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## ASSOCIATION OF FINANCIAL GUARANTY INSURERS

Unconditional, Irrevocable Guaranty

July 22, 2013

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: Reopening of Comment Periods for Certain Rulemaking Releases and Policy Statement Applicable to Security-Based Swaps Proposed Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act

The Association of Financial Guaranty Insurers (“AFGI”) appreciates the opportunity to provide the Securities and Exchange Commission (“SEC” or “Commission”) with its comments on certain rulemaking releases applicable to security-based swaps proposed pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>1</sup>

AFGI, a trade association representing the unique perspective of financial guaranty insurers and reinsurers, has provided comments to the SEC regarding the application of various security-based swap dealer (“SBSD”) and major security-based swap participant (“MSBSP”) regulations to financial guaranty insurers. Particularly, AFGI provided comments in February 2013 regarding capital, margin, and segregation requirements for SBSDs and MSBSPs and capital requirements for broker-dealers.<sup>2</sup> In 2012, AFGI also provided comments regarding the SEC’s proposed business conduct standards for SBSDs and MSBSPs.<sup>3</sup>

Through this letter, AFGI incorporates its previous comments to the SEC, as summarized below, with respect to the application of SBSD and MSBSP requirements to legacy security-based swap (“SBS”) transactions. Importantly, no AFGI member has insured new credit default swaps (“CDS”) since 2009 except in connection with loss mitigation or risk reduction activities. Further, AFGI members are constrained from insuring CDS under applicable legal requirements, and do not expect to insure new CDS in the future, except perhaps in connection with loss mitigation and risk reduction

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<sup>1</sup> Reopening of Comment Periods for Certain Rulemaking Releases and Policy Statement Applicable to Security-Based Swaps Proposed Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act, 78 Fed. Reg. 30,800 (May 23, 2013).

<sup>2</sup> 77 Fed. Reg. 70,214 (Nov. 23, 2012).

<sup>3</sup> 76 Fed. Reg. 42,396 (July 18, 2011).

activities.<sup>4</sup> As such, AFGI strongly supports the Commission's initial determination that the proposed rules regarding business conduct standards and capital, margin, and segregation requirements for SBSs and MSBSPs be applied only to SBS executed on or after the rules' compliance date.

Separately, in relation to the SEC's 2011 proposed rules on the registration of SBSs and MSBSPs,<sup>5</sup> AFGI requests that the SEC evaluate the merits of requiring MSBSP registration if legacy positions on SBS transactions are expected to decline below MSBSP thresholds within 12 to 24 months of the effective date due to projected run-off or terminations.

### **I. Regulatory Framework for Cross-Border Swaps Transactions**

AFGI understands that the Commission will regulate as SBS some of the CDS entered into by affiliates of AFGI members and, as a result, some financial guaranty insurers may potentially be subject to regulation as MSBSPs. AFGI members are currently conducting calculations to determine whether they meet the threshold for registration as MSBSPs. AFGI members are using valuations employed in accordance with GAAP (FASB 157) to calculate an entity's current and potential exposure to determine whether they exceed MSBSP thresholds.

The SEC's proposed rules for cross-border swaps transactions state that, in determining whether a person falls within the MSBSP definition, certain SBS guaranteed by U.S. persons and non-U.S. persons would be attributed to the guarantor. As is most relevant for purposes of analyzing the potential need for any AFGI members to register as MSBSPs, we understand that a U.S. guarantor that guarantees the performance of the SBS obligations of a non-U.S. person would be required to attribute to itself all of that non-U.S. person's positions that the U.S. guarantor guarantees (regardless of whether the non-U.S. person's positions arise from transaction with a U.S. person counterparty or a non-U.S. person counterparty). Taking into account the proposed treatment of U.S. and non-U.S. guarantors in the context of cross-border transactions, AFGI encourages the SEC to coordinate its regulatory efforts with the Commodity Futures Trading Commission ("CFTC") and foreign regulators in order to ensure the consistent regulation of financial guaranty insurers. Indeed, AFGI believes that international harmonization is essential to enhance financial stability and market efficiency.

AFGI also restates its understanding that the SBS transactions that will be considered toward the MSBSP definition should not include previously-executed legacy SBS. As noted previously, financial guaranty insurers have discontinued certain business

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<sup>4</sup> As outlined in its letter to the SEC on February 15, 2013, AFGI understands the definition of an SBS legacy account to include loss mitigation transactions (i.e., transactions amending or otherwise reducing risk in a legacy portfolio).

<sup>5</sup> 76 Fed. Reg. 65,784 (Oct. 24, 2011).

lines as a result of the financial crisis. Since 2009, financial guaranty insurers have ceased insuring CDS (except in connection with loss mitigation or risk reduction activities). Thus, new risk associated with these activities is no longer being originated, while existing risk in these sectors is running off or being remediated.

## **II. MSBSP Requirements**

The proposed rules for cross-border swaps transactions indicate that U.S. MSBSPs will be required to comply with entity- and transaction- level requirements, while foreign MSBSPs will be required to comply with entity-level requirements. To the extent that any foreign or U.S. AFGI member falls within the MSBSP regulatory framework, AFGI reiterates the following comments related to entity-level requirements (such as capital, margin, and segregation) and transaction-level requirements (such as business conduct standards).

