ORAL ARGUMENT NOT SCHEDULED
No. 16-5086

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

METLIFE, INC.,
Plaintiff-Appellee,
v.

FINANCIAL STABILITY OVERSIGHT COUNCIL,
Defendant-Appellant.

On Appeal from the United States District Court
for the District of Columbia, No. 15-cv-45-RMC (Collyer, J.)

BRIEF FOR AMICUS CURIAE AMERICAN COUNCIL OF LIFE INSURERS IN SUPPORT OF APPELLEE

NOAH A. LEVINE
WILMER CUTLER PICKERING
HALE AND DORR LLP
7 World Trade Center
250 Greenwich Street
New York, NY 10007

DAVID W. OGDEN (DC Bar No. 375951)
KELLY P. DUNBAR (DC Bar No. 500038)
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue, NW
Washington, DC 20006
Tel.: (202) 663-6000
Fax: (202) 663-6363

GARY E. HUGHES
AMERICAN COUNCIL OF LIFE
INSURERS
101 Constitution Avenue, NW
Washington, DC 20001

CHRISTOPHER R. LOONEY (DC Bar No. 998730)
WILMER CUTLER PICKERING
HALE AND DORR LLP
60 State Street
Boston, MA 02109

August 22, 2016

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to Circuit Rule 28(a)(1), amicus curiae American Council of Life Insurers certify that:

(A) Parties and Amici

All parties, intervenors, and amici appearing before the district court and in this Court are listed in the Brief for Appellee and Appellant.

(B) Rulings under Review

References to the rulings at issue appear in the Brief for Appellee.

(C) Related Cases

The American Council of Life Insurers adopts the statement of related cases presented in the Brief for Appellee.

Dated: August 22, 2016

Respectfully submitted,

/s/ David W. Ogden

DAVID W. OGDEN
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue, NW
Washington, DC 20006
Tel.: (202) 663-6000
Fax: (202) 663-6363
David.Ogden@wilmerhale.com

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure and Circuit Rule 26.1, counsel for the American Council of Life Insurers hereby certifies that:

The American Council of Life Insurers is a nonprofit corporation that does not have outstanding shares or debt securities in the hands of the public and does not have a parent company. No publicly held company has a 10% or greater ownership interest in the American Council of Life Insurers.

Dated: August 22, 2016

Respectfully submitted,

/s/ David W. Ogden

DAVID W. OGDEN
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue, NW
Washington, DC 20006
Tel.: (202) 663-6000
Fax: (202) 663-6363
David.Ogden@wilmerhale.com

CIRCUIT RULE 29 STATEMENT

Pursuant to Circuit Rule 29(b), counsel for the American Council of Life Insurers previously certified to this Court that counsel for all parties have consented to the filing of this brief. *See* Notice of Intent to Participate as Amicus Curiae, Doc. #1631319 (Aug. 20, 2016).

Pursuant to Circuit Rule 29(c), counsel for the American Council of Life Insurers certifies that no counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than the amicus curiae made a monetary contribution to its preparation or submission.

Pursuant to Circuit Rule 29(d), counsel for the American Council of Life Insurers certifies that this separate brief is necessary. The American Council of Life Insurers appeared as amicus in the district court and provided a unique and helpful perspective on the issues presented by this matter in that court. As the largest life insurance trade association in the United States, representing the interests of hundreds of member companies, the American Council of Life Insurers is uniquely situated to provide information relating to the unique business of insurance, the differences between insurance companies and other financial institutions, such as banks, and the effectiveness of the existing scheme of state regulation of the insurance industry.

To the best of the knowledge of undersigned counsel for the American Council of Life Insurers, no other *amicus curiae* brief will address these specific concerns from the perspective of the life insurance industry.

In light of the distinct subject matters and the complexity of the issues presented by this matter, counsel for the American Council of Life Insurers certifies that filing a joint brief with other *amici* is not practicable.

Dated: August 22, 2016

Respectfully submitted,

/s/ David W. Ogden

DAVID W. OGDEN
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue, NW
Washington, DC 20006
Tel.: (202) 663-6000
Fax: (202) 663-6363
David.Ogden@wilmerhale.com

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES*

Page(s)

CASES

STATUTES AND LEGISLATIVE MATERIALS

---

* Authorities upon which the American Council of Life Insurers chiefly relies are marked with asterisks.

OTHER AUTHORITIES

GLOSSARY

AIG	American International Group, Inc.
APA	Administrative Procedure Act
Council	Financial Stability Oversight Council
DFS	New York State Department of Financial Services
Dodd-Frank	Dodd-Frank Wall Street Reform and Consumer Protection Act
GA	Guaranty Association
JA	Joint Appendix
NAIC	National Association of Insurance Commissioners
NOLHGA	National Organization of Life and Health Insurance Guaranty Associations
OTS	Office of Thrift Supervision
RBC	Risk Based Capital
SIFI	Systemically Important Financial Institution

STATEMENT OF INTEREST OF *AMICUS CURIAE*

The American Council of Life Insurers, or ACLI, is the largest life insurance trade association in the United States, representing the interests of hundreds of member companies. ACLI's member companies are the leading providers of financial and retirement security products covering individual and group markets, including life, annuity, disability income, and long-term care insurance products. ACLI's members account for more than 90 percent of the life insurance industry's total assets, premiums, and annuity considerations.

ACLI has a strong interest in the resolution of this case. It has substantial expertise that bears on the approach taken by the Financial Stability Oversight Council (the "Council") in assessing the systemic risk of insurance companies. Three of the four nonbank financial companies that the Council has designated to date for supervision as "systemically important financial institutions" ("SIFIs") are insurance companies. All three of those companies—American International Group, Prudential Financial, Inc., and MetLife, Inc.—are members of ACLI. ACLI, therefore, can offer a unique industry-wide perspective on this case, particularly regarding the basic differences between banks—long subject to federal regulation based on systemic risk concerns—and traditional life insurance companies, and regarding the role of state regulation of the life insurance industry.

