IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

METLIFE, INC., Plaintiff, v. FINANCIAL STABILITY OVERSIGHT COUNCIL, Defendant.	Civil Action No. 15-0045 (RMC)

BRIEF FOR AMICUS CURIAE AMERICAN COUNCIL OF LIFE INSURERS IN SUPPORT OF PLAINTIFF METLIFE, INC.

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

DAVID W. OGDEN (DC Bar No. 375951)
KELLY P. DUNBAR (DC Bar No. 500038)
ALBINAS J. PRIZGINTAS (DC Bar No. 1006955)
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue, NW
Washington, DC 20006
Tel.: (202) 663-6000
Fax: (202) 663-6363

Counsel for Amicus Curiae American Council of Life Insurers

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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, disability income, and long-term care insurance products. Indeed, 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, and it has substantial expertise that bears on the Financial Stability Oversight Council's (the "Council") analysis of 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, and all three of those companies—American International Group, Prudential Financial, Inc., and MetLife, Inc.—are members of ACLI. ACLI can offer a unique industry-wide perspective on the issues raised in 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 the role of state regulation of the life insurance industry. ACLI thus "'has unique information or perspective that can help the court beyond the help that the lawyers for the parties are able to provide.'" *Hard Drive Prods., Inc. v. Does 1-1,495*, 892 F. Supp. 2d 334, 337 (D.D.C. 2012).

INTRODUCTION AND SUMMARY OF ARGUMENT

ACLI fully endorses the legal arguments made by MetLife in its opposition and motion for summary judgment.[1] MetLife demonstrates convincingly why the Council's designation of MetLife as a SIFI was arbitrary and capricious; unsupported by the record, empirical fact, or economic logic; and contrary to law. ACLI writes separately to address two central topics from the broad perspective of the life insurance industry.

First, in important respects, the Council's designation of MetLife failed to account for the fundamental differences between banks, on the one hand, and life insurance companies, on the other—differences that render the Council's analysis unsound. Perhaps it is unsurprising that a federal agency dominated by federal regulators of banks and similar institutions would assume that life insurance companies (with which they have little familiarity) are just like banks. But bedrock principles of reasoned decisionmaking required the Council to identify and to account for the many differences between these types of financial institutions. The Council's unjustified bank-centric assumptions were the most prominent with respect to its asset liquidation transmission channel analysis—which, contrary to the weight of historical fact and economic logic, posited a massive bank-like "run" by MetLife's policyholders as a source of potential systemic risk to the U.S. financial system. *See* MetLife Br. 49-55.

Second, the Council continues to predicate its designations of life insurance companies on a basic misunderstanding of existing state regulation of the life insurance industry. The Council was under a specific statutory duty to assess existing regulation of MetLife before subjecting it to additional federal regulation, 12 U.S.C. § 5323(a)(2)(H), but the Council

[1] Memo. of Points and Authorities in Support of Plaintiff MetLife Inc.'s Cross-Mot. for Summary Judgment and in Opposition to Defendant's Mot. to Dismiss or, in the Alternative, for Summary Judgment, Dkt. 39-1 (June 16, 2015) ("MetLife Br.").

breached that duty by failing to engage meaningfully with the state regulation system that has long governed the life insurance industry effectively. *See* MetLife Br. 41-45.

Those errors are not unique to the Council's designation of MetLife, but instead have infected the Council's prior designations of life insurance companies. In fact, the Council's continuing confusion regarding life insurance companies and existing state regulation of the insurance industry has led it to make two SIFI designations over the vigorous objections of the two members of the Council with the most significant expertise in the life insurance industry—designations that were arbitrary and capricious and contrary to law.[2] For those reasons and others, this Court should order the Council to rescind MetLife's SIFI designation.

ARGUMENT

I. THE FINAL DETERMINATION ARBITRARILY AND CAPRICIOUSLY APPLIED A BANK-CENTRIC MODEL TO INSURANCE COMPANIES

The Council's designation of MetLife should be set aside because, in positing a massive bank-like "run" on MetLife as a potential source of harm to the broader financial system, the Final Determination unreasonably treated life insurance companies as if they were banks and it failed to consider the fundamental differences between those two types of financial institutions. Indeed, the Council's analysis of life insurance companies to date suggests that the Council lacks a fundamental understanding of the differences between banks and life insurance companies—differences that bear directly on whether life insurance companies pose a systemic risk to the U.S. financial system and should be regulated as SIFIs. 12 U.S.C. § 5323(h).

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[2] *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"). The Final Determination relied upon by ACLI has been redacted.

It is blackletter administrative law that an agency action is arbitrary and capricious if it is not "the product of reasoned decisionmaking." *Motor Vehicle Manufacturers Ass'n of the U.S. v. State Farm Mut. Automobile Ins. Co.*, 463 U.S. 29, 52 (1983); *see also Fox v. Clinton*, 684 F.3d 67, 75 (D.C. Cir. 2012) ("The requirement of reasoned decisionmaking indisputably applies in situations involving judicial review of agency adjudicatory actions."). Among other things, that core requirement demands that an agency "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *State Farm*, 463 U.S. at 43 (internal quotation marks omitted). The Council countermanded that duty in the Final Determination by failing sufficiently to account for the differences between banks and insurance companies.

