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November 24, 2014

Legislative and Regulatory Activities Division Office of the Comptroller of the Currency 400 7th Street, SW Suite 3E-218 Mail Stop 9W-11 Washington, DC 20219 RIN: 1557-AD43 Docket ID: OCC-2011-0008	Mr. Robert deV. Frierson, Secretary Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue, NW Washington, DC 20551 RIN: 7100 AD74 Docket ID: R-1415
Mr. Robert E. Feldman, Executive Secretary Attention: Comments Federal Deposit Insurance Corporation 550 17th Street, NW Washington, DC 20429 RIN: 3064-AE21	Mr. Alfred M. Pollard, General Counsel Attention Comments/ RIN 2590-AA45 Federal Housing Finance Agency Constitution Center (OGC Eighth Floor) 400 7th St., SW Washington, DC 20024
Mr. Barry F. Mardock, Deputy Director Office of Regulatory Policy Farm Credit Administration 1501 Farm Credit Drive McLean, VA 22102-5090 RIN: 3052-AC69	Mr. Christopher Kirkpatrick, Secretary Commodity Futures Trading Commission Three Lafayette Centre 1155 21st Street, N.W. Washington D.C. 20581 RIN: 3038-AC97

Re: Proposed Margin and Capital Requirements for Covered Swap Entities (the "Proposed Rules")

Ladies and Gentlemen:

MetLife appreciates the opportunity to comment on the proposed regulations regarding (i) Margin and Capital Requirements for Covered Swap Entities issued collectively by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Farm Credit Administration (collectively, "the Prudential Regulators") and (ii) Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants by the Commodity Futures Trading Commission ("CFTC" and together with the Prudential Regulators, the "Regulators"), which constitutes an

important component of the overall regulatory framework required under Title VII of the Wall Street Reform and Consumer Protection Act ("Dodd-Frank") in connection with the execution and margining of Uncleared Over-the-Counter ("OTC") swap transactions.

MetLife appreciates the substantial effort and consideration that the staff of the Regulators have dedicated to developing these Proposed Rules as well as the work of the Regulators in connection with the Working Group on Margin Requirements established by the Basel Committee on Banking Supervision ("BCBS") and the International Organization of Securities Commissions ("IOSCO"), including a consultative paper published in July 2012 (the "Consultative Paper") followed by a final framework in September 2013 (the "BCBS/IOSCO Framework"). MetLife is supportive of the BCBS/IOSCO Framework which balances the need for enhanced collateral requirements for uncleared swaps, with the practical cost and liquidity impacts that such requirements impose and generally supports the adoption of the BCBS/IOSCO Framework on a consistent basis in all G-20 jurisdictions.

MetLife has serious concerns that certain sections of the Proposed Rules that diverge from the BCBS/IOSCO Framework will cause financial end users to incur substantial unnecessary costs to prudently hedge capital markets risks. In the case of life insurers, this may lead to insurance and retirement product repricing or withdrawal from offering certain products, creating additional financial risk for individual families and retirees who may no longer have affordable access to retirement and savings products as a result of prohibitive cost increases or the reduced availability of such products.

In considering our comments, we respectfully request that the Prudential Regulators and the CFTC balance the public policy considerations of preserving safety and soundness in the U.S. financial markets through adoption of a set of rules that are harmonized among major financial jurisdictions against the need for financial end users such as MetLife to manage the capital markets risks associated with the insurance and retirement products we offer by utilizing derivatives as a risk management tool.

MetLife, Inc. is the holding company of the MetLife family of insurance companies. The MetLife organization is a leading provider of insurance, annuities and employee benefit programs, serving 90 million customers MetLife holds leading market positions in the United States (where it is the largest life insurer based on insurance in force), Japan, Latin America, Asia Pacific, Europe and the Middle East. MetLife, Inc. is a public company, registered under the Securities Act of 1934 and has securities listed on the New York Stock Exchange.

MetLife, like many life insurers, provides essential retirement and financial security to our customers through life and annuity products. These obligations often have durations that last one or more decades. Accordingly, in order to meet our commitments to policyholders, life insurers invest in a broad spectrum of assets, many of which are long-dated, including government and corporate bonds, mortgage backed securities, public and private equities, commercial real estate mortgages and alternative assets. Cash and cash equivalents represent a small percentage of life insurers' portfolios because holding a large percentage of cash and cash equivalents would be inconsistent with our goal of matching asset and liability durations.

MetLife is exposed to changes in interest rates, currency exchange rates and equity market performance, among others because of their long-dated liabilities and the accompanying asset portfolios that support them. Life insurers hedge the risks inherent in our assets and liabilities through the prudent use of exchange-traded futures, cleared and uncleared over-the-counter ("OTC") swaps. Insurers have generally preferred to use OTC swaps because the terms can be structured to most closely offset the risk in the asset or liability. While many OTC swaps used by insurers have become clearable, insurers will continue to use uncleared OTC swaps to hedge complex risks that are unique to specific combinations of assets and liabilities. Therefore, cost-effective access to, and participation in, the uncleared swap markets is critical to MetLife's ability to responsibly manage risks and deliver a wide variety of affordable products to policyholders.

State insurance laws and regulations govern MetLife's use of derivatives and restricts our use to hedging, asset replication and limited income generation transactions, in the form of covered calls. State laws contain limitations on our derivatives exposure generally as well as exposure to a single counterparty in order to manage concentration risk. Furthermore, each of MetLife's U.S. insurance companies that use derivatives file a comprehensive derivatives use plan with its state insurance regulator. In addition, MetLife has instituted a common framework of management constraints, and control and reporting processes which limit derivative usage for offshore entities to the same standard as US insurance entities. Finally, all derivatives transactions (including terminated transactions) are reported on a quarterly and annual basis. Like Title VII of the Dodd Frank Act, these long-standing regulatory mandates are designed to prevent financial and economic instability attributable to derivatives transactions.

MetLife utilizes collateral support arrangements to mitigate counterparty risk in uncleared OTC transactions. Under the terms of MetLife's agreements, Variation Margin is pledged on a daily basis. Furthermore, in response to the financial crisis, MetLife renegotiated its uncleared OTC agreements to eliminate thresholds for posting collateral and reduce minimum transfer amounts well below the USD650,000 limit specified in the BCBS/IOSCO Framework and Proposed Rules. As a result, their non-cleared swap exposures are generally fully collateralized with the exception of one day market movements.

