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MetLife

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Financial Stability Board (FSB)
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland
By Email: fsb@bis.org

Re: MetLife Inc. response to August 12, 2013 FSB Consultative Document on the Application of the Key Attributes (the "KAs") of Effective Resolution Regimes to Non-Bank Financial Institutions

Dear Sir/Madam:

MetLife, Inc. (together with its subsidiaries and affiliates, collectively, "MetLife" or "we") is a leading global provider of insurance, annuities and employee benefit programs.

MetLife thanks the FSB for the opportunity to comment on the August 12, 2013 Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions. Our comments are limited to Resolution of Insurers (Appendix II), which we refer to hereafter as "FSB Insurance Guidance".

On July 18, 2013, the FSB named MetLife a global systemically important insurer (G-SII), and the US Financial Stability Oversight Council (FSOC) continues to evaluate MetLife for US non-bank SIFI status. For these reasons, we have a strong interest in engaging constructively in both the domestic and international systemic risk work streams to provide to policymakers, standard-setters and regulators our views on the management and regulation of systemic risk. We believe the proper approach is one that is activities-based and recognizes the unique business model of insurance relative to banking (and other types of financial services). Equally important in our opinion is the recognition of existing effective regulatory measures and mechanisms addressing both capital requirements and resolution of global insurers.

While we acknowledge that questions remain to be answered, and the debate must therefore continue, our basic premise is that the resolution of insurers poses a far lower risk to the financial system than resolution of banks. We maintain that this is the case even where the insurer engages in activities of a type that in some circumstances could potentially pose systemic risk.[1] We are not alone in this assumption.

Adair Turner, the former chairman of the U.K. Financial Services Authority, said the following in an October 2010 speech:

> "What we almost never face in insurance is long-term assets held against short-term liabilities, [which is] the defining characteristic of banking and shadow banking and a key source of potential volatility. From that essential difference flows the reason why integrated regulators tend in a crisis to sleep easier at night about their insurance company charges than about their banks."

The Preamble to the FSB Insurance Guidance recognizes this fact in the acknowledgment that unviable insurance activities are typically resolved through run-off and portfolio transfer procedures. The resolution mechanisms of insurance regulatory regimes around the world are appropriately tailored to reflect this material difference. Therefore, before providing our response to the consultation questions, we think it may be instructive to set forth in detail some of the key differences between insurance and banking insolvencies.

Unique Characteristics of Insurance

Both in recovery and in resolution, time is on the side of the persons managing insurance insolvencies—whether they be management or resolution authorities. The insurance business model and existing regulatory and legal authority provide an often lengthy period of time within which management and regulators can take action required to avert failure or ensure resolution occurs in an orderly fashion. The FSB Insurance Guidance should take into account this important aspect of the insurance business model and its impacts on insurance insolvency and resolution.

Sudden deterioration caused by a "run" on an insurer is improbable due to the nature of traditional insurance liabilities, which differ in material respects from traditional bank liabilities. Unlike the sources of bank funding (depositors and other short-term creditors), who expect repayment on demand, the purchasers of most insurance products do not consider their insurance products to function as sources of liquidity. Furthermore, typical insurance policies and other products either are not "surrenderable" or contain terms, like

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[1] In its 18 July, 2013 G-SII Policy Measures, the IAIS provides guidance on how to classify activities as traditional, non-traditional or financial non-insurance activity (See Section 3.2, pp. 13-17). This guidance provides a good start toward clarifying prior guidance on this difficult issue, and we believe further discussion is warranted. Discussion of the further adjustments we would recommend is not within the scope of this consultation. We propose to engage with the IAIS separately on this matter. For this reason, we avoid use of the term "NTNI activities" in this document and refer only to "potentially systemically risky activities," by which we mean activities that have the potential to materially contribute to a global systemic failure.

surrender charges and tax penalties,[2] that create powerful disincentives to surrender or early withdrawal. Market experience on surrenders during the last financial crisis shows that in major insurance markets such as the U.S., the E.U. and Japan, surrender rates actually *decreased* during the 2008 crisis, indicating that insurance products tend to add stability to markets in times of turmoil *(Surrenders in the Life Insurance Industry and their Impact on Liquidity*, The Geneva Association, August 2012).

