

The FSOC's Designation Program as a Case Study of the New Administrative Law of Financial Supervision

Robert F. Weber[†]

When legal scholars specializing in financial regulation have examined the Financial Stability Oversight Council (FSOC), their lens has usually focused on matters outside of the core public law expertise they are best positioned to contribute. This curious state of affairs is the consequence of the historical mutual disinterest between administrative law scholars and financial regulatory scholars. This Article helps bridge this divide, conducting a comprehensive administrative law analysis of the FSOC's Section 113 designation program, and using it as a case study of an emerging trend in U.S. public law: increased contestation concerning the legal legitimacy of financial supervisory programs that provide for extensive, open-ended discretion on the part of regulators.

Today, the FSOC's designation program and other supervisory programs like it require financial supervisors to draw from an ever-deeper reservoir of administrative discretion to make hypothetical and conjectural assessments of future events. These programs have come to resemble so-called "risk regulatory" regimes—programs that require the exercise of significant regulatory discretion to counteract future harms subject to non-trivial uncertainty. In response, affected regulatory subjects have seized upon this discretionary power, calling into question the legality of its exercise. This Article analyzes the legal sufficiency of the procedural and substantive constraints on the FSOC's discretion embedded in the FSOC's designation statute and its own rulemakings.

It uncovers several structural problems with the FSOC framework. Whereas some of these problems are susceptible to amendatory fixes, others are not. These more trenchant problems are ubiquitous in risk regulatory regimes, but financial supervisory regimes have yet to develop the institutional and doctrinal forms needed to reconcile such open-ended discretion with the rule of administrative law. In presenting this analysis, the Article fires a warning shot in the direction of financial regulators, policymakers, and scholars, cautioning them that other programs are likely to be contested in the near future.

[†] Associate Professor, Georgia State University College of Law.

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Introduction

One of the key pillars of today’s financial supervisory system is the Financial Stability Oversight Council (FSOC, or Council).¹ This new

1. Where this Article uses the term “financial supervision,” it denotes the ongoing application of laws, as well as regulatory rules and guidance, to financial institutions. The practices falling under the “supervision” umbrella occur in the context of a relationship between a regulated institution and its supervisor. They are distinguishable from “financial regulation” in that the latter also includes formal notice-and-comment rulemaking—the making of the rules rather than their application. The supervision-regulation distinction is not airtight; after all, each federal supervisor (for example, the Federal Reserve) regularly promulgates regulations as well. Furthermore, the relationship is interdependent, as illustrated, for instance, by the Section 113 designation program that is the subject of this Article. The FSOC’s main task is neither purely supervisory nor purely regulatory. It enforces a regulatory regime embodied in a rulemaking, but the function of that rule is to initiate a supervisory relationship between the designee and the Federal Reserve. Nevertheless, the distinctive attribute of a supervisory regime is the ongoing relationship between the governmental regulator and the regulated institution. The Article will use “supervisor” and “regulator” interchangeably to refer to the agency performing the supervisory function.

administrative agency, created by Congress in 2010, is among the most important and most underappreciated regulatory bodies in American government. Congress charged the FSOC with sweeping statutory responsibilities to identify and respond to threats to the “financial stability of the United States,” outfitting it with a series of regulatory powers that had never existed before.² In this role, the FSOC serves as a sort of regulatory caulking device or sealant, designed to plug holes in the regulatory edifice that both hindsight and prospective analysis reveal.

This Article focuses on the FSOC’s most important responsibility: the designation of systemically significant nonbank financial institutions for federal supervision. Following the financial crisis, it quickly became an article of faith among policymakers and experts that one of the principal shortcomings of the pre-crisis legal-regulatory regime was that “investment banks and other types of nonbank financial firms operated with inadequate government oversight,” which in turn “left the government ill-equipped to handle the recent financial crisis.”³ The designation power, set forth in Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), authorizes the FSOC to require certain nonbank firms otherwise immune from federal regulatory oversight to submit to ongoing supervision by the Federal Reserve—the most sophisticated and well-resourced financial regulator. The crux of the designation authority is that the FSOC is required to designate any nonbank company that “could pose a threat to the financial stability of the United States.”⁴

This Article examines the Section 113 program as a case study of the administrative law implications of an emerging trend in U.S. public law: increased contestation concerning the legal legitimacy of financial supervisory programs. When legal scholars specializing in financial regulation have examined the FSOC, their lens has usually focused on matters outside of the core public law expertise they are best positioned to contribute. And this observation applies more broadly to studies of the other core pillars of the post-crisis financial supervisory regime.⁵ Historically, scholars, commentators, and lawyers engaged in financial regulation and supervision, on the one hand, and administrative law, on the other hand, have largely talked past each other. A curious disciplinary vertigo sets in when financial regulatory experts confront administrative law

2. Dodd-Frank Wall Street Reform and Consumer Protection Act § 112(a)(1), 12 U.S.C. § 5322(a)(1) (2018).

3. S. REP. NO. 111-176, at 2-3 (2010).

4. Dodd-Frank Act § 113(a)(1). Technically, as discussed at length below, the FSOC must link the possible threat to one of two sets of circumstances set forth in the statute. These two triggering factual predicates are (1) the particular “nature, scope, size, scale, concentration, interconnectedness, or mix of the activities” at the company; and (2) a “material financial distress” at the firm. *Id.*

5. Here, I refer primarily to the Federal Reserve’s stress testing initiative and its related capital review program, as well as the resolution planning exercise (also referred to as the “living wills” program) jointly administered by the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC).

doctrine and theory, or when administrative lawyers have occasion to peer into the black box of the bank regulatory bureaucracy.

This Article helps bridge this divide, presenting a comprehensive administrative law analysis of the Section 113 regime. Bearing in mind the central preoccupation of administrative law with cabining arbitrary bureaucratic discretion, this analysis must acknowledge how the Section 113 regime, and other supervisory programs like it, require financial supervisors to draw from an ever-deeper reservoir of administrative discretion to make conjectural assessments of future events. These programs have come to resemble so-called “risk-regulatory” regimes—programs that require the exercise of significant regulatory discretion to prevent or mitigate future harms subject to non-trivial uncertainty. For decades, most environmental, public health, and workplace safety regulation has been framed in these terms, but the risk regulation frame is altogether new in the financial supervisory context.⁶

In the case of the Section 113 program, the statute requires the agency to make a hypothetical assessment concerning whether the subject company *could* pose a threat to the financial stability of the United States, a task that requires the exercise of a significant degree of administrative discretion and judgment.⁷ The interpretive guidance promulgated by the FSOC in effect doubles down on conjecture and discretion. It clarifies that a “threat to the financial stability of the United States” exists “if 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.”⁸

The FSOC's critics have seized upon the discretionary power entailed by this program, decrying it as an example of unconstrained bureaucratic government. Notwithstanding these critiques, a review of the statutory and regulatory-supervisory framework for the Section 113 program reveals to the contrary an elaborate scaffolding of procedural and substantive devices designed to cabin, structure, and guide the FSOC's exercise of discretion.

That said, these devices, as with any administrative decisionmaking framework, will only perform a legitimating function if they are susceptible to consistent and transparent application. Where, on the other hand, regulatory rules or frameworks are internally inconsistent, or are otherwise insusceptible to regular, consistent application, they are vulnerable to a challenge on the grounds that they violate the APA's first commandment: thou shalt not take “arbitrary and capricious” actions.⁹ Even more fundamentally, they undercut the

6. To be sure, aspects of modern financial regulatory systems, particularly the bank supervisory regime, have resembled risk-regulatory regimes for decades. The point here is simply that those working in the financial regulatory arena did not conceive of the objects of their study and their practice in those terms.

7. See *supra* note 4 and accompanying text.

8. Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 77 Fed. Reg. 21,637, 21,657 (Apr. 11, 2012) [hereinafter Final FSOC Section 113 Guidance] (emphasis added).

9. See *infra* note 138 and accompanying text.

foundational sources of legal legitimacy claims—due process, administrative fairness, equality before the law, and the deployment of expertise—of which the APA is only our localized legislative expression.¹⁰

Underscoring the primacy of its Section 113 responsibilities, the FSOC's first action was to promulgate a rule setting forth a structured process and a substantive "Analytic Framework" for its designation inquiries. A detailed analysis of the Analytic Framework reveals four remediable structural inconsistencies. These flaws compromise the coherence of the FSOC's deliberations; consequently, they complicate the agency's ability to legitimate its designations by demonstrating its adherence to the core administrative law norms of analytic integrity and consistent and regular applications of rules. Fortunately, it should be possible for the FSOC to remedy these flaws through a suite of amendments that would not alter the basic substance of the designation inquiry.

On the other hand, three other structural problems with the Analytic Framework are not susceptible to quick amendatory fixes. The first and second of such problems highlight ubiquitous dilemmas in risk-regulatory regimes. However, the newness of the risk-regulatory lens in the financial supervisory context means that regimes such as the Section 113 program are not presently situated to benefit from the near half-century of institutional and doctrinal developments that have constrained administrative discretion and reconciled the existence of open-ended discretion with the rule of administrative law.

The first trenchant problem, which I label the *Causality Conundrum*, refers to a particular type of justificatory demand that administrative law increasingly makes of risk-regulatory agencies. We can think of it as posing the following question: why did the regulator assume that the future would look like *that*? The problem for the Section 113 program is that the Analytic Framework eschews any formal requirement that the Council specify, much less quantify, the predictive judgments embedded in its assessments of how and whether companies might cause disruptions to the financial system. The result is that the Framework makes FSOC designations susceptible to accusations of arbitrariness because it does not require probabilistic specification of the causal channels through which a systemic problem might hypothetically occur. The second trenchant problem, which I label the *Regulatory Costs Dilemma*, addresses the judiciary's practice, illustrated recently in the 2015 Supreme Court case *Michigan v. EPA*, of invalidating regulatory actions as "arbitrary and capricious" where the regulator's decision process does not formally account for the costs

10. See ROBERT BALDWIN, RULES AND GOVERNMENT 41-46 (1995) (fidelity to legislative mandate, democratic accountability, due process, expertise, and efficiency); CHRISTOPHER F. EDLEY, JR., ADMINISTRATIVE LAW: RETHINKING JUDICIAL CONTROL OF BUREAUCRACY 3 (1990) (adjudicatory fairness, expertise, and participatory politics); JAMES O. FREEDMAN, CRISIS AND LEGITIMACY: THE ADMINISTRATIVE PROCESS AND AMERICAN GOVERNMENT 11 (1978) (constitutionality, democratic accountability, procedural fairness, protection of individual rights, and commitment to just results).

incurred by regulated entities in connection with the regulatory action.¹¹ In each of its designations to date, the FSOC has opted not to take these costs into account—a practice that, if continued, makes the designations vulnerable to this de-legitimizing critique.

The third problem, which I label the *Filter Problem*, refers to the FSOC's decision to accommodate industry requests to insert an additional criterion into its deliberative process that narrows the universe of possible designees. This additional filter arguably contradicts the Section 113 statute, and it demonstrates that despite the clamor about regulatory *overreach* on the part of financial industry firms, one of the Framework's most trenchant flaws results in significant *under-regulation* compared to what the statute seems to require.

This Article proceeds as follows. Part I sets the context for the administrative law analysis by introducing the basic structure of the FSOC and the Section 113 program, tracing the genesis of the FSOC, explaining the consequences of designation, and describing the FSOC's early designation enforcement practice. Part II explains how the Section 113 program is an excellent contemporary case study for how government answers the foundational imperative of administrative law: how to legitimate discretionary bureaucratic power. It also explains how financial supervisory programs have historically elided the attention of administrative law, and how that mutual disinterest is no longer advisable—or even tenable. Part III details how Section 113 vests the FSOC with a deep reservoir of discretionary administrative power. Part III summarizes the procedural and substantive details of Section 113 investigations as set forth in the FSOC's 2012 administrative rulemaking, with special attention on how these procedures operate to channel the Council's discretion.

Parts IV and V set forth the Article's main findings and contributions. First, Part IV introduces the Filter Problem, the Causality Conundrum, and the Regulatory Costs Dilemma and clarifies why they are not susceptible to quick amendatory fixes. It also fires a warning shot in the direction of other financial supervisors and regulators, since these problems frustrate their attempts to legitimate their own regulatory actions. Part V identifies the four structural inconsistencies with the Analytic Framework and recommends a set of amendments to rationalize the same. In the course of uncovering these problems, it lays out the first comprehensive conceptual map of the FSOC's complicated Analytic Framework, and underscores how the identified problems presently compromise the legality of the Section 113 program. Part VI concludes.

I. FSOC: From Creation to Contestation

Following the financial crisis, it quickly became an article of faith among policymakers and experts that one of the principal shortcomings of the pre-Dodd-Frank legal-regulatory regime was that “investment banks and other types of

11. *Michigan v. EPA*, 135 S. Ct. 2699 (2015).

nonbank financial firms operated with inadequate government oversight,” which in turn “left the government ill-equipped to handle the recent financial crisis.”¹² The metaphor of the “regulatory gap” was frequently used to explain this administrative failure. One of the primary animating purposes behind the Dodd-Frank Act was the perceived need to fill those gaps: to construct an institutional apparatus to enable administrative government to surveil, understand, and ultimately protect the systemic integrity of the entire financial system. The Financial Stability Oversight Council would serve as this administrative gap-filling mechanism, occupying itself in the epistemic and, ultimately, legal-regulatory spaces that had gone under-examined in the lead-up to the financial crisis. With the FSOC, Congress built out the former financial regulatory system into a new dimension, focused on the financial *system* as such rather than individual financial institutions.¹³

A. *The Idea of the FSOC: The Ultimate Regulatory Caulking Device*

To appreciate the FSOC’s purpose, it is necessary to understand its origins. The FSOC was conceived of as a sort of regulatory sealant, filling in the perceived “gaps” in the institutional apparatus of financial regulation that policymakers identified, in hindsight, as having catalyzed the financial crisis.¹⁴ Historically, Congress has preferred to structure the financial regulatory system as an entity-centric system in which administrative agencies supervise individual financial institutions (and their holding companies) rather than the financial markets in which those institutions transact or the financial functions they perform—much less the entire financial system.¹⁵ This system has the advantage

12. S. REP. NO. 111-176, at 2-3 (2010).

13. Sometimes, this system-wide regulatory scheme is referred to as “macroprudential” to distinguish it from “microprudential” regulation’s focus on individual institutions. *See, e.g.*, Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Federal Reserve Bank of Chicago 47th Annual Conference on Bank Structure and Competition: Implementing a Macroprudential Approach to Supervision and Regulation (May 5, 2011), <http://www.federalreserve.gov/newsevents/speech/Bernanke20110505a.pdf> [<https://perma.cc/JJY2-5M3K>].

14. *See* TIMOTHY F. GEITHNER, STRESS TEST: REFLECTIONS ON FINANCIAL CRISES 96 (2014) (lamenting that “America’s balkanized regulatory system” was “riddled with gaps and turf battles”); FINANCIAL CRISIS INQUIRY COMM’N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES xviii (2011) (arguing that deregulation “had opened up gaps in oversight of critical areas with trillions of dollars at risk, such as the shadow banking system and over-the-counter derivatives markets”); U.S. DEP’T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION (2009) [hereinafter OBAMA REGULATORY REFORM WHITE PAPER], https://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf [<https://perma.cc/UWH4-86ES>].

15. *See* Anita K. Krug, *Escaping Entity-Centrism in Financial Services Regulation*, 113 COLUM. L. REV. 2039, 2049 (2013) (“Financial services regulation embodies entity-centrism, in that it is largely premised on the notion that the entity is the appropriate unit of regulation.”). It might be argued that some types of arguably “financial” regulation, such as securities mandatory disclosure rules, are function-based rather than entity-based in the sense that such regulations apply broadly to securities transactions irrespective of the type of entity undertaking the transactions. *See, e.g.*, 15 U.S.C. § 77b(a)(4)

of determinacy: specific charters are required for entry into specific markets (e.g., banking, insurance, and securities). And with the charter comes a designated supervisor. On the other hand, the system has the well-documented shortcoming of leaving the administrative state without the ability to see the (systemic) forest for the (institutional) trees. There were, in other words, regulatory gaps.

During and after the crisis, this spatial metaphor of the regulatory “gap” gained currency as a rhetorical device to describe the ways in which this entity-centric system was perceived to have failed.¹⁶ Policy entrepreneurs, understanding that the political economy of financial regulation is such that post-crisis environments are opportune reform times,¹⁷ deployed the metaphor extensively. Thus, there were regulatory “gaps” when it came to understanding the nature and size of markets for specific types of transactions, such as the repo market,¹⁸ or financial functions, such as the clearing and settlement of swaps.¹⁹ There were also “gaps” when it came to supervising individual institutions; that

(2018) (defining the gateway term “issuer” as “every person who issues or proposes to issue any security”); *id.* § 77b(a)(2) (defining “person” as “an individual, a corporation, a partnership, an association, a joint-stock company, a trust, any unincorporated organization, or a government or political subdivision thereof”). However, such regulatory regimes promote public purposes other than institutional safety-and-soundness and systemic stability and are therefore distinguishable from the supervisory regimes with which this Article is concerned. Despite efforts by financial economists to re-conceptualize the supervisory financial regulation on functional grounds (e.g., regulating insurance as the function of guaranteeing values of assets (by whatever contractual arrangement entered into with whatever entity) rather than the writing of insurance contracts by licensed insurance company entities), these regimes have remained steadfastly entity-centric. *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-16-75, FINANCIAL REGULATION: COMPLEX AND FRAGMENTED STRUCTURE COULD BE STREAMLINED TO IMPROVE EFFECTIVENESS 64-65 (2016) [hereinafter GAO STREAMLINING REPORT], <https://www.gao.gov/assets/680/675400.pdf> [<https://perma.cc/JGW6-8BYY>]; Robert C. Merton, *Financial Innovation and the Management and Regulation of Financial Institutions*, 19 J. BANKING & FIN. 461, 466-69 (1995) (advocating viewing the financial system from a “functional perspective” such that many existing “institutional categories (not only for institutions but for the very products themselves) will have to be redefined to be operationally effective in setting regulations”); Merton H. Miller, *Functional Regulation*, PAC-BASIN FIN. J. 91, 99-103 (1994) (favorably remarking on a “proposal for functional regulation” but ultimately arguing that “the prospects for [such a proposal] or any other sweeping reorganization of the current U.S. regulatory landscape are . . . remote”).

16. Here, I am using the notion of a regulatory gap to refer to a rhetorical expression about a prior regulatory failing. For a substantive and descriptive theory explaining the persistence of “regulatory gaps,” see William W. Buzbee, *Recognizing the Regulatory Commons: A Theory of Regulatory Gaps*, 89 IOWA L. REV. 1, 1 (2003).

17. *See* John C. Coffee, Jr., *Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019 (2012).

18. Hank Paulson, U.S. Treasury Secretary during the throes of the financial crisis at the end of the George W. Bush administration, blamed “gaps in authority” for, among other problems, the failure of U.S. financial regulators to “deal[] with the . . . problems” attendant to the “repo” market, the evaporation of which was a catalytic circumstance of the financial crisis. *See The Shadow Banking System, Perspective on the Shadow Banking System: Hearing Before the Fin. Crisis Inquiry Comm'n* (2010) (statement of Henry Paulson).

19. *See* Press Release, SEC, Chairman Cox Announces End of Consolidated Supervised Entities Program (Sept. 26, 2008), <https://www.sec.gov/news/press/2008/2008-230.htm> [<https://perma.cc/376B-SJDM>] (complaining of “major gaps in our regulatory framework,” including “a massive hole” in the form of the “approximately \$60 trillion credit default swap (CDS) market, which is regulated by no agency of government”).

is, even within the predominant paradigm of entity-centric regulation, some entities fell through cracks in the regulatory edifice.²⁰ Former Chairman of the Federal Reserve Ben Bernanke identified “gaps in the government’s crisis-response toolkit” as an explanation for “why the crisis was so severe and had such devastating effects on the broader economy.”²¹ Other commentators attributed the crisis in part to the unregulated “shadow banking system,” employing a similar metaphor to refer to nonbanks conducting the fundamentally bank-like business of extending credit with short-term, cash-like funding sources.²²

While widespread regulatory failures abounded, nowhere was the perception of regulatory gaps and shadows more pronounced than with respect to supervision of the entire financial *system*. During the financial crisis, both the George W. Bush and Barack Obama Treasury Departments published regulatory reform white papers; each document identified the absence of a regulator charged with the responsibility of systemic oversight as the key shortcoming of the pre-crisis framework. The Bush white paper complained that developments in financial markets “are pressuring the U.S. regulatory structure, exposing regulatory gaps as well as redundancies.”²³ Most importantly, “no single regulator possesses all of the information and authority necessary to monitor systemic risk.”²⁴ The Obama white paper similarly invoked the gap metaphor with respect to systemic risk: “Gaps and weaknesses in the supervision and regulation of financial firms presented challenges to our government’s ability to monitor, prevent, or address risks as they built up in the system. No regulator saw its job as protecting the economy and financial system as a whole.”²⁵

20. See Yuliya Demyanyk & Elena Loutschina, *A Gap in Regulation and the Looser Lending Standards That Followed*, ECON. COMMENT. (Oct. 9, 2014), <https://www.clevelandfed.org/newsroom-and-events/publications/economic-commentary/2014-economic-commentaries/ec-201420-a-gap-in-regulation-and-the-looser-lending-standards-that-followed.aspx> [<https://perma.cc/N2JM-SB58>] (“Mortgage companies were not funded by deposits, so no institutional regulator oversaw them . . .”); U.S. DEP’T OF THE TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE 6 (2008) [hereinafter BUSH BLUEPRINT FOR REGULATORY REFORM] (“The high levels of delinquencies, defaults, and foreclosures among subprime borrowers in 2007 and 2008 have highlighted gaps in the U.S. oversight system for mortgage origination. In recent years, mortgage brokers and lenders with no federal supervision originated a substantial portion of all mortgages and over 50 percent of subprime mortgages in the United States.”).

21. *Too Big to Fail: Expectations and Impact of Extraordinary Government Intervention and the Role of Systemic Risk in the Financial Crisis: Hearing Before the Fin. Crisis Inquiry Comm’n* (2010) (statement of Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys.).

22. See Demyanyk & Loutschina, *supra* note 20, at 1 (“Because the historical focus of banking regulation had always been on protecting depositors, shadow banks were subject to less regulation and oversight than banks before the financial crisis, allowing them to make the riskier loans that ultimately played such a large role in the crisis.”); Gary Gorton & Andrew Metrick, *Regulating the Shadow Banking System*, BROOKINGS INST. (Oct. 18, 2010), https://www.brookings.edu/wp-content/uploads/2010/09/2010b_bpea_gorton.pdf [<https://perma.cc/6MQ5-6VLP>].

23. BUSH BLUEPRINT FOR REGULATORY REFORM, *supra* note 20, at 4.

24. *Id.*

25. OBAMA REGULATORY REFORM WHITE PAPER, *supra* note 14, at 2.

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The Obama white paper envisaged the creation of a Financial Services Oversight Council as an interagency body designed “to identify emerging systemic risks and improve interagency cooperation.”²⁶ In the end, the Dodd-Frank Act gave form to this interagency body in the form of the FSOC, swapping out the Obama Treasury Department’s “Services” in favor of “Stability.” The House Committee report for the legislation identified three purposes for the new Council: (1) monitoring potential threats to the financial system, (2) providing more stringent regulation for nonbank financial companies that pose risks to financial stability, and (3) providing more stringent regulation for “financial activities” that pose risks to financial stability.²⁷

Section 112(a)(1) of the final Dodd-Frank Act set forth the formal statutory mandate for the new regulatory council:

(1) IN GENERAL.—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 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.

By including subparagraph (B), with its focus on “promot[ing] market discipline,” Congress ultimately diverged from the House Committee report, tipping its hat to the standard pro-market faith in the self-equilibrating tendency of privately ordered markets. But the mandate contemplates an unmistakably active role for the new Council: it would “identify” and “respond” to “emerging threats.”²⁸

In a sense, then, the FSOC was designed as the ultimate regulatory caulking device, filling in the gaps and shadows in the regulatory system that hindsight revealed. As for the perceived *functional* gaps, the FSOC was charged in Section 804 with the responsibility of designating firms engaged in systemically significant financial activities—the final legislation termed these firms “financial market utilities” (FMUs)—for heightened supervision (as well as access to

26. See OBAMA REGULATORY REFORM WHITE PAPER, *supra* note 14, at 3.

27. H.R. REP. NO.111-517, at 865 (2010).

28. Subparagraph (C) used the word “identify” to capture what the House Committee report referred to as “monitoring.”

Federal Reserve liquidity).²⁹ In July 2012, the FSOC unanimously designated eight FMUs responsible for the clearing and settling of transactions among financial institutions.³⁰

Congress filled the *entity* gap with the Section 113 designation program.³¹ In a world where entity-centrism had prevailed from the beginning, this charge was the most important of the FSOC's responsibilities. Section 113, especially when considered in combination with the Council's new informational duty to monitor system-wide risk and coordinate among the diverse entity-supervisors, also addressed the perceived *system* gap—that is, the gap in surveillance of systemic risk as such. In case there remained any other conceptual category of regulatory space that was not addressed by these gap-fillers, Congress vested the FSOC with a residual authority to “to identify gaps in regulation that could pose risks to the financial stability of the United States.”³² Having patched over all the gaps, the new regulator was told to keep a tube of sealant on hand going forward, keeping an eye out for any new emerging cracks.

The picture that emerges from the FSOC's genesis story is the design of an institutional panacea capable not only of curing the ills of the last crisis, but also of monitoring and forestalling the next one. It is an instrumentalist tool designed to colonize a new and potentially unbounded regulatory space. Whether it is, as a practical matter, capable of succeeding in that charge is an empirical matter that is altogether outside the scope of this Article, which focuses more narrowly on the administrative law questions concerning the legal control of the FSOC's discretionary powers.

B. An Introduction to the Designation Statute: Its Significance and Structure

The linchpin of this new system-focused financial regulatory regime is the FSOC's authority under Section 113 of the Dodd-Frank Act to “designate” financial institutions not presently supervised by federal banking regulators—referred to by the legislation as “nonbank financial companies”—for supervision

29. Dodd-Frank Wall Street Reform and Consumer Protection Act, §§ 112(a)(2)(J), 804, 12 U.S.C. §§ 5322, 5463 (2018). Specifically, Section 804 requires the FSOC, after consultation with the Federal Reserve and the relevant federal agency that has primary jurisdiction over an FMU under federal banking, securities, or commodity futures laws (e.g., the SEC or the CFTC), to identify and designate an FMU that is, or is likely to become, systemically important. *See* Authority to Designate Financial Market Utilities as Systemically Important, 44 Fed. Reg. 44,763, 44,763 (July 27, 2011) (to be codified at 12 C.F.R. pt. 1320). In assessing a possible FMU's systemic importance, the Council considers whether a “failure of or disruption to an FMU could create, or increase, the risk of significant liquidity or credit problems spreading across financial institutions and markets and thereby threaten the stability of the U.S. financial system.” *Id.*

30. *See* Press Release, Financial Stability Oversight Council, Financial Stability Oversight Council Makes First Designations in Effort to Protect Against Future Financial Crises (July 18, 2012) <https://www.treasury.gov/press-center/press-releases/Pages/tg1645.aspx> [<https://perma.cc/9TXF-JJMJ>].

31. The FSOC was also instructed to recommend additional supervisory requirements for the Federal Reserve to implement in connection with its supervision of such companies.

32. Dodd-Frank Act § 102(a)(2)(G).

by the Federal Reserve.³³ The FSOC's role is that of a gatekeeper rather than a supervisor; the FSOC designates, and the Federal Reserve supervises. The statute is noteworthy because of both its consequences and its structure.

1. The Significance of Section 113

The anticipated consequences of the Section 113 designation program are significant for both the economy and the designated companies. Given the centrality of the idea of the “systemic risk” problem to the broader Dodd-Frank legislative scheme,³⁴ it is not surprising that the FSOC's organic statute is set forth in Title I, Subtitle A of the Act. As noted earlier, the FSOC's Section 113 authority is its most consequential power.³⁵ As a baseline matter, most of the nonbank financial companies subject to potential designation will never have been subject to any consolidated supervision,³⁶ let alone federal supervision by the Federal Reserve, by good measure the most sophisticated and well-resourced of U.S. financial regulators. Once designated, nonbank financial companies will be required to report to, and submit to examinations by, the Federal Reserve.³⁷ These companies are also made subject to Section 8 of the Federal Deposit Insurance Act,³⁸ which outfits supervisors with wide-ranging enforcement authority, including the power to issue cease-and-desist orders on the company (or its affiliates) if the company engages in any “unsafe or unsound practice[s] in conducting [its] business.”³⁹ The Act also submits designees to the existing regulatory regimes concerning prior approval of bank acquisitions⁴⁰ and management interlocks at unaffiliated banking institutions.⁴¹

Perhaps even more significantly, Section 165 of the legislation instructs the Federal Reserve to create and apply a heightened suite of prudential standards to Section 113 designees, as well as large bank holding companies (BHCs) with

33. See Patricia A. McCoy, *Systemic Risk Oversight and the Shifting Balance of State and Federal Authority over Insurance*, 5 U. CAL. IRVINE L. REV. 1389, 1411-12 (2015) (referring to the FSOC as the “linchpin” of a “new framework for the federal oversight of systemic risk”).

34. See *supra* Section I.A.

35. See Stavros Gadinis, *From Independence to Politics in Financial Regulation*, 101 CALIF. L. REV. 327, 369 (2013).

36. Supervision is said to be “consolidated” when it encompasses an entire company group—that is, a parent company and its subsidiaries. See BD. OF GOVERNORS, FED. RESERVE SYS., 102ND ANNUAL REPORT 47 (2015), <https://www.federalreserve.gov/publications/annual-report/files/2015-annual-report.pdf> [<https://perma.cc/X4YE-ACLE>].

37. Dodd-Frank Act § 161.

38. *Id.* § 162.

39. Federal Deposit Insurance Act § 8(b)-(c), 12 U.S.C. § 1818(b)-(c) (2018).

40. Federal Deposit Insurance Act § 163 (applying the Bank Holding Company Act § 3, 12 U.S.C. § 1842 (2018), to companies designated under Section 113).

