November 1, 2012

By Hand Delivery

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U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Ms. Elizabeth M. Murphy
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Stable Value Contract Study (Release No. 34-67927) (File No. S7-32-11)

Dear Ms. Warfield and Ms. Murphy:

On behalf of its members, the Stable Value Investment Association ("SVIA" or "Association") thanks you for reopening the comment period for "*Acceptance of Public Submissions Regarding the Study of Stable Value Contracts*" ("Notice of Reopening"),[1] and submits this brief letter for your consideration. The purpose of the Association's comments is to supplement the SVIA's responses to the 29 questions posed by the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (collectively, "Commissions"), published for comment on August 18, 2011. As the Commissions note in the Notice of Reopening, there have been significant regulatory developments since the original comment period closed, the most notable being publication of the Final Rule further defining the term "swap" and the inclusion of the insurance product test therein.[2]

The Association believes that the Commissions' analysis in the Final Rule informs the discussion of stable value contracts and provides a useful framework within which to analyze whether the stable value contract is appropriately excluded from the swap definition. For the reasons set forth in this letter, the SVIA believes that the logic underpinning the Commissions' decision to exempt, for example, certain insurance products and commercial agreements serves to reinforce the conclusion that the stable value contract does not fall within the definition of swap.

I. Background

Section 719(d)(1)(A) of "The Dodd-Frank Wall Street Reform And Consumer Protection Act" ("Dodd Frank Act") requires the Commissions jointly to conduct a study to determine whether stable value contracts fall within the definition of swap ("Study"). For purposes of the Study, Congress defined the term "stable value contract" as follows:

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[1] *See* 77 Fed. Reg. 60113 (Oct. 2, 2012).

[2] *See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48208 (Aug. 13, 2012) ("Final Rule").

> 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).[3]

It is for this contract type alone that Congress directed the Commissions to perform the above referenced Study, and it is with regard to this specific contract that the SVIA now comments.

II. <u>Stable Value Contracts Are Not "Swaps" Under the Commissions' Stated Rationale</u>

To this point, the Study has largely been a one-way exchange of information with interested market participants, like the SVIA, articulating reasons why the stable value contract is not a swap, and the Commissions demurring comment until completion of the deliberative process on the definition of swap.

As a result of this exchange, the Commissions have had the benefit of formal comments from at least 38 entities since the first comment period for the "*Acceptance of Public Submissions Regarding the Study of Stable Value Contracts"* closed on September 26, 2011. When coupled with the detailed definition of stable value contacts provided by Congress in the Dodd Frank Act, which includes the specific providers of these contracts, we are hopeful that the Commissions now have sufficient information to understand and analyze these contracts.

Furthermore, the SVIA believes that the Final Rule sheds light on the logic train used by the Commissions to help delineate between what is, and what is not, a swap. That same logic informs this discussion and reinforces the conclusion that the stable value contract is not a swap.

A. Participants in Stable Value Funds have a "Stake" in the Underlying Assets

In concluding that certain insurance products[4] are not encompassed in the swap definition, the Commissions explained, among other things, that the beneficiary of these agreements, contracts, or transactions has an "insurable interest that is the subject of the agreement, contract, or transaction and thereby carr[ies] the risk of loss with respect to that interest continuously throughout the duration of the agreement, contract, or transaction."[5] In contrast, "a credit default

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[3] *See* Pub. L. No. 111-203 (2010), Title VII, Section 719(d)(2) .

[4] Many stable value contracts issued by regulated insurance companies are considered "annuities", which are included among the list of enumerated products excluded from the swap definition in the Final Rule.

[5] *Id*. at 48212.

swap ('CDS') (which may be a swap or a security-based swap) does not require the purchaser of protection to hold any underlying obligation issued by the referenced entity on which the CDS is written."[6] Explaining the significance of an insurable interest, the Commissions stated, "[t]he requirement that the beneficiary be at risk of loss . . . with respect to the interest that is the subject of the agreement, contract, or transaction . . . will ensure that an insurance contract beneficiary has a **stake in the interest** on which the agreement, contract, or transaction is written."[7] Simply stated, the beneficiary of an insurance contract is at risk of loss tied to the interest that is the subject of the insurance contract regardless of the existence of the insurance contract. In contrast, and as the Commissions pointed out, "the parties [to a credit default swap] will be obligated to perform . . . irrespective of the existence or amount of the parties' credit exposure to a Referenced Entity, and [the] buyer need not suffer any loss nor provide evidence of any loss as a result of the occurrence of a Credit Event."[8]

