analyzed the ten statutory factors that it was required to consider in evaluating the effects that material financial distress at MetLife could have on the broader financial system. The court concluded, however, that the Council's guidance contemplated a different analysis and required that the Council analyze "the likelihood of material financial distress at a target company." Op. 23 [JA 801] (quotation marks and alteration omitted). The court rejected what it viewed as the Council's effort "to distinguish between assessing vulnerability to distress and evaluating likelihood of distress," describing it as a "facile distinction." *Id.* at 22-23 [JA 800-01]. The court believed that such a distinction was at odds with the language of the interpretive guidance, which states that "'[n]onbank 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.'" *Id.* at 23 [JA 801] (quoting 12 C.F.R. pt. 1310, App. A, § II(d)(1)) (district court's emphasis).

Second, the court held that the Council had deviated from the guidance's statement that a nonbank financial company could threaten financial stability "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). Although the Council discussed at length the ways in which distress at MetLife could affect its counterparties and the risks those exposures posed to the broader economy, the court believed that the guidance contemplated a different approach. The court stated that the Council "never projected *what* the losses would be, *which* financial institutions would have to actively manage their balance sheets, or *how* the market would destabilize as a result." Op. 25-26 [JA 803-04] (district court's emphasis). The court stated, in particular, that the Council had failed to adequately account for the fact that companies would attempt to mitigate their losses if MetLife suffered from financial distress, and instead relied on the total amount of exposure that other companies had to MetLife. *Id.* at 27 [JA 805].

In addition to the two asserted departures from the Council's interpretive guidance, the district court held that the Council had improperly failed to consider the costs to MetLife resulting from the designation. The court relied heavily on *Michigan v. Environmental Protection Agency*, 135 S. Ct. 2699 (2015), which held that the Environmental Protection Agency could not exercise its authority to regulate power plants without considering the costs to the power plants of regulation under a statute

that conditioned the agency's exercise of regulatory authority on a determination that "regulation is appropriate and necessary." The district court recognized that Dodd-Frank (unlike the statute at issue in *Michigan*) specified ten factors to guide the agency's determination and that other considerations are limited to "any other risk-related factors that the Council deems appropriate." 12 U.S.C. § 5323(a)(2)(K). The court reasoned, however, that the costs to MetLife were "risk-related" within the meaning of this provision because, in its view, the cost of additional regulation could make MetLife more likely to fail. Op. 31-32 [JA 809-10]. The court thus concluded that the cost of regulation to MetLife was a risk-related factor that the Council should have appropriately considered.

Because the district court concluded that the Council had impermissibly departed from its interpretive guidance and failed to adequately consider the costs of its decision to MetLife, the court did not reach MetLife's other claims challenging the designation.

SUMMARY OF ARGUMENT

After an exhaustive analysis, the Council concluded that material financial distress at MetLife "could pose a threat to the financial stability of the United States." *See* 12 U.S.C. § 5323(a)(1). The district court did not hold that the collective expert judgment of the nation's federal financial regulators was mistaken. It nevertheless set aside the designation on the ground that the Council had misunderstood its own interpretive guidance. The court read into the guidance an obligation to assess the

likelihood that MetLife would experience financial distress and a requirement to identify with precision the impact that distress would have on the broader financial system during a hypothetical future crisis. The court did not hold that the statute required the kind of analysis that it envisioned, and it had no grounds for inferring such a requirement from the interpretive guidance, which, as the Council stressed, established no additional requirements but merely outlined the manner in which the Council intended to apply the ten statutory considerations.

The court similarly erred in holding that the Council was required to consider the potential costs of regulation to MetLife. The statute here bears no resemblance to the statute at issue in *Michigan v. EPA*, 135 S. Ct. 2699 (2015), on which the district court relied. Dodd-Frank sets out ten specific factors to guide the Council's determination and, at the conclusion of that list, instructs the Council to consider "any other risk-related factors that the Council deems appropriate." 12 U.S.C. § 5323(a)(2)(K). The Council expressly declined to consider potential costs to designated companies. The statute's focus on risk to the nation's financial stability rather than on costs to large financial companies, and its use of language that "fairly exudes deference," *Webster v. Doe*, 486 U.S. 592, 600 (1988), preclude the district court's imposition of its own, very different, interpretation.

STANDARD OF REVIEW

This Court reviews "the district court's grant of summary judgment *de novo*." *Anna Jacques Hosp. v. Burwell*, 797 F.3d 1155, 1163 (D.C. Cir. 2015). Like the district

court, this Court's review "shall be limited to whether the final determination . . . was arbitrary and capricious." 12 U.S.C. § 5323(h). Such review is particularly deferential where, as here, the agency's decision involves highly technical analysis. *See Marsh v. Oregon Nat. Res. Council*, 490 U.S. 360, 377 (1989). The agency's construction of the statute it is charged with administering, and its interpretation of its own administrative materials, are entitled to deference. *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-44 (1984); *Auer v. Robbins*, 519 U.S. 452, 461 (1997).

ARGUMENT

I. The Council Conducted Its Analysis in the Manner Contemplated by the Statute and the Council's Interpretive Guidance.

A. Neither the statute nor the interpretive guidance requires the Council to determine the likelihood that a particular company will be subject to distress or to estimate specific counterparty losses.

1. The statute takes account of the inherent uncertainty of financial crises.

Section 113 of the Dodd-Frank Act instructs the Financial Stability Oversight Council to identify nonbank financial companies that could threaten the nation's financial stability. As relevant here, Congress directed that a nonbank financial company should be subject to Federal Reserve supervision and enhanced prudential standards "if the Council determines that material financial distress at the U.S. nonbank financial company . . . could pose a threat to the financial stability of the United States." 12 U.S.C. § 5323(a)(1). The statute lists ten considerations that the

Council must take into account in making a determination, and also grants it broad discretion to consider "any other risk-related factors that the Council deems appropriate." *Id.* § 5323(a)(2)(K).

