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February 22, 2011

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: Definitions - File Number S7-39-10

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, 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 seek to further define certain key terms under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), including "swap dealer," "security-based swap dealer," "major swap participant" and "major security-based swap participant".

National and MBIA Corp. are both active members of the Association of Financial Guaranty Insurers ("AFGI"). AFGI has submitted a comment letter to the Commissions under separate cover on these definitions and other interpretative issues (the "AFGI Letter") which is included herein as Attachment I. National and MBIA Corp. fully support AFGI's positions and recommendations and would like to emphasize certain key points expressed in their letter, in particular:

(i) that the Commissions should clarify the definitions of "swap dealer," "security-based swap dealer," "major swap participant" and "major security-based swap participant" to specifically exclude entities whose sole exposure to swaps and other derivatives is contained in legacy, discontinued portfolios; and

(ii) that a named swap or security-based swap counterparty's position should not be attributed to an unaffiliated third-party insurer of such obligations under a financial guarantee insurance policy.

In addition, we would respectfully ask the Commissions to clarify that insurance products, including financial guarantee insurance products, are neither "swaps" nor "security-based swaps" for the purposes of the Dodd-Frank Act.

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, has written 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 certain credit default swaps ("CDS").

Legacy Portfolios

The Commissions have requested comment as to whether the definition of "major swap participant" and "major security-based swap participant" should exclude entities whose portfolios are limited to legacy positions that were entered into in connection with the activities of monoline insurance companies, such as MBIA Corp., or credit derivative product companies. As we noted in our letter to the Commissions dated September 20, 2010 (included as Attachment II), we believe the context of these entities' past and future business operations, as well as the risks they present to overall capital markets, must be considered when finalizing these critical definitions. We firmly concur with AFGI that the Commissions should explicitly clarify that such an entity should <u>not</u> be designated as a "major swap participant" or a "major security-based swap participant," nor as a "swap dealer" or a "security-based swap dealer" based solely on discontinued business activities.

LaCrosse permanently ceased executing new credit derivative transactions in early 2008. With the very limited exception of possible loss mitigation and other remediation efforts relating to its existing book of business, LaCrosse does not contemplate the execution, nor will MBIA Corp. or National undertake the guarantee of, new credit default swaps. The cessation of these activities leaves a residual book of business that MBIA will manage and service until such time as all existing contracts either mature or are terminated. Designation of these entities as "swap dealers," "security-based swap dealers," "major swap participants" or "major security-based swap participants" would be fundamentally inconsistent with a regulatory framework, as promulgated under Title VII of the Dodd-Frank Act, that is meant to oversee and control the ongoing activities of market participants, rather than to introduce new risks or financial strain based on discontinued operations.

Guarantees of Unaffiliated Entities

The Commissions have requested comment on whether attribution of swap and security-based swap positions is appropriate when third parties provide guarantees on behalf of unaffiliated entities. Likewise, the Commissions have requested comment as to whether an entity could be designated as a "major swap participant" or "major security-based swap participant" based solely on guarantees it provides for unaffiliated third parties.

To be clear, we understand the Commissions' concerns over the possible dispersion of derivative related market risks to entities that are not direct counterparties to the related contracts, and therefore potentially not subject to the oversight and regulation contemplated by the Dodd-Frank Act. We appreciate that this is particularly true with respect to credit support providers, whose guarantees of performance under a derivative contract expose them to certain financial risks in the case of non-performance by the counterparty that is subject to such support.

It is important, in the context of financial guarantee insurers, to understand the basis under which certain guarantees of derivative contracts arise, the means by which such guarantees would result in financial liability for the insurer, and the fundamental economic risks involved. As noted in the AFGI Letter, National, along with almost all of the other financial guarantors, guarantees the obligations of certain U.S. municipal entities under traditional fixed to floating interest rate swaps. Such guarantees were provided in order to allow a municipal issuer to access floating rate investors while locking in a fixed rate cost of funds. As the AFGI Letter illustrates, though two insurance policies were generally issued, including one to protect the bank intermediating the fixed to floating rate swap and one to protect the bond holders purchasing the municipalities' obligations, the economic exposure to the financial guarantor was the equivalent of having underwritten a fixed rate bond issued by the particular municipal entity. Such exposures are subject to the normal underwriting process at National as well as significant risk management and regulatory oversight. The counterparties subject to such guarantees are diversified across approximately 50,000 issuers of municipal debt throughout the United States and it is only upon their individual default, a risk incurred and underwritten in the ordinary course by National, that any exposure to a potential payment would come due. Further, it is important to note that in such a case, payment would have been necessary even in the absence of a derivative.

