THE STABLE VALUE INVESTMENT ASSOCIATION,

THE AMERICAN BANKERS ASSOCIATION, AND

THE FINANCIAL SERVICES ROUNDTABLE

RESPONSE TO THE

U.S. COMMODITY FUTURES TRADING COMMISSION

AND THE

SECURITIES AND EXCHANGE COMMISSION

ACCEPTANCE OF PUBLIC SUBMISSIONS REGARDING

STUDY OF STABLE VALUE CONTRACTS

RELEASE NO. 34-65153; FILE NO. S7-32-11

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By Electronic Submission

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Re: Acceptance of Public Submissions Regarding Study of Stable Value Contracts Release No. 34-65153; File No. S7-32-11

To Whom It May Concern:

On behalf of their members, the Stable Value Investment Association ("SVIA"), the American Bankers Association ("ABA"), and the Financial Services Roundtable ("Roundtable" and collectively, "Joint Associations") wish to recognize, and express their appreciation for, the continued efforts of the U.S. Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (collectively, "Commissions") to understand stable value funds and the important role that these investment vehicles play in over 127,000 employer-sponsored, tax-deferred, retirement and other similar savings plans.[1]

Section 719(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") requires the Commissions to conduct a study, in consultation with the Department of Labor ("DOL"), the Department of the Treasury, and the state entities that already regulate the stable value industry, to determine whether stable value contracts fall within the definition of "swap" in Title VII of the Dodd-Frank Act ("Stable Value Study").[2] Pursuant to Section 719(d),

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[1] SVIA 15th Annual Stable Value Funds' Investment and Policy Survey Covering Assets Under Management as of December 31, 2010. Defined contribution plans, plans or plan will be used throughout the submission to encompass, "employer-sponsored, tax deferred, retirement and other similar savings plans" includes 401(k), 403(b), and 475 retirement savings plans, 529 tuition assistance plans, and other similar employee-sponsored, tax deferred savings plans.

[2] Pub. Law No. 111-203, 124 Stat. 1376 (2010).

on August 25, 2011, the Commissions published for comment in the Federal Register 29 questions related to stable value contracts and stable value funds, and the potential consequences of regulating these products under the Dodd-Frank Act ("Stable Value Study Questions").[3]

The Joint Associations submit this letter in response to the 29 Stable Value Study Questions to facilitate the Commissions' ongoing review of stable value contracts and, in particular, to: (i) address why stable value contracts are not swaps; (ii) provide the Commissions with more detailed information about the existing, robust regulatory framework within which stable value products have operated for many years; and (iii) preview the significant, adverse consequences to stable value fund plan participants should the Commissions impose an additional layer of regulation (and cost) over stable value contracts. To convey this information in the most concise and practical manner possible, the Joint Associations have organized their responses according to several common themes rather than the numeric order in which the questions were posed in the Federal Register.[4]

The SVIA is a non-profit organization dedicated to educating policymakers and the public about the importance of saving for retirement and the contribution stable value funds can make toward achieving a financially secure retirement. As of December 31, 2010, the SVIA's members managed over $540 billion invested in stable value funds by more than 25 million participants. The SVIA's 75 member companies represent all segments of the stable value community, including public and private retirement plan sponsors, insurance companies, banks, and investment managers.

The ABA represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees. The ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities.

The Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine and account directly for $92.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs.

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[3] Acceptance of Public Submissions Regarding the Study of Stable Value Contracts, 76 Fed. Reg. 53,162 (Aug. 25, 2011).

[4] *See* the Index of Questions and Responses attached as Exhibit A. In addition, the Joint Associations incorporate by reference two letters filed by the SVIA with the CFTC regarding the treatment of stable value contracts under the Dodd-Frank Act. *See* November 10, 2010 Letter to Stephen Kane; February 28, 2011 Letter to Stephen Kane, attached at Exhibits B and C, respectively.

I. Executive Summary

The Joint Associations respectfully submit that:

- Stable value contracts are not swaps. Congress recognized that stable value contracts are a unique risk management instrument that merits separate consideration and potentially separate treatment from "swaps" and other derivative instruments when it directed the Commissions to conduct the Stable Value Study. The Commissions should determine that stable value contracts do not fall within the definition of "swap" under the Dodd-Frank Act.

- Stable value products are wholly unrelated to the transactions that Congress sought to regulate through the Dodd-Frank Act. Significantly, stable value contracts and stable value funds *do not* pose systemic risk concerns. On the contrary, stable value products are highly-specialized, conservative investment products used by plan participants to *reduce* their exposure to market volatility within defined contribution plans. Regulating stable value contracts as swaps could eliminate this important investment option.

- The existing regulatory structure applicable to providers of stable value contracts and the defined contribution savings plans that offer stable value funds is effective and consistent with the goals Congress set out in the Dodd-Frank Act – namely, to provide transparency, safeguards against systemic risks to the U.S. financial system, and appropriate oversight of the financial markets.

- Nevertheless, should the Commissions find that stable value contracts fall within the definition of "swap," the Joint Associations believe the Commissions should utilize the exemptive authority specifically provided in Section 719(d)(1)(B) of the Dodd-Frank Act to exempt stable value contracts from the definition and thereby avoid the potentially significant unintended and detrimental consequences that would result if stable value contracts were to be subject to regulation as "swaps" under the Commodity Exchange Act, as amended ("CEA"), the Securities Exchange Act of 1934 ("Exchange Act"), and corresponding CFTC and SEC regulations thereunder.

- An exemption is not only appropriate and in the public interest, but also necessary to ensure that defined contribution plan participants will continue to have access to high-quality, conservative investment options. Without stable value, retirees and other defined contribution plan participants would have no alternative but to switch to investments that either carry greater risk or offer lower returns. Congress did not intend to cause such uncertainty or jeopardize plan participants' and retirees' retirement investments or income.

II. The Commissions Should Exclude Stable Value Contracts from the Definition of "Swap."

A. Stable Value Contracts are not "Swaps."

The Commissions asked:

- Do stable value contracts possess characteristics that would cause them to fall within the definition of a swap? If so, please describe those characteristics.[5]

- What characteristics, if any, distinguish stable value contracts from swaps?[6]

Stable value contracts are a component of stable value funds available only in defined contribution plans. Stable value contracts are not swaps. Participant directed withdrawals from stable value funds are, in most cases, not dependent on the stable value contract nor are they made at fixed settlement periods or upon the exercise of an "option" related to the stable value contract. On the contrary, transactions are made directly between the participant and the fund without regard to the stable value contract and are conditioned only on the occurrence of certain narrowly defined circumstances (*e.g.*, the participant's death, disability, retirement, enrollment in college, or similar life event or the participant's election to transfer amounts to other investment options within the plan in accordance with the plan's rules).[7]

Stable value contracts and swaps are fundamentally different in several important ways:

- Stable Value Contracts are not Used to Provide a Leveraged Investment. A stable value fund achieves its investment objectives by investing in a diverse portfolio of high-quality bonds rated, on average, AA- or better, with an average duration of approximately three years.[8] As usually the most conservative, lowest risk investment option offered by plan sponsors to their participants, the introduction of leverage into the fund is specifically prohibited. For any stable value fund, the total contract value associated with the stable value products the fund has entered into *cannot* exceed the sum of the fund's reported contract value for each of those stable value products. In turn, the aggregate contract value of all outstanding stable value products *cannot* exceed the sum of each stable value fund's contract value for the stable value products for which they report contract value. Stable value contracts simply do not provide stable value funds with a means of leveraging the fund's investment strategy. Rather, stable value contracts are designed to facilitate the stable value fund's management of risk (*i.e.*, the risk of divergence between the fund's market value and its contract value at a time when

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5 Stable Value Contract Study Question No. 1.

6 Stable Value Contract Study Question No. 2.

7 *See infra* Section IV.B.2 (discussing certain limitations that stable value funds may place on participant transactions in order to protect the fund).

8 SVIA's Stable Value Funds' Quarterly Characteristics Survey as of June 30, 2011.

the fund's participants make withdrawals which result in the complete depletion of the fund's market value). As described later in the submission, risk of such a "run on the fund" is remote.[9]

- Stable Value Contracts do not Permit Either Party to Precipitate a Payment. Stable value contracts do not permit either party – automatically or acting unilaterally – to cause the stable value contract provider to make a payment equal to the difference between the market value and contract value of the stable value fund.[10] Further, an individual plan participant's decision to withdraw from his/her stable value fund would not trigger a payment by the stable value contract provider pursuant to the stable value contract. Although participant withdrawals could, collectively and under extreme circumstances, trigger a payment obligation under the stable value contract, it is not possible for any one participant, a group of participants, or even the stable value fund itself to use the stable value contract for speculative or arbitrage purposes.

- Stable Value Contracts Protect Participants by Preserving Principal. Stable value contracts require participants in a stable value fund to transact at contract value (*i.e.*, the participant's investment in the fund plus accrued interest), regardless of declines in the market value of the fund's underlying assets. The requirement to transact at "contract value" is often referred to as "benefit responsiveness." Applicable accounting rules, which permit stable value funds to value fund assets at contract value regardless of fluctuations in the value of the fund's investments, *require* the fund to obtain a stable value contract providing this participant protection.[11]

- There is no Market and no Trading in Stable Value Contracts. Each stable value contract is customized to meet the specific needs of an associated stable value fund and its participants. Because these contracts are individually tailored to the unique requirements of a specific defined contribution plan, stable value contracts cannot be traded or freely assigned. There is no secondary market for trading stable value contracts, nor do the Joint Associations believe that such a market could exist.

- Stable Value Contracts Cannot be Cleared. Each stable value contract is the product of a lengthy analysis that includes a comprehensive review of the

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[9] *See* Section IV.A for additional detail.

[10] Note, in this submission, the terms "stable value contract provider" and "stable value contract issuer" are used interchangeably.

[11] *See* FASB Staff Position Nos. AAG INV-1 and SOP 94-4-1. Indeed, the ability to report assets at contract value rather than market value is a key difference between stable value funds and traditional bond funds that is particularly important for individuals evaluating retirement savings plan investment alternatives.

associated fund's investment strategy and plan design.[12] Stable value contracts, thus, *do not* contain standardized, fungible commercial terms that are comparable to most swaps. As a result, stable value contracts cannot, in the estimation of the Joint Associations, be cleared by a clearinghouse.[13]

Please note, to provide a timely and informative response to the Commissions' questions, the Joint Associations' responses generally focus on regulation and oversight of "Synthetic GICs" (defined below) which represent the about half of the stable value contracts provided by banks and insurance companies; however, the regulatory approaches discussed herein are also conceptually similar to state insurance departments' regulations of other types of insurer-issued stable value contracts.[14]

B. Stable Value Contracts do not Have an "Underlying Reference Asset."

The Commissions asked:

- If the Commissions were to determine that stable value contracts fall within the definition of a swap, what would be their underlying reference asset?[15]

Stable value contracts do not have an underlying reference asset. Although stable value contracts are provided in connection with a stable value fund's assets (*i.e.*, a portfolio of high-quality bonds), this portfolio is not an "underlying reference asset" comparable to the commodity (or other assets) that underlies a swap or other derivative instrument.

C. The Dodd-Frank Definition of "Stable Value Contract" is Sufficiently Broad.

The Commissions asked:

- Does the definition of the term "stable value contract" in Section 719(d)(2) of the Dodd-Frank Act encompass all of the products commonly known as stable value contracts?[16]

The definition of "stable value contract" in Section 719(d)(2) of the Dodd-Frank Act is sufficiently broad and encompasses the overwhelming majority of products commonly known as stable value contracts.

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[12] *See also* Sections III.A and III.C, *infra*.

[13] One of the primary goals of the Dodd-Frank Act was to strengthen the integrity of the swaps markets by, among other things, moving many over-the-counter swap transactions onto exchanges and into clearinghouses. However, "swaps" are subject to mandatory trade execution and clearing only if an exchange and clearinghouse has been approved to trade and clear the swap. Congress recognized that, to the extent that stable value contracts are not standardized and not traded or cleared, these goals cannot be achieved. *See* CEA § 2(h).

[14] *See* Section V.A for more detail on the specific regulatory requirements applicable to Synthetic GICs.

[15] Stable Value Contract Study Question No. 5.

[16] Stable Value Contract Study Question No. 3.

D. The Proposed Definition of "Swap" and Related Interpretive Guidance do not Provide an Appropriate or Sufficient Framework for Evaluating How Stable Value Contracts Should be Regulated.

The Commissions asked:

- Are the proposed rules and the interpretive guidance set forth in the Product Definitions Proposing Release useful, appropriate, and sufficient for persons to consider when evaluating whether stable value contracts fall within the definition of a swap? If not, why not? Would stable value contracts satisfy the test for insurance provided in the Product Definitions Proposing Release? Why or why not? Is additional guidance necessary with regard to stable value contracts in this context? If so, what further guidance would be appropriate? Please explain.[17]

Although stable value contracts are structurally and functionally similar to certain insurance products, the Joint Associations believe that the Commissions' proposed rules and interpretive guidance in the Product Definitions Proposing Release are incomplete and too generalized to address stable value products with sufficient certainty.[18] The Stable Value Study called for in Section 719(d) of the Dodd-Frank Act explicitly permits the Commissions to evaluate stable value contracts on a separate, slower timeline than most other commercial agreements.[19] The Joint Associations encourage the Commissions to use this flexibility to ensure that they fully understand stable value contracts and the potential consequences if these contracts are ultimately regulated as swaps. Consistent with Congress's intent, the Commissions should evaluate stable value contracts separately rather than under the more general framework set forth in the Product Definitions Proposing Release.

The Product Definitions Proposing Release would exclude from the definition of swap any insurance product that, among other things:

- is provided by a state or federally regulated insurance company;
- is regulated as insurance under state or federal law; and

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[17] Stable Value Contract Study Question No. 4.

[18] *Further Definition of "Swap"; "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 76 Fed. Reg. 29818, 29821 (May 23, 2011) (the "Product Definitions Proposing Release"). As the Commissions stated in the Product Definitions Proposing Release, the proposed rules and interpretive guidance do not address stable value contracts other than to note that "[t]he Commissions currently are conducting the required joint study and will consider whether to propose any implementing regulations (including, if appropriate, regulations determining that stable value contracts: (i) are not encompassed within the swap definition; or (ii) are encompassed within the definition but are exempt from the swap definition) at the conclusion of that study."

[19] Section 712(e) of the Dodd-Frank Act states that "[u]nless otherwise provided . . . the [CFTC] or [SEC] or both shall . . . promulgate rules and regulations . . . not later than 360 days after the date of enactment." In contrast, Section 719(d)(1)(A) requires the Commissions to conduct the Stable Value Study "[n]ot later than 15 months after the date of enactment."

- requires an actual loss to occur and be proven with respect to a beneficiary's insurable interest, and that any payment be limited to the value of that insurable interest.

Significantly, the insurance product exclusion would not be available to bank-issued stable value contracts, and is in many ways even inadequate with respect to stable value contracts provided by insurance companies. All stable value contracts protect against market value fluctuations and market volatility by providing "benefit-responsiveness" (*i.e.*, the assurance that participants transact at contract value). Payment under a stable value contract is limited to the difference between the market value of the fixed income portfolio and contract value; however, under state insurance law, the insurable interest requirement generally applies only to insurance products that have the potential to create a conflict of interest, such as life insurance and property insurance.[20] In most jurisdictions, insurable interest rules *do not* apply to forms of insurance that do not raise these conflicts or concerns, such as stable value contracts. As a result, it is unclear whether insurer-issued stable value contracts would be excluded from the definition of "swap" under the Commissions' proposed insurance product exclusion because currently applicable requirements under state insurance statutes generally do not require an insurable interest with respect to stable value contracts, and accordingly the requirement is not included in the contracts.[21]

III. Stable Value Contracts are Customized Risk Management Agreements Used Solely to Reduce Volatility and Risk for Stable Value Funds.

