The Lebanese American University

Unravelling the Financial Stability Oversight Council: The MetLife, Inc. Case

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A thesis

Submitted in partial fulfilment of the requirements for the degree of Masters in Business Law

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March 2020

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Abstract

The 2007-2008 financial crisis was a devastating on many households peaking global unemployment at 10% and dropping Global GDP by 5%. To deter another financial crisis the United States government passed the most complex and stringent legislation since the Great Depression of the 1930's. The legislation created many agencies, and the 'Financial Stability Oversight Council', FSOC, was the most prominent agency that designated bank and nonbank financial institutions as 'Systemically Important Financial Institutions', or SIFIs. The designation mandates the organizations to adhere to extensive and costly 'prudential standards' and 'enhanced supervision'. Several institutions were designated, however, only MetLife, Inc. fought its designation in the Court which led to rescinding, the remaining institutions designations followed. The focus of this work will be the introduction of the FSOC and its reasoning to the designation of MetLife along with the legal framework that took part in the court and led to the rescinding of MetLife's designation along with the rescinding of other designations. The subject matter of this thesis is a good example of the reasonableness of laws & regulations.

Keywords: MetLife, Inc., Financial Stability Oversight Council, Prudential Standards, Enhanced Supervision, Stability, United States, Economy.

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Chapter 1: Introduction

The Great Recession, the most severe economic recession in the United States since the Great Depression of the 1930s, is the economic downturn that took place from 2007 - 2009 after the busting of the United States Housing bubble and global financial crisis. The Great Depression featured a gross domestic product (GDP) drop of more than 10% and an unemployment rate that reached a high of 25%. Although there are no clear criteria to distinguish a depression from a recession, there is a agreement among economists that the downturn of the late 2000s, during which the United States GDP declined by 0.3% in 2008 and 2.8% in 2009 along with a brief unemployment rate of 10%, did not reach the depression criterion. However, the event is, without question, the worst economic downturn since the Great Depression (Chappelow , 2019).

After the crisis, Barak Obama, the United States president, wanted to show a strong standing response to the financial crisis and prevent another one from occurring. In 2010, he signed into law The Dodd-Frank Act, officially called the Dodd-Frank Wall Street Reform and Consumer Protection Act. The complex and dense Dodd-Frank instilled regulations on the financial industry and created programs to stop mortgage companies and lenders from taking advantage of consumers. The act remains an interesting topic in American political scene as many supports the restrictions and control on Wall Street, while others criticize it claiming that it burdens investors with too many strict rules that hinder economic growth.

The Dodd-Frank act was designed for simple but necessary reasons, but mainly to:

1) Promote the US financial stability by improving accountability and transparency in the overall financial system,
2) to protect the US citizens by ending bailouts,
3) to protect consumers from abusive financial services practices and,
4) to end ‘too big to fail enterprises

The Dodd-Frank act was clearly an aggressive reform with strong emphasis on financial stability, prudential regulation and consumer protection.

Chapter 2: The Dodd Frank Act- Rise from the Ashes

According to the first official government issued report by the "Financial Crisis Inquiry Commission (FCIC)" who researched and investigated the root causes of the financial and economic crisis and by reviewing "millions of pages of documents, interviewed more the 700 witnesses, and held 19 days of public hearing in New York, Washington, C.C., and communities across the country that were heavily impacted" (Financial Crisis Inquiry Commission, 2011). The Commission also "resorted to the large body of work about the crisis developed by congressional committees, government agencies, legal investigators, academics, journalists, and many others. The Commission conducted research into several subjects, such as mortgage lending and securitization, derivatives, corporate governance, and risk management." (Financial Crisis Inquiry Commission, 2011). For practical purposes, it conducted case study investigations of specific financial firms that had critical roles. "Those institutions included American International Group (AIG), Bear Stearns, Citigroup, Countrywide Financial, Fannie Mae, Goldman Sachs, Lehman Brothers, Merrill Lynch, Moody's, and Wachovia." (Financial Crisis Inquiry Commission, 2011). The Commission also looked at the roles and actions of scores of other companies but in a more general way. "The Commission studied relevant policies put in place by successive Congresses and administrations and examined the roles of policy makers and regulators, including at the Federal Deposit Insurance Corporation, the Federal Reserve, the Federal Reserve Bank of New York, the Department of Housing and Urban Development, the Office of the Comptroller of the Currency, the Office of Federal Housing Enterprise Oversight (and its successor, the Federal Housing Finance Agency), the Office of Thrift

Supervision, the Securities and Exchange Commission, and the Treasury Department" (Financial Crisis Inquiry Commission, 2011).

The commission concluded that the crisis was avoidable and a direct result of human actions, inactions and misjudgments. The main causes are as follows:

1) "Widespread failures in financial regulation, including the Federal Reserve's failure to stem the tide of toxic mortgages;
2) Dramatic breakdowns in corporate governance including too many financial firms acting recklessly and taking on too much risk;
3) An explosive mix of excessive borrowing and risk by households and Wall Street that put the financial system on a collision course with crisis;
4) Key policy makers ill prepared for the crisis, lacking a full understanding of the financial system they oversaw;
5) And systemic breaches in accountability and ethics at all levels" (Financial Crisis Inquiry Commission, 2011).

Phil Angelides, Chairman of the Commission said "Despite the expressed view of many on Wall Street and in Washington that the crisis could not have been foreseen or avoided, there were warning signs. The greatest tragedy would be to accept the refrain that no one could have seen this coming and thus nothing could have been done. If we accept this notion, it will happen again."

The Commission's report also provided conclusions on specific components of the financial system that contributed significantly to the financial meltdown. There the Commission concluded that "collapsing mortgage-lending standards and the mortgage securitization pipeline lit and spread the flame of contagion and crisis, over-the-counter derivatives contributed significantly to this crisis, and the failures of credit rating agencies were essential cogs in the wheel of financial destruction."

The Commission also "examined the role of government sponsored enterprises (GSEs), with Fannie Mae as the case study. The Commission found that the GSEs contributed to the crisis but were not a main cause. They had a deeply defective business model and suffered from many of the same failures of corporate governance and risk management seen in other financial firms but ultimately followed rather than led Wall Street and other lenders in purchasing subprime and other risky mortgages." (Financial Crisis Inquiry Commission, 2011).

In brief, the report identified failure on the part of the government to regulate the financial industry and the FEDs inability to curb toxic mortgage lending. In addition, too many financial firms taking on too much risk whereby the shadow banking system, which included investment firms, rivaled depository banking without its matching scrutiny or regulation. When the shadow banking system failed, the outcome impacted the flow of credit to consumers & businesses enabling the creation of credit across the global financial system but whose members are not subject to regulatory oversight. The "shadow banking system consists of lenders, brokers, and other credit intermediaries who fall outside the realm of traditional regulated banking. It is generally not regulated nor subject to the same kinds of risk, liquidity, and capital restrictions as traditional banks are." (Chappelow, 2019). Other causes that led to financial collapsing was the excessive borrowing by consumers and corporations and lawmakers who were not able to understand the financial system collapse.

To recover from the Great Recession, aggressive monetary policies by the Federal Reserve and other central banks was taken and credited with limiting the damage to the global economy. The federal reserve “lowered a key interest rate to nearly zero to promote liquidity and, for the first time, provided banks with $7.7 trillion of emergency loans in a policy known as quantitative easing. Along with the flood of liquidity by the Fed, the U.S. Federal government embarked on a massive program of fiscal policy to try to stimulate the economy in the form of the $787 billion in deficit spending under the American Recovery and Reinvestment Act, according to the Congressional Budget Office” (Chappelow, 2019).

