Statement of MetLife, Inc.

Before the

U.S. House of Representatives Committee on Financial Services

On

Systemic Regulation, Prudential Matters, Resolution Authority and Securitization

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Statement made by Steven A. Kandarian
Executive Vice President and Chief Investment Officer
MetLife, Inc.

Introduction

Chairman Frank, Ranking Member Bachus, members of the Committee, my name is Steve Kandarian and I am the Chief Investment Officer for MetLife, Inc. ("MetLife"). I want to thank you for inviting me to testify today at this hearing on Systemic Regulation, Prudential Matters, Resolution Authority and Securitization. I am here today in my capacity as an executive of MetLife. My testimony reflects the views of MetLife.

MetLife 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 reaches more than 70 million customers around the world and MetLife is the largest life insurer in the United States (based on life insurance in-force). 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 has a large, diversified investment portfolio that supports our promises, including investments in financial institutions and mortgage and asset-backed securities. In our 140 plus year history we have grown into a global company that is strong and trusted by our customers and our shareholders and we pride ourselves on having accomplished this not by taking unnecessary risks but through thoughtful strategies prudently implemented. We believe this view was reinforced by the results earlier this year of the capital assessment exercise, or "stress tests," performed by the Federal Reserve on MetLife. In addition, we were the only company among the 19 participants in the stress tests that did not also participate in the TARP Capital Purchase Program.

You have asked that MetLife provide its perspective on the various topics covered by the Obama Administration's regulatory reform proposals, including systemic risk, prudential matters, and resolution authority, as well the Committee's discussion drafts on these topics, which were released earlier this week (the "discussion drafts"). MetLife is the largest life insurer in the United States, based on life insurance in-force. We are also the only life insurer that is also a financial holding company. Because of our financial holding company status, the Federal Reserve serves as the "umbrella" supervisor of our holding company, in addition to the various "functional regulators" that serve as the primary regulators of our insurance, banking and securities businesses, such as our state insurance regulators, the OCC, and the SEC. While I will comment on certain aspects of the draft legislation, I believe that I can best contribute to the dialogue on systemic risk, holding company supervision, and resolution authority by providing some observations about the potential impact – generally and on insurance companies specifically – of the proposals being discussed. In addition, we have included at the end of this statement some suggested guidelines that we believe are important to keep in mind in connection with improving the securitization process.

We support the efforts of Congress and the Administration to address the root causes of the recent financial crisis and better monitor systemic risk within the financial system. It is reassuring to see that you are proceeding thoughtfully and deliberatively.

While we want to ensure that the activities that led to the problems in the financial market are subject to proper regulation and oversight, we believe that Congress should consider whether its proposals are appropriately tailored to address the problems and be confident that its solutions do not result in unintended consequences, which will only lead to new problems. We are pleased to be able to serve as a resource to the Committee in this effort.

Systemic Regulation, Prudential Matters, and Resolution Authority

The Administration and Congressional discussion drafts propose, among other things, to establish a new regulatory structure to oversee systemic risk within the financial system, enhance the prudential regulation of bank holding companies ("BHCs") and FHCs, and authorize federal regulators to assist and/or wind down certain financial companies whose failure could pose a threat to financial stability or economic conditions in the United States. In reviewing the discussion drafts, we have some questions about how each of the pieces will fit together, particularly how new regulators and regulatory structures would coordinate with existing regulators and regulatory structures, both on the domestic and the international front. For example, Congress proposes to establish a Federal Insurance Office ("FIO") but does not consistently require other regulators to consult and coordinate with that office or state insurance departments when they are taking actions that could impact a specific insurer or the insurance industry. We would propose that whenever an action taken by a federal official will affect a specific insurer or the insurance industry, that official should consult with the FIO. Also, new disclosure requirements should be reconciled with existing securities laws or exchange rules and requirements. We think it is critical that these questions be addressed as part of the regulatory reform process.

Systemic Risk

We recognize the need to identify, monitor, and control systemic risk within the financial system to help avoid future financial market crises. But, we are concerned that creating a system under which companies are subjected to different requirements will result in an unlevel playing field, which will raise its own issues and problems. This issue becomes particularly problematic if only a single company (or very small number of companies) in an industry is designated as a Tier 1 FHC. As proposed, we believe the concept of designating Tier 1 FHCs and subjecting such companies to enhanced prudential standards, including risk-based capital requirements, credit concentration limits, leverage limits, liquidity requirements and risk management requirements will create vulnerabilities in the financial system and result in an unlevel playing field.

