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Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

February 22, 2013

Re: Proposed Rules Governing Capital, Margin and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants; File No. S7-08-12; RIN 3235-AL12

Dear Ms. Murphy:

The American Council of Life Insurers ("ACLI") is a national trade association with 300 members that represent more than 90 percent of the assets and premiums of the life insurance and annuity industry. Life insurers actively participated in the legislative dialogue concerning regulation of derivatives markets and have provided constructive input on proposed rulemaking implementing Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

ACLI respectfully submits the following response to the SEC's request for comment on proposed rules governing capital, margin and segregation requirements for Security-Based Swap Dealers ("SBSDs") and Major Security-Based Swap Participants (MSBSPs"). Life insurers manage asset and liability risks by hedging with derivatives instruments, and are among the financial end users affected by the SEC's proposed initiative. Life insurers support the legislative objectives of the Dodd-Frank Act in Title VII designed to ensure stability of the financial markets. We greatly appreciate the SEC's response to our request for an extension of the initial comment period on the proposal.[1]

I. Summary of Position

Our comments focus on the margin, collateral, and segregation aspects of the proposal. ACLI has previously submitted detailed comments on parallel regulatory proposals developed by U.S. prudential regulators, the Commodity Futures Trading Commission (CFTC), and international derivatives regulatory bodies.[2] These concomitant proposals represent multiple moving parts in a multi-layered regulatory system that will directly affect life insurers.

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[1] *See* ACLI request for comment period extension dated January 11, 2013 at http://www.sec.gov/comments/s7-08-12/s70812-10.pdf .
[2] *See, e.g.* ACLI submissions on:

- Supplemental Request for Comments on Proposed Margin and Capital Requirements for Covered Swap Entities; [http://www.fhfa.gov/webfiles/24691/95_American%20Council%20of%20Life%20Insurers%20ACLI.pdf] [five prudential regulators];
- Supplemental Request for Comments on Proposed Margin Requirements Governing Uncleared Swap Transactions for Swap Dealers and Major Swap Participants [http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58806&SearchText=wilkerson] [CFTC];

We strongly encourage coordinated domestic and international approaches to derivatives regulation that will ensure cost-effective, harmonized regulation and prevent regulatory arbitrage. Regulations governing SBSDs and MSBSDs should be conceptually uniform with regulations governing swap dealers and major swap participants to minimize or eliminate unnecessary and costly differences that could thwart enterprise-wide compliance procedures and greatly increase systems costs.

While aspects of the SEC proposals that differ from other regulators' parallel initiatives are based on preexisting broker-dealer provisions, they consequently impose one-size standards that do not acknowledge differences in counterparties' regulatory framework, business models, and market practices. We encourage modifications that accommodate these substantive distinctions while also protecting the economy and the derivatives marketplace.

II. Overview: Proposed Margin, Collateral, and Segregation Standards in Non-Cleared Securities-Based Swap Transactions

Proposed Rule 18-3 is modeled on existing broker-dealer margin and collateral rules "to promote consistency within the Federal securities laws and to facilitate portfolio margining of security-based swaps with other types of securities."[3] The initiative would not limit collateral to cash and government securities, and would permit a prudent range of instruments to be used as collateral. Proposed Rule 18a-4 applies to all types of SBSDs and establishes standards on how customer cash, securities, and money market instruments in cleared security-based swap transactions must be segregated when a SBSD commingles those assets with the cash and securities of other customers under current provision of the Securities Exchange Act that reflect special protections under the U.S. Bankruptcy Code.[4] Proposed Rule 18a-4 requires that customer assets in non-cleared security-

- CFTC Proposal on Protection of Cleared Swaps Customer Contracts and Collateral [http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48045&SearchText=wilkerson] [CFTC]; and,
- Submission on Consultative Paper on the Regulation of Derivatives published by the Basel Committee on Bank Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) ("BCBS-IOSCO Consultative Paper") [http://www.bis.org/publ/bcbs226/acoli.pdf] [BCBS-IOSCO].

[3] See 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70259. The release explains that:

> Under the broker-dealer margin rules, an accountholder is required to maintain a specified level of *equity* in a securities account at a broker-dealer (*i.e.,* the market value of the assets in the account must exceed the amount of the accountholder's obligations to the broker-dealer by a prescribed amount). This equity serves as a buffer in the event the accountholder fails to meet an obligation to the broker dealer and the broker-dealer must liquidate the assets in the account to satisfy the obligation. The equity also provides liquidity to the broker-dealer with which to fund the credit extended to the accountholder. The amount of the equity required to be maintained in the account depends on the securities transactions being facilitated through the resources of the broker-dealer because the equity requirement increases as the risk of the securities purchased with borrowed funds or sold short with borrowed securities increases. Proposed new Rule 18a–3 is based on these same principles and is intended to form part of an integrated program of financial responsibility requirements, along with the proposed capital and segregation standards. Id. (emphasis added, footnotes omitted).

[4] *Id.* at 70274. Segregation requirements are designed to identify customer property as distinct from the proprietary assets of the firm and to protect customer property by, for example, preventing the firm from using it to make proprietary investments. The goal of segregation is to facilitate the prompt return of customer property to customers either before or during a liquidation proceeding if the firm fails. The Dodd-Frank Act contains provisions designed to ensure that cash and securities held by an SBSD relating to security-based swaps will be deemed customer property under the stockbroker liquidation provisions. Id.

based swaps be treated in the same manner as customer assets in cleared security-based swap transactions, unless the counterparty elects to have individual segregation of assets.[5]

II. The Regulation and Use of Derivatives by Life Insurers

A brief explanation on the regulation and use of derivatives by life insurers provides useful context for our comments below. Life insurers' financial products protect millions of individuals, families and businesses through guaranteed lifetime income, life insurance, long-term care insurance and disability income insurance, among other products. These products provide consumers with financial security through various stages of life and enable them to plan for their financial future, including retirement. Accordingly, many life insurer obligations to policyholders, as well as the assets that are purchased to support those liabilities, have durations that extend for one or more decades. Life insurers prudently manage asset and liability risks associated with their financial products with derivatives.

Life insurers' use of derivatives is strictly limited and subject to comprehensive state insurance regulation.[6] Consistent with such regulations and the needs of their business and contract holders, life insurers predominantly use derivatives for hedging transactions to reduce risks associated with existing or anticipated assets or liabilities. Such risks include the risk of changes in value, yield, price, cash flow or quantity of assets or liabilities as well as foreign currency exchange risk. In order to mitigate such risks, life insurers participate in both the exchange-traded futures and options markets and over-the-counter ("OTC"), bilaterally negotiated markets.

Life insurers are among the financial end users that will be subject to mandatory clearing requirements and margin requirements for non-cleared swaps under the Dodd-Frank Act. For most of insurers' existing OTC transactions, no initial margin or independent amount is required and variation margin is exchanged on a daily basis.[7] Furthermore, in response to the financial crisis, many life insurers renegotiated their OTC agreements to reduce or eliminate thresholds for posting collateral. As a result, their derivatives exposures are generally fully collateralized with the exception of one day market value movements. Very simply, life insurers are financial end users of derivatives

[5] 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70267. Thus, the release explains Rule 18a-4 would establish an alternative omnibus or "commingled" segregation approach for non-cleared security-based swaps that would operate as a default procedure.

[6] For example, state insurance regulation precludes life insurers from taking the speculative side of a derivatives transaction, and limits life insurers to hedging and replication transactions. Unlike other financial service institutions, life insurers typically are fully collateralized. To provide further context on the state regulation of insurers' derivatives activities, we attach as Appendix A an outline of the National Association of Insurance Commissioners' ("NAIC") Investments of Insurers Model Act which shows the breadth and depth of regulatory oversight of derivatives transactions. The NAIC's Financial Regulation Standards and Accreditation Program requires adoption of legislation that is substantially similar to the Investments of Insurers Model Act. *See* NAIC 2012 Statement on Existing U.S. Corporate Governance Requirements at 8, Section c [http://www.naic.org/documents/committees_ex_isftf_corp_governance_111222_existing_us_corp_gov_reqs.pdf]. The outline in Appendix A also summarizes the NAIC Derivatives Instruments Model Regulation, which further implements the Investments of Insurers Model Act. In addition, as Appendix B we provide portions of the NAIC's Financial Condition Examiner's Handbook that provides guidance to examiners in reviewing an insurer's derivatives activities. Finally, in Appendix C we show sample pages from an insurer's annual statutory financial statements where all derivatives transactions must be reported. These documents demonstrate that insurers' use of derivatives is already carefully regulated and routinely examined by, as well as transparently reported to, state insurance regulators.

[7] We appreciate that the release recognizes ACLI's position in a submission to prudential regulators which emphasized that we "pointed out that life insurers also typically do not post initial margin and recommended that initial margin requirements be appropriately sized to reflect the potential exposure during the close out of a defaulting party." 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70266, footnote 575.

that pose minimal risk to the financial markets – their trades are risk reducing in nature and almost fully collateralized.

Life insurers appreciate that the Dodd-Frank Act requires adoption of margin requirements for Covered Swap Entities ("CSEs"), such as security-based swap dealers, in order to offset perceived greater risk associated with non-cleared swaps. Nevertheless, ACLI and its members believe it is important for the SEC to recognize that the proposed rules could impose significantly greater costs on life insurers due to both substantial initial margin requirements and potential narrowing of the security categories eligible to be used as margin. As more particularly described in this letter, rules limiting the asset types that may be pledged by financial end users as margin, and failing to require bilateral pledging of margin by CSEs and financial end users, threaten to undermine numerous conservative, risk-mitigating OTC arrangements that have been carefully negotiated between life insurers and their counterparties, potentially exacerbating systemic risk rather than reducing it.

Although the proposed rules govern SBSDs and MSBSPs, they will unequivocally have a direct and significant impact on counterparties to SBSDs and MSBSPs in non-cleared derivatives transactions. In evaluating the economic and competitive impact of the proposed rules, it will be important to recognize distinctions among counterparties to SBSDs and MSBSPs involving their unique regulatory framework, business models, and role in the derivatives markets. In this way, the proposed rules will fulfill the mandate of the Dodd-Frank Act in a fair and cost-effective manner.

For example, life insurers are limited to hedging and replication transactions, and are precluded from speculative positions under state insurance laws. Life insurers tend to be fully collateralized in their non-cleared derivatives transactions. Life insurers have long been fully transparent in their derivatives obligations through schedule DB of the life insurers' state insurance reporting obligations, and are fully examined on these specific transactions pursuant to meticulous standards in the NAIC Financial Examiners Handbook.

In sum, life insurers present a different profile from most other financial service institutions. A "one-size-fits-all" design in the proposed rules would ignore these important substantive distinctions. As discussed further below, several directly parallel issues currently under consideration by domestic and international derivatives regulators address regulatory solutions that flexibly recognize differences among counterparties to SDs and MSPs. The SEC's proposed rules governing SBSDs and MSBSPs would be even more effective if they followed similar conceptual paths.[8]

[8] In the release, the SEC itself recognizes that different counterparties to SBSDs and MSBSDs present different risk profiles. For example, proposed Rule 18a-3 provides an exception from margin requirements for "commercial end users" which is "intended to account for the different risk profiles of commercial end users from financial end users." 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70265. In explaining this exception, the release references the margin proposal of the prudential regulators, noting "financial end users are considered more risky than nonfinancial end users because the profitability and viability of financial end users is more tightly linked to the health of the financial system than nonfinancial end users. Because financial counterparties are more likely to default during a period of financial stress, they pose greater systemic risk and risk to the safety and soundness of the covered swap entity." Id. at footnote 554 on page 70265. The release explains that when

> ''trigger events'' occurred during the financial crisis, counterparties faced significant liquidity strains in seeking to meet the requirements to deliver collateral. As a result, some dealers experienced large uncollateralized exposures to counterparties experiencing financial difficulty, which, in turn, risked exacerbating the already severe market dislocation. The Dodd-Frank Act seeks to address the risk of uncollateralized credit risk exposure arising from OTC derivatives by, among other things, mandating margin requirements for non-cleared security-based swaps and swaps. In particular, section 764 of the Dodd- Frank Act added new section 15F to the Exchange Act.480 Section 15F(e)(2)(B) of the Exchange Act provides that the Commission shall adopt rules for

III. Comment on Proposed Margin & Collateral Standards

A. Margin Requirements

Pursuant to Section 15F(e) of the Securities Exchange Act, the SEC proposed Rule 18a–3 to establish margin requirements for nonbank SBSDs and nonbank MSBSPs on non-cleared security-based swaps. The provisions of proposed Rule 18a–3 are based on the margin rules applicable to broker-dealers (the ''broker-dealer margin rules''). According to the release, the goal of modeling proposed new Rule 18a–3 on the broker-dealer margin rules is to promote consistency with existing rules and to facilitate the portfolio margining of security-based swaps with other types of securities.[9]

Under the broker-dealer margin rules, an accountholder is required to maintain a specified level of equity in a securities account at a broker-dealer (i.e., the market value of the assets in the account must exceed the amount of the accountholder's obligations to the broker-dealer by a prescribed amount). This equity serves as a buffer in the event the accountholder fails to meet an obligation to the broker-dealer and the broker-dealer must liquidate the assets in the account to satisfy the obligation. The equity also provides liquidity to the broker-dealer with which to fund the credit extended to the accountholder. The amount of the equity required to be maintained in the account depends on the securities transactions being facilitated through the resources of the broker-dealer because the equity requirement increases as the risk of the securities purchased with borrowed funds or sold short with borrowed securities increases.

The release explains that proposed Rule 18a–3 is based on these same principles and is intended to form part of an integrated program of financial responsibility requirements, along with the proposed capital and segregation standards. For example, proposed Rule 18a–1 would impose a capital charge in certain cases for uncollateralized exposures arising from security-based swaps. The

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> nonbank SBSDs and nonbank MSBSPs imposing ''both initial and variation margin requirements on all security based swaps that are not cleared by a registered clearing agency.'' Section15F(e)(2)(A) of the Exchange Act provides that the prudential regulators shall prescribe initial and variation margin requirements for non-cleared security-based swap transactions
> applicable to bank SBSDs and bank MSBSPs. Section 15F(e)(3)(A) also provides that ''[t]o offset the greater risk to the security-based swap dealer or major security-based swap participant and the financial system arising from the use of security-based swaps that are not cleared,'' the margin requirements proposed by the Commission and prudential regulators shall ''help ensure the safety and soundness'' of the SBSDs and the MSBSPs, and ''be appropriate for the risk associated with non-cleared security-based swaps held'' by an
> SBSD or MSBSP. 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70258 [footnotes omitted].

In significant contrast, although life insurers invoke the definition of financial end user under the Dodd-Frank Act, they do not share the risk profile described in the above quoted language in the SEC release. As previously explained, life insurers are hedgers, fully collateralized and fully transparent. As such, they present significantly lower risk profiles than other financial end users. Indeed, life insurers generally did not suffer the negative consequence of the 2008 market stresses in their derivatives transactions like other financial end users because life insurers were fully collateralized with their counterparties and engaged only in hedging asset and liability risks. They were not engaged in speculative positions, as mandated by state insurance laws. Accordingly, it is sound to recognize the substantive, regulatory and business model differences among counterparties to SBSDs and MSBSPs in promulgating the margin and collateral standards in the proposed rules.

