ACLI
Financial Security for Life

August 21, 2023

Submitted Electronically

Vanessa A. Countryman, Secretary
Securities & Exchange Commission
100 F Street NE
Washington DC 20549-1090

RE: File Number S7-32-10 - 17 CFR Part 240 [Release No. 34-97762] RIN 3235-AN27 Reopening of Comment Period for Position Reporting of Large Security-Based Swap

Dear Ms. Countryman,

The American Council of Life Insurers (ACLI)[1] appreciates the opportunity to comment on the reopened proposal, Position Reporting of Large Security-Based Swap Positions, Release No. 34-93784, (Dec. 15, 2021) ("Reopened Proposal" or "Proposed Rule").

Life insurance companies are highly regulated and significant end-users of derivatives that enable the prudent management of asset and liability risks, as permitted under state insurance codes and regulations. As active participants in the security-based swap ("SBS") markets, with often long-dated and directional hedging positions, life insurance companies share the goals of the Securities & Exchange Commission ("SEC") of preserving healthy and stable SBS markets, and ACLI members are broadly supportive of the protection of market participants through SEC monitoring and surveillance. More information about Life Insurance Companies' use of derivatives to manage risks is available in Appendix I at the end of this letter.

Executive Summary

The Securities and Exchange Commission ("SEC")'s Division of Economic Risk Analysis ("DERA") memorandum providing supplemental data and analysis related to anticipated economic effects of the Proposed Rule ("the DERA Memo") is appreciated, but it is limited. The data that does exist supports removal of notional based thresholds.

In response to the specific questions asked, the ACLI urges the SEC to reassess and recalibrate reporting threshold amounts in a manner that reflects: underlying securities to an SBS should not be reportable with the SBS position; notional reporting thresholds for CDS and other debt SBS should be more accurately tailored to the risk posed by owning such a position; and life insurance companies should not be required to aggregate general account securities and SBS positions with

[1] The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States.

securities or SBS held by entities managed by an investment adviser under common control with the insurance company.

In this letter, we: (1) comment on the DERA Memo; (2) provide feedback on the SEC's specific requests for comment in the Reopened Proposal; and (3) re-emphasize several important topics covered in ACLI's original comment letter dated March 21, 2022, a copy of which is attached as Appendix II ("ACLI's Original Comment Letter"). While those topics were not specifically included in the Reopened Proposal, they are important context for the SEC to consider as part of the entire Proposed Rule.

I. SEC Division of Economic Risk and Analysis Memorandum

ACLI and its members appreciate DERA's memorandum providing supplemental data and analysis related to anticipated economic effects of the Proposed Rule.[2] ACLI's Original Comment Letter and several other industry comment letters submitted in response to the Proposed Rule urged the SEC to take advantage of information available from Regulation SBSR to better calibrate the proposed SBS reporting thresholds, if it determined that additional reporting of SBS positions is necessary. The DERA Memorandum itself acknowledges several limitations of the data. These limitations significantly limit the ability to draw conclusions about the impact of the Proposed Rule as originally drafted. In addition, the results described in the DERA Memo suggest that including a combination of notional and market cap thresholds for equity SBS is unnecessary. We continue to support the adoption of a market cap-based threshold for equity SBS without a notional threshold, if the SEC determines that additional reporting of equity SBS positions is necessary.

Limitations of Data

The DERA Memo notes that affiliate position data could not be completely incorporated in its analysis, even as the rule as drafted requires grouping across affiliates. We appreciate the painstaking analysis done by the staff at DERA. We do note a few additional limitations:

- The analysis does not span different product types (CDS, Fixed Income) and focuses on equities exclusively thereby limiting its usefulness.
- The sample period of 1 year included the Fed rate hiking cycle which was a risk-off period with several equity participants remaining out of the equities markets during this period.

Removing Notional Based Thresholds for Equity SBS

The data and analysis support removing notional based thresholds as described below:

1. Looking at data from 13D filings, based on the percentage of market cap thresholds, the DERA Memo notes that five out of nine 13D filers would have had to report SBS data. This >50% coverage lends support to the proposed 2.5% and 5% threshold levels. On the other hand, based on the data provided, the \$300m notional threshold is only breached by one 13D filer. Four 13D filers had SBS notional between \$150m and \$300m but it is not clear if

[2] Memorandum of the Staff of the Division of Economic and Risk Analysis, Supplemental data and analysis regarding the proposed reporting thresholds in the equity security-based swap market" (June 20, 2023), available at https://www.sec.gov/comments/s7-32-10/s73210.htm.

their combined ownership exceeds $300m requiring them to file. In any case, the data provided shows that the market cap based thresholds do an adequate job in capturing more than 50% of the 13D filers. From a concentration perspective, the $300m notional threshold is an arbitrary limit not representative of concentration risk and the data does not show any clear benefits of a notional based threshold.

2. The analysis focusing on activist investors also supports the use of a threshold for equity SBS based on market capitalization. Comparing figures 3B and 4B of the DERA Memo, it is seen that the total number of activist investors' gross positions that exceeded $300 million exceeds the total number of activist investors' gross positions that exceeds 5% of market capitalization during November 2021 to August 2022. However, during the period from August 2022 to November 2022, this is reversed. This shows that imposing a $300m notional threshold will not always capture a higher number of SBS filers. Even in periods that the $300m notional limit does capture more filings, the notional limit may not be representative of concentration risk, which is the main purpose of the SEC rule.

3. Focusing on SBS generally across market participants, the tables below show the summary of the results from the DERA memo. The Average # of participants with at least 1 gross position table shows that the 5% Mkt Cap Threshold captures 90 market participants which is comparable to the 97 market participants under the $300m threshold. Further, it is seen from the Average Total # of gross positions table that the 5% Mkt Cap Threshold is adequate since it captures 545 market participants, which is the average of 868 participants under the $300m threshold and 154 participants under the $1bn threshold, thus making the notional based thresholds superfluous.

