

BUSINESS INSURANCE

MetLife victory gives hope to other 'too big to fail' firms

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A ruling that regulators were “arbitrary and capricious” in their decision to designate MetLife Inc. a systemically important financial institution is a major victory for insurers, but the battle continues.

Within hours of last week's unsealing of the ruling by U.S. District of Columbia Court Judge Rosemary M. Collyer, who late last month overturned the “fatally flawed” MetLife designation, Treasury Secretary Jack Lew promised a vigorous appeal.

MetLife was one of three insurers — the others being American International Group Inc. and Prudential Insurance Co. — that The Financial Stability Oversight Council designated as SIFIs, making them subject to heightened reporting and financial stress tests.

Shortly after Judge Collyer issued her initial order late last month but before it became public, AIG President and CEO Peter Hancock said in a CNBC interview that he expected an appeal and “we'll see how it progresses.”

The ruling “certainly opens the opportunity” for AIG, which the government bailed out in 2008, to seek to shed its SIFI designation, but Mr. Hancock said the company would reserve judgment until rules governing SIFIs are ultimately written and interpreted.

Insurers have long argued that they, by their very nature, do not present the same sort of the threat to the national economy as do banks, but MetLife was the only insurer to challenge the SIFI designation.

“I think this is the single biggest victory for the insurance industry in the post crisis era,” said Grace Vandecruze, managing director of New York-based Grace Global Capital L.L.C., an insurance-specialist consulting firm and adviser to regulators. “It gives the industry the ammunition to fight federal regulation with a higher level of conviction. To date the industry has spent in excess of \$4 billion in regulatory and compliance costs with little tangible benefits to the policyholders.”

While SIFIs are subject to “enhanced supervision” and “prudential standards” as defined by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which created FSOC, the Federal Reserve has yet to announce what that supervision and standards will be, Judge Collyer wrote.

FSOC “determined that 'material financial distress' at MetLife Inc. could 'pose a threat to the financial stability of the United States,' ” which FSOC defined in formal guidance years before MetLife's designation, the judge wrote.

But “during the designation process, two of FSOC's definitions were ignored or, at least, abandoned. Although an agency can change its statutory interpretation when it explains why, FSOC insists that it changed nothing. But clearly it did so. FSOC reversed itself on whether MetLife's vulnerability to financial distress would be considered and on what it means to threaten the financial stability of the United States,” Judge Collyer wrote.

She said FSOC focused exclusively on the presumed benefits of its designation and ignored the potential costs.

“While MetLife advances many other arguments against its designation, FSOC's unacknowledged departure from its guidance and express refusal to consider cost(s) require the court to rescind the final determination” that MetLife be designated a SIFI, the judge ruled in dismissing other issues MetLife had raised in its legal challenge.

The treasury secretary strongly disagreed.

“This decision leaves one of the largest and most highly interconnected financial companies in the world subject to even less oversight than before the financial crisis,” Mr. Lew said in a statement. “This is wrong and dangerously ignores the lessons of the financial crisis. FSOC's authority to designate nonbank financial companies is a critical tool to address potential threats to financial stability, and it has made our financial system safer and more resilient.”

Insurers and insurance regulators, however, praised the ruling.

In a statement, the National Association of Insurance Commissioners said the ruling confirms what its members “have long argued: the Financial Stability Oversight Council's designation of MetLife as a systemically important financial institution is flawed,” including concerns about its analytical approach and lack of ability to show that MetLife's failure would affect the broader economy.

“The facts quite simply did not support MetLife being designated as a SIFI,” Dirk Kempthorne, president and CEO of the Washington-based American Council of Life Insurers said in a statement.

“FSOC should also offer a clear 'exit ramp' to companies so that they can understand the de-risking strategies they could use to be de-designated from SIFI oversight,” Mr. Kempthorne said.

The “ruling hopefully will be seen as a significant, independent affirmation that there are critical flaws in the FSOC process and that Congress needs to establish more transparency and accountability,” Dave Snyder, vice president in the Washington office of the Property Casualty Insurance Association of America, said in an email.

Nonindustry observers also look forward to the appeal.

“I think it's going to be interesting what the (appellate court) does with this decision,” said Thaya Brook Knight, associate director of financial regulation studies at the Cato Institute, a Washington-based free-market think tank. “I really don't think the judge pulled any punches in this. She said FSOC really didn't have any standards in assessing (MetLife's) the threat to U.S. financial stability.”

But some say the government's appeal looks to put efforts to shed SIFI designations or impose new ones on hold.

“FSOC is going to be less likely to designate large insurance companies as SIFIs if it's repeatedly being reversed by the district courts,” said Bruce Grohsgal, a law professor at the Delaware Law School at Widener University in Wilmington, Delaware. “The bigger elephant in the room I think is Judge Collyer's requirement that FSOC must now undertake a cost-benefit analysis prior to designating a SIFI, even though Congress in Dodd-Frank did not require this.”

The government's promised appeal could “dampen enthusiasm for AIG or Prudential to try to dedesignate,” said Tom Dawson, a partner in the New York office of Drinker Biddle & Reath L.L.P. and co-head of the firm's insurance transactional and regulatory team. “It's conceivable that Treasury could prevail on the appeal; but if they don't, I think at worst, Judge Collyer has given them pretty detailed instructions on how to proceed the second time around.”