Consistent with the concept articulated by the Commissions, most stable value contracts are written with reference to an identifiable pool of assets, e.g., a diverse portfolio of high-quality bonds usually rated, on average, AA- or better, usually with an average duration of approximately three years. Further, participants in a stable value fund are at risk of loss based on this pool of assets irrespective of the existence of the stable value contract. Indeed, it is not possible to purchase a stand-alone stable value contract that is written without regard to such a pool of assets. Thus, beneficiaries of stable value contracts i.e., plan participants have a "stake" in the interest on which the stable value contract is written.[9]

B. Wrap Providers only Pay Out if a Loss has Occurred and is Proven and the Payout is Limited to the Pool of Wrapped Assets

As another point of reference, the Commissions focused on the fact that insurance products require a loss to occur and to be proven as a condition of performance under the agreement, contract or transaction. Moreover, any payment under the same is limited to the value of the "insurable interest."[10] In other words, the beneficiary of the contract receives payment only if there is a proven loss to the beneficiary tied to the interest on which the contract was written. Like the existence of a stake in the underlying asset, the Commissions agreed that the

[6] *Id*. at 48214.

[7] *Id*. (emphasis supplied).

[8] *Id*. at fn. 48.

[9] As the Commissions noted in the Final Rule, the criteria identified in the product test serve as a "useful tool" to distinguish insurance from swaps and security-based swaps because swaps and security-based swaps do not require the presence of an insurable interest. *Id*. at 48216 ("[T]he Commissions do not [however] interpret any such failure to mean that life insurance, property insurance, and annuities are not insurance products . . . ."). Moreover, the product test is not meant to be all inclusive. Its underlying rationale, therefore, serves as a useful guide for the Commissions' consideration of other products.

[10] *Id*. at 48212.

requirement of a proven loss to the contract beneficiary serves as another *indicium* that a contract is not a swap.[11]

Here as well, the stable value contract falls outside the Commission's swap definition framework. As the SVIA has explained, stable value contracts do not permit any party (plan sponsor, trustee, fund manager or any other fiduciary) to cause the stable value contract provider to make a payment. Indeed, even an individual plan participant's decision to withdraw from his/her stable value fund would not necessarily trigger a payment by the stable value contract provider pursuant to the stable value contract. Rather, it is only under extreme circumstances that participant withdrawals, collectively, could result in the stable value contract provider making payment under the stable value contract. Importantly, in many circumstances, that payment is contingent on the existence of a proven loss to the remaining plan participants. Equally relevant to this discussion, the payment is limited to the difference between the market value and contract value of the stable value fund, in other words, the difference between the market value and the contract value of the pool of wrapped assets supporting the stable value fund, i.e., the insurable interest.

C. Stable Value Contracts are not Traded on an Organized Market or Over the Counter

In distinguishing both insurance products and certain commercial agreements from swaps, the Commissions further seized on the fact that the agreement, contract, or transaction (1) in the case of an insurance product, is not traded, separately from the insured interest, on an organized exchange or over the counter, and (2) with regard to a commercial agreement, is not traded on an organized market or over the counter.[12] As the Commissions explained, this criterion is significant because, absent trading, an agreement, contract or transaction "does not involve risk-shifting arrangements with financial entities, as would be the case for swaps and security-based swaps."[13]

As explained in the SVIA's previous submissions to the Commissions, there is no market in and there is no trading of stable value contracts. Rather, each stable value contract is customized to meet the specific needs of an associated stable value fund and its participants. Because these contracts are individually tailored to the unique requirements of a specific stable value fund, stable value contracts cannot be traded or freely assigned. There is no secondary market for trading stable value contracts, nor does the SVIA believe that such a market could ever exist.[14]

III. Stable Value Contracts Are Incompatible With the Framework Congress Constructed to Regulate Over-The-Counter Swaps

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[11] "The Commissions continue to believe that this requirement is a useful tool to distinguish insurance from swaps and security-based swaps, because payments under swaps and security-based swaps may be required when neither party incurs a loss, nor is the amount of payment limited by any such loss." *Id*. at 48216.

[12] *See id*. at 48212 and 48247.

[13] *Id*. at 48248.