The statutory standard for designations instructs the Council to assess the effects of material financial distress at the company on the U.S. financial system. Nothing in the statutory standard or in the list of required considerations contemplates an assessment of the likelihood of a company's financial distress or a prediction of the specific losses that such distress would impose on counterparties during an unforeseeable financial crisis of unknown magnitude. Indeed, the statute directs the Council to assume a company's material financial distress and to assess the risks that the company might pose to the financial system as a result. *See* 12 U.S.C. § 5322(a)(2)(H) (directing the Council to "require supervision by the [Federal Reserve] for nonbank companies that may pose risks to the financial stability of the United States *in the event of their material financial distress or failure*" (emphasis added)).

Congress was well aware of the difficulties of trying to predict whether and exactly how a specific company might fail and what the specific consequences of that failure would be. In the hearings leading up to Dodd-Frank's passage, several financial regulators testified about the need for greater oversight of nonbank financial companies whose failure, even if highly unlikely and unexpected, could threaten the national economy. Vice Chairman of the Federal Reserve Donald Kohn explained, for example, how AIG's collapse in 2008 stemmed from the company's failure to

"protect [itself] against a very unlikely event"—namely, "a massive weakening in the housing market and the economy." *American International Group: Examining What Went Wrong, Government Intervention, and Implications for Future Regulation: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 111th Cong. 18 (Mar. 5, 2009).[7] Federal Reserve Chairman Ben Bernanke likewise testified about the difficulties of determining "whether [a] firm's failure would likely have systemic effects during a *future* stress event, the precise parameters of which cannot be fully known." *Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Proposals, Part II: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 77 (July 24, 2009) (prepared statement of Chairman Bernanke) (emphasis in original). Indeed, at an earlier hearing, Chairman Bernanke specifically pointed to AIG's collapse to illustrate the futility of attempting to predict exactly how a financial crisis will unfold. *See Oversight of the Federal Government's Intervention at American International Group: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 11 (Mar. 24, 2009) (statement of Chairman Bernanke).[8]

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[7] *See also AIG: Examining What Went Wrong*, 111th Cong. 18-19 (statement of Donald Kohn) ("[AIG] was part of a systemically important financial institution, the largest insurance company in the United States, one of the largest in the world, and no one was minding the whole company and looking at how things interacted and whether the whole company would under some circumstances put the financial system at risk.").

[8] Other prominent government officials offered similar testimony. *See, e.g.*, *Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and of*

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Thus, although the Council's analysis was based on extensive qualitative and quantitative analyses, the Council recognized that "financial crises can be hard to predict and can have far-reaching and unanticipated consequences." Final Determination 29 [JA 391]. MetLife contended that the Council erred when it sought to assess "events that 'could' occur 'rather than ask whether financial distress and systemic effects are likely,'" but the Council properly concluded that its "approach is consistent with the statutory standard." *Id.* at 9 [JA 371]. The statute directs the Council to determine whether a company's material financial distress "could pose a threat," 12 U.S.C. § 5323(a)(1), and does not contemplate that the Council will forecast the collapse of the next financial bubble and predict the specific effects it will have on particular companies.

2. The Council's interpretive guidance did not commit the Council to assessing the likelihood of a company's distress or the specific losses that would be incurred by market participants.

The Council's interpretive guidance followed the statute and took account of the lessons from the financial crisis. The guidance did not suggest that the Council

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Government Lending and Insurance Facilities' Impact on the Economy and Credit Availability: Hearing Before the H. Comm. on Fin. Servs., 110th Cong. 192 (Nov. 18, 2008) (prepared statement of Secretary Paulson) ("If we have learned anything throughout this year we have learned that this financial crisis is unpredictable and difficult to counteract."); *The Financial Crisis and the Role of Federal Regulators: Hearing Before the H. Comm. on Oversight and Gov't Reform*, 110th Cong. 83 (Oct. 23, 2008) (statement of Alan Greenspan, former Chairman, Federal Reserve) ("[A] financial crisis must of necessity be unanticipated, because if it is anticipated, it will be arbitraged away.").

would seek to assess the likelihood that a company would experience distress, or that the Council would estimate the specific amounts of losses that the company's distress would impose on its direct counterparties or on the many known and unknown market participants that could be harmed by the firm's distress. Rather, the Council stated that its responsibility was to apply the statutory standard and "consider each of the statutory considerations." 12 C.F.R. pt. 1310, App. A, § II(d).

In order to "organize its evaluation of a nonbank financial company under the statutory considerations," the interpretive guidance grouped the ten statutory factors into six categories. 12 C.F.R. pt. 1310, App. A, § II(d). The Council emphasized that the categories and groupings were intended to "assist the Council in assessing the extent to which the transmission of material financial distress is likely to occur." *Id.* § III(c). And the Council stressed that its decisions would "not be based on a formulaic application of the six categories," but that the Council would, instead, "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." *Id.* § II(d)(2).

The guidance notes that the categories of size, substitutability, and interconnectedness "seek to assess the potential impact of the nonbank financial company's financial distress on the broader economy," while the categories regarding 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.* § II(d)(1). The guidance recognized that these two groups are interrelated. For example, high leverage is relevant to assessing a company's vulnerability in the event of distress because it "raises a company's dependence on its creditors' willingness and ability to fund its balance sheet." *Id.* § II(d)(1). A highly leveraged company that finds itself in distress may be forced to liquidate its assets in response to a loss of funding. By the same token, high leverage "can also amplify the impact of a company's distress on other companies" both by increasing the amount of exposures that other companies have and by increasing the size of any asset liquidation the troubled company could be forced to undertake. *Id.*

The district court mistakenly suggested that, by using the term "vulnerability" in characterizing one of the groups of statutory factors, the Council committed itself to conducting a separate assessment of the likelihood of distress at MetLife. Op. 22 [JA 800]. While the Council's guidance identified specific issues that it intended to address in considering the statutory factors, it never stated that it would perform a separate analysis of the type envisioned by the district court. *Cf.* 12 C.F.R. pt. 1310, App. A, § II(a) (analysis "will incorporate a review of the competitive landscape for markets in which a nonbank financial company participates"); *id.* § II(d)(2) (analysis "will include assessments of the ability of . . . competitors to expand to meet market needs"); *id.* § III(c) ("analysis will also include an evaluation of a nonbank financial company's resolvability").