Average # of participants with at least 1 gross position

$300m threshold	$1bn threshold	5% Mkt Cap Threshold
97	38	90

Average Total # of gross positions

$300m threshold	$1bn threshold	5% Mkt Cap Threshold
868	154	545

4. As we have argued in more detail in ACLI's Original Comment Letter, any advantages of a bright-line notional threshold will be negated by the costly and burdensome monitoring necessary to comply with the percentage-based threshold. As proposed, companies seeking to comply with any final rule will have to monitor both the notional and percentage-based thresholds to make sure they are reporting when they have exceeded the lesser of the two thresholds. Additionally, a notional-based criterion starting at $300 million will eventually result in disclosures for positions that only represent a small portion of the equity securities issued by companies with large market capitalization. Such reports may not achieve the SEC's objectives of giving market participants relevant information about potentially large exposures or an indication of buildup of large exposures that might suggest fraud or manipulation.

To summarize, we appreciate the DERA Memo's data-driven approach to analyzing the likely impact of the rule; however, we find its limitations are significant. In particular:

A. The DERA Staff Memo focused on equities and did not include data on CDS or fixed income. Reporting thresholds, if enacted, should distinguish between different types of SBS and be based on robust data for each category.

B. The data used in the analysis does not capture affiliated entity positions. The data being used for analysis is inconsistent with the current rule proposal for aggregating positions. Data consistent with the aggregation methodology of any final rules, if enacted, should be used to determine reporting thresholds.

C. Finally, the DERA Memo's analysis does not support the SEC's proposal to use a combination of notional and market cap thresholds for equity SBS. We continue to support adoption of a simplified, market cap-based threshold, if enacted.

II. Reopened Proposal Questions

In addition to the points raised above, ACLI and its members appreciate the opportunity to respond to certain of the questions posed in the Reopened Proposal. As noted, the ACLI does, by reference, reiterate comments in ACLI's Original Comment Letter. [3]

The SEC asked whether, for each asset class, the Reporting Threshold Amount in any final rule should be higher or lower than the proposed Reporting Threshold Amount under a number of different possible scenarios, including: if the value of associated securities owned by the holder of the security-based swap position is excluded[4] or aggregation of security-based swap positions across entities that are both separately legally established and capitalized is not required.[5] We appreciate the SEC's additional questions on how the Proposed Rule might be revised to balance the SEC's interest in additional reporting of large SBS positions with the significant operational burdens of the Proposed Rule in its original form. As suggested in ACLI's Original Comment Letter, the SEC should reassess and recalibrate the reporting threshold amounts to make sure they reflect the following points.

1. **The underlying securities to an SBS should not be reportable with the SBS position.** Should the SEC decide to impose public reporting of SBS, there is no market need or investor protection justification to support reporting requirements that are more onerous than those that apply to actual holdings of equity securities. Cash-settled security-based swaps do not grant any voting rights, dispositive rights, or control over the underlying issuer. It is not reasonable to subject an SBS to more onerous reporting obligations under the Proposed Rule than would be applicable if the investor held the underlying shares directly under current Section 13 reporting standards. Importantly, removing the requirement to report related securities would also ease some of the operational burden of the Proposed Rule.

[3] https://www.sec.gov/comments/s7-32-10/s73210-20120762-272942.pdf (A copy of which is appended at Appendix II.)
[4] Question 2(b) of Reopened Proposal.
[5] Question 2(e) of Reopened Proposal.

2. **The SEC should increase the notional reporting threshold for CDS and other debt SBS to a level that is more appropriately tailored relative to the risk posed by owning such a position.** The proposed reporting thresholds for CDS and other debt based SBS currently do not take into account the varied features of the reference entities and debt markets underlying those transactions. The threshold applicable to SBS with a reference security of an issuer of high-yield bonds with a smaller market capitalization should differ significantly from the threshold for the same SBS with a reference underlier issued by an investment grade company with a large market capitalization. The SEC should therefore consider higher thresholds for different categories of SBS underlier or reference entity.

3. **The SEC should not require life insurance companies to aggregate general account securities and SBS positions with securities or SBS held by entities managed by an investment adviser under common control with the insurance company.** The SEC's questions in 2(e) and 2(f) of the Reopened Proposal ask for feedback on the correct level of aggregation across entities for purposes of SBS reporting. As described in more detail in the ACLI Letter, we believe the most appropriate approach to aggregation for purposes of SBS reporting would be to follow the approach in place for Section 13 reporting. The SEC previously has provided guidance that attribution to the parent or other related entities may not be necessary for purposes of determining whether a filing threshold has been crossed and in computing the aggregate ownership of the parent or controlling person when voting and investment powers are exercised independently by the direct owner of the applicable securities as a result of the organizational structure in place. We believe the SEC is aware that life insurance subsidiaries cannot act in concert with one another or with the parent insurance company to cause the kinds of market disruptions the SEC is trying to prevent because they operate under separate investment guidelines and strategies that the investment adviser must follow. The ACLI members will incur significant costs to develop methods to cost-effectively aggregate SBS transactions and securities holdings information for entities that might use different trading and accounting systems and do not currently aggregate for Section 13 reporting.

   Furthermore, the SEC should explicitly allow entities under common control to disaggregate their SBS positions when the entities operate subject to appropriate information barriers, consistent with those explained in the SEC's Section 13 guidance. Allowing life insurance companies to depend on the procedures they currently employ for Section 13 compliance would dramatically lower operational expenses and the burdens of maintaining disparate reporting systems. In addition, life insurance companies and entities under their common control may risk losing the trust of those who share material non-public information if they have to breach information barriers to aggregate reporting for Schedule 10B. It could also require our member companies to lose the regulatory exemption currently applicable to independently controlled positions for other regulatory purposes.

   Disaggregation might also lead to Schedule 10B submissions that are more beneficial. The market would receive more precise disclosure through a disaggregated reporting approach about which entities truly built concentrated positions based on their investment strategy. On the other hand, disclosing aggregate positions at the life insurance parent company level, where those positions include holdings of independent business units or separate legal entities, such as mutual fund complexes managed by affiliated advisers, will create exaggerated and misleading impressions of concentrated risk. Such perceptions would likely cause broker-dealers to increase swap pricing unnecessarily or impose higher margin requirements, thereby reducing the efficiencies obtained from utilizing SBS to manage an insurer's risk. Limiting the availability of SBS on the market would have a negative impact on the overall liquidity of the swaps market.

III. Important Contextual Points

Finally, ACLI would also like to reiterate a few additional points from our March 21, 2022 comment letter.

