NOTE

Holding the Line or Changing Tides? The Future of "Too Big to Fail" Regulation

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More than ten years have passed since the 2008 financial crisis. In the years immediately following the crisis, systemically important financial institutions—known colloquially as too-big-to-fail firms—became a prominent subject in discussions about the underlying causes of the crisis. Indeed, the 2008 financial crisis drew into clear focus the unprecedented complexity and interconnectedness of the modern U.S. financial system. The 2008 financial crisis brought with it a new and unfamiliar type of bank run: a run on the shadow banking system—a system upon which Wall Street banks depended and of which Main Street investors were oblivious. To mitigate the systemic risks lurking in the shadow banking system, Congress enacted the Dodd–Frank Act, which established a federal systemic risk regulator, the Financial Stability Oversight Council, and empowered it to designate as "systemically important" those financial institutions whose material financial distress it determined could pose a threat to the financial stability of the United States. Once so designated, these institutions became subject to heightened prudential regulation by the Federal Reserve.

Now, less than ten years after the enactment of the Dodd–Frank Act and the establishment of the Federal Stability Oversight Council, legislators and federal regulators have begun to revisit the notion that systemically important financial institutions should be subject to heightened prudential regulation. Legislative and executive proposals for regulatory reform range from relaxing federal prudential regulation to eliminating it altogether. These proposals mistakenly prioritize the costs of designation to impacted institutions over the value of properly mitigated systemic risk to taxpayers. Although the 2008 financial crisis devastated millions, it also taught valuable lessons about the consequences of unmitigated systemic risk. Amid a plethora of proposals for financial reform, the time to revisit those lessons is now.

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INTRODUCTION

In the wake of the 2016 election of President Donald J. Trump, many questions have surfaced with respect to the federal government's ability to effectively regulate "too-big-to-fail" institutions. Too-big-to-fail institutions—known formally as systemically important financial institutions (SIFIs)—played a significant role in the 2008 financial crisis. In the years immediately following the crisis, Congress identified the risks associated with SIFIs and established a framework to mitigate these risks in the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010. Now, just ten years after the worst financial crisis since the Great Depression, both Congress and the Department of the Treasury have set forth proposals for rolling back post-crisis financial reforms, placing the existing federal regulatory framework for SIFIs squarely in their deregulatory crosshairs. This deregulatory pressure is troubling. The purpose of the regulatory framework for SIFIs is to prevent the circumstances that precipitated the 2008 financial crisis from developing again. Dismantling the regulatory framework for SIFIs would pose a serious threat to the stability of the U.S. financial system and the global economy.

In January 2018, the uncertainty surrounding the continued vitality of SIFI regulation was drawn into even sharper focus when the Financial Stability Oversight Council (FSOC) and MetLife filed a joint motion to dismiss the appeal of a decision in which the district court struck down FSOC's designation of MetLife as a SIFI. This Note examines the precedential implications of the district court's decision in *MetLife, Inc. v. Financial Stability Oversight Council*[1] and analyzes the joint motion to dismiss the appeal of the *MetLife* case as well as current proposals for regulatory reform to highlight potential issues with the current Administration's attack against SIFI regulation.

Part I provides an overview of SIFIs—colloquially referred to as too-big-to-fail firms—and the role that such institutions played in the 2008 financial crisis. This overview looks at three distinct sets of SIFIs: banks, nonbank financial institutions, and financial market utilities. Although financial market utilities did not play a significant role in the 2008 financial crisis, many believe that such institutions could have prevented the financial crisis. As a result, many post-crisis regulatory reforms have imposed requirements that institutions conduct certain kinds of transactions through financial market utilities, which would mitigate some of the risks inherent in those transactions.

Part II details the regulatory framework for SIFIs set forth in the Dodd–Frank Act of 2010. In response to the 2008 financial crisis, Congress enacted Dodd–Frank in part to establish a framework for the designation and regulation of SIFIs. Central to the Dodd–Frank framework for regulating SIFIs was the creation of an agency tasked with the identification and mitigation of systemic risks posed by SIFIs: the FSOC.

Part III turns to the District Court for the District of Columbia's decision in *MetLife, Inc. v. Financial Stability Oversight Council*, as well as the subsequent voluntary dismissal of the appeal, to assess the jurisprudential status of prudential regulation of nonbank financial institutions as SIFIs. Specifically, this Note argues that the district court's holding in *MetLife* encompasses not only the court's rejection of the FSOC's proposed designation of MetLife as a SIFI, but also a fundamental reaffirmation of the FSOC's authority to designate nonbank financial institutions as SIFIs. Under the direction of Treasury Secretary Steven Mnuchin, the FSOC and

1. 177 F. Supp. 3d 219 (D.D.C. 2016).

MetLife filed a motion to voluntarily dismiss the appeal of the district court's decision in *MetLife*. This motion to dismiss is merely one of many threats to the continued vitality of prudential SIFI regulation. The *MetLife* case has reached its conclusion, but the uncertain future of *Chevron* raises serious concerns about whether the designation process would be able to withstand future judicial challenges.

Part IV picks up on the deregulatory thread introduced at the end of Part III by cataloging recent regulatory reform proposals and assessing the potential consequences for SIFI regulation. Following the 2016 election of President Trump, the Financial CHOICE Act and a set of reports issued by the Department of the Treasury have set forth two different proposals for financial reform, each bearing the prospect of significant changes to the Dodd–Frank framework for SIFI regulation.[2] These proposals, if implemented, would roll back post-crisis financial reform and potentially allow the same circumstances that precipitated the 2008 financial crisis to develop yet again.

I. THE FINANCIAL CRISIS AND REGULATORY REFORM

Central to understanding the current U.S. system for federal regulation of SIFIs is an understanding of the role that these institutions played in the financial crisis of 2008. Although lawmakers discussed the need to regulate too-big-to-fail institutions prior to the crisis, the monumental role played by the mass insolvency of SIFIs in 2008 brought the term "too big to fail" to the forefront of public discussion.[3] So what does it mean for an institution to be too big to fail? Contrary to what this colloquial name might suggest, too-big-to-fail institutions are not

2. Prior to publication of this Note, Congress passed, and President Trump signed into law, the Economic Growth, Regulatory Relief, and Consumer Protection Act. Pub. L. No. 115-174 (2018). This Act has been described as "the most significant piece of legislation for financial institutions since the enactment of the Dodd-Frank Act in 2010." *See* MAYER BROWN, CONGRESS PASSES REGULATORY REFORM FOR FINANCIAL INSTITUTIONS (2018), https://m.mayerbrown.com/files/Publication/43c75d60-9b25-44a4-a9ff-34e813e7ec18/Presentation/PublicationAttachment/0f58c749-360a-4f3d-a778-78b080e76e4c/Congress-Passes-Regulatory-Reform-for-Financial-Institutions.pdf. Among other financial reforms, Title IV of the Act amends the Financial Stability Act of 2010 to increase the asset threshold past which nonbank financial companies may be subjected to supervision by the Federal Reserve Board. *See* S. 2155, 115th Cong. § 401 (2018). Specifically, Title IV increases the threshold at which (1) enhanced prudential standards shall apply, from $50 billion to $250 billion, providing further that the Federal Reserve Board shall have discretion to determine whether a financial institution with assets greater than or equal to $100 billion (but less than $250 billion) must be subject to such standards; (2) company-run stress tests are required, from $10 billion to $250 billion; and (3) mandatory risk committees are required, from $10 billion to $50 billion. *Id.* Despite these recent changes to the financial regulatory landscape, the arguments set forth in this Note remain valid and the analysis remains timely because the nonbank financial institutions at issue in this Note are institutions whose total assets greatly exceed even the increased thresholds instituted by the Act. *See, e.g.*, FIN. STABILITY OVERSIGHT COUNCIL, U.S. DEP'T OF THE TREASURY, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S FINAL DETERMINATION REGARDING METLIFE, INC. 7 (2014), https://www.treasury.gov/initiatives/fsoc/designations/Documents/MetLife%20Public%20Basis.pdf (describing MetLife as "one of the largest financial services companies in the United States" with "$909 billion of total consolidated assets" as of September 30, 2014). Understanding how these too-big-to-fail institutions figure into the U.S. financial system and global economy remains crucial to effective financial regulation.

3. Representative Stewart McKinney is widely credited with coining the colloquial term "too big to fail" during the 1984 congressional hearings on the failure of Continental Illinois National Bank and

immune from insolvency or bankruptcy; they are institutions that, when faced with insolvency, will potentially qualify for a taxpayer bailout rather than being forced to file for bankruptcy. Indeed, as demonstrated by the financial crisis, these institutions are not too big to fail; they are too big to be allowed to fail.

Taxpayer bailouts tend to stir up strong reactions, feelings, and opinions among taxpayers: "Why should *my* hard-earned dollars be used to save Wall Street firms from *their* bad investments?" Yet taxpayers would have likely faced much worse consequences if the federal government had not bailed out financial institutions.[4] Too-big-to-fail institutions do not operate in a vacuum; they operate as part of an interconnected financial system that constitutes the U.S. (and global) economy. Some institutions in this system are so large and critical to the economy that allowing them to fail would start a chain reaction: After the first institution failed, many others would follow, eventually resulting in systemic economic collapse. If not proactively regulated, these too-big-to-fail firms give rise to an unfortunate dilemma when they are facing insolvency: either bailout, which is funded by taxpayer dollars, or bankruptcy, which would potentially devastate the U.S. and global economies, resulting in massive losses to employment, retirement investments, and many other aspects of the economy that fundamentally impact the financial security of Main Street investors.[5]

A. SETTING THE STAGE: ACTORS IN THE FINANCIAL CRISIS

The 2008 financial crisis featured two sets of financial actors, as well as a third set that emerged in the wake of the crisis. The first set, systemically important banks, have long been the subject of discussion about regulation and regulatory

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Trust Company. Renee Haltom, *Failure of Continental Illinois*, FED. RES. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/failure_of_continental_illinois [https://perma.cc/66QS-KLRS]; *see also Inquiry into Continental Illinois Corp. and Continental Illinois National Bank: Hearings Before the Subcomm. on Fin. Insts. Supervision, Regulation & Ins. of the H. Comm. on Banking, Fin. & Urban Affairs*, 98th Cong. 300 (1984) [hereinafter *Continental Illinois Hearings*] (statement of Rep. Stewart McKinney, Member, H. Comm. on Banking, Fin. & Urban Affairs) ("Mr. Chairman, let us not bandy words. We have a new kind of bank. It is called *too big to fail*. TBTF, and it is a wonderful bank." (emphasis added)).