Also, the government put new financial regulation place. According to some economists, the repeal of the Glass-Steagall Act, the depression-era regulation, in the 1990s helped cause the recession. The repeal of the regulation allowed some of the United States' larger banks to merge and form larger institutions. Therefore in 2010, President Barack Obama signed ‘The Dodd-Frank Wall Street Reform and Consumer Protection Act’ (Dodd-Frank) to give the government expanded regulatory power over the financial sector.

This Act, named after sponsors Sen Christophe J. Dodd and Rep. Barney Frank, contains provisions that were to be implemented over a certain timeframe. A comprehensive piece of legislation that brought the most significant changes to financial regulation in the United States since the reform that followed the Great Depression, Glass-Steagall, which included 16 major areas of reform. The law places strict regulations on the financial industry to protect consumers and prevent another economic recession. The main method to accomplish its aim was by increasing the mechanisms through which the government can regulate and enforce laws against banks and financial institutions. The

Dodd-Frank created several new federal agencies to facilitate the mission of the consumer protection and financial regulation.

The most well-known agency is the Financial Stability Oversight Council (FSOC), which will be the most relevant to this paper as this agency designated Bank & Non-Bank financial institutions as Systematically Important financial Institution (SIFI). The most interesting of designations was the MetLife one which was heavily challenged in the courts.

2.1 The Financial Stability Oversight Council (FSOC)

The FSOC, or the Council, "has a statutory mandate that for the first time created accountability for identifying risks and responding to emerging threats to the financial stability. Chaired by the Secretary of the Treasury, it's a collaborative body that brings together the combined experience of the federal financial regulators, state regulators and independent insurance expert appointed by the President". The FSOC has "very important new authorities to contain extreme risk in the financial system. For example, the FSOC can designate a nonbank financial firm for stringent new supervision to help lessen the risk threatening the stability of the financial system" (Chappelow, 2019).

Additionally, to help "identify developing risks to the financial stability, the FSOC can provide direction to, and request data and analyses from, the Office of Financial Research (OFR) that is held within Treasury" (What is the Financial Stability Oversight Council (FSOC) and what does it do?, n.d.).

The OFR reports to the Treasury and was established to support the work of the FSOC and tasked with:

1) Gathering and standardizing data,
2) Performing applied & long-term research; and
3) Developing tools to monitor quantify risk

Preceding the financial "crisis, the financial governing framework in the United States attended mostly individual institutions & markets, that permitted supervisory gaps and irregularities to grow and emerge leading to arbitrage and weakened standards" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

These was no regulator with monitoring responsibility, or even attending to overall risks to the financial stability, which involved several kinds of financial firms working across numerous markets leaving imperative portions of the system unattended.

The Act attended to these issues by creating the FSOC agency authorizing it to:

1) Enable Regulatory Co-ordination: To facilitate information sharing and coordination among the associated agencies regarding domestic financial services policy development, reporting requirements, examinations, rulemaking, and enforcement actions. This would help reduce gaps and strengthen the regulatory structure, along with promoting a safer and more stable system.
2) Enable Information collection & sharing: Facilitate the sharing of data and information among the associated agencies. Direct the OFR to collect information from certain financial companies in order to assess risks to the financial system. The collection and analysis of data will help the FSOC remove blind spots within

in the financial system and support regulators in identifying risks & developing threats.

3) Designate Nonbank Financial Companies for Consolidated Supervision: The FSOC had the authority to necessitate consolidated supervision of nonbank financial companies, irrespective of their corporate form.
4) Designate Systemic Financial Market Utilities and Systemic Payment, Clearing, or Settlement Activities: The FSOC can designate financial market utilities that complete payment, clearing, or settlement activities as systemic. This requires them to meet arranged risk management standards and sensitive oversight by the Federal Reserve, the Securities and Exchange Commission, or the Commodities Futures Trading Commission.
5) Recommend Stricter Standards: The FSOC can recommend stricter standards for the largest, most interconnected firms, including designated nonbank financial companies, as described above. Also, where the FSOC determines that certain practices or activities pose a threat to financial stability, they may make recommendations to the primary financial regulatory agencies for new regulatory standards.
6) Break Up Firms that threaten the Financial Stability: The significant role in determining whether action should be taken to break up those firms that pose a serious threat to the financial stability of the US.

The FSOC was given “broad authorities to identify and monitor excessive risks to the U.S. financial system arising from the distress or failure of large, interconnected bank holding companies or non-bank financial companies, or from risks that could arise outside the financial system; to eliminate expectations that any American financial firm is ‘too big to fail’; and to respond to emerging threats to U.S. financial stability” (Stupak, 2018).

Chapter 3: The MetLife Designation

Recognizing that the FSOC was founded with 3 purposes:

1) promoting market discipline;
2) identifying U.S. financial stability risks; and
3) responding to developing threats to the U.S financial system stability

To mitigate conceivable risks to U.S. financial stability, the FSOC is authorized to determine that some non-bank financial corporations can be, by the "Board of Governors of the Federal Reserve System, supervised and subject to enhanced prudential standards".

Since MetLife was regarded by the FSOC as an important player in the economy and financial markets in the U.S., that is intertwined to other financial companies via its products related to insurance and activities in capital markets, and for the reasons that will be elaborated in later stages of this paper, the FSOC found "that MetLife's material financial distress could weaken the financial intermediation or functioning of financial markets that would be severe enough to impair the economy".

In light of all the factors that the FSOC considered in its evaluation, the FSOC made a final determination "that MetLife's financial distress can threaten the financial stability of the U.S." and must be overseen by the Board of Governors along with being subject to "enhanced prudential standards". Noting that FSOC's determination doesn't infer a conclusion that "MetLife is undergoing substantial financial distress, nor does it infer that it is likely to. Rather, the FSOC has determined that material financial distress at

MetLife could pose a threat to the financial stability of the U.S. if it were to occur" (What is the Financial Stability Oversight Council (FSOC) and what does it do?, n.d.).

MetLife got notified by the FSOC that was under consideration for a proposed determination during July 2013. In reaching its conclusion, the FSOC considered public & regulatory sources of data along with data provided by MetLife.

The FSOC decided to make a proposed determination regarding MetLife by holding a vote and notified the company and explained the basis of the proposed determination. MetLife requested a hearing before the Council that was granted and held on November 3rd, 2014. "MetLife's submissions were considered in the following month the FSOC made a final determination and provided a detailed statement of the basis for the its decision" (Basis for the Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

The detailed basis statement relied on non-public data that was given by MetLife, such as:

1) "the size, collateralization, and liquidity of the company's securities lending program;
2) the amounts & types of counterparty exposures to MetLife rising from the company's guaranteed investment contracts (GICs), securities issuances, and derivatives activities;
3) the scale of the company's insurance liabilities with discretionary withdrawal features; and
4) the impact on capital of the company's use of captive reinsurance; the terms of inter-affiliate transactions".

The FSOC is mandated to keep specific information that was submitted to it confidential. Thus, the public clarification for basis for the FSOC's final determination did not include such information. The public clarification addresses "key factors that the FSOC measured in its evaluation of MetLife and the main reasons for its determination". The clarification was intended to give public and Congress the understanding of the analysis, and at the same time protect the confidential info submitted by MetLife (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

3.1 The Legal Analysis for the Final Determination

A "nonbank financial company" can be determined, by the FSOC, that it "will be supervised by the Board of Governors and get subjected to prudential standards if the FSOC finds that either the First or Second Determination Standard is met".

1) "The First Determination Standard: material financial distress at the nonbank financial company could threaten the financial stability of the U.S, or
2) The Second Determination Standard: the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company can threaten the financial stability of the U.S." (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

The FSOC assessed MetLife under the First Determination Standard.

During its consideration, the FSOC is must consider the following 10 statutory factors (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014):

1) "the leverage degree of the company;
2) the level and nature of the transactions & relationships with other significant nonbank financial companies and bank holding companies;
3) the level & nature of the company's off-balance-sheet exposures;
4) the significance of the company as a source of credit for businesses, households, and State and local governments & as a liquidity source for the U.S. financial system;
5) the company's significance as a source of credit for low-income, minority, or underserved communities, and the effect that the company's failure on the availability of credit in those communities;
6) the company's nature, scope, size, scale, concentration, interconnectedness, and mix of the activities;
7) the degree of which assets are being managed instead of owned by the company, and the degree of which ownership of assets under management is diffuse;
8) whether company is already regulated by 1 or more primary financial regulatory agency;
9) the amount & nature of the financial assets of the company; and
10) the liabilities of the company in terms of types & amount, including the degree of reliance on short-term funding."

In its determination, the FSOC states that it considered all the statutory consideration mentioned in the Dodd-Frank Act along with all the facts of record. The

FSOC implemented a rule and “interpretive guidance” (Basis for The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014). which explains the way FSOC uses the considerations and statutory standards, along with the procedures and processes that FSOC follows, in making determinations. The rule and “Interpretive Guidance” define the factors that the FSOC should utilize whilst scrutinizing establishments in different phases of the determination course. “Based on an evaluation of each of the statutory considerations and whilst taking into account facts and circumstances relevant to the company, the FSOC makes a decisive valuation of whether financial establishment meets the statutory standard for determination” (Basis For The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014).

The ‘Interpretive Guidance’ clarifies the basis that the FSOC developed to cluster the 10 statutory considerations into 6 groups:

1) size,
2) leverage,
3) substitutability,
4) interconnectedness,
5) existing regulatory supervision and scrutiny, and
6) liquidity risk & maturity mismatch.

MetLife was examined using suitable data relevant to each of these 6 groups. The “Interpretive Guidance” defined the relevant legal terms of the determinations course. Also, it states that the FSOC 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 addition, the “Interpretive Guidance” states that the FSOC will find that “material financial distress” occurs when a financial establishment “is in imminent danger of insolvency or defaulting on its financial obligations.”

The FSOC’s analysis, in alignment with its duty, stresses on the conceivable result of substantial monetary distress at MetLife “in the context of a period of overall stress in the financial services industry and in a weak macroeconomic environment.” Thus, FSOC measured a many possible consequences that differ in likelihood of occurring.

3.2 Transmission Channels for Material Financial Distress

A weakening of financial intermediation and financial market operation can happen through several channels . In the “Interpretive Guidance”, the FSOC recognized the succeeding “channels as most likely to enable the transmission of negative effects of financial establishment’s substantial monetary distress to other financial firms and markets” (Basis for The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014):

1) *“Exposure*: if a non-bank financial company’s creditors, counterparties, investors, or other market participants have exposure to the company that’s significant enough to materially impair them and thus threaten the financial stability of the U.S.
2) *Asset liquidation*: FSOC evaluates whether a financial establishment carries assets that, if quickly liquidated, would lead to a drop in the asset prices and thus disrupt

trading /or funding in key markets significantly or lead to material losses or funding issues for other similar firms.

3) *Critical function or service*: The possible impact if a financial establishment company is unable or keen to offer a critical function or service that is depended on by market members and that have no ready alternatives".

Nevertheless, the "Interpretive Guidance" elaborates that the risk a financial establishment has on the financial stability can be worsened if the establishment is adequately "complex, opaque, or difficult to resolve in bankruptcy in a manner that its resolution in bankruptcy can disturb key markets. An establishment's resolvability could alleviate or worsen the likelihood for the establishment to threaten the financial stability of the United States".

3.3 Is MetLife Eligible for Final Determination?

The FSOC is lawful to find that a "nonbank financial" establishment will be subject to supervision by the "Board of Governors" and to "enhanced prudential standards". (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). An establishment "is eligible for a determination by the FSOC, if its mainly involved in financial activities, subject to certain exceptions." (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). A establishment is mainly involved in financial activities if "at least 85% of the company's and all of its subsidiaries' annual gross revenues are derived from, or at least 85 % of the company's and all of its subsidiaries' consolidated assets are related to", "activities that are financial in nature" as "defined by the Bank Holding Company Act of 1956, as amended"

(Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

MetLife has in excess of 85% of their revenues resulting from doings "that are financial in nature, and more than 85 % of its assets are connected to activities that are financial in nature" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). Therefore, MetLife is qualified for the FSOC's final determination.

3.4 Introducing MetLife

MetLife, Inc., a Delaware corporation, is a publicly traded holding company with its headquarters in New York City. A prominent member in "financial markets and the U.S economy", MetLife was considered by the FSOC as "interconnected to insurance companies and other financial firms through its capital market activities and products". It is the largest publicly traded U.S insurance organization and, based on total assets, is considered one of the biggest financial services companies in the U.S.

As of September 2014, MetLife had (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014):

1) A total of $909 billion in consolidated assets, split between
    - General Account (MetLife account) amounting to $516 Billion invested assets (monies & its equivalents),
    - Separate account (clients account) assets amounting $319 Billion and,
    - $ 74 Billion in others

2) $71 Billion in total equity

3) $61 Billion in market capitalization.

MetLife is a leading provider of several “financial services, including:

1) group and individual life insurance,

2) annuity products, and

3) retirement-related products and services.”

It is the largest provider of life insurance in the U.S as calculated by total Statutory Accounting Principles “SAP”. MetLife has “admitted assets and gross life insurance in-force, with $4.4 trillion of gross life insurance in-force (excluding annuities) as of December 31, 2013” and it functioned in nearly 50 countries through 359 subsidiaries (Basis For The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014).

As of September 30th, 2014, MetLife had “more than 75% of its assets and revenues from its U.S. and Latin American operations”. Its assets “located outside of the U.S are mainly in Asia. Other regions including Asia is Europe, the Middle East and Africa. Its U.S. operations are managed by line of business” (Basis for The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014), including:

1) Retail; which offers “whole life, term life, variable life, and universal life insurance; disability and property and casualty insurance; and fixed and variable annuities”

2) Group Benefits,

3) “Voluntary & Worksite Benefits”; and

4) “Corporate Benefit Funding”.

The “Group, Voluntary & Worksite Benefits business line provides term life, variable and universal life, disability, dental, and property and casualty insurance. The Corporate Benefit Funding line of business mainly manages the company’s institutional business, which offers insurance, annuity, and investment products that include GICs, funding agreements, other stable value products, and separate account contracts for the investment management of defined benefit and defined contribution plan assets” (Basis For The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014). Moreover, “MetLife provides institutions with products to fund post-retirement benefits and corporate-owned, bank-owned, insurance company-owned life insurance, and trust-owned life insurance (COLI, BOLI, ICOLI, and TOLI, respectively) for certain corporate employees” (Basis For The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014). “MetLife’s U.S. insurance company subsidiaries are regulated and supervised by their respective home state insurance regulatory authorities which, as of December 31st, 2013, include New York, Connecticut, Delaware, Rhode Island, and Missouri” (Basis for The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014).

Domiciled in New York, Metropolitan Life Insurance Company (MLIC), one of MetLife’s wholly owned subsidiaries, has approximately $396 billion in assets, over 40 % of MetLife’s total consolidated assets. MLIC underwrites life insurance and issues annuity products, which are sold to individuals, corporations, and other institutions along with their employees.

