STATES AND SYSTEMIC RISK: AN ANALYSIS OF THE DODD-FRANK ACT'S (UN)COOPERATIVE FEDERALISM

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The Financial Stability Oversight Council represented an innovative approach to the problem of systemic risk in the American economy. It also represented an innovative form of cooperative federalism. By grafting state regulators onto the Council as nonvoting members, Congress hoped this new federal super-regulator would draw upon a reservoir of state expertise and local knowledge so that the Council's final decisions reflected a collaborative effort between the nation's top experts at the federal and state level.

But looking back over the first decade of the Council's operations, it is clear that this experiment failed to work as Congress intended. Federal decisionmakers consciously minimized the role of their state counterparts and asserted jurisdiction over America's largest insurance companies, stepping confidently into an industry that was historically the prerogative of the states over the objection of the Council's state regulator members. Ultimately, the D.C. district court vacated the Council's overreach, citing the very same arguments pressed by state regulators that were disregarded by the Council during its deliberations. By publicly dissenting from the Council's decisions, state regulators planted seeds of doubt that would ultimately lead the Council to abandon its efforts. The Council's foray into insurance regulation reflected not the collaborative consensus of cooperative federalism, but a more discordant process in which state officials work within a federal system to resist policies with which they disagree—a phenomenon known as "uncooperative federalism."

This Article critically examines the role that state regulators could, and did, play during the Council's first decade of deliberations and explores the ramifications of that experience for theories of cooperative and uncooperative federalism. The Dodd-Frank Act's experiment with integrating state regulators at the federal decision-making level did not work as Congress hoped, but it inadvertently revealed a powerful way that states can use tools of administrative law to protect state autonomy from agency overreach through the administrative safeguards of federalism.

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INTRODUCTION

It has been over a decade since Congress passed the Dodd-Frank Act,[1] and it is easy to forget just how truly innovative this statute was. Enacted against the backdrop of the worst economic crisis in seventy-five years, and responding to President Obama's call for a "sweeping overhaul of the United States financial regulatory system, a transformation on a scale not seen since . . . the Great Depression,"[2] this landmark legislation urged a comprehensive re-thinking of the

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1 Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376, 1376 (2010).

2 President Barack Obama, Remarks by the President on 21st Century Financial Regulatory Reform (June 17, 2009) (transcript available at https://obamawhitehouse.archives.gov/the-pre

financial services industry.[3] Consistent with the idiom that challenging situations require creative solutions, the Act's 849 pages[4] were filled with revolutionary new ideas and administrative structures designed to challenge the status quo—some of which have worked out better than others.[5]

A key innovation was the establishment of the Financial Stability Oversight Council,[6] a regulatory super-committee aptly described by one article as "a 'Justice League' of federal financial regulators . . . charged with keeping the world safe from systemic risk."[7] Congress created the Council to address the perception that financial regulation was carried out piecemeal by several disparate entities, none of which was charged with monitoring the system as a whole.[8] The Council fills this hole using several policy tools designed to identify and respond to risks to the American financial system.[9] Among other charges, the Council has the authority to regulate bank holding companies with over $50 billion in assets and any other bank or nonbank financial company that the Council designates as systemically important.[10]

The Council's unique structure also reflects an innovative form of cooperative federalism. Much of the Council's attention focuses on the banking, securities, and insurance industries—areas traditionally regulated (at least in part) by the states.[11] In recognition of the states' historical expertise in these areas, and cognizant of the potential for jurisdictional conflicts, Congress endowed states with an unusually prominent voice in the Council's deliberations.[12] Three active

ss-office/remarks-president-regulatory-reform [perma.cc/6PMS-Z7M4]).

3 *See* DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES 2 (2010).

4 *See* Dodd-Frank Act.

5 *See, e.g.*, Seila Law LLC v. Consumer Fin. Prot. Bureau, 140 S. Ct. 2183, 2191 (2020) (noting that the Consumer Financial Protection Bureau, created by the Dodd-Frank Act, "deviated from the structure of nearly every other independent administrative agency in our history" in ways that "violates the Constitution's separation of powers").

6 *See* Dodd-Frank Act § 111-123.

7 Adam J. Levitin et al., *The Dodd-Frank Act and Housing Finance: Can It Restore Private Risk Capital to the Securitization Market?*, 29 YALE J. ON REG. 155, 163 (2012).

8 *See, e.g.*, EDWARD V. MURPHY & MICHAEL B. BERNIER, CONG. RSCH. SERV., R42083, FINANCIAL STABILITY OVERSIGHT COUNCIL: A FRAMEWORK TO MITIGATE SYSTEMIC RISK 1 (2011).

9 *Id.* at 4.

10 *Id.* at 24; *see, e.g.*, Dodd-Frank Act § 121; Skeel, *supra* note 3, at 78.

11 *See, e.g.*, Patricia A. McCoy, *Systemic Risk Oversight and the Shifting Balance of State and Federal Authority Over Insurance*, 5 UC IRVINE L. REV. 1389, 1391 (2015) (discussing traditional federal regulation of insurance); Renee M. Jones, *Dynamic Federalism: Competition, Cooperation, and Securities Enforcement*, 11 CONN. INS. L.J. 107, 111–12 (2005) (discussing federal and state authority over securities regulation); *see also infra* text accompanying notes 87–106.

12 *See* Daniel Schwarcz & David Zaring, *Regulation by Threat: Dodd-Frank and the Nonbank Problem*, 84 U. CHI. L. REV. 1813, 1821 (2017) ("This membership incorporates a number of diverse viewpoints and, unlike other interagency committees, uniquely includes voices of state regulators in its mix.").

state regulators (one each from the banking, securities, and insurance sectors) participate as non-voting members of the Council.[13] And the Act makes multiple other provisions for state officials to influence Council decision-making, either directly (such as by participating in ad hoc advisory committees)[14] or indirectly (by filling newly created federal positions where prior state regulatory experience would be beneficial, as happened when former state insurance regulators served as the inaugural Director of the new Federal Insurance Office and as the Council's Independent Member with Insurance Expertise).[15]

This structure reflects an interesting evolution in Congress's ongoing experiments with federalism. Traditionally, the government adhered to a "Dual Federalism" model, wherein federal and state sovereigns operated autonomously within clearly delineated spheres of authority.[16] More recently, Congress has enacted statutes "that invite state agencies to implement federal law," a model dubbed "cooperative federalism" by scholars.[17] In most cooperative federalism programs, federal authorities design the overarching policy, and the states' role is largely to help carry out those mandates.[18] But the Dodd-Frank Act integrates state regulators much earlier—at the decision-making stage—which raises questions about its compatibility with the original constitutional design.[19] By grafting state regulators into the federal process, Congress intended for this new federal regulator to draw upon a reservoir of state-level knowledge to improve the Council's decision-making processes and minimize friction with state regulators—so that the Council's final actions reflect a collaborative effort between the nation's top experts at both the federal and state level.[20]

But looking back over the first decade of the Council's operations, this experiment in federalism often failed to work as Congress intended. The agency immediately took steps to minimize the state regulators' role.[21] When the Council designated insurance firms like Prudential and MetLife as "too big to fail"[22]—

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[13] Dodd-Frank Act § 111(b)(2).
[14] *Id.* § 111(d), (g).
[15] *See infra* text accompanying notes 52–54.
[16] *See e.g.*, Daniel A. Lyons, *Protecting States in the New World of Energy Federalism*, 67 EMORY L.J. 921, 928 (2018).
[17] Philip J. Weiser, *Towards a New Constitutional Architecture for Cooperative Federalism*, 79 N.C. L. REV. 663, 665 (2001).
[18] *See* Jessica Bulman-Pozen & Heather K. Gerken, *Uncooperative Federalism*, 118 YALE L.J. 1256, 1258 (2009).
[19] *See infra* Section II.B.1.
[20] *See* 156 CONG. REC. 7672 (2010) (statement of Sen. Susan Collins) ("I think those State regulators should be brought on to the council . . . . What we want is a council with as broad an overview as possible, bringing together everyone who has a role so we do not have these regulatory gaps, these black holes developing in the future, and so that we can bring the collective wisdom of these officials to the table.").
[21] *See infra* text accompanying notes 233–51.
[22] Fin. Stability Oversight Council, Basis for the Financial Stability Oversight Council's Final Determination Regarding Prudential Financial, Inc. (Sept. 19, 2013) [hereinafter Prudential Decision], https://www.treasury.gov/initiatives/fsoc/designations/documents/prudential%20

stepping confidently into an industry that was historically the prerogative of the states—its decisions proved controversial and came over the objection of the Council's state insurance regulators.[23] Ultimately, the D.C. district court vacated the Council's *MetLife* decision, citing the very same arguments pressed earlier by state regulators and leading the Council to abandon its insurance regulations.[24]

Thus, the Council's insurance decisions reflect not the collaborative consensus of cooperative federalism, but a more discordant process in which state regulators used their position within the federal scheme to resist decisions with which they disagreed—a phenomenon that Jessica Bulman-Pozen and Heather Gerken have dubbed "uncooperative federalism."[25] While the work to date on uncooperative federalism focuses on the states' role in carrying out federal mandates, the Council demonstrates that states achieve many of the same advantages when embedded in the initial process of formulating those mandates.[26] Written opinions by the state insurance regulator members (and the dissenting opinion by Independent Member Roy Woodall, a former state insurance regulator) placed important concerns into the Council's official record and laid the groundwork for eventual reversals of the Council's insurance designation decisions.[27]

This Article will critically examine the role that state regulators could and did play during the Council's first decade of deliberations and explore the ramifications of this experience for theories of cooperative and uncooperative federalism. Part I will examine the Council's structure and the myriad ways, both obvious and subtle, that state regulators could influence Council deliberations. Part II will discuss why Congress included state regulators in the Dodd-Frank Act, analyzing the benefits that legislators hoped to achieve by giving states a seat at the federal table and the concerns about the undue influence granted to the intergovernmental lobby as a result of this structure. Part III will show how the Council's actual experience fell short of legislators' hopes by chronicling the Council's efforts to identify and mitigate systemic risk in the insurance sector. Part IV will examine this interaction between the Council's state and federal officials

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financial%20inc.pdf [perma.cc/C869-QUKA]; Fin. Stability Oversight Council, Basis of the Financial Stability Oversight Council's Final Determination Regarding MetLife, Inc. (Dec. 18, 2014) [hereinafter MetLife Decision], http://www.treasury.gov/initiatives/fsoc/designations/Documents/MetLife%20Public%20Basis.pdf [perma.cc/P5TF-8WDQ].

[23] Fin. Stability Oversight Council, View of Director John Huff, the State Insurance Commissioner Representative on the Council's Final Determination Regarding Prudential Financial, Inc. (Sept. 19, 2013) [hereinafter Huff Prudential Dissent], https://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/September%2019%202013%20Notational%20Vote.pdf [perma.cc/R3MW-FXU9]; Fin. Stability Oversight Council, View of Adam Hamm, the State Insurance Commissioner Representative on the Council's Final Determination Regarding MetLife, Inc. (Dec. 18, 2014) [hereinafter Hamm MetLife Dissent], https://www.treasury.gov/initiatives/fsoc/designations/Documents/Dissenting%20and%20Minority%20Views.pdf [perma.cc/6T4C-DQBY].

[24] *See infra* Section III.C.1.

[25] Bulman-Pozen & Gerken, *supra* note 18, at 1259.

[26] *See infra* Parts III–IV.

[27] *See infra* Part III.

through the lens of uncooperative federalism, showing how state regulators ultimately succeeded in preventing the Council from regulating the insurance industry despite having no vote on Council decisions. It will also show how the story of the Financial Stability Oversight Council's foray into insurance advances our understanding of the "administrative safeguards of federalism."[28]

I. THE FINANCIAL STABILITY OVERSIGHT COUNCIL AND THE ROLE OF THE STATES

A. *The Council's Mission and Composition*

Congress created the Financial Stability Oversight Council to fill gaps in the financial regulatory scheme that may have contributed to the 2008 financial crisis.[29] The Dodd-Frank Act ("the Act") tasks the Council with monitoring the financial system as a whole, by bringing regulators together at least quarterly to discuss the general stability of the financial system outside of the myopic confines of their daily responsibilities.[30] One article has aptly described the body as "a financial uber-regulator" tasked with identifying and mitigating systemic risk in the American economy.[31]

The Act charges the Council with three primary responsibilities. First, it is to "identify risks to the financial stability of the United States" that could arise from large bank holding companies, nonbank financial companies, or other entities outside the financial services marketplace.[32] Second, the Council should "promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties . . . that the Government will shield them from losses in the event of failure."[33] And finally, the body is tasked with a general duty to "respond to emerging threats to the stability of the United States financial system."[34]

To fulfill these mandates, the Act grants the Council with a wide range of duties and powers, which in turn can also be classified into three general categories. The first is information gathering and sharing, a category that includes collecting data from member agencies and regulated entities, facilitating information sharing and coordination among federal and state regulators, and directing the Office of Financial Research (a new, permanent data-gathering and analysis office housed within the Treasury Department and staffed by financial

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28 Bulman-Pozen & Gerken, *supra* note 18, at 1285; *see also* Stuart Minor Benjamin & Ernest A. Young, *Tennis with the Net Down: Administrative Federalism Without Congress*, 57 DUKE L.J. 2111, 2145 (2008).
29 *See, e.g.*, Murphy & Bernier, *supra* note 8, at 1.
30 *Id.* at 7.
31 Levitin et al., *supra* note 7, at 163.
32 Dodd-Frank Act, Pub. L. No. 111-203, § 112(a)(1)(A), 124 Stat. 1376 (2010).
33 *Id.* § 112(a)(1)(B).
34 *Id.* § 112(a)(1)(C).

experts to support the Council's deliberations).[35] The second and most prominent duty could be called supervision and regulation, which includes designating which firms are systemically important and subjecting them to oversight by the Federal Reserve, recommending prudential standards that the Federal Reserve should use to evaluate banks and systemically important nonbank firms, suggesting that regulators adopt new or more stringent standards, and deciding whether a particular nonbank firm should be liquidated by the Federal Deposit Insurance Corporation rather than through a bankruptcy court.[36] Finally, the Council plays a coordinating role among financial regulators, not only by providing a forum to discuss issues but also by formally resolving jurisdictional disputes among member agencies.[37]

As indicated above, the Council's ten voting members comprise a veritable who's who of federal financial regulation. This list includes heads of the following agencies:

- Department of the Treasury
- Federal Reserve Board
- Office of the Comptroller of the Currency
- Consumer Financial Protection Bureau (CFPB)
- Securities and Exchange Commission
- Federal Deposit Insurance Corporation
- Commodity Futures Trading Commission
- Federal Housing Finance Agency
- National Credit Union Administration[38]

The Council also includes an Independent Member with Insurance Expertise as a voting member, who is appointed by the President to a six-year term with the advice and consent of the Senate.[39] The Secretary of the Treasury serves as the Chairperson of the Council, a position with substantial influence over the Council's deliberations.[40]

To help inform the Council's deliberations, the Act also provides for five subject-matter experts to participate as nonvoting members. The first of these is

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35 *Id.* § 112(a)(2).