INTRODUCTION AND SUMMARY OF ARGUMENT

ACLI fully endorses the arguments made by plaintiff-appellee MetLife in its brief before this Court. MetLife convincingly demonstrates why its designation as a systemically important financial institution ("SIFI") by the Council was arbitrary and capricious; unsupported by the record, empirical fact, or economic logic; and contrary to law. ACLI also agrees with the analyses and holding by the district court in this case. ACLI writes separately to address from the broad perspective of the life insurance industry two issues raised by the Council's designation of MetLife.

First, in the Final Determination, the Council failed to account for the basic differences between banks, on the one hand, and insurance companies, on the other, including differences in the products offered, the liabilities assumed, and the economic risks respectively faced by banks and insurers.[1] Bedrock principles of reasoned decisionmaking under the Administrative Procedure Act ("APA") required the Council both to identify and account for the differences between these two very different types of financial institutions. Instead, the Council glossed them over, effectively assuming that banks and insurance companies were alike, when,

---

[1] *See* Explanation of the Basis of the Financial Stability Oversight Council's Final Determination that Material Financial Distress at MetLife Could Pose a Threat to U.S. Financial Stability and that MetLife Should Be Supervised by the Board of Governors of the Federal Reserve System and Be Subject to Prudential Standards (Dec. 18, 2014) ("Final Determination") (JA361-778).

in fact, they differ. The Council's erroneous bank-centric assumptions were perhaps most prominent in its conjecture—contrary to all historical evidence and economic logic—that insurers, like banks, face the risk of massive "runs" by policyholders and that such runs pose a systemic risk to the U.S. economy. When the differences, reflected in the administrative record, are rightly understood, it is clear that the designation of MetLife cannot stand.

Second, the Council's designation of MetLife as a SIFI—subjecting MetLife to more burdensome federal regulation—reflected the Council's misunderstanding and unreasonable disregard of existing state regulation of the life insurance industry. Congress imposed a specific statutory duty on the Council to assess existing regulation of nonbank financial institutions before subjecting them to additional federal regulation. 12 U.S.C. § 5323(a)(2)(H). The Council violated that duty by failing to assess meaningfully the time-tested system of state regulation that has governed the life insurance industry effectively.

Each of those two grounds provides a more than sufficient basis for affirming the district court's rescission of MetLife's SIFI designation. Although the district court did not expressly rely on either, MetLife raised those or similar arguments before the district court and on appeal here, *see* MetLife Br. 44-46 (the Council arbitrarily posited a run scenario at a life insurer); *id.* at 46-51 (the Council arbitrarily disregarded state regulation), and this Court may affirm on any basis

supported by the record, *see Wilburn v. Robinson*, 480 F.3d 1140, 1148-1149 (D.C. Cir. 2007). In addition, the two significant failures of reasoned decisionmaking identified by ACLI help to inform, and further support, the district court's conclusion that the Council "hardly adhered to any standard when it came to assessing MetLife's threat to U.S. financial stability." JA803.

ARGUMENT

I. THE FINAL DETERMINATION INAPPROPRIATELY ASSUMED THAT A BANK-CENTRIC MODEL OF RISK AND REGULATION WAS APPLICABLE TO INSURANCE COMPANIES

Agency action is arbitrary and capricious if it is not "the product of reasoned decisionmaking." *Motor Vehicle Mfrs. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 52 (1983). An agency fails to satisfy that standard when it "fail[s] to consider an important aspect of the problem." *Id.* at 43. Here, the district court held that "the Final Determination hardly adhered to any standard when it came to assessing MetLife's threat to U.S. financial stability." JA803 (district court opinion). That conclusion is well-founded in multiple respects. But one important example of the Council's failure to apply standard-based decisionmaking relates to the Council's refusal to account for fundamental differences between banks and insurance companies—differences that substantially undermine the Council's risk assessment.

A. Banks And Insurance Companies Differ In Critical Respects

The business of banks and insurers differs in multiple fundamental ways: obviously they are engaged in different lines of business, and they offer different products and services with fundamentally different characteristics; they hold different kinds of liabilities on their balance sheets; they manage and match assets and liabilities differently; and they operate in utterly different regulatory landscapes. *See generally* Bipartisan Policy Center, *The Business of Insurance and Banking: Understanding Two Different Industries* (Sept. 2015); Thimann, *How Insurers Differ from Banks: A Primer on Systemic Regulation* 4-12 (July 2014). Critically—unlike banks—life insurers' liabilities are long-dated and not subject to immediate withdrawal, and so for insurers the risk of a bank-like "run" resulting from loss of customer confidence is virtually non-existent.

Banks' primary liabilities are bank deposits, which depositors may call on demand. As one regulator explained in the record, "[a] bank's liabilities … take the form of promises to repay its depositors' funds *upon demand at any time no matter how short the notice*." JA234 (Letter from Benjamin M. Lawsky, Superintendent of N.Y. Dep't of Fin. Servs., to the Honorable Jacob Lew, Secretary, U.S. Dep't of the Treasury, at 1 (July 30, 2014) ("*DFS Letter*")) (emphasis added). At the same time, bank assets—primarily loans—are longer maturing and *cannot* be called upon by banks to provide immediate liquidity. As

the same regulator explained, this combination of short-term liabilities and longer-maturing assets creates the risk of runs on banks, suddenly depleting them of assets, if customers lose faith in the bank's ability to meet its obligations:

> Bank deposits create immediate potential liabilities while the bank invests in assets that mature over time. Banks therefore rely heavily on their depositors' faith in the institution and the fact that all depositors are unlikely to demand their funds at the same moment. If that faith is shaken, large numbers of depositors may seek to withdraw their funds at the same time, thereby creating a "run on the bank."