1. The SEC could significantly reduce the operational expense associated with complying with Rule 10B-1 and reporting on Schedule 10B by extending the reporting deadline to match the deadlines for reporting of Securities under Section 13. We also continue to believe it is appropriate to allow a tiered approach to the reporting deadlines, with a longer reporting period for certain entities, like life insurance companies, as reflected in the different reporting timelines under Section 13D and Section 13G for securities reporting. We are aware that the SEC is currently engaged in rulemaking to modernize the reporting requirements for securities and we request that the SEC review the timeline for SBS reporting after those timeframes are established under the SEC's separate rulemaking proposal. The T+1 reporting timeframe places an enormous burden on large, complex organizations like life insurance companies and presents a unique derivatives-reporting scenario for buy-side participants in the swap markets.

2. The SEC should reconsider whether public disclosure of Schedule 10B information is necessary to achieve its goals, particularly in light of information already available to the public resulting from Section 13 and Regulation SBSR reporting. Regulators responsible for market liquidity and predictability should weigh the effects overly swift public disclosure will likely have on life insurers against the rare occasion when certain market participants attempt to manipulate the market in ways that would otherwise go undetected.

3. The SEC should remove sovereign debt from the scope of the proposed rules.

4. Should the SEC decide to enact SBS reporting rules, the SEC must provide an extended implementation deadline to allow market participants to build new processes and procedures for monitoring and reporting the novel data proposed in Schedule 10B.

Conclusion

We appreciate the SEC's decision to reopen the comment period on the Proposed Rule and to provide some additional data, as we requested in our original ACLI Letter and by other industry groups, as well. For the reasons described above, we think the data provide a significantly limited picture of the Proposed Rule's likely effects and we do not think the data support the use of both a notional and a market-capitalization threshold for equity SBS reporting. We also appreciate the SEC's openness to considering different approaches to aggregating positions across either or both of (1) SBS positions as well as related positions and (2) the relationships across legal entities holding SBS positions and/or related positions. As we described above and in the ACLI Letter, we continue to urge the SEC to harmonize the SBS reporting rule with the requirements for reporting securities under Section 13. Finally, we reiterate several suggestions from the ACLI Letter that remain central to our consideration of the Proposed Rule, including that the SEC: consider whether any SBS reporting must be made public, remove CDS from the reporting rule, and provide a significant implementation period upon adoption of any final rule, given the significant operational work that would be necessary for compliance.

Very truly yours,

Patrick Reeder
Deputy General Counsel

Kristin M. Abbott
Counsel

Appendix I

Background on Life Insurers' Use of Derivatives to Manage Asset and Liability Risks Associated With Products They Provide to Millions of Americans

Life insurers provide essential retirement and financial security to millions of customers through products such as life, long-term care and disability insurance and annuities. These obligations often have durations that last decades. Accordingly, in order to meet our commitments to policyholders, life insurers invest in a broad spectrum of assets, many of which are long dated, including government and corporate bonds, mortgage-backed securities, public and private equities, commercial real estate mortgages and alternative assets.

Because of the lengthy duration of our liabilities and the accompanying asset portfolios that support them, insurers are exposed to significant risks posed by changes in interest rates, currency exchange rates, equity market performance, and credit defaults, among others. Life insurers hedge the risks inherent in our assets and liabilities through the prudent use of derivatives, including SBS.

Life insurers typically use SBS to hedge our debt holdings. It is often common to use sovereign credit default swaps (CDS) – or CDS on foreign debt – as a hedge of foreign corporate debt or a macro hedge of insurance operations or other affiliated entities' operations in foreign countries. Standard, simple instruments for managing portfolio interest rate risk include Treasury futures, interest rate swaps and swaptions. It would be operationally inefficient to allocate hedges to specific assets because the notional amounts, exercise dates and other terms of the hedges differ from the investments. By excluding hedges of liability duration, the asset manager also avoids complex measurement and operational issues. Some life insurers sell SBS such as total return swaps or CDS while holding a cash instrument (such as a U.S. Treasury bond) of at least equal notional value to generate the desired risk exposure and terms of an asset it could otherwise invest in directly when that asset is not available on favorable terms (i.e., a Replication). As an additional example, life insurers issue fixed indexed annuity products that provide policyholders with principal protection on the downside while allowing them to participate in the upside of the underlying index. Certain indices used in these products may come under the definition of narrow-based indices and thus derivatives on them may be classified as SBS. Insurers purchase these SBS for hedging purposes to mitigate risks and stabilize their regulatory capital, thereby allowing them to offer related retirement products to millions of retirees.

In contrast to many other market participants in the SBS markets, life insurers are subject to state insurance laws and regulations that restrict life insurers' use of derivatives to hedging, asset replication, and limited income generation transactions. A recent National Association of Insurance Commissioners (NAIC) Special Report on insurers' derivatives usage indicates that life insurers mostly use derivatives for hedging – in fact, 95% of insurers' derivatives exposure at year-end 2018 was for hedging.[6]

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[6] A 2019 NAIC Capital Markets Special Report on the Insurance Industry's Derivatives Exposure at Year-End 2018 (the NAIC Special Report") indicated that the notional amount of insurers' derivatives holdings was $2.6 trillion. There were 298 insurance companies using derivatives, of which 219 were life insurance companies. Life insurance companies are the primary users of derivatives, with $2.5 trillion notional amount of 96.6% of the outstanding notional at year-end 2018.

State laws contain limitations on an insurer's derivatives exposure and combine counterparty swap exposure limits with other exposures to the same counterparty to manage concentration risk.[7] Furthermore, many state laws require life insurers to maintain comprehensive derivatives use plans which may be reviewed by the applicable regulator. Finally, all derivatives transactions (including terminated transactions) are publicly reported on a quarterly and annual basis on Schedule DB in life insurers' statutory financial statements. These long-standing regulatory mandates are designed to prevent financial and economic instability attributable to derivatives transactions.

[7] The National Association of Insurance Commissioners' (NAIC) *Derivatives Instruments Model Regulation*:

- Limits derivative transactions to hedging (with limited exceptions) and for prudent uses;
- Requires effectiveness testing to monitor uses over time;
- Requires internal control procedures;
- Establishes counterparty exposure limits and credit quality standards;
- Establishes documentation and trading requirements;
- Achieves transparency through statutory reporting (Schedule DB).