4. *See, e.g.*, *Turmoil in U.S. Credit Markets: Recent Actions Regarding Government-Sponsored Entities, Investment Banks, and Other Financial Institutions: Hearing Before the S. Comm. on Banking, Housing & Urban Affairs*, 110th Cong. 2 (2008) (testimony by Henry M. Paulson, Jr., Treasury Secretary, U.S. Dep't of the Treasury) ("[We] are working closely together so that we can help the American people by quickly enacting a program to stabilize our financial system. We must do so in order to avoid a continuing series of financial institution failures and frozen credit markets that threaten American families' financial well-being, the viability of businesses both small and large, and the very health of our economy.").

5. *See* Fred Moseley, *The Bailout of the "Too-Big-To-Fail" Banks: Never Again*, *in* THE HANDBOOK OF THE POLITICAL ECONOMY OF FINANCIAL CRISES 644, 645 (Martin H. Wolfson & Gerald A. Epstein eds., 2013). The U.S. Department of the Treasury recognized this choice and elected to "bail out" the financial institutions facing insolvency in an effort to stabilize the U.S. economy, citing in support of its decision the financial "hardship that fell upon millions of American families." *See About TARP*, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/initiatives/financial-stability/about-tarp/Pages/default.aspx [https://perma.cc/S2HW-KPJ8] (last updated Aug. 8, 2018, 4:14 PM). The Treasury Department described the primary purpose of the Troubled Asset Relief Program (TARP) as "arrest[ing] the economy's free fall and limit[ing] the recession's devastation." *Id.*

reform.[6] Given the inextricability of banks and other depository institutions from the economy, longstanding regulatory interest is unsurprising.

The second set of institutions, systemically important nonbank financial institutions, historically have not been the subject of federal financial regulation. However, due to the increasingly complex and interconnected nature of the global economy and other fundamental systemic changes to our financial system—including the emergence of "shadow banking"[7]—regulation aimed at effectively promoting financial stability can no longer focus solely on traditional banks and depository institutions. Indeed, as traditionally nonfinancial institutions—such as General Electric, originally an electric company cofounded by Thomas Edison—foray into the world of financial activities,[8] the appropriate reach of financial regulation is increasingly difficult to discern. On its face, the concept sounds absurd: Why would an electric company be subjected to financial regulation? Though the FSOC eventually revoked General Electric's "systemically important" designation,[9] General Electric's previous designation as a systemically important *financial* institution is striking because, at its inception, General Electric bore no resemblance to a bank or traditional financial institution and was indisputably beyond the ambit of bank regulation. The 2008 financial crisis made clear that both sets of institutions—banks and nonbank financial institutions—can become too big to fail.

The third set of financial actors, financial market utilities, are central to understanding the role of systemic risk in the 2008 financial crisis and how effective regulation is able to mitigate that risk. Financial market utilities have played an

6. *See, e.g.*, *Continental Illinois Hearings*, *supra* note 3, at 1–2 (statement of Rep. Fernand St. Germain, Chairman, H.R. Subcomm. on Fin. Insts. Supervision, Regulation & Ins.).

7. *See* Paul A. McCulley, *Global Central Bank Focus: Teton Reflections*, PIMCO (Sept. 5, 2007), https://www.pimco.com/en-us/insights/economic-and-market-commentary/global-central-bank-focus/teton-reflections/ [https://perma.cc/5ZX2-2GJM] ("Unlike *regulated real banks*, who fund themselves with insured deposits, backstopped by access to the Fed's discount window, *unregulated shadow banks* fund themselves with un-insured commercial paper, which may or may not be backstopped by liquidity lines from real banks. Thus, the shadow banking system is particularly vulnerable to runs . . . ." (emphasis added)).

8. *Compare Thomas Edison & The History of Electricity*, GEN. ELEC., https://www.ge.com/about-us/history/thomas-edison [https://perma.cc/JA9F-F9SB] (last visited Feb. 28, 2019) ("By 1890, Edison established the Edison General Electric Company by bringing his various businesses together. . . . Several of Edison's early business offerings . . . includ[ed] lighting, transportation, industrial products, power transmission, and medical equipment."), *with General Electric Capital Corp: Company Profile*, BLOOMBERG, https://www.bloomberg.com/profiles/companies/GELK:US-general-electric-capital-corp [https://perma.cc/6E6V-GPS5] (last visited Oct. 22, 2018) (describing General Electric Capital Corporation as a financial sector company that "provides financing, mortgage, and insurance services" as well as "commercial lending and leasing, consumer financing, investments in alternative energy, aircraft leasing and financing, and real estate investment services").

9. *See* FIN. STABILITY OVERSIGHT COUNCIL, U.S. DEP'T OF THE TREASURY, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S RESCISSION OF ITS DETERMINATION REGARDING GE CAPITAL GLOBAL HOLDINGS, LLC 2 (2016) [hereinafter FSOC, RESCISSION OF GE DETERMINATION], https://www.treasury.gov/initiatives/fsoc/designations/Documents/GE%20Capital%20Public%20Rescission%20Basis.pdf. In the years following its designation, GE Capital fundamentally altered its funding model, undertook several transactions in which it "divested approximately $272 billion of bank and nonbank assets," and ultimately underwent a significant corporate reorganization. *Id.* at 9–10.

increasingly vital role in the U.S. financial system during the post-crisis era. In particular, post-crisis reforms have required that certain derivative financial instruments be transacted exclusively using central counterparty clearing houses, a type of financial market utility that specializes in mitigating risk. The remainder of this section takes a closer look at each type of institution.

1. Banks: Lehman Brothers and Bear Stearns

Banks and depository institutions are unambiguously and integrally linked to the broader U.S. economy.[10] This relationship has been clear since the Panic of 1930, which precipitated the Great Depression.[11] When depositors put their money in a bank, the money does not just sit in the bank's vault. If that were the case, banks could not make a profit and thus would be unable to stay in business. Banks put the depositors' money to work by reinvesting it—often by lending the money—so it can charge an interest rate. The bank uses earnings from the interest rate it charges on the loan to pay the depositor a return on the deposit and retains the remainder as profit.[12] Because the bank does not hold 100% of deposits in its reserves, if every single depositor came to the bank at the same time demanding their money, the bank would be unable to return every depositor's money and would become insolvent.[13] This is called a bank run, and it is exactly what happened during the Panic of 1930.[14]

The story of the 2008 financial crisis bears striking resemblance to the Panic of 1930. However, the bank run in the 2008 financial crisis looked much different than the bank run during the Panic of 1930. Unlike in 1930, when the crisis was precipitated by angry depositors driving to their local banks to demand the bank return their deposits, the 2008 crisis was precipitated by a bank run on the shadow banking system. The actors in the shadow bank run were large Wall Street financial institutions. The case of Lehman Brothers is illustrative. Prior to its collapse in 2008, Lehman Brothers was the fourth-largest investment bank, with $639

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10. *See generally* Gary Richardson, *Banking Panics of 1930–31*, FED. RES. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/banking_panics_1930_31 [https://perma.cc/FL9K-RQ3G] (detailing "a series of crises among commercial banks" in November 1930 that transformed "a typical recession," for which rapid and robust recovery was anticipated, "into the beginning of the Great Depression").

11. *Id.*

12. *See* Stephen D. Simpson, *The Banking System: Commercial Banking – How Banks Make Money*, INVESTOPEDIA, https://www.investopedia.com/university/banking-system/banking-system3.asp [https://perma.cc/S8X6-VP3T] (last visited Feb. 28, 2019).

13. When an entity's short-term liabilities (in this case, depositors demanding immediate return of their money) exceed its short-term assets (in this case, the amount of cash and readily liquidable assets the entity holds), it is insolvent. *See What if I Am Insolvent?*, IRS, https://www.irs.gov/newsroom/what-if-i-am-insolvent [https://perma.cc/3ZK8-SWXN] (last updated July 27, 2018). Once a bank turns away one or more depositors who are demanding their money, fear rapidly turns into panic, which quickly develops into a contagion that amplifies the consequences of the bank's (often) curable insolvency and chokes off the means by which the bank could otherwise boost short-term liquidity to meet its obligations.

14. The movie *It's a Wonderful Life* provides a colorful (though technically black-and-white) depiction of the bank run of 1930, in which angry and frightened depositors storm the bank demanding to get their money back. *See* IT'S A WONDERFUL LIFE (RKO Radio Pictures 1946).

billion in assets at the time it filed for bankruptcy.[15] The Lehman Brothers bankruptcy was the largest bankruptcy filing in American history.[16] Although Lehman Brothers was too big to fail by any reasonable standard, the federal government allowed it to fail anyway. Before Lehman Brothers was allowed to fail, then-Treasury Secretary Henry Paulson and then-Federal Reserve Chairman Ben Bernanke suggested that the U.S. financial system could withstand the collapse of Lehman Brothers, a conclusion that proved to be inaccurate.[17]

Lehman Brothers, like many other financial institutions impacted by the 2008 crisis, had a substantial position in asset-backed securities, which it used as collateral to secure many of its obligations to its various creditors.[18] When market uncertainty emerged surrounding the value of these asset-backed securities, the result was a bank run on the shadow banking system. Firms with substantial positions in asset-backed securities, fearing that the value of these securities would continue to decline, began to rapidly liquidate their positions.[19] As firms began selling their asset-backed securities, the market quickly became oversaturated with a tremendous supply of these securities, causing the price of the securities to plummet.[20] Institutions—like Lehman Brothers—using these asset-backed securities as collateral were overwhelmed with margin calls,[21] which eventually spiked beyond what the system could handle, froze interbank lending, and paralyzed the U.S. financial markets.[22] As for Lehman Brothers, it was unable to satisfy all of the margin calls from its various creditors, which led to insolvency and, ultimately, bankruptcy.[23]

Bear Stearns was also devastated by the 2008 financial crisis. Prior to the crisis, Bear Stearns had eighty-five years of history, $400 billion in assets, and connections

15. *Collapse of Lehman Brothers Proves a Bank's Size Isn't All That Matters*, RUTGERS BUS. SCH. (Oct. 16, 2012), http://www.business.rutgers.edu/business-insights/collapse-lehman-brothers-proves-banks-size-isnt-all-matters [https://perma.cc/53Z8-PMQZ] [hereinafter *Collapse of Lehman Brothers*].

