



**AMERICANS
FOR FINANCIAL REFORM**

ACCOUNTABILITY * FAIRNESS * SECURITY

Americans for Financial Reform

1629 K St NW, 10th Floor, Washington, DC, 20006
202.466.1885

November 1, 2012

Ms. Stacy Yochum
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Commodity Futures Trading Commission and Securities and Exchange Commission Acceptance of Public Submissions Regarding the Study of Stable Value Contracts (File No. S7-32-11)

Ladies and Gentlemen:

Thank you for the opportunity to further address the regulation of Stable Value Contracts (“SVCs”) as swaps now that the definition of swaps has been finalized by the Commodity Futures Trading Commission (“CFTC”) and the Securities Exchange Commission (“SEC”) (hereinafter when referred to collectively “the Commissions”). These comments are submitted jointly by Professor Michael Greenberger of the University of Maryland Francis King Carey School of Law and Americans for Financial Reform (“AFR”).

AFR is a coalition of over 250 national, state, local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups along with prominent independent experts.

These comments follow up on earlier comments also made by AFR on the issue of stable value contracts.¹ These earlier comments agree with other organizations such as Better Markets that SVCs are indeed swaps and should be regulated as such. Our views in this matter have only been strengthened by the final swaps definition promulgated by the Commissions. This definition already creates a Product Safe Harbor for certain financial guarantee products sold by regulated insurance companies. Thus, the continuing debate concerning stable value contracts only applies to those SVCs that would not already qualify for the product safe harbor under the swaps definition rule. These SVCs are generally those that most closely replicate the characteristics of swaps and appear most likely to create systemic risk. Furthermore, the safe harbor already provides insurance companies and re-insurers the ability to provide financial guarantees that are not classified as swaps.

“Stable value contract” is a term that applies to several types of agreements used in order to form stable value funds. Two common forms of SVCs are Guaranteed Investment Contracts (“GIC”) and a synthetic Guaranteed Investment Contracts (“synthetic GIC”). A traditional GIC is a contract that provides a fixed rate of return based on a portfolio of assets, where the plan provider both owns the underlying assets and provides the rate guarantee.² In a synthetic GIC, a provider pays a rate of return based on the performance of the underlying portfolio and the assets are held either in a separate account or a trust instead of in the provider’s general account.³ A third party then provides a “wrap” contract, an instrument that closely mirrors insurance on the investment, which guarantees the rate of return. These synthetic contract forms are “the most common element of stable value funds offered by the stable value providers.”⁴ Given the risk-transferring nature of these contract forms, SVCs fall under the definition of “swap” in the Commodity Exchange Act (“CEA”).

The swap definition applies to SVCs

The CEA, as amended by the Dodd-Frank Act, defines a swap as 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.”⁵ SVCs fall under this definition because a SVC’s “rate of return may be fixed, indexed, or reset periodically based on the actual performance of the underlying assets.”⁶

¹ Americans for Financial Reform, Comment for Proposed Rule 76 FR 53162, p. 1-2, 6-7, Sept. 26, 2011. Available at <http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2011/09/AFR-CFTC-Stable-Value-Contracts-9-26-11.pdf>

² Department of Labor, Report on Stable Value Funds and Retirement Security in the Current Economic Conditions, 2009. Available at: <http://www.dol.gov/ebsa/publications/2009ACreport3.html> See also Record of Society of Actuaries, “Synthetic Guaranteed Investment Contracts: An Overview,” p. 20, 1995. Available at: <http://www.soa.org/search.aspx?searchterm=synthetic%20GIC>

³ *Id.*

⁴ MetLife, MetLife Stable Value Study: A Survey of Plan Sponsors and Stable Value Fund Providers, April 2010. Available at: <http://stablevalue.org/wp-content/uploads/2009/06/MetLife-Stable-Value-Study1.pdf>

⁵ 7 U.S.C. §1a(47)(ii)

⁶ Department of Labor, Report on Stable Value Funds and Retirement Security in the Current Economic Conditions, 2009. Available at: <http://www.dol.gov/ebsa/publications/2009ACreport3.html>

Additionally, the CEA also defines a swap as a contract that exchanges payments based on “other financial or economic interests or property of any kind,” and thereby transfers the financial risk of future changes in the value without also transferring ownership interest in the underlying asset.⁷ SVCs also meet this definition because these financial products often provide an exchange of payments based on underlying debt instruments, transferring the risk from the investor to the SVC issuer. We concur with the conclusion reached by Better Markets – SVCs meet two provisions in the statutory definition of swap, and should be regulated as such.⁸

An exemption should not be granted because an exemption is not appropriate and not in the public interest