A critical element of MetLife's uncleared OTC agreements is the broad range of highly-liquid collateral eligible to be pledged as Variation Margin. Essentially, MetLife has been able to pledge our assets to fully secure our uncleared swap obligations, while maintaining a match between our assets and obligations to our policyholders If cash becomes the sole means of satisfying Variation Margin, insurers will confront meaningfully increased hedging costs and may be forced to reduce hedging activity or alter investment allocations, such as investing in higher-yielding, less liquid assets to offset the increased cash requirements. This shift in investment strategy may lead to a reduction in the range of products that support our customers' financial stability and security.

Summary of MetLife Position

As described below, we recommend modifications to the Proposed Rules to achieve consistency with the BCBS/IOSCO Framework in three broad categories:

Variation Margin Eligibility and Treatment

- Eligible collateral for variation margin should include U.S. Treasuries, U.S agency-backed, residential mortgage-backed securities ("Agency RMBS") and highly liquid corporate bonds[1]
- Minimize exclusions of highly liquid corporate bonds so that collateral pool diversification can be maximized.
- Categorization of Variation Margin for uncleared swap transactions as a security interest, rather than a settlement or payment.
- Phase-in of Eligible Collateral for Variation Margin requirements consistent with the phase-in for Initial Margin

Margin Calculation/Valuation

- Standardization and full transparency of initial margin models to all market participants, including financial end-users.
- Mid-market calculation of Variation Margin with valuation by the party asking for the posting or release of collateral, rather than the value to the Covered Swap Entity.
- Difference of Initial Margin requirements between cleared and uncleared swaps limited to the amount necessary to mitigate the incremental counterparty credit risk of uncleared swaps.

Definition of Eligible Master Netting Agreement ("EMNA")

- Permit an exception for a limited stay under state insolvency laws
- Permit standard conditions precedent that allow a party to suspend payments upon the occurrence of an Event of Default with respect to the other party

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

Variation Margin Eligibility and Treatment

I. MetLife Opposes the Cash Only Limitation for Variation Margin in the Propose Rule

In stark contrast to the BCBS/IOSCO Framework, the Proposed Rules limit eligible collateral for Variation Margin to cash. This limitation to a single class of eligible collateral is a significant departure from the BCBS/IOSCO Framework, the text and intent of the Dodd Frank Act and a substantial departure from current market practice of financial end-users. The Regulators stated rationale for the differences between the BCBS/IOSCO Framework and the Proposed Rules do not account for the structural and operational differences between swaps that are centrally cleared and uncleared bi-lateral swaps. The Regulators rationale also rests on a number of inaccurate assumptions related to the market acceptance of the "Standard" CSA, frequency of collateral disputes based on collateral valuation and the availability of collateral transformation. For the reasons described below, we believe that eligible collateral for Variation Margin should be expanded to include the types of highly liquid collateral listed in the BCBS/IOSCO Framework.

A. The Regulators Choice of Cash as the Only Acceptable Form of Variation Margin is a Significant Departure from the International Consensus contained in the BCBS/IOSCO Framework

The Regulators departure from the list of highly-liquid forms of eligible collateral for Variation Margin contained in the BCBS/IOSCO Framework to cash only is the item of greatest concern to MetLife and other financial end-users. The failure to follow the unequivocal recommendation of BCBS-IOSCO on the use of noncash assets, including high-quality corporate debt, for Variation Margin in non-cleared swap transactions creates a disconnect between the U.S. regulatory regime and the consensus international approach. It is noteworthy that the proposed requirements for Variation Margin set forth by the European Securities Market Authority follow the international consensus and expressly permit non-cash collateral to be posted as Variation Margin.[2]

BCBS-IOSCO explicitly considered, and ultimately rejected, narrowly constraining the range of assets eligible as collateral for non-cleared swaps:

> BCBS and IOSCO have considered the types of collateral that should be deemed eligible for use in meeting margin requirements. . . . One approach would be to restrict eligible collateral to the most liquid top-quality assets, such as cash and high-quality sovereign debt. . . . Another approach would be to permit a broader set of eligible collateral and address the potential volatility of such assets through the application of appropriate haircuts to their valuation for margin purposes. . . .

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[2] *See* European Securities Market Authority, Draft Regulatory Technical Standards on Risk-Mitigation Techniques for OTC-Derivative Contracts Not Cleared by a CCP under Article 11 (15 of Regulation (EU) No. 648/2012, Consultation Paper 32 (April 14, 2014), available at: http://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf.

After evaluating each of these alternatives, the BCBS and IOSCO have opted for the second approach (broader eligible collateral).[3]

Accordingly, the BCBS/IOSCO Framework provided the following examples of recommended eligible collateral:

- Cash;
- High quality government and central bank securities;
- High quality corporate bonds;
- High quality covered bonds;
- Equities included in major stock indices; and
- Gold.

In adopting this more expansive approach, BCBS-IOSCO recognized that permitting the use of a wide range of assets as collateral, subject to appropriate haircuts, would reduce the potential liquidity impact of margin requirements, while still providing adequate protection against systemic risk in times of financial stress. MetLife, individually, and through the American Council of Life Insurers ("ACLI") has consistently supported this view; in fact, the BCBS/IOSCO Framework is largely consistent with the framework for the inclusion of highly-liquid corporate bonds as eligible collateral that MetLife and the ACLI presented to the Regulators and BCBS/IOSCO.[4]

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[3] BCBS/IOSCO Framework at 16.