The district court also misunderstood the relevance of the three categories that seek to assess a company's vulnerability to distress. These categories shed light on the effects that distress could have on the company, and on how the company may respond in the event of material financial distress. Because the company's responses may affect other market participants, analysis of those characteristics is relevant to the ultimate statutory question of whether material distress at the company could pose a threat to financial stability.

The distinction "between assessing vulnerability to distress and evaluating likelihood of distress" is not, as the district court declared, "facile." Op. 22-23 [JA 800-01]. As discussed above, Dodd-Frank was enacted in response to the 2008-2009 financial meltdown, in which large, complex, and respected companies faced sudden, unpredicted financial distress. The provisions at issue here were designed to protect the public from a future financial crisis, whose timing, nature, and severity also cannot be predicted. The statute accordingly sets out risk-related considerations to guide the Council's assessment of particular companies, and those considerations were the basis for the interpretive guidance. Neither the statute nor the guidance contemplates an assessment of the "likelihood" of financial distress.[9]

[9] The district court also stated that it would treat the guidance as formal rulemaking merely because the Council had "engaged in notice-and-comment procedures." Op. 8 n.6 [JA 786 n.6]. The preamble to the guidance specifically notes that the guidance was issued under the Council's "inherent authority to promulgate

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B. The Council's analysis of MetLife was consistent with the statute and the Council's interpretive guidance.

1. The Council analyzed each of the three categories described in the interpretive guidance that seek to assess vulnerability.

The Council's guidance identified three analytic categories that seek to assess a company's vulnerability to distress: leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny. The guidance stated that the Council intended to consider those three categories. It is uncontested that in evaluating MetLife, the Council examined each of those three categories in detail, as described below.

a. Liquidity Risk and Maturity Mismatch

The category of liquidity risk and maturity mismatch relates to the statutory requirement that the Council consider "[t]he amount and types of the liabilities of the company, including the degree of reliance on short-term funding." 12 C.F.R. pt. 1310, App. A, § II(d)(1) (quoting 12 U.S.C. § 5323(a)(2)(J)).

In its analysis, the Council discussed whether, in the event of MetLife's distress, the company could be forced to sell securities or other assets in a manner that could disrupt key markets or cause losses to other firms by driving down the market prices of similar assets held by those firms. The Council found that MetLife offers a number of financial products that allow its customers and counterparties to withdraw

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interpretive rules and interpretive guidance," and "does not impose duties on, or alter the rights or interests of, any company." 77 Fed. Reg. at 21,647.

their cash or other assets from MetLife, and that in the event of material financial distress, MetLife could be forced to liquidate assets to satisfy these obligations. Final Determination 144 [JA 506]. This is a liquidity risk.

The Council identified two significant sources of liquidity risk that could lead to rapid forced asset liquidations by MetLife. Final Determination 143 [JA 505]. First, MetLife engages in an array of complex financial transactions with institutional counterparties. Many of these transactions are short-term arrangements that are regularly renewed (or "rolled over"). If MetLife experienced distress, the company's institutional counterparties could seek to reduce their exposures to MetLife by refusing to roll over those transactions, instead terminating their relationship with MetLife and depriving MetLife of access to short-term funding that the company extensively uses. *Id.* Second, the company sells a significant amount of retail insurance and annuity products that the holders can surrender or withdraw for cash, which means that these products can become, in effect, short-term liabilities. *Id.* Demands for liquid assets could "occur[] simultaneously or in rapid succession" either if MetLife's counterparties had "a rapid loss of confidence in MetLife," or if it became known that one MetLife counterparty had taken actions to reduce its exposure to MetLife and other counterparties or policyholders "decide[d] to take similar protective actions." *Id.* at 144 [JA 506].

As explained below, the Council examined in detail how MetLife's specific products create substantial liquidity risk and maturity mismatch.

Securities lending. In MetLife's $30 billion securities-lending program, the company essentially borrows cash from a counterparty using securities as collateral, and then uses the borrowed cash to purchase riskier investments that have longer maturities. Final Determination 143 [JA 505]. If MetLife's counterparties elect to "close out their transactions by returning the borrowed securities to MetLife in order to recoup the cash collateral," MetLife could be forced "to rapidly sell a substantial volume of relatively illiquid assets at discount prices." *Id.* Further, MetLife may not be able to sell some of its liquid assets to repay securities loans, because a substantial portion of MetLife's assets "support multiple purposes." *Id.* at 146 [JA 508]. For example, the company sometimes lends out a U.S. Treasury security, but still uses that security to support capital and reserve requirements. *Id.* at 146 n.708 [JA 508 n.708]. MetLife may be unable to use securities that are being used to support capital and reserve requirements to satisfy its other obligations.

Funding agreements. MetLife's over $30 billion of funding agreement-related obligations also contribute significantly to its liquidity risk and maturity mismatch. Funding agreements are essentially a form of debt issued by an insurance company, and MetLife uses the proceeds to buy various investments. *See* Final Determination 49-52 [JA 411-14]. Although the company can typically pay off its debt as it comes due by issuing more debt, the Council found that MetLife's ability to keep issuing debt could be impaired in the event of the company's distress. The Council explained that because some of MetLife's obligations are short-term, "MetLife is exposed to

liquidity risk in the event that its investors determine not to renew their investment." Final Determination 52 [JA 414]. Moreover, in many cases MetLife's counterparties would not need to wait until the debt matures, because some of the company's agreements allow counterparties to require MetLife to pay the principal amount on demand or in the event that MetLife's credit ratings are downgraded. *See id.* The Council determined that "[t]he rollover risk and demand provisions associated with these products create liquidity risk for MetLife." *Id.*

Guaranteed investment contracts. Guaranteed investment contracts, of which MetLife had almost $50 billion outstanding, generally are contracts in which an insurance company receives money from clients that the insurer typically repays with a guaranteed amount of interest. *See* Final Determination 57-58 [JA 419-20]. The client generally has the right to withdraw those investments at any time. The Council found that, in a distress situation at MetLife, the holders could withdraw their investments, forcing the company to sell assets to meet this sudden, increased demand for liquidity. *Id.* at 59-60 [JA 421-22].