A. Stable Value Contracts are Structured in Various Ways.

The Commissions asked:

- What are the different types of stable value contracts, how are they structured, and what are their uses? Please describe in detail.[22]

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[20] These rules prevent "wagering" on the loss of life or property by limiting persons eligible to purchase these forms of insurance to those with a close relationship to the person or property insured.

[21] There is additional uncertainty for stable value contracts structured as annuity contracts. For example, the Commissions noted in the Product Definitions Proposing Release that "certain variable life insurance and annuity products are securities and would not be swaps or security-based swaps regardless of whether they met the requirements under the proposed rules." 76 Fed. Reg. at 29822, n.31. Stable value contracts issued by insurance companies are typically structured as annuity contracts. The Joint Associations strongly support the comments on the Product Definitions Proposing Release submitted by the Committee of Annuity Insurers and the American Council of Life Insurers, which in part recommend that annuity contracts subject to state insurance regulation be excluded from the definition of swap (and security-based swap), without regard to tax treatment under section 72 of the Internal Revenue Code. The comments also recommend that the Commissions clarify and confirm that insurance products that fall within section 3(a)(8) of the Securities Act (*i.e.*, non-securities), or that are insurance products that are also securities, whether or not registered under the Securities Act, are excluded from the definitions of swap. These changes would help to clarify that stable value contracts subject to state insurance regulation fall outside of the definition of swap.

[22] Stable Value Contract Study Question No. 8.

- Please describe the operation of stable value contracts and stable value funds generally in terms of contract structure, common contract features, investments, market structure, stable value contract providers, regulatory oversight, investor protection, benefits and drawbacks, risks inherent in stable value contracts, and any other information that commenters believe the Commissions should be aware of in connection with the stable value contract study.[23]

Stable value funds are, by their nature, fixed income investments in which participants receive a rate of return that is comparable to the return earned on an intermediate-term investment grade bond fund without the associated volatility. Stable value funds enter into different types of stable value contracts offered by banks and/or insurance companies:

(1) Guaranteed Investment Contracts ("GICs"). GICs are interest bearing contracts purchased from insurance companies. Pursuant to these contracts, the seller guarantees the purchaser a stated rate of interest (which may or may not be adjusted) and return of principal. The insurer's general account backs the principal and the interest rate guarantee.

(2) Synthetic GICs. Synthetic GICs are portfolios of diversified, high-quality (average credit quality of AA- or better) short- and intermediate-term fixed income securities combined with stable value wrap contracts issued by a bank or insurance company, with a rate that resets periodically. Pursuant to these wrap contracts, the bank or insurer agrees to maintain the principal value and accumulated interest for withdrawals at contract value.

(3) Separate Account GICs. Under a Separate Account GIC, a segregated portfolio of assets is held in an insurance company's separate account to support the company's obligation to pay principal and interest to plan participants at a rate that, as with GICs and Synthetic GICs, can be fixed or reset periodically. If the fund's obligations or liabilities exceed the value of the separate account's assets, the insurance company's general account backstops the excess liabilities.

(4) Insurance Company General Account Portfolio Rate Products ("Insurance Company General Accounts"). Under these arrangements, the general account of an insurance company supports the insurance company's obligations to pay principal and interest to plan participants.

Currently, stable value funds hold 2.6% of assets in GICs, 26.7% in insurance company Synthetic GICs, 22.7% in bank Synthetic GICs, 4.8% in Separate Account GICs, 40.9% in Insurance Company General Accounts, and 2.3% in cash.[24]

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[23] Stable Value Contract Study Question No. 9. The regulatory oversight of stable value contracts and stable value funds is discussed below in response to Stable Value Contract Study Question Nos. 24 and 25.

[24] SVIA 15th Annual Stable Value Funds Investment and Policy Survey covering assets as of December 31, 2010; SVIA-LIMRA Stable Value Sales and Assets Survey for the First and Second Half of 2010.

Although different types of stable value contracts may incorporate different rate reset, guarantee, and balance sheet structures, *all* stable value contracts provide benefit responsiveness and require that participant initiated transactions occur at contract value.

B. "Pull to Par" and Immunization Provisions are Standard Features in Stable Value Contracts.

The Commissions asked:

- The Commissions' staffs understand that "pull to par" provisions of stable value contracts provide that stable value contracts will not terminate (absent the application of another contract termination provision) until the gap between the market value of the wrapped assets and the contract value is closed, however long that takes. The Commissions' staffs also understand that pull to par provisions are standard for stable value contracts. Are these understandings correct? Please describe pull to par provisions and how prevalent such provisions are in stable value contracts.[25]

- The Commissions' staffs understand that stable value contract providers sometimes negotiate so-called "immunization" provisions with stable value fund managers and that such provisions typically allow stable value contract providers (or stable value fund managers) to terminate the stable value contracts based upon negotiated triggers, which can include underperformance of the portfolio against a benchmark. The Commissions' staffs also understand that, once immunization provisions have been triggered and are in effect, the stable value funds must be managed according to the immunization guidelines, which typically require the liquidation of all securities rated below AAA and in certain cases may require the portfolio to be invested 100% in Treasury securities. What risks, if any, do "immunization" provisions in stable value contracts pose to investors in stable value funds? If immunization provisions in stable value contracts pose risks to investors in stable value funds, are these risks clearly disclosed to investors? Are these risks required to be disclosed to investors? What are the sources of such requirements? How do stable value fund managers or stable value contract providers address the risk that immunization will be exercised? How effective are any such measures?[26]

"Pull to par" provisions are an important component of stable value contracts. The "pull to par" provision allows the difference between a fund's market value and contract value, whether positive or negative, to be amortized over a period of time by either increasing or decreasing the fund's crediting rate. By adjusting the crediting rate periodically to reflect changing market conditions, the "pull to par" provision is designed to bring the fund's market value and contract

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[25] Stable Value Contract Study Question No. 16.

[26] Stable Value Contract Study Question No. 13.

value into parity over a period of time related to the portfolio duration. Most stable value contracts are "evergreen," meaning that the funds underlying assets continually rollover such that the duration of the portfolio effectively remains constant.

Immunization provisions provide the stable value contract provider and the stable value fund manager with a mechanism for terminating a stable value contract in a manner that does not disturb the contract value protection for plan participants. Under immunization, the fund's crediting rate achieves convergence of market value and contract value as the portfolio's duration gradually rolls down to zero. As this convergence takes place, the portfolio's duration/maturity profile is managed with a declining duration strategy increasingly focused on high quality securities that present minimal cash flow risk such that immediately prior to convergence the portfolio would consist of very liquid, short-term securities. Significantly, even during immunization, stable value funds operate as usual and plan participants continue to transact at contract value.

Immunization provisions do not relieve stable value contract providers from their obligation to pay contract value; however the contract provider typically has the right to extend the immunization convergence date if full convergence is not achieved by the scheduled termination date. Extending the convergence period could be necessary if, for example, there were significant changes in reinvestment rates, or exceptional market volatility; however, strict investment guidelines imposed during the immunization period are designed to reduce these risks.

Although uncommon, stable value contract providers do occasionally elect to immunize a stable value contract. Stable value fund managers address the risk of the immunization provision being triggered by designing funds that contain multiple components (*e.g.*, a liquidity buffer, multiple stable value contracts issued by multiple stable value contract providers, etc.) that, when combined, diversify the funds' exposure to any one stable value contract provider's decision to immunize its stable value contract. Even though there are no risks to plan participants specifically associated with the immunization process, these provisions are fully disclosed and explained to the plan fiduciaries.[27]

C. Stable Value Contracts are Designed to Mitigate the Impact of Exceptional Withdrawals or Redemptions from the Stable Value Fund Caused by Employer-Driven Events or Plan Changes.

The Commissions asked:

- The Commissions' staffs understand that some stable value contracts grant stable value contract providers the right to limit coverage of employer-driven events or employee benefit plan changes. Such events or changes could cause a decrease in a stable value contract fund's value and result in large scale investor withdrawals or redemptions (sometimes called a "run on the fund"). How do stable value

[27] Disclosures are discussed in more detail in Section V.E, *infra*.

> contract providers and stable value fund managers manage this risk, if at all? How effective are any such measures?[28]

Stable value funds provide liquidity to participants such that all independently initiated, benefit responsive plan participant transactions occur at contract value. Large scale withdrawals that are the result of an employer initiated or corporate event may be covered at contract value, but on a more limited basis and in a manner that is consistent with the coverage of the applicable stable value contract.

The likelihood of a large scale withdrawal is inherently limited by the number and diversity of the fund's participants. Although certain external events will affect all plan participants similarly, no single plan participant or group of participants can act unilaterally – there is no "option" to cause a run on the fund. Rather, investment decisions are diffused among a large number of individual decision makers, each making his or her own withdrawal decisions on the basis of his or her own personal circumstances. To date, stable value fund managers have been able to accurately anticipate the need for greater fund liquidity and increase the fund's cash reserves when necessary to cover anticipated withdrawals. This ability is enhanced by the fact that stable value funds are actively managed according to conservative guidelines that focus on highly liquid assets, including publicly traded fixed income securities and cash. It is uncommon for stable value funds to turn to a stable value contract for payment, and even less likely for a fund to ultimately lose value.

Based on their assessment of this risk, stable value fund managers and stable value contract providers monitor the risk of a run on the fund through constant and comprehensive oversight of their funds' cash flows, investments, and risk profile of the funds to ensure that the market value of the fund's assets and contract value do not diverge substantially.

D. Stable Value Contracts may be Terminated by the Provider Only Under Limited and Extraordinary Circumstances.

The Commissions asked:

- What provisions of stable value contracts, if any, allow stable value contract providers to terminate stable value contracts that prevent benefit plan investors from transacting at contract value? What are the tradeoffs, including the costs and benefits of such provisions? Please describe in detail.[29]

Stable value funds are generally prohibited from making payments to plan participants at anything other than the contract value; however, market value payments are permissible under certain extraordinary circumstances, including breach of a material obligation by the asset manager or trustee, or termination of the plan. In most cases there is an established grace period, during which time such events may be cured.

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[28] Stable Value Contract Study Question No. 14.

[29] Stable Value Contract Study Question No. 10.

E. Stable Value Fund Managers are Fiduciaries Responsible for Protecting the Interests of Plan Participants and their Beneficiaries.

The Commissions asked:

- What role do stable value fund managers play in protecting the interests of plan participants with respect to stable value funds? How effective are any such measures?[30]

Stable value fund managers play an important role in protecting the interests of plan participants invested in stable value funds. Stable value fund managers are responsible for negotiating and entering into stable value contracts on behalf of the fund and managing the fund's assets pursuant to investment guidelines with the overall objective of maintaining the fund's liquidity and duration while preserving its capital and long-term stability. Stable value fund managers are subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), with a fiduciary duty to adhere to ERISA's provisions as well as the prohibited transaction rules of ERISA and the Internal Revenue Code of 1986, as amended ("Code"). Accordingly, such managers must act in the interests of plan participants and beneficiaries. The failure by a stable value fund manager to comply with the relevant provisions when carrying out its duties could expose a fiduciary manager to liability under ERISA and Section 4975 of the Code.[31]

ERISA imposes clear obligations on parties that are fiduciaries to ERISA covered plans. Under ERISA, a person is a fiduciary to the extent that: (i) it exercises any discretionary authority or control respecting the management of a plan or exercises any authority or control respecting the management or disposition of its assets or (ii) it renders investment advice for a fee or other compensation with respect to any money or other property of such plan or has authority or responsibility to do so.[32] Thus, managers of stable value funds or accounts subject to ERISA are considered fiduciaries.

As an ERISA fiduciary, a plan manager must comply with the fiduciary duties in Section 404 of ERISA. These requirements provide that a fiduciary must discharge its duties to the plan *solely* in the interest of the participants and beneficiaries and:

- for the exclusive purposes of providing benefits to the participants and beneficiaries and defraying reasonable expenses of administering the plan;

- consistent with ERISA's prudence standard;

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[30] Stable Value Contract Study Question No. 26.

[31] Governmental plans may also use stable value funds. Because such plans are not covered by ERISA, managers of such plans are not subject to the ERISA provisions described herein; however, the laws applicable to governmental plans also impose fiduciary standards, which may include provisions substantially similar to those found in ERISA.

[32] ERISA Section 3(21).

- by diversifying plan investments to minimize the risk of large losses unless it is clearly imprudent to do so; and

- in accordance with plan documents insofar as such documents are consistent with ERISA.[33]

With regard to the prudence standard, an ERISA fiduciary must act "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[34] The foregoing standard is sometimes referred to as the "prudent expert" standard, mandating that the fiduciary act with the care of an individual with the appropriate level of expertise in the conduct of its activities with respect to plans. This standard of care applicable to the plan fiduciary in carrying out its fiduciary activities has been referred to as the "highest known to law" and serves to protect the interests of participants investing in stable value alternatives.[35]

In addition, a plan fiduciary must avoid engaging in prohibited transactions under ERISA and Section 4975 of the Code. The applicable prohibited transaction rules, which are another means in ERISA to protect the interests of the participants and beneficiaries of plans, are of two types: (i) explicit (or *per se*) prohibited transaction rules; and (ii) conflict of interest rules. Under the explicit prohibited transaction rules, a plan is prohibited from engaging in specified transactions with a party that is a "party in interest" (the term used in ERISA) or a "disqualified person" (the term used in Section 4975 of the Code) with respect to the plan, unless there is an available statutory or administrative prohibited transaction exemption.

As a general matter every large financial services firm (including stable value contract providers) assumes that it is a party in interest (or a disqualified person) with respect to most plans. As such, the parties to plan transactions do not enter into the transactions unless they are comfortable that the conditions of an exemption have been satisfied. There are multiple exemptions that plan managers and stable value contract providers may rely upon in entering into stable value contracts. Importantly, many of the relevant exemptions impose conditions speaking to the quality of the transaction between the plan and its counterparty.[36]

Importantly, should a manager breach its fiduciary responsibilities or participate in a non-exempt prohibited transaction, ERISA and the Code impose potentially severe penalties. In this regard, a

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[33] ERISA Section 404(a)(1).

[34] ERISA Section 404(a)(1)(B).

[35] *See Donovan v. Bierwirth*, 680 F. 2d 263, 272, n.8 (2nd Cir. 1982).

[36] For example, Prohibited Transaction Class Exemption 84-14, as amended, provides relief for transactions entered into on behalf of a plan by a "qualified professional asset manager." This exemption, commonly used to provide relief from the prohibited transaction rules in connection with stable value contracts, requires that, at the time the transaction is entered into or any subsequent renewal or modification thereof requiring the consent of the qualified professional asset manager, the terms of the transaction are at least as favorable to the plan or fund as terms generally available in arm's length transactions between unrelated parties.

fiduciary may be personally liable to a plan for any losses resulting from its breach of the ERISA fiduciary provisions. In addition, the manager may have to restore to the plan profits made through the use of plan assets. Further, the fiduciary may be subject to other equitable or remedial relief a court may deem appropriate, including removal.[37] Finally, the fiduciary may also face civil penalties under ERISA[38] and excise taxes under the Code[39] in connection with entering into prohibited transactions.

F. Capital Infusions into Stable Value Funds are a Rare Occurrence.

The Commissions asked:

- The Commissions' staffs understand that stable value fund managers infuse capital into their funds in certain instances. Please describe the circumstances under which a stable value fund manager would provide such capital support for its fund.[40]

There is no requirement that stable value fund managers infuse capital into stable value funds that they manage, although some managers have made such capital infusions in the past. Because the details of such capital infusions are not public information, each manager would have to communicate its reasons for injecting capital into the stable value funds under its management.

