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 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
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 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.

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).
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vertigo sets in when financial regulatory experts confront administrative law 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

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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.

and capricious” actions. 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.

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”

9. See infra note 138 and accompanying text.
where the regulator’s decision process does not formally account for the costs incurred by regulated entities in connection with the regulatory action.\textsuperscript{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 \textit{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 \textit{overreach} on the part of financial industry firms, one of the Framework’s most trenchant flaws results in significant \textit{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 legitimize 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-

\textsuperscript{11} Michigan v. EPA, 135 S. Ct. 2699 (2015).
Frank 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.”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

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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
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. Policy entrepreneurs, understanding that the political economy of financial regulation is such that post-crisis environments are opportune reform times, 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, or financial functions, such as the clearing and settlement of swaps. There were also “gaps” when it came to supervising individual institutions; that transactions irrespective of the type of entity undertaking the transactions. See, e.g., 15 U.S.C. § 77b(a)(4) (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).


is, even within the predominant paradigm of entity-centric regulation, some entities fell through cracks in the regulatory edifice. 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.” 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.

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.” Most importantly, “no single regulator possesses all of the information and authority necessary to monitor systemic risk.” 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.”

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22. See Demyanyk & Loutskina, 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/6MQS-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.
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.” 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.

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.”

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

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26. See OBAMA REGULATORY REFORM WHITE PAPER, supra note 14, at 3.
28. Subparagraph (C) used the word “identify” to capture what the House Committee report referred to as “monitoring.”
Federal Reserve liquidity). In July 2012, the FSOC unanimously designated eight FMUs responsible for the clearing and settling of transactions among financial institutions.

Congress filled the entity gap with the Section 113 designation program. 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.”

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.


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).
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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

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34. See supra Section I.A.
37. Dodd-Frank Act § 161.
38. Id. § 162.
more than $250 billion in total consolidated assets. 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. In recognition of the reality that Section 113 designees are not primarily involved in the banking business, Congress instructed the Federal Reserve to “take into account differences” among large bank holding companies and Section 113 designees when promulgating these enhanced standards. After initially proposing a one-size-fits-all set of standards for both large BHCs and Section 113 designees, the Federal Reserve eventually acceded to industry requests to promulgate separate sets of standards for large BHCs and Section 113 designees.

The enhanced standards for large BHCs were finalized in March 2014. 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. 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.


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.


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 113, 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 BHCS 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
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of prudential standards for Section 113 designees primarily engaged in the insurance business. 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. 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.

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.” Such mitigatory actions could include requirements that the company restrict or cease certain activities and transactions, or even divest certain assets. 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.

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

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).
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.” 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.”

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” and (2) not subject to an express exclusion, 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).

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).
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important of which is the BHC exclusion. 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. The statute further instructs the Federal Reserve to promulgate standards for determining if a company is “predominantly engaged in financial activities.”

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. The FSOC refers to these pathways to designation as “Determination Standards.” 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.

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.
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

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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”).
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. The non-voting members are the Director of the Office of Financial Research (OFR), the Director of the Federal Insurance Office (FIO), a state insurance commissioner, a state banking supervisor, and a state securities commissioner.

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.


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.


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 Schwarz and David Zaring have made this very point with respect to the FSOC. 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.

**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.

In June of 2013, the FSOC announced that it had preliminarily designated Prudential, AIG, and GE Capital. 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. On September 19, 2013, the FSOC published its...
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

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.
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, despite pressure from House Republicans to fundamentally restructure the designation program. 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. In November 2017, the Treasury Department published the Report, recommending several reforms that will, if adopted, likely reduce the application of the designation statute. 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. 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. Such a reform would fundamentally restructure the FSOC’s task and de-


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, 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.” 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 swathes 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. The build-up of discretionary power in these salient regulatory programs has caused tension to build along the line that has historically separated

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100. See Kress et al., supra note 99, at 48-49.
101. See, e.g., id. at 9.
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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 RECASTING 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 RECASTING 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.


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.