JA234-235.

Insurance liabilities and products are critically different. Consumers do not purchase life insurance products for use as immediate sources of liquidity, but rather to obtain long-term financial protection. Traditional life insurance policies protect families from financial hardships associated with the death of a family member or other loved one and provide a reliable source of assets to pay for death-related expenses and other needs. *See* JA174 (Letter and Supplemental Statement from NOLHGA President Peter G. Gallanis to Jacob Lew, Sec'y, U.S. Dep't of the Treasury , at 1 (Oct. 14, 2014) ("*Gallanis Supp. Statement*") ("Insurance customers bargain for … long-term protection against future financial exposures (e.g., the costs of dealing with fires or accidents, providing for family members' needs upon the insured's death, funding retirement expenses, and the like)."). Insurers also offer annuity products that help policyholders save and in due course receive a steady and reliable source of income during retirement. *See* ACLI, *America's Life*

Insurance Industry: Security Families Count On 1 (Feb. 2016). As record evidence demonstrated, consumers do not purchase insurance products with the expectation they will provide availability of funds on demand; thus, insurance products do "not … serve as a source of near-term liquidity, as in the case with bank deposits and other banking products." JA103 (Letter from James J. Donelon, La. Ins. Comm'r, to Jacob Lew, Sec'y, U.S. Dep't of the Treasury, at 2 (Mar. 27, 2014) ("*Donelon Letter*")).

Indeed, many life insurance products are structured to include significant disincentives to or limitations on early withdrawals. Structural disincentives to early withdrawal may include "early termination charges, tax penalties, loss of insurance coverage after termination and, in some cases, loss of embedded value." JA103 (*Donelon Letter* 2); *see also* JA176 (*Gallanis Supp. Statement* 3) ("[I]ncentives to hold insurance contracts for their originally contemplated terms … include surrender or withdrawal 'penalties' …, interest charges for policyholder loans; and cash value calculations that make a whole life contract materially more valuable when held to maturity than if surrendered early."). Moreover, surrender of an insurance contract defeats the customer's very purpose for purchasing insurance—protection against future loss or assurance of long-term financial stability: "Many considerations (payment of a new commission, an insured's age or health or changed market conditions) may make the replacement of the original

contract significantly more expensive (if not impossible)." JA176 (*Gallanis Supp. Statement* 3 n.3).

Those defining characteristics ensure that life insurance products, in fact, are used for long-term financial protection, and also drive how life insurance companies manage their assets. As ACLI has explained: "Life insurers provide coverage to customers for their long-term risks, and their regulation requires them to match those long-term, illiquid liabilities with appropriate assets to ensure that those liabilities can be met." *Legislative Proposals to Reform Domestic Insurance Policy: Hearing Before the Subcomm. on Ins., Housing, and Community Opportunity of the H. Comm. on Financial Servs.*, 113th Cong. 4 (2014) (statement of ACLI). Put differently, because "[a] large portion of life insurer liabilities do not have an immediate call capability by the contract holder (or have protection features built into the contract)," "[l]ife insurers assume extensively underwritten long-term risks and acquire an asset mix intended to reflect the characteristics of those risks." *The Impact of Dodd-Frank's Insurance Regulations on Consumers, Job Creators, and the Economy: Hearing Before the Subcomm. on Ins., Housing, and Community Opportunity of the H. Comm. on Financial Servs.*, 112th Cong. 2 (2012) (statement of ACLI).

These fundamental differences between the insurance and banking business models mean that insurers are not faced with the same mismatch of asset and

liabilities that makes banks susceptible to runs. As MetLife's lead state regulator—the New York Department of Financial Services ("DFS")—explained in the administrative record, the "difference between the contractual promises insurers make and the on-demand nature of bank deposits means that the life insurance business is less susceptible to liquidity problems or mismatch between asset and liability maturity than banking." JA234 (*DFS Letter* 1). Rather than being driven by consumer confidence and fluctuations in economic conditions, insurance liabilities mature in accord with actuarially predictable events. "Life insurers" therefore "are … able to match their various investment maturity dates with relatively predictable long-term liabilities." JA235 (*Id.* at 2).

Finally, even when questions about the long-term solvency of insurers do arise, the characteristics of the insurance business mitigate any risk of financial disintermediation. Because insurance liabilities mature gradually, insurers will not be forced to hold a "fire sale" of assets to meet liquidity demands. "Because the life insurance business is based on contractual liabilities that develop over time, life insurance failures are relatively slow moving. Regulators can generally intervene early when significant assets are still available, and commence a receivership that runs off the liabilities against the assets as they mature." JA235-236 (*DFS Letter* 2-3); *see also* JA104 (*Donelon Letter* 3). By contrast, when a

bank is subject to a sudden "run" neither it nor its regulators has time or readily available assets with which to respond.

B. The Final Determination Failed Adequately To Account For The Differences Between Banks And Insurers

Rather than take account of the crucial differences identified above between banks and insurance companies, the Council ignored them, particularly with respect to the nature of underlying liabilities and asset matching. Standing alone, the Council's failure to account for these material differences violated the Council's duty of "reasoned decisionmaking." *International Ladies' Garment Workers' Union v. Donovan*, 722 F.2d 795, 824 (D.C. Cir. 1983) (agency violated duty of "reasoned decisionmaking" where there were "obvious and substantial differences between rural and urban areas," there was evidence those differences were "relevant to enforcement of the [statute]" at issue, and the agency failed adequately to account for the differences).

The Council's error was even more significant here because it lay at the heart of the Council's asset liquidation transmission channel analysis. That analysis rested largely on speculation that—contrary to historical fact and economic logic—a massive and unprecedented bank-like "run" might occur at MetLife and force the company to engage in a "fire sale" of assets to address immediate liquidity needs. *See, e.g.*, JA377-380; 400 (Final Determination 15-18, 38). This bank-centric scenario failed to account for the many ways in which

insurance companies are different and unique. Crucially, as explained above, unlike banks, insurance companies do *not* face meaningful risk of an immediate and uncontrollable need for liquidity to satisfy policyholders' demands because policyholders, unlike bank depositors, would not *en masse* demand the cash value of their insurance products. *See supra* pp. 5-10.