The Dodd-Frank Act requires the Commissions to consider exempting SVCs from the swaps definition if an exemption is “appropriate and in the public interest.”⁹ SVCs do not qualify for an exemption under this standard. First, some stable value industry representatives assert in their comments that SVCs are individualized agreements and therefore unfit for trading or clearing and inappropriate for regulation.¹⁰ This argument is all too familiar. In 1989, swaps were initially unregulated under a similar argument that swaps were customized and tailored contracts.¹¹ However, by 1993, a mere four years later, the International Swaps and Derivatives Association offered its members a standardized, boilerplate contract for swaps.¹² By 2008, the American taxpayer was absorbing the multi-trillion-dollar cost of systemic market risk, caused in large part by this unregulated, over-the-counter derivatives market.¹³

Given this historical backdrop, it is foreseeable that a broad exemption for SVCs could be utilized to avoid regulation by industrious financial engineers who design increasingly standardized SVC products and seek to avoid the requirements of Dodd-Frank. This is especially true because, while the CFTC adopted anti-evasion provisions in its swap regulations, the SEC failed to adopt any such

⁷ 7 U.S.C. §1a(47)(iii)

⁸ Dennis Kelleher, Better Markets, Comment for Proposed Rule 76 FR 53162, p. 1-2, 6-7, Sept. 26, 2011. Available at: <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48228&SearchText=>

⁹ Dodd-Frank Act, §Section 719(d)(1)(B)

¹⁰ Stable Value Investment Association, American Bankers Association, Financial Services Roundtable, Comment for Proposed Rule 76 FR 53162, Sept. 26, 2011, p. 54. Available at:

<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48226&SearchText=>

See also BlackRock, Comment for Proposed Rule 76 FR 53162, Sept. 26, 2011, p. 3-4. Available at:

<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48215&SearchText=>

¹¹ Michael Greenberger, Overwhelming a Financial Regulatory Black Hole with Legislative Sunlight: Dodd-Frank’s Attack on Systemic Economic Destabilization Caused by an Unregulated Multi-Trillion Dollar Derivatives Market, 6 MARYLAND JOURNAL OF BUSINESS & TECHNOLOGY LAW 127, 133 (2011). This article provides a detailed analysis of relationship between the deregulation of over the counter derivatives and the market crash of 2008.

¹² *Id.* at p. 134.

¹³ *Id.* at p. 143-45.

provision.¹⁴ Because many SVCs are based on securities and would fall within the jurisdiction of the SEC, this regulatory gap increases the likelihood that SVCs could be used to evade regulation without consequences. Permitting such a loophole in the regulatory framework would put the American taxpayer at substantial risk once again.

In addition to being inappropriate, a SVC exemption is not in the public interest. This is because the appropriate oversight and regulation of swaps promotes transparency and fairness in financial markets where both had been sorely lacking. Even the financial press has noted that stable value funds have an “utter lack of transparency,” as the funds are “not subject to any of the fee-disclosure or portfolio-holdings reporting that governs mutual funds.”¹⁵ In other words, it is difficult for investors to ascertain exactly what is contained in the stable value fund’s underlying pool of assets,¹⁶ putting investors at a disadvantage in evaluating investment opportunities and making investment decisions. For example, though the \$1.8 billion JPMorgan Stable Asset Income Fund invested as much as 13% in private mortgage assets that were underwritten by JP Morgan itself,¹⁷ investors were unaware of this significant risk prior to the market crash in 2008.¹⁸ Thus, the public interest in having and maintaining orderly, transparent, and fair markets would not be served by granting a SVC exemption.

Some industry representatives argue that an exemption is justified because SVCs are currently regulated by regimes such as state insurance laws and ERISA fiduciary requirements.¹⁹ However, a MetLife survey found that only about half of stable value providers actually considered themselves fiduciaries.²⁰ Indeed, fiduciary relationships cannot be helpful to consumers if plan providers do not view themselves as under the affirmative obligation to act and, in fact, act commensurately. In addition, ERISA and other existing regulatory systems are not sufficient to justify an exemption from the swap definition. The purpose of these existing regulatory regimes is not to protection of the American

¹⁴ See Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping; Final Rule, 77 F.R. 48303 (Aug. 13, 2012). Available at: <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-18003a.pdf>

¹⁵ Beverly Goodman, Cloudy in a Transparent World, Barron’s, Aug. 4, 2012. Found at: http://online.barrons.com/article/SB50001424053111903940904577559020072129662.html?mod=bol_share_tweet

¹⁶ Larry Swedroe, Are Stable-Value Funds Really Stable?, CBS News Moneywatch, April 24, 2009, available at: http://www.cbsnews.com/8301-505123_162-37840348/are-stable-value-funds-really-stable/

¹⁷ Jessica Toonkel, Labor Department Looking Into JPMorgan Stable Value Fund, Reuters, July 21, 2012. Available at: <http://www.reuters.com/article/2012/07/21/us-labor-jpmorgan-idUSBRE86J1B720120721>

