

Metropolitan Life Insurance Company  
10 Park Avenue, Morristown, NJ 07962

**Todd F. Lurie**  
Assistant General Counsel  
Tel 973-355-4368  
tlurie@metlife.com



**September 14, 2012**

Office of the Comptroller of the Currency 250 E Street, SW Mail Stop 2-3 Washington, DC 20219 RIN1557-AD43 Docket ID OCC-2011-0008	Ms. Jennifer J. Johnson, Secretary Board of Governors of the Federal Reserve System 20 <sup>th</sup> Street and Constitution Avenue, NW Washington, DC 20551 RIN 7100 AD74 Docket No. R-1415
Mr. Robert E. Feldman, Executive Secretary Attention: Comments/Legal ESS Federal Deposit Insurance Corporation 550 17 <sup>th</sup> Street, NW Washington, DC 20429 RIN 3064-AD79	Mr. Alfred M. Pollard, General Counsel Attention Comments/ RIN-AA45 Federal Housing Finance Agency Fourth Floor 1700 G Street, NW Washington, DC 20552 RIN2590-AA43
Mr. Gary K. Van Meter, Acting Director Office of Regulatory Policy Farm Credit Administration 1501 Farm Credit Drive McLean, VA 22102-5090 RIN3052-AC69	Mr. David Stawick, Secretary Commodity Futures Trading Commission Three Lafayette Centre 1155 21 <sup>st</sup> Street, N.W. Washington D.C. 20581 RIN 3038-AC97

**Re: Supplemental Request for Comment on Proposed Margin Requirements for Swap Dealers and Major Swap Participants**

Ladies and Gentlemen:

MetLife appreciates the opportunity to supplement our comments on the proposed regulations regarding Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants by the Commodity Futures Trading Commission (“CFTC”), which constitutes an important component of the overall regulatory framework required under Title VII of the Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) in connection with the execution and margining of uncleared over the counter swap transactions. For reference, our previous letter dated July 11, 2011 (the “July 2011 Letter”) is attached hereto as Appendix A.

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 in over 60 countries. 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 Pacific, Europe and the Middle East. MetLife, Inc. is a public company, registered under the Securities Act of 1934 and has securities listed on the New York Stock Exchange.

MetLife appreciates the substantial effort and consideration that the staff of the CFTC and the staffs of the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Farm Credit Administration (collectively, “the Prudential Regulators” and together with the CFTC, the “Regulators”) have dedicated to developing these Proposed Rules as well as the work of the Regulators in connection with the Working Group on Margin Requirements established by the Basel Committee on Banking Supervision (“BCBS”) and the International Organization of Securities Commissions (“IOSCO”) to develop harmonized international standards for margin for uncleared swaps. Further, MetLife fully recognizes the public policy rationale behind the Proposed Rules and supports the Regulators’ attempts to increase the safety and soundness of the derivatives markets. However, we have serious concerns that the Proposed Rules will dramatically increase MetLife’s costs and/or decrease the effectiveness of our hedging strategies, ultimately affecting the cost and range of products we are able to offer to the public.

BCBS and IOSCO published a July 2012 consultative paper (“Consultative Paper”) that outlined proposed margin requirements for non-centrally cleared derivatives. The consultative paper addressed: (i) the instruments that would be subject to margin requirements; (ii) the market participants to be subject to margin requirements; (iii) initial and variation margin posting methodology; (iv) eligible collateral; (v) treatment of provided margin; (vi) treatment of inter-affiliate transactions; and, (vii) treatment of cross-border transactions.

In response to these international efforts to implement consistent global standards for margin requirements for non-centrally cleared derivatives, the CFTC indicated that it will consider the final WGMR policy recommendations when adopting final CFTC rules for margin on uncleared swaps, and may adapt final rules that conform to the final policy recommendations of BCBS and IOSCO. The CFTC, therefore, determined it was appropriate to extend the comment period on its proposed margin requirements to give interested parties an opportunity to submit comments on the Consultative Paper concurrently with the CFTC’s proposed rule.

In considering our comments, we respectfully request that the CFTC and the Prudential Regulators continue to balance the public policy considerations of preserving safety and soundness in the financial markets against the need for financial end users 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 the Proposed Rules, as currently drafted, will cause financial end users to incur substantial costs and create additional financial risk for individual families and retirees 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

As described below and in the July 2011 Letter, we recommend the following modifications to the Proposed Rules to preserve life insurers' ability to provide the wide range of financial products on which our contract and policy holders depend:

- Reduction of initial margin requirements to be more consistent with comparable cleared derivatives trades and reflective of the actual risk of the particular transaction;
- Expansion of the types of eligible collateral that can be used as margin to include high-quality corporate bonds and U.S agency-backed, residential mortgage-backed securities ("Agency RMBS");<sup>1</sup>
- Mutual, two-way variation margin posting requirements applicable to Swap Dealers ("SDs"), Major Swap Participants ("MSPs") and financial end users with flexibility for financial end users, SDs and MSPs to determine the circumstances and amounts of Initial Margin to be pledged by SDs and MSPs to financial end users ;
- Netting of margin across product types and across pre- and post-enactment uncleared swaps with the same derivatives counterparty; and
- Flexibility for CSEs and financial end users to negotiate and determine the appropriate level of margin segregation and protection, and selection and approval of margin models

As a result of further consideration related to Initial and Variation Margin, and discussions with other market participants, MetLife has further refined its analysis and position with respect to Initial margin as set forth in greater detail below.

### **Expansion of the Two-Way Margin Posting Requirement for Variation Margin; Flexibility to Determine the Circumstances and Amounts of Initial Margin to be Pledged by SDs and MSPs to Financial End Users**

The Regulators' margin requirements focus exclusively on the collection of margin by SDs and MSPs from their counterparties. This formulation is based on the Regulators' preliminary determination that both the safety and soundness of the individual SDs and MSPs and of the financial system as a whole are enhanced by requiring such entities to collect, but not necessarily to post, margin in support of the uncleared swap transactions to which they are party.<sup>2</sup>

Although the CFTC's rule proposal regarding margin requirements preliminarily adopts an approach consistent with that of the Prudential Regulators, it does so with reservations, particularly

---

<sup>1</sup> Agency RMBS would include securities issued by the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Government National Mortgage Association ("Ginnie Mae").

<sup>2</sup> 76 Fed. Reg. 27564, 27567 (May 11, 2011)



in the context of swaps between SDs, MSPs and financial end users.<sup>3</sup> Specifically, the CFTC notes that two-way variation margin is an important and effective risk-mitigation tool for DCOs.<sup>4</sup> Moreover, the CFTC suggests that the imposition of a two-way margin requirement will enhance the stability of SDs, MSPs and the financial system for a number of reasons, including the following:

- A two-way variation margin requirement removes each day's exposure from the marketplace for all products and all participants and prevents SDs and MSPs from accumulating obligations they cannot fulfill.
- Unchecked accumulation of exposures was a contributing factor to the financial crisis that led to the enactment of the Dodd-Frank Act.

We generally agree with the CFTC position on variation margin, and note that the requirement of two-way posting of variation margin between SDs, MSPs and financial end users is of particular significance to MetLife. The mutual posting requirement for variation margin preserves the market practice typically observed in our swap transactions. This market practice enhances the safety and soundness of MetLife in a manner consistent with the regulatory scheme to which we are subject, thereby enhancing the stability of the financial system as a whole. Although the Prudential Regulators' approach presumably permits financial end users to require two-way posting as a matter of contract, we are concerned that SD and MSP counterparties may attempt to use this discrepancy to avoid two-way margining. We believe this result is undesirable, and recommend adoption of the CFTC approach requiring the posting of both variation margin by SDs and MSPs to their financial end-user counterparties, as a means of promoting safety and soundness in the financial markets.

The CFTC position is also broadly consistent with the preliminary positions set forth in the BCBS and IOSCO Consultative Paper which indicates that a majority of the BCBS and IOSCO members supported margin requirements that, in principle, would involve the mandatory exchange of both initial and variation margins among parties to non-centrally cleared derivatives, which was labeled as "Universal Two-way Margin." BCBS and IOSCO recognized that two-way posting of initial margin would impose substantial liquidity costs, and that the use of thresholds could potentially balance the policy goals of reducing systemic risk and promoting central clearing while mitigating the costs of bilateral margin exchange. BCBS and IOSCO considered a variety of options for implementing universal two-way margin. The Consultative Paper, however, revealed that no unanimous view developed on the design and calibration of thresholds to achieve an optimal compromise between liquidity burdens and reduced systemic risk.

As a result of further consideration of the liquidity constraints associated with universal two-way initial margin and discussions with other market participants, MetLife believes that SDs, MSPs and financial firms should have the flexibility to determine whether SDs, MSPs will be required to post initial Margin on a case-by-case basis depending on the nature of the trade, product type or creditworthiness of the SD or MSP, in order to mitigate the impacts of initial

---

<sup>3</sup> 76 Fed. Reg. 23732, 23736 (April 28, 2011).

<sup>4</sup> *Id.*

margin requirements on liquidity. For example, initial margin may be required for a customized fully-paid purchased equity option since the SD will have no continuing exposure to the financial end-user, whereas the financial end-user could have substantial exposure during the Close-Out Period on such option. Moreover, financial firms should have the ability to choose the type of protection applicable for initial or variation margin pledged to Swap Dealers and Major Swap Participants, which could include Tri-party or Custodial Arrangements, as well as granting re-hypothecation rights over initial or variation margin.

## **Conclusion**

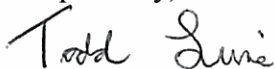
MetLife appreciates the thoughtful approach that the Regulators have taken in formulating proposed rules under Dodd-Frank. However, we respectfully submit that certain aspects of the proposed rules related to margin for uncleared swaps have the potential to unintentionally decrease liquidity, increase risk and unnecessarily increase costs to market participants, including MetLife, leading to increased costs and/or decreased product offerings for our customers. By modifying the proposals in the manner we have suggested, many of these risks and costs can be mitigated. Specifically, we suggest revising the proposed rules by:

- Expanding the range of eligible collateral to include High-quality Corporate Bonds and Agency RMBS;
- Reducing initial margin requirements to be more consistent with comparable cleared trades and consistent with the actual risk of the particular transaction;
- Preserving mutual two-way netting and collateral arrangements consistent with current market practice;
- Providing a measure of flexibility to financial end users, SDs and MSPs in the calculation of initial margin, the choice of margin model;
- Adopting mutual, two-way variation margin posting requirements applicable to SDs, MSPs and financial end users with flexibility for SDs, MSPs and financial end users to determine the circumstances and amounts of Initial Margin to be pledged by SDs and MSPs to financial end users; and
- Allowing financial end users to determine the type of protection applicable to margin pledged by financial end users to SDs and MSPs, which could include Custodial or Tri-party Accounts.

We believe that with these changes, the cleared and uncleared OTC derivatives markets can function in a manner that promotes safety and soundness for the financial markets and still allow market participants to continue to appropriately hedge risks and provide the insurance products upon which our customers rely.

Please feel free to contact me if you have any questions regarding this comment letter.

Respectfully,



Todd F. Lurie

# APPENDIX A

Metropolitan Life Insurance Company  
10 Park Avenue, Morristown, NJ 07962

**Kevin M. Budd**  
Associate General Counsel  
Tel 973-355-4985  
kbudd@metlife.com



**Todd F. Lurie**  
Assistant General Counsel  
Tel 973-355-4368  
tlurie@metlife.com

**July 11, 2011**

Office of the Comptroller of the Currency 250 E Street, SW Mail Stop 2-3 Washington, DC 20219 RIN1557-AD43 Docket ID OCC-2011-0008	Ms. Jennifer J. Johnson, Secretary Board of Governors of the Federal Reserve System 20 <sup>th</sup> Street and Constitution Avenue, NW Washington, DC 20551 RIN 7100 AD74 Docket No. R-1415
Mr. Robert E. Feldman, Executive Secretary Attention: Comments/Legal ESS Federal Deposit Insurance Corporation 550 17 <sup>th</sup> Street, NW Washington, DC 20429 RIN 3064-AD79	Mr. Alfred M. Pollard, General Counsel Attention Comments/ RIN-AA45 Federal Housing Finance Agency Fourth Floor 1700 G Street, NW Washington, DC 20552 RIN2590-AA43
Mr. Gary K. Van Meter, Acting Director Office of Regulatory Policy Farm Credit Administration 1501 Farm Credit Drive McLean, VA 22102-5090 RIN3052-AC69	Mr. David Stawick, Secretary Commodity Futures Trading Commission Three Lafayette Centre 1155 21 <sup>st</sup> Street, N.W. Washington D.C. 20581 RIN 3038-AC97

**Re: Request for Comment on Margin and Capital Requirements for Covered Swap Entities**

Ladies and Gentlemen:

MetLife appreciates the opportunity to comment on the proposed regulations regarding (i) Margin and Capital Requirements for Covered Swap Entities issued collectively by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Farm Credit Administration (collectively, "the Prudential Regulators") and (ii) (Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants by the Commodity Futures Trading Commission ("CFTC" and together with the Prudential Regulators, the "Regulators"), which constitutes an important component of the overall regulatory framework required under Title VII of the Wall Street Reform and Consumer Protection Act ("Dodd-Frank") in connection



with the execution and margining of uncleared Over the Counter swap transactions.

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 in over 60 countries. 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 Pacific, Europe and the Middle East. MetLife, Inc. is a public company, registered under the Securities Act of 1934 and has securities listed on the New York Stock Exchange.

MetLife appreciates the substantial effort and consideration that the staffs of the Regulators have dedicated to developing these Proposed Rules. Further, MetLife fully recognizes the public policy rationale behind the Proposed Rules and supports the Regulators' attempts to increase the safety and soundness of the derivatives markets. However, we have very serious concerns that the Proposed Rules will dramatically increase MetLife's costs and/or decrease the effectiveness of our hedging strategies, ultimately affecting the cost and range of products we are able to offer to the public.

MetLife is providing this comment letter from the perspective of a financial end-user of derivatives that regularly uses these instruments to responsibly and effectively hedge the risks associated with our investment portfolio, capital markets risks 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 in the U.S. and across the globe, with a personal financial safety net that protects against catastrophic losses and ensures financial stability in retirement. If compliance with the Proposed Rules 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 the costs of hedging certain products becomes prohibitive, MetLife may, in some instances, be forced to discontinue offering certain insurance or retirement products altogether.

In considering our comments, we respectfully request that the Regulators balance the public policy considerations of preserving safety and soundness in our financial markets against the need for financial end users 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 the Proposed Rules, as currently drafted, will cause financial end users to incur substantial costs and create additional financial risk for individual families and retirees 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

As described below, we recommend the following modifications to the Proposed Rules to preserve life insurers' ability to provide the wide range of financial products on which our contract and policy holders depend:

- Reduction of initial margin requirements to be more consistent with comparable cleared derivatives trades and reflective of the actual risk of the particular transaction;
- Expansion of the types of eligible collateral that can be used as margin to include high-quality corporate bonds and U.S. agency-backed, residential mortgage-backed securities ("Agency RMBS");<sup>1</sup>
- Mutual, two-way margin posting requirements applicable to both CSEs and financial end users;
- Netting of initial margin across product types and across pre- and post-enactment uncleared swaps with the same derivatives counterparty; and
- Flexibility for CSEs and financial end users to negotiate and determine the appropriate level of margin segregation and protection, and selection and approval of margin models

In addition, the rules proposed by the Regulators and the Securities and Exchange Commission ("SEC") must be consistent. Failure to achieve consistency will only exacerbate the adverse impact on life insurers and create unnecessary costs and confusion.

