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**Via E-Mail**
Mr. David A. Stawick
Secretary, Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Ms. Elizabeth M. Murphy
Secretary, Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-1090

**Re: MetLife Comment on Core Definitions in Title VII of the Dodd-Frank Act; CFTC Release No. 34-62717; SEC File No. S7-16-10**

Dear Mr. Stawick and Ms. Murphy:

We welcome the opportunity to offer our preliminary conceptual comments on the core definition of "major swap participant" in connection with your proposed rulemaking under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank"). The appropriate policy resolution of the issues posed as the Commodity Futures Trading Commission ("CFTC"), Securities Exchange Commission ("SEC") (collectively, "Commission") as well as the federal banking regulators is of critical importance to the U.S. economy at large and to those financial firms, such as MetLife, Inc. ("MetLife"), potentially affected and their stakeholders.

For ease of reference, this letter refers to the sections of Dodd Frank amending the Commodity Exchange Act ("CEA"), the defined terms thereunder and the rules to be adopted by the CFTC thereunder, but the discussion is intended to relate equally to the parallel regulation by the SEC contemplated under equivalent amendments to the Securities Exchange Act of 1934.

**<u>MetLife Background</u>**.

**Business.** MetLife has been in the business of providing insurance for over 140 years, and is a leading provider of insurance, employee benefits and financial services with operations throughout the United States and the Latin America, Europe and Asia Pacific regions. Through its subsidiaries and affiliates, MetLife, Inc. reaches more than 70 million customers around the world and its financial products and services are offered to over 90 of the top 100 FORTUNE 500® companies. MetLife is the largest life insurer in the United States (based on life insurance in-force). The MetLife companies offer life insurance, annuities, auto and home insurance, retail banking and other financial services to individuals, as well as group insurance and retirement and savings products and services to corporations and other institutions. MetLife's products and services are offered globally, through agents, third-party distributors such as banks and brokers, and direct marketing channels.

**Regulation.** MetLife's largest insurance company, Metropolitan Life Insurance Company, is licensed to transact insurance business in, and is subject to regulation and supervision by, all 50 states, the District of Columbia, Guam, Puerto Rico, Canada, the U.S. Virgin Islands and Northern Mariana Islands. Each of MetLife's insurance subsidiaries is licensed and regulated in each U.S. and international jurisdiction in which it conducts business.

In the U.S., state insurance laws and regulations govern the financial aspects of the insurance business, including standards of solvency, statutory reserves, reinsurance and capital adequacy, and the business conduct of insurers. Each insurance subsidiary is required to file reports, generally including detailed annual financial statements, with insurance regulatory authorities in each of the jurisdictions in which it does business, and its operations and accounts are subject to periodic examination by such authorities. Each of the Company's U.S. insurance subsidiaries 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. The major categories of risk involved are asset risk, insurance risk, interest rate risk, market risk and business risk. The formula is used as an early warning regulatory tool to identify possible inadequately capitalized insurers for purposes of initiating regulatory action, and not as a means to rank insurers generally. State insurance laws provide insurance regulators the authority to require various actions by, or take various actions against, insurers whose RBC ratio does not meet or exceed certain RBC levels.

The insurance contracts written by MetLife in the U.S. are generally subject to prior filing with and approval by state insurance regulators, as well as to rate regulation in some contexts.

The investments of each of the Company's U.S. insurance subsidiaries which back our contractual liabilities are subject to regulation under relevant state insurance laws that require diversification of the insurers' investment portfolios and limit the amount of investments in certain asset categories. The state regulation applicable to MetLife generally limits our U.S. insurers' use of derivatives to hedging, asset replication and limited writing of covered calls.

As a result of its ownership of MetLife Bank, NA, a federally chartered commercial bank, MetLife, Inc. became subject to regulation as a bank holding company and financial holding company on February 28, 2001. As such, it is subject to regulation under the Bank Holding Company Act of 1956 and to inspection, examination, and supervision by the Board of Governors of the Federal Reserve Bank of New York. MetLife, Inc. and MetLife Bank are subject to risk–based and leverage capital guidelines issued by the federal banking regulatory agencies for banks and financial holding companies. The federal banking regulatory agencies are required by law to take specific prompt corrective actions with respect to institutions that do not meet minimum capital standards. At December 31, 2009, MetLife, Inc. and MetLife Bank were in compliance with the aforementioned guidelines.

