Royal Bank of Canada

3 World Financial Center
200 Vesey Street
New York, NY 10281-8098
Telephone: (212) 428-6200

September 26, 2011

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, DC 20581

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release No. 34-65153; File No. S7-32-11 – CFTC and SEC Request for Comment Regarding the Study of Stable Value Contracts

Dear Mr. Stawick and Ms. Murphy:

Royal Bank of Canada ("RBC") appreciates the opportunity to comment on the CFTC and SEC questions regarding the study of stable value contracts ("SVCs") mandated by Section 719(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). We hope that our response to the questions set forth below will assist the CFTC and SEC (the "Commissions") with their study.

RBC has sought to provide thorough and detailed responses to the questions posed by the Commissions, supported by data, wherever possible. But, given the relatively brief length of the comment period and the breadth of the information requested in the questions posed, we recognize that it is critical that the Commissions receive and review a complete body of information in order to complete their study. To that end, should the Commissions' staff wish to discuss any of the responses or supporting data contained below, RBC would welcome that opportunity.

The Stable Value Investment Association ("SVIA") is also submitting comments in response to the Request for Comment (the "SVIA Response"). RBC has participated in and supports the SVIA Response, which further details why SVCs are not swaps and why it is in the public interest to ensure that SVCs are not subject to swap regulation.

RBC has reviewed and responded to the questions posed in the Commissions' Request for Comment. Set forth below is an executive summary of the key issues discussed in our response. The detailed responses that follow generally conform to the question-and-answer format of the Request for Comment and we have noted the questions to which we respond. Where appropriate, we have grouped questions and provided a single, comprehensive response.

I. EXECUTIVE SUMMARY

Stable value products are an important capital preservation option for individuals that are invested in employer-sponsored, tax-deferred retirement savings plans ("ETRS Plans"),[1] and an invaluable tool for investment fund managers. Stable value funds ("SVFs") performed extremely well throughout the 2008 and 2009 financial crisis and in the period since, as did related SVCs,[2] both conveying substantial benefits to ETRS Plan participants. While RBC understands and supports the goals articulated by the Act related to strengthening the operation and integrity of swaps markets through increased efficiency and transparency, for the reasons stated below, RBC believes that application of the swaps regime set forth in Title VII of the Act ("Title VII") to stable value products would not be consistent with these goals.

- **SVCs are not "swaps."**[3] While SVCs do involve the transfer of financial risks between the

[1] ETRS Plans include employer-sponsored defined contribution plans qualified under Internal Revenue Code Section 401(a) and other tax-qualified retirement arrangements.

[2] RBC's responses and observations throughout this paper, unless otherwise indicated, relate specifically to SVCs issued by banking institutions.

[3] For purposes of the RBC response, the term "swap" as used in the response shall generally refer to the definition of "swap" in Section 721(a)(21) of the Dodd-Frank Act, which defines "swap" to include the following instruments (with certain exceptions): any agreement, contract, or transaction—

(i) that is a put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind;

(ii) that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence;

(iii) that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so transferred, including any agreement, contract, or transaction commonly known as—

(I) an interest rate swap;
(II) a rate floor;

counterparties to the transaction,[4] they do not fall within the definition of swaps. Specifically, SVCs differ meaningfully from swaps in numerous ways:

- SVCs are individually tailored, negotiated agreements that are not a "traded" product. There is no secondary market for SVCs, nor could one be created.

- SVCs are not fungible and not suitable for clearing. SVCs do not involve the counterparty credit risk associated with swaps, and rely on each party to the SVC to perform its specific obligations under the agreement.

- SVCs do not rely on an underlying reference asset and, unlike swaps, are not priced based on a reference asset, index or similar financial instruments in the manner of

---

(III) a rate cap;
(IV) a rate collar;
(V) a cross-currency rate swap;
(VI) a basis swap;
(VII) a currency swap;
(VIII) a foreign exchange swap;
(IX) a total return swap;
(X) an equity index swap;
(XI) an equity swap;
(XII) a debt index swap;
(XIII) a debt swap;
(XIV) a credit spread;
(XV) a credit default swap;
(XVI) a credit swap;
(XVII) a weather swap;
(XVIII) an energy swap;
(XIX) a metal swap;
(XX) an agricultural swap;
(XXI) an emissions swap; and
(XXII) a commodity swap;

(iv) that is an agreement, contract, or transaction that is, or in the future becomes, commonly known to the trade as a swap;

(v) including any security-based swap agreement which meets the definition of 'swap agreement' as defined in section 206A of the Gramm- Leach-Bliley Act (15 U.S.C. 78c note) of which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein; or

(vi) that is any combination or permutation of, or option on, any agreement, contract, or transaction described in any of clauses (i) through (v).

[4] It is noteworthy that SVCs do not represent the transfer of risk (either in the form of credit risk or price movement between the time of transaction and payment) between the ultimate beneficiaries of the contract in the manner that swaps transactions do. The primary beneficiary of an SVC is the ETRS Plan participant, who can be assured that he will receive the full value of his principal and accumulated earnings at the time he redeems his investment.

most swap transactions.

- SVCs cannot be used for speculation or arbitrage. Neither party to an SVC can automatically or unilaterally compel the SVC issuer to make payments based on the difference between the market value and book value of the high quality, diversified fixed income portfolio (the "Covered Assets").

- **Public policy dictates that SVCs should not be treated as swaps.** If the Commissions determine to include SVCs in the definition of swap, SVCs and stable value products should be exempted from the application of the Title VII rules on numerous public policy grounds, including the preservation of a viable principal preservation investment alternative for ETRS Plan participants.

  - Application of the Title VII swaps regime to the SVC marketplace could threaten the ongoing viability of the product. This unintended consequence would not only fail to add to the market's efficiency and transparency, but rather could have a materially detrimental impact on ETRS Plan participants who rely on these investments. Stable value products provide ETRS Plan participants with an investment option that is generally not available as part of other investment choices within ETRS Plans. Duplicative and potentially conflicting regulation could disrupt the stability and viability of stable value products currently relied upon by ETRS Plan participants.

- **SVCs are robustly and comprehensively regulated, and were never intended to be subject to the Title VII regime.** Based on the well-developed legislative record which surrounds Title VII specifically, and derivatives reform more broadly in the United States, SVCs inherently are not the sort of contract that was intended to be covered by the Title VII rules. SVCs and the institutions that issue them are already subject to comprehensive and affirmative regulatory requirements. SVCs have not been shown to contribute to the systemic risk of the firms that enter into the SVCs and are not and cannot be traded on a speculative basis. Further, SVCs are neither standardized nor are they capable of being standardized, and are documented through individually, highly-negotiated contracts based on the characteristics of the underlying ETRS Plan, and are not the subject of counterparty credit provisions that might benefit from third-party clearing.

II. DESCRIPTION OF RBC BUSINESS

RBC began offering SVCs in early 2003 to further its goals of achieving a certain risk/return profile, providing an important product to the ETRS Plan marketplace, and serving relationships with asset managers and ETRS Plan sponsors. Since that time, the RBC SVC book of business has grown to approximately $11 billion in contract value.

RBC considers its SVC product to have been a success for both ETRS Plan participants and for RBC. ETRS Plan participants have benefitted from substantial investment stability marked by both principal preservation and premium rates of return when compared to other forms of capital preservation investments. For RBC, offering SVCs provides a consistent revenue stream and a predictable risk profile in support of many of our important clients. Even during the recent financial crisis, the RBC book of SVC business performed well, providing a safe haven for ETRS Plan participants in a time of uncertainty and a manageable risk profile for RBC. Since the start of our participation in the SVC market, RBC has never exercised any contract provision relieving it of its obligation to pay book value to ETRS Plan participants.

III. DISCUSSION

Swap Definitional and Exemptive Issues

Question 1. Do SVCs possess characteristics that would cause them to fall within the definition of a swap? If so, please describe those characteristics.

Question 2. What characteristics, if any, distinguish SVCs from swaps?

RBC believes that SVCs do not fall within the definition of a swap. Although SVCs do involve the transfer of financial risks between counterparties, SVCs are structurally and economically distinct from swap transactions, not capable of standardization, do not "trade" in a manner that is consistent with swaps, and, as a function of their provisions, are not suitable for clearing.

RBC understands and supports the goals articulated by the Act related to strengthening the operation and integrity of swaps markets through increased efficiency and transparency. However, an application of the mandatory clearing and exchange trading requirements proposed under Title VII of the Act would not, by including SVCs within the definition of a "swap," be consistent with those stated goals, since such a result would serve to disrupt existing, well-functioning bilateral agreements which were not intended to be captured within the Title VII regime.[5] Fundamentally,

---

[5] See Appendix A for the detailed legislative record with respect to stable value and the Act.
Further, Section 719(d) of the Dodd-Frank Act provides as follows:

SVCs are designed to provide ETRS Plan participants with the ability to transact at book value, in contrast with a swap whose value is derived from and is designed to be traded in response to changes in the price of the underlying reference asset or assets.

A. SVCs are Structurally and Economically Distinct From Swaps

Unlike swaps, SVCs are entered into for the benefit of ETRS Plan participants, rather than the counterparties to the SVC. SVCs are not speculative contracts that can be separately traded in response to changes in the value of the Covered Assets, nor are they based on a set of standardized provisions.

