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November 4, 2011

Mr. David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the Commodity Exchange Act (*RIN 3038—AD60);*Trading Documentation and Margining Requirements under Section 4s of the Commodity Exchange Act *(RIN 3038—AC96/97).*

Dear Mr. Stawick:

The American Council of Life Insurers ("ACLI") is a national trade association with 300 members that represent more than 90 percent of the assets and premiums of the life insurance and annuity industry. Life insurers actively participated in the legislative dialogue concerning regulation of derivatives markets and have provided constructive input on proposed rulemaking implementing Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Title VII"). The ACLI respectfully submits the following comments in response to the notices of proposed rulemaking (collectively, the "NPRs") to implement Title VII by the Commodity Futures Trading Commission ("CFTC") concerning (i) Clearing and Trade Execution Requirements under Section 2(h) of the Commodity Exchange Act ("CEA") and (ii) Trading Documentation and Margining Requirements under Section 4s of the CEA.

As we have stated in previous comment letters, life insurers are among the financial end users that will be subject to mandatory clearing and margin requirements for non-cleared swaps under Title VII. ACLI and its members support the CFTC's efforts to reduce risk, increase transparency and promote market integrity within the financial system through the prudent regulation of the derivatives marketplace. Furthermore, we appreciate the CFTC's recognition and acknowledgement that implementation of Title VII will be an expensive, time-consuming and burdensome task for all parties involved and that phasing is an essential element of an orderly transition that does not unduly disrupt markets and transactions. The transition is further complicated by (i) the use of customer-to-agent futures documentation as the basis for cleared, over-the-counter ("OTC") swaps and (ii) the introduction of derivatives clearing organizations ("DCOs") and Swap Execution Facilities ("SEFs") as additional participants to what has been previously a bilateral, two party arrangement. We also agree that some market participants may require more time to ensure that their swap transactions comply with new regulatory requirements.
However, while the NPRs move in the right direction, they fail to provide market participants sufficient guidance and certainty as to the overall schedule and timeframe for Title VII rule-making

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and implementation that will enable them to facilitate prudent resource planning, investment, budgeting and hiring. Currently, market participants must cobble together possible timetables based on tentative rule-making schedules, the NPRs, references in speeches by Chairman Gensler and other Commissioners, as well as constant commentary and speculation by various other sources. Such an approach is simply untenable given the transformational character of Title VII's reforms. In this new landscape, every market participant has its own vertical learning curve involving numerous, inter-related and complex issues. This learning curve, in turn, must be translated by each participant -- including swap dealers, major swap participants ("MSPs"), futures commission merchants ("FCMs"), DCOs, financial end users and SEFs as well as numerous technology providers and consultants -- into multiple legal agreements, operational process changes and software revisions and upgrades, all of which will be resource intensive and expensive. As we describe in this letter, the challenge becomes exponential when many market participants are attempting to accomplish these efforts at virtually the same time and each needs the assistance of other participants and many of the same resource providers in order to become compliant with Title VII.

Timeframes Generally

As financial end users, most life insurers expect to be classified as Category 2 Entities.[1] Despite minimal transparency on the number of entities within each category,[2] we believe the proposed 180-day timeframe for implementation by Category 2 Entities is insufficient. As drafted, the timeframes for each participant category appear to run concurrently. Using the CFTC's own estimates, approximately 200 swap dealers, 50 MSPs[3] and an unknown number of active funds will need to become compliant with respect to clearing, trade documentation and margining during the first 90 days.[4] During this period, we believe that Category 1 Entities will be focused exclusively on themselves and their dealings with other Category 1 Entities.[5]

In effect, the timeframe for Category 2 Entities will be carved down to the second 90 days of its 180-day period. As described below, life insurers alone will have difficulty completing the tasks required to become compliant within 90 days, and they are only a fraction of all Category 2 Entities. As Category 1 Entities determine how to prioritize their efforts among Category 2 Entities, larger participants will almost certainly be favored over smaller participants and participants pushed to the end of a period may have the unenviable choice between compliance with the law and unattractive business terms offered by Swap Dealers and FCMs. In addition, time pressure may result in financial end users settling to use too few FCMs, thereby giving the FCMs excessive market power and potentially limiting the risk mitigation that financial end users can achieve. Accordingly, we believe that the length of each timeframe must take into account the number of participants within the applicable category and the timeframes for each category should be designed to run consecutively rather than concurrently. We also suggest that the Commission consider using a set of longer timeframes for initial efforts by all market participants to comply with the Act's new requirements with shorter timeframes being established for incremental changes thereafter.

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[1] Insurers with derivative assets held as a third-party subaccount and those who manage third-party subaccounts for others may be Category 3 Entities.
[2] We believe that the number of entities within Categories 1, 2 and 3 will increase incrementally.
[3] 76 FR 45730, 45732 (August 1, 2011).
[4] The CFTC should clarify how timeframes for different activities relate to each other. For example, if the 180 days for Category 2 Entities to comply with clearing <u>and</u> trade documentation is the identical 180 day period, we believe the timeframe is much too short.
[5] We think it is highly unlikely that any Category 2, 3 or 4 Entities will be capable of early implementation because Category 1 Entities simply will not have time to address their needs.

