IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

METLIFE, INC.,

Plaintiff,

v.

FINANCIAL STABILITY OVERSIGHT COUNCIL,

Defendant.

Civil Action No. 1:15-cv-45 (RMC)

REDACTED BRIEF

FINAL REPLY MEMORANDUM IN SUPPORT OF PLAINTIFF METLIFE, INC.'S CROSS-MOTION FOR SUMMARY JUDGMENT

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GLOSSARY

AIG	American International Group, Inc.
AIG Public Designation	Basis of the Financial Stability Oversight Council's Final Determination Regarding AIG (July 8, 2013)
BHCA	Bank Holding Company Act
Board	Board of Governors of the Federal Reserve System
CCAR	Comprehensive Capital Analysis and Review
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010)
FABCP	Funding Agreement-Backed Commercial Paper
FABN	Funding Agreement-Backed Note
FABS	Funding Agreement-Backed Security
Final Rule and Interpretive Guidance	Authority to Require Supervision & Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21,637 (Apr. 11, 2012)
FSOC	Financial Stability Oversight Council
FSOC Opp.	FSOC's Reply Memorandum in Support of Its Motion to Dismiss or, in the Alternative, for Summary Judgment, and in Opposition to MetLife's Cross-Motion for Summary Judgment (July 31, 2015)
G-SIB	Global Systemically Important Bank
MetLife Br.	MetLife's Memorandum of Points and Authorities in Support of Its Cross-Motion for Summary Judgment and in Opposition to FSOC's Motion to Dismiss Or, in the Alternative, for Summary Judgment (June 16, 2015)
NAIC	National Association of Insurance Commissioners
RBC	Risk-Based Capital
SIFI	Systemically Important Financial Institution

INTRODUCTION

In its Opposition, FSOC claims that it is entitled to such sweeping deference that it is effectively unconstrained by statutory mandates, its own regulations, or even the Constitution, leaving it free to substitute guesswork and speculation for reasoning and evidence in a process that abridges basic procedural rights. These unprecedented assertions underscore the degree to which FSOC's Final Designation of MetLife departs from the Dodd-Frank Act, the Administrative Procedure Act ("APA"), and the Due Process Clause.

FSOC erred at the very outset of its designation inquiry when it classified MetLife as a U.S. nonbank financial company eligible for designation. Then, contrary to its own Final Rule and Interpretive Guidance, FSOC refused to assess the extent to which MetLife is vulnerable to material financial distress and declined to estimate the losses that MetLife's counterparties could be expected to suffer in the event of that distress, and the impact of those losses on the broader financial system. For good measure, FSOC completely dismissed the ability of state regulators to alleviate a "run" on MetLife through the imposition of a stay on withdrawals, ignored reasonable regulatory alternatives to designation, and refused to give any consideration to the consequences of designation for MetLife, its stakeholders, and the financial markets.

To prop up this tenuous analysis, FSOC's Opposition repeatedly turns to arguments that appear nowhere in the Final Designation and that lack support in the administrative record. For example, MetLife established that its financial distress would not have systemic consequences by showing that any losses its distress caused its counterparties would be orders of magnitude less than the losses those counterparties could withstand under the economic scenarios used in bank "stress tests." FSOC now attempts to dismiss that record evidence on the basis of post hoc rationalizations that are devoid of factual grounding. And, in FSOC's view, this Court should defer to the agency's "prediction" that state regulatory intervention staying policyholders' withdrawals would cause a "crisis of confidence" prompting runs on other insurers—even though the record provides no evidence to substantiate that prediction.

According to FSOC, its "extensive engagement with MetLife over a 17-month period" is sufficient to excuse all of these errors. FSOC Opp. 4. But an agency's obligations under the APA and due process are not measured by the passage of time or the number of meetings. Rather, an agency's obligation is to provide a reasoned decision—based on substantial evidence and a thorough consideration of the arguments and alternatives—that shows the regulated party was *heard*, and that gives the Court cogent and ascertainable grounds to affirm the agency's action.

Ultimately, FSOC asks this Court to endorse an infinitely elastic framework that would permit the agency to designate a company based on whatever adverse financial conditions and macroeconomic consequences its boundless imagination can conceive. That free-wheeling approach is irreconcilable with the designation criteria prescribed in Dodd-Frank, the reasoned decisionmaking mandated by the APA, and the fair notice required by due process.

ARGUMENT

I. MetLife Is Not A "U.S. Nonbank Financial Company" Eligible For Designation.

FSOC erred at the very first step of its designation analysis. Under the plain language of the Dodd-Frank Act and Bank Holding Company Act ("BHCA"), MetLife is not a "U.S. nonbank financial company" eligible for designation because it is not "predominantly engaged in financial activities." 12 U.S.C. § 5311(a)(4)(B).

A. FSOC Cannot Overcome Section 4(k)'s Unambiguous Language.

In determining that MetLife is a U.S. nonbank financial company, FSOC relied on two subsections of the BHCA, Sections 4(k)(4)(B) and 4(k)(4)(I). Section 4(k)(4)(B) defines as "financial" certain insurance activities that occur "in any State," 12 U.S.C. § 1843(k)(4)(B), which unambiguously excludes activities that occur outside the United States. *See* MetLife Br. 21. Section 4(k)(4)(I) permits an insurance company affiliated with a financial holding company to make so-called "portfolio investments" in "portfolio companies" and classifies those investments as "financial" activities, but only where the investments are made in the "ordinary course" "in accordance with relevant State law governing such investments," and where, among other things, the insurance company's parent company does not "routinely manage or operate" the portfolio company. 12 U.S.C. § 1843(k)(4)(I). MetLife does not meet the 85% threshold necessary to qualify as a U.S. nonbank financial company under either definition because more than 15% of MetLife's consolidated assets and annual gross revenues are related to or derived from insurance activities that do not occur "in any State" under Section 4(k)(4)(B), and because MetLife, Inc. actively manages the operations of its non-U.S. subsidiaries as part of its global business strategy, meaning that those investments are not "portfolio investments" under Section 4(k)(4)(I). JA 849-50, 861-62, 2576.

FSOC offers several unavailing responses. *First*, FSOC invokes Regulation Y—which was promulgated by the Federal Reserve Board ("Board") outside the Dodd-Frank designation setting—and urges this Court to defer to FSOC's reliance on that rule in construing Section 4(k). But the portion of Regulation Y that FSOC invokes does not determine the category of activities that are considered "financial." *See* 12 C.F.R. § 225.86 (defining "financial activities" by reference to Section 4(k)(4) of the BHCA). Rather, it addresses whether activities defined as "financial" under Section 4(k) of the BHCA may be conducted abroad. *See id.* § 225.85(b) (stating that a "financial holding company may conduct any activity listed in § 225.86 . . . at any location outside of the United States"). The question of *where* financial activities may be conducted is distinct from the question *whether* an activity is financial in the first place. In any event, courts "accord no deference to [an agency's] interpretation of [a] statute [it does not administer]." *U.S. Dep't of Homeland Sec. U.S. Customs & Border Prot. v. Fed. Labor Relations Auth.*, 751 F.3d 665, 668 (D.C. Cir. 2014). This is particularly true where, as here, the agency is relying *on the wrong regulation*: As FSOC concedes, Regulation PP, not Regulation Y, implements Dodd-Frank's "predominantly engaged" test for purposes of FSOC's designation authority. *See* FSOC Opp. 60 n.48; *see also* Regulation PP, 12 C.F.R. pt. 242, App. A.[1]

Second, FSOC contends that, "absent some clear indication to the contrary," this Court should presume that Congress was aware of Regulation Y when it referred to Section 4(k) in Dodd-Frank. FSOC Reply 59-60. But FSOC gets the presumption precisely backward. Courts can conclude that a statute incorporated an agency interpretation only when there is some evidence of congressional intent to do so. *See Brown v. Gardner*, 513 U.S. 115, 121 (1994). FSOC made no such showing here.

