Falling on Deaf Ears: The FSOC's Evidentiary Hearings Provides Little Opportunity to Challenge a Nonbank SIFI Designation

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In a recent profile article, Kent Sluyter, Chief Executive Officer of Prudential Individual Life Insurance, likened the present state of the life insurance industry to his Alaskan white water rafting experience. Although the industry previously enjoyed “calm water” and the ability to “see a great distance . . . and set a course from point A to point B without having to worry,” the past several years have disrupted the market in many respects. Among the most worrisome shifts, according to Sluyter, is regulatory uncertainty. Sluyter acknowledged that some companies facing these changes fear that they “don’t have the right craft” and are “pulling out of the white water.” On the other hand, he suggested that “shooting the rapids” brings a surge of energy and excitement that will propel those who take the plunge. Soon after the interview, Prudential indeed took a plunge into uncharted territory; however, its course sought to avoid the regulatory “white water” and to maintain the status quo.

On July 2, 2013, Prudential Financial, Inc. (Prudential) became the first company to challenge the Financial Stability Oversight Council’s (FSOC) proposed determination to designate it as a nonbank systemically important financial institution (SIFI). One month earlier

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2. Id.
3. See id.
4. Id.
5. See id.
6. See Prudential Financial, Inc., Current Report (Form 8-K) (July 2, 2013) (giving notice that Prudential will challenge the FSOC’s proposed SIFI designation).
7. See id.; see also Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), 12 U.S.C. §§ 5311(a)(4)(B)(ii), 5311(a)(6), 5323(a)(1) (2012) (defining a systemically important “nonbank financial company” as a company predominantly engaged in financial activities whose material financial distress or whose nature, scope, size, scale, concentration, or interconnectedness “could pose a threat to the financial stability of the United States”).
the FSOC had issued its first nonbank SIFI designations to American International Group, Inc. (AIG), GE Capital Corporation (GE Capital), and Prudential. AIG and GE Capital accepted their designations, subjecting the companies to supervision by the Board of Governors of the Federal Reserve System (Federal Reserve) and heightened regulation under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

Prudential, on the other hand, requested an oral hearing “to demonstrate that [it is] not a systemically important nonbank financial institution.” Given the potentially enormous shift in oversight that will most likely saddle nonbank SIFI designees, the mechanics and the outcome of the hearing “could have significant bearing on how regulators proceed with future designations.” As many expected, the FSOC upheld its proposed designation of Prudential.

This Note will discuss issues concerning the hearing process and procedure as well as certain rationales for the FSOC’s designations and

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13. See Fin. Stability Oversight Council, Notational Vote (September 19, 2013); see also Louie Woodall, Prudential Financial SIFI Appeal ‘Futile,’ RISK.NET (July 5, 2013) http://www.risk.net/insurance-risk/news/2279791/prudential-financial-sifi-appeal-futile (“[The hearing] could be viewed as a futile effort.” (quoting Don Lamson)); Douglas, supra note 12 (“The three-step process of examination was so lengthy and detailed that it may be difficult for Prudential to make its case at this point.”).
how these issues subvert the efficacy of an evidentiary hearing. Part II provides a background on the FSOC and the method by which it designates nonbank SIFIs. Part III details the process leading to an evidentiary hearing. Part IV then identifies some of the key concerns regarding the hearing procedures with respect to how they might affect a company’s ability to contest a designation. Part V addresses how substantial portions of the FSOC’s analysis of AIG and Prudential shield highly contested assumptions from a challenge. Part VI will conclude by suggesting that despite its faults, a hearing may provide an opportunity for a designated company to propose industry-tailored prudential standards to the FSOC.

II. DODD-FRANK AND SIFIS, THE FSOC, AND THE DESIGNATION PROCESS

Dodd-Frank provides that SIFIs should receive enhanced supervision by the Federal Reserve under the heightened standards. Bank holding companies with at least $50 billion in assets are automatically held to these more stringent standards. Also, nonbank financial companies may be designated as SIFIs under certain conditions, subjecting them to the same supervision from the Federal Reserve and the heightened standards as bank holding companies. A “financial company” under Dodd-Frank is any company with at least 85 percent of annual gross revenues or consolidated assets that are derived or related to financial activities as defined by the Bank Holding Company Act. To identify which nonbank financial companies are SIFIs, Dodd-Frank established the FSOC.

The FSOC consists of the heads of the major federal regulatory agencies, an independent member, and representatives from state regulators. The voting members include: the Secretary of the

14. See infra Part II. 
15. See infra Part III. 
16. See infra Part IV. 
17. See infra Part V. 
18. See infra Part VI. 
20. See id. § 5365(a)(1). 
21. See id. 
22. Id. §§ 5311(a)(4)(B), (a)(6)(A) 
23. Id. § 5322(a)(2)(H). 
Treasury, who also serves as the Chairperson of the FSOC; the Chairman of the Board Governors of the Federal Reserve System; the Comptroller of the Currency; the Director of the Consumer Financial Protection Bureau; the Chairman of the Securities and Exchange Commission; the Chairperson of the Federal Deposit Insurance Corporation; the Chairperson of the Commodity Futures Trading Commission; the Director of the Federal Housing Finance Agency; the Chairman of the National Credit Union Administration Board; and an independent member appointed by the President. The FSOC also has several nonvoting members. Dodd-Frank requires a two-thirds supermajority of the voting members, as well as the vote of the Chairperson, to designate a financial company as a nonbank SIFI.

To determine which financial companies it should designate, the FSOC conducts a three-stage analysis. Stage 1 is entirely quantitative with certain threshold limits explicitly defined. A company must meet these thresholds or it will not qualify as a nonbank SIFI. The FSOC examines a company's total consolidated assets, which must exceed $50 billion; its credit default swaps outstanding, which must exceed $30 billion; its derivatives liabilities, which must exceed $3.5 billion; total debt outstanding, which must exceed $20 billion; its leverage ratio of total consolidated assets to total equity, which must exceed 15 to 1; and its short term debt ratio of total debt outstanding with a maturity of less than 12 months to total consolidated assets, which must exceed 10 percent.

With a pool of potential designees narrowed, the FSOC conducts both quantitative and qualitative analysis in Stage 2. The FSOC focuses on six categories for each company: (1) interconnectedness, (2) substitutability, (3) size, (4) leverage, (5) liquidity risk and maturity mismatch, and (6) existing regulatory

25. Id. §§ 5321(b)(1)(A)-(J)
26. Id. § 5321(b)(2) (stating that the nonvoting members include the Director of the Office of Financial Research, the Director of the Federal Insurance Office, a State insurance commissioner, a State banking supervisor, and a State securities commissioner).
27. Id. § 5323(a)(1).
30. Id. § 1310 app. A at 359-61.
31. Id. § 1310 app. A at 362.
The FSOC also begins a preliminary examination of "whether the resolution of a nonbank financial company . . . could pose a threat to the U.S. financial stability." The FSOC issues a "Notice of Consideration" informing the company of its status and requesting detailed information for further review. The FSOC focuses on the central issue of "whether the nonbank financial company could pose a threat to U.S. financial stability because of the company's material financial distress or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company." The FSOC uses the six categories from Stage 2 as its analytical framework, within which there are ten statutory considerations. Also, the FSOC analyzes a company's risk in the context of "transmission channels." The two primary transmission channels, through which a company could transmit its material financial distress to the broader financial system, are "exposure" and "asset liquidation." Exposure encompasses the financial company's creditors, counterparties, investors, and other market participants that "have exposure to the nonbank financial company that is significant enough to materially impair" those parties. Asset liquidation considers the effect of a nonbank financial company rapidlyliquidating its assets, causing a dramatic fall in asset prices and significantly disrupting trading or funding in markets. Additionally, the FSOC continues to analyze how complex and difficult a company's resolvability would be in the event