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

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114.    M i c h a e l  S .  P i w o w a r ,  C o m m ’r, S E C ,  R e m a r k s  a t  A E I  C o n f e r e n c e  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”).
118.    S e e  W i l l i a m  M. B u t l e r , F a l l i n g  o n  D e a f  E a r s : T h e  F S O C ’ s  E v i d e n t i a r y H e a r i n g P r o v i d e s L i t t l e O p p o r t u n i t y t o C h a l l e n g e a N onbank SIFI D e s i g n a t i o n , 18 N.C. B A N K I N G I N S T . 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.    P e t e r  W a l l i s o n , F S O C  L a c k s C r e d i b i l i t y i n D e s i g n a t i n g S I F I s , A M . B A N K E R (Jun. 30, 2014) (emphasis added), https://www.americanbanker.com/opinion/fsoc-lacks-credibility-in-designating-sifs [https://perma.cc/Z4B6-M4LE].
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House Committee on Financial Services describe the FSOC’s designation process as “arbitrary and inconsistent.” Others level their aim at Congress, decrying the FSOC as having been “famously underinstructed” with an “ill-defined mandate” and “vague directive.”

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. 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. 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. 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

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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”).


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”); Friedman, 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. 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.”

Care should be taken not to overstate this characterization of administrative law as procedurism. 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 objectives and in accordance with appropriate forms of scientific or professional methodology. Administrators were analogous to “skilled doctors” whose judgment, because it adhered to professional norms, was beyond reproach. 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. Richard Stewart has aptly

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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.”).


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,
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characterized this development as the “analytic management” turn of U.S. administrative law. Cost-benefit analysis, the method of evaluating possible projects or regulations based on economic principles, has supercharged this trend in public administration and law toward substantive, instrumental rationality. In particular, it has bolstered the faith of government actors to obtain substantively correct, or at least “better,” policy outcomes. 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.


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.\(^\text{138}\) 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.\(^\text{139}\)

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].

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.

A few months later, in January 2011, the FSOC issued its first formal notice of proposed rulemaking and nine months later, the FSOC published a second notice of proposed rulemaking, 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. 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.

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).
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 Plumber’: 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 DUKL.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”\(^\text{146}\) 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.\(^\text{147}\) 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.\(^\text{148}\) 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,\(^\text{149}\) taking into account public and confidential information obtained from regulatory reports as well as any information voluntarily supplied by the company in question.\(^\text{150}\) 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.\(^\text{151}\)

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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 than thirty days after the company invokes such rights.156 The hearing rights are

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

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158. Dodd-Frank Act § 113(a); 12 C.F.R § 1310.10(b)(2) (2018).
160. 12 C.F.R § 1310.23(a) (2018).
161. This dynamic is what Dan Schwarz and David Zaring describe as “regulation by threat.” See generally Schwarz & 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 transformative restructuring).
163. See supra text accompanying notes 91-93.
164. Dodd-Frank Act § 113(d)(2).
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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

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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 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
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, one of which is the Nonbank Financial Company Designations Committee (the Section 113 Committee). 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. The Section 113 Committee is responsible for supporting the Council in fulfilling the latter’s responsibilities to consider, make, and review Section 113 designations. A Deputies Committee comprised of a senior official from each FSOC member agency oversees and directs the Section 113 Committee, as well as the other functional committees. Finally, the Secretary of the Treasury, who chairs the Council, maintains a Secretariat to assist the Secretary in carrying out duties associated with chairpersonship.

APA, are highly particularized. It is probably better to refer to it as legislative rulemaking, and to refer to formal rulemaking as adjudicatory rulemaking.


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).
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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.

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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

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.

In the Framework, the FSOC deploys two sets of conceptual tools to guide it through the various Stages 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. 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.” The FSOC refers to the types of data it will take into account during this analysis as “metrics.” Furthermore, it claims that the categories simply encapsulate the ten criteria outlined in the statute to provide structure to both determination standards.

The FSOC states that it intends to apply these “categories” in the contexts of both Determination Standards. 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.” 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.

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. See supra text accompanying notes 65-67.
183. 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.”).
184. See supra text accompanying note 176.
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 markets: (1) exposure, (2) asset liquidation, and (3) critical function-service. 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 outsized 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. 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. 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.” 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.”

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
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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. financial stability.”\footnote{Id. at 21,646.} The factors include the company’s “resolvability, the opacity of its operations, its complexity, and the extent and nature of its existing regulatory scrutiny.”\footnote{Id.}

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

\footnote{Id. at 21,646.}
\footnote{Id.}
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 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. 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. 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.