[4] On July 11, 2011, ACLI submitted a proposal to the CFTC and U.S. prudential regulators based on an analytic framework utilizing basic diversification techniques on a portfolio of corporate bonds. ACLI also met with staff in the Office of General Counsel of the Board of Governors of the Federal Reserve to explain our concerns about variation margin and our proposed solution to defining high-quality corporate debt on May 23, 2012 (summary of meeting) and again on June 16, 2014. This analysis demonstrates, almost to the level of statistical certainty, that high-quality corporate collateral would provide enough cushion even against some of the most severe economic downturns. A brief summary of this proposal provides support for the position advanced in this letter.
In light of the Dodd Frank Act's prohibition against reliance on credit ratings provided by nationally recognized statistical rating organizations (NRSROs), ACLI's proposal uses the Barclays U.S. Credit Index, a broad-based index containing 4,430 issues/CUSIPs representing an outstanding amount of $3.4 trillion. The Barclays U.S. Credit Index (together with its predecessor, the "Barclays Index") has many advantages, including clearly defined eligibility rules, a defined list of eligible CUSIPs limited to large liquid issues, and a ready source of daily pricing and historical data. The Barclays Index is also widely benchmarked by money managers evidencing wide acceptability by other financial end users. In addition, the Barclays Index is one of many indices that are available to reference high-quality, U.S. corporate bonds and we believe our analysis could be applied to other indices as well.
Following the Prudential Regulators' determination that close out of uncleared derivatives and liquidation of collateral could take ten days in a stress scenario, we analyzed individual CUSIPs from the Barclays Index during 2008 and found that nearly 20% of CUSIPs experienced a ten-day price decline in excess of 20% with a maximum decline in excess of 90% in 0.2% of the CUSIPs, leading to the conclusion that tail events, though rare, do occur. Thus, a collateral pool consisting of one or a very small number of CUSIP is not advisable.
In expanding the analysis to look at the impact of adding additional CUSIPs to the collateral pool, ACLI chose a single month (September 2008) to ensure a continuous set of CUSIPs and selected a random portfolio as of September 1, 2008, subject to diversification rules limiting each issuer to a specified percentage and each broad sector (Financial Institutions, Industrials, Utilities, Transportation, Agencies, Local Authorities, Sovereign and Supranational) to no more than 45% of the portfolio. The market value of the equally weighted portfolio was calculated as it evolved through the month, including the largest 10-day (rolling) price drop that occurred during the month.
The analysis shows that corporate bond tail risk can be controlled with basic diversification rules (e.g., minimum of 20

In sum, the BCBS/IOSCO Framework strikes an appropriate balance between security and liquidity considerations and advances the Key Principles in the BCBS/IOSCO Framework, including Element 7, that "[r]egulatory regimes should interact so as to result in sufficiently consistent and non-duplicative regulatory margin requirements for non-centrally cleared derivatives across jurisdictions."[5] Accordingly, we strongly recommend that the Regulators follow the consensus enunciated in the BCBS/IOSCO Framework by allowing broader categories of eligible collateral, such as high-quality corporate debt, subject to appropriate haircuts.[6]

B. The Proposed Rule is Inconsistent with the Statutory Mandate to the Regulators to Permit Noncash Margin Unless Doing So Would Negatively Affect the Financial Integrity of the Swaps Trading Market or Threaten the Stability of the U.S. Financial System

Section 4s(e)(3)(C) of the Commodity Exchange Act (CEA) states that the Regulators "***shall*** permit the use of noncash collateral, as the regulator...determines to be consistent with ***(i) preserving the financial integrity of markets trading swaps; and (ii) preserving the stability of the United States financial system.***"[7] In the Proposed Rules, the Prudential Regulators permit only cash collateral for Variation Margin and do not provide an analysis that would support a determination that permitting noncash collateral for Variation Margin would negatively affect the

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CUSIPs and 45% concentration limit per broad sector) and that collateral haircuts of 15-20% provide a high degree of protection upon the occurrence of a covered swap entity default. The maximum decline at the 99th percentile was 10.25% in our portfolio simulation. We also learned that further diversification beyond these rules provided little incremental benefit while substantially increasing operational burdens.

Our analysis shows that high-quality corporate bonds, appropriately haircut and diversified, can be prudently included as eligible collateral for cleared and non-cleared swap exposure. We also suggest that other high-quality collateral types such as Agency Debentures and Agency RMBS should also be included as eligible collateral. Our proposal recommended prudent haircuts, portfolio diversification and concentration limits to further support an expanded list of eligible collateral.

[5] BCBS/IOSCOl Framework Key Principles 4 and 7.

[6] The BCBS/IOSCO Framework observed that its list of eligible collateral should not be considered exhaustive. *See* Final Framework at 17. We therefore recommend that additional assets and instruments, such as residential mortgage-backed securities and commercial mortgage-backed securities should also be evaluated by regulators for inclusion as eligible collateral. A broad range of eligible, high-quality collateral - with appropriate haircuts - would prudently assure satisfaction of counterparty obligations while also enhancing liquidity in the market and reducing systemic risk. We also note that the haircuts provided in Appendix B of the Proposed Rule (at 57396) suggest an additional haircut of 8% for the value of assets denominated in a currency that differs from the currency of the swap obligation. We believe that parties should have the option of using a model-based haircut to account for currency risk, an approach that is consistent with the Final Framework's suggestion that haircuts could be based on either quantitative models or a standardized schedule. *See* Final Framework at 17. We believe that an 8% adjustment will result in over-collateralization and place additional stress on margin requirements applicable to financial end-users such as life insurers. We note that ISDA has persuasively argued that this risk is more accurately addressed by incorporating FX risk into an initial margin model (*See* ISDA letter to the European Securities and Markets Authority, the European Banking Authority and the European Insurance and the Occupational Pensions Authority re: Proposed Margin Requirements: Analysis of Currency Mismatch Haircut, dated 17 August 2014 and available at http://www2.isda.org/functional-areas/wgmr-implementation/) and we would be supportive of that approach as an alternative to the less precise 8% haircut.

[7] 7 U.S.C. § 6s(e)(3)(C) (2012) (emphasis added).

financial integrity of the swaps market or the stability of the U.S. financial system.[8] Accordingly, the rules of statutory construction strongly support the conclusion that Section 4s(e)(3)(C) should be read as mandating the Prudential Regulators to allow noncash collateral for Variation Margin.

1. The Proposed Rules Ignore the Legislative History of the New Margin Rules

Statutes are found to be mandatory or permissive on the basis of legislative history establishing legislative intent.[9] Courts normally refer to relevant legislative history if the statutory text and the canons of construction leave uncertain the congressional intent underlying the specific issue or provision, *i.e.,* the statute is ambiguous with respect to a specific provision or issue.[10] Were a court to find that the phrase "permit the use of non-cash collateral" to be ambiguous with respect to Variation Margin, the court would look at the legislative history of Section 4s.