16. *The Causes and Effects of the Lehman Brothers Bankruptcy: Hearing Before the H. Comm. on Oversight & Gov't Reform*, 110th Cong. 2 (2008) (statement of Rep. Henry A. Waxman, Chairman, H. Comm. on Oversight & Gov't Reform).

17. *See id.*

18. Karen Berman & Joe Knight, *Lehman's Three Big Mistakes*, HARV. BUS. REV. (Sept. 16, 2009), https://hbr.org/2009/09/lessons-from-lehman [https://perma.cc/7D5N-4XDC].

19. *See* STAFF OF PERMANENT S. SUBCOMM. ON INVESTIGATIONS, WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE 5 (2011) [hereinafter ANATOMY OF A FINANCIAL COLLAPSE].

20. *See id.* at 6.

21. A creditor will issue a margin call to a debtor when the debtor's posted collateral is no longer sufficient to secure the value of the obligation owed. As an example, assume *A* owes $100 in cash to *B* and that *A* has asked *B* to post $100 in securities or other consideration to secure the value of the $100 obligation owed to *A*. In response, *B* posts ten securities worth $10 each as collateral, but a month later, the value of the securities falls to $5. *B*'s total posted collateral is now only worth $50, but *B* still owes *A* $100. *A* will issue what is known as a margin call, demanding that *B* post enough additional collateral to bring the total value of posted collateral back up to $100.

22. *See Collapse of Lehman Brothers*, *supra* note 15.

23. *Id.*

to every big bank on Wall Street.[24] As with many large, seemingly impervious Wall Street institutions, Bear Stearns found itself teetering on the brink of bankruptcy in 2008.[25] However, unlike Lehman Brothers, Bear Stearns benefited from a $29 billion capital infusion from the Federal Reserve and thus avoided complete collapse.[26] The capital infusion allowed Bear Stearns to avoid filing for bankruptcy, but it was ultimately insufficient to sustain the firm, which JPMorgan Chase bought in a fire sale.[27] As for other large Wall Street investment banks, the federal government ultimately committed $245 billion across five different bank bailout programs to prevent recipient banks from also facing insolvency and bankruptcy.[28] These bank bailout programs were part of a broader program known as the Troubled Asset Relief Program (TARP), under which the federal government committed a total of $700 billion[29] to bail out economically distressed companies across numerous sectors.[30]

2. Nonbank Financial Institutions: General Motors and AIG

The story of the 2008 financial crisis was not just limited to banks. Nonbank companies, including General Motors and American International Group (AIG), were also among the companies that received federal funds under TARP.[31] In the

24. Justin Baer & Ryan Tracy, *Ten Years After the Bear Stearns Bailout, Nobody Thinks It Would Happen Again*, WALL ST. J. (Mar. 13, 2018, 7:22 PM), https://www.wsj.com/articles/ten-years-after-the-bear-stearns-bailout-nobody-thinks-it-would-happen-again-1520959233 [https://perma.cc/U66N-XNHL]; *see also* Barry Ritholtz, *What We Didn't Learn from the Bear Stearns Collapse*, BLOOMBERG: OPINION (Mar. 19, 2018, 12:24 PM), https://www.bloomberg.com/view/articles/2018-03-19/what-we-didn-t-learn-from-the-bear-stearns-collapse [https://perma.cc/H9UT-EEPZ] (describing the "combination of excessive, subprime mortgage-concentrated leverage and poor risk controls" as proximate causes of the financial crisis, which precipitated the collapse of Bear Stearns).

25. *See* Baer & Tracy, *supra* note 24 (describing Bear Stearn's 2008 crisis as "one of the first dominoes in a downturn that months later engulfed all of Wall Street").

26. *Id.*

27. *See* Andrew Ross Sorkin, *JP Morgan Pays $2 a Share for Bear Stearns*, N.Y. TIMES (Mar. 17, 2008), https://www.nytimes.com/2008/03/17/business/17bear.html [https://nyti.ms/2ktkEqL]. In its all-stock acquisition of Bear Stearns, JPMorgan Chase paid a mere $2 per share of Bear Stearns stock. *Id.* This fire sale occurred over the course of a weekend, and notably, Bear Stearns was trading at more than $20 per share on the Friday before the sale occurred. *Id.*

28. *Bank Investment Programs*, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/bank-investment-programs/Pages/default.aspx [https://perma.cc/55VC-UTWV] (last updated Nov. 15, 2016, 3:40 PM). Some of the most prominent Wall Street investment banks, including Bank of America, Citigroup, JPMorgan Chase, Wells Fargo, Goldman Sachs, and Morgan Stanley, were recipients of federal funds from the bank bailout programs. *See Bailout Recipients*, PROPUBLICA, https://projects.propublica.org/bailout/list [https://perma.cc/6BFD-UQQR] (last updated Jan. 22, 2019).

29. Of the $700 billion in funds authorized by Congress for TARP, $235 billion was cancelled, capping the total funds actually committed at $465 billion. *Where Did the Money Go?*, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/initiatives/financial-stability/about-tarp/Pages/where-did-the-money-go.aspx [https://perma.cc/YBR5-TAHE] (last updated Aug. 8, 2018, 4:12 PM).

30. *See id.*

31. *Auto Industry*, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/automotive-programs/Pages/default.aspx [https://perma.cc/BB7S-E2CZ] (last updated Jan. 8, 2015, 4:46 PM); *Investment in American International Group (AIG)*, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/aig/Pages/default.aspx [https://perma.cc/2FHP-U669] (last updated Dec. 9, 2013, 4:53 PM) [hereinafter *Investment in AIG*].

wake of the 2008 financial crisis, access to credit for vehicle loans was widely frozen and automobile sales had fallen by forty percent, causing devastating financial hardship in the automobile industry.[32] General Motors, like so many other companies, was facing insolvency and the possibility of bankruptcy.[33] In its Restructuring Plan, General Motors highlighted the likely systemic impacts of its bankruptcy on the U.S. economy:

> The systemic risk to the automotive industry and the overall U.S. economy are considerable, just as the bankruptcy of Lehman had a ripple effect throughout the financial industry. Indeed, the risks relating to a bankruptcy in the automotive sector may be more extensive than Lehman presented in light of the wider range of constituencies, profound employment effects and the potential impact on consumer sentiment.[34]

The U.S. Department of the Treasury agreed, ultimately determining that the collapse of General Motors would devastate the U.S. auto industry, which would have resulted in the loss of one million U.S. jobs and posed a significant risk to the financial system and overall economic stability.[35] To obviate this risk, the Department of the Treasury committed $68 billion in TARP funds to automotive industry investments.[36]

One of the largest, and perhaps the most widely discussed, bailouts of the financial crisis was the $182 billion bailout of AIG.[37] AIG is a global insurance company and, as of 2008, had more than $1 trillion in assets as well as 116,000 employees and 74 million customers spread across 130 countries.[38] Before the 2008 financial crisis, AIG's Financial Products branch was selling credit default swaps, a derivative financial instrument that gave buyers synthetic short positions on mortgage-backed and other asset-backed securities.[39] Due to the low creditworthiness of the underlying securities,[40] these credit default swaps ended up

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32. *See Auto Industry*, *supra* note 31.

33. *See* Gen. Motors Corp., 2009 — 2014 Restructuring Plan (Form 425) 5 (Feb. 17, 2009), https://www.sec.gov/Archives/edgar/data/40730/000095015209001529/k47452ae425.htm [https://perma.cc/83U2-Z94C].

34. *Id.* at 103 app. L.

35. *See Auto Industry*, *supra* note 31.

36. *Where Did the Money Go?*, *supra* note 29.

37. *See Investment in AIG*, *supra* note 31.

38. *The Causes and Effects of the AIG Bailout: Hearing Before the H. Comm. on Oversight & Gov't Reform*, 110th Cong. 10 (2008) (statement of Eric Dinallo, Superintendent, New York State Insurance Department).

39. *See* Robert McDonald & Anna Paulson, *AIG in Hindsight*, 29 J. ECON. PERSP. 81, 90–91 (2015).

40. Many of the residential mortgage-backed securities (RMBS), for instance, were structured by bundling hundreds or thousands of high-risk mortgages. *See, e.g.*, ANATOMY OF A FINANCIAL COLLAPSE, *supra* note 19, at 18. These mortgages were high-risk for a variety of reasons, including that mortgagees failed to verify mortgagors' incomes and imposed terms such as adjustable rates, under which the monthly mortgage payments would as much as quadruple after a fixed period of time. *Id.* at 18–21 (describing a plethora of high-risk mortgage lending practices employed by home mortgage lenders leading up to the financial crisis). As long as the mortgagors did not default on their mortgage payments, the RMBS would pay steady returns. *Id.* at 34. Notwithstanding the poor creditworthiness of the

being much riskier than AIG anticipated and gave rise to more than $30 billion of liabilities that pushed AIG to the brink of collapse.[41] The federal government concluded that the disorderly failure of AIG would have caused catastrophic damage to the U.S. financial system and economy and thus committed a total of $182 billion in taxpayer funds to restore AIG's financial condition.[42]

3. Financial Market Utilities

Although not truly an "actor" in the financial crisis, there is a third character worth casting: financial market utilities (FMUs). One of the ways in which the Dodd–Frank Act attempted to promote financial stability in the post-crisis era was by mandating that financial institutions execute certain transactions through intermediaries that specialize in managing liquidity risk.[43] Liquidity risk, also commonly referred to as settlement or counterparty default risk, describes the chance and consequences of one party to a transaction defaulting on its payment obligation.[44] The chain reaction of events that precipitated the 2008 financial crisis is a perfect example of the way in which unmitigated liquidity risk can rapidly escalate from a single counterparty default to a systemic threat to global financial stability.

Central counterparty clearing houses (CCPs) are FMUs that intermediate transactions and thereby absorb the liquidity risk that each party would otherwise assume in a bilateral transaction.[45] For instance, consider a transaction between two parties: *A* and *B*. If *A* defaults on its payment obligation to *B* in a bilateral transaction, *B* is out of luck. *B* will not receive whatever consideration (typically,

underlying mortgages, these RMBS were marketed as investment-grade—a falsity that was easily concealed because the RMBS were described as "diversified" investments, and, between 1993 and 2007, the delinquency rate on single-family residential mortgages had never exceeded 2.5%. *See id*. at 29–30; Bd. of Governors of the Fed. Reserve Sys., *Delinquency Rate on Single-Family Residential Mortgages, Booked in Domestic Offices, All Commercial Banks*, FRED ECON. DATA, https://fred.stlouisfed.org/series/DRSFRMACBS [https://perma.cc/962K-GZ74] (last updated Nov. 26, 2018).

