MEMORANDUM

TO: File
FROM: Aaron Foxman
RE: Meeting with the National Association of Insurance Commissioners, the Conference of State Bank Supervisors, and the North American Securities Administrators Association
DATE: September 1, 2010

On September 1, 2010, Cristie March, Darren Vieira, Iliana Lundblad, Joshua Kans, Kenneth Riitho, Matthew Daigler, Michael Hershaft, Sheila Swartz, Thomas Eady, Emre Carr, Matthew Reed, Jeffrey Minton, Christine Sibille, David Labhart, Jennifer McCarthy, Ling Yu, Richard Ferlauto, Timothy Riley, Michael Reedich, Linda Sundberg, Katherine Martin, Jason Anthony, and Jeffrey Dinwoodie of the Securities and Exchange Commission and David Aron, Julian Hammar, George Wilder, Mark Higgins, Ted Kneller, and Thelma Diaz of the Commodities Futures Trading Commission met with Ethan Sonnichsen (Director of Government Relations, National Association of Insurance Commissioners ("NAIC")), Edward Toy (Sr. Financial Regulation & Capital Markets Advisor, NAIC), Mark Sagat (Government Relations Analyst and Counsel, NAIC) (collectively, the "NAIC representatives"), Michael Stevens (SVP Regulatory Policy, Conference of State Bank Supervisors ("CSBS")) (the "CSBS representative"), Deborah House (Director of Policy, North American Securities Administrators Association ("NASAA")), and Rex Staples (General Counsel, NASAA) (collectively, the "NASAA representatives").

The NASAA representatives discussed the relationship between state pension funds and novel derivative products, conflicts of interest, clearing and eligible contract participants, the classification of end users, and the classification security-based swap dealers and major participants.

The NAIC representatives raised questions regarding the insurance industry as it relates to the definitions of "swap", "major swap participant", "commercial risk", and "swap dealer." Additionally, the NAIC representatives discussed capital requirements, margin requirements, and derivative clearing.

The CSBS representative raised questions regarding an exemption for small banks and the incorporation of derivatives in state banking regulations.

NASAA Questions for SEC Discussion

NASAA Questions for SEC

1. Novel Derivative Products

   a. Dodd-Frank establishes a three-part procedure by which new derivatives may be introduced, evaluated, and approved. Given the number of state pension funds and municipalities that purchased custom derivatives, will nature of the entities that seek to enter into the arrangement be given consideration?

2. Conflicts of Interest

   a. Section 765(a) requires the Commission, within 180 days after enactment, to adopt rules to mitigate conflicts of interest in specified entities by imposing restrictions on the control of certain entities. Restrictions may be placed on, among other entities, a "major security-based swap participant". What constitutes a "major security-based swap participant"?

3. Clearing

   a. Section 723(a) (2) makes it unlawful for any person other than an eligible contract participant, to enter into a swap (subject to certain rules). What constitutes an "eligible contract participant"? Would a state pension fund or state/local government be considered "eligible contract participants"? If so, would this make state pension funds "major swap participants"? Do the exclusions under Sections 723(a)(3) apply in this case?

4. Swap Dealers and Major Swap Participants

   a. Although Senators Dodd and Lincoln have stated that their intent was not to regulate end users as major swap participants and, according to the Congressional Record, regulators cannot impose capital and margin requirements on end users. Would a state pension fund or state/local government be considered an "end user"

5. Regulation of Dealers and Major Participants

   a. Would state pension fund or a state/local government be considered a major security-based swap participant for registration, capital, and margin requirements?

NAIC Questions/comments for SEC

1. “Swap” Definition
    a. One of the definitions of swap in 721(a)(21) is an agreement or contract that provides for any purchase, sale, payment, or delivery that is dependent on the occurrence, non-occurrence or the extent of the occurrence of an event or contingency associated with a potential financial, economic or commercial consequence.
    b. Can you confirm that this was not intended to capture any insurance products?
    c. Are there any plans to clarify this by rule?
2. “Major Swap Participant” Definition
    a. How do you plan to define “major swap participants”?
    b. Will the definition be consistent across types of financial institutions?
    c. Also, the Act provides that positions used for hedging or mitigating commercial risk will be excluded from the criteria used to identify major swap participants Has there been any thought to how the “commercial risk” will be defined and how it will be applied to the risks insurance companies hedge?
3. “Swap Dealer” Definition
    a. Among other definitions, “swap dealer is defined as a person or entity that regularly enters swaps with counterparties. It excludes individuals that enter into swaps for their own account.
    b. In further clarifying this definition by rule, will there by a materiality threshold?
    c. Also, has there been thought as to how “entering into swaps for their own account” will be applied to insurers?
4. Margin and Capital Requirements
    a. With respect to imposition of new margin and capital requirements for swap market participants generally and major swap participants, will such requirements be applied consistently across financial institutions?
    b. Do you intend to consult with us as such requirements are developed?
5. Clearing
    a. Insurance companies use a variety of what might be defined as non-standardized derivatives to hedge legitimate business risks that may or not be accepted for clearing depending on how broadly such requirements are applied.
    b. Do you plan to consult with regulators and/or insurance companies to identify such derivatives and work towards making them “clearable?”

CSBS Questions

Is there any information we can provide to assist in determining an exemption for small banks and savings associations?

States need to incorporate derivatives in the legal lending limit. Do you have an interest in how the states approach this area?