History confirms that these differences between banks and insurance companies are not merely theoretical. A recent comprehensive assessment of the empirical literature concluded that "*[n]o* runs on U.S. life insurers occurred during the recent financial crisis." Cummins & Weiss, *Systemic Risk and the U.S. Insurance Sector*, 81 J. of Risk & Ins. 489, 501 (2014) (emphasis added). That result was not surprising, because it was consistent with the history of the life insurance industry. As the authors explain:

> The *only* documented run involving U.S. life insurers occurred in 1991 when six life insurers failed after substantial investment losses, primarily in junk bonds. These insurers were already financially weak prior to the investment losses, and the runs did not spread to financially sound insurers. Even during the Great Depression … , life insurer insolvency problems were *minimal.* From 1929 to 1938, net losses from life insurer insolvencies were about 0.6 percent of industry assets, and 30 of the 45 states where life insurers were domiciled (representing 85 percent of industry liabilities) did not record a single life insurer insolvency.

Id. at 501 n.20 (emphases added; citations omitted).

The Council ignored all of this historical evidence in the Final Determination. As non-voting State Insurance Commissioner Representative

Adam Hamm explained, the Final Determination "offer[s] merely speculative outcomes related to the liquidation of assets based in large part on hypothetical and highly implausible claims of significant policyholder surrenders." JA669-670 (Final Determination 307-308) (Dissenting View of Adam Hamm, the State Insurance Commissioner Representative). He added that the Council relied on "evidence" that "treats all financial institutions *exactly the same*" and that it disregarded other evidence—for example, the Oliver Wyman study submitted by MetLife—that "more appropriately captured the *unique characteristics of the insurance business model*." JA670 (emphases added).

In short, the Council applied a one-size-fits-all model to assess systemic risk, a model that simply does *not* fit MetLife or other life insurers. In doing so, it failed to grapple with "an important aspect of the problem" before it, *State Farm*, 463 U.S. at 43, and it disregarded Congress's intent that the Council consider the distinctive features of the insurance industry, *see* 156 Cong. Rec. S5869, S5902 (daily ed. July 15, 2010) (statement of Sen. Collins) (Congress expected the Council "to specifically take into account … how the nature of insurance differs from that of other financial products"). That failure of reasoned decisionmaking

renders the Final Determination arbitrary and capricious, and supports rescission of MetLife's SIFI designation.[2]

II. THE FINAL DETERMINATION ARBITRARILY AND CAPRICIOUSLY DISREGARDED EXISTING STATE INSURANCE REGULATION

The Final Determination is also unlawful because the Council did not reasonably account for existing state regulation of the insurance industry in assessing MetLife's risk profile. In establishing the Council as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), Congress created a federal agency—made up principally of regulators experienced with banks and similar institutions—with considerable power to bring nonbank financial institutions under the oversight, supervision, and regulation of the Board of Governors of the Federal Reserve System. 12 U.S.C. § 5323. At the same time, however, Congress enacted important safeguards to ensure the Council would not unnecessarily intrude upon the domain of other regulatory authorities, federal or

---

[2] The Council's mechanical application of a bank-centric framework to MetLife's designation decision repeats errors in the Council's approach to insurance companies to date. As one dissenter from the Council's 2013 designation of Prudential explained in terms that apply equally well here:

> The [Council's] analysis cites run-risk of Prudential's products as a key catalyst for a destructive asset liquidation. However, insurance products and liabilities are not the same as bank deposit liabilities. A number of existing mitigants are in place to limit run-risk that should be given greater weight when addressing this risk.

Views of the Acting Director of the Federal Housing Finance Agency 2 (Sept. 18, 2013) (Edward J. DeMarco, dissenting).

state. *See FSOC Accountability: Nonbank Designations: Hearing Before the Sen. Banking Comm.*, 114th Cong. 8-9 (2015) (statement of ACLI).

Specifically, Dodd-Frank requires the Council to give reasoned consideration to an institution's *existing* regulatory oversight before deciding to impose an *additional*, and potentially very costly, layer of federal supervision. 12 U.S.C. § 5323(a)(2)(H). This makes sense: federal SIFI regulation is needed only when existing regulation is insufficient. For MetLife and other life insurance companies, the primary system of existing regulation is state-based. Before designating MetLife as a SIFI, Dodd-Frank accordingly required the Council to consider whether existing state regulation made such a designation necessary or appropriate. The Council breached that statutory duty here by wholly failing to account for certain features of state regulation and unreasonably disregarding others.

A. The Council Had A Duty To Give Careful Consideration To Existing State Regulation In Assessing MetLife's Risk Profile

Section 113 of Dodd-Frank instructs that the Council, "[i]n making a [SIFI] determination, … *shall* consider," among other things, "the degree to which the company is already regulated by 1 or more primary financial regulatory agencies." 12 U.S.C. § 5323(a)(2)(H) (emphasis added).

Careful consideration of that statutorily mandated factor is particularly important where, as here, most Council members (and most voting members,

including the Chairman) lack expertise regarding the type of nonbank financial company at issue—a life insurance company. Indeed, this requirement to consider existing regulatory scrutiny works hand-in-hand with Dodd-Frank's consultation requirement, *see* 12 U.S.C. § 5323(g), to ensure that the Council pays close attention to existing state regulation as well as to the views of "State regulators who … can bring a valuable contribution to the oversight responsibilities when it comes to determining whether institutions themselves … are so risky that they endanger our financial system." 156 Cong. Rec. S5797, S5832 (daily ed. July 14, 2010) (statement of Sen. Dodd).