Further, in many jurisdictions, court-issued moratoria on creditor action in insurance receiverships are longer and more expansive than in the bank receivership context. In addition, policyholder protection schemes like the state Guaranty Association system in the United States assure coverage to policyholders and contract holders up to statutorily-mandated levels upon the insolvency/liquidation of an insurer. Moreover, and perhaps most critically, insurance regulators and supervisors closely monitor the financial condition of insurance companies and, in many jurisdictions, have broad authority to and in practice do require insurers to take prompt corrective actions (such as analysis of the causes of financial deterioration and remediation plans)[3] prior to any insolvency or receivership process.

The nature of insurance itself tempers the risk of financial instability. What banks call maturity transformation at the core of the banking business, an insurer would call a maturity mismatch in its asset-liability insurance portfolio. Whereas banks typically borrow short-term and lend long-term, life insurers write long-term policies and invest premium dollars in long-term assets to satisfy those policy obligations as they mature. Prudent insurers avoid, and robust insurance regulatory regimes require them to avoid, such maturity mismatches. Lastly, portfolio size mitigates rather than aggravates the risk of an insurer's failure. Contrary to the notion for banking institutions of "too big to fail", bigger, generally speaking, is better for traditional insurance—the larger the risk pool, the more manageable the liability risks.

The above supports the premise that life insurer resolutions generally take place in an orderly manner over time and regulators are able to manage the resolution process with a minimum of disruption to the overall financial system.

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[2] For a full discussion of disincentives, please see *Surrenders in the Life Insurance Industry and their Impact on Liquidity*, Geneva Association, August 2012.

[3] For example, the NAIC supervisory intervention ladder would authorize the regulator of an insurer whose risk-based capital ratio falls below 200% RBC to require the insurer to submit a comprehensive capital plan identifying causes of deficiencies and corrective measures, to conduct an examination of the insurer's operations and activities and to require immediate remedial action. The Solvency II intervention ladder would authorize similar regulatory actions.

Insurance Companies do not provide systemically critical services or functions.

Although insurance plays an important social and economic role, insurance is not a systemically critical service or function. Whereas banks are critical to—indeed they form a part of—the payments system, insurers play no such systemically critical role. Unlike financial banks and shadow banks, insurers do not provide clearing or payment services relied upon by the entire market. Therefore, we believe that the FSB Insurance Guidance inappropriately implies the potential for insurance to be a source of systemic risk by defining insurance as critical or vital.

For example, the guidance asserts in Paragraph 1.2 that '[f]unctions provided by insurers that may constitute vital economic functions include risk transfer, risk pooling and the pooling of savings. The protection of these functions should include securing appropriate continuity of insurance coverage and payments." The foregoing statement would apply to the entire business of insurance—not just to a few, "systemically risky" insurers or activities.

In other instances the FSB Insurance Guidance describes ordinary business activities in ways that imply those activities are critical functions.

- Section 9.2 indicates that resolvability assessments should take into account whether a "chosen resolution strategy ensures the continuity of critical functions, including continuity and payment for critical insurance contracts".

- Section 9.4 (i), which provides guidance on how to assess the resolution strategy, suggests employers' liability, trade credit and transport liability insurance are examples of insurance that is "a pre-requisite to day-to-day economic activity" and which therefore could have "a material adverse impact on economic activity as a result of . . . disruption to continuity of insurance cover and payment". The failure of water supply would also have a material adverse impact on economic activity, but the failure of a single water company will not cause other water companies to fail, and will not halt the water supply.