Third, FSOC argues that MetLife qualifies as a U.S. nonbank financial company because the investments of MetLife subsidiary ALICO in foreign insurance subsidiaries are portfolio investments under Section 4(k)(4)(I). FSOC Opp. 63; JA 382-83. MetLife demonstrated, however, that those investments do not satisfy the four requirements of Section 4(k)(4)(I) because the foreign insurance subsidiaries are managed by MetLife, Inc. MetLife Br. 22 n.8. In

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[1] FSOC contends that the Court should nonetheless defer to the Federal Reserve Board's interpretation of Section 4(k) because the Board is tasked with implementing the BHCA. But the interpretation for which FSOC seeks deference is not an interpretation of Section 4(k) by the Board, but instead *FSOC*'s interpretation of Regulation Y, a regulation the Board promulgated in a wholly different context and to which no reference is made in Dodd-Frank or FSOC's own regulations. For similar reasons, [redacted] is irrelevant in the entirely distinct Dodd-Frank designation context. *See* FSOC Opp. 53.

response, FSOC recites MetLife's statement to the agency, JA 1398, that its foreign insurance subsidiaries are [redacted] for purposes of orderly resolution; FSOC argues that this means MetLife, Inc. does not "routinely manag[e] and operat[e]" those subsidiaries, FSOC Opp. 65 n.53; JA 383 n.158. But the fact that MetLife's foreign subsidiaries may be [redacted] is simply a reflection of their separate corporate identities and applicable regulatory requirements, not an indication of whether they are managed by MetLife, Inc. JA 1389. FSOC's misleading focus on this isolated statement made in a different context ignores the lists of directors and officers in the same document, *see, e.g.*, JA 1486, 1493-95, 1502, 1510-11, which illustrate that numerous individuals serve in management capacities for multiple MetLife companies, and similarly disregards information in MetLife's financial filings clearly demonstrating that MetLife's foreign insurance subsidiaries, particularly MetLife Japan, are managed and operated as key components of MetLife, Inc.'s global insurance business. JA 2576. Accordingly, ALICO's investments in those subsidiaries are not portfolio investments covered by Section 4(k)(4)(I).[2]

B. FSOC Misreads The "Related To" Clause In Section 102(a)(6).

FSOC also contends that MetLife qualifies as a nonbank financial company under Dodd-Frank because "nearly all of [MetLife's] consolidated assets . . . are *related to* its U.S. insurance activities." FSOC Opp. 53. But the "related to" language in Section 102(a)(6)(B) makes clear

[2] MetLife did not waive this argument. MetLife had no notice in the Proposed Designation that FSOC would rely on ALICO's supposed "portfolio investments" in foreign subsidiaries as a basis for designating MetLife and thus had no opportunity to raise the argument prior to the Final Designation. Moreover, MetLife was not required to raise the argument before the agency because the issue is one of pure statutory interpretation and does not require any factual development or agency expertise. *See Athlone Indus., Inc. v. Consumer Prod. Safety Comm'n*, 707 F.2d 1485, 1489 n.24 (D.C. Cir. 1983).

that the "consolidated assets" must be "related to" *activities that are financial in nature under Section 4(k)*. 12 U.S.C. § 5311(a)(4)(B). While the assets of foreign entities may be "related to" the activities of those foreign entities, they are not "related to" the *U.S. insurance activities* of other MetLife subsidiaries that are defined by Section 4(k) to be "financial in nature." Under FSOC's expansive reading, if a company being considered for designation engages in any financial activities, all of its commercial activities could be deemed "related to" those financial activities and counted toward satisfying the 85% threshold simply because of the existence of enterprise-wide shared services. But Congress plainly did not intend Dodd-Frank's "related to" language to eviscerate the distinction between financial and non-financial activities, including non-U.S. insurance activities, for purposes of designating "nonbank financial companies."

C. AIG Does Not Compel A Contrary Conclusion.

Lastly, FSOC contends that MetLife's plain language interpretation of Section 4(k) should be rejected because that interpretation would have precluded the designation of AIG on the eve of the financial crisis. *See* FSOC Opp. 52, 61. That is wrong. While FSOC's public designation of AIG did not cite the specific provisions of Section 4(k) on which it relied in finding that AIG was predominantly engaged in financial activities, FSOC clearly relied on several Section 4(k) categories not at issue here. *See* AIG Public Designation 3-4 (referring to lending, underwriting and dealing, investing and trading, and merchant banking).

More broadly, FSOC argues that "MetLife's approach would create a specific carve-out for U.S.-based insurance companies with substantial overseas operations." FSOC Opp. 61. Non-insurance foreign financial operations, however, plainly count toward the 85% threshold. In any event, Congress reasonably could have concluded that only a predominantly *U.S.* insurance company would pose levels of risk to the U.S. economy sufficient to warrant designation.

II. FSOC Applied The Designation Criteria In A Manner That Violated Dodd-Frank And Conflicted With FSOC's Final Rule And Interpretive Guidance.

After erring at the first step of its designation inquiry, FSOC proceeded to defy both Dodd-Frank's statutory designation criteria and the designation standard it adopted in its Final Rule and Interpretive Guidance. In particular, FSOC refused to make any assessment of the extent to which MetLife is vulnerable to material financial distress despite its own prior statements that such an assessment was essential to the designation analysis; redefined "material financial distress" so that the agency could hypothesize the effects of MetLife's total financial collapse; and largely disregarded several of the statutory designation factors, including the extent to which MetLife is already subject to regulation. FSOC offers no persuasive explanation for its cavalier approach to the statutory and regulatory standards that should have guided its inquiry.

A. FSOC's Refusal To Consider MetLife's Vulnerability To Material Financial Distress Violated Section 113 And Conflicted With Its Own Final Rule And Interpretive Guidance.

In its Final Rule and Interpretive Guidance, FSOC characterized "the vulnerability of a nonbank financial company to financial distress" as one of two central issues addressed by Dodd-Frank's statutory designation criteria. Authority to Require Supervision & Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21,637, 21,641 (Apr. 11, 2012). The other was the "potential impact of a nonbank financial company's financial distress on the broader economy." *Id.*

This two-step inquiry—under which FSOC is to consider both the risk that a company will experience material financial distress, and the impact that distress reasonably could be expected to have on U.S. financial stability—is mandated by Section 113, which directs FSOC to evaluate ten non-exhaustive statutory criteria, including the company's leverage, liabilities, and existing regulatory oversight. *See* 12 U.S.C. § 5323(a)(2)(A)-(J). There is no dispute that these three factors predominantly relate to a company's vulnerability to financial distress. *See* 77 Fed. Reg. at 21,641; FSOC Opp. 39. When the statutory criteria are read against the backdrop of FSOC's overarching responsibility to identify companies whose material financial distress "could pose a threat to [U.S.] financial stability," it is clear that Congress intended for FSOC to assess a company's vulnerability to financial distress as an indispensable step in determining whether designation is appropriate. *Cf. Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc*., 467 U.S. 837, 842-43 n.9 (1984). Instead, FSOC based its designation of MetLife on the assumption that MetLife would encounter severe distress under implausible scenarios with no grounding in reality. In addition, even assuming that the statute does not unambiguously *require* an assessment of MetLife's vulnerability, it was still arbitrary and capricious for FSOC to construe the statute as authorizing the agency to forgo an assessment of vulnerability. *See Goldstein v. SEC*, 451 F.3d 873, 878 (D.C. Cir. 2006) (holding that an agency interpretation was unreasonable even if not foreclosed because it was inconsistent with statutory language and purpose). Ignoring the degree to which a company is or is not vulnerable to material financial distress renders the entire designation undertaking a fool's errand predicated on purely illusory harms. Indeed, under FSOC's analysis, it would be irrelevant whether a company's likelihood of experiencing material financial distress were closer to 0.1%, 5%, or 51%.

FSOC offers no intelligible response to MetLife's demonstration that the Final Designation collapsed what, by FSOC's own account, were to be two "categories" of considerations—a company's vulnerability to financial distress, on the one hand, and the systemic impact of that distress, on the other—into consideration of the systemic impact of an entirely assumed failure. *See* MetLife Br. 29-30. Instead, FSOC insists that "an assessment of the vulnerabilities at MetLife . . . is relevant to an assessment of whether and how material financial distress at MetLife could be transmitted to other financial firms and markets." FSOC Opp. 42. Possible overlap, however, between considering the vulnerability of a company to material financial distress and the impact of that distress on other firms does not change the fact that, in its Final Rule and Interpretive Guidance, FSOC stated that these were two *separate* inquiries, *see* 77 Fed. Reg. at 21,641, and now it says they are one. Moreover, as recently as 2014, FSOC told state regulators that it would assess MetLife's vulnerability in considering the potential designation of the company—a fact FSOC does not contest in its brief. JA 2834. FSOC's about-face in the Final Designation was arbitrary and capricious.

