Remarks
of
Ricardo Anzaldua
Executive Vice President and General Counsel
MetLife, Inc.

Exchequer Club
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Thank you, Jerry, and congratulations to Alison Watson on becoming the new Chancellor of the Exchequer Club. I hope your new position does not cause Northwestern Mutual to be deemed systemically important.

I am pleased to have this opportunity to speak to the members of the Exchequer Club ─ including my colleague Heather Wingate, who is head of global government relations for MetLife and a Club member.

In my remarks today, I will ─

- Provide some background on MetLife;
- Describe ─ in general terms ─ our interactions with FSOC;

- Discuss our legal challenge to our designation as a systemically important company; and
- Propose an alternative to the FSOC designation process.

Background on MetLife

MetLife is a large life insurance company. We provide life insurance, annuities and employee benefits to approximately 100 million customers.

MetLife is a global life insurance company. We operate in 46 countries around the world. Our largest market is the U.S., followed by Japan, Mexico and Chile.

MetLife is a traditional life insurance company. Ninety-eight percent of our consolidated assets are held by regulated insurance subsidiaries – and the other two percent is holding company cash that we use to support our insurance operations. MetLife does not and has not ever engaged in any "shadow banking" or other activities that are not visible to our state insurance regulators or that could pose risk to any other entity.

To make good on our promises to policyholders, MetLife holds general account assets of nearly $500 billion. We provide capital to virtually every sector of the economy. Our largest holding is investment grade corporate bonds, but we also invest in mortgage loans, Treasury and agency securities, as well as real estate and corporate equity.

Like all great companies – especially those that have been around for as long as the nearly 150 years of our company's existence – MetLife is also evolving. Earlier this year, we announced a plan to separate a substantial portion of our U.S. Retail business. This will remove hundreds of billions in assets from our balance sheet, including three-fourths of our variable annuity business, which certain regulators of systemic risk have identified as a potentially risky category of liabilities that should draw additional capital charges.

Our planned separation was driven by an assessment of the current macroeconomic and regulatory environment. As part of MetLife, our U.S. Retail business could have been subject to higher capital requirements, which would have made it difficult to price products competitively.

Our concerns about the potential competitive impact of our designation were confirmed by the capital regulation recently proposed by the Federal Reserve Board. That proposal would establish two distinct capital standards: one for insurers designated as SIFIs, and another for insurers that are federally regulated because they own a depository institution. Thus, the question is not *whether* SIFIs will have to hold more capital than non-SIFIs. The question is *how much more.* We can debate whether that additional capital will make the financial system safer. What is clear is that it will put SIFIs at a competitive disadvantage to their non-SIFI peers.

I will now turn to our engagement with FSOC.

Engagement with FSOC

Our engagement with FSOC began three years ago this week. I will give you a brief chronology of that experience.

On July 16, 2013, we received a notice that MetLife was under consideration for a proposed determination. That notice invited us to submit written materials contesting a determination.

Two days later, on July 18, the Financial Stability Board issued its list of global systemically important insurers, or so-called "G-SIIs." MetLife was one of the nine insurers on that list. Three of the voting members of FSOC serve on the FSB – the Secretary of the Treasury, who chairs FSOC and whose vote is necessary to designate a company as a SIFI; the Chair of the Board of Governors of the Federal Reserve, and the Chair of the Securities and Exchange Commission. Since these FSOC members were voting members of a body that had already decided MetLife was a G-SII, it seemed like a fait accompli that we would be designated a SIFI. As our CEO, Steve Kandarian, later put it, "the cake was already baked."

We subsequently submitted a FOIA request for communications between U.S. regulators and the FSB related to our G-SII designation. That request was denied. FSOC also denied nine other requests that we made during the course of the designation process for access to the administrative record they were compiling as the basis for their designation. Their response to all ten requests was that nothing in the administrative record would be relevant to explaining the basis of designation other than the formal written decision they would eventually provide, known as the notice of final determination.

Over the course of the sixteen-month determination process, we provided all the information requested by FSOC, along with additional information demonstrating that neither MetLife's activities nor material distress at the company would pose a threat to U.S. financial stability. MetLife representatives met with FSOC 12 times during that period, but only at the staff level. We also made multiple requests to meet with FSOC principals, either individually or collectively. All of those requests were denied.