IV. Stable Value Contracts are a Cost-Effective, Low-Risk Method for Reducing the Volatility and Risk of Stable Value Funds Without Contributing to Systemic Risk.

A. Stable Value Funds Consistently Deliver a Stable, Low-Risk Rate-of-Return.

The Commissions asked:

- How have stable value funds and stable value contracts been affected by the recent financial crisis? How many stable value contracts providers are in the market today? Is the number of stable value contract providers higher or lower than prior to the financial crisis that began in 2008? Are fees now higher or lower than prior to the financial crisis?[41]

Stable value products allow defined contribution plan participants to avoid losses and minimize risk while preserving a rate of return that is typically superior to those offered by money market funds. Even at the height of the financial crisis in 2008 and 2009, stable value funds consistently offered a relatively high rate of return and low-risk preservation of capital. Throughout the

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37 *See generally* ERISA Section 409.

38 *See* ERISA Section 502(l).

39 *See* Code Section 4975.

40 Stable Value Contract Study Question No. 15.

41 Stable Value Contract Study Question No. 17.

recent market instability, stable value funds have maintained their high overall credit quality with an average credit rating of AA- to AAA and an average overall duration of less than three years.[42]

These characteristics and investment objectives are consistent with an aging population, increased financial market volatility, lower equity return expectations, and the potential loss of principal associated with bonds. Between December 2008 and June 2011, the total amount invested in stable value funds increase from $347 billion to $404 billion.[43] Currently, stable value funds hold between 10% and 15% of all defined contribution assets and are a core component of more than half of all defined contribution plan portfolios.[44]

Stable Value Funds' Averaged Statistics from December 2008 through June 2011

	Total AUM	Crediting Rate	Average Duration	Average Credit Quality	Average MV/CV Ratio
	$ in million	Annualized	Years	10=AAA, 9=AA+, 8=AA	
Dec-08	$346,843.5	4.1%	2.8	9.0	95.1%
Mar-09	$358,490.1	3.4%	2.6	8.9	95.6%
Jun-09	$355,614.9	3.2%	2.8	8.8	97.2%
Sep-09	$387,743.4	3.5%	2.8	8.9	100.6%
Dec-09	$423,469.9	3.4%	2.9	8.7	101.0%
Mar-10	$438,854.2	3.2%	2.9	8.6	101.5%
Jun-10	$436,838.8	3.3%	2.8	8.5	102.9%
Sep-10	$437,315.0	3.1%	2.8	8.5	104.0%
Dec-10	$443,612.9	3.3%	3.0	8.5	102.0%
Mar-11	$434,175.7	3.0%	2.8	8.7	102.7%
Jun-11	$404,868.5	3.0%	2.8	8.7	103.7%

Stable value fund yields and crediting rates have tracked market interest rates lower but have decreased relatively little when compared to similar asset classes. In December 2008, stable value funds had a crediting rate of, on average, 4.1%.[45] As of June 2011, the average crediting

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[42] SVIA Stable Value Funds' Quarterly Characteristics Survey as of June 30, 2011.

[43] *Id*. Note, references to the $404 billion invested in stable value funds differ from references to the $540 billion total stable value market due to differences in how each figure was calculated. The $404 billion figure is based on a quarterly survey of 25 stable value fund managers and is useful for analyzing market trends, but does not capture the entire stable value fund market. The $540 billion figure is based on a less frequent, but broader market survey.

[44] *401(k) Plan Asset, Allocation Account, Balance and Loan Activity in 2008*, Investment Company Institute Research Perspective, October 2009, Vol. 15, No. 3; Independent Directors' Council on Retirement Assets as of First Quarter 2011; Stable Value Funds' Quarterly Characteristics Survey as of June 30, 2011.

[45] SVIA Stable Value Funds' Quarterly Characteristics Survey as of June 30, 2011.

rate decreased to 3.0%.[46] Stable value funds continue to provide a significant premium above money market funds.

Currently, approximately 20 banks and insurance companies provide stable value contracts. Although this number is consistent with historical averages, demand for stable value contracts is increasing while the capacity to issue new contracts is flat or, in some cases, contracting. Since 2000, total assets invested in stable value funds have increased by $183 billion or 81%, while the number of stable value contract providers has been relatively stable.[47] However, despite the demand for stable value products, potential stable value contract providers have been reluctant to enter the market or expand capacity due to the current regulatory uncertainty. Significantly, Congress considered the risks posed by this regulatory uncertainty to be so important that it expressly provided that no requirement under Title VII of the Dodd-Frank Act would apply to stable value contracts unless and until the Commissions affirmatively determined that stable value contracts were swaps and that an exemption from regulation was not appropriate or in the public interest.[48]

Limited capacity has led to changes in stable value contract terms, issuing guidelines, and ultimately higher fees. For example, fees associated with Synthetic GICs ranged from 4 to 8 basis points prior to the financial crisis. Although these fees have recently increased to between 20 and 25 basis points because of limited capacity in the market, the significant uncertainty regarding the regulation of stable value contracts still discourages providers from participating in the stable value industry. Increased fees in the industry have not drawn in many new providers or encouraged more providers that are currently participating in the market to expand their stable value business because most providers generally do not believe the increased fees are adequate to compensate for regulatory uncertainty in the industry and the potential costs that would be associated with complying with regulations applicable to stable value contracts, should the Commissions deem stable value contracts to be "swaps."[49] At a certain point, additional costs associated with new regulations could make stable value contracts no longer commercially viable for providers.

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[46] *Id.*

[47] SVIA's 5th Annual Stable Value Funds' Investment and Policy Survey as of December 31, 2000; SVIA's 15th Annual Stable Value Funds' Investment and Policy Survey as of December 31, 2010. This calculation is based on a constant set of stable value fund managers. Because the number of survey respondents increased between 2000 and 2010, stable value fund managers who did not participate in previous surveys were removed to provide a consistent basis of comparison.

[48] Dodd-Frank Act Section 719(d)(1)(B).

[49] *See infra* Section VI.C (discussing the impact on the stable value industry of increase regulatory costs that would be associated with regulation of stable value contracts as "swaps").

B. Stable Value Contracts are Structured to Reduce Risk to Providers While Providing Predictability and Security for Plan Participants.

The Commissions asked:

- Describe the benefits and risks of stable value contracts for stable value contract providers. How do stable value contract providers mitigate those risks? Please provide detailed descriptions. How effective are any such measures?[50]

- Describe the benefits and risks of stable value contracts for investors in stable value funds. Please provide detailed descriptions.[51]

1. Benefits of Stable Value Contracts and Stable Value Funds

Stable value funds are a low-risk, fixed income investment option offered exclusively in defined contribution plans. These funds offer plan participants the liquidity and principal protection features of money market products with higher yields that are comparable to intermediate-term bonds. Stable value funds are able to offer this beneficial combination by investing in higher-yielding intermediate-term bonds and securing wrap coverage that provides liquidity and principal preservation. Because of this combination, stable value funds have historically yielded a rate of return that is higher than comparable rates offered by money market funds over the same period of time. Between 1989 and 2009, stable value funds achieved an average annual return of 6.1%, which was higher than intermediate term fixed income funds (at 5.6%) and money market funds (at 3.9%).[52]

Stable value funds provide plan participants with investment security and diversification in uncertain markets. Compared to other investment options, stable value funds offer low-volatility, negative equity correlation, and predictable, long-term value. Moreover, stable value funds achieve relatively high returns despite having lower costs than most comparable investment vehicles.[53] Because of these characteristics, the market for stable value funds has grown consistently, particularly during times of uncertainty in the economy and volatile financial markets.

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[50] Stable Value Contract Study Question No. 11.

[51] Stable Value Contract Study Question No. 12.

[52] *See* Dr. David Babbel and Dr. Miguel A. Herce, *Stable Value Funds: Performance to Date*, The Wharton School (January 2011). Returns for all three alternatives were above the average inflation rate (3%) during the same period. *See* Consumer Price Index Data from 1913 to 2009, Bureau of Labor Statistics, http://www.usinflationcalculator.com/inflation/consumer-price-index-and-annual-percent-changes-from-1913-to-2009.

[53] Median expense ratios for stable value funds were 34 basis points in 2009, while ratios for money market funds and fixed income funds were at 42 and 44 basis points, respectively. *Defined Contribution / 401(K) Fees*, Deloitte / Investment Company Institute (June 2009).

2. Risks Associated with Stable Value Contracts and Stable Value Funds and How Those Risks are Mitigated

The primary risk to stable value contract providers is that participant withdrawals will exceed the market value of the stable value fund at a time when market value is less than contract value.[54] In such an event, the stable value contract provider could be required to make a payment as a result of the shortfall.

These risks are substantially mitigated in three ways: (i) due diligence; (ii) the terms of the stable value contract; and (iii) the stable value fund's investment guidelines.

- Due Diligence. Stable value contract providers review plan structure, participant demographics, and associated cash flows to assess the relevant risks and appropriate pricing. If a plan has an unfavorable risk profile, a stable value contract provider may decline to issue the contract or only agree to issue the contract subject to appropriate terms, investment guidelines, and price.

  In addition, when analyzing a plan structure, stable value contract providers may limit the extent to which a stable value fund may be offered alongside competing funds, such as a money market fund, within a defined contribution plan.[55] A money market fund is considered competing because the participants can engage in a risk free transfer of their balances to and from the stable value fund in order to take advantage of changes in relative returns between the two funds. Alternatively, if a stable value fund and a competing fund are offered within the same defined contribution plan, the stable value contract provider may require restrictions on free transfers of participant balances to competing options to deter this activity. These restrictions insulate stable value contract providers from volatile cash flows and serve to protect stable value plan participants.

- Contract Terms. Generally, stable value contract providers may limit coverage of losses associated with certain non-conforming participant withdrawals or non-conforming underlying assets of the fund. With respect to withdrawals, accounting rules of the Financial Accounting Standards Board ("FASB") require stable value contracts to cover at contract value all participant-initiated transactions that are permitted under the terms of the stable value fund. However, stable value contracts typically provide limited coverage to withdrawals initiated by a plan sponsor or caused by plan sponsor activities. With respect to non-conforming underlying assets, if a fund exceeds a contractually defined limit for certain low-credit quality securities, the securities would no longer be entitled to coverage at contract value. Such securities would be marked-to-market and resulting losses would be borne by the fund.

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[54] Provisions in the stable value contract require that such withdrawals be initiated by the participants independent of any employer activity or influence.

[55] *See* the discussion of equity wash provisions in Section IV.C, *infra* for more detail.

In addition, as discussed above in Section III.B, virtually all stable value contracts mitigate risk through the crediting rate mechanism that helps to regulate the difference between the market and contract value of the fund.

- Investment Guidelines. Appropriate risk-return parameters that require the stable value fund's investments to be diversified in high-quality assets and managed by a well-qualified manager, further mitigate risks to the contract providers and plan participants.

C. Stable Value Funds are Structured to Protect Against a "Run on the Fund."

The Commissions asked:

- Do investors have incentives to make a run on a stable value fund when its market-to-book ratio is substantially below one? What protections, if any, do stable value contracts provide to protect fund investors who do not redeem their fund shares amid a run on the fund? How effective are any such protections?[56]

- How do market risk measures assess the risk of a run on a stable value fund? To the extent that stable value contract providers use value-at-risk ("VaR") models, do such VaR models adequately assess the risk of loss resulting from such events or other possible but extremely unlikely events? Do other loss models more adequately assess the risk of loss, such as the expected value of a loss or the expected value given a loss, which employs the entire loss probability distribution without excluding events in the extreme tail of the loss distribution?[57]

Stable value funds are structured in a way that inherently limits any incentive to make a "run on a fund." As discussed above, stable value funds require plan participants to transact at contract value (*i.e.*, principal invested plus accumulated interest) even if a fund's market value is below par (*i.e.*, stable value funds are "benefit responsive"). In the unlikely event that the value of a stable value fund's portfolio (which is based on conservative investments and backed by high quality fixed income assets) declines significantly *and* a significant number of plan participants make withdrawals from the fund, the stable value contract will continue to allow plan participants to transact at contract value. These fundamental features are common to all stable value funds and make arbitrage between a stable value fund and other plan options impractical.

Stable value contracts contain "equity wash" provisions to protect existing stable value fund participants from other participants who may attempt to arbitrage between the fund and competing investments. Transferring funds from a stable value fund to a competing fund which may temporarily offer a higher rate of return would not result in losses to any stable value fund participant, but could disrupt the stability of the stable value fund and, ultimately, impair the stable value fund's future rate of return. Equity wash provisions protect the long-term stability

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[56] Stable Value Contract Study Question No. 18.

[57] Stable Value Contract Study Question No. 19.

of stable value funds by preventing stable value fund participants from making such "free transfers." These rules are similar to other limitations used by defined contribution plans to address market timing.

Stable value contract providers also use "value at risk" or "VaR" models to monitor and assess the exposure associated with various investment vehicles, including stable value products. These models are tailored to assess risks associated with individual stable value funds, including the risk of exceptional withdrawals, extreme market volatility, and portfolio illiquidity. Together with other risk management tools, VaR models allow stable value contract providers to assess both the probability and value of potential losses, including remote tail-risk scenarios. Stable value contract providers use VaR models to set capital and reserve requirements, and to determine future capital needs based on potential market changes.

As a practical matter, the market value to contract value ratio of a stable value fund is most likely to be less than one during periods of volatility and decreasing market prices – the same general conditions that typically lead to increased demand for stable value funds and conservative investment options. As a result, adverse market conditions most often lead to a run *to* stable value funds, not a run *on* stable value funds. As long as stable value funds are able to deliver a competitive, stable rate of return, even in comparatively poor market conditions, the Joint Associations believe that this correlation is unlikely to change.

D. Stable Value Contract Providers do not Pose Systemic Risk Concerns and are no More Likely than any Other Financial Entity to Become Distressed.

The Commissions asked:

- Do stable value contract providers pose systemic risk concerns? Are there concerns with entities that may be systemically important institutions providing stable value contracts? What are the consequences for stable value funds, employee benefit/retirement plans, and the financial system should a stable value contract provider fail?[58]

- Are there issues specific to financial institutions providing stable value contracts, including institutions that are systemically significant, that the Commissions should consider in connection with the stable value contract study? If so, please describe.[59]

- Are certain stable value contract providers more likely, as a result of credit cyclicality, to become financially distressed? If so, is such financial distress likely to occur concurrently with financial distress of stable value funds? If so,

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[58] Stable Value Contract Study Question No. 21.

[59] Stable Value Contract Study Question No. 22.

can the risk of such concurrent financial distress be mitigated? How effective are any such measures?[60]

Stable value contract providers do not pose particular systemic risk concerns, even if the contract provider is deemed to be systemically significant. Similarly, stable value contract providers are no more susceptible to particular risks associated with credit cyclicality than any other financial entity. As discussed in detail in Section V below, banks and insurance companies that issue stable value contracts and managers of stable value funds are pervasively regulated by one or more federal and/or state regulators, and, in addition, stable value fund managers are subject to fiduciary obligations under ERISA. Regulating stable value contracts as "swaps" would be duplicative for stable value contract providers and ultimately detrimental for plan participants.

In addition, as discussed above, stable value contracts are just one of several risk management components used to ensure that stable value fund participants will be able to make benefit responsive withdrawals regardless of market conditions. Separately, stable value funds are offered only as part of a defined contribution plan and are based upon a highly conservative portfolio of securities. As a result, most stable value fund participants are long-term investors who are unlikely to engage in the type of trading that could undermine the stability of the stable value fund or the stable value contract provider, and the risk of a stable value fund incurring losses is correspondingly lower than with most other asset classes.

