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December 3, 2010

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Re: **Definitions Contained in Title VII of Dodd-Frank Wall Street Reform And Consumer Protection Act: Clarifying the Status of Insurance Products under the Definition of "Swap" in Title VII of the Dodd-Frank Act (Securities and Exchange Commission File No. S7-16-10)**

We are submitting this letter on behalf of the Committee of Annuity Insurers in response to the Securities and Exchange Commission's (the "SEC") and the Commodity Futures Trading Commission's (the "CFTC," and together with the SEC, the "Commissions") ongoing request for comments on certain definitions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or "Act") and in anticipation of proposed rulemakings by the Commissions. The Committee of Annuity Insurers was formed in 1982 to address Federal legislative and regulatory issues relevant to the annuity industry and to participate in the development of federal securities, banking, and tax policies regarding annuities. Over the past 28 years, the Committee has played a prominent role in shaping the Federal Government's policies with respect to annuities. The Committee is a coalition of 31 of the largest and most prominent issuers of annuity contracts. The member companies of the Committee represent over 80% of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.

Committee members have a fundamental interest in ensuring that the term "swap" in Title VII of the Dodd-Frank Act is defined in the manner intended by Congress with respect to their businesses – that is, that the term "swap" not unintentionally encompass the annuities and other guaranteed retirement income products which Committee members issue to broad classes of savers, investors, retirement plan participants, and other policyholders. It is therefore submitting this letter in order to assist the Commissions in this regard.

Background and Overview

The Dodd-Frank Act included within clause (A)(ii) of the swap definition any contract that "provides for any purchase, sale, payment, or delivery ... 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."[1] Notwithstanding the broad scope of this definition of "swap" in the Dodd-Frank Act, both during and following the Dodd-Frank Act legislative process, the insurance industry has taken considerable comfort in the fact that, while the Act gave the CFTC and the SEC rulemaking authority to interpret terms used in the Act, there was absolutely no indication that Congress intended the definition of swap to broadly include state-regulated insurance, annuity, and other guaranteed retirement income products.

In late September, in response to an Advance Notice of Proposed Rulemaking (RIN 3235-AK65; Release No. 34-62717) issued by the Commissions requesting comments on certain definitions contained in Title VII of the Act, several commentators filed letters noting that the definition of swap could be construed to capture traditional insurance products. These commentators requested that the CFTC and SEC clarify that the Dodd-Frank Act was not intended to cover insurance products.

Regrettably, one of these commentators proposed certain parameters to define which insurance products should be regulated as swaps, which parameters could have the unintended consequence of sweeping in a number of products currently regulated as insurance.[2] The Committee believes that the formulation included in this comment is entirely unworkable and that the flawed parameters offered to exclude insurance from the definition of "swap" would create confusion, severe disruption, and significant unintended consequences in the annuity and retirement income marketplace – all at a time when both Congress and the Obama administration have recognized the importance of providing broad accessibility to the substantial protections these products afford consumers saving and planning for retirement. Moreover, insofar as numerous commentators, notably including the National Association of Insurance Commissioners, have acknowledged the uncertainty about the scope of the definition of swap and its potential application to insurance and annuity products, it is important that the SEC and CFTC now provide legal certainty.

As leading issuers of annuity and other guaranteed retirement income products, Committee members strongly support the American Council of Life Insurers' ("ACLI") letter, which articulates the fundamental premise that the definition of swap set forth in Title VII of Dodd-Frank was never intended to encompass state-regulated insurance and annuity products.[3] In that regard, the Committee offers additional information about why Congress could never have intended for the definition of swaps to encompass annuity contracts and other state-regulated guaranteed retirement income products. Especially given the unnecessary disruption that would be created by any lingering uncertainty related to the scope of the "swap" definition as it relates to state-regulated annuity and other guaranteed retirement income products, the Committee believes that additional

[1] Dodd-Frank Act Section 721(a)(21), amending Commodity Exchange Act (the "CEA") by adding paragraph 47 to Section 1a. of the CEA.
[2] Letter of Cleary Gottlieb Steen & Hamilton, dated September 21, 2010, at http://sec.gov/comments/s7-16-10/s71610-63pdf. The Cleary Gottlieb letter concluded that insurance contracts could fall within the definition of the term "swap."
[3] Letter of American Council of Life Insurers, dated November 12, 2010, at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/derivative21sub111210-acli.pdf.

clarification would be very helpful.[4]

Summary and Support of Comments Submitted by the ACLI

The ACLI's recent comment letter to the CFTC urged the CFTC and the SEC to issue parallel guidance drawing an explicit line between swaps, on the one hand, and insurance, on the other. The ACLI explained that such guidance was necessary and appropriate because the broad definition of "swap" contained in the Dodd-Frank Act has been argued by some observers to have injected a degree of uncertainty concerning the application of this definition of "swap" to life insurance products. The ACLI noted that the Act's very clear preemption of the authority of states to regulate swaps as insurance further increases the demand for clarity.[5] The ACLI asserted, among other things, that the seemingly broad definition of "swap" contained in Dodd-Frank should be read in light of Congress's need to react to the severity of the financial crisis of 2008-2010 by developing in some cases deliberatively overly-broad definitions, with the expectation that the appropriate agencies would further hone and narrow such definitions.

