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October 17, 2011

Mr. David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington DC 20581

Ms. Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Acceptance of Public Submissions Regarding the Study of Stable Value Contracts; Release No. 34-65153; File No. S7-32-11

Dear Mr. Stawick and Ms. Murphy:

Fidelity Investments[1] ("Fidelity") appreciates the opportunity to comment on the Commodity Futures Trading Commission (the "CFTC") and the Securities Exchange Commission (the "SEC," and together with the CFTC, the "Commissions") release, published in the Federal Register on August 25, 2011, regarding stable value contracts (the "Release").[2]

Fidelity acts as an investment manager to registered investment companies, pension and other retirement plans, and separately managed accounts (collectively, "clients"). A number of Fidelity's clients offer stable value funds as investment options in their defined contribution retirement plans. With approximately $50 billion in stable value assets under management, Fidelity is one of the largest stable value managers in the financial services industry.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")[3] requires the Commissions to conduct a study to determine whether stable value contracts fall within the definition of "swap" under Title VII of Dodd-Frank and, if so, whether stable value

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[1] Fidelity Investments is one of the world's largest providers of financial services, with assets under administration of more than $3.6 trillion, including managed assets of over $1.6 trillion. Fidelity is a leading provider of investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 20 million individuals and institutions, as well as through 5,000 financial intermediary firms.

[2] Acceptance of Public Submissions Regarding the Study of Stable Value Contracts, 76 Fed. Reg. 53162 (CFTC and SEC Aug. 25, 2011) (the "Study").

[3] Pub. L. 111-203, 124 Stat. 1376 (2010).

contracts should nonetheless be exempted from the definition and, therefore, from the new requirements applicable to swaps under Title VII. The Release is intended to assist the Commissions in conducting the study.[4]

We applaud the Commissions' efforts to understand more comprehensively stable value contracts and stable value funds and the important role they play in the defined contribution retirement plan market. Stable value funds are offered in approximately half of all 401(k) plans, and represent approximately 13% of all defined contribution plan assets.[5] The basis of this popularity is attributable to the benefits of the stable value contracts – principal protection and a yield that historically has been significantly higher than that earned in a money market fund. Because of the structure and characteristics of a stable value contract, participants in stable value funds attain a more consistent, less volatile investment experience than traditional bond funds. These features are particularly attractive to retirees and other risk-averse participants with shorter investment horizons.

As discussed in greater detail below, Fidelity does not believe that stable value contracts meet the definition of a "swap" under Title VII of Dodd-Frank, based on their product structure and risk profile. If the Commissions nevertheless determine that stable value contracts fall within the definition of swaps, we believe that an exemption for stable value contracts from the definition and, thus, from the substantive requirements of Title VII, is appropriate and in the public interest. We request that the Commissions take into account the following considerations:

- Unlike swaps, stable value contracts are individually negotiated, highly customized financial agreements that cannot be cleared through a clearinghouse and for which no trading market exists.

- Stable value contracts have fundamentally different purposes from those of swaps.

- Stable value funds are a conservative investment option offered in defined contribution plans that are particularly popular with retirees and other risk-averse participants. Stable value funds rely on stable value contracts to provide benefits to millions of participants.

- The conservative nature of a stable value fund is a function of the fund's investments and the features of the related stable value contracts.

- Stable value funds are already subject to significant regulation.

[4] *See* the Study at 53163.

[5] *401(k) Plan Asset, Allocation Account, Balance and Loan Activity in 2008*, INVESTMENT COMPANY INSTITUTE RESEARCH PERSPECTIVE, Vol. 15, No. 3 (October 2009).

Description of Stable Value Funds and Stable Value Contracts

A stable value fund is designed to combine bond-like returns with money market-like stability. The returns are generated by the fund's underlying assets – a diversified portfolio of short- to intermediate-term corporate and government bonds typically rated, on average, AA- or better. The stability comes from stable value contracts (also known as wrap contracts) issued by banks and insurance companies. Stable value contracts serve as a guarantee of the participants' principal and accumulated interest if the bonds in the fund's portfolio decline in value. Thus, subject to certain conditions, the fund maintains a stable value regardless of when a participant redeems out of the fund.