36 *Id.* §§ 113, 115, 120.

37 *Id.* § 119.

38 *Id.* § 111(b)(1).

39 *Id.* § 111(b)(1)(J), (c)(1). This position is currently filled by Thomas Workman, an insurance lawyer and former president and CEO of Life Insurance Council of New York, Inc. He was appointed in 2018 to succeed Roy Woodall, a former Kentucky state insurance commissioner and former chief counsel for state relations for the American Council of Life Insurers.

40 *Id*. § 111(b)(1)(A). As David Skeel has noted, the choice of the Treasury Secretary to chair the Council is curious, as the Treasury Department is the only executive branch agency on the Council; the other agencies are largely independent agencies that are somewhat insulated from White House control. This structure raises questions about the Council's ability to be independent of political pressure in the event of a crisis. *See* Skeel, *supra* note 3, at 12 ("Because the Treasury secretary is directly responsible to the President, he is the least independent, and the most political, of the financial regulators. Yet the Treasury secretary is given leadership responsibility on the new Financial Stability Oversight Council and in other areas.").

the Director of the afore-mentioned Office of Financial Research, who (like the Independent Member with Insurance Expertise) is appointed by the President to a six-year term with the advice and consent of the Senate.[41] This list also includes the Director of the Federal Insurance Office (FIO), a position appointed by the Treasury Secretary.[42] Rounding out the list, the Council also includes a state insurance commissioner, a state banking supervisor, and a state securities commissioner, all of whom are elected by their fellow state regulators.[43]

B. State Influence on Council Decision-Making

The Dodd-Frank Act creates at least three opportunities for state officials to have a direct and systemic impact on the Council's deliberations. The first and most obvious is the three state regulators appointed to the Council.[44] While these members do not vote on Council matters, the Act makes clear that they "shall not be excluded from any of the proceedings, meetings, discussions, or deliberations of the Council."[45] The only exception is if exclusion is "necessary to safeguard and promote the free exchange of confidential supervisory information," whereupon the Chairperson may exclude a nonvoting member if a majority of the member agencies concur.[46]

The Act also allows the Council to appoint any special advisory, technical, or professional committee as "may be useful in carrying out the functions of the Council."[47] Congress explicitly clarified that this authority includes the power to appoint "an advisory committee consisting of State regulators."[48] Importantly, the Act exempts the Council and any committees established under this section from compliance with the Federal Advisory Committee Act,[49] a "Sunshine Act" for advisory committees that requires, among other things, that committee meetings be open to the public, that notice of meetings be published in the Federal

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41 Dodd-Frank Act § 152(b)(1).
42 *Id.* § 502. This position is currently held by Steven Seitz, who served as deputy director under inaugural director Michael McRaith, a former Illinois state insurance commissioner.
43 *Id.* § 111(b)(2).
44 *Id.*
45 *Id.* § 111(b)(3).
46 *Id.* The Council's bylaws also require a member to disqualify himself or herself in the event that the member has, or appears to have, a financial conflict of interest or appearance of partiality, the latter of which is defined as participation in a proceeding that has a financial effect on the council member's household or that involves certain defined relationships. *See* Rules of Organization of the Financial Stability Oversight Council, § XXX.9 (Oct. 1, 2010) [hereinafter Council Bylaws] http://www.treasury.gov/initiatives/Documents/FSOCbylaws.pdf [perma.cc/4BW8-PHX6].
47 Dodd-Frank Act § 111(d).
48 *Id.*
49 *Id.* § 111(g).

Register, and that detailed minutes of each meeting be kept and made available to the public.[50]

Finally, the two insurance positions present yet another, more subtle, way that state regulators might influence the Council. The Act contemplates that both the voting Independent Member and the nonvoting Federal Insurance Office Director have prior experience in the insurance industry.[51] Because the bulk of insurance regulation occurs at the state level, state regulators comprise an attractive pool from which to fill these positions. And indeed, the first official appointed to each position was a former state insurance regulator. Independent Member Roy Woodall was a former Kentucky state insurance commissioner who highlighted his decade of experience in the Kentucky Insurance Department in his opening remarks as a nominee.[52] Similarly, FIO Inaugural Director Michael McRaith was actively serving as Illinois Insurance Director when Treasury Secretary Tim Geithner appointed him to the federal position in 2011.[53] Unlike the nonvoting state regulator members, neither Woodall nor McRaith held state office concurrently with their federal duties, though both could draw upon their perspectives as former state regulators when participating in Council deliberations. (It is also worth noting that while, by custom, a state regulator will typically resign his or her position upon assuming federal office, as Director McRaith did—and some states require it—there is no federal constitutional prohibition on an official holding federal and state regulatory appointments simultaneously.)[54]

By integrating state regulators into the Council structure, the Dodd-Frank Act gives states potentially significant influence over federal financial regulation decisions.[55] Commentators have criticized the Dodd-Frank Act for refusing to make important policy judgments about how the financial industry should be

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50 Federal Advisory Committee Act, Pub. L. No. 92-463, § 10, 86 Stat. 770, 770 (1972) (codified as amended at 5 U.S.C. app.). The Federal Advisory Committee Act was passed in 1972 in response to criticism that the advisory committee process was wasteful and abused by special interests seeking access to agencies or the executive; *see, e.g.*, Pub. Citizen v. U.S. Dep't of Just., 491 U.S. 440, 453 (1989).

51 Dodd-Frank Act § 111(b)(1)(J).

52 *Financial Stability Oversight Council Nominations Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 112th Cong. 321 (2011).

53 *See* Arthur D. Postal, *McRaith to Lead FIO*, THINKADVISOR (Mar. 17, 2011, 8:00 PM), http://www.thinkadvisor.com/2011/03/17/mcraith-to-lead-fio [perma.cc/M7HU-3BE6]. McRaith stepped down at the end of the Obama administration. He was succeeded by Steve Dreyer, who served for five months in 2018 before resigning and being replaced by Steve Seitz. Both successors had prior experience in the insurance industry but unlike McRaith were not former state regulators.

54 *See* Steven G. Calabresi & Joan L. Larsen, *One Person, One Office: Separation of Powers or Separation of Personnel?*, 79 CORNELL L. REV. 1045, 1047 (1994) (noting that the Constitution does not prohibit one from holding federal and state office simultaneously, and that the founders may in fact have favored the practice, but that a strong norm against it has developed over time).

55 *Cf.* Bulman-Pozen & Gerken, *supra* note 18, at 1268–69 (noting that "integration" of state officials into federal policymaking can give states leverage to effect change by opting out of, or otherwise resisting, enforcement).

regulated, instead punting those difficult questions to agencies that the Act created or strengthened.[56] The Financial Stability Oversight Council acts as a coordinator of these efforts, endowed with considerable authority to make recommendations to these agencies regarding how best to carry out their duties.[57] Among other duties, the Council is charged to:

> facilitate information sharing among . . . Federal and State agencies regarding domestic financial services policy development, rulemaking . . . and enforcement actions;
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> recommend to the member agencies general supervisory priorities and principles . . . ;
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> . . . .
>
> require supervision by the Board of Governors [of the Federal Reserve] for nonbank financial companies that may pose risks to the financial stability of the United States . . . ;
>
> make recommendations to the [Federal Reserve] concerning the establishment of heightened prudential standards for . . . [oversight] for [systemically important] nonbank financial companies and . . . bank[s] . . . ;
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> . . . .
>
> make recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks . . . [in the] financial markets;
>
> review and, as appropriate, . . . submit comments to the [Securities and Exchange] Commission and any standard-setting body with respect to . . . accounting principle[s].[58]

Although the state regulator members lack a vote on Council actions, the Act mandates that they are otherwise to be treated as equal participants in Council discussions.[59] Under the Council's bylaws, the chairperson must consult regularly with all members, voting and nonvoting alike.[60] And the Council must meet at least quarterly,[61] ensuring that the states, through their appointed regulators, have regular input into some of the most significant regulatory questions in the financial sector.

This routine representation has important implications for the division of authority between the federal government and the states. As Larry Kramer observes, "states have been able to use their position in the administrative system to protect state institutional interests," a process he describes as one of the modern-day political safeguards of federalism.[62] Like many other agencies, the

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[56] *See, e.g.*, Kimberly D. Krawiec, *Don't 'Screw Joe the Plumber': The Sausage-Making of Financial Reform*, 55 ARIZ. L. REV. 53, 54–59 (2013) (examining the comments received by the Council in connection with its efforts to implement the Volcker Rule and the ways in which policymaking devolves to the agencies under Dodd-Frank).

[57] *See, e.g.*, Dodd-Frank Act, Pub. L. No. 111-203, § 112(a)(2), 124 Stat. 1376, 1376 (2010).

[58] *Id.* § 112(a)(2)(E)–(L).

[59] *Id.* § 111(b)(3).

[60] *See* Council Bylaws, *supra* note 46, § XXX.3(a)(1).

[61] *Id.*; *see also* Dodd-Frank Act § 111(e).

[62] Larry D. Kramer, *Putting the Politics Back into the Political Safeguards of Federalism*, 100 COLUM. L. REV. 215, 283 (2000). Roderick Hills has noted that this camaraderie could go too

Council has the potential to significantly affect state law by recommending areas where federal agencies could preempt state authority or enlisting states to help carry out federal mandates.[63] The nonvoting member seats give state interests a direct input into these questions, ensuring at a minimum that the Council is fully informed of the states' perspectives on issues with federalism implications.[64]

But the influence of these state members potentially stretches beyond the Council's official business. The Council also provides a forum through which state regulatory officials regularly interact with the federal government's most important financial policymakers. State regulators who participate on the Council build a rapport with these officials, giving them the opportunity to advocate on behalf of state interests even on matters not formally before the Council.[65]

One might argue this influence is tempered by the two-year term for the state regulator nonmembers, which is considerably less than most other Council members.[66] But for state regulators, informal ties developed with federal policymakers during their service on the Council may remain valuable even after they step down. In that sense, the two-year limit may be advantageous to states, as it increases the number of state regulators who have the opportunity to develop lasting relationships with their federal counterparts.

Thus, through the Financial Stability Oversight Council, Congress gave state regulators a significant voice in the regulatory overhaul of the financial sector that the Dodd-Frank Act was meant to instigate. The next Part discusses Congress's motivation for doing so: Why were state regulators added to the Council, and what were the potential benefits and risks of this innovative form of cooperative federalism?

II. THE HOPES AND FEARS OF THE DODD-FRANK ACT'S COOPERATIVE

far if state bureaucrats feel such a kinship to their federal counterparts over time that they effectively shift allegiance from the state to the federal regime. He dubs this "picket-fence federalism." Roderick M. Hills, Jr., *The Eleventh Amendment as Curb on Bureaucratic Power*, 53 STAN. L. REV. 1225, 1227 (2001). The picket fence metaphor assumes the horizontal flats on the fence represent the various levels of government, and the vertical posts represent bureaucrats. The metaphor is meant to suggest that the federal and state "posts" often "share more in common with each other than they do with the level of government by which they are employed." *Id.*

63 *See, e.g.*, Adam Levitin, *The Consumer Financial Protection Bureau: An Introduction*, 32 REV. BANKING & FIN. L. 321, 353 (2013) (noting that the Council can veto proposed rulemakings by the Consumer Financial Protection Bureau, which could otherwise preempt state law).

64 *See, e.g.*, Opinion, *In Washington, Every Problem Is a Bank*, WALL ST. J., (Aug. 28, 2013, 6:25 PM) https://www.wsj.com/articles/SB10001424127887324591204579039221557807450 [perma.cc/2ZN2-BSFH] (discussing state insurance commissioner member John Huff's advice to the Council during his term).

65 *See* Bulman-Pozen & Gerken, *supra* note 18, at 1268–69 ("When an actor is embedded in a larger system, a web of connective tissues binds higher- and lower-level decisionmakers. Regular interactions generate trust and give lower-level decisionmakers the knowledge and relationships they need to work the system.").

66 Dodd-Frank Act § 111(c)(1).

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It was not obvious that Congress would explicitly make such a prominent opportunity for state regulators on a council designed to regulate the nation as a whole. Indeed, the Dodd-Frank Act was designed to cure perceived deficiencies in state-level regulation in the years leading up to the Great Recession, particularly in the realms of consumer protection and insurance that were traditionally prerogatives of the states.[67] The Senate Committee Report explained that the Consumer Financial Protection Bureau was necessary because the pre-Dodd-Frank "system of consumer protection suffer[ed] from a number of serious structural flaws that undermine[d] its effectiveness."[68] And the Federal Insurance Office was created because the 2008 bailout of prominent insurer American International Group (AIG) suggested that state insurance regulators lacked the perspective to manage systemic risk.[69]

At the same time, Congress recognized that state regulators could be instrumental in helping solve the problems that Dodd-Frank sought to fix. For example, the same Senate Report recognized that many states did attempt to tighten up consumer lending through more aggressive anti-predatory lending laws, only to find those efforts stymied by federal preemption.[70] And other than AIG, most insurance companies weathered the 2008 financial crisis without the significant turmoil that befell subprime lending, investment banks, depository institutions, and other distressed segments of the financial sector.[71] As Patricia McCoy explains, "With one exception, insurance seemed to remain the sleepy and unglamorous outpost of financial services it had always been in recent years."[72]

A. Benefits of Dodd-Frank's Cooperative Federalism

With respect to the Financial Stability Oversight Council in particular, the inclusion of the state regulators as nonvoting members represented a conference-committee compromise between the House and Senate versions of the bill.[73] The original House bill included state insurance and banking regulators as nonvoting members.[74] It was later amended to add a state securities commissioner and the Director of the Federal Insurance Office, and additional language was added to clarify that they "shall not be excluded from any of the Council's proceedings,

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[67] McCoy, *supra* note 11, at 1394.
[68] S. REP. NO. 111-176, at 10 (2010).
[69] McCoy, *supra* note 11, at 1401.
[70] S. REP. NO. 111-176, at 16; *see* Arthur E. Wilmarth, Jr., *The Dodd-Frank Act's Expansion of State Authority to Protect Consumers of Financial Services*, 36 J. CORP. L. 893 (2011).
[71] McCoy, *supra* note 11, at 1401.
[72] *Id.*
[73] *See* Gillian E. Metzger, *Federalism Under Obama*, 53 WM. & MARY L. REV. 567, 586–87 (2011).
[74] H.R. 4173, 111th Cong. § 1001(b)(1) (as introduced, Dec. 2, 2009), https://www.congress.gov/111/bills/hr4173/BILLS-111hr4173ih.pdf [perma.cc/FF6C-659X].

meetings, discussions, and deliberations."[75] But the Senate version of the bill lacked these provisions[76] despite lobbying from state interest groups.[77] The Conference Committee used the Senate's bill as the base text, but later added back the nonvoting members in the final language.[78]

While the legislative history on this issue is sparse, the few breadcrumbs suggest that Senator Susan Collins may have helped keep the state members on the Council. Collins herself served for five years as Commissioner of Maine's Department of Professional and Financial Regulation before being elected to federal office, and touted this prior experience while playing an active role in the bill's final passage.[79] During Senate deliberations, she and Senator Patty Murray co-sponsored an amendment that would have added the state members to the Senate version of the bill, but the amendment was tabled without a vote.[80] This amendment, and her statement in support,[81] suggests that she was vested in the idea of maintaining a state voice on the Council. She was also one of few Republicans willing to cross the aisle to support the Act, which gave her significant influence over the final draft.[82] Fortune Magazine reported at the time that "[a]lthough she is not one of the conference committee members negotiating the final package, Collins is masterfully playing herself as the key vote to get reform done."[83] Given her background and her statements before the Senate, it is possible her support helped get the nonvoting members language into the final compromise bill.

