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ASSOCIATION OF FINANCIAL GUARANTY INSURERS

Unconditional, Irrevocable Guaranty ®

July 20, 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. 33-9204; 34-64372; File Number S7–16–11, Product Definitions (the **"Product Definitions Release"**)

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 definitions of "swap" and "security-based swap" (which we refer to collectively as "swaps" unless the context indicates otherwise) 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 thanks the Commissions for their review of AFGI's comment letter submitted on September 20, 2010 and appreciates the effort the Commissions have made to exclude financial guaranty insurance from the definitions of the terms "swap" and "security-based swap" under proposed rule 1.3(xxx)(4) under the Commodity Exchange Act (the "**CEA**") and proposed rule 3a69-1 under the Securities Exchange Act of 1934 (the "**Exchange Act**"). These exclusions recognize that financial guaranty insurance, as implemented through financial guaranty insurance policies and surety bonds, can be distinguished on structural, legal and economic grounds from credit default swaps intended to be regulated by Title VII of the Dodd-Frank Act. These exclusions also acknowledge that financial guarantee insurance is already subject to comprehensive state regulation designed to balance the public benefits and attendant risks of such activity and,

furthermore, that Congress did not intend for Title VII of the Dodd-Frank Act to introduce a new regime for the regulation of insurance.[1]

In the Product Definitions Release, the Commissions requested comments on, among other things, (i) the scope of the exclusion of insurance products from the definition of "swap" and (ii) whether insurance of a swap should itself be regulated as a swap under the Dodd-Frank Act. We write (a) to discuss the scope of the exclusion of insurance products from the definition of the term "swap", (b) to provide background on certain terms used in the proposed definitions, which terms have a long history of interpretation under the insurance laws and regulations and (c) to submit that insurance of a swap should not itself be regulated as a swap under the Dodd-Frank Act.

The Exclusion of Insurance Policies and Contracts from the Definition of the Term "Swap"

The proposed definitions generally exclude insurance policies and contracts from the definition of the term "swap". However, instead of simply excluding all insurance policies and contracts, the proposed definitions set forth additional requirements that must be satisfied before an insurance policy or contract (and specifically a financial guaranty insurance policy) can be excluded. These requirements include (i) incorporating the concept of "insurable interest"[2], (ii) that the beneficiary "carry the risk of loss throughout the duration of the agreement, contract, or transaction"[3], (iii) that losses occur and be proved[4] and (iv) that acceleration of payments under a financial guaranty insurance policy be at the sole discretion of the insurer.[5] While we appreciate the Commissions' intention to ensure that the insurance exclusion not be exploited to avoid the new regulations improperly, we believe that the additional conditions lead to ambiguities, given the long history of interpretation under state law, which would unnecessarily complicate implementation of the proposed rules. We therefore respectfully submit that it would be preferable to provide a bright-line exclusion of all insurance policies and contracts provided by a regulated insurance company.

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1 AFGI also urges the CFTC and SEC to work with regulators abroad to ensure a consistent global approach to the regulation of financial guaranty insurance that generally exempts insurance contracts from regulation as derivatives. In particular, AFGI strongly encourages the Commissions to work to promote consistency between the European Commission's European Market Infrastructure Regulations and the Product Definitions Release and related CFTC and SEC regulations.

2 Proposed rule 1.3(xxx)(4)(i)(A) and (B); Proposed rule 3a69-1(a)(1) and (2)

3 Proposed rule 1.3(xxx)(4)(i)(A); Proposed rule 3a69-1(a)(1)

4 Proposed rule 1.3(xxx)(4)(i)(B); Proposed rule 3a69-1(a)(2)

5 Proposed rule 1.3(xxx)(4)(i)(D); Proposed rule 3a69-1(a)(4)

Such a bright-line exclusion of all insurance policies and contracts would be consistent with existing provisions of the Securities Act of 1933 and the Investment Company Act of 1940. Section 3(a)(8) of the Securities Act exempts from the definition of "security" any "insurance or endowment policy . . . issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia."[6] Similarly, the Investment Company Act provides an exemption from the scope of "investment company" for any company that is "organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or similar official or agency of a State."[7] This approach has a long history under the securities laws and is well understood by the regulated community, making it an ideal means for clarifying the purpose and scope of Title VII.

The addition of further qualifications that must be met before an insurance policy or contract is exempted from the definition of the term swap creates legal uncertainty. Such uncertainty can be a significant burden, especially in financial guaranty transactions, which typically require the delivery of a legal opinion in connection with the issuance of an insurance policy.