Stable value funds distribute returns to participants through a crediting rate that amortizes the portfolio's market value gains or losses over the duration of the portfolio.[6] The crediting rate is periodically recalculated and reset (typically monthly), which moderates market value fluctuations in the fund's assets and the impact of participant purchases and redemptions, as it also works to pull the fund's market value back in line with its contract value.[7] The crediting rate is essentially a risk-sharing mechanism that requires participants to share in the fund's gains and losses.

Providers of stable value wrap contracts face the risk that the market value of a fund will be depleted through participant withdrawals at a time when the fund's market value is less than its contract value. In such a case, the wrap provider would be required to fund the deficit. Contract providers – most commonly insurance companies or large banks - control this risk through the underwriting process, investment parameters, and contract terms. If a contract provider elects to issue a stable value contract to a particular plan, the resulting stable value contract will be customized to meet the needs of both the plan and the contract provider based on the results of the underwriting process. Part of that customization is the approval of specific investment parameters for the underlying portfolio. These parameters are designed to ensure that, under most circumstances, the ratio of the fund's market value to its contract value does not stray too far from par. In addition, as with other insurance and insurance-type products, the terms of a stable value contract will define the scope of its coverage. Generally, that coverage

[6] Using the crediting rate formula, an estimated future market value is calculated by compounding the fund's current market value at the fund's current yield to maturity for a period equal to the fund's duration. The crediting rate is the discount rate that equates that estimated future market value with the fund's current contract value. Thus, the mechanism of the crediting rate provides a stable value fund with the means to amortize gains and losses on the fund's underlying assets over the duration of the portfolio (typically three years or less).

[7] As with money market funds, this method of accounting results in a divergence between the market value of the stable value fund's assets and the contract value of participants' interests in the fund. During the normal course of a stable value fund's operation, this divergence (along with gains and losses on the fund's underlying assets) is continually amortized through the fund's crediting rate. However, the crediting rate can also be affected by several other factors, including purchases and redemptions by participants. The impact depends on whether the fund's market value is higher or lower than its contract value.

will limit the types of withdrawals entitled to coverage at contract value and the types of securities wrapped by the contract.[8]

Stable Value Contracts Are Not Swaps under Title VII

Based on a review of Dodd-Frank and the policy objectives behind the statute, Fidelity does not believe that stable value contracts fit within the definition of a swap. Among Dodd-Frank's stated purposes are ending "too big to fail" and "protect[ing] the American taxpayer by ending bailouts."[9] No stable value fund was bailed out during the 2008 financial crisis and there is no evidence of which we are aware that stable value funds contributed to the crisis or created systemic risk. Unlike a swap, a stable value contract is not a mere investment tool. Stable value contracts represent a highly negotiated commercial arrangement fundamental to the existence and operation of stable value funds. Without stable value contracts, stable value funds would not survive.

We believe that statutory analysis appropriately begins with the words Congress has chosen. In this case, Congress defined swap quite broadly to mean "any agreement, contract, or transaction . . . (ii) that 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 a contingency associated with a potential financial, economic, or commercial consequence."[10] We recognize that one could argue that a stable value contract meets this definition, as it provides for a "payment" to a defined contribution plan "that is dependent on the occurrence of an event," such as the depletion of the stable value fund's assets at a time when the fund's market value is less than its contract value, "associated with a potential financial consequence" such as a market-to-contract value deficit.

However, such a broad reading of Dodd-Frank's definition of swap describes an incredibly wide range of commercial agreements. For example, an employee bonus program based on company performance would be a swap under this interpretation of the definition in Dodd-Frank. Similarly, commission payments, sales incentives, targeted bonus payments and countless other examples of everyday business practices would also fall within an expansive literal reading of the definition. We urge the Commissions not to read Section 719 so broadly.

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[8] With respect to withdrawals, although the Financial Accounting Standards Board (FASB) accounting rules require stable value contracts to cover all permitted participant-initiated transactions at contract value, stable value contracts are permitted to, and typically do, either exclude from coverage or provide limited coverage to withdrawals that are initiated or caused by single decision makers such as plan sponsors (e.g., plan terminations, large-scale layoffs).

