**From:** Brown, Kevin <Kevin.Brown@optinuityar.com>
**Sent:** Monday, September 20, 2010 4:32 PM
**To:** dfadefinitions <dfadefinitions@CFTC.gov>
**Subject:** Definitions
**Attach:** JWB Comments on Dodd-Frank Definitions.pdf

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In response to the request for comments on Definitions Contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, please find the attached letter from Jay Brown, CEO of MBIA Inc.

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**Joseph W. Brown**
Chief Executive Officer
jay.brown@mbia.com

September 20, 2010

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

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

**Re: File Number S7-16-10; Comments on Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act**

Dear Mr. Stawick and Ms. Murphy:

MBIA Inc., on behalf of its financial guarantee insurance subsidiaries National Public Finance Guarantee Corporation ("National") and MBIA Insurance Corporation ("MBIA Corp.") and its transformer (as discussed below) LaCrosse Financial Products, LLC ("LaCrosse"), appreciates the opportunity to provide comments to the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC", and together with the CFTC the "Commissions") as you begin the process of refining the definitions of certain key terms in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Following an extensive review of the legislation, we respectfully request certain clarifications to the definitions of the terms "swap" and "major swap participant" in order to ensure that the implementation of the Dodd-Frank Act reflects the intent of Congress not to regulate insurance policies as swaps and to limit the potential for unintended negative consequences as a result of imposing the requirements of the Dodd-Frank Act on a product and an industry that are already extensively regulated by 50 state insurance regimes and that cannot be viewed as systemically significant to the financial system.

**Background – MBIA Inc. and the Financial Guarantee Industry**

Our financial guarantee insurance generally provides investors with an unconditional and irrevocable guarantee of the payment of the principal, interest or other amounts owing on insured obligations when due or, in the event that we have the right at our discretion to accelerate insured obligations upon default or otherwise, upon our election to accelerate. Because a financial guarantor's ratings are generally assigned to insured obligations, the principal economic value of financial guarantee insurance for capital markets issuers has been the lower interest cost at issuance of an insured obligation relative to the same obligation on an uninsured basis. For investors, our insurance provides not only an additional level of credit protection but also the benefit of our portfolio monitoring and remediation skills throughout the life of the insurance policy. In addition, for complex financings and for obligations of issuers that are not well-known by investors, insured obligations have historically received greater market acceptance than uninsured obligations.

We conduct our financial guarantee business, as well as related reinsurance, advisory and portfolio services, through our wholly-owned subsidiaries National, our United States public finance-only financial guarantee company, and MBIA Corp., which together with its subsidiaries, writes global structured finance and non-U.S. public finance financial guarantee insurance. MBIA Corp. has also written insurance policies guaranteeing the obligations of an affiliate, LaCrosse, under credit default swaps ("CDS").

**Clarification – Financial Guarantee Insurance Policies are Not Swaps**

We believe that the Commissions should clarify that insurance policies, and financial guarantee insurance policies in particular, do not qualify as swaps under the Dodd-Frank Act. As enacted, Section 721(a)(21) of the Dodd-Frank Act includes in the definition of a swap any contract that:

> (ii) 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;

Likewise, Section 761(a)(6) of the Dodd-Frank Act includes in the definition of a security based swap any swap contract that, among other things, involves:

> (III) The occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer.

While these definitions would appear to cover contracts that convey rights or require payments upon the default of a financial obligation, we firmly believe the extension of such a definition to financial guarantee insurance policies is neither appropriate nor warranted given the objectives of the Dodd-Frank Act. From a policy and market standpoint there are two key facts to support this conclusion:

1. Financial guarantee insurance policies are subject to significant state regulation and oversight

   One of the cornerstone objectives of the Dodd-Frank Act was to bring oversight to the previously unregulated over the counter swaps and derivatives market. There can be no doubt that the requirements under Title VII achieve this goal, providing for sweeping changes to the manner in which swaps and derivatives are executed and traded, and to how participants in the market are overseen and capitalized.

   However, the holders of financial guarantee insurance policies already benefit from an extensive system of state regulation and supervision. The regulations cover capital and surplus requirements, risk limits and product approval. In addition, state regulators have the ability to determine the types of insurance guarantees that can be provided by the financial guarantee insurers and the terms under which those financial guarantee insurance policies can be issued. Regulators have broad powers to intervene on behalf of policyholders, and as a result of the current financial crisis, have taken significant action with respect to certain firms in the industry to protect the beneficiaries of financial guarantee insurance policies. We firmly believe that the

existing regulatory framework provides the protections, oversight and transparency necessary for policyholders.

2. Despite the size of the financial guarantee market and the issues that have surrounded the industry over the last three years, there is no mention of insurance products within the definition of "swap" under Title VII of the Dodd-Frank Act

   Discerning legislative intent can be difficult. However, the lack of any reference to insurance, or in particular, financial guarantee insurance, within the very comprehensive definition of a "swap" provides significant insight. Though it is clear that credit default swaps, including those entered into by affiliates of financial guarantors and which benefit from a guarantee of payments when due under the insurance contract, are intended to be covered by the definition with section 721(a)(21), there is no other direct or indirect mention of surety or insurance activities. Given the size and extent of the financial guarantee insurance market, particularly within the U.S. municipal marketplace where a significant portion of outstanding municipal debt continues to carry a financial guarantee insurance policy from a financial guarantor, we believe Congress would have been explicit in directing the inclusion of these products in the definition of swaps had it intended the Dodd-Frank Act to provide the basis for such new regulation.