A. There Are Fundamental Differences Between Banks And Insurance Companies That Are Directly Relevant To Systemic Risk

There can be no reasonable debate on the threshold point that banks and life insurance companies are different. They are engaged in different lines of business; offer different services; hold different liabilities; manage and match their assets and liabilities differently; and operate in different regulatory landscapes. *See generally* Thimann, *How Insurers Differ from Banks: A Primer on Systemic Regulation* 4-12 (SRC Special Paper No. 3 July 2014).[3] Perhaps most importantly, key differences in how and why consumers purchase life insurance as opposed to banking products explain why the risk of a bank-like "run" on insurance companies—a key premise of the Final Determination—is virtually non-existent.

Life insurance products are important sources of long-term financial protection for American consumers. Traditional life insurance policies protect families from financial hardships associated with the death of a loved one and provide a reliable source of assets to pay

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[3] *Available at* http://eprints.lse.ac.uk/61218/1/sp-3_1.pdf.

for death-related expenses and other needs. *See* ACLI, *America's Life Insurance Industry: Security Families Count On* 1 (Mar. 2015).[4] Annuities are a different insurance product that help policyholders save and turn those savings into a steady paycheck during retirement. *Id.*

Consumers do not purchase life insurance products for use as immediate sources of liquidity, but rather for long-term protection. Indeed, for many life insurance products, there are significant disincentives to or limitations on early withdrawals. *See* Wimberly, *SIFI Designations of Insurance Companies–How Game Theory Illustrates The FSOC's Faulty Conception of Systemic Risk*, 34 Rev. of Banking & Fin. L. 337, 358-359 (2014); Litan, *Insurers Aren't Banks: What the Differences Mean for Regulating Their Solvency* (Aug. 12, 2014) ("Unlike bank depositors, who can run on a moment's notice (sometimes paying a small penalty), insurance policy holders cannot. They must have claims first and then wait for them to be paid, or in the case of life insurance investment products, there are a variety of restrictions that keep the money from rapidly flowing out, even in a crisis.").[5] Those disincentives may include (1) loss of coverage (from changes in age or health that make it difficult for policyholders to replace insurance at similar terms, or at least require a lead time of months); (2) surrender charges/foregone benefits (withdrawal penalties, lost premiums, etc.); (3) loss of guarantees (such as locked-in favorably high interest rates for minimum crediting rates); (4) tax implications (such as taxable income or lost tax benefits to policyholders from surrender); and (5) switching costs (administrative expenses/sales costs of picking a new insurer). *See, e.g.*, MetLife Br. 39.

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4 *Available at* https://www.acli.com/About%20ACLI/Pages/FS12-005.aspx.

5 *Available at* http://www.brookings.edu/research/opinions/2014/08/12-insurers-arent-banks-regulating-solvency-litan.

Those defining characteristics of life insurance products—which help to ensure that the products, in fact, are used for long-term financial protection—drive how life insurance companies manage their assets. As ACLI previously 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 (May 20, 2014) (statement of ACLI) ("*ACLI 2014 Statement*").

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)," "life 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) ("*ACLI 2012 Statement*").

As described above, the "business model" of life insurance companies is "fundamentally different" from the business model of banks. *ACLI 2014 Statement* 4.[6] Banks, unlike insurance companies, do not "match their assets with their long-term liabilities." Wallison, *What the FSOC's Prudential Decision Tells Us about SIFI Designation* 3 (American Enterprise Institute

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[6] MetLife describes these important differences in its complaint. *See* MetLife Compl. ¶ 16 ("The traditional business of life insurance in which MetLife engages differs dramatically from the traditional business of banking. In general, banks borrow short term and lend long term—for example, by taking liquid, short-term deposits and wholesale funding and investing in illiquid long-term assets, such as commercial loans. In contrast, life insurers generally write long-term policies and invest premium dollars in long-term assets to make good on those obligations when they come due.").

for Public Policy Research, Financial Services Outlook Mar. 2014).[7] And because banks' "assets and liabilities are not matched" banks are "more dependent on short-term, on-demand funding," making them "potentially subject to a 'run' in periods of stress." *ACLI 2014 Statement* 4.

In addition, the differences in the characteristics of banks' and insurance companies' liabilities are significant. An insurance company's liabilities, by design, are long-term: life insurance companies collect premiums from policyholders over a period of time in exchange for an agreement to pay out a certain amount upon disability or death. *See* 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*") ("An insurer's liabilities take the form of collecting premiums in exchange for a promise to pay upon the occurrence of a fortuitous future event that is beyond the control of either the insurer or the insured party.").[8] By contrast, banks collect *short-term* deposits—which typically may be withdrawn by depositors freely with no notice—and invest in *long-term* asserts such as commercial loans. *See* MetLife Br. 4; *DFS Letter* 1 ("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.").

These distinctions are vital to understanding the systemic risk of banks and insurance companies, respectively. As MetLife's lead state regulator has explained, 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." *DFS Letter* 1. Put differently,

> [b]ank deposits create immediate potential liabilities while the bank invests in assets that mature over time. Banks therefore rely

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[7] *Available at* http://www.aei.org/publication/what-the-fsocs-prudential-decision-tells-us-about-sifi-designation/.

[8] *Available at* http://www.dfs.ny.gov/about/press2014/pr140730-MetLife-FSOC-letter.pdf.

> 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." There is much less "run risk" for a life insurer like MetLife. Life insurance liabilities develop over time because the insurer is not obligated to pay until the occurrence of the insured event like death. ... Life insurers are therefore able to match their various investment maturity dates with relatively predictable long-term liabilities.