41. McDonald & Paulson, *supra* note 39, at 102.

42. *Investment in AIG*, *supra* note 31.

43. *See* Dodd–Frank Wall Street Reform and Consumer Protection Act § 802, 12 U.S.C. § 5461(a) (2012) ("Congress finds the following: (1) The proper functioning of the financial markets is dependent upon safe and efficient arrangements for the clearing and settlement of payment, securities, and other financial transactions. (2) Financial market utilities that conduct or support multilateral payment, clearing, or settlement activities may reduce risks for their participants and the broader financial system . . . ."); David S. Huntington, *Summary of Dodd-Frank Financial Regulation Legislation*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 7, 2010), https://corpgov.law.harvard.edu/2010/07/07/summary-of-dodd-frank-financial-regulation-legislation/ [https://perma.cc/JA6J-6H3Z] (summarizing the provisions of the Dodd–Frank Act that prompted agencies, including the CFTC and SEC, to establish rules requiring mandatory clearing for certain OTC derivative transactions).

44. *See* Jose A. Lopez, *What is Liquidity Risk?*, FED. RES. BANK S.F.: ECON. RES. 1 (Oct. 24, 2008), https://www.frbsf.org/economic-research/publications/economic-letter/2008/october/liquidity-risk/ [https://perma.cc/2798-LXHN].

45. *See generally* ROBERT S. STEIGERWALD, FED. RESERVE BANK OF CHI., UNDERSTANDING DERIVATIVES: MARKETS AND INFRASTRUCTURE 12–26 (2013), https://www.chicagofed.org/publications/understanding-derivatives/index (providing an overview of central counterparty clearing and the legal framework governing the operation of CCPs).

cash or securities) it was expecting to receive from *A*. This escalates into a systemic problem when *A*'s default has so great an impact on *B*'s liquidity that it curtails *B*'s ability to meet its own payment obligations. When *B* defaults with respect to its creditors, those creditors may also be unable to pay their creditors, and the chain continues until the impact has diffused throughout the entire economy. CCPs manage liquidity risk by maintaining capital reserves, which bolster their ability to absorb counterparty default risk.[46] So if *A* and *B* conduct their transaction through a CCP rather than bilaterally, when *A* defaults on its payment obligation, the CCP ensures *B* still receives the cash or securities it was expecting by paying the cash or securities out of its own reserves. The CCP substitutes itself for *B* as *A*'s creditor with respect to the transaction and will follow up with *A* until *A* has delivered the cash or securities to the CCP. In this way, the CCP mitigates systemic risk by eliminating the chance that *B* will default with respect to its own creditors as a result of *A*'s default.

B. RECOGNITION OF THE NEED TO REGULATE NONBANK FINANCIAL INSTITUTIONS

Although federal regulation of banks and depository institutions was deeply entrenched in the United States,[47] the notion of federally regulating systemic risk in nonbank financial institutions, such as hedge funds and insurance companies, proved to be much more controversial.[48] Insurance companies, for instance, were historically regulated almost exclusively by state law.[49]

However, feeling the devastating effects of the financial crisis—including skyrocketing unemployment, severely depressed prices in the stock market, and waves of housing foreclosures—the public outcry for change was deafening. The most severe critics suggested that any bank or other financial institution that is too big to fail is too big to exist at all.[50] It had become abundantly clear that some level of regulatory reform was necessary.

The pressing goal in Washington, D.C. was to determine what caused the crisis and what could be done to prevent it from happening again. In December 2008, then-Chairman of the Federal Reserve, Ben Bernanke, gave a speech at the Greater Austin Chamber of Commerce, during which he cautioned that "recent

46. *See id*. at 12–13.

47. *See* Jerry W. Markham, *Banking Regulation: Its History and Future*, 4 N.C. BANKING INST. 221, 221 (2000).

48. *See, e.g.*, Douglas J. Elliott, *Regulating Systemically Important Financial Institutions that Are Not Banks*, INITIATIVE ON BUS. & PUB. POL'Y BROOKINGS 3–4 (May 9, 2013), https://www.brookings.edu/wp-content/uploads/2016/06/09-regulating-financial-institutions-elliott.pdf (describing the unique challenges of crafting an effective regulatory scheme that adequately addresses the nuances specific to nonbank financial companies).

49. Md. Cas. Co. v. Witherspoon, 993 F. Supp. 2d 1178, 1184 (C.D. Cal. 2014) ("Traditionally, 'states ha[ve] a free hand in regulating the dealings between insurers and their policyholders.'" (quoting Clarendon Am. Ins. Co. v. Sorg Corp., No. 07–1966 SC, 2007 WL 1880291, at *2 (N.D. Cal. June 29, 2007))).

50. *E.g.*, Eric Dash, *If It's Too Big to Fail, Is It Too Big to Exist?*, N.Y. TIMES (June 20, 2009), https://www.nytimes.com/2009/06/21/weekinreview/21dash.html?partner=rss&emc=rss [https://nyti.ms/2qqch5D].

events have revealed a serious weakness of our system: the absence of well-defined procedures and authorities for dealing with the potential failure of a systemically important nonbank financial institution."[51] President Barack Obama echoed this sentiment in his remarks on financial regulatory reform, in which he highlighted that "some firms that posed a so-called 'systemic risk' were not regulated as strongly as others; they behaved like banks but chose to be regulated as insurance companies, or investment firms, or other entities that were under less scrutiny."[52]

A common thread emerged in the rhetoric surrounding post-financial crisis reform: any institution, traditional bank or otherwise, capable of posing a threat to the economic stability of the United States should be subject to federal financial regulation. In 2010, Congress responded by enacting the Dodd–Frank Act, which authorized the establishment of enhanced prudential regulatory standards for certain nonbank financial institutions.[53]

II. THE DODD–FRANK ACT AND TOO BIG TO FAIL

One of the Dodd–Frank Act's key purposes was to promote financial stability by "end[ing] 'too big to fail' . . . [and] protect[ing] the American taxpayer by ending bailouts."[54] In an effort to achieve this goal, the Dodd–Frank Act authorized the creation of a federal systemic risk regulator, the FSOC, with the power to designate too-big-to-fail firms and subject those firms to increased scrutiny. This Part describes the establishment of the FSOC and the designation process for nonbank financial institutions.

A. ESTABLISHMENT OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL

Among the most significant reforms instituted by the Dodd–Frank Act was the unprecedented creation of a federal agency authorized to regulate systemic risk: the FSOC.[55] The stated purposes of the FSOC are threefold: identify risks posed by too-big-to-fail institutions, quash the expectation that such institutions are entitled to taxpayer bailouts, and respond to systemic risks posed by these institutions.[56] In other words, not only was the FSOC endowed with the authority to

51. *See* Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Speech at the Greater Austin Chamber of Commerce: Federal Reserve Policies in the Financial Crisis (Dec. 1, 2008), https://www.federalreserve.gov/newsevents/speech/bernanke20081201a.htm [https://perma.cc/M45R-599X].

52. *See* President Barack Obama, Remarks by the President on 21st Century Financial Regulatory Reform (June 17, 2009), https://obamawhitehouse.archives.gov/the-press-office/remarks-president-regulatory-reform [https://perma.cc/XT89-XKKG].

53. *See* 12 U.S.C. § 5323(a) (2012).

54. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of U.S.C.).

55. *See* 12 U.S.C. § 5321.

56. *See* § 5322(a)(1).

> The purposes of the Council are—
>
> (A) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank

monitor systemic risk, it was also given the authority to curb the risks that it identified. Moreover, the FSOC's authority to curb systemic risk extended beyond historical regulatory boundaries and included regulation of "certain nonbank financial companies."[57] At its core, the FSOC was established to render the too-big-to-fail concept obsolete across all sectors of the U.S. economy.

B. DESIGNATION OF NONBANK FINANCIAL INSTITUTIONS

One of the key mechanisms by which the FSOC limits systemic risk in the financial markets is through the process of designation. Under section 113 of the Dodd–Frank Act, the FSOC is empowered to determine that "material financial distress at the U.S. nonbank financial company . . . could pose a threat to the financial stability of the United States."[58] Upon such a determination, the FSOC may require that company be "supervised by the Board of Governors [of the Federal Reserve] and . . . subject[ed] to prudential standards."[59] In essence, these determinations by the FSOC constitute a prospective identification of companies that might become too big to fail. These SIFIs are then subjected to heightened prudential regulatory standards established by the Federal Reserve Board in a process carefully calculated to prevent the U.S. economy from facing another systemic collapse.[60]

However, this tremendous statutory authority accorded to the FSOC is far from plenary. As part of the designation process, the FSOC must undertake a two-step inquiry. As a threshold matter, the FSOC must first determine whether the firm is a U.S. nonbank financial company, which is defined in the Dodd–Frank Act as "a company (other than a bank holding company) . . . predominantly engaged in financial activities."[61] Once the FSOC has determined that a firm is a "nonbank

holding companies or nonbank financial companies, or that could arise outside the financial services marketplace;

(B) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure; and

(C) to respond to emerging threats to the stability of the United States financial system.

Id.

57. § 5323(a)(1) (establishing the authority of the FSOC to require supervision by the Board of Governors and regulation through prudential standards of certain nonbank financial companies).

58. *Id.*

59. *Id.*

60. *See supra* notes 4–5 and accompanying text.

61. § 5311(a)(4)(B).

A company is 'predominantly engaged in financial activities' if—

(A) the annual gross revenues derived by the company and all of its subsidiaries from activities that are financial in nature . . . represents 85 percent or more of the consolidated annual gross revenues of the company; *or*

(B) the consolidated assets of the company and all of its subsidiaries related to activities that are financial in nature . . . represents 85 percent or more of the consolidated assets of the company.