V. Stable Value Contracts and Stable Value Funds are Subject to Comprehensive Regulatory Oversight.

The Commissions asked:

- What financial and regulatory protections currently exist that are designed to ensure that stable value contract providers can meet their obligations to investors, and what are the sources of such protections? Does the level of protection vary depending on the stable value contract provider? How effective are any such measures?[61]

- Currently, do entities other than state-regulated insurance companies and federally- or state-regulated banks provide stable value contracts? If so, what kinds of entities do so and how are they regulated? If not, are there any barriers to the provision of stable value contracts by entities other than state-regulated insurance companies and federally- or state-regulated banks?[62]

Stable value contract providers and managers of stable value funds are pervasively regulated by one or more federal and/or state regulators, and stable value managers are subject to fiduciary obligations under ERISA (or comparable provisions applicable to governmental benefit plans).

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[60] Stable Value Contract Study Question No. 20.

[61] Stable Value Contract Study Question No. 24.

[62] Stable Value Contract Study Question No. 25.

These regulatory requirements include comprehensive risk controls that prevent financial distress and protect fund participants and stable value contract providers.

A. Regulatory Requirements Applicable to Providers of Stable Value Contracts that are Banks

Banking institutions that issue stable value contracts are already subject to significant regulatory requirements that are consistent with the fundamental objectives of the Dodd-Frank Act, including substantial risk-based capital requirements under the Basel frameworks. Banking institutions are regulated and supervised by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively "Federal Banking Agencies"). This oversight is comprehensive and pervasive. For example, in many instances, examiners of the Federal Banking Agencies generally remain on-site at large banking institutions to facilitate ongoing supervision of the activities of the bank.

Although the Federal Banking Agencies may impose regulatory obligations on stable value contract providers and their products that differ from what would be required under the Commissions' regulations, the purpose and effect of these regulations are wholly consistent with and comparable to the basic goals of the Dodd-Frank Act. For example, as with requirements that will be established by the Commissions to impose minimum capital and margin requirements or mandatory clearing for swaps, the regulations applicable to banking institutions that provide stable value contracts effectively reduce the risk inherently associated with banking activities by ensuring that regulated entities have adequate capital and liquidity to meet their obligations, even during extreme periods of market stress. Likewise, the disclosure and reporting requirements that apply to banking institutions that provide stable value contracts, although different from the swap reporting provisions proposed by the Commissions, achieve the same goals of transparency and promote market integrity as contemplated in the Dodd-Frank Act. Additional regulatory requirements, therefore, would be unnecessary, costly, and potentially incompatible with the current regulatory regime.

Banking institutions are required to hold capital against their obligations under stable value contracts in accordance with risk-based capital guidelines. These guidelines are a largely uniform set of risk-based capital standards applicable to all national banks, bank holding companies, and state FDIC-member banks.[63] The guidelines generally require banks to risk-weight assets to account for credit, market, and operational risks. [64] Banks calculate their risk-based capital ratio by risk-weighting assets and off-balance sheet items to account for the particular risks associated with each asset and off balance sheet item.[65] Stable value contracts issued by banks must be risk-weighted under the same guidelines. Accordingly, banks subject to these guidelines must hold capital against the market risk under the applicable Basel guidelines

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[63] *See* 12 C.F.R. Part 225, Appendix A; 12 C.F.R. Part 208, Appendix A; 12 C.F.R. Part 3, Appendix A; 12 C.F.R. Part 325, Appendix A; Risk-Based Capital Guidelines, 54 Fed. Reg. 4186 (Jan. 18, 1989).

[64] Basel I does not require risk-weighted assets for operational risk unlike Basel II and Basel III.

[65] 12 C.F.R. Part 225, App. A, III(A).

with respect to the stable value contracts they have issued. When fully effective, the Basel II and Basel III framework are expected to result in higher capital requirements for all banks subject to their standards, including banks that issue stable value contracts.

The Basel I guidelines, which are currently in effect in the United States, require banks to calculate risk-based capital under the market risk measure to ensure that banks hold sufficient capital to provide a cushion against changes in the market value of "trading contract" exposures.[66] Under the market risk measure, a stable value contract provided by a bank would be treated as a "trading contract" activity of the bank for regulatory capital purposes, and the bank would thus be required to calculate a market risk capital charge with respect to each stable value contract.[67] The capital charge that a bank takes under the market risk measure also generally includes a credit risk measure, if applicable.[68]

The Federal Banking Agencies are currently transitioning to the Basel II framework for large, internationally-active banks. Basel II is comprised of three Pillars that address minimum capital requirements, the supervisory review process, and enhancement of disclosure on a bank's risk process and risk profile. Under Pillar I, risk-weighted assets are estimated: (i) using internal quantitative models for market and operational risk; and (ii) inputting parameter estimates into regulatory formulas for credit risk. Pillar II requires the development of an internal capital adequacy assessment process ("ICAAP"), where each institution determines the amount of capital needed to support its specific risk profile. ICAAP is intended to capture the credit, market and operational risks of Pillar I, in addition to any other material risks faced by that institution. Pillar III increases transparency through enhanced disclosure requirements, enabling the market to make a more informed assessment of an institution's creditworthiness. Examiners from the Federal Banking Agencies must approve a bank's internal models, parameter estimates, stress testing approaches, assumptions and processes under Pillars I and II.[69]

Basel II, and specifically Pillar II, and Basel III have led to the development of a stress testing framework for large, complex financial institutions, both domestically and internationally. In the

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[66] 12 C.F.R. Part 225, Appendix E; Risk-Based Capital Standards: Market Risk, 61 Fed. Reg. 47358 (Sept. 6, 1996).

[67] Banking institutions generally must categorize assets and liabilities as being held in either the "banking book" or the "trading book" when filing their quarterly and annual Reports of Condition and Income. "Banking book" assets are those the bank intends to hold for an extended period of time, and which the bank may value at cost, while "trading book" assets generally are those that the bank must mark-to-market with any change in value recorded through its profit and loss statement; "trading assets" are intended to be held for a short time-period (*i.e.*, it must apply "fair value" accounting.) *See generally* Consolidated Reports of Condition and Income, FFIEC 031 (March 2011) at A-78a, *available at* http://www.fdic.gov/regulations/resources/call/crinst/callinst2011_mar.html. Note the distinction between (a) the obligation of the bank to assess its exposures under a stable value contract at fair value and (b) the obligation of the stable value fund to value its assets at cost pursuant to FASB rules, as discussed above.

[68] Note that a bank need only calculate capital adequacy under the market risk measure if its worldwide trading activity is at least $1 billion or 10% of total assets. Otherwise, the credit risk measure alone applies. 12 C.F.R. Part 225, App. E, § 1(b); Risk-Based Capital Standards: Market Risk, 61 Fed. Reg. at 47362.

[69] Note that the implementation period for Basel II has been delayed due to ongoing discussions at the Basel Committee on Banking Supervision regarding Basel III.

United States, the Federal Reserve is making regular use of stress testing in the assessment of capital adequacy and more recently, the ability of banks to increase their dividend payouts. Large, complex banks, including the banks that issue stable value contracts, are the main focus of these tests. The potential effects on the value of the stable value product under extreme economic conditions can have a material impact on the capital adequacy of the offering institution. This is another example of the increased capital impact that the implementation of Basel II and Basel III will have on this product.

Maintenance of the relevant capital ratios is a continuous, ongoing requirement for banking institutions.[70] Entities with capital ratios that do not meet the minimum requirements must submit plans to their regulator describing the manner in which they plan to remedy the capital shortfall.[71] A bank's Examiner-in-Charge ("EIC") must examine the bank at least once during each 12-month period.[72] The EIC, in its discretion, may (and for large complex institutions almost certainly does) examine a bank more frequently, and such an examination may be tailored to any one or more of the bank's business lines and products.[73]

In addition, FASB rules require banking institutions to account for stable value contracts at "fair value."[74] The determination of fair value requires the banking institution to make certain assumptions regarding redemption levels that the underlying funds may experience. Redemption levels depend on the performance of the manager of the stable value fund, the fund's investment strategy, investor demographics, and other general market factors. Banking institutions must report their stable value contract exposures in the footnotes to the banking institution's consolidated financial statements.

B. Regulatory Requirements Applicable to Providers of Synthetic GICs that are Insurance Companies

Insurance companies, which have been involved in the stable value fund market for almost forty years, are regulated by state insurance departments in each state in which the insurer is licensed.[75] State insurance departments generally implement regulatory requirements recommended by the National Association of Insurance Commissioners ("NAIC"). As with regulated banking institutions, insurance companies that provide stable value products are already subject to a combination of regulatory requirements that are effective and in complete accord with the goals of the Dodd-Frank Act. For example, insurers that issue stable value

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[70] 12 C.F.R. § 3.6 (national banks).

[71] 12 C.F.R. § 3.7 (national banks).

[72] *See* 12 C.F.R. § 4.6 (national banks); *see generally* Comptroller's Handbook: Bank Supervision Process (Sept. 2007), *available at* http://www.occ.gov/handbook/banksup.pdf.

[73] *See id.* at 8.

[74] *See* FASB Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosures (formerly FAS No. 157).

[75] There are generally two types of insurance companies: life insurers and property and casualty insurers. Because the authorization to issue Synthetic GICs under state law is generally limited to life insurers, references herein to "insurers" are to life insurers only.

contracts are subject to substantial capital and surplus requirements to guarantee their ability to safely absorb losses while continuing to accommodate requests for withdrawals and to perform other routine functions. Insurers that issue stable value contracts also are subject to comprehensive disclosure and reporting requirements that are intended to improve industry oversight and transparency. As explained below, additional regulation of insurance companies that issue stable value contracts under the Dodd-Frank Act would be unnecessary and would not advance the goals of the statute further.

One form of stable value contract provided by insurance companies is the Synthetic GIC. The NAIC Synthetic GIC Model Regulation ("NAIC Model") imposes specific disclosure obligations, in addition to reserve requirements, with respect to Synthetic GICs.[76] Because Synthetic GICs are generally considered to be a type of annuity product under the insurance laws of most states, many state insurance departments require that the Synthetic GIC contract forms be filed with the state insurance departments prior to the issuance of a Synthetic GIC.[77] The filing allows the departments to evaluate whether the contract terms of a Synthetic GIC comply with the insurance regulatory requirements and whether the issuing insurer maintains the capital level and status qualification requirements applicable to insurance company issuers of Synthetic GICs.

Insurers that have issued Synthetic GICs are required to disclose specific reserves relating to their exposures under Synthetic GICs on their statutorily required financial statements.[78] Insurers are required to maintain reserves in support of issued Synthetic GICs in an amount estimated in the aggregate to provide for payment of all potential losses and claims.[79] The insurer must retain actuaries to calculate required reserves in accordance with applicable regulatory requirements. These actuaries are subject to an independent set of professional actuarial standards.[80]

State insurance departments have adopted different rules as to the reserves required for Synthetic GICs. These reserves must be reported (often quarterly) to the state insurance department and,

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[76] The reserve requirements of the NAIC Model have been widely adopted by state insurance departments, either directly through implementation of the NAIC Model itself or through the adoption of the NAIC's Accounting Practices & Procedures Manual, Appendix A-695. Appendix A-695 includes the reserve requirement in the NAIC Model. The NAIC Model provides additional information that the Commissions may find useful and is available through the state insurance departments. Similarly, the NAIC has adopted the Separate Accounts Funding Guaranteed Minimum Benefits Under Group Contracts Model Regulation (the "NAIC Separate Accounts Model") for Separate Account GICs. The NAIC Separate Accounts Model sets forth a regulatory framework as rigorous and comprehensive as that set forth in the NAIC Model.

[77] *See, e.g.,* N.Y. Ins. Law § 3201(b)(1).

[78] In New York, the obligation to comply with reserve and risk-based capital requirements is determined as of the time the insurance company files statutory financial statements. N.Y. INS. LAW § 307. *See generally* Harry P. Kamen & William J. Toppeta, The Life Insurance Law Of New York, 33-36 (1991).

[79] N.Y. Ins. Law § 1303. *See* Kamen & Toppeta, *supra* note 78, at 34.

[80] Similar to banking institutions, insurers are subject to ongoing examination by insurance regulators; in New York State, the New York State Insurance Department must examine life insurers at least once every five years. N.Y. Ins. Law § 309.

for entities required to file periodic reports pursuant to the Exchange Act, to the SEC. An insurer subject to the risk-based reserving requirements set forth in the NAIC Model is required to maintain specific reserves relating to its actuarially determined economic exposure associated with issued and outstanding Synthetic GICs. These reserves represent an estimate of the insurer's expected liabilities relating to each Synthetic GIC, taking into account both the nature of the specific liabilities associated with the Synthetic GIC and the underlying investment account to which the Synthetic GIC relates. Some state insurance departments, such as California's and Nebraska's, mandate premium-based reserving requirements, which require insurers to identify specific reserves relating to risk premiums collected by the insurer in connection with Synthetic GICs.[81] Such premium-based reserve requirements generally equal the sum of the insurer's gross unearned risk premiums on its Synthetic GIC business plus at least 30% of any annual excess of the risk premium over claims, subject to a maximum required reserve of 150% of the current annualized risk premium the insurer collects under issued Synthetic GICs.

In addition to the specific reserves that must be maintained with respect to the issuance of Synthetic GICs, insurers are required to hold levels of capital to support all aspects of their operations, including those relating to the issuance of Synthetic GICs. Pursuant to the NAIC's risk-based capital system, insurance regulators calculate an insurer's target capital, based on a comprehensive formula that includes specific capital charges relating to the insurer's assets, underwriting activities, the mismatch between such assets and liabilities (including interest rate exposures) and operational risk.[82] This target capital is then compared to the insurer's actual total adjusted capital to arrive at a risk-based capital ratio that the insurance department uses to assess the relative financial strength of the insurer. The risk-based capital ratio is the basic metric underlying the NAIC's Risk-Based Capital Model Act, a version of which has been adopted in every state.[83]

C. Regulatory Requirements Applicable to Stable Value Contract Providers Subject to ERISA

Many stable value funds or accounts are subject to ERISA, the comprehensive federal law governing U.S. private sector employee benefit plans. Importantly, as discussed in more detail in Sections III.C and VI.E, the fiduciary responsibility provisions of ERISA and the prohibited transaction provisions of ERISA and the Code are applicable when a fund or account is subject to ERISA. In such circumstances, the plan fiduciary must conduct its activities in the interests of plan participants and beneficiaries subject to ERISA's high standard of care, and the parties must

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[81] The "risk premium" under a Synthetic GIC is the fee that an insurer charges the plan for the guarantee provided under the Synthetic GIC.

[82] NAIC's model risk-based capital measurements take account of "asset market and credit risks (often referred to as C-1 risk), underwriting and pricing risks (C-2 risk), the risk of that the return from assets are not aligned with the requirements of the company's liabilities (C-3 risk) and general business risk (C-4 risk)." *See* Risk-Based Capital, at 3, *available at* http://rmtf.soa.org/riskbased_capital.pdf.

[83] Note that Standard and Poor's has published a capital framework for life insurers that issue Synthetic GICs, which effectively imposes additional capital requirements on insurers in the ratings process from the agency.

endeavor not to engage in prohibited transactions. To the extent applicable, ERISA is another important regulatory regime serving to protect the interests of plans and their participants and beneficiaries in connection with stable value contracts.

D. Regulatory Requirements Applicable to New Stable Value Contract Providers

There are two significant barriers for entities to become stable value contract issuers:

- FASB Codification Paragraphs 945-210-45-9 through 45-18, which was previously known as "Reporting of Fully Benefit-Responsive Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined Contribution Health and Welfare and Pension Plans, FSP AAG INV-1 and SOP 94-4-1" (the "FASB FSP/Codification")[84]; and

- The definition of "stable value contract" in Section 719(d) of the Dodd-Frank Act.