Clearing and Trade Execution

The so-called "future-ization" of the swaps market will require the marriage of two frameworks for derivatives that are very different. The OTC swaps market is built on principal-to-principal model that uses form documentation that is bi-laterally negotiated between two parties and allows for both relatively standard and customized trades. The flexibility permitted under the OTC model allows financial end users to more closely hedge their risks.[6] By contrast, the industry relies on an agency-based model where futures agreements are proprietary to each FCM and the role of FCM as agent for pre-defined standardized futures contracts generally leads to one-sided arrangements in which the customer/end user has few rights. In establishing implementation timeframes, the CFTC must recognize that initial efforts to blend the futures agency and OTC principal-to-principal frameworks will inevitably surface complex issues that will be best solved through thoughtful consideration by experts on both sides. Furthermore, the CFTC should not assume that a company with experience in the futures market will necessarily have experience in the swaps market, and vice versa, or that the individuals responsible for a company's futures transactions will be the same individuals who will be responsible for that company's swap transactions. Therefore, individuals with expertise in one framework will be diligently working to understand the other framework, and as a result, everything including document negotiation, creating operational workflows and implementing related technology solutions, will be subject to a learning curve, will be more contentious and will take longer than expected.

All insurers, together with many other Category 2 participants, will require the attention and resources of the same limited number of FCMs during the proposed 180 day period of time. FCMs should not be permitted to "leverage" time and limited resources to present "take-it or leave-it" agreement terms, but the proposed rule could potentially give the FCMs this ability. Compliance with the mandatory clearing obligation requires financial end-users to engage FCMs through futures agreements together with clearing addendums and clearing execution agreements to address unique issues presented by swaps. While some life insurers may have futures agreements already in place with entities that will register as FCMs, those agreements may not be with FCMs that will clear the particular swaps that the insurer requires, or the terms of the agreements may need to be revised to reflect the new environment. Other insurers will have to commence entirely new relationships with FCMs. In order to ensure portability, adequate trade limits and access to various swap types and clearinghouses, life insurers will have to rely on many more FCMs than they did for traditional exchange-traded futures. Furthermore, although the CFTC is mandating relatively low capital requirements for clearinghouse membership, insurance companies will prefer to deal with extremely well-capitalized and experienced FCMs that are capable of clearing various derivatives products.

The obvious response to concerns about short timeframes is to begin work early before the clock starts ticking. However, the current lack of clarity on final rules on multiple topics makes it difficult to efficiently commence negotiations early without risking having to re-negotiate documents several times over.[7] FCM technology solutions vary widely in their level of development and sophistication.

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[6] We recognize that some of the flexibility associated with the OTC swaps market will be lost in the transition toward clearing. However, we believe that the Commission should continue to evaluate how the benefits that low-risk financial end users have negotiated in their OTC agreements – specifically, expanded types of eligible collateral, mutual margin posting and once daily margin calls – can be implemented under the new futures-based clearing model.

[7] One of our members is aware of one FCM who is unwilling to sign its own proposed version of the clearing addendum until the landscape becomes clearer and the document closer to final.

Derivatives software vendors describe having connectivity to clearinghouses through a small number of possible SEFs, but also describe constantly evolving workflows which will remain uncertain until the rules are finalized.[8] Accordingly, vendors are not yet able to provide end user customers with needed interfaces, extracts and reports. With limited resources, all participants are faced with balancing early engagement in implementation with accompanying inefficiencies and re-work versus slower implementation in hopes of greater certainty while risking that they will be unfairly treated as a result of tight timeframes.

Life insurers will have the additional burden of ensuring that compliance with Federal requirements is consistent with their state regulatory obligations. For example, statutory accounting guidance may need to be refreshed to contemplate the clearing environment and initial margin requirements while quarterly financial reporting forms will need to be revised to accommodate new data. Some insurers will have to work with their state regulators to modify derivatives use plans and still others may need legislative revisions to their authority to use derivatives or pledge assets.

Trade Documentation and Margining

Many life insurers already have ISDA Master Agreements and Credit Support Annexes with either zero or minimal thresholds to cover their swap transactions. However, amendments will likely be required to address valuation methodologies, eligible collateral types, margin calls, margin transfer timing and mechanics for initial margin.[9] Parties may also need to modify custodial requirements, investment of margin and re-hypothecation and other provisions to address grandfathered trades versus new cleared and uncleared trades. Review of agreements negotiated years ago will almost certainly highlight the need for additional amendments. In some instances, entirely new agreements will be needed to accommodate changes in the legal entities that Swap Dealers will choose to use in the post-enactment world.