Even absent a statutory mandate, basic respect for principles of federalism would compel an agency to take account of state law and regulation. But where, as here, Congress has identified a statutory factor to guide an agency's decisionmaking, the agency must give that factor serious consideration. "A statutorily mandated factor, by definition, is an important aspect of any issue before an administrative agency, as it is for Congress in the first instance to define the appropriate scope of an agency's mission. When Congress says a factor is mandatory, that expresses its judgment that such a factor is important." *Public Citizen v. Federal Motor Carrier Safety Admin.*, 374 F.3d 1209, 1216 (D.C. Cir. 2004). For an agency to assess properly a factor that Congress has required it to consider, an agency must demonstrate "a rational connection between the facts

found and the choice made" and the agency "must cogently explain why it has exercised its discretion in a given manner." *State Farm*, 463 U.S. at 43, 48 (internal quotation marks and citations omitted).

B. The Council Breached Its Duty To Consider Existing Regulation In Designating MetLife As A SIFI

In designating MetLife as a SIFI, the Council glossed over and misunderstood the role and effectiveness of state insurance regulation, which has long and successfully governed the insurance industry. The Council's errors support rescission of the designation.

1. States Have a Long History of Successfully Regulating the Life Insurance Industry

"Insurance companies, unlike banks and securities firms, have been chartered and regulated solely by the states for the past 150 years." Webel, *Insurance Regulation: Issues, Background, and Legislation in the 113th Congress*, Cong. Research Serv. 1 (Sept. 17, 2014). For many years, Congress has recognized and promoted that state-based system of regulation. In 1945, Congress adopted the McCarran-Ferguson Act, which embodies an affirmative judgment that "States" and not the federal government should regulate the "business of insurance." 15 U.S.C. §§ 1011, 1012(a). Congress enacted that statute to ensure "the supremacy of the States in the realm of insurance regulation." *United States Dep't of Treasury v. Fabe*, 508 U.S. 491, 500 (1993).

State-based regulation's twin goals are to bring financial stability to the insurance industry and to ensure that insurance companies satisfy their obligations to policyholders. To accomplish those goals, state regulation imposes a variety of significant requirements on life insurance companies, including relating to: mandatory minimum capital stock and reserves; permissible and prohibited investments; affiliate transactions; reinsurance agreements; reporting of financial information; and mandatory onsite examinations by regulators. *See, e.g.*, NAIC, *The United States Insurance Financial Solvency Framework* 3-4 (2010) ("*NAIC Solvency Framework*").

This state-based regulatory program is far from static. "A hallmark of the state regulatory system is its dynamic efforts to constantly improve the regulatory solvency system and adjust the system as needed, especially regarding inputs into the model used to determine asset, liability and capital requirements." *NAIC Solvency Framework* 6.

DFS summarized the operation of this comprehensive state-based regime as follows:

> DFS and other state regulators who supervise each MetLife insurance subsidiary employ a wide array of tools to ensure solvency, including limitations on the type and concentration of invested assets; conservative risk-based capital and reserving requirements focused on early intervention in times of distress; review of filed derivative use plans; prior approval of intercompany transactions; prior approval of new policy types, rates, and lines of business; annual and quarterly financial reporting; statutory accounting requirements that are more

> conservative than generally accepted accounting principles; and constant and ongoing supervision and examination.

JA236 (*DFS Letter* 3).

Thus, through various mechanisms, state regulation works to *prevent* an insurance company from ever reaching a point of material financial distress; to *cabin* any distress from spreading within an insurance holding company system; and to *mitigate* the broader repercussions of the failure of a life insurer. A few aspects of state regulation bear particular emphasis:

***Ring-fencing*.** Central to state regulation is "ring-fencing." Ring-fencing is an approach designed to insulate each insurance subsidiary from the others and so protect a company's healthy insurance entities from distress experienced by affiliates. *See, e.g.*, NAIC, *Insurance Group Supervision*, CIPR Newsletter (Apr. 2012) ("*NAIC Group Supervision*").

Ring-fencing ensures that insurance subsidiaries are protected from risk in other parts of a holding company group in two ways: (1) each subsidiary company is subject to separate, stand-alone capital requirements under specified statutory accounting principles; and (2) the transfer of capital and assets between insurance company affiliates or between an insurance company and the parent is subject to significant constraints and regulatory approvals. Ring-fencing "makes it much less likely that insurance companies will fail, and in the rare instances where a regulated company does find itself in distress, ring fencing ensures that the distress

does not spread to other entities within an affiliated group." JA150-151 (Letter from Karen Weldin Stewart, Del. Ins. Comm'r, to Jacob Lew, Sec'y, U.S. Dep't of the Treasury, at 2-3 (Oct. 13, 2014)).

Risk Based Capital Requirements. Risk based capital ("RBC") requirements are another important element of state regulation. Under RBC principles, using a risk-based formula established by the National Association of Insurance Commissioners ("NAIC"), state regulators determine the minimum amount of capital that a life insurer is required to maintain to avoid regulatory action. NAIC, *Risk-Based Capital* (June 13, 2016). These RBC requirements also serve as early warning tools designed to signal when a life insurer may be facing liquidity problems or other potential material financial distress, and thus in need of regulatory intervention. As NAIC has explained:

> [RBC] is a method of measuring the minimum amount of capital appropriate for a reporting entity to support its overall business operations in consideration of its size and risk profile. RBC limits the amount of risk a company can take. It requires a company with a higher amount of risk to hold a higher amount of capital. Capital provides a cushion to a company against insolvency.

Id.; *see also* JA109 (*Donelon Letter* 2). These RBC requirements rest on very conservative assumptions about the amount of capital a life insurer needs.[3]

[3] Many life insurers, such as MetLife, maintain capital levels "at several multiples in excess of RBC requirements." JA384 (Final Determination 22).