FSOC's shift in position was all the more problematic because it was unacknowledged. "One of the core tenets of reasoned decision-making is that an agency [when] changing its course . . . is obligated to supply a reasoned analysis for the change." *Republic Airline Inc. v. U.S. Dep't of Transp.*, 669 F.3d 296, 299 (D.C. Cir. 2012) (internal quotation marks omitted). FSOC failed to provide any justification for its change of heart, opting instead to insist that it had also assumed material financial distress in prior designations of other companies and that it had never construed Section 113 to require a vulnerability assessment. *See* FSOC Opp. 42, 43 n.35. FSOC's attempt to backpedal from the position it took in its guidance and to supplement in these proceedings the inadequate explanations it offered for declining to assess MetLife's vulnerability is a post hoc litigation strategy undeserving of any deference. *See Alpharma, Inc. v. Leavitt*, 460 F.3d 1, 6 (D.C. Cir. 2006) ("[P]ost hoc rationalizations 'have traditionally been found to be an inadequate basis for review' of agency decisions.") (citation omitted).

FSOC's contention that requiring an assessment of vulnerability will preclude the agency from designating a company until it "reaches the cusp of failure and the financial system is on the edge of collapse," FSOC Opp. 38, is a red herring. MetLife does not dispute that vulnerability should be established *before* financial distress materializes. That prospective inquiry, however, must be grounded in a company's actual financial condition, existing regulatory scrutiny, and empirically-based scenarios based on fact, experience, and rational analysis. That FSOC is vested with prophylactic authority does not absolve it from engaging in reasoned analysis. *See Chem. Mfrs. Ass'n v. EPA*, 28 F.3d 1259, 1264 (D.C. Cir. 1994).

B. FSOC Erred By Assuming Distress At MetLife More Severe Than The Definition Of "Material Financial Distress" In Its Final Rule And Interpretive Guidance.

Just as it abandoned its earlier commitment to assess vulnerability, FSOC also discarded the definition of "material financial distress" adopted in its Final Rule and Interpretive Guidance, instead claiming unbridled discretion to plunge MetLife into however deep a financial catastrophe it deemed necessary to generate "impacts" sufficient to justify designation.

FSOC defined "material financial distress" in its Final Rule and Interpretive Guidance as "imminent danger of insolvency," 77 Fed. Reg. at 21,657; JA 351, but then assumed states of distress in the Final Designation that were far more severe, including—in the words of dissenting FSOC member Roy Woodall—a "massive and total insolvency" of "unprecedented scale, of unexplained causation, and without effective regulatory responses." JA 642-44 (Woodall Dissent); *see also, e.g.*, JA 437. By assuming that MetLife's "material financial distress" would take the form of a "massive insolvency" rather than an imminent one, FSOC operated as though it had not promulgated interpretive guidance at all.

FSOC insists that it was entitled to "consider[ ] the range of potential outcomes of MetLife's material financial distress, rather than relying on a worst-case scenario or any other specific scenario." FSOC Opp. 44. But this again conflates the two distinct components of the designation inquiry: The presence of "material financial distress"—which FSOC defined as "imminent . . . insolvency" in the Final Rule and Interpretive Guidance—is distinct from the "potential outcomes" of that distress for other market participants. Moreover, FSOC's repudiation of its definition of material financial distress was instrumental, in its "asset liquidation" analysis and elsewhere, to its reliance on precisely the sort of "worst-case scenarios" it now disclaims. *See, e.g.*, JA 480 (assuming mass surrender by MetLife policyholders).

FSOC's assumption of material financial distress at MetLife, and the license it took to define that distress as extraordinarily severe, even unprecedented, were two important steps away from the regulatory structure established by Congress and FSOC's interpretive guidance. And they were two decisive steps toward an ad hoc designation process guided not by legal standards, evidence, or accepted principles of risk analysis, but by FSOC's own unfettered imagination.

C. FSOC Failed To Give Due Consideration To Several Statutory Designation Criteria, Including The Extent To Which MetLife Is Already Regulated.

FSOC further tilted the standards in favor of designation by giving undue weight to MetLife's size and purported interconnectedness, at the expense of other statutory criteria, including existing regulatory scrutiny. In fact, FSOC's apocalyptic forecasting assumed the worst not only about MetLife's financial distress, but also about the state insurance regulatory system (again without basis in the historical record). FSOC assumed the nearly total ineffectiveness of state regulatory tools to avert financial distress and systemic risk, MetLife Br. 41, and then doubled-down by treating state regulation as a risk *catalyst* rather than a mitigant. *See infra* Part III.B.2. In so doing, FSOC disregarded historical experience, the consensus of state regulators, and the dissenting views of FSOC's members with insurance expertise.

FSOC nevertheless insists that it gave due consideration to existing state regulation and found it to be deficient. *See* FSOC Opp. 16-17. But the Final Designation reflects no meaningful assessment of the efficacy of state regulation. Instead, FSOC listed several state regulatory tools, JA 363, acknowledged in a single sentence that they "may be effective to mitigate the risks arising from an insurance company" "[i]n some cases," JA 364, and then summarily dismissed *all of them* on the ground that "state regulators' authorities have never been tested by an event of the material financial distress at an insurance company of the size, scope and complexity of MetLife's large insurance subsidiaries," *id*. That conclusory dismissal of a congressionally enumerated statutory factor is arbitrary and capricious. *See D&F Afonso Realty Trust v. Garvey*, 216 F.3d 1191, 1195-96 (D.C. Cir. 2000).

FSOC's insistence that the state regulatory framework is inadequate because it does not provide for "consolidated supervision" of MetLife, FSOC Opp. 17, JA 584, is equally flawed. The statute does not authorize FSOC to treat consolidated supervision as *per se* superior and grounds by itself to favor regulation by the Federal Reserve Board over the state-based insurance regulatory system protected by the McCarran-Ferguson Act. On the contrary, while Dodd-Frank directs FSOC to consider "the extent to which" a *foreign* nonbank financial company "is subject to prudential standards on a consolidated basis," 12 U.S.C. § 5323(b)(2)(H), Congress did not include the same reference to "consolidated" supervision in authorizing the designation of U.S. nonbank financial companies. Instead, it referred to whether "the company is already regulated *by 1 or more* primary financial regulatory agencies." *Id.* § 5323(a)(2)(H) (emphasis added). That distinction reflects Congress's awareness and acceptance of multi-state regulation of U.S. nonbank financial companies such as insurers and must be presumed to be intentional. *See Russello v. United States*, 464 U.S. 16, 23 (1983). Moreover, FSOC's naked assertion that state regulation provides no consolidated supervision is contradicted by the evidence of coordination among state regulators through supervisory colleges and the testimony of state insurance regulators regarding their supervision of the MetLife holding company. *See, e.g.*, JA 2776-77; JA 2839, 2843-44. FSOC failed even to address that evidence. And it nowhere linked the absence of consolidated supervision to the assumption about the state system that was most central to its decision—namely, that intervention by state regulators would exacerbate rather than avert a supposed "run" on MetLife.

FSOC also maintains that the Final Designation focused not on "traditional life insurance" activities, but on MetLife's "capital market offerings" and certain other non-insurance activities. FSOC Opp. 1 & 16 n.11. But FSOC ignores the explanation of one of MetLife's primary regulators that "[t]he risks associated with non-traditional non-insurance activities that felled AIG . . . are decidedly diminished in the case of MetLife," whose "activities are more closely tethered to the business of insurance *qua* insurance." JA 2865. For instance, MetLife's derivatives program is overwhelmingly used for hedging purposes in furtherance of MetLife's "traditional life insurance" activities by protecting the investments that MetLife makes in order to satisfy policyholder liabilities. *See* NAIC *Amicus* Br. 6 (quoting JA 2865). Those activities are subject to state regulatory oversight, as is MetLife's securities lending program, which also serves to buttress MetLife's ability to meet policyholder obligations and is subject to state restrictions on size, concentration limits, and counterparty creditworthiness. In fact, no fewer than 97% of MetLife's activities, including all of the activities identified by FSOC, are conducted within MetLife's highly regulated insurance companies, and the aggregate amount of these activities is considerably smaller than the balance sheets of a number of hedge funds and securities firms that have not been considered for designation. JA 1644-48.