The Conference Committee Report provides an illuminating view to the extent to which non-cash collateral would be available as Initial and Variation Margin. Senator Chris Dodd, the cosponsor of the Dodd Frank Act, wrote a letter intended to be an explanatory floor statement. This letter was incorporated into the Conference Committee Report.[11] By "specifically mandat[ing]" that the Regulators permit the use of noncash collateral, Senator Dodd appears to have intended that non-cash collateral be available as Initial and Variation Margin.[12]

Moreover, allowing non-cash collateral as Initial and Variation Margin supports the legislative purpose of Section 4s. In this case, the purpose of Section 4s(e)(3)(C) of the CEA is clearly stated in its legislative history. The Prudential Regulators were tasked with ensuring that the margin rules would not be prohibitively expensive for end users to manage their risk. Senator Dodd stated:

> ....[T]he [P]rudential [R]egulators ***must not make hedging so costly it becomes prohibitively expensive for end users to manage their risk***....It is imperative that the regulators do not ...***discourage hedging by end users or impair economic growth***....
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> ...a consistent Congressional directive...and in Congressional debate, has been ***to protect end users from burdensome costs associated with margin requirements***.... [13]

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[8] *See* Proposed Rules at 57371. The only reference to the two-prong statutory provision is a background reference in footnote 10 of the Prudential Regulators' Proposal.

[9] 3 SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 57:5 (Norman J. Singer ed., 7th ed. 2014 rev.).

[10] *See, e.g., Muscarello v. United States*, 524 U.S. 125, 132 (1998) (analyzing evidence of congressional intent because ambiguous statutory language was identified).

[11] 156 CONG. REC. H5233-61 (daily ed. June 30, 2010) (letter of Sen. Chris Dodd) (emphasis added).

[12] Senator Dodd stated: "....Congress ***specifically mandates that regulators permit the use of non-cash collateral*** for counterparty arrangements with Swap Dealers and Major Swap Participants to permit flexibility. Mitigating risk is one of the most important reasons for passing this legislation." *Id.*

[13] 156 CONG. REC. H5233-61 (daily ed. June 30, 2010) (letter of Sen. Chris Dodd) (emphasis added).

Thus, Section 4s(e)(3)(C) of the CEA was written with the intent to specifically mandate that the Regulators allow noncash collateral as Initial and Variation Margin because Congress was concerned with protecting end users from burdensome costs. The Proposed Rule, which permits only the use of cash collateral for Variation Margin contradicts the congressional purpose of protecting end users from prohibitive costs. Indeed, excluding non-cash collateral for Variation Margin is economically burdensome for financial end users such as MetLife that match the duration and cashflows of their investment assets and policyholder liabilities through the purchase of non-cash assets.. The corresponding treatment of Variation Margin as a Settlement Payment instead of collateral securing a swap transaction increases the economic burden of financial end-users, as described in greater detail in Section C.1. below.

In sum, therefore, based on the foregoing analysis of Section 4s(e)(3)(C) of the CEA and absent a clear determination by the Regulators that allowing non-cash collateral would negatively affect the financial integrity of the swaps trading market or threaten the stability of the U.S. financial system, it would be reasonable to conclude that Congress mandated the Regulators to permit the use of non-cash collateral as Initial and Variation Margin for counterparty arrangements with Covered Swap Entities.

C. The Cash-Only Limitation for Variation Margin in the Proposed Rules is not Consistent with Market Practice of Financial End-Users

1. The Regulators Characterization of Variation Margin as a "Settlement" or "Payment" rather than as a "Pledge" or "Collateral as Security"

The Regulators state that they use the terms "pay" and "paid" when referring to Variation Margin based on their preliminary understanding that market participants "view the economic substance of variation margin as settling the daily exposure of non-cleared swaps between the counterparties."[14] The Regulators also make certain comparisons between the markets for cleared and non-cleared swaps that ignore significant differences between the two markets. The Regulators seek comment on the appropriateness of the proposed terminology. As we explain in more detail below, characterizing the transfer of Variation Margin as a "settlement" or "payment" is not an accurate characterization of how participants in the non-cleared swap markets treat collateral from a legal, accounting, economic or tax perspective.

a) Contractual and Accounting Treatment

The Regulators note that, the "market perception that Variation Margin essentially *settles* the current exposure may not always align with the underlying legal requirement or with contracts that document the parties' rights and obligations with respect to swaps." It is certainly the case that the legal requirements expressed in the counterparties' contracts do *not* reflect the "payment"

[14] Proposed Rules at 57369. Elsewhere, the prudential regulators state that "[v]ariation margin payments reflect gains and losses on a swap transaction, and payment or receipt of variation margin generally represents a transfer of ownership in the collateral." (Proposed Rules at 57371).

of Variation Margin but rather, refer to VM transfers as collateral pledges or postings.[15] In addition, Variation Margin is accounted for as collateral (whether in the form of cash of Securities) under GAAP and Statutory accounting principles and practices.

When the out-of-the-money party pledges non-cash collateral, the asset transferred (e.g., a treasury or a corporate bond) stays on the balance sheet of the pledger, subject to the in-the-money-counterparty's security interest. If Variation Margin is accounted for as a settlement rather than collateral, the pledgor records a debit to its derivative liability and a credit to cash, which is inconsistent with the accounting for Variation Margin on OTC Cleared Swaps, where , the pledgor records a debit to a receivable for the return of cash collateral and a credit to cash.

b) There are Significant Differences Between the Centrally Cleared and Uncleared Swap Markets That Should be Reflected in the Characterization of Variation Margin

The suggestion that Variation Margin for uncleared swaps can be characterized the same as Variation Margin for centrally cleared swaps fails to recognize the fundamental differences between a central clearinghouse on the one hand and a swap counterparty on the other. In the case of cleared swaps, the clearinghouse becomes the party to each of the two equal and opposite transactions with the original parties to the swap that arise from the clearing function. With respect to Variation Margin, the clearinghouse acts solely as an intermediary between the two original parties to the swap, receiving Variation Margin from the out-of-the money party and delivering it to the in-the-money party. Likewise, because the parties to the equal and offsetting swaps are not counterparties with each other, the party posting the Variation Margin to the clearinghouse has no claim against the party receiving Variation Margin from the clearinghouse. In the case of uncleared swap, the in-the-money party (Secured Party) receiving Variation Margin retains it as security for future performance of the swap by the out-of-the money party (Pledgor). The Variation Margin remains an asset of the Pledgor, unless and until the Secured Party realizes on the security in connection with a termination.

