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MetLife®

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Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

International Organization of Securities Commissions
C/ Oquendo 12
28006 Madrid
Spain

Re: Margin Requirements for Non-Centrally Cleared Derivatives (Second Consultative Document)

Ladies and Gentlemen:

MetLife appreciates the opportunity to comment on the Second Consultative Document issued by the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions (collectively, "BCBS-IOSCO") regarding Margin Requirements for Non-Centrally Cleared Derivatives (the "Margin Requirements"), which constitutes an important component of the overall regulatory framework for derivatives reform contained in the G-20's original 2009 reform program.

MetLife, Inc. is the holding company of the MetLife family of insurance companies. The MetLife organization is a leading provider of insurance, annuities and employee benefit programs, serving 90 million customers on a global basis. MetLife holds leading market positions in the United States (where it is the largest life insurer based on insurance in force), Japan, Latin America, Asia, Europe and the Middle East. MetLife, Inc. is a public company with securities listed on the New York Stock Exchange and registered under the United States Securities Act of 1934.

The MetLife insurance companies are licensed and regulated in jurisdictions where they are domiciled and conduct business. Such regulations govern the business conduct and financial aspects of the insurance business, including standards of solvency, statutory reserves, reinsurance and capital adequacy. Each insurance subsidiary is required to file detailed operating and financial reports with and is subject to periodic examination by financial regulatory authorities in each jurisdiction where it conducts business. Each of the MetLife insurance companies is subject to risk-based capital (RBC) requirements, which are calculated by weighting various asset, premium and statutory reserve items, as well as considering the risk characteristics of the insurer. These risk categories include insurance and business risk as well as the risks inherent in the financial markets. This formula is used by regulators as an indicator to identify potential capital inadequacy of an insurer, not as a means to rank insurers generally. Insurance laws provide regulators with the authority to take or compel corrective action in respect of an insurer whose RBC ratio does not meet or exceed certain RBC levels. The financial investments that support contractual liabilities of each MetLife insurance subsidiary are subject to regulation requiring asset diversification within the insurers' investment portfolios and limit the amount invested in certain asset classes. These regulations also govern an insurers' use of derivatives and generally limits such activities to hedging, asset replication and limited writing of covered calls.

MetLife appreciates the substantial effort and consideration that the Working Group on Margining Requirements (the "Working Group") has dedicated to developing the "near final" rules set forth in the Second Consultative Document. Further, MetLife fully recognizes the important public policy implications of a consistently applied international margin framework and supports the Working Groups' attempts to increase the safety and soundness of the derivatives markets by reducing systemic risk through central clearing of standardized derivatives and margin requirements for uncleared derivatives. We are broadly supportive of the Elements that have been finalized in the Second Consultative Paper and commend the Working Group for their thoughtful, comprehensive approach to these important issues.

MetLife is providing this comment letter as a financial end-user of derivatives that regularly uses these instruments to responsibly and effectively hedge the risks associated with our investment portfolio, and insurance and annuity product liabilities. MetLife's continued ability to manage and hedge financial risks through the use of derivatives is an essential component of our risk management program. This risk management framework allows MetLife to offer a broad range of insurance and annuity products that provide over 90 million policyholders across the globe, with a personal financial safety net that protects against catastrophic losses and ensures financial stability in retirement. To the extent compliance with the Margin Requirements increases MetLife's costs of hedging these insurance and retirement products, a portion of such costs are likely to be passed on to our customers in the form of higher premiums. To the extent that MetLife is unable to appropriately hedge the financial risks in certain products or the costs of hedging certain products becomes prohibitive, MetLife may, in some instances, be forced to discontinue offering certain insurance or retirement products altogether.

Responses to Specific Questions Posed in the Second Consultative Document

Question 1. *Given the particular characteristics of physically settled FX Forwards and Swaps, should they be exempted from initial margin requirements with variation margin required either as a result of either supervisory guidance or national regulation? Should physically-settled FX forwards and swaps with different maturities be subject to different treatments of different maturities have different treatments?*

Response to Question 1. We largely agree with the position taken by the regulators in the U.S. that FX Forwards and Swaps that are physically–settled do not pose systemic risk where well developed payment and settlement systems exist. Accordingly, Initial Margin should not be required in such circumstances because the payment versus payment settlement methods of such contracts mitigate systemic risk. The U.S. Regulators noted that Initial Margin requirements for physically-settled FX Forwards and Swaps may increase operational risk in markets that already operate in an efficient manner. Exempting physically-settled FX Forwards and Swaps that are settled on a recognized payment system provides sufficient protection to market participants, without increasing systemic risk or providing opportunities for market participants to structure their FX trading activities to avoid otherwise valid margin requirements.