Despite all of these errors, FSOC attempts to salvage its consideration of existing regulatory scrutiny by claiming that it used its "expert judgment." FSOC Opp. 11. But in evaluating the efficacy of existing oversight of MetLife, the state insurance regulators were the true experts, not FSOC. The two FSOC members with the most extensive insurance expertise *dissented* from MetLife's designation, and both identified FSOC's overemphasis on size and its failure to consider existing regulatory scrutiny as serious deficiencies in FSOC's assessment. JA 641-42 (Woodall Dissent); JA 646-47 (Hamm Dissent). FSOC's failure to respond to these dissenting views—and its back-of-the-hand treatment of many of the statutory designation criteria—are by themselves sufficient reason to rescind MetLife's designation.

III. In Assessing The "Exposure" And "Asset Liquidation" Channels, FSOC Ignored Basic Principles Of Risk Analysis, The Statutory Language, Record Evidence, And Its Own Prior Statements, And Now Seeks To Defend Its Analysis With Impermissible Post Hoc Rationales.

In assuming without basis that MetLife would experience unprecedented financial distress, FSOC ignored elementary principles of risk analysis—an error it repeated when it purported to assess the effects of that distress on other parties through the "exposure" and "asset liquidation" transmission channels. FSOC's assessment of the transmission channels also defied its own prior statements in its Final Rule and Interpretive Guidance and its statutory obligations under Dodd-Frank. FSOC's attempt to defend this flawed reasoning through a medley of new arguments fails as a matter of law and underscores the degree to which FSOC improperly ignored MetLife's arguments in its Final Designation. *See SEC v. Chenery Corp*., 318 U.S. 80, 93-94 (1943) (an agency "must be measured by what [it] did, not by what it might have done").

A. FSOC Arbitrarily And Capriciously Rejected Settled Principles Of Risk Analysis.

In the Final Designation, FSOC offered no response to MetLife's repeated requests that it adhere to widely accepted principles of risk analysis by offering objective definitions of the scenarios FSOC intended to analyze, identifying relevant economic variables it intended to measure, evaluating those scenarios against real-world experience, and reaching concrete and definable outcomes. JA 1904-11; *see also* MetLife Br. 35-37. Now, FSOC asserts that applying accepted principles of risk analysis would "set 'an unduly high and falsely precise threshold'" for designation, FSOC Opp. 14 (quoting JA 369), and that there is no "universally accepted" methodology of risk analysis. *Id*. at 13. These rationales appear for the first time in FSOC's brief and thus cannot properly be considered. *See Chenery*, 318 U.S. at 94.

In any event, FSOC's position is directly contrary to the directive in Section 113(a)(1) that the level of harm necessary to justify designation amount to a "threat" to U.S. financial stability. Nor can it be reconciled with FSOC's own representations in its Final Rule and Interpretive Guidance that designation would turn on whether a company's material financial distress "would . . . [cause] an impairment of financial intermediation or of financial market functioning . . . sufficiently severe to inflict significant damage on the broader economy." 77 Fed. Reg. at 21,657. FSOC's refusal to be guided by historical experience and parties' rational economic interests was also squarely at odds with the practice of financial regulators, among others. *See* MetLife Br. 38.

Consideration of such traditional principles of risk analysis was mandated as well by the requirements of "reasoned decisionmaking." *Motor Vehicle Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 52 (1983). FSOC makes no attempt to explain how one can reasonably discern "threat[s] to [U.S.] financial stability," 12 U.S.C. § 5323(a)(1), without assessing the probability and magnitude of harm, *cf.* FSOC Opp. 13. Nor does it explain how it determined that its dire liquidation scenarios were "plausible," *id.* at 5, 32, without assessing how likely they were to occur. Instead, FSOC urges this Court to affirm an approach predicated on "assuming that everything that can go wrong will go wrong and, simultaneously, treating that worst-case scenario as the baseline for regulation," Fin. Reg. Academics *Amicus* Br. 3.

By failing to identify the scenarios it intended to test, manufacturing implausible scenarios that defied objective definition and real-world experience, and refusing to assess the severity or likelihood of the imagined events, FSOC acted arbitrarily and capriciously.

B. FSOC's Analyses Of The Exposure And Asset Liquidation Transmission Channels Are Thoroughly Flawed.

Having ignored accepted principles of risk analysis and assumed MetLife's material financial distress and the ineffectiveness of state regulation, FSOC's "transmission channels" analysis was flawed from the outset. FSOC's exposure analysis amounts to little more than 67 pages devoted to tallying counterparty "exposures" to MetLife, JA 417-83, with no attempt to estimate the potential *losses* that could result from those exposures. Likewise, FSOC's asset-liquidation analysis rests on the assumption that state regulators would fail to respond to—and, if they did respond, would actually exacerbate the effects of—a liquidity strain on MetLife, despite the total absence of historical support for this conclusion.

FSOC's overarching response—that 236 pages of the Final Designation, encompassing the entire transmission channels discussion, should be treated as "the Council's predictive judgments" deserving of deference (FSOC Opp. 8-9)—would eviscerate the "arbitrary and capricious" standard of review. As MetLife explained in its opening brief, even when an agency "cast[s] its analysis" as a predictive judgment, *BellSouth Telecomm., Inc. v. FCC*, 469 F.3d 1052, 1060 (D.C. Cir. 2006), deference to that predictive judgment "cannot overlook the absence of record evidence" sustaining it, *id.*, and is only appropriate where the judgment is "based on some logic and evidence, not sheer speculation," *Sorenson Commc'ns, Inc. v. FCC*, 755 F.3d 702, 708 (D.C. Cir. 2014) (citation omitted). FSOC has not cited a single case deferring to "technical expertise" when an agency repeatedly ignored historical evidence, industry-specific expertise, and relevant regulatory standards. Far from "seek[ing] to squeeze the Council's expertise and judgment out of the equation," FSOC Opp. 5, MetLife is simply demanding what the APA itself requires: reasoned, transparent analysis based on logic, evidence, and experience.

1. FSOC's Exposure Analysis Erroneously Concluded That Counterparty Exposures Threatened Systemic Effects Because FSOC Failed To Estimate Potential Losses And Ignored Key Evidence.

FSOC asserts that one of the bases for its designation of MetLife was its determination that "MetLife's inability to pay its obligations to investors and counterparties . . . could expose them to significant losses." FSOC Opp. 22; *id.* at 1 ("substantial losses"); *id.* at 8 ("significant losses"). That is not the analysis FSOC conducted, however. In fact, FSOC resolutely refused to estimate the losses associated with the "exposures" it identified, and therefore has no basis now to declare that those exposures threaten losses sufficiently "significant" to warrant designation.

The distinction between bare exposures and expected losses is critical. As FSOC itself has repeatedly recognized, an exposure is relevant to its analysis of a company's systemic importance if and when the exposure "is significant enough to materially impair those creditors, counterparties, investors, or other market participants and thereby pose a threat to U.S. financial stability." JA 417; 77 Fed. Reg. at 21,657. "Material[ ] impair[ment]" can only occur, however, when a company incurs actual *losses* as a result of its "exposure" to a financially distressed counterparty. FSOC nevertheless refused in the Final Designation to explain how its exposure calculations would translate into expected losses in the event that MetLife experienced material financial distress, FSOC Opp. 24; JA 476—a fatal omission that defied economic principles and the position that FSOC took in its own Final Rule and Interpretive Guidance. *See* 77 Fed. Reg. at 21,657 (adopting material impairment standard).

Instead, FSOC did no more than observe that various exposures "could" cause MetLife's counterparties losses that were not quantified or estimated in any way. For example, FSOC asserted that MetLife's financial distress "could expose . . . beneficiaries or guarantors to losses," JA 418, FABS holders "could sustain losses," JA 444, and FABN and FABCP holders "could suffer losses," JA 451. FSOC made no effort to determine how likely it was that those "losses" would occur, how large they would be, or what effect they would have. And its Opposition—only pages after insisting that FSOC found MetLife could cause "significant" and "substantial" losses—takes umbrage at MetLife's suggestion that FSOC was required to "replace the Council's estimates of *exposures*" with estimates of "likely counterparty *losses*," since "exposure estimates" are different in kind from "expected losses." FSOC Opp. 26.

