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Challenging Nonbank SIFI Designations: GE, Metlife, and the Need for Reform

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CHALLENGING NONBANK SIFI DESIGNATIONS: GE, METLIFE, AND THE NEED FOR REFORM

ABSTRACT

The Dodd-Frank Wall Street Reform and Consumer Protection Act created, among other things, the Financial Stability Oversight Council (FSOC), an entity within the U.S. Department of the Treasury tasked with assessing and mitigating financial risk. Financial institutions with over $50 billion in assets are automatically deemed "systemically important." However, under the Dodd-Frank Act, FSOC has the authority to designate non-bank companies engaged in financial activity as systemically important as well. Once designated as a systemically important financial institution (SIFI), these companies are subject to enhanced regulation and supervision by the Federal Reserve. Because the costs associated with such enhanced regulation are significant, most companies do not actively welcome a SIFI label. In 2016, two of the four non-bank SIFIs (GE Capital and MetLife, Inc.) had their SIFI labels rescinded. GE was able to shed its SIFI label by minimizing the size of its assets and operations. MetLife chose to challenge FSOC's designation in federal district court. This Note reviews the available methods for challenging SIFI designations and proposes alternative methods to increase fairness in these challenges, including amending FSOC's evidentiary hearing procedures to more closely resemble federal court proceedings, and creating an internal appeals process within the U.S. Department of the Treasury as an alternative to bringing suit in district court.

I. INTRODUCTION

In response to the financial crisis the United States experienced in 2008, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] (Dodd-Frank), which made numerous changes to the U.S. financial markets, the regulation of these markets, and the regulation of market participants. One of the regulatory bodies created by Dodd-Frank is the Financial Stability Oversight Council (FSOC), which is tasked with assessing potential risks to the U.S.'s financial stability.[2] In assessing and attempting to mitigate risk, FSOC has the authority under Dodd-Frank to designate certain nonbank financial entities as "systemically important," and these systemically important financial institutions (SIFIs) are subject to enhanced regulatory requirements and Federal Reserve (the Fed) supervision.[3]

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1. *See generally* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S.C.).
2. Dodd-Frank § 113, 12 U.S.C. § 5323 (2012).
3. *Id.* § 113.

MetLife, one of the three current nonbank SIFIs, challenged their SIFI designation against FSOC in the District Court for the District of Columbia in 2016.[4] The District Court found that FSOC's MetLife determination was arbitrary and capricious, and that FSOC had contradicted standards it had previously set forth in its final rule and interpretive guidance regarding SIFI designations.[5] This Note assesses the implications that MetLife's judicial challenge presents for other nonbank SIFIs, considers the need for change in FSOC's designation process, and evaluates the need for change in the available methods for challenging SIFI designations. This Note argues that FSOC's evidentiary hearing procedures should be amended to create a fairer forum for challenging SIFI designations and should be governed by the Administrative Procedure Act (APA).[6] Further, Congress should create an internal appeals process within the U.S. Department of the Treasury for challenging FSOC's SIFI designations, as an alternative to bringing suit in federal district court.

Part II of this Note provides background information on FSOC, SIFIs, and the SIFI designation process. Part III discusses the available methods for challenging a SIFI designation and reviews how some of those methods have been employed by existing and previously designated SIFIs. Part IV discusses *MetLife, Inc. v. Financial Stability Oversight Council*,[7] in which MetLife sued FSOC in federal district court to rescind its SIFI label. Part V argues the need for change in the current process for challenging designations and proposes an alternative solution.

II. FSOC, SIFIS, AND THE DESIGNATION PROCESS

In 2010, in response to the financial crisis of the preceding years, Congress enacted Dodd-Frank, which, among other things, created FSOC.[8] With its establishment of FSOC, Congress in Dodd-Frank for the first time created "accountability for identifying risks and responding to emerging threats to financial stability."[9] FSOC is comprised of a team of federal financial regulators, state regulators, and an independent insurance expert

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4. *See generally* MetLife Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219 (D.D.C. 2016).

5. *See generally* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 70 Fed. Reg. 21,637 (Apr. 11, 2012) (to be codified at 12 C.F.R. pt. 1310).

6. *See generally* Administrative Procedure Act, 5 U.S.C. §§ 551–559 (2012).

7. *See generally MetLife Inc.*, 177 F. Supp. 3d 219.

8. *See The Financial Stability Oversight Council and the Financial Stability Board: Issues in International Regulation: Hearing on "The Growth of Financial Regulation and its Impact on International Competitiveness" Before the H. Fin. Serv. Subcomm. on Oversight and Investigations*, 113th Cong. 1 (2014) (statement of Peter J. Wallison, Arthur F. Burns Fellow in Financial Policy Studies, American Enterprise Institute for Public Policy Research) [hereinafter *Hearing on Growth of Financial Regulation*].

9. *About FSOC*, U.S. DEP'T. OF TREASURY, FIN. STABILITY OVERSIGHT COUNCIL, https://www.treasury.gov/initiatives/fsoc/about/Pages/default.aspx [hereinafter *About FSOC*] (last updated June 23, 2016, 3:55 PM).

appointed by the President.[10] Ten voting members serve on FSOC, as well as five nonvoting members.[11] Voting members include heads of other federal regulatory agencies, such as the Chairperson of the Federal Deposit Insurance Corporation, the Chairperson of the Securities and Exchange Commission, the Director of the Consumer Financial Protection Bureau, and the Comptroller of the Currency.[12] FSOC's non-voting members include state regulators from the banking, insurance, and securities sectors, who serve in an advisory capacity.[13]

FSOC has three primary purposes: (1) identifying risks to U.S. financial stability arising from the activities or financial distress of banks or nonbank financial companies; (2) promoting market discipline by removing the expectation for the U.S. government to shield shareholders, creditors, and counterparties of these companies in the event of failure; and (3) to "respond to emerging threats to the stability of the U.S. financial system."[14] Ultimately, FSOC's goal is to assess risks to the economy and implement regulatory mechanisms in an effort to mitigate those risks.[15] Regulatory methods employed by FSOC include facilitating information-sharing, data-sharing, and coordination among regulatory agencies, recommending stricter standards for large, interconnected firms, and determining whether to break up firms that pose a "grave threat" to the country's financial stability.[16]

For example, FSOC has determined interconnectivity to be a significant source of economic risk.[17] Large institutions can be connected directly, through exposure in short-term funding, trading, and derivatives activities, or indirectly, through common exposure to similar assets or funding sources.[18] This risk is intensified "when there is insufficient transparency to determine which entities are connected to each other, or when certain entities are not subject to robust risk management standards."[19] FSOC therefore requires financial institutions to make certain disclosures regarding their liquidity and risk management practices, as well as about their external financing sources.[20] Improving the quality of information available to regulators and to the public about financial institutions enhances transparency, and therefore,

10. *See id.*
11. *See id.*
12. *Id.*
13. *Id.*
14. FIN. STABILITY OVERSIGHT COUNCIL, 2016 FSOC ANNUAL REPORT i (2016), https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC%202016%20Annual%20Report.pdf [hereinafter 2016 FSOC ANNUAL REPORT].
15. *See About FSOC, supra* note 9.
16. *Id.*
17. FIN. STABILITY OVERSIGHT COUNCIL, 2011 FSOC ANNUAL REPORT 3 (2011), https://www.treasury.gov/initiatives/fsoc/Documents/FSOCAR2011.pdf.
18. *Id.*
19. *Id.* at 133.
20. *Id.*

is expected to reduce some of the risk posed by this interconnectivity.[21] The assumption is that risk is decreased when market participants have adequate information about the financial products and entities they are doing business with.[22]

While FSOC employs a variety of regulatory methods to address and mitigate financial risk, the most important method, arguably, is designating bank and nonbank financial entities as SIFIs, thereby subjecting them to enhanced regulation and supervision by the Fed.[23] FSOC has determined these SIFIs to be *so* important to the U.S. economy that additional regulation is required to reduce the likelihood of their failure, and to ensure that if the company *does* fail, it does not bring the rest of the U.S. economy down with it.[24]

The designation requirements differ for bank SIFIs and nonbank SIFIs.[25] Any bank with over $50 billion in assets is determined to be systemically important under Dodd-Frank.[26] Some of the most prominent bank SIFIs include JPMorgan Chase and Bank of America.[27] As of September 30, 2016, they each held over $1.5 trillion in U.S.-held assets.[28] There is also a SIFI subclass for Globally Systemically Important Banks (G-SIBs),[29] and these entities are held to stricter levels of risk mitigation than traditional U.S. SIFIs.[30] G-SIBs are designated by the Basel Committee on Banking Supervision (BCBS)—an international financial regulator—and are subject to regulation by both the BCBS and the Fed.[31] There are currently thirty-three bank SIFIs and G-SIBs, with JP Morgan Chase, Bank of America, Citigroup, and Wells Fargo rounding out the four largest, based on size and amount of U.S.-held assets.[32]

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21. *Id.*

22. *Id.*

23. *See Hearing on Growth of Financial Regulation*, *supra* note 8, at 1–2.

