MEMORANDUM

TO: File Number S7-08-12

FROM: Sheila Dombal Swartz
Senior Special Counsel
Division of Trading and Markets
U.S. Securities and Exchange Commission ("Commission")

DATE: July 20, 2015

RE: Meeting with the American Council of Life Insurers

On July 20, 2015, Commission staff met with representatives of the American Council of Life Insurers ("ACLI") to discuss the proposed rules and rule amendments regarding capital, margin, and segregation requirements for security-based swap dealers and/or major security-based swap participants and capital requirements for broker-dealers (Release No. 34-68071).

Commission staff included Gary Barnett, Mike Macchiaroli, Tom McGowan, Brian Bussey, Randall Roy, Carol McGee and Sheila Swartz from the Division of Trading and Markets.

The ACLI participants at the meeting included Joe Demetrick, Metlife; Todd Lurie, MetLife; Richard Miller, Prudential Financial; Gary Neubeck, Prudential Financial; Kathleen O'Neill, New York Life; and Carl Wilkerson, ACLI.

ACLI
Financial Security. For Life.

Margin Requirements for Uncleared Security-Based Swaps

Presentation to SEC Division of Trading & Markets

July 20, 2015

101 Constitution Ave., NW, Washington, DC 20001-2133

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American Council of Life Insurers ("ACLI")

- ACLI is a national trade association with 300 members representing more than 90 percent of the assets and premiums of the life insurance and annuity industry in the U.S.
- ACLI members offer life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, and reinsurance.
- Life insurers provide the second largest U.S. source of corporate bond financing, holding over 30% of total U.S. corporate bonds held by financial firms.
    - In 2014, approximately 49% of life insurers' $6.4 trillion of total assets were held in bonds, including corporate bonds (32%) and government bonds (7%).
    - Over 70% of bonds purchased by life insurers for their general accounts have maturities in excess of ten years at the time of purchase.

Sources: ACLI tabulations of NAIC data (year-end 2014), used by permission; Federal Reserve Board, Z.1 Financial Accounts of the United States, June 11, 2015.