## General

The version of Title VII of Dodd Frank enacted by Congress reoriented the new swap regulatory regime for financial market end users, by separating mandatory clearing and transparency requirements from the new regulatory scheme relating to Major Swap Participants (MSPs).

Under Section 723 of Title VII (new Section 2(c)(1)(h) of the CEA), all financial entities, other than those smaller institutions which may be exempted by the Commission, will be required to clear their non-customized swap trades through a derivatives clearing organization ("DCO") rather than trading bilaterally as before. This requirement will apply whether or not the financial entities are MSPs or Swap Dealers and whether or not they are engaging in hedging activity.[1] In addition, the trading of financial end-users, both cleared and uncleared, will be subject to transaction reporting and consequent regulatory oversight under the new real-time public reporting requirements under Section 727 of Dodd Frank (new Section 2(a)(13) of the CEA).

The adopted statutory structure clarifies that the policy mandate under the MSP provisions is to identify and appropriately regulate that category of market end users whose swap activities pose a systemic risk to the market and the broader economy. Such end-users are to be designated as "major swap participants" subject to business conduct regulation, capital requirements and margin requirements for their non-cleared swaps. MetLife submits that there is now no practical need for the Commission to designate financial end users as MSPs in order to bring their trades into a cleared environment or to obtain transparency with respect to their trading activity.

**The MSP Provision**. Under Section 721(a)(2) of Dodd Frank (new Section 1a (33) of the CEA) there are three alternative ways for a non-dealer to be characterized as a major swap participant. The person must be **either**:

(1) a person who maintains a "substantial position" in any major swap category, **excluding** positions held for "hedging or mitigating" "commercial risk" or the positions of a pension plan held for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan (a "Category 1" MSP) ; **or**

(2) a person whose outstanding swaps (whether or not for hedging) create "substantial counterparty exposure" that could have serious adverse effects on the financial stability of the United States banking system or financial markets (a "Category 2" MSP); **or**

(3) a financial entity that is "highly leveraged relative to the amount of capital it holds" , is not subject to capital requirements established by an appropriate federal banking agency **and** has a "substantial position" (whether or not for hedging) of swaps in any major swap category (a "Category 3" MSP).

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[1] We note that during the course of the legislative debate over financial reform, the Chairman of the CFTC advocated strongly for the mandatory clearing of financial institutions trading volume, due to size of their participation in the over-the-counter derivatives markets. This policy recommendation was reflected in the final legislation.

"Substantial position" as used in Category 1 and Category 3 is to be defined at a "threshold that the Commission determines to be prudent for the effective monitoring, management and oversight of entities that are systemically important or can significantly impact the U.S. financial system. In setting the definition, the Commission must consider whether the contract is cleared or uncleared, and may take into consideration the value and quality of collateral held against counterparty exposures"

Regarding these criteria for regulation in the context of Dodd Frank, we have four initial observations before addressing the specifics of the definitions.

1. For each MSP Category, a determination of whether an end-user's swap positions are of a magnitude to pose a risk to the U.S. banking system or financial system is key to the regulatory decision as whether to regulate that end-user as an MSP. This focus, which is on the risk posed by the person's derivative positions, as a "substantial position" under Category 1 or Category 3 or as "substantial counterparty exposure" under Category 2, is to be distinguished from the identification, under Title I of Dodd Frank, of systemically important companies. Under Dodd Frank, an entity or enterprise subject to regulation as systematically important under Title I may nevertheless not be required to be regulated under Title VII, since its derivatives positions may not be sufficiently sizeable or risky to meet the Title VII criteria.