SVCs are intended primarily to provide book value assurance to all ETRS Plan participants invested in the SVF. In this sense, although the individual ETRS Plan participants do enjoy book value protection along with all of the SVF investors, the protection afforded by the SVC in the form of the SVC provider's payment obligation is linked to the withdrawal behavior of the ETRS Plan participants – not to changes in the value of the Covered Assets or to the SVC issuer. In contrast, payment obligations arising under swap transactions are normally based on the agreed-upon

---

(d) STABLE VALUE CONTRACTS.—

(1) DETERMINATION.—

(A) STATUS.—Not later than 15 months after the date of the enactment of this Act, the Securities and Exchange Commission and the Commodity Futures Trading Commission shall, jointly, conduct a study to determine whether stable value contracts fall within the definition of a swap. In making the determination required under this subparagraph, the Commissions jointly shall consult with the Department of Labor, the Department of the Treasury, and the State entities that regulate the issuers of stable value contracts.

(B) REGULATIONS.—If the Commissions determine that stable value contracts fall within the definition of a swap, the Commissions jointly shall determine if an exemption for stable value contracts from the definition of swap is appropriate and in the public interest.

The Commissions shall issue regulations implementing the determinations required under this paragraph. Until the effective date of such regulations, and notwithstanding any other provision of this title, the requirements of this title shall not apply to stable value contracts.

(C) LEGAL CERTAINTY.—Stable value contracts in effect prior to the effective date of the regulations described in subparagraph (B) shall not be considered swaps.

(2) DEFINITION.—For purposes of this subsection, the term "stable value contract" means any contract, agreement, or transaction that provides a crediting interest rate and guaranty or financial assurance of liquidity at contract or book value prior to maturity offered by a bank, insurance company, or other State or federally regulated financial institution for the benefit of any individual or commingled fund available as an investment in an employee benefit plan (as defined in section 3(3) of the Employee Retirement Income Security Act of 1974, including plans described in section 3(32) of such Act) subject to participant direction, an eligible deferred compensation plan (as defined in section 457(b) of the Internal Revenue Code of 1986) that is maintained by an eligible employer described in section 457(e)(1)(A) of such Code, an arrangement described in section 403(b) of such Code, or a qualified tuition program (as defined in section 529 of such Code).

exchange of a fixed price payment for a future payment to be determined based on an observable reference price (or related calculation), and are established at the time of the transaction.

SVCs provide book value protection to ETRS Plan participants when the market value of the Covered Assets is insufficient to return principal and accumulated earnings. The SVC obligation arises as a function of the ETRS Plan participants' withdrawal decisions related to their retirement savings. In this sense, SVCs materially differ from swaps, as swap obligations and valuations are determined based on the change in value of the referenced asset, index or other similar financial instrument.

SVC provisions are not capable of standardization in the same manner as swaps provisions. SVCs are individually tailored to the demographics of the relevant ETRS Plan participants and the characteristics of the relevant ETRS Plan. Each SVC is the result of a detailed negotiation between the counterparties to the transaction, who agree based on terms that result from a detailed assessment of the associated SVFs strategy and characteristics of the ETRS Plan. Components taken into consideration include the cash flow history,[6] the demographics of the ETRS Plan participants, the other types of investments offered by the ETRS Plan, the individual profile of the ETRS Plan sponsor as well as the SVF's investment strategy. Based on those and other factors, the parties enter into a customized contract that reflects agreed-upon terms, including the manner in which the individual transaction may be terminated, which is normally limited to specific situations relating to subscription in the SVF. This customized documentation makes SVCs distinct even from the standardized option contracts that fall within the Commissions' proposed swap definition under Title VII. Given the nature of the varying demographics and tailored characteristics of the ETRS Plans at issue, such provisions are not capable of standardization in the manner that provisions related to swaps are.

B. SVCs Are Not Traded Products, Cannot Be Cleared, and Are Not Suitable for Margin Treatment

SVCs are not "traded" in the manner that the swaps transactions contemplated by Title VII are, and do not exhibit the optionality and price volatility traditionally associated with swaps. Further, the nature of SVCs is such that they cannot be cleared and are unsuitable for margin treatment. Subjecting SVCs to additional regulation under Title VII would be costly and would likely not provide any of the benefits contemplated by the Act.

As discussed above, SVCs are individually negotiated, bilateral agreements between an SVC provider and SVF manager that are specifically structured to meet the needs of the manager and the ETRS Plan participants. Each SVC is the product of a lengthy underwriting process, the terms of which

[6] The cash flow history of the ETRS Plan refers to participant's withdrawal, contribution and re-allocation history.

are unique to the ETRS Plan offering the SVF. This lack of standardized substantive terms (e.g., the underlying Covered Assets with respect to a particular SVC and SVF would vary depending on the age and demographic profile of the associated ETRS Plan participants) as among SVCs, including even between different SVCs entered into to support the same SVF, renders SVCs unsuitable for trading on an exchange or other platform. Further, there is no existing bilateral trading market for SVCs, which are fee-based agreements, in contrast to typical swap transactions, which involve the payment of a fixed amount in exchange for a "floating" or fluctuating price, determined based on the future settlement price of a given interest rate, currency or commodity.

In contrast, swap transactions are normally undertaken pursuant to the International Swaps & Derivatives Association (ISDA) Master Agreement, and associated Credit Support Addendum, and are then transacted by way of individual transaction confirmations. The market risk arising from entering into a swap transaction can generally be largely, sometimes completely, offset by entering into other transactions, frequently other swaps. This renders swaps capable of centralized clearing and standardized execution and exchange trading in a manner contemplated by Title VII.

In the context of swaps transactions, margin or other collateral is required to protect the counterparties to the transaction against price fluctuations in the reference price of the swap or a credit event of one of the counterparties to the transaction. This concept has no application to SVCs, because both the fee charged by the provider and the potential payment obligation of the provider are tied to withdrawal events at a time when the market value of the Covered Assets is below book value. Given the lack of a single underlying reference asset, assessing traditional swap margin on SVCs would be impossible to calculate. Such a requirement, however calculated, would materially add to the costs incurred by SVF managers related to the agreement, without providing any benefit to either party.

Given the nature of the market for SVCs, in which SVF managers and SVC providers transact bilaterally after lengthy negotiation, it is extremely unlikely that the sort of immediate, intra-day "bid-offer" market contemplated by the Title VII regime would develop by designating SVCs as swaps, nor is RBC aware of any market participant indicating that the efficiency or transparency associated with SVCs would benefit from such development. Further, it is the increasingly standardized nature of swaps transactions and the ability to contract with multiple counterparties on substantially similar terms that provide a significant basis for the application of the mandatory clearing requirements of Title VII to swaps. These distinct characteristics underscore the significant differences between swaps and SVCs.

In addition, the Congressional intent underlying the Act's clearing requirement is founded on reducing or eliminating bilateral credit risk by clearing transactions through a central clearinghouse, thereby shifting the risk of the transaction from the original party to the clearinghouse. However, the entire premise of an SVC is based on the fact that it is a customized product that provides for a specific allocation of risk throughout the life of the SVC. An SVC cannot operate consistent with its original purpose and intent if a central clearinghouse replaces an SVC provider or SVF manager as a counterparty to the SVC. It is not possible to negotiate a contract customized to the characteristics of the relevant ETRS Plan with a third-party clearinghouse that has no knowledge of the characteristics of the relevant ETRS Plan. An SVC is intended to provide for a specific allocation of risk based on the characteristics of the relevant ETRS Plan, with the SVC provider retaining its allocation throughout the life of the contract and with the SVF manager complying with its specific obligations under provisions governing investment guidelines and liquidity maintenance similarly for the life of the contract. The interposition of a central clearinghouse would be inconsistent with this intent.

Question 3. Does the definition of the term "stable value contract" in Section 719(d)(2) of the Dodd-Frank Act encompass all of the products commonly known as SVCs?

RBC believes that the definition as articulated in the Act is sufficient to encompass all forms of SVCs.

Question 4. Are the proposed rules and the interpretive guidance set forth in the Product Definitions Proposing Release useful, appropriate, and sufficient for persons to consider when evaluating whether SVCs fall within the definition of a swap? If not, why not? Would SVCs satisfy the test for insurance provided in the Product Definitions Proposing Release? Why or why not? Is additional guidance necessary with regard to SVCs in this context? If so, what further guidance would be appropriate?

RBC believes that the definition as drafted is sufficiently broad and encompasses all products currently known as "Stable Value Contracts." We do, however, suggest that a mechanism be in place to add to or amend the current list of SVCs to keep pace with any material changes in tax legislation or ERISA that could apply to SVCs as contemplated herein.

Question 5. If the Commissions were to determine that SVCs fall within the definition of a swap, what would be their underlying reference asset?

This question reinforces RBC's belief that it is inappropriate to include SVCs in the definition of "swap" as contemplated in the Act as it highlights the fact that SVCs are not based on any underlying reference asset. The portfolio of Covered Assets is not an "underlying reference asset" in the manner that a particular interest rate or price of a given commodity provides a reference price to a swap transaction. Rather, SVCs and the book value assurance provided by SVCs arise in response to ETRS Plan participants' behavior with respect to withdrawals and not in response to changes in the value of a underlying or referenced asset, index or similar financial instrument.

Question 6. If the Commissions were to determine that SVCs fall within the definition of a swap, what facts and considerations, policy and otherwise, would support exempting SVCs from the definition of a swap? What facts and considerations, policy and otherwise, would not support exempting SVCs from the definition of a swap?

To the extent that the Commissions determine that SVCs fall within the definition of a swap, there are important reasons why the Commissions should exempt SVCs from the definition of a swap:

- SVFs that rely on SVCs are unique investment options that offer ETRS Plans participants principal safety[7] combined with competitive rates of return. SVFs have delivered remarkable stability in the period prior to and since the fiscal crisis, preserving meaningful retirement savings for ETRS Plan participants.