[9] *See* 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70259. The release further explains that in the securities markets, margin rules have been set by relevant regulatory authorities (the Federal Reserve and the SROs) since the 1930s. The requirement that an SRO file proposed margin rules with the SEC has promoted the establishment of consistent margin levels across the SROs, which mitigates the risk that SROs (as well as their member firms) will compete by implementing lower margin levels and also helps ensure that margin levels are set at sufficiently prudent levels to reduce systemic risk.

segregation requirements are intended to ensure that initial margin collected by SBSDs is protected from their proprietary business risks.

The margin requirements drawn from existing broker-dealer rules provide a framework that is consistent, in part, with domestic and global derivatives initiatives, and different in other areas. As discussed further below, the SEC proposal comports with global initiatives in permitting a broad range of collateral for margin and in allowing minimum transfer amounts. The initiative conflicts with domestic and global initiatives in not requiring bilateral margining, and in segregation mechanics. These similarities and distinctions are discussed in greater detail below. ACLI recommends, as an overarching construct, that the SEC's margin, collateral, and segregation proposals reflect parallel positions with global and domestic derivatives regulators.

The release elicits suggestions on alternative models form the SEC proposal that would (i) more appropriately address the risks of non-cleared security-based swaps, and (ii) provide more practical margining programs for non-cleared security based swaps. The global derivatives developments provide an excellent, partially alternate framework for harmonized regulation by U.S. regulators, and are summarized immediately below.

As a general matter, the BCBS-IOSCO Consultative Paper emphasizes that all derivatives not centrally-cleared by a central clearing party (CCP) should be subject to margining requirements. In principle, the paper indicates this includes all five major asset classes of derivatives (interest rate, credit, equity, foreign exchange and commodity) and all derivative products (both standardized and bespoke) that are not centrally cleared by a central counterparty for any reason.[10]

The Consultative Paper establishes initial policy standards for margin requirements for non-centrally-cleared derivatives through key principles addressing seven main elements:

1. Appropriate margining practices should be in place with respect to all derivative transactions that are not cleared by CCPs.

2. All financial firms and systemically-important non-financial entities ("covered entities") that engage in non-centrally-cleared derivatives must exchange initial and variation margin as appropriate to the risks posed by such transactions.

3. The methodologies for calculating initial and variation margin that must serve as the baseline for margin that is collected from a counterparty should (i) be consistent across entities covered by the proposed requirements and reflect the potential future exposure (initial margin) and current exposure (variation margin) associated with the portfolio of non-centrally-cleared derivatives at issue and (ii) ensure that all exposures are covered fully with a high degree of confidence.

[10] *See* BCBS-IOSCO Consultative Paper (July 2012) [http://www.bis.org/publ/bcbs226.pdf] at 7. On February 15, 2012, BCBS-IOSCO published a second Consultative Paper "which represents a near-final proposal on margin requirements for non-centrally-cleared derivatives." *See* http://www.bis.org/publ/bcbs242.htm . Each of the elements referenced in this letter from the Consultative Paper were left unchanged in the "near final" second Consultative Paper. In the interest of harmonized domestic and global derivatives regulation, it would be sound to frame amendments to the SEC proposal around the principles and recommendations in the Consultative Paper.

4. To ensure that assets collected as collateral for initial and variation margin purposes can be liquidated in a reasonable amount of time to generate proceeds that could sufficiently protect collecting entities covered by the proposed requirements from losses on non-centrally-cleared derivatives in the event of a counterparty default, these assets should be highly liquid and should, after accounting for an appropriate haircut, be able to hold their value in a time of financial stress.

5. Initial margin should be exchanged by both parties, without netting of amounts collected by each party (i.e. on a gross basis), and held in such a way as to ensure that (i) the margin collected is immediately available to the collecting party in the event of the counterparty's default; and (ii) the collected margin must be subject to arrangements that fully protect the posting party in the event that the collecting party enters bankruptcy to the extent possible under applicable law.

6. Transactions between a firm and its affiliates should be subject to appropriate variation margin arrangements to prevent the accumulation of significant current exposure to any affiliated entity arising out of non-centrally-cleared derivatives.

7. Regulatory regimes should interact so as to result in sufficiently consistent and non-duplicative regulatory margin requirements for non-centrally-cleared derivatives across jurisdictions.

These seven principles comport with the concepts enunciated in the release. We encourage coordinated symmetry between these elements from the Consultative Paper and the SEC's proposed margin, collateral, and segregation rules. With harmonized domestic and global regulation, the derivatives markets will operate more efficiently.

B. Collateral for Margin

The release explains that prudential regulators and the CFTC are proposing to specifically identify the asset classes that would be eligible collateral for purposes of their margin rules. Proposed new Rule 18a-3 would not limit collateral in this way. The release, however, elicits comment on the question of whether to define the term *eligible collateral* in a manner that is similar to the proposals of the prudential regulators and the CFTC.

The SEC release explains that the reason for not proposing a definition of eligible collateral is that counterparties are expected to engage in a wide range of trading strategies that include security-based swaps. As a result, the release further notes that the account of a counterparty may hold, for example, the security underlying a security-based swap, as well as a short position, option, and single stock future on the underlying security. Because of the relationship between security-based swaps and these other security positions, the release observes that permitting various types of securities to count as collateral may be more practical for margin arrangements involving security-based swaps than for other types of derivatives.

We endorse the SEC's determination not to limit collateral in proposed Rule 18a-3. ACLI strongly supported a directly parallel approach in the BCBS-IOSCO Consultative Paper as explained below, and opposed the limitation of collateral to cash and government securities in the CFTC and prudential regulators' proposals. Narrow limits on the types of permitted collateral could greatly impair liquidity in the derivatives marketplace and thwart constructive risk management.

The BCBS-IOSCO Consultative Paper states that the potential benefits of margin requirements must be weighed against the liquidity impact that would result from derivative counterparties' need to provide liquid, high-quality collateral to meet those requirements, including potential changes to market functioning as result of an increasing demand for such collateral in the aggregate. The paper notes that financial institutions may need to obtain and deploy additional liquidity resources to meet margin requirements that exceed current practices. Moreover, the paper observes that liquidity impact of margin requirements cannot be considered in isolation.

We fully agreed with the Consultative Paper's position that the potential benefits of margin requirements must be weighed against the liquidity impact that would result from derivative counterparties' need to provide liquid, high-quality collateral to meet those requirements, including potential changes to market functioning as result of an increasing demand for such collateral in the aggregate. ACLI's July 11, 2011 submission to the CFTC and prudential regulators noted that limiting eligible collateral to cash and government securities could impose unintended negative consequences on the market for these securities, and could create liquidity log jams.[11]

We emphasized that limiting non-cash eligible collateral to U.S. Treasuries and guaranteed agency securities may also alter the markets for these securities -- artificially increasing prices due to rising demand and suppressing yields for investors in these securities. There could be new sensitivity in the markets for these securities which could lead, in times of market stress, to increased volatility which could ripple across the financial markets. Increased demand for U.S. Treasuries as eligible collateral would be exacerbated by the "flight to quality" in times of market turmoil or distress. Otherwise sound firms could potentially be placed into a scenario where they are forced to liquidate other high quality asset types to fulfill increasing margin requirements with a narrowly defined collateral universe. Being able to avoid this type of scenario is arguably a primary reason behind the wide range of eligible collateral types available at the Federal Reserve Discount Window.

The Consultative Paper's focus on the impact of margin requirements on liquidity reflects a prudent approach to designing margin requirements for non-cleared swaps. We encourage the SEC to include this conceptual framework in its proposed rule.

Following the publication of the Consultative Paper, the CFTC and the prudential regulators invited supplemental comment on their proposed limitations on collateral in light of the paper's recommendations. We understand that the CFTC and the prudential regulators are carefully evaluating the more expansive approach to collateral in the Consultative Paper, and are tentatively inclined to reach a similar position in the interest of harmonized global derivatives regulation and to avoid opportunistic regulatory arbitrage.

The BCBS-IOSCO Consultative Paper discusses two means to define eligible collateral. One approach would limit eligible collateral to only the most liquid, highest-quality assets, such as cash and high-quality sovereign debt, on the grounds that doing so would best ensure the value of collateral held as margin could be fully realized in a period of financial stress.

A second approach in the Consultative Paper would permit a broader set of eligible collateral, including assets like liquid corporate bonds and equity securities, and address the potential volatility of such assets through application of appropriate haircuts to their valuation for margin purposes. The

[11] *See* ACLI Comment Letter to CFTC dated July 11, 2011 at 6.

Consultative Paper observes that potential advantages of the second approach would include (i) a reduction of the potential liquidity impact of the margin requirements by permitting firms to use a broader array of assets to meet margin requirements and (ii) better alignment with central clearing practices, in which CCPs frequently accept a broader array of collateral, subject to collateral haircuts. After evaluating each of these alternatives, the BCBS and IOSCO have proposed the second approach allowing broader eligible collateral.

ACLI fully supported the second approach in the Consultative Paper to broadly define collateral eligible for margin. In our July 11, 2011 comment letter[12], we explained that ACLI developed a proposal based on an analytic framework that utilizes basic portfolio diversification techniques on corporate bonds to demonstrate, 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.[13] Our proposal recommended prudent haircuts, portfolio diversification and concentration limits to further support an expanded list of eligible collateral. Permitting a broader list of eligible collateral for both initial and variation margin would achieve the intent of securing derivatives positions and minimizing the liquidity stress on the marketplace and other unintended consequences described above.

In sum, therefore, we strongly recommend the incorporation of the Consultative Paper's approach allowing broader categories of eligible collateral into the SEC's final rule to promote domestic and global harmonization of derivatives regulation, and to enable constructive risk management that

[12] *See* ACLI Comment Letter at 7.

[13] A brief summary of ACLI's approach in our July 11, 2011 comment letter may provide helpful context. In light of the Dodd Frank Act's prohibition on relying 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 our analysis could be applied to other indices as well.

Following the Prudential Regulators' position that termination (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 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 CUSIPs and 45% concentration limit per High Level Sector) and that collateral haircuts of 15-20% provide a high degree of protection upon the occurrence of a CSE 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 uncleared derivative exposure. We also suggest that other high-quality collateral types such as Agency Debentures and Agency RMBS should also be included as eligible collateral.

protects the financial economy. Specific suggestions for the types of eligible collateral are discussed immediately below.

C. Examples of Eligible Collateral

While the SEC release explains that proposed Rule 18a-3 would not specifically identify the asset classes that would be eligible for collateral, the release does, however, propose several additional requirements for eligible collateral that are modeled on existing requirements for broker-dealers in current Rule 15c3-1 under the Securities Exchange Act.[14] ACLI observes that these additional requirements may introduce unnecessary constraints on eligible collateral that while appropriate in the world of broker-dealer collateral with securities customers, may fit collateral in derivatives transactions poorly. ACLI recommends instead that the SEC endeavor to coordinate any requirements for eligible collateral with the more flexible standards enunciated in the BSBS-IOSCO Consultative Paper, which is summarized immediately below.

As a guide, the BCBS-IOSCO Consultative Paper also provided general examples of the types of eligible derivatives collateral, including:

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

The Consultative Paper noted that

> The illustrative list above should not be viewed as being exhaustive. Additional assets and instruments that satisfy the key principle may also serve as eligible collateral. Also, in different jurisdictions, some particular forms of collateral may be more abundant or generally available due to institutional market practices or norms. Eligible collateral can be denominated in any currency in which payment obligations under the non-centrally-cleared derivative may be made, or in highly-liquid foreign currencies subject to appropriate haircuts to reflect the inherent FX risk involved.

ACLI strongly supported the examples of eligible collateral listed in the Consultative Paper in fulfillment of the paper's key principle, and endorses the statement that the illustrative list is not exhaustive. We agreed that additional assets and instruments, such as Residential Mortgage-backed

[14] 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70264. The proposed additional requirements for eligible collateral include:

- The collateral must be subject to the physical possession or control of the nonbank SBSD;
- The collateral must be liquid and transferable;
- The collateral must be capable of being liquidated promptly by the nonbank SBSD without intervention by any other party;
- The collateral agreement between the nonbank SBSD and the counterparty must be legally enforceable by the nonbank SBSD against the counterparty and any other parties to the agreement;
- The collateral must not consist of securities issued by the counterparty or a party related to the nonbank SBSD, or to the counterparty; and
- If the Commission has approved the nonbank SBSD's use of a VaR model to compute net capital, the approval allows the nonbank SBSD to calculate deductions for market risk for the type of collateral.

Securities and Commercial Mortgage-Backed Securities may also satisfy the Paper's key principle, and should be evaluated by regulators as eligible collateral. A broad range of eligible high-quality collateral, with appropriate concentration limits, diversification constraints and haircuts, will prudently assure satisfaction of counterparty obligations while also enhancing liquidity in the market.

In sum, therefore, we recommend that the SEC initiative not limit categories of eligible collateral in proposed Rule 18a-3, not incorporate requirements for collateral drawn from broker-dealer collateral standards for securities customers in current Rule 15c3-1 under the Securities Exchange Act, and carefully parallel the approach recommended in the BCBS-IOSCO Consultative Paper for eligible collateral in derivatives transactions.

D. Bilateral Margin Requirements

Proposed Rule 18a-3(c)(2) would require SBSDs to collect collateral from their counterparties in non-cleared security-based swap transactions to buffer current and potential future exposure from the counterparty. The rule, however, would *not* require bilateral exchange of collateral to cover potential future exposure from the SBSD.

In opposition to this proposed standard, we strongly recommend that SBSDs post margin to non-SBSD counterparties in the same way as required for counterparties to the SBSD. The BCBS-IOSCO Consultative Paper advises that entities engaged in non-centrally cleared derivatives should exchange margin on a bilateral basis, observing a "broad consensus within the BCBS and IOSCO that all covered entities engaging in non-centrally cleared derivatives must exchange" margin.[15] Bilateral margin standards promote economic stability in the financial markets and prevent the accumulation of systemic risk at financial institutions engaged in significant derivatives transactions. Quite simply, bilateral margining protects both sides of a swap transaction against future credit risk and default by either counterparty.

The proposed initiative, therefore, should be revised to impose bilateral margin requirements. These modifications reflect the intent and purposes of the Dodd-Frank Act to ameliorate systemic risk to the financial system in non-cleared swap transactions. Further, paralleling the approach suggested in the BCBS-IOSCO Consultative Paper would achieve global harmonization in derivatives regulation, as explained immediately below, and would promote enterprise-wide compliance and concomitant cost-effectiveness.