The ACLI recommended that the CFTC and SEC clarify the definition of swap in order to exclude insurance contracts or transactions from the definitions of swap and security-based swap based on a three part test premised on state-level authorization and regulation of insurance products and life insurers. Specifically, under the proposed test, the contract first must be issued by an insurance company and subject to state insurance regulation; second, the contract must be a type of contract as described in the exclusion; and third, the insurance contract must not be a type of contract that the CFTC or the SEC has affirmatively decided to regulate.[6] The ACLI also explained why the multi-part definition of insurance proposed by the commentator noted above, which relies on linking payments to loss contingencies and insurable interests, is unworkable and falls well short of covering a wide range of common insurance products, particularly those used in the retirement markets.

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[4] The Committee's comments contained in this letter with respect to the definition of "swap" should in no way be regarded as relating to any existing exclusions provided by the Dodd-Frank Act to that definition or to stable value contracts that will be the subject of a study required by the Act within 15 months of enactment.

[5] Dodd-Frank Act Section 722(b). As explained below, any instrument deemed to fall within the swap definition would fall out of the state regulatory scheme, come within the Commission's regulations, and could be deemed an unlawful insurance contract.

[6] Under the ACLI's proposed test, the terms "swap" and "security-based" swap would not include any agreement, contract or transaction that:

(i) Is issued or engaged in by an insurance company . . . in respect of which the sale, reserving, payment of performance of such agreement, contract or transaction is subject to supervision by an insurance commissioner or similar official or agency of a State, or any receiver or similar official or liquidating agent for such company, in his capacity as such;

(ii) Is an insurance contract, including, without limitation, a life insurance contract, annuity contract, endowment, funding agreement, guaranteed investment contract, settlement option, long-term care insurance contract, disability insurance contract, or any reinsurance contract in respect thereof, that is issued on an individual, group or other basis, whether fixed, variable or otherwise, and is supported by such insurance company's general assets or separate accounts, as permitted under state insurance law; and

(iii) The CFTC or the SEC has not determined by rule or regulation to be a swap or security-based swap, based on an individual determination that state regulation of the contract is insufficient to warrant the exclusion following a notice and opportunity for a hearing on the record under the Administrative Procedure Act.

The Committee fully supports the ACLI's proposed clarification of the definition of swap and shares the serious concerns the ACLI has expressed regarding the commentator's suggested multi-part definition of insurance.

Why Congress Could Not Have Intended That Annuity and Other State Regulated Guaranteed Retirement Income Products Be Included within the Definition of "Swaps"

General Observations. Congress passed Title VII of the Dodd-Frank Act to provide regulatory oversight for over-the-counter derivatives and related transactions, a marketplace that due to certain regulatory compromises and other historical reasons has been largely unregulated over the past several decades. However, there is no indication that Congress meant for Title VII to replace 150 years of extensive and pervasive state regulation of insurance with a federal system of insurance regulation. Other titles of the Act confirmed this intent. For example, Title X expressly provided that the business of insurance is specifically excluded from regulation by the newly-established Bureau of Consumer Financial Protection. When structuring the Federal Office of Insurance under Title V, Congress specifically provided that the Office not be imbued with general supervisory or regulatory authority over the business of insurance and limited the Office's federal preemption authority over state insurance laws.

Significantly, the Act's definition of "swap" does not expressly list insurance, annuity or other insurance products as swaps.[7] The absence of these products from the listed items preserves the longstanding recognition under federal law that the insurance business and its products are to be regulated by the states unless Congress has expressly indicated that federal law shall apply.[8]

Moreover, as discussed in more detail below, state laws impose a multitude of regulatory requirements on insurance, annuity, and other guaranteed retirement income products that relate to licensing, accounting, investment, solvency, minimum capital, reporting, and consumer protection. These longstanding regulatory requirements and protections go to the heart of what Congress found generally absent in the derivatives marketplace.