¹⁸ *Id.*

¹⁹ Stable Value Investment Association, American Bankers Association, Financial Services Roundtable, Comment for Proposed Rule 76 FR 53162, Sept. 26, 2011, p. 54. (SVIA) Available at: <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48226&SearchText=>
See also BlackRock, Comment for Proposed Rule 76 FR 53162, Sept. 26, 2011, p. 4. Available at: <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48215&SearchText=>

²⁰ MetLife, MetLife Stable Value Study: A Survey of Plan Sponsors and Stable Value Fund Providers, p. 3, April 2010. Available at: <http://stablevalue.org/wp-content/uploads/2009/06/MetLife-Stable-Value-Study1.pdf>

taxpayer from systemic market risk, and there is no reason to believe that existing laws would prevent future use of SVCs to avoid swaps regulations. Furthermore, by dividing SVC regulation into various silos – ERISA, state insurance regulators, and so on – regulators will not be able to monitor the sum of the risk presented by SVCs, thereby sharply undermining one of the primary goals of Dodd-Frank.

Finally, while many SVCs today are utilized within retirement funds, others are not. Some state and local governments, for example, use SVCs in managing their bonds. Without transparency regarding the underlying assets in the stable value fund, governments' budgets are at risk. Moreover, with regulation, state and municipal governments will receive the protection of the business conduct standards that apply to swap dealers and major swap participants who contract with local government entities.²¹ It is also unclear, due to the presently opaque nature of the market, to what degree, if any, SVCs that exist outside traditional retirement plans are regulated, leaving substantial risk of improper speculative use or standardization by financial entities in order to avoid Dodd-Frank regulations. A broad exemption for SVCs would create future systemic market risk to the American taxpayer and should not be granted.

Even if SVCs are granted an exemption, such exemption must be narrowly tailored to prevent abusive uses and practices

Should the Commissions exempt SVCs from the swap definition, this exemption should be narrowly framed. In requiring this joint study of SVCs in its enactment of Dodd-Frank, Congress defined SVCs to include four categories of products that are already regulated by either ERISA or the Internal Revenue Code.²² Specifically, these are employee benefit plans,²³ eligible deferred compensation plans,²⁴ annuity contracts purchased by public schools or certain non-profit entities,²⁵ and qualified tuition programs.²⁶ Any exemption must be limited by this statutory definition of SVCs and must not be extended to all existing SVC-based products to prevent abusive and evasive use of SVCs.

Additionally, any SVC product that is standardized or becomes standardized in the future should not be eligible for any exemption. It is imperative that the Commissions be able to monitor the overall market for systemic risk even if individual SVC products are regulated through other agencies. This will help prevent and curtail abusive uses of SVCs entered into for the purpose of avoiding swap regulations. Finally, any exemption should not apply to any use of SVCs that is purely speculative in nature.

The need to narrowly tailor and regularly revisit any exemption is made even more imperative by the failure of the Securities and Exchange Commission to include broad anti-evasion provisions in its

²¹ 17 C.F.R. 23.440 (setting forth business conduct standards for swap dealers acting as advisors to special entities); 17 C.F.R. 23.450 (additional business conduct standards for swap dealers and major swap participants when the counterparty is a special entity).

²² Dodd-Frank Act, §Section 719(d)(2), codified at 15 U.S.C. §8307 (d)(2).

²³ As defined at 29 U.S.C. §1002(3).

²⁴ As defined at 26 U.S.C. §457.

²⁵ 26 U.S.C. §403(b).


²⁶ As defined at 26 U.S.C. §529(b).

swaps regulations. Such anti-evasion authority would be a natural tool to use in restricting the ability of financial engineers to structure SVCs that effectively replicate swaps and pose similar risks. Its absence means that the SEC must rely on the structure of any exemption granted. As discussed above, the failure of the SEC to incorporate such anti-evasion provisions into its rules puts taxpayers at risk.

Conclusion

SVCs meet the statutory definition of swap and should be regulated as such. An exemption from the swap definition must be both appropriate and in the public interest – an exemption for SVCs is neither. An exemption for SVCs would create an attractive regulatory loophole for financial engineers to exploit, and SVCs must therefore be found unqualified for an exemption. However, should the Commissions choose to provide an exemption from the swap definition to SVCs, such exemption must be narrowly tailored so that SVCs do not become a method for evading the regulations of Dodd-Frank. Loopholes that could create systemic risk cannot be allowed to proliferate, lest the retirement funds of millions of Americans, as well as the financial well-being of hundreds of city and state governments, be placed in peril.

Sincerely,



I. Michael Greenberger
Law School Professor
University of Maryland
Francis King Carey School of Law
500 W. Baltimore Street
Baltimore, MD 21201
410-706-3846



Brandy L. Bruyere, J.D.
Law and Policy Analyst
University of Maryland
Center for Health and Homeland Security

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Global Communications

- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Council of Women's Organizations
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute

- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Affiliates

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers

- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York

- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET