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A MetLife Victory Won't Solve FSOC's Biggest Problems

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By Paul Schott Stevens

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On June 16, the Financial Stability Oversight Council is due to file arguments on why the federal courts should uphold the council's designation of MetLife as a "systemically important financial institution." The FSOC is appealing a lower court's decision that overturned the MetLife designation, in a severe rebuke to the council of regulators created under the Dodd-Frank Act.

While that battle rages in the courts, it's vital that we do not lose sight of the need to reform FSOC. Even if the initial decision against FSOC is upheld, there remains a compelling case to pursue legislation like the bipartisan Financial Stability Oversight Council Improvement Act, sponsored by Reps. Dennis A. Ross, R-Fla., John Delaney, D-Md., and 58 other Republicans and Democrats.

The ruling by Judge Rosemary M. Collyer of the U.S. District Court for the District of Columbia is welcome. But it does not guarantee any procedural protections for the next company that the council targets for SIFI designation. That is because FSOC could still move a financial institution toward SIFI designation without first having to spell out for the company what the risks are, or giving the company any chance to restructure or address those risks itself.

Nor would the council be required to give the company's primary regulator a chance to address those risks before FSOC designates the company as a SIFI and turns it over to the Federal Reserve for extra regulation. Instead, the next designee would have to retrace MetLife's steps to the courthouse to get due process.

The FSOC Improvement Act would provide the missing safeguards. But its impact would go beyond mere process: The bill's reforms would actually make FSOC more effective in reducing systemic risk.

Under the bill, the oversight council would be required to spell out clearly the risks that a prospective SIFI poses. That common-sense step is missing now, but isn't understanding a risk the first step toward mitigating it?

The legislation would also give the company's primary regulator a chance to address any identified risks before FSOC designates. Fixing specific risks is more effective than wrapping a company in costly red tape. The bill would also give the company itself the chance to restructure or change its practices to reduce FSOC-identified systemic risks. If the goal is to reduce risk in the system, companies should be given a chance to do so before they're designated — not after, as has been the case with some SIFIs.

Collyer's ruling put the council on notice that it needs to raise its game. But is there any evidence that a chastened council might heed that warning and reform itself? Unfortunately, the signs are not encouraging.

Instead, FSOC officials and their supporters are digging in, warning that any change to the Dodd-Frank framework — whether from the courts or from Capitol Hill — will undermine financial stability. Treasury Secretary Jacob J. Lew said that the court's decision "overturn[ed] the conclusions of experienced financial regulators … imposed new requirements that Congress never enacted, and contradicted key policy lessons from the financial crisis."

One wonders whether Secretary Lew actually read Judge Collyer's opinion. The decision didn't bar FSOC from designating SIFIs — in fact, the court rejected claims that FSOC lacked authority to designate the insurer. But the council has to follow its own rules — and Judge Collyer found it failed to do so with MetLife.

The judge's opinion notes that the council's explanation of MetLife's designation "hardly adhered to any standard when it came to assessing MetLife's threat to U.S. financial stability. … This Court cannot affirm a finding that MetLife's distress would cause severe impairment … when FSOC refused to undertake that analysis itself." Lacking the necessary analysis to show that MetLife met the standards the council itself established, the council rendered its designation "arbitrary and capricious."

The judge also found that FSOC ignored the potential consequences of its actions. The council "intentionally refused to consider the cost of regulation, a consideration that is essential to reasoned rulemaking," the opinion states. Applying the U.S. Supreme Court's 2015 decision in Michigan v. Environmental Protection Agency, Collyer dismissed the council's claim that Dodd-Frank exempted designation decisions from cost-benefit analysis.

Collyer's decision is firmly rooted in well-established principles of administrative law. The judge noted that FSOC's determination to designate MetLife was so flawed that she didn't need to address MetLife's other powerful arguments against the council — including constitutional concerns.

I believe MetLife should prevail against the council's appeal. But we shouldn't wait to reform the council through legislation. The courts could address a few of the many flaws in the council's SIFI process, but there's still a need for the bipartisan FSOC Improvement Act. It's the better route to the ultimate goal: a sounder and more stable financial system with more accountable regulation.

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