Consequently, we respectfully request that the Commissions clarify that the swap contracts guaranteed by financial guarantors will not be attributed to the financial guarantors for the purposes of the above-mentioned definitions under the Dodd-Frank Act.

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 inclusion of financial guarantee insurance policies within the scope of the definitions 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

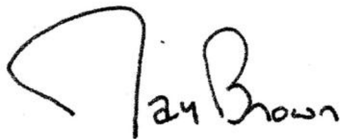
inclusion of these products in the definition of swaps had it intended the Dodd-Frank Act to provide the basis for such new regulation.

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". Finally, the McCarran-Ferguson Act requires Congress to express a clear intention to override state regulation of insurance when it intends to do so, and the Dodd-Frank Act is notably silent in this regard.

In summary, we respectfully ask that the Commissions clarify the definitions of "swap dealer," "security-based swap dealer," "major swap participant" and "major security-based swap participant" to specifically exclude entities whose sole exposure to swaps and other derivatives is contained in legacy, discontinued portfolios. Likewise, we believe it is important for the Commissions to clarify that a named swap or security-based swap counterparty's position should not be attributed to an unaffiliated third-party insurer of such obligations under a financial guarantee insurance policy. Finally, we request that the Commissions clarify the definitions of "swap" and "security-based swap" to specifically exclude insurance products, particularly financial guarantee insurance policies.

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,



Attachment I

ASSOCIATION OF FINANCIAL GUARANTY INSURERS

Unconditional, Irrevocable Guaranty ®

February 18, 2011

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: Release No. 34-63452; File Number S7–39–10, Definitions (the "Proposed Interpretations")

Dear Ms. Murphy and Mr. Stawick:

The Association of Financial Guaranty Insurers ("**AFGI**") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "**CFTC**") and the Securities and Exchange Commission (the "**SEC**" and, together with the CFTC, the "**Commissions**") with its comments on the Proposed Interpretations regarding the definitions of "swap dealer," "security-based swap dealer," "major swap participant" and "major security-based swap participant" pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"). AFGI is the trade association for financial guaranty insurers and reinsurers.

AFGI commends the Commissions for evaluating the potential regulatory burden of their rulemakings under Title VII prior to adoption. Such an evaluation is consistent with President Obama's recent initiative to focus federal agencies on the proper balance between promoting economic growth and protecting the public interest.[1]

In the Proposed Interpretations, the Commissions requested comments on whether (a) state-regulated insurers should be excluded from regulation under certain

[1] Exec. Order No. 13563, 76 Fed. Reg. 3821 (Jan. 21, 2011).

aspects of Title VII; (b) the rules should exclude an entity from the definitions of major swap participant and major security-based swap participant if such entity's positions are limited to legacy portfolios; and (c) attribution of a swap or security-based swap position would be appropriate when third parties provide guarantees of swap or security-based swap obligations of unaffiliated entities.

For the reasons discussed in this letter, AFGI submits that (a) the Commissions should clarify that neither the definition of "swap" nor the definition of "security-based swap" encompasses insurance policies issued by state-regulated insurers (as a subsidiary matter, the exclusion of state-regulated insurers from the definitions of major swap participant and major security-based swap participant also would address some of AFGI's concerns); (b) financial guaranty insurers and their affiliated "transformers" (described below) that have ceased adding new swap and security-based swap transactions to their insured portfolios should not be characterized as swap dealers, security-based swap dealers, major swap participants or major security-based swap participants based on their legacy portfolios; and (c) attribution to a financial guaranty insurer of swap or security-based swap positions would not be appropriate when the insurer guarantees a swap or security-based swap obligation of an unaffiliated entity.