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

\(^{194}\) See supra notes 132-137 and accompanying text.


\(^{196}\) 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.


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.

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

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.”).
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 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

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

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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)).


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

\(^{214}\) 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).

regulations at executive agencies (with OIRA oversight),\(^{219}\) such efforts remain “ad hoc and largely unmanaged.”\(^{220}\) Just as importantly, the actual designation-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 \textit{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


\(^{221}\) See \textit{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. \textit{See MetLife Brief} 50.
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view or the product of agency expertise." 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. State Farm applies universally to administrative decisionmaking, but it has special force in the risk-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.” 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.”

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. 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 process and may even predispose regulators, who cannot possibly consider and filter out all the irrelevant information, to outcomes preferred by regulated entities. 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.” As such, an agency possesses the “undoubted power to use predictive models” in responding to future threats. Nevertheless, when using predictive analytic techniques, the agency must “explain[] the

224. Id. at 52.
226. Id. at 52.
227. See supra text accompanying notes 223-224.
228. See supra text accompanying notes 223-224.
229. See supra text accompanying notes 223-224.
230. See supra text accompanying notes 223-224.
231. See supra text accompanying notes 223-224.
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 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

232. Id. (citation omitted).
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.”).
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Board, which itself composes subcommittees to focus on discrete matters.237 Furthermore, environmental statutes are structurally more cabined than Section 113.

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

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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).
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 argued that “a risk analysis that does not meaningfully examine both the probability and magnitude of harm is no risk analysis at all.” 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.

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. 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. 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.

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

242. MetLife Brief, supra note 120, at 35.
244. See supra text accompanying notes 228-229.
246. Fisher, supra note 204, at 115.
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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-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. As a doctrinal matter, there is presently no general requirement that agencies demonstrate that the benefits of proposed agencies actions outweigh their costs. 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.

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.
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.\textsuperscript{249}

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 \textit{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.\textsuperscript{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.”\textsuperscript{251}

In 2012, the EPA made an “appropriate and necessary” finding after reviewing the results of its study concerning mercury.\textsuperscript{252} As an Executive Branch agency, the EPA, it will be recalled,\textsuperscript{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.\textsuperscript{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.\textsuperscript{255}

\textsuperscript{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 \textit{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)).

\textsuperscript{250} Michigan v. EPA, 135 S. Ct. 2699, 2707 (2015).

\textsuperscript{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.

\textsuperscript{252} See 77 Fed. Reg. 9,304 (Feb. 16, 2012).

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

\textsuperscript{254} Supra note 252, at 9,326-27.

\textsuperscript{255} Id. at 9,363.
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 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

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.”).
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 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.”

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

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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.

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. 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. 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

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.

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 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

266.   First FSOC Section 113 Notice of Proposed Rulemaking, supra note 143, at 4,558.
267.   Id. at 4,556.
268.   See supra Section IIA 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).
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 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, which recognizes an agency’s interpretive authority with respect to matters for which its organic statute has not clearly specified a contrary treatment. 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.” 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.

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

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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 "rel[ied] 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).


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”).
apply the statute. Recently, courts and commentators have identified an additional analytic inquiry in the framework, sometimes referred to as “Chevron Step Zero.” With Step Zero, a court considers whether it is inappropriate to find an implicit delegation of interpretive authority because the context would have required Congress to make any such grant express.

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. 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.

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.\textsuperscript{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 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.\textsuperscript{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 maven 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.\textsuperscript{284} For example, paragraph (a)(2)(H) of Section 113 requires an assessment of existing regulatory

\textsuperscript{282} This description privileges a sort of normative representational model of lawmakers. 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.

\textsuperscript{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).

\textsuperscript{284} MetLife made this argument before the district court. See infra notes 368-370 and accompanying text.
scrutiny. 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. In the case of insurance-focused businesses, state 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.

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. 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

285. See infra text accompanying note 395.
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.
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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.

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.

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 (“Standing 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).
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 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
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

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.


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).
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

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


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 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).


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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) 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

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”).

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.


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

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.

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—constitute[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 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).