24. *See* Emily Liner, *Understanding SIFIs: What Makes an Institution Systemically Important?*, THIRD WAY (Nov. 30, 2016), http://www.thirdway.org/report/understanding-sifis-what-makes-an-institution-systemically-important.

25. *See id.*; *see also* 12 U.S.C. § 5331 (2012).

26. Liner, *supra* note 24.

27. *See* Steve Schaefer, *JPMorgan, BofA, Goldman Sachs Among Eight U.S. Banks on Global Too Big To Fail List*, FORBES (Nov. 4, 2011, 11:21 AM), http://www.forbes.com/sites/steveschaefer/2011/11/04/jpmorgan-bofa-goldman-sachs-among-eight-u-s-banks-on-global-too-big-to-fail-list/#7dce04e94710.

28. *See* FED. RES. STAT. RELEASE, INSURED U.S.-CHARTERED COMMERCIAL BANKS THAT HAVE CONSOLIDATED ASSETS OF $300 MILLION OR MORE, RANKED BY CONSOLIDATED ASSETS (2016).

29. *See* Liner, *supra* note 24.

30. *See* FIN. STABILITY BD., 2016 LIST OF GLOBAL SYSTEMICALLY IMPORTANT BANKS (G-SIBS) (2016), http://www.fsb.org/wp-content/uploads/2016-list-of-global-systemically-important-banks-G-SIBs.pdf.

31. *See generally* BASEL COMM. ON BANKING SUPERVISION, THE G-SIB ASSESSMENT METHODOLOGY – SCORE CALCULATION (2014), http://www.bis.org/bcbs/publ/d296.pdf; *see also* Liner, *supra* note 24.

32. *See* Liner, *supra* note 24.

FSOC is further responsible for designating nonbank SIFIs and systemically important financial market utilities (FMUs).[33] There are currently eight systemically important FMUs[34] and two nonbank SIFIs—American International Group, Inc. (AIG), and Prudential Financial, Inc. (Prudential).[35] FMUs are responsible for transferring, clearing, and settling payments, securities, and other financial transactions among or between financial institutions.[36] FMUs are determined to be systemically important if a failure or disruption to their functioning could create or increase the risk of liquidity or credit problems across financial institutions or markets, thereby threatening the stability of the U.S. financial system.[37]

AIG's near-failure played a significant role in the 2008 financial crisis—in fact, some attribute the crisis entirely to AIG's collapse.[38] While there were many decisions and events that ultimately led up to it, the catastrophic end result was that AIG lost $99.2 billion and the Fed provided the company with an $85 billion bailout loan to keep it from going under.[39] Arguably, this was one of the driving factors in Congress's decision to establish FSOC and grant it the authority to monitor and continuously assess financial risk.[40] One of FSOC's purposes is to remove the expectation that these systemically

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33. *Designations*, U.S. DEP'T. OF TREASURY, FIN. STABILITY OVERSIGHT COUNCIL, https://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx [hereinafter *Designations*] (last updated Jan. 31, 2017, 10:40 AM).

34. The eight current systemically important financial market utilities are: The Clearing House Payments Company LLC, CLS Bank International, Chicago Mercantile Exchange, Inc., The Depository Trust Company, Fixed Income Clearing Corporation, Ice Clear Credit LLC, National Securities Clearing Corporation, and The Options Clearing Corporation. *Id.*

35. *Id.* On June 28, 2016, FSOC rescinded GE Capital's SIFI designation, bringing the number of nonbank SIFIs down from four to three. *See generally* U.S. DEP'T. OF TREASURY, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S RESCISSION OF ITS DETERMINATION REGARDING GE CAPITAL HOLDINGS, LLC (2016), https://www.treasury.gov/initiatives/fsoc/designations/Documents/GE%20Capital%20Public%20Rescission%20Basis.pdf [hereinafter GE CAPITAL HOLDINGS]. Part III of this Note provides information regarding the rescission of GE's designation. Also in 2016, MetLife, Inc. challenged its SIFI label in federal district court, and the District Court rescinded its designation. *See* MetLife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219 (D.D.C. 2016). See Part IV of this Note for information regarding the *MetLife* case and the rescission of MetLife's SIFI designation.

36. *Designated Financial Market Utilities, About,* BOARD OF GOVERNORS OF FED. RES. SYS., https://www.federalreserve.gov/paymentsystems/designated_fmu_about.htm (last updated Jan. 29, 2015).

37. *Designations, supra* note 33.

38. While AIG was not the only financial institution to need, and receive a significant amount of government assistance, people were shocked that a company with about $1 trillion in assets could allow itself to lose almost $100 billion. There was also controversy over AIG's bailout by the Fed, centering around whether the government should be using taxpayer dollars to bail out financial companies. This remains a topic of much discussion. *See* Valerie Ross, *What Went Wrong at AIG? Unpacking the Insurance Giant's Collapse*, KELLOGG INSIGHT (Aug. 3, 2015), http://insight.kellogg.northwestern.edu/article/what-went-wrong-at-aig.

39. *Id.* at 2.

40. *See* EDWARD V. MURPHY & MICHAEL B. BERNIER, FINANCIAL STABILITY OVERSIGHT COUNCIL: A FRAMEWORK TO MITIGATE SYSTEMIC RISK, CONGRESSIONAL RESEARCH SERVICE 1 (2011), http://www.llsdc.org/assets/DoddFrankdocs/crs-r42083.pdf.

important entities will receive a government bailout if they should fail, the way AIG did in 2008.[41] While this was likely one of Congress's primary goals in providing FSOC with the authorities that it did, there are continuing debates surrounding whether or not FSOC actually eliminates this expectation.

One journalist argues that FSOC is a dangerous entity and is Dodd-Frank's worst creation.[42] Since "financial stability" has not been defined in Dodd-Frank or anywhere else in the U.S. Code, this creates a vague standard that gives FSOC far too much reach and discretion in its SIFI designations.[43] He argues that because the Fed is responsible for supervising these SIFIs, the Fed will not allow any of these companies to fail, as doing so would imply that the Fed is incapable of saving them.[44] Others have supplied similar ideas, arguing that the Fed's enhanced supervision creates a vested interest in these companies' wellbeing, thereby making it more likely that the Fed will bail them out if they should fail.[45] Some have also argued that FSOC lacks transparency, specifically with regard to its designations.[46] In early 2015, the U.S. House Financial Services Committee (House Committee) complained of "serious deficiencies" in FSOC's SIFI designation decision-making process, and requested FSOC provide documents showing how its decisions are made.[47] Later that year, the House Committee held a hearing on the matter, and accused FSOC of a lack of transparency and responsiveness to the requests for information made earlier that year.[48] The "lack of transparency" accusation was based largely on the fact that the majority of FSOC meetings were conducted privately and there were few details or substantive information provided in the meeting minutes.[49] Still, while they may be relatively vague, FSOC continues to operate under the authorities provided to it under Dodd-Frank.[50]

Dodd-Frank expressly provides the authority for FSOC to require supervision and regulation for the nonbank entities they determine are systemically important, and the Act sets forth the factors FSOC should

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41. *See* 2016 FSOC ANNUAL REPORT, *supra* note 14, at i.