Id. at 1-2. Indeed, the record before the Council fully supported the conclusion that life insurance policyholders, unlike bank depositors, do not view insurance policies as sources of liquidity in a time of crisis. *See, e.g.*, Complaint, *MetLife, Inc. v. Financial Stability Oversight Council* ¶ 57, Dkt. 1 (Jan. 13, 2015) ("MetLife Compl.") (citing survey evidence submitted in the record establishing that "policyholders do not treat insurance policies as sources of liquidity"); MetLife Br. 39 (citing "evidence showing that policyholders historically have maintained their policies in times of financial distress").

Existing state regulation of the life insurance industry (discussed further below in Part II) accounts for the specific business model of life insurers. In fact, "State insurance regulators have long recognized the difference in business models between banks and insurers." *ACLI 2012 Statement* 2. State regulation is carefully "designed to measure asset default risk over extended periods of time for the types of investments that insurers own. These laws and regulations have been specifically designed for life insurers to ensure that the liabilities that have been assumed by the insurer will be covered by adequate assets when they come due." *Id.*[9]

[9] Although MetLife makes use of derivatives and securities lending, those practices are subject to careful review, surveillance, and regulation by state regulators, as DFS has explained. *See DFS Letter* 2.

B. The Final Determination Failed To Account Properly For The Differences Between Banks And Life Insurance Companies

Applying a bank-centric analytical framework, the Council turned a blind eye in the Final Determination to the crucial differences between banks and insurance companies, 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." *Int'l Ladies' Garment Workers' Union v. Donovan*, 722 F.2d 795, 824 (D.C. Cir. 1983) (holding than an agency violated its obligation 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 those differences); *cf. Petroleum Commc'ns, Inc. v. FCC*, 22 F.3d 1164, 1172-1173 (D.C. Cir. 1994) (holding arbitrary and capricious an agency's promulgation of uniform standards for licensees where the agency "glosse[d] over [the] differences" between two types of licensees).

The Council's error was even more significant because it struck at the heart of the Council's asset liquidation transmission channel analysis. That analysis rested on the unfounded assumption that—contrary to historical fact and economic logic—a massive and unprecedented bank-like "run" might occur at MetLife, prompting the company to engage in a fire sale of assets to address liquidity needs. *See, e.g.*, Final Determination 15-16; MetLife Compl. ¶ 72(e). The problem is that this bank-centric model failed to account for the many ways in which insurance companies are different and unique. Most importantly, as explained above, banks and insurance companies have dissimilar liabilities and they match their assets and liabilities in distinct ways: insurance companies, unlike banks, do not face any meaningful risk of an immediate and massive need for liquidity to satisfy policyholders' claims because there are powerful reasons why policyholders, unlike bank depositors, would not *en masse* demand the cash value of their life insurance products. *See supra* pp. 7-8; MetLife Br. 50.

History confirms that these differences between banks and insurance companies are not merely theoretical. For example, 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) (internal citations omitted; emphasis added). That result was not surprising, but 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).

In the Final Determination, the Council neither discussed this historical evidence nor did it account for the differences between banks and insurance companies. As non-voting State Insurance Commissioner Representative Adam Hamm stated, 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." Final Determination 307-308. He explained that the Council relied on "evidence" that "treats all financial institutions *exactly the same*" and that it disregarded other record evidence—for example, the Oliver Wyman study submitted by MetLife—that "more appropriately captured the *unique characteristics of the insurance business model*." *Id.* (emphases added). As

Representative Hamm's statements show, the Council applied a one-size-fits-all model to assess systemic risk. 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. S5902 (daily ed. July 15, 2010) (statement of Sen. Collins) (explaining that Congress expected the Council "to specifically take into account … how the nature of insurance differs from that of other financial products … and … is reflected in the structure of traditional insurance companies").[10]

The Council's mechanical application of a bank-centric framework was not unique to the MetLife designation, but repeats errors in the Council's approach to insurance companies to date. Indeed, in many ways the Council's designation of MetLife builds on conceptual flaws with the Council's designation of Prudential Financial as a SIFI. As one dissenter from the Council's 2013 designation of Prudential explained in terms that apply equally 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 liability 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).[11] A second Prudential dissenter—the one voting member of the Council

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[10] Having failed to account for those differences, the Council was left to rely on a cascade of speculative assumptions to support its asset liquidation transmission channel analysis. *See, e.g.*, Final Determination 142-144. That, too, violated the Council's duty of reasoned decisionmaking. *See Horsehead Resource Dev. v. Browner*, 16 F.3d 1246, 1269 (D.C. Cir. 1994); *NRDC v. U.S. EPA*, 859 F.2d 156, 210 (D.C. Cir. 1988) ("mere speculation" is not an "adequate ground[] upon which to sustain an agency's action"); *Business Roundtable v. SEC*, 647 F.3d 1144, 1150 (D.C. Cir. 2011) (rejecting "mere speculation" where an agency "has presented no evidence" that something is "ever seen in practice"); MetLife Compl. ¶ 109.

[11] The public versions of the Prudential dissents and oppositions are available here: http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/September%2019%202013%20Notational%20Vote.pdf.

with significant life insurance experience—explained that the Council's designation of Prudential was based on a bank-centric model that improperly conflated bank deposits (which are a source of liquidity for consumers) and insurance policies (which are not): "There … appears to be a false perception, contradicted by facts and experience, that policyholders value life insurance only or primarily as cash instruments." Views of the Council's Independent Member Having Insurance Expertise 3 (Sept. 19, 2013) (S. Roy Woodall Jr.).