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75 H.R. 4173, 111th Cong. § 111(b)(2) (2009), https://www.congress.gov/111/bills/hr4173/BILLS-111hr4173eh.pdf [perma.cc/KXW7-9W27].

76 S. 3217, 111th Cong. § 111(b)(2) (2010); H.R. 4173, 111th Cong. § 111(b)(2) (as amended by the Senate, May 20, 2010), https://www.congress.gov/111/bills/hr4173/BILLS-111hr4173eas.pdf [perma.cc/SDF4-Q47F]. The Senate bill did provide for the Director of the Office of Financial Research to participate *ex officio*.

77 The National Association of Insurance Commissioners lobbied the Senate to include an active state insurance regulator as a voting member on the Council, but it was unsuccessful. *See*, Letter from Jane L. Cline et al., Nat'l Ass'n of Ins. Comm'rs Bd., to Senators regarding Restoring American Financial Stability Act of 2010 (April 20, 2010) (available at https://www.naic.org/documents/testimony_100420_rafsa.pdf [perma.cc/TP4A-R24U]).

78 Dodd-Frank Act, Pub. L. No. 111-203, § 111(b)(2), 124 Stat. 1376 (2010). As Gillian Metzger notes, the Senate bill also included a more powerful Office of National Insurance, which suggests a desire for the Council to play a more active role in insurance regulation. Metzger, *supra* note 73, at 586 n.94. This was replaced in conference with the weaker Federal Insurance Office.

79 *See* Anna Palmer, *How Susan Collins Became the Key to Financial Reform*, FORTUNE (June 25, 2010, 9:18 AM), https://archive.fortune.com/2010/06/25/news/susan_collins_financial_reform.fortune/index.htm [perma.cc/5EVP-ALBW].

80 *See* S.A. 3754, 111th Cong., 156 CONG. REC. 6938–39 (2010).

81 156 CONG. REC. 8193 (2010) (statement of Sen. Susan Collins).

82 Ultimately Collins and fellow New England Republicans Olympia Snowe and Scott Brown were the only three Republicans to support the bill in the Senate.

83 *See* Palmer, *supra* note 79.

When discussing her amendment, Collins cited two rationales supporting the integration of state regulators into the Council,[84] both of which would sound familiar to federalism scholars: expertise and local knowledge.[85]

1. Expertise

As the Council was charged with conducting detailed analyses of financial risks in the banking, securities, and insurance sectors, Congress wanted to make sure it could draw upon the expertise of state regulators with accumulated experience overseeing these sectors.[86] Senator Collins noted that state regulators "play such a critical role" in regulating these fields and that the bill should "bring the collective wisdom of these officials to the table" when deliberating.[87]

Of course, the expertise that state regulators could bring vis-à-vis their federal counterparts varied. For instance, in banking, the industry over which the Council has the most oversight, federal and state regulators have shared regulatory authority since at least 1933.[88] State-chartered banks are subject to significant state banking regulations and oversight by the Federal Reserve Board, while federally chartered banks are regulated and overseen by the Office of the Comptroller of the Currency.[89] This shared regulatory authority has not always translated to peaceful coexistence: as hinted above, state and federal banking regulators famously clashed over the enforcement of state predatory lending prohibitions in the years leading up to the financial crisis, leading to mixed results in the Supreme Court.[90] The Dodd-Frank Act sided with the states in these disputes and restricted the Comptroller's ability to preempt state law.[91] The Senate Report on the Act strongly suggests that Congress felt that state regulators deserved a stronger voice than they had before the Act was passed.[92]

Securities regulation is similarly divided between the federal government and the states, although in recent years the state's role has been significantly

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[84] 156 CONG. REC. 8193 (2010) (statement of Sen. Susan Collins).

[85] *See, e.g.*, Lyons, *supra* note 16, at 958–61 (discussing expertise and local knowledge); Daniel A. Lyons, *Federalism and the Rise of Renewable Energy: Preserving State and Local Voices in the Green Energy Revolution*, 64 CASE W. RSRV. L. REV. 1619, 1652 (2014) (discussing local knowledge in context of optimal energy policy).

[86] *See, e.g.*, 156 CONG. REC. 8193 (2010) (statement of Sen. Susan Collins).

[87] *Id.* at 7671–72.

[88] *See* Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.).

[89] *Are All Commercial Banks Regulated and Supervised by the Federal Reserve System, or Just Major Commercial Banks?*, FED. RSRV. BANK S.F., https://www.frbsf.org/education/publications/doctor-econ/2006/november/commercial-banks-regulation/ [perma.cc/89WT-8FJE].

[90] Cuomo v. Clearing House Ass'n, 557 U.S. 519, 536 (2009) (rejecting OCC claim that National Bank Act preempts states from enforcing state banking laws against national banks); Watters v. Wachovia Bank, N.A., 550 U.S. 1, 21 (2007) (holding National Bank Act preempts state laws regulating state subsidiaries of national banks engaged in real estate lending); *see* Metzger, *supra* note 73, at 583; *see also* Wilmarth, *supra* note 70, at 896.

[91] Metzger, *supra* note 73, at 583.

[92] S. REP. NO. 111–176, at 76 (2010).

circumscribed. Congress enacted the 1933 and 1934 Securities Acts to create a uniform system of national regulation supplemented by pre-existing state securities laws.[93] While federal and state regulators coexisted side by side for several decades, Congress began preempting state securities laws in the mid-1990s, particularly regarding securities registration and litigation of fraud claims.[94] By 2002, "it would be most descriptively accurate to say that federal securities law has occupied the securities field and that state law development has been marginal,"[95] although the years immediately preceding the economic crisis saw a renewed effort by some states to enforce consumer protection statutes against major players.[96]

By comparison, insurance law has been regulated primarily by the states.[97] Since 1945, the McCarran-Ferguson Act placed insurance regulation squarely in state regulators' hands by adopting a reverse-preemption provision that prohibits the federal government from invalidating, impairing, or superseding state insurance laws unless the federal law "specifically relates to the business of insurance."[98] While commentators advocated for a stronger federal presence as markets became more intertwined and risk grew more complex,[99] those pleas largely fell on deaf ears until the Dodd-Frank Act.[100] And even the Act itself seems content to adjust jurisdiction only at the margins: it potentially subjects to the Council's jurisdiction large insurance companies like AIG, whose failure might pose a systemic risk to the economy, and establishes a Federal Insurance Office to gather information, but otherwise leaves the insurance industry intact.[101] The Conference Committee rejected a provision in the Senate version of the bill that would have created a stronger National Insurance Office with explicit authority to preempt some state insurance laws.[102] Even the Federal Insurance Office's

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93 *See* Jones, *supra* note 11, at 111–12.

94 *Id.* at 114–15.

95 ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION 2 (2002).

96 *See* Jones, *supra* note 11, at 115.

97 Robert H. Jerry, II & Steven E. Roberts, *Regulating the Business of Insurance: Federalism in an Age of Difficult Risk*, 41 WAKE FOREST L. REV. 835, 837–40, 878 (2006).

98 McCarran-Ferguson Act, 15 U.S.C. §§ 1011–15; *see* McCoy, *supra* note 11, at 1394.

99 *See, e.g.*, Jerry & Roberts, *supra* note 97, at 837.

100 "Apart from . . . limited federal incursions, the states succeeded brilliantly in fending off federal encroachment in insurance regulation through 2010." McCoy, *supra* note 11, at 1396.

101 As discussed in greater detail below, the designation of larger insurers as systemically important financial institutions subject to Council oversight could be the proverbial camel's nose under the tent for federal insurance regulation. *See id.* at 1393 ("In short, systemic risk regulation by the federal government . . . is a game changer. It is likely to transform the locus of insurance regulation both in ways that are predictable and others that are not. Yet the larger implications of this change for continued state dominance in insurance regulation are not well recognized. To that extent, federal oversight of systemic risk in insurance has the stealth potential to affect the insurance industry by imposing certain federal regulatory standards industry wide.").

102 *See* H.R. 4173, 111th Cong. § 502 (as amended by the Senate, May 20, 2010).

own mission statement recognized that "[i]nsurance is primarily regulated by the individual States."[103]

Thus, while federal regulators have varying levels of experience regulating the three primary industries falling under the Council's purview, state regulators have continuously operated in areas not preempted by federal law and have developed expertise that federal regulators lack. That expertise is particularly valuable given the fact that in all three fields, state regulators were actively pursuing enforcement actions in the years leading up to the crisis, sometimes in the face of opposition from their federal counterparts.[104] In all three industries, the states' experience would help inform the Council's perspective on systemic risk. In the insurance industry, the state perspective is critical, while in securities and banking it appears more complementary to that of federal regulators.

2. Local Knowledge

The other advantage that state regulators bring to the Council is local knowledge. State regulators are responsible for a smaller constituency than their federal counterparts, which puts them in a better position to know and respond to local needs.[105] Barry Friedman notes that state representatives "ought to look their constituents in the eye on the street and see them in the grocery store."[106] While this vignette may be a bit exaggerated when applied to state financial regulators, the larger point remains that state officials are better informed of the unique needs of their constituents.[107]

By sharing this local knowledge with the Council, state regulators can achieve two related goals. First, it can make the Council aware of issues that are of particular importance to that state's population but are not shared with the population as a whole. Because federal regulators have their gaze fixed at the national level, they are unlikely to notice the idiosyncratic needs of only a portion of the marketplace. By giving state regulators a seat at the table, the Act provides a conduit by which that local knowledge could flow up from individual state regulators through their designated representatives to be shared with their national counterparts.[108]

Second, a state regulator can inform the Council of trends that are developing on the state level but are not yet widespread enough to demand a national

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[103] *See* Randy Gray, *One Click is Enough: Satisfying FDA's Fair Balance in the Highly-Regulated Marketplace*, 39 RUTGERS COMP. & TECH. L.J. 95, 95, 118 n.126 (2013) (quoting Federal Insurance Office Mission Statement).

[104] *See supra* text accompanying notes 90–92, 96; *see also* S. REP. NO. 111–176, at 16 (2010).

[105] *See* Ernest A. Young, *The Rehnquist Court's Two Federalisms*, 83 TEX. L. REV. 1, 59 (2004).

[106] Barry Friedman, *Valuing Federalism*, 82 MINN. L. REV. 317, 395 (1997).

[107] Daniel A. Lyons, *Technology Convergence and Federalism: Who Should Decide the Future of Telecommunications Regulation?*, 43 U. MICH. J.L. REFORM 383, 424 (2010).

[108] *Id.*

regulator's attention. Senator Collins referred to this insight when calling for the state regulators to be added to the Council:

> State banking, insurance, and securities regulators are on the front lines of financial regulation and therefore have information and perspectives that are necessary components of an effective regulatory structure. State regulators could act as "first responders" to the Council, in that they see trends developing at the State level. They could serve as an early warning system, identifying practices and risk-related trends that are substantial contributing factors to systemic risk.[109]

The ability to identify signs foreshadowing impending danger, like the proverbial canary in the coal mine, is of tremendous value to a body whose task is to gather information on potential risks to the national economy. In terms of both expertise and local knowledge, the Financial Stability Oversight Council would, at least in theory, benefit from the participation of state regulators as nonvoting members.

B. *Potential Concerns*

Not everyone agreed, however, that integrating state regulators within the decision-making organ of a federal agency is wise or permissible.[110] The Dodd-Frank Act included a variety of creative new legislative solutions and administrative structures, which prompted numerous questions—and lawsuits—about whether Congress had stretched beyond what was permissible or prudent.[111] The Financial Stability Oversight Council was not immune from this phenomenon.[112] One might put the various objections to the Council in two buckets: formalist and functionalist concerns. The two buckets have different methodologies, but both lines of inquiry point to the same basic concern, namely the potential that states have too much influence over a federal decision-making body.

1. *States and the Appointment Power*

The formalist challenge to the Financial Stability Oversight Council involves the method by which the state regulators are appointed.[113] The Dodd-

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[109] 156 CONG. REC. 8193 (2010) (statement of Sen. Susan Collins).

[110] *See, e.g.*, Anne Joseph O'Connell, *Bureaucracy at the Boundary*, 162 U. PENN. L. REV. 841, 904 (2014) (discussing concerns); State Nat'l Bank of Big Spring v. Lew, 958 F. Supp. 2d 127, 136–39 (D.D.C. 2013), *aff'd in part & rev'd in part*, 795 F.3d 48 (D.C. Cir. 2015) (raising Appointments Clause challenge).

[111] *See, e.g.*, Seila Law LLC v. Consumer Fin. Prot. Bureau, 140 S. Ct. 2183 (2020) (finding structure of Bureau, created by Dodd-Frank Act, violated separation of powers); Thomas W. Merrill & Margaret L. Merrill, *Dodd-Frank Orderly Liquidation Authority: Too Big for the Constitution?*, 163 U. PENN. L. REV. 165, 173 (2014). *See generally* Arielle Rabinovitch, *Constitutional Challenges to Dodd-Frank*, 58 ANTITRUST BULL. 635 (2013) (collecting arguments and cases).

[112] *See* O'Connell, *supra* note 110, at 904.