The FASB FSP/Codification establishes five criteria, all of which must be met for a plan to achieve benefit responsiveness:

- The stable value contract must be executed between a stable value fund and a stable value contract provider and must prohibit the sale or assignment of the contract or its proceeds to another party without the consent of the provider.

- The stable value contract provider must be a financially responsible third-party. In addition, either repayment of principal and interest credited to participants in the stable value fund must be a financial obligation of the stable value contract provider, or the prospective interest crediting rate adjustments provided to participants in the fund on a designated portfolio of investments held by the fund or the contract provider must not result in a crediting rate that is negative or less than zero.

- The terms of the stable value contract must require all permitted participant-initiated transactions with the stable value fund to occur at contract value.

- An event (such as bankruptcy or workforce reduction) that limits the ability of the stable value fund to transact at contract value with the provider and that also limits the ability of the stable value fund to transact at contract value with participants in the fund must not be probable of occurring.

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[84] Paragraphs 945-210-4509 through 45-18 of the FASB FSP/Codification. The Government Accounting Standards Board mirrors the FASB standard. *See* Government Accounting Standards Board Statement No. 53, Accounting and Financial Reporting for Derivative Instruments, Paragraph 67.

- The stable value fund itself must allow participants reasonable access to their funds.

FASB's requirement that stable value contract issuers be a "financially responsible third-party" and its recognition of stable value contracts as financial obligations, as a practical matter, limits stable value contract issuers to only the largest and most creditworthy financial institutions.

Section 719(d) of the Dodd-Frank Act further narrows stable value contract issuers to state-regulated insurance companies and federally- or state-regulated banks.

E. The Limited Risks Associated with Stable Value Funds are Disclosed to all Stable Value Fund Defined Contribution Plan Participants.

The Commissions asked:

- What disclosures to benefit plan investors in stable value funds currently are required, and what are the sources of such requirements? What additional disclosure typically is provided, either voluntarily or on request? What additional disclosure, if any, would be warranted and why would it be warranted? Please explain in detail.[85]

Stable value funds are offered to plan participants through a number of different vehicles including bank collective trust funds, separately managed portfolios, and insurance products. Regardless of the vehicle type, investment disclosures are dictated by the general rules applicable to all investment products in the defined contribution space. These vehicles, while specifically exempt from registration under the securities laws, remain subject to the anti-fraud provisions of the Securities Act of 1933 and the Exchange Act. Consequently, material information is disclosed to the plan sponsor and, directly or indirectly, to the plan participant.

In addition, disclosure requirements may currently (and in the near future, will) apply under ERISA rules with respect to plans providing for participant-directed investments. For plans intended to comply with Section 404(c) of ERISA, which generally provides that a plan fiduciary will not be liable to a participant for any loss resulting from the participant exercising control over the investment of his or her account, there are certain disclosure obligations. The DOL has issued regulations under Section 404(c) providing that participants must receive or have access to sufficient information to make informed investment decisions. In this regard, the regulation currently provides that a participant must (depending upon the item) receive or have access to, among others: descriptions of plan investment alternatives (*e.g.*, stable value), including covering investment objectives and risk and return characteristics of each alternative; an explanation of the circumstances under which investment instructions may be given and of any limitations on instructions (including restrictions on transfers to or from investment alternatives); a description of the annual operating expenses for each alternative which reduce the rate of

[85] Stable Value Contract Study Question No. 23.

return to participants; and copies of prospectuses, financial statements and reports, and of any other materials relating to the alternatives to the extent provided to the plan.

In October 2010, the DOL released final regulations imposing disclosure requirements that apply more generally with respect to participant-directed individual account plans.[86] Under the new regulations, first applicable for plan years beginning on or after November 1, 2011, certain plan and investment information must be provided on or before the date a participant can first direct investments and then at least annually thereafter.[87] Included among the initial and annual plan-related information is an explanation of the circumstances under which participants may give investment instructions, an explanation of the limitations on instructions, and identification of designated investment alternatives (*e.g.*, stable value) or managers. Regarding initial and annual investment information, which is to be provided in a format designed to permit a participant to compare information for each investment alternative, the required material includes: the name and type (*e.g.*, stable value) of each alternative; performance data with respect to alternatives; and certain detailed information regarding fees and expenses (including total annual operating expenses) applicable to each alternative. A website address that leads participants and beneficiaries to information concerning the available investment alternatives (including information relating to an alternative's principal strategies and risks) must also be provided. In addition, the new rules mandate the provision of certain disclosures subsequent to investment and the provision of certain information on request (including prospectuses, financial statements or reports to the extent provided to the plan and information regarding the assets held in alternatives).

In practice, all investment vehicles provide a fund fact sheet (also known as an investment profile). Although individual fund fact sheets vary, typically the fund fact sheets include information such as fund management, investment strategy overview, duration, net of fees blended yield, net of fees performance, and portfolio composition. Additional disclosures may include a disclosure book that is used to detail specific risks, portfolio strategy, and operational details for the portfolio. In the event there are additional inquiries from plan participants, many plan sponsors work with their investment providers to provide additional *ad hoc* responses as necessary.

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[86] *See* Fiduciary Requirements for Disclosure in Participant-Direct Individual Account Plans, 75 Fed. Reg. 64910 (October 20, 2010). The required disclosures must be provided to participants regardless of whether a plan is intended to comply with Section 404(c) of ERISA. The DOL amended the Section 404(c) regulations in connection with this effort

[87] Although under a DOL transition rule, the earliest date on which disclosures under the rule must be made is May 31, 2012.

VI. If The Commissions Determine That Stable Value Contracts Fall Within the Definition of "Swap," They Should Use the Exemptive Authority Specifically Provided by Congress to Avoid the Risk of Significant Unintended Negative Consequences for Defined Contribution Plan Participants That Rely on Stable Value Funds.

The Commissions asked:

- If the Commissions were to determine that stable value contracts fall within the definition of a swap, what facts and considerations, policy and otherwise, would support exempting stable value contracts from the definition of a swap? What facts and considerations, policy and otherwise, would not support exempting stable value contracts from the definition of a swap?[88]

- If the Commissions were to determine that stable value contracts fall within the definition of a swap and should not be exempted from such definition, would the requirements of any regulatory regime for swaps impact fee structures or fees charged by stable value contract providers? Please describe (quantitatively, if possible) the relationship of any new federal regulation under the Dodd-Frank Act to possible changes in fee structures or fees, to the extent feasible, and state any assumptions used in quantifying such relationship.[89]

- If the Commissions were to determine that stable value contracts fall within the definition of a swap and should not be exempted from such definition, would this decision influence the availability of stable value funds to investors? Would this designation affect existing stable value funds and the ability of stable value funds to purchase stable value contracts? If so, how and why?[90]

- If the Commissions were to: (1) determine that stable value contracts fall within the definition of a swap but provide an exemption from the definition of a swap, (2) determine that stable value contracts fall within the definition of a swap and not provide an exemption from such definition, or (3) determine that such contracts are not swaps, what beneficial or adverse regulatory or legal consequences, if any, could result? For example, could any of such determinations lead to beneficial or adverse treatment under the ERISA, bankruptcy law, tax law, or accounting standards, as compared to the regulatory regimes applicable to stable value contracts, in the event that the Commissions were to determine that stable value contracts are not swaps or grant an exemption from the definition of a swap?[91]

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88 Stable Value Contract Study Question No. 6.

89 Stable Value Contract Study Question No. 28.

90 Stable Value Contract Study Question No. 29.

91 Stable Value Contract Study Question No. 7.

- If the Commissions were to determine that stable value contracts fall within the definition of a swap and should not be exempted from such definition, should the regulatory regime for stable value contracts be limited or tailored in any way? If so, how? Please explain in detail. Should any of the requirements for capital and margin for stable value contracts differ from those for swaps that are not stable value contracts? Why or why not? If the requirements for capital and margin should differ, please explain in detail what those differences should be.[92]

Should the Commissions conclude that stable value contracts fall within the definition of "swap" under Section 721(a) of the Dodd-Frank Act,[93] the Joint Associations urge the Commissions to jointly exempt stable value contracts from the definition. Such an exemption is consistent with Section 719(d)(1)(B) of the Dodd-Frank Act and Congress's intent to provide relief where, as here, an exemption is "appropriate and in the public interest."[94]

The Joint Associations believe that exempting stable value contracts from the definition of "swap" under Section 719(d)(1)(B) of the Dodd-Frank Act is "appropriate and in the public interest" because: (i) the regulatory requirements currently applicable to stable value contracts under state and federal law already achieve the goals of transparency and market integrity sought to be achieved by the regulation of "swaps" under the Dodd-Frank Act; (ii) the anticipated regulatory regime for "swaps" under the Dodd-Frank Act is potentially incompatible with stable value contracts, and replacing (or adding to) the existing regulatory regime currently applicable to stable value contracts with that applicable to "swaps" will have unintended negative consequences for the prudent regulation of stable value contracts; and (iii) further regulating stable value contracts as "swaps" will have a significant and potentially irreversible detrimental impact on the retirement income and savings of defined contribution plan participants, including retirees.

A. Regulatory Requirements Currently Applicable to Stable Value Contracts Under State and Federal Laws and Regulations Already Achieve the Goals of Transparency and Market Integrity.

Stable value funds and the stable value contract providers are already regulated by a combination of federal and state authorities, including the Federal Banking Agencies, the DOL, the SEC, and state insurance departments.[95] For example, as discussed above, stable value contract providers

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92 Stable Value Contract Study Question No. 27.

93 CEA § 1a(47).

94 Dodd-Frank Act § 719(d)(1)(B). Similar to the Commissions' exemptive authority in Section 719(d)(1)(B) of the Dodd-Frank Act, CEA Section 4(c) provides the CFTC with authority to exempt certain futures transactions from certain requirements of the CEA if such an exemption is "consistent with the public interest and with the purposes of the [CEA]." The exemptive standard of Section 4(c) does not control the Commissions' determination whether to grant an exemption from the definition of "swap" under the Dodd-Frank Act, but the standard may serve as a useful guidepost in evaluating whether such an exemption would be "appropriate and in the public interest." *Compare* CEA § 4(c)(1)-(2) [7 U.S.C. § 6(c)(1)-(2)].

95 *See supra* Section VII.

are subject to risk-based capital, reserve, and reporting requirements with respect to stable value contracts. Similarly, stable value fund managers must comply with various reporting obligations and generally submit to periodic, independent reviews by the fund's plan sponsor (typically quarterly or on a more frequent basis). These requirements serve to protect the ultimate beneficiaries of stable value contracts – plan participants – by ensuring the capital adequacy of issuers of stable value contracts and transparency to stable value fund participants of the terms of their investments in stable value funds. The existing regulatory regime thus achieves similar, if not the same, transparency and market integrity goals of the Dodd-Frank Act through wholly comparable regulatory requirements applicable to contract issuers and stable value fund managers. Regulating stable value contracts as "swaps", therefore, is unnecessary and not what Congress intended to occur.

B. Regulating Stable Value Contracts as "Swaps" may be Inconsistent With the Dodd-Frank Act and Incompatible With Other Existing Regulatory Requirements Applicable to Stable Value Contracts.

Regulating stable value contracts as "swaps" is potentially incompatible with other regulatory requirements currently applicable to stable value contracts and will create substantial regulatory and commercial uncertainty as to the continued viability of stable value funds. As a result, superimposing the regulatory regime applicable to "swaps" on top of the existing regulatory regime in which stable value contracts operate will lead to substantial uncertainty in the market for conservative retirement investments.

For example, with respect to margin requirements, because stable value contracts cannot be cleared, if stable value contracts are "swaps" they would presumably be subject to the Commissions' (or the banking regulators') proposed margin requirements for uncleared swaps, which require posting of initial and variation margin.[96] However, subjecting stable value contracts to initial and variation margin would be generally inconsistent with accounting rules in place for stable value funds, which, pursuant to FASB rules, *do not* apply mark-to-market valuation to the fund's assets. Stable value funds *are required* to report assets at contract value, not fair value.[97]

Similarly, proposed rules regarding reporting and margining requirements for "swaps" may be unworkable for stable value contracts. The Commissions' proposed reporting rules generally require reporting of the "primary economic terms" relating to all "swaps," cleared and uncleared, to centralized swap data repositories.[98] However, because stable value contracts have no underlying reference asset, it is not clear how reporting of stable value contracts "primary

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[96] *See generally* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23732 (April 28, 2011).

[97] *See* FASB Staff Position Nos. AAG INV-1 and SOP 94-4-1.

[98] *See generally* Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76139 (proposed Dec. 10, 2010); Reporting, Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 76666 (proposed Dec. 9, 2010); *Swap Data Recordkeeping and Reporting Requirements*, 75 Fed. Reg. 76573 (proposed Dec. 8, 2010).

economic terms" data would function. Even if it could be achieved, it is unclear what practical benefit having such data would be for the Commissions or other market participants.

Treating stable value contracts as "swaps" also will create conflicts and considerable uncertainty with respect to the regulatory regimes applicable to bank and insurer issuers of stable value contracts. If the Commissions deem stable value contracts to be "swaps," the activities of bank and insurer issuers with respect to stable value contracts could effectively be removed from the oversight of the applicable regulatory agencies because: (i) with respect to banks, the activities of banks with respect to "swaps" are significantly restricted under the Dodd-Frank Act; and (ii) with respect to insurers, the Dodd-Frank Act contains express provisions limiting the ability of state insurance regulatory authorities to regulate "swaps."[99] Further, it is unclear whether existing bank- and insurer-issued contracts would effectively be exempted from existing capital, reserve, and reporting requirements applicable to banks and insurers with respect to their portfolio of stable value contracts. The combined effect of deeming stable value contracts to be "swaps" likely would, paradoxically, be *reduced* transparency, *reduced* market integrity, and *increased* volatility for participants in stable value funds.

1. Bank Issuers of Stable Value Contracts that are Deemed "Swaps" Could be Required to "Push Out" Stable Value Activities to Less Regulated Affiliates.

With respect to bank issuers, Section 716 of the Dodd-Frank Act significantly restricts the types of "swaps" in which a bank may deal. As such, a finding that a stable value contract is a "swap" may, depending in part on the further definition of the term "swap," prohibit banks from offering stable value contracts. Section 716 of the Dodd-Frank Act, commonly referred to as the "swaps push-out rule," effectively prohibits banks, thrifts, and U.S. branches of foreign banks[100] from acting as a swap dealer except in certain limited circumstances. The effect of the prohibition is to require such institutions to "push out" most activities relating to a "swaps" dealing business into an affiliate that is not insured by the FDIC and that does not otherwise access Federal Reserve credit facilities.[101] Thus, if the Commissions were to deem stable value contracts to be a

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[99] CEA § 12(h) ("A swap – (1) shall not be considered to be insurance; and (2) may not be regulated as an insurance contract under the law of any State.").

[100] The list of entities to which the prohibition applies generally includes institutions insured by the Federal Deposit Insurance Corporation ("FDIC") and other entities that have access to Federal Reserve credit facilities. Because maintenance of FDIC insurance is a requirement for all national banks, all federal thrifts, all state Member banks, and all (if not virtually all) state non-Member banks and state thrifts, Section 716 effectively precludes a bank or thrift from being a "swap dealer" after the effective date of the swaps push-out rule. In a similar fashion, the push-out would apply to those branches of foreign banks operating in the U.S. that solicit retail deposits in the U.S. and therefore have obtained FDIC insurance: FDIC-insured branches of foreign banks are considered "insured depository institutions" under federal banking law. These FDIC-insured foreign branches would be required also to push out any dealing activity into an affiliate (or alternatively forego federal assistance, including FDIC insurance). The push-out would appear to apply as well to uninsured branches of foreign banks which, although not insured by the FDIC, have access to Federal Reserve credit facilities and the Federal Reserve discount window, both of which are "Federal assistance" prohibited to swap dealers.