2. Congress has recognized clearing and collateralization as risk mitigants and potential offsetting factors in the risk determination. Quantitative thresholds established for determining what is a "substantial position" and what constitutes "substantial counterparty risk" should therefore be at levels at which such systemic risk is likely to be present as the result of the bankruptcy or failure to perform of a market end-user (for example through causing the failure of a major dealer, DCO or clearing member), taking into consideration the risk mitigation benefits of netting, collateral, and clearing.

3. Congress generally recognized that the use of swaps to manage business risk is socially beneficial and potentially not generative of systemic risk, through the carve-outs from the "substantial position" definition in Category 1 as well as in the commercial end-user hedging exclusion from mandatory clearing. The "commercial risk" and hedging and risk mitigation concepts should accordingly be given an appropriately broad definition under Category 1 of the MSP definition.

4. Dodd Frank does not mandate imposing a duplicate scheme of capital, margin and other prudential regulation upon entities already subject to market appropriate capital and trading restrictions and regulation.

The following analysis discusses each of the relevant statutory provisions of the MSP definition and suggests how the definitions could appropriately implement the purpose of Title VII.

## Discussion of MSP Elements

**Category 1 – Exclusion of positions held for "hedging or mitigating commercial risk".** The legislative history of Dodd Frank shows that the use of derivatives to hedge or mitigate business risks is beneficial and should not be inappropriately limited or penalized under the legislation.[2] The inclusion of Category 1 indicates that Congress did not intend businesses managing their risk to be subjected to regulation as MSPs absent other indicia of risk from their derivatives activity. Thus Category 1 requires that a person must have a "substantial position" in any swap category, *"excluding positions held for hedging or mitigating commercial risk,"* for MSP status under that Category to arise.

The logical starting point for defining a Category 1 hedge under the CEA would be the definition of bona fide hedging in Reg. 1.3(z)[3] and the CFTC's history of interpretation of that rule. By its very terms, Reg. 1.3(z) requires that hedging transactions be "economically appropriate to the reduction of risks in the conduct and management *of a commercial enterprise*" *[emphasis added].* The CFTC has flexibly applied this terminology over time to reflect development of the commodity markets from a predominantly agricultural market in physical commodities to a market in which financial exposures are hedged and managed by a wide range of market users, including financial businesses.[4] From the CFTC record it is clear that "hedging" through use of futures has

[2] In a July 15, 2020, colloquy between Senator Dodd, Chairman of the Senate Banking Committee and Senator Lincoln, Chair of the Senate Agriculture, Nutrition and Forestry Committee states that:

> "It is also important to note that few end users will be major swap participants, as we have excluded ''positions held for hedging or mitigating commercial risk'' from being considered as a ''substantial position'' under that definition….
>
> It is also the intent of this bill to distinguish between commercial end users hedging their risk and larger, riskier market participants. Regulators should distinguish between these types of companies when implementing new regulatory requirements."

[3] "Reg. 1.3 (z) ***Bona fide hedging transactions and positions*** **(1)** ***General definition***. Bona fide hedging transactions and positions shall mean transactions or positions in a contract for future delivery on any contract market, or in a commodity option, where such transactions or positions normally represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and ***where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise [emphasis added]***, and where they arise from:
(i) The potential change in the value of assets which a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising,
(ii) The potential change in the value of liabilities which a person owns or anticipates incurring, or
(iii) The potential change in the value of services which a person provides, purchases, or anticipates providing or purchasing ….
(3) ***Non-enumerated cases***. Upon specific request made in accordance with §1.47 of the regulations, the Commission may recognize transactions and positions other than those enumerated in paragraph (z)(2) of this section as bona fide hedging in such amount and under such terms and conditions as it may specify in accordance with the provisions of §1.47. . ."