[113] It is worth noting that there may be a separate Appointments Clause issue about the Dodd-Frank Act's decision to expand the duties of existing federal officers. When the Treasury Secretary, the Federal Reserve Board chairman, and the other voting members were appointed to

Frank Act contemplates that the three state regulatory members will be chosen by their peers to serve a two-year period on the Council.[114] In practice, this appointment power has fallen on three organizations whose primary purpose is to represent their member state regulators at the national level: the North American Securities Administrators Association, the Conference of State Bank Supervisors, and the National Association of Insurance Commissioners.[115] This unusual process at least raises questions about whether the statute is compatible with the Appointments Clause, which requires that all principal officers be selected by the President with the advice and consent of the Senate.[116] This claim was brought as part of a wholesale attack on the legality of the Dodd-Frank Act in *State National Bank of Big Spring v. Geithner*,[117] though the court dismissed the claim for lack of standing without reaching the merits.[118]

At first glance, this seems an unusual line of attack, as the Appointments Clause is often classified as a bulwark protecting the separation of powers between the executive and legislative branches.[119] This typology is not surprising, given that many significant cases interpreting the Clause have involved congressional attempts to usurp the appointment power to itself. For example, the landmark Appointments Clause case *Buckley v. Valeo*[120] invalidated a law that vested the appointment of four Federal Election Commission members in the President

their positions with the advice and consent of the Senate, they were appointed to fulfill specific agency responsibilities and were judged based upon their fitness for those positions. The Dodd-Frank Act dramatically expanded each voting member's responsibilities by adding to their portfolios the additional duties that come with being a member of the Council. The Supreme Court has held that if Congress creates enough additional duties or authority for an officer as to effectively create a new office, the officeholder must be reappointed and reconfirmed. *See, e.g.*, Weiss v. United States, 510 U.S. 163, 173–74 (1994); Shoemaker v. United States, 147 U.S. 282, 301 (1893). *See generally* Matthew Hunter, Note, *Legislating Around the Appointments Clause*, 91 B.U. L. REV. 753, 764–65 (2011). This analysis, which turns on whether the new duties are "germane" to the officer's preexisting commitments, lies beyond the scope of this Article.

114 Dodd-Frank Act, Pub. L. No. 111-203, § 111(b)(2), 124 Stat. 1376, 1392–93 (2010) (codified as 12 U.S.C. § 5321(b)(2)).

115 *See, e.g.*, *State Regulators Announce Representatives for the Financial Stability Oversight Council*, NORTH AM. SEC. ADM'RS ASS'N (Sept. 23, 2010), http://www.nasaa.org/1520/state-regulators-announce-representatives-for-the-financial-stability-oversight-council/ [perma.cc/Z963-2NSU].

116 U.S. CONST. art. II, § 2, cl. 2; *see* O'Connell, *supra* note 110, at 904.

117 *See* Complaint for Declaratory and Injunctive Relief at 21–22, 29, State Nat'l Bank of Big Spring v. Lew, 958 F. Supp. 2d 127 (D.D.C. 2013), *aff'd in part & rev'd in part*, 795 F.3d 48 (D.C. Cir. 2015) (No. 12-01032).

118 *Lew*, 958 F. Supp. 2d, at 139.

119 *See, e.g.*, Seattle Master Builders Ass'n v. Pac. Nw. Elec. Power & Conserv. Plan. Council, 786 F.2d 1359, 1364–65 (9th Cir. 1986) ("The appointments clause is addressed to the separation of powers between the President and Congress.")

120 Buckley v. Valeo, 424 U.S. 1 (1976).

pro tempore of the Senate and the Speaker of the House, rather than in the President or some other permissible entity.[121]

But pigeonholing the Appointments Clause as simply a safeguard against *congressional* hegemony reads the text too narrowly.[122] By "limit[ing] the universe of eligible recipients of the power to appoint," the Appointments Clause "prevents Congress from dispensing power too freely" to *anyone*.[123] Thus, while the restriction prevents Congress from allowing itself to appoint federal officers, it also prevents that body in most circumstances from vesting the appointment power in other entities as well. These limits are "among the significant structural safeguards of the constitutional scheme" and are "designed to preserve political accountability relative to important Government assignments."[124]

The concern with vesting the appointment of federal officers in the states would not seem foreign to the founders, who debated this very question. During the Constitutional Convention, Virginia's Edmund Randolph observed the "formidable" nature of the President's appointment power and suggested that the legislature should be "left at liberty to refer appointments in some cases, to some State Authority."[125] John Dickenson of Delaware then moved to amend the Appointments Clause to add "except where by law the appointment shall be vested in the Legislatures or Executives of the several States."[126] This amendment would thus have allowed Congress to vest appointment of federal officers in state legislatures or with state governors.[127] But several members objected to this state intrusion into the federal sphere. Gouverneur Morris claimed the amendment would "be putting it in the power of the States to say, 'You shall be the viceroys but we will be the viceroys over you,' " while James Wilson noted that state legislatures would quickly instruct their senators to make sure any office Congress

121 *Id.* at 126–27. The decision also held that although the President got to nominate the remaining two FEC commissioners, those appointments were also invalid because the Act required concurrence by both the Senate and the House, rather than the Senate alone. *Id.* at 126–28.

122 *See Seattle Master Builders Ass'n*, 786 F.2d at 1374, n.3 (Beezer, J., dissenting) ("Congressional authority would be enhanced at the expense of the executive if Congress had the unrestricted power to confer the appointment authority on third parties. To the extent that a governor can appoint a [federal officer] who would otherwise be subject to the Appointments Clause, the power of the executive branch is diminished. . . . Indeed, the Framers expressly rejected the idea that the Appointments Clause is not violated so long as Congress does not arrogate to *itself* the power to appoint or remove federal officers.").

123 Freytag v. Comm'r, 501 U.S. 868, 880 (1991).

124 Edmond v. United States, 520 U.S. 651, 659, 663 (1997); *see also Freytag*, 501 U.S. at 880 ("The structural interests protected by the Appointments Clause are not those of any one branch of Government but of the entire Republic."). The *Freytag* Court explained that the Appointments Clause would be equally violated whether Congress improperly vested the appointment power in itself or in another position prohibited by the Clause's text, including an inappropriate member of the executive branch.

125 MAX FARRAND, 2 RECORDS OF THE FEDERAL CONVENTION OF 1787, at 405 (1911); *see Seattle Master Builders Ass'n*, 786 F.2d at 1374 n.3 (Beezer, J., dissenting).

126 FARRAND, *supra* note 125, at 406.

127 *Id.*

creates would vest the appointment power in the states.[128] The amendment was soundly defeated.[129]

Wilson's comment highlights the fact that, under the original framework, the states maintained some indirect influence over federal appointments. Prior to the enactment of the Seventeenth Amendment in 1913, senators were chosen by state legislatures.[130] Because of the Senate's advice and consent authority,[131] this procedure gave state legislatures as a whole a veto over the selection of federal officers. But most considered this power too remote to be concerning.[132] The framers felt that Senate consent would be useful for small states to combat the political tendencies of the President to fill federal positions primarily with nominees from larger states.[133] They also felt the Senate, as a collegial and deliberative body, would prevent the President from appointing unqualified nominees on the basis of personal ties, state prejudice, or popular will.[134] But there seemed to be little concern that the Senate's advice-and-consent role, alone, would lead to inappropriate state interference into the federal sphere. Direct state appointments of federal officials, however, would be more problematic because it would muddy the boundary between the federal government and the states.[135]

Modern scholars have argued that the Appointments Clause serves two primary purposes,[136] both of which are implicated by a state appointment power. The first, hinted at above, is an anti-aggrandizement principle. As Justice David Souter explained in *Weiss v. United States*,[137] one purpose of the Appointments Clause is to prevent one branch of government from aggrandizing the appointment power at the expense of another.[138] "Congress . . . may not unilaterally fill any federal office; and the President may neither select a principal officer without the Senate's concurrence, nor fill any office without Congress's authorization."[139] By unilaterally appointing a particular federal official, a branch could wield considerable influence over how the officer's duties are carried out.[140]

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128 *Id.*
129 *Id.* at 418–19.
130 U.S. CONST. art. I § 3 cl. 1.
131 *See id.* art. II § 2 cl. 2.
132 *See, e.g.*, THE FEDERALIST NO. 66, at 405 (Alexander Hamilton) (Clinton Rossiter ed., 1961).
133 *See, e.g.*, Adam J. White, *Toward the Framers' Understanding of "Advice and Consent": A Historical and Textual Inquiry*, 29 HARV. J.L. & PUB. POL'Y 103, 113 (2005); James E. Gauch, Comment, *The Intended Role of the Senate in Supreme Court Appointments*, 56 U. CHI. L. REV. 337, 347–51 (1989).
134 THE FEDERALIST NO. 76 (Alexander Hamilton).
135 *See supra* text accompanying note 128.
136 *See, e.g.*, Hunter, *supra* note 113, at 763–65.
137 Weiss v. United States, 510 U.S. 163, 182 (1994) (Souter, J., concurring).
138 *Id.* at 186; *see* Walter E. Dellinger, *The Constitutional Separation of Powers Between the President and Congress*, 63 L. & CONTEMP. PROBS. 513, 521 (2000).
139 *Weiss*, 510 U.S. at 187 (Souter, J., concurring).
140 As Justice Souter notes, the Appointments Clause is less concerned with aggrandizement of the power to appoint inferior officers, which Congress can choose to vest in the President

It is not difficult to imagine instances in which states granted an appointment power would exercise it for self-interested purposes. Federal agencies play the predominant role today in statutory interpretation and therefore increasingly represent the most likely locus of power to preempt state law.[141] It is no stretch to think that state officials, if given the power to appoint those who would exercise that power, would prefer individuals less inclined toward preemption, even if those individuals were otherwise less qualified or if preemption represented the optimal policy choice for the country as a whole.

The Appointments Clause also helps ensure political accountability. As one of the more detailed constitutional provisions, the Clause delineates which segment of the government is responsible for creating an office and which is responsible for staffing it, so the public knows who to hold accountable in the event that a particular officer or agency goes astray.[142] This rationale, too, is implicated by the prospect of state appointment of federal officials. In another context, the Supreme Court has prohibited federal programs from commandeering state officials to carry out federal mandates, in part because of concern that the public will unfairly fault state officials for unpopular federal decisions.[143] The inverse dynamic could occur if states use the appointment power to install federal officials to carry out a state's agenda. James Madison's famous ode to the separation of powers in Federalist 51 highlights the importance of dividing power both within the federal government *and* between the government and the states:

> In the compound republic of America, the power surrendered by the people is *first divided between two distinct governments*, and then the portion allotted to each subdivided among distinct and separate departments. Hence a double security arises to the rights of the people. The different governments will control each other, at the same time that each will be controlled by itself.[144]

To avoid muddying this division of authority and jeopardizing the benefits of divided government, Madison advised that "the members of each [department] have as little agency as possible in the appointment of the members of the others."[145]

2. *Are Nonvoting Members Officers of the United States?*

By integrating active state regulatory officials into a federal agency, the Dodd-Frank Act has waded into a decades-long conversation about the scope of

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alone, in heads of departments, or in courts of law. *Id.* at 183. Presumably, this is because inferior officers, by definition, wield less power than principal officers, so controlling personnel decisions of these lesser offices would not threaten the balance of powers among the branches.

141 *See* Catherine M. Sharkey, *Inside Agency Preemption*, 110 MICH. L. REV. 521, 523 (2012).

142 Hunter, *supra* note 113, at 764–65.

143 *See* Printz v. United States, 521 U.S. 898, 930 (1997).

144 THE FEDERALIST NO. 51, at 323 (James Madison) (Clinton Rossiter ed., 1961) (emphasis added).

145 *Id.* at 239.

the Appointments Clause. *Buckley v. Valeo* held that the Clause applies to "any appointee exercising significant authority pursuant to the laws of the United States."[146] Despite repeated entreaties from academy, bench, and bar, the Supreme Court has explicitly declined to elaborate on the meaning of "significant authority,"[147] stating tartly in its latest decision on the subject in 2018 that "maybe one day we will see a need to refine or enhance the test *Buckley* set out so concisely. But that day is not this one . . . ."[148] And as Anne Joseph O'Connell points out, the inquiry is further complicated when that authority is wielded by a non-federal actor such as a state official.[149]

a. *Status as State Official*

Under the Clinton Administration Office of Legal Counsel's interpretation, active state officials might not fall under the Appointments Clause even if they exercise significant authority under *Buckley*. In *The Constitutional Separation of Powers Between the President and Congress*, the OLC argued that the Appointments Clause is limited only to those officers who are "appoint[ed] to a position of employment within the federal government."[150] "The Appointments Clause simply is not implicated when significant authority is devolved upon non-federal actors."[151] The memo further asserted that "[i]t is conceptual confusion to argue that federal laws delegating authority to state officials create federal 'offices' . . . . Rather, the 'public station, or employment' has been created by state law; the federal statute simply adds federal authority to a pre-existing state office."[152]

The Clinton-era OLC opinion finds some support in a Ninth Circuit decision, *Seattle Master Builders v. Pacific Northwest Electrical Power & Conservation Planning Council*.[153] Plaintiffs had challenged the constitutionality of a council charged with preparing a conservation and energy usage plan for the Pacific Northwest in consultation with the Bonneville Power Administration, a federal agency under the umbrella of the Department of Energy.[154] The Council was established by an act of Congress but was staffed by appointees selected by four governors whose states opted into participation via state legislation.[155] The Court

146 Buckley v. Valeo, 424 U.S. 1, 126 (1976).

147 Lucia v. SEC, 138 S. Ct. 2044, 2051 (2018) ("Both the amicus and the Government urge us to elaborate on *Buckley*'s 'significant authority' test, but another of our precedents makes that project unnecessary.").

148 *Id.* at 2052.

149 O'Connell, *supra* note 110, at 903.

150 The Const. Separation of Powers Between the President and Cong., 20 Op. O.L.C. 124, 145 (1996) [hereinafter Clinton OLC Memo].

151 *Id.*

152 *Id.*

153 Seattle Master Builders Ass'n v. Pac. Nw. Elec. Power & Conserv. Plan. Council, 786 F.2d 1359 (9th Cir. 1996).

154 *Id.* at 1362.