- SVCs, SVC issuers and SVFs are already subject to comprehensive regulation,[8] and will be subject to further scrutiny as a result of the implementation of other provisions of the Act as well as increased global regulatory requirements pursuant to Basel II[9] and Basel III.[10]

- The fundamental characteristics of SVCs render them unsuitable for the application of the Title VII regime, which could threaten the future viability of SVCs as a product offering. The ability of SVC issuers to continue to offer SVCs could be materially compromised without an exemption from the swap definition or an exclusion on public policy grounds.

- SVCs are not contracts that are used for speculation, nor do they introduce financial leverage or increase systemic risk. There is substantial evidence in the legislative record[11] that the drafters of the Act appreciated the unique nature of SVCs and did not intend that they be covered by the Title VII requirements.

- SVCs could be materially affected by the potential impact of other regulatory initiatives, including the ongoing review by the Department of Labor ("DOL") related to the definition of a "fiduciary" under ERISA, and the application of Basel III to money market funds. In

---

[7] SVFs are designed to protect principal, but are not principal guarantees.

[8] Specifically, both SVFs and SVCs are subject to regulation pursuant to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), the purpose of which is to provide protection to ETRS Plan participants.

[9] Basel Committee on Banking Supervision, "International Convergence of Capital Measurement and Capital Standards, A Revised Framework, June 2004.

[10] Bank for International Settlements, "Basel III: A global regulatory framework for more resilient banks and banking systems," December 2010 (rev June 2011).

[11] See Appendix A for the detailed legislative record with respect to stable value and the Act.

order for the SVC market to remain viable, it is crucial that a single, practical regulatory regime result from the rulemaking processes proceeding in parallel as between the Commissions and the DOL, and that the Commissions consider the effect of all regulation on ETRS Plan investment options, viewed as a whole. In the event that conflicting or overlapping regulation renders the provision of SVC agreements functionally impermissible or commercially impracticable, an important capital protection mechanism for affected ETRS Plans could cease to exist. In this regard, RBC greatly appreciates the efforts of the Commissions to coordinate their deliberations with the DOL in the conduct of this study.

A. Stable Value Products are Significant, Unique and Stable Investment Options

SVFs are designed to preserve capital and offer a yield in excess of money market funds.[12] Approximately half of all ETRS Plans that are subject to Code Section 401(k) ("401(k) Plans") offer SVFs as an investment choice for their participants and approximately 15% of all 401(k) Plan assets are currently invested in SVFs.[13] SVFs assist ETRS Plan sponsors with providing participants an increased range of lower volatility cash management options in their plan retirement asset allocation.

SVFs generally performed better than comparable options during the recent financial crisis. 401(k) Plan participants who defaulted into target-date fund qualified default investment alternatives during the financial crisis may have emerged from the financial crisis with less than what they had contributed.[14] During 2008, SVFs delivered an average return of 4.7% compared with an average loss of 23% for target-date funds designed for individuals retiring in 2010.[15]

B. SVCs, SVC issuers and SVFs are Subject to Robust, Comprehensive Regulation; Additional Regulation Would Produce No Appreciable Benefit

Bank-provided SVCs are subject to comprehensive regulatory and capitalization regimes under significant risk-based and capital requirements of Basel I,[16] Basel II and Basel III, and SVC providers

---

[12] Babbel, David F. and Herce, Miguel, Stable Value Funds: Performance to Date (January 1, 2011). This study analyzed the returns of stable value funds from 1989 to 2008. The study found that stable value funds delivered higher returns of 6.3% annually with lower volatility than their most common alternatives, intermediate-term investment-grade bond funds, which returned 5.6%, and money market funds, which returned 4.1%.

[13] "401(k) Plan Asset, Allocation Account, Balance, and Loan Activity in 2008," Investment Company Institute Research Perspective, October 2009, Vol 15, No.3.

[14] The consequences of losses inside tax-deferred vehicles are magnified by their inability to offset losses with taxable gains. This tax consideration further highlights the importance of having a principal preservation investment alternative inside ETRS Plans.

[15] Pension and Investments Online, "The case for stable value fund QDIA," Christine C. Marcks, October 5, 2009.

[16] Basel Committee on Banking Supervision, "International Convergence of Capital Measurement and Capital Standards" Basle, July 1988.

like RBC must comply with the supervisory and oversight requirements imposed by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation.

ETRS Plans that offer SVFs as investment options to ETRS Plan participants are comprehensively regulated by ERISA. The principal purpose of ERISA is "*to protect ... the interests of participants in employee benefit plans ... by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies ... and ready access to the Federal courts.*"[17] ERISA also imposes important transparency obligations and fiduciary obligations on fund managers, who are obligated to provide detailed information regarding the composition of and associated risks related to the ETRS Plan.

While the bank regulatory and ERISA regimes do not impose requirements that are identical to the specific transparency requirements imposed on entities such as Swap Dealers[18] under the Title VII regime, they do serve much of the same purpose as the transaction reporting requirements imposed by the Act. The addition of a duplicative and potentially conflicting layer of regulation to SVCs through the application of the Title VII regime would not serve to improve the protections offered to ETRS Plan participants and could materially hamper the availability of these products.

C. Application of the Title VII Regime Could Threaten the Viability of Stable Value as a Product Offering

RBC believes that regulation of SVCs under Title VII could jeopardize the availability of SVFs to ETRS Plan participants as a result of unintended adverse consequences to stable value products. As detailed in our answer to Question 7 below, the requirements of the proposed "Business Conduct" regulations promulgated under the Act[19] could be prohibitively burdensome to SVC issuers. Further, the interaction of potential DOL regulations and the Business Conduct regulations could render SVCs legally prohibited.

D. SVCs are not Contracts that are Used for Speculation, nor do they Introduce Financial Leverage or Increase Systemic Risk

As detailed above in our answers to Question 1 and 2, SVCs are not by their nature speculative, nor

---

[17] ERISA Section 2(b).

[18] Based on the Entity Definitions as currently proposed by the Commissions, RBC anticipates that it will be considered a "Swap Dealer" and will be required to register either on its own behalf or on behalf of one if its related entities in order to comply with the requirements of Title VII, and of the Act more broadly.

[19] Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR 42396 (July 18, 2011).

can they be used for arbitrage purposes. ETRS Plan participants invested in SVFs cannot engage in trading with respect to the SVF or Covered Assets that would introduce systemic risk. Nor do SVC providers introduce systemic risk; SVC providers are not susceptible to credit cyclicality risks, nor does the nature of the SVC market pose any systemic risk concerns. As further explained below, there is generally a negative correlation between credit cyclicality and financial distress of SVC providers.

E. The Commissions Should Consider the Potential Impact of other Regulatory Initiatives

As described below, potential DOL regulations could have an adverse impact on the viability of SVCs. Further, as set forth in Appendix B, RBC believes that the requirements of Basel III could adversely affect the viability of money market funds. If the availability of SVFs *and* money market funds to ETRS Plan participants becomes limited, ETRS Plan participants could potentially be without a meaningful capital preservation option with respect to their retirement funds.

Question 7. If the Commissions were to (a) determine that SVCs fall within the definition of a swap but provide an exemption from the definition of a swap, (b) determine that SVCs fall within the definition of a swap and not provide an exemption from such definition, or (c) determine that such contracts are not swaps, what beneficial or adverse regulatory or legal consequences, if any, could result? For example, could any of such determinations lead to beneficial or adverse treatment under the Employee Retirement Income Security Act ("ERISA"), bankruptcy law, tax law, or accounting standards, as compared to the regulatory regimes applicable to SVCs, in the event that the Commissions were to determine that SVCs are not swaps or grant an exemption from the definition of a swap?

RBC believes the following to be the likely outcome based on the scenarios posited by the Commissions:

- If the Commissions determine that SVCs are deemed to be swaps, but provide an exemption from Dodd-Frank requirements, RBC may be able to continue to offer SVCs to SVFs, depending on whether SVCs are exempted from the Business Conduct regulations described below, which regulations may, depending on the content of potential DOL regulations, prohibit ETRS Plans from entering into swaps.

- If the Commissions determine that SVCs are deemed to be swaps and provide no exemption, in addition to the potential effect of the Business Conduct Rules and the potential DOL regulations, the marketplace for SVCs would be severely challenged by the prospect of adhering to a set of rules that are impracticable and would obviate the basis on which the SVC product is founded. In the event the Commissions do not provide an exemption for SVCs, RBC expects that it will have to put on hold the issuance of any new SVC while it examines the evolving application of the Title VII requirements. RBC expects that it is likely that the challenges associated with compliance with Title VII will be so significant for SVC providers, and for their counterparties, as to render SVCs non-viable.

- If the Commissions were to determine that SVCs should not be deemed to be swaps as defined in the Act, RBC will be able to continue to offer SVCs to the marketplace. Importantly, RBC will continue to be comprehensively overseen by the regulatory agencies identified above, and the RBC SVCs will continue to be subject to the robust capital requirements and other relevant provisions imposed by those regulations.

A. SVCs May be Prohibited as a Result of the Effect of Potential DOL Regulations and Business Conduct Regulations

Pursuant to rules issued under ERISA, ETRS Plans are prohibited under ERISA from transacting with fiduciaries[20] to ETRS Plans. Consequently, if SVCs are designated as swaps, ETRS Plans may be precluded from entering into SVCs because the SVC counterparty could be effectively treated as an ERISA fiduciary to the ETRS Plan.

Under Title VII, the Commissions have each issued external Business Conduct Rules with counterparties to which Swap Dealers must adhere. In the context of SVC transactions, certain entities, including ETRS Plans, will likely be designated as "Special Entities" under the Business Conduct Rules, to whom Swap Dealers owe enhanced obligation under these rules.[21] The combined effect of the CFTC's proposed regulations implementing these Business Conduct standards (the "Proposed Regulations"), and impending DOL regulations that are expected to be proposed in early 2012 (the "Fiduciary Regulations"[22]) that will amend or possibly expand the definition of fiduciary conduct under ERISA, is likely to render a Swap Dealer who complies with the Proposed Regulations a fiduciary under ERISA, which would preclude the parties from entering into an SVC.