In addition, the Representative of State Insurance Commissioners at the time of the Prudential designation made the same point, and emphatically so. He explained that, in designating Prudential, the Council elided distinctions between banks and insurance companies:

> Insurance is not the same as a banking product yet the Statement of the Basis for the Council's Final Determination … inappropriately applies bank-like concepts to insurance products and their regulation, rendering the rationale for designation flawed, insufficient, and unsupportable. Consumers purchase insurance primarily to indemnify against a contingent event, protect against property loss or damage, replace the loss of income in the event of death or disability, and provide stable retirement income. Indeed, consumers seek insurance as a source of stability even in times of economic stress and the authorities of insurance regulators have long protected insurance consumers in difficult times such as the Great Depression and the recent financial crisis.

View of Director John Huff, the State Insurance Commissioner Representative 1 (Sept. 19, 2013). Even in the face of these previous dissents, the Council's designation of MetLife continued those profound mistakes, without any attempt to avoid or explain them.

In short, in the Final Determination, the Council failed cogently to acknowledge and address head-on the critical differences between banks and life insurance companies. That failure of reasoned decisionmaking renders the Final Determination arbitrary and capricious.

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

Independently, the Final Determination did not reasonably account for existing state regulation of the insurance industry. 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 federal 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. In doing so, however, Congress enacted important safeguards to ensure the Council would not unnecessarily intrude upon the domain of other regulatory authorities, federal or state. *See FSOC Accountability: Nonbank Designations: Hearing Before the Sen. Banking Comm.*, 114th Cong. 8-9 (Mar. 25, 2015) (statement of ACLI); MetLife Compl. ¶ 28.[12]

One statutory safeguard designed to confine the scope of the Council's authority is directly at issue here. Under Dodd-Frank, the Council is required to give reasoned consideration to an institution's *existing* regulatory authority before deciding to impose an *additional*, and potentially very costly, layer of federal supervision. 12 U.S.C. § 5323(a)(2)(H); *see* MetLife Compl. ¶ 47 (citing quantitative analysis of potential costs of capital requirements to insurance companies designated as SIFIs). That makes good sense: federal SIFI regulation should be imposed only when existing regulation is insufficient. For a life insurance company, such as MetLife, the key system of existing regulation is state-based insurance regulation. Before designating MetLife as a SIFI, the Council accordingly was required to consider whether existing state regulation made such a designation necessary or appropriate. The Council breached that

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[12] *Available at* http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=3de94733-85ac-496d-b065-1e4a4232d7d0.

statutory duty here by wholly failing to account for certain features of state regulation and unreasonably disregarding others. *See* MetLife Br. 14, 41-45.

A. The Council Had A Duty To Give Careful Consideration To The Role And Effectiveness Of State Regulation In Assessing MetLife's Risk Profile

Congress has required the Council to consider existing regulatory scrutiny in making a decision whether to subject a nonbank financial company to prudential regulation as a SIFI. 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 significant expertise regarding the type of nonbank financial company at issue—namely, 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. S5832 (daily ed. July 14, 2010) (statement of Sen. Dodd).

The Council's duty to consider existing regulation is thus a central part of Dodd-Frank's scheme. Indeed, 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. It is a "[f]undamental principle[] of administrative law" that an "agency action [must] be 'based on a consideration of the relevant factors.'" *USTA v.*

FCC, 227 F.3d 450, 461 (D.C. Cir. 2000). And "[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); *accord Owner-Operator Independent Drivers Ass'n, Inc. v. Federal Motor Carrier Safety Admin.*, 656 F.3d 580, 587 (7th Cir. 2011) ("when an agency ignores a mandatory factor it defies a statutory limitation on its authority") (internal quotation marks and citations omitted).

Analysis of existing regulatory scrutiny is equally important to the Council's independent "determin[ation] that a U.S. nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards." 12 U.S.C. § 5323(a)(1). A determination of a threat to financial stability is a necessary but not sufficient condition to support a second, and separate, decision that a nonbank financial company should be subject to supervision by the Board of Governors. A reasoned analysis of existing regulatory scrutiny, and a comparison with potential federal regulation, is critical to that latter determination.

On each of these points, conclusory, shallow, and mistaken analysis will not do. For a federal agency to assess properly a factor that Congress has required it to consider, the agency's consideration must "demonstrate[] a rational connection between the facts found and the choices made" and the agency "must cogently explain why it has exercised its discretion in a given manner." *Owner-Operator Independent Drivers Ass'n*, 656 F.3d at 588 (internal quotation marks omitted). "[S]uperficial or perfunctory" reasoning is not sufficient. *Id.*; *see Business Roundtable v. SEC*, 647 F.3d 1144, 1155 (D.C. Cir. 2011) (agency "*ipse dixit*" is insufficient).

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

In designating MetLife as a SIFI, the Council paid insufficient attention to, and in certain respects, misunderstood the role and effectiveness of state regulation—a regime that has long successfully regulated ACLI's members. The Council's errors are not unique to MetLife but illustrate the Council's mistaken approach to designating life insurance companies to date.

1. States Have Long Successfully Managed Life Insurance Companies

"Insurance companies, unlike banks and securities firms, have been chartered and regulated solely by the state for the past 150 years." Webel, *Insurance Regulation: Issues, Background, and Legislation in the 113th Congress*, Cong. Research Serv. 1 (Sept. 17, 2014). Congress has promoted that state-based system of regulation. In 1945, Congress adopted the McCarran-Ferguson Act, which embodies an affirmative judgment that "States" should regulate the "business of insurance." 15 U.S.C. § 1012(a); *id.* § 1011 ("continued regulation … by the several States of the business of insurance is in the public interest"). 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), and "to throw the whole weight of [Congress'] power behind the state systems" of insurance regulation, *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 430 (1946). Within the space afforded by McCarran-Ferguson, state regulation has long brought stability to the insurance industry and protected policyholders.