155 *Id.*

found that, although the Council was charged with a regional mandate by Congress and coordinated with a federal agency, it was properly considered an interstate compact rather than a federal agency.[156] As a result, the Council members do not "perform their duties pursuant to the laws of the United States" but instead "pursuant to a compact which requires both state legislation and congressional approval."[157] It also noted that "[t]he appointment, salaries and direction of the Council members are state-derived" and that concerns about separation of powers were "not implicated here" because "Congress has not arrogated to itself a power that would otherwise be exercised by the President."[158]

The Clinton-era memo disavowed an earlier 1990 OLC memo that argued that "[t]he Appointments Clause has both a 'horizontal' and 'vertical' role to play in the separation of powers" and that "[v]ertically, the clause protects against the delegation of federal executive authority to private entities outside the constitutional framework."[159] While the memo focused primarily upon outsourcing government work to private contractors, O'Connell suggests that the same logic could limit the devolving of federal authority to state actors.[160]

The current OLC memo strikes a somewhat frustrating middle ground. Unlike the Clinton-era memo, the OLC currently suggests that "a position, however labeled, is in fact a federal office if (1) it is invested by legal authority with a portion of the sovereign powers of the federal Government, and (2) it is 'continuing.' "[161] This language would suggest that the operative inquiry should focus on the duties of the official in question, not the status of his or her employment. But somewhat inconsistently, it goes on to state that "an individual . . . who possesses his authority from a state does not hold a position with delegated sovereign authority of the federal Government and therefore does not hold a federal office."[162]

While the current OLC guidance is thus ambiguous as to the status of state officials generally, this debate is likely inapposite to the specific case of the Financial Stability Oversight Council. Although discussing state officers in seemingly sweeping terms, the Clinton OLC memo distinguishes between an "individual who is appointed to his or her office by the federal government" and regimes wherein "significant authority is devolved upon non-federal actors."[163] This distinction reflects the typical cooperative federalism structure wherein federal decisionmakers set policy and delegate authority to state officials, in their

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156 *Id.* at 1363.
157 *Id.* at 1365 (internal quotations omitted).
158 *Id.*
159 Const. Limits on "Contracting Out" Dep't of Just. Functions Under OMB Circular A-76, 14 Op. O.L.C. 94, 96 (1990).
160 O'Connell, *supra* note 110, at 903.
161 Officers of the U.S. Within the Meaning of the Appointments Clause, 31 Op. O.L.C. 73, 73–74 (2007) [hereinafter Officers OLC Memo].
162 *Id.* at 77.
163 Clinton OLC Memo, *supra* note 150, at 145.

capacity as state officials, to carry out those federal mandates.[164] For example, to enforce the new federal interconnection mandate between local telephone companies, the Telecommunications Act of 1996 appointed state public utilities commissions to arbitrate disputes between parties, pursuant to guidelines established by the Federal Communications Commission.[165] The Financial Stability Oversight Council departs from this model in a way that conflates the OLC memo's two categories: it does not charge state regulators in their pre-existing capacity with enforcing a federal policy, but instead invites them to participate as members of a new federal agency to create those policies.[166] Because the Council is a new federal agency, its positions are likely new "offices," and therefore, each member is "appointed to his or her office by the federal government."[167] *Seattle Master Builders* is not inapposite: the key question in that case was whether the regional council was an interstate compact or a new federal agency; if it had been an agency, its members would have been susceptible to an Appointments Clause challenge despite the fact that they had been appointed by state governors.[168]

b. Significant Authority

The more significant question, therefore, is whether the state appointees and the other nonvoting members exercise "significant authority" under *Buckley*.[169] *Buckley*'s conclusory analysis of this issue provides little guidance regarding how to draw the line between an officer and a mere employee.[170] But the remedial portion of the opinion provides some clues. Having found that the members of the Federal Election Commission were unconstitutionally appointed, the Court could not simply rewrite the statute's appointment procedure, so instead, it reduced the commissioners' powers that led to their classification as officers rather than employees.[171] After all, if one's duties do not rise to the level of an officer but are instead "part of the broad swath of 'lesser functionaries' in the Government's workforce," then "the Appointments Clause cares not a whit about who named them."[172] *Buckley* distinguished between the FEC's enforcement powers (in particular, its ability to bring suits to enforce election law) from those duties

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164 *See* Weiser, *supra* note 17, at 665.
165 *See* AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366, 371–73 (1999).
166 *See* text accompanying notes 41–46.
167 Clinton OLC Memo, *supra* note 150, at 145.
168 *See* Seattle Master Builders Ass'n v. Pac. Nw. Elec. Power and Conserv. Plan. Council, 786 F.2d 1359, 1364–65 (9th Cir. 1986).
169 Buckley v. Valeo, 424 U.S. 1, 126 (1976).
170 *See* Landry v. Fed. Deposit Ins. Corp., 204 F.3d 1125, 1132–33 (D.C. Cir. 2000) (noting that *Buckley* is an "attempt to clarify" the "circular logic" of earlier opinions on this topic). To be fair, the *Buckley* Court felt little need to dwell on this question in the course of its hundred-plus pages of analysis because the parties did not contest that the commissioners were officers rather than employees. *See also Buckley*, 424 U.S. at 126 n.162.
171 *Buckley*, 424 U.S. at 137–38.
172 Lucia v. SEC, 138 S. Ct. 2044, 2051 (2018) (quoting *Buckley*, 424 U.S. at 126 n.162).

that are "of an investigative and informative nature."[173] Enforcement is an executive function that an officer could perform.[174] But mere investigation and advisement duties were permissible because they "fall[] in the same general category as those powers which Congress might delegate to one of its own committees."[175] Moreover, while the Commission's "broad administrative powers" such as "rulemaking, advisory opinions, and determinations of eligibility" for federal office or funding are more "legislative or judicial in nature," they nonetheless retain an executive flavor and do not "merely operate[] in aid of congressional authority."[176] Therefore, only an officer may perform these duties as well.

If the state regulators were voting members of the Financial Stability Oversight Council, they would unquestionably be considered officers under *Buckley* and therefore violate the Appointments Clause. Like the FEC Commissioners, the Council's voting members can conduct investigations,[177] issue rules (such as the standards for determining when a nonbank financial company poses a threat to America's financial stability),[178] and adjudicate individual cases (for example, designating particular nonbank financial companies under those standards).[179] It was likely this concern that Senator Collins had in mind when she suggested in Committee that "I think those State regulators should be brought on to the council in a nonvoting capacity given the constitutional issues."[180]

Collins's assumption finds some support in the 2007 OLC memo. Expanding on the *Buckley* test, the memo explains that an officer must have received "a delega[tion of] legal authority of a portion of the sovereign powers of the federal Government."[181] "Delegated sovereign authority," in turn, is defined as "power lawfully conferred by the Government to bind third parties, or the Government itself, for the public benefit."[182] By contrast, says the memo, "an individual who occupies a purely advisory position (one having no legal authority) . . . does not

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173 *Buckley*, 424 U.S. at 137.
174 *Id.* at 140.
175 *Id.* at 137.
176 *Id.* at 140–41.
177 Dodd-Frank Act, Pub. L. No. 111-203, § 112(a)(2)(A), 124 Stat. 1376 (2010).
178 *Id.* § 113; *see* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 84 Fed. Reg. 71,740 (Dec. 30, 2019).
179 Dodd-Frank Act § 112(a)(2)(H) ("The Council shall . . . require supervision by the Board of Governors for nonbank financial companies that may pose risks to the financial stability of the United States in the event of their material financial distress or failure, or because of their activities pursuant to section 113."); *id.* § 113(a) ("The Council . . . may determine that a U.S. nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards, in accordance with this title.").
180 156 CONG. REC. 7672 (2010) (statement of Sen. Susan Collins).
181 Officers OLC Memo, *supra* note 161, at 77.
182 *Id.* at 87 ("[S]uch authority primarily involves the authority to administer, execute, or interpret the law.").

hold a position with delegated sovereign authority of the federal Government and therefore does not hold a federal office."[183]

But the OLC memo lacks the force of law, and Supreme Court precedent cuts against this categorical rule. In *Freytag v. Commissioner*, the government argued that special trial judges of the Tax Court were employees rather than officers because they "lack authority to enter a final decision" in significant cases, instead making recommended rulings to tax court judges.[184] But the Court found that despite the inability to bind parties, these judges exercised "significant authority" by taking testimony, conducting trials, ruling on the admissibility of evidence, and possessing the ability to enforce discovery orders.[185] The Court noted in the alternative that these special judges could render final decisions in smaller cases,[186] leading some later courts to hold that final decision-making authority was a necessary element.[187] But the Supreme Court clarified in *Lucia v. SEC* that *Freytag* "explicitly rejects [the] theory that final decision-making authority is a *sine qua non* of officer status."[188]

An earlier D.C. Circuit decision casts greater doubt that merely making a position nonvoting is sufficient to insulate it from Appointments Clause scrutiny. In *Federal Election Commission v. NRA Political Victory Fund*,[189] plaintiffs challenged the FEC's constitutionality because the Secretary of the Senate and the Clerk of the House of Representatives served as *ex officio* members.[190] The government argued that their participation in Commission deliberations posed no constitutional problem because they could not vote, could not chair the meeting, could not call or adjourn a meeting, and were not counted in determining a quorum.[191] But the court disagreed, finding that Congress intended the *ex officio* members to participate in Commission deliberations and specifically to represent Congress's views on matters before the agency.[192] While the members were intended to "play a mere 'informational or advisory role' in agency decision-

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183 *Id.* at 87.
184 Freytag v. Comm'r, 501 U.S. 868, 881 (1991).
185 *Id.* at 881–82.
186 *Id.* at 882.
187 *See* Landry v. Fed. Deposit Ins. Corp., 204 F.3d 1125, 1133 (D.C. Cir. 2000) (finding administrative law judges were mere employees because, unlike in *Freytag*, they issued only a "*recommended* decision, *recommended* findings of fact, *recommended* conclusions of law, and [a] *proposed* order" to agency officials (alteration in original) (quoting 12 C.F.R. § 308.38 (1996))).
188 Lucia v. SEC, 138 S. Ct. 2044, 2052–53 n.4. Writing in dissent, Justice Sotomayor would have held that "one requisite component of 'significant authority' is the ability to make final, binding decisions on behalf of the Government. Accordingly, a person who merely advises and provides recommendations to an officer would not herself qualify as an officer." *Id.* at 2065 (Sotomayor, J., dissenting).
189 FEC v. NRA Political Victory Fund, 6 F.3d 821 (D.C. Cir. 1993).
190 *Id.* at 823.
191 *Id.* at 826.
192 *Id.*

making,"[193] the court found that this implied that they had "some influence" over the Commission's deliberations.[194] Because the *ex officio* members had "the potential to influence the other commissioners," their appointment was unconstitutional.[195]

Despite this uncertainty, the Council's nonvoting members are unlikely to be considered federal officers. Unlike the special judges in *Freytag* and *Lucia*, the state regulator members do not exercise "substantial powers" involving "significant discretion" in pursuit of "important functions."[196] They do not conduct trials, rule on admissibility of evidence, or issue recommended decisions.[197] Instead, they seem more akin to duties "essentially of an investigative and informative nature" that *Buckley* found to be on the "employee" side of the constitutional line.[198] Statutorily, they are charged with serving "in an advisory capacity,"[199] providing information to the voting members of the Council to help inform their deliberations—a service "in the same general category as those powers which Congress might delegate to one of its own committees."[200] Of course, they actively participate in the Council's deliberations.[201] But unlike the voting members, the nonvoting members are not required to submit an annual report to Congress certifying the Council's compliance with its duties or noting areas of disagreement,[202] suggesting that their responsibilities are limited to an advisory role with regard to the Council's more executive duties, much as a legislative committee is to the body as a whole.

Of course, the Council itself exercises significant authority, and like the *ex officio* FEC members in *NRA Political Victory Fund*, the nonvoting members have "the potential to influence the other commissioners" in their deliberations.[203] But a closer examination reveals that this opinion was concerned primarily about Congress asserting itself into the Commission's deliberations. The court repeatedly emphasized that the *ex officio* members were "agents of

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193 *Id.* at 827.

194 *Id.* at 826.

195 *Id.* The Supreme Court granted certiorari in this case, 512 U.S. 1218 (1994), but later dismissed it as improvidently granted because the FEC had improperly sought certiorari on its own, and the Solicitor General (who should have filed the petition for certiorari) ratified the agency's action after the filing date had passed. *See* FEC v. NRA Political Victory Fund, 513 U.S. 88 (1994).

196 Lucia v. SEC, 138 S. Ct. 2044, 2052 (quoting Freytag v. Comm'r, 501 U.S. 868, 882 (1991)).

197 *Id.* at 2052.

198 Buckley v. Valeo, 424 U.S. 1, 137 (1976).

199 Dodd-Frank Act Pub. L. No. 111-203, § 111(b)(2), 124 Stat. 1376 (2010).

200 *Buckley*, 424 U.S. at 137.

201 *See* Dodd-Frank Act § 111(b)(3) ("The nonvoting members of the Council shall not be excluded from any of the proceedings, meetings, discussions, or deliberations of the Council," with limited exceptions.).

202 *See* Dodd-Frank Act § 112(b); Council Bylaws, *supra* note 46, at § XXX.3.

203 FEC v. NRA Political Victory Fund, 6 F.3d 821, 826 (D.C. Cir. 1993).

Congress."[204] The court cited the Constitution's "structural ban on legislative intrusions into other governmental functions" and explained that "the mere presence of agents of Congress on an entity with executive powers offends the Constitution."[205] The court was concerned about congressional influence in particular because "Congress enjoys ample channels to advise, coordinate, and even directly influence an executive agency" through oversight hearings, appropriations, authorization of legislation, or direct communication with the agency.[206] Given the plethora of powers already at Congress's disposal, Congress in particular must "limit the exercise of its influence . . . to its legislative role."[207] The *NRA* court seemed focused not on whether the *ex officio* members exceeded the appropriate sphere of their authority, but whether Congress had exceeded its appropriate sphere. The Dodd-Frank Act does not raise similar concerns about Congress giving itself a seat at the Council, so the opinion seems less relevant.

3. *Preferential Access by the Intergovernmental Lobby*

But the *NRA Political Victory Fund* decision raises an important pragmatic concern, even if it does not rise to the level of a constitutional violation. The court was undeniably correct that nonvoting members have at least "the potential to influence" an agency's decisions.[208] The Dodd-Frank Act effectively granted three special interest groups—the North American Securities Administrators Association, the Conference of State Bank Supervisors, and the National Association of Insurance Commissioners—permanent seats at the Council table.[209] These groups are part of the informal collection of entities known as the "intergovernmental lobby," whose influence is "widely acknowledged and respected in Washington."[210] Some may question whether it is wise to give these lobbyist groups unique and ongoing access to the most important financial regulators in the American government, for at least two reasons.