---

[20] ERISA Section 3(21).

[21] The Business Conduct rules were originally issued on July 18, 2011 (see footnote 19). On September 8, 2011, the CFTC held an open meeting, in which the CFTC distributed a one-page document entitled "*Outline of Final Dodd-Frank Title VII Rules the CFTC May Consider in 2011 and the First Quarter of 2012*" (Available at http://www.cftc.gov/PressRoom/SpeechesTestimony/genslerstatement090811c.html). The outline indicated that the CFTC may consider final rules in 2011 on external business conduct standards and internal business conduct standards (e.g., duties, recordkeeping and chief compliance officer requirements). The outline also indicated that the CFTC may consider final rules during the first quarter of 2012 on internal business conduct (documentation).

[22] On September 19, 2011, the DOL issued a press release, "US Labor Department's EBSA to re-propose rule on definition of a fiduciary" in which the DOL stated that it planned to re-propose regulations in "early 2012. " (http://www.dol.gov/opa/media/press/ebsa/EBSA20111382.htm).

Under the Act's Business Conduct standards, a Swap Dealer that acts as an "advisor" to a Special Entity has a duty to act in the "best interests" of the Special Entity. The dealer must make reasonable efforts to obtain such information as is necessary to make a reasonable determination that any swap recommended by the Swap Dealer is in the best interests of the Special Entity, including information relating to:

- the financial status of the Special Entity;
- the tax status of the Special Entity;
- the investment or financing objectives of the Special Entity; and
- any other information that the CFTC may prescribe by rule or regulation.

Under ERISA, a fiduciary is defined to include anyone who exercises any control over the management of plan assets or anyone who renders investment advice with respect to plan assets (or has any authority or responsibility to do so) for a fee or other compensation.

The definition of advisor in the Proposed Regulations is broad, and may encompass Swap Dealers who otherwise would not consider themselves as providers of advice. The Proposed Regulations include as advisors Swap Dealers who recommend a swap or a trading strategy involving the use of swaps. While the Proposed Regulations state that they are "not intended to preclude, *per se,* a Swap Dealer from both recommending a swap to a Special Entity and entering into that swap with the same Special Entity where the parties abide by the requirements of the [Proposed Regulations]," it appears that Swap Dealers who comply with the duties imposed could run the risk of exercising such a degree of control over ETRS Plan assets that they engage in fiduciary conduct as defined in ERISA.

Significantly, the proposed definition of "recommendation" is broad, and is defined as "any communication by which a Swap Dealer provides information to a counterparty about a particular swap or trading strategy that is tailored to the needs or characteristics of the counterparty." Information that is general transaction, financial or market information, or swap terms in response to a competitive bid request from the counterparty, is not a recommendation. By contrast, customized information specific to the characteristics and needs of a particular counterparty may constitute a recommendation under the Proposed Regulations.If SVCs are treated as swaps, then any customized SVC could constitute a "recommended" swap. Since, by their nature, SVCs are customized to the ETRS Plan counterparty, it is possible that all SVC issuers would be considered to be making recommendations and thus would be deemed advisors under the Proposed Regulations.

Further, the term "best interests" is not defined under the Proposed Regulations. The Proposed Regulations state generally that best interest principles would "impose affirmative duties to act in good faith and make full and fair disclosure of all material facts and conflicts of interest, and to employ reasonable care that any recommendation given to a Special Entity is designed to further the purposes of the Special Entity."

Under the Proposed Regulations, Swap Dealers who act as advisors run the risk of being treated as an ERISA fiduciary by reason of providing "investment advice" under ERISA. Currently, regulations under ERISA provide a five-part test for determining whether providing a recommendation would constitute providing "investment advice" and therefore result in fiduciary status. Under this test, among other factors, in order to constitute "investment advice," and confer fiduciary status, a recommendation must be provided pursuant to a mutual agreement, arrangement or understanding, must be part of advice provided on a regular basis, and must serve as the primary basis for investment decisions with respect to plan assets. However, the DOL recently proposed and then withdrew regulations that significantly broadened the standard for providing "investment advice." Under these DOL proposed regulations, a counterparty providing a recommendation, as defined in the Proposed Regulations, could be an ERISA fiduciary if the recommendation was part of advice that may be considered in making investment or management decisions with respect to the plan. If these DOL proposed regulations had been finalized in substantially their proposed form, it is possible that under those regulations a Swap Dealer that provided recommendations and complied with the Business Conduct requirements could have been treated as an ERISA fiduciary, regardless of the representations obtained from a ETRS Plan counterparty.

The DOL withdrew these regulations in part to "ensure an open exchange of views and protect consumers while avoiding unjustified costs and burdens."[23] The DOL anticipates revising the proposed regulations in the re-proposal to clarify "the limits of the rule's application to arm's length commercial transactions, such as swap transactions."[24] Therefore, it is apparent that the DOL is cognizant of the negative effect the Proposed Regulations and the DOL's withdrawn regulations could have had on swap transactions with ETRS Plans, including stable value transactions.

While uncertainty remains with respect to the specific impact of an amended proposal from the DOL with respect to its fiduciary definition, what is clear from the breadth of the ERISA regulation over SVCs is that the imposition of an additional, potentially conflicting body of rules under Title VII would likely result in negative consequences. In the best case scenario, the application of the rules would be largely impracticable (i.e., imposing clearing or execution requirements would frustrate their purpose), whereas in the worst case, a swap designation could render institutions such as RBC legally incapable of offering capital protection to SVFs.

Market and Product Structure Issues

---

[23] DOL News Release, "US Labor Department's EBSA to re-propose rule on definition of fiduciary" September 19, 2011, www.dol.gov.

[24] *Id.*

Question 8. What are the different types of SVCs, how are they structured, and what are their uses? Please describe in detail.

Question 9. Please describe the operation of SVCs and SVFs generally in terms of contract structure, common contract features, investments, market structure, SVC providers, regulatory oversight, investor protection, benefits and drawbacks, risks inherent in SVCs, and any other information that commenters believe the Commissions should be aware of in connection with the SVC study.

Question 10. What provisions of SVCs, if any, allow SVC providers to terminate SVCs that prevent benefit plan investors from transacting at book value? What are the trade- offs, including the costs and benefits of such provisions? Please describe in detail.

Question 11. Describe the benefits and risks of SVCs for SVC providers. How do SVC providers mitigate those risks? Please provide detailed descriptions. How effective are any such measures?

Question 14. The Commissions' staffs understand that some SVCs grant SVC providers the right to limit coverage of employer-driven events or employee benefit plan changes. Such events or changes could cause a decrease in a SVF's value and result in large scale investor withdrawals or redemptions (sometimes called a "run on the fund"). How do SVC providers and SVF managers manage this risk, if at all? How effective are any such measures?

A. Description of Stable Value Products

SVFs generally consist of pools of Covered Assets combined with benefit responsive payment obligations by SVC issuers. The SVC helps to reduce the volatility associated with the underlying portfolio (e.g., largely insulating investors from market value exposure attributable to changes in interest rates and credit spreads), providing investors in SVFs the price stability of a money market fund coupled with the higher yield of an intermediate duration bond fund.

The SVCs issued by RBC are sometimes referred to as "Synthetic Guaranteed Investment Contracts ("Synthetic GICs")." Pursuant to these contracts, RBC agrees to provide a "fully benefit responsive" investment contract that provides book value protection for all ETRS Plan participant-initiated transfers and withdrawals made consistent with the rules of the ETRS Plan. RBC, as issuer of the Synthetic GIC, agrees to maintain the payments pursuant to these transfers and withdrawals at book value and absorbs the market value risk on these payments. RBC provides SVCs to both collective investment trusts as well as individual ETRS Plans. The contracts can be written as either a two party agreement (between RBC and either the ETRS Plan trustee or the ETRS Plan's investment manager/advisor) or as a tri-party agreement (between RBC, the ETRS Plan trustee and the investment manager/advisor).[25]

While the construct of each of the SVCs issued by RBC provides for book value protection for all ETRS Plan participant-initiated transfers and withdrawals made consistent with the rules of the ETRS Plan, the SVCs are nonetheless tailored to the specific goals, objectives and characteristics of the particular ETRS Plan. As a result, the economic purpose of the SVCs is consistent but the terms of the SVCs are not standardized. Rather, as described above, each SVC is customized based on the characteristics of the ETRS Plan.

B. RBC Provides Evergreen and Fixed Maturity Contracts

SVCs can have a variety of horizon characteristics and interest-crediting features. Many SVCs are known as "Evergreen Contracts," which have no pre-determined maturity. Synthetic GICs that are Evergreen Contracts are typically managed and invested in a specific constant-duration, fixed income investment portfolio. Evergreen Contracts can be terminated at market value under certain extremely rare circumstances as further discussed in paragraph (d) below and most can be terminated at book value following a multi-year notice period typically known as the immunization period as further described in our answer to Question 13. During this immunization period, the portfolio is reinvested in shorter -- and typically lower-yielding -- assets that mature near the agreed upon date.

In addition to Evergreen Contracts, SVCs can be arranged with a fixed maturity date. This maturing structure provides for a declining duration portfolio that targets the convergence of market value and book value at the maturity date.