The Consultative Paper indicates that a majority of the BCBS and IOSCO members supported margin requirements that, in principle, would involve the mandatory exchange of both initial and variation margins among parties to non-centrally cleared derivatives, which was labeled as "Universal Two-way Margin." BCBS and IOSCO recognized that two-way margining would impose substantial liquidity costs, and that the use of thresholds could potentially balance the policy goals of reducing systemic risk and promoting central clearing with mitigating the costs of bilateral margin exchange. BCBS and IOSCO considered a variety of options for implementing universal two-way margin. The Consultative Paper, however, revealed that no unanimous view developed on the design and calibration of thresholds to achieve an optimal compromise between liquidity burdens and reduced systemic risk.[16]

[15] *See* BCBS-IOSCO Consultative Paper at 14.
[16] In its second Consultative Paper, BCBS-IOSCO published and reiterated Element 2 in its Key Principles, which states:

In our July 11, 2011 comment letter to the CFTC, ACLI emphasized that two-way posting between CSEs and financial end users is of particular significance to the life insurance industry. It is customary practice for life insurers to require two-way posting of variation margin in the OTC market, which enhances the safety and soundness of life insurance companies in a manner consistent with the regulatory scheme to which they are subject, thereby enhancing the stability of the financial system as a whole. In our comment letter, ACLI strongly supported the CFTC's approach to two-way variation margin over the prudential regulator's disinclination for two-way margining.

ACLI emphasized the CFTC's observation that the imposition of a two-way margin requirement will *enhance* the stability of CSEs and the financial system for a number of reasons, including:

- Two-way margin removes each day's exposure from the marketplace for all products and all participants and prevents CSEs from accumulating obligations they cannot fulfill; and,

- Unchecked accumulation of exposures was a contributing factor to the financial crisis that led to the enactment of the Dodd-Frank Act.

As a result of further discussions with market participants, ACLI believed that swap dealers and financial firms should have the flexibility to determine whether swap dealers will be required to post initial margin on a case-by-case basis depending on the nature of the trade, product type or creditworthiness of the Swap Dealer or Major Swap Participant, in order to mitigate the impacts of Initial Margin Requirements on liquidity.[17] Moreover, financial firms should have the ability to choose the level of protection for initial or variation margin pledged to Swap Dealers and Major Swap Participants, which could include Tri-party or Custodial Arrangements as well as granting re-hypothecation rights over Initial or Variation Margin

In sum, therefore, ACLI broadly supports two-way margin requirements between swap dealers and financial firms in variation margin, while providing flexibility for the parties to determine whether and to what extent Swap Dealers and Major Swap Participants should be required to pledge Initial margin to financial firms. We also recommend that the parties have the right to determine the protections afforded to initial margin pledged by financial firms to Swap dealers and Major Swap Participants, which could include placement in third-party custodial or Tri-party Accounts, and note that liquidity concerns can be addressed in part by establishing appropriate initial margin requirements and broadening eligible collateral types.

> 2(e) In the case of variation margin, the BCBS and IOSCO recognise that regular and timely exchange of variation margin represents the settlement of the running profit/loss of a derivative and has no net liquidity costs as variation margin represents a transfer of resources from one party to another. The BCBS and IOSCO also recognise that the regular and timely exchange of variation margin is a *widely adopted best practice that promotes effective and sound risk management*. See second Consultative Paper (Feb. 15, 2013) http://www.bis.org/publ/bcbs 242.pdf at 7 [emphasis added].

Thus, even though the proposed SEC standard is based on currently existing broker-dealer margining standards, global regulators, which included SEC participation, recognized that bilateral margining is a widely adopted best practices. Currently, most non-cleared swap transactions have Credit Support Annexes (CSAs) stipulating bilateral margin, especially with variation margin. A CSA is a legal document which regulates credit support (collateral) for derivative transactions.

[17] Additionally, the On February 15, 2012, BCBS-IOSCO published a second Consultative Paper "which represents a near-final proposal on margin requirements for non-centrally-cleared derivatives." *See* http://www.bis.org/publ/bcbs242.htm . Under the second Consultative Paper's near final initiative, BCBS-IOSCO recommended reciprocal, bilateral margining. The SEC, therefore, has additional reason to adopt bilateral margining requirements in the interest of harmonized domestic and global derivatives regulation.

(E) $ 100,000 Minimum Transfer Amount

Proposed Rule 18a–3 would establish a minimum transfer amount of $100,000 with respect to a particular counterparty.[18] Under this provision, a nonbank SBSD and a nonbank MSBSP would not be required to collect or deliver collateral to meet an account equity requirement if the amount required to be collected or delivered is equal to or less than $100,000. If the minimum transfer amount is exceeded, the entire account equity requirement would need to be collateralized, not just the amount of the requirement that exceeds $100,000. The proposed minimum transfer provision is designed to establish a threshold so that the degree of risk reduction achieved by requiring account equity requirements to be collateralized is sufficiently small that the costs of delivering collateral may not be justified. The proposed $100,000 threshold is based on the proposals of the prudential regulators and the CFTC.

ACLI commented on this CFTC and prudential regulator proposal, and while generally supporting the use of minimum transfer amounts, recommended having the flexibility to set higher minimum transfer amounts and that minimum transfer amounts up to $250,000 were more consistent with prevailing industry practice.[19] Consistent with ACLI's overall suggested approach to margin requirements, we expected that these standards would be imposed on both the SCEs and their financial end user counterparties, and that the parties would be permitted, subject to the limitations in the final CFTC and prudential regulator rules, to establish thresholds as a matter of contract. In that regard, we supported initial margin threshold upper limits, up to which dealers and qualifying market participate should negotiate the appropriate threshold, based on traditional credit parameters. For ease of calculation and administration, ACLI suggested avoiding references to CSE's capital ratios and other opaque and continuously variable measures (unless measured annually, based on public figures.

We respectfully recommend parallel positions on minimum transfer amounts in proposed Rule 18a-3, as a matter of uniformity and substance. Our recommended modifications comport with the goals of the Dodd-Frank Act to protect the financial economy from systemic risk.

III. Segregation Standards

Proposed Rule 18a-4 applies to all types of SBSDs and establishes standards on how customer cash, securities, and money market instruments in cleared security-based swap transactions must be segregated when a SBSD commingles those assets with the cash and securities of other customers under current provision of the Securities Exchange Act that reflect special protections under the U.S. Bankruptcy Code.[20] Proposed Rule 18a-4 requires that customer assets in non-cleared security-based swaps be treated in the same manner as customer assets in cleared security-based swap transactions, unless the counterparty elects to have individual segregation of

[18] 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70272.

[19] *See* ACLI letter of comment dated July 11, 2011 to the CFTC on margin and collateral requirements for uncleared swap transactions; http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47742&SearchText=wilkerson . In its release, the SEC recognized ACLI's recommendation for flexibility to negotiate higher minimum standards; 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70272, footnote 612.

[20] *Id*. at 70274. Segregation requirements are designed to identify customer property as distinct from the proprietary assets of the firm and to protect customer property by, for example, preventing the firm from using it to make proprietary investments. The goal of segregation is to facilitate the prompt return of customer property to customers either before or during a liquidation proceeding if the firm fails. The Dodd-Frank Act contains provisions designed to ensure that cash and securities held by an SBSD relating to security-based swaps will be deemed customer property under the stockbroker liquidation provisions. Id.

assets.[21] Proposed Rule 18a-1 and proposed amendments to current Rule 15c3-1 under the Securities Exchange Act would impose a capital charge on any SBSD that does not retain the margin collateral when a counterparty elects to have the collateral segregated as permitted under Section 3E(f) of the Securities Exchange Act.

The release explains that The U.S. Bankruptcy Code provides special protections for customers of stockbrokers (the ‘‘stockbroker liquidation provisions’’). Among other protections, the release elucidates that customers share ratably with other customers ahead of all other creditors in the customer property held by the failed stockbroker. Segregation requirements are designed to identify customer property as distinct from the proprietary assets of the firm and to protect customer property by, for example, preventing the firm from using it to make proprietary investments. The goal of segregation, thus, “is to facilitate the prompt return of customer property to customers either before or during a liquidation proceeding if the firm fails.”[22]

Section 3E(f)(3) of the Securities Exchange Act provides that the segregated account shall be carried by an independent third-party custodian and be designated as a segregated account for and on behalf of the counterparty (‘‘individual segregation’’). The Dodd-Frank Act added this provision which allows a counterparty to request an additional level of protection for the collateral it has posted. Importantly, the release notes that the “objective of individual segregation is for the funds and other property of the counterparty to be carried in a manner that will keep these assets separate from the bankruptcy estate of the SBSD or MSBSP if it fails financially and becomes subject to a liquidation proceeding. Having these assets carried in a bankruptcy-remote manner protects the counterparty from the costs of retrieving assets through a bankruptcy proceeding.”[23]

In the case of non-cleared security-based swaps, therefore, each counterparty has the right to require its collateral to be isolated in an account at an independent custodian that identifies the counterparty by name, rather than commingled with collateral of other counterparties. The objective of individual segregation is for the funds and other property of the counterparty to be carried in a manner that will keep these assets separate from the bankruptcy estate of the SBSD or MSBSP if it fails financially and becomes subject to a liquidation proceeding.

ACLI supports the proposal’s framework that allows counterparties to SBSDs to elect having collateral maintained by an independent custodian. This option fulfills the goals of the Dodd-Frank Act by allowing SBSD counterparties to insulate themselves from retrieving assets of an insolvent SBSD through bankruptcy proceedings. We are concerned, however, that the imposition of a capital charge on SBSDs when their counterparties elect to obtain the insulation provided by segregation may force SBSDs to pass these added capital charge on to the counterparties.

It would be confusing and ironic that counterparties electing the segregation allowed and perhaps encouraged by the Dodd-Frank Act would be penalized for exercising this prudent option. While it seems reasonable that counterparties electing segregation should incur added expenses for an

[21] 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70267. Thus, the release explains Rule 18a-4 would establish an alternative omnibus or “commingled” segregation approach for non-cleared security-based swaps that would operate as a default procedure.

[22] *Id*. at 70275. The Dodd-Frank Act contains provisions designed to ensure that cash and securities held by an SBSD relating to security-based swaps will be deemed customer property under the stockbroker liquidation provisions. Section 3E(g) of the Securities Exchange Act provides that an account that holds a security-based swap shall be considered to be a securities account as that term is ‘‘defined’’ in the stockbroker liquidation provisions.

[23] *Id.* at 70275.

custodian independent of the SBSD, the provision's assessment of a capital charge may exceed the actual cost of an independent custodian and thus discourage or disadvantage counterparties reasonably seeking protective segregation of their assets.

In solution to this anomaly, we recommend the elimination of the capital charge when a counterparty elects segregation. This makes especially good sense regarding transactions with financial institutions that are fully collateralized, such as life insurers, that present little default risk to the SBSD. To address the SEC's concern that assets in a custodial arrangement cannot be promptly liquidated for SBSD access, the proposal could be modified to ensure prompt access to the collateral by incorporating terms drawn from tri-party custodial arrangements allowing the pledge of collateral to an entitlement order following default of the pledging party. Entitlement orders stipulate prompt action by custodians and allow SBSDs to have immediate access to the collateral.

In a related 2011 initiative, the CFTC issued a proposal to implement provisions in Title VII of the Dodd-Frank Act that require each futures commission merchant (''FCM'') and derivatives clearing organization (''DCO'') to ''segregate'' customer collateral supporting cleared swaps.[24] The proposed rules would impose requirements on FCMs and DCOs regarding the treatment of cleared swaps customer contracts (and related collateral), and make conforming amendments to bankruptcy provisions applicable to commodity brokers under the Commodity Exchange Act (the ''CEA'').

The CFTC had proposed that each FCM and DCO be required to enter (or ''segregate''), in its books and records, the cleared swaps of each individual customer and relevant collateral. The CFTC proposal would also permit each FCM and DCO to operationally hold (or ''commingle'') all relevant collateral in one account. The initiative also proposed that, in the event that an FCM defaults simultaneously with one or more cleared swaps customers, the DCO may access the collateral of the FCM's defaulting cleared swaps customers to cure the default, but not the collateral of the FCM's non-defaulting cleared swaps customers. The release referred to this combined approach to protecting customer collateral on cleared swaps as the "Complete Legal Segregation Model."

ACLI supported the CFTC's determination that the "Complete Legal Segregation Model" provides the best balance between benefits and costs in order to protect market participants and the public. Additionally, ACLI supported the ability of individual companies to optionally elect to negotiate complete physical segregation of collateral in their agreements with FCMs and DCOs, referred to in the release as the "Physical Segregation Model." ACLI supported the CFTC's judgment against rules based on practices in the futures markets, and referred to as the "Futures Model" in the CFTC's release. The Futures Model would not achieve a proper balance of costs and benefits, nor fairly protect market participants and the public.

Accordingly, we support the proposal's option for counterparties to elect segregation separate from the swap dealer's omnibus or "commingled" segregation. ACLI urges the elimination of a capital charge to SBSDs when counterparties elect segregation to prevent unnecessary disincentives to this prudent practice, and suggest that incorporation of provisions for entitlement orders will alleviate the SEC's concern about prompt SBSD access to collateral from custodians.

[24] The release explains that under the Dodd-Frank Act, the FCM and the DCO (i) must hold such customer collateral in an account (or location) that is separate from the property belonging to the FCM or DCO, and (ii) must not use the collateral of one customer to (A) cover the obligations of another customer or (B) the obligations of the FCM or DCO.

III. Margin Standards Across Jurisdictions

The release perceptively observes that capital, margin, and segregation requirements could have a substantial impact on international commerce and the relative competitive position of intermediaries operating in various, or multiple, jurisdictions.[25] In particular, the release notes that intermediaries operating in the U.S. and in other jurisdictions could be advantaged or disadvantaged if corresponding requirements are not established in other jurisdictions or if the Commission's rules are substantially more or less stringent than corresponding requirements in other jurisdictions. According to the release, this could affect the ability of intermediaries and other market participants based in the U.S. to participate in non-U.S. markets, the ability of non-U.S.-based intermediaries and other market participants to participate in U.S. markets, and whether and how international firms make use of global ''booking entities'' to centralize risks related to security-based swaps.[26]

The release commendably observes that the potential international implications of the proposed capital, margin, and segregation requirements warrant further consideration. It notes, however, that "consistent with the SEC's general approach with respect to its other proposals under Title VII, these implications are recognized here but not fully addressed."[27] Instead, the release explains that the SEC intends to publish a comprehensive release seeking public comment on the full spectrum of issues relating to the application of Title VII to cross-border security-based swap transactions and non-U.S. persons that act in capacities regulated under the Dodd-Frank Act. According to the release, "this approach will provide market participants, foreign regulators, and other interested parties with an opportunity to consider, as an integrated whole, the proposed approach to the cross-border application of Title VII, including capital, margin, and segregation requirements."

These statements in the SEC's release prudently acknowledge the significance of harmonized global derivatives regulation. In this regard, we strongly support the sentiment reflected in the BCBS-IOSCO Consultative Paper that:

> Market conditions and asset availability differ across jurisdictions. National supervisors should develop their own list of eligible collateral assets based on the key principle, taking into account the conditions of their own markets and making reference to the list of examples of eligible collateral under the proposed requirement section. Allowing jurisdictions to develop their own list of eligible collateral assets is expected to reduce margining requirements' impact on the liquidity and prices of eligible assets, reduce concentration risk, and provide sufficient flexibility to permit new assets to serve as collateral in the future as markets evolve.
>
> Subject to meeting the key principle, the scope of eligible collateral assets should be kept broad, with appropriate haircuts. It is expected that demand for high quality liquid assets may increase with the implementation of various regulatory reforms, including central-clearing, margin requirements for non-centrally-cleared derivatives and Basel liquidity requirements. Keeping the scope of eligible assets broad may help relieve pressure on the supply of eligible collateral assets. It may also help avoid concentration risks.
>
> Haircut requirements should be transparent and easy to calculate, so as to facilitate payments between counterparties, avoid disputes and reduce overall operational risk. Haircut

[25] 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70305 .
[26] *Id.*
[27] 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70217.