The central clearinghouse requires Variation Margin to be delivered to it in the form of cash so that it can re-deliver such margin to the party to the offsetting trade on the same day. The Central Clearinghouse does not have the liquidity facilities necessary to convert noncash Variation Margin to Cash in the time required for the central clearinghouse to redeliver Cash to the in-the-money party. In the case of uncleared swaps, neither party has any obligation to convert non-cash Collateral.

Another fundamental distinction between Variation Margin for cleared swaps and Variation Margin for uncleared swaps relates to the manner in which Variation Margin is determined. In the case of cleared swaps, the amount of VM to be transferred is always determined by the central clearinghouse, which is a neutral body that has the ability to perform this function in a non-biased and objective manner. The central clearinghouse generally has extensive pricing data for executed arm's length transactions, either identical or highly comparable to the

[15] We note that Proposed Rules at §___.6(a) correctly directs a "covered swap entity" to collect and "post" Initial Margin and Variation Margin.

trades being valued, on which to base its Variation Margin determinations. The situation for uncleared swaps is entirely different. Valuations are made by the party calling for the pledge or return of collateral. The counterparties to the clearinghouse in respect of a cleared swap have no input into valuation or right to dispute the valuation of a cleared swap.

c) Interest is paid on Variation Margin for Uncleared Swaps

Well-established industry practice requires the secured party to pay interest to the Pledgor on cash collateral and to remit to the Pledgor any interest received by the Secured Party holding the Pledgor's securities.[16] This practice has continued with regard to cleared swaps in the form of "price alignment interest". By contrast, it has never been the practice for central clearinghouses to pay interest (or its equivalent) to futures customers with respect to Variation Margin posted to the central clearinghouse. If Variation Margin for uncleared swaps truly represented "settlement" there would be no reason to require the Secured Party to pay interest (or to return interest earned on pledged securities) to the Pledgor.

d) The Pricing of Variation Margin for Uncleared Swaps Reflects Its Treatment as Collateral

The treatment of Variation Margin for non-cleared swaps as "settling daily exposures" also ignores the reality of pricing of uncleared swaps. Swaps that are sufficiently standardized may well be eligible for clearing (on a mandatory or optional basis) and daily pricing by a clearinghouse, but this is not the case with respect to most non-cleared swaps that are not amenable for clearing. Such swaps must be priced based on various pricing inputs and models and/or by obtaining quotes from market participants that trade comparable instruments. The absence of publically accessible prices for comparable transactions also explains why VM in non-cleared swaps has historically been based on estimates of mid-market prices rather than actual transaction prices and why the procedure for resolving disputes regarding VM determinations has entailed seeking market quotes from multiple dealers. The bid-ask spread for non-cleared swaps can, and in most cases will, be materially larger than for cleared swaps.

The significance of the bid-ask spread in uncleared swaps is apparent in a close-out situation. The cost of replacing a defaulted uncleared swap will differ (often by a material amount) depending on which side of the transaction defaults. The documentation for master agreements and collateral arrangement for uncleared swaps underscore this point. The distinction between the value of swaps for purposes of Variation Margin transfers is specified as estimates of mid-market prices whereas the value of swaps for close-out purposes is determined for replacement transactions at the side of the market of the non-defaulting party. This is completely inconsistent with the idea that Variation Margin should be viewed as a "settlement."

For all these reasons, we suggest that the Regulators reconsider characterization of variation margin as "payments" or "settlements,' as this characterization is contrary to the legal,

[16] The practice of paying and receiving price alignment interest is paralleled by the Pledgor's receipt of coupon interest if it has posted a noncash asset such as corporate bond.

accounting and economic treatment of variation margin in uncleared swap transactions and agreements.

2) The 2013 ISDA Standard Credit Support Annex (the "SCSA")

The Regulators make several observations in support of their contention that limiting Variation Margin payments to cash is consistent with market practice. The Regulators cite the SCSA which calls for all Variation Margin payments to be made in cash. However, this agreement has not gained any significant market acceptance among financial end-users and to our knowledge no life insurer uses this agreement. The SCSA is primarily utilized by dealers who enter into swaps where payments are to be made in multiple foreign currencies[17]. Indeed, a draft ISDA publication summarizing the history and explaining the operation of the SCSA specifically acknowledges why it may not be an attractive alternative for many end-users:

> It is important to note that the [SCSA] offers a new alternative to the existing [Credit Support Annex], but does not replace it in any sense. In fact, because the [SCSA] necessarily standardizes many terms that are variable under the [Credit Support Annex], it is anticipated that some market participants will continue to use the classic [Credit Support Annex] because it affords useful flexibility. ***For example, market participants who are natural holders of long security positions that can be cost-effectively deployed as collateral may find problematic the [SCSA]'s restriction of variation margin collateral to cash only.***[18]

Instead, the overwhelming majority of Credit Support Annexes ("CSA") currently in use allow for transfer of noncash assets, subject to agreed haircuts, to satisfy margin requirements. In addition to Treasury securities, CSAs generally allow for various high-quality, liquid assets to be eligible collateral including agency and high quality corporation obligations. Recognizing that assets pledged as collateral must be liquidated in a reasonable amount of time to generate proceeds that protect secured parties from losses and that the value of such assets may fluctuate – especially in a time of market stress - the traditional CSA used by MetLife and other life insurers includes prudent haircuts. This approach is consistent with the BCBS/IOSCO Framework, which observed that the assets posted as collateral should be liquid and, after accounting for an appropriate haircut, maintain their value in time of financial stress.[19] The BCBS/IOSCO Framework concluded that securities issued by the counterparty or its related entities should not be accepted as collateral and that accepted collateral should be reasonably diversified. MetLife agrees with these constraints on non-cash collateral (including appropriate haircuts on non-cash assets) in order to balance the need to pledge such assets as Initial and Variation Margin against the safety and soundness of the U.S.