§ 5311(a)(6) (emphasis added).

financial company," it must undertake a comprehensive analysis of statutorily prescribed risk-related factors as they pertain to that company to determine whether "material financial distress" at the company "could pose a threat to the financial stability of the United States."[62]

In October 2010, the FSOC released an advance notice of proposed rulemaking, in which it solicited public comment on the application of the risk-related factors set forth in the Dodd–Frank Act.[63] Following the advance notice of proposed rulemaking, the FSOC issued two notices of proposed rulemaking, considered comments received for each notice, and, in April 2012, put forth a final rule and interpretive guidance intended to "foster transparency with respect to the [two-step] Determination Process."[64]

Among other things, this rule and interpretive guidance established a six-category framework to be used by the FSOC when considering whether a nonbank financial company should be designated as a SIFI.[65] The first three categories—leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny—assess the company's susceptibility to financial distress, whereas the second three categories—size, substitutability, and interconnectedness—assess the potential that financial distress at the company would impact the broader economy.[66] The FSOC highlighted that its application of the six-category framework would be case-specific rather than formulaic.[67]

C. DESIGNATION OF FINANCIAL MARKET UTILITIES

In addition to its authority to designate nonbank financial institutions, the FSOC also has the authority to identify and designate systemically important FMUs.[68] When Congress recognized the potentially stabilizing effect of mandatory central clearing for certain financial transactions, such as through a CCP, it also highlighted the potential for adverse consequences of FMUs that are not adequately designed to operate in a safe and sound manner.[69] Because intermediating transactions requires FMUs to absorb counterparty default risk, FMUs are necessarily in the business of aggregating and concentrating risk. Although FMUs can mitigate risk through various processes, such as netting,[70] it is

62. § 5323(a).

63. Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 75 Fed. Reg. 61,653, 61,653 (Oct. 6, 2010).

64. Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21,637, 21,639 (Apr. 11, 2012).

65. *Id.*

66. *Id.* at 21,658.

67. *Id.*

68. Dodd–Frank Wall Street Reform and Consumer Protection Act § 112(a)(1)(J), 12 U.S.C. § 5322 (a)(1)(J) (2012).

69. § 5461(a)(2) ("Financial market utilities that conduct or support multilateral payment, clearing, or settlement activities may reduce risks for their participants and the broader financial system, but *such utilities may also concentrate and create new risks* and thus must be well designed and operated in a safe and sound manner." (emphasis added)).

70. Netting is "the termination or cancellation of reciprocal obligations, the valuation of terminated obligations and its replacement by a single payment obligation." INT'L SWAPS & DERIVATIVES ASS'N,

impossible for these institutions to entirely eliminate risk. If FMUs are not carefully designed to effectively manage the liquidity risk they have absorbed, they pose the same systemic threat to economic stability as too-big-to-fail firms defaulting in bilateral transactions. Thus, Congress empowered the FSOC to designate an FMU upon determining that the failure of or disruption to the FMU could "create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system."[71]

As it did for nonbank financial company designation, the FSOC promulgated a rule in which it outlined the criteria, processes, and procedures for the designation of FMUs.[72] After implementation of this rule, the FSOC unanimously voted to designate eight FMUs, including several high-volume CCPs, as systemically important.[73] Designated FMUs are subject to the heightened prudential and supervisory standards set forth in Title VII of the Dodd–Frank Act.[74] The provisions of Title VII promote robust risk management and safety and soundness by requiring designated FMUs to conduct operations in compliance with risk-management standards, provide advance notice of any material changes to operating policies and procedures impacting their risk levels, and submit to examination and enforcement procedures.[75]

D. IMPACTS OF DESIGNATION

Designation has an undeniably substantial impact on a company's operating model and potentially its capability to offer certain products and services. Nonbank financial companies and FMUs designated as systemically important are subjected to supervision and regulation by the Federal Reserve,[76] a federal

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NETTING AND OFFSETTING: REPORTING DERIVATIVES UNDER U.S. GAAP AND UNDER IFRS 10 (2012), https://www.isda.org/a/veiDE/offsetting-under-us-gaap-and-ifrs-may-2012.pdf (describing the process of balance-sheet netting and offsetting and assessing the efficacy of enforceable master netting arrangements as a risk mitigation technique for systemic risk, market risk, and liquidity risk).

71. *Financial Stability Oversight Council*, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx [https://perma.cc/MW6G-U6RW] (last updated Oct. 17, 2018, 8:13 AM).

72. *Id.*

73. *See id.* The FMUs designated by the FSOC are (1) The Clearing House Payments Co., (2) CLS Bank International, (3) Chicago Mercantile Exchange, Inc., (4) The Depository Trust Co., (5) Fixed Income Clearing Corp., (6) ICE Clear Credit, (7) National Securities Clearing Corp., and (8) The Options Clearing Corp. *Id.* Several of the designated FMUs are among the largest clearing houses in the United States. *See* Michelle Price, *Three Biggest U.S. Clearing Houses Pass Liquidity Stress Tests: CFTC*, REUTERS (Oct. 16, 2017, 12:08 AM), https://www.reuters.com/article/us-cftc-clearing-tests/three-biggest-u-s-clearing-houses-pass-liquidity-stress-tests-cftc-idUSKBN1CL09Q [https://perma.cc/P8WN-DN7P] (describing the outcome of liquidity stress tests conducted by the CFTC that ensured that the large clearing houses—including ICE Clear and CME Clearing—were able to generate sufficient liquidity to settle payments in the event that significant clearing members default).

74. *Financial Stability Oversight Council*, *supra* note 71.

75. *Id.*

76. 12 U.S.C. § 5365 (2012) (setting forth enhanced supervision and prudential standards for nonbank financial companies that are designated and subject to supervision by the Board of Governors of the Federal Reserve).

regulator traditionally charged solely with oversight of banks and bank holding companies.[77] Both the supervisory and regulatory components of this new framework impose substantial costs on designated companies. A company subjected to supervision by the Federal Reserve will face increased operating costs and other operational challenges associated with financial reporting, particularly because the Federal Reserve's system of reporting was developed specifically for banks.[78] Designated companies also face significant costs in complying with prudential standards imposed by the Federal Reserve under section 165 of the Dodd–Frank Act.[79] These prudential standards focus on ensuring that a designated company's capital reserves are sufficient to withstand economic stress, which can be costly because capital reserves must remain readily liquidable and thus are unable to be reinvested.

Since the implementation of the Dodd–Frank Act in 2010, the FSOC has designated four nonbank financial companies: American International Group and General Electric Capital Corporation were designated in July 2013, Prudential Financial was designated in September 2013, and MetLife was designated in December 2014.[80] However, MetLife challenged its designation in federal court, and in March 2016, the District Court for the District of Columbia issued an opinion in *MetLife, Inc. v. Financial Stability Oversight Council* in which it rescinded the FSOC's final determination for MetLife.[81] In the year and a half following the court's decision in *MetLife*, regulatory scrutiny for nonbank financial institutions continued to unravel: the FSOC voted to rescind the designations for GE Capital Global Holdings (the successor company of General Electric Capital Corporation) in June 2016[82] and American International Group in September 2017.[83] After the FSOC vote to rescind American International Group's designation, Prudential Financial became the only nonbank financial institution still

77. *See* James McBride & Mohammed Aly Sergie, *The Role of the U.S. Federal Reserve*, COUNCIL ON FOREIGN REL., https://www.cfr.org/backgrounder/role-us-federal-reserve [https://perma.cc/59MR-8AKP] (last updated Feb. 2, 2018); Staff of Fed. Reserve Bank of Kan. City, *Federal Reserve Act Signed by President Wilson*, FED. RES. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/federal_reserve_act_signed [https://perma.cc/S3Z8-U8L2].

78. *See* DELOITTE CTR. FOR REGULATORY STRATEGIES, SIFI DESIGNATION AND ITS POTENTIAL IMPACT ON NONBANK FINANCIAL COMPANIES 8 (2013).

79. *See, e.g.*, Brief of Amici Curiae Chamber of Commerce of the United State of America and Investment Company Institute in Support of Appellee at *17, MetLife, Inc. v. Fin. Stability Oversight Council, No. 16–5086, 2018 WL 1052618 (D.C. Cir. Jan. 23, 2018), 2016 WL 4440273 (highlighting "the impact of billions of dollars in compliance costs" accompanying designation); Alistair Gray, *AIG Sheds $150m in Costs Along with SIFI Label*, FIN. TIMES (Oct. 1, 2017), https://www.ft.com/content/31b36b9a-a662-11e7-93c5-648314d2c72c [https://perma.cc/U5GF-Y266] (highlighting that AIG's conservative estimate of compliance costs related to its designation was between $100 and $150 million per year).

80. *Financial Stability Oversight Council*, *supra* note 71.

81. MetLife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219, 242 (D.D.C. 2016).

82. *See* FSOC, RESCISSION OF GE DETERMINATION, *supra* note 9.

83. Press Release, U.S. Dep't of the Treasury, Financial Stability Oversight Council Announces Rescission of Nonbank Financial Company Designation (Sept. 29, 2017), https://www.treasury.gov/press-center/press-releases/Pages/sm0169.aspx [https://perma.cc/EC6F-36HJ].

designated as a SIFI.[84]

III. CHALLENGE TO NONBANK FINANCIAL DESIGNATION IN *METLIFE*

In January 2015, MetLife became the first designee to challenge a Final Designation issued by the FSOC in federal court. Specifically, MetLife sought judicial review and rescission of the FSOC's Final Designation under section 113(h) of the Dodd–Frank Act.[85] Under section 113(h) of the Dodd–Frank Act, a nonbank financial company designated as systemically important by the FSOC is entitled to challenge the FSOC's final determination under which the company was designated.[86] MetLife cited the "substantial costs" and "adverse[] [impacts on] its competitive position in the market" as injuries establishing standing.[87] Unsurprisingly, the steep forecasted costs of designation became a recurring theme of MetLife's case, both in the action it brought before the district court and in the FSOC's appeal of the district court's decision.[88]

MetLife argued that the FSOC's designation was arbitrary and capricious on seven grounds: (1) MetLife is not a "U.S. nonbank financial company," (2) the FSOC's designation was "fatally premature," (3) the FSOC failed to "consider alternatives to designation and to provide a reasoned explanation for rejecting alternatives," (4) the FSOC failed to "assess MetLife's vulnerability to material financial distress," (5) the FSOC's designation was "inconsistent with the statutory criteria set forth in Section 113(a)(2)" of the Dodd–Frank Act, (6) the FSOC employed "unsubstantiated, indefinite assumptions and speculation that failed to satisfy the statutory standards for designation and FSOC's own interpretive guidance," and (7) the FSOC failed to "consider the economic effects of designation on MetLife."[89]

Ultimately, the court held that, although MetLife is eligible for designation under section 102(a) of the Dodd–Frank Act, the FSOC's designation was arbitrary and capricious because (1) it made two critical, unexplained departures from the standards it adopted in its Guidance, and (2) it purposefully omitted consideration of the cost of designation to MetLife.[90]

84. Hazel Bradford, *MetLife, FSOC End Legal Case over SIFI Designation*, PENSIONS & INV. (Jan. 19, 2018, 12:02 PM), http://www.pionline.com/article/20180119/ONLINE/180119843/metlife-fsoc-end-legal-case-over-sifi-designation [https://perma.cc/9J9R-Q2NL].