For example, the requirement that a beneficiary of an insurance policy carry the risk of loss continuously throughout the duration of such insurance policy creates legal uncertainty when applied to a freely tradable insured bond. Likewise, with respect to the requirement that a loss occur and be proved, because financial guaranty insurance policies generally guarantee the payment of scheduled interest payments, a financial guaranty insurer could be required to make a timely payment of interest even if the issuer of the bond eventually reimburses the payment, resulting ultimately in no loss (other than perhaps the time value of money).

Additionally, certain qualifications contained in the insurance product exclusions in the proposed rules are already requirements of state insurance law and therefore would be addressed by a general exception of all insurance policies or contracts issued by regulated insurers. As discussed in more detail below, such qualifications have also been the subject of significant analysis and interpretation by state insurance regulatory authorities over the years, so including them in the proposed rules could result in conflicting interpretations which would create additional legal uncertainty.

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6 15 U.S.C. 77c(a)(8)

7 15 U.S.C. 80a-2(a)(17)

Finally, the Commissions have requested comments as to whether the proposed rules should provide that any product regulated as insurance before July 21, 2010 and issued by a state-regulated insurer should be excluded from the swap definitions. For the reasons noted above, we submit that all such insurance products, regardless of their date of issuance should be excluded from the swap definitions, but in the alternative, at least all insurance products regulated as insurance prior to July 21, 2010 should be excluded so as not to retroactively apply the requirements of Title VII to state-regulated insurance products issued prior to the enactment of the Dodd-Frank Act.

Additional Exceptions to the Insurance Products Exclusion are Unnecessary

The Commissions have asked for comments on whether the Commissions should (i) add, as a requirement for insurance not to be characterized as a swap, that the insurance not be based on the price, rate or level of a financial instrument and (ii) include in the proposed rules relating to insurance a provision related to whether a product is recognized at fair value on an ongoing basis with changes in fair value reflected in earnings under U.S. generally accepted accounting principles. In this regard, if a bond insurer guaranteed principal and interest on a bond, how could one conclude whether or not the insurance is based on the price, rate or level of the financial instrument and why should it matter, for purposes of the Title VII exemption, whether the investment is recognized at fair value by the initial or any subsequent bondholder? For the reasons noted above, AFGI submits that all insurance policies and contracts issued by a state-regulated insurer should be excluded from the definition of the term swap and the addition of any additional requirements to qualify for such exclusion creates unnecessary legal uncertainty which would significantly burden parties to financial guaranty insurance transactions.

States Have Issued Significant Interpretive Guidance Regarding Certain Insurance Law Concepts Used in the Proposed Definitions

The concept of "insurable interest" and the requirement that acceleration of payments under a financial guaranty insurance policy be at the sole discretion of the insurer have been the subject of significant analysis and interpretation by state insurance regulatory authorities over the years. If these concepts are retained, they should be applied in a way consistent with their historical interpretation.

For example, the New York Insurance Department routinely issues circular letters and opinions from its Office of the General Counsel that provide interpretations and guidance with respect to New York State insurance law, including the provisions of New York State insurance law applicable to financial guaranty insurers. Furthermore, in many circumstances a state insurance statute or regulation will set forth a broad requirement, but will then clarify that certain types of transactions or events do not violate the requirement. Such clarifications, analysis and other interpretive guidance reflect the

considered judgment of state legislatures, insurance regulators and other governmental authorities.

As one example, in the context of financial guaranty insurance, "insurable interest" is understood to mean the right to full payment of principal and interest pursuant to the terms of the insured obligation, regardless of the amount that the beneficiary of the insurance has invested in that obligation. In other words, a distressed debt investor who paid less than 100% for an insured bond nevertheless has the right to receive 100% of the principal and interest under the insurance policy.

As another example, insurance regulators have interpreted insurance of qualifying swap termination payments as not constituting prohibited acceleration payments for insurance under applicable insurance law. In addition, long-standing practice has allowed municipal bond insurance to include "term-outs", where the maturity of the bonds is substantially shortened (but such bonds do not become immediately due) upon the occurrence of specified events. Furthermore, financial guarantors, for some time and in full compliance with state insurance laws, have issued insurance policies that contemplate acceleration upon events unrelated to an issuer default, e.g., upon a downgrade of the insurer.