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[17] ISDA, "The Annotated ISDA 2013 Standard Credit Support Annex for New York law and English law forms" at p. 4 (Draft 6/10/13 available at: http://www.fpml.org/wgroup/scsawg/First-Draft-Annotated-SCSA.pdf). We note that even the SCSA allows parties to select collateral from among seven major currencies, and does not limit collateral to U.S. dollars or the currency in which payment obligations under the swap are required to be settled (*see* footnote [8] infra). The SCSA defines "*Eligible Transport Currency*" as "any of AUD, CHF, CAD, EUR, GBP, JPY and USD" at p. 14.

[18] *Id.* (emphasis added).

[19] Element 4 of the BCBS/IOSCO Framework, pages 16-18.

Financial system.

3) Availability of Collateral Transformation

The regulators also cite the availability of collateral transformation and other structured solutions that allow an insurer, such as MetLife, to "swap" its corporate bond holdings into cash or U.S. Treasury securities, which can then be used as Variation Margin. In theory, collateral transformation allows an insurer to avoid liquidation of corporate bonds and / or the reallocation of other invested assets to satisfy Initial and Variation Margin requirements. It should be noted, however, that collateral transformation is a short-term, quantitatively limited source of cash or US treasury securities that is not guaranteed to be available to financial end-users in times of market turmoil.

Collateral transformation involves the concurrent execution of a repurchase transaction to deliver corporate bonds (the "Repo Leg"), and a reverse repurchase transaction to obtain U.S. treasury securities (the "Reverse Repo Leg"), with the same counterparty, subject to a single Master Repurchase Agreement, and reflecting the same transaction terms (i.e. trade date, maturity date etc.). Collateral transformation can also be effected by executing a repurchase transaction by selling corporate bonds and/or U.S. treasury securities and receiving cash. During the term of the collateral transformation transaction, each leg is subject to daily mark-to-market requirements set forth in the Master Repurchase Agreement. Each party to the transaction will pay the other interest on the respective cash components of the transaction (the "repo rate); with the net of the repo rates calculated as an expense to the insurer that is obtaining the treasury securities.

The primary risk with collateral transformation is the potential inability to roll an outstanding transaction into a new transaction on the scheduled termination date. Assuming that the U.S. treasury securities or cash acquired in the collateral transformation are being used to satisfy Variation Margin at a Covered Swap Entity, the inability to roll a collateral transformation transaction would compel the financial end-user to find replacement collateral to support such margin requirements, or prematurely unwind the hedging transaction. During a time of financial distress, sourcing additional U.S. Treasury securities or unwinding a hedging transaction on short notice would likely be expensive, and would create additional risks in the investment portfolio. Although this risk can be mitigated by entering into longer term collateral transformation transactions, twenty states have investment or receivership laws that limit the duration of an insurers' Repurchase Transactions to one year.[20]

Collateral transformation transactions also have quantitative limits based on an insurer's internal transaction and counterparty risk limits. Statutory investment restrictions in an insurer's state of domicile may further limit the amount and duration of collateral transformation transactions. For example, NY State Insurance Law Section 1411(c), limits the amount of outstanding repurchase transactions a NY domiciled insurer may execute to 5 % of admitted assets.

[20] http://www.naic.org/documents/committees_e_app_restricted_asset_sg_exposure_state_restrictions.pdf

Although collateral transformation transactions serve as a cost effective tool for sourcing US Treasury securities and cash collateral, it is a short term, temporary solution for obtaining limited quantities of US Treasury securities and cash collateral that is not guaranteed to be available in volatile markets and is insufficient to satisfy the total Variation Margin requirements associated with an insurer's uncleared OTC swaps.

4) Restricting Variation Margin to Cash May Cause Life Insurers to Alter Their Investment Strategies Which May Have Unintended Consequences for the Capital Markets

Life insurers are the single largest investor in U.S. corporate debt.[21] The Proposed Rules' restriction of Variation Margin to Cash could require life insurers like MetLife to reduce the purchase of high-quality corporate bonds, impacting the financing costs of U.S. Corporations or to alter our investment strategies to increase investment in higher-yielding, longer-dated assets to satisfy our asset liability matching goals while retaining sufficient cash to satisfy potential Variation Margin requirements. In times of higher volatility (when life insurers' hedges in the uncleared OTC swap markets fluctuate more widely), insurers may be required to raise larger amounts of cash to satisfy potential Variation Margin calls.

5) Restricting Variation Margin to Cash has No Impact on Valuation Disputes

In further support of the cash-only Variation Margin requirement, the Regulators state that "[l]imiting variation margin to cash should sharply reduce the potential for disputes over the value of variation margin collateral."[22] In our experience, valuation of non-cash collateral has not been a source of disputes in the uncleared swap markets. Disputes between swap counterparties generally involve the changing value of underlying trades or the time of day at which such trades are valued, not on the value of collateral delivered. Disagreements over the value of non-cash collateral are rare and have been limited to the unavailability of a price source for a specific security over a limited time frame.

Standardization and Transparency of Initial Margin Models

The Regulators should promote consistency and transparency in approving and updating Initial Margin Models, which will limit disputes between financial end-users and Covered Swap Entities ("CSEs"). Initial margin model calculations should apply equally to both CSEs and financial end-users. Financial end-users ordinarily transact with a number of CSEs across multiple asset types. Having a single, transparent model in place across all market participants would significantly reduce operational risk and complexity. A lack of transparency in initial margin

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[21] Life insurers provide the largest U.S. source of corporate bond financing, holding 20% of total U.S. corporate debt outstanding ($2.3 trillion at the end of 2013). In 2013, approximately 51% of life insurers' $6.2 trillion of total assets were held in bonds, divided between corporate bonds (38%) and government bonds (13%). Over 37% of general account bonds purchased by life insurers have maturities in excess of twenty years at the time of purchase. *Sources*: ACLI tabulations of NAIC data (year-end 2013), used by permission; Federal Reserve Board, Z.1 *Financial Accounts of the United States, Second Quarter 2014.*

[22] Proposed Rules at 57371.

models would force MetLife to rely upon the CSE for the calculation of Initial Margin.