[4] For general background, see "The CFTC's Hedging Definition – Development and Current Issues" by Blake Imel, Ronald Hobson and Paula Tosini, November 1985 ("CFTC Hedging Paper"); and the Hedging Definition and

been viewed by the CFTC as well as Congress as an activity that can validly be conducted by financial businesses.[5]

It follows that for purposes of Category 1, the term "commercial risk" should be defined to include the risks of financial as well as non-financial businesses. CFTC Reg. 1.3(z). is a flexible notion, linked to the development of futures markets and their use to hedge business risk. [6] Given the CFTCs history of treating financial business as "commercial enterprises" and hedgers under the CEA with respect to their activities in the regulated futures markets, it would be incongruous for the CFTC to conclude that the same activities, conducted over the counter, are not commercial. [7]

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the Use of Financial Futures and Options: Problems and Recommendations for Reform," Report of the Financial Products Advisory Committee of the Commodity Futures Trading Commission, June 1987. For specific instances of the applicability of the hedging exemption to financial entities, see, e.g., CFTC Interpretive Letters 94- 21, January 24, 1994 (CPO exemption granted to private investment limited partnership), 95-27 (CPO exemption granted for real estate fund hedging interest rate risk with financial futures), 97-30, April 21,1997 (CBOE market maker hedging its positions in the futures market) and other letters issued pursuant to request under Reg. 1.47 and 1.3(z)(3).

Under CFTC Reg. 4.5, certain financial entities which operated pooled investments may obtain exemption from CPO status. This exemption expressly includes, among a limited group, insurance companies with respect to futures activity conducted in their separate accounts. The exemption for some time required insurance companies claiming exclusion from regulation as CPOs to make representations with respect to the status of the separate account futures activity as "bona fide hedges" within the meaning of Reg. 1.3(z). It is noteworthy that the CFTC was directed to create this exemption, including the limitation that the futures be used by the excluded entity solely for hedging purposes, by the Senate Committee on Agriculture, Nutrition, and Forestry in the Committee Report relating to the 1982 amendments to the Commodity Exchange Act ("CEA") See S.Rep No. 384, 97th Cong., 2d Sess. 80 (1982) , quoted at pp. 27-28 of the CFTC Hedging Paper.

Other contexts under the CEA where hedging treatment has been relevant to financial firms include the use of the hedge definition for FCM net capital requirements (where hedged positions are subject to lower haircuts) and hedge exemptions from speculative limits on futures exchanges, for which financial institutions are eligible, as to which financial businesses routinely make hedge representations.

[5] The codification of the Rule 1.3(z) definition in Section 737(c) of Dodd Frank (CEA Section 4(c)(2)) does not appear to alter the situation. We believe that insurer hedging activity should continue to be regarded as bona fide hedging under this section as well, to the extent applicable.

[6] The CFTC's own website Glossary defines "commercial" as "an entity involved in the production, processing or merchandising of a commodity". Under the CEA, the term "commodity" is defined to include, in addition to a long list of physical commodities (excluding onions but now including movie rights) other goods and articles, ***and "all services, rights and interests in which contracts for future delivery are presently or in the future dealt in" (emphasis added)***, Given that a wide list of financial interests including bonds, interest rates, foreign currency, equity and debt indexes and credit characteristics are now the subject of contracts traded in the regulated futures markets, entities that trade and use these financial interests in their business are clearly "commercial" within the CFTC definition.

[7] A more recent document is further indicative that the CFTC has not viewed the term "commercial" in a way that would exclude financial end-users. In a preliminary release relating to the most recent restructuring of the CFTC's COT or "commitments of traders" report, the CFTC observed that the distinction between commercial and

From an economic standpoint, insurers and other financial service businesses, such as MetLife, are commercial enterprises, indistinguishable as to the hedging of their business risks from industrial, merchandising and other business organizations which might claim the hedge exclusion. Insurers create commercial financial products (insurance contracts or policies) which are sold to individual consumers, pension plans and other customers through a wide range of marketing channels across the country and globally. An insurer uses derivatives, whether swaps or traditional exchange traded futures, to reduce and manage risks associated with these contractual obligations, as well as risks related to its investment portfolio backing its insurance liabilities, the relation of its assets to its liabilities, and foreign currency risks relating to foreign investments and operations. Insurer usage is fundamentally the same as that of any non-financial business enterprise (be it an automaker or an integrated global oil company) which offers products and services, in commerce, to retail and institutional markets and hedges its requirements, commitments and exposures arising out of that business in the derivatives markets.