Escalating Stages of Regulatory Intervention. Based in part on a life insurer's RBC level, state regulators have the authority to engage in escalating intervention to stabilize an insurer facing potential material distress. *See* JA109-110 (*Donelon Letter* 2-3). The options for intervention include supervision, conservation or rehabilitation, and liquidation. *Id.* In addition, in the unlikely event of a potential "run" on an insurance company, state regulators have the authority to issue moratoriums or stays on policyholder surrenders. *See* JA236 (*DFS Letter* 3) ("[R]egulators have the power to direct insurers to cease writing new business, and can suspend claims payments and other expenses to stave off short-term liquidity shortfalls."). Indeed, the administrative record made clear that state regulators would impose stays in the unlikely event of a "run" scenario hypothesized by the Council. *See, e.g.*, JA165-167 (*Gallanis Statement* 10-12).

These regulatory tools equip state regulators with flexibility to respond effectively and promptly to financial distress, often well before such distress ever materializes. It is a time-tested, highly effective system structured to prevent precisely the harms Dodd-Frank is intended to address.

Mechanisms for Interstate Cooperation and Coordination. Although state regulation of life insurance companies occurs on a state-by-state basis, regulators have long effectively coordinated their efforts. Two mechanisms support and facilitate that coordination. *First*, NAIC is an important means of ensuring

uniformity and promoting cooperation among state regulators. NAIC "is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 States, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight." NAIC, *State Insurance Regulation* 2 (2011).

Second, "supervisory colleges" facilitate information sharing, coordination, and group-level supervision. Supervisory colleges are "joint meetings of interested regulators with company officials and include detailed discussions about financial data, corporate governance, and enterprise risk management functions." NAIC, *Supervisory Colleges* (July 5, 2016). Supervisory colleges, by nature, are "designed to share prudential information about cross-border institutions" and "are also meant to supervise companies at the group level, rather than legal entity level." Kirby, *Supervisory Colleges: Improving International Supervisory Coordination*, 19 Conn. Ins. L.J. 149, 158 (2012) (internal footnote omitted).

State Guaranty Association System. Finally, the guaranty association ("GA") system is a critical component of the existing insurance regulatory system designed to protect policyholders and to ensure the stability of the life insurance industry. *See* JA156-170 (*Gallanis Statement*); JA171-199 (*Gallanis Supp. Statement*). Consumers of life, annuity, and health insurance receive protection

against the risk of insolvency through GAs in their states of residence. *See* National Organization of Life and Health Insurance Guaranty Associations ("NOLHGA"), *What Happens When An Insurance Company Fails?* (2015). All 50 States, as well as the District of Columbia and Puerto Rico, have created by statute GAs as specially chartered, not-for-profit legal entities. *Id.*

Interstate coordination is an important feature of the GA system. States' life and health GAs are members of the National Organization of Life and Health Insurance Guaranty Associations. NOLHGA is a mechanism through which multiple GAs can act (and have acted on dozens of occasions) in concert to implement a single, national insolvency response plan for multistate insolvencies or resolutions. *See* NOLHGA, *Impairments & Insolvencies* (2015).

Each life and health insurance GA is authorized to collect its assessments from insurance companies issuing life, annuity, or health insurance in the state, providing the GA system with vast assessment capacity. In 2014, for example, the overall annual assessment capacity of the life and health GA system exceeded $11 billion. *See* NOLHGA, *Assessment Data* (2015). That capacity significantly exceeds the GA system's funding needs, as demonstrated by historical experience; as of 2011, the total net assessments that had been required to provide all of the needed life and health guaranty protection since the inception of the GA system in the 1970s totaled approximately $5.3 billion—less than *half* of the GA system's

capacity for 2013 alone. *See Insurance and Legislative Proposals: Hearing Before the Subcomm. on Ins., Housing, and Community Opportunity of the H. Comm. on Financial Servs.*, 112th Cong. 9 (2011) (statement of Peter G. Gallanis, President, NOLHGA).

In short, the state-based system of life insurance regulation is both comprehensive and effective. It has worked well to prevent material financial distress at insurance companies, to cabin any distress in specific insurance subsidiaries, and to prevent that distress from affecting policyholders and the broader economy, rendering an additional layer of federal regulation unnecessary.

2. The Council's Consideration of State Regulation Was Unreasonable

The administrative record before the Council made clear the myriad ways that state regulation has worked to protect policyholders and to maintain the financial stability of the life insurance industry. It also made clear that state regulators continue to work aggressively to address emerging concerns. DFS, MetLife's lead regulator, submitted comments to the Council raising these points. *See* JA234 (*DFS Letter* 1). So, too, did regulators from five other states. JA102, JA108 (Louisiana); JA139 (California); JA148 (Delaware); JA200 (North Carolina); JA212 (Connecticut). The comments of these regulators—reflecting their deep experience with and expertise regarding life insurance generally and

MetLife in particular—are precisely what Congress intended the Council to consider seriously in making SIFI determinations.

The Council disregarded the opinions of these state regulatory experts and it all but ignored the ways in which existing state regulation militated heavily against designating MetLife as a SIFI. In the Final Determination, the Council's principal reason for disregarding state regulation was its conclusion that "MetLife is not subject to *consolidated* supervision" under state law and that, after a SIFI designation, "MetLife would be subject to *consolidated* supervision by the Board of Governors." JA599 (Final Determination 237) (emphasis added). This "consolidated supervision" rationale—which is, at bottom, an outcome-oriented justification for enhanced *federal* regulation—is unpersuasive and it demonstrates the Council's failure to consider meaningfully how existing state regulation obviates the need for additional federal regulatory controls.