### **Initial Margin and Financial End Users**

MetLife has traditionally been an active participant in the exchange-traded futures and options markets, as well as the bilaterally negotiated over-the-counter (OTC) derivatives markets to facilitate the hedging of our investment portfolio and insurance and retirement product liabilities. In executing OTC derivatives transactions, MetLife utilizes the industry standard International Swaps and Derivatives Association (ISDA) Master Agreement and Credit Support Annex which provides for the systematic exchange of variation margin between the parties to cover changes in market value, generally on a daily basis. The MetLife family of insurance companies are licensed and subject to regulation in each U.S. and international jurisdiction in which they conduct business. The state insurance regulation applicable to MetLife generally limits our U.S. insurer's use of derivatives to hedging, asset replication and limited writing of covered calls. Accordingly, the vast majority of MetLife's derivatives activity is confined to the hedging of investment portfolio assets and insurance and retirement product liabilities. As mentioned

---

<sup>1</sup> Agency RMBS would include securities issued by the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Government National Mortgage Association ("Ginnie Mae").

previously, MetLife's counterparty derivatives exposure is currently fully collateralized with the exception of intra-day market value movements. Finally, each of the MetLife U.S. insurance companies is subject to risk based capital (RBC) Requirements and reports its RBC based on a formula calculated by applying factors to various asset, premium and statutory reserve items, as well as taking into account the risk characteristics of the insurer. State insurance laws provide insurance regulators the authority to require various actions by, or take various actions against, an insurer whose RBC ratio does not meet or exceed certain RBC requirements. Clearly, the comprehensive scope of state insurance regulation regarding Risk Based Capital, the limited use of derivatives as hedging vehicle, and the prudent exposure reducing collateral management practices of MetLife have proven, and will continue to ensure, that MetLife pose very little risk to the financial markets.

Prior to 2008, MetLife exchanged variation margin with our trading counterparties subject to threshold amounts based on credit agency ratings. As a result of the financial crisis of 2008, MetLife, renegotiated our bilateral derivatives master agreements substantially reducing, and in many cases completely eliminating, exposure thresholds for the posting of variation margin. Consequently, MetLife's counterparty derivatives exposure is generally fully collateralized with the exceptions of intra-day market value movements and the one day period between when a margin call is made and satisfied. With limited exceptions, MetLife does not currently pledge initial margin with our trading counterparties in respect of OTC derivatives transactions. The concept of initial margin, or "Independent Amount" as currently referred to under the ISDA Definitions, has been universally recognized in the derivatives marketplace as an *additional* measure of protection, to cover market exposure in respect of derivatives transactions during the time period in which transactions are valued and closed-out against a defaulting counterparty. To the extent that insurers, such as MetLife, remain fully collateralized with respect to their derivatives exposure, the initial margin requirements under the Proposed Rules are disproportionate in relation to the risk such initial margin is intended to mitigate. Under the Proposed Rules, the initial margin requirements 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 for the Regulators to use a five (5) day close-out window instead of the ten (10) day period utilized in the Proposed Rules. As drafted, the proposed rules would require initial margin that, in some instances, is at least double the amounts that apply to comparable exchange-traded, futures.<sup>2</sup> We believe that these amounts are excessive, particularly where there is no alternative for Centralized Clearing or no CSE margin model has been approved by the Prudential Regulators or developed by clearinghouses in accordance with the CFTC proposed rules.<sup>3</sup> Implementation of initial margin rules should closely track the implementation of clearing to the extent that it is phased in by asset class or type of counterparty.

As a financial end-user of derivatives, MetLife poses no substantial risk to the U.S. financial markets. MetLife respectfully requests that the Regulators reduce the standard initial

---

<sup>2</sup> For example, under the Prudential Regulators' proposed initial margin look-up table, 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.

<sup>3</sup> We presume that margin models will require lower initial margin amounts, but that remains uncertain.



margin requirements in the Proposed Rules to levels consistent with those required to protect swap participants from the risk of loss due to the insufficiency of variation margin during the close-out of a defaulted swap counterparty.

### **Eligible Collateral and Increased Hedging Costs.**

MetLife believes that the Proposed Rules will result in substantially increased hedging costs because; (i) as stated above, the level of initial margin for uncleared OTC derivatives trades under the Proposed Rules is disproportionately high relative to the risk it seeks to mitigate, and (ii) the exclusion of high quality corporate bonds and agency MBS, which are a mainstay of an insurance company's investment portfolio, from the list of eligible collateral.

MetLife anticipates that, at least until central clearinghouses accept a broad range of derivatives transactions for clearing that will more precisely match the underlying asset or liability being hedged, necessity will require that we execute bilateral OTC derivative transactions to effectively implement our hedging strategies. The alternative would be to execute exchange traded derivatives with less correlation to the underlying asset or liability, which would ultimately reduce the effectiveness of our hedging strategies, and increase the risk inherent in our insurance and retirement products. However, the restrictions on eligible collateral imposed by Proposed Rules will substantially increase the costs associated with such OTC derivatives.

Existing OTC derivatives market practice permits the parties to pledge a range of securities as collateral for transactions documented under ISDAs and CSAs.<sup>4</sup> Contrary to the current market practice, the Proposed Rules severely limit the type of eligible collateral for initial margin on uncleared swap transactions to cash, U.S. treasuries and agency debt, and further restricts variation margin to cash and treasuries. The restrictions on eligible collateral in the Proposed Rules would force a significant departure from current collateral pledging practices which in turn will necessitate substantial changes to the way MetLife manages our investment portfolio.