   The lack of any reference to insurance within Title VII of the Dodd-Frank Act appears even more deliberate in the context of the legislation put forth for the Federal Insurance Office as well as for the mandate of the Bureau of Consumer Financial Protection. The Federal Insurance Office's initial mandate is focused primarily on monitoring the insurance industry, particularly for systemic risks and information gathering and reporting. The Bureau of Consumer Financial Protection is specifically prohibited from regulating insurance products or activities that are currently under the oversight of state regulators. The decision by Congress not to interfere with the state insurance regulatory framework would make the lack of reference to insurance products within Title VII even more telling, further supporting the exclusion of such products from the definition of "swap".

**Clarification - Financial Guarantors and Their Transformers That Have Exited the Swap Market Are Not "Major Swap Participants"**

The Dodd-Frank Act introduced the concept of a major swap participant in order to extend the reach of the proposed regulation outside of the banking and financial industry. In finalizing the legislation, Congress included certain key exceptions for end users to ensure that they did not incur undue financial costs or regulatory burdens which would cause them to reconsider or completely abandon prudent risk management activities. This reasoned approach appropriately took into consideration the activities being undertaken, the costs associated with being designated a major swap participant through increased capital and margin requirements as well as the overall volatility that would be introduced into the capital markets and the respective end user industries should such hedging activities cease.

An extension of such an approach seems appropriate in the context of certain firms and special purpose entities that are just now recovering from the financial crisis. Financial guarantee insurance companies, including MBIA Corp., have significant exposure to credit default swaps,

including credit default swaps on structured products such as collateralized debt obligations ("CDOs") and CDOs of asset backed securities ("CDOs of ABS") as a result of business written in the period leading up to 2008. The credit default swaps guaranteed by financial guarantee insurers were entered into by affiliate special purpose entities, including LaCrosse, generally referred to as "transformers." The purpose of the transformers was to act as the counterparty under the derivative on a bilateral basis with another financial institution, generally large, sophisticated money center banks and investment banks. The transformers were themselves minimally capitalized, had no employees and no business activities other than entering into credit default swaps wherein the transformer would agree to provide credit protection on an asset or basket of assets, such as CDOs or CDOs of ABS. The obligations of the transformer, which included the payment of principal and interest when due on the financial assets subject to the credit protection, or payments as due resulting from default of the reference asset, were in turn guaranteed by the affiliated financial guarantee insurance company.

In the case of MBIA and other New York domiciled insurers, the credit default swap activities, including the guarantees thereof, were permissible under Article 69 of the New York State Insurance Law, and non-New York financial guarantee insurers were subject to the insurance laws of their respective states of domicile. Moreover, the financial wherewithal of the various parties, including the transformers, was fully understood by all of the parties to the swap contracts. Unlike AIG, we carefully and intentionally excluded margin and collateral requirements from our derivative contracts in order to protect our company's liquidity and solvency in times of market dislocation and stress.

We are not aware of any company within the financial guarantee industry that has insured a new credit default swap since early 2009. MBIA Corp. permanently ceased all new credit default swap activities in early 2008.

It is this backdrop that we firmly believe must be considered in process of determining which firms or industries will be designated as major swap participants, and more importantly, what rules will define when a firm, which might otherwise meet certain of the current definitional terms, would not be included in such designation.

For MBIA Corp. and LaCrosse in particular:

> <u>No new credit default swaps have been entered into by its transformer, LaCrosse Financial Products, since early 2008</u>
>
> While LaCrosse maintains a book of credit default swaps with a notional amount in excess of $100 billion, it has not added to this exposure in over two and a half years, and does not contemplate the execution of any additional credit default swaps outside of very limited circumstances associated with restructuring or remediating an existing transaction.
>
> <u>Losses associated with expected future payments under the credit default swaps are required to be adequately reserved by MBIA Corp., the guarantor</u>
>
> As a regulated insurance company, MBIA Corp. is responsible for maintaining adequate reserves for expected losses under the credit default swap contracts it has guaranteed for LaCrosse.

Loss reserves on guaranteed credit default swaps are a fraction of the aggregate notional amount outstanding under LaCrosse's credit default swaps and LaCrosse's aggregate notional outstanding is a fraction of the overall market, limiting the credit risk MBIA Corp. poses to any one financial institution or to the entire financial system.

We do not believe that MBIA Corp., or even the financial guarantee industry as a whole, can or will create systemic financial risks for the US financial markets given the insignificance of loss reserves compared to the notional amount of guaranteed credit default swaps or to the notional amount outstanding in the broader market.

The obligations of MBIA Corp. under its guarantee of credit default swaps fall under the regulatory authority and oversight of the New York State Insurance Department

Unlike most other potential major swap participants, MBIA Corp. benefits from an experienced and diligent regulator who monitors its statutory surplus, liquidity and claims paying resources.

We believe that the Commissions should consider clarifying the definition of the term major swap participant to account for the following:

- Whether the entity in question is subject to any other form of regulation, either at the federal or state level, particularly with respect to its swap and derivative activities
- Whether or not the entity in question, or affiliates thereof, continue to actively enter into swap transactions

In the case of MBIA Corp. and LaCrosse, we believe the lack of systemic risk implications, the oversight of a highly capable regulator in the New York State Insurance Department and our decision to permanently cease insuring new credit default swaps creates an appropriate and defendable case for the implementation of these definitional refinements.

We appreciate the opportunity to provide you with our thoughts on these issues and look forward to providing the Commissions with additional input on the remaining parts of the Dodd-Frank Act. We would welcome any questions you may have and look forward to working constructively with you as the Dodd-Frank Act is implemented.

Sincerely,