Eventually, we submitted more than 21,000 pages of materials to FSOC. Those materials addressed the three "transmission channels" that FSOC has identified as most likely to transfer material financial distress to other financial firms and markets and addressed the six risk categories developed by FSOC to evaluate nonbank financial companies under the statutory factors set out in the Dodd-Frank Act.

Our materials showed that:

- MetLife's interconnections with other financial market participants are limited;
- Our leverage is moderate and stable;

- We conduct virtually all of our business through regulated insurance subsidiaries;
- Over one-quarter of our assets are held in separate accounts with the investment risk largely borne directly by policyholders, much like the assets managed by entities such as Fidelity, Vanguard and Blackrock; and
- We have materially less liquidity risk than a bank.

We also provided FSOC with an analysis of the comprehensive legal framework that state and foreign regulators have in place for resolving companies like MetLife. We also analyzed the market impacts of every major insurance insolvency since 1990. Contrary to the hypothesis promulgated by FSOC in its designations of AIG, Prudential and MetLife, in no case has the failure of an insurer caused "contagion" that imperiled the business prospects of any large insurer. On the contrary, most life insurance insolvencies – irrespective of the size of the failed institution – have demonstrably improved the business prospects of the life insurers remaining in the market.

Finally, the resolvability of MetLife was affirmed in a letter to FSOC from Benjamin Lawsky, then head of New York's Department of Financial Services. Lawsky concluded that New York and other state insurance regulators could resolve MetLife in an orderly manner, and I quote:

"MetLife does not engage in any non-traditional, non-insurance activities that create any appreciable systemic risk.

In the event that MetLife or one or more of its insurance subsidiaries were to fail, [the New York Department of Financial Services] and other state regulators would be able to ensure an orderly resolution of the enterprise.

MetLife's insurance businesses already are closely and carefully regulated."

We also submitted an analysis of the impact of a liquidity crisis on MetLife, prepared by Oliver Wyman, a management consulting firm with deep expertise in our business. This analysis tested FSOC's theory that a "run" on a MetLife experiencing hypothetical distress would force MetLife to liquidate assets in such volumes as to cause values of those assets to collapse and thereby impair the solvency of other institutions holding identical assets. That analysis evaluated four stress scenarios. The most benign was a re-run of the 2008 financial crisis. The most severe assumed that *every* policyholder who could surrender a policy for cash would do so – in insurance parlance, a 100% lapse rate. For context, MetLife's lapse rate during the Great Depression peaked at 8 percent. The analysis found that even under the completely unrealistic doomsday scenario of a 100% lapse rate, the sale of assets by MetLife would not destabilize U.S. financial markets; in fact, the most heavily impacted systemically important bank would experience a decline equal to less than two percent of its regulatory capital.

The Oliver Wyman analysis is also consistent with our experience during the financial crisis. During 2007 and 2008, surrenders never imposed meaningful stress on MetLife's liquidity position. Moreover, during that period, we experienced increases in premiums across a range of products. Shortly after the crisis, MetLife was able to fund a $16 billion acquisition from AIG, which AIG used to help repay its bailout by the U.S. government. Similarly, during the 2014 liquidity crisis in Greece, lapse rates for MetLife actually decreased, suggesting that consumers seek the security of insurance investments during periods of financial turmoil and crisis.

Despite the submission of this remarkable record of evidence, FSOC voted on September 3, 2014 to preliminarily designate MetLife as too big to fail. After we received the notice of that designation, we submitted our request that the Council hear our so-called "appeal" of its preliminary designation, a procedural recourse made available under the Dodd-Frank Act to any designated entity. FSOC held that appeal hearing on November 3, 2014. This was the *first time* that MetLife was ever permitted to meet with the FSOC voting members.

Six weeks later, on December 18, 2014, FSOC voted, 9-1, to designate MetLife as a SIFI, concluding that material financial distress at the company could pose a threat to the financial stability of the U.S., with the dissenting vote coming from the Council's only voting member with expertise in insurance. In reaching this conclusion, FSOC said it was not required to evaluate the degree to which MetLife actually was vulnerable to material financial distress. FSOC's decision not to conduct a vulnerability assessment turned out to be a key issue for the District Court. I will now turn to the status of that legal challenge.