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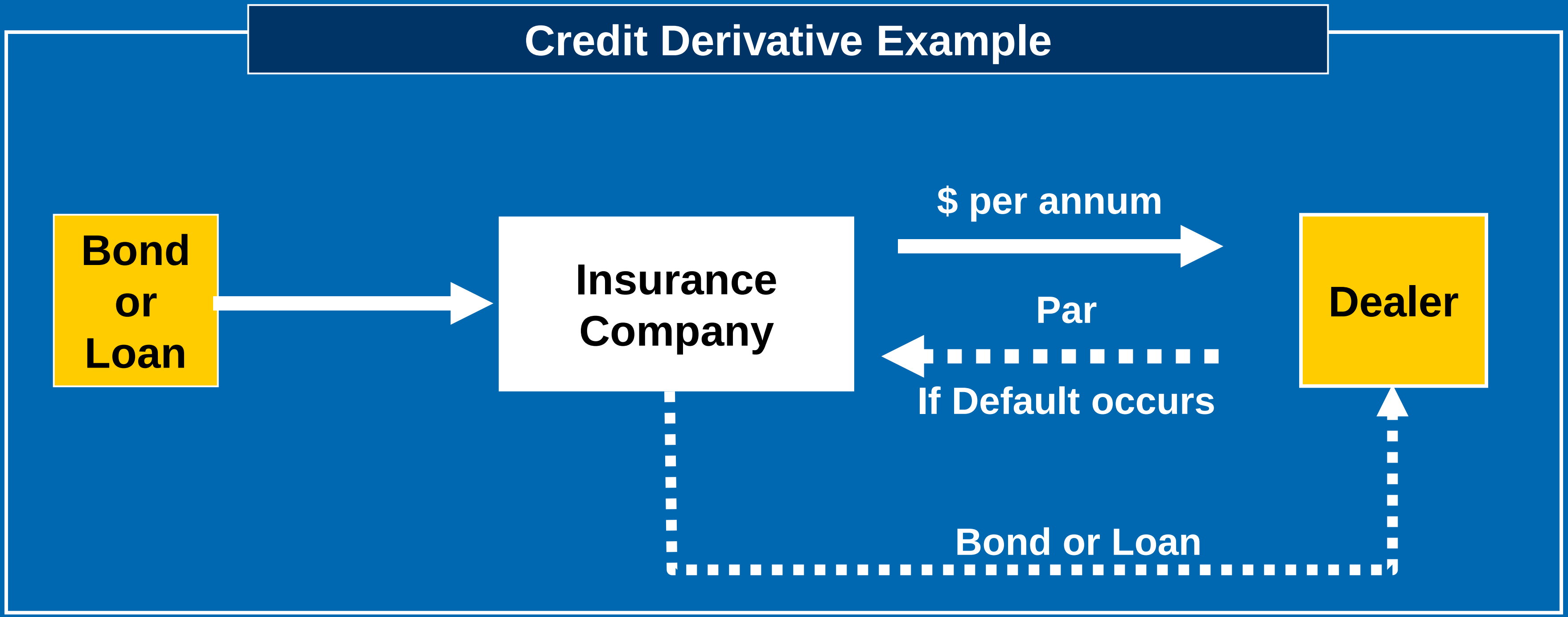
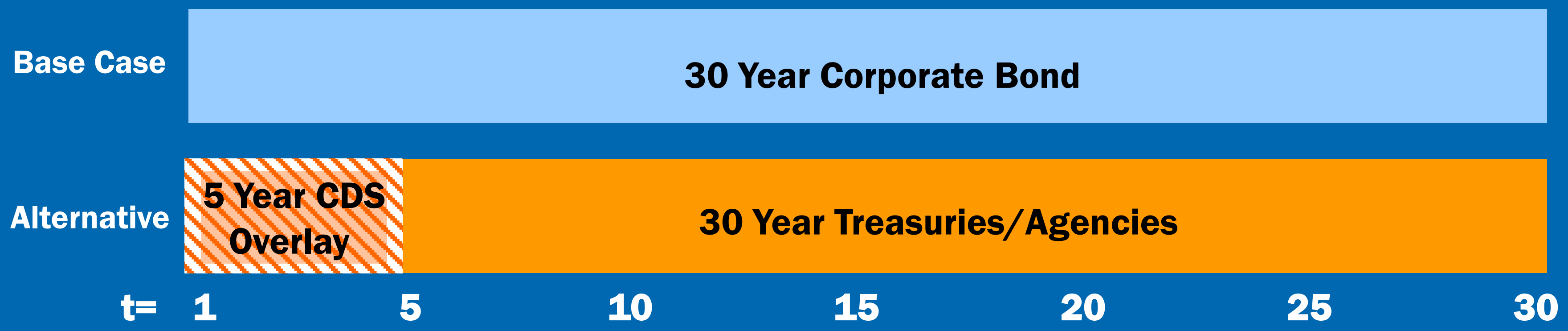
Summary

- ACLI is concerned about regulatory treatment of uncleared swaps; e.g., submitted comment letters on the Prudential Regulators' and CFTC's Proposed Margin Rules for Uncleared Swaps.
- Uncleared swaps and security-based swaps have a role in Life Insurers' hedging programs:
  - Credit Hedging
  - Asset Replication
- Several aspects of the Proposed Rules have the potential to limit Life Insurers' abilities to manage assets and liabilities in a prudent manner:
  - Elimination of non-cash collateral for variation margin (VM)
  - Characterization of VM as settlement payments
  - Creation of significant operational risk through accelerated implementation
  - Lack of consistency and transparency in initial margin (IM) models
  - Market fragmentation due to inconsistency with BCBS-IOSCO Framework