Indeed, ACLI's members are subject to comprehensive state regulation. All States have a robust body of statutes, regulations, accounting principles, and actuarial guidelines that govern virtually every aspect of life insurance operations. *See, e.g.*, MetLife Br. 5-6. In ACLI's experience, this framework has been remarkably successful in preserving the stability of the life insurance industry, including during the financial crisis that prompted Congress's enactment of Dodd-Frank, as well as in addressing emerging regulatory concerns.[13]

The fundamental objects of the state-based regulatory scheme are to bring financial stability to the insurance industry and to ensure that insurance companies satisfy their long-term obligations to policyholders. To accomplish those goals, state regulation imposes a variety of significant requirements on life insurance companies, including regulations relating to: mandatory minimum capital stock and reserves; permissible and prohibited investments; affiliate transactions; reinsurance agreements; mandatory reporting of financial information; and mandatory onsite examinations by regulators. *See, e.g.*, NAIC, *The United States Insurance Financial Solvency Framework* 2-3 (2010) ("*NAIC Solvency Framework*").[14]

This state-based regulatory regime is far from static. To the contrary, "[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. Indeed, as described in further detail below, state regulators continue to work diligently to respond to concerns emerging from the 2007-2008 financial crisis. *See infra* pp. 29-30.

Although insurance companies are regulated by each State in which they do business, life insurers are assigned a "lead" regulator to coordinate regulation of the insurance holding company system as a whole. *See, e.g.*, NAIC, *Insurance Group Lead State Report 2015 – Quarter 1*.[15] MetLife's lead regulator—the New York Department of Financial Services

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13 Although AIG conducted most of its operations at the time of the financial crisis through its insurance subsidiaries, AIG's failure concerned its *non*-insurance operations (which were regulated at the federal, not state, level), as discussed further below. *See infra* pp. 31-33.

14 *Available at* http://www.naic.org/documents/committees_e_us_solvency_framework.pdf.

15 *Available at* https://i-site.naic.org/leadState/publeadstate/pubLSHtml.

("DFS"), an active state regulatory body—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.

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. These features of the state regulatory system are obviously quite relevant to the Council's analysis of whether MetLife is vulnerable to material distress and whether such distress would negatively affect the U.S. financial system. A few aspects of state regulation bear 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 in that way to protect a company's healthy insurance entities from distress experienced by affiliates. *See, e.g.*, NAIC, *Insurance Group Supervision*, CIPR Newsletter (Apr. 2012) ("*Group Supervision*").[16] Ring-fencing ensures that insurance subsidiaries are protected from risk in other parts of the holding company group in two ways: (1) each subsidiary insurance company is subject to separate,

[16] *Available at* http://www.naic.org/cipr_newsletter_archive/vol3_ins_group_ supervision.htm.

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 thus makes it exceptionally unlikely that all insurance companies within a holding company—and specifically that all insurance subsidiaries—would experience material financial distress simultaneously.

Risk Based Capital Requirements. Risk based capital ("RBC") requirements are an equally important element of state regulation. Under RBC principles, using a 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* (Feb. 27, 2015) ("*NAIC RBC*");[17] MetLife Compl. ¶ 67. 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. RBC is intended to be a minimum regulatory capital standard and not necessarily the full amount of capital that an insurer would want to hold to meet its safety and competitive objectives.

NAIC RBC. The Council acknowledges that "[a]ll of the jurisdictions of MetLife's principal insurance companies have adopted the RBC framework." Final Determination 240.

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[17] *Available at* http://www.naic.org/cipr_topics/topic_risk_based_capital.htm.

Importantly, these RBC requirements rest on very conservative assumptions about the amount of capital a life insurer needs. Moreover, many life insurers, such as MetLife, maintain capital levels well *above* those conservative RBC requirements. MetLife Br. 5.

Escalating Stages of Regulatory Intervention. Based in part on a life insurer's RBC level, state regulators have various authorities as well as mandates to intervene to remedy an insurance company facing potential material distress. *See, e.g.*, MetLife Compl. ¶¶ 66, 70. Those options include supervision, conservation or rehabilitation, and liquidation. In addition, state regulators have the authority to issue moratoriums or stays on policyholder surrenders in the event of a potential "run" on an insurance company. *See id.* ¶ 70. Indeed, as MetLife argues, the record made clear that state regulators, in fact, would impose stays in the unlikely event of the "run" scenario hypothesized by the Council. *See, e.g.*, MetLife Br. 32-33, 40, 42.

This mix of regulatory tools equips state regulators with flexibility to respond effectively and promptly to financial distress, often well before such distress ever materializes. *See, e.g.*, NAIC White Paper, *The U.S. National State-Based System of Insurance Financial Regulation and the Solvency Modernization Initiative* 14 (Aug. 14, 2013);[18] MetLife Br. 13-14.[19]

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

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[18] *Available at* http://www.naic.org/documents/committees_e_isftf_related_white_paper_state-based_financial_reg_smi_130825.pdf.

[19] *Available at* http://www.naic.org/documents/committees_e_isftf_related_white_paper_state-based_financial_reg_smi_130825.pdf.