Insurance and annuity products. Even in its "traditional" insurance business, more than half of MetLife's $275 billion of liabilities in its general account can be surrendered by policyholders for cash, including $50 billion that can be withdrawn with little or no penalty. Final Determination 143 [JA 505]. Further, as an alternative to surrendering their policies, MetLife's policyholders can take out policy loans from the company against an aggregate liability amount of $116 billion. *Id.* at 143-44

[JA 505-06]. The scale of these potential liquidity demands, in the event of MetLife's distress, contributes meaningfully to the company's liquidity risk. *Id.* at 143 [JA 505].

b. Leverage

The category of leverage relates to the statutory requirement that the Council consider "[t]he extent of the leverage of the company." 12 C.F.R. pt. 1310, App. A, § II(d)(1) (quoting 12 U.S.C. § 5323(a)(2)(A)). Leverage generally refers to the ratio between the company's indebtedness and its total equity.

Firms with limited leverage are better able to satisfy their obligations in the event of distress, because the extent of their obligations is smaller relative to their resources. Conversely, "[f]irms with more leverage that become distressed will deplete their capital more quickly and thus be forced to sell more assets, or stop writing new policies, in order to lower their leverage." Final Determination 192 [JA 554].

Based on a number of different metrics, the Council found that MetLife had more debt and more leverage than nearly any other large U.S. life insurance company. Final Determination 192 [JA 554]. Certain forms of "operating debt," such as funding agreements and securities lending, are not captured by traditional measures of financial leverage but have a similar effect on a company's ability to satisfy its obligations in the event of financial distress. *See id.* at 196 [JA 558]. MetLife's $85 billion of operating debt resulted in its operating leverage being the second-highest among its peers. *Id.* The Council noted that while these obligations "may be

considered low risk during normal market conditions, the risks posed by these activities can be amplified during periods of financial stress." *Id.* The Council thus concluded that "MetLife's operating debt . . . could increase the risk that MetLife could have to liquidate assets at fire-sale prices." *Id.* at 197 [JA 559].

Combining these measures, the Council noted that MetLife's "total leverage ratio . . . is higher than all but one of its peers." Final Determination 198 [JA 560]. The Council concluded that MetLife's "high leverage could amplify the scale and accelerate the pace of asset liquidation by MetLife if it were forced to liquidate assets to meet increased liquidity demands," *id.*, and that "[a] forced liquidation could be made more likely because of, and exacerbated by, the scale and composition of MetLife's leverage," *id.* at 146 [JA 508].

c. Existing Regulatory Scrutiny

The Council carefully considered the existing regulatory scrutiny of MetLife, which in the United States consists primarily of state regulation of the company's insurance subsidiaries. *See* 12 U.S.C. § 5323(a)(2)(H) (requiring Council to consider "the degree to which the company is already regulated by 1 or more primary financial regulatory agencies"). The Council concluded that while existing state regulation of MetLife may mitigate some potential risks to financial stability, it did not address many others. Final Determination 237-46 [JA 599-608]. In fact, in testimony before the Council, MetLife conceded that state regulators do not "think it is their role to look at systemic risks across entire economies," Hearing Tr. 100 [JA 338], and that

"[t]he insurance regulatory system is not designed to serve the purposes that are set out in Dodd-Frank. That's for sure," *id.* at 116 [JA 354].

The Council found that "MetLife's diverse subsidiaries are subject to supervision by a number of U.S. and international regulators," but "MetLife is not currently supervised on a consolidated basis," Final Determination 20 [JA 382], and "there is no single interstate regulator with jurisdiction across state boundaries" or over the company's foreign affiliates, *id.* at 25 [JA 387]. Beyond these jurisdictional limitations, the Council identified limitations in the timeliness of company data available to state regulators, *id.* at 240-41 [JA 602-03], the extent of authority over MetLife's parent holding company and non-insurance subsidiaries, *id.* at 242 [JA 604], the procedures for potential regulatory interventions in the case of MetLife's distress, *id.* at 239 [JA 601], and the authorities of "supervisory colleges" at which regulators periodically convene to share information, *id.* at 242 [JA 604].

MetLife also takes advantage of the limitations of state regulatory supervision of individual subsidiaries by using "captive reinsurers," which are created to assume insurance risk while being permitted to hold lower-quality capital and lower reserves than MetLife's commercial insurance subsidiaries. Final Determination 242-44 [JA 604-06]. Instead of holding assets that they could sell to back their insurance liabilities, MetLife's captive reinsurers are often supported by financing arrangements, such as letters of credit issued by large financial institutions, to meet regulatory reserve requirements. *Id.* at 112 [JA 474]. The parent company guarantees these letters of

credit, and could therefore face liquidity risks arising from any need to satisfy obligations under the guarantees. *See id.* at 61, 117 [JA 423, 479]. The use of captive reinsurance subsidiaries enables MetLife to hold lower-quality capital and lower reserves and "creates a greater risk that MetLife could be required to engage in asset sales to satisfy an increase in demand for liquidity." *Id.* at 7 [JA 369].

2. The district court misconstrued the interpretive guidance and ignored the Council's exhaustive analysis of the statutory factors.

The district court did not question the accuracy of the Council's analysis or intimate that the Council had contravened the statute. It concluded, however, that the Council had departed from its interpretive guidance by not "evaluat[ing] the . . . likelihood of material financial distress" at MetLife. Op. 23 [JA 801] (alterations in original).

In reaching this conclusion, the district court appeared to rely primarily on a single statement in the guidance that

> 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.

Op. 22 [JA 800] (quoting 12 C.F.R. pt. 1310 App. A, § II(d)(1)) (district court's emphasis).

As discussed above, this passage plainly does not contemplate a determination of the "likelihood" of a company's distress. *See supra* Part I.A.2. Even if the guidance were ambiguous on this point, the Council's interpretation of its own guidance would be entitled to considerable deference. *See* Final Determination 27-29 [JA 389-91]. While "[i]t is true that 'an agency changing its course by rescinding a rule' or departing from precedent 'is obligated to supply a reasoned analysis for the change' . . . it is also true that [courts] must defer to an agency's reading of its own regulations unless that reading is 'plainly erroneous or inconsistent with the regulation[s],'" *Global Crossing Telecomms., Inc. v. FCC*, 259 F.3d 740, 746 (D.C. Cir. 2001) (quoting *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 42 (1983), and *Auer v. Robbins,* 519 U.S. 452, 461 (1997)). The district court invoked the first part of this precept but ignored the second part entirely.

The district court also disregarded the Council's public explanations of its three prior designations, each of which—like the MetLife designation—never suggested that the guidance requires an assessment of the likelihood of a company's distress. Instead, the Council observed in its designation of Prudential Financial that "[a]s history has shown, including in 2008, financial crises can be hard to predict and can have consequences that are both far-reaching and unanticipated." Final Determination Regarding Prudential Financial 6 (Sept. 19, 2013). *See generally* Final Determination Regarding GE Capital; Final Determination Regarding AIG. MetLife was aware of the Council's public explanations for the prior designations, and

expressly referenced them (as relevant to a different issue) in its submissions to the Council before its designation. *See* Final Determination 202 [JA 564].

The district court also noted the statement in the guidance that, in analyzing liquidity risk and maturity mismatch the Council "might consider '[a]sset-backed funding versus other funding, to determine a nonbank financial company's *susceptibility to distress* in particular credit markets.'" Op. 22 [JA 800] (citing 12 C.F.R. pt. 1310 App. A, § II(d)(2)) (district court's emphasis). This reference to "susceptibility to distress" does not suggest that the Council would evaluate the likelihood that a company will experience financial distress. Rather, it contemplates an analysis of the company's reliance on particular credit markets and how distress in those markets might affect the company. The Council undertook that inquiry with respect to MetLife. *See, e.g.*, Final Determination 153-54, 158 [JA 515-16, 520].

C. The Council appropriately assessed whether MetLife's material financial distress could pose a threat to U.S. financial stability.

1. The Council analyzed in detail the ways in which distress at MetLife could destabilize the financial system.

Consistent with the governing statute and its interpretive guidance, the Council extensively analyzed how MetLife's material financial distress could destabilize the U.S. financial system. The Council found that distress at MetLife could be transmitted to other firms and markets primarily through two of the three mechanisms identified in the guidance: the exposure transmission channel and the

asset liquidation channel. After reviewing the significant exposures of large, interconnected financial institutions and other market participants to MetLife, the Council concluded that

> [t]he exposure of institutional customers and individual policyholders to MetLife is significant enough that the negative effects of MetLife's material financial distress could be transmitted to other financial firms and markets . . . which could in turn cause an impairment of financial intermediation or financial market functioning that could be sufficiently severe to inflict significant damage on the broader economy.

Final Determination 85 [JA 447]. The Council also concluded that MetLife could be required to liquidate a significant amount of assets to satisfy its obligations, and that "[t]he resulting erosion of capital and potential de-leveraging by market participants could result in asset fire sales that could disrupt financial market functioning and that could ultimately damage the broader economy." *Id.* at 146 [JA 508]. The Council's analysis of these two transmission channels, described below, was entirely consistent with the statute and the guidance.

Exposure Transmission Channel

In its analysis of exposures to MetLife, the Council found that "[l]arge financial intermediaries and other companies have significant exposures to MetLife arising from its institutional products and activities," and that MetLife's inability to meet its obligations to these market participants could impair these companies in the event of MetLife's distress. Final Determination 75 [JA 437]. The Council relied heavily on

quantitative assessments to evaluate MetLife's financial products that created exposures among MetLife's creditors, counterparties, investors, and policyholders.

The Council estimated that capital market exposures to MetLife—just one of the many kinds of exposures considered by the Council—totaled $183 billion. Final Determination 78 [JA 440]. For an array of financial products sold by MetLife primarily to institutional counterparties, the Council evaluated the size of the exposures, the types of risks posed by the products, the nature of the specific counterparties, and numerous factors that could exacerbate or mitigate the risks posed.

For example, MetLife's largest institutional business product offering is guaranteed investment contracts. Final Determination 75 [JA 437]. These generally are contracts in which MetLife receives money from clients that it later repays with a guaranteed amount of interest. MetLife had almost $50 billion of guaranteed investment contracts outstanding as of June 2013. *Id.* Although guaranteed investment contracts give rise to large potential liabilities, the requirements for MetLife to hold assets in reserve to satisfy these obligations are "relatively modest." *Id.* at 87 [JA 449]. The Council also considered a history of defaults by insurers on guaranteed investment contract obligations. *Id.* at 196 n.941 [JA 558 n.941].

The Council also found that MetLife had approximately $30 billion in outstanding funding agreement backed securities, which are essentially a form of debt issued by an insurance company. Final Determination 49-52 [JA 411-14]. Much of

the risk from MetLife's funding agreements is held by large, interconnected financial institutions and investment funds, including money market funds, which are designed to maintain an asset value of one dollar per share. *Id.* at 79-80 [JA 441-42]. If the assets held by a money market fund deteriorate in value, the money market fund can "break the buck," meaning that its asset value falls below one dollar per share. "As witnessed during the 2007-2009 financial crisis, when one [money market fund] breaks the buck, a broader run on [money market funds] can be triggered, such as that which occurred in September 2008 after the collapse of Lehman Brothers." *Id.* at 110 [JA 472]. The Council concluded that if MetLife were to default on its funding agreements, up to sixty-five money market funds could "break the buck." *Id.* at 79 [JA 441]. Thus, the Council's determination explained how material financial distress at MetLife could give rise to the same kind of market disruptions that occurred during the 2008-2009 financial crisis.