First, "consolidated supervision" is not an end in itself, but a possible mechanism for achieving certain congressional objectives. The Council never cogently explained *why* consolidated supervision is necessary *if* the existing state-based insurance regime has been and would be successful in preserving the financial stability of life insurers individually and the life insurance industry as a whole. State regulation has proven adept at protecting the stability of the life insurance industry for more than 100 years. *See supra* pp. 16-23. That time-tested

system of state regulation should not be lightly displaced based on an unexamined assumption or assertion that "consolidated supervision" is an unqualified good. JA599 (Final Determination 237).

Indeed, it could not have been the case that Congress intended the absence of consolidated supervision alone to be a basis for a designation because, with respect to life insurance companies, the absence of consolidated supervision was obvious. Congress was well-aware that regulation of insurance companies had long been the prerogative of states. If Congress intended consolidated supervision to be a determinative factor, there would have been no need for the SIFI-designation process itself.[4] Instead of automatically assuming that consolidated supervision was all but dispositive, the Council was required to do two things. First, it needed to explain *how* current regulation falls short. Second, it needed to explain *why* federal consolidated supervision would address those concerns in some fashion beyond asserting that a single regulator would more effectively supervise a holding company system. The Council did neither. And the Council's

[4] Dodd-Frank explicitly instructed the Council to consider the existence of consolidated supervision when determining whether to designate a *foreign* institution as a SIFI. *See* 12 U.S.C. § 5323(b)(2)(H). The absence of any similar instruction to consider the existence of consolidated supervision of *domestic* institutions, coupled with Congress's awareness that the insurance industry has long been subject to state-based regulation, strongly suggests that Congress did not consider the existence of consolidated supervision to be a relevant, let alone dispositive, factor.

"[c]onclusory statements" about consolidated supervision "will not do; an agency's statement must be one of *reasoning*." *Foster v. Mabus*, 103 F. Supp. 3d 95, 109 (D.D.C. 2015).

Second, the Final Determination reasonably disregarded recent and significant efforts by state regulators to coordinate group-level supervision—that is, oversight over the entire insurance holding company system—thus responding directly to the Council's concern with the absence of "consolidated supervision." JA599 (Final Determination 237). Indeed, as described further below, since the financial crisis, state regulators have worked to develop further tools "to assess the enterprise risk within a holding company system and its impact and contagion upon the insurers within that group." *NAIC Group Supervision* ("Current Status and Looking Forward"). NAIC has been leading the way on these reform efforts, including with amendments to the NAIC Model Act, and New York—MetLife's lead regulating state—has adopted these important reforms. *See, e.g.*, N.Y. Ins. Law §§ 1501(a)(7), 1503(b).

Third, the Council unreasonably discounted the mechanisms that state regulators have in place for coordinating regulatory efforts. As Representative Hamm explained, the Council "failed to appropriately consider the efficacy of the state insurance regulatory system. As President of [NAIC] I have seen first-hand how states effectively coordinate and address regulatory concerns." JA666 (Final

Determination 304). The Council's failure to grasp that history of effective coordination was part of what Representative Hamm saw as the Council's "disturbing" effort to "diminish the role of the state insurance regulatory framework." *Id.* The Council provided no explanation, much less a reasoned one, for why these well-established state-law mechanisms for coordinating regulatory activities were insufficient. "[E]ven pursuant to [a] deferential standard of review," the Council "must articulate an explanation for its action." *Amerijet Int'l., Inc. v. Pistole*, 753 F.3d 1343, 1350 (D.C. Cir. 2014).

The Council's perfunctory assessment and misguided dismissal of state regulation infected the core of the Final Determination. For example, the Council's disregard of state regulation substantially affected its asset liquidation transmission channel analysis, which is predicated on speculative and ahistorical assumptions about financial distress at MetLife leading to *en masse* policyholder demands for the immediate surrender or withdrawal of the cash value of life insurance policies or annuities. *See, e.g.*, JA377 (Final Determination 15-16). State regulation is well-designed to prevent *all* of that from happening: State regulation is structured, first, to prevent distress through solvency and RBC requirements and similar measures, and, in the event of distress, to prevent a bank-like "run" on insurers through regulatory moratoriums or stays. *See supra* pp. 16-23.

C. The Critiques Of State Insurance Regulation Offered By The Government's Amici Are Deeply Flawed

In its brief, the Council says virtually nothing to address the issue of existing state regulation. The amicus brief of one group of professors, however, disparages the state-based system of insurance regulation. *See* Scholars of Insurance and Financial Regulation, Doc. #1621471 ("Scholars Br."). Their arguments are unpersuasive.

First, the professors argue that state regulation is narrowly focused on individual life insurance subsidiaries and that regulation designed to anticipate and mitigate systemic risk requires group-level supervision. Scholars Br. 15-24. That account is both simplistic and misleading. To be sure, a "fundamental tenet" of state insurance regulation "is to protect policyholders by ensuring the solvency of the insurer and its ability to pay insurance claims." *Insurance Oversight and Legislative Proposals: Hearing Before the Subcomm. on Ins., Housing and Community Opportunity of the H. Comm. on Financial Servs.*, 112th Cong. 2 (2011) (statement of Joseph Torti, III, NAIC) ("*Insurance Oversight Hr'g*"). But protecting policyholders and assuring solvency is not inconsistent with protecting against systemic risk.

To the contrary, the goals are complementary. As explained above, the state-based solvency framework subjects individual insurance companies to a broad array of stringent regulatory requirements including, among other things,

"detailed reporting and disclosure requirements"; "the risk-based capital system"; and "the state-based receivership to resolve troubled insurers." *Insurance Oversight Hr'g*, 112 Cong. 2 (Torti statement). State regulation does not focus *only* on individual insurance entities. Rather, "[t]he solvency framework of the U.S. system of state-based insurance regulation has included a review of the holding company system for decades." *NAIC Group Supervision* ("Conclusion"). Under this approach, "regulators have 'windows' to scrutinize group activity and assess its potential impact on the ability of the insurer to pay its claims and 'walls' to protect the capital of the insurer by requiring the insurance commissioner's approval of material related-party transactions." *Id.* ("Introduction"). These "windows" and "walls" operate to both mitigate the risk of financial distress in the first instances and to cabin any distress from spreading through a holding company. *See supra* pp. 16-23.