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.
Several decades later, the Court began to retrench from its permissive posture, exercising the “passive virtue” of judicial restraint by denying standing more frequently. In doing so, it was motivated by a fear that 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.” Quoting from the 1944 case *Stark v. Wickard*, 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.” 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.” 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.”

This judicial disinclination to redress undifferentiated, generalized injuries is most evident in the historically litigation-rich context of environmental law, but the same principle should apply to other risk regulation regimes—including, most obviously for our purposes, financial regulation. The wider the class of


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


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 Daniël Evans, Concrete Private Interest in Regulatory Enforcement: Tradable Environmental Resource Rights as a Basis for Standing, 29 Yale J. on Reg. 201 (2012).

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,”
injury sufferers, the less likely one of its representatives will have standing. 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 services and credit without disruption). Both of these plaintiffs, whether acting on their own or through an association, 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.”

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. 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.” The net effect of this case law channels contestation about regulatory process away from the courts and into the political process.

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

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”).


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).
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. 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 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.

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. 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. The majority expressly rejected the dissent’s preferred “realistic threat” approach—criticized as a “probabilistic standing” approach—which emphasized instead the concreteness of the likelihood of future harm, even where the precise manner by which it materializes is uncertain. Here the legal system draws on the familiar

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**Footnotes:**

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.
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
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 would allege an injury arising out of a causal environment that is entirely insusceptible 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.”

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.

Nevertheless, for the sake of completeness it bears mentioning that courts have established 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).

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

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 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. 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. 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.

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. 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.” 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”—a regulatory charge that equally benefits all users of finance as well as wider arrays.

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.


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


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.”).


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.\textsuperscript{346} Of course, for reasons alluded to above, this conclusion likely provides cold comfort to public advocacy groups, who face gusty headwinds in their efforts to establish constitutional standing when challenging financial supervisory actions.\textsuperscript{347}


For all the focus in the standing jurisprudence on types of \textit{plaintiffs}, it is crucial to remember that “it is the \textit{injury} and not \textit{[the]} party” on which standing ultimately depends.\textsuperscript{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.\textsuperscript{349} Nevertheless, in the final analysis, it should be borne in mind that a plaintiff must identify an \textit{injury} that the plaintiff has suffered or will suffer. This reminder will focus the analysis for those categories of plaintiffs, such as competitors,\textsuperscript{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 \textit{rulemaking} or judicial review of agency \textit{adjudications}. The APA defines the terms “adjudication” and “rulemaking” such that they include mutually exclusive categories of all types of administrative actions.\textsuperscript{351} Although the distinction matters in certain contexts,\textsuperscript{352} for purposes of the APA judicial

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347. \textit{See supra} notes 306-310 and accompanying text.
349. \textit{See supra} notes 306-310 and accompanying text.
350. \textit{See supra} Section IV.B.2.b.
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. \textit{See} 5 U.S.C. § 555 (2018).
\end{flushright}
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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

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

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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(c)(2)(C), 12 U.S.C. § 5463(c)(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 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 atmospherics than to the patently demonstrable”).


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).
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 statute— for which Congress has not provided an alternate statute of limitations in the applicable statute. 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. The petitioner has the right to seek judicial review of an agency’s denial. 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.”

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:

358. See supra Section IV.B.1 (discussing the merits).
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).
362. See id. § 702.
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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 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 \textit{Chevron}.\textsuperscript{367} MetLife argued that the FSOC plainly stated that several of the statutory factors—specifically, the extent of pre-existing regulatory scrutiny, a company’s use of leverage, and a company’s liability structure—are relevant to the question of whether material financial distress is \textit{likely} to occur.\textsuperscript{368} As discussed above, that much is correct.\textsuperscript{369}

However, MetLife takes the further step of interpolating from the \textit{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 \textit{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 \textit{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 \textit{only} be relevant to likelihood—is fatuous.\textsuperscript{370}

Nevertheless, underneath the flaws in MetLife’s statutory argument lies a troubling implication. Although the statute itself does not \textit{require} consideration of the likelihood of financial distress, the FSOC \textit{did in fact decide} to include it

\textsuperscript{367}. See \textit{supra} notes 273-287 and accompanying text (discussing \textit{Chevron} deference).

\textsuperscript{368}. See MetLife Brief, \textit{supra} note 120, at 26-28.