Each insurance company that uses derivatives may have relationships with 10-20 Swap Dealers[10] and may have multiple entities within the same insurance company family with similar arrangements. Our members have estimated that active derivatives users may have anywhere from 50-200 existing agreements that will need amendment or replacement. Again, while focusing solely on life insurers within Category 2, completing the necessary documentation within 180 days (which, as we describe above, could effectively be 90 days if the timeframes overlap) with a small group of Swap Dealers will be difficult. Staffing on both sides is likely to be stretched and everyone will be negotiating on topics of first impression.[11] In addition, unless the scope of eligible collateral is expanded, insurers will be compelled to negotiate collateral transformation arrangements during this period. They may also consider outsourcing their collateral operations in order to efficiently manage collateral for new OTC swaps, cleared swaps, exchange-traded futures and grandfathered swaps. As with the transition to clearing, implementing new documentation and related margin

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[8] Previous experience shows that the expense and time required for software revisions and upgrades routinely exceeds management's expectations. One of our members estimates that it will spend $750,000 - $1,000,000 in IT and legal costs and at least 10,000 man hours to meet Title VII requirements.

[9] Margin requirements will be governed not only by the CFTC, but also the SEC and the Prudential Regulators. Margin rules should be finalized by all of the regulators prior to implementing the trade documentation requirements.

[10] Many state insurance laws governing investments by insurers significantly limit an insurer's ability to transact with lower-rated counterparties. Accordingly, most life insurers primarily use the same 10-20 derivatives counterparties, most of which are highly-rated, well-capitalized U.S. or foreign banks or their affiliates.

[11] As evidenced by the need for regulatory intervention in the confirmation backlog several years ago, Swap Dealers have historically demonstrated understaffing for documentation processes.

requirements will also result in operational and technology changes that will need to be accomplished in this period. In addition, life insurers will need to negotiate or amend the documents referred to in this paragraph concurrently with negotiating the documents needed to comply with the clearing and trade execution requirements discussed above, further stretching staffing.

Finally, we recommend that the Commission consider whether the implementation plan for margining on uncleared trades take into account whether parties already fully collateralize their transactions using zero thresholds. These trades already represent substantially lower systemic risk than un- or under-collateralized transactions and perhaps could be pushed later in the implementation timetable.

Who is the "Buy-Side"?

We support the Commission's desire to have "buy-side" representation in the problem solving likely to occur early in the implementation process. With so little transparency to the identities of MSPs and "active funds," however, we are not convinced that they have sufficient experience to contribute meaningfully to the "buy-side" perspective as industry standards are being developed. The "buy-side" is not a monolithic category. Among others, it includes insurance companies, hedge funds, mutual funds and commercial end users such as airlines, farmers and manufacturers who may elect to clear swaps – all of whom have a distinct set of concerns. Indeed, as we have written in earlier letters, insurers are highly-regulated, well-capitalized, unlevered, low-risk, financial entities that use derivatives primarily for hedging risks associated with their assets and liabilities in compliance with state insurance investment laws. We are not comfortable that high-risk, highly-leveraged hedge funds that lack transparency or other financial end users of derivatives will appreciate some of the nuanced differences that may be required for our regulated industry. Indeed, hedge funds have typically had to accept significantly less favorable terms in their agreements to compensate for their high-risk, reduced transparency model, thus making them poor representatives of the "buy-side" in general and insurance companies, in particular. Nor do we believe, as the Commission suggests, that MSP status or the frequency of trading that characterizes active funds should be deemed an indicator of experience or resources that will enable them to come into compliance more readily than entities that trade swaps less frequently. Indeed, to the extent that derivative activities contributed to the financial crisis, frequency of trading had no correlation with experience and/or resources.

Category 2 Entities could be seriously disadvantaged if the "sell-side" concludes that Category 1 "buy-side" Entities are proxies for all buy-side entities. Negotiations on extremely tight timelines will encourage establishment of "market standards" that may not be fair or prudent. Furthermore, as time grows short for compliance, "market standards" will be offered to some "buy-side" participants on a "take it or leave it" basis.

Even life insurers are diverse "buy-side" participants because their hedging needs are guided by the products that they sell. Some are more focused on equity derivatives while others rely more heavily on interest rate swaps, currency swaps or credit derivatives. Some trade frequently while others focus on larger portfolio based trades. Life insurers also differ significantly among each other in resources that they have available to handle the Dodd-Frank transition.

Other Considerations

As with all aspects of the Act, in order to facilitate a smooth transition and avoid regulatory arbitrage, the implementation timetable must be coordinated between the Commission and the

Securities and Exchange Commission as well as with international efforts to regulate the derivatives markets. Where possible, consistency should be achieved in order to reduce costs.

Conclusion

The ACLI and its member companies appreciate the thoughtful approach that the Commission has taken in formulating proposed rules under the Dodd-Frank Act. We are particularly grateful for the continuing opportunity to provide commentary in the process, given the significant effect these new rules will have on our business and on the customers who rely on our products to secure their financial futures. Please let me know if any questions develop, or if we can provide additional information.

Sincerely,

Carl B. Wilkerson