FSOC's attempt to defend its omission by claiming that a focus on losses "would ignore the means by which distress of a large, interconnected financial institution could destabilize the U.S. economy," FSOC Opp. 22, is flawed in several respects. First, it is based on the erroneous assumption that consideration of these two factors—counterparty losses and potential systemic effects on the U.S. economy—is incompatible. In fact, an assessment of counterparty losses is *essential* to the analysis of potential systemic effects. Second, FSOC's destabilization hypothesis relies on speculation that third parties who do not do business with MetLife might be "uncertain" about the extent of MetLife's losses, causing them to "pull back from a range of firms and markets, in order to reduce [their own] exposures, thereby increasing the potential for destabilization." JA 426, 478; *see also* FSOC Opp. 24, 31 n.24. But this theory of exposure—in which a company is deemed a threat not because it is one, but because some other "uncertain," uninformed company worries it might be—turns reasoned decisionmaking on its head by basing designation on fear and conjecture rather than on principled analysis of potential distress and its effects. Finally, FSOC cites no evidence to demonstrate that "uncertainty" about a company that is *not* causing its counterparties significant losses could nonetheless imperil the entire U.S. financial system. Allowing this kind of speculation to support a designation would render meaningless the ten factors set forth in the Dodd-Frank Act as designation criteria.

In proceedings before FSOC, MetLife identified specific benchmarks for assessing whether its counterparties' "losses" would be "significant," but FSOC rejected those metrics in favor of content-free *ipse dixit*. Although FSOC now attempts to explain away this evidence, its explanations do not appear in the Final Designation and thus cannot be invoked to defend that decision. *See Chenery*, 318 U.S. at 94. FSOC's arguments also fail on their own terms.

"Stress tests." FSOC contends that the Federal Reserve Board's Comprehensive Capital Analysis and Review ("CCAR") stress tests were irrelevant to assessing the significance of putative losses by Global Systemically Important Banks ("G-SIBs") "because the standard for designations under Section 113 is different than that for a stress test, which asks *whether a particular firm is strong enough to withstand market disruptions*." FSOC Opp. 24-25 (emphasis added). But since FSOC's exposure analysis is concerned with whether an exposure is "significant enough to materially impair" a counterparty, JA 417, a regulatory test of firms' ability to withstand losses (and still provide a meaningful return on capital) during severe market disruptions is plainly "an important aspect of the problem" that FSOC was required to consider. *State Farm*, 463 U.S. at 43. Moreover, FSOC's exposure analysis emphasized that MetLife's counterparties include a number of G-SIBs, *see* JA 425-26, making it particularly relevant for FSOC to consider a test used by one of its member agencies to appraise the effect of potential losses on G-SIBs.

Fines. For the same reason, the fines and penalties imposed on G-SIBs were relevant to those banks' ability to absorb the smaller potential losses attributable to MetLife. FSOC's arguments for discounting this evidence are no excuse for failing even to consider it, FSOC Opp. 25 n.19, and the rationalizations in its brief are, once again, barred by *Chenery*, 318 U.S. at 94.

Money market funds. FSOC also failed to explain how "65 MMFs could 'break the buck' if MetLife were to default on its funding agreement-backed securities," FSOC Opp. 27, given the recent SEC reforms that are designed to control MMF outflows, *see* Money Market Fund Reform (Final Rule), 79 Fed. Reg. 47,736, 47,749 (Aug. 14, 2014), and that categorically eliminate the possibility that institutional MMFs will ever "break the buck" in the future. *See* MetLife Br. 48-49. Nothing in the record before FSOC gave it grounds to second-guess the SEC's conclusions regarding the efficacy of those reforms. And for FSOC to have "found" (FSOC Opp. 27) that, despite these reforms, MetLife could cause 65 instances of a failure that had only occurred twice in U.S. financial history is a stunning example of the absurd hypotheses FSOC indulges throughout its Final Designation. As for FSOC's argument that it could disregard the SEC's reforms because they do not require full implementation until 2016, *see id.*, that explanation also appears nowhere in the Final Designation and is barred by *Chenery*. It also fails to account for the fact that MetLife's designation extends beyond 2016.

Collateral. As MetLife explained in its Opening Brief and FSOC does not dispute, collateral is a fundamental risk mitigant, and federal standards give specific weight to collateral in analogous contexts. MetLife Br. 44 n.20. FSOC nonetheless ignored collateral when tallying "exposures."[3] When MetLife objected to that omission, FSOC replied that if MetLife counterparties *did* rely on collateral, those assets might flood the markets and pose systemic risk through the "asset liquidation" channel. *See* JA 475; FSOC Opp. 27. By this sleight of hand, a financial protection as basic as collateral was rendered meaningless in FSOC's analysis. Worse—and just like state regulatory intervention—a risk mitigant was converted into a risk

[3] For example, FSOC states that the exposure arising from MetLife's securities lending business is $30.1 billion. JA 441 tbl. 8. Record evidence demonstrated, however, that if MetLife were to default, its counterparties would retain $29.6 billion—or 98% of the exposure amount—in securities borrowed. *See* JA 1693

generator, through unsubstantiated, unquantified *ipse dixit*.[4]

Ultimately, FSOC falls back on its standard refrain that its assessment of MetLife's exposures was based on the agency's expertise and predictive judgments, and therefore warrants deference. FSOC Opp. 5-9; *see also id.* at 2, 11, 14, 15, 33, 35, 46. But merely incanting the term "expertise" does not render agency action unimpeachable. *See Adirondack Med. Ctr. v. Sebelius*, 935 F. Supp. 2d 121, 134 (D.D.C. 2013) (Collyer, J.) ("intent as [the agency head] is on arguing about . . . how courts must defer to her expertise," she nevertheless failed to "provide[ ]" any "affirmative case or rationale" for why her approach "complies with" the statute). It took no particular expertise to reject longstanding principles of risk analysis applied by FSOC's member agencies, inflate counterparty exposures, and then rely on ad hoc, doomsday conjecture divorced from evidentiary support, historical experience, and economic reality.

2. FSOC Erred In Assessing MetLife Under The Asset Liquidation Transmission Channel.

FSOC's asset-liquidation analysis fares no better. The agency's conclusion that MetLife's material financial distress could result in a liquidation of assets sufficient to destabilize markets is based entirely on faulty and ahistorical assumptions about the likely sources of liquidity strain on MetLife and the efficacy of state regulators in responding to that strain. *See supra* Part II.C.

FSOC's asset-liquidation analysis turns in large part on the unsubstantiated theory that policyholder surrenders could cause a fire sale of assets to satisfy MetLife's liabilities—a theory

[4] FSOC's treatment of collateral gives the lie to its attempt to avoid meaningful judicial review by contending that its exposure and asset liquidation analyses are wholly independent and that a shortcoming in one analysis therefore cannot undermine the other. *See* FSOC Opp. 10 n.7. In fact, as this approach to collateral reflects, FSOC treated the exposure and asset liquidation analyses as intertwined. *See id*. at 27 (reiterating argument at JA 475).

that required FSOC to assume not only that MetLife's policyholders would act against their self-interest by engaging in a mass surrender of their policies and that state regulators would be ineffective in responding to such a "run," but also that, if state regulators did impose a stay on withdrawals, their intervention would make matters worse by stoking a "crisis of confidence" at other insurers and throughout the economy. *See* JA 432-33, 480, 486-87; *see also* JA 478. The record overwhelmingly demonstrated the opposite—that state-imposed stays, which have been utilized in multiple situations, would shield MetLife from FSOC's theoretical fire sale without fomenting economy-wide panic. MetLife Br. 50. Moreover, FSOC never explained how lost "confidence" among insureds would actually destabilize the U.S. economy, or why—as Member Hamm proposed in dissent, JA 647-48 (Hamm Dissent)—state regulators could not impose stays at other insurers, too, if such an implausible scenario came to pass. FSOC's novel theory of financial catastrophe required explanation, substantiation, and a direct response to Member Hamm. FSOC provided none of this.

In its brief, FSOC insists that its asset-liquidation analysis is based on "historical evidence regarding policyholder contagion in the insurance industry." FSOC Opp. 18; *see also id.* at 31. The Final Designation's *only* historical precedent for this supposed "contagion" effect, however, is a single sentence in an Assistant Comptroller General's testimony to Congress—asserting that the 1991 takeover of Executive Life Insurance Company and Executive Life Insurance Company of New York "spurred policyholder runs on junk bond laden First Capital and Fidelity Bankers," which is only mentioned in a footnote in the Final Designation. JA 481 n.672. In addition, FSOC fails to acknowledge that a central conclusion of this 24-year-old testimony was that the insurers failed simultaneously because of a common cause, *i.e.*, "reckless practices of poorly controlled growth and risky high-yield investments"—*not*, as FSOC implies, as a result of another insurer's failure, much less contagion resulting from regulatory intervention. JA 1703. Because it confused correlation with causation, FSOC's reasoning was arbitrary and capricious. *See, e.g.*, *Tex Tin Corp. v. EPA*, 992 F.2d 353, 356 (D.C. Cir. 1993). The Final Designation offered no response to this aspect of the testimony or to evidence provided by MetLife confirming that First Capital's surrenders increased due to causes wholly unrelated to the regulatory takeover of Executive Life. JA 1702-03.