- Section 10.3 provides that authorities require identification in RRPs of a firm's "essential and systemically important functions". These include "critical types of insurance policies the continuity of which is a priority in resolution for reasons of policyholder protection or financial stability".

If the intention in the use of this terminology is to classify life insurance as a systemically critical function, it is inconsistent with the FSB's definition of a critical function in its July 16 2013 Guidance on Identification of Critical Functions and Critical Shared Services. Therefore, we recommend correction in the FSB Insurance Guidance of any terms that suggest life insurance is systemically critical.

Reliance on existing Resolution Regimes

We are encouraged by and agree with the acknowledgment in the Preamble to FSB's Insurance Guidance "that traditional insurance activities and even some non-traditional insurance activities that are no longer viable will typically be resolved through run-off and portfolio transfer procedures". In keeping with the suggestion that existing tools should suffice in the majority of circumstances, we urge the FSB to specifically recognize the existing functioning regulatory and insolvency systems in various jurisdictions and provide flexibility in the application of the FSB Insurance Guidance in such jurisdictions.

For this reason, we strongly recommend that the KAs serve as illustrative guidance, rather than as standards. For example, resolution of insurers in the United States is the province of state insurance law. These laws contain, among other things, robust, time-tested resolution regimes that provide regulators with the necessary tools to resolve even a deeply insolvent insurer in an orderly and efficient manner, without exposing taxpayers to losses or causing material systemic effects. Insurance resolution regimes in Europe, Asia and South America share these attributes. Flexible application of the KAs would avoid unnecessary changes to well-tested regulatory frameworks and potential disruption of well-developed insurance markets without commensurate benefits to enhancing financial stability.

Our responses below to specific questions posed in the FSB Insurance Guidance reflect this premise.

Comments on Questions for Consultation

Question 23: MetLife strongly recommends avoiding distinctions between insurers that engage only in "traditional" activities and those that carry out "NTNI activities". In the current state of the art, systemic risk analysts can, as between institutions or activities, make no distinctions that would be fair and justified—or even analytically useful. As discussed below, any such distinction between institutions would be arbitrary and unfair to the "NTNI" group if it were to result in more onerous resolution measures.

As discussed in Footnote 1 above, the IAIS July 18 2013 G-SII Policy Measures definition of activities labeled "NTNI" demonstrates that defining which non-traditional activities may pose risk and which ones may pose no risk or even mitigate risk depends on many variables, including regulatory treatment and internal company management of the activity. While we would agree with certain aspects of the IAIS definition, we recommend moving away from the label "NTNI" itself toward a focus on and assessment of activities that have the potential to materially contribute to a global systemic failure. The questions to be asked include, for example, whether these activities involve "bank-like leverage and maturity transformation" not tied to an appropriate insurance purpose, and whether these activities are connected with the global financial system as to engender material systemic risk. As further illustration, in the context of derivatives utilization by insurers, prudent employment of credit default swaps to hedge credit risk of an insurance company investment portfolio or other types of derivatives to hedge existing insurance company product liabilities actually mitigate the risk of an insurance company failure. In contexts where derivatives activities are not tied to an appropriate insurance company objective, such activities should be subject to increased regulatory scrutiny and potential restrictions. A deeper analysis of the purpose of any particular activity should be the focus, as opposed to reliance on terminology that displaces careful analysis.

Furthermore, the FSB Insurance Guidance should recommend that Recovery and Resolution Planning should be consolidated and comprehensive, with all activities in a group (irrespective of whether activities conducted are considered potentially systemically risky) encompassed within a single comprehensive plan.

Question 24: While we agree that protection of policyholders is the paramount objective in insurance resolution, we recommend that the guidance should be clear that full recoveries are not promised, nor are they necessary to avoid systemic impact to the financial system.

Question 25 is encouraging in its recognition that procedures under ordinary insolvency law may be suitable in many insurance failures and that resolution tools are likely to be required less frequently for insurers than other kinds of financial institutions (such as banks).