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32. *Id.* § 1310 app. A at 356-59, 362.
33. *Id.* § 1310 app. A at 362.
34. 12 C.F.R. § 1310 app. A at 362.
35. *Id.*
36. 12 U.S.C. § 5323(a)(2) (2012) (naming (1) the extent of the leverage; (2) the extent and nature of off-balance-sheet exposures; (3) the extent and nature of the transactions and relationships with other significant financial companies; (4) the importance of the company as a source of credit; (5) the extent to which assets are managed rather than owned by the company; (6) the nature, scope, size, scale, concentration, and interconnectedness of the company; (7) the extent to which the company is regulated; (8) the amount and nature of the company's financial assets; (9) the amount and types of the company's liabilities; and(10) any other risk-related factors as the statutory factors); see also 12 C.F.R. § 1310 app. A at 362.
38. *Id.* § 1310 app. A at 354.
39. *Id.*
40. *Id.*
that the company failed.\footnote{Id. § 1310 app. A at 362-63.}

After Stage 3, the FSOC votes on a "proposed determination" for any company it determines should be designated as nonbank SIFIs.\footnote{See 12 U.S.C. § 5323(e)(1) (2012); see also 12 C.F.R. § 1310 app. A at 363.} A proposed determination requires a two-thirds majority including the vote of the Chairperson.\footnote{12 C.F.R. § 1310 app. A at 363. As a reminder, the Chairperson is the Secretary of the Treasury.} The FSOC must provide the company with a written notice, and the company may request a hearing to challenge its designation.\footnote{Id. §§ 5323(a)(1), (e)(3).} Whether or not the company challenges its designation, the FSOC will vote on a "final determination," which also requires a two-thirds majority and the vote of the Chairperson.\footnote{Id. § 5323(h).} If the company decides to challenge its designation further, it must do so in a federal district court.\footnote{See generally Danielle Douglas, Council Identifies Non-bank Financial Companies for Additional Supervision, THE WASH. POST, June 3, 2013, http://articles.washingtonpost.com/2013-06-03/business/39712911_1_financial-stability-oversight-council-financial-system-firms ("[The designation] sets the stage for a major shift in the oversight of a broad swath of big companies.").}

### III. Purpose and Process of an Evidentiary Hearing

When the FSOC issued the first proposed designations on June 3, 2013, it exercised an extraordinary power to make nonbank SIFI designations.\footnote{See Letter from Alexander G. Acree et al, Gibson, Dunn & Crutcher, LLP, FSOC Designation: Consequences for Nonbank SIFIS 1 (April 11, 2013) ("The Federal Reserve did not, however, discuss in greater detail how it would adapt such standards."); see also} Nonbank SIFIs, many for the first time, will be subject to oversight by the Federal Reserve and regulations that include capital requirements, leverage limits, liquidity requirements, resolution plans or living wills, credit exposure report requirements, concentration limits, contingent capital requirements, public disclosures, short-term debt limits, and other risk management requirements that the FSOC may recommend to the Federal Reserve.\footnote{12 U.S.C. §§ 5324-5325(b)(1).} Potential nonbank SIFI designees argue that the new standards are unsuitable for nonbank business models such as insurance and that the impact is difficult to measure given the lack of specificity of the standards.\footnote{See 12 U.S.C. §§ 5324-5325(b)(1).}
avoid application of the standards and the accompanying uncertainty of
the new regulations is to request an evidentiary hearing before the
FSOC.\textsuperscript{50}

A. \textit{What Is the Purpose of an Evidentiary Hearing?}

A company receiving a proposed designation as a nonbank SIFI
"may request, in writing, an opportunity for a written or oral hearing
before the [FSOC] to contest the proposed determination.\textsuperscript{51}"
The central issue for the hearing is whether the company can demonstrate
that it would not threaten the financial stability of the United States
through either "material financial distress at the nonbank financial
compny, or the nature, scope, size, scale, concentration,
 interconnectedness, or mix of the activities of the nonbank financial
compny."\textsuperscript{52} This hearing is the company’s only opportunity after a
proposed determination to convince the FSOC that it does not pose a
systemic risk to the financial system.\textsuperscript{53} If a company succeeds, it will
most likely remain in Stage 2 of the FSOC's three-stage designation
process;\textsuperscript{54} otherwise the company must accept the FSOC’s designation
and future regulation by the Federal Reserve or challenge the
designation in federal court.\textsuperscript{55}.

B. \textit{Process Leading to an Evidentiary Hearing Under Dodd-Frank}

The first notice that a company receives from the FSOC advises
that the FSOC is reviewing the company under its Stage 3 criteria and is

\textsuperscript{50} See 12 U.S.C. § 5323(e)(2).
\textsuperscript{51} Id.
\textsuperscript{52} 12 C.F.R. § 1310.21(c) (2013).
\textsuperscript{54} See FIN. STABILITY OVERSIGHT COUNCIL, NOTATIONAL VOTE, VIEWS OF THE ACTING
DIRECTOR OF THE FEDERAL HOUSING FINANCE AGENCY at 1 (2013) [hereinafter FHFA
DIRECTOR’S DISSENT ON PRUDENTIAL DETERMINATION] (stating that there is an
"understanding that the company would remain in Stage 2" if the FSOC did not finalize the
designation after the hearing).
\textsuperscript{55} See 12 U.S.C. §§ 5323(e)(3)-(h).
considering a proposed designation. At this point, the company may submit written materials to the FSOC explaining why it does not pose a systemic risk to the financial stability of the United States. Regardless, the company most likely has to submit information to the FSOC because a Stage 3 review also allows the FSOC to request information from the company through the Office of Financial Research, including "confidential business information such as internal assessments, internal risk management procedures, funding details, counterparty exposure or position data, strategic plans, resolvability, potential acquisitions or dispositions, and other anticipated changes to the nonbank financial company's business or structure." While the FSOC has voted against advancing companies from Stage 2 to Stage 3, it appears that the FSOC has yet to vote against issuing a proposed designation to a company already considered at Stage 3.

During a Stage 3 review, the FSOC hears from various agencies, including the Federal Reserve, the Federal Housing Finance Agency, and the Treasury Department, regarding the Stage 3 qualitative and quantitative analysis. Before the FSOC voted on AIG, GE Capital, and Prudential, it met twice to consider information from the agencies and once to decide if the evidentiary record was complete. After a

56. 12 C.F.R. § 1310.21(a)(1); see also id. § 1310 app. A at 362 (describing Stage 3 criteria which focuses on channels through which a company may transmit risk and "information relating to factors that are not easily quantifiable").

57. Id. § 1310 app. A at 362.

58. See, e.g., 12 C.F.R. § 1310 app. A (stating that Stage 3 will focus particularly on the channels through which the company might transmit its risk and factors that are not easily quantifiable such as "opacity of the nonbank financial company's operations, its complexity, and the extent to which it is subject to existing regulatory scrutiny and the nature of such scrutiny"); see also FIN. STABILITY OVERSIGHT COUNCIL, MINUTES OF FINANCIAL STABILITY OVERSIGHT COUNCIL HELD JANUARY 21, 2013 (2013).