Systemic threats can stem from varied sources, in addition to large institutions. For example, systemic risk can arise from problems affecting a collection of small institutions, rapidly increasing exposures to a particular asset class, unexpected volatility in key markets, pervasive deficiencies in risk management methodologies, or difficulties in the financial system's payments, clearing, and settlement infrastructure. Attempting to monitor, assess, and address systemic risk by focusing a higher level of regulation on a

discrete group of companies under a "tiered" system could result in little or no oversight of these types of sources, leaving the financial system exposed to potentially significant problems.

We propose that Congress consider regulating systemic risk by regulating – or enhancing existing regulation of – the activities that contribute to systemic risk and requiring that such regulation be applied and enforced without regard to the type or size of institution that is conducting the activity. Linking regulatory requirements, such as capital or risk management practices, to the activity rather than to the size of the institution engaging in the activity will help closing existing – and prevent future – regulatory gaps that could be exploited by companies looking to operate under a more lenient regulatory regime. The proposed systemic risk overseer could monitor the financial system as a whole, help identify new or growing sources of systemic risk, provide guidance on appropriate regulation of such activities, and ensure that regulators uniformly enforce consistent requirements on the companies engaged in these activities.

In addition, an activity-based system would help avoid the following negative consequences stemming from the unlevel playing field that would be created under a tiered system:

- Economies of scale and efficient allocation of capital could be adversely impacted to the detriment of consumers and shareholders of Tier 1 FHCs, as these companies will have to operate under higher regulatory standards than their non-Tier 1 competitors.

- Allowing non-Tier 1 FHCs to operate at less than a "well capitalized" and "well managed" status on a consolidated basis while engaging in the same activities as their Tier 1 competitors introduces additional systemic risk into the financial system and encourages companies to seek ways to qualify for the more lenient form of regulation.

- A tiered system that imposes heightened regulation and prudential standards on certain companies, as well as questions about the treatment of interests in such companies during a resolution proceeding, could adversely impact how such companies are perceived by analysts, investors and counterparties. Congress should carefully consider whether it wants to introduce uncertainty in the markets and make it more difficult for Tier 1 FHCs to raise capital or generate liquidity, which was one of the key problems that accelerated the financial crisis.

Benefits of Functional Regulation

The discussion drafts also propose to make significant changes to the concept of functional regulation. We need clarity and consistency on the treatment of insurers, and do not believe that they should be treated differently than banking and securities subsidiaries by taking away their status as "functionally regulated subsidiaries." In our view, the system of functional regulation worked well in the insurance industry, both

before and during the financial crisis, with few problems arising out of the regulated insurance companies, and can continue to be effective going forward.

Currently, the FED as the financial holding company regulator works in partnership with the other functional regulators, including state insurance regulators. While the FED currently serves as the "umbrella" supervisor of all BHCs, including FHCs like MetLife, the Bank Holding Company Act ("BHCA") appropriately limits its supervisory powers with respect to functionally regulated subsidiaries, including insurance companies. Supervision of these subsidiaries is left primarily to the subject matter experts, in our case, the state insurance departments. In order to fulfill its role as the "umbrella" supervisor the FED is able to obtain information and examine the non-functionally regulated subsidiaries of a BHC or FHC. With respect to the functionally regulated subsidiaries, the FED is able to obtain and rely on audited financial statements, reports submitted to functional regulators, and reports of examination prepared by the subsidiary's functional regulator and may conduct certain examinations. In our experience, the FED and the functional regulators have worked cooperatively, sharing information and insights that allow each regulator to perform its function. We believe that this model has worked well and we have benefited from the observations of our FED examiners.

Under the proposal, the new systemic regulator would have authority to prescribe more stringent prudential standards, conduct exams, require reports and enforce regulations; these powers would extend to all subsidiaries with no deference given to functional regulators, creating potential for inconsistent regulation. In addition, more stringent activity restrictions could be placed on functionally regulated subsidiaries than required by the functional regulators. In granting these authorities and extending them to functionally regulated subsidiaries, the proposed legislation arguably makes the new systemic regulator in some areas the de facto regulator for the entire Tier 1 company, including its insurance company subsidiaries, even though the new systemic regulators requirements may be in conflict with or duplicative of the work of the functional regulator. In contrast to other functionally regulated businesses, the discussion draft provides no enforcement role for state insurance regulators and instead leaves direct enforcement action to the FED.