As discussed above, we urge the FSB to specifically recognize the existing functioning regulatory and insolvency systems in various jurisdictions and provide flexibility in the application of the FSB Insurance Guidance in such jurisdictions. Flexible application of the KAs would avoid unnecessary changes to time-tested regulatory regimes and potential disruption of functioning insurance markets without resulting benefits to stability of the global economy. We further recommend that the guidance focus on activities that have the potential to materially contribute to a global systemic failure and correct any suggestion that insurance is a systemically critical or vital function.

Question 26: Insurance is intensively regulated in many jurisdictions, and many of the broad range of resolution powers recommended to resolution authorities under KA 3.2 are reflected in the regulatory and insolvency regimes in such jurisdictions. For example, in the United States, state laws, regulations and best practices promote early intervention and in many cases obligate insurance regulators to require insurers to take corrective action well in advance of any insolvency or receivership process. In terms of specific provisions, Section 4.1 of the guidance in setting forth standards for when to institute insurer resolution blurs the line between recovery and resolution and would impose fixed triggers for initiating resolution processes. In particular, the policy objectives in Sections 4.1 (i) and (ii), which focus on policyholder recoveries, and Sections 4.1 (iii) and (iv), which focus on viability of the insurer, may be inconsistent. Furthermore, as mentioned in our comment on Question 24, less than full payment of policies would not expose the financial system to systemic risk. Although it requires further detail and flexibility, Section 4.1 (v) contains the more reasonable trigger.

The guidance could more meaningfully recognize existing supervisory intervention ladders such as the NAIC and EU Solvency II ladders of intervention.[4]

We reiterate our strong recommendation that the FSB take into account and acknowledge current, well-established and fully-functioning resolution regimes. We further recommend that in its evaluation of existing regimes, the FSB Insurance Guidance avoid focusing on form, which may differ by jurisdiction, and focus instead on substance and outcome, which may in all material respects be similar if not identical. This would deter inflexible rules, achieve the greatest level of consistency and avoid unnecessary regulatory duplication and disruptions to well-functioning insurance supervisory regimes and insurance markets.

<u>Question 27</u> asks whether the draft guidance deals appropriately with the application of powers to write down and restructure liabilities of insurers (paragraphs 4.4 to 4.6). Some of the resolution powers enumerated in paragraphs 4.3 (such as using bridge institutions), 4.4 and 5.5 should be informed by the local laws of the applicable jurisdiction and whether they conflict with market expectations. Established recovery rules for policyholders and creditors do not by themselves destabilize the insurance market, nor do they create any systemic risk. Consistent with our recommendation on recognition of existing regulatory and insolvency regimes, we urge that the FSB Insurance Guidance contemplate flexibility in its application, including discretion to write down and restructure liabilities of insurers in such regimes.

Several of the "essential elements" of a resolution plan set forth in Section 10.10 would be burdensome to compile, require numerous assumptions, and be of little practical use in an insolvency scenario. For instance, Section 10.10 (viii) requires the preparation and inclusion of "an estimate of the outcome for each class of policyholder upon winding up." Since creditor recoveries are necessarily dependent upon the distress event and conditions preceding resolution, it is unclear how such an exercise would be of any utility in actual resolution. MetLife submits that the primary focus of any resolution plan should be to identify the resolution tools and strategies, and to describe in practical terms how they could be implemented in the event of material financial distress or failure.

<u>Question 33</u>: Resolvability assessments and recovery and resolution planning are two areas requiring further attention. As an initial matter, MetLife supports the concept that resolution authorities should be coordinated in "undertaking a resolvability assessment to evaluate the feasibility and credibility of implementing the resolution strategy and operation resolution plan developed for the insurer".