MetLife v. FSOC

On January 13, 2015, MetLife requested judicial review of FSOC's determination decision , in the U.S. District Court for the District of Columbia. Utilizing the right to judicial review created in Section 113(h) of the Dodd-Frank Act, we filed a 10-count complaint asking the Court to rescind FSOC's determination.

To be clear, we did not file our lawsuit to challenge the legitimacy of the Dodd-Frank Act. We filed the suit to exercise a right Congress created in the Act — the right to seek an independent judicial review of a designation – which is a right also embedded in many other federal laws.

Although the right to a judicial review was created by the statute itself, initiating such an action is not an easy decision for a public company to make. Legally, we would have to show that FSOC's determination was "arbitrary and capricious," and, as most of you know, federal courts often give deference to regulators.

Nonetheless, we concluded that FSOC had not properly analyzed the systemic risk posed by MetLife, and that supervision by the Federal Reserve Board could jeopardize our ability to compete and serve customers. As a result, our senior management and our Board of Directors determined, after months of briefings and analysis, that we had an obligation to our shareholders, our customers and our employees to challenge what we saw as an incorrect and harmful decision by the Federal Government.

Most of the claims in our complaint were based upon actions by FSOC that we believed to be arbitrary and capricious. For example, we argued that it was arbitrary and capricious for FSOC not to consider an "activities-based" approach to addressing potential systemic risks as an alternative to designating MetLife. That's an approach FSOC is using for other firms that I'll discuss more in a moment. We also argued that it was arbitrary and capricious for FSOC to deny us access to the administrative record in response to our 10 FOIA requests, in contravention of established DC Circuit caselaw. After we filed our request for judicial review, we became aware that FSOC had in fact compiled an administrative record consisting of some 88,000 pages of record evidence.

We also raised claims under the due process clause of the Fifth Amendment and the separation of powers embedded in the Constitution. Our separation of powers claim is based upon the way that FSOC has structured itself. Other Federal agencies break legislative, executive, and adjudicative functions into separate divisions. FSOC, by contrast, combines all these functions in the same 10 individuals and staff, which we believe violates the constitutional separation-of-powers principle. This structure is not a requirement of the Dodd Frank Act, but rather an infirmity that arises from the manner in which FSOC exercised its discretion in structuring itself.

On March 30, 2016, Judge Rosemary Collyer of the U.S. District Court of the District of Columbia issued a ruling rescinding MetLife's designation as a nonbank SIFI. Judge Collyer did not rule on our constitutional claims. Rather, she based her decision on two basic grounds: First, FSOC's failure to follow its own interpretive guidance in designating MetLife, and second, FSOC's failure to consider the costs of its determination on MetLife. I will explain these two pieces of reasoning in a little more detail.

Accompanying its final rule governing the procedures for making determinations, FSOC included interpretive guidance that outlined the risk transmission channels and specific risk categories it would assess in making a determination. Two parts of that guidance are at issue in the case.

First, the guidance classified the ten statutory designation considerations into six risk categories and identified half of those categories as seeking "to assess the vulnerability of a nonbank financial company to financial distress." The guidance went on to state that the "analytic framework consisting of the six categories . . . and the metrics used to measure each of [them] … will assist the Council in assessing the extent to which the transmission of material financial distress is likely to occur." In its designation of MetLife, however, FSOC did not conduct any assessment of the vulnerability of MetLife to financial distress, and stated explicitly in its final determination that it had no obligation to do so because the statute did not require any vulnerability assessment. Instead, FSOC simply assumed that MetLife was experiencing material financial distress — even though the information and data we submitted to the agency demonstrated that MetLife is financially sound, could withstand severe economic stress without impairing other firms or markets, and, in the worst case, could be resolved by its existing regulators in an orderly manner.

The other part of the guidance at issue in the case defines the statutory standard for threatening U.S. financial stability, and requires there "be an impairment of financial intermediation or financial market functioning that would be sufficiently severe to inflict significant damage on the broader economy." The District Court found that FSOC did not adhere to this standard because it failed to calculate, or even to estimate, losses if MetLife were to experience material financial distress. In fact, the District Court noted that the determination "hardly adhered to any standard when it came to assessing MetLife's threat to U.S. financial stability." In sum, the court concluded that FSOC's failure to adhere to its own guidance was arbitrary and capricious.