Other sources of exposure from institutional products and capital markets activities examined in detail by the Council include MetLife's $30 billion securities-lending program, $19 billion of long-term debt, $3 billion of derivatives liabilities, $16 billion under unsecured credit and committed facilities, and $50 billion of outstanding equity securities. Final Determination 75-141 [JA 437-503]. In each case, the Council considered not only the amounts of the exposures, but the specific characteristics of the risks.

In addition to analyzing MetLife's extensive capital markets activities, the Council considered exposures arising from MetLife's retail insurance business. "MetLife has 90 million customers, including approximately 50 million U.S. customers," who could face losses in the event of MetLife's financial distress. Final Determination 76 [JA 438]. Beyond the risks borne by individual retail policyholders, the Council found that MetLife's financial distress could also destabilize the state-based guaranty associations designed to ensure the payment of insurance policies in the event of an insurer's failure. *Id.* at 94 [JA 456]. Because of MetLife's size and scope, the state guaranty associations "could have insufficient capacity to handle a resolution of one of MetLife's lead insurance underwriters," which could limit their ability to respond to the failure of other insurers during a period of broader financial distress. *Id.* at 77 [JA 439].

Moreover, because of MetLife's complex interactions with other parts of the financial system, MetLife's material financial distress could cause market participants to pull back from a range of firms and markets in order to reduce exposures, thereby increasing the potential for destabilization. Final Determination 136 [JA 498]. Preventing such a contagion effect was an animating force behind the government's decision to step in to prevent the disorderly failure of AIG. *Id.* at 85 [JA 447].

Based on these analyses, the Council concluded that "[t]he direct or indirect exposures of MetLife's creditors, counterparties, investors, policyholders, and other market participants to MetLife are significant enough that MetLife's material financial

distress could impair those entities or the financial markets in which they participate and thereby could pose a threat to U.S. financial stability." Final Determination 4 [JA 366] (footnote omitted).

Asset Liquidation Transmission Channel

The Council also concluded that, in the event of material financial distress, MetLife could face sudden liquidity strains and be forced to quickly liquidate assets at fire-sale prices. Final Determination 142-226 [JA 504-588]. Such a fire sale could impair financial intermediation or financial market functioning. *Id.* In its analysis, the Council observed that many of MetLife's financial products, as well as many of its insurance policies, allow counterparties and policyholders to withdraw tens of billions of dollars of cash from MetLife upon demand with little or no penalty. Final Determination 148-84 [JA 510-546]; *see supra* Part I.B.

The Council also assessed in considerable detail the types of assets MetLife could be forced to sell in the event of sudden liquidity demands, including hundreds of billions of dollars of equity holdings, government securities, mortgage-backed securities, and asset-backed securities. After analyzing the liquidity of the markets for the various assets held by MetLife, and quantitatively modeling the potential effects of MetLife's asset liquidations, the Council determined that a fire sale by MetLife could

lead to disruptions in key financial markets. Final Determination 142-226, 329-40 [JA 504-588, 691-702].[10]

2. The district court misconstrued the interpretive guidance and ignored the Council's exhaustive analysis of the factors bearing on the impact of distress at MetLife on the broader economy.

The district court did not question the Council's conclusion that material distress at MetLife could pose a threat to U.S. financial stability, and the record would leave no room for setting aside the Council's expert judgment. The court concluded, however, that the Council had failed to adhere to a statement in the guidance that a threat to U.S. financial stability would occur "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." Op. 24 [JA 802] (quoting 12 C.F.R. pt. 1310 App. A, § II(a)). As discussed above, however, the Council's analysis was designed precisely to determine whether that standard was satisfied.

The district court mistakenly read this general statement in the guidance as requiring the Council to predict the course of a hypothetical financial crisis in

[10] The Council also analyzed the "critical function or service transmission channel," through which a threat to stability could arise if MetLife could no longer provide a critical function or service that was relied on by market participants, although the Council ultimately concluded that transmission of distress through this channel was less likely than through the other channels. Final Determination 19-20 [JA 381-82].

considerable detail. The court acknowledged that the Council had assessed exposures to MetLife, but faulted the Council for failing to "project[ ] *what* the losses would be, *which* financial institutions would have to actively manage their balance sheets, or *how* the market would destabilize as a result." Op. 25-26 [JA 803-04].

The interpretive guidance contains no suggestion that the Council would predict the specific causes and effects of the next financial crisis, and the district court's reasoning takes little account of the complexity of the financial arrangements at issue, the size of MetLife, the number of parties with complex interactions with MetLife, and the inherent uncertainty in predicting the precise course of a hypothetical crisis. The Council correctly declined to focus exclusively on the expected net losses of MetLife's direct counterparties and properly considered a number of different measures of the effects that MetLife's distress could have on a range of firms and markets. As Federal Reserve Chairman Ben Bernanke explained in testimony describing the 2008-2009 financial crisis, "focusing on the direct effects of a default on AIG's counterparties understates the risks to the financial system as a whole. Once begun, a financial crisis can spread unpredictably." *Oversight of the Federal Government's Intervention at American International Group: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 11 (Mar. 24, 2009) (statement of Chairman Bernanke). As in its previous designations, the Council properly took into account the indirect as well as direct potential effects of MetLife's failure, such as spread of contagion. *See* Final

Determination Regarding Prudential 8; Final Determination Regarding GE Capital 6; Final Determination Regarding AIG 2-3.

The Council also undertook an extensive analysis of the direct effects of a MetLife failure that was more than "a summary of exposures and assets," Op. 26 [JA 804]. The Council analyzed in detail the exposures of individual counterparties, *see, e.g.*, Final Determination 83, 108 [JA 445, 470], factors that could mitigate the risks arising from those exposures, *see, e.g.*, *id.* at 96-97 [JA 458-59], and how market destabilization could result, *id.* at 85 [JA 447]. The Council also specifically analyzed the potential deleterious effects of a default by MetLife on each of its individual financial instruments. *See, e.g.*, *id.* at 80-81 [JA 442-43] (derivatives); *id.* at 81-82 [JA 443-44] (securities lending). The Council explained, step by step, how MetLife's distress could lead to disruptions in particular markets. *See, e.g.*, *id.* at 135-48, 188, 191, 226 [JA 497-510, 550, 553, 588].

