National Association *of* Insurance Commissioners
The Center for Insurance Policy and Research

February 23, 2011

David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Re: Confirmation, Portfolio Reconciliation and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants

Dear Mr. Stawick:

We write on behalf of the National Association of Insurance Commissioners (NAIC) to submit this comment regarding the Commodity Futures Trading Commission's (the "Commission") proposed rule regarding Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants.[1] Founded in 1871, the NAIC is the voluntary association of the chief insurance regulatory officials of the 50 states, the District of Columbia and the five U.S. territories. The NAIC serves the needs of state insurance regulators as they protect consumers and maintain the financial stability of the marketplace.

<u>Portfolio Compression</u>

We have reviewed the Commission's proposed rule and are concerned that aspects of the rule relating to portfolio compression could undermine state regulators' ability to effectively monitor certain insurers for solvency. As indicated in previous submissions, insurers enter into swaps to either hedge commercial risks or for the purpose of income generation. They also use swaps to create replications that would serve these purposes. By far, the most prominent use of swaps by insurers is for hedging—approximately 92 percent of all swaps are used by insurers for this purpose.

Consistent with our comment to the Commissions dated February 18, 2011, we believe few insurers should be designated by the Commission as major swap participants or swap dealers because insurers primarily use swaps for hedging risks.[2] However, to the extent certain insurers may receive

[1] Confirmation, Portfolio Reconciliation, and Portfolio Compression for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 81519-81532 (December 28, 2010).
[2] We also incorporate by reference letter comments submitted on September 20, 2010 and November 9, 2010, which detail how insurers use swaps, and the extent and nature of their regulation by state insurance regulators.

such designations, we are concerned that a rule that potentially requires such entities to terminate each fully offsetting swap among themselves and other major swap participants or swap dealers will undermine the ability of those insurers to hedge risks, and hinder the state regulators' ability to regulate the solvency of the insurer. While we recognize that the proposed rule includes an exception in §23.503(c)(3)(i) that allows entities to exclude swaps from the proposed rule if the inclusion of the swap in the portfolio compression exercise would be reasonably likely to significantly increase the entity's risk exposure, we are not convinced that the language of the exception adequately addresses these concerns.

Provided it is done in compliance with relevant state investment and reporting laws, entering into swaps for hedging purposes is encouraged by state insurance regulators because it reduces an insurer's risk exposure. Despite the exception, we are concerned that the portfolio compression rule would nevertheless require certain insurers to terminate certain swap trades used for hedging. This would have the effect of leaving certain positions unhedged that the insurer and the state regulator feel are appropriate or beneficial to hedge. Depending on the nature of the position and the extent of the trades implicated by the proposed rule, terminating such positions could affect the overall solvency of the insurer and, by extension, threaten policyholder interests.

Even more significantly, such a rule could limit the ability of regulators to effectively monitor the swap positions of insurers. State insurance laws and regulations have detailed reporting and valuation rules that require insurers to literally "tag" each swap position to specific hedging, replication, or income generation transactions. If insurers' positions did not meet the proposed rule's exception, those subject to the rule might have to utilize a different approach to taking such positions, and would most likely do so on a portfolio basis. Portfolio trades are less transparent to insurance regulators because they make it difficult for insurance regulators to track the particular risk being hedged by the swap position and confirm the effectiveness of the hedge.

In light of these concerns, we respectfully request that §23.503 incorporate language whereby any swap position of an insurer that is specifically designated or tagged to the instrument being hedged as required by state insurance statutory accounting rules be allowed to remain outstanding and not be subject to portfolio compression rules.[3] Swap positions that are designated or tagged in this manner serve a specific legally permitted purpose within the insurance companies' portfolio strategy and are specifically monitored by insurance regulators in this manner. If this language is adopted by the Commission, the rule would continue to be in place for naked positions held by insurers, but the rule would reflect the extent and nature of insurer uses of swaps, and, even more importantly, not conflict with the states' regulation of the insurer for solvency.

Conclusion

We appreciate the opportunity to comment and look forward to continuing the open and constructive dialogue we have had with the Commission to date. Should you wish to discuss this comment or any other matter relating to the NAIC's views on the rulemaking process, please do not hesitate to contact Ethan Sonnichsen, Director of Government Relations, at (202) 471-3980; Moira Campion McConaghy, Government Relations Manager; at (202) 649-4997; or Mark Sagat, Government Relations Analyst and Counsel, at (202) 471-3987.

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[3] This proposal might also be appropriate for other types of financial institutions, but we defer to the considerable expertise of the Commission and such entities' primary financial regulators in this regard.

Sincerely,

Susan E. Voss, Commissioner
Iowa Insurance Division
NAIC President

Therese M. Vaughan, Ph.D.
NAIC Chief Executive Officer