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).[20] One example of NAIC coordinating work is the Financial Analysis Work Group. Through this Group, state regulators analyze particular insurance companies or groups of companies that may be approaching insolvency or distress and work closely with lead regulators to assist and advise on appropriate regulatory responses. *See* NAIC, *Financial Analysis Working Group* (2015).[21]

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* (Feb. 27, 2015).[22] 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); *see* Federal Insurance Office, *How to Modernize and Improve the System of Insurance Regulation* 41 (2013) ("In the absence of direct federal regulation of insurance groups, supervisory colleges will be an important means of addressing the conduct of group supervision in the intermediate term.").

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* MetLife Compl. ¶ 71.

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[20] *Available at* http://www.naic.org/documents/topics_white_paper_hist_ins_reg.pdf.

[21] *Available at* http://www.naic.org/committees_e_fawg.htm.

[22] *Available at* http://www.naic.org/cipr_topics/topic_supervisory_college.htm.

GAs ensure that policyholders are protected in the event of distress, and they thus work to preserve confidence in the life insurance industry, even in periods of distress. 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, *What Happens When An Insurance Company Fails?* (2015).[23] 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.* Each GA has as members the insurance companies licensed to write covered lines of business in the State.

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"). NOLHGA is a mechanism through which multiple GAs can act in concert to establish and implement a single, national insolvency response plan for multistate insolvencies or resolutions. NOLHGA has been involved in the successful liquidation of dozens of insurance companies (life and health). *See* NOLHGA, *Impairments & Insolvencies* (2015).[24]

Assessments collected from the insurance industry are the principal source of GA funding. Each life and health insurance GA is authorized to collect its assessments from insurance companies issuing life, annuity, or health insurance in the State. The GA system has vast assessment capacity. In 2013, for example, the overall annual assessment capacity of the life and health GA system exceeded $10 billion. *See* NOLHGA, *Assessment Data* (2015).[25] That capacity significantly exceeds the GA system's funding needs, as demonstrated by

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[23] *Available at* https://www.nolhga.com/policyholderinfo/main.cfm/location/insolvencyprocess.

[24] *Available at* https://www.nolhga.com/factsandfigures/main.cfm/location/insolvencies.

[25] *Available at* https://www.nolhga.com/factsandfigures/main.cfm/location/assessmentdata.

historical experience. As of 2011, for example, 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. *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).[26] Thus, in the GA system's more than four decades of existence, the net assessments required to pay the aggregate covered claims of all policyholders have totaled only approximately *half* of the system's capacity for 2013 alone.

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In short, from the perspective of ACLI's members, the state-based system of insurance regulation is comprehensive and 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.

2. The Council's Analysis Of State Regulation Was Unreasonable

The 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. *See* MetLife Compl. ¶¶ 18, 65-66; MetLife Br. 13-14. 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 DFS Letter* 1. So, too, did regulators from five States. *See* MetLife Compl. ¶ 125. The comments of these state regulators—reflecting their deep experience with and expertise regarding life insurance generally

[26] *Available at* https://www.nolhga.com/resource/file/HFSCnolhgaTestimony Nov15_2011.pdf.

and MetLife in particular—were the very types of views Congress intended the Council to consider seriously in deciding whether to designate a nonbank institution as a SIFI.

However, in its apparent rush to bring MetLife under the ambit of federal regulation, the Council disregarded the opinions of these state regulatory experts and it all but ignored the ways in which existing state regulation counted heavily against designating MetLife as a SIFI. In the Final Determination, the Council's principal reason for disregarding the perspectives of state regulators as well existing 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." Final Determination 237; *see id.* 20, 37, 250. That line of argument—which is, at bottom, an outcome-oriented justification for enhanced federal insurance 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. *See* MetLife Br. 41-45.

First, "consolidated supervision" is not an end in itself, but only a possible mechanism for achieving some congressional objective. The Council, however, 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. As explained above and by MetLife, state regulation has proven adept at protecting the stability of the life insurance industry for more than 100 years. *See supra* pp. 16-23; MetLife Br. 13-14, 41-45. That time-tested system of state regulation should not be lightly displaced based on an unexamined assumption or mere implicit assertion that "consolidated supervision" is an unqualified good. 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 an obvious and well-known fact. Instead, the Council was required to explain *how* current regulation falls short and *why* consolidated supervision would remedy those concerns. The Council did neither. The Council's summary analysis was a failure of reasoned decisionmaking: "Conclusory statements will not do; an agency's statement must be one of *reasoning*." *Foster v. Mabus*, 2015 WL 2198851, at *9 (D.D.C. May 12, 2015); *see also Judulang v. Holder*, 132 S. Ct. 476, 484 (2011) (courts must "examin[e] the *reasons* for agency decisions") (emphasis added).

Second, the Final Determination unreasonably disregarded recent and significant efforts by state regulators to enhance 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." Final Determination 237. Indeed, as described further below, since the financial crisis, state regulators have been working diligently to enhance event further tools "to assess the enterprise risk within a holding company system and its impact and contagion upon the insurers within that group." *Group Supervision*, *supra*; *see infra* pp. 29-30.[27]

Third, the Council effectively ignored 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

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[27] *Available at* http://www.naic.org/cipr_newsletter_archive/vol3_ins_group_supervision.htm. NAIC has been leading the way on these important reform efforts, including with amendments to the NAIC Model Act. New York—MetLife's lead regulating state—has adopted these statutory and regulatory reforms. *See, e.g.*, N.Y. Ins. Law §§ 1503(b), 1501(a)(7); MetLife Compl. ¶ 68. The Council acknowledged these new state-law provisions, *see* Final Determination 241-242, but it offered no reasonable basis for concluding that these enhancements are inadequate to remedy the concerns the Council identified.

concerns." Final Determination 304. The Council's failure to account for 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). Here, the Council violated that basic tenet of reasoned decisionmaking.