Question 2. *Should re-hypothecation be allowed to finance /hedge customer positions if customer assets are protected in a manner consistent with the key principle? Specifically, should re-hypothecation be allowed under strict conditions such as (i) collateral can only be re-hypothecated to finance/hedge customer, non-proprietary positions, (ii) the pledgee treats re-hypothecated collateral as customer assets, and (iii) the applicable insolvency regime allows customer first priority claim over the pledged collateral?*

Response to Question 2. As a result of the liquidity constraints associated with universal two-way initial margin, MetLife believes that customers and swap dealers should have the flexibility to determine whether swap dealers will be required to post Initial Margin on a case-by-case basis. Such a determination would be based upon the nature of the trade, product type and creditworthiness of the swap dealer. For example, an initial margin posting by a swap dealer may be appropriate when a customer purchases a fully-paid option from the swap dealer because the customer could have substantial continuing exposure to the swap dealer during the Close-Out Period associated with the bankruptcy/insolvency of such swap dealer. Moreover, customers should have the ability to choose the appropriate form and type of protection applicable to initial and variation margin pledged, including Tri-party or Custodial Arrangements, as well as granting limited re-hypothecation rights over initial or variation margin. We agree with the observations of the Working Group in Section 5(b) of the Background Information that requiring the segregation or other protection of initial margin may create material incremental liquidity demands and trading costs relative to current practices, Swap Dealers and financial firms will be required to divert significantly more liquid assets to provide initial margin to counterparties on a gross, rather than net, basis. MetLife is concerned that an increase in swap dealers' trading costs will be passed through to financial end-users and that a portion of such costs will have to be passed on to our customers in the form of higher premiums. To the extent that the costs of hedging certain insurance products becomes prohibitive, MetLife may, in some instances, be forced to discontinue offering certain insurance or retirement products altogether.

Question 3. *Are the proposed phase-in arrangements appropriate? Do they appropriately trade off the systemic risk reduction and the incentive benefits with the liquidity, operational and transition costs associated with implementing the requirements? Are the proposed triggers and dates that provide for the phase-in of the requirements appropriately calibrated so that (i) the largest and most systemically-risky covered entities would be subject to the margining requirements at an earlier stage so as to reduce the systemic risk of non-centrally cleared derivatives and create incentive for central clearing, and (ii) the smaller and less systemically risky covered entities would be allowed more time to implement the new requirements? Should the phase-in arrangements apply to the exchange of variation margin, in addition to the exchange of initial margin as currently suggested? Or, given that variation margin is already a widely-adopted market practice, should variation margin be required as soon as the margin framework becomes effective (on 1 January 2015 as currently proposed) so as to remove existing gaps and reduce systemic risk? Do differences of market circumstances such as readiness of market participants and relatively small volumes of derivatives trading in emerging markets require flexibility with phase-in treatment, even for variation margin?*

Response to Question 3. MetLife supports the Working Group's proposed phase-in arrangements. We believe that the proposed phase-in periods are appropriate and represent a prudent balance between systemic risk considerations and liquidity, operational and transitional factors associated with implementing the recommendations in the Second Consultative Document. Because the near-final proposal would only apply the requirements to new transactions, Initial and Variation Margin would be posted gradually over time as new transactions replace old ones. The phase-in periods allow for responsible harmonization with numerous concurrent regulatory initiatives. We agree with the background discussion in Element 8 that BCBS-IOSCO should undertake a coordinated review of the margin standards once the requirements are in place and functioning to assess the overall efficacy of the standards and to ensure coordination across international jurisdictions.

Question 4. *BCBS-IOSCO seek comment on the accuracy and applicability of the Quantitative Impact Study (QIS) results.*

Response to Question 4. The conclusions of the QIS rely considerably on the ability of market participants to adopt internal models for the purposes of calculating initial margin requirements. This introduces practical considerations. First, the Margin Requirements mandate that margin models be approved by the appropriate regulatory body. Unless a standardized model is approved, the relevant regulatory bodies will spend significant time reviewing and approving margin models for each market participant who chooses to use one. Second, lack of an approved standardized model will give rise to increases in margin disputes as an outgrowth of universal two way margining. Third, lack of consistency among swap dealer models will inhibit the ability of financial end-users to novate trades between counterparties. In the event of a novation, the original swap dealer may need to post additional initial margin to the swap dealer entering into the trade. We believe this will decrease liquidity and price transparency and increase costs to swap dealers, which will likely be passed on to financial end-users.

In considering our comments, we respectfully request that the Working Group balance the public policy considerations of preserving safety and soundness in our financial markets against the need for customers such as MetLife to manage the capital markets risks associated with the insurance and retirement products we offer by utilizing derivatives as a risk management tool. We believe that certain aspects of the Margin Requirements, as currently drafted, could have unintended consequences to derivatives end-users like MetLife. Certain provisions, which are described in greater detail below, would cause MetLife to incur substantial costs as a result of reduced liquidity and availability of hedging instruments, thereby creating additional financial risk for our customers who may no longer have affordable access to retirement and savings products as a result of prohibitive cost increases or the reduced availability of such products.