42. *See generally* Norbert Michel, *Dodd-Frank's Financial Monster Council: The FSOC*, FORBES (Jul. 7, 2014, 9:19 AM), http://www.forbes.com/sites/norbertmichel/2014/07/07/dodd-franks-financial-monster-council-the-fsoc/#36f8b30c4ffb.

43. *Id.*

44. *Id.*

45. *See* Emerich Gutter, Note, *Too-Big-To-Fail and the Financial Stability Oversight Council*, 30 REV. BANKING & FIN. L. 73, 77 (2010).

46. *See* Ian Katz, *Republicans Order Records in New Attack on FSOC Transparency*, BLOOMBERG (May 30, 2015, 4:10 PM), http://www.bloomberg.com/news/articles/2015-05-29/republicans-demand-records-in-new-attack-on-fsoc-transparency.

47. *Id.*

48. *See House Committee Faults FSOC for "Lack of Transparency" in SIFI Designations*, CTR. FOR STUDY OF FIN. MKT. EVOLUTION (Dec. 10, 2015), http://csfme.org/News/house-committee-faults-fsoc-for-lack-of-transparency-in-sifi-designations.

49. *See id.*

50. *See generally* 12 U.S.C. § 5323 (2012).

consider in making these nonbank SIFI designations.[51] Dodd-Frank defines a "U.S. nonbank financial company" as a company that is not a bank holding company, and is: (1) incorporated or organized under the laws of the United States or any State, and (2) predominantly engaged in "financial activities."[52] A company is "predominantly engaged in financial activities" if the company and its subsidiaries' annual gross revenues from activities that are financial in nature represent 85% or more of the company's consolidated gross revenue, or if the company's consolidated assets and all of its subsidiaries related to financial activities represent 85% or more of the company's consolidated assets.[53] Under Dodd-Frank, the Fed's Board of Governors is responsible for establishing the requirements for determining if a company is predominantly engaged in financial activities.[54]

In 2012, FSOC published its final rule and interpretive guidance (Guidance), which describes its process for reviewing nonbank financial companies for potential designation.[55] The Guidance states that there is no specific formula for making a SIFI designation, but rather that each determination should be made based on a "company-specific evaluation" and should take into account the statutory factors set forth in Dodd-Frank, as well as other information that FSOC deems necessary or relevant.[56] Common factors include the company's leverage, size, interconnectedness, and existing regulatory scrutiny.[57] For example, in FSOC's final determination of AIG as systemically important, FSOC notes that the company's size and interconnectedness played a significant role in its designation.[58] The report points out that AIG is the third-largest insurance company in the United States, underwrites a wide range of insurance products throughout the world, has over 60,000 employees, and operates across 400 offices in the United States and 600 offices abroad.[59] FSOC considered AIG's significant amount of customers (including over 18 million life insurance and retirement product customers in the U.S.) and the financial distress the company would suffer if

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51. *Id*.
52. *Id*. § 5311(a)(4)(B).
53. *Id*. § 5311(a)(6).
54. *Id*. § 5311(b).
55. *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 70 Fed. Reg. 21,637 (Apr. 11, 2012) (to be codified at 12 C.F.R. pt. 1310).
56. *Id*.
57. *See Nonbank Designations FAQs*, U.S. DEP'T. OF TREASURY, FINANCIAL STABILITY OVERSIGHT COUNCIL [hereinafter *Designations FAQs*], https://www.treasury.gov/initiatives/fsoc/designations/Pages/nonbank-faq.aspx (last updated Feb 4, 2015).
58. *See* U.S. DEP'T. OF TREASURY, BASIS OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S FINAL DETERMINATION REGARDING AMERICAN INTERNATIONAL GROUP, INC. 5 (2013), https://www.treasury.gov/initiatives/fsoc/designations/Documents/Basis%20of%20Final%20Determination%20Regarding%20American%20International%20Group,%20Inc.pdf [hereinafter AIG DESIGNATION].
59. *See id.* at 2.

these customers withdrew their accounts early.[60] FSOC also points out how the numerous financial entities exposed to AIG as counterparties and customers could also face significant losses in the event that AIG were to suffer significant financial distress.[61]

There are three stages in the SIFI designation process.[62] In Stage One, FSOC reviews a broad group of nonbank financial companies to determine which of those will require further evaluation.[63] In Stage Two, FSOC analyzes the potential threat these companies could present to U.S. financial stability, based on "quantitative and qualitative industry- and company-specific standards."[64] If FSOC begins an active review of a company during this stage, it notifies the company and the company's primary regulator within thirty days.[65] In Stage Three, those companies selected for official review immediately receive notice that they are being considered for proposed SIFI designation.[66] In addition to continued analysis and evaluation of the company, FSOC will agree to meet with the company to allow the company to present any information it deems relevant to FSOC's evaluation.[67] At the end of Stage 3, FSOC may make a proposed designation upon an affirmative majority vote of at least two-thirds of its voting members.[68]

Dodd-Frank provides that a nonbank company may be designated as a SIFI if FSOC determines that either of the following could pose a threat to U.S. financial stability: (1) "material financial distress at the…company;" or (2) "the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the…company."[69] FSOC provides a written basis for the final determination of each designated SIFI and these decisions are made public on FSOC's website.[70] Once designated as systemically important, Dodd-Frank subjects these corporate entities to "enhanced prudential standards" and Fed supervision.[71]

The history surrounding the creation of FSOC and the SIFI designation process are important in understanding the need for reform in this area. SIFIs are designated as systemically important because FSOC has reviewed various aspects of the company, including size, scale, and interconnectedness, and

60. *See id.* at 6.
61. *Id.* at 3.
62. *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 70 Fed. Reg. 21,637, 21,642 (Apr. 11, 2012) (to be codified at 12 C.F.R. pt. 1310).
63. *Id.*
64. *Id.* at 21,645.
65. *Designations FAQs, supra* note 57.
66. *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 70 Fed. Reg. at 21,645; *see also Designations FAQs, supra* note 57.
67. *Designations FAQs, supra* note 57.
68. *Id.*
69. 12 U.S.C. § 5323(a)(1) (2012).
70. *Designations, supra* note 33.
71. *Id.*

determined that should these companies fail, the U.S. economy will be significantly damaged as a result. The purpose for the creation of FSOC and SIFIs was to protect the U.S. economy against another financial crisis like the one experienced in 2008.[72] However, while taking proactive, precautionary measures is obviously imperative to secure the country's economic standing, it needs to be done within reason, and companies designated as SIFIs should have an appropriate method of challenging those determinations if they feel that they've been designated incorrectly.

III. THE HISTORY OF SIFI DESIGNATION CHALLENGES

While there are obvious benefits to enhanced regulation in the financial sector, there are substantial costs associated with a SIFI designation. The Fed is required, under Dodd-Frank, to establish stricter prudential standards for all nonbank SIFIs.[73] This includes conducting annual stress tests to examine whether companies can assess risk across all of their operations, and preparing for these tests can cost a company millions of dollars.[74] In preparation for these tests, many banks have had to make significant investments in risk management, liquidity assessment, monitoring tools, and in the infrastructure required to support these kinds of systems.[75] In 2015, banks across the world spent about $29 billion on consultants[76]—a significant increase from the $16.35 billion spent in 2007.[77] Analysts estimate that financial firms globally will spend $4 billion on stress-test information technology in 2016 and expect that number to increase by 15% in 2017.[78]

In 2015, JPMorgan Chase "had about 550 people working solely on the Fed stress tests, with more than 2,000 employees contributing indirectly."[79] Stress-testing alone has created an entirely new industry related to regulation and compliance, worth billions of dollars. However, it seems counterintuitive to have financial institutions spend billions of dollars annually in an attempt to prove that they are financially stable. As part of its stress test, the Fed provides a worst-case scenario to the financial institutions, "in which the

72. *See* MURPHY & BERNIER, *supra* note 40, at 1.