Appendix II

ACLI's Original Comment Letter
(Originally Submitted March 21, 2022)

21 March 2022

Via email to *rule-comments@sec.gov*

Vanessa A. Countryman, Secretary
Securities & Exchange Commission
100 F Street NE
Washington DC 20549-1090

RE: File # S7-32-10; 17 CFR Part 240; RIN 3235-AK77; 87 Fed. Reg. 6652: Prohibition Against Fraud, Manipulation…in Connection with Security-Based Swaps; Prohibition Against Undue Influence Over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions

Dear Secretary Countryman,

The American Council of Life Insurers (ACLI) appreciates the opportunity to comment upon two elements of the captioned proposals (the Proposed Rules), which address two provisions of the Exchange Act as follows:

- A new Rule 9j-1 intended to prevent fraud and manipulation; and
- A new Rule 10B-1 intended to require prompt public disclosure of certain security-based swap positions.

The ACLI is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States.

The ACLI contributes frequently to regulatory proposals and requests for information relating to life insurer use of swaps and derivatives. Life insurers are significant end-users of derivatives that enable the prudent management of asset and liability risks, as permitted under state insurance codes and regulations.

As highly regulated participants in the security-based swap (SBS) markets, with often long-dated and directional hedging positions, life insurers share the concerns of the Securities & Exchange Commission (SEC) for preserving healthy and stable SBS markets, and we are broadly supportive of the protection of market participants through SEC monitoring and surveillance. We are concerned that the T+1 public reporting regime in the Proposed Rules will be harmful to life insurers and other financial end-users. Life insurers are not strangers to delayed public reporting of our SBS positions; however, we are concerned that the Proposed Rules, as currently drafted, create unnecessary obstacles to our ability to use SBS for prudent risk management. For reasons elaborated more fully in the remainder of this letter, the ACLI urges the SEC to consider the following points as it works toward promulgation of final rules:

(1) The SEC should revise proposed Rule 9j-1(a) to explicitly recognize all affirmative defenses that apply in the securities anti-fraud context including, but not limited to, those available under Rule 10b5-1, in particular the use of information barriers; and to require scienter, rather than a negligence standard. Market participants like life insurance companies use SBS for hedging and replication purposes, not to manipulate the market or a particular securities issuer, and they employ compliance controls including, but not limited to, information barriers, as permitted under Rule 10b5-1, to appropriately manage any material non-public information (MNPI) in their possession.

(2) The SEC should take advantage of additional information that is just becoming available from Regulation SBSR to determine whether that reporting provides sufficient additional market surveillance to address the concerns expressed in this rulemaking proposal. If it determines that additional reporting is necessary, the data received under Regulation SBSR should be used to better calibrate the proposed SBS reporting thresholds and to rethink the cost-benefit analysis of that additional reporting.

(3) The SEC should re-examine the SBS reporting thresholds and methodology in Rule 10B-1 to align them with levels realistically indicating market manipulation, raising the thresholds for some types of SBS and eliminating the use of notional metrics altogether for equity SBS.

(4) The SEC could significantly reduce the operational expense associated with complying with Rule 10B-1 and reporting on Schedule 10B by extending the reporting deadline to match the deadlines for Section 13G reporting after those timeframes are established under a separate SEC rulemaking proposal. The T+1 reporting timeframe places an enormous burden on large, complex organizations like life insurance companies and presents a unique derivatives-reporting scenario for buy-side participants in the swap markets.

(5) The SEC should reconsider whether public disclosure of Schedule 10B information is necessary to achieve its goals, particularly in light of information already available to the public resulting from Section 13 and Regulation SBSR reporting. Regulators responsible for market liquidity and predictability should weigh the effects overly swift public disclosure will likely have on life insurers against the rare occasion when certain market participants attempt to manipulate the market in ways that would otherwise go undetected.

(6) The SEC should redefine the term “group of persons” to exclude the word “relationship” and to provide affirmative defenses or safe harbors to exclude from the “group” definition entities under the discretionary management of investment advisers under common control with a life insurance company and entities that trade SBS behind effective information barriers.

(7) The SEC should remove sovereign debt from the scope of the proposed rules.

Background on Life Insurers' Use of Derivatives to Manage Asset and Liability Risks Associated With Products They Provide to Millions of Americans

Life insurers provide essential retirement and financial security to millions of customers through products such as life, long-term care and disability insurance and annuities. These obligations often have durations that last decades. Accordingly, in order to meet our commitments to policyholders, life insurers invest in a broad spectrum of assets, many of which are long dated, including government and corporate bonds, mortgage-backed securities, public and private equities, commercial real estate mortgages and alternative assets.

Because of the lengthy duration of our liabilities and the accompanying asset portfolios that support them, insurers are exposed to significant risks posed by changes in interest rates, currency exchange rates, equity market performance, and credit defaults, among others. Life insurers hedge the risks inherent in our assets and liabilities through the prudent use of derivatives, including SBS.

Life insurers typically use SBS to hedge our debt holdings. It is often common to use sovereign credit default swaps (CDS) – or CDS on foreign debt – as a hedge of foreign corporate debt or a macro hedge of insurance operations or other affiliated entities' operations in foreign countries. Standard, simple instruments for managing portfolio interest rate risk include Treasury futures, interest rate swaps and swaptions. It would be operationally inefficient to allocate hedges to specific assets because the notional amounts, exercise dates and other terms of the hedges differ from the investments. By excluding hedges of liability duration, the asset manager also avoids complex measurement and operational issues. Some life insurers sell SBS such as total return swaps or CDS while holding a cash instrument (such as a U.S. Treasury bond) of at least equal notional value to generate the desired risk exposure and terms of an asset it could otherwise invest in directly when that asset is not available on favorable terms (i.e., a Replication). As an additional example, life insurers issue fixed indexed annuity products that provide policyholders with principal protection on the downside while allowing them to participate in the upside of the underlying index. Certain indices used in these products may come under the definition of narrow-based indices and thus derivatives on them may be classified as SBS. Insurers purchase these SBS for hedging purposes to mitigate risks and stabilize their regulatory capital, thereby allowing them to offer related retirement products to millions of retirees.