"On November 17th, 2014, MetLife announced that it had completed a merger of four insurance subsidiaries (MetLife Investors USA Insurance Company, MetLife Investors Insurance Company, Exeter Reassurance Company Ltd., and MetLife Insurance Company of Connecticut) into a single surviving company domiciled in Delaware named MetLife Insurance Company USA. Prior to the merger, these entities had total combined assets of over $150 billion" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

3.5 MetLife During the Recent Financial Crisis

The FSOC stipulated that like many companies throughout the financial crisis, MetLife had a substantial decrease "in the value of its assets". "MetLife's GAAP total equity significantly decreased between 2007 and the first quarter of 2009, due in part to the reduced value of the company's fixed income portfolio" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). In 2008, among life insurers in the U.S, "MetLife had the second largest amount of unrealized losses, and in 2009, MetLife's unrealized losses amounted to 22.5% of all unrealized losses among life insurers" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). Although much of the reductions in the worth of its assets continued unrealized, this experience was used by the FSOC as suggestive of the weight of MetLife's investments and the extent the value of that portfolio can drop.

During the crisis, MetLife had several funding options. "In the times of the crisis, MetLife was a bank holding company, which gave it access to a range of liquidity and capital sources offered to banking entities. MetLife did utilize several emergency federal government-sponsored facilities. During 2008 - 2009, MetLife's subsidiary bank accessed the Federal Reserve Term Auction Facility nearly 20 time for a total of $17.6 billion in 28-day loans and $1.3 billion in 84-day loans" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

"In March 2009, MetLife raised $397 million through the Temporary Liquidity Guarantee Program run by the Federal Deposit Insurance Corporation (FDIC), which allowed it to borrow funds at a lower rate than it otherwise would have been able to obtain. Additionally, MetLife borrowed $1.6 billion through the Federal Reserve's Commercial Paper Funding Facility. MetLife also accessed the capital markets beyond the use of TLGP during the crisis. MetLife also raised additional capital via debt and equity issuances between April 2008 and July 2009" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

3.6 Possible Effects of MetLife's Financial Distress

In accordance with the Act & the "Interpretive Guidance", the FSOC studied "the extent to which material financial distress at MetLife could be transmitted to other financial firms and markets and thereby pose a threat to U.S. financial stability through 3 transmission channels" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014):

1) *Exposure*: if a "non-bank financial company's creditors, counterparties, investors, or other market participants have exposure to the company that's significant

enough to materially impair them and thereby pose a threat to U.S. financial stability".

2) *Asset liquidation*: The FSOC "assesses whether a nonbank financial company holds assets that, if liquidated rapidly, would cause a fall in asset prices and thereby significantly disrupt trading /or funding in key markets or cause significant losses or funding complications for other similar companies".

3) *Critical function or service*: The possible impact if a nonbank financial company is left unable to offer an important function or service that market participants depend on and there are no alternatives.

In its assessment of if MetLife's financial distress "could be conveyed to other firms and markets through the transmission channels and cause a greater weakening of financial intermediation or of financial market functioning", the FSOC took into consideration the legal aspects set in the Dodd-Frank Act.

Given "MetLife's size, leverage, interconnectedness with other large financial firms & financial markets, provision of products that may be surrendered for cash at the will of its institutional and retail contract holders and policyholders, and impediments to its rapid and orderly resolution, the FSOC found that material financial distress at MetLife could have significantly impact a broad range of financial firms and financial markets, and could impair financial intermediation or financial markets functionality that could be sufficiently severe to inflict significant damage on the economy". Accordingly, the FSOC found that MetLife's substantial financial distress puts the United States financial stability at risk. The FSOC had considered a wide set of data in its analysis, the following defines imperative aspects it considered in MetLife's determination.

The threat to the U.S financial stability that could be posed by substantial financial distress at MetLife's mainly comes from the exposure & asset liquidation transmission channels. The critical function or service channel can also worsen the extent that the distress could be transmitted to the entire financial system and economy. "In addition, MetLife's complexity, intra-firm connections, and possible difficulty to resolve, heighten the risk that the company's material financial distress could materially impair financial intermediation & financial market functioning, noting that large financial intermediaries have significant exposures to MetLife arising from the company's institutional products and capital markets activities, such as funding agreements, general and separate account GICs, pension closeouts, securities lending agreements, and outstanding indebtedness. The company's material financial distress could also expose certain of MetLife's approximately 100 million worldwide policyholders and contract holders to losses." (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

"If MetLife were to experience material financial distress, it could be forced to liquidate assets to meet its obligations to counterparties, contract holders, and policyholders. A liquidity strain could come from MetLife's institutional & capital market products that can be early termination or not renewed at the liberty of counterparties, or from the substantial portion of the company's insurance liabilities that policyholders can surrender. in exchange for cash value. A required by state laws, in lieu of surrenders for life insurance products that accrue a cash value, policyholders may borrow against their outstanding policies" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). A forced liquidation of its huge portfolio of comparatively non-liquid assets could disturb trading or funding markets. A forceful liquidation of assets can be intensified by the leverage of MetLife.

MetLife is “leading in many financial markets, including life insurance, retirement products, and commercial real estate lending. Though the transmission of stress could be intensified through the critical function and service channel, especially in times of macroeconomic pressure in markets where MetLife is a key player, the company’s contribution in these markets is not large enough to lead significant disruption in providing of services if the company were to experience material financial distress” (Basis For The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014).

3.7 First Transmission Channel: Exposure

“The exposure of a nonbank financial company that is substantial enough to impair creditors, counterparties, investors, .or other market participants and thus pose a threat to U.S. financial stability is one of the 3 channels identified by the FSOC as most likely to transmit the negative effects of a nonbank financial company’s material financial distress or activities to other financial firms or markets. The direct and indirect exposures of MetLife’s. creditors, counterparties, investors, policyholders, and other market. participants to MetLife are substantial enough to a point that MetLife’s material financial distress could materially impair those entities or the financial markets where they operate, and thus could pose a threat to U.S. financial stability” (Basis For The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014).

Large financial intermediaries, “including global systemically important banks (G-SIBs) and global systemically important insurers (G-SIIs), have substantial exposures and interconnections to MetLife through its institutional products and capital markets activities. MetLife’s capital markets activities, including securities lending and outstanding indebtedness, create substantial exposures to the company, including exposures among G-SIBs and G-SIIs. In addition, large financial intermediaries and other companies have substantial exposures to MetLife arising from the company’s institutional products” (Basis for The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014).

For institutional customers, “MetLife offers various insurance, annuity, and investment products that include GICs, funding agreements, other stable value products, and separate account contracts for the investment management of defined benefit and defined contribution plan assets. In addition, MetLife provides institutions with products to fund post-retirement benefits and COLI, BOLI, ICOLI, and TOLI for certain corporate employees. Many of MetLife’s institutional products are in separate accounts (clients account on the books of MetLife), but guarantees for these products, such as minimum value guarantees, are obligations of the general account (MetLife’s own accounts), and thus are reliant on on MetLife’s financial strength. If MetLife were to experience material financial distress, it may be unable to honor the guarantees on these institutional products, potentially exposing holders or beneficiaries of these products to losses” (Basis for The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014).

Also exposed to MetLife are the retail policyholders. “MetLife has approximately 100 million customers worldwide” (Basis for The Financial Stability Oversight Council’s

Final Determination Regarding MetLife, Inc, 2014). “MetLife’s material financial distress could directly expose certain of these policyholders & contract holders to losses, particularly those who hold products with cash values and guaranteed benefit features. Retail policies are usually long-term liabilities realized over time, which may minimize the potential impact in any given year. Further, state guaranty and security fund associations (GAs) may mitigate some U.S. policyholder losses from certain insurance and annuity products in case the insurance company issuing those products faces insolvency. Although the GAs could mitigate some policyholder losses, the GAs only covers certain products & policies up to the point of state-specific coverage limits” (Basis for The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014).