73. 12 U.S.C. § 5325.

74. *See* Ryan Tracy, *The Short Answer, What You Need to Know About SIFIs*, WALL ST. J. (Mar. 30, 2016, 1:33 PM), http://blogs.wsj.com/briefly/2016/03/30/what-you-need-to-know-about-sifis-the-short-answer/; *see also* DELOITTE CTR. FOR REGULATORY STRATEGIES, SIFI DESIGNATION AND ITS POTENTIAL IMPACT ON NONBANK FINANCIAL COMPANIES 8 (2013) http://fsroundtable.org/wp-content/uploads/2014/05/SIFI-designation-and-its-potential-impact-on-nonbank-financial-companies.pdf [hereinafter POTENTIAL IMPACT].

75. *See* Bryan Yurcan, *Lessons Learned from the Fed Stress Tests*, FIN. SERVICES ROUNDTABLE, http://fsroundtable.org/lessons-learned-fed-stress-tests/ (last visited Feb. 17, 2017).

76. Ryan Tracy, *Stress Test Inc.: Billions of Dollars, Bank Consultants to Manage Other Consultants*, WALL ST. J. (June 28, 2016, 2:50 PM), http://www.wsj.com/articles/stress-test-inc-billions-of-dollars-consultants-to-manage-other-consultants-1467139620.

77. *Id.*

78. *Id.*

79. *Id.*

unemployment rate doubles, stock prices plunge by half, and interest rates turn negative."[80] The Fed doesn't provide exactly how it will calculate the companies' losses, in an effort to prevent them from "gaming the exercise."[81] Critics of the stress tests provide that the tests' simulations do not fully capture the extent of how the company would be affected in a real economic crisis.[82] If the stress tests do not adequately reflect the impact of such a setback, yet cause companies to expend millions of dollars to prove that they can withstand a significant economic setback, the tests seem to be doing more harm than good.[83]

In addition to annual stress tests, Fed supervision includes additional reporting requirements in an effort to improve transparency.[84] This presents challenges for nonbank SIFIs, as nonbank financial companies typically have diverse business models with different risk drivers, which may not fit neatly into a uniform reporting framework the way traditional financial institutions do.[85] These companies are also required to maintain a certain amount of capital, limit their credit exposure, manage liquidity risk, comply with debt-to-equity ratio requirements, and create a "living will" to assist the company in winding down, should it fail.[86] Nonbank SIFIs may also need to limit expansion or dispose of assets, and may be prohibited from participating in "systemically risky" activities.[87] For example, a nonbank SIFI will not be allowed to acquire or merge with another company if the resulting consolidated liabilities exceed 10% of the aggregate consolidated liabilities of all financial companies at the end of the year.[88] After considering the significant costs and additional regulatory requirements imposed on SIFIs after their designation, it is easy to see why a nonbank financial company might oppose being designated as systemically important.

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80. *Why the Fed's Stress Tests Aren't Credible*, BLOOMBERG VIEW (June 22, 2016, 7:30 AM), https://www.bloomberg.com/view/articles/2016-06-22/why-the-fed-s-stress-tests-aren-t-credible.

81. *Id.*

82. The effect would harm "many of a bank's counterparties at once, magnifying losses many times over." *Id.*

83. While the costs and resources associated with the Fed's stress tests are significant, the penalties for failing these tests are not. Morgan Stanley was the only major bank to fail the stress test in 2016, yet it received no fines or penalties, but only needs to resubmit its plan by the end of the year. Deutsche Bank and Santander, which have also failed the stress tests two and three years in a row were also not forced to pay any fines or add capital. *See* Stephen Gandel, *Why the Bank Stress Tests Don't Really Matter*, FORTUNE (July 2, 2016), http://fortune.com/2016/07/02/fed-bank-stress-tests/. If the stress tests are as significant as the Fed portrays them to be, why are there no penalties associated with failing the tests? Perhaps the Fed feels that fear of a tarnished reputation (*if* that) is a sufficient incentive to push the companies to pass the tests. But if that is not a real incentive, and the Fed will not impose any penalties on a company who fails, where is the importance in expending significant time, money, and effort in preparing for these tests?

84. POTENTIAL IMPACT, *supra* note 74, at 8.

85. *Id.*

86. *Id.* at 8–9.

87. *Id.* at 10.

88. *Id.*

Companies may choose to significantly alter their business operations in an attempt to have their SIFI designation rescinded, and FSOC annually reevaluates each of its previous designations to account for these changes and potentially rescind designations as it sees fit.[89] GE Capital (GE) was designated a nonbank SIFI until June 2016, at which time FSOC agreed to rescind GE's designation after the company drastically altered its size.[90] At the end of 2014, GE had $500 billion in assets;[91] in 2015, in an effort to significantly shrink its operations, the company devised a plan to sell approximately $260 billion worth of those assets.[92] GE sold a number of its businesses, including vehicle-fleet financing, commercial real estate, restaurant lending, and online banking.[93] The plan was to sell these assets by the end of 2017, but GE was able to get it done a year ahead of schedule.[94] In June 2016, in light of GE's reduced size and assets, FSOC voted to rescind the company's SIFI designation.[95] GE's executives have indicated that this decision allows the company to add around $20 billion of new debt, which creates the opportunity for stock buybacks and company acquisitions.[96] GE was the first nonbank SIFI to shrink its operations in order to rid itself of its designation.[97]

While companies can adjust their operations and dispose of assets as GE did, there are other methods available for challenging a SIFI designation. Companies may appear before FSOC prior to its vote on a proposed designation, may contest their designations during annual reevaluation, and may request an evidentiary hearing before FSOC to challenge their designations.[98] Still, some companies may choose to accept their SIFI designation and not challenge it at all. For example, AIG elected not to contest its designation after FSOC notified it in 2013.[99] In fact, in a public statement issued immediately following FSOC's proposed designation, AIG

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89. *See Designations FAQs, supra* note 57, at 4–5.

90. *See Designations, supra* note 33.

91. Ted Mann & Ryan Tracy, *GE Capital Sheds 'Systemically Important' Label*, WALL ST. J. (June 29, 2016, 7:11 PM), http://www.wsj.com/articles/ge-capital-sheds-systemically-important-label-for-too-big-to-fail-firms-1467205963.

92. Ted Mann & Emily Glazer, *GE to Sell Commercial Lending, Leasing Businesses to Wells Fargo*, WALL ST. J. (Oct. 13, 2015, 12:48 PM), http://www.wsj.com/articles/ge-to-sell-commercial-lending-leasing-businesses-to-wells-fargo-1444742310.

93. Rick Clough, *GE Says Too-Big-To-Fail Exit Puts Stamp of Approval on Overhaul*, BLOOMBERG (Jun. 29, 2016, 9:00 AM), http://www.bloomberg.com/news/articles/2016-06-29/ge-wins-regulatory-approval-to-shed-too-big-to-fail-designation.

94. Mann & Tracy, *supra* note 91.

95. GE CAPITAL HOLDINGS, *supra* note 35, at 7–9.

96. *See* Mann & Tracy, *supra* note 91; *see also* Clough, *supra* note 93.

97. Mann & Tracy, *supra* note 91.

98. *See Designations FAQs, supra* note 57; *see also* William Butler, *Falling on Deaf Ears: The FSOC's Evidentiary Hearing Provides Little Opportunity to Challenge a Nonbank SIFI Designation*, 18 N.C. BANKING INST. 663, 671 (2014).