This sole historical example is also inapposite because in the intervening 24 years, many new state regulatory tools have been implemented to prevent or address an insurer's financial distress, including risk-based capital and investment diversification requirements. *See* JA 1703-04 & nn.217-18, 1891, 1893, 1915; JA 2767; *cf.* JA 2775. FSOC could only continue to rely on the quoted sentence to support its theory of state regulatory incompetence by assuming away more than two decades of regulatory improvements. In fact, the record is replete with submissions from MetLife's state regulators confirming the efficacy of existing state regulatory tools to manage policyholder surrenders and alleviate liquidity strain. *See, e.g.*, JA 2767; JA 2682-83; JA 2806-19; JA 2827; JA 2866. All of this evidence was ignored by FSOC, despite its express obligation to consider how MetLife "*is* . . . regulated," 12 U.S.C. § 5323(a)(2)(H) (emphasis added), rather than how the industry was regulated a quarter century ago.

In the face of these evidentiary shortcomings, FSOC now attempts to de-emphasize its reliance in the Final Designation on policyholder surrenders as the primary trigger for MetLife's asset sales by pointing to other "sources of potential liquidity strains at MetLife." FSOC Opp. 28. The Final Designation makes clear, however, that policyholder surrenders—and the effects of a stay imposed in response to those surrenders—were the linchpin of FSOC's asset-liquidation analysis. *See* JA 357-61, 484-87. Moreover, the record demonstrated that [redacted] of MetLife's surrenderable liabilities are owed to retail policyholders, rather than institutional investors, JA 1035[redacted], JA 1075-77, and MetLife has the contractual right to defer payouts for many of its products, JA 487. FSOC dismissed this evidence outright, asserting that invoking MetLife's deferral option "could send" a "negative signal . . . to counterparties, policyholders, and investors" and thus transmit contagion. *Id.* But FSOC's claim that its "detailed findings" on this point are "amply supported by the record, including historical evidence and relevant research literature," is belied by the very material it cites. FSOC Opp. 31 (citing JA 481 nn.672 & 673 and Insurance Scholars *amicus* brief). The *amicus* brief on which FSOC relies is outside the administrative record and therefore irrelevant, and the footnotes cited from deep within the Final Designation refer to the same testimony of the Assistant Comptroller General and the 1991 failure of Executive Life, which are inapposite for the reasons detailed above. In any event, even accepting FSOC's contention that it relied on "several other sources of potential liquidity strains . . . independent of policyholder surrenders," FSOC Opp. 28, FSOC never stated that they were an independent basis for designation, meaning that the flaws in the agency's analysis of policyholder surrenders are sufficient to require rescission. *See Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 839 (D.C. Cir. 2006); *see also* 12 U.S.C. § 5323(h).

FSOC's asset-liquidation discussion also failed to provide any cogent defense of its dismissal of Oliver Wyman's liquidity analysis, which sought to test whether liquidation of large blocks of MetLife's assets would trigger a "fire sale." MetLife Br. 15, 51-53. FSOC suggests that Oliver Wyman's assumptions were insufficiently conservative, FSOC Opp. 30-31, but it is *FSOC*'s failure to define distress scenarios, including relevant economic variables, that forced

Oliver Wyman to generate its own scenarios in the first place. *See supra* Part III.A. In addition, FSOC made at least two fatal errors that undermine this aspect of its asset-liquidation analysis.

First, FSOC relied for the first time on a Monte Carlo simulation, which—despite being "a standard technique for determining average values across a range of potential scenarios," FSOC Opp. 34—FSOC misused by *randomizing* a series of decisions that would invariably fall within the control of MetLife's management. Specifically, FSOC unreasonably assumed that MetLife would sell securities *in random order* despite fiduciary duties requiring the company to liquidate assets in a manner that minimizes losses and despite the D.C. Circuit's admonition that it is arbitrary and capricious for an agency to assume action contrary to board members' fiduciary duties. *See Bus. Roundtable v. SEC*, 647 F.3d 1144, 1150 (D.C. Cir. 2011). FSOC's suggestion that it should be commended because its Monte Carlo simulation involved the creation of "500 randomized" scenarios is particularly audacious. FSOC Opp. 35. Not only did FSOC never describe or provide these 500 scenarios to MetLife, but it is the very fact that the scenarios were "randomized" that prevents them from properly capturing how corporate fiduciaries would address a crisis and therefore renders the Monte Carlo simulation utterly meaningless in predicting the market impact, if any, of hypothetical asset sales.

Second, FSOC's contention that it was free to ignore Oliver Wyman's Scenario 4 demonstrates a clear misunderstanding of that scenario. Oliver Wyman established that, even under the extraordinarily adverse conditions of Scenario 4, MetLife would satisfy all liquidity demands arising from the surrender of all surrenderable insurance policies and other surrenderable liabilities, as well as its financial and operating debt, *without* causing price impacts that would significantly disrupt financial markets. MetLife Br. 52-53; JA 1101-06, 1735, 1756, 1791, 2303-04. The extreme nature of these assumptions was precisely the point: to show the absence of a threat to financial stability even under circumstances so adverse as to be wholly implausible. While FSOC continues to assert, incorrectly, that Scenario 3 "underestimated the negative effects of MetLife's asset sales," FSOC Opp. 32, the Final Designation contains no explanation for FSOC's refusal to consider the even-more-dire Scenario 4, which resulted in significantly more severe negative effects. FSOC thus completely misses the point when it touts the fact that the Final Designation "made clear that it did not rely on" Scenario 4. *Id*. at 32 n.25. That is precisely the problem. Because the Oliver Wyman analysis showed no significant disruption even under the extreme conditions of Scenario 4, reasoned decisionmaking required FSOC to explain either why that analysis was flawed or how conditions of financial distress at MetLife even more severe than those in Scenario 4 could plausibly occur. *Cf. State Farm*, 463 U.S. at 42-43. FSOC failed to take either of those steps.

* * *

FSOC claims that it was called to make difficult predictions based on technical criteria and expert judgment, and that it now deserves deference. What is remarkable, though, is the persistence with which FSOC rejected materials that would have made its action better informed, more expert, and less speculative. FSOC had previously specified how it would conduct designation inquiries—and then it disregarded that guidance. There are well-established principles to guide risk analysis—FSOC ignored them. Federal regulators have no meaningful experience with insurance, so Congress placed insurance experts on FSOC—the FSOC majority spurned their counsel. There are developed federal guidelines on banks' capacity to withstand losses—FSOC deemed them irrelevant. The SEC adopted extensive money market fund reforms—FSOC assumed that a single company could cause a crisis 30-fold worse than occurred before the reforms. In prior designations, FSOC had postulated that an insurer's failure could cause "contagion," so MetLife commissioned a study showing that had never occurred. FSOC cast it aside, preferring its own conjecture. MetLife also commissioned a study showing that, under wholly implausible scenarios, its failure would not cause significant market disruption. FSOC—the "expert" agency—conducted no study, but merely asserted that things could always be worse. And when MetLife and state regulators said they were legally obligated to stop the kind of financial hemorrhaging that FSOC forecast, FSOC disregarded those representations and assumed without basis that tried and true protective measures would be a likely cause of crisis in insurance markets as to which, to repeat, it has no expertise.

Having resisted technical criteria and expert judgment at every turn, FSOC cannot now be heard to demand deference to its expertise.