With respect to securities, stable value contracts typically provide very limited or no coverage for securities held in the portfolio that default or are otherwise impaired. In the event that a fund exceeded its contractually defined limit for defaulted or impaired securities, such securities would no longer be entitled to coverage under the wrap or to be accounted for at contract value. Once outside the wrap, these securities would have to be marked-to-market with any resulting loss borne by the participants in the fund.

[9] Pub. Law No. 111-203, 124 Stat. 1376 (2010), at 1376.

[10] Pub. Law No. 111-203, 124 Stat. 1376 (2010), at 1666.

On the contrary, Fidelity believes it is entirely appropriate, and consistent with Congressional intent, to exclude stable value contracts from the definition of swap. If Congress had plainly intended that the definition of swap covered these contracts, it would have been unnecessary to direct the Commissions to conduct a study to make such a determination. However, Congress recognized that the unique characteristics of stable value contracts may warrant a determination by the Commissions that stable value contracts are not swaps. We therefore believe that in order to interpret the definition of a swap in accordance with Congressional intent, the Commissions must take into account the differences between stable value contracts and swaps, as well as other policy considerations. This approach would be consistent with contemporaneous statements made by members of Congress. For example, Senator Harkin, chairman of the Health, Education, Labor, and Pension Committee, proposed the stable value study to ensure that Title VII did not "cause unintended harm to people's pension plans"[11] and that stable value contracts would only be regulated as swaps if doing so would "achieve[] goals underlying the derivatives title."[12] Additionally, as Senator Lincoln, a primary architect of Title VII, stated: "We should try to avoid doing any harm to pension plan beneficiaries."[13]

Fidelity believes that stable value contracts should not be considered swaps under Title VII of the Dodd-Frank Act because stable value contracts are fundamentally different from traditional swaps in many ways. First, stable value contracts serve a very different purpose from those of a swap. A traditional swap is an investment tool used by institutional investors to gain exposure or mitigate risk to specific assets or market conditions. Stable value contracts, in contrast, are highly specialized agreements used in a very specific manner in the construction of conservative defined contribution plan investment options. Stable value contracts are not used to gain or reduce economic exposure to a specific rate or entity.

Second, a traditional swap is traded under a standardized ISDA master agreement. There is no analogous agreement for a stable value contract, given its highly customized nature. Each stable value contract grows out of an individualized underwriting process in which contract providers evaluate plan- and fund-specific information such as demographics, cash flow history, and investment strategy. As a result, each stable value contract is a function of the unique characteristics of the stable value fund, the investment manager's approach to portfolio construction, and the defined contribution plan that purchased it. The idiosyncratic nature of stable value contracts means that they are not tradeable publicly or privately between unrelated funds or plans. There is, in fact, no trading market for stable value contracts and they cannot be cleared by a clearinghouse.

[11] 156 CONG. REC. S5906 (daily ed. July 15, 2010) (statement of Sen. Thomas Harkin).

[12] *Id.*

[13] 156 CONG. REC. S5906 (daily ed. July 15, 2010) (statement of Sen. Blanche Lincoln).

Third, swaps are generally subject to collateral requirements in an amount equal to the market exposure of the party that is out of the money. Stable value contracts do not have or need collateralization features. When a stable value fund's market value is greater than its contract value there is nothing to collateralize because the contract provider is under no risk of payment. Even when a fund's market value falls below the contract value, the contract provider's payment obligation is contingent on a series of withdrawals (i.e., individual participants reducing the market value of the fund to zero through redemptions that are covered by the stable value contract). Given this structure, requiring collateral in the full amount of the market to contract value deficit makes no sense — it would be akin to requiring an insurer to collateralize a homeowner's policy by the full value of the home at all times.