85. Complaint at 1–2, MetLife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219 (D.D.C. 2016) (No. 1:15-cv-00045-RMC) [hereinafter MetLife Complaint].

86. 12 U.S.C. § 5323(h) (2012 & Supp. V. 2017).

87. MetLife Complaint, *supra* note 85, at 9–10.

88. *See, e.g.*, *id.* at 6 ("The designation of MetLife will inevitably impose significant costs on the Company—and its shareholders and customers—a concern that MetLife addressed at length in its submissions to FSOC."); Brief for Appellee at *14, MetLife, Inc. v. Fin. Stability Oversight Council, No. 16-5086, 2018 WL 1052618 (D.C. Cir. Jan. 23, 2018) ("MetLife submitted evidence that the increased capital requirements and other regulatory burdens that accompany designation could have severe financial and competitive consequences for the company.").

89. MetLife Complaint, *supra* note 85, at 40–72.

90. MetLife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219, 230–33, 239–42 (D.D.C. 2016).

First, the court held that the FSOC made critical, unexplained departures from two of the principles it set forth in its Guidance.[91] Although interpretive guidance issued by an agency is typically not binding, the requirement of "reasoned decisionmaking" requires the agency to "acknowledge and explain the reasons for a changed interpretation."[92] The first of the two principles in the Guidance from which—according to the court—the FSOC departed required it to assess the susceptibility of the institution to "financial distress" through measures of "leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny."[93] As the court explained, these three measures are subsumed within one analytical category that seeks to "assess a company before it bec[omes] distressed."[94] The court held that, in reaching its Final Determination, the FSOC treated the measures within this analytical category as indicators of whether MetLife's distress could "pose a threat to the broader economy," rather than as indicators of MetLife's susceptibility to such distress.[95] Because its application of these measures in reaching its final determination with respect to MetLife was deemed inconsistent with the application prescribed in the Interpretive Guidance, the court found that the FSOC's action was arbitrary and capricious.[96]

In its opinion, the court also held that the FSOC failed to adhere to the standard it set forth in the Interpretive Guidance for determining whether a nonbank financial company "could pose a threat to the financial stability of the United States."[97] In its Interpretive Guidance, the FSOC highlighted three criteria—size, substitutability, and interconnectedness—that it would use to assess whether a nonbank financial company's distress would constitute a "threat to U.S. financial stability."[98] The Guidance further clarified that establishing "threat" requires a showing that there would be "an impairment of financial intermediation or of financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy."[99] The court found that, although the FSOC assessed MetLife's size in reaching its final determination, FSOC failed to show any probable causal link between size and impact on the broader economy.[100] With respect to this departure, the court held that the FSOC's reliance on assumptions in its determination was arbitrary and capricious.[101]

In addition to citing the FSOC's departures from two principles included in the Interpretive Guidance as arbitrary and capricious, the court also held that the FSOC's failure to consider the costs of designation to MetLife also rendered its

91. *Id.* at 233–39.
92. *Id.* at 233 (quoting Verizon v. FCC, 740 F.3d 623, 636 (D.C. Cir. 2014)).
93. *Id.* at 234.
94. *Id.*
95. *Id.* at 233–34.
96. *Id.* at 236.
97. *Id.* at 237.
98. *See supra* notes 65–67 and accompanying text.
99. 12 C.F.R. pt. 1310 app. A (2018).
100. *See MetLife, Inc.*, 177 F. Supp. 3d at 237.
101. *Id.*

designation arbitrary and capricious.[102] The FSOC justified its omission of a cost–benefit analysis on the grounds that such analysis was not required by either the text of the Dodd–Frank Act or the Interpretive Guidance issued by the FSOC and urged the court not to imply a cost–benefit analysis requirement where none was explicitly stated.[103] However, the court held that "reasoned decision-making" requires "consideration of all the relevant factors," which—in the view of the court—undoubtedly and implicitly includes cost.[104]

Ultimately, the district court invalidated the FSOC's determination as arbitrary and capricious and rescinded its designation of MetLife as a systemically important nonbank financial institution.[105] The FSOC filed a motion to appeal the district court's decision and prepared a brief in preparation for oral arguments. However, after the change in presidential administrations, the FSOC and MetLife filed a joint motion to voluntarily dismiss the appeal.[106]

A. HOLDING THE LINE: DDC BOLSTERS THE VALIDITY OF NONBANK DESIGNATIONS

The *MetLife* case and the surrounding press has sparked broader debates about the designation process.[107] Although MetLife's theory of the case was that the FSOC's designation was arbitrary and capricious, some amicus briefs filed in the case focused instead on arguing the fundamental validity (or invalidity) of nonbank financial institution designation and the process by which it occurs.[108]

Although the district court ultimately struck down the FSOC's designation as arbitrary and capricious, it also reaffirmed the validity of nonbank SIFI designation. The district court's opinion in *MetLife* proceeds in two distinct inquiries, each of which contributes to the holding of the case.[109] The first inquiry assesses whether MetLife is eligible for designation by the FSOC, and the second inquiry decides whether the FSOC's designation of the FSOC was arbitrary and

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102. *Id.* at 242.

103. *Id.* at 239.

104. *Id.* at 239–40 (citing Michigan v. EPA, 135 S. Ct. 2699 (2015)).

105. *Id.* at 229.

106. *See infra* Section III.B.

107. *See, e.g.*, Ryan Tracy, *MetLife Cements Legal Victory in Shedding 'Systemically Important' Label*, WALL ST. J. (Jan. 18, 2018, 9:09 PM), https://www.wsj.com/articles/metlife-and-fsoc-file-motion-to-dismiss-appeal-in-sifi-litigation-1516325850 [https://perma.cc/FML3-WHHG].

108. *See, e.g.*, Brief Amicus Curiae of Ben S. Bernanke and Paul A. Volcker in Support of Defendant-Appellant at *8, MetLife, Inc. v. Fin. Stability Oversight Council, No. 16-5086, 2018 WL 1052618 (Jan. 23, 2018), 2016 WL 3453712 (describing as "unfortunate" that the District Court's ruling "fails to recognize the compelling logic of the FSOC designation process").

109. Underlying this Note's analysis of the court's holding in *MetLife* is the assumption that the holding of a case is its *ratio decidendi*. *See generally* Arthur L. Goodhart, *Determining the* Ratio Decidendi *of a Case*, 40 YALE L.J. 161 (1930) (describing the formation of judicial precedent through the holding of a case, which is limited to those opinions given by a judge which are necessary to reach the outcome in a particular case); Lawrence B. Solum, *Legal Theory Lexicon: Holdings*, LEGAL THEORY BLOG (July 30, 2017, 9:23 AM), http://lsolum.typepad.com/legaltheory/2017/07/legal-theory-lexicon-holdings.html [https://perma.cc/TZ9L-6K9S] (describing the *ratio decidendi* as the formalist theory of the holding and highlighting the descriptive and normative debates between formalist and realist theories of the holding).

capricious.[110] At first blush, the court's inquiry into and analysis of MetLife's eligibility for designation may appear to be mere dicta. One might be tempted to reason that, because the court struck down FSOC's designation as arbitrary and capricious, its analysis regarding eligibility was not necessary to reach the outcome in this case. This reasoning, however, would be faulty.

MetLife challenged the FSOC's designation under section 113(h) of the Dodd–Frank Act.[111] Section 113(h) enables designated companies to seek judicial review of the FSOC's final determination in a district court, but expressly limits the court's review to whether the FSOC's determination was arbitrary and capricious.[112] Under the highly deferential arbitrary-and-capricious standard, the court is not permitted "to substitute its judgment for that of the agency," but rather is limited to consideration of "whether the [agency's] decision was based on a consideration of the relevant [data and] factors."[113] The thrust of this deferential standard derives from principles of democratic legitimacy and comparative institutional competence; where Congress—our democratically elected legislature—has made a determination that an agency is well suited to implement statutory provisions and has expressly delegated to the agency the authority to do so, the court should only intervene if the agency's decision is tainted by a "clear error of judgment."[114]

Thus, to apply the arbitrary-and-capricious standard of review, the court must first determine that the challenged agency action was taken pursuant to a valid statutory grant of authority. Indeed, in *MetLife*, the court could not possibly have reached the inquiry of whether the FSOC designation was arbitrary and capricious without first establishing that the FSOC had the authority to designate MetLife. Say, for instance, that the text of section 113(h) permitted FSOC designation of banks and depository institutions, but expressly estopped FSOC designation of nonbank financial institutions. In such a case, the FSOC's designation of MetLife would not have been deemed arbitrary and capricious. The court would not have employed this deferential standard of review because the agency would have been acting beyond the scope of its statutory authorization. Instead, the court would have struck down the designation as inconsistent with the clear command of the statute under Step One of *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*[115]

110. *See MetLife, Inc.*, 177 F. Supp. 3d at 230.

111. *Id.* at 229.

112. 12 U.S.C. § 5323(h) (2012 & Supp. V 2017).

113. *MetLife, Inc.*, 177 F. Supp. 3d at 229–30.

114. *See, e.g.*, Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 33, 43 (1983) (highlighting an instance in which Congress acknowledged that the implementation of a statutorily designated policy required "considerable expertise" and responded by delegating authority to an agency to implement standards that would satisfy the statutorily prescribed goal).

