NAIC
National Association of Insurance Commissioners
& The CENTER for INSURANCE POLICY and RESEARCH

July 22, 2011

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F St., NE
Washington, D.C. 20549

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

Re: S7-16-11: Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping.

Dear Ms. Murphy and Mr. Stawick:

We write on behalf of the National Association of Insurance Commissioners (NAIC) regarding the Securities and Exchange Commission and Commodity Futures Trading Commission proposed rule to further define the terms "swap" and "security-based swap" contained in Title VII of the Dodd-Frank Wall Street and Consumer Protection Act (the Act)[1] and related implementing regulations. 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. The NAIC respectfully submits the following comment to the proposed rule published in the May 23, 2011 issue of the Federal Register as well as on the Commissions' websites.

Insurance Contract Exclusion

We are in agreement with the Commissions' proposal to exclude insurance contracts from the definitions of "swap" and "security-based swap." As we indicated in our letter of September 20, 2010, we believe that Congress did not intend for these definitions to cover insurance contracts. We do have some additional comments and concerns regarding the Commissions' general approach to implementing such a standard by establishing both a per se exclusion for certain defined types of insurance products and a legal test to distinguish insurance from swaps and security-based swaps based on the nature of the product and its regulation.

[1] Pub. L. No. 111-203.

List of Specific Insurance Products

While we agree with the identification of certain insurance products that in the Commissions' view are not swaps or security-based swaps, we strongly urge you to include this list in the rule text itself and not just the preamble to the rule. Such inclusion is critical to create the necessary legal certainty that such products will in fact not be treated as swaps and security-based swaps by the Commissions. In addition, there are certain products, such as mortgage guaranty, accident, and disability insurance that are not on the Commissions' current list of specifically identified insurance products. These items are traditional insurance products sold by regulated insurance companies and should also not be considered swaps or security-based swaps. **Therefore, we respectfully request that mortgage guaranty, accident, and disability insurance be added to the list of excluded products, and that the entire product list be included in the actual rule text.**

In addition, there are other state-regulated products such as service contracts that are not on this enumerated list, and may not necessarily meet the legal test established by the Commissions' rule. We hope to continue to work with you to determine whether such products should be regulated as swaps, security-based swaps or insurance.

Test for Identification of Insurance Contracts

Under the proposed rule, an insurance contract is excluded if it meets the requirements set forth by the Commissions to identify an insurance contract ("Insurance Product Test") and is provided by an entity organized as an insurance company and subject to supervision by an insurance regulator ("Insurance Company Test").

Insurance Company Test

Of significant concern is that if an insurance contract met the requirements of the Insurance Product Test but failed to meet the Insurance Company Test, it would be possible for a non-insurance company to write traditional insurance products and evade the state-based insurance regulatory system designed to protect policyholders. Currently, state insurance regulators have the regulatory authority to prohibit such activities by unlicensed companies and vigilantly pursue wrongdoers. However, since Title VII of the Act provides that swaps shall not be considered insurance and prohibits swaps to be regulated as insurance contracts under the laws of any state,[2] an insurance product that met the Insurance Contract test but failed the Insurance Company Test would have the unintended consequence of being treated as a swap rather than insurance. Importantly, such a company would not be subject to the type of regulation that has been specifically designed to protect policyholders including stringent solvency, reporting, disclosure, investment limitations, and other important consumer protections. For example, property and casualty insurance offered by an unlicensed company that failed the Insurance Company Test would be treated as a swap rather than insurance and by virtue of the Act, state regulators would be prohibited from using their regulatory authority to prohibit such unlicensed activities.

Furthermore, the Insurance Company Test appears to capture insurance contracts written in foreign countries where the risk is reinsured by domestic reinsurers, yet appears to exclude insurance contracts written domestically where the risk is reinsured by companies located abroad. Such an approach would inevitably create an unlevel playing field as between domestic and foreign reinsurers.

[2] Pub. L. No. 111-203. §722(a).

For these reasons, we strongly urge you to amend ii(A) of the proposed rule to read as follows:

"By a person or entity that is subject to the insurance laws of any State, the United States, or a foreign jurisdiction."