Fourth, there are significant differences in the default provisions of stable value contracts and swaps. Upon default under a traditional swap, the non-defaulting party has the option to terminate all transactions under the ISDA agreement. Upon termination, the party with the out-of-the-money position (which is not necessarily the defaulting party) makes a payment based on a calculation agreed to in the ISDA agreement. However, if a stable value fund defaults on its obligations under a stable value contract, the contract provider has the right to terminate the contract and obviate all obligations thereunder. The contract provider neither makes nor receives any payment. If the contract provider is the defaulting party, the fund similarly does not have a right to a termination payment (although the fund could sue for breach of contract and damages). Therefore, unlike swaps, stable value contracts operate more like general commercial contracts common to many service and manufacturing industries, rather than financial trading contracts.

Fifth, unlike certain types of swaps, stable value contracts are not used as a tool to create leverage within a stable value fund. In fact, stable value contracts generally prohibit managers from creating leverage within stable value funds.

Finally, unlike a traditional swap, stable value contracts have a number of additional risk mitigating features. For example:

1. By virtue of a stable value fund's structure, the ratio of a fund's market value to its contract value will generally range between 96% and 104%. This means that in the very unlikely event that participant-initiated redemptions actually did reduce a fund's market value to zero at a time when market value is less than contract value, the deficit that would have to paid by the contract provider would most likely be less than 4% of the contract value of the fund.

2. By restricting contract value coverage to participant-initiated withdrawals and requiring participants to transact at contract value, stable value contracts are designed to avoid giving plan sponsors or other entities unfettered discretion to exercise a contract when market value is less than contract value.

3. By providing little or no coverage for defaulted or impaired securities, contract providers significantly reduce the amount of credit risk they are underwriting. Stable value contracts are not credit default swaps. There is no underlying reference asset

> and, although underperformance of a fund portfolio relative to the contract rate is a necessary condition to any payment by a contract provider, unlike traditional swaps the performance of obligations under a stable value contract are not directly tied to the financial performance of any issuer, bond or index.

Fidelity urges the Commissions to consider the above factors as further evidence that stable value contracts are not swaps.

Recognizing that Congress did not prescribe any specific factors to the Commissions in making the determination of whether stable value contracts are swaps, Fidelity suggests that the Commissions may find it helpful to examine another example of Congress directing a regulatory authority to determine whether a particular financial instrument is a swap. In Section 721(47)(E) of Dodd-Frank, Congress created a presumption that foreign exchange swaps and foreign exchange forwards are swaps and directed the Secretary of the Treasury to determine if that presumption was correct.[14] Recently, the Secretary issued a proposed determination to exempt foreign exchange swaps and foreign exchange forwards from the definition of swap.[15] In proposing this determination, the Secretary relied on a number of factors similar to the ones described above with respect to stable value contracts – whether trading and clearing would alleviate systemic risk; whether the instruments are already subject to a regulatory scheme; and whether regulators provide adequate supervision.[16]

Significantly, in contrast to the presumption that foreign exchange swaps and foreign exchange forwards are swaps, Congress created a presumption that stable value contracts are not swaps. Section 719(d)(1)(C) of Dodd-Frank states that "[s]table value contracts in effect prior to the effective date of the regulations described in subparagraph (B) shall not be considered swaps."[17] Under the regulatory regime established by Congress, therefore, a stable value contract that is executed prior to the effective date of regulations that arise out of the Commissions stable value study will never be a swap.

If the Commissions Determine that Stable Value Contracts Are Swaps, Stable Value Contracts Should Be Exempt from the Swap Definition

If the Commissions determine that stable value contracts are swaps under Dodd-Frank, Fidelity urges the Commissions to exempt stable value contracts from the definition and, accordingly, from regulation under the Commodity Exchange Act (as amended by Dodd-Frank). Such an exemption is consistent with Section 719(d)(1)(B) of Dodd-Frank and Congress's intent to provide relief where, as here, the request is "appropriate and in the public interest."

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[14] Pub. Law No. 111-203, 124 Stat. 1376 (2010), at 1668.

[15] Department of the Treasury, Notice of Proposed *Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act*, 76 Fed. Reg. 25774 (May 5, 2011).

[16] *Id.* at 25775.

[17] Pub. Law No. 111-203, 124 Stat. 1376 (2010), at 1657.