41. Federal Deposit Insurance Act § 164 (applying the Depository Institution Management Interlocks Act, 12 U.S.C. §§ 3201-3208 (2018), to companies designated under Section 113).

more than \$250 billion in total consolidated assets.⁴² These standards include risk-based capital requirements and leverage limits, liquidity requirements, risk management mandates, resolution planning requirements (also known as “living wills”), single-counterparty credit limits, and stress testing requirements.⁴³ In recognition of the reality that Section 113 designees are not primarily involved in the banking business,⁴⁴ Congress instructed the Federal Reserve to “take into account differences” among large bank holding companies and Section 113 designees when promulgating these enhanced standards.⁴⁵ After initially proposing a one-size-fits-all set of standards for both large BHCs⁴⁶ and Section 113 designees,⁴⁷ the Federal Reserve eventually acceded to industry requests to promulgate separate sets of standards for large BHCs and Section 113 designees.⁴⁸

The enhanced standards for large BHCs were finalized in March 2014.⁴⁹ In July 2015, the Federal Reserve published a particularized set of standards that would apply uniquely to General Electric Capital Corporation, then and now the only company designated by the FSOC that is not engaged primarily in the insurance business.⁵⁰ A year later, the Federal Reserve published a proposed set

42. BHCs are already subject to consolidated supervision by the Federal Reserve under the Bank Holding Company Act. These “heightened” standards, which apply to BHCs with greater than \$250 billion in total consolidated assets, are more stringent than the general standards applicable to all BHCs. *See* Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174 § 401(a), 132 Stat. 1296 (2018) (amending Section 165 to increase the initial threshold from \$50 billion to \$250 billion); Dodd-Frank Act § 165(a)(1) (initially providing for a \$50 billion threshold).

43. Dodd-Frank Act § 165(b)(1); Enhanced Prudential Standards for Systemically Important Insurance Companies, 81 Fed. Reg. 38,610, 38,610 (June 14, 2016) [hereinafter Proposed Section 113 Insurance-Focused Standards].

44. Otherwise, these companies (along with their holding companies and depository affiliates) would already be supervised by federal banking authorities.

45. Dodd-Frank Act § 165(b)(3)(A).

46. “Large BHCs” refers here to BHCs with over \$50 billion in total consolidated assets, although today the applicable threshold would be \$250 billion. *See supra* note 42 and accompanying text.

47. *See* Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594, 597 (proposed Jan. 5, 2012) (to be codified at 12 C.F.R. pt. 252).

48. Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17,240, 17,243-44 (Mar. 27, 2014) (to be codified at 12 C.F.R. pt. 252).

49. *See id.*

50. *See* Application of Enhanced Prudential Standards and Reporting Requirements to General Electric Capital Corporation, 80 Fed. Reg. 44,111 (July 24, 2015). GE Capital is a *sui generis* case for another reason: owing to its status as a savings and loan holding company (SLHC), GE Capital, unlike the other Section 113 designees to date, was already subject to consolidated supervision by the Federal Reserve. However, despite its massive balance sheet (\$539 billion as of the end of the 2012 calendar year), as a SLHC it was not automatically subject to Section 165, which applied exclusively to Section 113 designees and large BHCs. The Federal Reserve divided the GE Capital standards into two groups, to be phased in according to different timetables: the so-called Phase I standards applied from January of 2016 the *existing* BHC standards concerning the risk-based capital, capital conservation buffer liquidity coverage, and leverage ratio rules; the so-called Phase II standards, by contrast, were to apply *enhanced* requirements concerning general risk management, capital planning, stress testing, liquidity risk management, and restrictions on inter-affiliate transactions. The Phase II standards will never go into effect because their initial date of application (in January of 2018) post-dates the date the FSOC rescinded GE Capital’s Section 113 designation (in June of 2016). *See* FIN. STABILITY OVERSIGHT COUNCIL, BASIS

of prudential standards for Section 113 designees primarily engaged in the insurance business.⁵¹ The Federal Reserve started with insurance standards because at the time of publication, three of the four Section 113 designees were insurance-focused financial conglomerates.⁵² And while this initial set of standards applies exclusively to insurance-focused designees, the Federal Reserve should be expected to roll out analogous packages of regulatory standards as the FSOC identifies other companies from other sectors for designation.⁵³

As consequential as these heightened prudential standards are, the ramifications of designation are wider still. One of the under-examined provisions of the Dodd-Frank Act authorizes the Federal Reserve to take “mitigatory actions” against any Section 113 designee or large BHC that “poses a grave threat to the financial stability of the United States.”⁵⁴ Such mitigatory actions could include requirements that the company restrict or cease certain activities and transactions, or even divest certain assets.⁵⁵ The latter authority is only available to the Federal Reserve if other mitigatory actions prove insufficient, but its import is clear: it authorizes a “break-up” of financial institutions.⁵⁶

These regulatory consequences will affect fundamental aspects of some of the largest financial companies in the economy.⁵⁷ For example, in the words of

FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S RESCISSION OF ITS DETERMINATION REGARDING GE CAPITAL GLOBAL HOLDINGS, LLC (2016) [hereinafter GE CAPITAL RESCISSION].

51. See Proposed Section 113 Insurance-Focused Standards, *supra* note 43.

52. See *infra* Section I.D (explaining that AIG, Prudential, and MetLife were among the first four Section 113 designees).

53. See Christina Parajon Skinner, *Regulating Nonbanks: A Plan for SIFI Lite*, 105 GEO. L.J. 1379, 1392-95 (2017) (suggesting that asset managers might be the next segment of the financial sector to be subject to potential Section 113 designation).

54. Dodd-Frank Wall Street Reform and Consumer Protection Act § 121(a), 12 U.S.C. § 5331 (2018).

55. *Id.*

56. The related, but distinct, Title II regime authorizes the appointment of the FDIC as receiver in an “orderly liquidation” proceeding upon the satisfaction of strict requirements—the most important of which is a determination, shared by the Secretary of the Treasury and two-thirds of each of the governing boards of the Federal Reserve and the FDIC, that a financial company is on the verge of a default that “would have serious adverse effects on financial stability in the United States.” The universe of companies potentially eligible for orderly liquidation under Title II (“financial companies”) is wider than the universe of Section 113 designees, who would be eligible for Title II *a fortiori* merely due to their status as nonbank *financial companies*. Nevertheless, the triggering event for the authority to impose mitigatory actions under Section 121 (i.e., the company must pose a grave threat to the financial stability of the United States) is arguably less demanding than that required to trigger the applicability of Title II (i.e., the company must be on the verge of a default that would have serious adverse effects on the financial stability of the United States).

57. See, e.g., Proposed Section 113 Insurance-Focused Standards, *supra* note 43, at 38,612 (mandating the establishment of an independent risk committee of the board of directors with at least one member with experience in risk management at large, complex financial firms); *id.* at 38,613-14 (requiring the appointment of a chief risk officer with experience in risk management at large, complex financial firms and a separate role of chief actuary, as well as the reporting obligations of each); *id.* at 38,614 (requiring an internal control regime for liquidity risk management); *id.* at 38,618-21 (requiring

one commenter affiliated with the pro-business lobby group U.S. Chamber of Commerce, the “prescriptive mandates” set forth in the proposed enhanced Section 165 prudential standards would amount to “micromanagement” by the Federal Reserve of private companies that will only “wring out risk by sacrificing growth and job creation.”⁵⁸ Writing of the BHC standards, the American Bankers Association warned of “anticompetitive pressures” that threaten to “contribute to the sluggishness of the economy” and “weaken[] the very institutions whose financial health they are charged with overseeing.”⁵⁹

Whatever we might think of these plaintive protests on the part of industry associations, it is unquestionably true that the consequences of designation for subject nonbank companies will be significant. Consequently, as would occur with any major administrative process, the Federal Reserve should expect contestation as it finalizes its Section 165 enhanced prudential standards—both for the present insurance company proposals and any future proposed standards for other companies and sectors. It should also prepare for the possibility of litigation challenging them later on. But notwithstanding the import of these standards, this Article takes as its object of inquiry the analytically prior administrative process: the FSOC’s gatekeeping action to designate a company in the first place.

2. The Structure of Section 113

The structure of the designation statute requires the FSOC to make highly discretionary judgments concerning the systemic significance of nonbank financial companies. The statute defines the term “nonbank financial company” to include any “U.S. nonbank financial company” and any “foreign nonbank financial company.” Together, these terms cover any company, whether domiciled in the United States or elsewhere, that is (1) “predominantly engaged in financial activities”,⁶⁰ and (2) not subject to an express exclusion,⁶¹ the most

at-least-monthly liquidity stress tests and imposing a ninety-day liquidity buffer requirement that must be maintained over the range of liquidity stress scenarios).

58. Comment Letter, Center for Capital Markets Competitiveness, Proposed Enhanced Prudential Standards for Systemically Important Insurance Companies (Aug. 17, 2016).

59. Comment Letter, American Bankers Association, Proposed Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies (Apr. 30, 2012).

60. Dodd-Frank Act § 102(a)(4).

61. Excluded from the definition of “nonbank financial companies” are (i) BHCs, (ii) Farm Credit System institutions chartered and subject to the provisions of the Farm Credit Act of 1971, (iii) SEC-registered national securities exchanges, clearing agencies, and security-based swap execution facilities and data repositories (in each case, including their corporate parents), (iv) CFTC-registered boards of trade designated as contract markets and derivatives clearing organizations (in both cases, including their corporate parents), and (v) CFTC-registered swap execution facilities and data repositories. These non-BHC exclusions operate to channel most securities and derivatives facilities into the Section 804 designation regime for financial market utilities rather than the Section 113 designation regime for nonbank financial companies. Even in the Section 804 context, the SEC and CFTC, the federal regulators of securities and derivatives markets, protected their turf by obtaining a similar exclusion for entities registered with their agencies; however, the Section 804 exclusion applies “only with respect to the activities that require the entity to be so registered.” *Id.* § 803(6)(B).

important of which is the BHC exclusion.⁶² The statute specifies that a firm is predominantly engaged in financial activities if “activities that are financial in nature” (as that phrase is defined in the Bank Holding Company Act of 1956) *either* “account for” at least 85% of its consolidated annual gross revenues or “relate to” 85% or more of the company’s consolidated assets.⁶³ The statute further instructs the Federal Reserve to promulgate standards for determining if a company is “predominantly engaged in financial activities.”⁶⁴

As described so far, the statutory scheme entails very little administrative discretion. That assessment changes once we consider the Section 113 systemic risk determination. Section 113 empowers the FSOC to designate a nonbank financial company if it finds one or both of two factual predicates is present: (1) a “material financial distress” at the company “could pose a threat to the financial stability of the United States”; and (2) the “nature, scope, size, scale, concentration, interconnectedness, or [the] mix of [its] activities” could pose such a threat.⁶⁵ The FSOC refers to these pathways to designation as “Determination Standards.”⁶⁶ Both Determination Standards share a conditional grammar. In each case, the statute requires the agency to make a conjectural assessment concerning whether the subject company *could* pose a threat, a task that requires the exercise of a significant degree of administrative discretion and judgment. With Section 113, Congress has instructed the regulator to inquire into what “could” occur—namely, whether a given set of factual circumstances concerning a nonbank financial company could *hypothetically* pose a threat to the financial stability of the United States. Furthermore, with the First Determination Standard, the factual circumstance itself is conditional—the FSOC must hypothesize that a presently solvent company enjoying access to liquidity sufficient to support its operations would experience a material financial distress.⁶⁷

Figure 1 below illustrates the two layers of conditionality that are preconditions to a Section 113 designation under the First Determination Standard—the only standard the FSOC has invoked to date.

62. The definition excludes bank holding companies because they are already subject to consolidated supervision by the Federal Reserve. It reflects the reality that the entity gap emerged outside the bank regulatory system, hence the need for the FSOC to designate “nonbank financial companies.”

63. Dodd-Frank Act § 102(a)(6).

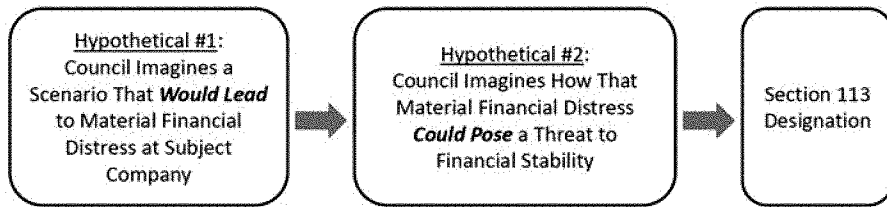
64. *Id.* § 102(b); *see also* Definitions of “Predominantly Engaged in Financial Activities” and “Significant” Nonbank Financial Company and Bank Holding Company, 78 Fed. Reg. 20,756 (Apr. 5, 2013).

65. *Id.* § 113(a)(1).

66. *See infra* text accompanying notes 381-385.

67. *See infra* text accompanying note 383.

Figure 1



On its face, the statute metes out a virtually limitless decision space for the FSOC. It is possible to imagine a vast array of hypothetical scenarios that *could* cause material financial distress that *could* pose a threat to financial stability. By requiring the Council to make these inherently contestable determinations, Congress has plainly woven a significant degree of discretion into the administrative apparatus it created.

While there are theoretical limits on the ability of Congress to delegate discretion to administrative officials, those limits have little real-world bite. When delegating lawmaking authority to an agency, Congress is bound only by the non-delegation doctrine. As a doctrinal matter, that administrative law canon, which arises out of the separation-of-powers principle of U.S. constitutional law, requires Congress to set forth an “intelligible principle to which the person or body authorized to [exercise administrative discretion] is directed to conform.”⁶⁸ As a practical matter, however, the doctrine has rarely limited Congress,⁶⁹ and today amounts at most to a “kind of vagrant [judicial] threat” that Congress “*could* go too far in transferring unguided power.”⁷⁰ The doctrine is the judicial expression of the familiar linear, instrumentalist logic of administrative law, requiring only that the agency’s compliance with the instructions of Congress is susceptible to ex post ascertainment.

With Section 113, Congress set forth ten criteria the FSOC must consider in deciding whether to designate a nonbank financial company, and also included an eleventh catch-all criterion covering “any other risk-related factor that the [FSOC] deems appropriate.”⁷¹ While the primary effect of including these criteria was to respond to a *political* imperative to structure and cabin the delegation of discretion to the FSOC, in the process they also ensured the designation statute satisfied—indeed, by good measure—the exiguous requirements of the non-delegation doctrine. To be sure, interesting legal

68. J.W. Hampton, Jr. & Co. v. United States, 276 U.S. 394, 409 (1928).

69. See *Yakus v. United States*, 321 U.S. 414, 426 (1944) (limiting the non-delegation doctrine’s application to legislative delegations characterized by “an absence of standards for the guidance” of regulatory discretion, such that “it would be impossible in a proper proceeding to ascertain whether the will of the Congress has been obeyed”).

70. GLEN O. ROBINSON, *AMERICAN BUREAUCRACY: PUBLIC CHOICE AND PUBLIC LAW* 72 (1991) (emphasis added).

71. Dodd-Frank Wall Street Reform and Consumer Protection Act § 113(b), 12 U.S.C. § 5323(b) (2018).

questions remain concerning the proper *application* of the FSOC's designation discretion, but the constitutionality of the statutory basis for that discretion is beyond legal reproach.

C. (A Brief Note on) Organizational Structure

The FSOC is a formal, standing interagency body comprised primarily of the heads of existing financial supervisors. Its membership consists of ten voting members, each with an equal vote, and five non-voting members. The voting members are the Secretary of the Treasury (who serves as chair of the FSOC), the Chairperson of the Federal Reserve, the Comptroller of the Currency, the Chairperson of the Federal Deposit Insurance Corporation (FDIC), the Director of the Consumer Financial Protection Bureau (CFPB), the Chairperson of the Securities and Exchange Commission (SEC), the Chairperson of the Commodity Futures Trading Commission (CFTC), the Chairperson of the National Credit Union Administration Board (NCUAB), the Director the Federal Housing Finance Agency (FHFA), and an independent presidential appointee with insurance expertise.⁷² The non-voting members are the Director of the Office of Financial Research (OFR),⁷³ the Director of the Federal Insurance Office (FIO),⁷⁴ a state insurance commissioner, a state banking supervisor, and a state securities commissioner.⁷⁵

This Article focuses on the problem of administrative discretion in connection with the FSOC's Section 113 program. It is concerned with the breadth of that discretion, the constraints on that discretion, and, ultimately, the adequacy of those constraints under currently applicable U.S. administrative law. In conducting that analysis, it also presents the Section 113 program as a case study that offers lessons to financial regulators, financial institutions, and scholars of financial regulation and administrative practice more broadly.

As such, it does not purport to undertake a comprehensive analysis of the Council's structure. Instead, it adopts a black-box approach that takes as its object of inquiry a decision, action, or inaction of an agency, whatever the structure of the agency might be. That decision is motivated by both methodological and doctrinal considerations. Methodologically, isolating the decision-action-inaction results in a cleaner, more analytically compact unit of

72. See *id.* § 111(b)(1).

73. The Dodd-Frank Act established the OFR within the Department of the Treasury "to support the [FSOC] in fulfilling [its] purposes and duties." *Id.* § 153(a).

74. The Dodd-Frank Act established the FIO within the Department of the Treasury. Its most important duties are to coordinate and consult with foreign and state insurance regulators (as appropriate) on behalf of the U.S. federal government (with respect to "prudential aspects of international insurance matters," "insurance matters of national importance," and "prudential insurance matters of international importance"), "monitor all aspects of the insurance industry," and provide advice to the FSOC in connection with insurance matters. See *id.* § 502(a).

75. Each of the state regulator non-voting members are "designated by a selection process determined by such [state regulators]." *Id.* § 111(b)(2).

inquiry. Moreover, the subject of inquiry—discretion and its constraints—is the core subject of administrative law, which will allow the analysis to apply more readily in other administrative contexts. Finally, the choice to focus on discretion and its constraints rather than on the Council’s structure is consistent with the current state of administrative law doctrine, which provides that the APA applies equally to all administrative agency action, irrespective of the structure and form of the particular agency at question.⁷⁶

Nothing here is meant to suggest that the FSOC’s structure does not merit further study. In fact, its novel structure makes it an ideal case study for the developing literature on coordination and collaboration between agencies and within multi-member agencies.⁷⁷ Its combination of organizational structure and powers is unique in U.S. administrative practice, but the FSOC bears some resemblance to other regulatory bodies. The FSOC is a *sui generis* council comprised of individuals appointed to head *other* agencies, with significant and administratively conclusive⁷⁸ policymaking authority. It therefore resembles independent commissions and executive agencies in the scope of its authority, but not in its composition. Contrariwise, it resembles statutorily constituted groupings of regulators like the Federal Financial Institutions Examination Council (FFIEC) in its composition, but not in the scope of its more fulsome authority.⁷⁹ In the same way, the FSOC bears a resemblance to less formally constituted groupings of regulators, such as interagency working groups⁸⁰ or supervisory colleges.⁸¹ These interagency associations are designed to facilitate and inform the distinct decisionmaking tasks for which the member agencies ultimately retain individual responsibility.

76. See, e.g., *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 525 (2009). *But cf.* Catherine M. Sharkey, *State Farm “with Teeth”: Heightened Judicial Review in the Absence of Executive Oversight*, 89 N.Y.U. L. REV. 1589 (2014) (proposing a more deferential standard of review for executive agencies in recognition of their greater degree of political accountability due to executive branch oversight).

77. See Jody Freeman & Jim Rossi, *Agency Coordination in Shared Regulatory Space*, 125 HARV. L. REV. 1131 (2012); Jason Marisam, *Interagency Administration*, 45 ARIZ. ST. L.J. 183 (2013); Jennifer Nou, *Intra-Agency Coordination*, 129 HARV. L. REV. 421 (2015); Bijal Shah, *Uncovering Coordinated Interagency Adjudication*, 128 HARV. L. REV. 805 (2015); cf. Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEXAS L. REV. 15 (2010); Buzbee, *supra* note 16.

78. Of course, as with most agency action, FSOC determinations are subject to judicial review. See Dodd-Frank Act § 113(h).

79. As with the FSOC, the membership of FFIEC (pronounced “Fee-Feck”) consists of the heads of existing supervisors. Specifically, it is comprised of six members: the four heads of the federal bank and credit union supervisory agencies (Federal Reserve, OCC, FDIC, and NCUAB), a representative of state bank examiners, and, since 2011, the Director of the CFPB.

80. See Jonathan Masur & Eric A. Posner, *Climate Regulation and the Limits of Cost-Benefit Analysis*, 99 CALIF. L. REV. 1557, 1561 (2011) (chronicling how the Office of Management and Budget in the White House convened an informal “interagency working group” for the discrete purpose of formulating a range of value estimates for the social cost of carbon).

81. See Rolf H. Weber, *Multilayered Governance in International Financial Regulation and Supervision*, 13 J. INT’L ECON. L., 683, 702-03 (2010) (defining a supervisory college as a “multilateral working group of all supervisors involved in the supervision of an international banking group”).

The FSOC's Designation Program as a Case Study

These structural features of an agency's design obviously impact the efficiency and output of its administrative process, but they also have deeper implications for the felt legitimacy of agency programs; Dan Schwarcz and David Zaring have made this very point with respect to the FSOC.⁸² The legitimating effect of agency structure, while of obvious significance to any agency, ultimately concerns a more protean, polymorphous idea of administrative legitimacy writ large—of which compliance with the rule of administrative law, the subject of this Article, is but a single and discrete contributing factor.⁸³

D. Early History of Section 113 Designations

The FSOC's first eight years have been turbulent and eventful, with multiple designations and rescissions, judicial review of designations, as well as political and administrative efforts to shape FSOC designation policy. As of February 2018, the FSOC had used its Section 113 authority four times to designate nonbank financial companies for Federal Reserve supervision. Three of these designations involved financial companies engaged primarily in insurance activities: MetLife, Inc.; Prudential Financial, Inc. (Prudential); and American International Group, Inc. (AIG). The fourth designated firm, General Electric Capital Corporation, Inc. (GE Capital), was the financial services arm of the multinational conglomerate General Electric Company. In each case, the FSOC designated the company pursuant to the First Determination Standard: that is, it determined that a material financial distress at the company could pose a threat to the financial stability of the United States.⁸⁴

In June of 2013, the FSOC announced that it had preliminarily designated Prudential, AIG, and GE Capital.⁸⁵ AIG and GE Capital acquiesced to the FSOC's determination, and the FSOC published its final determinations with respect to those companies on July 8, 2013. Prudential invoked its rights under Section 113(e) and requested and received the opportunity to argue its case for non-designation through submission of written materials and a hearing, which was held on July 23, 2013.⁸⁶ On September 19, 2013, the FSOC published its

82. See Daniel Schwarcz & David Zaring, *Regulation by Threat: Dodd-Frank and the Nonbank Problem*, 84 U. CHI. L. REV. 1813 (2017).

83. See Henry S. Richardson, *Administrative Policy-Making: Rule of Law or Bureaucracy?*, in RECRAFTING THE RULE OF LAW 309, 310 (David Dyzenhaus ed., 1999) (“[T]he rule of law, while a necessary support of legitimate democracy, is hardly a sufficient guarantor thereof.”).

84. See *infra* text accompanying note 383 (introducing the distinction between the two determination standards).

85. Matthew Yglesias, *AIG, Prudential Financial, and GE Capital Receive Preliminary Designation as “Systemically Important” Financial Institutions*, SLATE (Jun. 4, 2013), http://www.slate.com/blogs/moneybox/2013/06/04/sifis_aig_prudential_and_ge_capital_are_systemically_important_financial.html [<https://perma.cc/KGK5-YNW5>].

86. See *infra* text accompanying note 156 (discussing right to hearing provided by subsection (e)).

final determination with respect to Prudential, maintaining its initial position that Section 113 designation was appropriate.⁸⁷

As discussed in greater detail below, the FSOC has a statutory obligation to review its designations “not less frequently than annually.”⁸⁸ In July 2016, the FSOC rescinded GE Capital’s Section 113 designation, describing how the company had “fundamentally changed its business. . . . [t]hrough a series of divestitures, a transformation of its funding model, and a corporate reorganization,” the sum of which resulted in GE Capital becoming “a much less significant participant in financial markets and the economy.”⁸⁹ Many observers interpreted the rescission of the GE Capital designation as evidence that the Section 113 program was working as designed. Faced with the prospect of onerous Federal Reserve supervision, GE Capital had embarked on an ambitious corporate restructuring that pared back its systemic footprint.

In March of 2016, a district court judge ordered rescission of the MetLife designation, holding that the FSOC had acted arbitrarily and capriciously in designating MetLife.⁹⁰ The analysis of the Section 113 program set forth below in Parts III-IV addresses this litigation where relevant.

The attrition from the ranks of Section 113 designees continued, catalyzed not by the intended systemic-risk-reducing effects of the statute (as with GE Capital) or by judicial applications of administrative law principles (as with MetLife), but by politics. The deregulatory winds following the 2016 election blew another designation aside, when in September 2017 the Council, chaired by new Secretary of the Treasury Steven Mnuchin, announced it had voted to rescind AIG’s designation as well.⁹¹ The Mnuchin-led FSOC also cemented the removal of MetLife’s designation by withdrawing the pending Obama era appeal of the judicial order.⁹² On October 16, 2018, the FSOC rescinded Prudential’s designation.⁹³

The winnowing ranks of Section 113 designees should not be interpreted as the FSOC’s slow march to the gallows. In May 2018, Congress enacted the first significant rollback of the Dodd-Frank regime in the form of the Economic

87. U.S. DEP’T OF THE TREASURY, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL’S FINANCIAL DETERMINATION REGARDING PRUDENTIAL FINANCIAL, INC. (2013).

88. See *infra* Section III.A.6.

89. GE CAPITAL RESCISSION, *supra* note 50, at 2. Also recognizing the fundamental changes ushered in by the General Electric Company restructuring, the Federal Reserve accepted GE Capital’s request to de-register as a savings-and-loan holding company in late 2015.

90. *MetLife, Inc. v. Fin. Stability Oversight Council*, 177 F. Supp. 3d 219, 233-36 (D.D.C. 2016).

91. Press Release, U.S. Dep’t of the Treasury, Financial Stability Oversight Council Announces Rescission of Nonbank Financial Company Designation (Sept. 29, 2017).

92. John Heltman, *FSOC Gives Up Effort to Designate MetLife as SIFI*, AM. BANKER (Jan. 18, 2018), <https://www.americanbanker.com/news/fsoc-gives-up-effort-to-designate-metlife-as-sifi> [<https://perma.cc/C3D8-RYSN>].

93. Alan Rappeport & Peter Eavis, *Trump Administration Releases Prudential from Strict Post-Crisis Oversight*, N.Y. TIMES (Oct. 17, 2018), <https://www.nytimes.com/2018/10/17/us/politics/prudential-financial-regulation-trump-administration.html> [<https://perma.cc/XX44-2XYA>].

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Growth, Regulatory Relief, and Consumer Protection Act, known colloquially as the “Crapo Bill,” in reference to sponsoring senator Mike Crapo, the Idaho Republican. The Crapo Bill left the FSOC regime entirely untouched,⁹⁴ despite pressure from House Republicans to fundamentally restructure the designation program.⁹⁵ The fact that the program survived the Crapo Bill—despite a Republican White House, a Republican majority in the Senate (along with several sympathetic Democrat senators), and a Republican majority in the House of Representatives—seems to make it safe to view the Section 113 program as a fixture in the post-crisis regulatory landscape.

Nevertheless, the federal deregulatory political climate, if not strong enough to change legislation, has had effects at the administrative level. In April 2017, President Trump requested that the Treasury Department prepare a report (the Treasury Designations Report) to the White House concerning the FSOC's designations processes.⁹⁶ In November 2017, the Treasury Department published the Report, recommending several reforms that will, if adopted, likely reduce the application of the designation statute.⁹⁷ However, the FSOC has taken no action with respect to the Treasury Designations Report. Moreover, the Report's recommended reforms fall well short of a comprehensive rework of the FSOC's designation process. The recommendations—which, again, have yet to be formally proposed, let alone adopted—would, among other things, require the FSOC to formally assess the likelihood that a potential designee experiences material financial distress, conduct cost-benefit analysis of contemplated designations, and take into account mitigating factors when analyzing the systemic effects of a firm's failure.⁹⁸ The Report's most significant recommendation is to redirect the FSOC's attention away from entity designation and towards an “activities-based approach” to preventing systemic risk.⁹⁹ Such a reform would fundamentally restructure the FSOC's task and de-

94. See generally Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, 132 Stat. 1296 (2018).

95. See, e.g., REPUBLICAN STAFF OF THE COMM. ON FIN. SERVS., U.S. HOUSE OF REPS., 115TH CONG., THE ARBITRARY AND INCONSISTENT FSOC NONBANK DESIGNATION PROCESS (2017), https://financialservices.house.gov/uploadedfiles/2017-2-28_final_fsoc_report.pdf [<https://perma.cc/J9NS-RKYY>]; Ian McKendry, *House Panel Approves Bill to Raise SIFI Threshold, 20 Other Relief Measures*, AM. BANKER (Oct. 12, 2017), <https://www.americanbanker.com/news/house-panel-approves-bill-to-raise-sifi-threshold-20-other-reg-relief-measures> [<https://perma.cc/H5FR-HHJZ>].

96. President Donald J. Trump, Memorandum on the Fin. Stability Oversight Council (Apr. 21, 2017), <https://www.gpo.gov/fdsys/pkg/DCPD-201700265/pdf/DCPD-201700265.pdf> [<https://perma.cc/HC2W-5FZJ>].

97. See U.S. DEP'T OF THE TREASURY, REPORT TO THE PRESIDENT OF THE UNITED STATES: FINANCIAL STABILITY OVERSIGHT COUNCIL DESIGNATIONS (2017) [hereinafter TREASURY DESIGNATIONS REPORT].

98. See *id.* at 9-12.

99. *Id.* at 10. The “activities-based approach” to systemic risk regulation is discussed in a forthcoming article. Jeremy Kress et al., *Regulating Entities and Activities: Complementary Approaches to Nonbank Systemic Risk*, 92 S. CALIF. L. REV. (forthcoming 2019). Kress et al. characterize the support for the activities-based approach as a “new consensus that systemic risk regulation should focus on an activities-based approach.” *Id.* While such a consensus is evident in some policymaking circles (including the present White House), the authors perhaps overstate the degree of accord, as demonstrated by their

prioritize the designation power, but it would also require congressional action,¹⁰⁰ which is highly unlikely, at least in the near future—as evidenced by the Crapo Bill’s modesty with respect to the FSOC and Section 113.

The significance of these reforms will stand out in starker relief as the reader proceeds through the description of the FSOC’s Analytic Framework, but it suffices for present purposes to note that they would leave intact the basic regulatory framework. Even during its present quiescence, the designation power remains as both a symbolic force and a profound threat held in reserve by the government—including future governments less solicitous of industry complaints about the need to minimize short-term regulatory “burdens” and the accompanying threats to withhold “products and services.”¹⁰¹ In the parlance of the insurance companies who have populated the list of designees so far, the regime may face some short-term morbidity risk, but very little long-term mortality risk.