For example, the Proposed Rules, give the CSE discretion in choosing certain calculation methods (subject to Regulator approval). Where discretion is granted to the CSE, we believe the financial end user must be involved in the valuation process in the same manner as in the Credit Support Annex to existing ISDA Master Agreements for uncleared OTC derivatives, which provides for 2-way valuations and a robust dispute resolution mechanic.

The Proposed Rules contain requirements for "documentation of margin matters."[23] Specifically, CSEs would be required to execute trading documentation with other swap dealers or financial end-users regarding credit support arrangements that:

1. Provide contractual rights to collect and post Initial Margin and Variation Margin as required by the new margin rules;
2. Specify "the methods, procedures, rules, and inputs for determining the value of each non-cleared swap ... for purposes of calculating variation margin requirements."; and
3. Specify procedures by which disputes "concerning the valuation of non-cleared swaps" or the "valuation of assets collected or posted as initial margin or variation margin, may be resolved."[24]

The requirement that the documentation specify "inputs" seems particularly onerous as the inputs may vary from swap to swap and will change over the life of the swap. As a practical matter, this requirement will lead to documentation containing a very generic description of the inputs to be utilized in any dispute resolution procedure. Instead, we believe the focus should be on requiring parties to share the actual "inputs" being used to determine Initial Margin and Variation Margin at any particular point in time upon request (and particularly in the event of a dispute).

To promote consistency, transparency, and to limit potential disputes, Regulators should require that Initial Margin be calculated using industry standard models that are applied equally to CSEs and financial end-users. A single, transparent model utilized by all market participants would significantly reduce operational risk and complexity, and would be consistent with practices in the cleared derivatives market.

I. Variation Margin Amount Should be Determined with Reference to Mid-market Pricing

The Prudential Regulators Proposed Rules define "Variation Margin Amount" to mean "the cumulative mark-to-market change in value to a covered swap entity of a non-cleared swap or non-cleared security based swap ..."[25] The determination of the Variation Margin Amount with

[23] Proposed Rule §__.10 at p. 57395-57396.
[24] *Id.*
[25] Proposed Rule §__.2 (definition of *Variation Margin Amount*).

reference to the value of the swap to the covered swap entity constitutes a dramatic departure from industry practice which has long determined Variation Margin on the basis of an estimate of mid-market swap values.[26] Both the CSA and the more recent SCSA clearly contemplate that VM will be determined at mid-market prices.

The determination of Variation Margin based on a valuation at the covered swap entity's side of the market, is fundamentally flawed and highly skewed in favor of the covered swap entity. This methodology also ignores the sophistication of financial end-users that have invested time and money to develop systems to appropriately value derivative positions. Under the Prudential Regulators Proposed Rules, the Variation Margin pledged to an end-user that is in-the-money will be insufficient to cover its replacement cost should the swap dealer default. The Proposed Rules create an exposure or unsecured amount upon the occurrence of a swap counterparty default, which is contrary to other provisions in the Proposed Rules that seek to reduce or eliminate exposures through the reduction or elimination of unsecured thresholds and minimum transfer Amounts. For an end-user that is out-of-the-money, the amount of Variation Margin pledged will likely be greater than the amount owed upon a swap dealer default. The non-defaulting end-user s excess collateral will result in an unsecured claim against the defaulting swap dealer.

CFTC Reg. §23.504(b)'s description of dispute resolution procedures focuses on "methods, procedures, rules, and inputs, for determining <u>the value of each swap</u> at any time from execution to the termination, maturity, or expiration of such swap for the purpose of complying with the margin requirements under section 4s(e) of the [CEA]."[27] It goes on to specify that such documentation shall include either "[a]lternative methods for determining <u>the value of a swap</u>" or "[a] valuation dispute resolution process by which the <u>value of the swap</u> shall be determined..."[28]

In summary, we believe that the Prudential Regulators should coordinate with the CFTC and the SEC to adopt a consistent, balanced set of margin documentation requirements that clearly provide for resolution of disputes regarding Initial Margin and Variation Margin in a manner that is fair for all market participants.

<u>Initial Margin should reflect incremental Counterparty Credit Risk</u>

While life insurers such as MetLife support reducing risk to the financial system through the use of central clearinghouses, the Regulators should consider that not all swaps are or will be suitable for clearing. Life insurers. Accordingly, life insurers will need to continue to rely on the uncleared OTC markets for a meaningful portion of their hedging activities to mitigate the risks inherent in our assets and liabilities. Uncleared swaps enable insurers to more precisely match our assets and liabilities. Accordingly, it is important to life insurers that Initial Margin be appropriately sized to reflect the potential exposure during the close-out of a defaulting

[26] The CFTC proposed margin rule for non-cleared swaps does not contain a similar definition and presumably leaves undisturbed the existing market practice with respect to determining VM. *See* CFTC Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 Fed. Reg. 59898 (Oct. 9, 2014) (the "CFTC Reproposed Rule"), at 59928 (definition of "Variation Margin").
[27] CFTC Reg. §23.504(b)(4)(i).
[28] CFTC Reg. §23.504(b)(4)(ii).

counterparty. As drafted, the Proposed Rules would require Initial Margin that, in some instances, is at least double the amounts that apply to comparable exchange-traded futures. We believe that these amounts are excessive, particularly where there is no alternative for clearing or no CSE margin model has been approved by the Prudential Regulators or developed by clearinghouses in accordance with the CFTC Proposed Rules.

We believe that Proposed Rules impose a number of requirements in the calculation of Initial Margin, that when taken collectively, go far beyond what should be considered reasonable to offset the incremental counterparty credit risk that these transactions contain.

- Initial Margin models calibrated to a period of sector-specific market stress
- Additive 8% haircut for currency differences between swap obligation and collateral
- No netting across asset classes is permitted

Phase-in for Variation Margin Requirements

The Regulators proposed a compliance deadline of December 2015 to implement the new rules regarding Variation Margin, while specifying a phase-in schedule for Initial Margin that extends to 2019. MetLife supports the December 2015 implementation deadline to the extent that daily, bi-lateral posting of Variation Margin is required. However, any rules that restrict eligible collateral types, or establish new rules regarding netting agreements, or that otherwise represent significant deviations from current practice, should be subject to a longer phase-in period. In order to preserve rights under existing ISDA Master Agreements and Credit Support Annexes, parties will need to re-negotiate these agreements with their counterparties prior to the implementation date. In addition, operational changes to support many of the changes contemplated by the Proposed Rules would need to be implemented. MetLife believes that adherence to a December 2015 implementation date in light of the substantial changes in the Proposed Rules would create significant operational risk for the OTC derivatives market as a whole and recommends that to the extent that the Final Rules substantially change existing market practice with respect to Variation Margin, that the phase-in period for such changes be extended to match the phase-in period for the Initial Margin requirements.