[14] The Commissions clarified that "merely because an agreement, contract, or transaction is assignable does not mean that it is 'traded' or that the agreement, contract, or transaction is a swap or security-based swap." *Id*.

As the CFTC explained, the Dodd Frank Act amended the Commodity Exchange Act ("CEA")

> to establish a comprehensive new regulatory framework for swaps. The legislation was enacted to reduce risk, increase transparency and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating robust and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission's oversight.[15]

The SVIA does not challenge the importance of the task Congress assigned to the Commissions to regulate the over-the-counter swaps markets or the framework Congress constructed to achieve the goals of risk reduction, transparency and market integrity. However, the SVIA strongly believes that the above stated goals would not be advanced by regulating stable value contracts as swaps, and this fact further supports the conclusion that stable value contracts are not swaps and were never intended to be designated or regulated as such.

A. The Lack of Trading of Stable Value Contracts Obviates Concerns about Protecting Market Integrity

The Dodd Frank Act introduced a regulatory framework that governs who can trade, where trading must occur, how trading can occur, and the information that must flow between counterparties and to the market in connection with such trading. Many of these regulatory requirements derive from a concern about the impact of trading on market integrity and the potential to disrupt the process of price discovery.

However, as described above, stable value contracts are neither listed on an exchange nor traded in the over-the-counter market. Indeed, stable value contracts are a bespoke product, individually negotiated between a stable value contract provider and a stable value fund manager and/or plan sponsor, all of whom are sophisticated counterparts. At no point is the broader market privy to the negotiation of the contract terms or the contract as executed. Thus, arguably, the stable value contract is not factored into, and does not have the ability to impact, market prices.

B. Stable Value Contracts are not Clearable

Mandatory clearing, another hallmark of the Dodd Frank Act, is intended to reduce risk within the financial system by centralizing as much of the over-the-counter swap risk as feasible onto regulated exchanges. In this way, it is anticipated that the risk will be more transparent and identifiable and that regulators will be in a position to better manage the risk, for example, through capital and margin requirements imposed on market participants.

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[15] *See*, *e.g.*, 77 Fed. Reg. 9734, 9735 (Feb. 17, 2012).

Stable value contracts, however, cannot be cleared. Each stable value contract is the product of a lengthy analysis that includes a comprehensive review of the associated fund's investment strategy and plan design. Stable value contracts, thus, do not contain standardized, fungible commercial terms that are comparable to most swaps. As a result, stable value contracts cannot, in the estimation of the SVIA, be cleared by a clearinghouse.

Moreover, the SVIA does not believe that trying to force stable value contracts to be cleared would further the goal of reducing risk because stable value contracts do not pose a significant risk. As stated above, stable value contracts do not permit parties to the contract to cause the stable value contract provider to make a payment equal to the difference between market and contract value of the stable value fund. Rather, it is only in the instance of widespread withdrawals by plan participants that the payment obligation might be triggered. As the SVIA previously explained, the likelihood of a large scale withdrawal is inherently limited by the number and diversity of the fund's participants. Although certain external events will affect all plan participants similarly, no single plan participant or group of participants can act unilaterally – there is no "option" to cause a run on the fund. Rather, investment decisions are diffused among a large number of individual decision makers, each making his or her own withdrawal decisions on the basis of his or her own personal circumstances.

C. Swap Data Repository and Real Time Reporting Requirements will not Enhance Price Formation for Stable Value Contracts

Congress and the Commissions have repeatedly stressed the importance of greater market transparency not only to help identify and understand the nature of the risk embedded in the over-the-counter swaps market, but also to facilitate the price discovery process. Access to price and volume information allows market participants to form a better view about how the broader market values a given product and to measure the depth of the market for a particular instrument. A better informed market potentially results in less volatility in prices and greater market integrity.

However, the goal of transparency and the benefits that are expected to flow from greater transparency likely will not materialize through the designation of stable value contracts as swaps. In order for price discovery to occur, the market must perceive the price and volume information from one transaction as a relevant proxy for the value of another to-be-executed transaction. Thus, for example, what a participant is willing to pay today for wheat delivered in Kansas City, Missouri one month from today may be a relevant proxy for other potential buyers and sellers of wheat who are looking to make or take delivery of the same commodity at the same delivery location during a similar time period.