The District Court also ruled that FSOC acted in an arbitrary and capricious manner by not considering the cost of its designation of MetLife. This does not mean that the court read a cost-benefit analysis into the Dodd-Frank Act. Instead, the court concluded that, just like all other federal agencies, FSOC has a legal obligation to consider the consequences of its actions before taking those actions. The legal foundation for this position arises under a case involving an EPA regulation, *Michigan v. EPA,* decided by the U.S. Supreme Court last year.

These findings go to the fundamental legal standard underlying the arbitrary and capricious standard of review. The standard is admittedly a deferential one, but deferential does not mean nonexistent. The legal standard is that a federal agency's action will be found to be arbitrary and capricious if it is not grounded upon a reasonable basis in fact. That's the standard. That standard does not allow federal agencies to take actions on the naked grounds that they are experts and no one else has the right to question that expertise. If that were the standard, then judicial review created by the Congress would be meaningless.

As I mentioned, Judge Collyer issued her rescission of MetLife's designation as a SIFI on March 30, 2016. Just eight days later, on April 7, 2016, the Treasury Department announced its appeal of the District Court's ruling. The case is now before the U.S. Court of Appeals for the District of Columbia Circuit. We will defend the lower court's opinion on appeal. In addition, we will have the opportunity to raise with the Circuit Court the six counts in our complaint not addressed in the lower court opinion, including our constitutional claims. Presumably, final action by the Court of Appeals will take several months, with a decision not likely until late this year or early next.

This has been a costly and time consuming process for both MetLife and FSOC. We believe there is a better way to address any potential risks to financial stability. I'll now address that approach.

Activities-based Approach

Throughout the designation process, MetLife has urged FSOC to consider an activities-based approach to regulation as an alternative to designation.

The Dodd-Frank Act gives FSOC two key powers. One is the power to designate a nonbank financial company for supervision by the Federal Reserve Board. That power, which appears in section 113 of the Act, is focused upon systemic risks posed by individual companies.

The other power, which is contained in section 120 of the Act, is the power to recommend standards to address risky acts or practices. This "activities-based" power is directed at groups or categories of companies.

An activities-based approach to systemic risk has distinctive public policy advantages over the designation of individual companies. An activities-based approach can have a broader impact on potential systemic risks because it reaches the activities or practices of an entire class or category of financial firms, not just the activities of an individual company. Applying more stringent regulation to activities and practices also avoids the competitive harm that an individual company may face following designation. An activities-based approach also avoids the "too-big-to-fail" stigma that some have associated with designations.

The Dodd-Frank Act provides that FSOC's recommendations for more stringent regulation of specific activities or practices must be made to "primary financial regulatory agencies." These agencies are defined to include the SEC for securities firms, the CFTC for commodity firms, and state insurance commissioners for insurance companies.

The Dodd-Frank Act also includes a provision that is designed to ensure that any recommendation made by FSOC to a primary financial regulatory agency is given serious consideration. That provision requires the regulatory agency to notify FSOC within 90 days if it does not intend to follow the recommendation. FSOC also is required to report to Congress on the status of each recommendation.

FSOC has recognized the value of the activities-based approach in the context of the asset management industry. In September 2013, the Treasury Department's Office of Financial Research issued a report describing a number of significant risks in the asset management sector that could result in threats to U.S. financial stability. In contrast to its approach to insurance companies, after hearing some public debate, FSOC directed its staff to undertake, rather than a strategy for designating specific asset managers, a focused analysis of industry-wide products and activities to assess potential risks in the industry. In December 2014, FSOC also invited public comment on the potential risks of specific asset management products and activities. FSOC has now released a comprehensive report highlighting specific practices that may require additional regulation. The report also illustrates the close working relationship FSOC has established with the SEC in order to implement any recommendations made by FSOC.

In sum, activities-based regulation is a better approach to regulating systemic risk by addressing risks on a broader basis than the designation of an individual company, and avoiding the negative consequences of designating individual companies. We believe that FSOC would be well-served by engaging with state insurance authorities to pursue a similar approach to the insurance industry.

Thank you, again, for the opportunity to speak to you today, and I would be happy to take your questions.