IV. FSOC Made Additional Errors That Require Rescission.

A. FSOC Failed To Consider Reasonable Alternatives To Designation.

MetLife asked FSOC to consider an activities-based approach to managing systemic risk of insurance companies before deciding to designate MetLife. JA 2513-16. MetLife never contended that FSOC was required to *adopt* an activities-based approach, *see* FSOC Opp. 48-49, but FSOC was unquestionably obligated to *consider* that approach and other reasonable alternatives to designation and to provide a reasoned explanation for rejecting them, *see* MetLife Br. 57-58. FSOC utterly failed in this regard. FSOC's discussion of the activities-based approach in the Final Designation speaks for itself: FSOC's only explanation for failing to consider that approach was that Dodd-Frank does not *require* it. *See* JA 372-73. FSOC's effort to supplement that response with new rationales in its brief is both procedurally improper, *see*

Chenery, 318 U.S. at 94, and substantively flawed.[5]

FSOC's contention that it was excused from considering the activities-based approach because it was acting incrementally is misplaced. *See* FSOC Opp. 49-50. Even where an agency acts incrementally, it is required to consider reasonable alternatives and explain its grounds for rejecting them. *Cf. Neighborhood TV Co. v. FCC*, 742 F.2d 629, 639 (D.C. Cir. 1984). Nor does the activities-based approach fall outside the ambit of Section 113. *See* FSOC Opp. 51 n.42. Section 113(a)(1) provides that "[t]he Council . . . *may* determine" that a company should be supervised by the Board—it does not prescribe a *mandatory* binary decision between designation of the company or forbearance from all regulation. 12 U.S.C. § 5323(a)(1) (emphasis added); *see also* FSOC Opp. 49. Indeed, FSOC acknowledges that Dodd-Frank "does not constrain the Council to address a given risk in only one way," FSOC Opp. 49, which is precisely the point. Dodd-Frank authorizes FSOC to employ a variety of regulatory tools to address systemic risk, and when choosing among those tools, FSOC must provide a cogent explanation for rejecting reasonable alternative approaches. *See Int'l Ladies' Garment Workers' Union v. Donovan*, 722 F.2d 795, 817 (D.C. Cir. 1983); MetLife Br. 58-59. Because the activities-based approach "was neither frivolous nor out of bounds"—and, in fact, is explicitly being evaluated by FSOC for other financial services companies—FSOC "had an obligation to consider it" as an alternative to designation of MetLife. *Chamber of Commerce v. SEC*, 412 F.3d 133, 145 (D.C. Cir. 2005).

B. FSOC Arbitrarily And Capriciously Refused To Consider The Effects Of Designation On MetLife And Its Shareholders And Customers.

FSOC takes the extraordinary position that it—alone among federal agencies—can ignore

[5] In particular, the fact that FSOC may have taken other actions documented in its annual reports "to address certain market-wide risks in the insurance industry," FSOC Opp. 50, is a post hoc litigation position that does not satisfy FSOC's obligation to provide reasoned explanation for rejecting the activities-based approach at the time it designated MetLife.

the effect of its decision on the sole company that is the object of its action. According to FSOC, this is because Section 113 of Dodd-Frank is "silent as to costs." FSOC Opp. 45. But when read "fairly and in context"—as FSOC acknowledges must be done, *id.* at 46—Dodd-Frank plainly requires consideration of the effects of designation on the company being designated.

When Congress established FSOC's designation authority, it sought to address systemic risk by preventing a designated entity's insolvency and averting the resulting financial instability in U.S. markets. *See* 12 U.S.C. § 5323. If designation imposes costs and burdens that weaken the designated company—and make the company's financial distress *more* likely—that is undeniably a "risk-related facto[r]" that is relevant to FSOC's inquiry under Section 113(a)(2)(K). *Id.* § 5323(a)(2)(K). Consideration of the effects of designation on the designated company is also a necessary component of the vulnerability assessment required under the Dodd-Frank Act and FSOC's interpretive guidance. *See supra* Part II.A. A thorough assessment of a company's vulnerability must account for any consequences of designation that could exacerbate that vulnerability. FSOC's refusal to consider the effects of designation on MetLife is therefore at odds with the plain language of Dodd-Frank and FSOC's own interpretive guidance, and "frustrate[s] the policy that Congress sought to implement" when it enacted the statute. *Wash. Hosp. Ctr. v. Bowen*, 795 F.2d 139, 149 (D.C. Cir. 1986) (citation omitted).

Michigan v. EPA, 135 S. Ct. 2699 (2015), underscores FSOC's obligation to consider the effects of designation on MetLife. "[R]easonable regulation ordinarily requires paying attention to the advantages *and* the disadvantages of agency decisions," the Supreme Court explained, and accordingly "[a]gencies have long treated cost as a centrally relevant factor when deciding whether to regulate." *Id.* at 2707. Applying those settled principles, the Court construed the term "appropriate" in a provision of the Clean Air Act to require consideration of the costs of regulation. *Id.* Similarly here, nothing in Dodd-Frank freed FSOC from the requirement of "reasonable regulation" to consider "the advantages *and the disadvantages*" of its action. *Id.* (emphasis added). Because FSOC concedes that—like the EPA—it "*could* have interpreted" Dodd-Frank to require considering costs, it was arbitrary and capricious for it to read the reference to "appropriate" risk-related factors in Section 113(a)(2)(K) as "an invitation to ignore cost." *Id.* at 2706, 2708. And, here, as in *Michigan*, "[s]tatutory context reinforces the relevance of cost," *id.* at 2708, because the adverse effects of designation on a company could result in designation actually undermining the stability that Congress sought to promote.

While FSOC downplays the consequences of designation by emphasizing that the Board has not yet established prudential standards for insurers, FSOC Opp. 47, designation in fact had immediate, far-reaching consequences for MetLife. Those burdens include preparing resolution and recovery plans, 12 U.S.C. § 5365(d)(1), obtaining Federal Reserve Board approval for certain large acquisition transactions, *id.* § 5363(b)(1), paying assessments to fund the Board's supervision and regulation, *see id.* § 5345; *see also id.* § 248(s), and regular examinations by Board examiners (who even now occupy MetLife office space), *id.* § 5361(b). These are direct consequences of designation itself and are independent of the costs associated with the imposition of capital standards. Accordingly, the fact that Congress has clarified that the Board possesses discretion not to impose bank-centric capital standards on designated insurers—but instead to develop standards tailored to the insurance setting—does not eliminate the obligation to consider the burdensome effects of designation on MetLife and is irrelevant in any event under *Chenery* because FSOC did not consider that legislation in the Final Designation. *See* FSOC Opp. 48.

V. FSOC's Structure And Procedures Violate Due Process And The Separation Of Powers.

A. The Final Designation Violated Due Process Because FSOC Denied MetLife Access To The Record And Introduced New Evidence And Analysis.

FSOC does not dispute that it failed to provide MetLife with access to the administrative record before its designation decision, that it continues to deny MetLife access to nearly a thousand pages of record material, and that it introduced new arguments and analysis in the Final Designation. Instead, FSOC offers assorted arguments intended to shield itself from this Court's scrutiny and the requirements of due process. Each of FSOC's contentions is meritless.

First, FSOC asserts that designation "imposes no penalty" and thus that "MetLife has no liberty or property interest in never being designated." FSOC Opp. 69. This extraordinary argument—which would mean that FSOC could designate companies free from any of the constraints of due process—fails because designation has numerous immediate regulatory consequences for a company. *See supra* Part IV. Designation also triggers the future imposition of prudential standards that could impose considerable additional costs. *See* MetLife Br. 61. [redacted], *see* JA 2390-92. Because FSOC's designation of MetLife imposes substantial costs and regulatory burdens on MetLife—and thereby is impairing its property interests, *see Reeve Aleutian Airways, Inc. v. United States*, 982 F.2d 594, 598 (D.C. Cir. 1993)—the designation must comport with the due process requirements that apply whenever the government impairs constitutionally protected rights. *See Matthews v. Eldridge*, 424 U.S. 319, 333 (1976).

Second, FSOC contends that MetLife was not "entitled to the complete administrative record before the Council issued its final decision." FSOC Opp. 69. The case law is plainly to the contrary. *See, e.g.*, *Walter O. Boswell Mem'l Hosp.v. Heckler*, 749 F.2d 788, 792 (D.C. Cir.