In contrast to many other market participants in the SBS markets, life insurers are subject to state insurance laws and regulations that restrict life insurers' use of derivatives to hedging, asset replication, and limited income generation transactions. A recent National Association of Insurance Commissioners (NAIC) Special Report on insurers' derivatives usage indicates that life insurers mostly use derivatives for hedging – in fact, 95% of insurers' derivatives exposure at year-end 2018 was for hedging.[8]

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[8] A 2019 NAIC Capital Markets Special Report on the Insurance Industry's Derivatives Exposure at Year-End 2018 (the NAIC Special Report") indicated that the notional amount of insurers' derivatives holdings was $2.6 trillion. There were 298 insurance companies using derivatives, of which 219 were life insurance companies. Life insurance companies are the primary users of derivatives, with $2.5 trillion notional amount of 96.6% of the outstanding notional at year-end 2018.

State laws contain limitations on an insurer's derivatives exposure and combine counterparty swap exposure limits with other exposures to the same counterparty to manage concentration risk.[9] Furthermore, many state laws require life insurers to maintain comprehensive derivatives use plans which may be reviewed by the applicable regulator. Finally, all derivatives transactions (including terminated transactions) are publicly reported on a quarterly and annual basis on Schedule DB in life insurers' statutory financial statements. These long-standing regulatory mandates are designed to prevent financial and economic instability attributable to derivatives transactions.

I. The SEC Should Revise Proposed Rule 9j-1(a) to Explicitly Recognize Defenses that Apply in the Securities Anti-fraud Context

A meaningful number of life insurers will be adversely affected if the Proposed Rules are adopted in their present form. Rule 10b5-1 is expressed to apply to insider trading cases brought under Section 10(b) of the Act and Rule 10b-5 thereunder, and so by its terms the affirmative defenses set out therein would not explicitly apply to Rule 9j-1(a) for SBS. Life insurers actively invest in both the public and private debt of corporate issuers.[10]

Typically, such a life insurer will have a public-side investment team that buys and sells the public-issue bonds of corporate issuers and a separate, private-side investment team that invests in private placement bonds of corporate issuers including issuers of publicly held bonds.[11] It thus happens that a life insurer may simultaneously own both the public and private debt of the same corporate issuer.

It is well-established in securities markets that information barriers may be used within firms to permit activities to occur that otherwise would not be permitted while possessing MNPI. This is recognized for the securities anti-fraud rule as one of the affirmative defenses set out in Rule 10b5-1. Specifically, Rule 10b5-1(c)(2) provides an affirmative defense for an individual making an investment decision on behalf of a legal entity to purchase or sell securities while the entity is in possession of MNPI, if that individual is not aware of the MNPI and the entity has reasonable policies and procedures in place. For example, a firm may enter into SBS transactions in a public side business, operated by individuals who are separated by appropriate information barriers from others working in the private side of the firm. Without recognition of an information barrier affirmative defense, the public side of the firm could be effectively prevented from trading SBS where individuals on the private side of the firm possess MNPI, even though the individuals on the public side are unaware of it.

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[9] The National Association of Insurance Commissioners' (NAIC) *Derivatives Instruments Model Regulation*:

- Limits derivative transactions to hedging (with limited exceptions) and for prudent uses;
- Requires effectiveness testing to monitor uses over time;
- Requires internal control procedures;
- Establishes counterparty exposure limits and credit quality standards;
- Establishes documentation and trading requirements;
- Achieves transparency through statutory reporting (Schedule DB).

[10] Life insurers as a class are the single largest investor in U.S. corporate debt. Life insurers provide the largest U.S. source of corporate bond financing, holding 23% of total U.S. corporate debt outstanding ($3.2 trillion at the end of 2020). In 2020, approximately 50% of life insurers' $8.2 trillion of total assets were held in bonds, divided between corporate bonds (39%) and government bonds (11%). Over 40% of bonds purchased by life insurers for their general accounts have maturities 20 years and greater at the time of purchase. Sources: ACLI tabulations of NAIC data (year-end 2020), used by permission; Federal Reserve Board, Z.1 *Financial Accounts of the United States, Third Quarter 2021*.

[11] For example, large utility companies (e.g., Southern Companies and Duke Energy) commonly have public bond issues and also borrow privately from life insurers.

One of the most relevant affirmative defenses for the SBS markets is likely to be the use of information barriers. However, we believe that all affirmative defenses set forth in Rule 10b5-1 should apply to SBS under Rule 9j-1(a), and it should be made clear that the affirmative defenses apply to all activities within scope of the SBS anti-fraud rule.

Insurers holding debt commonly hedge their exposures by means of CDS; hence, an insurer might simultaneously hold a corporate issuer's public bonds, private debt, and a CDS referencing the same issuer. As proposed, however, the Proposed Rules will disrupt unnecessarily well-established debt and hedging markets. Because the SEC has chosen a negligence standard for proposed 9j-1(a)(3) and (4) rather than the more typical standard requiring scienter in the context of fraud liability and, because the Proposed Rules do not incorporate the affirmative defenses under Rule 10b5-1, a life insurer operating in the normal course of business could be vulnerable to charges of fraud because of actions taken in connection with SBS based on imputation of the MNPI restricted to the private side of the business. The Proposed Rules, in effect, would make it impossible for an insurer to hedge its bond exposure with CDS confidently when the insurer also lends privately to the same corporate borrower. Any MNPI learned on the private side would taint the insurer's capability of hedging with CDS -- even though appropriate compliance controls between the public and private "cash" traders are accepted in the ordinary course of business.

The proposal of a negligence standard (rather than one of scienter) coupled with the omission of the affirmative defenses under Rule 10b5-1 could impact detrimentally other market participants that are involved in private credit markets and originations. Detrimental impacts could make credit less available to private companies, diminish insurance companies' ability to lend in these markets, adversely impact returns and adversely constrain availability and liquidity of SBS-based hedging tools.

Therefore, the SEC should require a scienter standard in connection with proposed rule 9j-1(a)(3) and (4) and explicitly recognize the affirmative defenses under Rule 10b5-1 for all activities in connection with SBS.

II. The SEC Should Adjust its Proposed Rule 10B-1 In Light of Additional Data, Fashioning a Rule More Tailored to its Stated Concerns Around Market Manipulation and Concentrated Exposures

The SEC Should Revisit This Rulemaking With the Benefit of Additional Data

Proposed Rule 10B-1 would require extensive new reporting requirements for users of SBS, based on the idea that such additional information could help market participants and regulators:

- Identify when a person or group of persons is building up a large SBS position which could be indicative of fraud or manipulation;
- Adjust risk management programs based on concentrated exposures that otherwise would not be apparent; and

- Obtain advance notice of any large CDS positions that might indicate a potential manufactured credit event or other opportunistic strategy.

While life insurers support reforms that increase market integrity and stability, the Proposed Rules would impose significant costs on life insurers, even though life insurers' SBS use is unlikely to raise any of the concerns at the heart of the SEC's rulemaking. Moreover, the Proposed Rules' estimates of costs and benefits fail to consider the costs imposed on market participants like life insurers that use SBS for prudent hedging, even though data inclusive of such groups is now becoming available to the SEC.

In addition, the reporting thresholds suggested by the SEC are poorly calibrated to achieve the SEC's goals, as they would require reporting of – in some cases – small positions unlikely to indicate either the buildup of large SBS position or concentrated, leveraged exposures. As a result, the Proposed Rules will have the unintended consequences of (1) generating such a large quantity of reporting that both regulators and other market participants will have difficulty separating the signal from the noise in the resulting data, while also (2) deterring market participants from using SBS to engage in legitimate hedging activity to avoid triggering a reporting obligation; and (3) imposing costly buildouts of monitoring and reporting functions with little benefit to either regulators or other market participants for institutions which continue to use SBS for prudent risk management purposes. For instance, some firms typically may be well under the reporting thresholds but, due to a desire to avoid the complex reporting build-out that would have to span multiple systems and investment managers, instead opt to avoid hedging credit using SBS. This would be an undesirable outcome of the Proposed Rules.

The Costs and Benefits of the Proposed Rules and the Reporting Thresholds Should Be Reconsidered Using Data Obtained From Regulation SBSR

In the commentary accompanying the Proposed Rules, the SEC notes that its proposed thresholds are based on information gathered from DTCC-TIW (in the case of CDS) and the N-PORT filings of certain registered investment funds. The cost-benefit analysis related to these thresholds also relies heavily on extrapolations from this limited data. These sources of data are deficient in at least two respects:

(1) While the DTCC-TIW data includes weekly CDS positions for all U.S. entities, or foreign counterparties to a U.S. entity, or foreign counterparties trading CDS referencing a U.S. underlying entity, the SEC does not have similarly rich data for non-CDS SBS and must therefore make inferences only loosely based on available data for those categories of SBS; and

(2) The use of N-PORT data excludes significant users of SBS, including insurance companies, whose use of SBS is not well represented by N-PORT filers.

We understand that regulators are often forced to use imperfect data when fashioning a regulation and estimating its benefits and costs. However, we note that the SEC's Regulation SBSR went into effect just last month. Regulation SBSR provides the SEC with extensive data on SBS as of late 2021, and Regulation SBSR's requirement for reporting historical positions will begin providing the

SEC even richer data on all categories of SBS starting in April of this year. While the SEC acknowledges its intention to “consider this newly available data in determining thresholds to use in connection with Security-Based Swap positions based on equity securities when adopting a final rule,” we urge the SEC to take additional time to digest the considerable data becoming available because of Regulation SBSR.

After considering the available SBSR data, the SEC should (1) reconsider whether additional reporting requirements for SBS are necessary and, (2) if it still believes additional reporting is required, reconsider the proposed thresholds for reporting all categories of SBS under this Proposed Rule based upon the data provided under Regulation SBSR. We also urge the SEC to update its cost-benefit analysis using this richer dataset and to resubmit its recommendations for further public comment.

CDS and Other Debt SBS Thresholds Should Be More Carefully Calibrated

The SEC has proposed reporting thresholds for CDS and other, debt based SBS that do not take into account the varied features of the reference entities and debt markets underlying those transactions. For most sovereign issuers and for many large companies with significant outstanding debt, a notional amount of $150 million (for CDS) or $300 million for other debt based SBS is not a reliable indicator that the reporting party’s position has become large enough to raise the concerns at the heart of the Proposed Rules. We urge the SEC to raise the reporting thresholds for these instruments significantly or, in the alternative, to make them more granular.

The SEC might consider higher thresholds for different categories of SBS underlier. For example, the threshold that might cause concern with respect to debt-based SBS issued by an investment grade company with a large market capitalization is likely to differ significantly from the threshold that would indicate the same for an issuer of high-yield bonds with a smaller market capitalization.

We urge the SEC to use the Regulation SBSR data to analyze these or other more targeted approaches to setting thresholds for non-equity SBS. We also request that any final proposal on thresholds be easy to understand and calculate in order to reduce the cost of monitoring and compliance. A revised proposal should be released for further comment from market participants before a final rule is adopted.

The threshold calculation for CDS requires the subtraction of long positions in deliverable debt obligations from long notional amounts of CDS. As recent market events have demonstrated, determining which debt obligations are deliverable in the event of a Credit Event under standard CDS documentation is not always straightforward.[12] We urge the SEC to provide specific guidance that debt obligations reasonably believed to be deliverable debt obligations may be netted from the long notional amount of CDS in making any threshold calculation.

The Notional Threshold for Equity SBS Should Be Removed

[12] The ISDA Credit Determinations Committee is often called upon to adjudicate which bonds are deliverable in the event of a Credit Event. As an example, the ISDA Credit Determinations Committee has recently had to consider deliverable Russian bonds.

The reporting thresholds proposed for equity SBS include a component based on notional amounts and a separate component based on the percentage of shares represented by the SBS position. The SEC should remove the notional threshold for equity SBS. As proposed, companies seeking to comply with any final rule will be required to monitor both the notional and percentage-based thresholds to ensure that they are reporting when they have exceeded the greater of the two, so any benefits of a bright-line notional threshold are vitiated by the monitoring required to comply with the percentage-based threshold.

In addition, given the wide range of equity issuer market capitalization, a notional-based threshold starting at $300 million will inevitably lead to filings for positions that represent a small fraction of the equity securities issues by companies with a large market capitalization. For example, 5% of the market capitalization of the smallest company in the S&P 500 is a multiple of the proposed notional-based threshold. Such reports will not further SEC goals of providing an early indication of market participants building up a large exposure that might indicate fraud or manipulation or provide useful information to market participants about possibly large exposures.