First, giving state voices preferential access to the Council can tilt the conversation toward protecting state interests, even when preemption is the optimal policy. The intergovernmental lobby is a fierce and effective advocate of state autonomy. As Miriam Seifter explains, because these interest groups must forge consensus among disparate members to speak with one voice, "the groups' advocacy tends toward lowest-common-denominator positions that members can

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[204] *Id.*
[205] *Id.* at 827.
[206] *Id.*
[207] *Id.*
[208] *Id.* at 826.
[209] *See, e.g.*, Press Release, State Regulators Announce Representatives for the Financial Stability Oversight Council (Sept. 23, 2010), http://www.nasaa.org/1520/state-regulators-announce-representatives-for-the-financial-stability-oversight-council/ [perma.cc/SAW4-K9M2].
[210] Kramer, *supra* note 62, at 285. *See generally* Miriam Seifter, *States as Interest Groups in the Administrative Process*, 100 VA. L. REV. 953 (2014); Note, *The Lesson of* Lopez*: The Political Dynamics of Federalism's Political Safeguards*, 119 HARV. L. REV. 609, 622 (2005).

agree upon, often addressing the importance of state authority."[211] For example, the Conference of State Bank Supervisors adopted a Statement of Principles asserting that "[b]ank supervision is best conducted at the state level" and "[b]road federal regulatory preemption of state laws endangers the dual banking system and consumer protection."[212] It is in their collective self-interest to promote state autonomy and resist preemption before the Council. In a sense, this is the potential downside to the benefits described in Section II.A.[213] Giving state regulators a place at the Council table provides a conduit for state expertise and local knowledge—and also self-interested advocacy.

The law has long recognized the danger of special influence access to agency decisionmakers. The D.C. Circuit has criticized the related practice of *ex parte* presentations because these representations have not been tested for truth by the public comment process, putting them at risk for unreliability.[214] It also threatens public confidence in agency deliberations: "Even the possibility that there is here one administrative record for the public and this court and another for the Commission and those 'in the know' is intolerable."[215]

Typically, the remedy for these concerns is disclosure—but in this case, that remedy is stymied by the fact that the Council is exempt from the Government in the Sunshine Act.[216] By its terms, the Sunshine Act applies only to agencies "headed by a collegial body composed of two or more individual members, a majority of whom are appointed to such position by the President with the advice and consent of the Senate."[217] While the Council's voting members do experience nomination and Senate confirmation, they are not appointed directly to the Council.[218] Rather, they become members of the Council by virtue of their primary appointed positions.[219] Because of this, they are not "appointed to such position" in a way that triggers the Act.[220] Similarly, the Dodd-Frank Act

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[211] Seifter, *supra* note 210, at 958.

[212] *CSBS Board Adopts Statement of Principles*, STATESIDE NEWS & VIEWS (Conf. of State Bank Supervisors, Washington, D.C.), November-December 2004, https://www.michigan.gov/documents/CSBS_Stateside_News_&_Views,_November-December_2004_113607_7.pdf [perma.cc/PT9M-DAC4].

[213] *See supra* text accompanying notes 87–109.

[214] *See* Home Box Off. v. FCC, 567 F.2d 9, 52–55 (D.C. Cir. 1977).

[215] *Id.* at 54.

[216] *See* Martin E. Lybecker, *American Bar Association Comments and Suggestions Concerning Consumer Protection Provisions in Title X of S. 3217*, *the Restoring American Financial Stability Act of 2010*, *in* DODD-FRANK FINANCIAL REFORM AND ITS IMPACT ON THE BANKING INDUSTRY 381, 388 (ALI-ABA, Course of Study Materials SS038, 2010).

[217] 5 U.S.C. § 552b(a)(1).

[218] Dodd-Frank Act, Pub. L. No. 111-203, § 111(b)(1), 124 Stat. 1376 (2010).

[219] *Id.*

[220] *See* Lybecker, *supra* note 216. This is one reason why the reappointment question discussed *supra* note 113 may be of more than mere academic significance. If the officials' current positions are not sufficiently germane to their primary appointments, and therefore reappointment and reconfirmation are necessary for the agency to take their posts, then the Council might be subjected to the Sunshine Act.

exempted the Council's advisory committees—including those comprised of state regulators—from compliance with the Federal Advisory Committee Act,[221] which would otherwise require open meetings with advance notice and public minutes.[222] In lieu of these protections, the Council has adopted a Transparency Policy that commits it to open meetings when possible but reserves the right to close a meeting to the public upon the vote of a majority of members.[223]

Second, the intergovernmental lobby may not adequately convey the benefits sought from state participation. Seifter argues persuasively that because of the pressure to speak with one voice, state interest groups "tend[] to squelch the diversity of state perspectives" and "mute states' varied knowledge."[224] To the extent that the NASAA, CSBS, or NAIC provides guidance to its representative on the Council, that guidance may not capture the local knowledge of individual state regulators, as Senator Collins and other supporters of state participation seek.[225] And of course, in the absence of such guidance, the Council risks each nonvoting member representing only the parochial interests of his or her state, rather than the states as a whole.

III. DODD-FRANK'S COOPERATIVE FEDERALISM IN PRACTICE

The congressional architects of the Dodd-Frank Act hoped that by including state regulators on the Council, the new agency's processes would reflect a collaborative effort between federal and state regulators, especially on topics that traditionally fell within the states' sphere of influence, in the spirit of cooperative federalism.[226] Detractors feared that this access would give states an outsized influence on Council deliberations: whether couched in formalist Appointments Clause terms or more functionalist policy arguments, the concern was that allowing state regulators into the decision-making process would amplify states' voices and influence.[227]

In retrospect, both these hopes and fears seem misplaced. The initial establishment of the Financial Stability Oversight Council was marked by friction

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[221] 5 U.S.C. app.; *see* Dodd-Frank Act § 111(d).
[222] 5 U.S.C. app. § 10.
[223] *See* Transparency Policy for the Financial Stability Oversight Council, https://www.treasury.gov/initiatives/Documents/FSOCtransparencypolicy.pdf [perma.cc/L588-5NRQ].
[224] Seifter, *supra* note 210, at 991, 996.
[225] It appears that at least the NAIC has formal processes in place to facilitate the flow of information from its members to its designated representative. For example, on the eve of Council deliberations regarding proposed rules to govern nonbank companies, John Huff, the Council's nonvoting insurance regulator, solicited comments from other NAIC members, held a conference call to discuss the issue, and circulated a draft to the organization reflecting the comments and the proposed rule. *See* Nat'l Ass'n of Ins. Comm'rs, State Insurance Regulator Comments Regarding FSOC Proposed Rule and Guidance, (Nov. 9, 2011) https://content.naic.org/sites/default/files/inline-files/testimony_111215_comments_fsoc_guidance.pdf [perma.cc/HX7Y-AQ8U].
[226] *See supra* text accompanying notes 79–85.
[227] *See supra* text accompanying notes 113–18.

between state regulators and their federal counterparts, particularly with inaugural Council Chairman Timothy Geithner.[228] As the Council transitioned to investigation of the insurance industry—the financial services sector where federal expertise was lowest and state regulators could prove valuable—the views of state insurance regulators were marginalized.[229] The Council designated insurance giants Prudential and MetLife as systemically important financial institutions over the objections of both the state insurance regulator and Independent Insurance members, each of which criticized the Council for lacking an understanding of insurance markets.[230] Ultimately, both decisions were reversed, in part because of concerns cited by these dissenting members.[231] When it came to the Council's foray into insurance, state voices were not too loud—if anything, they were too soft.

A. *Federal-State Friction During the FSOC's Founding Phase*

From the beginning, Treasury Secretary Tim Geithner made clear that while Congress wanted state regulators to play an integral role in the Council's operations, the executive branch felt quite differently.[232] Shortly after Director John Huff took his seat as the state insurance regulators' designated member, the Treasury Department restricted Huff from consulting with other NAIC members on Council matters.[233] Geithner took the position that when on the Council, Huff represented the state of Missouri, not the state insurance regulatory system as a whole.[234] Therefore, the Chairman asserted, it would be inappropriate for Huff to share Council information with NAIC members, even on a confidential basis.[235] His support was limited to three NAIC employees hired to support his Council duties.[236]

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228 *See infra* text accompanying notes 232–36.
229 *See infra* text accompanying notes 237–42.
230 *See infra* text accompanying notes 278–98.
231 *See infra* text accompanying notes 299–326.
232 *See* Letter from Susan E. Voss et al., Nat'l Ass'n of Ins. Comm'rs, to Timothy Geithner, Secretary, U.S. Dep't of the Treasury 2 (Feb. 9, 2011) [hereinafter Geithner Letter] (available at https://www.naic.org/documents/testimony_letter_110209_fsoc_geithner.pdf [perma.cc/HN7T-BSEK]) ("We disagree with the argument put forward by the Department that the role of the state insurance regulator on FSOC is simply to represent his state agency.").
233 *See Oversight of the Financial Stability Oversight Council: Hearing Before the Subcomm. on Oversight & Investigation of the H. Comm. on Fin. Servs.*, 112th Cong. app. at 79 (2011) [hereinafter *Huff Testimony*] (testimony of John Huff, Director, State of Missouri Department of Insurance, Financial Institutions, and Professional Registration).
234 *Id.*; *see also* Geithner Letter, *supra* note 232, at 2 ("We disagree with the argument put forward by the Department that the role of the state insurance regulator on FSOC is simply to represent his state agency.").
235 Geithner Letter, *supra* note 232, at 2.
236 *Id.*

Director Huff testified before Congress about how these restrictions hampered his ability to execute his Council duties.[237] During the first nine months he was on the Council, Huff attended four full Council meetings and "innumerable meetings and conference calls" involving the Council's nine committees.[238] Quite apart from the time commitment that this placed on Huff and his small three-person staff, his contribution to these meetings was dampened because he was unable to leverage "all the regulatory resources and expertise that [NAIC's] regulators can provide to FSOC's important work in protecting the U.S. financial system."[239] This, he argued, "contradicts Congressional intent and the deference accorded to state insurance regulators in the explicit language of the statute itself."[240] After six months of negotiations, the NAIC finally took the extraordinary step of writing a public letter to Geithner, complaining that neither Huff nor his three-person staff "can have the depth of knowledge with all insurance regulatory topics necessary for full, active, and effective participation in the activities of FSOC."[241] It argued that Congress intended that the nonvoting member be able to draw upon not only "assistance from insurance regulators in other states" but also "experts from within their regulatory systems, from financial analysts to investment experts to actuaries, to answer the tough questions and review the data necessary to assess the entire breadth of the financial system."[242]

Huff was quite right, of course, that these restrictions limit the state regulators' ability to communicate their expertise and local knowledge to the Council and thus impede on Congress's intent that the Council benefit from a full and fair presentation of the states' perspectives.[243] States are not monolithic actors, and particularly in the fragmented market of insurance products, there is no reason to believe that one regulator can draw upon his or her own experience alone to represent the interests of states as diverse as Missouri and New York. Congress determined that the nonvoting insurance regulator should be appointed by a process that includes all insurance regulators, precisely because the position is intended to represent the interests of the state insurance regulatory system, not just the interests of one particular state.[244] By limiting the flow of information between the nonvoting member and the NAIC, Geithner's restrictions limited the ability of state regulators to share their expertise and local knowledge with the Council during its deliberations.[245] NAIC members routinely collaborate and share

[237] *Huff Testimony*, *supra* note 233, at 78–80.
[238] *Id.* at 78.
[239] *Id.* at 79.
[240] *Id.*
[241] Geithner Letter, *supra* note 232, at 2.
[242] *Id*.
[243] *Huff Testimony*, *supra* note 233, at 77; *see also* Geithner Letter, *supra* note 232, at 2.
[244] Huff noted in his congressional testimony that two staff members to the House Financial Service Committee, James Segal of Rep. Frank's staff and Eric Thompson of Rep. Bachus's staff, were deeply involved in drafting the Act and concurred with this position. *Huff Testimony*, *supra* note 233, at 77.
[245] *See* Geithner Letter, *supra* note 232, at 2.

information, and as a result have protocols in place to address Geithner's concerns about confidentiality.[246]

Tensions between the Treasury Department and the NAIC were heightened by the slow pace of Council appointments. Although the Dodd-Frank Act provided for three insurance-related positions—the state regulator, the Director of the Federal Insurance Office, and the Independent Member with Insurance Expertise—the executive branch dragged its feet on filling the final two seats.[247] Geithner's FIO Director appointee did not take office until June 2011, and the White House did not nominate and confirm an Independent Member until September.[248] This meant that for the Council's first year, Huff was the Council's lone insurance voice, a fact that he noted in his 2011 testimony to Congress.[249] NAIC President Susan Voss complained about both the restrictions on Huff and the slow pace of appointments, which she "saw as a deliberate shutting-out of state voices from the work of the nascent Financial Stability Oversight Council."[250] And as Huff noted in his testimony, the Council also declined to establish any advisory committee of state regulators as provided for in the Dodd-Frank Act.[251]

B. *The Insurance Designation Decisions*

This conflict continued to spill out into the public sphere as the Council took up the question of whether particular insurance companies posed a systemic risk to the American financial system. At first, the system seemed to work as Congress intended, as the Council's state and federal members unanimously designated troubled insurer AIG as a systemically important financial institution ("SIFI") subject to federal oversight.[252] But this unanimity hid deep, fundamental disagreements about the nature and magnitude of risk in the insurance industry generally. The Council's subsequent decisions to similarly designate Prudential and MetLife as SIFIs came over public objections by the Council's Independent

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246 *Huff Testimony*, *supra* note 233, at 80; *see also* Geithner Letter, *supra* note 232, at 2 ("State insurance regulators confront and store highly confidential information each day, and virtually every state insurance department has Memoranda of Understanding for confidential information sharing with federal agencies. The issue of confidentiality should not be an obstacle to our constructive participation.").

247 Jeff Jeffrey, *McRaith May Shape New Federal Insurance Office's Role*, BESTWIRE, (June 13, 2011); Sean P. Carr, *Senate Confirms Woodall for FSOC Post*, BESTWIRE, (Sept 27, 2011).

248 *Id.*

249 *Huff Testimony*, *supra* note 233, at 77.

250 *See* Sean Carr, *Perspectives: Federal Insurance Office Chief Named, but Other Dodd-Frank Post Still Vacant*, BESTWIRE, (Mar. 21, 2011).

251 *Huff Testimony*, *supra* note 233, at 79; *see* Dodd-Frank Act, Pub. L. No. 111-203, § 111(d), 124 Stat. 1376 (2010).

252 *See* Fin. Stability Oversight Council, Basis for the Financial Stability Oversight Council's Final Determination Regarding American International Group, Inc. (July 8, 2013) [hereinafter AIG Decision], https://home.treasury.gov/system/files/261/American%20International%20Group%2C%20Inc.pdf [perma.cc/7AZT-DKUB].