Fidelity believes that many of the reasons why stable value contracts should not be considered swaps in the first instance also justify granting an exemption from further regulation if the Commissions decide that stable value contracts meet the swap definition. For example, stable value contracts are highly individualized agreements that cannot be cleared through a clearinghouse and for which no trading market exists. Thus, the risk mitigating effects of central clearing would have no benefit to stable value contracts. Rather, there would be significant harm to millions of individual retirement investors who would no longer have stable value funds available to them as an investment option. In addition, Fidelity believes that the conservative nature of the funds' investments, the lack of leverage and the inherent risk-limiting features of stable value contracts mean that the requirements applicable to swaps under the Commodity Exchange Act, such as centralized clearing, real-time reporting and margin requirements, are both inapplicable and unnecessary.

Regulation under Title VII would Increase Costs and Hinder the Industry

Fidelity believes that treating stable value contracts as swaps will increase uncertainty in the market, raise costs, and harm investors. What is at stake is the value proposition of stable value – principal protection with a bond-like return. If stable value contracts are regulated as swaps, the additional regulatory requirements (e.g., collateral and margin requirements) would add significant costs for contract issuers. These costs would not be absorbed by the issuers. They would, instead, be passed on to individual retirement investors in the form of substantially higher fees. This would, in turn, reduce participant returns, potentially calling into question the product's viability.

Fidelity also does not believe that regulating stable value contracts as swaps will result in any meaningful public benefits. Title VII requires that information about swaps be reported in both real-time and on an ongoing basis. While such reporting provides valuable information for swap contracts that are standardized and liquid, stable value contracts are, as noted above, complex, highly individualized contracts. As a result, any information the Commissions obtained through the reporting of a stable value fund would have very limited use in connection with any other stable value fund. Further, because of their highly idiosyncratic terms and the unique investment and demographic experience of each associated plan, stable value contracts are neither tradeable nor clearable.

Stable Value Funds Currently Are Subject to Significant Regulation

Stable value funds and stable value contract issuers are already highly regulated by a combination of federal and state authorities. In defining a stable value contract, Congress specifically recognized the role that certain federal and state regulatory authorities have over these contracts. Banking institutions that issue stable value contracts are subject to significant regulatory requirements, a number of which were augmented by Dodd-Frank, in addition to substantial risk-based and leverage capital requirements under the Basel regime. Banking institutions are also extensively supervised by the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

Insurance companies that issue stable value contracts are regulated by state insurance commissions in each state in which they are licensed. As with regulated banking institutions, insurance companies that provide stable value products are subject to an extensive array of regulatory requirements. For example, insurers that issue stable value contracts are subject to substantial capital and surplus requirements to guarantee their ability to safely absorb losses. Insurers that issue stable value contracts are also subject to comprehensive disclosure and reporting requirements that are intended to improve industry oversight and transparency.

Stable value funds themselves are also subject to significant regulation. FASB rules require that purchasers of stable value contracts make a determination that the issuers of the contracts are creditworthy.[18] FASB rules also specify the criteria that stable value contracts must satisfy to be eligible for contract value accounting.[19] The vast majority of stable value funds, plan sponsors, and stable value investment managers are also subject to the fiduciary rules and the reporting and disclosure requirements of the Employee Retirement Income Security Act of 1974 as well as regulation by the Department of Labor and the Internal Revenue Service.

Conclusion

For the reasons stated above, we urge the Commissions to clarify that stable value contracts are not swaps. If, however, the Commissions determine that stable value contracts are swaps, we urge the Commissions to exercise the authority granted under Section 719(d)(1) of Dodd-Frank to exempt stable value contracts from that definition.

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We appreciate the opportunity to comment on the Release. Fidelity would be pleased to provide any further information or respond to any questions that the Commissions or their staff may have.

Sincerely,

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner

[18] FASB Staff Position Nos. AAG INV-1 and SOP 94-4-1.

[19] *Id.*

Honorable Bart Chilton, Commissioner
Honorable Scott D. O'Malia, Commissioner

Commodity Futures Trading Commission

Honorable Mary L. Schapiro, Chairman
Honorable Luis A. Aguilar, Commissioner
Honorable Troy A. Paredes, Commissioner
Honorable Elisse B. Walter, Commissioner

U.S. Securities and Exchange Commission