ACLI

Financial Security...for Life.

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September 26, 2011

Mr. David A. Stawick, 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: File No. S7-32-11C, "Stable Value Contract Study"

Dear Mr. Stawick and Ms. Murphy:

The American Council of Life Insurers ("ACLI") is a national trade association with over 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 ways in which the proposed rulemaking implementing Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") can appropriately accommodate the business of insurance. The ACLI appreciates the opportunity to respond to the Commissions' Request for Comment in connection with the joint study regarding stable value contracts. At the outset, we would like to emphasize several points.

Stable Value Investments Are Essential to Many Defined Contribution Plans

Stable value investments comprise a successful asset class that plays a critical role in employee benefit plan sponsors' ability to design financially sound retirement programs for participants. Stable value contracts were created specifically for the defined contribution plan environment. Plan design, tax rules and contract features give participants the yield of an intermediate duration bond fund together with the preservation of principal and liquidity of a money market fund. Stable value contracts have performed as designed, and this combination of increased yield and preservation of principal has been crucial to the retirement security and peace of mind of millions of Americans.

Most Retirement Plans Must Offer Stable Value or a Lower-Yielding Alternative

Today, most plan sponsors wish to utilize the safe harbor provided for participant choices among investment options available by regulations under Section 404(c) of the Employee Retirement Income Security Act ("ERISA"). 29 C.F.R. § 2550.404c-1(b)(2)(ii)(C)(2)(ii) requires, as an element of the safe harbor, that plan sponsors provide "an income producing, low risk, liquid fund." Plan sponsors have generally responded to this requirement by introducing stable value options, money market options or both. However, stable value returns have been found over time to surpass not only money market returns, but also those of other options that meet the Section 404(c) requirement. To the ACLI's knowledge, there has never been a single instance where stable value participants have experienced a negative return on a year-over-year basis.

Stable Value Investments Continued to Provide Guaranteed Positive Returns During the 2008 Financial Crisis

Stable value investment products performed as intended during the recent financial crisis by providing a stable, guaranteed return for plan participants, especially those closest to retirement age. This investment class was critical to millions whose retirement plans were put at risk during the financial meltdown. Not only did this investment class provide a safer option for retirement savers, it had no impact on or contribution to the financial crisis of 2008. The stable value investment products provided by ACLI members, whose solvency, investment products and contracts are heavily regulated and examined extensively by 50 state insurance departments, raise no risk to the financial system in the future.[1]

Increased Regulation Would Severely Limit or Eliminate the Ability for Life Insurers to Continue to Provide this Critical Retirement Investment Product

Subjecting stable value contracts to the swaps regulatory regime would contradict the interests of plan participants, retirement plan sponsors, and stable value manufacturers who seek to provide a more secure, guaranteed, and stable investment option for millions of Americans struggling to save for their retirement. Fundamentally, if stable value products are characterized as swaps, we believe the preemption provisions of the Dodd-Frank Act could preclude state-regulated insurance companies from offering them to customers.[2] The consequences of this determination would potentially remove a conservative and successful product offering from the array of choices within retirement plans at precisely the time Americans need more of such options in planning for their financial futures. Even if alternative investment products were developed to replace this option, the increased expense which would accompany such products would put further negative pressure on the already historically low yields that retirement savers are currently able to obtain in this investment class. It is impossible to conceive that Congress could have intended this result when it adopted the Dodd-Frank Act.

[1] As we have observed in numerous commentaries submitted in various aspects of the Dodd-Frank rulemaking, we are compelled to observe once again that the defaults connected to AIG occurred in its AIG Financial Products, Inc., subsidiary, not within its regulated insurance companies. These defaults were due in large part to the lack of capital and collateral backing its credit default swaps business, a business vastly different from that contemplated in any discussion of stable value products, and the kind of business that will be subject to considerably greater regulation under any conceivable version of the final regulations issued pursuant to the Dodd-Frank Act.

[2] Section 722(b) of the Dodd-Frank Act specifically provides that a product characterized as a swap "shall not be considered to be insurance" and "may not be regulated as an insurance contract under the law of any state."