\textsuperscript{369}. See \textit{supra} notes 284-285 and accompanying text.

\textsuperscript{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.” \textit{Id.} That argument seems correct, but MetLife’s suggested remedy for the incongruence—namely, that the “FSOC must establish \textit{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.
in its Analytic Framework.\textsuperscript{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 Analytic Framework,\textsuperscript{372} contradicted the terms of the Analytic Framework itself.\textsuperscript{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.\textsuperscript{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.\textsuperscript{375} Here, however, the agency displayed no awareness—at least prior to trial—that it was changing its position at all.\textsuperscript{376}

If the Filter remains in place, this shortcoming likely frustrates any future FSOC designations.\textsuperscript{377} In fact, the district court found in favor of MetLife on this argument and ordered rescission of MetLife’s designation.\textsuperscript{378} The FSOC, which

\begin{itemize}
  \item \textsuperscript{371} See supra Section IV.B.1.
  \item \textsuperscript{372} See supra text accompanying note 364.
  \item \textsuperscript{373} MetLife Brief supra note 120, at 29-30.
  \item \textsuperscript{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).
  \item \textsuperscript{375} See FCC v. Fox Television Stations, Inc., 556 U.S. 502, 515 (2009) (requiring merely a “conscious change of course”).
  \item \textsuperscript{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.").
  \item \textsuperscript{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.
  \item \textsuperscript{378} See MetLife, 177 F. Supp. 3d at 233-36.
\end{itemize}
initially had appealed the district court judgment, voluntarily dismissed its appeal in January 2018, cementing the district court judgment as final. While MetLife (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. In the Analytic Framework, the FSOC refers to these pathways as “Determination Standards.” Each Determination Standard is ostensibly predicated on a distinct set of facts. 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.” The FSOC guidance clarifies that a “material financial distress” exists when a

380. See supra text accompanying note 66.
381. See supra note 66.
382. See supra note 8, at 21,640.
383. See infra text accompanying note 386.
The FSOC’s Designation Program as a Case Study

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, 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

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384. Final FSOC Section 113 Guidance, supra note 8, at 21,657.
385. Id.
386. Id.
387. The latter is entirely subsumed by the former, which is more capacious.
388. Id.
more relevance to a course in legislation than a course in financial regulation or administrative law.

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

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.
Second Determination Standard, they explain why the problem might be unlikely to present complications for the Council in the future.

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

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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.
into its designation framework through its open-ended invitation to the agency to consider “any other risk-related factors that the Council deems appropriate.”\footnote{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.\footnote{See supra text accompanying note 178.} 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).\footnote{See supra text accompanying note 389.}

\section*{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,\footnote{Final FSOC Section 113 Guidance, supra note 8, at 21,658} and the three separate channels are used to evaluate” a company’s “potential to pose a threat.”\footnote{Id. at 21,661.} 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

\begin{footnotes}
\footnote{See supra text accompanying note 178.}
\footnote{See supra text accompanying note 389.}
\footnote{Final FSOC Section 113 Guidance, supra note 8, at 21,658}
\footnote{Id. at 21,661.}
\end{footnotes}
channels” analysis? For example, consider that interconnectedness plainly only makes sense in the context of a transmission analysis, yet the FSOC considers it 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” and the “interconnectedness category.” Or when the guidance requires consideration of the “consolidated assets” metric in the analysis of both the “exposure channel” and the “size category.” Similarly, the critical function-service channel expressly requires the FSOC to determine that “there are no ready substitutes.” 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.

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

<table>
<thead>
<tr>
<th>Problem</th>
<th>Brief Description</th>
<th>Potential Remedy</th>
</tr>
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<tbody>
<tr>
<td>Redundancy Problem</td>
<td>The two statutory “determination standards” are redundant in that the first standard is necessarily included in the second standard</td>
<td>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</td>
</tr>
<tr>
<td>Category Problem</td>
<td>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</td>
<td>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</td>
</tr>
<tr>
<td>Double-Counting Problem</td>
<td>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”</td>
<td>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</td>
</tr>
<tr>
<td>Category-Channel Framing Problem</td>
<td>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</td>
<td>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</td>
</tr>
</tbody>
</table>
In the high style of substantive-instrumental rationality, 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 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

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