> levels should be risk-based and should be calibrated appropriately to reflect the underlying risks that affect the value of eligible collateral, such as market price volatility, liquidity, credit risk and FX volatility, during both normal and stressed market conditions.
>
> Given the diversity of eligible collateral assets, there may be practical difficulties for supervisors to stipulate in advance the haircut level for each type of collateral. The pre-determined haircut levels may also become outdated as market conditions change. Adopting internal or third party models that have been approved by supervisors to calculate haircut level may therefore be desirable. However, some firms may be unable or unwilling to develop internal haircut calculation models that meet regulators' requirements. To provide a conservative alternative in those cases, the Consultative Paper proposes a set of standardized haircuts that can be used in lieu of model-based haircuts.

ACLI strongly supports the recommendations in the Consultative Paper that the scope of eligible collateral should be kept broad, with appropriate haircuts. Alternatives reflecting internal or third party haircut models coextensively with a set of standardized haircuts that can be used in lieu of model-based haircuts provide a sound and responsible flexibility.

We encourage The SEC to carefully consider the recommendations in the BCBS-IOSCO Consultative Paper's concerning harmonized international derivatives regulation, and to coordinate with U. S. prudential regulators who are currently evaluating public comment on their margin and collateral rule proposals under the Dodd-Frank Act in light of the Consultative Paper. In the interest of harmonized international derivatives standards and to avoid the potential regulatory arbitrage recognized in the SEC's release, we recommend revisions to the SEC proposal incorporating the prudent flexibility reflected in the above quoted language on margin, collateral, and haircuts.

IV. Conclusion

ACLI supports harmonized domestic and international standards for margin in uncleared swaps transactions. The BCBS and IOSCO Consultative Paper contained several important elements very relevant to the SEC's proposed rule that would establish margin and collateral requirements on uncleared swaps for SBSDs and MSBSPs. Most of the concepts in the Consultative Paper dovetail with the SEC's rule proposals on margin and collateral requirements for uncleared swaps. SEC representatives participated in the Working Group on Margining Requirements of the Basel Committee on Banking Supervision and the International Organization of Securities Commissions.[28]

We strongly encourage coordinated domestic and international approaches to derivatives regulation that will ensure cost-effective, harmonized regulation and prevent regulatory arbitrage. Regulations governing SBSDs and MSBSDs should be conceptually uniform with regulations governing swap dealers and major swap participants to minimize or eliminate unnecessary and costly differences that could thwart enterprise-wide compliance procedures and greatly increase systems costs.

It is appropriate that the SEC intends to publish a comprehensive release seeking public comment on the full spectrum of issues relating to the application of Title VII to cross-border security-based swap transactions and non-U.S. persons that act in capacities regulated under the Dodd-Frank Act.

[28] See second Consultative Paper (Feb. 15, 2013) http://www.bis.org/publ/bcbs 242.pdf on the second unnumbered page following the table of contents.

The release correctly recognizes that intermediaries operating in the U.S. and in other jurisdictions could be advantaged or disadvantaged if corresponding requirements are not established in other jurisdictions or if the SEC's rules are substantially more or less stringent than corresponding requirements in other jurisdictions. We strongly recommend that the SEC's approach to collateral and margin requirements parallel the recommendations in the BCBS-IOSCO Consultative Paper and the approaches implemented by the CFTC and prudential regulators in light of the Consultative Paper.

ACLI supports the incorporation of concepts about initial and variation margin from the Consultative Paper into the SEC's proposed rule, including enlarging the scope of eligible collateral and focusing on the impact of margin requirements on liquidity. ACLI concurs with the Consultative Paper's strong support for universal two-way variation margining and urges the SEC to adopt a flexible approach with respect to initial margin requirements for SBSDs and MSBSPs to mitigate the impact on liquidity. We support alignment of margin requirements for uncleared swaps globally, especially between major market jurisdictions. All of these matters will lower the risk of financial entities, and prevent regulatory arbitrage.

ACLI supports the option for counterparties of SBSDs to elect segregated treatment of collateral to avoid commingled or omnibus treatment by default. The option to elect segregation of collateral fulfills the intent of the Dodd-Frank Act to allow counterparties to insulate their assets from general bankruptcy treatment of defaulted or insolvent SBSDs. We recommend that the SEC eliminate the credit charge to SBSDs whose counterparties elect segregated treatment to eliminate disincentives for taking this prudent action due to the passing on of costs to counterparties that exceed the cost of third party custody of the collateral.

We greatly appreciate your attention to our views. If any questions develop, please let me know.

Sincerely,

Carl B. Wilkerson

Carl B. Wilkerson

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Appendix A

The Use of Derivative Financial Instruments by Life Insurers Under State Insurance Law

Carl B. Wilkerson, Vice President & Chief Counsel- Securities & Litigation
American Council of Life Insurance

I. The National Association of Insurance Commissioners (NAIC) Investments of Insurers Model Acts Govern Derivatives Transactions by Life Insurers

A. Purpose of Investment Law Provisions, as noted in the NAIC Investments of Insurers Model Act (*Defined Limits Version*) (1996):

1. The development of regulation of the investments of insurers requires an analysis of the complexities, uncertainties, competitive forces and frequent changes in the investment markets and in the insurance business, the diversity among insurers, and the need for a balance among risk, reward and liquidity of an insurer's investments. NAIC Model Reporting Service, Vol. II, Section 1, at 280-1.

2. It also requires an analysis of how to safeguard the financial condition of domestic insurers and at the same time to permit domestic insurers to be competitive with insurer's domiciled in other states and with other financial industries that operate under different regulatory regimes. *Id.*

3. The NAIC advises each state to determine through independent study which methods are best suited to its needs and whether its existing regulatory structure may be improved by using provisions of model laws recommended by the National Association of Insurance Commissioners (NAIC) or existing regulatory structures in other states or industries. *Id.*

4. This model law is not considered by the NAIC to exhaust regulatory methods to address the regulation of investments of insurers. Nor is this model law recommended by the NAIC to be used as a standard for the examination of insurers unless *substantially similar* provisions are found in the statutes and regulations of the state of domicile of the insurer. *Id.* (emphasis added).

B. The NAIC has addressed these goals with two different approaches:

1. The NAIC Investments of Insurers Model Act (*Defined Limits Version*) sets forth specific limits on insurers investments, including derivatives, and is discussed below.

2. A second alternate choice exists in the NAIC Investments of Insurers Model Act (*Defined Standards Version*) which implements modern portfolio management practices.

   a. The Defined Standards version serves as an alternative to the Defined Limits version of the Investments of Insurers Model Act which requires that investments be made only in assets that are specifically identified and with quantitative limits for assets invested in each category.

b. The Defined Standards version provides a "prudent person" approach to investments that implements modern portfolio theory, and establishes the following type of investment authority:

(1) An insurer is obligated to fulfill the "minimum asset requirement" as that term is defined in the model act.

(a) The minimum asset requirement is made up of an insurer's liabilities and what is called the "financial security benchmark."

(b) This benchmark equals either the company's minimum capital surplus as required by statute or the authorized control level risk-based capital which applies to the insurer as set forth in the risk-based capital law of the state, whichever is greater; and,

(2) An insurer invests its assets after fulfilling the minimum asset requirement according to a prudence standard. The Defined Standards version establishes factors that must be evaluated and considered by the insurer in determining whether its investment portfolio is prudent.

C. **Overview of the Investments of Insurers Model Act (Defined Limits Version) and its application to derivatives**

1. **Scope**

a. That applies only to investments and investment practices of domestic insurers and United States branches of alien insurers entered through the individual states.

b. The Act does not apply to investments for separate accounts of an insurer except to the extent the provisions of the NAIC Model Holding Compact so provide.

2. **Purpose to the defined limits version**

a. The purpose of this Act is to protect the interests of insureds by promoting insurer solvency and financial strength. This will be accomplished through the application of investment standards that facilitate a reasonable balance of the following objectives:

(1) To preserve principal;

(2) To assure reasonable diversification as to type of

investment, issuer and credit quality; and

(3) To allow insurers to allocate investments in a manner consistent with principles of prudent investment management to achieve an adequate return so that obligations to insureds are adequately met and financial strength is sufficient to cover reasonably foreseeable contingencies.

3. **Treatment of Derivatives**

a. Article II Section 18 governs derivative transactions

b. The NAIC Commentary indicates that derivatives by insurers should be limited to hedging and, to a limited extent, income generation transactions.

4. **Definitions**

a. "Derivative instrument" [Article I, Section 2 (V)] means an agreement, option, instrument or a series or combination thereof:

(1) To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or

(2) That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.

b. “Derivative instruments” include options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures and any other agreements, options or instruments substantially similar thereto or any series or combination thereof and any agreements, options or instruments permitted under regulations adopted under Section 8. *Id.*

c. "Derivative transaction" means a transaction involving the use of one or more derivative instruments. [Article I, Section 2 (W)].

5. Substantive provisions permitting life insurers to engage in derivative transactions.

a. **General conditions**

(1) Limitations on Hedging Transactions

(a) An insurer may use derivative instruments under

Section 18 of the Model Act to engage in hedging transactions and certain income generation transactions, as these terms may be further defined in regulations promulgated by the commissioner.

(b) An insurer shall be able to demonstrate to the commissioner the intended hedging characteristics and the ongoing effectiveness of the derivative transaction or combination of the transactions through cash flow testing or other appropriate analyses.

(2) An insurer may enter into hedging transactions under Section 18 of the Model Act if, as a result of and after giving effect to the transaction :

(a) The aggregate statement value of options, caps, floors and warrants not attached to another financial instrument purchased and used in hedging transactions does not exceed seven and one half percent (7.5%) of its admitted assets;

(b) The aggregate statement value of options, caps and floors written in hedging transactions does not exceed three percent (3%) of its admitted assets; and

(c) The aggregate potential exposure of collars, swaps, forwards and futures used in hedging transactions does not exceed six and one-half percent (6.5%) of its admitted assets.

(3) **Limitations on Income Generation Transactions**

(a) An insurer may only enter into the following types of income generation transactions if as a result of and after giving effect to the transactions, the aggregate statement value of the fixed income assets that are subject to call or that generate the cash flows for payments under the caps or floors, plus the face value of fixed income securities underlying a derivative instrument subject to call, plus the amount of the purchase obligations under the puts, does not exceed ten percent (10%) of its admitted assets:

i) Sales of covered call options on non-callable fixed income securities, callable fixed income securities if the option expires by its terms prior to the end of the noncallable period or derivative instruments based on fixed income securities;

ii) Sales of covered call options on equity securities, if the insurer holds in its portfolio, or can immediately acquire through the exercise of options, warrants or conversion rights already owned, the equity securities subject to call during the complete term of the call option sold;

iii) Sales of covered puts on investments that the insurer is permitted to acquire under this Act, if the insurer has escrowed, or entered into a custodian agreement segregating, cash or cash equivalents with a market value equal to the amount of its purchase obligations under the put during the complete term of the put option sold; or

iv) Sales of covered caps or floors, if the insurer holds in its portfolio the investments generating the cash flow to make the required payments under the caps or floors during the complete term that the cap or floor is outstanding.

(4) **Counterparty Exposure**

(a) An insurer shall include all counterparty exposure amounts in determining compliance with the limitations of Section 10 of the Model Act, which governs diversification standards and certain foreign investments.

(b) Additional Transactions

i) Pursuant to regulations to implement the Model Act which may promulgated under the authority of Section 8, the insurance commissioner may approve additional transactions involving the use of derivative instruments in excess of the limits imposed by Section 8(B) or for other risk management purposes under regulations promulgated by the commissioner, but replication transactions shall not be permitted for other than *risk management* purposes.

(c) Definition: "Counterparty Exposure Amount" means:

i) The net amount of credit risk attributable to a derivative instrument entered into with a business entity other than through a qualified exchange, qualified foreign exchange, or cleared through a qualified clearinghouse ("over-the-counter derivative instrument")

ii) The amount of credit risk equals:

a) The market value of the over-the-counter derivative instrument if the liquidation of the derivative instrument would result in a final cash payment to the insurer; or

b) Zero if the liquidation of the derivative instrument would not result in a final cash payment to the insurer.

iii) If over-the-counter derivative instruments are entered into under a written master agreement which provides for netting of payments owed by the respective parties, and the domiciliary jurisdiction of the counterparty is either within the United States or if not within the United States, within a foreign jurisdiction listed in the Purposes and Procedures of the Securities Valuation Office as eligible for netting, the net amount of credit risk shall be the greater of zero or the net sum of:

a) The market value of the over-the-counter derivative instruments entered into under the agreement, the liquidation of which would result in a final cash payment to the insurer; and

b) The market value of the over-the-counter derivative instruments entered into under the agreement, the liquidation of which would result in a final cash payment by the insurer to the business entity.

a. **Written Agreement and Conditions Required Under the Act**

(1) The insurer shall enter into a written agreement for all transactions authorized in this section other than dollar roll transactions.

(a) "Dollar roll transaction" means two (2) simultaneous transactions with different settlement dates no more than ninety-six (96) days apart, so that in the transaction with the earlier settlement date, an insurer sells to a business entity, and in the other transaction the insurer is obligated to purchase from the same business entity, substantially similar securities of the following types:

i) Asset-backed securities issued, assumed or guaranteed by the Government National Mortgage Association, the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation or their respective successors; and

ii) Other asset-backed securities referred to in Section 106 of Title I of the Secondary Mortgage Market Enhancement Act of 1984 (15 U.S.C. s 77r- 1), as amended.

(2) The written agreement shall require that each transaction terminate no more than one year from its inception or upon the earlier demand of the insurer.

(3) The agreement shall be with the business entity counterparty.

D. **NAIC Derivative Instruments Model Regulation, NAIC Model Reporting Service, Volume III at 282-1(1996).**

1. This model regulation was adopted together with the NAIC Investments of Insurers Model Act (Defined *Limits* Version).

2. It provides additional guidance and clarification for application of the model law.

3. **Selected provisions**

a. Guidelines and Internal Control Procedures are set forth at Section 4

(1) Before engaging in a derivative transaction, an insurer shall establish written guidelines that shall be used for effecting and maintaining the transactions. The guidelines shall:

(a) Address investment or, if applicable, underwriting objectives, and risk constraints, such as credit risk limits;

(b) Address permissible transactions and the relationship of those transactions to its operations, such as a precise identification of the risks being hedged by a derivative transaction; and

(c) Require compliance with internal control procedures.

(2) An insurer shall have a system for determining whether a derivative instrument used for hedging has been effective.

(3) An insurer shall have a credit risk management system for over-the-counter derivative transactions that measures credit risk exposure using the counterparty exposure amount.

b. Documentation Requirements are set forth at Section 5

(1) An insurer shall maintain documentation and records relating to each derivative transaction, such as:

(a) The purpose or purposes of the transaction;

(b) The assets or liabilities to which the transaction relates;

(c) The specific derivative instrument used in the transaction;

(d) For over-the-counter derivative instrument transactions, the name of the counterparty and the counterparty exposure amount; and

(e) For exchange traded derivative instruments, the name of the exchange and the name of the firm that handled the trade.