1984). In fact, FSOC has no answer to *National Council of Resistance of Iran v. Department of State*, 251 F.3d 192 (D.C. Cir. 2001) ("*NCRI*")—which held in an analogous two-step designation process that due process requires access to the record "as soon as the [agency] has reached a tentative determination that the designation is impending," *id.* at 209—except to contend that the consequences of designation as a Foreign Terrorist Organization are more severe than the consequences of SIFI designation. FSOC Opp. 70. But the Court's holding did not turn on the relative severity of the sanction; it turned on a "fundamental norm of due process" applicable whenever the government seeks to "deprive a person of [a] protected liberty or property interest." *NCRI*, 251 F.3d at 205; *see also Ralls Corp. v. Comm. on Foreign Inv. in U.S.*, 758 F.3d 296, 318-19 (D.C. Cir. 2014) (due process was violated where an agency failed to provide access to record evidence prior to prohibiting a proposed commercial transaction).[6]

Third, FSOC contends that "an administrative record need not include confidential information." FSOC Opp. 70. But that does not alter the fact that FSOC had an obligation to disclose all non-confidential portions of the record to MetLife in advance of its designation, which FSOC failed to do despite repeated requests from MetLife. In any event, FSOC fails to acknowledge that, by its own admission, the withheld materials that are the subject of MetLife's pending motion to compel—whether confidential or not—are in fact part of the administrative record. *See* ECF No. 17-1 ¶ 3 (Pinschmidt Decl.).[7]

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[6] *Kadi v. Geithner*, 42 F. Supp. 3d 1, 29 (D.D.C. 2012), is inapposite because the plaintiff there sought access to classified material. *See* FSOC Opp. 69.

[7] Because due process required FSOC to afford MetLife access to the full record *before* it was designated, granting MetLife's motion to compel and requiring the disclosure of the withheld materials at this juncture would not moot MetLife's due process claim. FSOC Opp. 71. With respect to that pending motion, FSOC suggests that the existing protective order is insufficient to safeguard the confidentiality of the state regulators' withheld documents because MetLife has refused to "abandon its plan to modify the protective order to permit certain MetLife employees

These due process shortcomings were exacerbated by FSOC's reliance on new material in the Final Designation, which denied MetLife a meaningful opportunity to respond to FSOC's reasoning, including the Monte Carlo simulation on which it places so much weight. FSOC's reliance on the "logical outgrowth" doctrine is misplaced. FSOC Opp. 72. Even if that doctrine—which has been applied only to rulemakings—were applicable here, it "focuses on whether interested parties reasonably could have anticipated the final rulemaking from the draft rule." *Anne Arundel Cnty. v. EPA*, 963 F.2d 412, 413, 418 (D.C. Cir. 1992). MetLife had no basis for anticipating FSOC's Monte Carlo analysis and thus no opportunity to explain why that analysis was improper, particularly in the context of managers' fiduciary duties. MetLife Br. 66.

Finally, FSOC's designation of MetLife was based on vaguely defined and endlessly shifting standards that departed from the requirements of the Dodd-Frank Act and FSOC's own interpretive guidance. As a result, MetLife was denied any opportunity to tailor its submissions in a manner responsive to FSOC's concerns and to take steps that could have potentially avoided designation. FSOC's insistence that any ambiguity in the statutory procedures was "clarified" by FSOC's interpretive guidance is belied by the numerous respects in which FSOC failed to adhere to that guidance in designating MetLife, an error it compounded by refusing to let MetLife see the precedents in which FSOC had designated other nonbank financial institutions. In all of these respects, FSOC violated MetLife's due process rights.

B. FSOC's Structure Violates The Separation Of Powers And Led To A Designation That Denied MetLife Its Due Process Rights.

FSOC's unprecedented structure—which lodges investigative, prosecutorial, and

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to view the withheld documents." *Id.* at 71 n.60. But MetLife's motion to compel should be decided based on the sufficiency of the protective order as it now stands. To the extent that MetLife seeks to expand the protective order in the future, that can only be accomplished with court approval, which will ensure a full airing of FSOC's position.

adjudicative functions in the same individuals—is incompatible with the constitutional separation of powers and denied MetLife its due process rights because subjecting a party to proceedings before an unconstitutionally structured agency is necessarily a denial of due process. MetLife has consistently staked out these interrelated separation of powers and due process arguments. *See* MetLife Br. 68 (discussing *Stevenson v. Willis*, 579 F. Supp. 2d 913 (N.D. Ohio 2008), a due process case, and explaining that "[it] is precisely what happened here").[8]

FSOC faults MetLife for "point[ing] to no case . . . holding that a 'blending' of functions contravenes the separation of powers." FSOC Opp. 66. As the Sixth Circuit has explained, however, a "decisionmaker . . . engaged in both adjudicative and executive functions [is] *in violation of the principle of separation of powers*." *Hammond v. Baldwin*, 866 F.2d 172, 177 (6th Cir. 1989) (emphasis added); *see also Stevenson*, 579 F. Supp. 2d at 920. Likewise, in *Sheldon v. SEC*, 45 F.3d 1515 (11th Cir. 1995), the Eleventh Circuit considered a separation of powers claim that the SEC was improperly performing the functions of both enforcement and adjudication, and cited its prior recognition that "[a]n agency may combine investigative, adversarial, and adjudicative functions, *as long as no employees serve in dual roles*." *Id.* at 1519 (quoting *Elliot v. SEC*, 36 F.3d 86, 87 (11th Cir. 1994) (per curiam) (emphasis added)). Although the Eleventh Circuit denied the plaintiff's claim because "SEC employees gathered and presented the evidence, while the ALJ, *an independent adjudicator*, heard that evidence," *id.* (emphasis added), here, there was no independent adjudicator, and FSOC does not dispute that investigative, prosecutorial, and adjudicative functions were performed *by the same individuals*.

[8] While MetLife did consistently challenge FSOC's structure on separation of powers and due process grounds, it did not raise a claim under the APA, which is the principal focus of FSOC's response. *See* FSOC Opp. 66. MetLife cited Section 554(d) of the APA simply to illustrate Congress's concern that the same individuals in an agency not serve in the roles of both investigator and prosecutor. *See* MetLife Br. 68 n.25.

That there are no precedents squarely on point simply underscores the *sui generis*—and constitutionally unacceptable—nature of FSOC's structure. *See Honda Motor Co. v. Oberg*, 512 U.S. 415, 430 (1994) ("traditional practice provides a touchstone for constitutional analysis").[9]

C. Injunctive Relief Is Appropriate To Remedy FSOC's Separation Of Powers And Due Process Violations.

This Court should enjoin FSOC from initiating further designation proceedings because its structure violates the separation of powers and subjecting MetLife to further proceedings before that unconstitutionally constituted agency would be a denial of due process.

All of the requirements for injunctive relief are met here. *First*, the D.C. Circuit has repeatedly recognized that "a prospective violation of a constitutional right constitutes irreparable injury." *Gordon v. Holder*, 721 F.3d 638, 653 (D.C. Cir. 2013). *Second*, declaratory relief would be insufficient to remedy FSOC's separation of powers violation because the violation inheres in the structure of FSOC itself. *See Armstrong v. Exec. Office of the President, Office of Admin.*, 1 F.3d 1274, 1289 (D.C. Cir. 1993) (per curiam). *Third*, the balance of harms and the public interest weigh in favor of enjoining FSOC from initiating further designation proceedings because it would have no "adverse impact on third parties" and would serve the public interest by promoting "a system of laws free of unconstitutional" governmental action. *O'Donnell Constr. Co. v. District of Columbia*, 963 F.2d 420, 429 (D.C. Cir. 1992).

CONCLUSION

The Court should grant MetLife's Cross-Motion for Summary Judgment.

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[9] *City of Arlington v. FCC*, 133 S. Ct. 1863 (2014), is not to the contrary, *see* FSOC Opp. 65-66, because the only issue there was the deference owed to an agency when determining the scope of its own jurisdiction. *City of Arlington*, 133 S. Ct. at 1866.

Respectfully submitted,

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/s/ Eugene Scalia
Eugene Scalia (D.C. Bar No. 447524)
Counsel of Record
EScalia@gibsondunn.com
Amir C. Tayrani (D.C. Bar No. 490994)
Ashley S. Boizelle (D.C. Bar No. 1010322)
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036
Telephone: (202) 955-8500
Facsimile: (202) 467-0539

Indraneel Sur (D.C. Bar No. 978017)
GIBSON, DUNN & CRUTCHER LLP
200 Park Avenue
New York, NY 10166-0193
Telephone: (212) 351-4000
Facsimile: (212) 351-4035

Attorneys for Plaintiff MetLife, Inc.

CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of September, 2015, I caused the foregoing Final Redacted Reply in Support of MetLife's Cross-Motion for Summary Judgment to be filed with the Clerk of the Court for the United States District Court for the District of Columbia via the Court's CM/ECF system. I further certify that service was accomplished on all parties via the Court's CM/ECF system.

/s/ Eugene Scalia
Eugene Scalia