Of key importance to MetLife is the ability to post high quality corporate bonds and Agency RMBS to satisfy initial and variation margin requirements. As stated above, MetLife and other insurers are primarily fixed income investors, that invest in high quality assets subject to investment guidelines that are monitored internally and by our state insurance regulators. Among these eligible investments are corporate bonds and Agency RMBS. Without the ability to post corporate and RMBS securities, MetLife will be forced to carry a greater percentage of lower yielding treasury and agency securities in its investment portfolio to satisfy initial and variation margin demands at the expense of sacrificing the higher yields available in corporate and Agency RMBS securities. The investment portfolio reallocation from corporate bonds and Agency RMBS into Cash and US treasury securities, and the resulting loss of income, represent the increased costs to MetLife of complying with the Proposed Rules. In order to maintain yields on our investment portfolio, the Proposed Rules create additional risk by providing incentives to increase investments in higher yielding, lower quality assets to offset increased holdings of low yield, low risk



treasuries.

Regulations should not penalize risk mitigation activities of financial end-users whose investment activities are subject to state regulation and oversight. This is consistent with the intent of Congress in passing the Dodd Frank Act and the bipartisan letters from Members of Congress stating that the new Dodd Frank margin requirements should not cause an increase in the cost for end users to hedge business risk.

In addition, we believe that reliance on collateral transformation type facilities to exchange ineligible Collateral types into eligible Collateral does not represent best risk management practice. Collateral, in its requisite types, will need to be maintained not only for current initial and variation margin levels but also for potential collateral calls. Many collateral repo facilities are short term in nature, and their presence can not be relied upon in times of systematic market stress. Creating permanent facilities to cover potential calls will be costly, and their availability will ultimately be tied to the creditworthiness of the institution providing the facility.

### **Securities Eligible for Margin Should be Expanded to Include Agency RMBS and High Quality Corporates**

It is important to note that the life insurance industry's practice of posting high quality corporate bonds and Agency RMBS did not create or magnify the problems in the financial markets during the recent crisis. We believe the high quality, liquidity and diversity of the broad range of securities posted, along with the haircuts customarily applied to such collateral under present credit support agreements, act as mitigating factors to concerns surrounding use of such assets as collateral.

In light of the Dodd-Frank Act's prohibition on relying upon credit ratings provided by nationally recognized statistical rating organizations (NRSROs), MetLife in conjunction with the American Council of Life Insurers has developed a framework that utilizes basic portfolio diversification techniques on corporate bonds that are included in broad, publicly available credit indices to demonstrate, almost to a level of statistical certainty, that a portfolio of highly liquid corporate bonds subject to an appropriate haircut will provide sufficient protection for OTC uncleared derivatives market participants even in the most severe market conditions. The proposal is an example of one methodology for including Corporate Bonds as eligible collateral for uncleared swaps while preserving flexibility for market participants to make their own risk management assessments. The proposal represents a flexible framework rather than a series of absolute requirements.

The data utilized in the analysis was drawn from September, 2008, at the height of one of the most severe, if not the most severe, economic downturns in U.S. history. We have demonstrated to a high degree of statistical certainty that a diversified, appropriately haircut portfolio of high quality corporate bonds would provide sufficient cushion even against the most severe economic downturns.

As shown in the analysis discussed below, with the methodology presented and an

appropriate level of haircut, based on one of the most severe, if not the most severe, economic downturns in history, we have demonstrated almost to the level of statistical certainty that the collateral positions would provide enough cushion even against some of the most severe economic downturns. Permitting a broader range of eligible collateral for both initial and variation margins would achieve the intent of securing the derivatives positions and minimize the liquidity stress on the marketplace and other unintended consequences described above.

In crafting the proposal, we chose the Barclays U.S. Credit Index, a broad-based index containing 4,430 issues/CUSIPs representing an outstanding amount of \$3.4 trillion. Using the Barclays U.S. Credit Index and its predecessor, has many advantages, including clearly defined eligibility rules, a defined list of eligible CUSIPs limited to large liquid issues and a ready source of daily pricing & historical data. The Barclays U.S. Credit Index is also widely benchmarked by money managers, providing wide acceptability by other financial end users. In addition, the Barclays Index is one of many indices that are available to reference high-quality, U.S. corporate bonds and our analysis could be applied to other indices as well.

Consistent with the belief of the Regulators that termination (close-out) of OTC uncleared derivatives and liquidation of collateral could take ten days in a stress scenario, we analyzed individual CUSIPs during 2008 and found that nearly 20% of CUSIPs experienced a ten-day price decline in excess of 20% with a maximum decline in excess of 90% in 0.2% of the CUSIPs, leading to the conclusion that tail events, although rare, do occur. Thus, a collateral pool made up of a single CUSIP is not advisable.

In expanding the analysis to look at the impact of adding additional CUSIPs to the collateral pool, we chose a single month (September 2008) to ensure a continuous set of CUSIPs, selected a random portfolio on the 1st Day of September, 2008, subject to diversification rules limiting each issuer and each broad sector (Financial Institutions, Industrials, Utilities, Transportation, Agencies, Local Authorities, Sovereign, and Supranational) to no more than 45% of the portfolio. The market value of the equally weighted portfolio was calculated as it evolves through the month, including the largest 10-day (rolling) price drop that occurred during the month. 250,000 trials were conducted and stored.

The analysis proves that corporate bond tail risk can be controlled with basic diversification rules (e.g., minimum of 20 CUSIPs and 45% concentration limit per High Level Sector) and that collateral haircuts of 15-20% provide a high degree of protection upon the occurrence of a CSE default. The maximum decline at the 99<sup>th</sup> percentile was 10.25% in our portfolio simulation. We also learned that further diversification past these rules provided little incremental benefit while substantially increasing operational burdens.

Our analysis showed that high quality Corporate bonds, subject to an appropriate haircut and diversified, can be prudently included as eligible collateral for cleared and uncleared derivative exposure. We also suggest that other high-quality collateral types such as Agency Debentures and Agency RMBS should also be included as eligible collateral for these purposes.



## Expansion of the Two-Way Margin Posting Requirement

The Regulators' margin requirements focus exclusively on the collection of margin by CSEs from their counterparties. This formulation is based on the Regulators' preliminary determination that both the safety and soundness of the individual CSEs and of the financial system as a whole are enhanced by requiring CSEs to collect, but not necessarily to post, margin in support of the uncleared swap transactions to which they are party.<sup>5</sup>

Although the CFTC's rule proposal regarding margin requirements preliminarily adopts an approach consistent with that of the Prudential Regulators, it does so with reservations, particularly in the context of swaps between CSEs and financial end users.<sup>6</sup> Specifically, the CFTC notes that two-way variation margin is an important and effective risk-mitigation tool for DCOs.<sup>7</sup> Moreover, the CFTC suggests that the imposition of a two-way margin requirement will enhance the stability of CSEs and the financial system for a number of reasons, including the following:

- A two-way margin requirement removes each day's exposure from the marketplace for all products and all participants and prevents CSEs from accumulating obligations they cannot fulfill.
- Unchecked accumulation of exposures was a contributing factor to the financial crisis that led to the enactment of the Dodd-Frank Act.

We respectfully submit that the CFTC presents the more compelling position on this issue. Moreover, the absence of a two-way posting requirement may serve as an incentive for CSEs to structure transactions, where possible, in a manner that avoids central clearing. This result would be inconsistent with the ultimate objectives of Title VII of Dodd-Frank.

Finally, we note that the requirement of two-way posting between CSEs and financial end users is of particular significance to MetLife. The mutual posting requirement preserves the market practice typically observed in our swap transactions. This market practice enhances the safety and soundness of MetLife in a manner consistent with the regulatory scheme to which we are subject, thereby enhancing the stability of the financial system as a whole. Although the Prudential Regulators' approach presumably permits financial end users to require two-way posting as a matter of contract, we are concerned that CSE counterparties may attempt to use this discrepancy to avoid two-way margining. We believe this result is undesirable, and we request that the Prudential Regulators adopt the approach suggested by the CFTC and require the posting of both initial and variation margin by CSEs to their financial end-user counterparties, as a means of promoting safety and soundness in the financial markets.

---

<sup>5</sup> 76 Fed. Reg. 27564, 27567 (May 11, 2011).

<sup>6</sup> 76 Fed. Reg. 23732, 23736 (April 28, 2011).

<sup>7</sup> *Id.*



## **Initial Margin Models and Consistency of Regulatory Framework**

The Regulators should strive to have initial margin calculated using substantially similar calculation methodologies that are applied objectively to the CSE and financial end-user. In instances where discretion is granted to the CSE, such as choice of margining model, we believe the financial end user should be involved in the decision making process. Many financial end users will have transactions with a CSE across a number of product types. It would greatly improve efficiency and reduce operational risk and regulatory arbitrage across the derivatives marketplace to be able to utilize a single, objective method of initial margin calculation.

For example, the Prudential Regulator's Proposed Rules, gives the CSE discretion in choosing certain calculation methods. Where discretion is granted to the CSE, we believe the financial end user must be involved in the valuation process in the same manner as in the Credit Support Annex to existing ISDA Master Agreements for uncleared OTC derivatives. In other instances we believe that certain obligations should be mandatory, as opposed to discretionary, as described in more detail below.

For example, the Prudential Regulators proposed rule Section \_\_.8(b) permits the CSE to choose between an initial margin model that meets the rule's criteria and the calculation method set out in Appendix A of the rule. Similarly, in CFTC proposed rule 23.155(a)(2), the CSE selects the margin calculation method that they desire to use. We feel that the financial end user should have a role in determining which method is used to prevent the CSE from choosing the method that automatically generates the most initial margin. The existence of mandatory two-way Initial Margin will also help address this concern as will financial end user approval for material changes proposed by a CSE to its model. The financial end user should also be able to review the model being proposed and have an approval right, as a control to ensure that the CSE is not requiring collateral in excess of the requirements of the model on a recurring basis. The same section of the Prudential Regulators proposed rules states that a CSE "may" use its initial margin model to calculate margin on a portfolio basis if there is a qualifying master netting agreement in place. The CFTC's proposed rule 23.155(c)(2)(i) also permits netting on a portfolio basis, but does not require it. We feel that there should be an affirmative obligation on the CSE to develop initial margin models that calculate margin on a portfolio basis if there is a qualifying master netting agreement in place. Initial margin should be adjusted to reflect new models approved by the regulators or models are approved with respect to cleared contracts, if the regulators incorporate the CFTC's proposed alternative approach.

A further example arises under proposed Section \_\_.8(b)(1) of the Proposed Regulators Proposed Rules, where the CSE currently has the choice to offset transactions entered into prior to the effective date. We believe that the financial end user, as a hedging party, should have the right to require netting of pre- and post-enactment contracts. Otherwise, the financial end user may be forced to pledge Initial Margin on pre-enactment trades in order to preserve the right to portfolio margining. This "choice" is in contrast to Dodd-Frank's exemption of pre-enactment swaps from imposing retroactive margin requirements.

With regard to the quantitative requirements set forth in Prudential Regulators Section

\_\_8(d)(1) and the CFTC's, proposed rule 23.155(b)(2)(vi), we believe that the proposed ten day close-out period is too long. In the Lehman Brothers' bankruptcy, our trades were terminated and closed-out or transferred within 3 business days. MetLife believes that initial margin calculated to cover potential future exposures generated in a five-day period will be more than sufficient to protect the CSEs as well as the financial system. Moreover, the Prudential Regulators requirement in Section \_\_8(d)(1) tying the calculation of initial margin to an addition of a new swap or security-based swap should be expanded to provide for the termination and close-out of a swap or security-based swap, and the return of any associated initial margin.

The Prudential Regulators specifically seek comment on whether derivative transactions that pose no counterparty risk (such as options or swaptions where full premium is paid at inception of the trade) should be excluded from any initial margin calculation. We believe such exclusion is appropriate.

Finally, with regard to quantitative requirements set forth in Section \_\_8(d)(4), even in cases where the initial margin model does not explicitly reflect offsetting exposures, where two trades directly offset each other, such offset should be required unless the financial end-user elects not to have such trades offset.

#### **Netting of Initial Margin Across Product Types**

Any model for the calculation of initial margin permitted by the Regulators must include the ability to net across product types.<sup>8</sup> However, the alternative methods permitted by the Proposed Rules do not permit netting across multiple types of swaps, other than between currency and interest rate swaps under the CFTC rule (Section 23.155(c)(2)(i), where any such reduction may not exceed 50% of the amount that would be required for the uncleared swap in the absence of a reduction.<sup>9</sup> Under the Prudential Regulators' proposed rule \_\_8(d)(3), the initial margin models may only permit offsetting exposures under a Qualifying Master Netting Agreement within each broad risk category (commodity, credit, equity and foreign exchange/interest rate), but not across broad risk categories. Significantly, netting among all types of swaps and security based swaps should be permitted as long as all such swaps and security based swaps are governed by the same Qualifying Master Netting Agreement. Without the ability to net initial margin, a party may be required to substantially overcollateralize its exposure, a result that would be further magnified if the rule retains only one-way margining where a financial end user could end up with a large claim for the return of excess initial margin from the CSE upon a CSE default. 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.

#### **Qualifying Master Netting Agreement**

As mentioned previously in this letter, posting of margin CSEs and financial end-users should be mutually mandatory. References in the definition of Qualifying Master Netting

---

<sup>8</sup> See CFTC Rule Section 23.155(b)(2)(v) and FR Rule Section \_\_8(b).

<sup>9</sup> Section 23.155(c)(2)(iii).



Agreement to CSEs should, therefore, refer to both CSEs and their counterparties.

The proposed definition of Qualifying Master Netting Agreement should be amended to clarify that a Qualifying Master Netting Agreement does not exclusively need to address the provisions set forth in the definition, but rather may also include any agreement that, at a minimum, contains the required provisions. This modification is necessary to ensure that other agreements, such as ISDA Master Agreements, which contain the required netting provisions, would satisfy the requirements for a Qualifying Master Netting Agreement. A conforming change would need to be made to the requirement of enforceability in paragraph (t)(3)(ii), so that this requirement runs only to the provisions set out in paragraph (t)(1) and (2) instead of to the entire agreement, to prevent unrelated provisions from disqualifying an agreement from the definition.

As payments due under some counterparties' derivative transactions may be subject to a temporary suspension under Title II of the Dodd-Frank Act<sup>10</sup>, we suggest that the language in paragraph (t)(2) be qualified to permit suspensions of payments required by a counterparty's regulators.

Where an agreement is subject to enforcement in multiple jurisdictions, a party should only be required to conduct the legal review set out in paragraph (t)(3) in the jurisdiction where that party has a reasonable belief that it would seek enforcement.

The requirement in paragraph (t)(4) mandating the monitoring of all "possible" changes in law is too broad and places too large a burden on parties to maintain a prospective review procedure. More appropriately, the requirement should be to monitor *changes* as they occur, as opposed to monitoring *possibilities*.

The requirement in paragraph (t)(5) is not clear enough with regard to which types of provisions are prohibited. For example, can payments be reduced for interest and fees? We suggest that the requirement be clarified so that what should be prohibited are provisions that either do not create a payment obligation for a party or extinguish a payment obligation of a party in whole or in part solely because of a party's status as a non-defaulting party. This approach would work to restrict standard "walkaway" clauses while permitting standard ISDA provisions permitting reductions of payments for interest and fees.

### **Segregation of Initial Margin**

The Regulators have proposed a robust system for segregating the initial margin posted by CSEs to other swap entities, citing the need to protect the safety and soundness of the CSE.<sup>11</sup> Similarly, financial end-users such as MetLife, who are being asked to provide unprecedented amounts of initial margin, have a sincere interest in ensuring the security of our pledged assets and assurances that our initial margin is not used simply as a source of liquidity for the CSEs. Rather, financial end users should have the right to require CSE's to hold collateral in custodial accounts,

---

<sup>10</sup> Dodd Frank Act Section 210(c)(8)(F)(ii) .

<sup>11</sup> 76 Fed. Reg. 27579 (May 11, 2011).



which will allow substitution of assets in the ordinary course of business but secure the out-of-the-money counterparty in the event of a default. As such, we are supportive of the requirement under Section 724(c) of the Act<sup>12</sup>, requiring swap dealers to provide upon request the segregation of margin with a third-party custodian. In keeping with Congressional intent with respect to the protections given to end-users, we respectfully urge the Prudential Regulators to include a provision for the segregation of end-users' uncleared initial margin in the final rule similar to the CFTC's proposed rule 23.158(a). MetLife supports reciprocal treatment for initial margin posted by CSEs, which may be required by our own regulators.

### **Consistency Among Regulators**

MetLife urges the Regulators to ensure that the rules concerning margin are consistent across agencies.<sup>13</sup> Consistency will reduce complexity attributable to implementation and compliance with the new margin rules. This will reduce potential confusion and error, and costs of implementation attributable to systems, training, documentation, accounting, staffing as well as ongoing legal, accounting, and operational costs. It will be more difficult for financial end users to set up and operate internal systems where there are differing requirements among dealers based on differing regulatory requirements. In addition, consistency will reduce the impact on end users upon the implementation of bank "push out" rules. Finally, to the extent possible, the U.S. regulations should be consistent with foreign regulations, in particular those of the European Union.

### **Phase-in for Rules Implementation**

MetLife respectfully requests that the Regulators consider the following issues and factors in setting the effective date of the new margin rules for financial end users:

- To the extent that the derivatives reforms are designed to incentivize end users to clear trades by imposing sizable initial margin levels on uncleared trades, implementation of the new margin rules should reflect a realistic time frame for clearinghouses to develop and list a range of transactions available for clearing. It is unfair to require financial end users like MetLife to comply with substantial increases in margin requirements for transacting uncleared trades if viable substitute cleared transaction alternatives do not exist in the market. Further, to the extent the final rules on margin for uncleared swaps require (or permit) reference to or incorporation of initial margin models for similar cleared transactions, and require greater amounts of initial margin where a similar cleared model does not exist, it is similarly unfair to impose these additional margin requirements on financial end users before clearinghouses are able to handle such transactions. Similarly, clearinghouses must be fully operational, with adequate volumes to promote liquidity prior to compelling financial end users to transact through a clearinghouse for a particular product.

---

<sup>12</sup> Dodd-Frank Wall Street Reform and Consumer Protection, Pub. L. No 111-203, §724, 124 Stat. 1376 (2010).

- CSEs and financial end users will need additional time to amend their contractual arrangements (primarily ISDA Agreements and Credit Support Annexes) to conform with the new requirements after final rules are adopted. It is generally expected that, unless financial end users are prepared to execute one-sided dealer template documentation, negotiations on any one set of amendments for an agreement could take an extended period of time and are subject to the prioritization and staffing levels of CSEs. It would be unfair to penalize end users who are attempting to comply with the Proposed Rules and fulfill their obligations to policyholders, by preventing them from executing uncleared trades and managing risk due to delays in documentation of required amendments. Delays should also be expected as foreign financial reforms are put in place, and CSE staffs are further stretched to negotiate amendments necessitated by such rules.

### Conclusion

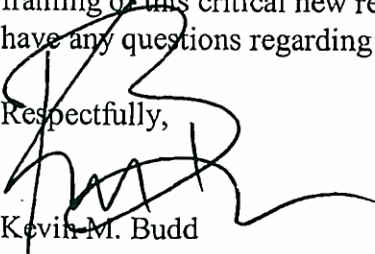
MetLife appreciates the thoughtful approach that the Regulators have taken in formulating proposed rules under Dodd-Frank. However, we respectfully submit that certain aspects of the proposed rules discussed above have the potential to unintentionally increase risk to a variety of market participants and unnecessarily increase costs to MetLife and our customers. By modifying the proposals in the manner we have suggested by:

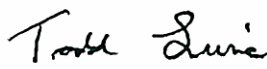
- Expanding the range of eligible collateral to include High-quality Corporate Bonds and Agency RMBS;
- Reducing initial margin requirements to be more consistent with comparable cleared trades and consistent with the actual risk of the particular transaction;
- Preserving mutual two-way netting and collateral arrangements consistent with current market practice;
- Providing a measure of flexibility to financial end users and CSEs in the calculation of initial margin, the choice of margin model; and
- Phasing-in new margin requirements in coordination with clearinghouse capabilities and in coordination with U.S. and foreign derivatives regulations.

We believe the cleared and uncleared OTC derivatives markets can function in a manner that promotes safety and soundness for our financial markets and still allow market participants 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,

  
Kevin M. Budd

  
Todd F. Lurie