(2) **Trading Requirements** are set forth at Section 6, which mandates that each derivative instrument shall be:

(a) Traded on a qualified exchange;

(b) Entered into with, or guaranteed by, a business entity;

(c) Issued or written by or entered into with the issuer of the underlying interest on which the derivative instrument is based; or

(d) Entered into with a qualified foreign exchange.

4. **Overview of the Defined Standards Version of the NAIC Investments of Insurers Model Act**

a. This Model Act is premised on specific capital standards, and provides a framework in which these standards relate to the investment laws, and established consequences for failure to meet capital standards. To the extent an insurer's investment program is imprudent, the insurer is deemed unsound.

b. The minimum financial security benchmark and the minimum asset requirement jointly form the foundation for regulating life insurer investments according to a modern portfolio or prudence standard.

(1) These twin tools allow a high level of investment discretion above the minimum asset requirement while still providing meaningful regulatory protections for policyholders and claimants from adverse investment management.

(2) Section 3 of the Defined Standards Proposal creates limitations and restrictions on investments counted toward the minimum asset requirement; Assets in excess of the minimum asset requirement would not be subject to these limitations and restrictions and may be invested according to the insurer's individual written investment policy.

c. Three philosophies to capital requirements are central to the Act's approach to regulating investments according to a prudence standard.

(1) The Act's "minimum capital" (for stock insurance companies) and "minimum surplus" (for mutual insurance companies) ensure financial stability at the inception of a new insurance enterprise. The amount of capital or surplus needed depends on what types of business the insurer intends to conduct, and are established based on the information the insurer gives the insurance commissioner at the time of formation. See, Annotations to Section 3 of NAIC Investments of Insurers Model Act

(Defined Standards Version) at 17 (1997).

(2) The “minimum financial security benchmark” measures the minimum capital requirements of an established enterprise, and expand as the financial needs to the enterprise expand, but may also contract with them. *Id.*

(3) The “proper surplus” appropriate for a particular company’s operation is determined by the insurer’s board of directors in consultation with management. *Id.*

d. The fundamental enforcement mechanism under the defined standards proposal appears in Section 11 which provides that if an insurer does not meet the minimum asset requirement, them under Section 11D, the insurer may be deemed to be in financially hazardous condition, and the commissioner may initiate liquidation and rehabilitation proceedings against the insurer. *Id.* at 21.

(5) Status of Investments of Insurers Model Acts in the States

(A) A state by state chart follows this section.

STATE	LAWS AND REGULATIONS
Alabama	ALA. CODE §§ 27-41-1 to 27-41-41 (1977/1993) (Life).
Alaska	ALASKA ADMIN. CODE tit. 3, §§ 21.201 to 21.399 (2001/2005). ALASKA STAT. §§ 21.21.010 to 21.21.420 (1966/2001) (Includes authority to adopt regulations consistent with defined limits version).
Arizona	ARIZ. REV. STAT. ANN. §§ 20-531 to 20-561 (1954/2000).
Arkansas	ARK. CODE ANN. §§ 23-63-801 TO 23-63-841 (1959/2009).
California	CAL. INS. CODE §§ 1170 to 1212 (1935/2009). CAL. CODE REGS. Tit. 10, §§ 2690.90 to 2690.94 (2007); BULLETIN 95-5A (1995).
Colorado	COLO. REV. STAT. §§ 10-3-213 to 10-3-242 (1969/2000).
Connecticut	CONN. GEN. STAT. §§ 38a-102 to 38a-102*i* (1991/2009); BULLETIN FS-14c-00 (2000).
Delaware	DEL. CODE ANN. Tit. 18, §§ 1301 to 1332 (1953/2002).
District of Columbia	D.C. CODE §§ 31-1371.01 to 31-1375.01 (2002).
Florida	FLA. STAT. §§ 625.301 to 625.340 (1959/1993).
Georgia	GA. CODE ANN. §§ 33-11-50 to 33-11-67 (2000).
Guam	GUAM GOV’T. CODE § 43166 (1951).
Hawaii	HAW. REV. STAT. §§ 431:6-101 to 431:6-501 (1987/2009); §§431:6-601 to 431:6-602 (1987/2008).
Idaho	IDAHO CODE ANN. §§ 41-701 to 41-736 (1961/2006).
Illinois	215 ILL. COMP. STAT. 5/126.1 to 5/126.32 (1997). ILL. ADMIN. CODE tit. 50, §§ 806.10 to 806.60 (1998/2001). Company Bulletin 92-2 (1992).
Indiana	IND. CODE §§ 27-1-12-2 to 27-1-12-3.5 (1935/2004) (Life); §§ 27-1-13-3 to 27-1-13-3.5 (1935/2004) (P/C).
Iowa	IOWA CODE §§ 511.8 to 511.8A (1868/2000) (Life); § 515.35 (1868/1997) (P/C). IOWA ADMIN. CODE r. 191-93.6; BULLETIN 2008-18 (2008).

STATE	LAWS AND REGULATIONS
Kansas	KAN. STAT. ANN. §§ 40-2a01 to 40-2a28 (1972/2005) (P/C); §§ 40-2b01 to 40-2b29 (1972/2005) (Life).
Kentucky	KY. REV. STAT. ANN. §§ 304.7-010 to 304.7-473 (2000).
Louisiana	LA. REV. STAT. ANN. §§ 22:581 to 22:601 (2007/2010).
Maine	ME. REV. STAT. ANN. Tit. 24-A, §§ 1101 to 1137 (1969/2000) (P/C); §§ 1151 to 1161 (1987/2000) (Life).
Maryland	MD. CODE ANN., INS §§ 5-501 to 5-512 (1922/2003) (Life); §§ 5-601 to 5-609 (1943/1997) (P/C); MD. ADMIN. CODE CH. 650 §§ 1 to 011 (1998/2008).
Massachusetts	MASS. GEN. LAWS. Ch. 175 §§ 63 to 68 (1817/1996).
Mississippi	MISS. CODE ANN. §§83-19-51 to 83-19-55 (1892/2010).
Missouri	MO. REV. STAT. §§ 375.325 TO 375.355 (1939/2002); §§ 375.532 TO 375.534 (1991/2005) (All insurers); §§ 376.300 to 376.311 (1939/2002) (Life) §§ 376.311, 379.083 (1997/2002); § 375.345 (2002); MO. CODE REGS. ANN. Tit. 20, § 200-12.020 (2009).
Montana	MONT. CODE ANN. §§ 33-12-101 to 33-12-312 (1999/2001).
Nebraska	NEB. REV. STAT. §§ 44-5101 to 44-5154 (1991/2009).
Nevada	NEV. REV. STAT. §§682A.010 to 682A.290 (1971/2003).
New Hampshire	N. H. REV. STAT. ANN. §§ 402:27 to 402:29-d (1917/1991) (All insurers); §§ 411-A:37 (1978/1990) (Life).
New Jersey	N.J. STAT. ANN. §§ 17:24-1 to 17:24-16 (1902/1995) (P/C); §§ 17B:20-1 to 17B:20-8 (1971/2005) (Life).
New Mexico	N.M. STAT. ANN. §§ 59A-9-1 to 59A-9-27 (1984/1988).
New York	N.Y. INS. LAW §§ 1401 to 1413 (1984/2008). N.Y. COMP. CODES R. & REGS. Tit. 11, §§ 178.0 to 178.10 (Regulation 168) (2001).
North Carolina	N.C. GEN. STAT. §§ 58-7-165 to 58-7-205 (1991/2005).
North Dakota	N.D. CENT. CODE §§ 26.1-05-18 to 26.1-05-22 (1983/2001).

STATE	LAWS AND REGULATIONS
Ohio	OHIO REV. CODE ANN. §§ 3907.14 to 3907.141; §§ 3925.20 to 3925.21 (1953/2001) (Life); §§ 3925.05 to 3925.06 (1953) (P/C).
Oklahoma	OKLA. STAT. tit. 36, §§ 1601 to 1629 (1957/2005).
Oregon	OR. REV. STAT. §§ 733.510 to 733.780 (1959/2006).
Pennsylvania	40 PA. STAT. ANN. §§ 504.1 to 506.1 (1986/2004) (Life).
Puerto Rico	P. R. LAWS ANN. tit. 26, §§ 648-662 (2003).
Rhode Island	R.I. GEN. LAWS §§ 27-11-1 to 27-11-3 (1947/1956); §§ 27-11.1 to 27-11.1-8 (1984/2002).
South Carolina	S.C. CODE ANN. §§ 38-12-10 to 38-12-510 (2002).
South Dakota	S.D. CODIFIED LAWS §§ 58-27-1 to 58-27-111 (1966/2005); S.D. ADMIN. R. 20:06:26:01 (2005/2008). S.D. ADMIN. R. 20:06:26:01 (1995/2008).
Tennessee	TENN. CODE ANN. §§ 56-3-301 to 56-3-409 (1907/1998) (Life); §§ 56-3-401 to 56-3-409 (1979/1984) (P/C).
Texas	TEX. INS. CODE ANN. §§ 424.001 to 424.218 (2005/2007).
Utah	UTAH CODE ANN. §§ 31A-18-101 to 31A-18-110 (1985/2006).
Vermont	VT. STAT. ANN. tit. 8, §§ 3461 to 3472 (1967/2000).
Virginia	VA. CODE ANN. §§ 38.2-1400 to 38.2.1447 (1986/2002).
Washington	WASH. REV. CODE ANN. §§ 48.13.010 to 48.13.360 (1947/2004).
West Virginia	W. VA. CODE §§ 33-8-1 to 33-8-32 (1957/2004).
Wisconsin	WIS. STAT. §§ 620.01 to 620.25 (1971/1992).
Wyoming	WYO. STAT. ANN. §§ 26-7-101 to 26-7-116 (1967/2001).

Appendix B

FEH

Examiners Handbook

Financial Condition

NAIC

making progress . . . together

National Association of Insurance Commissioners

	Exam Obj.	Identified Risk	Examiner/ Completion Date	Work Paper Ref.
15. Scan the cash receipts/disbursements journal and bank statements for unusual debits or credits.	CO AC			
16. Test whether account balances and disclosures comply with the NAIC *Accounting Practices and Procedures Manual* and *Annual Statement Instructions*.	PD			
17. Review the Notes to the Financial Statements and General Interrogatories and evaluate the completeness of information.	PD			
18. Consider the reasonableness of accrued interest and interest received during the year based on prior years.	VA			
19. Select a sample of interest payments included on the bank statements. Trace those amounts to the cash receipts journal.	CO AC			
20. Trace the total accrued interest to the detailed investment income exhibit and balance sheet.	CO AC			
21. Trace the total interest received to the detailed investment income exhibit.	CO AC			
22. Ensure that the net amounts of all cash accounts are reported jointly. If in the aggregate the insurer has a net negative cash balance, ensure that the amount is reported as a negative asset and not recorded as a liability, in accordance with **SSAP No. 2, paragraph 5**.	AC VA			
<u>Aggregate Write-ins for Invested Assets / Liabilities (Derivative Instruments)</u>				
1. Review available independent audit reports and management letters for evidence of inappropriate hedge accounting practices.	AC			
2. Obtain contracts that the insurer has entered into and agree them to the documentation provided in the insurer's records and Schedule DB.	EX OB/OW			

Elements of NAIC Financial Examiners Handbook Regarding Derivatives Start Here

Examiner/ Completion Date	Work Paper Ref.

		Exam Obj.	Identified Risk	Examiner Completion Date	Paper Ref.
3.	Obtain direct confirmation of all derivative instruments held at a custodian or a broker.	EX OB/OW			
4.	Review hedging transactions to determine whether they are consistent with the category hedged, in accordance with **SSAP No. 86, paragraph 18:**	VA			
	a. Fair value hedges (**SSAP 86, paragraph 19**);	VA			
	b. Cash flow hedges (**SSAP 86, paragraph 20**);	VA			
	c. Forecasted Transaction Hedges (**SSAP 86, paragraph 21**);	VA			
	d. Foreign currency hedges (**SSAP 86, paragraph 22-31**).	VA			
5.	Determine whether the appropriate accounting method was applied based on the type of derivative (e.g., swaps, options, forwards, etc.), in accordance with **SSAP No. 86.**	VA			
6.	Review the hedging transactions to determine that ineffective hedges have been accounted for at fair value with changes in the fair value recorded as an unrealized gain/loss in accordance with **SSAP 86, paragraph 15.**	VA PD			
7.	Select a sample of market values from Schedule DB and verify compliance with the guidelines set forth in **SSAP No. 86** and the *Purposes and Procedures Manual* of the NAIC SVO.	VA			
8.	Review the state investment statutes related to derivative instruments for compliance.	VA			

	Exam Obj.	Identified Risk	Examiner/ Completion Date	Work Paper Ref.
9. Verify that the insurer has properly documented derivative instruments opened during the year, derivative instruments terminated, expired or exercised during the year and derivative instruments open at quarter-end in accordance with **SSAP No. 86, paragraphs 34-36**.	PD			
10. Select a sample of transactions and test whether all significant terms (e.g., maturity, expiration or settlement date, contractual payments, purchase and sale price) were specified and documented, and whether the amounts and terms are consistent with those established by the insurer's hedging techniques.	CO AC			
11. Select a sample of values from Schedule DB and trace to appropriate source documents.	CO AC			
12. Test transactions settled after year-end for recording in the proper period.	CT			
13. Verify that disclosure requirements for derivative contracts in accordance with **SSAP 86, paragraph 53** have been met.	PD			
<u>**Other Invested Assets**</u>				
1. Review investment committee minutes and determine whether investment transactions have been properly authorized.	EX			
2. Review available independent audit reports and management letters for joint ventures, partnerships and limited liability companies in which the insurer has an interest.	AC			
3. Make inquiries to ascertain any conflicts of interest or improprieties affecting the directors, officers or employees of the company. (Review conflict of interest statements.)	CM			

SCHEDULE DB

DERIVATIVE INSTRUMENTS

All derivatives, regardless of maturity date, are to be reported on Schedule DB. Forward commitments where a Company cannot determine at the inception of the contract, with certainty, if delivery will be made at the earliest opportunity are essentially forward contracts and should be reported on Schedule DB.

This schedule should be used to report derivative instruments (including insurance futures and options on insurance futures). Specific accounting procedures for each derivative instrument will depend on the definition below and documented intent that best describes the instrument. Uses of derivative instruments that are reported in this schedule include hedging, income generation and other. State investment laws and regulations should be consulted for applicable limitations and permissibility on the use of derivative instruments. If the derivative strategy meets the definition of hedging as outlined in paragraph 7 of SSAP No. 86, Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions, then the underlying derivative transactions composing that strategy should be reported in that category of Schedule DB. If the underlying derivative strategy does not meet the definition of hedging, then the underlying derivative transactions composing that strategy should be reported as either income generation or other.

DEFINITIONS OF DERIVATIVE INSTRUMENTS

A hedge transaction is "Anticipatory" if it relates to:

a. A firm commitment to purchase assets or incur liabilities, or

b. An expectation (but not obligation) to purchase assets or incur liabilities in the normal course of business.

