The Daily Dish

What the FSOC Are You Thinking?

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Recent economic indicators and data have pointed to a slow but steady recovery. The New York Times reports that “The United States economy grew faster than first thought last quarter, the Commerce Department said on Thursday.”

The Times continued on to discuss how the improved trade picture has helped to bolster the recovery. “Increased investment by businesses and a slightly improved trade picture prompted the revision, which lifted the estimated annual rate of growth in April, May and June to 4.2 percent.”

A recent AAF primer examined the many economic benefits of international trade and free trade agreements. AAF Trade Policy Director Laura Collins writes: “The U.S. is a trade titan. We are the world’s largest trader, exporting nearly $2.3 trillion worth of goods and services. With free trade agreements in place with 20 countries, the U.S. and its trading partners account for a third of global GDP. These trade agreements are an important part of our economy, supporting millions of American jobs and giving consumers more affordable goods and services.”

Eakinomics: What the FSOC Are You Thinking?

Washington in August is as exciting as Cleveland Browns football. This year, however, there is an underlying tension as the Financial Stability Oversight Council (FSOC) contemplates whether to name MetLife as a “systemically important financial institution” or SIFI. Dodd-Frank gave the FSOC the power to identify threats to the financial system as a whole, and to impose upon those entities a much more severe regulatory regime.

But why is the FSOC after an insurance company? After all, the recipe for financial trouble is to combine leverage with short-term funding — i.e., owe a lot of people and owe it fast. Trouble is exacerbated by a mismatch in the duration of assets and liabilities– for example, when deposits that might have to be repaid overnight are used to make 30-year home loans. Insurance companies, in contrast, have longer-term liabilities (e.g., life insurance policies) that they put aside reserves of longer-term assets to fund. Indeed, looking at the MetLife 2013 balance sheet (get the Metlife annual report here) one can only find something like $40 billion of plausibly short-term borrowing, a tiny 5.7 percent of all liabilities and a mere 11.8 percent of funds made available by selling marketable securities on the balance sheet.

MetLife just does not look like a financial threat, which raises an important lesson: to find a SIFI look at the activities of the entity, not the label (“insurance company”) that is attached to the business. FSOC agreed this was the right thing to do with asset managers; why not for insurance companies? One theory is that it is because FSOC has already pulled the regulatory trigger and classified Prudential as a SIFI. But two wrongs do not make a right.

Of course, FSOC also named AIG a SIFI, but for AIG it was welcomed as a way to move from its much-

deserved pariah status to a regulated organ of the financial state. Remember, AIG came crashing down when Goldman Sachs came asking for collateral when securities prices plunged. As the report of the Financial Crisis Inquiry Commission noted “Remarkably, top AIG executives—including CEO Martin Sullivan, CFO Steven Bensinger, Chief Risk Officer Robert Lewis, Chief Credit Officer Kevin McGinn, and Financial Services Division CFO Elias Habayeb—told FCIC investigators that they did not even know about these terms of the swaps until the collateral calls started rolling in during July.” (See the report here and the remarkable video here .) From a substantive point of view, it was the *activity* that generated the risk. From a historical point of view it was a colossal exhibition of incompetence.

Another company’s history should not be the reason to designate another SIFI. A mistake on a previous insurance company is no reason to double down. Only if the activities of an entity merit SIFI designation should the FSOC take this step.