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# FSOC's Proposed SIFI Reforms Are 'Too Little, Too Late': Critics

by John Heltman
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WASHINGTON — The Financial Stability Oversight Council's proposed changes to its process for designating nonbanks as systemically important are being widely praised as helpful and responsive, but many stakeholders say that they do not go far enough.

During an open session last week, the council suggested an array of changes to its process, including talking to potentially designated firms earlier, greater public dissemination of details of the review process and a more substantial annual review of designated firms.

But many observers say the changes will not be substantial enough to fundamentally change the council's relationship with its critics in Congress and the industry.

"It's probably too little, too late," said Oliver Ireland, a partner at the law firm Morrison Foerster and a former Federal Reserve official. "I think they should have gone about this process very differently from day one. They should have put much greater effort into defining SIFI criteria and to define them in a way that made it much clearer who was going to get picked up and why."

Aaron Klein, a former Treasury official and head of financial reform at the Bipartisan Policy Center, said the changes only addressed relatively consensus-based changes to one aspect of the FSOC's work, namely the designation of nonbank systemically important financial institutions. As a result, the changes would not fundamentally change the minds of groups or individuals who are staunchly opposed to the council and its work. But they may send a signal that the FSOC is willing to make meaningful changes where they can and respond to reasoned arguments.

"If your inherent goal is to eliminate FSOC, this will not mollify you," Klein said. "I do think it is an important point that the administration has acknowledged that FSOC's process needs improvement, they're taking steps to improve it, and that creates a fundamentally different relationship between the administration and its critics in Congress."

One of the council's most persistent critics in Congress, Rep. Scott Garrett, R-N.J., disagrees. While the changes are welcome, Garrett said, they are not enough to change his position — a position he says is shared by many in the Republican caucus — that the FSOC's proceedings are far too opaque and its actions inadequately supervised. Garrett said the House Financial Services Committee, of which he is a top member, is likely to hold hearings on the council's activities in the near future.

"I do not find [the changes] are substantial," Garrett said in a brief interview. "It's better than taking no action whatsoever but they have not responded as Congress would like them to respond, so a legislative fix may very well be the end result."

In addition to criticisms from Congress, the FSOC is also facing a legal challenge from insurance provider MetLife over its SIFI designation, which was approved by the council in December. The suit is the first direct challenge to the council's designation authority — indeed, the first time the FSOC has been taken to court at all — and the case could potentially have wide-ranging effects on the Dodd-Frank Act regulatory architecture.

If it is unclear whether the changes will affect the FSOC's relationship with Congress, it is even less clear how the changes might affect the trajectory of the MetLife suit. The council has not yet responded to MetLife's complaint, which was filed in D.C. District Court on Jan. 16, and both MetLife and the FSOC declined to comment on the ongoing litigation.

Ireland said it is naïve to think that the suit did not inform the council's decision to change certain aspects of the nonbank SIFI designation process, though how the changes will interact with the suit is unclear.

The changes will give the FSOC a more robust annual review process, so by the time the suit gets under way, the basis for MetLife's designation may be different than what it cites in its suit. By the same token, the FSOC's decision to change its nonbank designation process unilaterally could be seen as an admission to its flaws. Ultimately, Ireland said, the case will likely be decided on the narrowest possible terms.

"I think the judge is going to do everything they can to get rid of this case," Ireland said. "They're going to try to rule on some procedural or technical legal grounds, because it falls on the judge to make very, very difficult judgments."

Many observers in the insurance industry, rather than backing up MetLife in its quest, have backed away from the insurer and its suit. Steve Miller, a non-executive chairman at American International Group — one of the other nonbanks to be named a SIFI — told CNBC last week that MetLife should not have filed the suit because it will not prevail.

"I don't think they can win," Miller said. "The legal argument is that FSOC was capricious? I don't think so. They've taken two years to think about it. That's not capricious. My main thing is, OK to be a SIFI, but please treat insurance companies different from banks. Otherwise you're at risk of destroying the insurance industry."

Grace Vandecruze, managing director of insurance sector advisory firm Grace Global Capital, agreed with Miller that MetLife will not prevail. But the suit will also not change the insurance industry's position that SIFI-designated insurance companies should be regulated by their state regulators as they are already rather than by an additional layer of regulation by the Federal Reserve.

"I see this playing out to the very end," Vandecruze said. "MetLife has presented a very strong lawsuit. My opinion is that they will not prevail and that the regulation from the Fed is going to be a bitter pill that the insurance industry will have to swallow."

Congress passed a bill late last year that allowed the Fed to issue regulations for nonbank SIFIs that differ from those capital rules applied to SIFI banks. The central bank has not yet issued those rules, and a Fed spokesman said the agency has no guidance on when they may be proposed.

Ireland pointed out that regulatory structures are often notoriously slow-growing — one example he cited was the Food and Drug Administration's decades-long effort to develop a regulatory definition of "peanut butter" — and litigation challenging executive rules are similarly long-lived. But the FSOC should take the time to ensure that its SIFI rules are executed correctly, regardless of the lawsuit. The changes may be the first step in that process.

"This is one of the key, if not the key, feature of the legislation to respond to the worst financial crisis since the Great Depression, and we don't seem to know what we're doing," Ireland said. "It's not like you got 'peanut butter' wrong. Major financial meltdowns are major financial meltdowns, and if you think it's important to avoid those, it's important to do this right."