60. See FIN. STABILITY OVERSIGHT COUNCIL, MINUTES OF FINANCIAL STABILITY OVERSIGHT COUNCIL HELD APRIL 4, 2013 (2013) (noting representatives from the agencies were available for questions posed by the FSOC); see also FIN. STABILITY OVERSIGHT COUNCIL, MINUTES OF FINANCIAL STABILITY OVERSIGHT COUNCIL HELD JUNE 3, 2013 (2013); FIN. STABILITY OVERSIGHT COUNCIL, MINUTES OF FINANCIAL STABILITY OVERSIGHT COUNCIL HELD APRIL 25, 2013 (2013).

vote that requires a two-thirds majority and the vote of the Chairperson approving a proposed designation, the FSOC provides a written notice with an explanation of the proposed designation to the company.\textsuperscript{62}

The company then has thirty days to request a written or oral evidentiary hearing to contest the proposed designation.\textsuperscript{63} Within thirty days of the request, the FSOC must hold an evidentiary hearing where the company may appear, personally or through counsel, to submit written materials.\textsuperscript{64} The FSOC may, but is not required to, grant a request for an oral hearing.\textsuperscript{65} The FSOC then has sixty days after the evidentiary hearing to make a final determination on the designation.\textsuperscript{66} If the FSOC finalizes the designation, which also requires a two-thirds majority and the vote of the Chairperson, then it must provide a written explanation of the basis of the designation.\textsuperscript{67} The FSOC will also notify the company at least one day before it publicly announces the designation.\textsuperscript{68}

Similar to other administrative processes, a company may challenge its final designation in federal district court.\textsuperscript{69} In reviewing the final determination of the FSOC, the district court must apply the "arbitrary and capricious" standard.\textsuperscript{70} Under this standard, a reviewing court will "hold unlawful and set aside agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."\textsuperscript{71} This highly deferential standard favors agencies, and "[c]orporations have not historically been successful in suing regulators."\textsuperscript{72} Perhaps the most significant outcome of a lawsuit could be access to documents regarding the FSOC's

\begin{itemize}
\item 62. 12 U.S.C. § 5323(e)(1) (2012); see also 12 C.F.R. § 1310.21(b).
\item 63. 12 U.S.C. § 5323(e)(2); see also 12 C.F.R. § 1310.21(c)(1).
\item 64. 12 U.S.C. § 5323(e)(2); see also 12 C.F.R. § 1310.21(c)(2).
\item 65. 12 U.S.C. § 5323(e)(2); see also 12 C.F.R. § 1310.21(c)(2).
\item 66. 12 U.S.C. § 5323(e)(3); see also 12 C.F.R. § 1310.21(d)(1).
\item 67. 12 U.S.C. § 5323(e)(3); see also 12 C.F.R. § 1310.21(b)(2).
\item 68. 12 C.F.R. § 1310 app. A at 363.
\item 69. 12 U.S.C. 5323(h) (stating that a designated company may bring an action in the United States district court for the judicial district in which the home office of the company is located or in the District of Columbia).
\item 70. Id. ("Review of such an action shall be limited to whether the final determination made under this section was arbitrary and capricious.").
\item 72. Douglas, supra note 12 (citing Daniel Meade, formerly at Hogan Lovells Internationals LLP and Senior Counsel to the House Committee on Financial Services); see also Glickman v. Wileman Bros. & Elliot, Inc., 521 U.S. 457, 506 n.8 (1997) (stating that the arbitrary and capricious standard under the Administrative Procedure Act is deferential).
\end{itemize}
designation process that would otherwise remain closed to the designated company and the public.\textsuperscript{73}

IV. Key Concerns Raised Over Hearing Procedures

The FSOC approved its hearing procedures on May 22, 2012.\textsuperscript{74} They detail the manner in which a designated company could obtain a hearing and the parameters of the hearing.\textsuperscript{75} The hearing procedures prompted four comment letters expressing concern that the procedures limit the ability of a company to challenge its designation.\textsuperscript{76} The procedural issues raise concern that there is (1) no right to an oral hearing; (2) no opportunity for discovery; and (3) a lack of information regarding the appointment and authority of the Hearing Clerk.

A. Companies Have No Right to an Oral Hearing

The FSOC’s hearing procedures do not entitle a company to an oral hearing to contest the proposed designation.\textsuperscript{77} Instead, a company must request an oral hearing with its written hearing request and justify “why [the FSOC] should exercise its discretion to grant such a hearing.”\textsuperscript{78} The FSOC retains “sole discretion” to grant a hearing, which it can only do with a majority vote.\textsuperscript{79} If the FSOC grants an oral hearing, the company still must submit written materials contesting the designation along with a list of individuals appearing and the nature of their presentations.\textsuperscript{80} The oral hearing procedures limit these

\textsuperscript{73} See Douglas, \textit{supra} note 12.

\textsuperscript{74} \textit{FIN. STABILITY OVERSIGHT COUNCIL, MINUTES OF FINANCIAL STABILITY OVERSIGHT COUNCIL HELD MAY 22, 2012} (2012).

\textsuperscript{75} \textit{See FIN. OVERSIGHT STABILITY COUNCIL, HEARING PROCEDURES FOR PROCEEDING UNDER TITLE I OR TITLE VIII OF THE DODD FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT § 5} (2012) [hereinafter THE FSOC HEARING PROCEDURES].

\textsuperscript{76} See Letter from Michael Bopp, Partner, Gibson, Dunn & Crutcher, LLP, to the FSOC (July 30, 2012) (on file with author); Letter from Bill Himpler, Exec. Vice President, American Fin. Servs. Ass’n., to the FSOC (July 30, 2012) (on file with author); Letter from Richard M. Whiting, Exec. Director & General Counsel, The Fin. Servs. Roundtable, to the FSOC (July 30, 2012) (on file with author); Letter from Stephen Zielezinski, Senior Vice President & General Counsel, Am. Ins. Ass’n., to the FSOC (July 30, 2012) (on file with author).

\textsuperscript{77} \textit{THE FSOC HEARING PROCEDURES, supra} note 75, § 5 (stating that the Council “may, at its sole discretion, grant a request for an oral hearing”).

\textsuperscript{78} \textit{THE FSOC HEARING PROCEDURES, supra} note 75, § 3(b).

\textsuperscript{79} Id. § 5.

\textsuperscript{80} Id. § 5(b)(2).
representatives to their presentations and answers to follow-up questions posed by FSOC members; the company’s representatives may not ask any questions of the FSOC or its staff regarding the designation. Additionally, FSOC members are not necessarily required to attend the hearing—although the hearing is technically before the FSOC, any FSOC member may select a representative to conduct the hearing on the member’s behalf if approved by a majority vote of FSOC members.

Given the substantial impact on a company’s finances, operations, and reputation that a designation will most likely carry, the FSOC should grant every request for an oral hearing. However, the FSOC is likely on firm statutory and constitutional grounds if it were to deny an oral hearing. Not only does Dodd-Frank expressly state that oral hearings are at the FSOC’s discretion, but the Fourth Circuit also approved a similar process in *Doolin Security Savings Bank, F.S.B. v. Federal Deposit Insurance Corporation.* The court held that the FDIC’s risk classification process, which involved “a detailed, expert evaluation of the financial condition of an institution,” satisfied due process requirements when it guaranteed only a written hearing and left oral hearings to the FDIC’s discretion. Under this analysis, a constitutional challenge to the FSOC’s hearing procedures would likely fail.

Nevertheless, “sound administrative practice” should compel the FSOC to hold oral hearings for companies challenging a proposed designation. Because the FSOC anticipates that only a small number of companies will receive designations, oral hearings would not burden the FSOC. Conversely, an FSOC designation will carry a substantial

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84. 12 U.S.C. § 5323(e)(2) (2012) (stating that an oral hearing may be granted “at the sole discretion of [the FSOC]”).
85. 53 F.3d. 1395 (4th Cir. 1995).
86. *Id.* at 1403.
87. *Contra* Zielezienski, *supra* note 76, at 3-4 (suggesting that an oral hearing is essential for due process).
88. *See id.* at 5.
burden on companies, as designated companies must comply with significant, yet still undetermined, prudential standards. Given the complexity and importance of the designation process, which includes a three-stage analysis and a host of quantitative and qualitative factors, an oral hearing is critical "to ensuring that a company knows why it is being considered for potential designation." While a company receives an explanation of the proposed designation from the FSOC, the explanation of AIG's determination was only fourteen pages. Such a short explanation is hardly sufficient for a complex decision with a potentially enormous impact. Additionally, a designated company has very limited opportunities to participate in the designation process. Prior to the proposed designation, a company can only submit written materials contesting the designation along with the information requested by the FSOC through the Office of Financial Research. An oral hearing is most likely the only opportunity a company will have to participate in the designation process "at a meaningful time in a meaningful manner." These same considerations should also push the FSOC to permit companies to question FSOC members or their staff. Particularly at

Congress 48 (2009) (statement of Ben S. Bernanke, Chairman of the Fed. Reserve) ("I would not envision the Fed's oversight extending to any significant number of additional firms."); Bopp, supra note 76, at 5.