"Underlying Interest" means the asset(s), liability(ies), or other interest(s) underlying a Derivative Instrument, including, but not limited to, any one or more securities, currencies, rates, indices, commodities, Derivative Instruments, or other financial market instruments.

"Option" means an agreement giving the buyer the right to buy or receive, sell or deliver, enter into, extend or terminate, or effect a cash settlement based on the actual or expected price, level, performance, or value of, one or more Underlying Interests.

"Cap" means an agreement obligating the seller to make payments to the buyer, each payment under which is based on the amount, if any, that a reference price, level, performance, or value of one or more Underlying Interests exceed a predetermined number, sometimes called the strike/cap rate or price.

"Floor" means an agreement obligating the seller to make payments to the buyer, each payment under which is based on the amount, if any, that a predetermined number, sometimes called the strike/floor rate or price exceeds a reference price, level, performance or value of one or more Underlying Interests.

"Collar" means an agreement to receive payments as the buyer of an Option, Cap or Floor and to make payments as the seller of a different Option, Cap or Floor.

"Swap" means an agreement to exchange or net payments at one or more times based on the actual or expected price, level, performance, or value of one or more Underlying Interests.

"Forward" means an agreement (other than a Future) to make or take delivery of, or effect a cash settlement based on the actual or expected price, level, performance, or value of, one or more Underlying Interests.

"Future" means an agreement traded on an exchange, Board of Trade, or contract market, to make or take delivery of, or effect a cash settlement based on the actual or expected price, level, performance, or value, one or more Underlying Interests.

"Insurance Futures Contract" means a futures contract based on an underlying index of performance of insurance contracts (policies) or factors relating thereto, or such other definition as may be specified under the statutes, regulations and administrative rulings of a particular state.

"Insurance Futures Option" means a put or call option on an Insurance Futures contract.

"Insurance Futures Call Option" means a contract under which the holder has the right to purchase the underlying insurance futures contract covered by the option at a stated price (strike price) on or before a fixed expiration date.

"Insurance Futures Put Option" means a contract under which the holder has the right to sell the underlying insurance futures contract covered by the option at a stated price (strike price) on or before a fixed expiration date.

"Option Premium" means the consideration paid (received) for the purchase (sale) of an Insurance Future Option.

"Margin Deposit" means a deposit that an insurer is required to maintain with a broker with respect to the underlying Insurance Futures Contracts purchased.

GENERAL INSTRUCTIONS FOR SCHEDULE DB

Each derivative instrument should be reported in Parts A, B, C, or D according to the nature of the instrument, as follows:

Part A: Options*, Caps, Floors and Insurance Futures Options Owned

Part B: Options*, Caps, Floors and Insurance Futures Options Written

Part C: Collars, Swaps and Forwards**

Part D: Futures Contracts and Insurance Futures Contracts Open

* Warrants acquired in conjunction with public or private debt or equity that are more appropriately reported in other schedules do not have to be reported in Schedule DB.

** Forward commitments that are not derivative instruments (for example, the commitment to purchase a GNMA security two months after the commitment date, or a private placement six months after the commitment date) should be disclosed in the Notes to Financial Statements rather than on Schedule DB.

Part E should be used to report the counterparty exposure, (i.e., the exposure to credit risk on derivative instruments) to each counterparty (or guarantor as appropriate).

SCHEDULE DB – PART A
SECTIONS 1, 2, AND 3

GENERAL INSTRUCTIONS

In each Section, separate derivative instruments into the following categories:

Category	Line Number
Call Options:	
Hedging	0199999
Other	0399999
Subtotal – Call Options	0499999
Put Options:	
Hedging	0599999
Other	0799999
Subtotal – Put Options	0899999
Caps:	
Hedging	0999999
Other	1199999
Subtotal – Caps	1299999
Floors:	
Hedging	1399999
Other	1599999
Subtotal – Floors	1699999
Insurance Futures Call Options:	
Hedging	1799999
Other	1999999
Subtotal – Insurance Futures Call Options	2099999
Insurance Futures Put Options	
Hedging	2199999
Other	2399999
Subtotal – Insurance Futures Put Options	2499999
Totals:	
Subtotal – Hedging	2599999
Subtotal – Other	2799999
Total	9999999

Column 1 – Description

Give a complete and accurate description of the derivative instrument, including description of underlying securities, currencies, rates, indices, commodities, derivative instruments, or other financial market instruments. Forward exchange rate must be stated as: Fx Currency per US$ (Fx/US$). Where leveraging is a feature of the payment terms, the multiplier effect will be clearly presented in the description. Two or more lines may be used to report a derivative instrument if such presentation provides a more accurate description.

Column 2 – Number of Contracts or Notional Amount

Where instrument positions are traded based on number of contracts, such as exchange traded options, show the number of contracts. For other instruments, such as caps and floors, show the notional amount (i.e., the amount upon which the next cash payment is based). Notional amount should be based on current U.S. equivalent of the amount receivable from the counterparty as of the (purchase/sale/reporting) date.

Column 3 – Date of Maturity, Expiry or Settlement

Show the date of maturity, expiry, or settlement, as appropriate.

Column 4 – Strike Price, Rate or Index

Show the strike price, rate, or index for which an option could be exercised or which would trigger a cash payment on a cap or floor. Forward exchange rate must be stated as: Fx Currency per US$ (Fx/US$).

Column 5 – Date of Acquisition

Show the date of the original transaction. The reporting entity may summarize on one line all identical derivative instruments with the same exchange or counterparty showing the date of last acquisition**,** but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).

Column 6 – Exchange or Counterparty

If exchange traded, show the name of the exchange, Board of Trade, or contract market. If OTC traded, show the counterparty or guarantor upon whose credit the insurer relies.

Column 7 – Cost/Option Premium

Indicate the cost of the instrument purchased. For insurance futures, indicate the consideration paid for the purchase of the instrument.

SCHEDULE DB – PART A – SECTION 1

OPTIONS, CAPS, FLOORS AND INSURANCE FUTURES OPTIONS OWNED DECEMBER 31 OF CURRENT YEAR

Column 8 – Book Value

Book value is the sum of cost plus cumulative increase (decrease) by adjustment in book value.

Column 9 – * Column

Insert "*" in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.

Insert "#" in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.

Insert "@" in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.

Column 10 – Statement Value

Instruments shall be valued as follows, providing the transaction is permitted by law or regulations of an insurer's state of domicile:

a. For Hedges of Items Carried at Amortized Cost

(i) Value at amortized cost, (or alternatively at cost if less than one year maturity).

(ii) If during the life of the instrument, it is no longer effective as a hedge, valuation at amortized cost ceases and the instrument shall be valued at current market value (marked to market).

b. For Hedges of Items Carried at Market Value

Value at current market price (marked to market).

c. For Hedges Adjusting the Basis of the Hedged Item

The book value of an instrument may be used to adjust the basis of the hedged item directly. In this case the statement value of the instrument would be zero.

d. For Other Derivative Transactions

Value at current market price (marked to market).

e. For Insurance Options

Column 11 – Fair Value

Fair value can be obtained from any one of five sources:

a. Public Market Quotes

b. Fair Value Provided by Broker

c. Management Estimate

d. Pricing Service

e. Pricing Matrix

Column 12 – Increase (Decrease) by Adjustment

This represents the current year's amortization of the initial cost. For insurance futures options, this represents the current year's increase or decrease in the market value.

Column 13 – Used to Adjust Basis of Hedged Item

This represents the amortized book value used to adjust the basis of the hedged item(s) during the current year.

Column 14 – Other Investment/Miscellaneous Income

Include current year earned income on caps and floors. The reporting entity should keep records for more detailed reporting of income (i.e., collected versus accrued). For insurance futures options, this represents any increase or decrease (in the value of the instruments) that corresponds to incurred losses for the current reporting period.

SCHEDULE DB – PART A – SECTION 3

OWNED OPTIONS, CAPS, FLOORS AND INSURANCE FUTURES OPTIONS TERMINATED DURING CURRENT YEAR

Column 8 – Indicate Exercise, Expiration, Maturity or Sale

Indicate the cause of termination.

Column 9 – Termination Date

Show the date in which the contract/agreement was terminated. Companies may summarize on one line all identical instruments with the same exchange or counterparty, using the latest termination date, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).

Column 10 – Book Value

Book value is the sum of cost plus cumulative increase (decrease) by adjustment in book value.

Column 11 – * Column

Insert "*" in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.

Insert "#" in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.

Insert "@" in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.

Column 12 – Consideration Received on Terminations

Show the amount of consideration received.

Column 13 – Increase (Decrease) by Adjustment

This represents the current year's amortization of the initial cost.

Column 14 – Gain (Loss) on Termination - Recognized

This represents gain (loss) on termination that is not deferred or used to adjust basis of hedged items.

Column 15 – Gain (Loss) on Termination - Used to Adjust Basis of Hedged Item

This represents the gain (loss) on termination that was used to adjust the basis of a hedged item in the current year. It includes the book value of premiums that were allocated to the purchase cost on exercise of an option.

Column 16 – Gain (Loss) on Termination - Deferred

This represents the gain (loss) on termination that was deferred over yearend.

This equals consideration received less book value at termination.

Column 17 – Other Investment/Miscellaneous Income

Include current year earned income on caps and floors. The reporting entity should keep records for more detailed reporting of income (i.e., collected versus accrued).

SCHEDULE DB – PART B
SECTIONS 1, 2, AND 3

GENERAL INSTRUCTIONS

In each Section, separate derivative instruments into the following categories:

Category	Line Number
Call Options:	
Hedging	0199999
Income Generation	0299999
Other	0399999
Subtotal – Call Options	0499999
Put Options:	
Hedging	0599999
Income Generation	0699999
Other	0799999
Subtotal – Put Options	0899999
Caps:	
Hedging	0999999
Income Generation	1099999
Other	1199999
Subtotal – Caps	1299999
Floors:	
Hedging	1399999
Income Generation	1499999
Other	1599999
Subtotal – Floors	1699999
Insurance Futures Call Options:	
Hedging	1799999
Income Generation	1899999
Other	1999999
Subtotal – Insurance Futures Call Options	2099999
Insurance Futures Put Options:	
Hedging	2199999
Income Generation	2299999
Other	2399999
Subtotal – Insurance Futures Put Options	2499999
Totals:	
Subtotal – Hedging	2599999
Subtotal – Income Generation	2699999
Subtotal – Other	2799999
Total	9999999

Column 1 – Description

Give a complete and accurate description of the derivative instrument, including a description of underlying securities, currencies, rates, indices, commodities, derivative instruments or other financial market instruments. Forward exchange rate must be stated as: Fx Currency per US$ (Fx/US$). Where leveraging is a feature of the payment terms, the multiplier effect will be clearly presented in the description. Two or more lines may be used to report a derivative instrument if such presentation provides a more accurate description.

Column 2 – Number of Contracts or Notional Amount

Where instrument positions are traded based on number of contracts, such as exchange traded options, show the number of contracts. For other instruments, such as caps and floors, show the notional amount (i.e., the amount upon which the next cash payment is based). Notional amount should be based on current U.S. equivalent of the amount receivable from the counterparty as of the (purchase/sale/reporting) date.

Column 3 – Date of Maturity, Expiry or Settlement

Show the date of maturity, expiry or settlement, as appropriate.

Column 4 – Strike Price, Rate or Index

Show the strike price, rate or index for which an option could be exercised or which would trigger a cash payment on a cap or floor. Forward exchange rate must be stated as: Fx Currency per US$ (Fx/US$).

Column 5 – Date of Issuance/Purchase

Show the date of the original transaction. The reporting entity may summarize on one line, all identical derivative instruments used in hedging transactions with the same exchange or counterparty showing the date of last transaction, but only if the instruments are identical in their terms; e.g., type, maturity, expiry or settlement, and strike price, rate or index. Similarly, the reporting entity may summarize on one line, all identical derivative instruments used in income generation transactions with the same exchange or counterparty inserting last transaction date, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).

Hedging and income generation derivative instruments for which the alternative accounting treatment is chosen should be summarized separately.

Column 6 – Exchange or Counterparty

If exchange traded, show the name of the exchange, Board of Trade, or contract market. If OTC traded, show the counterparty or guarantor upon whose credit the insurer relies.

Column 7 – Consideration Received

Indicate the consideration received for sale of the instrument written.

SCHEDULE DB – PART B – SECTION 1

OPTIONS, CAPS, FLOORS AND INSURANCE FUTURES OPTIONS WRITTEN AND IN FORCE DECEMBER 31 OF CURRENT YEAR

Column 8 – Book Value

Book value is the sum of consideration received plus cumulative increase (decrease) by adjustment in book value, if any.

Income Generation Transactions

For covered calls and covered puts, book value equals consideration received. For covered caps and floors, book value is the sum of consideration received plus cumulative increase (decrease) by adjustment in book value, if any.

Column 9 – * Column

Insert "*" in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.

Insert "#" in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.

Insert "@" in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.

Column 10 – Statement Value

Hedging Transactions

Instruments shall be valued as follows providing the transaction is permitted by law or regulations of an insurer's state of domicile (for more complete and detailed explanation, see the NAIC *Accounting Practices and Procedures Manual*):

a. For Hedges of Items Carried at Amortized Cost

(i) Value at amortized cost, (or alternatively at cost if less than one year maturity).

(ii) If during the life of the instrument, it is no longer effective as a hedge, valuation at amortized cost ceases and the instrument shall be valued at current market value (marked to market) and changes will be recognized currently.

b. For Hedges of Items Carried at Market Value

Value at current market price (marked to market) and changes will be recognized currently.

c. For Hedges Adjusting the Basis of the Hedged Item (Fixed Income Only)

The book value of an instrument may be used to adjust the basis of the hedged item directly. Prior to entering into the transaction, the insurer must state its intent to use this alternative and may not change methods while the transaction remains open.

Income Generation Transactions

a. If Underlying/Covering Item Carried at Amortized Cost:

(i) For covered puts and calls, value at consideration received.

(ii) For covered caps and floors, value at amortized value. If less than one year maturity to from date of acquisition, item may be carried at consideration received (unamortized).

b. If Underlying/Covering Item Carried at Market Value:

(i) Value at current market price (marked to market) and changes will be recognized currently.

c. If Adjusting the Basis of the Underlying/Covering Item (Fixed Income Only):

(i) The book value of a call option may be used to adjust the basis of the underlying/covering asset directly if the call option has a maturity of greater than one year from date of acquisition.

Other Derivative Transactions

Instruments shall be valued at current market price (marked to market). For insurance options, this statement value represents the value as of December 31, of the prior year.

Column 11 – Fair Value

Fair value can be obtained from any one of five sources:

a. Public Market Quotes
b. Fair Value Provided by Broker
c. Management Estimate
d. Pricing Service
e. Pricing Matrix

Column 12 – Increase (Decrease) by Adjustment

This represents the current year's amortization of the initial proceeds.

Column 13 – Used to Adjust Basis

Hedging Transactions:

This represents the consideration used to adjust the basis of the hedged item(s) during the current year.

Income Generation Transactions:

This represents the consideration used to adjust the basis of the underlying/covering asset during the current year.