II. The Administrative Discretion Problem and the FSOC

The FSOC and the Section 113 program face criticism that they violate the foundational principle of administrative law: namely, that the Council wields too much unconstrained discretion in administering the program. Critics of the Dodd-Frank regime have probably made the Section 113 program the target of this criticism more than any other program. Nevertheless, whatever the merits of this line of attack may be, it certainly applies with equal force to much broader swaths of the financial supervisory system, particularly the other core, highly discretionary post-crisis regulatory initiatives—such as stress testing, capital plan reviews, and resolution planning. As such, the Section 113 program provides an opportunity to conduct an administrative law case study that sheds light on the encounter between financial supervision and administrative law more generally.

Notwithstanding the obvious linkages between the two arenas, commentators involved in debates about administrative law and politics on the one hand, and financial regulation on the other, have largely talked past each other.¹⁰² The build-up of discretionary power in these salient regulatory programs has caused tension to build along the line that has historically separated

own detailed and convincing critique of activities-based regulation, as well as the Crapo Bill’s silence with respect to the matter. *See generally id.*; *see also supra* text accompanying notes 94-95.

100. *See* Kress et al., *supra* note 99, at 48-49.

101. *See, e.g., id.* at 9.

102. *See* Robert B. Ahdieh, *Notes from the Border: Writing Across the Administrative Law/Financial Regulation Divide*, 66 J. LEGAL EDUC. 64 (2016); Gillian E. Metzger, *Through the Looking Glass to a Shared Reflection: The Evolving Relationship Between Administrative Law and Financial Regulation*, 78 LAW & CONTEMP. PROBS. 129, 131 (2015) (registering the “upside-down aspect” financial regulation can possess when viewed from an administrative law perspective).

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financial supervision and administrative law.¹⁰³ It is only a slight exaggeration to state that the debates about the legitimacy of financial regulatory policy in the coming years will be written on what is little more than a *tabula rasa* at this point. James Freedman famously characterized U.S. administrative law as afflicted with a “recurrent sense of crisis.”¹⁰⁴ To borrow Freedman’s phrase, the administrative law of financial regulation is on the threshold of its own moment of “crisis.”¹⁰⁵ This Article is an early contribution to preempting—or, if it is too late, at least starting to quell—that crisis.

The foundational principle of administrative law is that discretionary administrative power of the sort contemplated by the Section 113 program demands legitimation of some form or another.¹⁰⁶ Although the specific institutional forms administrative law assumes in a given period or context may vary, its “much deeper purpose” always remains to answer to that justificatory imperative: to “protect[] against unnecessary or uncontrolled discretionary power.”¹⁰⁷ Unlike with other forms of governmental power, direct accountability of administrative officials through democratic elections is unavailable in most cases.¹⁰⁸ This ongoing search for alternative legitimating narratives motivated Freedman’s “crisis” observation.¹⁰⁹ Administrative discretion, however unavoidable and ubiquitous in modern government,¹¹⁰ is therefore always

103. To be clear, the separateness is a characterization of the self-conception of the respective sub-disciplines and the focus of those active in them; as a doctrinal matter, financial regulatory agencies have always been subject to the requirements of administrative law.

104. See FREEDMAN, *supra* note 10, at 6-7; cf. Henry S. Richardson, *Administrative Policy-Making: Rule of Law or Bureaucracy?*, in RECRAFTING THE RULE OF LAW: THE LIMITS OF LEGAL ORDER 309, 311 (David Dyzenhaus ed., 1999) (“Statutory vagueness is endemic in modern governments, and has long engendered a sense that their legitimacy is in crisis.”).

105. FREEDMAN, *supra* note 10, at 7.

106. Jody Freeman, *Private Parties, Public Functions and the New Administrative Law*, in RECRAFTING THE RULE OF LAW: THE LIMITS OF LEGAL ORDER 331, 332 n.7 (“Administrative law scholars have traditionally viewed administrative discretion as the greatest problem of the field.”). The idea that bureaucratic power demands some form of legitimation was a pillar of Weber’s sociology of bureaucracy. See 3 MAX WEBER, *ECONOMY AND SOCIETY: AN OUTLINE OF INTERPRETIVE SOCIOLOGY* 953 (Guenther Roth & Claus Wittich eds., Ephraim Fischoff trans., 1968) (registering the “generally observable need of any power, or even of any advantage of life, to justify itself”). Gerry Frug’s discussion of this idea’s application to the modern administrative state still stands out for its explanatory thoroughness and theoretical depth. See Gerald E. Frug, *The Ideology of Bureaucracy in American Law*, 97 HARV. L. REV. 1276 (1984). Frug, it should be pointed out, remains deeply skeptical of attempts to legitimate bureaucracy.

107. Kenneth Culp Davis, *A New Approach to Delegation*, 36 U. CHI. L. REV. 713, 725 (1969).

108. See FREEDMAN, *supra* note 10, at 7, 265 (noting that agencies are unable to rely on the legitimating effects of express constitutional treatment or direct political accountability). Of course, exceptions to this general rule exist, as with the insurance commissioners of California and a minority of other states, who are directly accountable to the electorate. See Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625, 629 (1999).

109. See *supra* note 104 and accompanying text.

110. See Keith Hawkins, *The Uses of Legal Discretion: Perspectives from Law and Social Science*, in THE USES OF DISCRETION 11, 12 (Keith Hawkins ed., 1992); Bruce Ackerman, *The New Separation of Powers*, 113 HARV. L. REV. 633, 696 (2000).

threatening crisis. It is “inevitable” but also “slightly deviant”;¹¹¹ “it is both necessary and problematic.”¹¹²

Critics have bestowed on the FSOC epithets denoting arbitrary discretionary governmental power, such as the Star Chamber¹¹³ and the Soviet Politburo.¹¹⁴ Their critiques center on the accusation that it wields too much discretion with too little accountability and transparency.¹¹⁵ Its “almost unlimited, unreviewable and sometimes secret bureaucratic discretion” amounts to a “threat to the Constitution” and a “breakdown of the separation of powers.”¹¹⁶

And separation of powers is not the only alleged constitutional infirmity; the FSOC’s broad discretionary powers also might implicate the due process rights of designated companies¹¹⁷—or at least fall short of “sound administrative practice.”¹¹⁸ Another commentator prefers literary allusion, arguing that pointing out the inherently arbitrary nature of the Council’s powers is tantamount to noticing that the “emperor has no clothes.”¹¹⁹ Formerly designated company MetLife complained that FSOC determinations result from “unbounded speculation and conjecture.”¹²⁰ More prosaically, the Republican members of the

111. D.J. GALLIGAN, *DISCRETIONARY POWERS: A LEGAL STUDY OF OFFICIAL DISCRETION* 1 (1990).

112. WILLIAM F. WEST, *ADMINISTRATIVE RULEMAKING: POLITICS AND PROCESSES* 29 (1985).

113. See *MetLife’s Big Win for Taxpayers*, WALL ST. J.: OPINION (Mar. 30, 2016), <https://www.wsj.com/articles/metlifes-big-win-for-taxpayers-1459381190> [https://perma.cc/W62S-KTAB].

114. Michael S. Piwowar, Comm’r, SEC, Remarks at AEI Conference on Financial Stability (July 15, 2014) [hereinafter Piwowar AEI Remarks], <https://www.sec.gov/news/speech/2014-spch071514msp> [https://perma.cc/P93F-NJYB] (referring also to the FSOC as the “Firing Squad on Capitalism”).

115. See C. Boyden Gray, *The Nondelegation Canon’s Neglected History and Underestimated Legacy*, 22 GEO. MASON L. REV. 619, 642 (2015) (complaining that Congress failed to provide the FSOC with “an intelligible principle to cabin the agency’s discretion”); Press Release, U.S. House of Representatives Fin. Servs. Comm., Hensarling: Bureaucrats’ Spending Should Be on Budget (Apr. 14, 2016), <https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=400566> [https://perma.cc/3QCF-K3PF].

116. C. Boyden Gray, *Dodd-Frank, The Real Threat to the Constitution*, WASH. POST (Dec. 31, 2010), <http://www.washingtonpost.com/wp-dyn/content/article/2010/12/30/AR2010123003482.html?noredirect=on> [https://perma.cc/C5NQ-7JQ8].

117. Complaint at 73-75, *MetLife, Inc. v. Fin. Stability Oversight Council*, 177 F. Supp. 3d 219 (D.D.C. 2016) (No. 15-45).

118. See William M. Butler, *Falling on Deaf Ears: The FSOC’s Evidentiary Hearing Provides Little Opportunity to Challenge a Nonbank SIFI Designation*, 18 N.C. BANKING INST. 663, 673-74 (2014) (suggesting that FSOC’s discretion to deny an oral hearing in a Section 113 designation process, despite likely surviving a due process challenge under current law, violates sound principles of administrative government).

119. Peter Wallison, *FSOC Lacks Credibility in Designating SIFIs*, AM. BANKER (Jun. 30, 2014) (emphasis added), <https://www.americanbanker.com/opinion/fsoc-lacks-credibility-in-designating-sifis> [https://perma.cc/Z4B6-M4LE].

120. Memorandum of Points & Authorities in Support of Plaintiff MetLife, Inc.’s Cross-Motion for Summary Judgment and in Opposition to Defendant’s Motion to Dismiss or, in the Alternative, Summary Judgment at 33, *MetLife, Inc. v. Fin. Stability Oversight Council*, 177 F. Supp. 3d 219 (D.D.C. 2016) (No. 15-45) [hereinafter *MetLife Brief*].

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House Committee on Financial Services describe the FSOC's designation process as "arbitrary and inconsistent."¹²¹ Others level their aim at Congress, decrying the FSOC as having been "famously underinstructed"¹²² with an "ill-defined mandate" and "vague directive."¹²³

These complaints are, at their core, objections about excessive unstructured discretion, and they therefore plainly implicate administrative law. According to these critics, the Section 113 program, either (or both) in its very structure or in the way it is applied, involves a pathological and illegitimate use of discretion.¹²⁴ This Article engages with these complaints, finding that they both understate and overstate the case, and also invites those working in and writing about financial supervision to draw analogies between the FSOC's Section 113 program and other regulatory programs.

The administrative law analysis of the program must evaluate the effects of the procedural and substantive scaffolding that Congress and the Council have built into the program to channel the Council's administrative discretion. Historically, modern administrative law has answered the legitimacy question by erecting regulatory *process* safeguards.¹²⁵ In a dynamic and complex regulatory space where delegated power is necessary, these procedural strictures and structured forms of decisionmaking perform a crucial legitimating role for regulatory bodies.¹²⁶ They channel delegated discretionary power, narrowing the agency's decision space, so that it exercises power in non-arbitrary ways. Furthermore, procedures force agencies to move deliberately and openly, giving

121. REPUBLICAN STAFF OF THE COMM. ON FIN. SERVS., U.S. HOUSE OF REPS., 115TH CONG., *supra* note 95, at 3 (2017), https://financialservices.house.gov/uploadedfiles/2017-2-28_final_fsoc_report.pdf [<https://perma.cc/J9NS-RKYY>].

122. PHILIP A. WALLACH, TO THE EDGE: LEGALITY, LEGITIMACY, AND THE RESPONSES TO THE 2008 FINANCIAL CRISIS 203 (2015); *see also id.* (faulting Congress for having hampered the efforts of the Council to "achieve legitimacy by producing a better-defined process, clear accountability mechanisms, and a clear statement of the outer limits of its authorities").

123. Norbert Michel, *Dodd-Frank's Financial Monster Council: The FSOC*, FORBES (July 7, 2014), <https://www.forbes.com/sites/norbertmichel/2014/07/07/dodd-franks-financial-monster-council-the-fsoc/#3dff70c82f8f> [<https://perma.cc/W7WT-396J>].

124. *Cf.* KENNETH CULP DAVIS, DISCRETIONARY JUSTICE: A PRELIMINARY INQUIRY 25 (1969) (comparing discretionary power in a "government of men" to a "malignant cancer" that tends "to stifle the portion [of the government] that is a government of laws").

125. *See* JERRY MASHAW, DUE PROCESS IN THE ADMINISTRATIVE STATE 15 (1985) (referring to the "peculiarly intense focus on the idea of legitimating administrative power through controlling administrative process"); Thomas W. Merrill, *Capture Theory and the Courts: 1967-1983*, 72 CHI.-KENT. L. REV. 1039, 1057 (1997) ("The overall objective was to legitimize the discretionary powers of agencies by assimilating them into a legal process that emphasized the importance of clearly articulated agency standards and the availability of judicial review as a check on abuses of agency discretion.").

126. *See* LAWRENCE M. FRIEDMAN, THE REPUBLIC OF CHOICE 39 (1990) (noting how legal procedures embody modern "rational-legal authority" because they "are nothing in themselves, but everything insofar as they are instruments for ascertaining, measuring, and aggregating *choice*"); FREEDMAN, *supra* note 10, at 266 (recommending "effective administrative procedures" in "formal and informal proceedings, that give promise of being fair, efficient, and responsive to democratic values and constitutional restraints").

politicians and their constituents time to react before decisions become final.¹²⁷ The directive for agencies and the legislative bodies that constitute them, then, is to cabin “discretion through appropriate safeguards and to confine and guide [it] through standards, principles, and rules.”¹²⁸

Care should be taken not to overstate this characterization of administrative law as proceduralism. The actual historical praxis of administrative law implicitly deconstructs one of the legal profession’s favorite formalist binaries, that of procedure and substance. Instead, procedure and substance are always co-determinants of a regulatory regime. For example, consider the important role of scientific, technical expertise in modern regulatory regimes. In an earlier era in which the “expertise” paradigm prevailed, agency discretion was legitimate because it would be exercised in furtherance of Congress’s identified objectives¹²⁹ and in accordance with appropriate forms of scientific or professional methodology.¹³⁰ Administrators were analogous to “skilled doctors” whose judgment, because it adhered to professional norms, was beyond reproach.¹³¹ While expertise appeared a substantive legitimating criterion, its effectiveness depended on adherence to disciplinary norms and scientific methods—factors of a decidedly procedural nature.

In recent decades, all three branches of government and the agencies themselves have increasingly leaned on *substantive, instrumental rationality* as a legitimating device for regulatory actions.¹³² Richard Stewart has aptly

127. See Matthew D. McCubbins et al., *Structure and Process, Politics and Policy: Administrative Arrangements and the Political Control of Agencies*, 75 VA. L. REV. 431, 442 (1989).

128. Davis, *supra* note 107, at 725; see also DAVIS, *supra* note 124, at 3-4 (arguing that the best way to “assure that where law ends tyranny will not begin” is to “do much more than we have been doing to confine, to structure, and to check necessary discretionary power”).

129. See ROBIN FELDMAN, *THE ROLE OF SCIENCE IN LAW* 59 (2009) (arguing that deference to administrators was justified as legitimate under the belief that “their expertise made them more trustworthy”); Robert B. Reich, *Public Administration and Public Deliberation: An Interpretive Essay*, 94 YALE L.J. 1617, 1618 (1985) (noting that under the expertise paradigm, “[t]he administrator’s task was merely to solve the problems identified by democratic processes,” which therefore meant that “the legitimacy of his role was no major issue”).

130. See MASHAW, *supra* note 125, at 18-19 (“By virtue of constant exposure to a single type of problem, as well as by selection of personnel with specialized training, the administrative agency could bring to bear an expertise that generalist courts and generalist legislatures could rarely hope to match.”); ROBINSON, *supra* note 70, at 19; Joseph G. Metz, *Democracy and the Scientific Method in the Philosophy of John Dewey*, 31 REV. POL. 242, 242 (1969) (describing how John Dewey thought that instrumentalism and the scientific method could invigorate democracy); cf. *Interstate Commerce Comm’n v. Chi., Rock Island, & Pac. Ry.*, 218 U.S. 88, 102 (1910) (“[T]he training that is required, the comprehensive knowledge which is possessed, guards or tends to guard against the accidental abuse of its powers, or, if such abuse occur, to correct it.”).

131. Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667, 1678 (1975).

132. This development has coincided with a waning of emphasis on political pluralism (and its procedural norms) and the waxing of republicanism and “deliberative democracy” (and its deliberative norms) as normative theories of good government. See PAUL P. CRAIG, *PUBLIC LAW AND DEMOCRACY IN THE UNITED KINGDOM AND THE UNITED STATES OF AMERICA* 334 (1990); CASS R. SUNSTEIN, *RISK AND REASON: SAFETY, LAW AND THE ENVIRONMENT* 64-65 (2002) (assigning a deliberative democracy government the role of “inform[ing] people of the real facts”); Mark Seidenfeld,

characterized this development as the “analytic management” turn of U.S. administrative law.¹³³ Cost-benefit analysis, the method of evaluating possible projects or regulations based on economic principles,¹³⁴ has supercharged this trend in public administration and law toward substantive, instrumental rationality.¹³⁵ In particular, it has bolstered the faith of government actors to obtain substantively correct,¹³⁶ or at least “better,” policy outcomes.¹³⁷ But here, too, we see the blending of procedural and substantive legitimating devices, particularly in the extent to which the analytic management model acknowledges the political-institutional realities of administration—namely, that agency action cannot be legitimated solely by reference to its adherence to expert disciplinary methods. Instead, Congress, the White House, the independent and department agencies, and the courts all play roles in developing and legitimating substantively rational regulatory policy.

So, what are we to make of the procedural and substantive devices channeling the FSOC's discretion in making Section 113 determinations? Despite the complaints about the FSOC's allegedly unbounded discretion, a review of (1) the Council's statute, (2) its detailed and descriptive interpretive guidance concerning the statute, (3) its formalized decisional process set forth in an administrative rulemaking and accompanying interpretive guidance, and (4) its early designation decisions and actions reveals to the contrary an elaborate scaffolding of procedural and substantive devices and practices designed to cabin, structure, limit, and guide the FSOC's exercise of discretion. That said, these devices, as with any administrative decisionmaking framework, will only perform a legitimating function for the Section 113 program if they are susceptible to consistent and transparent application.

A Civic Republican Justification for the Bureaucratic State, 105 HARV. L. REV. 1511, 1549 (1992); Cass R. Sunstein, *Beyond the Republican Revival*, 97 YALE L.J. 1539, 1549 (1988).

133. See Richard B. Stewart, *Administrative Law in the Twenty-First Century*, 78 N.Y.U. L. REV. 437, 443-44 (2003).

134. See Eric A. Posner & E. Glen Weyl, *Benefit-Cost Paradigms in Financial Regulation*, 43 J. LEGAL STUD. 51, 54 (2014); Nou, *supra* note 77, at 449 (describing cost-benefit analysis as “an accounting of the anticipated quantitative and qualitative effects of a regulation”).

135. See Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, 3 (1995).

136. Citing advances in probability theory, computing power, implicit preference analysis, and applied analytical techniques, policymakers have increasingly trumpeted “comprehensive rationality” as an ideal type of administrative policymaking. See Colin S. Diver, *Policymaking Paradigms in Administrative Law*, 95 HARV. L. REV. 393, 395-99 (1981) (noting that Charles Lindblom had, in an influential article published just two decades earlier, derided such a “comprehensive rationality” method of policymaking as a naïve ideal type).

137. At the risk of overly complicating things, it should also be pointed out that a qualification to the qualification is in order. When dealing with regulatory constraints, the procedure-substance dichotomy is frequently an unhelpful device, as most of these substantive restrictions on agency discretion take the form of procedural requirements with which agencies must comply. See, e.g., Nestor M. Davidson & Ethan J. Leib, *Regleprudence—at OIRA and Beyond*, 103 GEO. L.J. 259, 283 (2015) (referring to “trans-substantive administrative process”); Edward Rubin, *It's Time to Make the Administrative Procedure Act Administrative*, 89 CORNELL L. REV. 95, 136 (2003). Sure, these procedural requirements are unrelated to enhancing public participation in regulation (the pluralist desideratum of much of mid-twentieth century proceduralism), but they are procedural nonetheless.

Where, on the other hand, regulatory rules or frameworks are internally inconsistent, or are otherwise insusceptible to regular, consistent application, they are vulnerable to a challenge on the grounds that they violate the APA's first commandment: thou shalt not take "arbitrary and capricious" actions.¹³⁸ Even more fundamentally, they undercut the foundational sources of legal legitimacy claims—due process, administrative fairness, equality before the law, and the deployment of expertise—of which the APA is only our localized legislative expression.¹³⁹

III. Section 113 Rulemaking: The Three-Stage Investigation Process and the Substantive Analytic Framework

This Part prepares the necessary groundwork for the later exploration of the broader implications of the structural problems with the Section 113 program. It does so by introducing how the FSOC has set up the procedural details and analytic substance of its designation investigations. The stylized formalism of these regulatory materials disguises the reality that the nature of the fundamental inquiry that Congress delegated to the FSOC requires the agency to exercise a high degree of regulatory discretion and judgment. Of course, as discussed above in Part II, this problem is ubiquitous in administrative law. Together, the Analytic Framework and the structured process set forth in the FSOC's final rule are designed to legitimate the FSOC's designation process through procedural and substantive safeguards, focusing and narrowing the agency's focus and attention as a check against the potential exercise of arbitrary administrative power and discretion. How well these safeguards perform that function will be taken up below in Parts IV and V.

Faced with the task of interpreting and applying such a wide-ranging, not to mention centrally important, statutory mandate, the FSOC acted quickly to structure its administrative process for designating companies. Only three months after the enactment of the Dodd-Frank Act, the Council undertook its first ever rulemaking action by issuing an advanced notice of proposed rulemaking concerning the Section 113 designation process. It solicited feedback from interested parties in an effort "to gather information as it beg[an] to develop the specific criteria and analytical framework by which it will designate nonbank

138. See 5 U.S.C. § 706(2)(A); *Palermo v. FDIC*, 981 F.2d 843, 846-47 (5th Cir. 1993) (invalidating FDIC rule concerning evidence of ownership of bank certificates of deposit in part because it included "irreconcilable" provisions that could not "stand together" and therefore was "arbitrary and capricious" under the APA); see also *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1153 (D.C. Cir. 2011) (striking down the SEC's proxy access rule because court found the Commission's analysis to be "internally inconsistent"); *Gen. Chem. Corp. v. United States*, 817 F.2d 844, 857 (D.C. Cir. 1987) ("Because the ICC's analysis . . . is internally inconsistent and inadequately explained, we find its ultimate conclusion . . . to be arbitrary and capricious.").

139. See *supra* note 10 and accompanying text.

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financial companies for enhanced supervision under the [Dodd-Frank Act].”¹⁴⁰ The stated purpose of the FSOC's Section 113 rulemaking was twofold: first, to provide further structure, beyond the statutory criteria, to the agency's Section 113 deliberations; and second, to foster transparency and minimize uncertainty with respect to those determinations.¹⁴¹

A few months later, in January 2011, the FSOC issued its first formal notice of proposed rulemaking¹⁴² and nine months later, the FSOC published a second notice of proposed rulemaking,¹⁴³ in each case responding to comments from interested constituencies. As is customary with financial regulatory rulemaking, commenters consisted overwhelmingly of industry members and their trade associations.¹⁴⁴ In April 2012—almost two years following the enactment of the Dodd-Frank Act, but before it had designated any companies—the FSOC published a final set of rules structuring the Section 113 program. The rule sets forth (1) the procedural details of the Section 113 designation process and (2) accompanying interpretive guidance—referred to as the “Analytic Framework” and attached as an appendix to the rule—concerning how the FSOC intends to interpret the statute and apply its discretion in designating systemically important nonbank financial companies for supervision.¹⁴⁵

A. The Section 113 Designation Process

This Section introduces the procedural details of the Section 113 designation process, which are set forth in the final rule itself (as opposed to the accompanying Analytic Framework). The FSOC opted to structure its

140. See Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 75 Fed. Reg. 61,653, 61,653 (proposed Oct. 6, 2010).

141. See Final FSOC Section 113 Guidance, *supra* note 8, at 21,639 (to be codified at 12 C.F.R. pt. 1310).

142. See Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 4,555 (Jan. 26, 2011) [hereinafter First FSOC Section 113 Notice of Proposed Rulemaking].

143. See Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 76 Fed. Reg. 64,264 (Oct. 11, 2011) [hereinafter Second FSOC Section 113 Notice of Proposed Rulemaking].

144. See First FSOC Section 113 Notice of Proposed Rulemaking, *supra* note 142, at 4,556 (reporting that industry members and industry trade associations accounted for thirty-seven of the fifty comment letters submitted in response to the ANPR); cf. Kimberly D. Krawiec, *Don't 'Screw Joe the Plummer': The Sausage-Making of Financial Reform*, 55 ARIZ. L. REV. 53, 58-59 (2013) (using the so-called “Volcker Rule” rulemaking as a case study to illustrate that the phenomenon of industry domination of rulemaking proceedings is observable even where public interest groups successfully motivate citizens to submit comment letters). Wendy Wagner has described how this practice occurs during the agenda-setting phase—that is, before the agency even publishes a notice of proposed rulemaking. See Wendy E. Wagner, *Administrative Law, Filter Failure, and Information Capture*, 59 DUKE L.J. 1321, 1381-82 (2010) [hereinafter Wagner, *Filter Failure*]; Wendy E. Wagner et al., *Rulemaking in the Shade: An Empirical Study of EPA's Air Toxic Emission Standards*, 63 ADMIN. L. REV. 99, 124-28 (2011).

145. See Final FSOC Section 113 Guidance, *supra* note 8, at 21,637.

deliberations as a three-stage process, with a right to an administrative hearing and mandatory periodic reevaluation of all eventual designations.

1. Stage 1: An Automatic Sorting Mechanism

In Stage 1, the FSOC “narrow[s] the universe”¹⁴⁶ of potential designees through the application of quantitative filtering “thresholds” based on certain data that are reflective of the company’s potential vulnerability and riskiness: total assets, net derivatives liability, total notional amount of credit default swaps with the potential designee as the reference entity, total debt, leverage ratio, and short-term-debt-to-total-debt ratio.¹⁴⁷ The FSOC made clear that it was retaining the flexibility to transition nonbank companies into Stage 2 of the review process for reasons unrelated to the thresholds. It also stated its expectation that the list of thresholds would be provisional and subject to updates in the light of future market developments and regulatory experience.¹⁴⁸ In Stage 1, then, the FSOC simply applies an automatic sorting mechanism, and declines to account for firm-specific information beyond the quantitative thresholds. In light of the mechanistic, culling nature of this exercise, under the rule the FSOC does not provide notice to nonbank companies that pass from Stage 1 to Stage 2.

2. Stage 2: The Initial Application of Section 113’s Statutory Designation Criteria

Stage 2 is the first point in the Section 113 process at which the agency conducts a *particularized* application of the statutory criteria to a nonbank financial company under consideration. In Stage 2, the FSOC subjects those nonbank companies identified during the first stage to a “comprehensive analysis” in light of the Analytic Framework set forth in the interpretive guidance,¹⁴⁹ taking into account public and confidential information obtained from regulatory reports as well as any information voluntarily supplied by the company in question.¹⁵⁰ The Analytic Framework itself, discussed in detail below, represents the FSOC’s synthetic gloss on the ten statutory criteria that Congress set forth to structure the Section 113 designation process.¹⁵¹

146. *Id.* at 21,641.

147. *See id.* at 21,660-61.

148. *See id.* at 21,644.

149. *See supra* text accompanying note 145.

150. Final FSOC Section 113 Guidance, *supra* note 8, at 21,642. It is unclear how the FSOC contemplates that the nonbank financial company being reviewed in Stage 2 could voluntarily submit materials for the Council to consider if the subject company will only learn of its consideration of designation after the company has passed from Stage 2 to Stage 3. *See infra* text accompanying note 152.

151. *See supra* text accompanying note 71 (discussing statutory ten-criterion framework).

3. Stage 3: The Notice of Determination and the Consideration of Mitigating and Aggravating “Qualitative Factors”

Nonbank financial companies identified during the Stage 2 phase as having high potential to pose systemic risks to the economy move ahead to the final Stage 3 review characterized by a formal notice to subject companies and consideration of a suite of “qualitative” factors that might aggravate or mitigate the potential systemic threat. Here, the companies first receive formal notice of the investigation. In its rulemaking, the FSOC refers to this notification as a “notice of consideration of determination.”¹⁵² The FSOC provides companies receiving this notice with a non-statutory right to “submit written materials” within thirty days of receipt of the notice, though at this point the company would have no information other than the rule, the interpretive guidance, and the knowledge that it is presently under consideration for designation.¹⁵³

The transition from Stage 2 to Stage 3 is marked by the notice of consideration and likely involves an intensified investigation into the subject company, but the *substance* of the FSOC's inquiry will remain largely the same; Stage 3 is simply a continued engagement with the Analytic Framework. The only substantive difference between the Stage 2 and Stage 3 inquiries is that during the latter the FSOC will also consider certain “qualitative factors . . . that could mitigate or aggravate the potential of the nonbank financial company to pose a threat to U.S. financial stability.”¹⁵⁴ If, following the Stage 3 analysis, the FSOC decides to move forward with a designation, it will, if it deems it appropriate, “consult with” and “consider the views” of the company's primary regulator (if one exists).¹⁵⁵

4. Notice of Proposed Designation and the Right to an Administrative Hearing

If, following any consultation with the subject company's primary regulator, the FSOC remains resolved to designate the nonbank financial company, it will then provide the subject nonbank financial company with a notice of proposed designation. This notice will initiate a thirty-day period within which the company can exercise its rights under Section 113(e) to request an administrative hearing to contest the proposed determination, to be held no later

152. Final FSOC Section 113 Guidance, *supra* note 8, at 21,662; 12 C.F.R. § 1310.21(a) (2018).

153. 12 C.F.R. § 1310.21(a)(2) (2018).

154. Final FSOC Section 113 Guidance, *supra* note 8, at 21,646. See *infra* text accompanying note 191 for a more detailed explanation of these “qualitative factors.”

155. Final FSOC Section 113 Guidance, *supra* note 8, at 21,646.

than thirty days after the company invokes such rights.¹⁵⁶ The hearing rights are limited to submission of written materials; the FSOC has sole discretion to allow for oral testimony and argument.¹⁵⁷

5. The Final Determination

Whether the subject company requests a hearing or not, the next and final step is for the FSOC itself to determine whether to designate the subject company. Any final determination to designate a company must be approved by not fewer than two-thirds of the FSOC members, including an affirmative vote of the Secretary of the Treasury (in his capacity as FSOC Chair).¹⁵⁸

6. Periodic Reevaluation of Designation

The FSOC has a statutory responsibility to reevaluate each of its designations “not less frequently than annually.”¹⁵⁹ Unsurprisingly, the FSOC has implemented this requirement by conducting annual reevaluations. The Section 113 rulemaking simply tracks the statute’s requirements and does not include any meaningful interpretive gloss. In fact, the FSOC does not even commit in the rule to a specific periodicity of the reevaluation, instead copying and pasting the “not less frequently than annually” formulation from the statute.¹⁶⁰

One purpose of the reevaluation is to account for expected organizational responses to the designations. Section 113 (designation) and Section 165 (heightened prudential standards) alter the decision matrix for a nonbank financial institution. The regime works a twofold change to their incentive structures, operating to disincentivize actions that increase the risk of stumbling *onto* the FSOC’s radar screen¹⁶¹ and incentivizing actions to move *off* the FSOC’s radar screen. This experience of GE Capital was the first case study of this latter motivation.¹⁶² AIG and Prudential provide more recent examples.¹⁶³

However, barring a drastic GE Capital-style restructuring, the initial designation might prove sticky because the same two-thirds majority of FSOC member agencies that the statute requires for designation is also required to

156. *See id.*; 12 C.F.R. § 1310.21(c) (2018); *cf.* Dodd-Frank Wall Street Reform and Consumer Protection Act § 113(e), 12 U.S.C. § 5323(e) (2018) (providing the statutory basis for the hearing right).

