MetLife's Consent Solicitation: We Will Just Say "No"

"Just say no to crack". The "crack" in this case is the mere ¼ point consent fee (i.e., a small sum of $8mm) that MetLife is offering to distribute equally among hybrid preferred holders in solicitation of a protective bond covenant change that is likely to be triggered early next year (after 1Q18) if the covenant is not amended. Rather than get into the details of the trigger covenants and the proxy solicitation, which in large part stem from a smaller equity base and charges related to MetLife's Brighthouse Financial spin-off (for which there is continuing exposure), we focus here on the implications of the trigger event to hybrid holders and to MetLife:

Primary implications to holders of MetLife hybrid preferred securities:

- A vote to CONSENT would preclude a trigger event by allowing MetLife to change the rules of the financial tests in the covenant. Hybrids would continue to be paid.
- A vote to NOT CONSENT would allow existing financial tests to continue and advance the likelihood of a trigger event. Hybrids should continue to be paid.

So, if in either case the hybrids are likely to be paid, then why not just accept the nominal fee and get something for nothing? The rationale to **not accept** this solicitation is to deliver a message to MetLife's management that there is more at stake here in the proxy process than just a "friendly gesture" (i.e., the ¼ point) and that the consent fee needs to be meaningfully increased to sway the hybrid votes. What's the message at stake for MetLife?

Primary implications to MetLife of tripping a trigger period on hybrid payments:

- Management would be required to exercise an "alternative payment mechanism" (APM) by using "commercially reasonable efforts" to issue common stock to raise specific equity funds sufficient to pay interest on the hybrids and therefore, avoid having to execute a dividend stopper on its classes of capital stock.

- Any alternative payment mechanism having to be used would be viewed as a signal of operating weakness and even potential mismanagement. Exercise of the APM would establish a precedent as no other issuer in the United States has ever paid hybrid debt interest through such an arrangement to raise equity.
- There may be more than an insubstantial risk that an APM precedent could impel unwelcomed press and discussions that would seek to disallow the interest deduction on the MetLife hybrid securities during the APM period – The Senate Committee on Finance, Joint Committee on Taxation recently contemplated (see page 20) how debt may be *treated* as being payable in equity. The law stipulates that if debt has an "arrangement" that reasonably achieves the result of interest being paid by reference to or an arrangement of equity, then the interest deduction would be disallowed. An APM action that requires extended "commercially reasonable efforts" to specifically raise equity to pay debt coupons could be viewed as an arrangement resulting in the payment of debt by reference to equity during the trigger period. Management's willingness to seemingly game their indifference to triggering an APM could unintentionally ignite a tax court battle and grow legal expenses, among other things.
- Depending on the length of the trigger period (MetLife's preliminary proxy contemplates a trigger period of up to 2yrs), the amount of hybrid interest payments having to be paid substantially in equity through "Qualifying APM Securities" could be significant. An APM of 2yrs would sum to $516 million of required equity issuance and a potential tax-effective value specific to each coupon series -- this should require a range of consent fees in consideration of the total tax benefits saved ($181 million) but segmented economically to each hybrid series-based consent.

The spirit of debt vs. equity tax law treatment was based on Congressional concern that corporate taxpayers could issue instruments (i.e., hybrid capital securities) in debt form that may more closely resemble equity in function, for which an interest deduction would be inappropriate. MetLife's management should take note of this history and not run a proxy of risky ambition to underpay hybrid holders for such an important request to consent.

MetLife's consent solicitation of a mere ¼ point is materially underwhelming. Recent news reports of some hybrid holders seeking twice as much fee are underwhelming expectations too. Indeed, the offer by Chubb Limited today to pay a 1pt solicitation fee for a basic termination of its replacement capital covenant (RCC) is timely evidence of the sub-standard value in MetLife's solicitation which has far greater potential repercussions if not accepted than would a denial of a simple RCC, in comparison. We find it odd how MetLife's management appears so willing to self-impose an APM precedent that obligates the company to issue more common stock to protect total common shareholder value – this dysfunctional path could heighten arbitrary tax risks and prompt embarrassing headlines of management missteps worthy of boardroom discussion.

In conclusion, we do not take issue with the spirit of MetLife's consent request, but we do take issue with the significantly undervalued payment offered to grant the permission. We will act thoughtfully and responsibly to this solicitation and will "just say no to crack" – **we will vote to NOT consent** and ultimately expect discussions of fair value to follow. In the meantime, we give up little and are being paid to wait.

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