99. *See generally* AIG DESIGNATION, *supra* note 58.

stated that the company did not contest the designation, "and welcomes it."[100] Following the heat AIG faced after the 2008 financial crisis, it comes as no surprise that the company would be hesitant to publicly challenge any additional regulation. Still, the opportunity to challenge the designation is available to AIG, should it decide to pursue that route. Other companies, such as Prudential, have challenged their SIFI designation from the beginning. Immediately following FSOC's proposed designation of Prudential as a SIFI in June 2013, Prudential exercised its right to request a hearing.[101] The company submitted written materials and the hearing was held in July 2013.[102] Ultimately, despite Prudential's challenge, FSOC voted to make the determination final.[103] Another method available to challenge SIFI designations is a civil suit against FSOC,[104] and MetLife is the first of the nonbank SIFIs to utilize this method.[105]

In trying to determine what constitutes a fair forum for challenging designations, it is important to consider the methods employed in the past. All of the nonbank SIFI designations challenged before FSOC have been unsuccessful. GE had its SIFI label rescinded only after reducing the size of the company and its assets. MetLife was able to rescind its designation only by bringing suit against FSOC in federal district court. There should be a fairer way for companies to challenge and seek review of their SIFI designations, without requiring them to dilute their businesses in an effort to avoid a SIFI label, or to use up judicial resources challenging a designation.

IV. METLIFE, INC. V. FINANCIAL STABILITY OVERSIGHT COUNCIL

On July 16, 2013, FSOC notified MetLife that the company was being considered for nonbank SIFI designation.[106] Between September 2013 and

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100. *AIG (AIG) Will Not Contest SIFI Designation*, STREETINSIDER (July 9, 2013, 5:17 PM), http://www.streetinsider.com/Corporate+News/AIG+(AIG)+Will+Not+Contest+SIFI+Designation/8486665.html.

101. *See* U.S. DEP'T. OF TREASURY, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S FINAL DETERMINATION REGARDING PRUDENTIAL FINANCIAL, INC. (2013), https://www.treasury.gov/initiatives/fsoc/designations/Documents/Prudential%20Financial%20Inc.pdf.

102. *Id.*

103. *Id.*

104. Dodd-Frank Section 113(h) provides that a nonbank financial company designated as systemically important may, within thirty days of the final determination, bring an action in the U.S. district court for the district in which the home office of the nonbank SIFI is located, or in the U.S. district court for the District of Columbia, for an order requiring that the designation be rescinded. The court's review is limited to whether the final determination made was arbitrary and capricious. *See* 12 U.S.C. § 5323(h) (2012).

105. *See* Andrew Zajac, Ian Katz & Zachary Tracer, *MetLife Sues Over Too-Big-To-Fail Label by Regulators*, BLOOMBERG (Jan. 13, 2015, 5:40 PM), https://www.bloomberg.com/news/articles/2015-01-13/metlife-sues-over-too-big-to-fail-designation-by-u-s-regulators.

106. U.S. DEP'T. OF TREASURY, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S FINAL DETERMINATION REGARDING METLIFE, INC. (2014), https://www.treasury.gov/initiatives/

September 2014, MetLife representatives met with FSOC staff twelve times and provided over 21,000 pages of documentary material for evaluation.[107] Despite MetLife's efforts, on September 4, 2014, FSOC voted to make a proposed SIFI designation for MetLife and held a hearing on November 3, 2014, where MetLife was allowed to submit additional materials on its behalf.[108] On December 18, 2014, FSOC voted 9-to-1 to designate MetLife as a nonbank SIFI under Dodd-Frank.[109]

Section 113(h) of Dodd-Frank provides that a designated company may seek judicial review "in the United States district court for the judicial district in which the home office of such nonbank financial company is located, or the United States District Court for the District of Columbia."[110] The district court may then dismiss the action or "direct the final determination to be rescinded."[111] MetLife brought suit in the federal District Court for the District of Columbia, on the grounds that FSOC's final determination was "arbitrary and capricious," and the District Court rescinded the designation.[112]

The District Court's rescission of MetLife's SIFI designation was based on the grounds that "FSOC made critical departures from two of the standards it adopted in its guidance," and that "FSOC purposefully omitted any consideration of the cost of designation to MetLife"—making the designation arbitrary and capricious under the most recent Supreme Court precedent.[113] While the court acknowledged that "[a]n initial agency interpretation is not instantly carved in stone," an agency must "acknowledge and explain the reasons for a changed interpretation."[114]

MetLife's first contention in its suit was that FSOC violated its own Guidance by failing to assess the company's vulnerability to material financial distress before addressing the potential effect of that distress, when the Guidance said that FSOC would do so.[115] The Guidance created two groups of factors that would be used in determining a nonbank SIFI designation. The first group (size, substitutability, and interconnectedness) was meant "to assess the potential impact of the nonbank financial company's financial distress on the broader economy," while the second group (leverage, liquidity, risk, and maturity mismatch) was meant "to assess the vulnerability of a nonbank financial company to financial distress."[116]

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fsoc/designations/Documents/MetLife%20Public%20Basis.pdf [hereinafter METLIFE DESIGNATION].

107. MetLife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219, 229 (D.D.C. 2016).
108. *Id.*
109. *Id.*
110. *Id.*
111. *Id.*
112. *Id.* at 230.
113. *Id.* (citing Michigan v. EPA, 135 S. Ct. 2699 (2015)).
114. *Id.* at 233 (quoting Verizon v. FCC, 740 F.3d 623, 636 (D.C.C. 2014)).
115. *Id.*
116. *Id.* at 234.

The second group was intended to assess a company *before* it became distressed, and the first group was intended to assess the impact of such distress on the country's financial stability.[117] However, in its final determination of MetLife's SIFI status, FSOC provided that all six categories were meant only "to assess the potential effects of a company's material financial distress," and the court found this to be inconsistent with FSOC's Guidance.[118]

FSOC's second departure from its Guidance surrounds its statement that "a nonbank financial company could only threaten U.S. 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.'"[119] MetLife argued that because FSOC never projected any estimated losses, it "never established a basis for a finding that MetLife's material financial distress would 'materially impair' MetLife counterparties within the meaning of [the Guidance]," and the District Court agreed.[120] The District Court agreed that FSOC never projected what the losses would be in the event of MetLife's insolvency, which financial institutions would be affected as a result, or how the market would be destabilized.[121] The District Court further stated that a "[p]redictive judgment must be based on reasoned predictions,"[122] and provided that "a summary of exposures and assets is not a prediction."[123]

Furthermore, FSOC ignored the costs to MetLife associated with a SIFI designation. While FSOC is not required under Dodd-Frank to perform a cost-benefit analysis in making a SIFI determination, the District Court concluded that failing to consider the costs to MetLife was arbitrary and capricious.[124] In the most recent relevant case—*Michigan v. EPA*—the Supreme Court held that "agency action is lawful only if it rests 'on a consideration of the relevant factors,'" and that "an agency may not 'entirely fail to consider an important aspect of the problem' when deciding whether regulation is appropriate."[125] The Supreme Court held that "cost must be balanced against benefit because '[n]o regulation is "appropriate" if it does significantly more harm than good.'"[126] Since FSOC refused to consider cost in its determination, it was impossible to determine whether the designation

117. *Id.*
118. *Id.*
119. *Id.* at 237.
120. *Id.*
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.* at 241.
125. *Id.* at 240 (quoting Michigan v. EPA, 135 S. Ct. 2699 (2015)).
126. *Michigan*, 135 S. Ct. at 2707.

"does significantly more harm than good," thereby rendering the decision arbitrary and capricious.[127]

V. *METLIFE*'S IMPLICATIONS FOR OTHER NONBANK SIFIS, FUTURE DESIGNATIONS, AND FUTURE CHALLENGES

Challenging SIFI designations with legal action in federal district court is arguably much more effective than appearing before FSOC in an evidentiary hearing. One of the main questions presented by MetLife's challenge (and victory in district court) is whether the remaining nonbank SIFIs (AIG and Prudential) will follow suit, challenging their own designations in the same way.[128] It is likely that both companies may wait until the MetLife appeal is decided to determine their next steps. Should the decision be reversed, the nonbank SIFIs may choose to keep their designations and challenge them before FSOC upon their annual reassessment. If the decision is affirmed, AIG and Prudential may very well end up filing their own suits against FSOC on the same grounds as MetLife. If Prudential and AIG keep their SIFI labels and MetLife's rescission is upheld, the companies may find themselves at a disadvantage, having to compete with a company that doesn't face the same regulatory restrictions they do.[129] This may serve as incentive enough to compel Prudential and AIG to challenge their designations also.