The Statutory Definition of "Stable Value" and its Potential Application to Products Offered by Life Insurers

Pursuant to Section 719(d) of Dodd-Frank, Congress directed the SEC and CFTC (the "Commissions") to study "stable value contracts" and to determine whether they fall within the definition of "swap," and, if so, whether an exemption is appropriate and in the public interest. As we believe is the case with the statutory definition of "swap," the definition of a "stable value contract" is very broad, encompassing "any contract, agreement, or transaction that provides a crediting interest rate and guaranty or financial assurance of liquidity at contract or book value prior to maturity offered by a bank, insurance company, or other State or federally-regulated financial institution for the benefit of any individual or commingled fund available as an investment in an employee benefit plan (as defined in section 3(3) of the Employee Retirement Income Security Act of 1974, including plans described in section 3(32) of such Act) subject to participant discretion, an eligible deferred compensation plan (as defined in section 457(b) of the Internal Revenue Code of 1986) that is maintained by an eligible employer described in section 457(e)(1)(A) of such Code, an arrangement described in section 403(b) of such Code, or a qualified tuition program (as defined in section 529 of such Code)."[3] This expansive definition is essentially broad enough to encompass any non-variable product option available within any qualified plan, deferred compensation plan or tuition savings plan.

The Commissions observed in the Notice of Proposed Rulemaking for Product Definitions Contained in Title VII that the definition of "swap" "could be read to include certain types of agreements, contracts, and transactions that previously have not been considered swaps or security-based swaps and that nothing in the legislative history of the Dodd-Frank Act appears to suggest that Congress intended such agreements, contracts, and transactions to be regulated as swaps or security-based swaps under Title VII." [4] We respectfully submit that the same may be said with regard to the discussion of "stable value contracts." Congress intended the Commissions to make a broad examination of products commonly known as "stable value" products in the course of the legislatively-mandated study. We continue to believe, however, that Congress did *not* intend for products historically and successfully regulated as insurance to be regulated as swaps, regardless of their nomenclature.

Insurance Company General and Separate Account Fixed Annuity Contracts

Initially, ACLI believes it useful to clarify some of the terminology upon which the discussion of "stable value" is based. In our view, "stable value" is best characterized not as a single form of "contract," but as an asset class designed to maintain stable returns and capital protection for retirement plan participants. Many different asset types are often included under the general rubric of "stable value,"[5] one of the most common being individual and group fixed annuities (and the fixed portion of variable annuities) supported by insurance company general and/or separate accounts.[6] Under these annuity contracts, the plan participant makes a deposit with the

[3] Dodd-Frank Act Section 719(d).

[4] 76 Fed. Reg. 29818, 29821 (May 23, 2011).

[5] We believe this discussion is responsive to questions 8 and 9 of the Request for Comment.

[6] In the typical case of a separate account contract, the participant deposits are segregated from the assets of the insurance company, and thus not subject to the claims of the insurance company's other creditors. However, the life insurance company general account assets still support the obligation to return principal plus the guaranteed rate of return.

insurance company in exchange for the contractual obligation of the insurance company to return the principal plus interest at a guaranteed rate. This "crediting rate" is typically higher than the rate of return on a money market fund, but lower than that available for less conservative investment options where principal is at risk.

As is the case with other insurance products, the issuance of these annuities is governed by underwriting guidelines of the issuing companies. They are also subject to robust regulation under state insurance laws, which require insurance companies to establish reserves to support the guaranteed benefits they provide. Regulatory capital requirements provide a further cushion against the risk of investment losses. Insurance company investment laws restrict the manner in which participant deposits may be invested. The form of the contract itself is also subject to regulatory approval. In these respects, the annuity contracts commonly swept under the "stable value" umbrella are like any other garden-variety life insurance contract.

For all of these reasons, and as described in considerable detail in the comment letters submitted by the ACLI and by the Committee of Annuity Insurers in response to the joint proposed rules issued by the CFTC and the SEC further defining the terms "swap" and "security-based swap," these annuity products are insurance products.[7] We recognize that the CFTC and SEC specifically declined to address "stable value" in the context of that rulemaking, although the Request for Comment addressed here explicitly recognizes the interrelationship between that rulemaking and the Stable Value Study.[8] We respectfully submit that, for the avoidance of any doubt, this aspect of the "stable value" discussion should be resolved in the Stable Value Study.

Annuity contracts supported by insurance company general and separate accounts simply defy characterization as a swap. They incorporate no underlying reference asset. There is no notional amount to which an underlying reference can be applied. They require an initial net investment in a manner distinct from that in a typical derivatives contract. The nature of the contractual obligation also defies the kind of clearing and exchange-trading mechanism to which swaps will ultimately be subjected. They are not now and have never been commonly known in the industry as a swap. In short, they are and have been successfully regulated as insurance throughout their history, and should continue to be treated as such. We respectfully request that the Commissions so conclude in the context of the Stable Value Study.