The Council's perfunctory dismissal of existing state regulation is an error that strikes at 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. *E.g.*, Final Determination 15-16. State regulation is well-designed to prevent any of that from happening, as MetLife explains. *See* MetLife Br. 41-45. State regulation is structured, first, to ensure that a distress scenario never emerges through solvency and RBC requirements and, in the event of any distress, to prevent a bank-like "run" on insurers through regulatory moratoriums or stays. *See supra* p. 20.

The Council ignored or otherwise unreasonably did not account for these key features of state regulation.[28] As the Independent Member with insurance expertise, Roy Woodall,

[28] In addition to brushing aside state regulation on the ground that it did not amount to "consolidated" supervision, the Council in other places identified state law as a potential problem. For example, contrary to all available historical evidence, the Council speculated that state regulatory intervention in the event of distress could lead to an unprecedented "crisis of

explained in his dissent: "The [Council's asset liquidation transmission channel] analysis discusses in detail, and is dismissive of, the U.S. State insurance regulatory framework, the panoply of State regulatory authorities, and the willingness of State regulators to act, thereby overstating the shortcomings and uncertainties that are inherent in all regulatory frameworks, State or Federal." Final Determination 299-300.

In its brief, the government's defense of the Council's criticism of state insurance regulation is no more persuasive. *See* Memo. in Support of Defendants' Mot. to Dismiss or, in the Alternative, for Summ. Judg., Dkt. 22-1 (May 11, 2015) ("FSOC Br."). Indeed, one reading the brief might be left to wonder whether and how insurance companies were regulated at all before Congress created the Council. The government does not cite a single provision of state insurance law, *id.* at vii-viii (table of authorities); it mentions state regulation—the regime that has governed insurance companies successfully for more than a century—in only a handful of paragraphs, *id.* at 16, 28; and it relegates the vital state GA system, described above, to a single sentence in a footnote, *id.* at 28 n.19. The scant attention paid by the government in its brief to state regulation speaks volumes, and is illustrative of the indifferent approach taken to state regulation by the Council itself. *See* Final Determination 304 (Hamm dissent).

As to the merits of whether the Council complied with its statutory duty to consider existing regulation, the government simply asserts that the "Council carefully considered the degree to which MetLife is already regulated and reasonably determined that there are numerous risks not fully addressed by MetLife's existing regulation," citing the fact that section 5 of the Final Determination "is devoted to addressing existing regulatory scrutiny." FSOC Br. 28 & n.18. The government's assurance that the Council "carefully considered" state regulation is

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confidence" spreading through the life insurance industry. Final Determination 138. MetLife fully explains why this contagion theory lacks any reasoned basis. *See* MetLife Br. 41-42.

based on little more than numerous pages of the Final Determination that merely summarize mechanically *MetLife's* description of state regulation. Final Determination 237-249. That is not how administrative law works: Reasoned decisionmaking requires meaningful engagement with important aspects of a problem, not repetition of a party's position followed by its summary rejection. *See Amerijet Int'l*, 753 F.3d at 1350 ("conclusory statements will not do"); *Owner-Operator Independent Drivers Ass'n*, 656 F.3d at 588 ("superficial or perfunctory" reasoning does not satisfy the requirement of reasoned decisionmaking).

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

In contrast to the government's brief—which addresses state regulation as an afterthought—one amicus brief filed in support of the Council launches a full-scale assault on state-based insurance regulation. *See* Br. of Scholars of Insurance Regulation as Amici Curiae in Support of Defendant Financial Stability Oversight Council, Dkt. 34-1, at 1 (May 22, 2015) ("Professors Br."). That brief advances three objections, but none is persuasive.

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. Professors Br. 7. That account is highly 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 Services*, 112th Cong. 65 (2011) (statement of Joseph Torti, III, NAIC) ("*Insurance Oversight Hr'g*"). As explained above, that state-based solvency framework subjects 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." *Id.* at 65 (Torti statement).

But 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." *Group Supervision*, *supra*. 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.*

In addition, in the wake of the financial crisis, state regulators have been working diligently to enhance and expand group-level supervision, as noted above. As MetLife's lead state regulator, 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.

DFS Letter 3-4.

As one example of those state reform efforts—one the professors do not mention—state regulators are "currently implementing the international concept of the Own Risk and Solvency Assessment (ORSA)." *Group Supervision*, *supra*. Under ORSA principles, "every U.S. insurer (or their holding company group) will complete a self-assessment of their risk management, stress tests and capital adequacy on a yearly basis" and, in that way, "U.S. regulators will be able to add to their existing assessment of group capital with analysis of the company's own assessment of group capital needs." *Id.* ORSA is a significant development.[29] The ORSA framework was adopted by NAIC in the wake of the 2007-2008 financial crisis with the specific aim of enhancing the ability of state regulators to "assess the holding company's financial condition, as whole, and its impact on an insurer within the holding company system." NAIC, *Own Risk and Solvency Assessment (ORSA)* (Feb. 27, 2015).[30]

Second, the professors maintain that state regulation is not well designed to stop a large-scale run on large insurance conglomerates. Professors Br. 15-16. That is wrong for all the reasons identified above. *See supra* pp. 16-23. Indeed, as DFS has explained, "State insurance regulators have numerous tools at their disposal to manage insurer insolvencies." *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.* The effectiveness of these tools has been demonstrated 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.*[31]

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[29] *See* Liss, *New Law Brings New Management and Reporting Requirements*, N.J. Law J. (Feb. 17, 2015), *available at* http://www.njlawjournal.com/id=1202718137738/New-Law-Brings-New-Management-and-Reporting-Requirements?slreturn=20150508140028; GAO, *Insurance Markets: Impacts of and Regulatory Response to the 2007-2009 Financial Crisis* 50 (July 29, 2013).