The structure of the so-called commercial end-user exemption from mandatory clearing under new CEA Section 2(c)(1)(h)(7) also supports our position. That exemption has two relevant requirements, first, that the entity claiming the exemption be hedging or mitigating "commercial risk" and second, that the entity not be a financial entity. The addition of the second element reveals Congress's view that financial end users have commercial risks relating to their lines of business that they might hedge.

Moreover, we submit that Congress's use of "hedging and mitigating" commercial risk language in Category 1 indicates that Congress intends that an expansive view to be taken of the hedge exclusion. If Congress had intended a narrow definition it would have either used the term "hedging" alone or utilized the "bona fide hedging" definition of CFTC Reg. 1.3(z) or Dodd Frank Section 737(c). That fact that Congress did not do so and in fact added the words "and mitigating" plainly indicates that this exclusion intends an expansive definition of hedging and can also encompass non-speculative derivatives positions used to manage economic risk, including potentially diversification and synthetic asset strategies, such as the conservative "replication" strategy permitted under state insurance laws.

Finally, MetLife urges the Commission to take into consideration the special, pervasive regulatory scheme applicable to insurance companies such as those in the MetLife group. In particular, we submit that our regulation limits the nature and quantity of the risks we can take through the use of derivatives, through limitations on both the type and quantity of our derivatives positions, and that such uses must relate specifically to our regulated insurance business. Thus, the positions taken by insurers to hedge or mitigate risk should be included under the Category 1

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non-commercial was, in usage in their reporting structure, essentially equivalent to the distinction between hedging and speculation, In this context, it appears that the term "commercial" refers to a connection between the transactions and a business conducted by a person (i.e. commercial trades or hedges) whereas the term "speculation" (non-commercial") is unconnected to the needs of a business enterprise. In any event the "commercial" terminology did not distinguish between types of business enterprises. CFTC Notice of Comprehensive Review of the Commitments of Traders Reporting Program, 71 FR 35627 (June 21, 2006) hedge exclusion.[8]

**Category 1 and 3 - "Substantial Position".** This threshold is intended to quantify swap positions which are themselves systemically risky, in that they could "significantly impact the financial system of the United States". The types of systemic impacts which might be caused in this context would most likely arise if an end-user failed to meet its obligations, causing the failure of a DCO, major clearing member or systemically important swap dealer. As such, we submit that the "substantial position" limit should be set based on appropriate considerations of possible systemic risk effects of the derivative positions.

Consequently, we urge that "substantial position" not be calculated on a notional or gross basis. Notional and gross position sizes are not a good indicator of the systemic risk posed by swap positions, given the prevalence of contractual netting arrangements and other risk mitigants. The "substantial position" definition should thus be based on appropriate exposure concepts and measurement methodology which take into consideration such factors as contractual netting and collateralization. International and U.S. financial regulators use such measures, and we suggest that methodology such as those adopted by the Bank of International Settlements in the Basel II accords would be most appropriate in this context. Such a risk measure would also accord with the methods market participants currently use in calculating exposures, including the contractual netting and collateralization arrangements employed.

In setting the definition for "substantial position" the Commission is directed to take into consideration the person's relative position in uncleared as opposed to cleared swaps. This is indicative that Congress intends exposure to cleared swaps to at least be considered in the context of the "substantial position" for MSP Categories 1 and 3, whereas clearing is not mentioned in the context of "substantial counterparty exposure" for Category 2. Given the statutory policy preference for clearing as a risk mitigant, it would be rational for the Commission to calculate "substantial position" in a manner that resulted in a lesser "charge" for cleared trades, perhaps even no charge.

**Collateralization**. The statute states that the Commission may take into consideration the value and quality of collateral held against counterparty exposures. MetLife believes that the Commission should treat collateral or margin provided by a party to its counterparty or a clearinghouse or exchange as reducing its exposure for purposes of the "substantial position" calculation, provided that the collateral is marked to market regularly, has a readily observable price, and is traded in a liquid market.