Synthetic Guaranteed Investment Contracts[9]

One form of stable value contract is a synthetic guaranteed investment contract ("synthetic GIC"). The form of synthetic GIC issued by some life insurers is a group annuity contract, and is often referred to in the industry as a "wrap agreement." These are referred to as "synthetic" because the portfolio of assets which supports the investment is owned by the contract holder, not the issuing insurance company. A synthetic GIC guarantees liquidity for participant-initiated withdrawals from a plan's stable value option in the event that all of the stable value option's portfolio of assets has been liquidated, yet the contract value at that time is greater than zero. Liquidity comes first from the underlying portfolio of assets which are owned by the retirement plan itself, and secondarily from the general account assets of the insurance company issuing the synthetic GIC.

[7] A copy of the ACLI letter is available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47894&SearchText=. The Committee of Annuity Insurers' letter is found at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47899&SearchText=.

[8] *See* 76 Fed. Reg. (Aug. 25, 2011) 531362, 53163 at footnote 9.

[9] This segment of the letter is generally responsive to question 8.

Synthetic GIC "wrap" portfolios consist of high-quality, intermediate-duration fixed-income investments. Under a synthetic GIC, the issuer maintains a "book value record," which reflects the amount of deposits to the associated asset account (the "wrapped account"), the amount of withdrawals from the wrapped account, and amounts credited to the book value record at the wrap agreement's (periodically reset) crediting rate. Withdrawals from the wrapped account covered by the wrap agreement at "book value" are contractually limited to those which are initiated at the sole discretion of participants, without the influence of third parties such as the plan sponsor. Such book value withdrawals are administered by liquidating from the wrapped account an amount of fixed income securities equal to the amount of the withdrawal requested, with a dollar-for-dollar reduction in the book value record. As book value withdrawals are processed, the resulting market-to-book ratio will decrease (if the market-to-book ratio was below 100% beforehand) or increase (if the market-to-book ratio was above 100% beforehand).[10]

As noted above, a crediting rate formula is applied by the wrap agreement's issuer to the book value record. This is the means by which changes in the value of the wrapped assets relative to the book value record are passed through to participants. Unlike a traditional bond fund, in which market value changes have an immediate daily effect (positive or negative) on the value of the fund and thus participants' plan account balances, the wrap agreement provides that the value of a stable value fund is not immediately affected by changes in asset market values. Rather, the wrap agreement passes market gains and losses through to participants over time by periodically resetting the crediting rate using a formula that solves for a rate of growth in the book value record that will cause it to equal the market value over the duration of the wrapped assets. Thus, rather than subjecting the fund to daily market fluctuations, the wrap agreement holds steady the principal investment of participants and distributes any gains or losses to the book value record over a time horizon equal to the life of the investments covered by the agreement.

- ***Synthetic GICs Are Not Swaps***

Wrap agreements closely resemble insurance arrangements with a stop-loss feature triggered in rare circumstances. The wrap agreement's coverage protects against catastrophic loss by spreading the risk of loss over a large number of participants. The wrap agreements assure liquidity in the event of certain multiple independently derived participant withdrawals, and their coverage protects against catastrophic loss by spreading the risk of loss over a large number of participants. As with other insurance arrangements, payments under a wrap agreement cannot be precipitated by the plan sponsor. The wrap agreement is not an arrangement whereby a single decision-making counterparty is given an option to effectively exercise a "put" against the issuer when the interest rate environment causes the market value of the wrapped portfolio to decline relative to a "notional" amount. Wrap agreements exclude coverage for plan termination and plan changes that materially increase the issuer's risk.[11]

Wrap agreements are not tradable. These agreements involve purchaser-specific risk considerations based on the specific applicable fixed-income portfolio and the terms of the plan that cannot be unilaterally transferred by the purchaser to third parties whose risk profile may be different from that of the purchaser on which the underwriting and resulting contract term tailoring were based.[12]

[10] For a discussion about stable value contracts and historical performance, *see* Babbel and Herce, Stable Value Funds-Performance to Date, Wharton School at the University of Pennsylvania-Working Paper Series (Jan. 1, 2011) [http://papers.ssrn.com/sol3/papers.cfm?abstract_id=173499] 1 ; Donohue, *Stable Value Re-examined*, 54 Risks and Rewards (Society of Actuaries Investments Section) at 26 (Aug. 2009) [http://www.soa.org/library/newsletters/risks-and-rewards/2009/august/rar-2009-iss54-donahue.pdf].

[11] This paragraph is responsive to question 2.

[12] This paragraph is responsive to question 2.