90. See 12 U.S.C. § 5325(b)(1) (2012) (stating that new prudential standards may include risk-based capital requirements, leverage limits, liquidity requirements, resolution plan and credit exposure and credit requirements, concentration limits, a contingent capital requirement, enhanced public disclosures, short-term debt limits, and overall risk management requirements); see also Himpler, supra note 76, at 3; Acree, supra note 49 (noting provisions in Dodd-Frank to which nonbank SIFIs will be subject).


92. Whiting, supra note 76, at 4.

93. See AIG Final Determination, supra note 8.

94. See generally 12 C.F.R. § 1310.21 (providing only the hearing as a means of participation for potential designees).

95. See id. § 1310.21(a)(2); see also id. app. A at 362 ("The Notice of Consideration likely will include a request that the nonbank financial company provide information that the Council deems relevant to the Council’s evaluation, and the nonbank financial company will be provided an opportunity to submit the written materials to the [FSOC].").

96. Armstrong v. Manzo, 380 U.S. 545, 552 (1965) (recognizing that a fundamental requirement of due process is the "opportunity to be heard" (quoting Grannis v. Ordean, 234 U.S. 385, 394 (1914)); see Zielczienki, supra note 76, at 4.

Stage 3, the FSOC’s analysis is highly qualitative, and the written explanation describing subjective decisions such as a company’s risk to the financial system through “transmission channels”\(^98\) may raise more questions than it answers. For example, the FSOC states that individual exposures to AIG through derivatives, repurchase agreements, and securities lending “may be relatively small, but in the aggregate, the exposures are large enough that material financial distress at AIG . . . could have a destabilizing effect on the financial markets.”\(^99\) Whatever the flaws of the analysis may be,\(^100\) it involves “specific financial, accounting and other risk management considerations” and requires “not only direct knowledge of the facts, but also specialized expertise.”\(^101\) Surely issuing a sweeping conclusion without disclosing the supporting evidence behind it will provoke questions by the company that the explanation leaves unanswered. Therefore, a company should have the opportunity to question FSOC members and their staff during the hearing in order to clarify the FSOC’s subjective determinations and ensure that the designation is not based upon faulty information or analysis.\(^102\)

Finally, the FSOC should always exercise its discretion in granting an oral hearing because a written hearing potentially will have little effect.\(^103\) As previously mentioned, a company may submit written materials during Stage 3 to contest the designation before it is made.\(^104\) Presumably, a company will submit substantially similar materials in Stage 3 as it would in a written hearing. Since the FSOC will have already reviewed the materials and rejected the company’s argument against designation, a written hearing will most likely produce the same result.\(^105\) An oral hearing, on the other hand, would allow a

\(^98.\) 12 C.F.R. § 1310 app. A at 356-57 (describing transmission channels as the means by which a company’s financial distress could spread through the financial system; transmission channels include a company’s direct or indirect exposures to counterparties, total debt outstanding, amount of gross notional credit default swaps, and reinsurance obligations).

\(^99.\) AIG FINAL DETERMINATION, supra note 8, at 7.

\(^100.\) See infra Part IV.

\(^101.\) Whiting, supra note 76, at 4.

\(^102.\) See Zielezienski, supra note 76, at 4.

\(^103.\) See 12 U.S.C. § 5323(e)(2) (2012) (stating that a company may submit written materials contesting a designation after being granted an oral hearing); see also Himpler, supra note 76, at 2.


\(^105.\) Himpler, supra note 76, at 2.
company to present its argument more effectively and persuasively by establishing a "dialogue between FSOC and a petitioner company" and providing an opportunity to answer the FSOC's questions and concerns directly and in person. 106

B. There is No Further Discovery Process

The hearing procedures also do not afford the company a right to discovery regarding the specific data or analysis that the FSOC used for its proposed designation beyond the explanation accompanying the notice of proposed designation. 107 Additionally, the hearing procedures state that the Administrative Procedure Act, the Federal Rules of Evidence, and the Federal Rules of Civil Procedure do not apply to FSOC hearings. 108 Nothing requires FSOC hearings to permit discovery even if the FSOC followed the formalities of a hearing under the Administrative Procedure Act. 109

While the FSOC is not required to permit discovery or provide materials regarding the designation, the FSOC should nevertheless cooperate with a company seeking a more detailed explanation of the designation. The FSOC does provide a company with a written explanation of the basis of the proposed designation. 110 However, a company may still desire more details regarding how the FSOC interpreted the wealth of data and the factors considered in the designation process. 111 This might be particularly true for the

106. Id. at 3. This assumes, of course, that the FSOC members will not designate representatives to conduct hearings.

107. THE FSOC HEARING PROCEDURES, supra note 75, § 1 ("Nothing in these hearing procedures shall entitle a petitioner to discovery or other similar rights.").

108. Id. ("The provisions of the Administrative Procedure Act (5 U.S.C. § 551 et seq.) governing adjudications required by statute to be determined on the record, the Federal Rules of Evidence (28 U.S.C. Appendix), and the Federal Rules of Civil Procedure (28 U.S.C. Rule 1 et seq.), do not apply to the hearings to be conducted by [the FSOC] under these hearing procedures.").

109. See Kelly v. U.S. E.P.A., 203 F.3d 519, 523 (7th Cir. 2000) ("[T]here is no constitutional right to pretrial discovery in administrative proceedings."); see also Frilette v. Kimberlin, 508 F.2d 205, 208 (3rd Cir. 1974) ("The APA contains no provision for pre-trial discovery in the administrative process and, of course, the provisions of the Federal Rules Of Civil Procedure for discovery do not apply to administrative proceedings. Therefore, in the absence of special statutory provision, and in the absence of special administrative regulation, no procedure for discovery is normally available in a federal administrative proceeding." (citation omitted)).

110. See 12 C.F.R. § 1310.21(b) (2013).

111. See Himpler, supra note 76, at 2.
qualitative analysis that occurs largely in Stage 3.\textsuperscript{112} For instance, the FSOC states in its final explanation for AIG’s designation that

AIG also has the potential to transmit material financial distress to the broader economy through direct and indirect capital markets exposures. These exposures include holders of AIG securities, as well as derivatives, repurchase agreements, and securities lending counterparties. Individual exposures to AIG may be relatively small, but in the aggregate, the exposures are large enough that material financial distress at AIG, if it were to occur, could have a destabilizing effect on the financial markets.\textsuperscript{113}

The FSOC’s statement covers a broad spectrum of AIG’s financial activities, but it does not specify the data used to analyze that particular manner of risk transmission. To be sure, the explanation does include specific data such as its consolidated debt ($48.5 billion), gross notional derivatives outstanding ($215 billion), net liability for unpaid claims and claim adjustment expenses ($88 billion), and deposit contract obligations ($127 billion).\textsuperscript{114} Also, since the final explanation is a public document, the FSOC may be required to keep much of the information used to make the determination confidential.\textsuperscript{115} Still, a fourteen-page explanation, part of which simply states the methodology of the designation process,\textsuperscript{116} may not comprehensively address the questions and concerns a company might have about the three-stage, six-category, eleven-factor, part objective, part subjective, complex, and comprehensive designation process.

\begin{footnotes}
\item[112] See 12 C.F.R. § 1310 app. A at 362 ("[D]uring Stage 3, [the FSOC] expects to have access, to a greater degree than during earlier stages of review, to information relating to factors that are not easily quantifiable or that may not directly cause a company to pose a threat to financial stability, but could mitigate or aggravate the potential of a nonbank financial company to pose a threat to the United States.").
\item[113] AIG FINAL DETERMINATION, \textit{supra} note 8, at 7.
\item[114] \textit{Id.} at 11-13.
\item[115] See 12 C.F.R. § 1310.20(e) (requiring the FSOC to maintain the confidentiality of any information or data that companies submit and preserving all privileges to which the data or information is subject).
\item[116] See AIG FINAL DETERMINATION, \textit{supra} note 8, at 3-5.
\end{footnotes}
C. The Hearing Clerk Plays a Significant Role in the Hearing

Another subtle, yet significant, element of the hearing is the Hearing Clerk. This individual, appointed by the Treasury Secretary, is the "central point of contact for the petitioner." The Hearing Clerk sets the date and place for the written or oral hearing. Additionally, the Hearing Clerk is authorized to dictate procedural matters such as limitations on the quantity of written materials or the duration of an oral hearing. Given the lack of precedent for an FSOC hearing, the Hearing Clerk has wide discretion in establishing the procedural parameters of the hearing. For instance, in setting the hearing date, the Hearing Clerk controls the amount of time a company has to craft its challenge. The procedures also give no guidance as to how the Hearing Clerk might limit the amount of written materials or duration of an oral hearing. Despite the uncertainty surrounding the Hearing Clerk, the FSOC determined that it would not address these concerns regarding the particular limitations or arrangements that generally should apply in hearings... [because the FSOC] expects that, in the ordinary course of making procedural determinations, the Hearing Clerk will coordinate with the petitioner, as appropriate, for the purpose of facilitating an orderly and timely hearing.