C. RBC Provides "Participating Contracts"

RBC offers SVCs that are referred to as written on a "participating" basis. These participating contracts provide for adjustments to the crediting rate based on several variables including ETRS Plan participant contributions and withdrawals as well as the performance of the Covered Assets. The crediting rate is typically reset monthly or quarterly, and it is important to note that the rate cannot go below zero percent, thereby ensuring a stable net asset value to participants. Under the participating structure, the SVC issuer is called upon to make a payment or payments to the extent the remaining assets in the SVF are insufficient to meet ETRS Plan participant withdrawals.

---

[25] The contract terms provide that the relevant party will comply with, and the transactions entered into pursuant to the SVC will comply with, DOL Prohibited Transaction Exemption ("PTCE") 91-38, which generally exempts the operation of the collective trust fund from prohibited transactions with "parties in interest" to the collective investment trust fund, or PTCE 84-14, which provides for the ETRS Plan to be represented by a "qualified professional asset manager."

D. Description of RBC Risk and Mitigation as Issuer – In General

Risks for SVC providers generally stem from two factors: (1) the liquidity risk associated with participant withdrawals from the SVF; and (2) the market risk associated with the volatility of the underlying Covered Assets portfolio.

Liquidity or withdrawal risk is the risk that ETRS Plan participant withdrawals from the SVF will exceed expectations. During the normal daily operation of the SVF, there are likely to be both contributions to (or transfers into) and withdrawals from (or transfers out of) the SVF. The risk to the SVC issuer is that withdrawals will not only exceed contributions, but will also exhaust the liquidity buffer (cash) assets held to meet typical activity. To the extent there are significant withdrawals at a point in time when the market value of the Covered Assets is below the book value, the risk to the SVC issuer rises. Market risk generally includes interest rate risk and credit spread risk.

The SVC risks described above are not typically mitigated by means of external hedging activities. RBC mitigates these risks using various methods, including:

- Due diligence: As part of its due diligence process prior to issuing an SVC, RBC examines its SVC manager counterparties' track records with respect to investment performance and liquidity management.
- "Self-insurance": RBC establishes valuation adjustments and reserves to reflect increase risk associated with increased withdrawal activity.
- Contract structure: RBC incorporates features like "participation," as described above, to provide for periodic reset and adjustment of the crediting rate taking into account the effect of events associated with ETRS Plan participant withdrawals.
- Covered Asset parameters: RBC mitigates market risk by means of a thorough review of the investment guidelines associated with the SVF, taking such factors as duration, asset quality and sector concentration into account. The investment guidelines are thus designed to deliver a stable return on the Covered Assets.
- Contract features: RBC also mitigates withdrawal risk by providing certain exclusions from the general stable value protection. These exclusions generally relate to employer-initiated events which result in large numbers of ETRS Plan participants withdrawing assets from the relevant SVFs. Examples include employer bankruptcy or plan terminations.
- Maturing structures: Maturing structures may further mitigate withdrawal risk by providing an opportunity for all parties to frequently plan for employer-initiated events. In addition,

maturing structures provide the opportunity to periodically reassess the risks associated with a given SVF/ETRS Plan. Maturing structures also help minimize the market risk by requiring a reallocation into shorter duration assets as the SVC approaches maturity.

E. Effectiveness of Mitigation

The mitigation steps described above have allowed RBC to effectively manage its SVC exposure. Further, when employer-initiated events have arisen, RBC has consistently worked with employers and SVF managers to ensure book value treatment. RBC has never exercised any contract provision relieving it of its obligation to pay book value to ETRS Plan participants.

Question 12. Describe the benefits and risks of SVCs for investors in SVFs. Please provide detailed descriptions.

A. Benefits to SVC Investors

SVFs provide ETRS Plan participants with protections that are generally not available as part of most other investment choices within ETRS Plans. SVFs combine an investment in high-quality fixed income securities with a benefit responsive investment contract (provided by the SVC) that is designed to preserve ETRS Plan participants' entire principal and accumulated earnings when they redeem their investments. The source of earnings on the SVF is the crediting rate set forth in the SVC. Comparable investment options such as fixed income mutual funds and money market funds do not provide similar protections.

	Principal preservation	Intermediate duration yield
Fixed income fund		X
Money market fund	X	
Stable value fund	X	X

Stable value products are one of the few investment options that performed well throughout the financial crisis. During the financial crisis, SVFs offered ETRS Plan participants a shelter from market declines while providing a yield substantially better than most money market options. SVFs in which RBC has been involved have consistently met their objectives of offering ETRS Plan participants principal preservation and returns in excess of money market funds.

Unlike target-date funds, which are considered a "qualified default investment option" under DOL rules for ETRS Plan participants (in other words, a default destination for ETRS Plan participants) and can result in significant losses, SVFs are specifically designed to minimize the possibility of ETRS Plan participant losses through the SVC protection. Even in periods of market downturn, like the financial crisis, SVFs are designed to allow ETRS Plan participants[26] to continue to transact at book value. By contrast, during the recent financial crisis, ETRS Plan participants in target-date funds had significant losses. In 2008, for example, the average 2010 target-date fund declined by nearly 25% -- just two years away from many investors' retirement.[27] In fact, many target-date retirement investors were wiped out financially during the bear market.

Further, unlike money market funds, which are dependent on the short-term nature of the fund assets for their return, stable value products benefit from the additional protections of the SVCs that are issued by regulated entities like RBC. The support by the regulated entity increases the potential for increased return on the stable value product, combined with principal preservation, since the parties can manage the SVC during times of market turmoil (e.g., SVFs were not forced sellers of assets during the financial crisis, in contrast to other types of funds that did not have SVCs.

B. Risks to SVF Investors

In the ordinary course, the primary risk to SVF investors is risk associated with a large-scale draw down in Covered Assets. This risk is mitigated in large part by the existence of SVC agreements.

A recent GAO report[28] entitled "401(k) Plans: Certain Investment Options Practices That May Restrict Withdrawals Not Widely Understood" highlighted certain recent high-profile bankruptcies that created risk to plan participants employed by the bankrupt companies.[29] RBC notes that such employer-initiated events are extremely rare and the Mervyn's and Lehman examples are not representative of major concerns within the stable value industry. By an overwhelming percentage, SVFs have not encountered the issues cited in the GAO report. Even the Lehman SVF cited in the report had a positive return of 2% for the 2008 plan year,[30] which indicates that ETRS Plan participants did not suffer the losses that they could have experienced if they had transferred funds to an alternate investment option (e.g., a target date fund for the same period). Moreover, prior to an employer bankruptcy, ETRS Plan participants are still able to transfer at book value their SVF holdings into other ETRS Plan options, providing the ETRS Plan participants with a significant risk mitigation tool.

---

[26] See the answer to Question 12, section (b) for a description of the limited circumstances where investors may not receive 100% of their principal.

[27] Source: Ignites as of June 2010 http://ignites.com/articles/20091230/pivotal_year_retirement.

[28] http://www.gao.gov/products/GAO-11-291.

[29] No RBC SVC products were involved in the examples cited in the GAO report.

[30] http://stablevalue.org/help-desk/faq.

C. Risk Mitigants

As noted above, maturing SVC structures serve to further mitigate risk to the extent that ETRS Plan participants experience adverse effects of an employer-initiated event. Maturing SVC structures provide frequent opportunities to reassess exposure to employer-initiated events both for RBC and for ETRS Plan participants and to reconfigure the SVC to accommodate planned employer events. Further, as described above, RBC examines its SVF manager counterparties' track records with respect to employer-initiated events and the effect of the events on ETRS Plan participants in the SVF manager's funds.

Therefore, while stable value investing involves some risk to investors, these risks are both relatively small on an absolute basis and minimal when compared to other available fixed income alternatives. Additionally, the risk can be managed and in some instances potentially eliminated. The risks highlighted by the high-profile examples of Mervyn's and Lehman are not indicative of fundamental flaws in the stable value industry. The risks, including employer bankruptcies, can be managed through prudent management of the Covered Assets and negotiations among SVC parties.

Question 13. The Commissions' staffs understand that SVC providers sometimes negotiate so-called "immunization" provisions with SVF managers and that such provisions typically allow SVC providers (or SVF managers) to terminate the SVCs based upon negotiated triggers, which can include underperformance of the portfolio against a benchmark. The Commissions' staffs also understand that, once immunization provisions have been triggered and are in effect, the SVF must be managed according to the immunization guidelines, which typically require the liquidation of all securities rated below AAA and in certain cases may require the portfolio to be invested 100% in Treasury securities. What risks, if any, do "immunization" provisions in SVCs pose to investors in SVFs? If immunization provisions in SVCs pose risks to investors in SVFs, are these risks clearly disclosed to investors? Are these risks required to be disclosed to investors? What are the sources of such requirements? How do SVF managers or SVC providers address the risk that immunization will be exercised? How effective are any such measures?

Immunization provisions are generally found in Evergreen SVCs to provide the SVC issuer and SVC counterparty with a method of terminating the SVC while still allowing ETRS Plan participants to transact at book value. When an immunization occurs, the SVC parties establish a maturity date, and the existing investment guidelines are replaced with a new set of guidelines. The new guidelines typically reduce portfolio risk, primarily by shortening the duration of the Covered Assets. In essence, the goal of immunization is to have market value and book value of the Covered Assets converge at maturity. During the immunization period, the Covered Assets are invested in shorter -- and typically lower-yielding -- assets with higher credit quality that mature at or near the agreed upon SVC maturity.

An ETRS Plan participant could conceivably receive a lower crediting rate during an immunization period. However, immunization events do not change the payment obligation of SVC providers. During an immunization period, ETRS Plan participants can still transact at book value and the crediting rate is still floored at zero percent. To date, RBC has never exercised an immunization provision in any of its SVCs.