Furthermore, due to its size, scope, “the withdrawal features of some of its life insurance and annuity offerings, and broad national presence, the GAs could have insufficient capacity to handle a resolution of one of MetLife’s lead insurers, and the liquidation of MetLife’s large insurer subsidiaries could strain the GAs’ capacity for many years. The total annual GA assessment capacities of all 50 U.S. states, the District of Columbia, and Puerto Rico were $2.9 billion for life insurance and $3.4 billion for annuities as of December 31, 2012” (Basis for The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014).

Individual policyholders and institutional customers have exposures to MetLife that could harm those institutions and impact financial market operations and the economy if MetLife was to face significant financial distress.

“The negative effects resulting from the material financial distress or failure of a large, interconnected financial firm such as MetLife are not limited to the amount of direct losses suffered by any one of the firm’s counterparties, creditors, and customers” (Basis

For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). MetLife's distress could indirectly effect other firms due to uncertainty of the markets own exposure to MetLife and the possible "effect of such exposures on the financial health of those firms, their counterparties, or the financial markets in which they participate. This uncertainty can cause market members to exit from a range of firms and markets, in order to reduce exposures, thereby increasing the potential of de-stabilization. In the event of MetLife's material financial distress, large and leveraged counterparties with direct or indirect exposures to MetLife could participate in actions that results in a reduction in financial activity by those counterparties as well as others" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

3.8 Second Transmission Channel: Asset Liquidation

"The 2nd channel identified by the FSOC as most likely to facilitate the transmission of the negative effects of MetLife's material financial distress or activities to other financial firms or markets is if the company holds a large amount of assets that if liquidated quickly can substantially disrupt the operation of key markets or cause substantial losses or funding problems for other firms with similar holdings" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). During a stressful time for the economy and financial industry, a drop in prices of asset or market functioning could force other financial firms to liquidate their holdings of impacted assets to maintain adequate capital and liquidity which could lead to further asset sales in turn leading to more market disruptions. "In addition, if MetLife were to experience material financial distress, it could be forced to liquidate assets to meet its obligations to counterparties, contract holders, and policyholders. In order to quickly meet an increased liquidity demand, MetLife could be left with no choice but to sell assets at discount prices, which could harm financial intermediation or financial market functioning" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

The main causes of possible liquidity strains that can lead to a forced asset liquidation by MetLife:

1) "institutional and capital markets products that can be terminated or not renewed by the counterparty, and
2) Insurance-related liabilities that can be withdrawn or surrendered by the contract holder or policyholder" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

First, if "MetLife experienced material financial distress, it could be forced to liquidate assets in response to investors' refusal to rollover some of its approximately $35 billion of Funding Agreement Backed Commercial Paper (FABCP) and Funding Agreement Backed Notes (FABNs) outstanding," (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014) or due to "early returns of securities borrowed in connection with its approximately $30 billion securities lending" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014) programs.

"The second source of potential liquidity strains that could lead or contribute to a forced asset liquidation by MetLife is the share of its retail insurance & annuity products that could be surrendered or withdrawn for cash. While many insurance liabilities are long-term and cannot be withdrawn/ converted to cash at the discretion of the policyholder or contract holder, other insurance liabilities relate to products that have been sold as savings or investment products and have contractual terms that allow varying levels of discretionary withdrawals. The simplest life insurance product, term life insurance, is purely a protection product that doesn't allow policyholders to withdraw cash immediately or to surrender their policies for a cash value, this doesn't pose as a risk." (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). However, on there are "products that can be surrendered by a policyholder or contract holder upon demand, for cash, with minimal penalty / adjustment".

"MetLife sells products across this spectrum. At year-end 2013, of the $308 billion in general account liabilities of MetLife's U.S. insurance operating companies, roughly $49 billion may be withdrawn with little or no penalty" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). A share of the cash value of these liabilities is "available for discretionary withdrawal through policy loans and partial or full surrenders with little or no penalty and therefore can take on characteristics of short-term liabilities. Although these products generally are long-term liabilities and a number of these products include provisions that are intended to disincentivize withdrawals, such as penalties and loss of guarantee accumulation, these disincentives could be neglected by customers if MetLife's ability to meet its obligations were in doubt. Upon requests for early withdrawal or surrender of a portion of these products, the insurer may liquidate securities in its investment portfolio to generate the cash needed to meet those requests. Further, in lieu of surrenders, some policyholders may opt for partial surrenders or policy loans to reduce the impact of the contractual disincentives while still withdrawing available cash from their policies" (Basis for The

Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

FSOC considered that the probability for withdrawals can increase if MetLife undergoes substantial monetary distress, as worries about MetLife's capacity to meet obligations in the future could make many policyholders to "use or expedite contractual cash withdrawals or policy loans".

"Approximately $206 billion of MetLife's separate account liabilities can be withdrawn/transferred, even though separate account contract holders usually have stronger disincentives to surrender than general account policyholders" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

3.9 Third Transmission Channel: Critical Function/Service

"MetLife operates in a range of insurance, risk transfer, and capital markets, and has a leading position in several key markets where it offers products or participates, including life insurance, retirement products, and commercial real estate lending. MetLife is the leader in the life and health insurance market, with a market share of approximately 15 % based on premiums written" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). Also, MetLife is an important player in the "corporate benefit funding and annuity product markets. MetLife is ranked second in overall variable annuity assets in the U.S and represents approximately 10 % of the total market share based on net assets" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

In addition, “MetLife operates lines of business that provide credit to households, businesses, agricultural enterprises, and state and local governments, while also serving as a federal government contractor and a provider of credit to low-income, minority, or underserved communities” (Basis For The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014).

While the withdrawal of MetLife from many lines of business can worsen the transmission of “distress through the critical function or service channel, many of the insurance markets where MetLife operates seem to be competitive and thus other firms will likely absorb the increased demand for products and services if MetLife stopped offering them. MetLife’s shares in these fragmented & competitive markets do not appear large enough to cause a substantial disruption in the provision of services if the company was to experience material financial distress and was unable or even unwilling to provide the relevant services. Some markets in which MetLife is an important participant are more concentrated and potentially less substitutable, such as the corporate benefit funding market, but MetLife’s participation in these markets has noticeably fluctuated. In addition, it is undistinguishable whether these markets are adequately large or interconnected with the broader financial system such that MetLife’s withdrawal from these markets could pose a threat to U.S. financial stability”. Nevertheless, the transmission of stress through this transmission channel, under certain market circumstances, could be heightened, principally “in a period of macroeconomic stress and broader exits by other market participants in the markets in which MetLife is a key player”.

3.10 The Existing Regulation and Supervision

In considering whether to make a final determination regarding MetLife, the FSOC considered the "degree to which MetLife is already regulated by one or more primary financial regulatory agencies" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). MetLife was not "subject to consolidated supervision. The company's subsidiaries are subject to supervision by several U.S. and international regulators. MetLife's insurance company subsidiaries are subject to supervision by regulators in all 50 U.S. states, the District of Columbia, the five U.S. territories, and numerous foreign countries" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). As of December 31st, 2013, MetLife's primary "U.S. insurance regulators for its life insurance and annuity products businesses are the NYDFS, the Connecticut Insurance Department, and the Delaware Department of Insurance."