It is likely that AIG's and Prudential's shareholders will push for the two companies to follow MetLife's lead and challenge their SIFI designations in federal court. The companies' stock prices are likely to increase with the rescission of the SIFI label,[130] and funds currently reserved for the enhanced regulatory costs could be allocated elsewhere. Carl Icahn, a billionaire investor with a stake in AIG, has recently been pushing AIG to get "smaller and simpler" in an attempt to lose its designation.[131] He said recently that AIG's CEO should break the company into three separate insurers to help

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127. *MetLife*, 177 F. Supp. 3d at 241. FSOC filed an appeal on March 20, 2016 to the U.S. Court of Appeals for the D.C. Circuit. Oral arguments for the appeal were held on October 24, 2016. As of the publication of this Note, the appeal has not yet been decided.

128. *See* Ely Razin, *Will Prudential, AIG Follow MetLife's Model to Fight 'Too Big To Fail' Tag? There is Another Option*, FORBES (Apr. 13, 2016, 12:03 PM), http://www.forbes.com/sites/elyrazin/2016/04/13/will-prudential-aig-follow-metlifes-model-to-fight-too-big-to-fail-tag-there-is-another-option/#4fe507414f9e.

129. *See id.*

130. MetLife's stock increased 5.1% immediately following the District Court's decision to rescind MetLife's SIFI label. Tomi Kilgore, *MetLife's Stock Jumps in Active Trade After Judge Rescinds SIFI Designation*, MARKETWATCH (Mar. 30, 2016, 11:14 AM), http://www.marketwatch.com/story/metlifes-stock-jumps-in-active-trade-after-judge-rescinds-sifi-designation-2016-03-30.

131. Jeff Cox, *Why AIG, Prudential Could Face Shareholder Pressure*, CNBC (June 1, 2016, 12:54 PM), http://www.cnbc.com/2016/06/01/why-aig-prudential-could-face-shareholder-pressure.html.

avoid SIFI status.[132] While significantly decreasing operations and selling assets is clearly one effective way of shedding a SIFI label (the method successfully utilized by GE[133]), a company shouldn't have to fear growth and success because of the costs associated with being designated as systemically important. If all nonbank financial entities break themselves up solely to avoid SIFI designations, it serves a purpose completely opposite of wanting U.S. businesses to thrive and support themselves financially. It's one thing to want companies to remain financially stable—it's another to essentially push them to rid themselves of assets and diminish growth in an effort to avoid the exorbitant costs that come with a SIFI label.

It seems counterintuitive to want U.S. businesses to succeed and be able to support themselves financially, yet force them to expend countless resources on the enhanced requirements that come with a SIFI designation. Companies designated as systemically important spend millions of dollars each year on reporting and annual stress tests alone.[134] How can these nonbank financial companies be expected to remain financially stable when their resources are being spent preparing for unrealistic "what-if" scenarios? It is undoubtedly essential for all systemically important companies to have some sort of plans in place in preparation for the company's insolvency or outright failure, but causing companies to spend millions of dollars preparing for a failure that may never occur is excessive. FSOC and the Fed are going beyond comprehensive preparation and creating an outright waste of resources.

Another important consideration resulting from MetLife's suit is whether FSOC's SIFI designation process requires changes. As the District Court found in *MetLife,* FSOC employed different standards in its final determination of MetLife than the standards it provided for in its Guidance, and it did not consider MetLife's costs as the result of a SIFI designation when making its determination.[135] Regulatory agencies must be held accountable for discrepancies between public statements made regarding how they will analyze and regulate companies and how they *actually* do so. If FSOC plans to consider different factors, or to weigh and analyze the same factors differently, FSOC should be required to issue a new guidance letter informing companies and their shareholders of these changes.[136] On top of

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132. Emma Orr & Katherine Chiglinsky, *MetLife Victory Could Push AIG, Pru to Fight Systemic Risk Designations*, INSURANCE JOURNAL (Mar. 31, 2016), http://www.insurancejournal.com/news/national/2016/03/31/403746.htm.

133. *See* Mann & Tracy, *supra* note 91; *see also* Clough, *supra* note 93.

134. *See* Tracy, *supra* note 76.

135. *See* MetLife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219, 223 (D.D.C. 2016).

136. The Dodd-Frank Act provides very broad descriptions of what FSOC should use in its determinations, and it is therefore up to FSOC to provide sufficient information surrounding its determination process, so that companies can adequately prepare. *See* 12 U.S.C. § 5323(a)(2) (2012). Requiring FSOC to create and distribute guidance surrounding its determination process as

the fact that these corporations are forced to spend millions of dollars each year in preparing for enhanced regulatory requirements, now the companies may be focusing on mitigating risks that FSOC no longer considers threats. Alternatively, companies may be overlooking areas that they feel present little or no risk, whereas FSOC may be focusing more heavily on these areas in its SIFI determination process. These inconsistencies add to the waste of resources created by this enhanced regulation, and prevent a nonbank financial company from adequately addressing FSOC's areas of concern and effectively challenging their designation before FSOC.

Furthermore, Congress should reform Dodd-Frank to require FSOC to consider cost in its analysis and determination. As set forth in *MetLife* and by the Supreme Court, regulation is not appropriate if it does more harm than good.[137] Causing a company like MetLife to spend a significant amount of funds on reporting, stress tests, compliance tests, and other requirements that it could instead be using to make investments and expand capital is not only wasteful, but does the exact opposite of preparing a company for a potential financial crisis. To ensure a company can withstand a significant financial setback, the company must have adequate assets and equity available—diminishing those assets by feeding them into stress testing and reporting actually makes these companies worse-off.[138] FSOC must consider the costs associated with enhanced regulation as a result of a SIFI designation before making its designations. Congress should therefore amend Dodd-Frank to include a cost-benefit analysis requirement prior to a final SIFI designation.[139]

Arguably, the most important needs for reform surrounding FSOC's SIFI designations are the need for change in FSOC's hearing process and an appeal process within the organization. MetLife representatives met with FSOC staff numerous times during its designation process and presented FSOC staff with written materials to support its challenge; yet, FSOC still voted in favor of MetLife's proposed SIFI designation.[140]

There are several problems with challenging SIFI designations in hearings before FSOC. First, companies are not entitled to an oral hearing to

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those procedures change will help ensure fairness to all companies being reviewed and efficiency for both FSOC and the SIFIs when challenges are presented.

137. *See MetLife*, 177 F. Supp. 3d at 240 (quoting Michigan v. EPA, 135 S. Ct. 2699 (2015)).

138. Citigroup and Bank of America, specifically, have spent "tens of millions of dollars" in preparing for the Fed's stress tests, and the stock prices of many large U.S. banks have suffered because of hesitation and wariness on the part of investors afraid that over-regulation will hinder the banks' profitability. Nathaniel Popper & Michael Corkery, *Nearly All U.S. Banks Pass Fed's Stress Test*, N.Y. TIMES (June 29, 2016), http://www.nytimes.com/2016/06/30/business/dealbook/nearly-all-us-banks-pass-feds-stress-test.html?_r=0.

139. Financial stress alone, due to compliance with the enhanced regulation that comes with a SIFI label, should not imply that a company should not be designated as a SIFI. The cost-benefit analysis proposed should weigh both the costs and the hardship the proposed-SIFI will face with the need for the company to be regulated.