Question 16. The Commissions' staffs understand that "pull to par" provisions of SVCs provide that SVCs will not terminate (absent the application of another contract termination provision) until the gap between the market value of the wrapped assets and the SVC book value is closed, however long that takes. The Commissions' staffs also understand that pull to par provisions are standard for SVCs. Are these understandings correct? Please describe pull to par provisions and how prevalent such provisions are in SVCs.

"Pull to par" provisions are common to SVCs, permitting the difference between an SVF's market value and contract value, whether positive or negative, to be amortized over a period of time by either increasing or decreasing the SVF's crediting rate. By adjusting the crediting rate periodically (typically monthly) to reflect changing market conditions, the "pull to par" provision causes the SVF's market value and contract value to converge over a period of time equal to the portfolio duration.

"Pull to par" provisions are also used to address unexpected events such as significant market volatility, significant changes to reinvestment rates or other credit events that occur close to the scheduled termination date. The provisions can extend the maturity convergence date if such unexpected events delay or are expected to delay convergence. "Pull to par" provisions are intended to be short-term in nature and RBC would not expect such provisions to apply for an extended period.

Most importantly, SVC payment obligations to ETRS Plan participants remain in effect irrespective of pull to par provisions. Participants can continue to transact at book value and the crediting rate cannot be negative.

Question 17. How have SVFs and SVCs been affected by the recent financial crisis? How many SVC providers are in the market today? Is the number of SVC providers higher or lower than prior to the financial crisis that began in 2008? Are fees now higher or lower than prior to the financial crisis?

Like most other assets, SVF yields or crediting rates have declined as expected in the current low interest rate environment. However, SVFs continue to provide a significant premium when compared to money market funds. SVCs continue to provide an important mechanism for capital preservation in support of SVFs goals and ETRS Plan participants' demand for such capital preservation.

Despite the financial crisis and ongoing volatility and uncertainty in the financial markets, SVFs and SVCs have continued to perform as promised and expected, providing both capital preservation and strong and consistently positive returns. To illustrate, at the beginning of the crisis in December 2008, the $642 billion[31] invested in SVFs yielded 3.97%.[32] As of December 2010, the $540 billion[33] invested in SVFs yielded 3.43%.[34] RBC's SVC products have performed consistent with the overall market during this ongoing volatility and RBC has never exercised any contract provision relieving it of its obligation to pay book value to ETRS Plan participants.

By most measures, including assets under management, yield or crediting rate, overall portfolio credit quality, overall portfolio duration, and market value-to-contract value ratios ("MV/CV ratios"), SVFs demonstrate strength, vitality, and stability as an asset class. SVFs hold approximately 15% of 401(k) plan assets,[35] between 10% and 13% of defined contribution assets, which makes SVFs a core component of defined contribution plan portfolios.

SVF MV/CV ratios have strengthened since December 2008 from 95% to greater than 100% in June 2011, and continue to improve.[36] The MV/CV ratio for a SVF is always fluid. Historically, this ratio is within four percentage points of par. The MV/CV ratio is typically used by ETRS Plan sponsors and fiduciaries to evaluate the investment performance that underlies the SVF. Importantly, an MV/ CV ratio that is less than 100% does not in any way relieve the SVC issuer from its payment obligations.

Prior to the crisis, fees for Synthetic GICs ranged from 5 to 10 basis points. These fees now range between 15 and 25 basis points. Fees have increased to reflect both the new risk assessment by SVC issuers and their new and evolving capital and reserves requirements for their contracts. The fee increases may also reflect capacity concerns associated with increased ETRS Plan participant contributions. It is important to note, however, that, SVC fees have always fluctuated over time. Although the fees are significantly higher than pre-2008, they are not at an all-time high.

The financial crisis has forced all financial institutions to reflect on their experience and assess their product offerings and client interfaces. Because of the new risk environment created by the

---

[31] Stable Value Investment Association – 13th Annual Stable Value Investment & Policy Survey.

[32] *Id.*

[33] Stable Value Investment Association – 15th Annual Stable Value Investment & Policy Survey.

[34] *Id.*

[35] "401(k) Plan Asset, Allocation Account, Balance, and Loan Activity in 2008," Investment Company Institute Research Perspective, October 2009, Vol 15, No.3.

[36] Stable Value Funds' Quarterly Characteristics Survey as of June 30, 2011.

financial crisis, certain issuers have increased their SVC business; others have frozen or decreased their business. Although the number of SVFs and SVC issuers has remained relatively constant, capacity to issue new SVCs has been a growing concern within the SVF industry. Because SVFs have and continue to deliver capital preservation and positive, consistent returns above money market funds, SVFs have grown through increased contributions (e.g., increased contributions reflects increased demand for SVF by ETRS Plan participants). Contributions and a reassessment of risks by SVC issuers have raised capacity concerns and caused certain issuers to decrease their stable value business or to exit the market entirely.

Beginning with the 2008 financial crisis and in the intervening period, RBC decided not to increase the size of its SVC portfolio. RBC has used this time period to reflect on portfolio experience and performance, client goals and objectives and contract terms and conditions. Additionally, we have carefully assessed any potential risks in the new financial and regulatory environment and have taken the opportunity to consider product enhancements and structuring alternatives to ensure that our SVC offerings will continue to be consistent with the goals of ETRS Plan participants and fund managers while effectively managing any risks to RBC. We are eager to evolve our SVCs to ensure that they can continue to provide both capital preservation and strong and consistently positive returns to all ETRS Plan participants as well as a sound investment for RBC as an SVC provider. Based largely on the outcome of the Commissions' determination of the treatment of SVCs under Title VII and similar regulations affecting SVFs, RBC is currently weighing a return to the SVC market before the end of this calendar year.

Question 18. Do investors have incentives to make a run on a SVF when its market-to- book ratio is substantially below one? What protections, if any, do SVCs provide to protect fund investors who do not redeem their fund shares amid a run on the fund? How effective are any such protections?

The market value to book value ("MV/BV") alone says very little about the attractiveness of a SVF to ETRS Plan participants.[37] SVFs are among the lowest risk investment options available to ETRS Plan participants. Historically, MV/BV ratios in SVFs have been most impacted by market stress scenarios which reflected increased investment risk across all asset classes. As such, SVFs have been the beneficiaries of a flight-to-quality, increasing investment in the funds exactly at those times when the MV/BV might have been below one.

Further, history has shown that the MV/BV ratio has not been a relevant factor when ETRS Plan participants choose to invest in a SVF. In fact, the growth rate of funds to which RBC has provided a SVC has been significantly negatively correlated to the MV/BV ratio through the financial crisis

[37] ETRS Plan participants transact at book value.

(approximately -59%), reflecting the flight-to-quality which appears to most significantly influence ETRS Plan participant behavior.

SVCs and the underlying Covered Assets are not separately tradable and ETRS Plan participants cannot assess the value of the underlying portfolios apart from the protection offered by the SVC providers. RBC protects the ETRS Plan participant regardless of whether market-to-book ratio is below one or above one.[38] Therefore, a lower market-to-book ratio has virtually no significance for the ETRS Plan participant to cause a run, just as a higher market-to-book ratio would not provide an incentive for ETRS Plan participants to deposit more money. Investors generally like to see a steady growth of their contributions over time, which is exactly what SVC issuers have been able to help provide through SVCs.

Despite the unlikelihood of a large-scale run on SVCs, RBC has placed several protections in its SVCs to ensure that remaining investors would not be harmed if a handful of investors pull funds from the SVCs. For example, our SVCs are structured to avoid significant divergence between market and book value. RBC transacts with SVFs that have established investment guidelines such that the underlying portfolios are well diversified, high quality and prudently managed to meet the main objective of capital preservation. Further, RBC transacts with SVFs that are required to have reserve liquidity to manage outgoing investors. Other protections include the "equity wash" provision, employer-initiated events limits and others that are further described in our answers to prior questions. Most importantly, even if a large scale investor exit were to occur despite these protections, the investors would still be protected as the withdrawal behavior does not relieve the SVC issuers from their payment obligations.

Question 19. How do market risk measures assess the risk of a run on a SVF? To the extent that SVC providers use value-at-risk ("VaR") models, do such VaR models adequately assess the risk of loss resulting from such events or other possible but extremely unlikely events? Do other loss models more adequately assess the risk of loss, such as the expected value of a loss or the expected value given a loss, which employs the entire loss probability distribution without excluding events in the extreme tail of the loss distribution?

RBC employs a multi-variable approach in assessing the initial and ongoing risk of the SVCs that it issues. RBC's risk assessment involves:

- A demographic and corporate review of the employer and the associated contributions and withdrawals;
- A comprehensive review of the portfolio manager and its fixed income track record as well

[38] See the answer to Question 12, section (b) for a description of the limited circumstances where investors may not receive 100% of their principal.

as its SVF track record;

- A multi-department review of the SVC including a risk analysis associated with the SVF investment guidelines;
- A quantitative overlay of the critical SVC variables including expected loss, stress loss projections and macro-economic stresses; and
- A non-model driven quantitative assessment of exposure.

With respect to contingent risk measures, the quantitative aspect of RBC's approach to assessing the risk inherent in SVCs employs simulation modeling which generates the entire loss probability distribution including tail events. As such, there are many elements in the analysis process that are considered and projected over an extended time frame including:

- The withdrawal activity:
  - ETRS Plans typically grow and shrink as participants make deposits and withdrawals. Deposits and withdrawals are modeled based on an analysis of recent participant activity for each fund.

- The yield of the fixed income component of the protected fund:
  - Mean-reverting interest rate models project the yield of the underlying fund using parameters estimated from analysis of considerable historical data.

- The book value:
  - A function of the crediting rate and other parameters, the book value is projected through time for each simulation path.