In addition, in the wake of the financial crisis, state regulators have been working diligently to expand group-level supervision. As DFS explained to the Council:

> New York and other state regulators have adopted a number of measures to strengthen the state supervisory system, including revision of insurance holding company laws that vest regulators with greater authority to monitor and examine insurance holding companies and their non-insurance subsidiaries; improvement of methodologies for valuing mortgage-backed securities … ; development of new restrictions on insurer securities lending programs and the use of derivatives; and development of new

> requirements obligating companies to develop a risk management function on an enterprise-wide basis.

JA236-237 (*DFS Letter* 3-4).

Second, the professors maintain that state regulation is not well designed to stop a large-scale run on large insurance conglomerates. Scholars Br. 24-28. That is decidedly wrong, as set forth above. Indeed, as DFS has explained, "[s]tate insurance regulators have numerous tools at their disposal to manage insurer insolvencies." JA236 (*DFS Letter* 3). And "even before a receivership is commenced, regulators have the power to direct insurers to cease writing new business, and can suspend claims payments and other expenses to stave off liquidity shortfalls." *Id.* History has demonstrated the effectiveness of these tools in practice, time and again. In 2013, for example, "New York successfully resolved FGIC, a monoline guaranty insurer with hundreds of billions of dollars of notional exposure, by utilizing these tools and working with creditors to develop a court-approved rehabilitation plan." *Id.*

Finally, the professors wrongly insist that only the federal government is well positioned to mitigate systemic risk. Scholars Br. 28. For more than a century, states have served—effectively—as the principal regulators of life insurance companies. *See supra* pp. 16-23. "The strength of this [state] system was evident during the financial crisis." *Insurance Oversight Hr'g*, 112 Cong. 2, *supra* (Torti statement). As one commentator has explained,

> While banks and the real estate market sustained heavy losses during 2008 and beyond, the insurance industry … escaped relatively unscathed. The insurance sector's durability is largely attributable to both existing regulations mandated by state insurance departments as well as the business practices employed by the industry. Indeed, by sufficiently diversifying investments, utilizing more conservative accounting standards, and maintaining high levels of liquidity, insurers and state regulators were able to prevent the insurance industry from becoming systemically risky.

Rankin, *Fixing What Isn't Broken: Why The Federal Reserve's Potential Application of Banking Standards on 'Systemically Significant' Insurers Is an Unjustified Incursion that May Negatively Impact Economic Stability*, 23 Kan. J. L. & Pol'y 40, 55 (2013).

The professors' brief tells a different story, and attempts to assign blame for AIG's financial distress, and the resulting financial crisis, on state insurance regulators. That has things backwards. As the professors acknowledge, the AIG business line responsible for AIG's distress was *not* its state-regulated insurance business, but a subsidiary subject to *federal* regulation by the Office of Thrift Supervision ("OTS"). And as the professors concede, it was OTS whose regulation was "woefully deficient." Scholars Br. 20. AIG's collapse thus was "not an insurance regulatory failure" at all. Thomas, *Insurance Perspectives on Federal Financial Regulatory Reform: Addressing Misunderstandings and Providing a View from a Different Paradigm*, 55 Vill. L. Rev. 773, 773 (2010). It was the "federal regulatory system, with its responsibilities for securities and

banking" that failed to "distinguish[] itself" during the crisis. Tyler & Hornig, *Reflections of State Regulation: A Lesson of the Economic Turmoil of 2007-2009*, 4 J. Bus. & Tech. L. 349, 350 (2009). The history of the financial crisis thus supplies no basis for replacing state insurance regulation with new federal regulatory controls.

* * *

In sum, the Council's failure to assess meaningfully the existing state regime of insurance regulation renders the Final Determination arbitrary and capricious.

CONCLUSION

This Court should affirm the district court's order rescinding MetLife's SIFI designation.

Respectfully submitted,

/s/ David W. Ogden

DAVID W. OGDEN (DC Bar No. 375951)
KELLY P. DUNBAR (DC Bar No. 500038)
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue, NW
Washington, DC 20006
Tel.: (202) 663-6000
Fax: (202) 663-6363

CHRISTOPHER R. LOONEY (DC Bar No. 998730)
WILMER CUTLER PICKERING
HALE AND DORR LLP
60 State Street
Boston, MA 02109

NOAH A. LEVINE
WILMER CUTLER PICKERING
HALE AND DORR LLP
7 World Trade Center
250 Greenwich Street
New York, NY 10007

GARY E. HUGHES
AMERICAN COUNCIL OF LIFE
INSURERS
101 Constitution Avenue, NW
Washington, DC 20001

CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), the undersigned hereby certifies that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B).

1. Exclusive of the exempted portions of the brief, as provided in Fed. R. App. P. 32(a)(7)(B), the brief contains 6,999 words.

2. The brief has been prepared in proportionally spaced typeface using Microsoft Word 2010 in 14 point Times New Roman font. As permitted by Fed. R. App. P. 32(a)(7)(C), the undersigned has relied upon the word count feature of this word processing system in preparing this certificate.

/s/ David W. Ogden
DAVID W. OGDEN
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue, NW
Washington, DC 20006
Tel.: (202) 663-6000
Fax: (202) 663-6363
David.Ogden@wilmerhale.com

August 22, 2016

CERTIFICATE OF SERVICE

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

/s/ David W. Ogden
DAVID W. OGDEN
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue, NW
Washington, DC 20006
Tel.: (202) 663-6000
Fax: (202) 663-6363
David.Ogden@wilmerhale.com

August 22, 2016