Column 14 – Other Investment/Miscellaneous Income

Hedging Transactions:

Include current year incurred interest expense on caps and floors. The reporting entity should keep records for more detailed reporting of income (i.e., collected versus accrued).

Income Generation Transactions:

Include current year incurred interest expense on caps and floors as a negative number. The reporting entity should keep records for more detailed reporting of expense (i.e. incurred versus paid).

Other Derivative Transactions:

Include current year incurred interest expense on caps and floors as a negative number.

SCHEDULE DB – PART B – SECTION 3

WRITTEN OPTIONS, CAPS, FLOORS AND INSURANCE FUTURES OPTIONS TERMINATED DURING CURRENT YEAR

Column 8 – Indicate Exercise, Expiration, Maturity, or Closing Purchase Transaction

Indicate the cause of termination.

Column 9 – Termination Date

Show the date in which the contract/agreement was terminated. Companies may summarize on one line all identical derivative instruments used in hedging transactions with the same exchange or counterparty, using the latest termination date**,** but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index). Similarly, the reporting entity may summarize on one line, all identical derivative instruments used in income generation transactions with the same exchange or counterparty using the latest termination date, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).

Hedging and income generation derivative instruments, for which the alternative accounting treatment is chosen, should be summarized separately.

Column 10 – Book Value

Hedging Transactions:

Book value is the sum of consideration received plus cumulative increase (decrease) by adjustment in book value, if any.

Income Generation Transactions:

For covered calls and covered puts, book value equals consideration received. For covered caps and floors, book value is the sum of consideration received plus cumulative decrease by adjustment in book value, if any.

Other Derivative Transactions:

For other derivative transactions, book value equals consideration received.

Column 11 – * Column

Insert "*" in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.

Insert "#" in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.

Insert "@" in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.

Column 12 – Consideration Paid on Termination

Show the amount of consideration paid.

Column 13 – Increase/(Decrease) by Adjustment

This represents the current year's amortization of the initial proceeds.

This equals book value at termination less consideration paid on termination.

Column 14 – Gain (Loss) on Termination - Recognized

This represents gain (loss) on termination that is not deferred or used to adjust basis of hedged or underlying/covering items.

Column 15 – Gain (Loss) on Termination - Used to Adjust Basis

Hedging Transactions:

This represents the gain (loss) on termination that was used to adjust the basis of a hedged item in the current year. It includes the book value of premiums that were allocated to the sale proceeds on exercise of an option.

Income Generation Transactions:

This represents the gain (loss) on termination that was used to adjust the basis of an underlying/covering item in the current year. It includes the book value of premiums that were allocated to the sale proceeds on exercise of an option.

Column 16 – Gain (Loss) on Termination - Deferred

This represents the gain (loss) on termination that was deferred over yearend.

Column 17 – Other Investment/Miscellaneous Income

Hedging Transactions:

Include current year incurred interest expense on caps and floors. The reporting entity should keep records for more detailed reporting of income (i.e., paid versus accrued).

Income Generation Transactions:

Include current year incurred interest expense on caps and floors as a negative number. The reporting entity should keep records for more detailed reporting of expense (i.e. paid versus accrued).

Other Derivative Transactions:

Include current year incurred interest expense on caps and floors as a negative number.

SCHEDULE DB – PART C
SECTIONS 1, 2 AND 3

GENERAL INSTRUCTIONS

In each Section, separate derivative instruments into the following categories:

	Category	Line Number
Collars:		
	Hedging	0199999
	Other	0399999
	Subtotal – Collars	0499999
Swaps:		
	Hedging	0599999
	Other	0799999
	Subtotal – Swaps	0899999
Forwards:		
	Hedging	0999999
	Other	1199999
	Subtotal – Forwards	1299999
Totals:		
	Subtotal – Hedging	2599999
	Subtotal – Other	2799999
Total		9999999

Column 1 – Description

Give a complete and accurate description of the derivative instrument, including description of underlying securities, currencies, rates, indices, commodities, derivative instruments or other financial market instruments. Forward exchange rate must be stated as: Fx Currency per US$ (Fx/US$). Where leveraging is a feature of the payment terms, the multiplier effect will be clearly presented in the description. Two or more lines may be used to report a derivative instrument if such presentation provides a more accurate description.

Column 2 – Notional Amount

Where instrument positions are traded based on number of contracts, such as exchange traded options or futures, show the number of contracts. For other instruments, such as swaps, show the notional amount (i.e., the amount upon which the next cash payment is based).

Column 3 – Date of Maturity, Expiry or Settlement

Show the date of maturity, expiry or settlement, as appropriate.

Column 4 – Strike Price, Rate, or Index Rec (Pay)

Show the price, rate or index relative to which profits and losses on the transaction are determined (such as (paid) and received interest rate on an interest rate swap), or that is locked in, as under a currency forward. Forward exchange rate must be stated as: Fx Currency per US$ (Fx/US$).

Column 5 – Date of Opening Position or Agreement

Show the date of the original transaction. The reporting entity may summarize on one line, all identical instruments with the same exchange or counterparty using the latest termination date**,** but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).

Column 6 – Exchange or Counterparty

If exchange traded, show the name of the exchange, Board of Trade, or contract market. If OTC traded, show the counterparty or guarantor upon whose credit the insurer relies.

Column 7 – Cost or (Consideration Received)

Indicate the cost or (consideration received), if any.

COLLAR, SWAP AND FORWARDS OPEN DECEMBER 31 OF CURRENT YEAR

Column 8 – Book Value

Book value is the sum of cost paid or consideration received plus cumulative increase (decrease) by adjustment in book value.

Column 9 – * Column

Insert "*" in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.

Insert "#" in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.

Insert "@" in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.

Column 10 – Statement Value

Instruments shall be valued as follows providing the transaction is permitted by law or regulations of an insurer's state of domicile.

a. For Hedges of Items Carried at Amortized Cost:

(i) Value at amortized cost, (or alternatively at cost if less than one year maturity).

(ii) If during the life of the instrument, it is no longer effective as a hedge, valuation at amortized cost ceases and the instrument shall be valued at current market value (marked to market) and changes will be recognized currently.

b. For Hedges of Items Carried at Market Value

Value at current market price (marked to market) and changes will be recognized currently.

c. For Hedges Adjusting the Basis of the Hedged Item

The book value of an instrument may be used to adjust the basis of the hedged item directly. In this case the statement value of the instrument would be zero.

d. For Other Derivatives Transactions

Value at current market price (marked to market) and changes will be recognized currently.

Column 11 – Fair Value

Fair value can be obtained from any one of five sources:

a. Public Market Quotes
b. Fair Value Provided by Broker
c. Management Estimate
d. Pricing Service
e. Pricing Matrix

Column 12 – Increase (Decrease) by Adjustment

This represents the current year's amortization of the initial cost or proceeds.

Column 13 – Used to Adjust Basis of Hedged Item

This represents the amortized book value used to adjust the basis of the hedged item(s) during the current year.

Column 14 – Other Investment/Miscellaneous Income

Include current year earned income on collars and swaps. The reporting entity should keep records for more detailed reporting of income (i.e., collected versus accrued).

Column 15 – Potential Exposure

Potential Exposure is a statistically derived measure of the potential increase in derivative instrument credit risk exposure, for derivative instruments which generally do not have an initial cost paid or consideration received, resulting from future fluctuations in the underlying interests upon which derivative instruments are based.

For collars, swaps and forwards, the Potential Exposure = 0.5% x "Notional Amount" x Square root of (Remaining Years to Maturity).

SCHEDULE DB – PART C – SECTION 3

COLLAR, SWAP AND FORWARDS TERMINATED DURING CURRENT YEAR

Column 8 – Indicate Exercise, Expiration, Maturity or Sale

Indicate the cause of termination.

Column 9 – Termination Date

Show the date in which the contract/agreement was terminated. Companies may summarize on one line all identical instruments with the same exchange or counterparty, using the latest termination date, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement, and strike price, rate or index).

Column 10 – Book Value

Book value is the sum of cost plus cumulative increase (decrease) by adjustment in book value.

Column 11 – * Column

Insert "*" in this column if the book value is combined with the book value of assets or liabilities hedged, the book value is combined with the book value of underlying/covering assets or if the amount is combined with consideration paid on underlying/covering assets.

Insert "#" in this column if the book value was combined in prior years with the book value of assets or liabilities hedged.

Insert "@" in this column if the income/expenses is combined with income/expenses on assets or liabilities hedged.

Column 12 – Consideration Received or (Paid) on Termination

Show the amount of consideration received or paid.

Column 13 – Increase/(Decrease) by Adjustment

This represents the current year's amortization of the initial cost or proceeds.

Column 14 – Gain (Loss) on Termination - Recognized

This represents gain (loss) on termination that is not deferred or used to adjust the basis of hedged items.

Column 15 – Gain (Loss) on Termination - Used to Adjust Basis of Hedged Item

This represents the gain (loss) on termination that was used to adjust the basis of a hedged item in the current year.

Column 16 – Gain (Loss) on Termination - Deferred

This represents the gain (loss) on termination that was deferred over yearend.

This equals consideration received less book value at termination.

Column 17 – Other Investment/Miscellaneous Income

Include current year earned income on collars and swaps. The reporting entity should keep records for more detailed reporting of income (i.e., collected versus accrued).

SCHEDULE DB – PART D
SECTIONS 1, 2 AND 3

GENERAL INSTRUCTIONS

In each Section, separate derivative instruments into the following categories:

Category	Line Number
Long Futures:	
Hedging	0199999
Other	0399999
Subtotal – Long Futures	0499999
Short Futures:	
Hedging	0599999
Other	0799999
Subtotal – Short Futures	0899999
Insurance Futures Call Options:	
Hedging	1799999
Other	1999999
Subtotal – Insurance Futures Call Options	2099999
Insurance Futures Put Options:	
Hedging	2199999
Other	2399999
Subtotal – Insurance Futures Put Options	2499999
Totals:	
Subtotal – Hedging	2599999
Subtotal – Other	2799999
Total	9999999

At the end of each Section, list, in alphabetical sequence, brokers with whom cash deposits have been made.

Column 1 – Description

Give a complete and accurate description of the derivative instrument, including description of underlying securities, currencies, rates, indices, commodities, derivative instruments or other financial market instruments. Forward exchange rate must be stated as: Fx Currency per US$ (Fx/US$). Where leveraging is a feature of the payment terms, the multiplier effect will be clearly presented in the description. Two or more lines may be used to report a derivative instrument if such presentation provides a more accurate description.

Column 2 – Number of Contracts

Show the number of contracts.

Column 3 – Maturity Date

Show the date of maturity.

SCHEDULE DB – PART D – SECTION 1

FUTURES CONTRACTS AND INSURANCE FUTURES CONTRACTS OPEN DECEMBER 31 OF CURRENT YEAR

Columns 4 and 5 – Original Value & Current Value

Column 4 (Original Value) and 5 (Current Value) –

Represent the original or current value of open contracts even though this amount was not paid or received in cash. It equals (# of contracts) x (underlying value per contract) x (price per contract).

Column 6 – Variation Margin

On long contracts, it is the difference between Current Value minus Original Value (Column 5 – Column 4). On short contracts, it is the difference between Original Value minus Current Value (Column 4 – Column 5).

Column 7 – Date of Opening Position

Show the date of the original transaction. Summarize on one line and use the date of last transaction for instruments with the same exchange sign.

Column 8 – Exchange or Counterparty

Show the name of the exchange, Board of Trade, or contract market.

Column 9 – Cash Deposit

Show at the end of this section the amount of outstanding cash deposits at December 31, by broker, in alphabetical sequence.

Column 10 – Variation Margin Information - Recognized

This represents the variation margin recognized as an unrealized or realized gain (loss) or as investment income from inception of the contract.

Column 11 – Variation Margin Information - Used to Adjust Basis of Hedged Item

This represents the variation margin used to adjust the basis of a hedged item.

Column 12 – Variation Margin Information - Deferred

This represents the variation margin that has been deferred from inception of the contract.

Column 13 – Potential Exposure

Potential Exposure is a statistically derived measure of the potential increase in derivative instrument credit risk exposure, for derivative instruments which generally do not have an initial cost paid or consideration received, resulting from future fluctuations in the underlying interests upon which derivative instruments are based.

For futures, the Potential Exposure = (Initial Margin per contract on the valuation date, set by the exchange on which contract trades) x (the number of contracts open on the valuation date).

SCHEDULE DB – PART D – SECTION 2

FUTURES CONTRACTS AND INSURANCE FUTURES CONTRACTS OPENED DURING CURRENT YEAR

Column 4 – Original Value

Original value represents the original value of the contracts purchased or sold even though this amount was not paid or received in cash. It equals (# of contracts) x (underlying value per contract) x (price per contract).

Column 5 – Date of Opening Position

Show the date of the original transaction. Companies may summarize on one line all identical instruments with the same exchange using the date of last transaction.

Column 6 – Exchange or Counterparty

Show the name of the exchange, Board of Trade, or contract market.

Column 7 – Net Additions to Cash Deposits

Show at the end of this section the net additions of cash deposits during the year, by broker, in alphabetical sequence.

SCHEDULE DB – PART D – SECTION 3

FUTURES CONTRACTS AND INSURANCE FUTURES CONTRACTS TERMINATED DURING CURRENT YEAR

Column 4 and 5 – Original Value & Termination Value

Column 4 (Original Value) and 5 (Termination Value) –

Represent the original or termination value of terminated contracts even though this amount was not paid or received in cash. It equals (# of contracts) x (underlying value per contract) x (price per contract) less commission on terminated contracts.

Column 6 – Variation Margin

On long contracts it is the difference between Termination Value minus Original Value (Column 5 – Column 4). On short contracts it is the difference between Original Value minus Termination Value (Column 4 – Column 5).

Column 7 – Date of Opening Position

Show the date of the original transaction. Summarize on one line and use the date of last transaction for instruments with the same exchange sign.

Column 8 – Exchange or Counterparty

Show the name of the exchange, Board of Trade, or contract market.

Column 9 – Net Reduction to Cash Deposits

Show at the end of this section the net reductions of cash deposits during the year by broker, in alphabetical sequence.

Column 10 – Termination Date

Show the date in which the contract was terminated. Summarize on one line and use the date of last transaction for instruments with the same exchange sign, but only if the instruments are identical in their terms, (e.g., type, maturity, expiry or settlement).

Column 11 – Variation Margin Information – Gain (Loss) Recognized

This represents the total variation margin that was recognized as realized or unrealized gain (loss), or as investment income from inception of the contract.

Column 12 – Variation Margin Information – Gain (Loss) Used to Adjust Basis of Hedged Item

This represents the variation margin that was used to adjust the basis of a hedged item. It includes the variation margin that was allocated to the purchase cost or sales proceeds when delivery was taken or made on the underlying items of the futures contract.

Column 13 – Variation Margin Information – Gain (Loss) Deferred

This represents the variation margin that was deferred over yearend.

SCHEDULE DB – PART E – SECTION 1

COUNTERPARTY EXPOSURE FOR DERIVATIVE INSTRUMENTS OPEN DECEMBER 31 OF CURRENT YEAR

Counterparty Exposure to any one counterparty is the exposure to credit risk associated with the use of derivative instruments with that counterparty. This part displays the statement value exposure and market value exposure to each counterparty, net of collateral. Also displayed is the total potential exposure for each counterparty for Schedule DB, Parts C and D.