- The contract structure:
  - Other details of the structure are modeled on a contract-by-contract basis in order to ensure capture of idiosyncratic transaction characteristics.

Each of these parameters is the subject of discussion and agreement between the RBC business head responsible for the SVC book and RBC Group Risk Management, which oversees the modeling and analysis of the expected loss, VaR and stress testing for the SVC business. Expected loss and VaR calculations are done on a daily/ weekly basis while extensive stress testing is undertaken monthly. Each parameter is re-estimated and simulations performed in the context of enterprise-wide stress scenarios as well as in the context of business-specific stress scenarios to determine the extent to which these contracts are impacted by *extremely unlikely events*. The combination of analysis techniques ensures that the risk of the SVC portfolio under varied scenarios is adequately assessed.

These analyses are an important component of RBC's risk assessment process. Notwithstanding the comprehensive model-based market risk framework, RBC incorporates non-model driven quantitative measures to help bolster its exposure metrics and risk-taking appetite. For example, one of RBC's metrics assumes a large-scale uncorrelated ETRS Plan participant withdrawal. This helps to define RBC's extreme tail risk in the event that 100% of the ETRS Plan participants choose to exit their SVF on that day or in a very short time frame. This measure is explicitly incorporated into RBC's risk-taking appetite from that point forward.

The combination of qualitative assessments, sophisticated simulation analysis and less complex quantitative measures have helped RBC manage its SVC portfolio successfully through periods of extreme volatility, such as those seen during the financial crisis, and in the period since.

Question 20. Are certain SVC providers more likely, as a result of credit cyclicality, to become financially distressed? If so, is such financial distress likely to occur concurrently with financial distress of SVFs? If so, can the risk of such concurrent financial distress be mitigated? How effective are any such measures?

Since SVC providers tend to be large, diversified financial institutions with regulated capital, they are likely to be exposed to some credit risk. However, there is generally less stress on SVCs provided during times of greater credit risk in the overall market because investors tend to flock to SVC products during times of instability. In the aftermath of the financial crisis, ETRS Plan participants have generally become more conservative in their investments and they are increasingly looking for "safe" retirement investments. Stable value is considered a "safe" investment that is carefully designed to ensure principal protection, predictable returns, and a reasonable likelihood of delivering returns that outperform other investment options such as money market funds. As mentioned above, there is generally a negative correlation between credit cyclicality and financial distress of SVC providers. Increased demand and contribution tends to partly offset contingent risks that may be the result of financial distress.

As noted in our answer to Question 18, historical data indicates that SVFs tend to be the beneficiaries of general flight-to-quality behavior during periods of financial stress in the market. In addition to looking at the ETRS Plan participant behavior across the entire portfolio, RBC has conducted an analysis of ETRS Plan participant behavior in a subset of SVFs. At a high level, this analysis targets those SVFs whose MV/CV ratio is below one *and* whose average growth rate has been negative over the recent past (i.e., ETRS Plan participants have been net redeemers of shares). Here again, RBC has observed significant negative correlation between growth rates and MV/CV ratios (-37% correlation). As such, the likelihood of the SVC provider and the SVF itself being under concurrent distress is remote -- mathematically considerably less likely than the probability of either occurring.

Question 21. Do SVC providers pose systemic risk concerns? Are there concerns with entities that may be systemically important institutions providing SVCs? What are the consequences for SVFs, employee benefit/retirement plans, and the financial system should an SVC provider fail?

Question 22. Are there issues specific to financial institutions providing SVCs, including institutions that are systemically significant, that the Commissions should consider in connection with the SVC study? If so, please describe.

Because many SVC providers are financial institutions potentially subject to the designation as "systemically significant" pursuant to provisions of the Act,[39] there is some risk that insolvency or instability of an individual provider may occur. However, any concerns related to such an occurrence are no more acute with respect to SVCs than with any other product offered by large financial institutions. In fact, as a result of the structure of the SVCs as detailed above, while an insolvency of the SVC provider might be a termination event related to the SVC itself, there would be no payment triggered by such an event, and no need to close out positions or engage in the activity that would be required with respect to the institution's swap portfolio. Rather, in the event of the insolvency of an individual SVC provider, an SVF manager would most likely look to another SVC provider to negotiate a replacement SVC to "re-wrap the fund" and would enter into a new SVC on terms that are suitable to the relevant ETRS Plan at the time of the new agreement.

<u>Regulatory Issues</u>

Question 24. What financial and regulatory protections currently exist that are designed to ensure that SVC providers can meet their obligations to investors, and what are the sources of such protections? Does the level of protection vary depending on the SVC provider? How effective are any such measures?

RBC and other banking institutions that issue SVCs fall within the overall regulatory framework that applies to banks and are subject to significant regulatory requirements such as substantial risk-based and leverage capital requirements under Basel I, Basel II and Basel III. In the U.S., Banking institutions like RBC are further subject to regulation and supervision of the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, that together, provide comprehensive oversight[40].

---

[39] Title I – Financial Stability of the Act creates a new regulatory regime for "systemically significant" financial companies.

[40] RBC is also comprehensively regulated in Canada by is home country regulator, the Office of Superintendant of Financial Institutions, which has indicated that it will require all Canadian banks to be in compliance with the provisions of Basel III by 2013.

Banking institutions, including RBC, are required to hold capital against the credit and market risk under Basel I, currently in force in the United States, and the market, credit and operational risks under Basel II and Basel III associated with the SVCs they have issued. For large, internationally-active banks, the regulatory framework is currently transitioning to Basel II and Basel III. Basel II and Basel III are designed to cover minimum capital requirements and the supervisory review process as well as improve transparency through disclosure enhancement on a bank's risk process and risk profile, which will enable the market to make a more informed assessment of a bank's creditworthiness. The guidelines given under Basel II and Basel III are expected to result in higher capital requirements for all banks, including SVC providers. It should also be noted that maintenance of the relevant capital ratios is a continuous requirement.[41] Banking institutions with capital ratios that fall below the minimum requirements are required to submit their plans of remedying the shortfall to their regulators.[42]

Basel II and Basel III have also resulted in the development of a stress testing framework for large financial institutions like RBC, allowing the Federal Reserve to make use of stress testing in the assessment of capital adequacy. In addition, FASB rules require banking institutions to report their SVC exposures in the footnotes to the banking institution's consolidated financial statements.

Although the pre-existing regulatory requirements imposed on issuers of SVCs, such as those discussed above, may differ from what would be required under the Commissions' regulations, the purpose and effect of these regulations are consistent with the basic goals of the Act. For example, the regulations applicable to banking institutions that issue SVCs require regulated entities to have adequate capital and liquidity to meet their obligations even during extreme periods of market stress. These regulations cover risks similar to those that the Commissions aim to cover by requirements that impose minimum capital and margin requirements or mandatory clearing for swaps. As well, although the requirements may be different from those that would apply to swap reporting provisions, the disclosure and reporting requirements that apply to banking institutions are designed to advance the same goals of transparency and promoting market integrity as contemplated by the Act. Therefore, in addition to being costly, as explained in other parts of this comment letter, imposing additional regulatory requirements on the banking institutions that issue SVCs could be superfluous and may potentially conflict with the current regulatory regime.

Question 25. Currently, do entities other than state-regulated insurance companies and federally- or state-regulated banks provide SVCs? If so, what kinds of entities do so and how are they regulated? If not, are there any barriers to the provision of SVCs by entities other than state-regulated insurance companies and federally- or state-regulated banks?

---

[41] 12 C.F.R. § 3.6 (national banks).

[42] 12 C.F.R. § 3.7 (national banks).

RBC believes that SVFs and ETRS Plan fiduciaries enter into SVCs with an array of SVC providers that are state-regulated insurance companies and federally or state-regulated banks. While RBC cannot comment comprehensively on all other market participants, we note that Section 719(d) to the Act limits SVC issuers to state-regulated insurance companies and federally- or state-regulated banks. In addition, FASB Codification Paragraphs 945-210-45-9 through 45-18, which was previously, "Reporting of Fully Benefit-Responsive Contracts Held by Certain Investment Companies Subject to the AICPA investment Company Guide and Defined Contribution Health and Welfare and Pension Plans, FSP AAG INV-1 and SOP 94-4-1" (the "FASB FSP/Codification")[43] also provides a barrier.

The FASB FSP/Codification provides for five criteria, all of which must be met for an employee benefit plan (which would include an ETRS Plan) to achieve benefit responsiveness:

- The SVC must be executed between a SVF and SVC provider and the SVC must prohibit the sale or assignment of the SVC or its proceeds to another party without the consent of the provider.

- The SVC provider must be a financially responsible third-party and either repayment of principal and interest credited to participants in the SVF must be a financial obligation of the SVC provider or the prospective interest credit rate adjustments provided to participants in the SVF on a designated portfolio of investments held by the SVF or the SVC provider must not result in a crediting rate that is negative or less than zero.

- The terms of the SVC must require all permitted participant-initiated transactions with the SVF to occur at contract value.

- An event (such as bankruptcy or workforce reduction) that limits the ability of the SVF to transact at contract value with the SVC provider and that also limits the ability of the SVF to transact at contract value with participants in the SVF must not be probable of occurring.

- The SVF itself must allow participants reasonable access to their funds.

[43] Paragraphs 945-210-4509 through 45-18 of the FASB FSP/Codification. The Government Accounting Standards Board mirrors the FASB standard. *See* Government Accounting Standards Board Statement No. 53, Accounting and Financial Reporting for Derivative Instruments, Paragraph 67.