115. 467 U.S. 837, 842–43 (1984). When an agency acts pursuant to lawmaking authority expressly delegated to the agency by Congress, the agency's decision is entitled to *Chevron* deference, which implicates a two-step analysis. United States v. Mead Corp., 533 U.S. 218, 226–27 (2001). At Step One of *Chevron*, the court does *not* accord deference to the agency's interpretation of the statute. *See Chevron*, 467 U.S. at 842–43. Instead, the court makes its own independent determination of whether

So how does the court's analysis of MetLife's eligibility for designation interact with its determination that the FSOC's designation of MetLife was arbitrary and capricious? And how does this interaction impact the holding of the case? The court's conclusion that MetLife is eligible for designation constitutes legally salient reasoning, without which the court could not have concluded that the FSOC designation was arbitrary and capricious. Because the court's conclusion that MetLife is eligible for designation is necessary to reach the outcome of the case, this conclusion is part of the holding of the *MetLife* case. Although the real-world impact of the court's decision—the rescission of the MetLife designation—is unmistakably repugnant to the continued vitality of SIFI regulation, the court's holding carries with it a beacon of hope: MetLife—and, foreseeably, other similarly situated companies—can be properly classified as nonbank financial institutions eligible for designation as systemically important. Designations by the FSOC to that effect are valid, so long as they adhere to the criteria for designation (or adequately explain any departures therefrom) and are supported by reasoned decisionmaking.

B. CHANGING TIDES: DISMISSAL OF APPEAL AND THE UNCERTAIN FUTURE OF *CHEVRON*

Although the holding of the district court's decision in *MetLife* offers a beacon of hope, it is far from a judicial victory for SIFI regulation. On January 18, 2018, MetLife and the FSOC filed a joint stipulated motion to voluntarily dismiss the FSOC's appeal of the district court's decision in *MetLife*.[116] Because the FSOC is chaired by the Secretary of the Treasury, who is appointed by the President, it came as no surprise that the *MetLife* case ceased to be a priority for the FSOC under its new leadership. The motion to dismiss came amid a plethora of efforts by the Trump Administration to roll back financial regulations implemented during the Obama Administration.[117] Although the dismissal with prejudice bars any chance that the FSOC designation of MetLife will be reinstated, it also serves as a signpost of further changes to come. When asked about the voluntary dismissal, Treasury Secretary Steven Mnuchin announced his plans to "work[] with the [FSOC] to clarify and revise the non-bank designation rule and guidance."[118]

the statute is clear or ambiguous. *Id.* ("If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."). If the court determines that the statute is clear, it will then determine whether the agency's action was consistent with the clear command of the statute, again, without according deference to the agency's action or interpretation. *See e.g.*, FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 125–26, 131–33 (2000) (declining to defer to the FDA's interpretations of "drugs" and "devices" in section 321 (g)–(h) of the Food, Drug, and Cosmetic Act); MCI Telecomm. Corp. v. Am. Tel. & Tel. Co., 512 U.S. 218, 228–29 (1994) (declining to defer to the FCC's interpretation "modify" in section 203(b) of the Communications Act).

116. Joint Stipulated Motion to Voluntarily Dismiss Appeal, MetLife, Inc. v. Fin. Stability Oversight Council, No. 16–5086, 2018 WL 1052618 (D.C. Cir. Jan. 23, 2018).

117. *See, e.g.*, Exec. Order No. 13,772, 82 Fed. Reg. 9965, 9965 (Feb. 3, 2017).

118. Pete Schroeder, *MetLife, U.S. Regulators Agree to Set Aside Legal Fight*, REUTERS (Jan. 18, 2018, 8:53 PM), https://www.reuters.com/article/us-usa-metlife-fsoc/metlife-u-s-regulators-agree-to-set-aside-legal-fight-idUSKBN1F8064 [https://perma.cc/9APU-ZRUH].

Although the *MetLife* case has reached its conclusion, the uncertain future of *Chevron* raises serious concerns about whether the designation process would be able to withstand future judicial challenges. Since assuming office in 2016, President Trump has appointed two Justices to the Supreme Court: Justice Neil Gorsuch and Justice Brett Kavanaugh, both of whom have opposed *Chevron* as an improper shift of power to agencies.[119] Other Justices on the bench, including Justice Clarence Thomas and Chief Justice John Roberts, have also criticized *Chevron*'s expansive reach.[120] In view of the current Supreme Court's skepticism, many have suggested that the Supreme Court might overturn *Chevron*.[121]

A decision by the Supreme Court to overturn *Chevron* would have significant implications for the FSOC's authority, even if the law remains otherwise unchanged. Because MetLife sought judicial review of the FSOC's designation under section 113(h) of the Dodd–Frank Act, the court applied the arbitrary and capricious standard of review when evaluating the FSOC's final determination.[122] Because Congress prescribed the arbitrary and capricious standard of review for FSOC determinations in the Dodd–Frank Act, overturning *Chevron* would not change the standard of review for future cases in which designated companies challenge FSOC final determinations. Rather, the impact of overturning *Chevron* would be more fundamental: if *Chevron* were overturned, the final rules in which the FSOC sets forth processes and procedures for designation would no longer be entitled to *Chevron* deference.

The FSOC is a federal agency, and thus its decisions through rulemaking and formal adjudication are entitled to *Chevron* deference. Whenever the FSOC interprets ambiguous language in the Dodd–Frank Act, its judgment is entitled to deference; the court cannot disturb the FSOC's judgment unless its action was arbitrary and capricious, a high standard of judicial review. The FSOC exercised this authority to interpret and implement the Dodd–Frank Act through two key rulemakings: one clarifying the FSOC's authority to require supervision and regulation of certain nonbank financial companies, and another clarifying its authority to designate financial market utilities as systemically important.[123] In these rulemakings, the FSOC described the manner in which it would apply the statutory standards and considerations described in sections 113 and 804 of the Dodd–Frank Act

119. Cass R. Sunstein, *Chevron as Law*, 107 GEO. L.J. (forthcoming 2019) (manuscript at 2–3) (on file with author); Steven Pearlstein, *How This Supreme Court Pick Could Cement Trump's Real Economic Legacy*, WASH. POST: WONKBLOG (July 11, 2018), https://www.washingtonpost.com/business/2018/07/11/how-this-supreme-court-pick-could-cement-trumps-real-economic-legacy/?noredirect=on&utm_term=.3fcaa4cbabc2 [https://perma.cc/KS9G-NQ7B].

120. *Id.*

121. *See, e.g.*, Pearlstein, *supra* note 119 (explaining that the addition of President Trump's two Supreme Court nominees to the bench secures "five reliable votes . . . to effectively overturn Chevron," in what "is likely to be Trump's most enduring economic legacy").

122. MetLife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219, 230 (D.D.C. 2016).

123. *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21,637 (Apr. 11, 2012) (codified at 12 C.F.R. pt. 1310); Authority to Designate Financial Market Utilities as Systemically Important, 76 Fed. Reg. 44,763 (July 27, 2011) (codified at 12 C.F.R. ch. XIII & pt. 1320).

and clarified the processes and procedures it would employ when designating a nonbank financial company under section 113 or a financial market utility under section 804.[124] The rule in which the FSOC described the processes and procedures for designation under section 113 was the rule that governed the process by which the FSOC designated MetLife as a systemically important nonbank financial institution.[125] Because this rule had already been legitimized through the rulemaking process and was entitled to *Chevron* deference, it would have likely been fruitless for MetLife to challenge the validity of the rule itself when it challenged its designation in *Metlife, Inc. v. Financial Stability Oversight Council*.[126]

If *Chevron* were overturned, however, these processes and procedures set forth by the FSOC would no longer be entitled to such deference. Thus, companies mounting future challenges to their designations would have an interesting new strategy for litigation at their disposal: rather than arguing that their designation was arbitrary and capricious under section 113(h), these companies could argue that the FSOC rules governing the processes and procedures for designation are fundamentally invalid. Without the hurdle of *Chevron* deference in place, a court hearing such a challenge would be empowered to substitute its own judgment for that of the FSOC when determining the validity of these rules. Indeed, a court could find that the processes and procedures for designation described by the FSOC do not faithfully interpret the congressional intent of sections 113 and 804 of the Dodd–Frank Act and are thus invalid.

In such a situation, the court might take one of two approaches: it could set aside the rules promulgated by the FSOC and direct Congress to clarify the processes and procedures by which financial nonbank companies and financial market utilities are designated, or it could set forth its own interpretation of the processes and procedures Congress intended when it enacted sections 113 and 804 of the Dodd–Frank Act. The former approach by the court would create a gap in the framework for SIFI regulation: the Dodd–Frank Act authorizes the FSOC to designate nonbank financial institutions and financial market utilities as systemically important, but without the FSOC rule governing processes and procedures for designation, the FSOC would be left without a principled approach to designation unless and until Congress passed new legislation to clarify the appropriate processes and procedures for designation.

The latter approach by the court, from the perspective of comparative institutional competence and democratic legitimacy, would be even more troubling: in such a scenario, the court would be substituting its own judgment with respect to financial regulation for that of the FSOC, even though (1) the FSOC is an administrative agency and part of the executive branch and is thus more democratically accountable than federal court judges, who are unelected and enjoy life tenure

124. *See supra* notes 61–67 and accompanying text.

125. *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. at 21,639.

126. 177 F. Supp. 3d 219.

and salary protection,[127] and (2) the FSOC is comprised of voting members with deep expertise in financial regulation, including the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairpersons of other financial regulatory agencies including the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, and the Bureau of Consumer Financial Protection.[128]

Congress, of course, would be the most democratically legitimate branch of government to prescribe the processes and procedures by which the FSOC should designate companies because members of Congress are directly elected by their constituencies. Furthermore, Congress would be able to delegate the drafting of such legislation to a congressional caucus with the expertise in financial regulation needed to clarify processes and procedures for designation. However, the courts do not have a mechanism by which they can force Congress to make these policy decisions, and an already overburdened Congress may not prioritize this particular issue within the broader scope of financial regulation. Thus, overturning *Chevron* and empowering courts to act as the final arbiter on the congressional intent underlying Dodd–Frank would present severe risks to the extant framework for designation. At best, the extant framework would assume a gap unless and until Congress passed legislation to clarify the processes and procedures for designation; at worst, this gap would be filled in by courts, which have neither the democratic accountability nor the guarantee of expertise in financial regulation to do so.