Why the Congressional Concerns and Reforms Related to the Swaps Marketplace Are Inapposite in the Insurance Product Context. As noted, for several decades the enormous swaps market has largely operated without significant regulation. Excessive risk taking by some firms and poor counterparty credit risk management by certain market participants, saddled the financial system with an enormous unrecognized level of risk. During the ensuing financial crisis, the sheer volume of bad mortgage-backed securities and the supposed guarantee of these securities by credit default swaps overwhelmed some firms and left institutions with losses they believed they had

[7] The conclusion that insurance products were to be generally excluded from the scope of Title VII is not inconsistent with the title's jurisdictional provisions that amended the Commodity Exchange Act to provide that "[a] swap ...shall not be considered insurance.....and may not be regulated as an insurance contract under the law of any State." That provision was included in the Act to assure that products that were widely used in the derivatives market, particularly credit default swaps, were not regulated by state insurance regulators as insurance. It is inconceivable that Congress, by including the foregoing provision and not expressly stating the contrary, i.e., that all insurance products are not swaps, intended to give the CFTC and the SEC unfettered discretion to regulate insurance products.

[8] See the McCarran-Ferguson Act, which 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 (emphasis added)." 15 U.S.C. § 1012(b) ("McCarran Ferguson").

protected against. Regulators, lacking authority over this marketplace, were unable to identify or mitigate the enormous systemic threat to the U.S. and global financial system.

In response, Title VII of the Dodd-Frank Act brought three critical types of reform to the previously unregulated swaps marketplace that are intended to lower interconnectedness and risk in the financial system while promoting transparency. It accomplishes these three goals by imposing new requirements on:

- The *instruments* that are traded (swaps and security-based swaps);
- The *dealers* (swap and security-based swap dealers) and *major swap market participants* who are the intermediaries and primary obligors in the swap market; and
- The *facilities* where the trades are executed, cleared and reported (designated contract markets, swap execution facilities and security-based swap execution facilities, derivatives clearing organizations, and swap and security-based swap data repositories).

State insurance laws and regulations impose a multitude of regulatory requirements relating to licensing, accounting, investment, solvency, minimum capital, reporting, and consumer protection. The extensive regulation that already exists in the annuity marketplace provides longstanding protections that obviate the need for the protections provided by the Act, including:

- In adopting state insurance laws and regulations, state legislatures and insurance departments have been able to draw upon a multitude of model laws and regulations that carefully define all major types of life insurance, annuity, and retirement products and apply the protections provided by the laws and regulations described above as appropriate to each such type of insurance, annuity, or retirement product. These laws and regulations significantly limit the derivatives investments and related activities of insurers, including their ability to engage in over-the-counter swaps. In short, there is no reason to define annuity or other insurance contracts as swaps or security-based swaps or to apply the protections that will be afforded by Title VII of the Dodd-Frank Act, when such definitions and protections already exist under state insurance regulation.

- The financial integrity of insurers and the manner in which they distribute their products is highly regulated. Most significantly, state insurance regulators have well-defined capital and reserve requirements applicable to insurance companies that are tailored to the specific lines of insurance businesses conducted by a company, as well as extensive financial reporting requirements and well-defined monitoring systems to identify solvency issues before they become ungovernable. Accordingly, it is highly unlikely that adverse economic or financial developments could mushroom to uncontrollable panic situations for annuity contracts and other insurance and retirement products.

- Clearinghouses to be created in accordance with the Act are intended to mitigate credit risks posed by individual counterparties by interposition of the clearinghouses between buyers and sellers that undertake to take on each party's respective financial obligations. However, the diverse nature of the risks protected by insurers are not the sort of risks that can be prudently assumed by a clearinghouse. Purchasers of annuity and other state-regulated insurance products rely on extensive solvency regulations, reserve requirements and regulation of

permissible insurer investments, rendering it unnecessary for any clearinghouse to step into the shoes of the issuer of annuity or other insurance products to ensure that the contract owner's benefits are fully paid by the issuing insurance company, or for other requirements such as the establishment of swap and security-based data repositories to be imposed given the extensive reporting and accounting requirements already imposed by state insurance law.

Why Congress Could Never Have Intended the Severe Disruption to Insurers, Their Customers, and the Existing State Regulatory Framework Resulting from Applying the Definition of "Swap" to Annuity and Other Insurance Products. As explained above, insurance, annuity and other guaranteed retirement income products are extensively regulated under state insurance laws. For example, the form of a contract being issued generally must be filed with and approved by a state insurance regulator before being sold in the state. In addition, these contracts are subject to state insurance laws regulating the reserves a life insurer must maintain to support its obligations under the contract. However, if any of these contracts were determined to be a swap and the Dodd-Frank Act § 722(b) state law preemption were triggered, then no state could regulate the contract as an insurance contract. As a result, policy form approval laws and reserve requirements that are applicable to that contract would be preempted. Such preemption would therefore deprive states of their core functions of supervising the solvency of insurance companies and determining the sufficiency of assets supporting insurance company contract obligations, which in turn could force states to prohibit insurers from issuing products that the states could no longer regulate.

