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### Too Big to Fail, or Too Trifling for Oversight?



Chip Somodevilla/Getty Images

Representative Barney Frank says mutual fund and life insurance companies were not the causes of the financial meltdown. His Massachusetts base is home to many such companies.

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It is not very often that business people head to Washington to explain how unimportant they are.

But over the last several months, executives from more than two dozen financial companies and their trade groups have paraded into the Treasury Department, the Federal Reserve and other government agencies to try to persuade top regulators that they are not large or risky enough to threaten the financial system if they should ever collapse.

Big insurers like the Mass Mutual Financial Group and Zurich Financial Services; hedge funds like Citadel and Paulson & Company; and mutual-fund companies like BlackRock, Fidelity Investments and Pacific Investment Management Company have all been making the rounds, according to documents filed by the regulatory agencies.

What they are all hoping to avoid is being designated "systemically important" by a council of financial regulators. That would require them to face stricter federal oversight and keep more cash on hand, which they fear would erode profits.

Jeffrey A. Goldstein, the Treasury undersecretary for domestic finance, finds the arguments so familiar that he has opened some meetings by asking the firms if they would like to designate themselves as systemically important. "I can't recall a firm that came in and said yes," he said.

Hedge fund managers, for example, normally pride themselves on being Masters of the Universe. But armed with PowerPoint presentations and financial studies, representatives from some of Wall Street's most powerful funds, including D.E. Shaw and Company, Elliott Management and Caxton Associates, met with Federal Reserve staff members earlier this year to make one point: We're too small to matter.

The hedge funds insisted their activities would not threaten the financial system because they control \$1.7 trillion in assets, a drop in the bucket next to the \$21.4 trillion overseen by the global mutual fund industry, according to documents they filed with regulators that cited figures from 2010.

Two insurance giants took even stronger steps. They unloaded savings banks they owned as a preemptive strike against tougher federal supervision.

Regulators involved in the determination process say they are skeptical. "It is as if they are the Sisters of the Charity," said one government official who has participated in meetings with financial companies. "They present themselves as if they don't do anything complicated. They are playing a very interesting strategy game that nobody believes."

It's no secret that big banks with more than \$50 billion in assets - Bank of America, Goldman Sachs, Citigroup, Wells Fargo, among others - are automatically part of the club. But a wide variety of financial companies that are not banks are trying to avoid membership - or at least reduce their burdens. Besides the big insurers, hedge funds and mutual fund companies, major commercial lenders like General Electric have revved up their lobbying efforts.

There have also been a few surprises, like Boeing, I.B.M. and Caterpillar, which operate large finance businesses for their customers. Student lenders like Sallie Mae, auto finance companies like Ford Motor Credit and even quasi-government enterprises like the Federal Home Loan Banks have raised concerns about the designation process.

Deciding which firms should be deemed "systemically important" is at the heart of a package of new financial rules that aim to prevent a repeat of the recent financial crisis. But the lack of specific criteria from regulators so far has created uncertainty about who will get tagged.

More clarity may come later this summer when regulators are expected to put out a more detailed proposal. Criteria like size, how connected the firms are to each other, and overall risk levels will be more carefully defined.

Then, after regulators analyze the data, the designated companies will be notified and given a chance to argue why they do not pose a major financial threat. This means final determinations will not be made until the middle of 2012, at the earliest. That, of course, is just fine with many of the companies involved.

Insurers are feeling the most heat right now. In meetings, they go to great lengths to distance themselves from the speculative activities of the American International Group, whose losses from insuring troubled mortgages were so huge that it needed to be rescued by the government in the fall of 2008.

Instead, the insurers insist they are already well supervised by state authorities, and express concern about being shoehorned into a regulatory regime that they claim is designed mainly for banks. Some have hired consulting firms to buttress their arguments with 100-plus page reports featuring their own (favorable) criteria for determining what poses a serious financial threat.

"We don't want to be lumped into the same box with banks," said Robert Gordon of the Property Casualty Insurers Association of America.

A few big insurers have sheared off businesses that would land them under the Federal Reserve's thumb.

In May, the Hartford Financial Services Group sold off a thrift it bought in 2009 to secure billions of dollars of bailout funds designated for banks. In February, the Allstate Corporation sold a similar bank that had made it eligible for aid, though it decided not to accept the cash.

Now, both Hartford and Allstate are arguing that they should not be deemed systemically important - a claim raising eyebrows in financial policymaking circles.

"You would want to be particularly attentive to firms that got themselves into trouble during the crisis, needed government assistance, and now that they are subject to real supervision at the federal level, are hoping to escape additional regulation," said Michael S. Barr, who recently stepped down as the assistant Treasury secretary for financial institutions to return to the University of Michigan law school.

A Hartford Financial spokesman, David Snowden, said the sale was part of a broader strategy of "focusing our resources on our core business and insurance operations." Allstate, in a statement, said its decision was partly due to concerns that the new financial legislation would impose rules that the company "did not consider beneficial given the limited role of the Allstate Bank in our overall strategic plans."




Other financial giants have made their own arguments to regulators. In their comment letters, big asset managers like BlackRock and Fidelity claim that since they manage money on behalf of individual investors, the firms pose little risk to the system. General Electric, a huge lender to businesses and consumers, told Treasury officials that it should not be put in the same category as Goldman Sachs since it does not engage in risky derivatives trading or make other speculative bets with its own money, according to a person close to the discussions.

Meanwhile, several large financial companies are finding sympathetic ears in Washington. Barney Frank, the ranking member of the House Financial Services Committee and one of the chief architects of the new rules, said he did not believe life insurers and mutual-fund companies were risky enough to require heightened supervision.

"If you look at it, they weren't the causes of the problems," said Mr. Frank, the Massachusetts Democrat whose political region is home to many mutual fund and insurance companies.

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