While the FSOC decided against formalizing standards for the Hearing Clerk, such as a minimum time period between the grant of a hearing (written or oral) and the hearing date, the Hearing Clerk

117. THE FSOC HEARING PROCEDURES, supra note 75, § 3(c).
118. Id. §§ 4(a), 5(b)(1).
119. Id. § 3(c).
120. If the FSOC grants an oral hearing, a company most likely would have at least ten days to submit materials because it must submit written materials "not later than 10 days prior to the date of the oral hearing." Id. § 5(b)(3)(i).
121. See id. § 3(c).
123. See id.
124. See Himpler, supra note 76, at 4 ("In order to have an acceptable amount of time in which to gather the materials, we ask that the FSOC or Hearing Clerk submit notice of the hearing at least 60 days before the hearing is scheduled to take place.").
should accommodate the petitioning company to the greatest extent possible. Once the FSOC receives a request for a hearing, it must be held within thirty days. At most, a petitioning company would have sixty days to prepare for a hearing to contest a highly complex and comprehensive designation process. Prudential, not surprisingly, used all thirty days it had after receiving the notice of proposed designation to request its hearing. A written or oral hearing is a company’s one opportunity to contest a designation that carries significant regulatory burdens. In order to afford a company a meaningful hearing, the company must have an adequate opportunity to prepare. Therefore, in considering a hearing date and any limitations on the amount of written material or the duration of an oral hearing, the Hearing Clerk should cooperate and accommodate the petitioning company to the fullest extent.

V. HOW THE FSOC’S FLAWED ANALYSIS MAKES A SUCCESSFUL CHALLENGE UNLIKELY

The FSOC’s designation process is undoubtedly a complex, comprehensive, and thorough examination of a nonbank financial company and its potential effect on the U.S. financial system. The FSOC took nearly two years to develop its final rule detailing the designation process and three years to designate the first nonbanks as SIFIs. While Prudential had “faith in the integrity of the FSOC’s review process,” the FSOC might have been reluctant to overturn its lengthy and detailed preliminary decision. Prudential’s challenge was also the first test of the FSOC’s substantial powers under Dodd-

125. 12 U.S.C. 5323(e)(2) (2012) ("Upon receipt of a timely request [for a hearing], [the FSOC] shall fix a time [not later than 30 days after the date of receipt of the request].").
126. See id. ("Not later than 30 days after the date of receipt of any notice of a proposed determination under paragraph (1), the nonbank financial company may request, in writing, an opportunity for a written or oral hearing before [the FSOC] to contest the proposed determination.").
131. Id. (citing Isaac Boltansky).
Frank, perhaps pressuring the FSOC to stand firm on its decision.132 Moreover, the Financial Stability Board (“FSB”) named Prudential as one of nine insurers that pose a risk to the global financial system five days before Prudential’s hearing.133 Because the FSB does not provide company-specific explanations and the designations cannot be challenged like those by the FSOC,134 it is unclear whether assessment of Prudential by the FSB and the FSOC parallel each other. Nevertheless, the FSB’s designation could have provided strong ground for the FSOC’s determination that Prudential presents financial threat to the United States.135

The explanations for the AIG and Prudential determinations also shed light on two primary factors that appear important to the FSOC in making the nonbank SIFI determination, at least for insurance companies. First, the FSOC envisions a “run-on-the-bank” scenario where policyholders rapidly liquidated their insurance policies after a company experiences financial distress.136 The FSOC also places substantial weight on the size of a company in its analysis of both asset liability channel and exposure channel.137 Given the emphasis the FSOC placed on these two factors in its explanations for AIG and Prudential, it appears that the FSOC is holding tight to a misguided and narrow analytical framework.

132. Id.

133. FIN. STABILITY BOARD, GLOBAL SYSTEMICALLY IMPORTANT INSURERS (G-SIIS) AND THE POLICY MEASURES THAT WILL APPLY TO THEM, 4 (July 18, 2013); see also Elizabeth Festa, FSOC Member: Some colleagues do not understand insurance, LIFEHEALTHPRO.COM (Aug. 25, 2013), http://www.lifehealthpro.com/2013/08/25/fsoc-member-some-colleagues-do-not-understand-insurance (noting that FSB designations cannot be challenged); Crittenden & Scism, supra note 11.

134. See FIN. STABILITY BOARD, supra note 133 (summarizing and providing links to the specific framework for assessing a designation, but not detailing any particular company’s assessment).

135. See FIN. STABILITY OVERSIGHT COUNCIL, NOTATIONAL VOTE, VIEWS OF THE COUNCIL’S INDEPENDENT MEMBER HAVING INSURANCE EXPERTISE, 9 (September 19, 2013) [hereinafter INDEPENDENT MEMBER’S DISSENT ON PRUDENTIAL DETERMINATION] (“Although not binding on [the FSOC’s] decision, the declaration of Prudential as a G-SII by the FSB... has overtaken the Council’s own determination process.”); see also Crittenden & Scism, supra note 11.

136. See PRUDENTIAL FINAL DETERMINATION, supra note 8, at 9-10

137. See infra Part V.B
A. The "Run-on-the-Bank" Scenario is Firmly Entrenched in the FSOC's Assessment

The FSOC’s final determinations and explanations of Prudential’s and AIG’s designations indicate that the FSOC firmly believes that a "run-on-the-bank" scenario could occur in the insurance industry and cripple the broader financial system.138 In the explanation of AIG’s final determination, the FSOC repeatedly suggests a "run-on-the-bank" scenario where AIG experiences material financial distress, prompting policyholders to rapidly withdraw their life insurance and annuity policies, regardless of any early withdrawal penalties.139 The FSOC believes that a "rapid liquidation of AIG’s life insurance and annuity liabilities could strain AIG’s liquidity resources and compel the company to liquidate a substantial portion of its large portfolio.... This asset liquidation could have disruptive effects on the broader financial markets and impair financial market functioning."140 Using almost identical language, the FSOC repeats this analysis by explaining that a large number of withdrawals and surrender requests for its life insurance and annuity products “could strain Prudential’s liquidity resources and compel the company to sell assets in order to meet its obligations to policy holders.”141 This liquidation “could cause significant disruptions to key markets, including corporate debt and asset-backed securities markets.”142 As one of the two grounds for the designation, the FSOC clearly considers the "run-on-the-bank" scenario a viable and serious threat to the U.S. financial system.