Overview of the Financial Guaranty Industry

Financial guaranty insurers provide insurance policies in both U.S. and international public finance, infrastructure and structured finance markets. Such insurers apply their credit underwriting judgment, risk management skills and capital markets experience to develop insurance and reinsurance policies, including their primary product – the guaranty of principal and interest payments on third party debt securities. Debt securities guaranteed by such insurers include municipal finance obligations issued by state and local governmental authorities, utility districts and facilities, notes and bonds issued to finance international infrastructure projects and asset-backed securities issued by special purpose entities to provide financing for companies in the United States and internationally. Financial guaranty insurers market these products directly to issuers and underwriters of public finance, infrastructure and structured finance securities and to U.S. and foreign investors in such debt obligations.

Financial guaranty insurance policies facilitate the access of municipalities and other issuers to the capital markets and lower their borrowing costs. Smaller and lower-rated issuers rely on financial guaranty insurance to increase market liquidity. In fact, the

majority of transactions insured by financial guaranty insurers in 2010 were small issuances – the average par amount of new insured issues was less than $20 million – usually by small and lower-rated issuers such as cities, towns and school districts that would not have been able to access the market without insurance. These policies also benefit investors, as the marketability and trading prices of otherwise illiquid, uncommon or complex debt obligations, as well as those issued by infrequent issuers such as rural municipalities, are generally improved by the application of a financial guaranty insurance policy.

In addition to issuing financial guaranty insurance policies directly covering third party obligations, prior to 2009 financial guaranty insurers also wrote policies insuring CDS of affiliated special purpose entities known as "transformers." The transformers' sole purpose was to sell credit protection, and they typically engaged in no business other than writing CDS insured by their affiliated insurers. No financial guaranty insurer has insured a CDS transaction since early 2009, other than in connection with loss mitigation and other remediation and restructuring efforts relating to existing books of business.

Exclusion of State-Regulated Insurers from the Definitions of Major Swap Participant and Major Security-Based Swap Participant

The Commissions have requested comments on whether state-regulated insurers should be excluded from the major swap participant and major security-based swap participant definitions on the grounds that such entities do not present the risks that are the focus of Title VII, and to avoid duplication of existing regulation. Exclusion of state-regulated insurers from the definitions of major swap participant and major security-based swap participant would address some of AFGI's concerns. However, as discussed in more detail below, AFGI submits that, as a preliminary matter, the definitions of "swap" and "security-based swap" should be interpreted by regulation to clarify that they exclude insurance policies, including financial guaranty insurance policies and surety bonds, issued by state-regulated insurers. Without such clarity, market participants are unable to thoughtfully gauge the impact of the proposed rules because they do not know what activity would be considered "swap" or "security-based swap" activity.

The McCarran-Ferguson Act Precludes the Regulation of Insurance, Including Financial Guaranty Insurance, as Swaps or Security-Based Swaps Under the Dodd-Frank Act

Congress did not intend for Title VII of the Dodd-Frank Act to introduce a new regime for the regulation of insurance. The McCarran-Ferguson Act[2] requires Congress to express a clear intention to override state regulation of insurance when it intends to do so, and the Dodd-Frank Act does not include any such clear expression.

The McCarran-Ferguson Act states that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." The Supreme Court has stated that the law "seeks to protect state regulation primarily against inadvertent federal intrusion – say, through enactment of a federal statute that described an affected activity in broad, general terms, of which the insurance business happens to constitute one part."[3] The Second Circuit has similarly stated that "federal laws will be presumed not to reach insurance unless Congress expressly states an intent do so."[4]

Title VII provides that swaps and security-based swaps are not to be considered insurance and the states may not regulate them as such,[5] thereby defeating recent state proposals to regulate as insurance all CDS, including those issued by banks and other financial institutions. Congressional intent to maintain exclusive federal jurisdiction over swaps and security-based swaps does not, however, suggest a similar intent to mandate the federal regulation of products long recognized and regulated as insurance. In fact, characterizing transactions already regulated as insurance as swaps or security-based swaps, together with the Dodd-Frank Act's prohibition on state regulation of swaps and security-based swaps, would have the perverse effect of displacing a currently active, substantial and comprehensive state regulatory regime with a regime not designed to

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[2] 15 U.S.C. §§ 1011-1015.