Credit Hedging Example

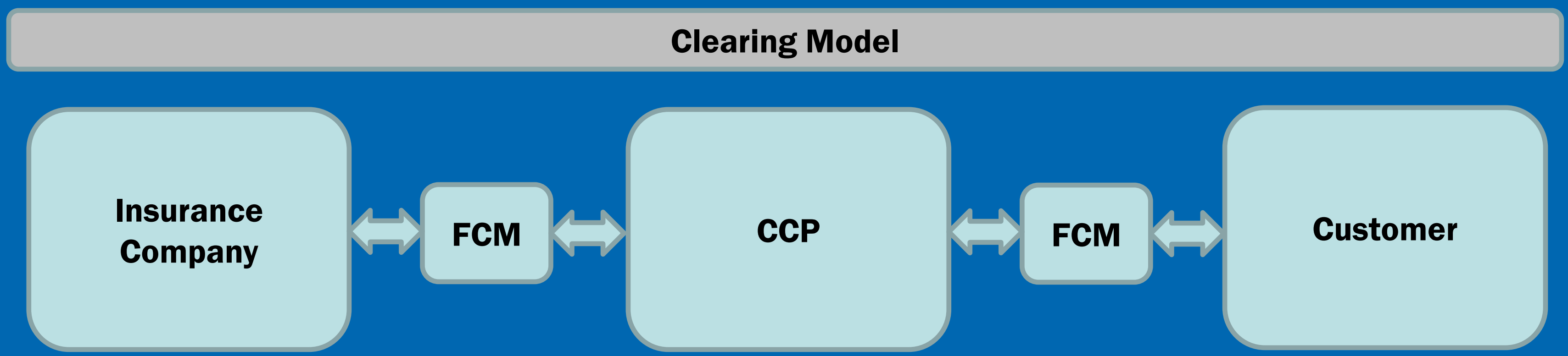


Credit Replication Example



- **Base Case:** Buy 30 year Corporates where available and attractive (limited supply)
- **Alternative:** Source credit exposure by using 5 year CDS with 30 year underlying bond

VM Treatment: Clearing Model



- CCP is a third party to trade, whose functions include:
  - Serving as *credit intermediary* to the transaction
  - *Transferring* VM between parties
  - *Sole arbiter* for end of day pricing, IM and VM
  - *Establishing* minimum margin requirements uniformly for participants