Although this analysis is a major basis for the SIFI designation, many industry experts strongly argue that the "run-on-the-bank" scenario is implausible.143 In his dissent from Prudential’s designation,

138. See PRUDENTIAL FINAL DETERMINATION, supra note 8, at 9-10 ("A forced liquidation of a significant portion of Prudential’s assets... could cause significant disruptions to key markets."); see also AIG FINAL DETERMINATION, supra note 8, at 7 ("[A] severe and sudden liquidity stress could force AIG to sell assets in such significant volume that these asset sales would place downward pressure on prices in certain markets, and under more severe conditions, cause markets to seize up.").
139. AIG FINAL DETERMINATION, supra note 8, at 2.
140. Id.
141. PRUDENTIAL FINAL DETERMINATION, supra note 8, at 9.
142. Id.
143. See, e.g., Crittenden & Scism, supra note 11 ("The reasoning offered by FSOC to justify the designation suggests a misunderstanding of the insurance business model and regulation of insurance." (quoting Ben Nelson, chief executive of the National Association...
voting member Edward J. DeMarco, the Acting Director of the Federal Housing Finance Agency, noted that fundamental problem with the FSOC’s rationale is that “insurance products and liabilities are not the same as bank deposit liabilities” with regard to withdrawals. For instance, the insurance industry considers life insurance and annuity products to be long-term liabilities because customers face strong disincentives against cashing in their policies. The disincentives include “federal income tax liability, federal income tax penalties, surrender penalties, and the loss of guarantees.” Experts argue that in light of these disincentives, policyholders do not consider life insurance and annuity policies as cash instruments. Moreover, life insurance and annuity products often have provisions that safeguard against rapid and mass liquidation, including contractual terms and conditions allow an insurer to defer payouts on a significant portion of immediately payable cash surrender values. The insurer can therefore responsibly manage its asset liquidation and avoid cataclysmic devaluing in markets like corporate debt and asset-backed securities. Additionally, state

of Insurance Commissioners).

144. FHFA DIRECTOR’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 54, at 2; see also INDEPENDENT MEMBER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 135, at 3 (dissenting from the Prudential designation in part because there is “no support for why such a [run-on-the-bank scenario] is warranted or reasonable); FINANCIAL STABILITY OVERSIGHT COUNCIL, NOTATIONAL VOTE, VIEW OF DIRECTOR JOHN HUFF, THE STATE INSURANCE COMMISSIONER REPRESENTATIVE (September 19, 2013) [hereinafter STATE INSURANCE COMMISSIONER’S DISSENT ON PRUDENTIAL DETERMINATION] (arguing that a mass liquidation of insurance is speculative and highly unlikely); Crittenden & Scism, supra note 11.

145. See PRUDENTIAL FINAL DETERMINATION, supra note 8, at 9 (“Prudential’s life insurance and annuity products are generally considered to be long-term liabilities.”); see also AIG FINAL DETERMINATION, supra note 8, at 7 (“AIG’s life insurance and annuity product reserves... are generally considered to be long-term liabilities.”).

146. STATE INSURANCE COMMISSIONER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 144, at 2.

147. See INDEPENDENT MEMBER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 135, at 3; see also STATE INSURANCE COMMISSIONER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 144, at 2 (“Most policyholders do not view insurance policies as checking accounts, or even as typical investment accounts.”).

148. INDEPENDENT MEMBER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 135, at 4; see also STATE INSURANCE COMMISSIONER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 144, at 1; INTERSTATE INSURANCE PRODUCT REGULATION COMMISSION (IIPRC) INDIVIDUAL ANNUITY PRODUCT STANDARDS, SP029 A.L.I. – A.B.A. 313, 320 (Nov. 13-14, 2008). (noting that insurance companies must request and receive approval before exercising contractual right to defer the payment of any general cash surrender value for a period of not more than six months).

149. See STATE INSURANCE COMMISSIONER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 144, at 1.
courts can impose stays on withdrawals and surrenders to protect insurers from insolvency. The combination of policyholder disincentives and institutional safeguards render “extraordinarily low” the likelihood of “a contemporaneous run against the general and separate accounts by millions of life insurance policyholders and a significant number of annuity and other contract holders of products with cash surrender value.”

The FSOC’s reliance on “run-on-the-bank” analysis despite its major flaws signals that a company cannot successfully challenge the rationale in a hearing. This is evident as the FSOC counters well-supported arguments with largely speculative and unjustified assumptions. For instance, while the FSOC acknowledges Prudential’s right to defer payments and the state courts’ authority to stay withdrawals, it claims that a company would not seek to invoke their rights for fear that counterparties, investors, and customers might lose confidence in the financial stability of the company. The FSOC does not explain, however, why a company would choose insolvency through mass liquidation rather than risk a loss in confidence by using tools designed to buffer mass liquidation. Additionally, the FSOC does not provide an explanation of why consumers would liquidate policies en masse. Rather, it simply concludes “a substantial portion of [life insurance and annuity products] are available for immediate discretionary withdrawal with little or no penalty and therefore could, in practice, have characteristics of short-term liabilities.” When the FSOC dismisses the strength of the mitigants and, as voting member S. Roy Woodall, Jr. notes in his dissent, “no historical, quantitative or qualitative evidence exists in the record that supports a run of the scale and speed posited,” challenging sweeping, groundless conclusions is nearly impossible. Consequently, a hearing appears much less

150. See INDEPENDENT MEMBER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 135, at 4; see also STATE INSURANCE COMMISSIONER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 144, at 1.

151. INDEPENDENT MEMBER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 135, at 3.

152. See PRUDENTIAL FINAL DETERMINATION, supra note 8, at 10 (discussing potential mitigants to asset liquidation); see also AIG FINAL DETERMINATION, supra note 8, at 3 (noting that the FSOC considered mitigants such as the nature of insurance products).

153. PRUDENTIAL FINAL DETERMINATION, supra note 8, at 9.

154. INDEPENDENT MEMBER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 135, at 3.
meaningful given that the asset liquidation channel, under which the FSOC analyzes the "run-on-the-bank" scenario, comprises a critical portion of the FSOC's rationale for a designation.\textsuperscript{155}

\textbf{B. The FSOC Bases Designations on the Size of a Company Rather Than Any Unique or Specific Characteristics of a Company}

The regulatory guidance states that the FSOC will analyze a company under ten statutory considerations within a six-category framework.\textsuperscript{156} Such a diversity of factors suggests that the FSOC would only designate a company when the company's specific risk profile satisfies multiple factors in a substantial manner.\textsuperscript{157} However, in light of Prudential's designation, the FSOC's analysis appears to concentrate almost entirely on the size of a company with respect to its potential threat to the financial stability of the United States.\textsuperscript{158} A categorical designation process undermines the FSOC's stated analytical framework and the "long accepted principle of [the designation process]

\textsuperscript{155} See Prudential Final Determination, supra note 8, at 8-10 ("A nonbank financial company holds assets that, if liquidated quickly, would cause a fall in asset prices and thereby significantly disrupt trading or funding in key markets."); see also 12 C.F.R. § 1310 app. A at 354 (2013) (naming the asset liquidation channel as one of three channels "most likely to facilitate transmission of the negative effects of a nonbank financial company's material financial distress or activities to other financial firms and markets");

\textsuperscript{156} See 12 C.F.R. § 1310 app. A at 355-59 (naming the statutory considerations to be (1) the extent of the leverage; (2) the extent and nature of off-balance-sheet exposures; (3) the extent and nature of the transactions and relationships with other significant financial companies; (4) the importance of the company as a source of credit; (5) the extent to which assets are managed rather than owned by the company; (6) the nature, scope, size, scale, concentration, and interconnectedness of the company; (7) the extent to which the company is regulated; (8) the amount and nature of the company's financial assets; (9) the amount and types of the company's liabilities; (10) and any other risk-related factors as the statutory factors and the six-category framework to be (1) interconnectedness; (2) substitutability; (3) size; (4) leverage; (5) liquidity risk and maturity mismatch; and (6) existing regulatory scrutiny as the six-category framework).

\textsuperscript{157} See id. § 1310 app. A at 360 ("[The FSOC] also will consider quantitative and qualitative information that it deems relevant to a particular nonbank financial company, as each determination will be made on a company-specific basis." (emphasis added)).