[3] *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 39 (1996) (emphasis in original).

[4] *Lander v. Hartford Life & Annuity Ins. Co.*, 251 F.3d 101, 115 (2d Cir. 2001).

[5] Dodd-Frank Act §§ 722, 767.

regulate insurance. There is no evidence that Congress intended to do this, and much evidence that it did not.[6]

Financial Guaranty Insurers Are Already Subject to Extensive State-Based Regulation

Financial guaranty insurers are currently regulated extensively by state insurance law. For example, Article 69 and other provisions of the New York Insurance Law apply to all financial guaranty insurers incorporated or licensed in New York and impose comprehensive requirements on financial guarantors, including: minimum surplus to policyholders (i.e., minimum capital levels) and contingency reserves; single and aggregate risk limits; investment portfolio diversification requirements; dividend payment restrictions; financial reporting and market conduct rules; and books and records examinations.[7]

During the fall of 2008, in order to address the challenges faced by the financial guarantors during the financial crisis, the New York Insurance Department issued Circular Letter No. 19,[8] which set forth certain "best practices" applicable to all New York-licensed financial guarantors. Notably, Circular Letter No. 19 prohibits financial guaranty insurers from posting collateral in connection with structured credit transactions. This is consistent with the long-standing public policy against favoring one set of insurance policyholders over another in insolvency. Circular Letter No. 19 also requires financial guarantors to, among other things, limit their issuance of policies that back collateralized debt obligations of asset-backed securities, apply stricter single risk limits, increase their capital and surplus levels and comply with additional reporting requirements. Clearly, this extensive state regulatory regime would be impaired or superseded by the application of Title VII's requirements to financial guaranty insurers.

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[6] For example, when speaking on the Dodd-Frank Act, Rep. Peters noted that Title VII was intended to, "for the first time, bring transparency and oversight to the *currently unregulated* $600 trillion derivatives market" (emphasis added). Similarly, Sen. Stabenow noted that reform was necessary as "[f]or too long the over-the-counter derivatives market has been unregulated." To our knowledge, no member of Congress explicitly suggested that Title VII was intended to replace or even supplement state insurance regulation.

[7] New York Insurance Law §§ 6901-6909.

[8] State of New York Insurance Department, "Best practices" for financial guaranty insurers (2008), *available at* http://www.ins.state.ny.us/circltr/2008/cl08_19.pdf.

Financial Guaranty Insurance Policies Differ Significantly from Traditional Swaps and Security-Based Swaps

There are numerous substantive differences between financial guaranty insurance policies (and surety bonds) issued in connection with the offering of a covered security and CDS contracts issued in reference to an obligation. While CDS may be used to hedge a wide range of exposures, such contracts also may be used to take purely speculative positions without any ownership stake in the underlying obligation. Unlike the beneficiaries of financial guaranty insurance policies, CDS counterparties are not required to have an insurable interest in the reference obligation, and transactions can be structured to allow the outstanding notional amounts of CDS to far exceed the outstanding principal amount of the reference obligation. Similarly, unlike CDS that are independent of the underlying obligation, a financial guaranty insurance policy is inseparable from the covered security and necessarily trades with such security. In other words, a financial guaranty insurance policy is effectively part of the security to which it is attached and does not require any performance by the policy beneficiary (other than possession of the underlying obligation).[9]

Financial guaranty insurance policies generally pay interest shortfalls over time and principal when scheduled to be paid according to the terms of the insured obligation (as if there were no default) and do not permit acceleration of payments except at the option of the insurer. In contrast, CDS may require physical settlement of the entire notional amount upon specified events, such as a failure to pay (even if the payment failure relates to a relatively small fraction of the notional amount, such as a single interest payment). Because financial guaranty insurance policies do not provide for any mark-to-market termination payments(unless they guarantee CDS termination payments), such policies are not subject to the same volatility as CDS.