In contrast to more fungible instruments, stable value contracts are not standardized. Rather, each stable value contract is customized to meet the specific needs of an associated stable value fund and its participants. The needs of each stable value fund are a function, among other things, of the fund participants' demographics, the fund's design, and the fund's investment strategy. As a result, the price and volume information associated with a particular stable value contract will be of limited (or no) use to other market participants. Given the inherent limitations in trying to discover information of general application from an otherwise bespoke transaction, the requirement imposed under the Dodd Frank Act of real time reporting of swaps to facilitate the market's price discovery function would seem to fall wide of the mark.

D. Requiring Swap Dealers to Apply the Business Conduct Requirements Standards to Stable Value Contracts would be Difficult and Ineffective

As one final example, Congress saw fit to regulate how market participants, and in particular swap dealers ("SD") and major swap participants ("MSP"), interact with their swap counterparts. To that end, Congress instituted business conduct standards with which SDs and MSPs must comply. These standards include, among other things, obligations to disclose the material risks and characteristics of swap transactions to their counterparts when entering into such transactions, and thereafter the obligation to provide daily marks, scenario analyses, and conflicts disclosures.

Even if there were a need to manage the interaction between counterparts to stable value contracts, which the SVIA believes there is not given the sophisticated nature of the stable value fund managers and plan sponsors who purchase stable value contracts and the defined and limited purpose for which they purchase such contracts, it would be difficult at best for SDs and MSPs to comply with these requirements given that stable value contracts are not traded and that they are bespoke. As but one example, SDs and MSPs for stable value contracts would not be able to create daily marks. Indeed, it is not clear what information they would even use to try and create such marks. And, even if they could create such marks, there would be no readily available means to verify the accuracy of those marks. For these reasons, the Association believes the business conduct standards for SDs and MSPs cannot be applied to counterparties of stable value contracts.

IV. Conclusion

In summary, the SVIA does not believe that stable value contracts are swaps or that regulation of these contracts as such would have any significant benefit to the stability or integrity of the financial system. The Association believes that the logic used by the Commissions in the Final Rule to distinguish and define certain insurance products and commercial agreements as exempt from the swap definition and subsequent regulations, also informs and reinforces the Association's conclusion that the stable value contract is not a swap.

The stable value contract is so fundamentally distinct and different from a swap that as discussed in this letter, it cannot be regulated as a swap. Further, as stated in the SVIA's previous submission, there is and has always been strong and dynamic regulatory oversight of stable value contracts by State and Federal regulators such as state insurance departments, the Federal Reserve, the Office of the Comptroller of Currency, the Federal Department of Labor's Employee Benefits Security and Administration as well as equivalent state regulators who exercise oversight over state and local defined contribution plans. There is no regulatory deficiency with stable value contracts and arguably no corresponding benefits to the financial system or individual plan participants to be gained by regulating stable value contracts as swaps.

The more than 38 years of regulatory oversight provided by the State and Federal regulators discussed above illustrates not only the strength and the success of the existing regulatory framework but also serves as a testament to the strength and history of stable value contracts as a financial product. Stable value contracts are time-tested and proven financial products, which further distinguishes them from the novel or emerging financial instruments that the Commissions have identified as concerning.

Further, determining stable value contracts are swaps and/or regulating these contracts as swaps will cause uncertainty and jeopardize plan participants' and retirees' retirement investments or income. Treating stable value contracts as swaps and/or regulating stable value as a swap, would make this popular conservative investment option that is available only in defined contribution plans unavailable to an investing public that is rapidly facing retirement, such as the baby boomers, as well as all defined contribution plan participants who are looking to either control or minimize their risk in an increasingly volatile financial market. Without stable value, retirees and other defined contribution plan participants would have no alternative but to switch to investments that either carry greater risk or offer lower returns. Congress did not intend to cause such an outcome for the 25 million plan participants and retirees who invest in stable value funds.

The SVIA hopes this discussion provides the Commissions with a better understanding of stable value contracts and why the Association believes that the existing regulatory framework that governs the $645 billion in assets[16] invested by 25 million plan participants in stable value funds is sufficient and achieves the goals of the Dodd Frank Act with respect to "swaps."

Thank you for your consideration of our views. We are available to answer any additional questions you may have at your convenience.

Sincerely,

Gina Mitchell

Gina Mitchell, President
Stable Value Investment Association

[16] SVIA 16th Annual Stable Value Funds Investment and Policy Survey covering stable value assets as of December 31, 2011.