[101] Section 716 creates a few express exemptions from the "push out requirement" for certain swaps issued by insured depository institutions, including swaps on interest rates, swaps on certain "bank-eligible" assets, and swaps

"swap" that is not permissible for a bank to deal in under Section 716(d), it is uncertain how such swaps would be treated under Section 716 and whether bank issuers of stable value contracts would effectively be prohibited from offering stable value contracts as part of the bank's regular course of business. Consequently, banks that currently issue stable value contracts may be required to "push" their activities with respect to stable value contracts that are "swaps" into "swap dealer" affiliates.

2. Insurer Issuers of Stable Value Contracts that are "Swaps" Could be Removed From Regulation by State Insurance Departments.

Deeming stable value contracts to be a "swap" also could effectively prohibit state insurance departments from continuing to regulate insurer issuance of stable value contracts because the Dodd-Frank Act provides that a swap "shall not be considered to be insurance" and "may not be regulated as an insurance contract under the law of any State."[102] Indeed, the Commissions have acknowledged this potential conflict in proposed rulemakings under the Dodd-Frank Act, stating that they "are aware of nothing in Title VII to suggest that Congress intended for insurance products to be regulated as swaps."[103]

Stable value contracts are often regulated as a form of annuity contract under state insurance laws. As such, the form of a stable value contract generally must be filed with and approved by a state insurance department before an associated stable value contract can be sold in the state. If stable value contracts are deemed to be "swaps," Section 722(b) of the Dodd-Frank Act may preempt state insurance law and prohibit such stable value contracts from being regulated as insurance products.[104] Deeming stable value contracts to be "swaps" may also create conflicts in state insurance statutes – *e.g.*, insurers would generally be authorized under state law to issue stable value contracts, but state insurance departments would lack the authority to regulate them as insurance products.[105] State legislatures would be forced to amend insurance statutes to eliminate the conflicts that would arise.[106]

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used for "hedging and other similar risk mitigating activities directly related to the insured depository institution's activities." *See* Dodd-Frank Act § 716(d).

[102] *See* Dodd-Frank § 722(b) (7 U.S.C. § 16(h)). The Dodd-Frank Act generally carves state-based regulation of insurance out from regulation by the Commissions. *See* Dodd-Frank § 1027(f) (regarding the authority of the Bureau of Consumer Financial Protection, which is prohibited from defining the "business of insurance").

[103] *See* 76 Fed. Reg. at 29821.

[104] Section 722(b) of the Dodd-Frank Act provides that "[a] swap... may not be regulated as an insurance contract under the law of any State."

[105] Under New York law, a "swap" is a permitted derivative instrument (New York Insurance Law Section 1401(a)(7)), but it can only be used in a hedging transaction (New York Insurance Law Section 1401(a)(12)), a replication transaction (New York Insurance Law Section 1401(a)(18)) or limited kinds of income generation transactions (see New York Insurance Law Sections 1410(c), 1410(l) and 1410(d)). However, stable value contracts are not currently subject to this restriction because, under New York insurance law, stable value contracts are not considered "swaps."

[106] This action may be necessary given the core functions of insurance regulators to supervise the solvency of insurance companies and determine the sufficiency of assets supporting insurance company contract obligations, which they would no longer be able to determine due to preemption of state insurance law.

C. Regulating Stable Value Contracts as "Swaps" Will Increase Costs and Negatively Impact Alternatives for Retirement and Similar Savings.

The combined cost of imposing on stable value contracts the regulatory regime applicable to "swaps," including capital, margin, reporting, and recordkeeping requirements, will reduce the availability of a low-risk savings option to individual plan participants saving for retirement and other long-term goals. Generally, regulatory costs would increase the operating expenses of stable value fund managers and issuers of stable value contracts. As discussed above,[107] stable value funds have a lower cost structure than all comparable investment vehicles. Because stable value funds operate within narrow profit margins, even a small change in a fund's cost structure can have a significant impact on a fund's overall performance and rate of return.[108] Any additional operational costs that are imposed on stable value fund managers as a result of regulating stable value contracts as "swaps" will be passed on to fund participants in the form of higher expenses and/or lower returns. As a result, stable value funds will likely become a less viable investment option to the detriment of plan participants. The Joint Associations do not believe that Congress intended such a result.

The impact of increased costs on individual retirement and other similar savings in stable value funds is particularly acute for stable value funds because they are a low-risk, low-cost investment vehicle that, by design, forgoes greater potential investment returns in favor of stable income and principal preservation. If stable value funds are available to fewer plan participants because of limited stable value contract supply or offer a lower rate of return because of new regulatory requirements, individuals will be forced to switch to other options that offer greater risk and/or lower returns. For plan participants with limited earning potential and no ability to responsibly assume more risk, including millions of retirees, these costs would result in irreversible losses that reduce their incomes and quality of life. Simply put, every dollar that is spent to comply with regulations that treat stable value contracts as swaps is a dollar that would otherwise have been earned as income by a retiree, a student saving for college, or another conservative, long-term plan participant. It is, therefore, essential that the Commissions be certain that the benefits of such regulations are worth the price.

VII. Conclusion

The Joint Associations do not believe that stable value contracts are swaps or that regulating them as such would have any significant benefits to the stability or integrity of the financial system. On the contrary, the Joint Associations have grave concerns that the costs associated with these new regulations could threaten the vitality and continued viability of an important, well-regulated, low-risk investment option upon which millions of defined contribution plan participants rely for a stable source of income. Accordingly, the Joint Associations urge the Commissions to carefully consider the potentially substantial costs of regulating stable value

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[107] *See supra* note 53 and accompanying text.

[108] The risk-reward premium rewards investors for investing in longer term (year or more) rather than short terns investments such as money market funds. The premium is typically 50 basis points +/- 10 basis points. *See supra* Section IV.A.

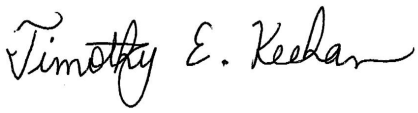
contracts as swaps before adopting regulations with arguably no corresponding benefits to the financial system or individual plan participants.[109]

We hope that this discussion provides the Commissions with a better understanding of the existing regulatory framework that governs the $540 billion in assets invested by 25 million plan participants in stable value funds.[110] The Joint Associations believe that the existing regulatory requirements applicable to stable value fund managers and banking institution and insurance company issuers of stable value contracts achieve the goals of the Dodd-Frank Act with respect to "swaps." We hope that the information we have provided in this letter serves as a useful supplement to discussions you have with the state and federal regulatory agencies during the course of your study of stable value contracts and the stable value industry.

We are available to answer any additional questions you may have at your convenience.

Sincerely,

Gina Mitchell
President
Stable Value Investment Association



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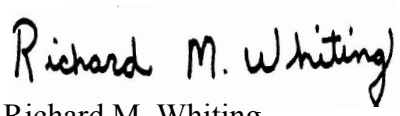

Richard M. Whiting
Executive Director and General Counsel
Financial Services Roundtable

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Mary L. Schapiro, Commissioner
Honorable Elisse B. Walter, Commissioner
Honorable Luis A. Aguilar, Commissioner
Honorable Troy A. Paredes, Commissioner

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[109] Collateral and margin requirements, particularly daily margining based on the relatively volatile value of stable value funds' underlying bond assets, would introduce unpredictability and risk to a conservative investment product that was specifically designed to minimize the impact of short-term market fluctuations.

[110] SVIA 15th Annual Stable Value Funds Investment and Policy Survey covering assets as of December 31, 2010.

EXHIBIT A

INDEX OF QUESTIONS AND RESPONSES

Question No.	Question	Page No.
	Market and Product Structure Issues	
8	What are the different types of SVCs, how are they structured, and what are their uses? Please describe in detail.	8
9	Please describe the operation of SVCs and SVFs generally in terms of contract structure, common contract features, investments, market structure, SVC providers, regulatory oversight, investor protection, benefits and drawbacks, risks inherent in SVCs, and any other information that commenters believe the Commissions should be aware of in connection with the SVC study.	9
10	What provisions of SVCs, if any, allow SVC providers to terminate SVCs that prevent benefit plan investors from transacting at book value? What are the trade-offs, including the costs and benefits of such provisions? Please describe in detail.	12
11	Describe the benefits and risks of SVCs for SVC providers. How do SVC providers mitigate those risks? Please provide detailed descriptions. How effective are any such measures?	18
12	Describe the benefits and risks of SVCs for investors in SVFs. Please provide detailed descriptions.	18
13	The Commissions' staffs understand that SVC providers sometimes negotiate so-called "immunization" provisions with SVF managers and that such provisions typically allow SVC providers (or SVF managers) to terminate the SVCs based upon negotiated triggers, which can include underperformance of the portfolio against a benchmark. The Commissions'' staffs also understand that, once immunization provisions have been triggered and are in effect, the SVF must be managed according to the immunization guidelines, which typically require the liquidation of all securities rated below AAA and in certain cases may require the portfolio to be invested 100% in Treasury securities. What risks, if any, do "immunization" provisions in SVCs pose to investors in SVFs? If immunization provisions in SVCs pose risks to investors in SVFs, are these risks clearly disclosed to investors? Are these risks required to be disclosed to the investors? What are the sources of such requirements? How do SVF managers or SVC providers address the risk that immunization will be exercised? How effective are any such measures?	10
14	The Commissions' staffs understand that some SVCs grant SVC providers the right to limit coverage of employer-driven events or employee benefit plan changes. Such events or changes could cause a decrease in a SVF's value and result in large scale investor withdrawals or redemptions (sometimes called a ''run on the fund''). How do SVC providers and SVF managers manage this risk, if at all? How effective are any such measures?	11

Question No.	Question	Page No.
15	The Commissions' staffs understand that SVF managers infuse capital into their funds in certain instances. Please describe the circumstances under which an SVF fund manager would provide such capital support for its fund.	15
16	The Commissions' staffs understand that ''pull to par'' provisions of SVCs provide that SVCs will not terminate (absent the application of another contract termination provision) until the gap between the market value of the wrapped assets and the SVC book value is closed, however long that takes. The Commissions' staffs also understand that pull to par provisions are standard for SVCs. Are these understandings correct? Please describe pull to par provisions and how prevalent such provisions are in SVCs.	10
17	How have SVFs and SVCs been affected by the recent financial crisis? How many SVC providers are in the market today? Is the number of SVC providers higher or lower than prior to the financial crisis that began in 2008? Are fees now higher or lower than prior to the financial crisis?	15
18	Do investors have incentives to make a run on a SVF when its market-to-book ratio is substantially below one? What protections, if any, do SVCs provide to protect fund investors who do not redeem their fund shares amid a run on the fund? How effective are any such protections?	20
19	How do market risk measures assess the risk of a run on a SVF? To the extent that SVC providers use value-at-risk (''VaR'') models, do such VaR models adequately assess the risk of loss resulting from such events or other possible but extremely unlikely events? Do other loss models more adequately assess the risk of loss, such as the expected value of a loss or the expected value given a loss, which employs the entire loss probability distribution without excluding events in the extreme tail of the loss distribution?	20
20	Are certain SVC providers more likely, as a result of credit cyclicality, to become financially distressed? If so, is such financial distress likely to occur concurrently with financial distress of SVFs? If so, can the risk of such concurrent financial distress be mitigated? How effective are any such measures?	21
21	Do SVC providers pose systemic risk concerns? Are there concerns with entities that may be systemically important institutions providing SVCs? What are the consequences for SVFs, employee benefit/retirement plans, and the financial system should an SVC provider fail?	21
22	Are there issues specific to financial institutions providing SVCs, including institutions that are systemically significant, that the Commissions should consider in connection with the SVC study? If so, please describe.	21
	Regulatory Issues	
23	What disclosures to benefit plan investors in SVFs currently are required, and what are the sources of such requirements? What additional disclosure typically is provided, either voluntarily or on request? What additional disclosure, if any, would be warranted and why would it be warranted? Please explain in detail.	29

Question No.	Question	Page No.
24	What financial and regulatory protections currently exist that are designed to ensure that SVC providers can meet their obligations to investors, and what are the sources of such protections? Does the level of protection vary depending on the SVC provider? How effective are any such measures?	22
25	Currently, do entities other than state-regulated insurance companies and federally- or state-regulated banks provide SVCs? If so, what kinds of entities do so and how are they regulated? If not, are there any barriers to the provision of SVCs by entities other than state-regulated insurance companies and federally- or state- regulated banks?	22
26	What role do SVF managers play in protecting the interests of plan participants with respect to SVFs? How effective are any such measures?	13
	Compliance Issues if the Commissions Were to Determine SVCs Were Swaps	
27	If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, should the regulatory regime for SVCs be limited or tailored in any way? If so, how? Please explain in detail. Should any of the requirements for capital and margin for SVCs differ from those for swaps that are not SVCs? Why or why not? If the requirements for capital and margin should differ, please explain in detail what those differences should be.	32
28	If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, would the requirements of any regulatory regime for swaps impact fee structures or fees charged by SVC providers? Please describe (quantitatively, if possible) the relationship of any new federal regulation under the Dodd-Frank Act to possible changes in fee structures or fees, to the extent feasible, and state any assumptions used in quantifying such relationship.	31
29	If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, would this decision influence the availability of SVFs to investors? Would this designation affect existing SVFs and the ability of SVFs to purchase SVCs? If so, how and why?	31

EXHIBIT B

NOVEMBER 10, 2010 LETTER TO STEPHEN KANE

SVIA

November 10, 2010

By Electronic Submission

Mr. Stephen Kane
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Stable Value Contracts

Dear Mr. Kane:

On behalf of the Stable Value Investment Association ("SVIA") and its members, we want to thank you for your continued efforts to understand stable value funds and the important role that stable value investment contracts have played in protecting the $561 billion invested by more than 25 million participants and their beneficiaries in the more than 173,000 defined contribution plans that offer stable value funds as an investment. On October 26, 2010, you relayed to us a request from Michael Kreps in Senator Tom Harkin's office to provide additional detail regarding the negative impact that collateral and margin requirements would have on stable value funds relative to other fixed income products.

Collateral and margin requirements would result in higher operating costs and potentially higher capital requirements to providers of stable value products. These added costs, which we believe unnecessarily duplicate costs already applied to these products, would diminish (or eliminate) the risk-reward premium available to investors in stable value funds. This premium is one of the primary benefits of stable value funds as compared to money market funds. Lowering this premium would threaten the long-term viability of this popular, low-risk investment vehicle. As discussed in greater detail below, this is one of many problems that may arise if stable value contracts are included within the definition of "swap" in Section 721 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). We do not believe that Congress intended this result.

SVIA does not believe that stable value contracts fall within the definition of a "swap." Even though "swap" is defined broadly in the Dodd-Frank Act, stable value contracts possess few, if any, of the characteristics commonly associated with these instruments. For example:

- Benefit Responsiveness. The stable value investment contract (or "wrap") ensures that all participants in a stable value fund may withdraw from the fund at contract value

contract value regardless of the market value of the fund's underlying assets. Significantly, because of the nature of the stable value product, all participant contract value transactions occur at contract value. Any difference between the market and contract value of the fund is a difference that can never be realized by the participant through the exercise of stable value investment contract.

- No Trading. Each stable value contract is tailored to meet the specific needs of the associated fund and its participants. Stable value contracts cannot be traded or even assigned. There is no market for stable value contracts, nor will such a market exist.