Insurance Product Test

The Insurance Product Test in the proposed rule generally states that the term "swap" does not include an agreement, contract, or transaction that by its terms or by law, as a condition of performance on the agreement, contract, or transaction:

> (1) requires the beneficiary to have an insurable interest that is the subject of the agreement, contract, or transaction and thereby carry the risk of loss with respect to that interest continuously throughout the duration of the agreement, contract or transaction;
> (2) requires the loss to occur and to be proved, and that any payment or indemnification thereof be limited to the value of the insurable interest; and
> (3) is not traded, separately from the insured interest, on an organized market or over-the-counter.

However, most insurance products would not qualify under this three prong test. Therefore, the proposed new requirements are not effective criteria for determining whether a product is insurance.

With regard to the first prong, most insurance products do not require a person or entity to have an insurable interest continuously throughout the duration of the insurance policy or contract. For example, if a person wishes to procure insurance on the life of another person, then he or she only needs to have an insurable interest at the time that he or she procures the life insurance policy. With regard to insurance covering property damage, in many jurisdictions, a person only needs to have an insurable interest at the time of the loss. Indeed, an insurable interest is not even required for a liability, surety or accident and health insurance policy or contract.

While we recognize that you may be concerned that certain entities could seek to evade the rule by creating swap products that meet a test designed to exclude insurance products, we believe that the additional requirements that the product be sold by a company that is subject to insurance laws and regulation, coupled with the Commissions' anti-evasion authorities, will prevent such scenarios from taking place.

There are also difficulties with the third prong. The preamble states that with limited exceptions (such as settled life insurance policies), insurance products traditionally have not been either entered into on or subject to the rules of an organized exchange or traded in secondary market transactions. While we recognize that this is the case for most insurance products, a limited number of states including New York, Illinois, and Florida have had insurance exchanges through which reinsurance and excess or surplus line insurance was sold. In addition, the federal health care act requires states or the federal government to establish health benefit insurance exchanges through which insurers will sell health insurance to individuals and small groups. As a result, we do not believe that the test should contain the requirement that such contract should not be traded on an exchange.

In light of these concerns, we believe that a more appropriate test for an insurance contract would be an agreement or contract that by its terms:

1) **Exists for a specified period of time;**
2) **Where one party (the "insured") to the contract promises to make one or more payments such as money, goods or services;**
3) **In exchange for another party's promise to provide a benefit of pecuniary value for the loss, damage, injury, or impairment of an identified interest of the insured as a result of the occurrence of a specified event or contingency outside the parties' control; and**
4) **Where such payment is related to a loss occurring as a result of the contingency or specified event.**

We believe that such a test along with the portion of your proposed Insurance Company Test as modified above will appropriately capture regulated insurance products.

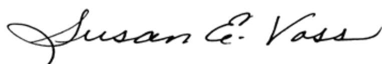
Contracts Based on Price, Rate, or Level of Financial Instrument or Asset

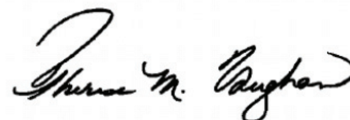
Finally, the Commissions also request comment as to whether they should require that an agreement, a contract, or a transaction not be based on the price, rate, or level of a financial instrument, asset, or interest or any commodity in order to meet the definition of an insurance agreement. We do not believe such a requirement would be appropriate, as it would not meaningfully distinguish swaps and security-based swaps from certain products sold by regulated insurance companies such as variable annuities, indexed annuities, guaranteed investment contracts, financial guaranty insurance, and mortgage guaranty insurance. While swaps and security-based swaps were historically unregulated, products such as those referenced above have been subject to stringent regulatory requirements including policy form filing, financial statement reporting, disclosure, capital, and reserve requirements designed to protect the policyholders. **For these reasons, we believe that the Commissions should not include an additional requirement for an agreement to be treated as insurance that the agreement not be based on the price, rate or level of a financial instrument, asset, or interest or any commodity.**

Conclusion

We appreciate the opportunity to comment and look forward to continuing the open and constructive dialogue we have had with the Commissions to date about the rulemaking process. 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 Policy Counsel, at (202) 471-3987.

Sincerely,





Susan E. Voss, Commissioner
Iowa Insurance Division
NAIC President

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