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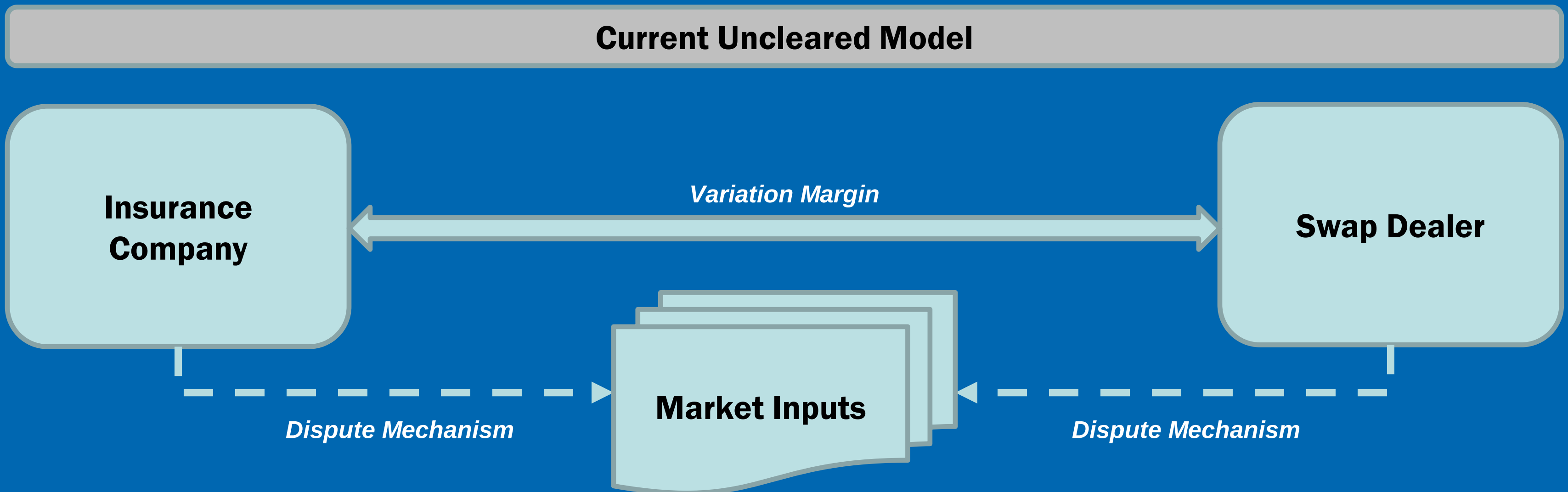
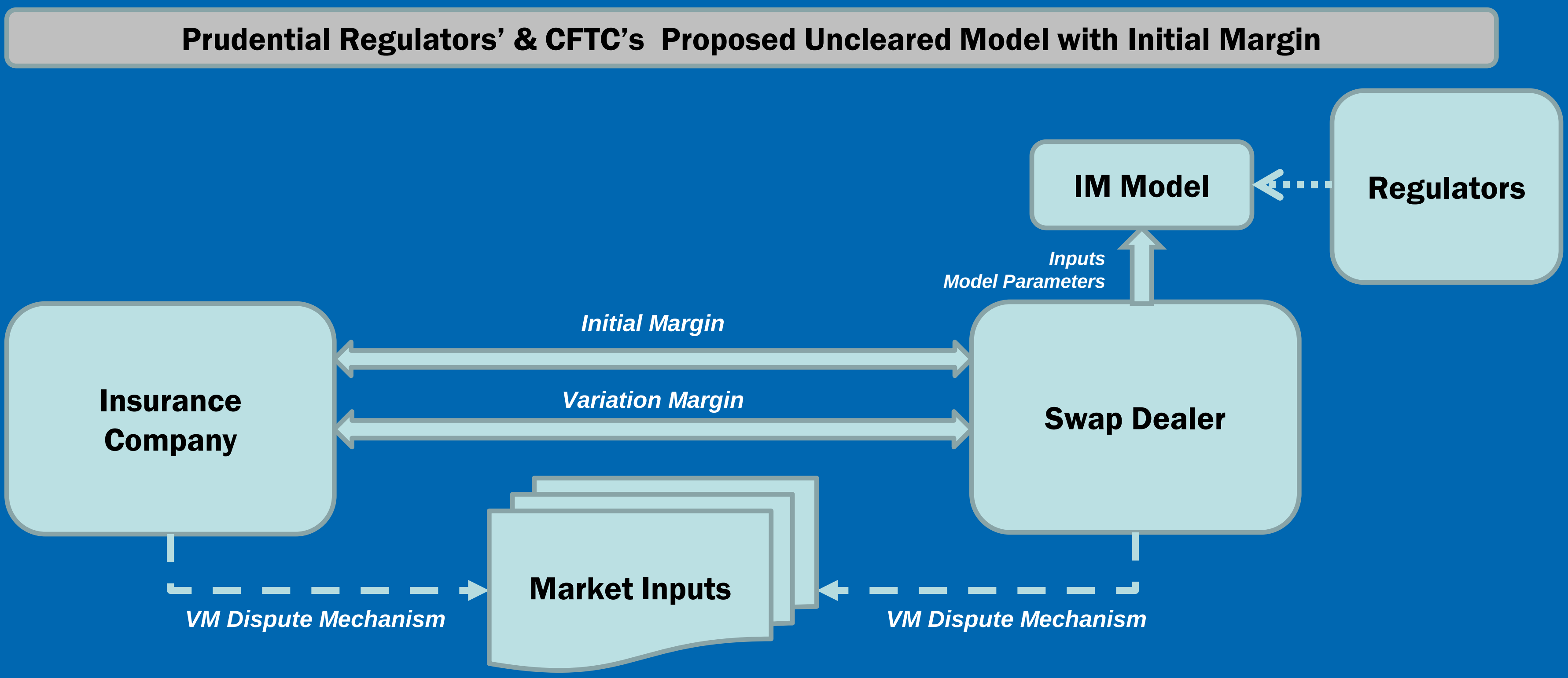
VM Treatment: Current Uncleared Model