To avoid these issues, we encourage Congress to maintain the structure that is currently in place for functionally regulated subsidiaries. We do believe that a new systemic risk regulator should have the ability to collect information and documents for the purpose of monitoring systemic risk. However, with respect to the insurance industry, any systemic regulator should be required to use the proposed FIO as a resource to help it collect and compile information from the insurance industry that it may need to fulfill its function. In addition, given the likelihood that the new systemic risk regulator will have limited insurance experience, we believe that when taking action that affects insurance company subsidiaries of an entity that is subject to the jurisdiction of the systemic risk regulator, the systemic risk regulator should give deference to the views of the proposed FIO, which, in turn would consult with the appropriate state insurance regulators.

Prompt Corrective Action and Enhanced Resolution Authority

The discussion drafts propose a new prompt corrective action ("PCA") regime for Tier 1 FHCs that tracks in many respects standards applicable to depository institutions and introduces a new resolution authority that would give the federal government new powers to assist and/or resolve BHCs or FHCs whose failure could have adverse effects on financial stability or economic conditions in the United States. We are pleased that the drafters have excluded certain types of institutions from the enhanced resolution authority provisions, including insurance companies, in recognition of the fact that there is already an effective process for addressing the resolution of distressed insurance companies under existing state law.

We are concerned, however, that in adopting the same type of tiered structure as has been proposed for addressing systemic risk, the PCA and enhanced resolution authority create potential conflicts. For example, under the proposed PCA regime, the measures which could be imposed if a Tier 1 FHC is less than well capitalized, include compelling divestiture or liquidation of an insurance company subsidiary, restricting capital distributions and mandating changes to the composition and compensation of management, could conflict with the insurance regulatory regime. Moreover, under the proposed enhanced resolution authority for BHCs and Tier 1 FHCs (and their non-excluded subsidiaries), what if the new federal resolution authority decided to wind down a financial holding company that also has a large insurance subsidiary? Given their different missions, the federal resolution authority might seek one treatment of the insurance subsidiary that is in direct conflict with the desires of state insurance regulators. In addition, it appears that neither a company that may be subject to the new resolution authority nor investors in such a company or counterparties in transactions with the company would know whether the bankruptcy code or the new resolution regime would apply. As a result, creditors, counterparties and other stakeholders will likely find it difficult to assess their credit risks to Tier 1 FHCs or BHCs subject to the enhanced resolution authority. This uncertainty would result in these companies paying a higher risk premium that would place them at a competitive disadvantage both domestically and globally and lead to higher costs that will ultimately be borne by consumers and shareholders.

In addition, only certain financial companies will bear the costs associated with utilization of the enhanced resolution authority through assessments that will be levied on these institutions. Given that the enhanced resolution authority is intended to benefit the nation as a whole, we do not believe that imposing its costs on a limited number of companies is appropriate.

Dangers of an Unlevel Playing Field

If the new systemic regulator is given the authority suggested in the discussion drafts, as described above, Tier 1 FHCs will have to operate on a different playing field

than their non-Tier 1 competitors. In addition to those cited above, other examples of this outcome include:

- If categorization and tiering of Tier 1 FHCs are left to the new systemic regulator, it could create an unlevel playing field, if widely divergent businesses and corporate forms are not considered. For example, would a mutual insurer be treated the same as a publicly traded insurer? Will the proposed regulatory regime account for the very different investment portfolios held by insurers as compared to banks?

- Stricter activity restrictions could be imposed on functionally regulated subsidiaries of Tier 1 FHCs than on those of their non-Tier 1 competitors.

- Companies engaged exclusively in activities "not financial in nature" would not be Tier 1 FHCs. Thus, firms engaged exclusively in activities deemed not financial in nature under the BHCA, e.g., real estate investment and management, would have a competitive advantage over Tier 1 FHCs engaged in those activities. So while these firms will engage in activities that could contribute significantly to the overall amount of risk in the financial system, they will do so without having to comply with any regulation applicable to a Tier 1 FHC or other regulated institution or oversight by the new systemic risk regulator.