157. Dodd-Frank Act § 113(e)(2); 12 C.F.R. § 1310.21(c)(2) (2018).

158. Dodd-Frank Act § 113(a); 12 C.F.R. § 1310.10(b)(2) (2018).

159. Dodd-Frank Act § 113(d), 12 U.S.C. § 5323(d) (2018).

160. 12 C.F.R. § 1310.23(a) (2018).

161. This dynamic is what Dan Schwarcz and David Zaring describe as “regulation by threat.” *See generally* Schwarcz & Zaring, *supra* note 82, at 1851-53.

162. *See supra* note 89 and accompanying text (discussing the FSOC’s rescission of GE Capital’s designation following the latter’s transformational restructuring).

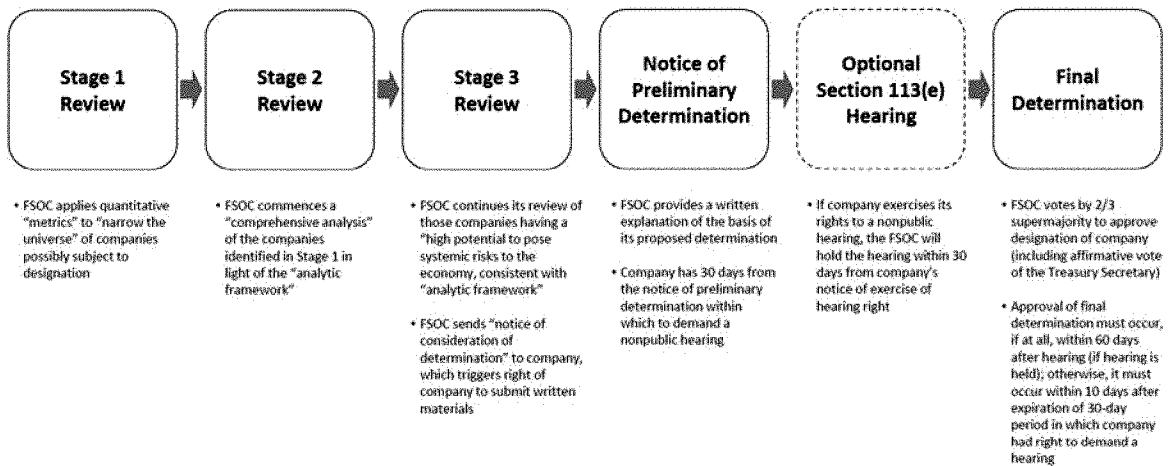
163. *See supra* text accompanying notes 91-93.

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rescind the designation.¹⁶⁴ Nevertheless, dramatic alterations in the political economy of financial regulation, as occurred once the Trump Administration stacked the Council with deregulatory appointees, can loosen the stickiness of the designation, as demonstrated in September 2017 when the Council rescinded the designation of AIG.¹⁶⁵

Figure 2 below illustrates the sequential procedural features of the Section 113 designation process.

Figure 2



7. Briefly Revisiting the Question of Organizational Structure: The FSOC’s Five Functional Staff Committees

A brief reprise on the FSOC’s structure is necessary to understand the administrative process contemplated by its final Section 113 rule. We have seen how the FSOC membership (i.e., constituent agency heads) votes for a final determination, and of course the membership approved the Stage procedures and the Analytic Framework discussed below through an informal rulemaking.¹⁶⁶

164. Dodd-Frank Act § 113(d)(2).

165. See U.S. DEP’T OF THE TREASURY FIN. STABILITY OVERSIGHT COUNCIL, NOTICE AND EXPLANATION OF THE BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL’S RESCISSION OF ITS DETERMINATION REGARDING AMERICAN INTERNATIONAL GROUP, INC. (AIG) (2017), [https://www.treasury.gov/initiatives/fsoc/designations/Documents/American_International_Group_Inc._\(Rescission\).pdf](https://www.treasury.gov/initiatives/fsoc/designations/Documents/American_International_Group_Inc._(Rescission).pdf) [<https://perma.cc/HX79-RTZ5>].

166. See JERRY L. MASHAW ET AL., ADMINISTRATIVE LAW: THE AMERICAN PUBLIC LAW SYSTEM: CASES AND MATERIALS 595-600 (2014) (describing how informal rulemaking is “by far

But who performs the work as the Council moves through Stages 1 through 3? Who, in other words, exercises agency discretion in the application of the framework—in, for example, setting the culling metrics during Stage 1 and identifying which companies should move from Stage 2 to Stage 3? The statute and the final rule are both curiously silent on that question.

The FSOC has had to build the organizational scaffolding to perform these tasks and support the ultimate decisionmakers. To that end, the Council has established five functional interagency staff committees,¹⁶⁷ one of which is the Nonbank Financial Company Designations Committee (the Section 113 Committee).¹⁶⁸ These staff committees are comprised of staff from member agencies, with each member agency having the right to appoint one or more representatives to participate in the committee.¹⁶⁹ The Section 113 Committee is responsible for supporting the Council in fulfilling the latter’s responsibilities to consider, make, and review Section 113 designations.¹⁷⁰ A Deputies Committee comprised of a senior official from each FSOC member agency¹⁷¹ oversees and directs the Section 113 Committee, as well as the other functional committees.¹⁷² Finally, the Secretary of the Treasury, who chairs the Council, maintains a Secretariat to assist the Secretary in carrying out duties associated with chairpersonship.¹⁷³

the dominant federal model” of administrative policymaking). Formal rulemaking, by contrast, employs formal trial-like procedures, including oral testimony and cross examination of witnesses. See RICHARD J. PIERCE, JR., 1 ADMINISTRATIVE LAW TREATISE § 7.1, at 561-63 (5th ed. 2010) [hereinafter PIERCE TREATISE]. There is nothing informal about informal rulemaking; instead, its procedures, set forth in the APA, are highly particularized. It is probably better to refer to it as legislative rulemaking, and to refer to formal rulemaking as adjudicatory rulemaking.

167. See GAO STREAMLINING REPORT, *supra* note 15, at 68 n.131. The term “interagency staff committees” originated in the FSOC’s bylaws, referred to as its “Rules of Organization.” See *Rules of Organization of the Financial Stability Oversight Council*, U.S. DEP’T OF THE TREASURY § 6(c)(18) (rev. 2018) [hereinafter FSOC Bylaws] <https://www.treasury.gov/initiatives/Documents/FSOCbylaws.pdf> [<https://perma.cc/874H-9MKY>].

168. See U.S. DEP’T OF THE TREASURY FIN. STABILITY OVERSIGHT COUNCIL, 2016 ANNUAL REPORT 107 (2016), <https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC%202016%20Annual%20Report.pdf> [<https://perma.cc/8ZMA-LWW6>].

169. See, e.g., *Charter of the Nonbank Financial Companies Designation Committee of the Financial Stability Oversight Council*, U.S. DEP’T OF THE TREASURY FIN. STABILITY OVERSIGHT COUNCIL § 5 [hereinafter Section 113 Committee Charter], <https://www.treasury.gov/initiatives/fsoc/governance-documents/Documents/The%20Council%27s%20Committee%20Charters.pdf> [<https://perma.cc/6GDT-8C8D>].

170. See *id.* § 1.

171. FSOC Bylaws, *supra* note 167, § 7(a).

172. See *id.* (listing among the Deputies Committee’s responsibilities “coordinating and overseeing the work of interagency staff committees”); Section 113 Committee Charter, *supra* note 169, § 3 (“The [Section 113] Committee is subject to the direction and oversight of the Deputies Committee”).

173. See GAO STREAMLINING REPORT, *supra* note 15, at 68. The expenses associated with the FSOC Secretariat (as well as the independent member of the Council with insurance expertise, who has no “home” regulator to pay his or her salary) are paid out of the budget for the Office of Financial Research, a new office established within the Department of Treasury pursuant to Section 152 of the Dodd-Frank Act. See Dodd-Frank Wall Street Reform and Consumer Protection Act § 118, 12 U.S.C. § 5328 (2018).

B. The Basic Structure of the Analytic Framework

This Section introduces in broad strokes the substantive analytic structure of the Section 113 designation program, as set forth in the Analytic Framework accompanying the rule. The Analytic Framework tells us how the FSOC will answer the fundamental question of whether a company could pose a threat to financial stability. Although the rule's procedural details described above in Section III.A are obviously necessary to appreciate how this regulatory program functions, the more consequential (and controversial) elements of the rule appear in the Analytic Framework. This material is prefatory, setting the stage for a fulsome exploration of the details and implications of the problems with the Analytic Framework in the subsequent Parts.

The purpose of the Analytic Framework is to sharpen and focus the FSOC's core substantive inquiry as initially formulated by Congress. It has the apparent virtue of setting forth a coherent and comprehensive set of articulable and analytically distinct inquiries that the FSOC is to undertake when conducting a Section 113 investigation. On the other hand, it has the obvious vice of being overly complicated, requiring the agency to consider a confounding admixture of "categories, metrics, thresholds, and channels" in the course of its inquiry.¹⁷⁴

1. The Analytic Framework's Interpretation of "Threat to the Financial Stability": Layering Conjecture on Conjecture

The FSOC's Analytic Framework layers on another layer of conjecture to the already conjectural statutory task of identifying "threats to the financial stability of the United States." As noted earlier, the operative logic of Section 113 clearly contemplates that the FSOC must exercise a significant degree of administrative discretion when implementing and applying the statute.¹⁷⁵ In particular, the statute plainly requires the FSOC to make hypothetical assessments of how the future events described by the Determination Standards might undermine the stability of the financial system. Nowhere is the intrinsically conjectural nature of the FSOC's designation task more apparent than in the open-textured phrase "threat to the financial stability of the United States." In the Analytic Framework, the FSOC embraces this task, in effect doubling down on conjecture by providing that such a threat exists "if 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."¹⁷⁶ Parsing this definition, we see yet another nested layer of conditionality and conjecture.

174. Final FSOC Section 113 Guidance, *supra* note 8, at 21,660.

175. *See supra* Section I.B.2.

176. Final FSOC Section 113 Guidance, *supra* note 8, at 21,657 (emphasis added).

Figures 3.1 and 3.2 below update Figure 1 from Section I.B.2 for each Determination Standard, to include consideration of this added layer of conjecture.

Figure 3.1 – First Determination Standard

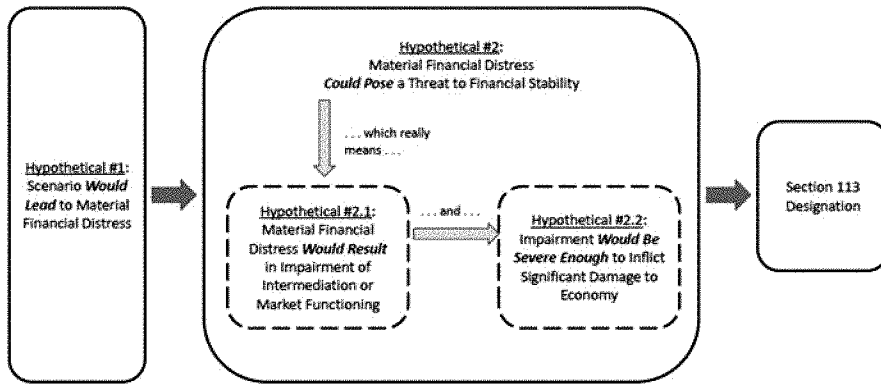
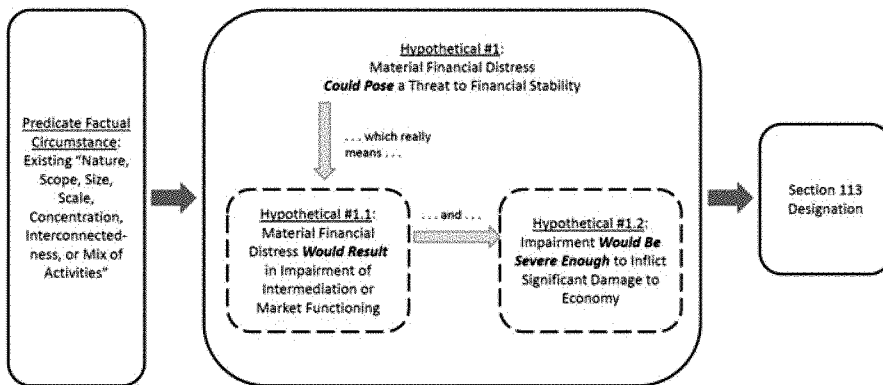


Figure 3.2 – Second Determination Standard



2. Building a Conceptual Map of the Analytic Framework

The Analytic Framework revolves principally around conceptual devices that the FSOC terms “categories” and “transmission channels.” In order to understand the Framework’s substantive logic, and how the FSOC orients itself to its discretionary tasks, one must first become familiar with the potpourri of conceptual tools the Framework introduces—including not only its “categories,” and “transmission channels,” but also its “metrics” and “qualitative factors.” This section will explain how the FSOC uses these other conceptual tools to structure its deliberative process.

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In the Framework, the FSOC deploys two sets of conceptual tools to guide it through the various Stages¹⁷⁷ of its Section 113 investigations: “categories” and “transmission channels.” The FSOC’s six categories are: (1) size, (2) interconnectedness, (3) substitutability of services, (4) leverage, (5) liquidity risk and maturity mismatch, and (6) existing regulatory scrutiny.¹⁷⁸ The FSOC insists that it will not apply the categories formulaically and will instead make a composite Section 113 determination based on “quantitative and qualitative data relevant to each of the six categories.”¹⁷⁹ The FSOC refers to the types of data it will take into account during this analysis as “metrics.”¹⁸⁰ Furthermore, it claims that the categories simply encapsulate the ten criteria outlined in the statute to provide structure to both determination standards.¹⁸¹

The FSOC states that it intends to apply these “categories” in the contexts of both Determination Standards.¹⁸² However, the FSOC also specifies that the categories concern the likelihood and impact of a material financial distress (the predicate factual circumstance for the First Determination Standard), which makes their application to the Second Determination Standard ambiguous—a matter taken up further below in Section V.B.

The epidemiological concept of contagion or transmission is ubiquitous in literature on systemic risk, so it is not surprising to see that the Analytic Framework uses “transmission channels” as a key conceptual tool. The statute itself is clear that the mere possibility, or even likelihood, of “material financial distress” at a nonbank financial company does not require designation under Section 113; instead, the statute directs the FSOC to take action only where such a failure “could pose a threat to the financial stability of the United States.”¹⁸³ The same applies to the firm’s mix of activities under the Second Determination Standard; designation is only proper where those activities could pose a systemic threat. As noted earlier, the FSOC decomposes this hypothetical inquiry into two further nested hypothetical inquiries: whether the catalytic circumstance (distress or activities, depending on the standard) would impair financial intermediation or financial market functioning in a manner that would be sufficiently severe to inflict significant damage on the broader economy.¹⁸⁴

In imagining how a material financial distress might give rise to a systemic problem, the Framework identifies three “transmission channels” through which that catalytic circumstance might transmit negative effects to other firms and

177. See *supra* Section III.A for a description of the “Stages” of the Section 113 inquiry.

178. Final FSOC Section 113 Guidance, *supra* note 8, at 21,641.

179. *Id.* at 21,658.

180. *Id.* at 21,646.

181. See *supra* text accompanying note 71 (discussing statutory factors).

182. *Id.* at 21,658 (“The Council expects to use these six categories to guide its evaluation of whether a particular nonbank financial company meets either Determination Standard.”).

183. See *supra* text accompanying notes 65-67.

184. See *supra* text accompanying note 176.

markets: (1) exposure, (2) asset liquidation, and (3) critical function-service.¹⁸⁵ These channels are a way of assessing the firm’s potential to pose a threat to U.S. financial stability given its position and role in the broader structure of the financial system. In contrast to the categories, which describe the characteristics of a particular firm, the FSOC’s “transmission channels” are analytical tools focused on the position of the firm within the financial system—in particular, its potential to transmit distress elsewhere.

The *exposure channel* refers to the process by which an outside exposure to a nonbank financial company causes failures or disruptions at other financial institutions. When considering the exposure channel, the FSOC will look at a series of what it calls “metrics,” including consolidated assets, credit default swaps outstanding, derivative liabilities, total debt outstanding, and leverage ratio.¹⁸⁶ Here, the focus is sensibly not on the magnitude of the aggregate claims against the company, but the dispersion and density of those claims among a company’s counterparties. The *asset liquidation channel* addresses the fire sale phenomenon, pursuant to which a firm liquidates assets, either in connection with a legally mandated liquidation-resolution proceeding or on its own accord in order to enhance its liquidity position. The concern here is—again, quite sensibly—that a sudden surge in sale orders could cause relevant asset prices to fall precipitously, disrupting trading in key markets or compromising other firms that hold the same asset class.¹⁸⁷ Finally, the *critical function-service channel* is implicated when a nonbank financial company “is no longer able or willing to provide a critical function or service that is relied upon by market participants and for which there are no ready substitutes.”¹⁸⁸ Here, the FSOC announced its intention to “apply company-specific analyses” rather than any “broadly applicable quantitative metric[s]” in recognition of the “unique ways in which a nonbank financial company may provide a critical function or service to the market.”¹⁸⁹

As a final component of the Analytic Framework, the FSOC will consider, beginning during its Stage 3 inquiry—that is, at a point in its process when designation is more of a concrete possibility—certain “qualitative factors.” Specifically, the FSOC assesses whether these factors “could mitigate or aggravate the potential of the nonbank financial company to pose a threat to U.S.

185. See Final FSOC Section 113 Guidance, *supra* note 8, at 21,641. The FSOC expressly retained the ability to add further transmission channels to its analysis if necessary. See *id.* at 21,657.

186. *Id.* at 21,658; *cf. supra* text accompanying note 180 (noting that the FSOC also uses “metrics” to refer to types of data it takes into account in consideration of the “categories”).

187. See Randall D. Guynn, *Are Bailouts Inevitable?*, 29 YALE J. ON REG. 121, 128-29 (2012) (discussing deadweight social loss entailed by “fire-sale liquidations” in the form of reduced “going concern surplus” and the “increased risk of a severe destabilization or collapse of the financial system”); Eric A. Posner, *What Legal Authority Does the Fed Need During a Financial Crisis?*, 101 MINN. L. REV. 1529, 1533-34 (2014) (describing a contagion phenomenon with respect to fire sale asset dispositions in terms of a “downward spiral”).

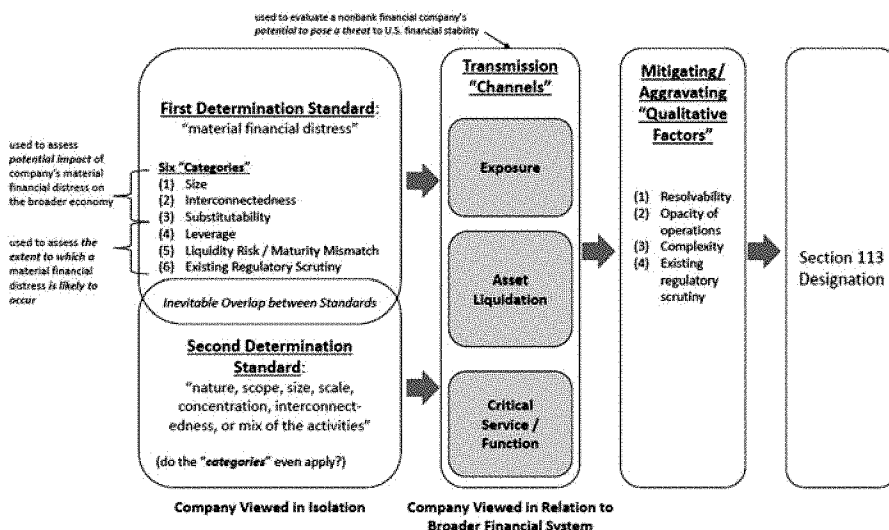
188. Final FSOC Section 113 Guidance, *supra* note 8, at 21,658.

189. *Id.*

financial stability.”¹⁹⁰ The factors include the company’s “resolvability, the opacity of its operations, its complexity, and the extent and nature of its existing regulatory scrutiny.”¹⁹¹

At this point, a complete picture of the Analytic Framework emerges. Figure 4 below illustrates the Framework as it presently exists.

Figure 4



IV. Three Trenchant Structural Problems with the Analytic Framework

Three trenchant structural problems compromise the long-term stability of the Section 113 designation program. The first and second such structural problems are to some extent common to all administrative schemes designed to prevent, counteract, or mitigate future harms that are subject to a significant degree of uncertainty. These regimes, which are described as “risk-regulatory” regimes, raise hybrid legal-political questions that unavoidably implicate normative positions that are best conceptualized as outside the legal system. Except in extreme cases, our evaluation of the merits of arguments about these issues is largely a function of our attitudes concerning governmental regulation and discretion. Nevertheless, interested litigants often frame these issues as legal problems, and they must be confronted as such. The first problem, which I will refer to as the “Causality Conundrum,” is that the Framework makes FSOC designations susceptible to accusations of arbitrariness because it does not require probabilistic specification of the causal channels through which a

190. *Id.* at 21,646.

191. *Id.*

systemic problem might hypothetically occur. The second problem, which I will refer to as the “Regulatory Costs Dilemma,” is that the Framework does not require the FSOC to explicitly and separately account for the anticipated cost impact of its designations on regulated entities.

The third trenchant problem, which I will label the “Filter Problem,” is really two problems. The “Basic Filter Problem” refers to the fact that the FSOC has arguably exceeded its statutory authority by imposing a filter that takes into account the *likelihood* of financial distress at an investigated company, in the process narrowing the scope of the Section 113 program. I refer to this filter as the “Vulnerability-Likelihood Filter” (or the “Filter”). The second, related problem, which I refer to for reasons detailed below as the “Zombie Filter Problem,” results from the curious fact that no sooner had the FSOC created this Filter than it disavowed its intention of applying it. So long as the FSOC maintains this perplexing enforcement stance, it opens its designations up to challenges on the grounds that the Council is acting arbitrarily by not following its own protocols.

Each of these problems is also equally applicable to much of the financial supervisory system, including the most important pillars of the post-crisis regime.¹⁹² Even the Filter Problem, a Section 113-specific problem, is generalizable to the extent that it sheds light on how the legal system responds when regulators acquiesce to industry attempts to pare back regulation in contravention of statutory directives.¹⁹³ The analysis below therefore presents the FSOC as a harbinger case study about the coming crisis in the administrative law of financial supervision.

A. Two Core Potential Risk-Regulatory Problems

Two problems complicate the integration of the Analytic Framework and similar risk-regulatory programs within today’s system of “analytically managed” administrative law. When regulatory critics attack the first such problem, which I label the “Causality Conundrum,” they take the agency to task for the alleged imprecision in specifying the causal factors and associated probabilities that give rise to regulated risks. When they attack the second problem, which I label the “Regulatory Costs Dilemma,” they fault the agency’s decision process for not formally accounting for the costs regulated entities are expected to incur in connection with the regulatory action.

192. These pillars include the Comprehensive Capital Analysis and Review (CCAR) program and the related Dodd-Frank stress testing program, as well as the review of resolution plans (also known as “living wills”).

193. This phenomenon results from what Charles Lindblom called the “privileged position” of business interests in a market-oriented political-economic system: policy outcomes inevitably depend on policymakers successfully inducing business leaders to risk capital, which affords the latter a privilege that laborers, because their livelihoods depend on their labor, do not enjoy. See CHARLES E. LINDBLOM, *POLITICS AND MARKETS: THE WORLD’S POLITICAL-ECONOMIC SYSTEMS* 172-77 (1977).

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As noted earlier, for at least three decades, administrative law has increasingly relied on substantive, instrumental rationality and analytic management to justify the exercise of administrative discretion.¹⁹⁴ According to this model of administrative legitimation, agencies validate the exercise of their discretion by referring to purportedly objective scientific and technical evidence supporting their decisions to act or not to act.¹⁹⁵ This model shares similarities with the earlier “expertise model” of administrative law, which also made legitimation depend in part on scientific, technocratic information.¹⁹⁶ However, they diverge to the extent the analytic management model acknowledges the political-institutional realities of administration—namely, that agency action cannot be legitimated solely by reference to its adherence to expert disciplinary methods.¹⁹⁷

Instead, this newer analytic management model is predicated on the institutional *management* of the *analytic* methods and information that contemporary risk regulation regimes require. As under the expertise model, its methodological forms borrow from science and economics.¹⁹⁸ However, its institutional forms borrow from traditions of American public law, such as checks and balances and separation of powers. Both Congress (by including increasingly precise analytic standards into legislation)¹⁹⁹ and the White House (in its centralized review and control of regulatory activity)²⁰⁰ have been active in this process.

Recently, the judiciary has also taken its turn in influencing the analytical plumbing of administrative process. Courts have admonished agencies that their responsibility to engage in reasoned decisionmaking requires them to base their predictive judgments on “logic and evidence” in the record rather than “sheer speculation”²⁰¹ and account for the costs of their actions (or inactions).²⁰² These two particular manifestations of judicial assertiveness within the broader analytic management trend threaten to complicate the FSOC's designation process—and other core financial supervisory programs as well.

194. See *supra* notes 132-137 and accompanying text.

195. Cf. THEODORE M. PORTER, *TRUST IN NUMBERS: THE PURSUIT OF OBJECTIVITY IN SCIENCE AND PUBLIC LIFE* (1996).

196. See *supra* notes 129-131 and accompanying text.

197. See *supra* text accompanying note 133.

198. The growing literature on cost-benefit analysis in the legal system is but one manifestation of this broader trend. See *supra* notes 134-137.

199. See Daniel B. Rodriguez & Barry R. Weingast, *The “Reformation of Administrative Law” Revisited*, 31 J. L., ECON. & ORG. 782, 797 (2015).

200. See Lisa Schultz Bressman, *Procedures as Politics in Administrative Law*, 107 COLUM. L. REV. 1749, 1758 (2007); Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2245 (2001).

201. *Sorenson Commc'ns Inc. v. FCC*, 755 F.3d 702, 708 (D.C. Cir. 2014).

202. See, e.g., *Michigan v. EPA*, 135 S. Ct. 2699, 2712 (2015).

1. Potential Risk-Regulatory Dilemma #1: The Causality Conundrum

The Causality Conundrum makes the FSOC's Analytic Framework vulnerable to legal attack on the grounds that it fails to require the FSOC to specify with adequate precision the causal channels through which the anticipated harm to be avoided will materialize. All risk-regulatory schemes share a common attribute that co-exists in some tension with the administrative law desideratum of structured and contained discretion: namely, that the predicate for regulatory action *today* is the prospect of a harm that might occur *tomorrow*.²⁰³ For all but the most mundane matters, the future is subject to a significant degree of uncertainty; and acting in conditions of uncertainty requires discretion. Indeed, the requirements for regulatory discretion increase as a function of the degree to which the regulatory problem is characterized by uncertainty. The decision space facing an environmental regulator responding to multi-source air pollution is much wider than it is for a township police department implementing a traffic regulation system for an intersection. And it is wider still for a financial regulator seeking to limit the risk that a future, unknown, and hypothetical distress event at a financial institution might precipitate breakdowns in the functioning of a future financial system, the parameters and components of which are presently unknown. Scientific uncertainty is a constitutive feature of these regulatory regimes; conjecture, imagination, and hypothesis are unavoidable.²⁰⁴

Of course, in its basic form this problem is as old as risk regulation itself.²⁰⁵ It articulates the central challenge of modern administrative law: how to accommodate the contemporaneous inevitability and toxicity of discretion—particularly the great degree of discretion required by risk-regulatory regimes. The point here is that the Section 113 program presents a context where the tension is particularly pronounced. Moreover, lessons from our engagement with these issues will follow for financial supervision more broadly, since supervisory programs are increasingly assuming classical risk regulation forms.²⁰⁶

As always, the regulator faces demands to justify its discretionary choices. What I refer to here as the Causality Conundrum looks at a particular justificatory

203. Cf. ULRICH BECK, *RISK SOCIETY: TOWARD A NEW MODERNITY* 34 (1992) (“We become active today in order to prevent, alleviate or take precautions against the problems and crises of tomorrow and the day after tomorrow—or not to do so.”).

204. See Elizabeth Fisher, *Drowning by Numbers: Standard Setting in Risk Regulation and the Pursuit of Accountable Public Administration*, 20 OXFORD J. LEGAL STUD. 109, 115 (2000).

205. A trio of mid-1970s scholarly treatments from judges of the Court of Appeals for the District of Columbia Circuit documents the early vigor of these debates. See David L. Bazelon, *Coping with Technology Through the Legal Process*, 62 CORNELL L. REV. 817 (1977); Harold Leventhal, *Environmental Decisionmaking and the Role of the Courts*, 122 U. PA. L. REV. 509 (1974); J. Skelly Wright, *The Courts and the Rulemaking Process: The Limits of Judicial Review*, 59 CORNELL L. REV. 375 (1974).

206. See Robert F. Weber, *The Comprehensive Capital Analysis and Review and the New Contingency of Bank Dividends*, 46 SETON HALL L. REV. 43, 50-51 (2015).

demand asking the following question: *why did the regulator assume that the future would look like that?* The thinner the conceptual thread that causally links the future harm to the present regulatory action, the more likely it is for a party aggrieved by that solution to challenge it, either politically (by complaining to the political branches) or judicially (by casting the ultimate exercise of that discretion as arbitrary and capricious or unsupported by substantial evidence).