Hedging Positions Should be Excluded from Threshold Calculations

Throughout the Proposed Rules, the SEC animates its case for public reporting by referencing the risks posed by market participants engaged in SBS for the purpose of engaging in fraud or manipulation, gaining a significant position for purposes of creating a manufactured credit event or other opportunistic strategy without prior market knowledge, or creating a large, leveraged position across multiple dealers that would make it hard for dealers to manage risk in the absence of the fuller picture provided by public reporting. SBS positions entered into by life insurers for hedging purposes pose none of these risks and should be excluded from the thresholds used to test each category of SBS for reporting purposes.

While such insurance company hedging positions pose none of the risks described by the SEC, the public disclosure of such positions promptly after such positions are entered substantially increases the cost of hedging by requiring significant monitoring and reporting systems to be developed and maintained. It also will provide information to other market participants that could lead markets to move against life insurers executing a significant hedging program over a period of time.

The Timeframe for Filing Proposed Schedule 10B Is Impractical and Must Be Extended

Proposed Rule 10B-1 would require reporting persons to file a Schedule 10B report no later than the end of the first business day following the execution of the SBS transaction that triggers the reporting requirements. Disclosing large SBS position information on a T+1 basis, as proposed, would be significantly faster than disclosure required under other reporting frameworks, even considering the SEC's proposal to shorten reporting timeframes for Section 13 reporting. The SEC has not articulated a compelling regulatory need for the information on such an expedited basis.

To accomplish this reporting, ACLI member companies would have to track and report several types of positions in a variety of securities and other derivatives relating to the reportable SBS position, as laid out in proposed Schedule 10B. The proposed equity-based SB swap reporting threshold presents additional complexity, requiring position tracking in the securities underlying an SB swap, as well as the number of shares attributable to any derivative instruments based on the same class of securities.

This timeline presents particular challenges for life insurance companies, which are organized with many subsidiaries and may employ the services of multiple affiliated and unaffiliated investment managers. ACLI member companies face the need to conduct -- *on a daily basis* -- complex analyses to assess when a particular reporting threshold has been met with respect to any of its positions and whether they hold any related disclosable positions. These analyses involve calculations that must be made while the company and the entities under its common control may have trades in reportable securities pending settlement. In cases where multiple Schedule 10B filings may be required in the same 24-hour period, the insurance company faces an immense burden to complete these steps for each filing by the deadline. These calculations carry even more complexity if Proposed Rule 10B-1 does not allow for disaggregated reporting by independent business units, as discussed below. Companies do not typically receive investment holding data from unaffiliated investment managers daily, making it impossible to aggregate data at the level desired within the time frame in the proposed rule without substantial changes to their systems.

Contrary to the SEC's view, we consider Schedule 10B significantly more complicated than Section 13 reports, which simply require disclosure of whether a single equity security position threshold has been exceeded. The SEC wisely tailored Schedules 13D and 13G reporting requirements and deadlines to the reporting person's role in the market. Persons taking a position to influence control over an issuer report more frequently than passive investors like ACLI member companies. This approach allows life insurance companies and their subsidiaries to avoid the operational costs associated with frequent reporting.

In contrast, Proposed Rule 10B-1 applies its much shorter reporting timeline without regard for business strategies or how the reported positions relate to the behavior the SEC intends to address with this rulemaking. To better tailor Proposed Rule 10B-1 to achieve its objectives and mitigate undue costs, the SEC should modify Proposed Rule 10B-1 to provide the same reporting timelines for Schedule 10B with that Rule 13d-1 provides for Schedules 13D and 13G. This will enable all market participants, including life insurance companies, to implement a coordinated modification to their Section 13 reporting processes and leverage that process for Schedule 10B reporting. The outcome will provide the SEC with a range of reporting to enable it to more closely monitor market positions and activity that raise concerns.

We are mindful that, since the announcement of the Proposed Rules, the SEC has also released a proposal to change the filing deadlines for Section 13 reporting. Our member companies observe that their existing Section 13 processes will likely require modification once the SEC's proposed Section 13 reporting rule changes become final. We urge the SEC to delay its decision on the appropriate timing of Schedule 10B reporting until it finalizes any changes to Section 13 reporting intervals, and to allow a further chance for market participants to comment on the appropriate timeline for filing Schedule 10B until after the Section 13 reporting timelines have been finalized.

Proposed Rule 10B-1 Reports Should Not Be Publicly Reporting on a T+1 Basis

The SEC should revise the public reporting elements of Proposed Rule 10B-1 to consider the public reporting available about SBS transactions through Regulation SBSR and about securities holdings through Section 13. Proposed Rule 10B-1 would add significant burdens to life insurance companies without any clear justification by the SEC as to the deficiencies of existing reporting rules. It will require life insurance companies to disclose information about sensitive large SBS positions that identify the entity holding the position and other details. Such disclosures increase the likelihood of revealing proprietary risk management techniques to other market participants.

Dealers may not have adequate time before public disclosure to lay off the risks associated with SBS they enter with life insurance companies. The dealers may face parties who use the Schedule 10B information to increase the cost to the dealer to offset the exposure the dealer accepted in the SBS trade with the life insurance company. This in turn would increase the cost to the life insurance company of using SBS to hedge its own risk exposure.

In this manner, life insurers face greater risks of front-running and predatory trading practices, which would adversely impact their ability to utilize SBS in an economically viable manner. Entities under common control with life insurance companies may face worse trade execution in securities identified in Schedule 10B reports. To avoid these risks, life insurance companies, which are significant providers of market liquidity in the swap market, may limit their use of SBS, diminishing overall SBS market liquidity. The harms to market participants of disclosure on a T+1 basis would likely outweigh the benefits the SEC associates with the implementation of the Proposed Rules.

If the SEC nevertheless determines to publicly disclose Schedule 10B filings, we urge the SEC to lengthen the time delay for public disclosure to a minimum of ten business days. This interval would not interfere with the SEC's objectives in requiring this reporting. It would, however, ease the operational burden of monitoring and reporting and also forestall the effects of providing information to other market participants that could lead markets to move against life insurers executing a significant hedging program over a period of time.