So what is the problem with creating different regulatory standards for different categories of financial services providers that directly compete with each other? Subjecting financial services providers who are engaged in the same lines of business or providing the same products to different standards will inevitably result in attempts to avoid the stricter form of regulation. As a result of the recent credit crisis there has been much discussion about the role of regulatory arbitrage. We have also heard that certain activities, which may have been curtailed in heavily regulated parts of the industry, may have continued in more lightly regulated institutions, exacerbating the existing problem. Although we can try to design barriers to prevent activity from moving to the least regulated type of entity, history shows that it is not possible to anticipate the ways that can be devised to get around these barriers.

We are not suggesting that the financial services industry is perfectly regulated now or that Congress should sit by and do nothing to address the problems that we have seen in the recent past. Instead we are strongly encouraging Congress to continue to think carefully about the consequences – including the unintended consequences – of the changes that are being proposed on the companies that may be subject to Tier 1 FHC status, the companies that will not be subject to Tier 1 FHC status, and the investors and the customers of all of these companies. Rather than creating new regulatory bodies and new classes of financial companies that are subject to differing regulation, we suggest that Congress regulate activities that contribute to systemic risk, rather than creating a system of regulation that uses size of the financial institution as a key criterion. We believe that such a system would be more effective, easier to administer, and would result in fewer unintended consequences than the tiered structure proposed in the discussion

drafts. In addition, Congress might also consider whether it can direct the better leveraging of existing regulatory capabilities where appropriate authority has already been delegated to the regulators. Recent examples of utilizing existing authority can be found in (i) interagency guidance on funding and liquidity risk management directed to banks and BHCs to reinforce Principles for Sound Liquidity Risk Management & Supervision issued by the Basel Committee in September 2008, and (ii) September 2009 U.S. Treasury Principles for Reforming the U.S. and International Regulatory Capital Framework for Banking Firms (in consultation with bank regulators and supported by the Basel Committee).

Improving Securitization Markets

Historically, the securitization market has played an instrumental role in making financing available to American consumers and companies.[1] This financing, whether in the form of credit card financing, auto loans, mortgage loans, etc., has been a driver of U.S. economic growth during the last 30 years and has contributed to our higher standard of living.

As of the end of the first quarter of 2009, existing transactions in the securitization market had provided over $11 trillion dollars in financing to the U.S. economy. However, this number is rapidly declining. Unfortunately, current conditions in the securitization market are preventing it from contributing to U.S. economic recovery in a meaningful way during a very critical time.

Recent government programs like TALF and PPIP have supported new issuance and improved market liquidity in certain securitization sectors, but this is only temporary relief. Fundamental changes to certain practices are needed to ensure the securitization market's long-term sustainability as a major source of credit for the economy.

The following set of guidelines, if implemented, will contribute to restoring investor confidence in this market. It is recognized that some of these guidelines are being addressed in the various legislative and regulatory proposals put forward by Congress, the Obama Administration and the Securities and Exchange Commission relating to asset-backed securitization and regulation of credit rating agencies. It may not be necessary to include each and every point in a legislative proposal to improve the securitization markets, but believe that using them as a general guide crafting regulatory and market reforms can help renew investor confidence and allow securitization once again to become a source of financing that contributes to economic growth.

[1] The views expressed in this section do not apply to the securitization of life settlements. MetLife opposes the securitization of life settlements because it would invariably lead to more stranger-originated life insurance (life insurance purchased on a person by someone without a legitimate insurable interest) and would result in securities with unknown risks.

Alignment of Incentives

The economic incentives of the various participants in the securitization market are often misaligned. Some have a very short term focus and others depend on long term results. This misalignment is a root cause of many of the securitization market's problems today, and the market's inability to recover more rapidly. Here are some examples of this issue:

- Loan originators benefit from origination fees and often from servicing fees, but have limited economic interest in the actual long-term performance of securitized loans.

- Most rating agencies derive the bulk of their business and compensation upfront from the rating of new transactions, with no impact from the actual long-term performance of those transactions. This gives them little incentive to devote sufficient resources to the ongoing monitoring of structured products.

- Investment banks – when an aggregator of collateral for securitization - are incentivized to structure and market transactions as quickly as possible, with no repercussions from the long-term performance of these transactions.

- On the other hand, institutional investors and their clients (e.g., pensioners, policyholders and retail investors) derive benefit and incur risk from the long-term performance of these transactions.