The Causality Conundrum results from the scope of risk-regulatory legislative directives themselves. The demise of the non-delegation doctrine, which would otherwise restrict the ability of Congress to delegate to agencies open-ended legislative tasks, leaves affected parties without recourse against Congress—no matter how broad those delegated discretionary powers are.²⁰⁷ Instead, parties aggrieved by risk-regulatory determinations such as Section 113 designations have incentives to deconstruct the causal threads the regulator strives to weave together—to support either general rulemakings or particular adjudications. With this particular regulatory program, the Causality Conundrum is likely to arise in the context of judicial review of designations.

a. The Causality Conundrum and Congress

Whereas Congress frequently becomes involved in specifying the degree of definiteness of the causal determinations supporting regulatory judgments, it did not do so with the Section 113 program. Viewed through the lens of administrative law *qua* analytic management, parties aggrieved by regulation can look to the political branches or to litigation and judicial review. For instance, aggrieved parties could petition Congress to draft or amend agency organic statutes so that they mandate that regulation be justified by reference to an analytic standard requiring a tight causal link between the regulation and the anticipated harm. Such a standard would require the agency to estimate the probabilities of the future contingent events on the basis of which the agency takes action. For instance, a statutory “feasibility” standard might require the regulator to restrict an environmental pollutant to the extent feasible—a standard that *requires* the regulator to predict both how the standard will restrict the pollutant and how it will affect the feasibility of the industry’s continuing operations.²⁰⁸ Similarly, a statutory cost-benefit standard might mandate that the regulator determine that the benefits of regulation exceed, or at least bear a reasonable relationship to, the costs of regulation.²⁰⁹ Such a standard would also

207. See *supra* notes 68-70 and accompanying text.

208. See, e.g., Occupational Safety and Health Act of 1970 § 6(b)(5), 29 U.S.C. § 655(b)(5) (2018) (authorizing Department of Labor to restrict “toxic materials” and “harmful physical agents” by means of setting the “standard which most adequately assures, to the extent feasible, on the basis of the best available evidence, that no employee will suffer material impairment of health or functional capacity even if such employee has regular exposure to the hazard dealt with by such standard for the period of his working life”).

209. See, e.g., Consumer Product Safety Act of 1972 § 9(f)(3)(E), 15 U.S.C. § 2058(f)(3)(E) (2018) (“reasonable relationship”); 49 U.S.C. § 60102(b)(3)-(5) (2018) (requiring the

require the regulator to specify the causal assumptions and predictive judgments underlying the analysis.

When it came to setting forth guidelines for the FSOC concerning the types of future possibilities that might justify SIFI designation, Congress was silent, deferring to—or leaving the problem for—the FSOC. Here, the Congressional silence inoculates the Section 113 program against the threat of potential designees arguing that the statute itself *requires* the Council to justify the causal logic underlying its rulemaking or designations by reference to a specific cost-benefit, feasibility, or similar standard.²¹⁰

b. The Causality Conundrum and the White House

While the FSOC is unique among financial regulators in that it is subject to regulatory review by the Executive Branch's Office of Information and Regulatory Affairs (OIRA), neither its Final Rules nor its Analytic Framework have been subject to review. The White House has also asserted itself as a force to channel regulatory discretion with respect to—and, concomitantly, to serve as a legitimating mechanism for—risk-regulatory standards.²¹¹ This trend has obvious implications for risk regulation and the Causality Conundrum, and aggrieved parties can attempt to profit from White House influence over regulatory outcomes. Most obviously, starting with the Reagan administration, each president has required executive agencies to submit regulatory analyses to OIRA, itself housed in the White House's Office for Management and Budget (OMB), for review before promulgating new rules or regulations.²¹² These reviews are an important piece of a broader effort, implemented by this series of executive orders, “to reform and make more efficient the regulatory process.”²¹³ They embody High Church substantive-instrumental rationality techniques.

The focal point of the executive orders is a requirement of executive agencies to submit a “regulatory impact analysis” (RIA) to OIRA for each

Secretary of Transportation to identify costs and benefits of proposed minimum safety standards applicable to pipeline transportation of hazardous liquids, and to reach a “reasoned determination that the benefits of the intended standard justify its costs”).

210. *Cf.* Nat'l Ass'n of Mfrs. v. SEC, 748 F.3d 359, 369 (D.C. Cir. 2014) (“An agency is not required to measure the immeasurable, and need not conduct a rigorous, quantitative economic analysis unless the statute explicitly directs it to do so.” (quotation marks omitted)).

211. *See* Patricia M. Wald, *The 1993 Justice Lester W. Roth Lecture: Regulation at Risk: Are Courts Part of the Solution or Most of the Problem?*, 67 S. CAL. L. REV. 621 (1994).

212. *See* Exec. Order No. 12,291, 46 Fed. Reg. 13,193 (Feb. 17, 1981); Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Sept. 30, 1993) [hereinafter EO 12,866].

213. *See* EO 12,866, *supra* note 212. President Obama restored to full effect President Clinton's Executive Order 12,866, which President Bush had amended without significantly altering the RIA process. *See* Exec. Order No. 13,497, 74 Fed. Reg. 6113 (Jan. 30, 2009) (the Obama order restoring Executive Order 12,866 as initially promulgated); Exec. Order No. 13,258, 67 Fed. Reg. 9385 (Feb. 28, 2002) (the first series of Bush amendments); Exec. Order No. 13,422, 72 Fed. Reg. 2736 (Jan. 18, 2007) (the second series of Bush amendments).

“significant regulatory action”²¹⁴ the agency proposes to undertake. The RIA must set forth the text of such proposed regulatory action, articulate the need for the action, explain how the action would meet that need, and include an “assessment of the potential costs and benefits of the regulatory action.”²¹⁵ For a subset of significant regulatory actions—namely, those “economically significant regulatory actions” that would entail \$100 million or more in annual costs—a more fulsome report on the proposal is required that (1) includes more specific information concerning anticipated costs and benefits and (2) identifies alternatives together with explanations for why the proposal is preferable to those alternatives.²¹⁶ These exercises require specification of the predictive judgments underlying the agency's decision to take action.

The FSOC, along with its parent the Department of the Treasury, is unique among federal financial regulators in that it *is* subject to OIRA regulatory review.²¹⁷ However, the FSOC contended that the Final Rule and the Analytic Framework were not “economically significant” regulatory actions—and President Obama's OMB and OIRA concurred. As such, the FSOC was not required to develop the more fulsome version of an RIA. These determinations, like any determinations made in furtherance of the OIRA regulatory review, are committed to the sole discretion of OIRA and OMB and are not susceptible to judicial review of any kind.²¹⁸ Once the RIA has moved through OMB and OIRA, White House involvement typically ends. Although the Obama administration endeavored to institutionalize periodic, retrospective review of regulations at executive agencies (with OIRA oversight),²¹⁹ such efforts remain “ad hoc and largely unmanaged.”²²⁰ Just as importantly, the actual designation-

214. Executive Order 12,866 defines “regulatory actions” to include only generally applicable statements that the agency intends to have the force and effect of law, thereby excluding adjudications from its scope. See EO 12,866, *supra* note 212, § 3(d). A regulatory action is “significant” if it would have an annual effect on the economy of \$100 million or more or otherwise have material adverse effects, create a serious inconsistency with other action taken or anticipated by other agencies, materially alter budget impacts of federal programs, or raise novel legal and policy issues. See *id.* § 3(f).

215. *Id.* § 6(a)(3)(B)(ii).

216. See *id.* § 6(a)(3)(C).

217. Executive Order 12,866 applies only to “agencies,” a category the order defined to include “[any] authority of the United States” that is not identified by the Paperwork Reduction Act as an “independent regulatory agency.” EO 12,866, *supra* note 212, § 3(b). The Paperwork Reduction Act includes all federal financial supervisors—along with non-supervisory financial regulators the SEC and CFTC and their independent commission cousins such as the FCC and FERC—as “independent regulatory agencies,” thereby excluding them from the scope of the order. See 44 U.S.C. § 3502(5) (2018) (FDIC, OCC, Federal Reserve).

218. EO 12,866, *supra* note 212, § 10; Nicholas Bagley & Richard L. Revesz, *Centralized Oversight of the Regulatory State*, 106 COLUM. L. REV. 1260, 1281 (2006). *But cf.* Richard L. Revesz, *Cost-Benefit Analysis and the Structure of the Administrative State: The Case of Financial Services Regulation*, 34 YALE J. ON REG. 545, 594-95 (2017) (clarifying that courts may make substantive inquiry into analysis submitted to OIRA if the agency later uses that analysis as support for its action).

219. See Exec. Order No. 13,610, 77 Fed. Reg. 28,469 (May 14, 2012); Exec. Order No. 13,563, 76 Fed. Reg. 3821 (Jan. 21, 2011).

220. Cary Coglianese, *Moving Forward with Regulatory Lookback*, 30 YALE J. ON REG. 57, 59 (2013).

adjudications themselves, as opposed to the generally applicable Final Rule and Analytic Framework, would not be subject to OIRA review in the first place.²²¹

c. The Causality Conundrum and the Courts

For risk-regulatory programs like the FSOC's Section 113 regime, motivated anti-regulation forces are able to marshal the full force of the Causality Conundrum in the context of judicial review. Where, as here, a regulator that is under-instructed by Congress and is not subject to the demanding form of OIRA review takes an action predicated on its assessment of contingent future events, the most likely forum in which that assessment will be contested is the judiciary. If it would be arbitrary (as it must be) for the FSOC to designate a company under Section 113 on the basis of a scenario involving an alien takeover of the Federal Reserve Board, the remedy is not presently found in the statute or in the White House; it can only come from the courts.

As for the Section 113 program, a nonbank financial company could initiate a judicial challenge to the generally applicable Framework (a rulemaking), or to an individual designation (an adjudication). A challenge to the rulemaking would call into question the predictive judgments embedded in the Framework (arguing, for example, that it is arbitrary and capricious to believe that a 15-to-1 leverage ratio is a meaningful historical level to use as a threshold metric when evaluating companies for potential designation during Stage 1 review stage). A challenge to an adjudication would call into question the predictive judgments embedded in the designation itself (arguing, for example, that it is arbitrary and capricious to consider a possible liquidity-destroying "run" on life insurance policies issued by a particular designee because such an event is highly unlikely to occur).²²²

The courts are not empowered, in the usual case, to substitute their judgments for those of agencies. Instead, under the familiar *State Farm* "hard-look" review standard, courts will only reverse an administrative decision when the agency "entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."²²³ The nettle of hard-look review prods an agency to premise its actions on "reasoned decisionmaking" rather than arbitrary or results-driven conjecture and speculation.²²⁴ *State Farm* applies universally to administrative decisionmaking, but it has special force in the risk-

221. See *supra* note 214 (explaining that EO 12,866 does not apply to adjudications and determinations).

222. MetLife, in its challenge to its designation, makes this argument. See MetLife Brief 50.

223. *Motor Vehicle Mfrs. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

224. *Id.* at 52.

regulatory context. Given the inherent contestability of the conjectural judgments underlying a given risk-regulatory action, affected parties contesting the action have incentives to engage in “analytical opportunism.”²²⁵ They follow *State Farm*'s lead and criticize agency decisions as inadequately “reasoned” by raising “important aspect[s] of the problem” and introducing “evidence before the agency.”²²⁶

Two considerations conspire to sharpen these incentives. For one, the exhaustion of administrative remedies doctrine provides that plaintiffs waive arguments they do not pursue at the administrative level.²²⁷ The result is that plaintiffs will inundate the agency with arguments and evidence during the adjudicatory phase for purposes of preserving issues for litigation. This strategy serves the second purpose of putting the regulator on its back foot, in a defensive posture. Scholars have documented how this strategy, coupled with the background threat of eventual litigation, at a minimum ossifies the regulatory process²²⁸ and may even predispose regulators, who cannot possibly consider and filter out all the irrelevant information, to outcomes preferred by regulated entities.²²⁹ These problems apply with particular acuteness to risk-regulatory decisions predicated on predictive judgments. The amount of information and data that is arguably relevant to risk-regulatory decisions like Section 113 designations is nearly boundless.

Courts have elaborated how *State Farm* applies to the predictive judgments underlying agency decisions concerning future risk states. Courts acknowledge that “complete factual support” for most conjectural risk-regulatory judgments is neither possible nor required, and that any “forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency.”²³⁰ As such, an agency possesses the “undoubted power to use predictive models” in responding to future threats.²³¹ Nevertheless, when using predictive analytic techniques, the agency must “explain[] the assumptions and methodology used in preparing the model and provide[] a complete analytic defense should the model be challenged.”²³² Where an agency fails to provide a “complete analytic defense”—where, in other words, the agency bases its predictive judgments on “sheer speculation” and not “logic and

225. See ELIZABETH FISHER, RISK REGULATION AND ADMINISTRATIVE CONSTITUTIONALISM 121-22 (2007).

226. See *supra* text accompanying notes 223-224.

227. See *Avocados Plus Inc. v. Veneman*, 370 F.3d 1243, 1247-50 (D.C. Cir. 2004).

228. See Thomas McGarity, *Some Thoughts on “Deossifying” the Rulemaking Process*, 41 DUKE L.J. 1385 (1992).

229. See Wagner, *Filter Failure*, *supra* note 144, at 1328.

230. *FCC v. Nat'l Citizens Comm. for Broad.*, 436 U.S. 775, 814 (1978) (citation omitted).

231. *Appalachian Power Co. v. EPA*, 249 F.3d 1032, 1054 (D.C. Cir. 2001) (citation omitted).

232. *Id.* (citation omitted).

evidence”—the court has no obligation to defer to the agency.²³³ Courts have interpreted the largely hollow directive to follow “logic and evidence” to require agencies to ground their predictive judgments in historical observation, where such data are present. Agencies have “no license to ignore the past when the past relates directly to the question at issue.”²³⁴

The vague terms “speculation,” “deductions based on expert knowledge,” “complete analytic defense,” and “logic and evidence” do nothing but invite contestation. They fail to meaningfully inform *State Farm’s* equally opaque directive that agencies must engage in “reasoned decisionmaking.” None of this presents an insurmountable problem; judicial interpretation of vague standards through analogical reasoning is the common law method—and administrative law, notwithstanding ceremonial incantations of its statutory roots, is no exception.²³⁵ In other risk-regulatory contexts, common law decisionmaking has influenced the ways agencies engage with scientific and other expert communities. For instance, Fisher, Pascual, and Wagner argue that courts are involved in a “constructive partnership” with the EPA concerning the latter’s National Ambient Air Quality Standards. In that context, the courts serve the institutional role of a “necessary irritant,” disciplining and holding to account the EPA based on that agency’s “own analytical process, methods, and epistemic frames.”²³⁶

The Section 113 program, on the other hand, is distinguishable from the EPA’s programs in ways that make it difficult to envisage a constructive role for courts and judicial review. First, it is an immature program. Common law methods require courts to analogize new circumstances to an accretive body of received wisdom. Here, there are no pre-existing administrative-judicial interactions on which to base decisions. Second, the statutory directive is so open-ended as to create a nearly boundless decision space for the agency. The analogy to the fixing of environmental air pollutant standards (itself a highly discretionary task) is only partially accurate; in reality, the scope of Section 113 discretion is much broader. For one, the EPA is assisted by a Scientific Advisory Board, which itself composes subcommittees to focus on discrete matters.²³⁷ Furthermore, environmental statutes are structurally more cabined than Section 113.

233. *Sorenson Commc’ns Inc. v. FCC*, 755 F.3d 702, 708 (D.C. Cir. 2014); *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1150 (D.C. Cir. 2011).

234. *BellSouth Telecomm., Inc. v. FCC*, 469 F.3d 1052, 1060 (D.C. Cir. 2006); *see also id.* at 1060 (“We cannot overlook the absence of record evidence [supporting the agency’s conclusion] simply because the Commission cast its analysis as a prediction of future trends.”).

235. *See Gillian E. Metzger, Embracing Administrative Common Law*, 80 GEO. WASH. L. REV. 1293 (2012).

236. Elizabeth Fisher et al., *Rethinking Judicial Review of Expert Agencies*, 93 TEX. L. REV. 1681, 1684 (2015).

237. *See SHEILA JASANOFF, THE FIFTH BRANCH: SCIENCE ADVISERS AS POLICYMAKERS* (1990).

The FSOC's Designation Program as a Case Study

Perhaps a better, but still incomplete, analogy would be to the sweeping authority bank supervisors have to discipline depository institutions for engaging in “unsafe or unsound practices”—an equally open-ended statutory directive.²³⁸ Courts have interpreted that designation broadly to include any imprudent acts that might result in “abnormal risk” to a bank’s financial stability.²³⁹ In *Gulf Federal Savings & Loan Ass’n v. FHLBB*, the most enduring of these precedents, the Fifth Circuit discussed how Congress, when it created the authority to issue cease-and-desist orders on persons undertaking such practices, intended that power to be a “flexible tool,” and proceeded notwithstanding complaints that the authority would be “too broad” and “unlimited.”²⁴⁰ However, even there, most (but not all) courts have grafted on a proximate causation limitation (i.e., “reasonably foreseeable”) onto the “unsafe or unsound practice” designation.²⁴¹ Nearly all safety and soundness litigation occurs in an ex post setting, after an institution has been placed in receivership and the receiver is seeking recovery from the persons responsible for the institution’s demise, or the supervisor is seeking penalties or prohibition orders against those same persons. The context is remedial litigation, not risk regulation. The “reasonably foreseeable” tort model works well in that context; the court assesses the damage and then enquires into the responsibility of the allegedly responsible defendant. In other words, facts and history conspire to focus the court’s attention, with the benefit of hindsight, on one particular world state: what actually occurred. Section 113, on the other hand, is entirely forward-looking and prophylactic.

So neither environmental regulation nor ex post bank safety-and-soundness litigation provide good models for courts in thinking about how to think about the Causality Conundrum in the context of Section 113 and other financial supervisory programs. Pointing to the FSOC’s virtually boundless decision space, companies objecting to the Framework or particular designations on causality grounds will demand that the Council justify in detail its discretionary judgments concerning the causal roots of the risks the Council seeks to prevent. Again, these demands will take the form of arguments that the FSOC generate and respond to large quantities of information concerning financial distress and its likely effects, preferably with probabilistic data. Indeed, that was a core pillar of MetLife’s case against its designation: in its summary judgment brief, MetLife

238. *E.g.*, 12 U.S.C. § 1818(b)(1) (2018) (providing authority to issue cease-and-desist orders).

239. *Landry v. FDIC*, 204 F.3d 1125, 1138 (D.C. Cir. 2000); *Kaplan v. OTS*, 104 F.3d 417, 421 (D.C. Cir. 1997); *Greene Cty. Bank v. FDIC*, 92 F.3d 633, 636 (8th Cir. 1996); *In re Seidman*, 37 F.3d 911, 932 (3d Cir. 1994); *Nw. Nat’l Bank v. United States*, 917 F.2d 1111, 1115 (8th Cir. 1990); *Gulf Fed. Sav. & Loan Ass’n v. Fed. Home Loan Bank Bd.*, 651 F.2d 259, 263-65 (5th Cir. 1981).

240. *Gulf Fed. Sav. & Loan Ass’n*, 651 F.2d at 264.

241. *See Kaplan*, 104 F.3d at 421 (“Any such risk must of course be reasonably foreseeable.”); *Gulf Fed. Sav. & Loan Ass’n*, 651 F.2d at 264 (“The breadth of the ‘unsafe or unsound practice’ formula is restricted by its limitation to practices with a reasonably direct effect on an association’s financial soundness.”). *But see Greene Cty. Bank*, 92 F.3d at 636 (rejecting defendant bank’s argument that the statute only covers practices “having a reasonably direct effect” on a bank’s financial soundness).

argued that “a risk analysis that does not meaningfully examine *both* the probability and magnitude of harm is no risk analysis at all.”²⁴² The brief quotes heavily from technical risk analysis literature, faulting the FSOC for not conducting a rationalized, formalistic, numbers-based analysis consistent with that discipline.²⁴³

Again, this tactic is unsurprising; there are strong incentives for those affected by risk-regulatory determinations to frame their objections as informationally intensive allegations of arbitrariness.²⁴⁴ The problem is that the tactic will present a conundrum for courts. First, there is active technical debate concerning the usefulness of probabilistic assessments of financial catastrophe due to the limited data and constantly evolving and open environment in which risk might materialize.²⁴⁵ Furthermore, once we view Section 113 and financial supervision more broadly with a risk regulation lens, we appreciate the normative implications of regulatory decisions, as well as a “whole series of methodological, epistemological, and even ontological problems inherent in determining the level of danger” that are obscured by the myopic focus on objective risk-related data.²⁴⁶

To take just a few examples, what does it mean to pose a “threat” to the “financial system”? What should be a polity’s tolerance to catastrophe within its financial system? And what exactly is the *system* the government seeks to preserve? Does the answer to that latter question refer to discrete financial functions, existing distributions of financial assets, or something else? As undeveloped as these normative issues are in risk regulation more broadly, they have gone entirely unexamined in the context of financial supervision. The FSOC (and financial regulators more broadly) have little to no experience in dealing with these issues when compared to other risk regulators. They therefore are unable to take advantage of the developed—if still incomplete—legal doctrines, methodological forms (statistical value of a human life, statistical cost of carbon), and institutional forms (scientific and citizen-focused advisory committees, inter-agency working groups) that have informed traditional risk-

242. MetLife Brief, *supra* note 120, at 35.

243. See *id.*; cf. Elizabeth Fisher, *Framing Risk Regulation: A Critical Reflection*, 2 EUR. J. RISK REG. 125, 125-28 (2013) (recounting how the “risk assessment/risk management framework has become the dominant account of risk regulation”).

244. See *supra* text accompanying notes 228-229.

245. Compare John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882 (2015), and Patricia A. McCoy, *Knightian Uncertainty, Systemic Risk Regulation, and the Limits of Judicial Review* (2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2944297 [<https://perma.cc/G8JM-KAJU>] (warning courts against “requiring FSOC to make statistical projections that are impossible to make with confidence”), and Jeffrey N. Gordon, *The Empty Call for Benefit-Cost Analysis in Financial Regulation*, 43 J. LEGAL STUD. S351 (2014), with Eric A. Posner & E. Glen Weyl, *Benefit-Cost Paradigms in Financial Regulation*, 43 J. LEGAL STUD. S1 (2014) [hereinafter Posner & Weyl I], and Eric A. Posner & E. Glen Weyl, *Benefit-Cost Analysis for Financial Regulation*, 103 AM. ECON. REV. (PAPERS & PROC.) 393 (2013) [hereinafter Posner & Weyl II], and Revesz, *supra* note 218, at 600.

246. Fisher, *supra* note 204, at 115.

regulatory praxis. Instead, an institutional quagmire is more likely to result—at least in the short term—with courts and financial supervisors drawn into an analytic management exercise for which both institutions are presently ill-equipped.

2. Potential Risk-Regulatory Dilemma #2:
The Regulatory Costs Dilemma

Yet another developing trend in judicial oversight of risk-regulatory determinations will likely complicate the work of the FSOC and other financial supervisors in the coming years. Specifically, courts have invalidated regulatory actions as arbitrary and capricious where the regulator's decision process does not formally account for the costs regulated entities are expected to incur in connection with the regulatory action. In each of its designations to date, the FSOC has opted not to take into account the costs the designated firm would be expected to incur as a result of the designation.

This line of argument is related to, but ultimately distinct from, the ongoing theoretical debate about how and to what extent marginal cost-benefit analysis should be used—as an informational tool or even a primary legitimating criterion—in financial and other regulatory systems.²⁴⁷ As a doctrinal matter, there is presently no general requirement that agencies demonstrate that the benefits of proposed agencies actions outweigh their costs.²⁴⁸ Executive Order 12,866 does require Executive Branch agencies to submit to OIRA cost-benefit analyses of all proposed rules and guidance documents that include point estimates of the expected costs (along with the expected benefits) associated with the particular proposed action. Nevertheless, the setting in which the analysis operates is more political than legal; the decision whether to proceed with a given action is a political decision negotiated between the White House and the agency. And although some agency statutes require cost-benefit analysis, these statutes are rare, and at any rate, they do not include the FSOC's organic statute.²⁴⁹

247. See *supra* note 245 and accompanying text. Shapiro and Glicksman use the descriptor “marginal” to refer to those requirements that agencies demonstrate that benefits exceed costs as a firm precondition to agency action. See SHAPIRO & GLICKSMAN, *supra* note 132, at 40.

248. In April 2017, bipartisan Senate sponsors introduced the Regulatory Accountability Act of 2017, which would impose a requirement on *independent* agencies to submit a regulatory impact analysis (with accompanying quantification of costs and benefits) to OIRA before promulgating economically significant rules or guidance. See S. 951, 115th Cong. § 4 (2017). Unlike Executive Order 12,866—which, again, simply imposes a procedural requirement to conduct an analysis with no judicial review concerning compliance or the substance of the analysis—the legislation would make the regulatory impact analysis (including the point estimates of costs and benefits) subject to judicial review. See *id.* § 4.

249. See *supra* note 210 and accompanying text; *cf.* *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1146 (D.C. Cir. 2011) (invalidating the SEC's proxy access rule because the Commission's organic statute, which *required* it to consider the effects of a proposed rule on “efficiency, competition, and capital formation,” failed altogether to “determine the [rule's] likely economic consequences” by not quantifying expected costs (or explaining why quantification was unnecessary)).

The FSOC has argued that the text of Section 113 supports its authority not to consider costs because the statute only requires the FSOC to consider, in addition to the statutorily enumerated factors, other factors that “the Council deems appropriate.” The FSOC’s plain meaning argument would appear to put the Council on firm footing; the statute quite apparently vests discretion in the FSOC to “deem” what factors are “appropriate” and what factors are not.

How that plain meaning argument will fare in court depends in large part on how the court interprets the Supreme Court’s 2015 case *Michigan v. EPA*. In that case, the Supreme Court held that the EPA acted arbitrarily and capriciously by failing to consider the costs that power companies would incur as a result of the agency’s decision to regulate oil- and coal-fired plants.²⁵⁰ Enacted as part of the 1990 Clean Air Act Amendments, Section 112(n)(1)(A) of the Act required the EPA to regulate emissions of hazardous air pollutants by power plants if the EPA “finds . . . regulation is appropriate and necessary after considering the results of [a statutorily-mandated] study.”²⁵¹

In 2012, the EPA made an “appropriate and necessary” finding after reviewing the results of its study concerning mercury.²⁵² As an Executive Branch agency, the EPA, it will be recalled,²⁵³ is required to prepare a regulatory impact analysis, but that statement is not formally part of the actual rulemaking; it is instead an ancillary, adjunct report to OIRA for purposes of coordinated Executive Branch review of regulatory activity. In its regulatory impact analysis, the agency estimated that the new regulations would impose \$9.6 billion in annual compliance, monitoring, and reporting costs on the power industry. In making the final appropriate-and-necessary determination in the rulemaking, the EPA disclaimed any obligation to consider these costs.²⁵⁴ Instead, the agency found regulation “appropriate” because power plant emissions of mercury, a substance for which emission-reducing controls were available, posed a risk to human health and the environment. The EPA found regulation to be “necessary” because no other provision in the Clean Air Act eliminated those health and environmental risks.²⁵⁵

The Supreme Court invalidated the EPA’s power plant mercury rule because the agency’s interpretation of the statutory “appropriate and necessary” language to exclude consideration of costs was outside “the bounds of reasonable interpretation.”²⁵⁶ Noting the “capaciousness” of the term “appropriate,” the

250. *Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015).

251. Clean Air Act Amendments of 1990 § 301, 42 U.S.C. § 7412(n)(1)(A). The statute was silent about what such “regulation” was to consist of, but the agency has interpreted it to apply the same “floor standards” applicable to major sources and area sources.

252. *See* 77 Fed. Reg. 9,304 (Feb. 16, 2012).

253. *See supra* text accompanying notes 214-216 (discussing requirement that Executive Branch agencies submit regulatory impact analyses to OIRA for proposed rulemakings).

254. *Supra* note 252, at 9,326-27.

255. *Id.* at 9,363.

256. *Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015).

Court held that it “requires at least some attention to cost.”²⁵⁷ Despite pointing out that “appropriate and necessary” might reasonably be read not to encompass cost in some contexts, the Court held that cost was a necessary part of any analysis as to the appropriateness or necessity of *regulation*.²⁵⁸ The opinion links the association between regulation and costs to *State Farm* hard-look review: “an agency may not ‘entirely fai[l] to consider an important aspect of the problem’ when deciding whether regulation is appropriate.”²⁵⁹ In a dictum likely to provide fresh ammunition to anti-regulatory arguments in the coming years, the Court speculated that “[o]ne would not say that it is even rational, never mind ‘appropriate,’ to impose billions of dollars in economic costs in return for a few dollars in health or environmental benefits.”²⁶⁰

A Section 113 designation is distinguishable from the “appropriate and necessary” determination underlying the EPA’s mercury rule in several potentially important respects. First, the Court held that the EPA erred in its interpretation, rather than its application, of its statute. In other words, *Michigan v. EPA* is a *Chevron* case. The problem was that the agency staked out a formal position that its statute forbade it to consider costs when gauging the necessity and appropriateness of regulation of power plants—that “cost [was] irrelevant to the decision to regulate.”²⁶¹ The FSOC has taken no such interpretation. A second distinction relates to the first: no statutory language analogous to the Clean Air Act’s “appropriate and necessary” phrase obviously cabins the FSOC’s discretion not to consider costs. Nevertheless, the *Michigan v. EPA* Court’s characterization of cost considerations as a necessary component of “rational” regulatory policymaking invites the reader to untether *Michigan v. EPA* from the narrow context of the Clean Air Act (and its “appropriate” phrase) and apply it more broadly. After all, an “irrational” explanation of agency action would hardly pass the general APA arbitrary-and-capricious test, no matter what the specifics of the statutory authorization were.²⁶²

The point here is that the FSOC is on contestable terrain when it disclaims a legal obligation to quantify costs. *Michigan v. EPA* hardly provides a clear answer for the Section 113 program, but it does provide a clear reminder that the status of cost considerations is unsettled. The same observation could be made with respect to most discretion-heavy financial supervisory regimes that do not formally account for costs—including the capital adequacy regimes for banks and insurance companies, the Federal Reserve’s stress testing and

257. *Id.*

258. *Id.*

259. *Id.* (citation omitted).

260. *Id.*

261. *Id.*

262. See *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 374 (1998) (“Not only must an agency’s decreed result be within the scope of its lawful authority, but the process by which it reaches that result must be logical and rational.”); *Sierra Club v. EPA*, 353 F.3d 976, 978-79 (D.C. Cir. 2004) (“The ‘arbitrary and capricious’ standard deems the agency action presumptively valid provided the action meets a minimum rationality standard.”).

comprehensive capital analysis and review (CCAR) programs, and bank safety-and-soundness supervision more broadly.

B. The Filter Problem

This Section will explain how the FSOC likely acted illegally by including the Likelihood-Vulnerability Filter in the Analytic Framework. However, contemporary standing doctrine will likely bar any effective judicial challenge to remediate the Filter Problem, which benefits potential designees and counteracts the purpose of Section 113 itself. Worse still, the Filter Problem, once safely buried into the Analytic Framework, acquires a second life as a Zombie Filter Problem, owing to the FSOC's curious disavowal of its intention to apply the Likelihood-Vulnerability Filter. This position significantly undercuts the legality of the FSOC's designation practice by giving to its opponents grounds to argue that the Council is acting arbitrarily and capriciously by failing to enforce its own guidance and rules.