Member and state insurance regulator, who declared in no uncertain terms that the Council's analysis was "antithetical to a fundamental and seasoned understanding of the business of insurance [and] the insurance regulatory environment."[253]

The designation of particular companies as systemically important financial institutions is among the Council's most important responsibilities. Seeking to avoid a repeat of the Great Recession of 2008, when financial firms like Bear Stearns and Lehman Brothers failed due to the bursting of the housing bubble and in turn triggered a domino effect throughout financial markets,[254] the Dodd-Frank Act directs the Council to designate a nonbank financial company as a SIFI if it "determines that material financial distress at the U.S. nonbank financial company, or 'the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities' of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States."[255] This requires the Council to have a detailed understanding of the proposed SIFI's industry and an appreciation of the risks that could jeopardize the company's stability and the ripple effect that a collapse would have on the financial sector.[256] Designated firms are subjected to oversight by the Federal Reserve and must comply with capital, liquidity, and risk-management requirements above and beyond those faced by their non-SIFI peers to limit the risk that a failure would spread to the larger economy.[257]

When considering whether to designate an insurance company as a SIFI, collaboration with the state regulator is especially important because of the federal government's lack of expertise in the area. As discussed above, unlike banking and securities regulation, insurance is primarily a state-regulated business with no federal regulatory counterpart.[258] This means there is no federal insurance regulator similar to the Federal Reserve or the Securities and Exchange Commission to inform the decisions of the Council's voting members. The

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253 *See* Fin. Stability Oversight Council, Views of the Council's Independent Member Having Insurance Expertise, Resolution Approving Final Determination Regarding Prudential Financial, Inc. (Sept. 19, 2013) [hereinafter Woodall Prudential Dissent], http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/September%2019%202013%20Notational%20Vote.pdf [perma.cc/5N32-G7H5]; *see also* Huff Prudential Dissent, *supra* note 23, at 1 ("I do not believe that there is a sufficient basis for the Council's final determination that Prudential's material financial distress could pose a threat to the financial stability of the United States. In particular, there appears to be a lack of recognition given to the nature of the insurance business and the authorities and tools available to insurance regulators.").

254 *See, e.g.*, Jeremy C. Kress, *The Last SIFI: The Unwise and Illegal Deregulation of Prudential Financial*, 71 STAN. L. REV. 171, 172 (2018).

255 Dodd-Frank Act § 113(a)(1). Note that this is not an analysis of the likelihood that a company will face material financial distress. Rather, the statute asks, assuming the company faces material financial distress, will that distress pose a risk to the system as a whole.

256 *See e.g.*, AIG Decision, *supra* note 252, at 1 (examining in detail risks to AIG business model and potential ripple effects of an AIG collapse).

257 Dodd-Frank Act § 165.

258 *See supra* text accompanying notes 84–103.

insurance industry "is fundamentally different from the banking and securities business models with distinguishing features and risks."[259] For example, unlike banking and securities products, which are subject to withdrawal on demand, insurance policies involve an upfront payment in exchange for a payout in the event of a catastrophic event, meaning insurers face less risk of bank runs.[260] As Director Huff testified, "[the Council] must recognize and acknowledge these differences in fulfilling its mission to monitor systemic risk within the U.S. financial system."[261] Moreover, state regulations typically require insurers to maintain a diverse product mix, minimum capital requirements, and regular examinations, which the Council must understand and evaluate before determining what extant risk is not currently captured by the regulatory environment.[262]

1. The AIG Decision

AIG was the first insurer to face Council scrutiny. This was unsurprising given the company's prominence in the headlines throughout the 2008 financial crisis. Bad business decisions left the company overexposed to changes in the housing market, leading to credit downgrades that forced the company to come up with $75 billion in cash overnight to cover its collateral obligations.[263] The company faced bankruptcy, which would in turn have threatened the solvency of its counterparties, who would have had to write down the company's $441 billion of credit default swap obligations.[264] With markets still reeling from the news the day before that venerable investment bank Lehman Brothers had collapsed, the U.S. government agreed on September 16, 2008, to a federal bailout in exchange for a 79.9% equity stake in AIG—a move that ultimately cost taxpayers $182 billion.[265] As a "poster child" of the financial crisis, AIG was the primary reason why the insurance industry was included in the discussion of Dodd-Frank reforms.[266]

Given that a significant purpose of the AIG bailout was to avoid contagion into adjacent markets,[267] it is unsurprising that the Council later concluded that

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259 *See* Geithner Letter, *supra* note 232, at 2.
260 *Huff Testimony*, *supra* note 233, at 74.
261 *Id.* at 73.
262 *Id.* at 74.
263 *See* McCoy, *supra* note 11, at 1404. McCoy faults the decision to sell credit default swaps on collateralized mortgage debt obligations and the decision to reinvest cash collateral received by its securities lending unit into residential mortgage-backed securities, which lost significant value during the 2007 subprime mortgage crisis. *Id.* at 1402–03.
264 *Id.* at 1404–05.
265 *Id.* at 1404.
266 *Id.* at 1401–02.
267 *See* CONG. OVERSIGHT PANEL, JUNE OVERSIGHT REPORT: THE AIG RESCUE, ITS IMPACT ON MARKETS, AND THE GOVERNMENT'S EXIT STRATEGY 108 (2010), https://fraser.stlouisfed.org/files/docs/historical/fct/cop_report_20100610.pdf [perma.cc/XS88-ELVH] ("Second, the Federal Reserve and Treasury attribute some of their actions to a stated belief that an AIG

"material financial distress at the company, if it were to occur, could pose a threat to U.S. financial stability."[268] Specifically, the Council cited three "channels" by which an AIG failure could spread to other entities:

- *Exposure*: AIG counts a large number of corporate and financial entities as customers.[269] Material distress at AIG could cause these counterparties to write down the value of their AIG-related assets.[270]
- *Asset Liquidation:* Though most retail insurance products are long-term liabilities, customers often have the opportunity to cash them out early.[271] In the event of material distress, a panicked public could trigger a large number of withdrawals in a short time, forcing AIG to liquidate its assets to satisfy these obligations. A significant liquidation of AIG assets could adversely affect the prices of those assets for other investors, reduce market-wide liquidity, and trigger a similar panic in the insurance industry generally (a hypothetical that some have dubbed a "bank run" scenario).[272]
- *Critical Function or Service*: AIG is America's leading commercial insurance underwriter.[273] If material distress caused it to default on its obligations, its competitors could not quickly fill this gap in the market, leaving significant portions of commercial activity exposed to uninsured risk.[274]

The decision noted AIG's "meaningful non-insurance-related exposures,"[275] which are typically subject to less regulatory oversight than its insurance products.[276] Importantly, AIG did not contest the Council's proposed designation of the company as a SIFI entity,[277] which may help explain why the Council decision was unanimous.

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default could have triggered severe disruptions to an already distressed commercial paper market.").

268 AIG Decision, *supra* note 252, at 1.

269 *Id.* at 3.

270 *Id.* at 5–6.

271 *Id.* at 7.

272 *Id.* at 7–8; *see* McCoy, *supra* note 11, at 1392.

273 AIG Decision, *supra* note 252, at 8.

274 *Id.*

275 *Id.* at 2.

276 J.P. Rankin, *Fixing What Isn't Broken: Why the Federal Reserve's Potential Application of Banking Standards on "Systemically Significant" Insurers Is an Unjustified Incursion that May Negatively Impact Economic Stability*, 23 KAN. J.L. & PUB. POL'Y 40, 64–65 (2013).

277 AIG Decision, *supra* note 252, at 1 ("The Council provided AIG with an explanation of the basis for the Council's proposed determination. On July 3, 2013, the Council received a letter from AIG stating that AIG had chosen not to contest the Council's proposed determination.").

2. *The Prudential Decision*

The Council quickly followed by designating Prudential a SIFI two months later, signaling concerns with the insurance industry beyond the troubled AIG.[278] The Council's concerns about Prudential mirrored those given in the AIG case. Like AIG, Prudential offered a wide range of products to large corporate and financial counterparties that could face significant losses if Prudential were to suffer material distress.[279] The Council highlighted, in particular, Prudential's derivatives counterparties and off-balance sheet exposures as vectors that could spread Prudential's distress to other financial markets.[280] The Council also reiterated its concern about a "bank run" scenario in which distress could cause Prudential's insurance customers to cash out their holdings early, triggering a Prudential asset fire sale that could spread through other financial sectors.[281] Unlike with AIG, the Council did not find that Prudential provided a critical service that could not easily be replaced.[282]

Unlike the AIG case, the Prudential decision was not unanimous. Both the Director of the Federal Housing Finance Authority and the Independent Member with Insurance Expertise issued written dissents from the Council's decision.[283] Director Huff, the nonvoting state insurance commissioner, also published a statement disagreeing with the Prudential designation.[284] Huff criticized the Council's poor understanding of insurance markets:

> [T]here appears to be a lack of recognition given to the nature of the insurance business and the authorities and tools available to insurance regulators. Insurance is not the same as a banking product yet the Statement of the Basis for the Council's Final Determination . . . inappropriately applies bank-like concepts to insurance products and their regulation, rendering the rationale for designation flawed, insufficient, and unsupportable.[285]

In particular, Huff criticized the Council's "bank run" hypothetical as "merely speculative" and "not supported by a sufficient understanding of the

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[278] The Council proposed designating both AIG and Prudential as SIFI entities on the same day: June 3, 2013. *See* AIG Decision, *supra* note 252, at 1; Prudential Decision, *supra* note 22, at 1. Unlike AIG, Prudential contested the proposed designation and sought a hearing before the Council, which helps explain why the final Prudential decision came after the AIG decision.

[279] Prudential Decision, *supra* note 22, at 7–8.

[280] *Id.* at 8.

[281] *Id.* at 9–10. For a discussion of the unique issues in the Prudential case, see Kress, *supra* note 254, at 171–73.

[282] Prudential Decision, *supra* note 22, at 10–11.

[283] *See* Fin. Stability Oversight Council, Resolution Approving Final Determination Regarding Prudential Financial, Inc. (Sept. 19, 2013), http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/September%2019%202013%20Notational%20Vote.pdf [perma.cc/9XVM-BRGM]. The final vote was 7–2, as the Chairwoman of the SEC recused herself from the vote. *Id.*

[284] *See* Huff Prudential Dissent, *supra* note 23, at 1.

[285] *Id.* at 1.

heterogeneity of insurance products or insurer asset disposition."[286] He argued that a mass panic-driven withdrawal was highly unlikely and that the Council failed to demonstrate that either its hypothetical asset liquidation or exposure events would be significant enough to pose a threat to America's financial stability.[287] And he asserted that the Council's analysis mischaracterized and otherwise misunderstood the existing protections that state insurance regulators established to address financial instability.[288] In short, the Council offered mere speculation, rather than proof, that Prudential was "too big to fail." Huff's critique mirrored the dissent of Independent Member Roy Woodall, who stated flatly:

> Key aspects of [the Council's] analysis are not supported by the record or actual experience; and, therefore, are not persuasive. The underlying analysis utilizes scenarios that are antithetical to a fundamental and seasoned understanding of the business of insurance, the insurance regulatory environment, and the state insurance company resolution and guaranty fund systems.[289]

3. *The MetLife Decision*

The tension between the Council's federal regulators and its nonvoting state insurance regulator continued in the following year's MetLife decision. As in the earlier cases, the Council found that MetLife's insurance and noninsurance products create exposure for large financial intermediaries, including globally systemically important banks and insurers.[290] The Council also reiterated its concern that a "bank run" on insurance deposits could trigger an asset liquidation that could threaten other financial sectors.[291] The Council found that MetLife's securities lending and other capital markets activities could also precipitate a similar asset liquidation event.[292] Finally, it noted that MetLife's complexity and intrafirm connections could aggravate these risks in the event of material distress.[293]

Again, Independent Member Woodall dissented,[294] and North Dakota Insurance Commissioner Adam Hamm, who had taken over from Huff as the Council's nonvoting state insurance member, published a lengthy statement disagreeing with the Council's "fundamentally flawed" decision.[295] Hamm noted

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[286] *Id.*
[287] *Id.* at 2.
[288] *Id.* at 3.
[289] Woodall Prudential Dissent, *supra* note 253, at 1.
[290] MetLife Decision, *supra* note 22, at 17.
[291] *Id.* at 21.
[292] *Id.* at 12.
[293] *Id.* at 16.
[294] Fin. Stability Oversight Council, View of Roy Woodall, the Council's Independent Member Having Insurance Expertise on the Council's Final Determination Regarding MetLife, Inc. (Dec. 18, 2014) [hereinafter Woodall MetLife Dissent], https://www.treasury.gov/initiatives/fsoc/designations/Documents/Dissenting%20and%20Minority%20Views.pdf [perma.cc/JQ45-B5DG].
[295] Hamm MetLife Dissent, *supra* note 23, at 8.

MetLife's argument, which went largely unaddressed in the decision, that the likelihood of a MetLife failure is quite low and that the state insurance regulatory framework reduces that likelihood further.[296] But even assuming such an event, the Council failed to prove that exposure by MetLife counterparties or asset liquidation would significantly impair the broader economy.[297] "Unsubstantiated qualitative statements describing 'concerns,' or 'potential negative effects,'" Hamm wrote, "should not be a substitute for robust quantitative analytics that demonstrate scenarios that MetLife's material financial distress could have substantial impacts to particular asset markets or the financial system as a whole. Saying it does not make it so."[298]

C. The Aftermath

The three insurance decisions signaled a potential sea of change in insurance regulation. By subjecting America's three largest insurers to oversight, the federal government "began to roll out a message to the industry about what sort of prudence it expected, as well as what kind of size would amount to systemic significance."[299] Analysts recognized that this use of systemic risk to increase federal oversight of the insurance industry could be a "game changer,"[300] shifting the locus of insurance regulation away from the states over the explicit objection of the state regulators that Congress intended to help inform the Council's deliberations.