A state insurance regulator oversees several parts of a certified entity's operations, including:

solvency	pricing and products	investments	reinsurance;	reserves
asset-liability matching	transactions with affiliates	use of derivatives	management	

Examination authorities are granted to state insurance regulators. In the U.S., "MetLife's insurance company subsidiaries are subject to state-based, legal entity regulation. All 50 U.S. states, the District of Columbia, and Puerto Rico are currently accredited under the NAIC's Financial Regulation Standards and Accreditation Program, which requires regulators to establish that they have adequate administrative authority to regulate an insurer's corporate and financial affairs. Insurance companies are required to prepare financial data and submit quarterly, and annual financial statements based on SAP and to provide information describing the businesses and financial matters they are engaged in. This legal entity–based regulatory reporting regime is used by state insurance regulators to monitor the financial health of state-licensed insurers through quarterly and annual analyses, and on-site examinations are completed at least once every 5 years" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

State insurance regulators have a variety of authorities. For example, "in addition to the regulator's financial analysis and examination authorities, an early intervention tool may be available to certain state insurance regulators if the state insurance regulator finds that an insurer is in hazardous financial condition. The intervention could include requiring an insurer to increase capital and surplus, requiring an insurer to file financial reports and a business plan, or a range of other corrective actions. Another example of state insurance regulatory authority is risk-based capital (RBC) requirements, a capital measurement tool intended to help state insurance regulators detect when increasingly more intense levels of intervention may be appropriate" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). The FSOC considered "that while one or more of the state regulators' authorities may be effective in mitigating the risks arising from an insurance company, these authorities have never been tested by the material financial distress of an insurance company of the size, scope, and complexity of MetLife's insurance subsidiaries. State regulators do not have direct authority relative to MetLife's international insurance activities. However, state insurance regulators have authority over MetLife's insurance subsidiaries domiciled in their respective states, state insurance regulators usually don't have direct authority to necessitate a non-mutual holding company of a state-licensed insurer or any non-insurance company subsidiary to take or not take actions outside of the insurer for the purpose of safety and soundness of the insurer or for the avoidance of risks from activities that could cause adverse effects on U.S. financial stability" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014)."State regulators and regulators in other countries are also currently involved in the regulatory oversight of MetLife's captive reinsurance companies, which reinsure risk from affiliated companies. MetLife's use of captive reinsurance subsidiaries usually enables the company to hold lower-quality capital & lower reserves than would otherwise be required, which produces a greater risk that MetLife could be obligated to liquidate assets to satisfy an increase in demand for liquidity" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

"For U.S. domiciled insurance holding companies with operations in multiple jurisdictions, state insurance regulators may organize supervisory colleges on a usual basis. These supervisory colleges are non-public regulator forums that may meet in session on an annual or semi-annual basis. They include the state insurance regulators of the largest insurance company subsidiaries in an insurance holding company and regulators responsible for supervising insurance subsidiaries in other countries, along with regulatory agencies that may be responsible for supervising the company's non-insurer affiliates. FSOC finds that while supervisory colleges may allow state insurance regulators to monitor other parts of an insurance organization, and may boost communications of confidential supervisory concerns across an enterprise, they are not comparable to the supervisory and regulatory authorities to which a nonbank financial company that it determines shall be subject to supervision by the Board of Governors and enhanced prudential standards is subject, nor do they have direct supervisory authority over the holding company or its non-insurance subsidiaries" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

MetLife's non-insurance subsidiaries include broker-dealers, regulated by the "Financial Industry Regulatory Authority and Securities and Exchange Commission (SEC)", and "registered investment advisers which are regulated by the SEC. MetLife issues variable annuity contracts and variable life insurance policies through separate accounts that are registered with the SEC as investment companies under the Investment Company Act of 1940" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). In addition, "the variable annuity contracts and variable life insurance policies issued by these registered separate accounts are registered with the SEC under the Securities Act of 1933" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

"From 2001 till early 2013, MetLife was subject to consolidated supervision by the Board of Governors as a bank holding company. While MetLife was under Board of Governors supervision, state insurance regulators supervised the insurance activities of its insurance subsidiaries. During that period, Federal Reserve System staff coordinated with insurance and other regulators to supervise MetLife's subsidiaries. MetLife, Inc. has deregistered as a bank holding company and MetLife was not subject to consolidated supervision" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014) at time of examination by the FSOC.

"The Board of Governors is responsible for establishing the prudential standards that will be applicable to MetLife under the Dodd-Frank Act. The FSOC's determination regarding MetLife does not offer the company any new access to government liquidity sources or create any authority for the government to rescue the company in the event of its failure. The FSOC considered the facts of record considering the requirement that it considers the degree to which MetLife is already regulated by one or more primary financial regulatory agencies and has determined that the Dodd-Frank Act provides additional regulatory and supervisory tools focused on financial stability" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

3.11 Resolvability of MetLife

The FSOC also "considered whether the threat that material financial distress at MetLife could pose to U.S. financial stability could be mitigated or worsened by its complexity, the opaqueness of its operations, or its difficulty to resolve". In light of all the facts the FSOC "has evaluated MetLife's resolvability, and the difficulty of effectively separating & liquidating or disposing of the company if it should fail".

The FSOC recognized that "some insurance assets and businesses will take longer to wind down than others due to their nature". Thus, in the framework of the expression “rapid and orderly resolution” and to these assets and businesses, the phrase “rapid” refers to the ability to implement a plan for resolving the company that calms markets and market participants in a timely manner. “By design, the winding-down of a failed insurer’s estate may take years to complete while policyholder and contract holder liabilities are paid off as they come due or are transferred to solvent insurers” (Basis For The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014).

“MetLife is a highly complex and interconnected financial services organization that operates in approximately 50 countries and provides services to approximately 100 million customers globally” (Basis for The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014). The FSOC found that due to “MetLife’s operations and intercompany relationships, including intra-group dependencies for derivatives management, risk management, cross-border operations, investment management, and critical services, creates complexities that could make a rapid and orderly resolution difficult. MetLife’s entities have a considerable number of interconnections to one another through intercompany funding arrangements, guarantees associated with inter-affiliate reinsurance, capital and net worth maintenance agreements, liquidity support commitments, and general account guarantees of separate account products that could transmit distress from one MetLife entity to other entities or parts of the organization” (Basis For The Financial Stability Oversight Council’s Final Determination Regarding MetLife, Inc, 2014). The FSOC found that due to these interconnections, and the fact that MetLife’s global network is extensive and complex, resolution of the company could be substantially challenging.

MetLife is “subject to separate regulatory regimes administered by several states, federal, and non-U.S. regulators”. An effort to achieve a “coordinated resolution of

MetLife would require accommodations with each of its local supervisory authorities, as well as cooperation and coordination among several home and host jurisdiction supervisory authorities and courts" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014). For instance, "if MetLife was to experience material financial distress, the resolution of its U.S. insurance subsidiaries would occur under the laws of the various state regulatory authorities where it operates and would involve various state GAs. An orderly resolution of MetLife would necessitate the immediate and effective cooperation between various parties, such as bankruptcy courts and state courts, in order to avoid disruptions to the employees, facilities and infrastructure, and other services provided by these entities. Also noting that there is no precedent for the resolution of an insurance organization of the size, scope, and complexity like MetLife. Though state insurance regulators coordinate resolution through interstate associations and colleges, there is no single interstate regulator with jurisdiction across state boundaries. There is no global regulatory framework for the resolution of cross-border financial organizations, and applicable U.S. resolution regimes, including the separate state GAs, have never been tested by the resolution of an insurance organization of the size, scope and complexity of MetLife. FSOC found that these factors can worsen the potential for MetLife's material financial distress, if it were to occur, to pose a threat to U.S. financial stability" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

Also, interstate and cross-border difficulties involved in resolving a large organization includes the "difficulty of ensuring the continuity of critical shared services, the separation of financial and operational linkages, the potential ring-fencing of assets, and the coordination of numerous receiverships and judicial proceedings across multiple jurisdictions. Numerous proceedings seeking to maximize recoveries for claimants could result in conflicts. Several receivers or judicial authorities would have to unravel a complex network of intercompany agreements. A complex resolution process could increase the possibility of delays in resolving claims and thus result in increased losses" (Basis for The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

Based on above, the FSOC determined that MetLife's resolvability could worsen the risk on financial stability of the United States if it were to experience financial distress.

3.12 The Council's Decision

In conclusion, the FSOC made a "final determination that material financial distress at MetLife could pose a threat to the financial stability of the United States and that MetLife should be supervised by the Board of Governors and be subject to enhanced prudential standards" (Basis For The Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc, 2014).

Chapter 4: The Consequences of the Designation to MetLife

Upon designation by the Council, a company becomes subject to “enhanced supervision” and “prudential standards” that notably were not yet set by the Federal Reserve. The ‘prudential standards’ shall include, at a minimum (12 USC 5365: Enhanced supervision and prudential standards for nonbank financial companies supervised by the Board of Governors and certain bank holding companies, n.d.):

1) “risk-based capital requirements and leverage limits”, subject to limited exception;
2) “liquidity requirements”;
3) overall risk management requirements; A risk committee shall:
    a) “be responsible for the oversight of the enterprise-wide risk management practices of the company”;
    b) “include such number of independent directors as the Board of Governors may determine appropriate, based on the nature of operations, size of assets, and other appropriate criteria related to the company”; and
    c) “include at least 1 risk management expert having experience in identifying, assessing, and managing risk exposures of large, complex firms.”
4) resolution plan; to “report periodically to the Board of Governors, the Council, and the Corporation the plan of such company for rapid and orderly resolution in the event of material financial distress or failure, which shall include:
    a) information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected

from risks arising from the activities of any nonbank subsidiaries of the company;

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

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

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

5) "credit exposure report requirements:

a) to report periodically to the Board of Governors, the Council, and the Corporation on the nature and extent to which the company has credit exposure to other significant nonbank financial companies & significant bank holding companies; and the nature & extent to which other significant nonbank financial companies & significant bank holding companies have credit exposure to that company; and"

6) concentration limits: In order to limit the risks that the failure of any individual company could pose to a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), the Board of Governors, by regulation, shall prescribe standards that limit such risks. The regulations prescribed by the Board of Governors under paragraph (1) shall prohibit each nonbank financial company supervised by the Board of Governors and bank holding company described in subsection (a) from having credit exposure to any unaffiliated company that exceeds 25% of the capital stock and surplus (or such

lower amount as the Board of Governors may determine by regulation to be necessary to mitigate risks to the financial stability of the U.S.) of the company" (12 USC 5365: Enhanced supervision and prudential standards for nonbank financial companies supervised by the Board of Governors and certain bank holding companies, n.d.)

The Federal Reserve may also establish "additional standards," such as:

1) "a contingent capital requirement; maintain a minimum amount of contingent capital that is convertible to equity in times of financial stress"
2) enhanced public disclosures; in order "to support market evaluation of the risk profile, capital adequacy, and risk management capabilities thereof;" and
3) short-term debt limits; "For purposes of this subsection, the term 'short-term debt' means such liabilities with short-dated maturity that the Board of Governors identifies, by regulation, except that such term does not include insured deposits.

In addition, the Federal Reserve is authorized to establish "such other prudential standards as determined appropriate." (12 USC 5365: Enhanced supervision and prudential standards for nonbank financial companies supervised by the Board of Governors and certain bank holding companies, n.d.).

Without doubt, the minimal mentioned standards are only the beginning as other requirements and standards can be added, however, the "enhanced supervision" and "prudential standards" were not yet set by the Federal Reserve, therefore MetLife couldn't possibly foresee all the requirements & standards that will be requested of it to examine them and check on their feasibility and other important aspects.

MetLife was left with three possible options:

1) drastically scale back its operations to seem less threatening;
2) challenge designation from within FSOC's own internal processes; or
3) challenge the SIFI designation in court.

In an unprecedented move, MetLife decided to challenge its designation in the courts.

Chapter 5: 'MetLife, Inc. v. Fin. Stability Oversight Council'; The Legal Standard

The Final Determination reached 4 main conclusions:

1) exposed counterparties could suffer significant losses if MetLife experienced substantial "financial distress"
2) The same financial distress might prompt "MetLife to liquidate assets quickly and thereby disrupt capital markets".
3) Existing regulatory scrutiny and framework cannot stop either threat from occurring; and
4) MetLife's complexity would hamper its resolution and thus "prolong uncertainty, requiring complex coordination among numerous regulators, receivers, or courts that would have to disentangle a vast web of intercompany agreements." (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016).

The Dodd-Frank "Section 113(h)" allows a designated company to seek judicial review which the home office of the company is located, or in the United States District Court for the District of Columbia. The district court can either dismiss such action or to direct the final determination to be rescinded. The court's review is specifically limited only to whether the final determination made was arbitrary and capricious. The Court's duty is to affirm if coherent basis for the agency's decision is offered, even if the court might otherwise disagree with the decision and to see if the agency engaged in "reasoned decision-making".

5.1 Court Analysis and Decision

The Court rescinded the Final Determination as it found FSOC's basis for designating MetLife was critically flawed in at least 3 respects, which are as follows (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016):

1) "FSOC deviated from its own guidance without explanation by failing to assess MetLife's actual vulnerability to financial distress".
2) "FSOC failed to establish a basis for a finding that MetLife's material financial distress would cause an impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy, within the meaning of FSOC's guidance".
3) "FSOC failed to weigh the perceived benefits of designating MetLife against the possible costs of taking such action", including the possibility that "imposing billions of dollars in cost could actually make MetLife more vulnerable to distress."

Even though MetLife provided additional arguments for rescinding the designation, the Court still settled that these 3 flaws were enough to "justify granting the relief requested by MetLife and thus did not reach those other grounds".

On March 30, 2016, Judge Collyer "issued an opinion and an order granting, in part, MetLife's motion for summary judgment, and denying the Department of Justice's cross-motion for summary judgment along with rescinding the Final Determination. MetLife was granted cross-motion for summary judgment to Counts IV, VI (in part) and VII" (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016), that argued as follows:

1) ***"Count IV** – FSOC's designation of MetLife was arbitrary and capricious and violated the Dodd-Frank Act, FSOC's own regulations, and the Administrative Procedure Act (APA) because FSOC failed to assess MetLife's vulnerability to material financial distress";*

2) ***"Count VI** – FSOC's designation of MetLife was arbitrary and capricious and violated the Dodd-Frank Act and the APA because it depended upon unsubstantiated, indefinite assumptions and speculation—both with respect to the severity of hypothetical material financial distress at MetLife, and with respect to the effect that MetLife's material financial distress could have on the broader economy—which failed to satisfy the statutory standards for designation and FSOC's own interpretive guidance;" ,and*

3) ***"Count VII** – FSOC's designation of MetLife was arbitrary and capricious and violated the Dodd-Frank Act and the APA because FSOC failed to consider the costs of designation on MetLife"*

The Court concluded that FSOC's Final Determination was instituted on "fundamental violations of established administrative law." (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016). In specific, without explanation, FSOC, "reversed itself on whether MetLife's vulnerability to financial distress would be considered and on what it means to threaten the financial stability of the United States," deviating from its own Guidance, and "focused exclusively on the presumed benefits of its designation and ignored the attendant costs." (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016).

5.2 FSOC's Critical errors

The Court noted that the Guidance broadcasted by FSOC considered 2 distinct inquiries:

1) an assessment of "the vulnerability of a nonbank financial company to financial distress," (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016), and
2) an assessment of "the impact of such distress on national financial stability." (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016).

FSOC argued that "the two separate inquiries cited in the Guidance should be interpreted as a one inquiry", as "the very risks that can make a company vulnerable to distress are the ones that can cause its distress to pose a threat to the broader economy," and that, as a result, the Final Determination reflected no change in position on the part of FSOC (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016). The Court did not accept this argument, concluding that it "misstates [the Guidance] in consequential fashion." (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016).

The Court's view, "the Guidance clearly considered a separate inquiry into the vulnerability of a nonbank financial company to financial distress; due to the fact FSOC failed to explain its deviating from the Guidance, the Court concluded that this change in position was arbitrary and capricious." (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016).

Also concluded by the Court that "FSOC did not—under either the Exposure or Asset Liquidation channels —apply the standard announced in the Guidance" that it will consider a threat to U.S. financial stability 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 fact, the Court concluded, "the Final Determination hardly adhered to any standard when it came to assessing MetLife's threat to U.S. financial stability. The Exposure channel analysis simply summed gross potential market exposures, without consideration to collateral or other mitigating factors," and "every possible effect of MetLife's imminent insolvency was considered grave enough to damage the economy." (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016).

The Department of Justice's argued that the FSOC must be allowed flexibility to "make predictive judgments about a company's possible threat to U.S. financial stability", the Court replied that "predictive judgment must be based on reasoned predictions; a summary of exposures and assets is not a prediction." (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016).

The Court recognized a 3rd important error in FSOC's reasoning: it "intentionally refused to consider the cost of regulation, a consideration that is essential to reasoned rulemaking." (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016). MetLife had highlighted the "substantial economic costs that could result from designation", including "the imposition of higher capital requirements that many of its main competitors would not be subject to. These capital requirements could leave MetLife no option but to increase costs to consumers and possibly withdraw from certain markets, or, if MetLife chose not to take such action, result in the loss of billions of dollars due to the resulting reduction in its return on investment" (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016). FSOC argued that it “was not obliged to consider these costs, as Section 113(a).(2).(K) of the Dodd-Frank Act did not expressly require any consideration of these costs,” (D.C. District Court Rescinds FSOC’s Designation of MetLife as Systemically Important, 2016). rather mandating that FSOC must consider “any other risk-related factors that it deems appropriate.” However, the Court noted that, as “held by the Supreme Court in *Michigan* v. *Environmental Protection Agency”* that “appropriate and necessary’ … plainly subsumes consideration of cost,” (D.C. District Court Rescinds FSOC’s Designation of MetLife as Systemically Important, 2016) adding that the qualifier “risk-related” used in “Section 113(a).(2).(K) of the Dodd-Frank Act implies that FSOC was obligated to consider both the risk of destabilizing the market and the risk of distress in the first place.” The Court noted that FSOC never replied to MetLife’s allegation that “imposing billions of dollars in cost could actually make MetLife more vulnerable to distress.” (D.C. District Court Rescinds FSOC’s Designation of MetLife as Systemically Important, 2016). FSOC’s rejection “to consider cost as part of its calculus” made it “impossible to know whether its designation ‘does significantly more harm than good’” and that rendered the Court to find the “Final Determination arbitrary and capricious” (D.C. District Court Rescinds FSOC’s Designation of MetLife as Systemically Important, 2016).

Chapter 6: Conclusion- Systematic Unimportance

This case had great significance in the U.S. It was a major win to MetLife, Inc. but a greater setback to the FSOCs designation 'SIFI' tool as it will hinder their future efforts to designate nonbank financial companies along with retaining the existing designations. Many global participants were closely monitoring the court battle, more closely than others were the SIFI designated companies such as American International Group, Inc., General Electric Capital Corporation, Inc., and Prudential Financial, Inc. General Electric Capital Corporation, Inc. submitted a request to FSOC to rescind its designation one day after the Judge has passed its ruling in favor of MetLife.

To date, all designations have been rescinded. Prudential Financial, Inc., designated as a SIFI in 2013, was the last nonbank financial company to have its designation rescinded in October 17th, 2018 via unanimous vote by the FSOC. There was a clear shift in the FSOC's designation process, especially after the Treasury issued a memo as per the directives of president Trump in November 2017 to review the FSOC's designation process.

It is noteworthy to shedlight on the extent the Court's judgement highlighted the importance of a "cost-benefit analysis to make feasible regulation and to the procedure of the administrative decision-making process", including where a regulator is engaged in predictive judgments and where such costs remain unclear. The Court's has clearly influenced the analysis of FSOC in their annually re-evaluation of existing designations and in adjudicating requests to rescind existing designations.

Although the court did not arrive to the "other arguments raised by MetLife regarding faults in the designation process and the substance of the Final Determination, these arguments can be used as possible grounds for affirming the Court's ruling. One example of these alleged faults it the fact that FSOC's failed to consider less costly alternatives to the designation and accordingly to give a reasoned explanation for rejecting these alternatives. Another alleged fault is the fact that the same officials at the FSOC were involved in several phases of the designation process, which allegedly violates the Due Process Clause of the Fifth Amendment and the constitutional separation of powers" (D.C. District Court Rescinds FSOC's Designation of MetLife as Systemically Important, 2016).

Nevertheless, the government needed to show a firm stance in preventing another financial crisis by implementing measures that ensure the safety of the economy, however, it must do so in a meticulous and careful manner. It must make sure that its regulation is fair and feasible. The regulator's approach should be one that seeks partnership with its stakeholders as the overall aim of a regulator, maintaining the stability and health of the economy, can be agreed upon by all market participants. Since the overall end can be agreed upon, the means should not be an unbearable burden that would harm the prosperity of the organizations and the overall economy. Several organizations did not battle their designation once made by the FSOC, they either chose to spin-off, divest and reach a level that is no longer enough to get designated or simply accept the consequences of their designation. This could have led to job cuts, seizing the offering of some services, and market shrinking due to regulatory burdens. GE Capital serves as an example as they massively reduced their footprint, selling their assets worth billions of dollars to become de-designated in 2016.

A considerable setback to the regulator whose establishment has been in vain due to faults in its process that could have been avoided. President Trump signed an Executive Order on February the 3rd, 2017, directing the Treasury Secretary and FSOC to "assess and identify financial regulations that promote or inhibit his principals for the regulation of the U.S. financial system" (Sundra Rajoo, 2017). The order was the beginning of significant financial deregulation under the Trump Administration and it indicated the possible repeal or claw back of parts of the Dodd-Frank. Trumps "commitment to reform the Dodd-Frank Act has been criticized and praised by many, with the House Financial Services Committee releasing their proposed alternative to the Act, Financial Choice 2.0, included detailed contemplations on parts of the Act that should be repealed or be reformed" (Sundra Rajoo, 2017). Nancy Pelosi, currently speaker of the United States House of Representatives criticized the House Republicans' "dangerous Wall Street-first" bill, saying it would "drag us back to the days of the Great Recession". Senator Elizabeth Warren called it a "handout to Wall Street" (Bryan, 2017).

It was evident that the government's failure to regulate played a role in the causation of the economic crisis of 2007-2009. An alternative solution to mitigate this regulatory weakness or gap would be to empower, give more authority and support the existing regulators of these financial institutions that are regarded as a possible threat to the broader economy should they fail. This would seem to a be more feasible approach rather than creating an entire new agency with a mission to burden large market players with unreasonably costly regulations. Noting that some of the proposed regulations by FSOC are logical to be put in place for companies to adhere to, but grouping and requiring the entire set of rules and regulations by one agency would only overwhelm those entities.

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