The district court believed that the Council's purported departure from its guidance was epitomized by the Council's response to MetLife's contention that it should "reduce exposure estimates by an expected recovery rate." Op. 27 [JA 805]. A recovery rate is the amount of money that a counterparty would recover in the event that MetLife were unable to fully comply with its obligations. For example, if a counterparty took protective measures, such as liquidating collateral, it might avoid losing the entire amount of MetLife's obligation. But the Council did consider expected recovery rates with respect to certain exposures, as appropriate, *see, e.g.*, Final

Determination 92 [JA 454], and nothing in the interpretive guidance required it to go further and base its ultimate conclusions on loss estimates.

As the Council noted, moreover, historical precedents regarding recovery rates may have limited value because "[t]he largest U.S. insurance company failures [to date] involved assets of less than $15 billion and fewer than 500,000 policyholders," while in June 2013 MetLife had "total consolidated assets of $816 billion and 90 million policyholders." Final Determination 139 [JA 501]. "[T]here is no historical precedent for the failure of an insurance organization of the size, scope, and complexity of MetLife." *Id.* at 140 [JA 502].

The Council also explained that designation would be appropriate even if it were to accept MetLife's preferred methodology. The Council noted that its "analysis estimates the aggregate capital markets exposure to MetLife at $183 billion," whereas "MetLife asserts that the figure is $90 billion." Final Determination 82 [JA 444]. The Council considered in detail the reasons for the different estimates, but stressed that "[n]otwithstanding these broad ranges, even exposures at the lower ends of these estimates are substantial and could lead the company's material financial distress to pose a threat to U.S. financial stability." *Id.*

To put the figures in perspective, the direct losses that MetLife acknowledged could occur in the event of its distress from its capital markets activities alone—not including potential losses to insurance customers and others with direct or indirect exposures to the company—amount to approximately half of one percent of U.S.

gross domestic product. *See* Final Determination 98-99 [JA 460-61]. And the $90 billion in direct *losses* that MetLife acknowledged might occur from its capital markets activities constitutes almost double the $50 billion in *assets* that a bank holding company must have in order to be automatically subject to enhanced prudential standards under Dodd-Frank. *See* 12 U.S.C. §§ 5365, 5366.

The district court presented no basis for second-guessing the expert judgment of the nation's federal financial regulators regarding the appropriate method of assessing the potential effects of a company's distress on U.S. financial stability. Congress did not establish a method for determining whether a company's distress could threaten financial stability, instead leaving to the Council's judgment how to analyze the magnitude and nature of the losses for any particular company.

The district court also believed it was inherently contradictory for the Council to postulate that market participants might react to distress at MetLife in different ways that would implicate more than one transmission channel. The court declared that "[i]f MetLife's reliance on collateral and other mitigating measures would prevent Exposure losses—even if at the cost of Asset-Liquidation losses—it would seem logical to conclude that MetLife would threaten U.S. financial stability through the Asset Liquidation Channel and not through the Exposure Channel." Op. 26 n.21 [JA 804 n.21]. Thus, in the court's view, the Council "maintained without reasoned explanation that both transmission channels were implicated by the same dire predictions." *Id.* at 26-27 n.21 [JA 804-05 n.21]. But the Council explained how both

transmission channels could be implicated by financial distress at MetLife. To simplify, in the event of financial distress, either MetLife could default on obligations or its counterparties could rapidly liquidate the assets they hold as collateral, and either course of action could destabilize the financial system. The Council simply recognized that both courses were possible and that either could independently, or in combination, threaten U.S. financial stability.

II. The Statute Did Not Require the Council to Consider the Potential Costs to MetLife of Designation.

The district court incorrectly held that the Council was obliged to consider the potential costs to MetLife of subjecting it to supervision and enhanced prudential standards to be promulgated by the Federal Reserve. This holding reflected a misunderstanding of the statutory scheme and the Supreme Court's decision in *Michigan v. EPA*, 135 S. Ct. 2699 (2015), and improperly set aside what is, at a minimum, a reasonable interpretation of the statute that the Council is charged with implementing. *See Chevron*, 467 U.S. at 843-44.

A. Congress vested the Council with designation authority as part of its effort to avoid a repetition of the 2008-2009 financial crisis, in which the distress or failure of a series of financial companies nearly brought the economy to its knees and prompted government rescues that put hundreds of billions of taxpayer dollars at risk. *See* Dodd-Frank Act, pmbl., 124 Stat. at 1376 (explaining that the Dodd-Frank Act is

designed "to end 'too big to fail'" and "to protect the American taxpayer by ending bailouts").

Accordingly, Dodd-Frank instructs the Council to designate a nonbank financial company if it "determines that material financial distress at the U.S. nonbank financial company . . . could pose a threat to the financial stability of the United States," 12 U.S.C. § 5323(a)(1), and provides a list of ten specific factors to guide the Council's determination, *see id.* § 5323(a)(2)(A)-(J). These statutory factors—such as the company's leverage, size, and interconnectedness—relate to the statutory standard of whether the company could pose a threat to U.S. financial stability. None relates to the costs that designation may impose on the company, or any other effect of designation. *See* 77 Fed. Reg. at 21,640 (observing that "[t]he relative cost and benefit" of designating an individual company "is not one of [the] statutory considerations").

Congress authorized the Council to consider additional factors, but it explicitly limited those considerations to "other risk-related factors." 12 U.S.C. § 5323(a)(2)(K). The statute thus makes it abundantly clear that the only considerations relevant to a designation are those related to the risk that the company's material financial distress could pose to the country's financial stability.