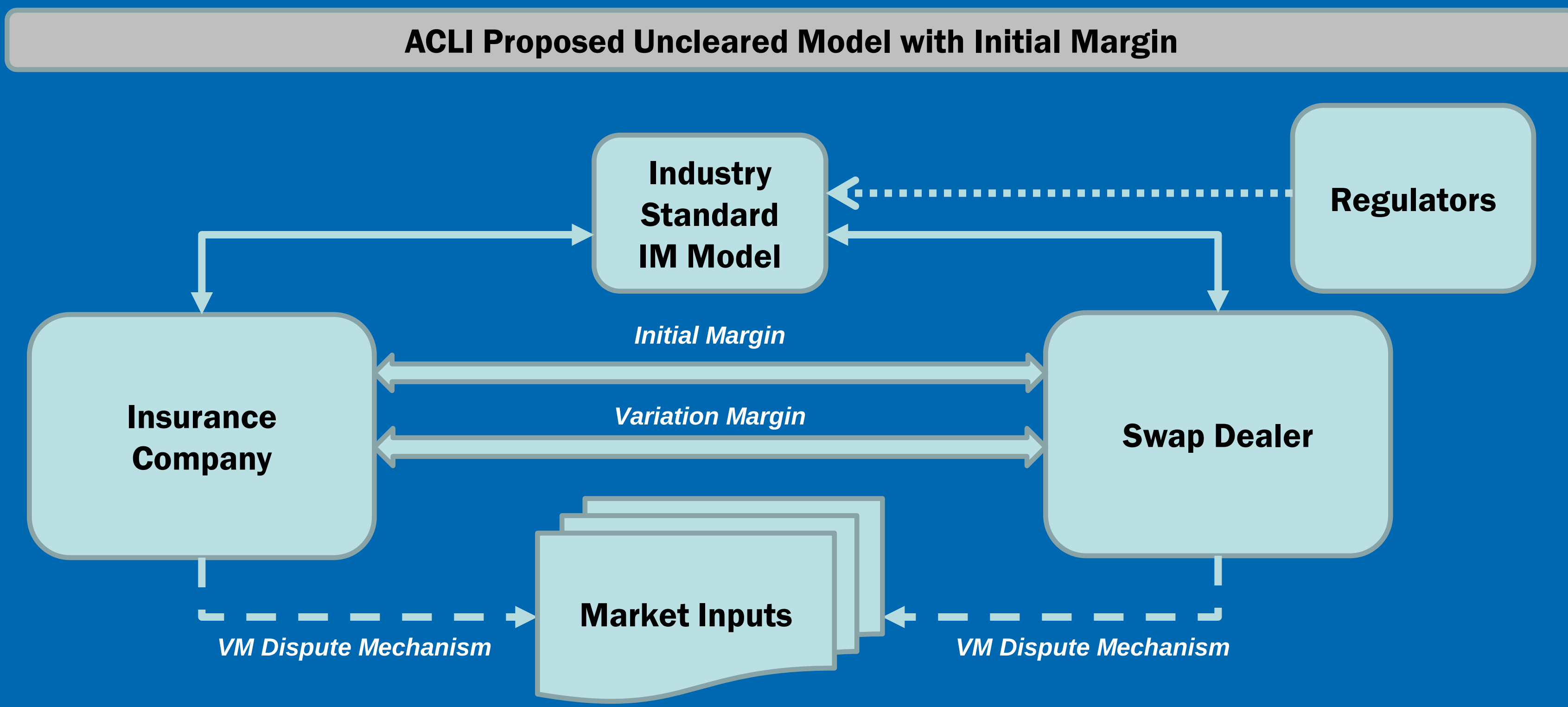
- **VM is not characterized as a settlement payment**
- **Collateral *pledged as security interest* against performance**
- **Market Mid Prices are agreed to by both parties with dispute rights**
- **Values do not reflect actual execution levels in a close-out situation**

Initial Margin Models Require Transparency



- Ins Cos have no mandated *transparency* into IM Models
- Ins Cos have no specific *dispute rights* in regards to IM calculation
- IM Model *consistency and transparency* is essential

Initial Margin Models Require Transparency



- **Advantages:**
  - **One consistent model for all market participants**
  - **IM model transparency to all facilitates dispute resolution**

Eligible VM Requirements should be phased-in with Initial Margin

- Currently, exchanging VM is broad based among market participants
- The proposed Prudential Regulator and CFTC rules will require:
  - Legal documentation changes requiring bi-lateral negotiation
  - Changes to portfolio asset allocation
  - Changes to trading & collateral management systems
- Separate phase-in for IM will require multiple sets of changes

Conclusions

- Eligible Collateral for Variation Margin should include non-cash collateral consistent with the BCBS-IOSCO Framework.
- Variation Margin for uncleared Security-Based Swaps should continue to be characterized as a pledge/security interest.
- Initial Margin Models should be consistent and transparent to all market participants.
- Requirements for IM or VM will require a phase-in schedule to modify legal documentation and IT systems.