140. *See* METLIFE DESIGNATION, *supra* note 106.

challenge their designation—companies must request the hearing in writing and present justification for why the hearing should be granted.[141] If FSOC does not find the company's justification adequate to require a hearing, the company has no alternative means of challenging the designation before FSOC, as a hearing is a company's only opportunity after proposed designation to convince FSOC that it does not pose systemic risk.[142] This leaves a federal district court challenge as *the only* means of having a SIFI designation reevaluated and possibly rescinded. Additionally, even if the hearing is granted, FSOC members are not required to attend the hearing,[143] and the procedures for presenting information and answering questions are limited far beyond any limitations present in federal court.[144] For example, while parties in federal court are bound by the Federal Rules of Civil Procedure, in an evidentiary hearing, the hearing clerk has extremely broad discretion in establishing the procedures for the hearing. The clerk controls the amount of time a company has to create its challenge and has virtually unlimited discretion in limiting the use of written materials or the duration of the hearing.[145] Furthermore, FSOC's hearing procedures do not give companies any right to obtain data or analysis used by FSOC in making its determination.[146] To resolve these issues, FSOC should amend its internal hearing procedures to create a fairer and more formal forum for challenging designations, similar to trial procedures in federal court. Congress should also create an internal appeal process within the Treasury Department to allow companies designated as SIFIs to appeal their designation within the Treasury structure, as an alternative to bringing suit in federal district court.

A. PROPOSED CHANGES TO FSOC'S EVIDENTIARY HEARING PROCESS

In addition to the significant costs associated with challenging a designation before FSOC,[147] companies have no right to an oral hearing; companies must request and justify an evidentiary hearing, and FSOC maintains its discretion regarding whether or not to grant the hearing.[148] Even if the hearing is granted, FSOC members are not required to attend, and they may select a representative to conduct the hearing on their behalf.[149] Furthermore, FSOC's hearing procedures do not grant companies a right to discovery regarding the information and analysis used by FSOC in making

141. *See* Butler, *supra* note 98, at 672.
142. *Id.* at 669.
143. *Id.* at 673.
144. *Id.* at 678.
145. *Id.*
146. *Id.* at 676.
147. SIFIs must compile evidence supporting their challenge and justifying rescission of their SIFI label, which requires both time and effort on the part of the challenging company.
148. Butler, *supra* note 98, at 671–72.
149. *Id.* at 673.

its determination.[150] In response to this unfairness, FSOC should amend its hearing procedures to ensure due process for all companies challenging designations, and to create the fairest possible forum within the agency.

FSOC's hearing procedures expressly provide that no rights are created within those procedures.[151] Section 1(b) of the Hearing Procedures provides that the provisions of the APA governing adjudications required by statute to be determined on the record, the Federal Rules of Evidence, and the Federal Rules of Civil Procedure do *not* apply to the hearings conducted by FSOC.[152] This provision alone implies that FSOC's hearings are arguably not as fair a forum as federal court. The APA sets forth the procedures for formal adjudications[153] and FSOC should be required to comply with these guidelines to best ensure both fairness and consistency.

Under its current procedures, a company challenging a proposed SIFI designation has thirty days from the time of its designation to request a written or oral evidentiary hearing to contest the designation.[154] If granted, FSOC must hold the hearing within thirty days of the request.[155] The purpose of challenging a proposed designation is for the company to demonstrate that it would not threaten the financial stability of the U.S. through material financial distress or "the nature, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company."[156] Conducting analyses and compiling data in support of this contention can require significant time and resources, and thirty days may be insufficient to adequately prepare evidence demonstrating that the company does not pose a threat to the country's financial stability.

A favorable alternative may be an "interval hearing" system, as opposed to the "continuous hearing" system traditionally followed by courts. In an interval hearing system, the government presents its case, and the hearing is then recessed for some time to allow the respondents to prepare an adequate defense.[157] By requiring FSOC to provide detailed information regarding its determination, as well as the data and analysis FSOC considered in making that determination, and then providing a sufficient amount of time for designated companies to prepare a defense, a fairer hearing process would be created. FSOC should adopt an interval hearing system for its evidentiary

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150. *Id.* at 676.

151. U.S. DEP'T. OF TREASURY, FINANCIAL STABILITY OVERSIGHT COUNCIL HEARING PROCEDURES FOR PROCEEDINGS UNDER TITLE I OR TITLE VIII OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (2016), https://www.treasury.gov/initiatives/fsoc/designations/Documents/FSOC%20hearing%20procedures.pdf [hereinafter HEARING PROCEDURES].

152. *Id.*

153. *See generally* Administrative Procedure Act, 5 U.S.C. §§ 554–57 (2012).

154. Butler, *supra* note 98, at 671.

155. *Id.*

156. *Id.* at 669.

157. ERNEST GELLHORN & RONALD M. LEVIN, ADMINISTRATIVE LAW AND PROCESS 251 (5th ed. 2006).

hearings, and the allotted timeframe for companies to prepare a defense should be increased from thirty days to at least sixty, allowing companies more time to adequately compile necessary resources and information in order to prepare a reasonable defense.

When requiring government agencies to hold evidentiary hearings, the Supreme Court held that consideration of three distinct factors is required to ensure due process: (1) "the private interest that will be affected by the official action;" (2) "the risk of an erroneous deprivation of such interest through the procedures used and the probable value, if any, of additional or substitute procedural safeguards;" and (3) "the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail."[158] In considering these factors as applied to FSOC and SIFI designation, the private interest affected is the designated company's assets and resources. There are costs associated with enhanced regulation and costs associated with challenging the designation as well.[159] These costs are significant, as millions of dollars go into regulatory requirements such as stress testing every year.[160] The government's interest here is the financial stability of the U.S. economy, an obviously important interest.[161] The risk of an erroneous deprivation of a designated company's assets and resources, however, is also significant, and very plausible. If a company is incorrectly designated as a SIFI and adequate tools are not in place to ensure a fair method for the company to challenge its designation, that company will spend millions of dollars on complying with regulatory requirements that it may not actually need to comply with. To ensure due process, proper measures need to be taken to create a fair forum for challenging designations, and that can be accomplished by modeling FSOC's evidentiary hearings more closely after proceedings in federal district court.

Another significant shortcoming in FSOC's evidentiary hearing process is the lack of possible discovery.[162] Civil suits brought in federal and state court routinely permit pretrial discovery,[163] and the advantages of discovery practice include ensuring fairness to the litigants and preventing "trial by

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158. Mathews v. Eldridge, 424 U.S. 319, 335 (1976).

159. As previously noted, additional costs that come with a SIFI label include the costs of preparing for and completing the Fed's stress tests, as well as additional reporting requirements and requiring companies to have more available capital. *See* Tracy, *supra* note 76. Costs associated with preparation of a SIFI challenge can include attorney's fees, the time and resources used to prepare and compile data, and analysis supporting rescission of the SIFI label.

160. *See id.*

161. The purpose behind FSOC, the SIFI designation process, and enhanced regulation was arguably to prevent another U.S. financial crisis such as the one the country experienced in 2008. *See generally About FSOC, supra* note 9. This interest cannot be disregarded, as this was likely Congress' main reason for creating the Dodd-Frank Act, however, it needs to be balanced against the private party's interest. *See Mathews*, 424 U.S. at 319, 335.

162. *See* Butler, *supra* note 98, at 676–77.