- No Leverage. Stable value funds are not leveraged. On the contrary, each stable value fund is well-collateralized and supported by a diverse portfolio of high quality bonds, typically rated on average AA or AAA, with an average maturity date of approximately 3 years. Any exposure to the issuers of stable value contracts is limited to the difference between the market value of the underlying portfolio and the contract value of the portfolio at a certain point in time – a difference that is generally less than 4% of the fund's overall value.[1] At the height of the financial crisis, the market to contract ratio for stable value funds averaged 95% (December 2008). As of September 2010, stable value funds' market to contract ratio averaged 104%.[2]

- No Clearing. Each stable value contract is the product of a lengthy underwriting process that includes a comprehensive review of the associated fund's investment strategy, relevant benchmarks (*e.g.*, bond indices, money market funds), and cash flow history. In addition, through the underwriting process, the stable value contract is designed and tailored to take into account the demographics of the particular benefit plan's participants, the other investment options offered by the plan, and the plan's management. As a result, stable value investment contracts are intrinsically non-standardized agreements that cannot be cleared by a clearinghouse.

Should the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission, (SEC) nevertheless, conclude that stable value contracts fit within the literal definition of swap, SVIA urges the Commission to support a preemptive exemption for stable value contracts from the swap definition. Such an exemption is consistent with Section 719(d)(1)(B) of the Dodd-Frank Act and Congress's intent to provide relief where, as here, the request is "appropriate and in the public interest."

Regulating stable value contracts as swaps is unnecessary and incompatible with the way in which stable value products have operated for more than 35 years. Stable value funds and investment contract issuers are already pervasively regulated by a combination of federal and state authorities, including the Office of the Comptroller of the Currency, the Department of Labor, the Securities and Exchange Commission, and state insurance departments. For example,

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[1] The difference between market value and contract value can be (and often is) positive, meaning that the market value of the fund actually exceeds its obligations to fund participants.

[2] The market to contract ratios referenced are from SVIA's Stable Value Funds Quarterly Characteristics Survey. The survey tracks 25 stable value managers who collectively manage $437 billion, which is a subset of the $621 billion under management by all SVIA members.

stable value investment contract issuers are already subject to capital requirements that are based on dynamic risk-based models. Stable value funds must also comply with various reporting obligations and submit to periodic independent reviews (typically quarterly or on a more frequent basis).

Subjecting stable value investment contracts to additional regulation by the CFTC would add significant cost and would not reduce systemic risk. Paradoxically, collateral and margin requirements, particularly daily margining based on the relatively volatile value of the funds' underlying bond assets, would introduce unpredictability and risk to a conservative investment product that was specifically designed to minimize the impact of short-term market fluctuations. The cost of collateral and margin requirements also would increase the operating costs of issuing stable value contracts and lower the return on stable value funds. In today's capital-scarce environment, requirements that increase operating costs such as margin and collateral may also drive some investment contract issuers out of the stable value market.

Stable value funds are an attractive investment alternative, not only because of the benefit responsiveness feature, but also due to the risk-reward premium they provide. The risk-reward premium rewards investors for investing in longer term (year or more) rather than short term investments such as money market funds. The premium is typically 50 basis points +/- 10 basis points. The crediting rate, which is set by formula in the contract, passes through the underlying gains and losses of the supporting portfolio of securities. Imposing margin and collateral requirements could significantly increase the costs borne by stable value funds. If stable value funds are unable to offer a significant premium over other conservative investment products, they will cease to be a viable and competitive investment option. No other investment alternative exists in defined contribution retirement plans that provide stable value's unique combination of benefits: principal preservation and a steady, positive return that consistently outperforms money market funds.

Treating stable value investment contracts as swaps also may create conflicts with other regulatory regimes. For example, stable value investment contracts are often regulated as a form of annuity contract under state insurance laws. As such, the form of a stable value investment contract generally must be filed with and approved by a state insurance department before an associated stable value investment contract can be sold in the state. Stable value investment contracts also are subject to state insurance laws regulating the reserves an insurer must maintain to support its obligations under a stable value contract.

If stable value contracts are regulated as swaps, Section 722(b) of the Dodd-Frank Act would preempt state insurance law and prohibit such investment contracts from being regulated as insurance products.[3] The result would potentially pose another paradox: insurance companies would be authorized under state law to *issue* stable value contracts, but state insurance departments would lack the authority to *regulate* stable value contracts as insurance products. In such a situation, state governments may be required to amend their insurance laws defining the

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[3] Section 722(b) of the Dodd-Frank Act provides that "[a] swap... may not be regulated as an insurance contract under the law of any State."

products that insurers may offer to exclude stable value investment contracts to eliminate this conflict.[4]

Existing restrictions on the use of derivatives by insurance companies also may limit the continued viability of stable value products. For example, under New York Insurance Law Section 1410, although a "swap" is a permitted derivative instrument, it can only be used in a limited few categories of transactions that do not include issuing stable value investment contracts.[5] As a result, any insurance company that issues stable value investment contracts would presumably violate New York law if it continues to do so. This is particularly significant because New York imposes its derivative regulation on not just insurers located in New York, but all insurers licensed to conduct insurance business in New York. Consequently, stable value providers would be forced from a safe and well-established line of business, and the personal investments of the more than 25 million 401(k) participants and beneficiaries who rely on stable value products would be seriously disrupted.

We hope that this answers the question posed by Senator Harkin's staff. SVIA is willing and able to continue to serve as a resource to you and your colleagues on this important issue. Please let us know if you have any further questions.

Best regards,

Gina Mitchell
President, Stable Value Investment Association

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[4] This action may be necessary given the core functions of insurance regulators to supervise the solvency of insurance companies and determine the sufficiency of assets supporting insurance company contract obligations, which they would no longer be able to determine due to preemption of state insurance law.

[5] Under New York law, a "swap" is a permitted derivative instrument (New York Insurance Law Section 1401(a)(7)), but it can only be used in a hedging transaction (New York Insurance Law Section 1401(a)(12)), a replication transaction (New York Insurance Law Section 1401(a)(18)) or limited kinds of income generation transactions (*see* New York Insurance Law Sections 1410(c), 1410(l) and 1410(d)).

EXHIBIT C

FEBRUARY 28, 2011 LETTER TO STEPHEN KANE

February 28, 2011

By Electronic Submission

Stephen Kane
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Stable Value Contracts

Dear Mr. Kane:

On behalf of the Stable Value Investment Association ("SVIA") and its members, we wish to recognize and express our appreciation for the working group's continued efforts to understand stable value funds and the important role that the $520 billion invested in these investment instruments play in over 173,000[1] defined contribution retirement savings plans. As a part of that process, we expect that the working group is evaluating the usefulness of superimposing the new swap regulatory structure over the existing framework within which the industry currently operates.

Section 719(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")[2] requires the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission (collectively "Commissions") to conduct a study, in consultation with the Department of Labor, the Department of the Treasury, and the State entities that regulate the stable value industry, to determine whether stable value contracts fall within the definition of "swap" in Title VII of Dodd-Frank. We submit this letter to facilitate the Commissions' ongoing study of stable value contracts[3] and, in particular, to provide the Commissions with more detailed information about the existing, robust regulatory framework within which stable value contracts have operated for many years.

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[1] SVIA 14th Annual Stable Value Funds' Investment and Policy Survey covering $520 billion in assets as of December 31, 2009.

[2] Pub. Law No. 111-203, 124 Stat. 1376 (2010).

[3] We are submitting this letter pursuant to the CFTC's general authority to accept comments regarding Dodd-Frank and the CFTC's rulemakings thereunder. *See* Acceptance of Public Submissions on the Wall Street Reform and Consumer Protection Act and the Rulemakings That Will Be Proposed by the Commission, 75 Fed. Reg. 52512 (Aug. 26, 2010).

For the reasons outlined below, the SVIA believes that the existing regulatory structure applicable to issuers of stable value contracts and the defined contribution retirement savings plans that offer stable value funds, achieves the goals Congress set out in Dodd-Frank – namely, to provide transparency, safeguards against systemic risks to the U.S. financial system, and more hands-on oversight of the swap markets. For reasons previously articulated, the SVIA does not believe that stable value contracts fall within the definition of "swap." However, even if they do, Section 719(d) of Dodd-Frank expressly authorizes the Commissions to exempt these contracts from the definition of "swap." Given the current regulatory structure applicable to the stable value industry, the SVIA believes that such an exemption would be in the public interest should the Commissions conclude that stable value contracts fall within the definition.

I. Stable Value Contracts are not "Swaps" Under Dodd-Frank

Stable value investment options are included in half of all 401(k) plans,[4] and represent approximately 15% of 401(k) plan assets.[5] We believe that their continued use in defined contribution plans is largely attributable to plan participants' desire to avoid loss and minimize risk. The desire to minimize risk and potential loss stems from a number of factors, including the aging of our population; increased volatility of equity assets combined with lower equity return expectations; the market correction of 2008 that produced significant declines in equity assets in most defined contribution plans; a long standing concern with the volatility of bonds and associated loss of principal; and a decline in interest rates, which make money market funds less appealing.

Stable value funds are, by their nature, fixed income investments in which participants receive interest income comparable to that earned on an intermediate-term investment grade bond fund, but without the associated volatility. To reduce the volatility associated with the underlying investments, stable value funds enter into different types of stable value contracts offered by banks and/or insurance companies as described below:

(1) *Guaranteed Investment Contracts ("GICs")*. These contracts are purchased from insurance companies. Pursuant to these contracts, the seller guarantees the purchaser a stated rate of interest (which may be adjusted) and return of principal;

(2) *Synthetic GICs*. These contracts are portfolios of diversified, high-quality (usually rated AA or better) intermediate-term fixed income securities combined with benefit-responsive contracts (each, a "stable value contract") purchased from a bank or insurance company. Pursuant to these contracts, the bank or insurer agrees to maintain the principal value and accumulated interest for benefit-responsive withdrawals;

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[4] "401(k) Plan Asset, Allocation Account, Balance and Loan Activity in 2008," Investment Company Institute Research Perspective, October 2009, Vol. 15, No. 3.

[5] *Id.*

(3) *Insurance Company Segregated Account Stable Value Investments ("Separate Account GICs")*. Under a Separate Account GIC, the segregated account of an insurance company supports the insurance company's obligation to pay principal to plan participants and to pay interest in an amount determined by a formula to plan participants;[6] and

(4) *Insurance Company General Account Portfolio Rate Products ("Insurance Company General Accounts")*. Under these arrangements, the general account of an insurance company supports the insurance company's obligations to pay principal and interest to plan participants.

Currently, stable value funds hold 8 percent of assets in GICs, 27 percent in insurance company Synthetic GICs, 23 percent in bank Synthetic GICs, 6 percent in Separate Account GICs, 30 percent in Insurance Company General Accounts, and 6 percent in cash.[7] For purposes of this discussion, we focus primarily on Synthetic GICs because the study team has asked for more information on this particular stable value product. The term "stable value contracts" is used to encompass Synthetic GICs.

While stable value contracts and derivative instruments generally involve the transfer of certain financial risks between parties to a transaction, important characteristics of stable value contracts demonstrate that they are more appropriately regulated as investment contracts and contractual assurances than over-the-counter derivatives or "swaps" under Title VII of Dodd-Frank:

- *Stable Value Contracts Protect Investors from Losses*. Investors in a stable value fund can make benefit-responsive withdrawals regardless of declines in the market value of the fund's underlying assets. In fact, applicable accounting rules, which permit stable value funds to value fund assets at "contract value," which is principal plus accumulated interest, regardless of fluctuations in the value of the fund's investments, *require* the fund to obtain a stable value contract providing this investor protection.[8] As a result, any difference between the market and contract value of the fund is a difference that cannot be realized by the participant through the exercise of the stable value contract. This is a fundamental difference between a stable value contract and a derivative or swap.[9]

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[6] This type of investment may alternatively be supported by an insurance company's general account, and the term Separate Account GIC is intended to include this type of investment regardless of the account supporting the obligation.

[7] SVIA 14th Annual Stable Value Funds Investment and Policy Survey covering assets as of December 31, 2009, and SVIA's Issuers' Survey, February 14, 2011.

[8] *See* FASB Staff Position Nos. AAG INV-1 and SOP 94-4-1.

[9] The imposition of initial and variation margin with respect to stable value contracts, as is required of "swaps" under Dodd-Frank, would be inconsistent with the existing regulatory framework applicable to stable value funds. Stable value funds do not report assets at fair value, but rather at contract value, pursuant to FASB rules. *See* FASB

- *There is No Market and No Trading in Stable Value Contracts*. Each stable value contract is tailored to meet the specific needs of the associated plan and its investors. Because these contracts are individually tailored to the unique requirements of a specific defined contribution retirement savings plan, stable value contracts cannot be traded or assigned. There is no market for stable value contracts, nor could such a market exist. One of the primary goals of Dodd-Frank was to strengthen the integrity of the market for "swaps" by moving swap transactions onto exchanges and imposing certain public reporting requirements on participants to certain "swap" transactions.[10] However, to the extent that stable value contracts are not traded (publicly or privately), this goal would not be achieved. Further, stable value funds are already subject to comprehensive reporting requirements as part of the regulatory obligations imposed by the Employee Retirement Income Security Act of 1974 ("ERISA")[11] on plan sponsors who offer stable value funds and stable value fund investment managers.

- *Stable Value Contracts Cannot Be Cleared*. Each stable value contract is the product of a lengthy analysis that includes a comprehensive review of the associated fund's investment strategy, relevant benchmarks (*e.g.*, bond indices, money market funds), and cash flow history. In addition, through this analysis, the stable value contract is designed to take into account the demographics of the particular benefit plan's participants, the other investment options offered by the plan, the plan's management and the characteristics of the plan sponsor. As a result, stable value contracts are intrinsically non-standardized agreements that cannot be cleared by a clearinghouse and, therefore, likely would not be subject to mandatory clearing even if they were deemed to be "swaps" under Title VII of Dodd-Frank. Accordingly, the Congressional mandate to reduce default risk among counterparties in the swaps market by requiring central clearing of

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Staff Position Nos. AAG INV-1 and SOP 94-4-1. Indeed, the ability to report assets at contract value rather than market value is a fundamental advantage that stable value funds have relative to bond funds as a retirement savings plan investment alternative.

[10] All "swaps," including those that are exempt from mandatory clearing, are subject to reporting requirements. With respect to swaps that are cleared, regulatory reporting and public dissemination of swap information is handled by the relevant clearinghouse and/or trade execution facility. Swaps that are not accepted for clearing at a clearinghouse must be reported to a "registered swap data repository" or a "registered securities-based swap data repository" (together, "swap data repositories") or, if no swap data repository will accept the report, directly to the relevant Commission. *See* Dodd-Frank §§ 727-29.

[11] Employee Retirement Income Security Act of 1974 (ERISA), Pub.L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 5 U.S.C., 18 U.S.C., 26 U.S.C , 29 U.S.C., and 42 U.S.C.). Public plans also use stable value funds and these plans are subject to similar ERISA standards that are mandated by the states.

certain standardized swaps cannot be applied regardless of whether stable value contracts are regulated as swaps.[12]

- *Stable Value Contracts Do Not Provide a Leveraged Investment*. Stable value contracts are not utilized by stable value funds as a means of obtaining a leveraged investment. Moreover, stable value funds themselves are generally non-leveraged investment vehicles. Each stable value fund is well-collateralized and supported by a diverse portfolio of high-quality bonds, typically rated AA or better, with an average maturity date of approximately three years.[13] Exposure to the issuers of stable value contracts is limited to participant withdrawals of the difference between the market value of the underlying portfolio and the contract value of the portfolio at a certain point in time – a difference that is generally less than four percent of the fund's overall value. *This exposure is generally much less than four percent, because all participants must exit simultaneously for the exposure to be realized. While not impossible, the risk of this happening is remote.* In December 2008, at the height of the financial crisis, the market to contract ratio for stable value funds averaged 95%. As of December 30, 2010, stable value funds' market-to-contract ratio averaged 103%.[14] To the extent that Congress intended through Dodd-Frank to reduce the unregulated use of leverage by financial market participants, the SVIA submits that stable value contracts are not a source or a contributing factor to this concern.