1. MetLife, Inc. v. Financial Stability Oversight Council

But the Council soon found that it ignored its state representatives at its peril. Unlike AIG and Prudential, MetLife contested its designation by challenging the Council's decision in federal court.[301] After lengthy deliberations, the court found that the designation was arbitrary and capricious—citing many of the same arguments pressed by Commissioner Hamm.[302]

First, the court found that under the Council's prior guidance, it was required to assess the likelihood of MetLife experiencing material distress before addressing the potential effect of that distress.[303] In hearings before the Council, MetLife

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296 *Id.* at 8.
297 *Id.* at 10.
298 *Id.*
299 David Zaring, *The Federal Deregulation of Insurance*, 97 TEX. L. REV. 125, 128 (2018).
300 McCoy, *supra* note 11, at 1393.
301 *See* MetLife, Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219, 223 (2016). Under the Dodd-Frank Act, judicial review of a final determination with respect to a nonbank financial company like MetLife is limited to whether the final determination was arbitrary and capricious. Dodd-Frank Act, Pub. L. No. 111-203, § 113(h), 124 Stat. 1376 (2010).
302 *MetLife*, 177 F. Supp. 3d at 230.
303 *Id*. at 233. As noted *supra* note 255, this preliminary determination is not required by the statute, which charges the Council only with determining whether "material financial distress . . . could pose a threat to the financial stability of the United States" (which the Council

stressed that the likelihood of material distress was low.[304] Commissioner Hamm highlighted these arguments in his dissenting statement: he explained in depth how "the state insurance regulatory framework . . . reduces the likelihood of failure."[305] Hamm also specifically criticized the Council for asserting that the probability of material distress was "an issue that the Council claims it does not have to consider."[306]

Second, and more significantly, the court faulted the Council for failing to show with evidence how material distress at MetLife would threaten the stability of the American financial system.[307] And again, the court's analysis echoes points Hamm made before the agency. The court noted that "[t]he Exposure channel analysis merely summed gross potential market exposures, without regard to collateral or other mitigating factors."[308] Hamm similarly asserted that "the Council has failed to address the criticism that it did not conduct a robust analysis of characteristics of MetLife beyond its size, particularly as it relates to the exposure channel discussion."[309] Similarly, the court sharply criticized the Council's predictive judgments about contagion: "FSOC never projected what the losses would be, which financial institutions would have to actively manage their balance sheets, or how the market would destabilize as a result."[310] It went on to state tartly that "[t]his Court cannot affirm a finding that MetLife's distress would cause severe impairment of financial intermediation or of financial market functioning . . . when FSOC refused to undertake that analysis itself. Predictive judgment must be based on reasoned predictions; a summary of exposures and assets is not a prediction."[311] Hamm similarly criticized the Council for "continu[ing] to offer merely speculative outcomes . . . based in large part on hypothetical and highly implausible claims."[312] He argued that in any case, the Council should "set[] forth specific quantitative scenarios, based on reasonable, albeit stressed assumptions, demonstrating that the material financial distress of the

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refers to as the "First Designation") or whether, because of the "nature, scope, size, scale, concentration, interconnectedness, or mix of . . . activities" it might pose such a risk (a so-called "Second Designation," a theory the Council declined to pursue in the insurance cases). Dodd-Frank Act § 113(a). But in its interpretative guidance, the Council stated that it would assess "the vulnerability of a nonbank financial company to financial distress." The Court faulted the Council for changing its position in the Final Determination without explanation. *MetLife*, 177 F. Supp. 3d at 233.

304 *See id.* at 234–36.

305 Hamm MetLife Dissent, *supra* note 23, at 7.

306 *Id.*

307 *MetLife*, 177 F. Supp. 3d at 237.

308 *Id.*

309 Hamm MetLife Dissent, *supra* note 23, at 7.

310 *MetLife*, 177 F. Supp. 3d at 237.

311 *Id.*

312 Hamm MetLife Dissent, *supra* note 23, at 10.

company meets the statutory standard."[313] By ruling for MetLife, the court agreed.[314]

2. *The Prudential Rescission Decision*

Similarly, Director Huff's dissent cast a long shadow in the Prudential case. In 2017, seeking to take advantage of the *MetLife* decision and a more deregulatory atmosphere under President Trump, Prudential requested that the Council reassess its status.[315] In a sixty-six-page opinion, the Council agreed to the request, and in the process revisited many of the assumptions that drove its earlier decision.[316] In particular, the Council found that its original decision overestimated the magnitude of the "bank run" scenario, finding upon further analysis that there is not significant risk that material distress would prompt retail policyholders to surrender their policies and trigger a liquidity crisis.[317] It also concluded with respect to the exposure transmission channel that "[w]hile Prudential's material financial distress could impose losses on pension plan sponsors, retirement plan participants, and pension plan participants, the products do not appear to contribute significantly to the threat that the company's material financial distress could pose to U.S. financial stability."[318]

As Jeremy Kress explains, Prudential stands in stark contrast to the Council's other rescission decisions.[319] With regard to AIG, GE Capital, and even MetLife, the designation of SIFI status prompted the company to downsize and reduce risk in the hope of escaping the Council's restrictions.[320] AIG contracted by ten percent, MetLife by twenty percent, and GE Capital shrank by more than half, to show they no longer posed systemic risk.[321] But Prudential actually grew during its time under Council oversight.[322] The Council's 2018 decision to rescind Prudential's SIFI status was not because Prudential reduced its risk profile; it was, instead, an implicit determination that "the Obama Administration FSOC made a mistake in 2013."[323]

As with the *MetLife* decision, the state commissioner's initial dissent helped sow the seeds for the eventual undoing of the Council's decision. As noted above,

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313 *Id.* at 12.
314 *MetLife,* 177 F. Supp. 3d at 237.
315 *See* Fin. Stability Oversight Council, Notice and Explanation of Basis for the Financial Stability Oversight Council's Rescission of Its Determination Regarding Prudential Financial, Inc., at 3 (Oct. 16, 2018) [hereinafter Prudential Rescission], https://home.treasury.gov/system/files/261/Prudential%20Financial%20Inc%20Rescission.pdf [perma.cc/E6NP-L6JD].
316 *Id.*
317 *Id.* at 32.
318 *Id.* at 6.
319 Kress, *supra* note 254, at 171–72, 174.
320 *Id.* at 174.
321 *Id.*
322 *Id.*
323 *Id.* at 176.

Huff argued that the "bank run" scenario was inappropriate in the insurance setting and criticized the Council for speculating, rather than proving its conjecture was plausible.[324] The rescission decision acknowledges that it changed position based on "[a]dditional consideration of incentives and disincentives for retail policyholders to surrender policies, including analysis of historical evidence of retail and institutional investor behavior,"[325] precisely what Huff had requested. The rescission decision also discussed state regulation in far greater depth (including citing with approval changes in New Jersey law since the original decision),[326] exhibiting a more nuanced understanding of the state regulatory environment Huff found lacking in the original designation.

IV. DODD-FRANK, AGENCIES, AND UNCOOPERATIVE FEDERALISM

The insurance designation decisions reveal some important lessons about cooperative federalism in the agency context. Cooperative federalism "envisions a sharing of regulatory authority between the federal government and the states that allows states to regulate within a framework delineated by federal law."[327] In this regime, states "serve not as rivals or challengers to federal authority, but as faithful agents implementing federal programs."[328] But this dynamic does not describe the relationship between the federal decisionmakers and their state advisors on the Financial Stability Oversight Council. The Chairman took steps to minimize the influence that Congress granted to the state members.[329] The state members, in turn, were hostile to the Council's decision to intervene in insurance, and the Council dismissed their critiques rather than engage them. But the state members still had an impact on the Council's activities: by using their voice and position to highlight deficiencies and knowledge gaps in the decisions, the state insurance regulator members influenced the later decision to overturn these designations.

In that sense, the Council's foray into insurance regulation reflects not traditional theories of cooperative federalism, but instead a unique permutation of what Jessica Bulman-Pozen and Heather Gerken have identified as "uncooperative federalism."[330] The authors argue that traditional conceptions of cooperative federalism fail to capture the ways in which "states playing the role of federal servant can also resist federal mandates" with which they disagree.[331] By leveraging their positions within a cooperative federalism regime, states can use

324 *See supra* text accompanying notes 286–88.
325 Prudential Rescission, *supra* note 315, at 32.
326 *Id.* at 7, 8.
327 Weiser, *supra* note 17, at 665.
328 Bulman-Pozen & Gerken, *supra* note 18, at 1262.
329 *See supra* text accompanying notes 227–36.
330 Bulman-Pozen & Gerken, *supra* note 18, at 1263.
331 *Id.*

various forms of dissent to slow the encroachment of federal authority into traditional state spheres and thus protect areas of traditional state sovereignty.[332]

Bulman-Pozen and Gerken focus primarily on the state's role in implementing federal mandates.[333] Their model focuses on a theory of the servant's power, highlighting dependence and integration.[334] Federal officials depend on state officials to carry out the policy, which gives the states discretion in choosing when and how to do so.[335] States also draw influence from integration with the federal bureaucracy: "[r]egular interactions generate trust and give lower-level decisionmakers the knowledge and relationships they need to work the system."[336] States can use their positions as "cogs in the machine" to forestall or even dissent from federal policies that intrude on state interests—a phenomenon that sound familiar to many students of bureaucracy.[337] And indeed, most of Bulman-Pozen and Gerken's examples involve states expressing various forms of dissent within the "carrying out" function, from "licensed dissent," such as Wisconsin and Michigan using Aid for Families with Dependent Children (AFDC) waivers to implement a new vision of welfare and thus shift federal dialogue toward a welfare-to-work model,[338] to the civil disobedience of numerous states refusing to carry out duties assigned to them by the Patriot Act.[339]

The insurance designation decisions show how Congress can achieve a similar level of protection by embedding states at the formulation stage of federal policymaking. While the Council's state regulators lack the power of dependency, in the sense that the Council does not rely on them to carry out its designation decision, they benefit from integration. As discussed above, participation on the Council grants state regulators direct access to their federal counterparts, direct input into Council deliberations, and a voice (albeit a non-binding voice) in Council decision-making.[340] In a very real sense, these regulators can "use their position in the administrative system to protect state institutional interests," a phenomenon that Larry Kramer described as one of the modern-day political safeguards of federalism.[341] But if the state regulators fail to convince the Council of their position, as happened in the Prudential and MetLife decisions, they can use their position as council members to "dissent" publicly in the hope of influencing subsequent developments. This gives them at least two bites at the

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332 *Id.* at 1260.
333 *Id.* at 1263.
334 *Id.* at 1266–70.
335 *Id.* at 1266.
336 *Id.* at 1268–69.
337 *See id.* at 1270–71 (discussing DANIEL P. CARPENTER, THE FORGING OF BUREAUCRATIC AUTONOMY: REPUTATIONS, NETWORKS, AND POLICY INNOVATION IN EXECUTIVE AGENCIES, 1862-1928, at 15 (2001)).
338 *Id.* at 1274–76. AFDC was a federal welfare program in place from 1935 until 1997.
339 *Id.* at 1278–80.
340 *See supra* Section I.B.
341 Kramer, *supra* note 62, at 283.

apple: directly, when a policy is established, and indirectly, when it is reviewed by a later court or carried out by lower-level officials.[342]

The benefit of dissenting from within is especially valuable given the threat that administrative agencies pose to states. Ernest Young writes convincingly that "[f]ederal administrative action is, in important ways, considerably more threatening to state autonomy than legislation is."[343] The decline of judicially enforceable federalism doctrines means that states are protected primarily by the political safeguards of federalism: the fact that states are represented in Congress and the sheer difficulty of getting a bill through the legislative process.[344] But neither of these is an effective check on agency preemption: states do not appoint federal officers, and agency rulemakings and adjudications are more efficient—and therefore more voluminous—than congressional action.[345]

Embedding a state regulator as a nonvoting member within the agency, as the Dodd-Frank Act does, can help combat this threat. By participating in the agency's process, the state regulator can shape the record to include evidence supporting state autonomy. Particularly in informal proceedings, agencies have significant discretion when assembling a record for judicial review.[346] If the agency decision fails to support state interests, state regulators participating within the agency can use dissents from agency decisions (as Commissioner Hamm did in the *MetLife* case) to highlight this record evidence and to spotlight areas in the agency's decision that are susceptible to an arbitrary and capricious challenge.[347] In that sense, the state regulator's dissent can serve a role similar to that of an appellate judge's dissent from denial of a motion to rehear a case en banc, which can be (and increasingly is) used to flag particularly problematic reasoning to the Supreme Court.[348] The state official on the inside can use the tools of administrative law as an administrative safeguard of federalism.[349]

The appointment of a state nonvoting member can also overcome uncooperative federalism's coordination problem. Under Bulman-Pozen and Gerken's dissent model, individual states refuse in some way to carry out their duties under

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342 *Cf.* Bulman-Pozen and Gerken, *supra* note 18, at 1293 ("States that will ultimately be insiders to the federal scheme, in contrast, are likely to have more than one bite at the apple. They can fight when the statute is passed. But if they lose that fight, they will still have ample opportunity to amend and challenge federal policy once the scheme is put in place.").

343 Ernest. A. Young, *Executive Preemption*, 102 NW. U. L. REV. 869, 869 (2008).

344 *Id.* at 869–70.

345 *Id.* at 870. From this perspective, it is not surprising that Congress (which is more politically sensitive to state concerns) included state representatives on the Council, or that the Executive (which is less concerned about states) was resistant to their participation.

346 *See* William F. Pedersen, Jr., *Formal Records and Informal Rulemaking*, 85 YALE L.J. 38, 64–65 (1975); Paul R. Verkuil, *Judicial Review of Informal Rulemaking*, 60 VA. L. REV. 185, 204 (1974) (noting record consists of "whatever the agency produces on review").

347 *See supra* Section III.C.

348 *See* Indraneel Sur, *How Far Do Voices Carry: Dissents from Denial of Rehearing En Banc*, 2006 WIS. L. REV. 1315, 1316–18 (2006).

349 Bulman-Pozen & Gerken, *supra* note 18, at 1285.

a federal scheme.[350] But as Seifter notes, "individual state officials are notoriously unreliable advocates of state power due to their more pressing short-term incentives and a collective action problem among states."[351] The structure established by the Dodd-Frank Act, of selecting a state regulator chosen by an interest group comprised of his or her peers, helps overcome this obstacle. The interest group becomes a locus to collect and distill state interests, and the representative provides a conduit for those interests to be expressed.[352]

CONCLUSION

The Financial Stability Oversight Council is an innovative agency designed to meet the significant challenge of mitigating systemic risk in an increasingly complex American financial ecosystem. Congress matched this structure with an equally innovative method for the states to participate in deliberations. The resulting hybrid model was designed to allow the Council to benefit from the states' extensive regulatory experience and to tap into local knowledge about trends in the banking, securities, and insurance sectors, while deliberating and deciding issues from an appropriately national scope.

The Council's insurance designation decisions were a baptism by fire for this new form of cooperative federalism. While the experiment did not function as intended and exposed a rift between Congress and the executive branch on the value of state involvement, it also unintentionally revealed a new vector for state dissent within a federal scheme. The state regulators used their position inside the Council to highlight deficiencies in federal policy, which ultimately helped courts and the Council itself to reconsider what the states saw as a flawed federal encroachment into insurance. The vignette thus fits comfortably into the emerging scholarship regarding uncooperative federalism and reveals how states can harness new administrative safeguards of federalism. If, as David Shapiro has suggested, federalism is a "dialogue" between the federal government and the states about national policy,[353] the Dodd-Frank Act shows us a creative new way to amplify the states' voice.

350 *Id.* at 1270–71.
351 Seifter, *supra* note 210, at 957.
352 *See id.* at 957–58.
353 DAVID L. SHAPIRO, FEDERALISM: A DIALOGUE 107–08 (1995).

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