By requiring the FSOC to take into account the extent to which an investigated company is *vulnerable* to material financial distress, the Filter excludes from the universe of potential designees those companies that are deemed unlikely to experience financial distress—even where that unlikely distress, were it to transpire, could credibly precipitate turbulence in the financial system. By so doing, it operates to the collective advantage of regulated parties and disfavors regulatory beneficiaries such as competitors, counterparties, consumers, and taxpayers—those who might benefit from regulation but are “not [themselves] the subject of the contested regulatory action.”²⁶³

Financial industry members initially proposed the Filter to the Council during the rulemaking process. By acceding to their request to add the Filter, the Council bestowed a benefit on potentially regulated entities, in the process possibly compromising its regulatory mission to curb systemic risk and harming regulatory beneficiaries. In analyzing the Vulnerability-Likelihood Filter, a curious and perhaps counter-intuitive observation emerges: despite the clamor about regulatory *overreach* on the part of financial industry firms, the Framework's most trenchant flaw results in significant *under-regulation* compared to what the statute seems to require. The Basic Filter Problem refers to the possibility that Congress never intended to authorize the FSOC to so restrict its deliberative process. This phenomenon is common in financial regulation, so the below analysis should be read as an invitation to apply this analysis to other regulatory programs.

263. *Clarke v. Sec. Ind. Ass'n*, 479 U.S. 388, 399 (1987); see generally Nina A. Mendelson, *Regulatory Beneficiaries and Informal Agency Policymaking*, 92 CORNELL L. REV. 397 (2007) (discussing the role and incentives of beneficiaries of regulatory policymaking).

Barring a decision on the part of the Council to revisit this issue (or a directive from Congress requiring it to do so), the most straightforward mode of redress for regulatory beneficiaries would be judicial review.

However, this Section will outline three reasons why judicial review is unlikely to prove an effective institutional setting for the remediation of the Problem. These reasons include the APA's statute of limitations and the inhospitable posture of current standing doctrine to judicial challenges initiated by regulatory beneficiaries. But perhaps the most significant barrier to judicial resolution of the Basic Filter Problem is that the FSOC has puzzlingly stated its intention to disregard it. That is, the FSOC insists, contrary to the express and clear terms of its own Framework, that it does *not* consider likelihood of financial distress as part of its deliberation process. This practice largely renders the Problem non-justiciable, at least for present purposes.²⁶⁴ But even as this practice obviates the Basic Filter Problem (at least as a proper subject for judicial review), it creates another problem in the form of the Zombie Filter Problem. It invites all future designated companies to argue that the Council has resolved not to apply its own Framework in ways that transparently prejudice designated companies—a cohort that, unlike regulated beneficiaries, has keen incentives *and* inarguable standing to challenge their designations. And because the APA statute of limitations for an adjudication like a Section 113 designation would run from the date of the designation, it would present no obstacle.

1. The Merits of the Case Against the Filter

This Basic Filter Problem results from the Framework's possible divergence from the statute, not from any internal inconsistency in the Analytic Framework. In other words, the problem is not that the FSOC, in structuring its deliberation process, has settled on a problematic means of channeling its discretion; instead, the problem is that it might have exercised discretion that Congress never granted to it in the first place. As is well familiar by now, Section 113 itself authorizes the FSOC to designate a nonbank financial company if it determines that a material financial distress at the company could pose a threat to the financial stability of the United States.²⁶⁵ A plain meaning reading of that statute suggests that the agency must *assume* that a material financial distress is occurring at the company, and determine whether such a distress event could have the required effect. The implicit legislative logic underlying this interpretation is that since any private firm could by definition fail, Section 113 would ensure that a supervisory apparatus would be in place for any company

264. Of course, the Council could always alter its enforcement practice, which would activate the Basic Filter Problem as a subject for judicial review. Indeed, the Treasury Designation Report recommended that the FSOC start to apply the filter. See TREASURY DESIGNATIONS REPORT, *supra* note 97, at 11.

265. Dodd-Frank Wall Street Reform and Consumer Protection Act § 113(a)(1), 12 U.S.C. § 5322(a)(1) (2018).

whose failure could precipitate the policy problem Congress wanted to counteract: i.e., compromising the financial system.

And yet, in the face of this plain meaning analysis, the FSOC accommodated industry efforts to introduce likelihood of material financial distress into the Analytic Framework. In the first notice of proposed rulemaking, the FSOC noted that among commenters, “there was a consensus that risk management practices be factored into the assessment of a nonbank financial company, because they are a key factor in determining *the probability of material financial distress*.”²⁶⁶ A number of commenters importuned the agency to include in its framework not just “an assessment of the likelihood of a firm’s failure having a material impact on the financial system,” but also “an assessment of the likelihood that it could experience material financial distress.”²⁶⁷

After considering these comments, the FSOC, in its first notice of proposed rulemaking, introduced six “categories” as conceptual tools to guide it through the various Stages²⁶⁸ of its Section 113 investigations: (1) interconnectedness, (2) size, (3) substitutability of services, (4) leverage, (5) liquidity risk and maturity mismatch, and (6) existing regulatory scrutiny.²⁶⁹ In describing them, the FSOC stated that “each of the proposed categories reflects a different dimension of a firm’s potential to experience material financial distress.”²⁷⁰

In the second notice of proposed rulemaking, the FSOC inserted the explanation, also embodied in the final guidance as noted earlier, that three of the “categories”—leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny—“seek to assess the vulnerability of a nonbank financial company to financial distress.”²⁷¹ The FSOC singled out leverage and maturity mismatch as destabilizing factors at the institutional level, again focusing on the likelihood of material financial distress: “Nonbank financial companies that are highly leveraged, have a high degree of liquidity risk or maturity mismatch, and are under little or no regulatory scrutiny are more likely to be more vulnerable to financial distress.”²⁷²

Again, this focus on a company’s vulnerability to financial distress (or the probability or likelihood thereof) does not appear in the statute. The notices of proposed rulemaking make clear that the FSOC incorporated these considerations as an accommodation to industry commenters. As a practical

266. First FSOC Section 113 Notice of Proposed Rulemaking, *supra* note 143, at 4,558.

267. *Id.* at 4,556.

268. See *supra* Section III.A for a description of the “Stages” of the Section 113 inquiry.

269. Final FSOC Section 113 Guidance, *supra* note 8, at 21,641.

270. First FSOC Section 113 Notice of Proposed Rulemaking, *supra* note 142, at 4,560.

In its final rule and guidance, the FSOC walked back from this characterization, as implied from the earlier discussion of the FSOC’s position that only the first three categories (leverage, liquidity risk, and maturity mismatch, and existing regulatory scrutiny) are meant to assess the likelihood of a material financial distress. In the process, it gave birth to the Category Problem. See *infra* text accompanying note 391.

271. Second FSOC Section 113 Notice of Proposed Rulemaking, *supra* note 143, at 64,278.

272. *Id.* (emphasis added).

matter, it introduces another incremental inquiry into the Section 113 deliberation process, and therefore it contracts the universe of companies that could be subject to designations.

The creation and application of the Likelihood-Vulnerability Filter gives rise to an administrative law question: did the FSOC have authority to so restrict the statute's application? Doctrinally, the answer will depend on the familiar *Chevron* rule,²⁷³ which recognizes an agency's interpretive authority with respect to matters for which its organic statute has not clearly specified a contrary treatment.²⁷⁴ The *Chevron* deference approach "is premised on the theory that a statute's ambiguity constitutes an implicit delegation from Congress to the agency to fill in the statutory gaps."²⁷⁵ In the arm-wrestling match over interpretive authority between courts and agencies, *Chevron* applies force to the latter's elbow. The rule is justified on the grounds that agencies are better situated than courts to resolve statutory indeterminacy due to their superior expertise and greater political accountability.²⁷⁶

Traditionally, courts have applied a two-stage test under *Chevron*, asking first whether the relevant statute is ambiguous and, secondly, if it is, whether the agency's interpretation is reasonable. Where a court finds that the statute is unambiguous, there is no room for agency discretion, and the court will simply apply the statute.²⁷⁷ Recently, courts and commentators have identified an additional analytic inquiry in the framework, sometimes referred to as "*Chevron* Step Zero."²⁷⁸ With Step Zero, a court considers whether it is inappropriate to

273. See *Chevron U.S.A., Inc. v. Nat'l Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

274. The "doctrinally" qualification is necessary because empirical studies have established that the framework does not shift interpretive discretion from courts to agencies nearly as much as expected. See William N. Eskridge, Jr. & Lauren E. Baer, *The Continuum of Deference: Supreme Court Treatment of Agency Statutory Interpretations from Chevron to Hamdan*, 96 GEO. L.J. 1083, 1090 (2008) (finding that the Supreme Court did not apply any deference at all in 53.6% of its post-*Chevron* cases involving an agency interpretation of a statute, and that it instead "relie[d] on ad hoc judicial reasoning of the sort that typifies the Court's methodology in regular statutory interpretation cases"); Thomas W. Merrill, *Judicial Deference to Executive Precedent*, 101 YALE L.J. 968, 984 (1992) ("Paradoxically, it appears that adoption of the *Chevron* framework has meant, if anything, a decline in deference to agency views."); Thomas J. Miles & Cass R. Sunstein, *Do Judges Make Regulatory Policy?: An Empirical Investigation of Chevron*, 73 U. CHI. L. REV. 823 (2006) (finding that the degree of judicial deference in Supreme Court cases discussing *Chevron* depends on the ideological orientations of the deciding justices); Connor N. Raso & William N. Eskridge, Jr., *Chevron as a Canon, Not a Precedent: An Empirical Study of What Motivates Justices in Agency Deference Cases*, 110 COLUM. L. REV. 1727, 1751 (2010) (building on an earlier study to determine what variables motivate Supreme Court justices to apply *Chevron* and other "deference regimes"); cf. Cass R. Sunstein, *Law and Administration After Chevron*, 90 COLUM. L. REV. 2071, 2075 (1990) (pointing out that the doctrinal implications of *Chevron* amount to a "counter-*Marbury*" rule pursuant to which agencies, rather than courts, interpret ambiguous or incomplete statutes).

275. *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 159 (2000).

276. See Kenneth A. Bamberger, *Normative Canons in the Review of Administrative Policymaking*, 118 YALE L.J. 64, 66 (2008) (noting that under *Chevron*, the "agency—armed with the very expertise and political sensitivity courts lack—may (so long as it meets a requisite level of decision-making formality) adopt any policy permitted by the scope of statutory indeterminacy").

277. See, e.g., *Smith v. City of Jackson*, 544 U.S. 228, 231-32 (2005).

278. See Cass R. Sunstein, *Chevron Step Zero*, 92 VA. L. REV. 187, 190-92 (2006).

find an *implicit* delegation of interpretive authority because the context would have required Congress to make any such grant *express*.²⁷⁹

So how would the FSOC's decision to impose the Likelihood-Vulnerability Filter fare on the merits under *Chevron*? First, the "Step Zero" analysis would likely not impede the adoption of the Filter. Nothing in the FSOC's statute would suggest that Congress clearly would not expect the FSOC to develop mechanisms for filtering the universe of designable companies. To the contrary, if it does nothing else, Section 113 clearly contemplates a filtering exercise built on several layers of ambiguous statutory terminology.

Moving to the next step, is Section 113 *ambiguous* when it comes to considerations of vulnerability to distress? The legality of the Likelihood-Vulnerability Filter would hinge on the answer to this question. A plaintiff might advance the plain meaning argument that the statute clearly contemplates that the FSOC must assume the material financial distress is already occurring.²⁸⁰ That is, the statute provides that if a material financial distress could pose a threat to systemic stability, then designation is appropriate. If an institution is too large, or if it maintains an irreplaceable presence at crucial nodes of the financial system, such that its failure poses a threat to the system's continued operation, then it should be supervised and perhaps even coerced into downsizing or restructuring its operations. The argument would stress that likelihood is addressed on the back end by the Federal Reserve and its Section 165 enhanced supervisory regime, not on the front end by the FSOC. In other words, the Federal Reserve might very well decide to focus its supervisory resources on firms presenting greater likelihood of experiencing distress.²⁸¹

In making the determination to assume material financial distress, the Congress, as with every legislative item, apparently assessed the net costs, risks, and benefits associated with such a rule and decided to proceed.²⁸² The costs associated with such a rule flow from the risk of overbroad application. A Section 113 program without the Filter would apply invariantly to all

279. See, e.g., *King v. Burwell*, 135 S. Ct. 2,480, 2,488-89 (2015). Note also that Step Zero is confusing to the extent it suggests Step Zero is analytically prior to the question concerning statutory ambiguity. Step Zero might be more appropriately termed Step One-and-a-Half because it operates as a check on the court before finding an implicit grant of interpretive authority to the agency—a circumstance only applicable after a court has determined that the statute itself is ambiguous and does not expressly address the matter.

280. Cf. *Pittston Coal Grp. v. Sebben*, 488 U.S. 105 (1988) (rejecting the Secretary of Labor's claim that a statute was ambiguous and invalidating a rule governing criteria for black lung benefit claims); Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 DUKE L. J. 511, 521 ("One who finds *more* often (as I do) that the meaning of a statute is apparent from its text and from its relationship with other laws, thereby finds *less* often that the triggering requirement for *Chevron* deference exists.").

281. See Julia Black & Robert Baldwin, *Really Responsive Risk-Based Regulation*, 32 L. & POL'Y 181, 185 (2010).

282. This description privileges a sort of normative representational model of lawmaking. It could be adjusted to adopt a normative pluralist account (in which the legislature responds to constituent preference sets) or a descriptive interest group account (in which the legislature responds to political demands of powerful, organized interests) without affecting the analysis that follows.

systemically important firms and would, at least at the margin, impose compliance costs and restrictions on firms that are unlikely to experience financial distress. Consequently, those firms swept up in the Section 113 net, along with those who fear being so swept up, might eschew providing services and credit that would otherwise promote social welfare. Interpreted thusly, the statute would seem to reflect a congressional determination that the benefits of crisis avoidance exceed these potential downsides and to express an unwillingness to consider the possibility that any single company's collapse might precipitate a financial crisis. Not only would such a policy be reasonable, it is also consistent with the weight of the policy discussion in the lead-up to passage of the Dodd-Frank Act.²⁸³

On the other hand, the FSOC (and the potential designees that benefit from the Filter) might argue the statute is ambiguous with respect to the status of material financial distress. It would respond that Congress, by declining to define material financial distress expressly, implicitly granted discretion to the agency to define the term, which describes a condition that is inherently a matter of degree and not susceptible to binary classifications. Such an argument would then point out that the indeterminate nature of the material financial distress concept means that Congress could not have entailed an automatic, mechanistic application of the Section 113 test. A further argument would contend that it is impossible to conceive of a future, hypothetical material financial distress without taking into account the actual circumstances through which distress might materialize—a task that naturally lends itself to consideration of the likelihood that those circumstances present themselves. Otherwise, there would be no principled way for the FSOC to exclude from Section 113, for instance, the possibility that aliens engineer a hostile takeover of Citigroup and direct investment bankers to eliminate or waive covenants from all loan documentation. (Of course, the plain meaning mavens would say, “So what if the scenario is unlikely? The problem is that the malevolent aliens would know they could go straight to Citi to collapse the system because Citi was too big!”).

Finally, some of the statutory factors themselves might be argued to contemplate consideration of the likelihood of distress.²⁸⁴ For example, paragraph (a)(2)(H) of Section 113 requires an assessment of existing regulatory scrutiny.²⁸⁵ The FSOC might plausibly argue that the primary focus of such a criterion is to account for the ability of pre-distress supervision to reduce the likelihood of distress.²⁸⁶ In the case of insurance-focused businesses, state

283. See *supra* Section I.A (discussing how the FSOC was intentionally structured to fill regulatory “gaps” such as the lack of supervision of systemically significant firms).

284. MetLife made this argument before the district court. See *infra* notes 368-370 and accompanying text.

285. See *infra* text accompanying note 395.

286. See Robert F. Weber, *Post-Crisis Reform of the Supervisory System and High Reliability Theory*, 50 GA. L. REV. 249 (2015) (distinguishing regulation that promotes ex ante anticipation of crisis from regulation that promotes ex post containment of crisis, and arguing that post-crisis environment has privileged the former).

insurance supervisors seek to minimize the risk of failure—at least at the operating company level—so as to protect policyholders and restrict access to state guaranty funds. Still, a plaintiff would have a ready retort: the consideration of existing scrutiny sheds light on the necessity of consolidated federal supervision, not the likelihood of financial distress. That is, where the Council determines that any material financial distress (irrespective of its likelihood) might pose a threat to systemic stability, it might nevertheless determine it would be inadvisable to impose consolidated federal supervision because there is an existing apparatus in place to police the company.

On balance, our putative plaintiff should have the weightier arguments as to the unambiguous nature of the statutory command, although not nearly so obviously as to preclude the possibility of a court coming to a good faith contrary determination. In any event, if the statute *is* ambiguous as to the question of whether the agency can consider the likelihood of material financial distress, then it is hard to see how a plaintiff can win on the merits of *Chevron* Step Two. It is plainly reasonable to do so by incorporating consideration of leverage, liquidity risk, maturity mismatch, and existing regulatory scrutiny at potential designee companies. These considerations are key determinants of a nonbank financial institution’s vulnerability to financial distress.²⁸⁷

The foregoing analysis suggests that, despite all the clamor against the twin perils of excessive agency discretion and regulatory overreach, the Analytic Framework might actually be illegal on account of its regulatory modesty and narrow reach. The important point here is that the FSOC, by introducing the Likelihood-Vulnerability Filter into its Analytic Framework, exercised administrative discretion to accommodate the short-term economic interests of potential designee companies.²⁸⁸ It could just as easily have eschewed likelihood-of-financial-distress considerations altogether and proceeded directly to an analysis of the effects of a distress. In doing so, the agency arguably acted contrary to its statute, opening itself up to a potential judicial correction that would operate to streamline the Analytic Framework and expand the universe of potential designees.

287. See Daniel Schwarcz & Steven L. Schwarcz, *Regulating Systemic Risk in Insurance*, 81 U. CHI. L. REV. 1569 (2014); Robert F. Weber, *Combating the Teleological Drift in Life Insurance Solvency Regulation: The Case for a Meta-Risk Management Approach to Principles-Based Reserving*, 8 BERKELEY BUS. L.J. 35, 46-48 (2011) (comparing the dangers to insurance companies and banks arising from maturity mismatch and liquidity risk); Daniel K. Tarullo, Governor, Bd. of Governors, Fed. Reserve Sys., *Financial Regulatory Reform, Remarks at The Clearing House 2014 Annual Conference* (Nov. 20, 2014).

288. The use of “short-term” descriptor here acknowledges the obvious incremental compliance costs associated with layering on a level of consolidated Federal Reserve supervision where none existed before. Of course, the long-term effects of such supervision are presently unknowable.

2. Standing Doctrine Complicates a Judicial Challenge to the Basic Filter Problem

Current standing jurisprudence likely would foreclose an attempt to redress the Filter Problem through judicial review. If we side with the plain meaning proponents and interpret Section 113 to require the FSOC to assume material financial distress, the Basic Filter Problem emerges as a bona fide legal problem for the FSOC. That problem could be remedied one of three ways: (1) Congress could amend the statute to clarify that vulnerability and likelihood considerations are irrelevant to the designation; (2) the FSOC could amend the Analytic Framework to clarify the same; or (3) a plaintiff could attempt to obtain judicial redress under the APA. If Congress and the FSOC decline to change the policy and resolution requires judicial review, an analytically prior question requires attention: is there a potential plaintiff with both the *incentive* to raise the issue and *standing* to prosecute its resolution in the courts? Before analyzing these related questions²⁸⁹ of regulatory postures and incentives, on the one hand, and standing on the other hand, some conceptual splitting will help to clarify the issues. This Article is not the forum for an exegesis on the notoriously complicated administrative law standing doctrine,²⁹⁰ but some general observations are necessary in order to understand how a legal challenge to the Basic Filter Problem might arise. Four distinctions frame the analysis below: (1) regulated entity vs. regulatory beneficiary; (2) competitor beneficiary vs. non-competitor beneficiary; (3) constitutional standing vs. statutory/prudential standing; and (4) adjudication vs. rulemaking.

The analysis set forth below leads to three conclusions. Firstly, potential nonbank Section 113 designees lack the incentive to seek a judicial remedy to the Basic Filter Problem. Secondly, non-competitor beneficiaries of the Section 113 program such as consumers and taxpayers have the incentive but lack standing. Thirdly, competitor beneficiaries of the program such as large bank

289. Cf. *Warth v. Seldin*, 422 U.S. 490, 498-99 (1975) (requiring federal courts to satisfy themselves that “the plaintiff has ‘alleged such a personal stake in the outcome of the controversy’ as to warrant his invocation of federal-court jurisdiction” (quoting *Baker v. Carr*, 369 U.S. 186, 204 (1962)); *Baker v. Carr*, 369 U.S. 186, 204 (1962) (“Have the [plaintiffs] alleged such a personal stake in the outcome of the controversy as to assure that concrete adverseness which sharpens the presentation of issues upon which the court so largely depends for illumination of difficult constitutional questions? This is the gist of the question of standing.”).

290. In issuing this qualification, I follow the tradition of abjuring attempts to formulate a scientific summation of standing law in the administrative context. Cf. *Ass’n of Data Processing Serv. Orgs. v. Camp*, 397 U.S. 150, 151 (1970) (“Generalizations about standing to sue are largely worthless as such.”); 3 *PIERCE TREATISE*, *supra* note 166 § 16.1 at 1401 (“[S]tanding law suffers from inconsistency, unreliability and inordinate complexity It is impossible to reconcile all of the majority opinions of the Court that purport to announce tests and decisional criteria that lower courts must follow.”); *Hearings on S. 2097 Before the Subcomm. on Constitutional Rights of the S. Comm. on the Judiciary*, 89th Cong. 498 (1966) (statement of Prof. Paul A. Freund) (describing the concept of standing as “among the most amorphous in the entire domain of public law”); Louis L. Jaffe, *Standing to Secure Judicial Review: Private Actions*, 75 *HARV. L. REV.* 255, 258 (1961) (explaining how standing analysis often bleeds into merits analysis).

holdings companies have both the incentive and standing to raise a judicial challenge (although we will see that statute of limitations will render judicial redress for such a plaintiff unavailable). Consequently, present standing doctrine complicates traditional judicial resolution of the problem because the parties with the keenest interest in remedying the problem (i.e., regulatory beneficiaries) likely lack standing to pursue the matter in the courts. And this dilemma is hardly unique to the FSOC and Section 113; current standing doctrine creates a one-way ratcheted reservoir of discretion for agencies to accommodate the interests of regulatees (who almost always have standing), often at the expense of legislative objectives and regulatory beneficiaries (who frequently lack standing). Here again, the Section 113 program serves as a case study for other financial regulatory programs.

a. Regulated Entities vs. Regulatory Beneficiaries: The Former Have Standing, But Lack the Incentive, to Challenge the Filter

This first distinction (regulated entities vs. regulatory beneficiaries) is important because we can note at the outset that the former always will have standing to seek judicial review over administrative actions that harm them.²⁹¹ Having said that, what they possess in ability they lack in motivation. An actual or potential Section 113 designee would be unlikely to raise a legal challenge to the Likelihood-Vulnerability Filter because the Filter can only lower the probability of its designation.²⁹² If such a company has not yet been designated, it is in its interest to keep the Filter in place; if it has been designated, the Filter would have no causal relationship with that regulatory fact. Instead, a challenge would have to come from a litigant who wants to expand the program's coverage.

Two sets of regulatory beneficiaries would be expected to have such an interest. First, competitors of potential designees, such as large regulated banks and their holding companies, would likely desire to promote an even supervisory playing field with respect to their nonbank financial institution competitors.²⁹³

291. See *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561-62 (1992) (observing that where the “plaintiff is himself an object of the action,” there is “ordinarily little question that the action or inaction has caused him injury, and that a judgment preventing or requiring the action will redress it”).

292. This characterization is subject to the qualification that an existing Section 113 designee might conceivably contest the application of the Filter to exclude a sectoral competitor. Such a potential challenge would be complicated by the lack of a final reviewable action and the related principle in favor of unfettered enforcement discretion on the part of agencies. See *infra* Section IV.B.2.d.

293. There is a long history of this sort of regulatory litigation to police inter-sectoral boundaries and competition within the financial industry. See, e.g., *Sec. Ind. Ass'n v. Bd. of Govs. of the Fed. Reserve Sys.*, 468 U.S. 137 (1986) (securities industry trade association contesting bank entry into commercial paper underwriting business); *Inv. Co. Inst. v. Camp*, 401 U.S. 617 (1971) (upholding mutual fund industry complaint that OCC approval of bank mutual fund sales violated Sections 16 and 21 of the Glass-Steagall Act); *Ass'n of Data Processing Serv. Orgs. v. Camp*, 397 U.S. 150, 150 (1970) (data processing servicers trade association contesting OCC decision to allow national banks to offer such services); *Am. Ins. Ass'n v. Clarke*, 865 F.2d 278 (D.C. Cir. 1989) (insurance trade association contesting OCC approval of Citibank's formation of a subsidiary to offer municipal bond insurance); *Clarke*, 479 U.S. at 388 (securities industry trade association contesting bank entry into discount brokerage business).

Specifically, they might be expected to seek to impose consolidated supervision (with the accompanying activity restrictions, and capital and liquidity requirements) analogous to the supervisory restrictions they face.²⁹⁴

Alternatively, non-competitor regulatory beneficiaries might also be expected to litigate such a case. The statute intends that this class of actors will indirectly benefit from the direct regulation of others—in this case, designated nonbank companies.²⁹⁵ Public interest advocacy groups representing consumer-taxpayer-citizen regulatory beneficiaries, such as Better Markets Inc., might be eager to remove the imposition of an illegal filter. Here, the motivation would be to reduce the probability that a nonbank financial company could, like Lehman Brothers and AIG in 2008, escape meaningful consolidated supervision and play a role, as either catalyst or accelerant, in a new financial crisis that would erode the value of assets, require government bailouts, and depress employment and economic activity.

b. Competitor Beneficiaries vs. Non-Competitor Beneficiaries: The Former May More Readily Establish Standing Than the Latter

These regulatory beneficiaries identified above might have the *incentive* to challenge the legality of the filter, but do they have *standing*? Since the 1970s, administrative law standing doctrine has required a plaintiff suing a government agency to establish two jurisdictional prerequisites.²⁹⁶ The first prerequisite is constitutional in nature, resulting from Article III's limitation of the federal "judicial Power" to "Cases" and "Controversies."²⁹⁷ The second prerequisite, alternatively referred to as a "statutory" or "prudential" requirement,²⁹⁸ further limits standing to those plaintiffs whose injuries are "arguably within the zone of interests" to be protected or regulated by the statute in question.²⁹⁹ The purpose of the statutory-prudential requirement is to screen out cases brought by regulatory beneficiaries to remedy injuries for which the statutory scheme obviously does not contemplate judicial redress.³⁰⁰

294. This is particularly true in light of the developing "enhanced" section 165 prudential standards applicable to large bank holding companies. *See supra* notes 42-53 and accompanying text.

295. *See Mendelson, supra* note 263, at 414.

296. *See* William A. Fletcher, *The Structure of Standing*, 98 YALE L.J. 221, 223 (1983) (noting the jurisdictional nature of standing inquiry).

297. U.S. CONST. art. III, § 2, cl. 1; *see also* Antonin Scalia, *The Doctrine of Standing as an Essential Element of the Separation of Powers*, 17 SUFFOLK U. L. REV. 881 (1983).

298. Since most instances of judicial review of administrative activity arise pursuant to the Administrative Procedure Act and agency organic statutes, it usually suffices to refer to this additional requirement as "statutory" in most administrative law cases. Nevertheless, this non-constitutional "complementary rule of self-restraint" applies equally to petitions for judicial review alleging injuries not arising out of particular statutes, in the administrative context and more broadly. *Barrows v. Jackson*, 346 U.S. 249, 255 (1953).

299. *See Bennett v. Spear*, 520 U.S. 154, 163 (1997) (citation omitted).

300. *See Clarke v. Sec. Ind. Ass'n*, 479 U.S. 388, 399 (1987) ("[T]he test denies a right of review if the plaintiff's interests are so marginally related to or inconsistent with the purposes implicit

I will return to consider how these two standing requirements would apply to a potential judicial challenge to the Basic Filter Problem by a regulatory beneficiary, but the second distinction (competitor beneficiary vs. non-competitor beneficiary) sets the stage for that analysis by addressing a preliminary concern: namely, that third-party regulatory beneficiaries normally face a hurdle to establishing standing. As the Supreme Court noted in *Lujan v. Defenders of Wildlife*, “when the plaintiff is not himself the object of the government action or inaction he challenges, standing is not precluded, but it is ordinarily ‘substantially more difficult’ to establish.”³⁰¹

This competitor/non-competitor distinction is important because the former—most obviously, regulated banks and their trade associations—clearly *would* possess standing to challenge the Likelihood-Vulnerability Filter. Courts routinely affirm that regulatory beneficiaries qua competitors of regulated entities have standing to redress the *competitive harm* resulting from the failure of agencies to apply and follow laws restricting the activities of the regulated entities. The result of this “competitor standing” doctrine is that, in most cases, a competitor of a regulated entity will satisfy both the constitutional and statutory-prudential standing requirements.³⁰²

Furthermore, this litigation could be initiated and directed not only by *individual* plaintiff competitors, but also by trade *associations*. In the case of trade associations, their standing is associational and representational; it derives from the standing of the association’s member entities.³⁰³ The availability of associational standing solves the collective action problem that otherwise might inhibit individual plaintiffs from challenging unlawful agency action or inaction.³⁰⁴ Interestingly, many of the key doctrinal reference points for standing jurisprudence arose from lawsuits brought by financial service trade associations (e.g., mutual funds, insurance companies, information technology providers)

in the statute that it cannot reasonably be assumed that Congress intended to permit the suit.”); *id.* at 389 (further interpreting the “zone of interests” prong to inquire into “whether Congress intended for a particular class of plaintiffs to be relied upon to challenge an agency’s disregard of the law”); *Ass’n of Data Processing Serv. Orgs. v. Camp*, 397 U.S. 150, 150 (1970).

301. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 562 (1992) (quoting *Allen v. Wright*, 468 U.S. 737, 758 (1984)).

302. *La. Energy & Power Auth. v. FERC*, 141 F.3d 364, 367 (D.C. Cir. 1998); *see also* *United Transp. Union v. ICC*, 891 F.2d 908, 913, 919 n.7 (D.C. Cir. 1989); *Nat’l Credit Union Admin. v. First Nat’l Bank & Trust Co.*, 522 U.S. 479, 488 (1998). Statutory-prudential considerations will only frustrate standing for such a competitor plaintiff where that plaintiff’s interest is “antithetical” to the “statutory purpose” of the law the agency allegedly violated. *Panhandle Producers & Royalty Owners Ass’n v. Econ. Regulatory Admin.*, 822 F.2d 1105, 1109 (D.C. Cir. 1987).