On the first line, show the aggregate sum for exchange traded derivatives. On subsequent lines, show separately six groups of OTC (over-the-counter) derivative counterparties by SVO Rating. Within each group, list the counterparties in alphabetical order. For each counterparty with a master agreement, show on a second line, if applicable, totals for derivative instruments not covered by the master agreement, and use additional lines as needed if multiple master agreements with the counterparty exist that do not provide for netting of offsetting amounts by the insurer against the counterparty upon termination in the event that the counterparty defaults. Show subtotals for each group.

If an insurer has any detail lines reported for any of the following required groups, it shall report the subtotal amount of the corresponding group with the specified subtotal line number appearing in the same manner and location as the pre-printed total.

Aggregate Sum of Exchange Traded Derivatives	0199999
Total NAIC 1 Designation	0299999
Total NAIC 2 Designation	0399999
Total NAIC 3 Designation	0499999
Total NAIC 4 Designation	0599999
Total NAIC 5 Designation	0699999
Total NAIC 6 Designation	0799999
Total	0899999

Column 1 – Description Counterparty or Exchange Traded

On the first line, show the phrase: Exchange Traded. On subsequent lines, show the name of the counterparty.

Column 2 – Master Agreement (Yes or No)

Show XXX for the aggregate reporting of Exchange Traded derivatives. For OTC Counterparties, indicate yes if:

1. The insurer has a written International Swaps and Derivatives Association (ISDA) master agreement with the counterparty that provides for the netting of offsetting amounts by the insurer against the counterparty upon termination in the event that the counterparty defaults, or if such netting provisions of an ISDA master agreement are either incorporated by reference in transaction confirmations or are otherwise contractual provisions to which derivative instrument confirmations with the counterparty are subject, or if the insurer has a written non – ISDA master agreement with the counterparty that provides for the netting of offsetting amounts or the right of offset by the insurer against the counterparty upon termination in the event that the counterparty defaults; and

2. The domiciliary jurisdiction of such counterparty is either within the United States or if not within the United States, is within a foreign (non-United States) jurisdiction listed in the *Purposes and Procedures* Manual of the NAIC Securities Valuation Office as eligible for netting.

Column 3 – Fair Value of Acceptable Collateral

Leave blank for the aggregate reporting of Exchange Traded derivatives. For OTC Counterparties, show the market value of acceptable collateral pledged by the counterparty.

"Acceptable collateral" means cash, cash equivalents, securities issued or guaranteed by the United States or Canadian governments or their government–sponsored enterprises, letters of credit, publicly traded obligations rated 1 by the SVO, government money market mutual funds, and such other items as may be defined as acceptable collateral in the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*. For purposes of this definition, the term "letter of credit" means a clean, irrevocable and unconditional letter of credit issued or confirmed by, and payable and presentable at, a financial institution on the list of financial institutions meeting the standards for issuing such letter of credit published pursuant to the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*. The letter of credit must have an expiration date beyond the term of the subject transaction.

Statement values that are debit balances on the balance sheet are positive numbers; those that are credit balances are negative numbers.

Column 4 – Contracts with Statement Value > 0 (i.e., debit balance on balance sheet)

On the first line, show the aggregate sum for exchange traded derivatives that have a positive statement value. For futures, this equals deferred variation margin losses (Part D, Section 1, Column 12); plus the sum of all cash deposits with brokers (Part D, Section 1, Column 9). On subsequent lines, show the sum of the statement values of all derivative instruments with the counterparty that have a positive statement value.

Column 5 – Contracts with Statement Value < 0 (i.e., credit balance on balance sheet)

On the first line, show the sum of the statement values in parentheses ( ) of all exchange traded derivatives that have a negative statement value. For Futures, this equals deferred variation margin gains (Part D, Section 1, Column 12). For written options, caps and floors on Part B, the positive statement values will be shown here in parentheses ( ). On subsequent lines, show the sum of the statement values in parentheses ( ) of all derivative instruments with the counterparty that have a negative statement value.

Column 6 – Exposure Net of Collateral

For the aggregate reporting of exchange traded derivatives, show amount in Column 4. For OTC Counterparties, if no master agreement is in place, show the sum of the statement values of all derivative instruments with the counterparty, which have a positive statement value, less any Acceptable Collateral (Column 4 – Column 3). If a master agreement is in place, show the net sum of the statement values of all derivative instruments with the counterparty, less any acceptable collateral (Column 4 + Column 5 – Column 3). This amount should not be less than zero.

Market values that would be debit balances on the balance sheet are positive numbers; those that would be credit balances are negative numbers.

Column 7 – Contracts With Fair Values > 0 (i.e., would be a debit balance on the balance sheet)

On the first line, show the sum of the market values of all exchange traded derivatives that have a positive market value. For futures, this equals the sum of all cash deposits with brokers (Part D, Section 1, Column 9). On subsequent lines, show the sum of the market values of all derivative instruments with the counterparty that have a positive market value.

Column 8 – Contracts With Fair Values < 0 (i.e., would be a credit balance on the balance sheet)

On the first line, show the sum of the market values in the parentheses ( ) of all exchange traded derivatives that have a negative market value. For futures this equals zero. For written options, caps and floors on Part B, the positive market values will be shown here in parentheses ( ). On subsequent lines, show the sum of the market values in parentheses ( ) of all derivative instruments with the counterparty that have a negative market value.

Column 9 – Exposure Net of Collateral

For the aggregate reporting of exchange traded derivatives, show amounts in Column 7. For OTC counterparties, if no master agreement is in place, show the sum of the market values of all derivative instruments with the counterparty which have a positive market value, less any acceptable collateral (Column 7 – Column 3). If a master agreement is in place, show the net sum of the market values of all derivative instruments with the counterparty, less any acceptable collateral (Column 7 + Column 8 – Column 3). This amount should not be less than zero.

Column 10 – Potential Exposure

Show the potential exposure for Parts C and D for exchange traded derivatives in aggregate and for each OTC counterparty.

Column 11 – Off–Balance Sheet Exposure

For Exchange Traded Derivatives, show Column 10.

For OTC counterparties:

If Column 2 = yes; show [Column 4 + Column 5 – Column 3 + Column 10] – Column 6 but not less than zero.

If Column 2 = no; show Column 10.

Optional: If there is no master netting agreement, companies may still encounter double counting in cases where a premium is received for an off balance sheet derivative transaction, such as an interest rate swap. In such cases, report “no” in Column 2 and calculate off balance sheet exposure on a contract–by–contract basis using the first formula.

NAIC Annual (& Quarterly) Statement Blank
Schedule DB (Derivative Instruments).

SCHEDULE DB – PART A – SECTION 1

Showing all Options, Caps, Floors and Insurance Futures Options Owned December 31 of Current Year

1 Description	2 Number of Contracts or Notional Amount	3 Date of Maturity, Expiry, or Settlement	4 Strike Price, Rate or Index	5 Date of Acquisition	6 Exchange or Counterparty	7 Cost/ Option Premium	8 Book Value	9 *	10 Statement Value	11 Fair Value	12 Increase/(Decrease) by Adjustment	13 Used to Adjust Basis of Hedged Item	14 Other Investment / Miscellaneous Income
2599999	Subtotal – Hedging Transactions							xxx					
2799999	Subtotal – Other Derivative Transactions							xxx					
9999999	Totals							xxx					

SCHEDULE DB – PART A – SECTION 2

Showing all Options, Caps, Floors and Insurance Futures Options Acquired During Current Year

1 Description	2 Number of Contracts or Notional Amount	3 Date of Maturity, Expiry, or Settlement	4 Strike Price, Rate or Index	5 Date of Acquisition	6 Exchange or Counterparty	7 Cost/ Option Premium
2599999	Subtotal – Hedging Transactions					
2799999	Subtotal – Other Derivative Transactions					
9999999	Total					

SCHEDULE DB – PART A – SECTION 3

Showing all Owned Options, Caps, Floors and Insurance Futures Options Terminated During Current Year

		2	3	4	5	6	7	8	9	10	11	12	13	Gain (Loss) on Termination 14	15	16	17
Description		Number of Contracts or Notional Amount	Date of Maturity, Expiry, or Settlement	Strike Price, Rate or Index	Date of Acquisition	Exchange or Counterparty	Cost/ Option Premium	Indicate Exercise, Expiration, Maturity or Sale	Termination Date	Book Value	*	Consideration Received on Terminations	Increase/ (Decrease) by Adjustment	Recognized	Used to Adjust Basis of Hedged Item	Deferred	Other Investment/ Miscellaneous Income
2599999	Subtotal – Hedging Transactions							xxx	xxx		xxx						
2799999	Subtotal – Other Derivative Transactions							xxx	xxx		xxx						
9999999	Totals							xxx	xxx		xxx						

SCHEDULE DB – PART B – SECTION 1

Showing all Options, Caps, Floors and Insurance Futures Options Written and In-Force December 31 of Current Year

1		2	3	4	5	6	7	8	9	10	11	12	13	14
Description		Number of Contracts or Notional Amount	Date of Maturity, Expiry, or Settlement	Strike, Price, Rate or Index	Date of Issuance/ Purchase	Exchange or Counterparty	Consideration Received	Book Value	*	Statement Value	Fair Value	Increase/ (Decrease) by Adjustment	Used to Adjust Basis	Other Investment/ Miscellaneous Income
2599999	Subtotal – Hedging Transactions								xxx					
2699999	Subtotal – Income Generation Transactions								xxx					
2799999	Subtotal – Other Derivative Transactions								xxx					
9999999	Totals								xxx					

SCHEDULE DB – PART B – SECTION 2

Showing all Options, Caps, Floors and Insurance Futures Options Written During Current Year

1 Description	2 Number of Contracts or Notional Amount	3 Date of Maturity, Expiry, or Settlement	4 Strike Price, Rate or Index	5 Date of Issuance/ Purchase	6 Exchange or Counterparty	7 Consideration Received
2599999 Subtotal – Hedging Transactions						
2699999 Subtotal – Income Generation Transactions						
2799999 Subtotal – Other Derivative Transactions						
9999999 Total						

SCHEDULE DB – PART B – SECTION 3

Showing all Written Options, Caps, Floors and Insurance Futures Options Terminated During Current Year

1 Description	2 Number of Contracts or Notional Amount	3 Date of Maturity, Expiry, or Settlement	4 Strike Price, Rate or Index	5 Date of Issuance/ Purchase	6 Exchange or Counterparty	7 Consideration Received	8 Indicate Exercise Expiration, Maturity or Closing Purchase Transaction	9 Termination Date	10 Book Value	11 *	12 Consideration Paid on Terminations	13 Increase/ (Decrease) by Adjustment	Gain/(Loss) on Termination 14 Recognized	 15 Used to Adjust Basis	 16 Deferred	17 Other Investment/ Miscellaneous Income
2599999 Subtotal – Hedging Transactions							xxx	xxx		xxx						
2699999 Subtotal – Income Generation Transactions							xxx	xxx		xxx						
2799999 Subtotal – Other Derivative Transactions							xxx	xxx		xxx						
9999999 Totals							xxx	xxx		xxx						

SCHEDULE DB – PART C – SECTION 1

Showing all Collar, Swap and Forwards Open December 31 of Current Year

1 Description	2 Notional Amount	3 Date of Maturity, Expiry, or Settlement	4 Strike Price, Rate or Index Rec (Pay)	5 Date of Opening Position or Agreement	6 Exchange or Counterparty	7 Cost or (Consideration Received)	8 Book Value	9 *	10 Statement Value	11 Fair Value	12 Increase/ (Decrease) by Adjustment	13 Used to Adjust Basis of Hedged Item	14 Other Investment/ Miscellaneous Income	15 Potential Exposure
2599999 Subtotal – Hedging Transactions								xxx						
2799999 Subtotal – Other Derivative Transactions								xxx						
9999999 Totals								xxx						

SCHEDULE DB – PART C – SECTION 2

Showing all Collar, Swap and Forwards Opened During Current Year

1 Description	2 Notional Amount	3 Date of Maturity, Expiry, or Settlement	4 Strike Price, Rate or Index Rec (Pay)	5 Date of Opening Position or Agreement	6 Exchange or Counterparty	7 Cost or (Consideration Received)
2599999 Subtotal – Hedging Transactions						
2799999 Subtotal – Other Derivative Transactions						
9999999 Total						

SCHEDULE DB – PART C – SECTION 3

Showing all Collar, Swap and Forwards Terminated During Current Year

1	2	3	4	5	6	7	8	9	10	11	12	13	Gain/(Loss) on Termination			17
													14	15	16	
Description	Notional Amount	Date of Maturity, Expiry, or Settlement	Strike Price, Rate or Index Rec (Pay)	Date of Opening Position or Agreement	Exchange or Counterparty	Cost or (Consideration Received)	Indicate Exercise, Expiration, Maturity or Sale	Termination Date	Book Value	*	Consideration Received or (Paid) on Terminations	Increase (Decrease) by Adjustment	Recognized	Used to Adjust Basis of Hedged Item	Deferred	Other Investment / Miscellaneous Income
2599999 Subtotal – Hedging Transactions							xxx	xxx		xxx						
2799999 Subtotal – Other Derivative Transactions							xxx	xxx		xxx						
9999999 Totals							xxx	xxx		xxx						

SCHEDULE DB – PART D – SECTION 1

Showing all Futures Contracts and Insurance Futures Contracts Open December 31 of Current Year

1	2	3	4	5	6	7	8	9	Variation Margin Information			13
									10	11	12	
Description	Number of Contracts	Maturity Date	Original Value	Current Value	Variation Margin	Date of Opening Position	Exchange or Counterparty	Cash Deposit	Recognized	Used to Adjust Basis of Hedged Item	Deferred	Potential Exposure
2599999 Subtotal – Hedging Transactions						xxx	xxx					
2799999 Subtotal – Other Derivative Transactions						xxx	xxx					
9999999 Totals						xxx	xxx					

SCHEDULE DB – PART D – SECTION 2

Showing all Futures Contracts and Insurance Futures Contracts Opened During Current Year

1 Description	2 Number of Contracts	3 Maturity Date	4 Original Value	5 Date of Opening Position	6 Exchange or Counterparty	7 Net Additions to Cash Deposits
2599999 Subtotal – Hedging Transactions				xxx	xxx	
2799999 Subtotal – Other Derivative Transactions				xxx	xxx	
9999999 Totals				xxx	xxx	

SCHEDULE DB – PART D – SECTION 3

Showing all Futures Contracts and Insurance Futures Contracts Terminated During Current Year

1	2	3	4	5	6	7	8	9	10	Variation Margin Information		
Description	Number of Contracts	Maturity Date	Original Value	Termination Value	Variation Margin	Date of Opening Position	Exchange or Counterparty	Net Reduction to Cash Deposits	Termination Date	11 Gain (Loss) Recognized	12 Gain (Loss) Used to Adjust Basis of Hedged Item	13 Gain (Loss) Deferred
2599999 Subtotal – Hedging Transactions						xxx	xxx		xxx			
2799999 Subtotal – Other Derivative Transactions						xxx	xxx		xxx			
9999999 Totals						xxx	xxx		xxx			