I. Definition of Eligible Master Netting Agreement Needs Clarification

Two elements of the proposed definition of Eligible Master Netting Agreement ("EMNA") should be revised or clarified to ensure that insurance company financial end users are not unintentionally disadvantaged. First, the definition of EMNA should be expanded to clarify that a limited stay under state insurance insolvency and receivership laws is a permissible exception to the requirement that "any exercise of rights under the agreement will not be stayed or avoided." Second, the definition of EMNA should be clarified to confirm that it does not intend to override standard conditions precedent in master netting agreements that permit a party to suspend payments if an Event of Default has occurred and is continuing with respect to the other party.

In the United States, an insurance company is regulated primarily by the insurance regulator in the State where it was incorporated (often referred to as its "domiciliary state"). The domiciliary state regulator also acts as receiver in an insurance company insolvency. In response to concerns raised by swap dealers in the aftermath of the financial crisis, a number of insurance companies, including MetLife, worked with the legislatures of their domiciliary state to adopt laws based on Section 711 ("Section 711") of the National Association of Insurance Commissioners (NAIC) Insurer Model Receivership Act (IRMA).[31] Section 711 was designed to mirror concepts in the U.S. Bankruptcy Code and provides clarity that a receiver may not stay or avoid the exercise of rights of counterparties under derivatives and other Qualified Financial Contracts. Among numerous arguments made to both legislatures and insurance departments to support the adoption of the new legislation was that it would enable insurance companies to be on a level playing field with banking institutions and other entities covered by the U.S. Bankruptcy Code.

The Financial Stability Board and Prudential Regulators have directed systemically important financial institutions ("SIFIs") and their affiliates to incorporate a limited stay into their derivatives contracts as a means to resolve the insolvency of a SIFI under the Orderly Liquidation Provisions of Dodd-Frank.[32] These financial institutions represent affiliates of the primary swap dealers with which insurance companies conduct their swap business. Recently, a committee of the NAIC has urged States that have not adopted Section 711-like legislation to consider the adoption of a 24-hour stay in future legislation similar to the provisions requested by the Financial Stability Board and Prudential Regulators. To the extent that state insurance regulators, require such legislation, insurance companies would no longer have an ENMA because the limited stay imposed by a regulator is not recognized in the proposed definition.[33]

EMNAs are necessary to net Variation Margin across swaps and net Initial Margin within broad risk categories. The absence of netting would significantly increase the cost of hedging and would diminish the ability of insurers to hedge their assets and liabilities. Meanwhile, it seems unfair that State insurance regulators (and the insurance companies they regulate) would be penalized for seeking to implement essentially the same limited stay that Federal and international regulators acknowledge is prudent. Accordingly, we encourage the Prudential Regulators to revise the definition to clearly address State insurance regulation which includes a limited stay to facilitate the orderly resolution of an insolvent insurance company.

Our second concern relates to the definitional requirements of an EMNA,[34] which forbid

[31] Currently, 22 states have adopted such legislation.

[32] *See* ISDA 2014 Resolution Stay Protocol, located at: http://assets.isda.org/media/f253b540-25/958e4aed.pdf/.

[33] The Prudential Regulators acknowledge State insurance regulators in the definition of financial end user. *See* Proposed Rule at §__.2 (definition of "*Financial End User*"), clause 1(x).

[34] Reproposed Rule at §__.2 (definition of "*Eligible Master Netting Agreement*"), clause (3). To the extent this language is designed to prohibit the use of the "first method" or so-called "walkaway clauses" following an Early Termination Event under a 1992 ISDA Master Agreement, we would not find it objectionable, but we believe the provision in its current form has potentially broader and undesirable consequences.

any clauses that "suspend or condition payment, to a defaulter." This provision should be clarified to confirm that it does not override standard conditions precedent in master netting agreements that permit a party to suspend payments if an Event of Default has occurred and is continuing with respect to the other party. It is unreasonable to require a party to continue to make payments and deliveries to a defaulted counterparty. The inability to suspend performance in the event of a default departs from current industry practice and the basic tenets of the ISDA Master Agreement structure, and could result in virtually all pre-existing ISDA Master Agreements failing to qualify as an EMNA. This requirement in the definition also creates risk of more frequent closeouts in the market, as parties will be incentivized to move quickly to close out trades (to avoid a requirement to continue making payments), instead of providing an opportunity to resolve non-payment defaults without termination. Such a requirement could have disastrous effects in the event of a market disruption, operational errors, or temporary factors unrelated to the financial condition or outside the control of the defaulting counterparty, where a temporary suspension would otherwise allow the parties to resolve the issue without proceeding to a close out.

Conclusion

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

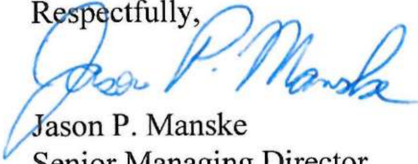
- Adopting the categories of Eligible Collateral specified in the BCBS/IOSCO Framework for Initial and Variation Margin
- Retain the characterization of Variation Margin for uncleared swap transactions as a security interest, rather than a settlement or payment.
- Standardization and full transparency of initial margin models to all market participants, including financial end-users.
- Mid-market calculation of Variation Margin, rather than calculation of value to the Covered Swap Entity.
- Difference of Initial Margin requirements between cleared and uncleared swaps limited to the amount necessary to mitigate counterparty credit risk of uncleared swaps.

We believe that with these changes, the cleared and uncleared OTC derivatives markets can function in a manner that promotes safety and soundness for the financial markets and still allow

financial end-users like MetLife to continue to appropriately hedge risks and provide the insurance products upon which our customers rely.

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

Respectfully,



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