\textsuperscript{158} See State Insurance Commissioner's Dissent on Prudential Determination, supra note 144, at 2 (noting that the FSOC's exposure channel analysis "merely demonstrates that Prudential is a large insurance company"); see also Hester Pierce, The FSOC's Latest Careless Too Big To Fail Decision, REALCLEARMARKETS (Sept. 25, 2013), http://www.realclearmarkets.com/articles/2013/09/25/the_fsocs_latest_careless_too_big_to_fail_decision_100_632.html (arguing that the FSOC's reasoning boils down to Prudential's size).
that size alone is not a sufficient basis for designation.”\textsuperscript{159} Consequently, the narrow approach taken by the FSOC severely hampers the ability of a company to challenge its designation given that “such a line of reasoning would inevitably lead to a conclusion that any nonbank financial company above a certain size is a threat.”\textsuperscript{160}

The FSOC’s designation focuses so sharply on size, in part, because the analytical framework applies the size of the company to nearly every statutory consideration. As seen below, the “size” category\textsuperscript{161} directly applies to six out of the ten statutory considerations that the FSOC uses to gauge a company’s threat to the U.S. financial system.\textsuperscript{162}

\textsuperscript{159} \textsc{State Insurance Commissioner’s Dissent on Prudential Determination}, \textit{supra} note 144, at 2; \textit{see} Letter from Paul Schott Stevens, President and CEO, Inv. Co. Inst., to the FSOC (Feb. 25, 2011) (“A company’s size alone reveals very little about its potential to pose risk to the financial system and, consequently, could be highly misleading if considered in isolation.”).

\textsuperscript{160} \textsc{Independent Member’s Dissent on Prudential Determination}, \textit{supra} note 135, at 2.

\textsuperscript{161} 12 C.F.R. § 1310 app. A at 357-58 (defining size as “the amount of financial services or financial intermediation that a nonbank financial company provides . . . conventionally measured by the assets, liabilities, and capital of the firm . . . [and] off-sheet assets and liabilities and assets under management”).

\textsuperscript{162} \textit{Id.} § 1310 app. A at 356 (providing the statutory consideration and category table).
<table>
<thead>
<tr>
<th>Statutory considerations:</th>
<th>Category or categories in which this consideration would be addressed:</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) The extent of the leverage of the company.</td>
<td>Leverage.</td>
</tr>
<tr>
<td>(B) The extent and nature of the off-balance-sheet exposures of the company.</td>
<td>Size; interconnectedness.</td>
</tr>
<tr>
<td>(C) The extent and nature of the transactions and relationships of the company.</td>
<td>Interconnectedness.</td>
</tr>
<tr>
<td>(D) The importance of the company as a source of credit for households, businesses, and State and local government and as a source of liquidity for the United States financially system.</td>
<td>Size; substitutability.</td>
</tr>
<tr>
<td>(E) The importance of the company as a source of credit for low-income, minority, or undeserved communities, and the impact that the failure of such company would have on the availability of credit in such communities.</td>
<td>Substitutability.</td>
</tr>
<tr>
<td>(F) The extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse.</td>
<td>Size; interconnectedness; substitutability.</td>
</tr>
<tr>
<td>(G) The nature, scope, size, scale, concentration, interconnectedness, and mix of activities of the company.</td>
<td>Size; interconnectedness; substitutability.</td>
</tr>
<tr>
<td>(H) The degree to which the company is already regulated by 1 or more primary financial regulatory agencies.</td>
<td>Existing regulatory scrutiny.</td>
</tr>
<tr>
<td>(I) The amount and nature of the financial assets of the company...</td>
<td>Size; interconnectedness.</td>
</tr>
<tr>
<td>(J) The amount and types of the liabilities of the company, including the degree of reliance on short-term funding.</td>
<td>Liquidity risk and maturity mismatch; size; interconnectedness.</td>
</tr>
<tr>
<td>(K) Any other risk-related factors that the Council deems appropriate.</td>
<td>Appropriate category or categories based on the nature of the additional risk-related factor.</td>
</tr>
</tbody>
</table>

Figure 1

In theory, the “interconnectedness” category\(^{164}\) should qualify the “size” category by distinguishing between the large nonbank financial companies that could potentially threaten the United States financial system and those that could not.\(^{165}\) The FSOC measures interconnectedness with quantitative standards such as

\(^{163}\) Id.

\(^{164}\) Id. § 1310 app. A at 356-57 (defining interconnectedness principally as exposures to counterparties).

\(^{165}\) See Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 64,265, 64,266 (proposed Oct. 18, 2011) (codified at 12 C.F.R. pt. 1310) (stating that commenters consider “size alone . . . [an insufficient] basis on which to make a determination . . . absent other considerations, such as the nonbank financial company’s interconnectedness”); see also Sean Campbell, Deputy Assoc. Dir. for Div. of Research and Statistics, Fed. Reserve Bd., Presentation on Agenda for Measuring Interconnectedness, at 27-33 (Apr. 6, 2012) (describing interconnectedness as a measure for how financial distress translates into a real effect on the broader economy).
[the] number, size, and financial strength of a nonbank financial company’s counterparties. Aggregate amounts of a nonbank financial company’s gross or net derivatives exposures and the number of its derivatives counterparties. The amount of gross notional credit default swaps outstanding. Total debt outstanding. [and] [r]einsurance obligations.\textsuperscript{166}

These measurements are closely related to the size of the company, but they target specific activities that could spread financial distress through to other companies and the broader financial system. Together, these two categories account for a substantial and significant portion of the FSOC’s analysis compared to the others.\textsuperscript{167}

In application, the FSOC treats interconnectedness more like an additional measure of size. In discussing the exposure channel analysis for Prudential and AIG, the FSOC acknowledges that the individual exposures of other financial firms to the companies are relatively small.\textsuperscript{168} The FSOC, however, aggregates the relatively small exposures and concludes the “exposures across multiple markets and financial products are significant enough that material financial distress at Prudential” could materially impact key markets through losses to large financial firms.\textsuperscript{169}

The FSOC’s analysis contains far too many shortcomings to constitute a major portion of the basis for a designation. Acting Director DeMarco, a voting member, argued that because “no large financial institution has more than a de minimus amount of its equity capital exposed to Prudential,”\textsuperscript{170} it is just as likely, or even more likely, that Prudential’s counterparties could absorb the individual losses without significant impact to their financial condition.\textsuperscript{171} Additionally,

\textsuperscript{166} 12 C.F.R. § 1310 app. A at 357.
\textsuperscript{167} \textit{See} PRUDENTIAL FINAL DETERMINATION, \textit{supra} note 8, at 10-12 (noting the “critical service or function” channel is not a factor because sufficient substitutes exists and that state authorities already regulate Prudential).
\textsuperscript{168} \textit{See id.} at 8; \textit{See} AIG FINAL DETERMINATION, \textit{supra} note 8, at 7.
\textsuperscript{169} PRUDENTIAL FINAL DETERMINATION, \textit{supra} note 8, at 8.
\textsuperscript{170} FHFA DIRECTOR’S DISSENT ON PRUDENTIAL DETERMINATION, \textit{supra} note 54, at 1.
\textsuperscript{171} \textit{See} INDEPENDENT MEMBER’S DISSENT ON PRUDENTIAL DETERMINATION, \textit{supra} note 135, at 2.
interconnectedness presents the greatest risks when nonbank financial company’s counterparties are highly leveraged. Only then is it likely that material financial distress could cause the failure of a counterparty. While the FSOC acknowledges this condition, it does not establish that any financial firms are so highly leveraged that their exposures to Prudential could cause the kind of devastating losses that could materially impair financial markets. The FSOC also characterizes Prudential’s derivatives portfolio as a source of risk to counterparties without noting, as Acting Director DeMarco does, that the largest component of the portfolio is interest rate swaps which “lack the same principal and jump-to-default risk as some other derivatives such as credit default swaps.” The flaws in the FSOC’s analysis of interconnectedness demonstrates that the FSOC focuses simply on the size and number of the relationships between a nonbank financial company and its counterparties rather than company-specific characteristics that may make transmission of material financial distress more or less likely.

The FSOC’s concentration on the size of a company also manifests itself in the asset liquidation analysis through the “run-on-the-bank” scenario. The underlying reason that the FSOC considers a rapid and widespread withdrawal of Prudential’s life insurance and annuity products to be a threat to the financial system is the fact that Prudential has $3.6 trillion of life insurance in force, $424 billion of general account investments, and $253 billion of separate account investments, making it the second largest life insurer in the United States. The analysis of a run on insurers does not consider the extremely low probability that it would occur; rather, the FSOC assumes it will occur then gauges the damage to financial markets that a company’s forced

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172. See Letter from Paul Schott Stevens, President and CEO, Investment Company Institute, to the FSOC (Nov. 5, 2010) (discussing the FSOC’s designation criteria).
173. See id. (“By contrast, in the event of the failure of a firm whose creditors are not highly leveraged, those creditors would take a charge against their own capital, but these events would be unlikely to spark further failures among other ‘interconnected’ firms.”).
174. See PRUDENTIAL FINAL DETERMINATION, supra note 8, at 8 (noting that “material financial distress at Prudential could aggravate losses to large, leveraged financials firms,” but failing to support the analysis with any facts).
175. See id. at 2.
176. FHFA DIRECTOR’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 54, at 1.
177. See PRUDENTIAL FINAL DETERMINATION, supra note 8, at 2; see also Company Fact Sheet, PRUDENTIAL FINANCIAL, INC. (Nov. 6, 2013), http://www.news.prudential.com/press_file.cfm?presskit_id=68.
asset liquidation would do. Such an approach depends entirely on the company’s assets and liabilities, the traditional measure of size. Not surprisingly, the FSOC is now considering MetLife, Inc. (“MetLife”), the largest insurer in the United States, under Stage 3. Under the FSOC’s “run-on-the-bank” rationale, being “one of the largest financial services companies in the United States . . . [and] among the largest U.S. insurance companies” necessarily creates a potential threat to the United States financial system.

When the FSOC bases the two most substantial portions of its designation, the exposure channel and the asset liquidation channel, predominantly on the size of the company, a challenge to the designation essentially becomes futile. The interconnectedness category should provide strong grounds from which to attack the FSOC’s designation as many insurance experts contend that the FSOC misunderstands the nature of an insurance company’s assets and liabilities and how they threaten the financial stability of the United States. However, the FSOC renders these arguments moot by glossing over the detailed nature of a company’s relationships with other financial institutions and giving more weight to quantitative analysis. If forced to argue against the FSOC’s quantitative analysis and conclusions derived from a company’s size, the company will almost certainly fail to prove that it does not pose a threat to the financial system. Likewise, a company’s most effective strategy to challenge the “run-on-the-bank” scenario and prove that asset liquidation would not harm financial markets is that the entire scenario

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180. PRUDENTIAL FINAL DETERMINATION, supra note 8, at 2.
181. See Elizabeth Festa, Tangled up in Pru, LIFEHEALTHPRO.COM (September 23, 2013), http://www.lifehealthpro.com/2013/09/23/tangled-up-in-pru (noting that Prudential’s designation was based “run-on-the-bank” and contagion rationales despite arguments from industry experts and members of the FSOC).
182. See, e.g., Kandarian, supra note 49, at 4 (“In MetLife’s programs, approximately three-quarters of the securities on loan are U.S. Treasuries . . . which would protect counterparties in the event of a forced sale.”).
183. See generally PRUDENTIAL FINAL DETERMINATION, supra note 8.
184. See Woodall, supra note 13 (noting that Prudential’s success hinges on its ability to refute the FSOC’s interpretation of the data and that “[i]t has to be a qualitative argument” (quoting Donald Lamson, head of the Washington, D.C. regulatory practice at Shearman & Sterling)).
is highly improbable barring "a catastrophic mortality event (which would affect the entire sector and also the whole economy)." Yet the validity of the scenario is entrenched in the FSOC’s basis for the designation, and by summarily dismissing the mitigating factors to asset liquidation, the question becomes simply how large are the company’s liabilities. With a disproportionate and narrow focus on size, the FSOC’s rationale potentially subjects any insurer above a certain size, whether it is measured by life insurance and annuity liabilities or other financial companies’ exposures, to a designation.

C. A Company May Be Able to Influence the Standards by which Nonbank SIFI Companies Will Be Regulated

Although the hearing is intended to allow a company to contest its designation, it may also present an opportunity to communicate the standards by which it should be regulated, if regulated at all. The FSOC will play a significant role in defining the particular prudential standards that the Federal Reserve will apply to nonbank SIFIs. Additionally, the FSOC may “differentiate among companies that are subject to heightened standards on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities . . . size, and any other risk-related factors.” Given that an oral hearing might be a company’s only face-to-face meeting with the FSOC, a company should recommend regulation standards that

185. INDEPENDENT MEMBER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 135, at 4.
186. See, e.g., PRUDENTIAL FINAL DETERMINATION, supra note 8, at 8, 10 (discussing mitigants to rapid asset liquidation and the FSOC’s rationale for why a company would not invoke them).
187. See INDEPENDENT MEMBER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 135, at 2 (“[S]uch a line of reasoning would inevitably lead to a conclusion that any nonbank financial company above a certain size is a threat.”); see also STATE INSURANCE COMMISSIONER’S DISSENT ON PRUDENTIAL DETERMINATION, supra note 144, at 2 (“[T]he Basis merely demonstrates that Prudential is a large insurance company.”); Festa, supra note 181 (“Using the same rationale, other large life insurers such as MetLife . . . and a number of other life insurers over the $50 billion in assets threshold could be viewed as potential SIFIs.”).
188. Douglas, supra note 12 (“There may come a point in the proceedings where the parties agree on a designation where the terms would be less onerous than what Prudential fears.” (quoting Donald Lamson)).
189. See 12 U.S.C. § 5325 (2012) (describing the various recommendations that the FSOC may make in developing the prudential standards for nonbank SIFIs).
190. Id. § 5325(a)(2)(A).
fit the company’s financial and operational profile.

MetLife Chairman, President, and Chief Executive Officer Steven A. Kandarian has already suggested alternative regulatory structures.191 Kandarian has urged that regulating insurance companies in a manner similar to banks, particularly with respect to capital requirements, would constrain the insurance companies’ ability to issue guarantees and increase the prices of consumer products.192 A more appropriate regulatory framework is an activities-based approach, as opposed to an institutions-based approach, where the FSOC can monitor certain activities and recommend tightened standards specifically for high-risk activities to the existing primary regulator.193 MetLife may well have the opportunity to present this framework in detail to the FSOC as MetLife will most likely request a hearing to challenge a proposed designation if and when the FSOC issues it.194

VI. CONCLUSION

Although the evidentiary hearing is a nonbank financial company’s last opportunity to argue to the FSOC that it does not pose a systemic risk to the United States financial system, the hearing does not offer a company a meaningful forum to challenge a designation. Even if the FSOC granted every request for an oral hearing and the Hearing Clerk accommodated each company to the greatest extent, the hearing procedures nevertheless constrain a company’s ability to examine the FSOC’s rationale because the company cannot pose any clarifying questions or seek additional information from the FSOC. This is particularly troublesome with respect to the FSOC’s major conclusions that often contain scant supporting evidence. Additionally, a company

194. See Zachary Tracer, MetLife Says Regulators May Miss Key Insurer Risks with Focus on Bank Rules, INSURANCEJOURNAL.COM (Sept. 19, 2013), http://www.insurancejournal.com/news/national/2013/09/19/305664.html (describing MetLife’s criticisms of the federal financial regulatory framework as applied to insurers); see also Elizabeth Festa, MetLife: We’re not risky, but a SIFI designation is, LIFEHEALTHPRO.COM (April 3, 2013), http://www.lifehealthpro.com/2013/04/03/metlife-were-not-risky-but-a-sifi-designation-is (noting Kandarian’s statements that MetLife is a systemically risky company and poses not threat to the U.S. financial system).
will have great difficulty challenging the FSOC’s core conclusions with respect to the exposure and asset liquidation channels. Although the analytical framework suggests differently, the FSOC demonstrated in its analysis of Prudential that it will disregard the relatively minor risks posed by the nature of a company’s assets and liabilities and instead gauge systemic risk by the size of a company, potentially subjecting all large insurers to a SIFI designation. However, a hearing would provide an in-person opportunity for a company to propose alternative, industry-tailored prudential standards that would strengthen regulation without imposing ill-fitting burdens on designated companies.

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