303. *See* *United Food & Commercial Workers Union Local 751 v. Brown Grp. Inc.*, 517 U.S. 544, 557 (1996) (noting, *inter alia*, that “associational standing” is but “one strand” of a broader doctrine of “representational standing”).

304. *See* *Mendelson*, *supra* note 263, at 413. For instance, an individual regulatory beneficiary would likely have to finance the initiation and prosecution of the lawsuit (e.g., attorney fees, expert witness fees) on its own. *See* 28 U.S.C. § 2412(d)(1)(A) (allowing for recovery of fees by plaintiffs in litigation against government agencies only if the court finds that agency position was not “substantially justified”).

against bank regulators to dispute agency actions that liberalized inter-sectoral competition by permitting banks to participate in formerly restricted activities.³⁰⁵

c. Constitutional Standing vs. Statutory-Prudential Standing: Courts Are Hesitant to Recognize the Standing of Non-Competitor Beneficiaries

If competitor beneficiaries nearly always possess standing, the situation is less favorable for non-competitor beneficiaries (such as individual citizens, consumers, taxpayers, or public interest organizations that represent them). The constitutional standing requirement calls for the plaintiff to establish an “injury-in-fact”—that is, an injury that is “concrete and particularized” and “actual or imminent, not conjectural or hypothetical.”³⁰⁶ Furthermore, the plaintiff must show that the injury is “fairly traceable to the challenged action of the defendant” and that “it is likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.”³⁰⁷ Together, these form a tripartite framework: a plaintiff must show (1) an *injury-in-fact*, (2) *caused* by the challenged agency action or inaction, (3) that can be *redressed* through judicial review.

Like magnets repelling their opposite pole, two doctrinal factors have combined over the past twenty-five years to push most non-competitor beneficiaries away from constitutional standing. First, courts are increasingly unwilling to recognize standing for plaintiffs to redress “generalized grievances” concerning government acts through the judiciary.³⁰⁸ Second, courts have balked at the prospect of recognizing “probabilistic standing” premised on an injury in the form of an uncertain, hypothetical, conjectural future harm.³⁰⁹ The first problem implicates the injury-in-fact analysis, and the second problem implicates the causal analysis. These problems complicate not only suits brought by individuals and single legal entities, but also suits initiated by citizen advocacy groups and trade associations in their representative capacities.³¹⁰

305. See *supra* note 293 and accompanying text.

306. See *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167, 180-81 (2000). The gloss on the injury-in-fact requirement that the injury or threat must not be “conjectural” or “hypothetical” originated in the 1983 case *City of Los Angeles v. Lyons*, 461 U.S. 95, 102 (1983), in which the Supreme Court cited to a series of cases from as early as 1923 that had used the terms in the standing context. By the 1990s, the language had become a *de rigueur* statement of the law in any case addressing constitutional standing. See, e.g., *Whitmore v. Arkansas*, 495 U.S. 149, 155 (1990); *Lujan*, 504 U.S. at 560.

307. *Laidlaw*, 528 U.S. at 180-81.

308. *Summers v. Earth Island Inst.*, 555 U.S. 488, 499 (2009).

309. See Daniel A. Farber, *Uncertainty as a Basis for Standing*, 33 HOFSTRA L. REV. 1123 (2005); F. Andrew Hessick, *Probabilistic Standing*, 106 NW. U. L. REV. 55 (2012).

310. Advocacy groups could, on the other hand, attempt to assert *organizational* standing, which requires a heavy burden of proof: “[s]uch concrete and demonstrable injury to the organization’s activities—with [a] consequent drain on the organization’s resources—constitut[ing] . . . more than simply a setback to the organization’s abstract social interests.” *Nat’l Ass’n of Homebuilders v. EPA*, 667 F.3d 6, 11 (D.C. Cir. 2011). Organizational standing is premised on a direct interest of the

These developments evolved from the risk regulation revolution of post-1960s American government. That period generated new forward-looking risk-regulatory programs, particularly in the environmental, public health, and workplace safety arenas. As the administrative state—along with the Congress that created it and sustains it—focused its attention on regulatory policy aimed to control and manage future risks, standing doctrine underwent an expansionary phase.³¹¹ Indeed, the impetus to democratize the regulatory process and reinvigorate moribund New Deal agencies through increased public participation³¹² was of a piece with the legislative zeal to expand this new risk-regulatory administrative state in an effort to make government more responsive to citizens' priorities.³¹³ Liberalized standing for citizens to challenge bureaucratic errors was a partial antidote to the perceived problem of regulatory sclerosis that prevailed at the time,³¹⁴ and Congress's seemingly boundless appetite for new regulatory legislation meant that citizens had more opportunities than ever before to call their government to account before courts.

Several decades later, the Court began to retrench from its permissive posture,³¹⁵ exercising the “passive virtue” of judicial restraint by denying standing more frequently.³¹⁶ In doing so, it was motivated by a fear that

organization, rather than a derivative, representational interest. It is exceedingly unlikely that an advocacy group could meet this standard in connection with a challenge to the Basic Filter Problem—or indeed, a challenge to any financial regulatory act. As an illustration, a U.S. district court dismissed for lack of organizational standing a case brought by a public interest group to challenge the Department of Justice's enforcement decision to settle a civil case against JPMorgan Chase & Co., the largest financial institution in the United States. See *Better Mkts., Inc. v. United States*, 83 F. Supp. 3d 250 (D.D.C. 2015).

311. For illustrative examples of this phenomenon, see, e.g., *United States v. Students Challenging Regulatory Agency Procedures (SCRAP)*, 412 U.S. 669 (1973); *Office of Comm'ns of the United Church of Christ v. FCC*, 359 F.2d 994 (D.C. Cir. 1966); *Scenic Hudson Preservation Comm. v. FPC*, 354 F.2d 608 (2d Cir. 1965). For scholarly analysis, see, e.g., JAMES Q. WILSON, *BUREAUCRACY: WHAT GOVERNMENT AGENCIES DO AND WHY THEY DO IT* 85-86 (1989) (highlighting standing as one of several aspects of a “remarkable transformation in American politics . . . in the middle decades of the twentieth century” in the form of a “redistribution of political access”); Louis L. Jaffe, *The Citizen as Litigant in Public Actions: The Non-Hohfeldian or Ideological Plaintiff*, 116 U. PA. L. REV. 1033, 1035-36 (1968); Stewart, *supra* note 131, at 1723-47.

312. Standing was only one part of a much broader trend toward increased participation by citizen interest groups in the regulatory process. See Jody Freeman, *The Private Role in Public Governance*, N.Y.U. L. REV. 543, 560 n.57 (2000); Robert B. Reich, *Public Administration and Public Deliberation: An Interpretive Essay*, 94 YALE L.J. 1617, 1620-21 (1985).

313. In a related phenomenon, Congress itself increasingly provided for express statutory rights to bring citizen beneficiary suits to enforce risk-regulatory legislation. See Cass R. Sunstein, *What's Standing After Lujan?*, 91 MICH. L. REV. 163, 192-93 (1992). Indeed, the legal literature is prone to overstating the role of the judiciary and understating the role of Congress in realigning the relationship between the government and the economy in the 1960s and 1970s. See Rodriguez & Weingast, *supra* note 199, at 784 (making, not illustrating, this observation).

314. See Sunstein, *supra* note 313, at 183-84.

315. See Jeffrey Kahn, *Zoya's Standing Problem, or, When Should the Constitution Follow the Flag?*, 108 MICH. L. REV. 673, 699-700 (2010). The 1980s and 1990s can be viewed as a period of judicial disinclination to interfere with administrative agencies and the executive branch more generally. See Thomas W. Merrill, *Capture Theory and the Courts: 1967-1983*, 72 CHI.-KENT L. REV. 1039, 1041 (1997).

316. ALEXANDER BICKEL, *THE LEAST DANGEROUS BRANCH* 111-98 (1965) (discussing how “devices of not doing,” including standing, constitute the passive virtues of judiciary).

liberalization of standing rules for regulatory beneficiaries had disrupted the balance of powers in American government. The Court complained in *Lujan* that then-prevailing notions of standing had enabled “the courts . . . to assume a position of authority over the governmental acts of another and co-equal department . . . and to become virtually continuing monitors of the wisdom and soundness of Executive action.”³¹⁷ Quoting from the 1944 case *Stark v. Wickard*,³¹⁸ the *Lujan* Court harkened back to an earlier period in which courts weighed in on matters of administrative government “only to the extent necessary to protect justiciable individual rights against administrative action fairly beyond the granted powers.”³¹⁹ The Court specified that “individual rights” did not include “public rights that have been legislatively pronounced to belong to each individual who forms part of the public.”³²⁰ The implication was that there was no constitutional authority for courts to enforce an “abstract, self-contained, noninstrumental ‘right’ to have the Executive observe the . . . law.”³²¹

This judicial disinclination to redress undifferentiated, generalized injuries is most evident in the historically litigation-rich context of environmental law,³²² but the same principle should apply to other risk regulation regimes—including, most obviously for our purposes, financial regulation.³²³ The wider the class of injury sufferers, the less likely one of its representatives will have standing.³²⁴ Consider the examples of a taxpayer qua regulatory beneficiary of Section 113 (that is, a person who benefits from a regime in which bailouts with public funds are unlikely) or a finance consumer qua regulatory beneficiary of Section 113 (that is, a person who generally enjoys the continuity of supply of financial

317. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 577 (1992) (quotation marks and citations omitted).

318. 321 U.S. 288 (1944).

319. *Id.*

320. *Lujan*, 504 U.S. at 578. Note that the Court’s concern here was not merely that it should abjure on justiciability grounds interpreting, for instance, a vague constitutional principle. Instead, *Lujan* stands for the proposition that courts should avoid asserting federal jurisdiction to redress general grievances even where Congress has expressly empowered the regulatory beneficiary to bring a lawsuit in federal courts. *See id.* at 571-72 (describing the citizen suit provision from the Endangered Species Act, 16 U.S.C. § 1540(g), before ruling it unconstitutionally broad).

321. *Id.* at 573.

322. *See Danieli Evans, Concrete Private Interest in Regulatory Enforcement: Tradable Environmental Resource Rights as a Basis for Standing*, 29 *YALE J. ON REG.* 201 (2012).

323. The principle is also established in the context of taxpayer standing. *See Frothingham v. Mellon*, 262 U.S. 447, 488 (1923) (holding that standing for a plaintiff taxpayer challenging the constitutionality of government grants to hospitals required plaintiff to show that “he has sustained or is immediately in danger of sustaining some direct injury as the result of its enforcement, and not merely that he suffers in some indefinite way in common with people generally”). Derogations from this general principle show up in the jurisprudence, but they are difficult to reconcile with the weight of precedent, and it is best to consider them as context-specific anomalies. *See, e.g., FEC v. Akins*, 524 U.S. 11, 24 (1998) (citizen standing to challenge FEC regulation, despite “generalized” and “widely shared” nature of injury to all voters, because the injury’s relationship to voting, “the most basic of political rights,” was “sufficiently concrete and specific” to establish standing); *Flast v. Cohen*, 392 U.S. 83 (1968) (taxpayer standing to challenge violations of Establishment Clause).

324. Since the standing of an association *supra* derives from the standing of its members, the same result obtains with respect to the association. *See supra* note 303 (discussing associational standing).

services and credit without disruption). Both of these plaintiffs, whether acting on their own or through an association,³²⁵ will almost certainly lack standing because his is a “generally available grievance about government—claiming only harm to his and every citizen’s interest in proper application of the Constitution and laws, and seeking relief that no more directly and tangibly benefits him than it does the public at large.”³²⁶

Even if a plaintiff can credibly allege a concrete and particularized injury, it will find yet another precedential booby trap complicating its access to the courts. Specifically, the current jurisprudence is inhospitable to plaintiffs seeking redress for bureaucratic errors giving rise to hypothetical future harms, risks, and dangers. The U.S. Constitution and the legislation establishing the Article III federal judiciary together empower courts to hear cases in equity, which includes lawsuits seeking prospective injunctions to enjoin future injuries resulting from current violations of law.³²⁷ Of course, many of the bureaucratic tasks involved in modern government require conjectural, hypothetical determinations about future harms that are inherently contestable and contingent. Nowhere is this more evident than in financial supervision and examination. For instance, the intrinsic regulatory logic of Section 113 is that Congress has entrusted the FSOC to make conjectural, speculative, future assessments about how turbulence in the financial system might emerge. Nevertheless, the Supreme Court has repeatedly incanted that in order to maintain standing, a plaintiff’s injury resulting from these determinations must not be “conjectural or hypothetical.”³²⁸ The net effect of this case law channels contestation about regulatory process away from the courts and into the political process.

The 2009 case of *Summers v. Earth Island Institute* is instructive. In that case, the Supreme Court faced a plaintiff’s challenge to the U.S. Forestry Service’s decision that it would not provide for public notice, comment, and appeal with respect to projects involving land tracts smaller than 250 acres.³²⁹ The only evidence plaintiff introduced that could establish a prospective injury was an affidavit from a member of the plaintiff organization who claimed to be aggrieved by the comment policy change because he could no longer seek to persuade the Service concerning the development of these smaller tracts of

325. If, on the other hand, these interested potential plaintiffs are able to mobilize a state government to spearhead the litigation, then standing will likely disappear as a problem. See *Massachusetts v. EPA*, 549 U.S. 497, 518 (2007); Lisa Heinzerling, *Massachusetts v. EPA*, 22 J. ENVTL. L. & LITIG. 301, 310-11 (2007). In *Massachusetts v. EPA*, the Court held that Massachusetts, in its capacity as an intervenor, had standing to sue under the Clean Air Act to challenge the EPA’s refusal to promulgate greenhouse gas emissions standards. In support of its decision as to standing, the Court stated that “[i]t is of considerable relevance that the party seeking review here is a sovereign State and not, as it was in *Lujan*, a private individual.” *Massachusetts v. EPA*, 549 U.S. at 518; see also *id.* at 520 (observing that sovereign states were “entitled to special solicitude in our standing analysis”).

326. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 573-74 (1992).

327. See Hessick, *supra* note 309, at 61.

328. See *supra* note 306 (discussing the genesis of the carve-out of “conjectural or hypothetical” injuries from constitutional standing).

329. 555 U.S. 488 (2009).

protected lands. The Court held that the plaintiff lacked standing. The problem, according to the majority, was that the causal thread linking the policy change to the plaintiff's future harm was too speculative:

Here we are asked to assume not only that [the affiant] will stumble across a project tract unlawfully subject to the regulations, but also that the tract is about to be developed by the Forest Service in a way that harms his recreational interests, and that he would have commented on the project but for the regulation.³³⁰

In other words, in the Court's view the problem with seeking redress in the judicial system was that courts exist to remedy injuries that are both concrete and specifically traceable to a regulatory action.³³¹ The injury was hardly illusory, but the causal nexus linking the alleged bureaucratic error to that injury was too tenuous. However likely (or even probable) the future harm was, standing would not lie if the plaintiff required the court to imagine a series of hypothetical causal scripts through which the harm materialized.³³² The majority expressly rejected the dissent's preferred "realistic threat" approach—criticized as a "probabilistic standing" approach³³³—which emphasized instead the concreteness of the likelihood of future harm, even where the precise manner by which it materializes is uncertain.³³⁴ Here the legal system draws on the familiar distinction between probability and risk, on the one hand, and uncertainty, on the other hand, to apportion legal entitlements and direct judicial resources in ways that harm regulatory beneficiaries.

This jurisprudence deals non-competitor beneficiaries of financial supervisory regulation a losing hand. Even more than the *Earth Island* plaintiff, a non-competitor regulatory beneficiary of a financial supervisory program

330. *Id.* at 496.

331. In the earlier case of *Friends of the Earth, Inc. v. Laidlaw Environmental Services*, the Court had held that a regulatory beneficiary need only establish a "reasonable concern" that the challenged action would have a particularized, direct adverse effect on the would-be plaintiff. *Laidlaw*, 528 U.S. at 183-84. In that case, the Court held that a plaintiff conservation association had standing to challenge defendant's non-compliance with a consent order entered by a state environmental regulator due to the former's members' "reasonable concerns" that "the effects of [the defendant's] discharges" would "directly affect[] [their] recreational, aesthetic, and economic interests." *Id.* While *Earth Island Institute* did not overrule *Laidlaw*, the two cases certainly stand in tension with one another. See Bradford Mank, Summers v. Earth Island Institute *Rejects Probabilistic Standing, But a "Realistic Threat" of Harm Is a Better Standing Test*, 40 ENVTL. L. 89, 137 (2010).

332. The subtext of this restrictive view of standing is, of course, that the plaintiff can seek redress through the political system by prevailing upon the legislative and executive branches concerning the projected causal conduits through which the harm, danger, or risk will materialize.

333. *Earth Island Institute*, 555 U.S. at 499-500.

334. *Id.* at 506 (Stevens, J., dissenting) ("[A] threat of future harm may be realistic even where the plaintiff cannot specify precise times, dates, and GPS coordinates."). The dissent quoted approvingly from the Court's opinion in *Los Angeles v. Lyons*, which provided that a plaintiff could establish a "realistic threat" (and establish his standing to sue to enjoin the use of an allegedly unconstitutional police choke-hold) if he could show that the hold would cause him harm "in the reasonably near future." 461 U.S. at 102 (1983).

would allege an injury arising out of a causal environment that is entirely unsusceptible to definite specification. It is not merely that such a plaintiff would be unable to specify when an event occurs, as with, for instance, a string of four consecutive “heads” flips of a coin—an event that is certain to occur, even if the precise sequence of flips is uncertain. With financial supervisory programs focused on systemic risk, the causal specifications of the harm a plaintiff suffers depend on complex and reflexive interactions among the financial system, the wider economic system, and the political system. The narrative linking the complained-of agency action—in this case, imposing an illegal barrier to Section 113 designation for some firms—to the harm plaintiff will suffer requires imagining at the very least that: (1) the FSOC would designate additional firms were the filter removed; (2) failure to designate these firms would contribute to their experiencing financial distress; and (3) the financial distress would cause a systemic breakdown of the financial system through specified channels.

Indeed, the plaintiff must ask the court to imagine further contingencies that link the systemic stress to that particular plaintiff. For instance, a consumer plaintiff might have to show that it will suffer from the disappearance of funding that otherwise would be available. And a taxpayer-citizen plaintiff might have to convince a court that the government would likely take specified remedial actions in response to the systemic stress (e.g., bailouts, prolonged interest rate cuts, fiscal stimulus). It is one thing to ask the FSOC to perform these tasks; indeed, that is exactly what Congress did. According to the current jurisprudence, it is another thing altogether to ask the courts to engage in this “ingenious academic exercise in the conceivable.”³³⁵

The dubious constitutional standing of non-competitor regulatory beneficiaries alleging generalized grievances premised on uncertain future harms largely moots any analysis of their statutory-prudential standing. After all, the two requirements are conjunctive and the courts apply the statutory-prudential test only *after* they consider the plaintiff’s constitutional standing.³³⁶ Nevertheless, for the sake of completeness it bears mentioning that courts have been more receptive to claims of non-competitor statutory standing than claims to constitutional standing, owing to a presumption in favor of statutory standing that requires a defendant to demonstrate congressional intent to preclude judicial review.³³⁷ The presumption contemplates a dynamic, functional conception of congressional intent, focusing not only on the plaintiff’s status as an actually “intended beneficiar[y]” at the time of the statute’s enactment but also including

335. *United States v. Students Challenging Regulatory Agency Procedures (SCRAP)*, 412 U.S. 669, 688 (1973).

336. *Nat’l Credit Union Admin. v. First Nat’l Bank & Trust Co.*, 522 U.S. 479, 504 (1998); *cf.* *Allen v. Wright*, 468 U.S. 737, 751 (1984) (referring to Article III injury-in-fact analysis as “a core component of standing”).

337. *See Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians v. Patchak*, 567 U.S. 209, 225 (2012) (“We apply the [statutory-prudential standing] test in keeping with Congress’s evident intent when enacting the APA to make an agency action presumptively reviewable.” (quotation marks omitted)); 3 *PIERCE TREATISE*, *supra* note 166, § 16.9 at 1521.

plaintiff interests that are “sufficiently congruent with” the interests of the intended beneficiaries.³³⁸

Courts have found sufficient evidence of an intent to preclude where a plaintiff suffering an *economic* injury sought to invoke statutory rights intended to protect the *environment*³³⁹ or where a *union* alleging injury from anticompetitive behavior on the part of a multi-employer association sought to bring a lawsuit premised on antitrust laws intended to promote *consumer* interests.³⁴⁰ In *Lujan*, the Court included a hypothetical illustration of an agency defendant that decides, in contravention of its statute, not to conduct an evidentiary hearing.³⁴¹ Such a defendant, the Court continued, could rebut the presumption if a stenographer sued it alleging an injury in the form of a lost opportunity to provide stenographic services; Congress obviously did not intend to benefit stenographers when it enacted the statute requiring the agency to conduct evidentiary hearings.³⁴²

For purposes of the “zone of interests” inquiry, the statutory provisions in question include not only the APA’s judicial review statute, but also the FSOC’s broader statutory scheme.³⁴³ The APA, of course, quite plainly contemplates a right of review for “a person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action.”³⁴⁴ And the entire FSOC statute, set forth in Title I of the Dodd-Frank Act, is intended to “respond to emerging threats to the stability of the United States financial system”³⁴⁵—a regulatory charge that equally benefits all users of finance as well as wider arrays of economic actors benefiting indirectly in their capacities as employees or taxpayers. Read together, these statutes in no way suggest a statutory logic to preclude the ability of consumers, citizens, and taxpayers to initiate judicial review of agency action adopted pursuant thereto.³⁴⁶ Of course, for reasons alluded to above, this conclusion likely provides cold comfort to public advocacy

338. First Nat’l Bank & Trust Co. v. Nat’l Credit Union Admin., 988 F.2d 1272 (D.C. Cir. 1993).

339. See *Ashley Creek Phosphate Co. v. Norton*, 420 F.3d 934, 940 (9th Cir. 2005) (National Environmental Policy Act).

340. See *Associated Gen. Contractors of Cal., Inc. v. Cal. State Council of Carpenters*, 459 U.S. 519 (1983).

341. See *Lujan v. Nat’l Wildlife Fed’n*, 497 U.S. 871, 883 (1990).

342. See *id.*

343. See 3 PIERCE TREATISE, *supra* note 166, § 16.9 at 1516; *cf.* *Clarke v. Sec. Ind. Ass’n*, 479 U.S. 388, 401 (1987) (“[W]e are not limited to considering the statute under which [plaintiff] sued, but may consider any provision that helps us to understand Congress’ overall purposes.”).

344. 5 U.S.C. § 702 (2018); *cf.* *Match-E-Be-Nash-She-Wish Band of Pottawatomi Indians v. Patchak* 567 U.S. 209, 225 (2012).

345. Dodd-Frank Wall Street Reform and Consumer Protection Act § 112(a)(1)(C), 12 U.S.C. § 5322(a)(1)(C) (2018).

346. See *Block v. Cmty. Nutrition Inst.*, 467 U.S. 340, 351 (1984) (“[T]he presumption favoring judicial review [is] overcome . . . whenever the congressional intent to preclude judicial review is ‘fairly discernible in the statutory scheme.’” (quoting *Ass’n of Data Processing Serv. Orgs. v. Camp*, 397 U.S. 150, 157 (1970))).

groups, who face gusty headwinds in their efforts to establish constitutional standing when challenging financial supervisory actions.³⁴⁷

d. Agency Adjudication vs. Agency Rulemaking: Any Judicial Challenge to the Filter Problem Will Likely Be Framed in Terms of Judicial Review of the Analytical Framework, Not an Agency Adjudication

For all the focus in the standing jurisprudence on types of *plaintiffs*, it is crucial to remember that “it is the *injury* and not [the] party” on which standing ultimately depends.³⁴⁸ Discussing standing in terms of plaintiff typology, particularly when specific categories of plaintiffs are associated with specific types of injury, helps identify which legal persons are proper conduits through which a legal issue arrives before the court. For example, as we saw above, given the structure of the Section 113 regulatory program, citizen advocacy groups will face great difficulty in establishing constitutional standing to challenge FSOC action or inaction.³⁴⁹ Nevertheless, in the final analysis, it should be borne in mind that a plaintiff must identify an *injury* that the plaintiff has suffered or will suffer. This reminder will focus the analysis for those categories of plaintiffs, such as competitors,³⁵⁰ with stronger arguments for standing.

The injury-based focus of standing doctrine implies a further principle: the standing analysis will also depend in part on the way the plaintiff frames and characterizes the bureaucratic error giving rise to the injury. A challenge to agency action can assume one of two forms: judicial review of agency *rulemaking* or judicial review of agency *adjudications*. The APA defines the terms “adjudication” and “rulemaking” such that they include mutually exclusive categories of all types of administrative actions.³⁵¹ Although the distinction matters in certain contexts,³⁵² for purposes of the APA judicial standard of review, both adjudications and rulemakings fall within the category of “agency actions, findings, and conclusions,” so the familiar arbitrary-and-capricious standard would apply equally to Section 113 rulemakings and adjudications.³⁵³

347. See *supra* notes 306-310 and accompanying text.

348. *Cardenas v. Smith*, 733 F.3d 909, 913 (D.C. Cir. 1984) (emphasis added).

349. See *supra* notes 306-310 and accompanying text.

350. See *supra* Section IV.B.2.b.

351. See 5 U.S.C. §§ 551(4)-(7).

352. For instance, a party to an adjudication, whether formal or informal, has a statutory right to appoint counsel or an authorized representative in connection with the proceeding. See 5 U.S.C. § 555 (2018).

353. Interestingly, the Dodd-Frank Act might provide that courts are to use the “substantial evidence” standard when reviewing a FSOC designation under Section 804—that is, a designation of an FMU for supervision by the Federal Reserve. See *supra* note 29 and accompanying text; Dodd-Frank Act § 804(e)(2)(C), 12 U.S.C. § 5463(e)(2)(C) (2018). I say “might” because the Act invokes the “substantial evidence” phrase in a curious manner. It provides to a potential designee a right to “demonstrate that the proposed designation or rescission of designation is not supported by substantial

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Although the standard of review might be the same, incentives are such that the rulemaking setting is likely to provide a more workable setting than the adjudication setting for judicial review of the Basic Filter Problem. The FSOC's organic statute provides for judicial review of final determination orders,³⁵⁴ and the APA provides for judicial review only of final agency actions.³⁵⁵ These statutes codify the bedrock principle that the means by which an agency enforces its policies are committed to the agency's absolute discretion.³⁵⁶ In the normal course, the only way the FSOC takes a reviewable agency action is *to designate* a nonbank company; as a result, there is no reviewable action in connection with its decision *not to designate* any particular company or groups of companies—whether on account of a perception that financial distress is unlikely or otherwise. Nevertheless, the issue might be ripe for consideration in the possible (although to-date unprecedented) event that the FSOC *rescinds* an in-force designation on the specific grounds that the designee is no longer sufficiently vulnerable to financial distress.³⁵⁷

Instead, a facial challenge to the Analytic Framework itself—a final agency action in the form of a rulemaking—would present a more likely vehicle for judicial review of the Likelihood-Vulnerability Filter. An interested party *with standing* (such as a competitor) could bring a lawsuit under the judicial review provision of the APA, alleging that the introduction of a potential designee's vulnerability to material financial distress into the FSOC's inquiry is arbitrary and capricious. The ultimate outcome of such a lawsuit will depend on whether the courts incline toward the plain-meaning, expansive reading or the contextual, restrictive reading of the statute.³⁵⁸

evidence.” *Id.* The statute therefore instructs the FSOC, rather than a reviewing court, to employ the standard. In any event, the distinction matters because the Supreme Court has characterized the arbitrary-and-capricious standard as “more lenient” than the “substantial evidence” standard, which the APA prescribed only for trial-like formal rulemaking proceedings. *See* *Am. Power Inst. v. Am. Elec. Power Svc. Corp.*, 461 U.S. 402, 412 n.7 (1983). *But see* *Bonnichsen v. United States*, 367 F.3d 864, 880 n.19 (9th Cir. 2004) (“When the arbitrary and capricious test is performing that function of assuring factual support, there is no substantive difference between what it requires and what would be required by the substantial evidence test.”) (citation omitted); *Aman v. FAA*, 856 F.2d 946, 950 n.3 (7th Cir. 1983) (ascribing the difference between the tests “more to atmospheric than to the patently demonstrable”).

354. Dodd-Frank Act § 113(h), 12 U.S.C. § 5323(h) (2018).

355. *See* 5 U.S.C. § 704 (2018).

356. *See* *Heckler v. Chaney*, 470 U.S. 821, 831 (1985) (holding that “an agency’s decision not to prosecute or enforce . . . is a decision generally committed to an agency’s absolute discretion”).

357. *See supra* Section III.6 (explaining (i) the requirement that FSOC periodically reevaluate its designations and (ii) the recent designation rescissions for GE Capital and AIG on grounds unrelated to the Likelihood-Vulnerability Filter).

358. *See supra* Section IV.B.1 (discussing the merits).

3. The Statute of Limitations Likely Bars Any Attempt to Redress the Filter Problem by Attacking the Framework Itself

Just as we have identified a possible redressable injury and plaintiff with standing—namely, a competitor beneficiary challenging the Analytic Framework—we come before another hurdle: the statute of limitations. A six-year statute of limitations applies to judicial review of actions against the government—such as actions pursuant to Section 702 of the APA and the Section 113 judicial review statute³⁵⁹—for which Congress has not provided an alternate statute of limitations in the applicable statute.³⁶⁰ While a facial challenge to the Framework brought by a competitor plaintiff benefiting from the Section 113 program presents the most effective vehicle for challenging the Likelihood-Vulnerability filter, such a litigant would have had to have filed a suit before April 2018—the point at which the six-year period ran out.