[4] We note the suggestion in Section 5.2 that resolution authorities should have discretion to divide policyholders into subclasses and to treat subclasses differently in resolution if necessary to contain the effects of the insurer's failure, to maximize the value for creditors as a whole, or to meet other objectives of resolution. This is directly at odds with the insurance laws several key U.S. jurisdictions, which specifically prohibit discriminatory treatment in the resolution of an insurer. We would assume that such differences/conflicts of law issues will arise in numerous circumstances, which supports our recommendation for further flexibility in application of the guidance.

Section 9.1 of the FSB Insurance Guidance would require resolution authorities to conduct regular resolvability assessments of "[a]ll insurers that could be systemically significant or critical upon failure in a domestic or cross-border context". As discussed above, we recommend correction in the FSB Insurance Guidance of any terms suggesting that life insurance is systemically critical. More importantly, such assessments should focus on activities that have the potential to materially contribute to a global systemic failure, rather on institutions identified on the basis of size alone.

For resolution and recovery planning to be effective, it must be tailored to reflect the realities of the business of insurance, the long-term nature of insurance liabilities and the assets that defease such liabilities. It must also consider the regulatory landscape and its focus on early intervention, and the manner and pace with which any distress event is likely to unfold.

We also agree with paragraph 10.4, which provides that "[r]ecovery plans should be developed on the basis of severe stress scenarios that combine adverse systemic and idiosyncratic conditions. They need to take into account insurance specificities such as the longer pay-out duration and the liquidity profile of insurers." However, to be effective, the capital framework underlying these resolvability and assessment and planning tools needs to be robust and holistic and recognize the unique characteristics of the business of insurance. MetLife understands that the bank capital framework is familiar to traditional banking regulators, but no amount of "tailoring" will ever make bank capital standards fit a life insurer's balance sheet. Bank capital rules were established to protect depositors. They were not designed to ensure that a life insurance company can fulfill its long-term policyholder obligations.[5]

An institution-based approach that uses size as a key criterion to regulate and mitigate systemic risk runs the risk of overlooking real threats to the financial system. Long-Term Capital Management was hardly the largest financial firm of its day, but it was highly interconnected with the financial system in ways that raised fears of contagion if the firm were allowed to fail. An approach that focuses on activities is more likely to capture systemic risk, regardless of the size of the institution. While industry and regulators can debate which activities qualify as NTNI, MetLife hopes we can agree that an activities-based

[5] To address the foregoing concerns and to provide a balanced and effective regulatory capital framework, MetLife has proposed a comprehensive "aggregated activities-based approach" to regulation that is calibrated to the risk profile and business of insurance. This approach allows regulators to use existing rules that were designed for a particular activity, such as local statutory regulations for life insurance, or Basel III for bank-like activities. The fundamental difference in the business models of banks and insurers in certain circumstances may actually cause regulators to overlook key insurance risks under Basel III, while the potential cost to consumers could be significant. Such costs are estimated, for the United States alone, at up to $8 billion a year in higher prices or lower benefits.

approach would eliminate regulatory "gaps" and provide protection against another financial crisis by subjecting all potentially systemic activities to regulatory scrutiny.

Conclusion

In closing, MetLife would like to highlight the importance it ascribes to the work being pursued by the Financial Stability Board to ensure financial stability of the global economy through effective regulation of financial activities. Effective regulation of life insurers should fully recognize that the purpose of life insurers is not to avoid risk; it is to accept risk from others, pool it and manage it so that promised benefits are satisfied when due. We acknowledge that international regulators have a legitimate interest in scrutinizing the activities of global life insurers and understanding how such activities are effectively managed. For this reason, we propose that the optimal and most comprehensive approach to managing systemic risk in the financial system is a focus on activities rather than institutions. This approach would help avoid having truly risky activities take place in institutions that fall outside the scope of systemic regulation, and also the blanket application of unnecessary and inappropriate bank-centric rules on a few large firms, which could harm competition, and therefore consumers, without really reducing risk.

We would welcome the opportunity to discuss any of the foregoing points with the FSB.

Sincerely,

Ricardo Anzaldua
Executive Vice President and General Counsel