163. GELLHORN & LEVIN, *supra* note 157, at 257.

surprise," encouraging settlements, and improving the efficiency of the trial and the quality of the decision.[164] The APA does not contain specific provisions related to discovery and, therefore, many agencies have different rules regarding discovery.[165] Some agencies, such as the Federal Trade Commission, have adopted broad discovery rules that mirror those in federal court,[166] whereas other agencies provide only limited opportunities for discovery before a hearing.[167] Agencies that limit discovery arguably do so to prevent costly and time-consuming "discovery wars,"[168] but that should not be a concern regarding companies seeking to rescind a SIFI label. Companies challenging a SIFI designation arguably want to get their label rescinded as quickly as possible—it would not make sense for these companies to drag out the hearing process. Additionally, having the right to discovery is practically essential in order to successfully challenge a SIFI label.[169]

FSOC's hearing procedures do not provide a right to discovery regarding the analysis and data that FSOC used in its determination, beyond the explanation FSOC provides accompanying the notice of proposed designation.[170] These explanations are vague and do not provide specific information about what exactly FSOC considered in its designation process or how it reached its determination.[171] The letters use terms like "significant presence" and "highly complex," but do not necessarily provide the specific assets or amounts that tipped the scale in favor of a designation.[172] To be able to effectively argue against a determination, the company needs to know the specific data considered and the analysis used. It is extremely difficult to argue that a company does not have a "significant presence" in the industry without knowing exactly what constitutes "significant." By requiring discovery and evidence procedures similar to those in federal court, companies challenging their designations will be able to gather all the information they need to bring an informed, effective, and well-prepared challenge. This will not only ensure fairness, but will limit resource waste. Expending time and money to challenge a broadly defined designation with little chance of success is wasteful. If companies are going to spend time and money challenging FSOC, they need to be able to do so with as much adequate preparation as is fairly possible.

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164. *Id.*
165. *Id.*
166. *Id.*
167. *Id.*
168. *Id.* at 257–58.
169. A company challenging a SIFI designation needs to know exactly what factors FSOC considered in their designation process to effectively challenge the label. Without having access to FSOC's analysis and factors considered, a SIFI challenging its label will arguably be unable to effectively justify rescission of its label, and therefore, discovery is necessary.
170. Butler, *supra* note 98, at 676.
171. *See generally* AIG DESIGNATION, *supra* note 58.
172. *See id.*

B. PROPOSED APPEAL PROCESS WITHIN THE TREASURY DEPARTMENT

Another safeguard to ensure fairness for challenging SIFI designations is the creation of an appeal process within the Treasury Department, so that companies can appeal their challenge within the structure of the agency before resorting to federal court. Since FSOC is a part of the Treasury Department,[173] Congress should create a mechanism within that agency that can hear appeals from FSOC's evidentiary hearings. High-ranking officials within the Treasury Department are arguably better equipped to review these decisions and challenges than members of the judiciary, at least in the first instance. Additionally, companies should have to exhaust all possible alternatives before bringing suit in federal court, and requiring an appeal within the agency is a method of ensuring exhaustion.

Members of the Treasury Department may be in a better position to decide challenges to SIFI designations than federal judges. It is important to note that FSOC's Chair is the Secretary of the Treasury Department;[174] therefore, he or she should not serve in the new appeal process, as that will arguably create a conflict of interest. Congress should create a panel of Treasury Department officials who can hear the challenge and review evidence from both sides,[175] ultimately making a determination as to whether the designation should stand or be rescinded. There are several offices within the Treasury Department,[176] and panel members can and should come from a variety of these offices, including the Office of Economic Policy, the Office of Legislative Affairs, the Office of Public Affairs, Chief Risk, the Office of the Treasurer, and the Office of Domestic Finance.[177] By creating a diverse panel of impartial Treasury Department officials with widespread knowledge of finance and the U.S. economy, Congress can ensure a fair group for hearing appeals challenging SIFI designations. Arguably, these officials will be better equipped to review and understand the challenges brought before them than federal judges,[178] making it easier for companies to effectively present the data and analysis being used to contest the challenge.

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173. *Designations, supra* note 33.

174. *See About FSOC, supra* note 9.

175. Both FSOC and the challenging SIFI should be able to appeal within the Department and be able to present their arguments and supporting evidence before the panel. This is another reason why the Treasury officials serving on such proposed panel need to be independent from those officials serving as members of FSOC.

176. *See Organizational Structure*, U.S. DEP'T. OF TREASURY, https://www.treasury.gov/about/organizational-structure/Pages/default.aspx (last updated Jan. 23, 2017, 4:33 PM).

177. *Id.*

178. While a federal judge may very well be capable of successfully analyzing and reviewing a SIFI designation appeal, because the Treasury Department officials who would make up a proposed appellate panel are arguably experts in this area, they should be *exceptionally*-equipped to adequately review and understand the implications of a designation and its rescission and should be able to make a well-informed decision regarding the appeal. Such experts should be utilized for their expertise where possible, such as here.

An important aspect of administrative law that should also be considered here is the need for exhaustion. When a person or company challenges an agency action in court while an administrative proceeding is still underway, the court will usually dismiss the action for failure to exhaust all possible administrative remedies.[179] Since FSOC's hearing procedures provide that they are not governed by the APA,[180] exhaustion is not required with regard to FSOC challenges. Companies may choose to bring suit against FSOC directly in federal court while their evidentiary hearing is pending, or without even requesting an evidentiary hearing. In that case, the court will not be *required* to dismiss the claim for failure to exhaust all administrative remedies. Creating a fair hearing process with an internal appeal system, and having both of these governed by the APA, will require companies to exhaust all remedies prior to bringing action in federal court.[181] This will help conserve judicial resources for cases where they are truly needed. Furthermore, some of the issues addressed in a SIFI label challenge may be so broad and encompassing regarding financial stability that the Treasury Department officials should have the final say in the matter, considering they make up the part of the U.S. government primarily concerned with preserving and enhancing the U.S. economy.[182]

Exhaustion serves several purposes, including preventing regulated parties from delaying or obstructing the agency's ability to conduct an orderly proceeding, giving the court the benefit of the agency's fact-finding capacity and expertise in analyzing the factual assertions underlying the plaintiff's complaint, and preventing unnecessary judicial relief by requiring postponement until the end of the administrative proceeding.[183] By creating an internal appeal process within the Treasury Department and requiring exhaustion of such remedies before an entity may bring suit against FSOC in federal court, a more robust record will be created that will be beneficial to a federal court later on, should the case eventually make its way there. Arguments will have been presented and perfected, and even though this may essentially remove the need for a company to ultimately bring suit in federal district court, if they ultimately decide to do so, both parties will have ample support for their arguments, thus conserving significant time and resources in both the pretrial and trial stages.

179. GELLHORN & LEVIN, *supra* note 157, at 391.

180. *See* HEARING PROCEDURES, *supra* note 151.

181. Challenging companies will need to request an evidentiary hearing before FSOC and should they choose to appeal FSOC's decision after the hearing, they *must* do so within the agency's new internal appeal process before they can sue in federal court or the court will have discretion to dismiss the action until the internal appeal has been completed.

182. *See About*, U.S. DEP'T. OF TREASURY, https://www.treasury.gov/about/role-of-treasury/Pages/default.aspx (last updated Apr. 22, 2016, 2:03 PM).

183. GELLHORN & LEVIN, *supra* note 157, at 391–92.

VI. CONCLUSION

The costs associated with a SIFI designation are significant, and it is obvious why companies designated as SIFIs have been eager to challenge such designations. A company may diminish its size and assets in an attempt to have FSOC rescind its SIFI label. However, if a company does not wish to decrease its operations, it may utilize two methods to challenge its designation: requesting an evidentiary hearing before FSOC, and bringing suit in federal district court. FSOC's hearing procedures, however, do not provide the same rights afforded to parties in federal court, and arguably, these hearings are an unfair forum for challenging SIFI designations.

To ensure fairness for companies challenging SIFI designations, FSOC should amend its evidentiary hearing procedures to comply with the same guidelines followed by the federal courts, and should be governed by the APA. This will create rights to discovery, allow companies more time to adequately prepare evidence to support their challenges, and require exhaustion prior to being able to bring a challenge in federal court. Additionally, Congress should reform Dodd-Frank to create an internal appeal process within the Treasury Department to allow nonbank SIFIs to challenge their designations within the agency before a panel of impartial, experienced Treasury Department officials. Congress should also reform Dodd-Frank to require a cost-benefit analysis of a SIFI label as part of FSOC's designation process, as "[n]o regulation is appropriate if it does significantly more harm than good."[184]

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184. MetLife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219, 240 (D.D.C. 2016) (quoting Michigan v. EPA, 135 S. Ct. 2699 (2015)).

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