There are various ways to better align incentives, including: (a) meaningful equity retention by originators and investment banks when acting as an aggregator of collateral, (b) strong representations and warranties from originators and banks, with the clear option to put back unqualified loans to originators and investment banks and (c) deferred or contingent compensation or compensation "clawbacks" or "escrows" for originators and investment banks tied to the long-term performance of securitization transactions. Implementation of any of these solutions, of course, must take into consideration the differences among the various types of securitizations (i.e., CMBS, RMBS and ABS), as well as the differences within the individual types (e.g., agency vs. non-agency RMBS).

Mitigation of Conflicts of Interest

Current practices in the securitization markets often present substantial conflicts of interest for many market participants. These conflicts may not be acted upon, but their mere presence detracts from the system's credibility and reduces investor trust and public confidence. These are some of the conflicts present in the current system:

- Although rating agencies must provide an impartial view of the credit quality of transactions, they risk losing a sale (and future business) if they have a more negative view than other agencies competing for that transaction.

- Certain critical servicing functions are often performed by institutions (or their affiliates) that also hold junior bonds in a transaction (or other related collateral outside the transaction), which may lead servicers to act in ways that are detrimental to senior bondholders.

Some actions that could help mitigate these conflicts of interest include: (a) consideration of alternative compensation models for rating agencies that extend for a longer time horizon and encourage ongoing monitoring, (b) implementation of transparency standards as to methodologies, analysis, data, and process to ensure independence in ratings decisions, (c) requirement for subordinated debt held by servicers or their affiliates to receive distributions only after all other debt has been fully paid off, and (d) requirement for control of securitization trusts to be exercised by the majority of bondholders rather than the junior bondholder class.

Improved Transparency

Structured finance investors are often unable to obtain key information that would allow them to make better investment decisions in some sectors. This leads to illiquidity, market distortions, or both. Here are some examples:

- Historical performance information on securitized assets is often incomplete or unavailable.

- Frequently, asset performance information in certain sectors is presented on a “pro-forma” basis, which can often be overly aggressive and misleading.

- Current performance information on securitized assets is often limited and not reported in a timely fashion.

- Rating agency surveillance reports often lack the frequency and depth required for investors to make better investment decisions.

The following are examples of actions that could improve transparency in the securitization markets: (a) establish minimum disclosure standards for assets to qualify for securitization, including granular loan level information when relevant, (b) require borrowers and servicers to provide key information on their securitized loans on a periodic basis, including supporting analysis for loan modifications or extensions granted by servicers, (c) require that rating agencies provide a set of performance statistics on a periodic basis during the life of a transaction and (d) establish an audit requirement to certify data accuracy and to review provider (e.g., trustee, servicer and depositor) compliance with required service standards.

Transaction Simplification

The complexity of many structured finance securities has added to the sector’s recent problems. To some extent, the lack of liquidity we have seen of late can be

attributed to the performance volatility of these transactions. This volatility could be partially mitigated with simpler structures. Some examples of this problem are:

- The size of many subordinate tranches, including junior AAA rated bonds, are often very small relative to the total amount of bonds in a securitization. As a result, losses on the underlying collateral can make these bonds behave in a binary way; either pay in full or lose the entire principal.

- Also, due to the small size of most bonds in a transaction and their resulting sensitivity to collateral losses, the ratings of these bonds can vary widely over time.

- In sectors such as commercial real estate, securitized loans are often part of a broader, complex financing package to the same borrowers and properties. This results in conflicting interests among multiple lenders and a lack of clarity about risk. It also results in a more difficult workout process for distressed loans.

Here are some alternatives to simplify structures: (a) establish a minimum relative size for subordinated bonds in a securitization transaction, (b) limit the number of bonds in securitization transactions to one per rating letter grade instead of the three now commonly used and (c) when a loan is part of larger financing package, extensive disclosure should be required regarding the structure of the overall financing package and the holders of other debt pieces.

Conclusion

In conclusion, we want to recognize the efforts of this Committee in taking on the complex task of updating our financial services regulatory structure and improving the securitization process. Addressing the issues that caused the financial crisis and proactively trying to prevent future crises are goals that are important to all of us. We hope that you will continue to reach out to us – and to all stakeholders – so that together we can develop solutions that are good for businesses, consumers and our overall economic system.