### *Proposed Rule Regarding Capital, Margin, and Segregation Requirements*

In our letter to the SEC in February 2013, we emphasized it is important that the SEC's proposed capital requirements not conflict with existing state insurance law requirements. Further, we cautioned the SEC against imposing unnecessarily burdensome, duplicative, and costly risk management controls on financial guaranty insurers. AFGI also expressed its support for the SEC's determination to include an exception from its proposed rule on account equity requirements for SBS legacy accounts. Indeed, retroactively applying margin requirements to legacy SBS would impose new burdens which would (1) not effectively address policy considerations in the context of existing trades, (2) likely contravene applicable requirements of state insurance law by prioritizing one class of policy holders over another, and (3) undermine the expectations that the parties had when entering into the SBS.

### *Proposed Rule Regarding Business Conduct Standards*

AFGI also commented on the SEC's proposed business conduct standards in September 2012. With regard to the proposed daily mark requirements, AFGI explained that, when financial guaranty insurers and their counterparties entered into legacy SBS transactions, they dealt at arm's length and determined that the issuance of daily marks was not necessary to further their respective business interests and they contracted accordingly.

Thus, AFGI questioned whether requiring one party to give the other daily marks on a legacy portfolio would further the goal of providing "helpful transparency." AFGI noted that, in most of these transactions, there is no trading market that provides meaningful pricing information – when marks are set, they are typically based on internal models or derived from indexes with which the transactions are not perfectly matched. Further, with regard to the fair and balanced communications requirements, we noted that the proposed rule is aimed primarily at undue conduct that may occur in new swaps

transactions. As such, the proposed rule is not necessary in the context of the AFGI members' legacy SBS portfolios where the only current activities are those aimed at loss mitigation and risk reduction, often in the context of significant restructurings. In these activities, the counterparties have typically engaged additional outside professional advisors, so the protections of the anti-fraud provisions are sufficient.

Finally, AFGI pointed out that legacy transactions do not require the posting of variation margin, so the SEC's proposed requirement to provide daily marks would not be useful for evaluating margin requirements.

### **III. Registration of Entities with Legacy Portfolios Running-Off Shortly After the Effective Registration Due Date**

As noted above, AFGI members are currently conducting calculations to determine whether they meet the threshold for registration as MSBSPs. Regardless of the results from such calculations, AFGI believes that the SEC should allow some flexibility regarding the application of MSBSP requirements for entities that will be required to register solely because of their legacy portfolios.

Importantly, for transactions executed after the compliance date, SBSBs, MSBSPs, and their counterparties will all be on notice of the new regulatory regime and will be able to structure transactions accordingly. In contrast, with regard to legacy transactions with a projected run-off at the end of this year or the next, financial guaranty insurers and their counterparties would not be afforded the same opportunity. Applying new rules to these transactions would be highly disruptive and could have financial consequences that neither party foresaw or desired. Moreover, there is no added benefit to applying the new rules to legacy transactions as such application would not further the SEC's stated objectives of protecting investors and promoting efficiency, competition, and capital formation.

Additionally, as noted in previous comment letters to the SEC, financial guaranty insurers are already subject to extensive state insurance law and regulations, and their SBS guarantees reflect the restrictions and obligations imposed by those regimes. The New York State Department of Financial Services ("DFS") is the primary prudential regulator for most United States financial guaranty insurance companies, and those domestic insurers that are not domiciled in New York are licensed to issue financial guaranty insurance under New York Insurance Law Article 69 ("Article 69") and are therefore also subject to regulation by the DFS.<sup>6</sup> Since its adoption, Article 69 and other provisions of the New York Insurance Law have provided the regulatory standard for the industry, implementing a comprehensive regulatory framework. This framework includes market conduct rules, financial reporting standards, contingency reserves, single and aggregate risk limits, investment requirements, and regulatory examinations.

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<sup>6</sup> N.Y. Code ISC Insurance §§ 6901-09 (2010).

Additionally, financial guaranty insurers domiciled in Europe and Bermuda are regulated appropriately and directly by the applicable sovereign insurance regulators in Europe, and will be subject to the requirements of the Solvency II Directive when implemented.

For these reasons, AFGI suggests that, for entities that will be required to register solely because of their legacy portfolios, the SEC should evaluate the merits of providing an exemption from MSBSP registration if legacy positions are expected to decline below MSBSP thresholds within 12 to 24 months of the effective date due to projected run-off or terminations. At a minimum, we submit that the SEC should consider a flexible approach to the application of MSBSP requirements for these entities.

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We thank the SEC for the opportunity to comment on various proposed rules related to the regulation of SBS transactions, and appreciate its attention to the concerns highlighted by AFGI in this letter. If you have any questions, please do not hesitate to contact the undersigned at [bstern@assuredguaranty.com](mailto:bstern@assuredguaranty.com) or (212) 339-3482.

Very truly yours,



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