Providing additional time to calculate SBS positions and submit a Schedule 10B filing would also reduce the likelihood of inaccurate or incomplete reporting and disclosure, and thereby reduce unnecessary reactions from other market participants in response. Further, aligning the reporting window for Schedule 10B to other reporting time frames will reduce the costs and time commitment necessary to prepare systems to generate reports about similar investments on multiple inconsistent time frames. ACLI believes that our proposal strikes an appropriate balance between supporting the SEC's regulatory oversight requirements and desire for public reporting without jeopardizing our use of SBS for prudent risk and portfolio management purposes or multiplying the costs of compliance.

In addition to a longer time delay for public disclosure, we encourage the SEC to consider measures adopted by the Commodity Futures Trading Commission (CFTC) for block trade reporting and real-time swap reporting that aid in making the information reported more anonymous.

The Timeline for Filing Amendments to Schedule 10B – and Their Public Disclosure – Should Also Be Reconsidered in Light of the Foregoing Arguments

For all the reasons described in the previous sections regarding the timing, contents, and public disclosure of Schedule 10B filings, we urge the SEC to reconsider the timing, contents, and potential public disclosure of any amendments to such filings.

Entities Filing Schedule 10B Should Not Be Required to Aggregate Across Information Barriers Within Legal Entities or To Include Separately Managed Accounts

We request that the SEC clarify the concept of "group of persons" to which Proposed Rule 10B-1 may apply for aggregation of SBS positions. The Proposed Rules would require a person (and any entity controlling, controlled by or under common control with such person), or group of persons who through any contract, arrangement, understanding ***or relationship*** (emphasis added) becomes the owner of an SBS position that exceeds the reporting thresholds to file a report on Schedule 10B. The Proposed Rules do not provide guidance on how to apply this group concept to a complex organization like a life insurance company, which involves many relationships among entities pursuing individual investment strategies. The ACLI believes the SEC can alleviate our concerns by explicitly creating safe harbors or affirmative defenses that reflect the way our member companies participate in the SBS and securities markets.

We ask the SEC to recognize and confirm that Proposed Rule 10B-1 does not require life insurance companies to aggregate general account securities and SBS positions with securities or SBS held by entities managed by an investment adviser under common control with the insurance company. We believe the SEC understands that such entities, operating under separate investment guidelines and strategies to which the investment adviser must adhere, cannot act in concert with each other or the insurance company to cause the sort of market disruptions the SEC is trying to eliminate. Without clarification from the SEC, the members of the ACLI will incur significant expense to build ways to efficiently aggregate SBS transactions and securities holdings information for entities that may use different trading and accounting systems and currently do not aggregate for Section 13 reporting.

Additionally, the SEC should explicitly allow entities under common control to disaggregate their SBS positions when the entities operate subject to appropriate information barriers, consistent with those enumerated in the SEC's Section 13 guidance. Following this approach would significantly reduce compliance costs by allowing life insurance companies to rely confidently on the processes they use for Section 13 purposes.

Crossing information barriers to aggregate reporting for Schedule 10B could result in life insurance companies and entities under their common control losing the confidence of those who share material non-public information with individuals or business teams with the expectation that the information cannot be shared. It could also require our member companies to lose the regulatory exemption currently applicable to independently controlled positions for other regulatory purposes like CFTC position limit calculation.

Disaggregation as described above could also result in more useful Schedule 10B filings. A disaggregated reporting approach would provide the market with more accurate disclosure as to which entities, for example, actually build concentrated positions based upon their investment strategies. Aggregating holdings across entities in a large group could inadvertently conceal the identity of entities building the concentrated positions.

We also believe that disclosing aggregate positions at the life insurance parent company level, where those positions include holdings of independent business units or separate legal entities managed by affiliated advisers, will create exaggerated and misleading impressions of concentrated risk. Such impressions would likely lead broker-dealers to increase swap pricing unnecessarily or impose higher margin requirements, thereby reducing the efficiencies gained from using SBS to manage an entity's risk. Constricting market availability of SBS would have a broad negative effect on overall swaps market liquidity.

Sovereign Debt Should Be Excluded

The Proposed Rules would include SBS on sovereign debt. We respectfully suggest that in this case the burdens of compliance outweigh the potential dangers that the SEC seeks to address, i.e., manufactured credit events and other abuses.

Life insurers make large investments in sovereign debt as means of obtaining relatively risk-free returns. In addition, insurers with foreign operations have significant exposures to some non-U.S. economies because of their insurance affiliates or other businesses in those countries. In both cases, insurers use SBS and particularly sovereign-denominated CDS to hedge their portfolios and business risks.

As a practical matter, it seems unlikely that *any* holders of SBS on sovereign debt would possess the leverage necessary to manufacture credit events related to a country's sovereign debt. It is noteworthy in this context that SEC rules requiring the reporting of large and concentrated positions, like Section 13D, do not encompass sovereign debt holdings.

More particularly, life insurers who hold sovereign debt and corresponding SBS or CDS are even more unlikely to engage in speculative efforts to leverage their SBS in order to reap windfall profits by means of manufactured credit events. In fact, because insurers are constrained by state law to only hedging and replication transactions, when it comes to their derivatives referencing sovereign (and for that matter, every) debt holdings, it would likely violate state insurance law for insurers to engage in the speculative and abusive conduct the Proposed Rules are aimed to prohibit.

In these circumstances it would not be unreasonable to completely exclude insurers' SBS on sovereign debt from both the conduct and reporting arms of the Proposed Rules. At the very least, it should be excluded from the reporting requirements. It should suffice that insurers' conduct remains subject to the general anti-fraud principles, including Rule 10b-5.

The SEC Must Provide an Extended Implementation Deadline To Allow Market Participants to Build New Processes and Procedures for Monitoring and Reporting The Novel Data Proposed in Schedule 10B

The information requested in Schedule 10B is not currently tracked by life insurers in the manner requested by the SEC. In order to build the processes and procedures for tracking and reporting required by any final rule, the SEC must provide ample time for life insurers and other market participants to build such processes and procedures.

Thank you for your consideration.

Sincerely,

THE AMERICAN COUNCIL OF LIFE INSURERS

Michael Lovendusky
Vice President & Senior Associate General Counsel
Telephone [redacted]