[30] *Available at* http://www.naic.org/cipr_topics/topic_own_risk_solvency_assessment.htm.

[31] The professors also criticize the state GA system, asserting it is not "designed to handle the failure of a massive financial conglomerate … in the context of broader financial instability." Professors Br. 18. Again, that concern is speculative and contrary to real-world experience. As Professor Schwarcz, a signatory to the brief, himself testified before Congress: The "guaranty system has not failed … it is true that it has worked, and it is true that historically the system has worked." *Insurance Oversight Hr'g*, 112th Cong. 15 (Schwarcz statement). In the Final Determination, the Council similarly engaged in sheer speculation about GA system capacity unmoored from real-world fact. *See, e.g.*, Final Determination 77 (suggesting the GAs "*could* have insufficient capacity" and that liquidation "*could* strain the GAs' capacity for many years" (emphases added)); *accord id.* at 91-97 (similar).

Finally, the professors contend that only the federal government—which exists, they say, outside "localized political and economic accountability"—is well positioned to mitigate systemic risk. Professors Br. 19. This line of argument is equally unavailing.

For more than a century, states have served—effectively—as the principal regulators of life insurance companies. *See supra* p. 16. "The strength of this [state] system was evident during the financial crisis." *Insurance Oversight Hr'g*, 112 Cong. 65 (Torti statement).

> 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); *see also Insurance Oversight Hr'g*, 112th Cong. 65 (Torti statement) ("in 2009, 140 banks failed, but only 18 insurers did").

Indeed, the professors' effort to assign blame for AIG's collapse, and the resulting financial crisis, on *state* insurance regulators and, on that basis, to justify *federal* regulation has things backwards. As one signatory of the brief elsewhere admits, "it is very difficult to blame state insurance regulators for AIGFP's [credit default swap] operations"—the root cause of AIG's meltdown—"or their impact on AIG itself. Neither AIG nor AIGFP were insurance companies and consequently neither one was regulated by state insurance departments." Abraham & Schwarcz, *Insurance Law & Regulation* 173 (6th ed. 2015) ("*Insurance Law & Regulation*"). AIG's collapse, in fact, 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). AIG's failure "was caused by a non-insurance subsidiary's overinvestment in credit default swaps," which "were not subject to insurance regulation" but were regulated by federal agencies. *Id.* at 776; *see also* MetLife Br. 4 (explaining the sizeable percentage (27%) of pre-crisis AIG's assets that were carried out through non-regulated insurance subsidiaries and comparing that with MetLife's profile in 2013, which showed that 98% of MetLife's consolidated assets were in a regulated insurance subsidiary).

In fact, 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) (emphasis added).

> If the financial crisis in general and the AIG crisis in particular are to be blamed on ineffective regulation, the blame should reflect the substantial evidence of fundamental failures in U.S. and foreign banking regulation, including in the U.S. by the [Office of Thrift Supervision ("OTS")], the Office of the Comptroller of the Currency, the [Federal Deposit Insurance Corporation], the [Securities and Exchange Commission], and the Federal Reserve.

Harrington, *The Financial Crisis, Systemic Risk, and the Future of Insurance Regulation*, 76 J. of Risk & Ins. 785, 800 (2009); *see* Abraham & Schwarcz, *Insurance Law & Regulation* at 179 ("the Fed, along with various other federal agencies, … failed to recognize the regulatory gaps and risks that permeated the financial system prior to 2008"); *see also* Thomas, 55 Vill. L. Rev. at 800 ("The financial crisis and the collapse of AIG certainly suggest that something is amiss in the regulatory environment in the United States. Nevertheless, that 'something' is not insurance regulation."). The professors' contention that state insurance regulators are responsible for the

2007-2008 financial crisis—as opposed to federal regulatory bodies such as OTS—is thus profoundly misguided.

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In sum, the Council's consideration of state regulation failed to satisfy its duty of reasoned decisionmaking. And the *post hoc* efforts by amici to make up for the Final Determination's gaps by broadly assailing state insurance regulation are misplaced. As history has demonstrated and as ACLI's members can attest, state insurance regulation works effectively to protect policyholders and to ensure the financial stability of the insurance industry as a whole. The Council's failure to engage meaningfully with this existing state-based regime of insurance regulation renders the Final Determination arbitrary and capricious.

CONCLUSION

This Court should order the Council to rescind MetLife's SIFI designation.

Dated: June 26, 2015

Respectfully submitted.

/s/ David W. Ogden

DAVID W. OGDEN (DC Bar No. 375951)
KELLY P. DUNBAR (DC Bar No. 500038)
ALBINAS J. PRIZGINTAS (DC Bar No. 1006955)
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Avenue, NW
Washington, DC 20006
Tel.: (202) 663-6000
Fax: (202) 663-6363

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

Counsel for Amicus Curiae American Council of Life Insurers

CERTIFICATE OF SERVICE

I hereby certify that on this 26th day of June, 2015, I electronically filed the foregoing Brief for Amicus Curiae American Council of Life Insurers in Support of Plaintiff MetLife, Inc. with the Clerk of the Court for the United States District of Columbia via the Court's CM/ECF system, causing it to be served electronically on all counsel of record.

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