Summary of MetLife Position on other Key Principles

As described below, we recommend the following modifications to the Margin Requirements to preserve life insurers' ability to provide the wide range of financial products on which our contract and policy holders depend, while preserving BCBS-IOSCO's core objectives of Reducing Systemic Risk and Promoting Centralized Clearing applied consistently on a cross-border basis. MetLife respectfully requests that the Working Group consider the following supplemental issues:

- Requirement 2.2 - Clarification that covered entities will have the flexibility to determine the allocation of the threshold amount (not to exceed Euro 50 million) among legal entities within the same consolidated group. This flexibility will reduce complexity and provide the risk management professionals at covered entities the opportunity to more efficiently manage counterparty risk
- Requirement 3.1 - Revision of the initial margin baseline to better reflect the length of time necessary to close out derivatives upon a swap dealer default, including distressed market scenarios such as those occurring in September 2008. Under the Margin Requirements, the standardized initial margin baseline contains initial margin requirements that greatly exceed the potential change in market value during the time period in which MetLife would close-out a defaulting counterparty. Based on our experience in the Lehman insolvency and other derivatives close-outs, we believe that it is more appropriate to use a five (5) day close-out window instead of the ten (10) day period specified in the Margin Requirements. As drafted, the Margin Requirements would require initial margin that, in some instances, is at least double the amounts that apply to comparable exchange-traded, futures. For example, under the standardized initial margin schedule, a non-cleared, 10-year interest rate swap could have initial margin of up to 6% of the notional amount. By contrast, a 10-year, exchange traded interest rate future typically has initial margin of approximately 3% of the notional amount. We believe that these amounts are excessive, particularly in circumstances where there is no approved margin model
- Requirement 3.3 - Creation of a framework to ensure consistency and standardization of margin models either across financial firms or through approved third party models. In addition to the robust dispute mechanics suggested by the Working Group, financial end-users should have full transparency into the margin model used by swap dealers as a

control to ensure that the financial end-user can validate the collateral requirements contained in the model;

- Requirement 3.4 – Clarification that initial margin for purchased options and credit default swaps that are not fully paid for at inception should be limited to the present value of the outstanding premium to be paid. This concept is a logical extension of the determination in Requirement 3.4 that for derivatives transactions where a firm faces no counterparty risk, collection of initial margin should not be required
- Requirement 3.4 – Allowance for netting of initial margin across product types for uncleared swaps governed under the same master netting agreement. The inability to net initial margin across product types would also create additional operational difficulties for tracking and exchanging margin for each class of products across multiple counterparties. As these swaps will be closed out contemporaneously and netted on a single payment basis, we believe that Initial margin, like variation margin should be netted
- Requirement 4.1 and Commentary 4(i) – We strongly support BCBS-IOSCO's position that "**The illustrative list in Requirement 4.1 should not be viewed as being exhaustive".** BCBS–IOSCO should strongly encourage national supervisors to, at a minimum adopt the Asset Classes and Haircuts listed in Appendix B, unless such national supervisors have a compelling reason not to do so in order to reduce cross-border regulatory arbitrage and to avoid reducing market liquidity. We further suggest that additional assets and instruments, such as Residential Mortgage-backed Securities and Commercial Mortgage-Backed Securities also be included to satisfy the Second Consultative Document's Requirement 4, and should be evaluated by regulators as eligible collateral. A broad range of high-quality collateral, with appropriate haircuts, will prudently allow covered swap entities to satisfy their margin obligations while also enhancing liquidity in the market and reducing systemic risk. The standardized haircut schedule in Appendix B, combined with the requirement that eligible collateral be highly liquid and hold its value in a time of market stress contained in Key Principle 4, largely addresses the Working Group's concern regarding collateral values during a derivatives close-out. Finally, MetLife believes that the additive haircut of 8% assessed to eligible collateral denominated in a currency other than its underlying derivative obligation is overly conservative and should be reduced to 3-5%.

<u>Conclusion</u>

MetLife appreciates the thoughtful approach that the Working Group has taken in formulating the Margin Requirements and we support the vast majority of the Principles and Requirements in the "Near Final" Rules. However, we respectfully submit that certain aspects discussed above have the potential to unintentionally increase risk to financial end-users and other similarly situated market participants whose derivatives usage largely consists of transactions to hedge financial and investment risk. Failure to address the items listed above will unnecessarily increase costs to MetLife and our customers.

We believe the uncleared OTC derivatives markets can function in a manner that promotes safety and soundness, while maintaining the ability of market participants like MetLife to continue to appropriately hedge risks and provide the insurance products upon which our customers rely.

MetLife is pleased to be able to continue to participate through the comment process in the framing of this critical new regulatory framework. Please feel free to contact either of us if you have any questions regarding this comment letter.

Respectfully,

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Todd F. Lurie

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