Moreover, if an annuity or other insurance contract offered by a life insurer were deemed to be a "swap" and as a result, regulation of the contract was shifted from state law (as an insurance contract) to federal law (as a swap), such a characterization could have the unintended result that the sale of the contract would become an unauthorized and impermissible use of derivatives by a life insurer under state insurance law.[9] In addition, the alternative of federal regulation of this market is not viable since the vast majority of an insurer's insurance and annuity customers would not meet the standards of being "eligible contract participants" and engaging in individually tailored, non traded, annuity and life insurance transactions deemed to be swaps with such customers would be illegal.[10] As a result, a determination that annuity and other retirement products issued by insurers are swaps could bar life insurers from issuing such products altogether under state law, thereby freezing life insurers out of their annuity, guaranteed retirement income, and other traditional insurance lines of business, and under the new federal law would be drastically limit the availability of these products to the retirement markets and the public generally.

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[9] New York Insurance Law Section 1410 (with applicable definitions found in Section 1401(a)) is illustrative, especially since New York imposes its derivative regulation on not just New York domestic insurers but all insurers licensed to do insurance business in New York. Under New York law, a "swap" is a permitted derivative instrument (Section 1401(a)(7)), but it can only be used in a hedging transaction (Section 1401(a)(12)), a replication transaction (Section 1401(a)(18)) or limited kinds of income generation transactions (*see* Sections 1410(c), 1410(l), and 1410(d), respectively). The sale of a contract deemed to be a swap would not constitute any of these permissible kinds of derivative transactions, so that as a result the sale of such a contract would not be an authorized use of derivatives under New York law and the sale could be held to violate New York law.

[10] See Section 723(a)(2) Swaps; limitation on participation, providing as follows: "Section 2 of the Commodity Exchange Act (*7 U.S.C. 2*) (as amended by paragraph (1)) is amended by inserting ...(e) Limitation on Participation.--It shall be unlawful for any person, other than an eligible contract participant, to enter into a swap unless the swap is entered into on, or subject to the rules of, a board of trade designated as a contract market under section 5."

In sum, the framework imposed by the Dodd-Frank Act would be incredibly disruptive of the manner in which insurers operate their annuity business, and would operate to adversely affect the availability of annuity and other guaranteed retirement income products at a time when Congress and the Obama administration are encouraging retirement savings and have recognized the critical importance of annuity products to the retirement markets.

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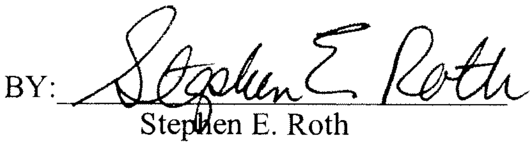
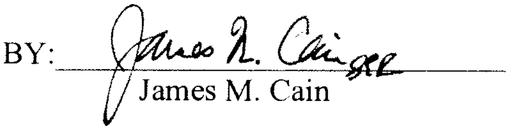
The members of the Committee very much appreciate your consideration of the views expressed above. If you have any questions, please feel free to contact the undersigned.

Respectfully submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: 
Stephen E. Roth

BY: 
James M. Cain

BY:
W. Thomas Conner

FOR THE COMMITTEE OF ANNUITY INSURERS

cc: Julian Hammar, Esquire
Commodities Futures Trading Commission (by electronic mail and hand delivery)

Attachments: Appendix A

Appendix A

THE COMMITTEE OF ANNUITY INSURERS

AEGON Group of Companies
Allstate Financial
AVIVA USA Corporation
AXA Equitable Life Insurance Company
Commonwealth Annuity and Life Insurance Company
CNO Financial Group, Inc.
Fidelity Investments Life Insurance Company
Genworth Financial
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Hartford Life Insurance Company
ING North America Insurance Corporation
Jackson National Life Insurance Company
John Hancock Life Insurance Company (USA)
Life Insurance Company of the Southwest
Lincoln Financial Group
Massachusetts Mutual Life Insurance Company
Metropolitan Life Insurance Company
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
RiverSource Life Insurance Company
(an Ameriprise Financial company)
SunAmerica Financial Group
Sun Life Financial
Symetra Financial
TIAA-CREF
USAA Life Insurance Company