Further, financial guaranty insurers typically have control, information and inspection rights with respect to the insured obligations and often provide direct assistance in restructuring transactions and remediating defaults, whereas the rights of CDS counterparties are generally much more limited. Financial guaranty insurance provides the insured securityholder with comfort that: (i) the underlying obligation was

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[9] The Commissions have recognized a similar difference between swaps as opposed to securities and commodities by noting that swaps "are notional contracts requiring the performance of agreed terms by each party." 75 Fed. Reg. 80174, 80176 (Dec. 21, 2010).

underwritten by the insurer to comply with its underwriting standards requiring an investment grade underlying obligation; (ii) performance of the obligation will be monitored by the insurer over the life of the obligation; and (iii) the insurer will be responsible for controlling any remediation activities should that become necessary, with respect to the underlying obligation.

As a further distinction, an insured bond generally carries a rating based upon the higher of the rating of the insurer and the rating of the underlying obligation, which does not apply in the case of CDS.

Market participants have long distinguished financial guaranty insurance policies from CDS. In addition, the Financial Accounting Standards Board has issued separate accounting guidance, with treatment of financial guaranty insurance addressed under ASC 944[10]and treatment of CDS addressed under ASC 815.[11] Entities dealing in both types of transactions are required to apply different accounting methodologies, including with respect to premium revenue recognition and claims liability measurement.

Congress Did Not Intend to Address Substantive Federal Regulation of Insurance in the Dodd-Frank Act

The Dodd-Frank Act requires the director of the Federal Insurance Office to prepare a report for Congress on improving U.S. insurance regulation. The report must cover, among other topics, the costs and benefits of potential federal regulation of insurance and the feasibility of regulating only certain lines at the federal level. In addition, Rep. Barney Frank (D-MA), former Chairman of the House Financial Services Committee, stated after the passage of the Dodd-Frank Act that legislation regarding federal regulation of insurance, including an optional federal charter, was yet to come. Accordingly, we submit that Congress views substantive federal regulation of insurance as a topic for consideration in the future and not a bridge already crossed by the Dodd-Frank Act.

[10] Financial Account Standards Board, ASC 944: Financial Services – Insurance.

[11] Financial Account Standards Board, ASC 815: Derivatives and Hedging.

Exclusion of Legacy Portfolios in Determining Swap Dealers and Security-Based Swap Dealers

For the reasons set forth below, the Commissions should, for the avoidance of doubt, clarify that an entity may not be designated as a swap dealer or security-based swap dealer based solely on discontinued business activities.[12]

The Statutory Definitions of Swap Dealer and Security-Based Swap Dealer Solely Contemplate Current Swap Dealing Activities

The Dodd-Frank Act defines "swap dealer" as "any person who– (i) *holds* itself out as a dealer in swaps; (ii) *makes* a market in swaps; (iii) regularly *enters* into swaps with counterparties as an ordinary course of business for its own account; or (iv) *engages* in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps."[13] Significantly, the qualifying activities are defined in a functional manner, encompassing the nature of a person's activities in the market. In addition, Title VII makes it illegal "to act as a swap dealer unless . . . registered as a swap dealer,"[14] which provides further evidence of the statutory focus on a person's current actions and not its past activities. Similar provisions apply to security-based swaps.

While we support the Commissions' view that the definitions should not be interpreted in a constrained manner, we believe that the legislative intent, when Congress cast these definitions in the present tense, was to limit the designations as swap dealer or security-based swap dealer solely to persons who currently or on an ongoing basis engage in swap or security-based swap dealing activities.

Designation as a Swap Dealer or Security-Based Swap Dealer Based on Discontinued Business Activities Would Do Little to Promote Title VII Policy Goals

Title VII provides business conduct standards to promote fair dealing and codifies best practices and reporting and recordkeeping requirements to reduce risk and

[12] For the reasons set forth above, we assume that financial guaranty insurance is not a swap or security-based swap under the Dodd-Frank Act and therefore exclude such insurance policies from our discussion of the definitions of "swap dealer" and "security-based swap dealer."

[13] Dodd-Frank Act §§ 721, 761 (emphasis added). While the definitions of swap dealer and security-based swap dealer vary, the relevant portions for the purposes of this letter are substantially similar.

[14] Dodd-Frank Act §§ 731, 764.

enhance operational standards.[15] These and related requirements, however, address the execution of swaps and security-based swaps and supporting activities. As such, application of these standards to those who no longer enter into new swap or security-based swap transactions would do little to advance these policy goals.

We recognize and support Title VII's goals of increasing swaps and security-based swaps market integrity and reducing counterparty risk through the improved soundness of its participants.[16] Requiring an entity to comply with capital and margin requirements with respect to legacy portfolios, however, could actually reduce the stability of the market. In addition, the retroactive application of margin requirements to private bilateral contracts, which were specifically negotiated to exclude such terms, could be detrimental to the financial condition and liquidity of the counterparties. Moreover, compliance with margin requirements, even if possible, would also subordinate insured municipal bondholders and other policyholders to CDS counterparties (generally large financial institutions).

We agree with Chairman Gensler and Chairman Schapiro, who recognized this risk when they testified before the Senate Banking Committee and indicated that margin requirements "should be prospective, not retrospective" and that the Commissions "would be hard pressed to suggest that there ought to be retroactive application of margin."[17] Similarly, the application of new capital requirements to entities whose swap and security-based swap positions are limited to legacy portfolios would not advance the policy goals of Title VII.

To avoid uncertainty, the interpreting regulations should specify that entities are not to be designated as swap dealers or security-based swap dealers solely based on discontinued activities.

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[15] Dodd Frank Act § 731, 764.

[16] We also recognize Title VII's goal of transaction transparency but respectfully submit that designation as a swap dealer or security-based swap dealer is a secondary method for providing the appropriate information to the market and the Commissions because Title VII and the Commissions' rules require the reporting of all swaps and security-based swaps, regardless of the counterparties' status.

[17] *Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 111th Cong. (2010).

The Definitions of Major Swap Participant and Major Security-Based Swap Participant[18]

The definitions of "major swap participant" and "major security-based swap participant" focus on the market impacts and risks associated with an entity's swap and security-based swap positions.[19] The Commissions have requested comment on whether the proposed rules further defining major swap participant and major security-based swap participant should exclude certain entities that maintain legacy portfolios of credit default swaps that previously had been entered into in connection with the activities of monoline insurers.[20] We believe that further regulation of such entities as major swap participants or major security-based swap participants would do little to reduce market risk.

Designation as a Major Swap Participant or Major Security-Based Swap Participant Based on Discontinued Business Activities Would Do Little to Promote Title VII Policy Goals

In particular, no financial guaranty insurer has insured a CDS of an affiliated transformer since early 2009, other than in connection with loss mitigation and other remediation and restructuring efforts relating to existing books of business, and it is unlikely that any existing financial guaranty insurers would write policies covering transformer CDS in the future.[21] Additionally, state insurance departments have undertaken significant efforts to address the impact of the economic crisis on financial guaranty insurers, including the impact on their legacy CDS portfolios, in an orderly manner that limits claims jumping and avoids larger systemic impact.

By definition, legacy portfolios present a risk to the market that diminishes as a result of the passage of time without the addition of new business. Not only does the aggregate outward exposure of an entity's portfolio decline over time, but the number of

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[18] For the reasons set forth above, we assume that financial guaranty insurance is not a swap or security-based swap under the Dodd-Frank Act and therefore exclude such insurance policies from our discussion of the definitions of "major swap participant" and "major security-based swap participant."

[19] 75 Fed. Reg. 80174, 80185 (Dec. 21, 2010).

[20] *Id*. at 80202 (Dec. 21, 2010).

[21] Obviously any new CDS transactions would not benefit from an exclusion for legacy transactions and would have to be analyzed in the context of the regulatory framework in place at the time.

individual institutions facing the entity decreases as the transactions expire. Because the run-off swap and security-based swap portfolios insured by financial guaranty insurers are confined to affiliated special purpose vehicles who do not conduct any other business activities, the related risk to the insurers is also more transparent and isolated. In addition, the fact that many financial guaranty insurers have already undergone significant restructurings since the crisis, without meaningful impact on the broader financial services sector, indicates that financial guaranty insurers do not present the systemic risk at issue in Title VII.

Policy concerns that justify considering only the current activities of an entity for purposes of the definitions of swap dealer and security-based swap dealer apply equally to the definitions of major swap participant and major security-based swap participant. That is: (a) the business conduct standards are only relevant in the context of on-going business activities; (b) the retroactive application of margin and capital requirements would be unnecessarily and unfairly disruptive if applied to legacy portfolios; and (c) the recordkeeping and reporting requirements of Title VII are adequately addressed without the designation of financial guarantors or their transformers as major swap participants or major security-based swap participants. As a result, an entity should not be deemed to be a major swap participant or major security-based swap participant solely as a result of its holding a legacy portfolio of swaps or security-based swaps.

Swaps and Security-Based Swaps of Unaffiliated Entities Should Not Be Attributed to Financial Guaranty Insurers Which Guarantee the Swaps or Security-Based Swaps as Part of their Basic Business

The Commissions have requested comment on whether attribution of swap and security-based swap positions would be appropriate when third parties provide guarantees on behalf of unaffiliated entities and, similarly, whether the major swap participant and major security-based swap participant definitions should be interpreted to encompass an entity that provides a guarantee of a named swap or security-based swap counterparty's obligations.

In addition to the activities of transformer affiliates described above, financial guarantors have often guaranteed, through the issuance of a financial guaranty insurance policy, the obligations of unaffiliated parties under swaps with other unaffiliated parties. These insurance policies typically cover obligations of municipalities under interest rate

or basis swaps relating to bonds issued by municipalities or in connection with asset-backed securities. During the past decade, these swaps played a significant role in the financing activities of many municipal issuers, and the combination of swaps and financial guaranty insurance has often helped municipalities lower and stabilize their borrowing costs. As such, these policies are an integral part of financial guarantors' basic business.

In a typical transaction of this nature, a municipality issues floating-rate bonds at the same time that it enters into a floating-to-fixed rate swap with the bank that is underwriting the bonds. The financial guaranty insurer will issue two policies: one to protect bondholders from the municipality's default on the bonds, and the other to protect the bank from the municipality's default on the swap. However, because the bank continues to pay the floating-rate leg of the swap even if the municipality has defaulted on the swap (because the financial guarantor makes the fixed-rate payments), the financial guarantor's exposure is of the same character or risk profile as a guarantee on a fixed-rate bond issued by the municipality. In the vast majority of these types of policies, the financial guarantor is not exposed to the fluctuating termination value of the interest rate swap, as it does not guarantee payment of that amount. In every case, the decision to provide the financial guaranty insurance is part of the standard underwriting process at the financial guarantor. This is the fundamental business of financial guarantors and is therefore subject to the comprehensive risk management, capital, regulatory and other constraints discussed in more detail above.

As a result, the swap obligations of municipalities which benefit from financial guaranty insurance policies should not be attributed to the provider of the policy for purposes of the definitions of major swap participant and major security-based swap participant.

* * * *

For the reasons stated above, the Commissions should clarify by regulation that: (1) the definitions of "swap" and "security-based swap" exclude insurance policies, including financial guaranty insurance policies and surety bonds; (2) an entity may not be designated as a "swap dealer," "security-based swap dealer," "major swap participant" or "major security-based swap participant" based on discontinued business activities; and (3) a named swap or security-based swap counterparty's position should not be attributed to

an unaffiliated entity guaranteeing such counterparty's obligations through a financial guaranty insurance policy.

We thank the Commissions for the opportunity to comment in advance of their joint rulemaking to implement the Dodd-Frank Act. We appreciate the Commissions' consideration of our views on the impact of Title VII on financial guaranty insurers. If you have any questions, please do not hesitate to contact me at bstern@assuredguaranty.com or (212) 339-3482.

Sincerely,

Bruce E. Stern
Chairman, AFGI Government Affairs Committee

Attachment II

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,