The statute also makes clear that the Council has broad discretion in determining which other risk-related factors it will consider, providing that the Council only needs to take into account those risk-related factors that "the Council

deems appropriate." 12 U.S.C. § 5323(a)(2)(K) (emphasis added). The Supreme Court recognized the flexibility inherent in this formulation in *Webster v. Doe*, 486 U.S. 592, 600 (1988), where a statute authorized the Central Intelligence Agency to terminate employees "whenever the Director 'shall *deem* such termination necessary or advisable in the interests of the United States.'" *Id.* (Supreme Court's emphasis). The Court stressed that the statute did not authorize termination "simply when the dismissal *is* necessary or advisable to those interests," and held on the basis of Congress's use of the word "deem" that the statutory "standard fairly exudes deference to the Director." *Id.*; *see also Zhu v. Gonzales*, 411 F.3d 292, 295 (D.C. Cir. 2005) (recognizing that a statute providing that Attorney General "may 'deem' a waiver of the requirement to be in the 'national interest'" ultimately "calls upon his expertise and judgment unfettered by any statutory standard whatsoever").

Elsewhere in Dodd-Frank, Congress explicitly mandated consideration of costs. *See, e.g.*, 12 U.S.C. § 5512(b)(2) (requiring consideration of "potential benefits and costs to consumers and covered [companies]"). Congress declined to do so in the statutory provision at issue here.

B. The district court nevertheless concluded that the Council was required to consider the costs of designation to MetLife based on the court's understanding of *Michigan v. EPA*. *Michigan* involved "a unique procedure to determine the applicability" of certain Clean Air Act provisions to fossil-fuel-fired power plants, that turned on an EPA determination that regulation was "appropriate and necessary."

135 S. Ct. at 2705. In contrast to the specific factors contained in Dodd-Frank to guide a designation determination, the Clean Air Act did not indicate what types of considerations would be relevant to determining whether regulation was "appropriate and necessary." Examining the relevant statutory background, the Court concluded that "[t]here are undoubtedly settings in which the phrase 'appropriate and necessary' does not encompass cost. But this is not one of them." *Id.* In the context of the statutory scheme at issue, the Court reasoned that "[n]o regulation is 'appropriate' if it does significantly more harm than good." *Id.* at 2707.

The district court recognized that, in contrast to the statute at issue in *Michigan,* Dodd-Frank circumscribed the scope of relevant considerations to "other risk-related factors"—a distinction that should have concluded its analysis. Instead, however, the court declared that the Council should have regarded cost as a "risk-related factor" because "imposing billions of dollars in cost could actually make MetLife more vulnerable to distress." Op. 32 [JA 810]. The court declared: "[b]ecause [the Council] refused to consider cost as part of its calculus, it is impossible to know whether its designation 'does significantly more harm than good.'" *Id.* (quoting *Michigan*, 135 S. Ct. at 2707).

Even assuming that the cost of Federal Reserve oversight and enhanced prudential standards could plausibly be described as a "risk-related factor" within the meaning of the statute, the plain language of 12 U.S.C. § 5323(a)(2)(K) vested in the Council discretion to consider that factor if it "deem[ed] appropriate." Here the

Council determined that consideration of cost was not appropriate. *See* Final Designation 29 [JA 391]; 77 Fed. Reg. at 21,640. The court did not attempt to reconcile its rejection of the Council's determination with the terms of the statute.

In any event, the interpretation of "risk-related factor" adopted by the district court is untenable. The cost of complying with regulation bears no resemblance to any of the ten statutory factors that guide a designation decision. Those factors reflect Congress's determination that designation is proper when a financial company's material financial distress could threaten the stability of the U.S. financial system. Keenly aware of the costs of inadequate regulation, Congress determined that the benefits outweigh the potential cost of regulations that are designed to improve the safety and soundness of the designated company as well as the stability of the financial system. And even if it were permissible to conclude that the cost of regulation is a "risk-related factor," it was, at a minimum, reasonable for the Council to conclude otherwise.

Although not material to the legal analysis, the district court's reference to "billions of dollars" in costs is also without basis. The Federal Reserve, which has broad statutory authority to tailor prudential standards for insurance companies, *see* 12 U.S.C. § 5365(a)(2), only recently issued a notice of proposed rulemaking regarding prudential standards and an advance notice of proposed rulemaking regarding certain capital standards that would apply to MetLife. *See* 81 Fed. Reg. 38,610 (June 14, 2016); 81 Fed. Reg. 38,631 (June 14, 2016). There is no reason to believe that any

prudential standards that are ultimately adopted will impose billions of dollars in cost. But if MetLife or other entities believe that the costs that might be imposed by the regulations are inappropriate, they will be able to set out those views in the course of the Federal Reserve's notice and comment rulemaking. The only immediate consequences of designation are that MetLife is subject to supervision by the Federal Reserve and is subject to certain regulatory requirements such as submitting a "plan . . . for rapid and orderly resolution in the event of material financial distress or failure." 12 U.S.C. § 5365(d)(1). In addition, any proposed acquisition of MetLife and certain acquisitions by MetLife would be subject to the prior approval of the Federal Reserve. *See id.* § 5363.

In sum, the statute specifies the factors to be considered in a designation and gives the Council discretion to consider "other risk-related factors" as it deems appropriate. The district court erred in reading language that "fairly exudes deference," *Webster*, 486 U.S. at 600, as impliedly imposing a mandate to consider cost untethered to the language or purpose of the statute.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be reversed.

Respectfully submitted,

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JUNE 2016

CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the requirements of Federal Rule of Appellate Procedure 32(a). This brief contains 13,463 words.

s/ Daniel Tenny
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CERTIFICATE OF SERVICE

I hereby certify that on June 16, 2016, I electronically filed the foregoing brief with the Clerk of the Court for the United States Court of Appeals for the District of Columbia Circuit by using the appellate CM/ECF system. Participants in the case are registered CM/ECF users, and service will be accomplished by the appellate CM/ECF system.

s/ Daniel Tenny
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ADDENDUM

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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;

. . .

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 2/3 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.

. . .

(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).

. . .

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 nonbank financial company to Board of Governors supervision and prudential standards.

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[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).

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 financial 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 potential 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 underserved 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 account 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 obligations, 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 regulatory 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

[4] *See* 12 U.S.C. 5323(d)(3).

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 (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

[5] *See* 13 C.F.R. 1310.21(c).

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.
- *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

[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.

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 Council.[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.

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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.

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 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

[9] *See* 12 C.F.R. 1310.21(c).

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

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.