<u>Compliance Issues if the Commissions Were to Determine SVCs Were Swaps</u>

Question 27. If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, should the regulatory regime for SVCs be limited or tailored in any way? If so, how? Please explain in detail. Should any of the requirements for capital and margin for SVCs differ from those for swaps that are not SVCs? Why or why not? If the requirements for capital and margin should differ, please explain in detail what those differences should be.

Question 28. If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, would the requirements of any regulatory regime for swaps impact fee structures or fees charged by SVC providers? Please describe (quantitatively, if possible) the relationship of any new federal regulation under the Dodd-Frank Act to possible changes in fee structures or fees, to the extent feasible, and state any assumptions used in quantifying such relationship.

Question 29. If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, would this decision influence the availability of SVFs to investors? Would this designation affect existing SVFs and the ability of SVFs to purchase SVCs? If so, how and why?

For the reasons discussed previously, we believe that the regulatory regime proposed for swaps under Title VII is wholly unsuited for customized, highly negotiated agreements such as SVCs that are not susceptible to secondary trading. Should the Commissions conclude that SVCs fall within the definition of a "swap" under Section 721(a) of the Act, as discussed throughout our response, RBC has serious concerns. RBC urges the Commissions to jointly exempt SVCs from the definition. Such an exemption would be consistent with Section 719(d)(1)(B) of the Act as noted above, and with Congress' intent to provide relief where, as here, relief is "appropriate and in the public interest."[44]

In summary, RBC believes that exemptive relief is appropriate and is in the public interest due to:

- The existing regulatory framework that governs both SVFs and SVCs and provides for an efficient, well functioning, transparent and equitable marketplace in which such agreements are negotiated and ETRS Plan investors are provided with capital protection.

- Regulation of SVCs as swaps could result in a significant decline in the number of SVC providers able or willing to offer such protection, resulting in a related decline in the

[44] Dodd-Frank Act Section 719(d)(1)(B).

availability of SVFs as an investment option for retirement savings.

- Depending on the outcome of the Commissions' other Title VII rulemaking proceedings, designating SVCs as swaps could make entering into SVCs prohibitive by materially increasing the costs associated with such transactions to both RBC and to SVF managers by imposing new technology, documentation, operational, and potentially new credit and collateral requirements that are not contemplated by the SVC structure today. Costs incurred by SVC providers would result in the need to increase fees associated with providing the protection; presumably, those costs would, in large measure be passed on to ETRS Plan investors participating in SVFs in the form of higher management fees related to the ETRS Plan.

III. CONCLUSION

RBC thanks the Commissions for their efforts in studying the issues raised by Section 719(d)(1)(B) of the Act with respect to SVCs and stable value products. We hope that the information provided in this response is useful to the Commissions and their staff, and welcome the opportunity to discuss these important issues. Please contact Eric Wise at (212) 428-6474 or Richard Chase at (212) 428-7014 if you have any questions or would like to discuss these issues further.

Sincerely,

Eric Wise
Managing Director
Royal Bank of Canada

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Mary L. Schapiro, Commissioner
Honorable Elisse B. Walter, Commissioner
Honorable Luis A. Aguilar, Commissioner
Honorable Troy A. Paredes, Commissioner

APPENDIX A

[Congressional Record Volume 156, Number 105 (Thursday, July 15, 2010)]
[Senate]
[Pages S5902-S5933]
From the Congressional Record Online through the Government Printing Office [**www.gpo.gov**]

Stable Value Funds

Mr. HARKIN. Mr. President, as chairman of the Health, Education, Labor, and Pensions Committee, the pensions community approached me about a possible unintended consequence of the derivatives title of the Dodd-Frank Wall Street Reform and Consumer Protection Act. They were concerned that the provisions regulating swaps might also apply to stable value funds.

Stable value funds are a popular, conservative investment choice for many employee benefit plans because they provide a guaranteed rate of return. As I understand it, there are about $640 billion invested in stable value funds, and retirees and those approaching retirement often favor those funds to minimize their exposure to market fluctuations. When the derivatives title was put together, I do not think anyone had stable value funds or stable value wrap contracts--some of which could be viewed as swaps--specifically in mind, and I do not think it is clear to any of us what effect this legislation would have on them.

Therefore, I worked with Chairman Lincoln, Senator Leahy, and Senator Casey to develop a proposal to direct the SEC and CFTC to conduct a study--in consultation with DOL, Treasury, and State insurance regulators--to determine whether it is in the public interest to treat stable value funds and wrap contracts like swaps. This provision is intended to apply to all stable value fund and wrap contracts held by employee benefit plans--defined contribution, defined benefit, health, or welfare--subject to any degree of direction provided directly by participants, including benefit payment elections, or by persons who are legally required to act solely in the interest of participants such as trustees.

If the SEC and CFTC determine that it is in the public interest to regulate stable value fund and wrap contracts as swaps, then they would have the power to do so. I think this achieves the policy goals underlying the derivatives title while still making sure that we don't cause unintended harm to people's pension plans.

Mrs. LINCOLN. Mr. President, I share Chairman Harkin's concern about possible unintended consequences the Dodd-Frank Wall Street Reform and Consumer Protection Act could have on pension and welfare plans which provide their participant with stable value fund options. These stable value fund options and their contract wrappers could be viewed as being a swap or a security-based swap. As Chairman Harkin has stated, there is a significant amount of retirement savings in stable value funds, $640 billion, which represents the retirement funds of millions of hardworking Americans. One of my major goals in this legislation was to protect Main Street. We should try to avoid doing any harm to pension plan beneficiaries. When the stable value fund issue was brought to my attention, I knew it was something we had to address. That is why I worked with Chairman Harkin and Senators Leahy and Casey to craft a provision that would give the CFTC and the SEC time to study the issue of whether the stable value fund options and/or the contract wrappers for these stable value funds are “swaps” or some other type of financial instrument such as an insurance contract. I think subjecting this issue to further study will provide a measure of stability to participants and beneficiaries in employee benefit plans--including those participants in defined benefit pension plans, 401(k) plans, annuity plans, supplemental retirement plans, 457 plans, 403(b) plans, and voluntary employee beneficiary associations--while allowing the CFTC and SEC to make an informed decision about what the stable value fund options and their contract wrappers are and whether they should be regulated as swaps or security-based swaps. It is a commonsense solution, and I am proud we were able to address this important issue which could affect the retirement funds of millions of pension beneficiaries.

APPENDIX B

ETRS Plan participants generally seek to allocate a portion of their retirement savings into fixed income products. Within the fixed income asset class, many participants seek to further allocate some or all of their fixed income assets to an investment option designed to preserve principal in order to minimize the market value volatility that could be attributable to moves in interest rates and/or credit spreads. ETRS Plan participants that seek principal preservation (e.g., as individuals approach retirement, they often reduce their risk tolerance and prioritize safety of principal) generally have two alternatives: (i) money market funds, and (ii) SVFs.

As noted in the RBC response letter, in the event SVCs are deemed "swaps" and are not granted an exemption from the Title VII requirements, there is a substantial risk that SVC availability may be materially reduced or eliminated. In this scenario, ETRS Plan participants may be directed to money market fund offerings as an alternative to SVFs. Ignoring for the moment the generally lower return associated with money market funds, it is important to consider the potentially negative effect of Basel III on money market funds. RBC is concerned that Basel III will severely and negatively affect the continued availability of money market fund offerings, which could leave ETRA Plan participants with no meaningful investment alternative that is designed to preserve principal.

To highlight the issue of money market fund availability, it is important to understand the principal workings of commercial paper and similar offerings. Money market funds typically buy very high credit quality commercial paper from a diversified base of issuers. These offerings are dependent on the provision of backstop liquidity facilities provided by regulated banks like RBC. Basel III introduces a number of new regulatory metrics and requirements that apply directly to the provision of these bank-provided backstop facilities. Most notably, there is:

- a new Liquidity Coverage Ratio ("LCR");
- a new global Leverage Ratio ("LR");
- a contemplated pro-cyclicality buffer; and
- higher capital requirements supported by more permanent forms of capital.

RBC estimates that should all of these requirements[45] go into effect as currently defined, banks will incur more than 100 basis points of incremental cost in the provision of this product that is critical to the ability of issuers to offer commercial paper. It is difficult to completely pre-determine the impact on the cost and availability of these bank-provided backstop liquidity facilities, but it is highly probable that costs will rise and availability could be meaningfully reduced. This would negatively

[45] The LCR and LR are currently in an 'Observation Period." The pro-cyclicality buffer has not yet been completed for implementation.

impact the availability of money market fund offerings inside ETRS Plans, leaving ETRS Plan participants without the necessary tools to protect a portion of their principal retirement savings.

Basel Capital Proposal
Quantitative Example

$100M A-rated Undrawn Corporate Commitment
Summary of implied costs

	Current	Proposed	Description
Tier 1 Capital			
Total Capital $	$4.52	$6.18	Increased PD per Procyclicality proposal
Capital Cost %	12%	18%	Narrowing definition of Tier 1 Capital
Tier 1 Capital Cost bps	**54.3**	**111.2**	
Leverage Ratio			
Add'l Capital for Undrawn Portion $	$0.00	$0.00	Undrawn amounts included in leverage ratio
Add'l Capital for HQ Assets $	$0.00	$0.68	HQ Assets from liquidity ratio hit leverage ratio
Total Add'l Capital $ (above Tier 1)	$0.00	$0.68	
Capital Cost %	12%	18%	
Leverage Ratio Capital Cost bps	**0.0**	**12.2**	
Liquidity Ratio			
Liquidity Reserve above Tier 1 $	$5.48	$102.35	High Quality Assets required for 100% reserve
Cost of 1 yr Debt	0.50%	0.50%	
Liquidity Ratio Debt Cost bps	**2.7**	**51.2**	
Total Regulatory Cost of Lending	**57**	**175**	