Nevertheless, a competitor regulatory beneficiary *might* be able to obtain judicial review by invoking its rights under § 553(e) of the APA. That provision allows “any person” to petition an agency to issue, amend, or repeal a rule; in response, the agency must justify any denial of a petition with a statement of reasons.³⁶¹ The petitioner has the right to seek judicial review of an agency’s denial.³⁶² However, the APA does not require the agency to respond to a § 553(e) petition by any particular time. Furthermore, although refusals to adopt the requested administrative action are susceptible to judicial review, “such review is extremely limited and highly deferential.”³⁶³

4. How the FSOC’s Curious Refusal to Apply the Filter Renders a Judicial Challenge Unlikely, But Also Creates a New “Zombie Filter Problem”

Having reviewed the foregoing explication of the Basic Filter Problem, the reader will likely be surprised to learn that the FSOC, in each of its designations to date, has disavowed any intention of applying the filter in the first place. In the introductory material explaining the basis for each of its designations to date, the FSOC has included the following perplexing qualification:

The Council’s final determination does not constitute a conclusion that [the company] is experiencing, or is likely to experience, material financial distress. Rather, consistent with the statutory standard for determinations by the Council under section 113 of the Dodd-Frank Act, the Council has determined that

359. See *supra* note 78 and accompanying text discussing § 113(h).

360. See, e.g., *Black Warrior Riverkeeper, Inc. v. U.S. Army Corps of Eng’rs*, 781 F.3d 1271, 1285-86 (11th Cir. 2015).

361. See 5 U.S.C. § 553(e) (2018).

362. See *id.* § 702.

363. *Massachusetts v. EPA*, 549 U.S. 497, 528 (2007) (internal quotations omitted).

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material financial distress at the company, if it were to occur, could pose a threat to U.S. financial stability.³⁶⁴

So long as the FSOC maintains a consistent policy of eschewing deployment of its potentially illegal filter, a judicial challenge to remedy the Basic Filter Problem will likely be non-justiciable because no potential plaintiff, not even a competitor beneficiary, will have suffered an injury-in-fact. However, as discussed below, the Council's inclusion of the Likelihood-Vulnerability Filter creates a further complication that *is* ripe for judicial review—in this case, by the designated companies themselves.

But no sooner have we safely interred the Basic Filter Problem, than the problem re-emerges, zombie-like, in a different guise to create new problems for the Council. Whether the inclusion of the Filter in the Analytic Framework was legal or not, by not applying it, the FSOC has opened itself up to criticism on the part of designated companies that the Council is acting arbitrarily by failing to apply its own rules.

MetLife seized upon precisely this issue in its lawsuit challenging its designation. In its motion for summary judgment, MetLife attacked the application of Section 113 and the Analytic Framework alleging an administrative impropriety that amounts to a spin-off of the Basic Filter Problem. Specifically, MetLife argued that the FSOC acted arbitrarily and capriciously by *not* considering MetLife's vulnerability to financial distress. At least half of that statement is unassailable; as noted above, the FSOC expressly disavowed any intention, much less a requirement, to consider MetLife's vulnerability to such a state.³⁶⁵ The other half of that argument—that MetLife acted arbitrarily and capriciously—is only partly meritorious (but meritorious enough to justify rescission of the designation).

First, MetLife advanced a statutory argument, claiming that its designation violates the express terms of Section 113. Agency action in contravention of an explicit Congressional dictate is the quintessence of administrative arbitrariness.³⁶⁶ On the other hand, if the FSOC used its discretion to interpret its ambiguous statute, it is entitled deference from the judicial branch under *Chevron*.³⁶⁷ MetLife argued that the FSOC plainly stated that several of the statutory factors—specifically, the extent of pre-existing regulatory scrutiny, a

364. *E.g.*, FIN. STABILITY OVERSIGHT COUNCIL, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S FINAL DETERMINATION REGARDING METLIFE, INC. (Dec. 18, 2014), <https://www.treasury.gov/initiatives/fsoc/designations/Documents/MetLife%20Public%20Basis.pdf> [<https://perma.cc/8MD9-U8V9>].

365. *See supra* text accompanying note 364.

366. *See, e.g.*, *NLRB v. Brown*, 380 U.S. 278, 291 (1965) (“Reviewing courts are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute.”); *Pub. Citizen v. Motor Carrier Safety Admin.*, 374 F.3d 1209, 1216 (D.C. Cir. 2004) (vacating final agency rule where on arbitrary-and-capricious grounds the agency “wholly failed to comply with [a] specific statutory requirement”).

367. *See supra* notes 273-287 and accompanying text (discussing *Chevron* deference).

company's use of leverage, and a company's liability structure—are relevant to the question of whether material financial distress is *likely* to occur.³⁶⁸ As discussed above, that much is correct.³⁶⁹

However, MetLife takes the further step of interpolating from the *possible* relevance of those factors to the likelihood issue a congressional directive *requiring* the FSOC to assess likelihood in its investigations. The Basic Filter Problem refers to the possibility that the FSOC has violated its organic statute by *including* vulnerability to financial distress as a screening factor, rather than simply assuming the existence of a material financial distress. But MetLife's argument here is altogether different, claiming in effect that vulnerability and likelihood are transparently necessary—that FSOC violates its statute by *excluding* their consideration when applying its framework. (This argument can only apply to the application of the Framework and not directly to the Framework itself, which, as discussed at length above, does in fact provide for the Likelihood-Vulnerability Filter).

The flaw in MetLife's argument is that the statutory factors to which MetLife refers, while certainly relevant to a discussion of likelihood of financial distress, are equally relevant to the question of how distress might transmit through the financial system. Companies that employ significant degrees of financial leverage, operate largely outside of regulatory scrutiny, and fund themselves with short-term liabilities present heightened risks of transmitting distress, once it does occur, through the exposure and liquidation channels. From a financial theory perspective, the argument that inclusion of such considerations in the statute makes it arbitrary for the agency not to look at likelihood—on the grounds that the considerations can *only* be relevant to likelihood—is fatuous.³⁷⁰

Nevertheless, underneath the flaws in MetLife's statutory argument lies a troubling implication. Although the statute itself does not *require* consideration of the likelihood of financial distress, the FSOC *did in fact decide* to include it in its Analytic Framework.³⁷¹ Here, MetLife's second argument has bite. Specifically, it argued that the FSOC, in announcing its intention to eschew consideration of MetLife's vulnerability to financial distress in applying its

368. See MetLife Brief, *supra* note 120, at 26–28.

369. See *supra* notes 284–285 and accompanying text.

370. MetLife also argues that the binary determination standards implicitly presuppose that the First Determination Standard requires assessment of the likelihood of financial distress. According to MetLife, the FSOC's reading of the statute not to require such an assessment would mean that "FSOC has no reason to consider designation under the Second Determination Standard, which looks at current reality." MetLife Brief at 28. Consequently, according to MetLife, the Second Determination Standard "is effectively a dead letter." *Id.* That argument seems correct, but MetLife's suggested remedy for the incongruence—namely, that the "FSOC must establish a *basis* for evaluating a company under the First Determination Standard," presumably by assessing the likelihood of financial distress—provides no cure. Even under that formulation, the Second Determination Standard ends up as a dead letter. Such is the implication of the Redundant "Determination Standards" Problem—the universe of cases meeting the First Determination Standard will by definition also meet the Second Determination Standard.

371. See *supra* Section IV.B.1.

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Analytic Framework,³⁷² contradicted the terms of the Analytic Framework itself.³⁷³ When it finalized its rule, the FSOC opted to accommodate industry requests to require an assessment of the likelihood of financial distress at the designated company. It was not required to do so, but it did; now it must comply.

The FSOC might advance two possible explanations for the discrepancy between the Analytic Framework and its determinations, neither of which is availing. First, it might claim that it is interpreting its Analytic Framework not to include a requirement to assess likelihood. The problem with that interpretation is straightforward: it expressly conflicts with the Analytic Framework. To expressly disclaim any intention of performing a duty it announced itself is to act arbitrarily and capriciously.³⁷⁴ Second, it might argue that it has reconsidered its position regarding the need to assess likelihood. Agencies have the legal discretion to alter their interpretations and practices, and are not required to demonstrate to courts that the reasons for a new policy are better than the reasons for a former policy.³⁷⁵ Here, however, the agency displayed no awareness—at least prior to trial—that it was changing its position at all.³⁷⁶

If the Filter remains in place, this shortcoming likely frustrates any future FSOC designations.³⁷⁷ In fact, the district court found in favor of MetLife on this argument and ordered rescission of MetLife's designation.³⁷⁸ The FSOC, which initially had appealed the district court judgment, voluntarily dismissed its appeal in January 2018, cementing the district court judgment as final.³⁷⁹ While MetLife

372. See *supra* text accompanying note 364.

373. MetLife Brief *supra* note 120, at 29-30.

374. Under the *Auer/Seminole Rock* line of precedent, administrative agencies are entitled to substantial deference when interpreting their own rules. (Indeed, they possess greater interpretive prerogative than that which *Chevron* provides them in interpreting their statutes). See *Auer v. Robbins*, 519 U.S. 452 (1997); *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945) (holding that judicial deference to agency action with respect to its own regulations is appropriate unless the action is “plainly erroneous or inconsistent with the regulation”). Notwithstanding its breadth, “such deference is appropriate only so long as the agency’s interpretation does no violence to the plain meaning of the provision.” *Deukmejian v. Nuclear Regulatory Comm’n*, 751 F.2d 1287, 1310-11 (D.C. Cir. 1984).

375. See *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (requiring merely a “conscious change of course”).

376. See *id.* (“[T]he requirement that an agency provide reasoned explanation for its action would ordinarily demand that it display awareness that it is changing position.”).

377. A reviewing court could plausibly find the FSOC acted arbitrarily but nevertheless reject MetLife’s motion to rescind the designation on the grounds of “harmless error.” See 5 U.S.C. § 706 (2018) (“[A] court shall review the whole record . . . and due account shall be taken of the rule of prejudicial error.”); *Shinseki v. Sanders*, 556 U.S. 396, 406 (2009) (holding that the reference to “the rule of prejudicial error” in § 706 should be read to incorporate the harmless error rule from appellate review of trial court judgments in civil litigation). The harmless error doctrine allows a court to affirm an agency action notwithstanding an error where it is “clear that a remand would accomplish nothing beyond further expense and delay.” *Save Our Heritage, Inc. v. FAA*, 269 F.3d 49, 61-62 (1st Cir. 2001). The application of such an argument to the MetLife designation is complicated by the clarity of the FSOC’s express disavowal of its need to follow its own Analytic Framework.

378. See *MetLife*, 177 F. Supp. 3d at 233-36.

379. Joint Stipulated Motion to Voluntarily Dismiss Appeal, *MetLife, Inc. v. Fin. Stability Oversight Council*, 177 F. Supp. 3d 219 (D.D.C. 2016) (No. 15-45).

(and other future designees) might prevail on this particular judicial challenge, it by no means insulates these companies from designation in the future. To the contrary, the FSOC could properly reinstate the designations through two separate courses of action. First, it could retain the Filter and issue a new explanation or amend its existing designation explanations linking the record evidence of vulnerability produced during its Stage 2 and Stage 3 reviews. Second, it could amend the Analytic Framework to remove the Filter, thereby abandoning the vulnerability inquiry altogether.

V. Four Other Structural Problems (with Ministerial Fixes)

This Part will describe four structural inconsistencies in the Analytic Framework. The continued existence of these flaws reinforces the legitimacy critiques of opponents of the Section 113 regime; more concretely, given the right circumstances they could give rise to a judicial challenge to the FSOC's determinations. I refer to these problems in turn as The Redundancy Problem, the Category Problem, the Double-Counting Problem, and the Category-Channel Framing Problem. Ultimately, these particular flaws are remediable through ministerial surface amendments to the rule without any significant effect on the core administrative praxis with which Congress charged the Council.

A. *The Redundancy Problem*

The “Redundancy Problem” refers to the fact that the bifurcation of the Section 113 into two separate pathways—one predicated on a “material financial distress” and the other predicated on a potential designee’s “activities”—unnecessarily complicates what is already an intricate, dense Analytic Framework. As noted earlier, Section 113 itself provides for two pathways to designation.³⁸⁰ In the Analytic Framework, the FSOC refers to these pathways as “Determination Standards.”³⁸¹ Each Determination Standard is ostensibly predicated on a distinct set of facts.³⁸² The first, which the FSOC refers to as the “First Determination Standard,” requires the Council to make a designation where a “material financial distress” at an investigated nonbank financial company “could pose a threat to the financial stability of the United States.”³⁸³ The FSOC guidance clarifies that a “material financial distress” exists when a nonbank financial company would be “in imminent danger of insolvency or defaulting on its financial obligations.”³⁸⁴ The FSOC’s “Second Determination Standard” requires designation if the agency finds that the “nature, scope, size,

380. See *supra* text accompanying note 66.

381. See Final FSOC Section 113 Guidance, *supra* note 8, at 21,640.

382. See *infra* text accompanying note 386.

383. Dodd-Frank Wall Street Reform and Consumer Protection Act § 113(a)(1), 12 U.S.C. § 5323(a)(1) (2018).

384. Final FSOC Section 113 Guidance, *supra* note 8, at 21,657.

scale, concentration, interconnectedness, or mix of activities” at the nonbank financial company could pose such a threat to financial stability.³⁸⁵

Although the Council formally separates the Determination Standards, it also recognizes the inevitable “significant overlap” between them.³⁸⁶ Characterizing these standards as “overlapping” is generous; the FSOC might have just as easily described them as “redundant” or “confusedly reflexive.” For instance, if the nature or scope of that firm’s “activities” alone could pose a threat to the financial system, then it is likely, if not inevitable, that a “material financial distress” at the firm could pose a threat. Similarly, it is difficult to imagine a “material financial distress” at a firm that is attributable to something distinct from that firm’s “activities.” The Second Determination Standard (activities) would seem to include *a fortiori* the First Determination Standard (financial distress).³⁸⁷ Indeed, the Framework almost reads as if the FSOC begrudgingly has included throw-away references to the Second Determination Standard out of fealty to its organic statute. For instance, the document states:

In evaluating a nonbank financial company under one of the Determination Standards, the Council intends to assess how a nonbank financial company’s material financial distress or activities could be transmitted to, or otherwise affect, other firms or markets, thereby causing a broader impairment of financial intermediation or of financial market functioning.³⁸⁸

Parsing this passage reveals that the FSOC intends to assess how a company’s “activities could be transmitted to other firms and markets.” But, of course, this makes no sense, and is not what the FSOC means. The policy problem is the transmission of *distress*. Now, that “distress” could—indeed, almost certainly *would*—result from the firm’s “activities,” but the FSOC’s language implies the obvious: that distress itself is the problem.

Here we see the first structural flaw of the framework, which we might refer to as its “Redundancy Problem.” This Redundancy Problem is both the most trivial and the most difficult to remedy. Since the problem flows from the statute, the FSOC cannot fix it directly. On the other hand, the FSOC’s early enforcement practice has been to make exclusive use of the First Determination Standard. For so long as the agency maintains that enforcement practice, the Redundancy Problem will remain unripe for judicial, or even political, interference—simply an example of syntactic overzealousness on the part of legislative drafters, with more relevance to a course in legislation than a course in financial regulation or administrative law.

385. *Id.*

386. *Id.*

387. The latter is entirely subsumed by the former, which is more capacious.

388. *Id.*

B. The Category Problem

The “Category Problem” refers to the fact that the FSOC insists that its “categories” apply to both Determination Standards, but the concepts only make sense if they apply to the First Determination Standard. As noted earlier in Section III.B, the FSOC insists that these “categories” apply to both Determination Standards, and that they simply encapsulate the ten criteria outlined in the statute to provide structure to *both* determination standards.³⁸⁹

However, the six “categories,” both on their face and as reflected in the FSOC’s descriptions of them, plainly can only make sense in the context of “material financial distress,” a condition that only applies in the context of the First Determination Standard. The first three categories (size, interconnectedness, and substitutability of services) help the FSOC gauge the “potential *impact* of [a nonbank financial company’s] financial distress on the broader economy.”³⁹⁰ And the second three categories (leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny) help the FSOC “assess the vulnerability of a [nonbank financial company] to financial distress.”³⁹¹ This second grouping of “categories” is, in a very loose sense, predictive and probabilistic, designed to help the FSOC obtain a sense of the *likelihood* that a material financial distress materializes in the first place.

Consequently, the Category Problem presents us with the Framework’s *second* structural inconsistency. The application of this key pillar of the Analytic Framework to the Second Determination Standard is, at best, ambiguous. The categories—which, again, assess the *likelihood* and the *impact* of a *material financial distress*, the predicate circumstance for the First Determination Standard—can only be relevant under that particular standard. But whereas the “categories” only can apply to the First Determination Standard, the FSOC insists that they apply equally to the Second Determination Standard. Having uncovered the limited scope of the categories, we are faced with a looming lacuna concerning how the FSOC would approach a Section 113 investigation pursuant to the Second Determination Standard.

The FSOC therefore risks judicial rescission of a potential future designation premised on the Second Determination Standard on the grounds that the FSOC will have acted arbitrarily and capriciously by applying in one context a regulatory standard expressly designed for another context. Two possible explanations might at least account for the Category Problem. Although neither of them can fully resolve the problematic nexus between the categories and the Second Determination Standard, they explain why the problem might be unlikely to present complications for the Council in the future.

389. See *supra* notes 181-182 and accompanying text.

390. Final FSOC Section 113 Guidance, *supra* note 8, at 21,658 (emphasis added).

391. *Id.*

First, we might read the plain application of the categories to the First Determination Standard as an implicit assertion on the part of the FSOC that it only intends to enforce that Standard. The fact that each of the FSOC's designations to date has relied on the First Determination Standard, without even mentioning the Second Determination Standard, supports—or at least fails to invalidate—that hypothesis. The nonbank financial industry (*qua* potential designees) would welcome such an approach because, as discussed above, the First Determination Standard is narrower than the Second Determination.³⁹² Moreover, this explanation would resolve the Redundancy Problem discussed above as well.³⁹³ Such an interpretation prompts a follow-on point: if the FSOC is undercutting the rationale for separating the two standards in the first place, and it should state so expressly.

Another possible interpretation would ascribe the Category Problem (and the FSOC's decision to carry forward the Redundancy Problem) to intra-governmental institutional comity. On this interpretation, the Council incorporated into its regulations congressional instructions that it knows to be misplaced—possibly with no intention of deploying them. This explanation also finds support in the FSOC's enforcement practices to date. Whatever the explanation for the Category Problem, the issue is not ripe at present for a judicial correction, notwithstanding the obvious confusion the categories present.

C. *The Double-Counting Problem*

The “Double-Counting Problem” refers to the fact that the analytic Framework confusedly includes “existing regulatory scrutiny” as both a “category” and a “qualitative factor.” As mentioned earlier in Section III.B, a final component of the Analytic Framework, the FSOC will consider certain “qualitative factors,” including existing regulatory scrutiny, during its Stage 3 inquiry. The FSOC assesses whether these factors might “mitigate or aggravate the potential of the nonbank financial company to pose a threat to U.S. financial stability.”³⁹⁴ Consideration of existing regulatory scrutiny flows from Section 113 itself, which includes as one of its ten statutory designation factors “the degree to which the company is already regulated by [one] or more primary financial regulatory agencies[.]”³⁹⁵ While the statute does not expressly refer to the other qualitative factors, it clearly authorizes the FSOC to incorporate them into its designation framework through its open-ended invitation to the agency to consider “any other risk-related factors that the Council deems appropriate.”³⁹⁶

392. See *supra* note 387.

393. See *supra* Section V.A (introducing the Redundancy Problem).

394. Final FSOC Section 113 Guidance, *supra* note 8, at 21,646.

395. Dodd-Frank Wall Street Reform and Consumer Protection Act § 113(a)(2)(H), 12 U.S.C. § 5323(a)(2)(H) (2018).

396. Dodd-Frank Act § 113(a)(2)(K), 12 U.S.C. § 5323(a)(2)(K) (2018).

Therefore, there is nothing objectionable with the Council's inclusion of mitigating-aggravating circumstances in the Framework; to the contrary, it would appear sensible to do so in light of the FSOC's responsibility to determine which companies could pose a systemic threat. Nevertheless, the Framework's treatment of the qualitative factors presents a problem inasmuch as the Framework *already* addresses the same "existing regulatory scrutiny" factor in the "category" analysis.³⁹⁷ The problem is as easily remediable as it is obvious; FSOC should simply restrict consideration of existing regulatory scrutiny in a single context. The question is which context: as a *category* or as a *qualitative factor*. Since the effectiveness of existing regulatory-supervisory scrutiny can limit the likelihood of a company's financial distress, consideration of this factor might more appropriately belong as one of the FSOC's "categories"—which, it will be recalled, in their present iteration are designed in part to assess a company's vulnerability to financial distress—instead of as a supplemental, add-on "qualitative factor." Inclusion as a category is also appropriate in light of the FSOC's position that the categories are intended to reflect the ten statutory factors (of which existing regulatory scrutiny is one).³⁹⁸

D. The Category-Channel Framing Problem

The "Category-Channel Framing Problem" refers to an ensemble of complications resulting from the Analytic Framework's ambiguous characterization of categories and transmission channels. The FSOC uses the categories to examine a firm in isolation and uses the transmission channels to view the company in relation to the system. On its own, such a conceptual framework would be unremarkable, but the statute itself never mentions this division. Numerous confusions and déjà vu moments result from this formulation because several of the category inquiries—which, again, focus on the firm itself—plainly relate to the *transmission* of distress through the financial system.

For example, it is puzzling that three *categories* (size, interconnectedness, and substitutability) are used to "assess the potential impact" of a material financial distress on the economy,³⁹⁹ and the three separate *channels* are used to evaluate" a company's "potential to pose a threat."⁴⁰⁰ If the FSOC meant to distinguish *having-a-potential-impact* from *potentially-posing-a-threat*, it did not explain itself. In other words, why not simply export the size, interconnectedness, and substitutability "categories" into the "transmission channels" analysis? For example, consider that interconnectedness plainly only makes sense in the context of a transmission analysis, yet the FSOC considers it

397. See *supra* text accompanying note 178.

398. See *supra* text accompanying note 389.

399. Final FSOC Section 113 Guidance, *supra* note 8, at 21,658

400. *Id.* at 21,661.

in the putatively firm-focused “category” analysis. Perhaps it might be objected that those category factors (size, substitutability, interconnectedness) are not themselves “transmission *channels*” themselves so much as transmission factors that make a company itself more likely to serve as a contagion vector in a given transmission channel. While that is true, it only highlights the problem: why bother with the artificial conceptual segregation of categories and channels? Two quick fixes are possible.

First, it would be clearer if the FSOC addressed those factors as part of the transmission channel inquiries themselves. For example, a company's size is by definition a relevant factor to considering how contagion might transmit through an asset liquidation, or “fire sale.” The guidance expressly acknowledges as much when it, for instance, includes “total debt outstanding” among the “metrics” it will consider when analyzing *both* the “exposure channel”⁴⁰¹ and the “interconnectedness category.”⁴⁰² Or when the guidance requires consideration of the “consolidated assets” metric in the analysis of both the “exposure channel”⁴⁰³ and the “size category.”⁴⁰⁴ Similarly, the critical function-service channel expressly requires the FSOC to determine that “there are no ready *substitutes*.”⁴⁰⁵ It is difficult to conceive of how this component of the channel analysis could differ from the “substitutability” “category.” With this approach, the FSOC could dispense with half of the “categories” altogether on the grounds that they are already *necessarily* taken into consideration as part of the transmission channels analysis. The category analysis would then emerge as sharply focused on the likelihood or vulnerability of the firm to material financial distress.

Second, it would also be clearer if the FSOC reorganized the “transmission channels” inquiry so that it would gauge more broadly a subject company's potential role as a contagion vector in the system. With that approach, the inquiry would more accurately map onto, and return focus to, the hypothetical inquiry actually set forth in the statute: assuming the material financial distress materializes, could it compromise the wider financial system? Such an approach would involve importing the contagion-related “categories” (i.e., size, substitutability, and interconnectedness) into a new impact-focused inquiry that would demote, in effect, the “transmission channels” from the organizing principle of the inquiry to a component part of the inquiry.

Compared to the three other fixable problems, the Category-Channel Framing Problem requires a more structural reworking of the Analytic

401. *Id.* at 21,657.

402. *Id.* at 21,659.

403. *Id.* at 21,657.

404. *Id.* at 21,659.

405. *Id.* at 21,657 (emphasis added); *see also id.* (providing that FSOC will consider “the ability of other firms to *replace* those services” in its critical function-service channel” inquiry (emphasis added)).

Framework. In the end, however, the FSOC can remedy these problems through what should be an uncontroversial amendatory rulemaking.

E. These Problems Have Ministerial Fixes

The foregoing discussion has individuated four problems with the existing Analytic Framework that threaten to undermine the conceptual regularity and consistency of Section 113 designations. I have labeled these problems the Redundancy Problem, the Category Problem, the Double-Counting Problem, and the Category-Channel Framing Problem. Figure 5 sets forth below a brief description of the problem and the proposed solution, if applicable.

Figure 5

<i>Problem</i>	<i>Brief Description</i>	<i>Potential Remedy</i>
<i>Redundancy Problem</i>	The two statutory “determination standards” are redundant in that the first standard is necessarily included in the second standard	Because the problem originates in the statute, only Congress can fix it definitively; the FSOC can moot the problem by continuing its enforcement practice of only designating under the first determination standard
<i>Category Problem</i>	The “categories,” which are analytic tools designed to assess the likelihood and impact of financial distress, can only apply to the first determination standard, but the FSOC states that they apply to both determination standards	So long as the FSOC continues its existing enforcement practice of designating companies only under the first determination standard, this problem is moot; on the other hand, if the FSOC ever departs from that practice, it must explain how the “categories” apply to the second determination standard
<i>Double-Counting Problem</i>	The Framework contemplates that the FSOC will consider “existing regulatory scrutiny” in two separate contexts: as a “category” factor to assess the likelihood of financial distress and as a mitigating “qualitative factor”	The FSOC should remove existing regulatory scrutiny from its list of “qualitative factors” and instead consider it as part of the “category” analysis, where it more properly belongs
<i>Category-Channel Framing Problem</i>	The Framework purports to inquire into firm-specific information (by looking at “categories”) and system-wide information (by looking at “transmission channels”), but several of the inquiries overlap	The FSOC should formally fold its consideration of those category factors that are relevant to the financial system as such, rather than to the likelihood of material financial distress at a particular firm (i.e., size, interconnectedness, substitutability), in the context of either (1) its transmission channel analysis as presently structured or (2) as part of a new analysis focused on the impact of the firm’s material distress on the financial system

In the high style of substantive-instrumental rationality,⁴⁰⁶ such a suite of amendments would structure a more coherent and transparent Section 113 designation administrative process without fundamentally paring back the discretionary powers that Congress plainly intended the Council to possess. The

406. See *supra* notes 132-137 and accompanying text (discussing substantive-instrumental rationality and “analytic management” as legitimating bases for administrative action).

FSOC’s discretion remains, but the legitimacy of its exercise is bolstered by a more streamlined and rationalized decision process, as well as more openness about what that process and analysis entail.

Figures 6 and 7 below illustrate conceptual maps of the Analytic Framework following the proposed amendments. Two separate figures are required to account for the two alternative modes of redressing the Category-Channel Framing Problem, as discussed above. Figure 6 integrates the size, interconnectedness, and substitutability “categories” into the extant “transmission channel” inquiry; Figure 7 imports those “categories” into a newly streamlined second-step inquiry that looks at firm-specific factors and system linkage factors that *impact* whether a material financial distress could pose a threat.

Figure 6

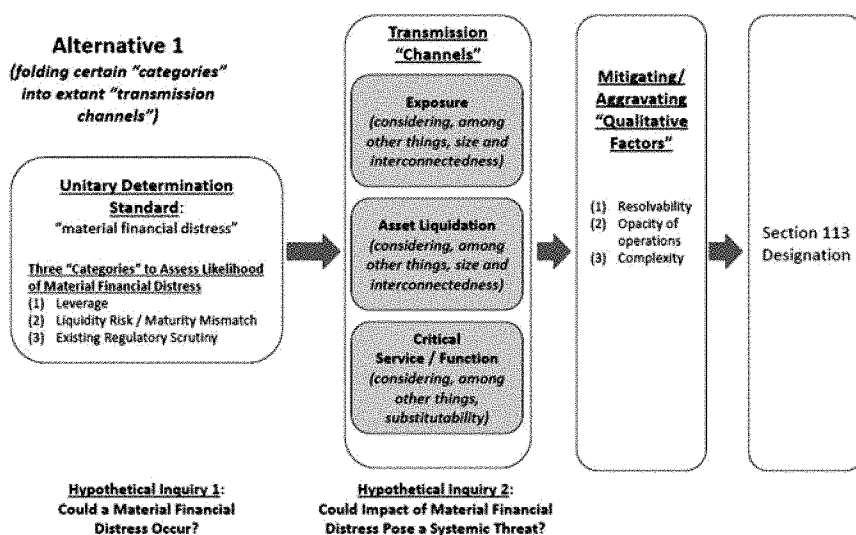
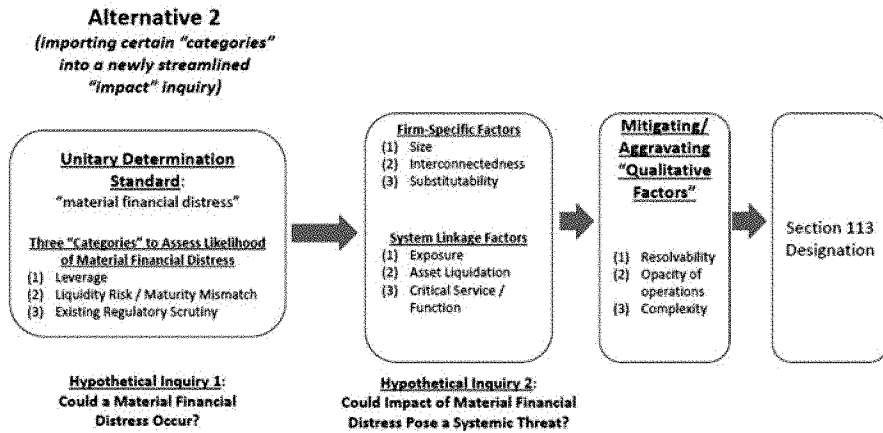


Figure 7



VI. Conclusions

An administrative law analysis of the FSOC’s Section 113 program yields two sets of findings. First, the FSOC’s Analytic Framework contains a series of internal inconsistencies and ambiguities that could potentially open its designations up to attacks in both the courts and the political branches. Given the complicatedness of the Section 113 inquiry that Congress created, this finding is unsurprising; but given the importance of the program to the post-crisis supervisory regime, it is also highly problematic. As such, this Article urges that the FSOC adopt a comprehensive suite of recommended remedial amendments that sharpen the Framework without altering its underlying substance or straying from the statute. Second, the Framework emerges as a case study for how a significant portion of the post-crisis financial supervisory regime is on the brink of an administrative law crisis. The three problems identified and discussed in this Article threaten to whittle away at the structure of not only the Section 113 designation program, but also other financial risk-regulatory programs. These programs—such as the Dodd-Frank stress tests, the CCAR, and the resolution planning programs—require financial regulators to take inherently contestable actions in conditions characterized by significant uncertainty. In doing so, the Article sketches out a roadmap for financial regulators, courts, and scholars of administrative law and regulation to reconcile these regulatory programs with U.S. public law doctrine.