Synthetic GICs Do Not Pose Systemic Risks to the Financial System

Synthetic GICs do not pose systemic risks to the financial system. Investment performance results are borne primarily by participants in the stable value fund, since portfolio gains and losses are passed through to them by the crediting rate mechanism over time. The exposure to wrap agreement issuers is limited to the difference between the market value of the wrapped assets and the book value record, which is the maximum amount due in the unlikely and unprecedented event that all participants covered by the agreement were to initiate withdrawals from all amounts so covered on the same day. Synthetic GICs do not have cross-default provisions, thereby limiting problems arising in particular case to the plan in question.[13]

- ***Existing Regulatory Regime Makes Regulation of Synthetic GICs Under Dodd-Frank Unnecessary***

As with all policy issuance activities undertaken by life insurance companies, a life insurer's activities associated with the synthetic GIC business are subject to an extensive and comprehensive regulatory regime, administered by its state of domicile, the National Association of Insurance Commissioners (the "NAIC"), and the other states where it conducts such activities. Most states follow the NAIC Synthetic Guaranteed Investment Contract Model Regulation (the "NAIC Model"), adopted by the NAIC in 1999, and Appendix A-695 of the NAIC's Accounting Practices & Procedures Manual, which address issues including the reserve requirements applicable to the issuance of synthetic GICs. In addition to reserves, life insurers are required under the NAIC's risk-based capital system to hold capital in support of all aspects of their operations, including those relating to their synthetic GICs.[14] Moreover, all aspects of this business are the subject of current regulations, including the forms of contracts, sales and marketing of the products, commissions if any, licensing of individuals and companies selling the products, general account solvency, and claims-paying ability of the insurance companies. In addition, the state insurance departments regularly undertake examinations of insurance companies with respect to these issues.

Conclusion

The ACLI and its member companies appreciate the thoughtful approach that the SEC and CFTC have taken in formulating proposed rules and studies under the Dodd-Frank Act. We greatly value the continuing opportunity to provide commentary in this process, given the significant impact of actions implementing the Dodd-Frank Act on life insurers' business and on the customers who rely on insurance products to secure their financial futures.

One of the fundamental goals of Title VII of the Dodd-Frank Act was to prevent entities from engaging in irresponsible practices and excessive risk-taking in the derivatives markets.[15] Title VII was designed to rectify unregulated, uncollateralized, and opaque transactions in the derivatives marketplace. In significant contrast to other business categories, life insurers are one of the most comprehensively regulated financial service industry groups. Among other things, state insurance laws impose conservative portfolio investment restrictions, significant reserving and risk-based capital requirements, and limit life insurers to hedging in derivatives transactions to manage asset and liability risks. Through extensive uniform reporting requirements, life insurers' assets, liabilities, and

[13] This paragraph is responsive to question 21.
[14] This paragraph is responsive to question 24.
[15] *See* Senate Banking Committee Summary of Conference Report on Dodd-Frank Act at http://banking.senate.gov/public/_files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf

derivatives transactions are fully transparent to regulators and the public. Life insurers' products do not, therefore, trigger the fundamental objectives of the Dodd-Frank Act: unregulated, uncollateralized, and opaque transactions. Accordingly, the Stable Value Contracts Study should not reasonably recommend that life insurers' stable value products be included in the definition of "swap."

Unlike the traditional swap market before the Dodd-Frank Act, life insurers' stable value products were already comprehensively regulated. These stable value products have a history of performance and proven regulation through a variety of market cycles. Life insurers' stable value products were one of the few asset classes to generate consistent performance during the recent market crisis. In large measure, this occurred because of over 35 years of rigorous regulation by agencies including the Department of Labor, the Federal Reserve, the OCC, the SEC, and state insurance departments. Another meaningful regulatory network is provided by the extensive regulation of qualified plans and plan fiduciaries, the purchasers of stable value products.

Life insurers' stable value products do not share characteristics associated with the targets of Title VII of the Dodd-Frank Act and the markets in which they operated. The stable value products offered by life insurers are not tradable or assignable – by their terms they cannot be assigned or transferred, due to restrictions required by accounting rules. There is no market for exchanging life insurers' stable value products. These stable value products are inherently collateralized because they are supported by an underlying portfolio of diversified high quality fixed income securities. Life insurers' stable value products are not marked to market, but are valued at contract value. A market value for stable value contracts would be difficult or impossible to determine, since it would be based on assumptions as to participant withdrawal patterns. Stable value products cannot be cleared through a clearinghouse because they are not uniform or standardized. Life insurers' extensive underwriting processes include a review of many unique factors, and contracts are tailored to meet the objectives of a specific retirement plan based on these unique factors.

In conclusion, life insurers' stable value products should be excluded from the scope of the term "swap," for the reasons stated above. We greatly appreciate your attention to our views. Please let me know if any questions develop, or if you need additional information.

Sincerely,

Carl B. Wilkerson

Carl B. Wilkerson