We respectfully submit that, where terms and concepts with a long history of interpretation under insurance laws and regulations are used in the proposed definitions, it is only sensible to apply them in a way that is consistent with that history. In other words, financial guaranty insurance policies which have long been recognized as such and which comply with insurance law requirements should not be subject to regulation as swaps under the Dodd-Frank Act due to a different interpretation of those terms and concepts under the proposed definitions.

The risk of ambiguous or conflicting interpretations of these established insurance concepts calls for a bright line exclusion of insurance policies and contracts that are already subject to comprehensive regulatory schemes imposed by state insurance departments.

Insurance of a Swap Should be Excluded from the Definition of a Swap and the Issuer of Such Insurance Should Not be Considered a Major Swap Participant or Major Security-Based Swap Participant

Financial guaranty insurance has traditionally included not just insurance of an obligation to pay under a debt instrument, but also insurance of payment obligations under other types of monetary obligations.[8] For example, when a municipality issues floating-rate debt, it may enter into a floating-to-fixed interest rate swap agreement with

[8] See, e.g., New York Insurance Law § 6901(a)(1).

the bank which underwrote the debt. If the debt is insured by a financial guarantor, it is common for the guarantor also to insure the municipality's payment obligations under the interest rate swap. Financial guaranty insurance of swaps, like financial guaranty insurance of other monetary obligations, is subject to comprehensive state regulation. As the Commissions noted in the Proposed Definitions Release, nothing in Title VII suggests that Congress intended for financial guaranty insurance products to be regulated as swaps.

Financial guaranty insurers provide insurance products to the United States and international public finance, infrastructure and structured finance markets. These products facilitate the access of municipalities and other issuers to the capital markets and lower borrowing costs. Although financial guaranty policies are most often issued to provide a guaranty of principal and interest payments on debt securities, the ability of financial guaranty insurers to issue policies with respect to a broader range of monetary obligations is necessary for financial guaranty insurers to carry out their core mandate. Financial guarantors have long done so in full compliance with the comprehensive body of state insurance laws and regulations. Because the issuance of insurance policies in respect of swaps is often done in connection with an issuance of insured debt securities, if insurance of swaps were regulated as a swap under Title VII of the Dodd-Frank Act or the issuer of such insurance were considered to be a major swap participant or a major security-based swap participant, the effect would be to regulate the core insurance business of financial guaranty insurers, which appears to be contrary to the intent of Title VII of the Dodd-Frank Act.

Furthermore, when a financial guaranty insurer does issue an insurance policy in respect of a swap, it does not become a party to the swap transaction. The insurer just guarantees the payment obligation of one of the parties. Because both of the actual counterparties to a swap and the swap transaction itself, would, unless otherwise exempted, be subject to regulation under Title VII of the Dodd-Frank Act, little purpose would be served by also subjecting the related financial guaranty insurance policy to additional federal regulation in addition to the comprehensive body of state insurance laws and regulations to which it is already subject.

Finally, subjecting an insurance policy written in respect of a swap to regulation as a swap or the issuer of such insurance to regulation as a major swap participant or a major security-based swap participant would likely cause financial guaranty insurers to withdraw from this segment of the market. Because the insurance of a related swap is often integral to the insurance of municipal bonds and other securities, such a withdrawal could have an adverse effect on the United States and international public finance, infrastructure and structured finance markets.

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We appreciate the effort of the Commissions to address the concerns of the financial guaranty insurance industry regarding application of the proposed Dodd-Frank Act derivative rules to insurance products. AFGI endorses the Commissions' recognition that insurance, and in particular financial guaranty insurance, should be excluded from the proposed regulations and respectfully suggests that the regulatory approach that best satisfies that intent, with the least likelihood of adverse unintended consequences, would be a simple exemption for insurance policies issued by state-regulated insurance companies. This approach functions effectively under the Securities Act and the Investment Company Act, while any other approach introduces unwarranted legal uncertainty.

We note that the Commissions are concerned that agreements, contracts, or transactions that are swaps or security-based swaps might be characterized as insurance products to evade the regulatory regime under Title VII. However, if abuses were to emerge in spite of the anti-evasion provisions in the proposed rules and the Dodd-Frank Act, they could always be addressed through interpretive guidance or, if necessary, further rulemaking. Accordingly, AFGI respectfully submits that the burden of legal uncertainty arising from the proposed additional requirements for insurance policies to qualify for exemption outweighs any benefit from closing hypothetical loopholes in the regulatory scheme that have been or can be addressed by other means.

We thank the Commissions for the opportunity to comment on these matters. 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