Although the district court's holding in *MetLife* leaves some room for optimism in the continued vitality of U.S. nonbank SIFI regulation, the Trump Administration's deregulatory agenda and the uncertain future of *Chevron* leave more questions than answers. Unfortunately, the FSOC's voluntary motion to dismiss its appeal of the district court's decision is far from the most drastic threat looming over the continued vitality of prudential SIFI regulation. Indeed, two categories of proposals for reforming—or altogether eliminating—federal regulation of SIFIs have been discussed in the past year: one set forth by the Department of the Treasury at the behest of President Trump, and the other set forth by Congress in the Financial CHOICE Act.[129]

IV. PROPOSALS FOR FINANCIAL REFORM

As the role played by the shadow banking system and nonbank financial institutions continues to grow, so too do deregulatory pressures from the Trump

127. *See* Sunstein, *supra* note 119, (manuscript at 9); *see also Financial Stability Oversight Council: About FSOC*, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/initiatives/fsoc/about/Pages/default.aspx [https://perma.cc/58FH-MG8K] (last updated Sept. 19, 2018, 1:59 PM) [hereinafter *About FSOC*] (highlighting that the FSOC is "held accountable to Congress through the publication of an annual report and testimony provided by the Chairperson on the FSOC's activities and emerging threats to financial stability").

128. *See About FSOC*, *supra* note 127.

129. *See* discussion *infra* Part IV.

Administration. This Part picks up on the deregulatory thread introduced at the end of Part III, discussing two sets of proposals to roll back financial regulation that have been advanced since the 2016 election of President Trump.

A. THE EXECUTIVE ENDEAVOR: TREASURY REPORTS

In February 2017, President Trump issued an Executive Order in which he set forth seven "core principles" for regulating the U.S. financial system.[130] Among these core principles are "mak[ing] regulation efficient, effective, and appropriately tailored" and "rationaliz[ing] the Federal financial regulatory framework."[131] The Executive Order directed the Department of the Treasury to consult with the heads of the member agencies of the FSOC and to compile reports highlighting which laws are not in line with the core principles.[132] Pursuant to this directive, Treasury officials met with hundreds of financial system stakeholders,[133] and in June 2017, the Treasury announced its intention to issue a series of four reports on the financial system covering the depository system, capital markets, the asset management and insurance industries, and nonbank financial institutions.[134]

Beyond directing the Department of the Treasury to inquire into the regulatory framework governing the U.S. financial system, the President issued a memorandum directing Treasury Secretary Mnuchin to report on FSOC processes, evaluate and review the FSOC, and temporarily suspend FSOC designations until the evaluation was completed.[135] Pursuant to this memorandum, the Department of the Treasury issued a report to the President detailing the FSOC's processes for making determinations that nonbank financial companies shall be subjected to supervision by the Federal Reserve and designating FMUs and nonbank financial institutions as "systemically important."[136]

The Treasury's recommendations questioned the validity of designation as a tool for mitigating systemic risk.[137] The report focuses on the financial burdens and other "serious implications" for institutions impacted by the designation process, the industries in which those institutions operate, and the economy as a whole, ultimately concluding that the "appropriateness of the nonbank financial

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130. *See* Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 3, 2017).

131. *Id.*

132. *Id.*

133. Press Release, U.S. Dep't of the Treasury, Treasury Releases First Report on Core Principles of Financial Regulation Stimulating Economic Growth, Increasing Access to Capital & Taxpayer Protection Are Top Priorities, (June 12, 2017), https://www.treasury.gov/press-center/press-releases/Pages/sm0106.aspx [https://perma.cc/254B-2NT6].

134. U.S. DEP'T OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS 4 (2017), https://www.treasury.gov/press-center/press-releases/documents/a%20financial%20system.pdf.

135. Memorandum on the Financial Stability Oversight Council, 2017 DAILY COMP. PRES. DOC. 1–2 (Apr. 21, 2017).

136. U.S. DEP'T OF THE TREASURY, FINANCIAL STABILITY OVERSIGHT COUNCIL DESIGNATIONS 4 (2017), https://www.treasury.gov/press-center/press-releases/Documents/PM-FSOC-Designations-Memo-11-17.pdf.

137. *Id.* at 9–14.

company designations tool as a mechanism for mitigating potential risks to U.S. financial stability should . . . be considered."[138] The report makes several recommendations for ways in which the nonbank financial institution designation process could be improved, but also questions the "appropriateness of the nonbank financial company designations tool as a mechanism for mitigating potential risks to U.S. financial stability" and suggests the process could be delegated to industry-specific regulators.[139] This recommendation is troubling. The FSOC is only authorized to designate a nonbank financial company as systemically important after it has determined that the company is susceptible to financial distress and that the company's financial distress would be likely to have systemic effects on the U.S. economy. Although designation does impose considerable operational burdens on the designated company, designation can also be seen as saving costs: it ensures taxpayers are not forced to bear the costs of the company's unmitigated risk.

Although the Treasury report attacked the validity of nonbank financial company designations, it did recommend retaining the designation process for FMUs, highlighting that FMUs, "by virtue of the scale of their activities, market reliance, and lack of competitive alternatives to services provided," inherently pose a systemic risk to financial stability.[140] However, the report does suggest that the regulation of FMUs would be made more effective by improving the analytical rigor of the designation process, engaging FMUs in the designation process to improve transparency, and "ensuring that the designation process is individualized and appropriately tailored."[141] It is unclear whether these changes to the FSOC process for designating FMUs would meaningfully improve the designation process or merely make it more difficult for the FSOC to designate FMUs as systemically important.

B. THE LEGISLATIVE LETUP: THE FINANCIAL CHOICE ACT

Even more troubling than the drastic reforms to SIFI designation proposed by the Treasury is the legislative proposal to altogether eliminate the FSOC's authority to designate both nonbank financial institutions and FMUs. The most sweeping proposal for financial reform is the Financial CHOICE Act of 2017, which was set forth by Congressman Jeb Hensarling, who also serves as chair of the House Financial Services Committee.[142] On June 8, 2017, the bill passed the House along party lines with 233 votes in support of the bill, all of which came from Republican members of Congress.[143] Although many suspect that the bill

138. *Id.* at 9.
139. *Id.* at 9–10.
140. *Id.* at 13.
141. *Id.*
142. *See* H.R. 10, 115th Cong. (as passed by House, June 8, 2017).
143. OFFICE OF THE CLERK, U.S. HOUSE OF REPRESENTATIVES, *Final Vote Results for Roll Call 299* (June 8, 2017, 4:38 PM), http://clerk.house.gov/evs/2017/roll299.xml [https://perma.cc/5UNK-YEKC]; *see also* Jeff Cox, *House Passes Choice Act That Would Gut Dodd-Frank Banking Reforms*, CNBC (June 8, 2017, 7:09 PM), https://www.cnbc.com/2017/06/08/house-has-votes-to-pass-choice-act-that-

will not pass the Senate as it is currently written, House Republicans touted the bill's passage as a "symbolic victory."[144] One of the stated purposes of the Financial CHOICE Act is "repealing the provisions of the Dodd–Frank Act that make America less prosperous, less stable, and less free."[145] Were the Financial CHOICE Act to pass the Senate, "any rule [] issued or revised pursuant to [a provision of law repealed by this Act] . . . shall have no force or effect."[146] Given the immense breadth of rulemaking authorized by the Dodd–Frank Act, this broad nullification provision would have a tremendous impact on the existing framework for financial regulation.[147]

Among the provisions of the Dodd–Frank Act targeted for repeal by the Financial CHOICE Act are the provisions that authorize the FSOC to designate FMUs and nonbank financial institutions as systemically important.[148] To say that the Financial CHOICE Act's proposal for reforming designation is drastic would be an understatement. Section 141 of the bill entirely repeals the FSOC's authority to designate financial market utilities—including payment, clearing, and settlement systems—as systemically important, and section 151 of the bill entirely repeals the FSOC's authority to designate nonbank financial institutions as systemically important.[149] In addition to revoking the FSOC's designation authority, the bill also repeals all provisions that authorize the Federal Reserve to supervise and take enforcement action against nonbank financial companies.[150] Put simply, if passed, the bill would strip the FSOC of its role as a prudential regulator and render it entirely incapable of employing any processes to meaningfully curb systemic risk.

What is utterly astounding about the Financial CHOICE Act is that it touts "ending bailouts and Too Big to Fail" as one of its foremost goals while stripping the FSOC of its ability to proactively regulate financial institutions.[151] During the 2008 financial crisis, bailouts were the better of two less-than-ideal options. Once widespread defaults among Wall Street firms began, the government faced a Sophie's Choice: intervene by using taxpayer dollars to prevent banks from failing, or allow dozens of large financial institutions to collapse, bringing the U.S. and global economies down with them. In implementing the Dodd–Frank Act,

would-gut-dodd-frank-banking-reforms.html [https://perma.cc/YY76-J93A]. Representative Maxine Waters referred to the bill as the "Wrong Choice Act" and described it as "one of the worst bills I have seen in my time in Congress." *Id.* Representative Waters further cautioned that the "bill would pave the way back to economic damage of the same scale (as the financial crisis), or worse." *Id.*

144. Cox, *supra* note 143 (describing the bill as "a highly controversial measure that stands virtually no chance to pass the Senate").

145. H.R. 10 at pmbl.

146. *Id.* § 2.

147. *See* DAVIS POLK, DODD-FRANK PROGRESS REPORT (2015), https://www.davispolk.com/files/2015-07-16_Dodd-Frank_Progress_Report_Five-Year_Anniversary.pdf (assessing the status of rulemaking progress for the 390 total rulemaking requirements imposed by the Dodd–Frank Act).

148. *See* H.R. 10 § 141.

149. *See id.*

150. *See id.* § 151.

151. *Id.* at pmbl.

Congress acknowledged that the best solution to the too-big-to-fail problem was to proactively regulate financial institutions to prevent such firms from operating in a way that allowed too-big-to-fail circumstances to develop. Although ending too-big-to-fail bailouts sounds like a great way to protect taxpayers, the taxpayers would indirectly bear the cost of too-big-to-fail bankruptcies, which would devastate the U.S. economy. Given the Financial CHOICE Act's refusal to make any meaningful attempt to proactively mitigate the risks that precipitate the failure of too-big-to-fail firms or manage the systemic economic impacts of bankruptcy for such firms, the Act is, at best, a hollow commitment to protecting American taxpayers.

CONCLUSION

We are at a critical juncture in financial regulation. The 2008 financial crisis, although devastating in countless ways, taught us valuable lessons about how severe the consequences of unmitigated systemic risk can be. The financial crisis proved that bad investments on Wall Street can escalate into a global economic depression. Although the regulatory framework imposed by the Dodd–Frank Act inevitably imposes costs and other challenges of compliance on affected institutions, the financial crisis demonstrated that complete absence of regulation comes at a heavy cost too. The right answer is not clear, but the wrong one is: Complete lack of oversight ultimately creates costs for taxpayers.