II. Existing Regulatory Requirements Applicable To Issuers of Stable Value Contracts Makes Regulation of Such Contracts as "Swaps" Unnecessary

The requirements of Dodd-Frank applicable to "swaps" generally were a response to the financial crisis of 2008 and, in particular, the perception that the lack of regulation in the over-the-counter derivatives markets with respect to capital requirements, transaction reporting, and default risk posed unacceptable levels of systemic risk to the U.S. financial system. The Dodd-Frank regime for regulation of "swaps" attempts to ameliorate these perceived shortcomings by: (i) imposing certain capital and margin requirements with respect to swaps and certain swap entities; (ii) requiring enhanced reporting of certain transactions in swaps to the Commissions and to other financial market participants (such as clearinghouses, exchanges, and swap data repositories); and (iii) requiring standardized "swaps" to be executed on a registered exchange and centrally cleared.

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[12] "Swaps" are subject to mandatory clearing only if a derivatives clearing organization or clearing agency has been approved to clear the swap, and the relevant Commission has determined, after at least a 30-day notice and comment period, that the relevant "swap, or group, category, type or class of swaps" described in the submission is required to be cleared. *See* Dodd-Frank § 723.

[13] SVIA's Stable Value Funds' Quarterly Characteristics Survey as of December 31, 2010.

[14] *Id.*

However, the goals of Dodd-Frank, as applied to the stable value industry, are already achieved by regulatory requirements imposed by state and federal regulatory authorities responsible for supervising issuers of stable value contracts. Indeed, the banking institutions and insurers who issue stable value contracts are subject to significant and continuous oversight that exceed Dodd-Frank's stated goals.

A. Regulatory Requirements Applicable to Banking Institution Issuers of Stable Value Contracts

Banking institutions that issue stable value contracts are already subject to significant regulatory requirements that are consistent with the fundamental objectives of Dodd-Frank, including substantial risk-based and leverage capital requirements under Basel I, Basel II and Basel III. Banking institutions are regulated and supervised by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively "Federal Banking Agencies"). This oversight is comprehensive and pervasive. For example, in many instances, examiners of the Federal Banking Agencies generally remain on-site at large banking institutions to facilitate ongoing supervision of the activities of the bank.

Although the Federal Banking Agencies may impose regulatory obligations on issuers of stable value contracts and their products that differ from what would be required under the Commissions' regulations, the purpose and effect of these regulations are wholly consistent with the basic goals of Dodd-Frank. As with comparable requirements that will be established by the Commissions to impose minimum capital and margin requirements or mandatory clearing for swaps, the regulations applicable to banking institutions that issue stable value contracts reduce the risk inherently associated with banking activities by ensuring that regulated entities have adequate capital and liquidity to meet their obligations, even during extreme periods of market stress. Likewise, the disclosure and reporting requirements that apply to banking institutions that issue stable value contracts, although different from the swap reporting provisions proposed by the Commissions, are meant to advance the same goals of transparency and promote market integrity as contemplated in Dodd-Frank. Additional regulatory requirements, therefore, would be unnecessary, costly, and potentially incompatible with the current regulatory regime.

Banking institutions are required to hold capital against their obligations under stable value contracts in accordance with risk-based capital guidelines. These guidelines are a largely uniform set of risk-based capital standards applicable to all national banks, bank holding companies, and state FDIC-member banks.[15] The guidelines generally require banks to risk-weight assets to account for credit, market, and operational risks.[16] Banks calculate their risk-based capital ratio by risk-weighting assets and off balance sheet items to account for the particular risks associated with each asset and off balance sheet item.[17] Stable value contracts

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[15] *See* 12 C.F.R. Part 225, Appendix A; 12 C.F.R. Part 208, Appendix A; 12 C.F.R. Part 3, Appendix A; 12 C.F.R. Part 325, Appendix A; Risk-Based Capital Guidelines, 54 Fed. Reg. 4186 (Jan. 18, 1989).

[16] Basel I does not require risk-weighted assets for operational risk unlike Basel II and Basel III.

[17] 12 C.F.R. Part 225, App. A, III(A).

issued by banks must be risk-weighted under the same guidelines. Accordingly, banks subject to these guidelines must hold capital against the market risk under Basel I and the market, credit and operational risks under Basel II and Basel III associated with the stable value contracts they have issued. The Basel II and Basel III framework are expected to result in higher capital requirements for all banks, including banks that issue stable value contracts.

The Basel I guidelines, which are currently in force in the United States, require banks to calculate risk-based capital under the market risk measure to ensure that banks hold sufficient capital to provide a cushion against changes in the market value of "trading book" exposures.[18] Under the market risk measure, a stable value contract issued by a bank would be treated as a "trading book" activity of the bank for regulatory capital purposes, and the bank would thus be required to calculate a market risk capital charge with respect to each stable value contract.[19] The capital charge that a bank takes under the market risk measure generally includes a credit risk measure, if applicable.[20]

The Federal Banking Agencies are currently transitioning to the Basel II framework for large, internationally-active banks. Basel II is comprised of three Pillars that address minimum capital requirements, the supervisory review process and enhancement of disclosure on a bank's risk process and risk profile. Under Pillar I, risk-weighted assets are estimated (i) using internal quantitative models for market and operational risk, and (ii) inputting parameter estimates into regulatory formulas for credit risk. Pillar II requires the development of an internal capital adequacy assessment process (ICAAP), where each institution determines the amount of capital needed to support their specific risk profile. ICAAP is intended to capture the credit, market and operational risks of Pillar I, in addition to any other material risks faced by that institution. Pillar III increases transparency through enhanced disclosure requirements, enabling the market to make a more informed assessment of an institution's creditworthiness. Examiners from the Federal Banking Agencies must approve a bank's internal models, and parameter estimates, stress testing approaches, assumptions and processes under Pillars I and II.[21]

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[18] 12 C.F.R. Part 225, Appendix E; Risk-Based Capital Standards: Market Risk, 61 Fed. Reg. 47358 (Sept. 6, 1996).

[19] Banking institutions generally must categorize assets and liabilities as being held in either the "banking book" or the "trading book" when filing their quarterly and annual Reports of Condition and Income. "Banking book" assets are those the bank intends to hold for an extended period of time, and which the bank may value at cost, while "trading book" assets generally are those that the bank must mark-to market with any change in value recorded through its profit and loss statement; "trading assets" are intended to be held for a short time-period (*i.e.*, it must apply "fair value" accounting.) *See generally* Consolidated Reports of Condition and Income, FFIEC 031 (March 2011) at A-78a, *available at* http://www.fdic.gov/regulations/resources/call/crinst/callinst2011_mar.html. Note the distinction between (a) the obligation of the bank to assess its exposures under a stable value contract at fair value and (b) the obligation of the stable value fund to value its assets at cost pursuant to FASB rules, as discussed above.

[20] Note that a bank need only calculate capital adequacy under the market risk measure if its worldwide trading activity is at least $1 billion or 10% of total assets. Otherwise, the credit risk measure alone applies. 12 C.F.R. Part 225, App. E, § 1(b); Risk-Based Capital Standards: Market Risk, 61 Fed. Reg. at 47362.

[21] Note that the implementation period for Basel II has been delayed due to ongoing discussions at the Basel Committee on Banking Supervision regarding Basel III.

Basel II, and specifically Pillar II, and Basel III have resulted in the development of a stress testing framework for large, complex financial institutions, both domestically and internationally. In the U.S. the Federal Reserve is making regular use of stress testing in the assessment of capital adequacy and more recently, the ability of banks to increase their dividend payouts. Large, complex banks, which are the ones offering stable value wrap products, are the main focus of these tests. The potential effects on the value of the stable value wrap product under extreme economic conditions can have a material impact on the capital adequacy of the offering institution. This is another example of the increased capital impact that the implementation of Basel II and Basel III will have on this product.

Maintenance of the relevant capital ratios is a continuous, ongoing requirement.[22] Banking institutions with capital ratios that do not meet the minimum requirements must submit plans to their regulator describing the manner in which they plan to remedy the capital shortfall.[23] A bank's Examiner-in-Charge ("EIC") must examine the bank at least once during each 12-month period.[24] The EIC, in its discretion may, and for large complex institutions almost certainly does, examine a bank more frequently, and such an examination may be tailored to any one or more of the bank's business lines and products.[25]

In addition, FASB rules require banking institutions to account for stable value contracts at "fair value."[26] The determination of fair value requires the banking institution to make certain assumptions regarding redemption levels that the underlying funds may experience. Redemption levels depend on the performance of the manager of the stable value fund, the fund's investment strategy, investor demographics, and other general market factors. Banking institutions must report their stable value contract exposures in the footnotes to the banking institution's consolidated financial statements.

B. Regulatory Requirements Applicable to Insurance Company Issuers of Synthetic GICs[27]

Insurers, which have been involved in the stable value fund market for approximately twenty years, are regulated by state insurance commissions in each state in which the insurer is

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[22] 12 C.F.R. § 3.6 (national banks).

[23] 12 C.F.R. § 3.7 (national banks).

[24] *See* 12 C.F.R. § 4.6 (national banks); *see generally* Comptroller's Handbook: Bank Supervision Process (Sept. 2007), *available at* http://www.occ.gov/handbook/banksup.pdf.

[25] *See id.* at 8.

[26] *See* FASB Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosures (formerly FAS No. 157).

[27] Please note that the term Synthetic GIC will now be used to describe stable value contracts since it is the term that state departments of insurance and the NAIC use in their respective regulations.

licensed.[28] State insurance commissions generally implement regulatory requirements recommended by the National Association of Insurance Commissioners ("NAIC"). As with regulated banking institutions, insurance companies that provide stable value products are already subject to a combination of regulatory requirements that are in accord with the goals of Dodd-Frank. For example, insurers that issue stable value contracts are subject to substantial capital and surplus requirements to guarantee their ability to safely absorb losses while continuing to perform. Insurers that issue stable value contracts also are subject to comprehensive disclosure and reporting requirements that are intended to improve industry oversight and transparency. As explained below, additional regulation of insurance companies that issue stable value contracts under Dodd-Frank would be unnecessary and would not advance the goals of the statute further.

Stable value contracts issued by insurers are generally referred to as Synthetic GICs. The NAIC Synthetic GIC Model Regulation ("NAIC Model") imposes specific disclosure obligations, in addition to reserve requirements, with respect to Synthetic GICs.[29] Because Synthetic GICs are generally considered to be a type of annuity product under the insurance laws of most states, many state insurance commissions require that the Synthetic GIC contract forms be filed with the state insurance commission prior to the issuance of a Synthetic GIC.[30] The filing allows the commissions to evaluate whether the contract terms of a Synthetic GIC comply with the insurance regulatory requirements and whether the issuing insurer maintains the capital level and status qualification requirements applicable to insurance company issuers of Synthetic GICs.

Insurers that have issued Synthetic GICs are required to disclose specific reserves relating to their exposures under Synthetic GICs on their statutorily required financial statements.[31] Insurers are required to maintain reserves in support of issued Synthetic GICs in an amount estimated in the aggregate to provide for payment of all potential losses and claims.[32] The insurer must retain actuaries to calculate required reserves in accordance with applicable

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[28] Note that there are generally two types of insurance companies: life insurers and property and casualty insurers. Because the authorization to issue Synthetic GICs under state law is generally limited to life insurers, references herein to "insurers" are to life insurers only.

[29] The reserve requirements of the NAIC Model have been widely adopted by the state insurance commissions, either directly through implementation of the NAIC Model itself or through the adoption of the NAIC's Accounting Practices & Procedures Manual, Appendix A-695. Appendix A-695 includes the reserve requirement in the NAIC Model. The NAIC Model provides additional information that the Commissions may find useful. Accordingly, the NAIC Model is available through the state insurance commissions.

[30] *See, e.g.,* N.Y. Ins. Law § 3201(b)(1).

[31] In New York, the obligation to comply with reserve and risk-based capital requirements is determined as of the time the insurance company files statutory financial statements. N.Y. INS. LAW § 307. *See generally* Harry P. Kamen & William J. Toppeta, The Life Insurance Law Of New York, 33-36 (1991).

[32] N.Y. Ins. Law § 1303. *See* Kamen & Toppeta, *supra* note 31, at 34.

regulatory requirements. These actuaries are subject to an independent set of professional actuarial standards.[33]

State insurance commissions have adopted different rules as to the reserves required for Synthetic GICs. These reserves must be reported (often quarterly) to the state insurance commission and, for entities required to file periodic reports pursuant to the Securities Exchange Act of 1934, to the Securities and Exchange Commission. An insurer subject to the risk-based reserving requirements set forth in the NAIC Model is required to maintain specific reserves relating to its actuarially determined economic exposure associated with issued and outstanding Synthetic GICs. These reserves represent an estimate of the insurer's expected liabilities relating to each Synthetic GIC, taking into account both the nature of the specific liabilities associated with the Synthetic GIC and the underlying investment account to which the Synthetic GIC relates. Some state insurance departments, such as California's and Nebraska's, mandate premium-based reserving requirements, which require insurers to identify specific reserves relating to risk premiums[34] collected by the insurer in connection with Synthetic GICs. Such premium-based reserve requirements generally equal the sum of the insurer's gross unearned risk premiums on its Synthetic GIC business plus at least 30% of any annual excess of the risk premium over claims, subject to a maximum required reserve of 150% of the current annualized risk premium the insurer collects under issued Synthetic GICs.

In addition to the specific reserves that must be maintained with respect to the issuance of Synthetic GICs, life insurers are required to hold levels of capital to support all aspects of their operations, including those relating to the issuance of Synthetic GICs. Pursuant to the NAIC's risk-based capital system, insurance regulators calculate an insurer's target capital, based on a comprehensive formula that includes specific capital charges relating to the insurer's assets, underwriting activities, the mismatch between such assets and liabilities (including interest rate exposures) and operational risk.[35] This target capital is then compared to the insurer's actual total adjusted capital to arrive at a risk-based capital ratio ("RBC Ratio") that the insurance commission uses to assess the relative financial strength of the insurer. The RBC Ratio is the basic metric underlying the NAIC's Risk-Based Capital Model Act, a version of which has been adopted in every state.[36]

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[33] Similar to banking institutions, insurers are subject to ongoing examination by insurance regulators; in New York State, the New York State Insurance Department must examine life insurers at least once every five years. N.Y. Ins. Law § 309.

[34] The "risk premium" under a Synthetic GIC is the fee that an insurer charges the plan for the guarantee provided under the Synthetic GIC.

[35] NAIC's model risk-based capital measurements take account of "asset market and credit risks (often referred to as C-1 risk), underwriting and pricing risks (C-2 risk), the risk of that the return from assets are not aligned with the requirements of the company's liabilities (C-3 risk) and general business risk (C-4 risk)." *See* Risk-Based Capital, at 3, *available at* http://rmtf.soa.org/riskbased_capital.pdf.

[36] Note that Standard and Poor's has published a capital framework for life insurers that issue Synthetic GICs, which effectively imposes additional capital requirements on insurers in the ratings process from the agency.

III. Conclusion

The SVIA is a non-profit organization dedicated to educating public policymakers and the public about the importance of saving for retirement and the contribution stable value funds can make toward achieving a financially secure retirement. We hope that this discussion provides the Commissions with a better understanding of the existing regulatory framework that governs the $520 billion in assets invested by 25 million plan participants in stable value funds. The SVIA believes that the existing regulatory requirements applicable to banking institution and insurance company issuers of stable value contracts achieve the goals of Dodd-Frank with respect to "swaps." We further hope that the information we have provided in this letter serves as a useful supplement to discussions you have with the state and federal regulatory agencies during the course of your study of stable value contracts and the stable value industry.

We are available to answer any additional questions you may have at your convenience.

Sincerely,

Gina Mitchell
President
Stable Value Investment Association