For financial institutions such as insurers, the continued ability to utilize high quality liquid securities such as investment grade corporate bonds and mortgage backed securities, in addition to cash, governments and agencies, as collateral for their swap transactions is a critical concern

[8] To the extent a distinction needs to be made, the insurance business is distinguishable to a great degree from the derivatives usage in pooled investment vehicles which offer a simple pass through (with or without the use of leverage) of investment fund performance to investors.

both in cleared and uncleared contexts. We recognize that appropriate haircuts would need to be developed and applied to some collateral securities both in the satisfaction of counterparty and exchange collateral/margin requirements and in application of the "substantial position" definition.

**Category 2 - "Substantial Counterparty Exposure".** MetLife submits that this term should also be defined in reference to systemic risk considerations and calculated in the same manner as "Substantial Exposure," that is, by giving effect to netting and collateral provided, but in this case excluding the exposure of regulated DCOs. This is because, in the OTC market, a counterparty exposure would normally derive from the creditworthiness of the bilateral party with which a person trades directly. Counterparty exposure is reduced when a person clears through a DCO. Category 2 of the MSP definition is intended to identify end-users (both hedging and speculative) whose swaps "create substantial counterparty exposure that could have serious adverse effects on the financial stability of the US banking system or financial markets".

In addition to a quantitative assessment of risk, the Commission might also seek to identify, for purposes of Category 2, qualitative factors which might bear on the riskiness of a person's arrangements with counterparties. Such factors might include the lack of standard market documentation, including master netting and collateral agreements or the type of very substantial "springing" collateral arrangements that were a major factor in the failure of AIG Financial Products Company.

**Category 3 Criteria**. A Category 3 MSP will be a financial entity which has "substantial positions", is "highly leveraged relative to the amount of capital it holds" and is not "subject to capital requirements established by an appropriate Federal banking authority". As with Category 2, MSP status may arise under this Category, whether or not the person engages in hedging. In this case, the primary additional factor of systemic risk identified as giving rise to MSP status is high leverage. While other types of financial entities may be operated in such a way as to pose this type of risk, the categories of entity normally identified as highly leveraged are unregulated investment vehicles such as hedge funds.

Highly Leveraged. We submit that the concept of "highly leveraged relative to the amount of capital it holds" should not be a mechanical concept but should relate to the types of risk potentially posed by a financial entity. Use of a simple balance sheet test or resort to the capital rules relevant to banks might be ultimately be determined to be workable. However, application of overly simplistic tests to diverse entities with different risk profiles might result in the regulatory net capturing an excessive number of non-systemically risky entities, burdening them with additional economic costs and constraints (including being commercially disadvantaged vis a vis competitors which are not MSPs) unjustified by any reasonable assessment of risk. We therefore urge careful development of this standard, supported by appropriate economic and financial analysis, including without limitation, review of leverage levels and standards prevailing in differing financial market sectors, and the risk posed by different business models and structures, to avoid such unintended consequences.

Subject To Capital Requirements Established By An Appropriate Federal Banking Authority. Entities subject to such requirements would not be treated as MSPs under Category 3. Thus, Congress has determined that any systemic risk posed by such entity's leverage is dealt with through application of a federal bank capital regime, in lieu of the MSP regulatory requirements. We submit that this carve-out should apply to (1) persons included in a bank holding company system which is subject to regulation and capital requirements on a consolidated basis under federal banking law as well as (2) persons which are individually or as part of a consolidated group subject to regulation (including potentially capital requirements) by the Federal Reserve under Title I of Dodd Frank, since the applicable federal banking requirements make regulation as MSPs under Category 3 unnecessary and burdensome.

**Swap Dealer**. While we are not commenting generally on the Swap Dealer definition, we believe that it should not be drawn to include companies that enter into derivatives only to aggregate or intermediate risk for their group companies and transact with third parties only in this limited capacity.

. . . .

The creation of a appropriate regulatory framework around the Title VII Dodd Frank provisions is of critical important to MetLife as an end-user of the over-the-counter derivatives markets. We are pleased to be afforded the opportunity to make this initial submission and look forward to continuing opportunities to participate as the rulemaking process proceeds. Please feel free to contact me at my email address above if you have any questions regarding this comment letter.

Respectfully,

Jennifer J. Kalb