



**Americans for Financial Reform**  
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September 26, 2011

Via Email

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

David A. Stawick, Secretary,  
Commodity Futures Trading Commission  
Three Lafayette Centre,  
1155 21st Street NW.  
Washington, DC 20581.

Re: *Stable Value Contract Study*, File No. S7-32-11

Dear Ms. Murphy,

American for Financial Reform (“AFR”) appreciates this opportunity to comment on Release No. 34-65153 (the “Release”) regarding the Study of Stable Value

Contracts (the “Study”) mandated by section 719(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“the DFA”). AFR is a coalition of more than 250 American organizations who have come together to advocate for reform of financial sector regulation. Members of the AFR include consumer, civil rights, investor, retiree, labor, religious and business groups along with prominent economists and other experts.

The Release asks commenters to state whether stable value contracts would fall within the definition of “swap” in the Dodd-Frank. AFR believes that a stable value contract clearly meets the definition of a ‘swap’, according to both Section 1a paragraph 47A(iii) of the Commodity Exchange Act (as added by Section 721 of the DFA) and Section 3a paragraph 68 A(ii) of the Securities and Exchange Act (as added by Section 761 of the DFA). Stable Value Contracts are clearly transactions based on the occurrence of events relating to a narrow set of securities (those insured under the contract), without any transfer of securities ownership necessarily taking place. Equally clearly, they exchange financial risk and payments between parties based on the valuation of financial assets without exchanging the underlying assets themselves.

The Release also asks whether stable value contracts might fall within the definition of insurance (and thus the insurance exception) set out within the Product Definitions Proposing Release. While many Stable Value Contracts may fall within this definition, current law does not require that they fall within the definition. For example, it is AFR's understanding that stable value wraps may be provided by financial institutions that are not regulated insurance companies, and need not be regulated as an insurance product. In addition, some of the particular contract characteristics suggested within the Product Definitions Proposing Release (such as the inability to accelerate principal payments) may be common in stable value contracts but are not necessarily required. Thus, should the Commissions wish to use the exceptions already proposed for insurance or financial guarantee products, they should at the very least issue additional regulations to ensure that stable value contracts must meet every element required under these definitions, rather than issue a general exception for stable value contracts as they currently exist.

Even if Stable Value Contracts do meet the definition of swaps, the DFA gives the Commissions the ability to exempt such contracts from the swaps definition based on a public interest justification. AFR believes that any such exemption must also preserve the public interest in effective swaps regulation to ensure financial stability, market transparency, and fairness to investors. If regulated relatively loosely, the similarity of stable value contracts to other instruments such as Credit Default Swaps may allow these contracts to become a device for evasion of swaps rules and for the undermining of the DFA's public interest goals in swaps regulation.

Beyond this general concern, AFR particularly concerned about two issues related to stable value contracts:

- 1) The possibility that uncollateralized stable value contracts may destabilize the financial system, much as uncollateralized credit default swaps did during the 2008 crisis. The Commissions should ensure issuers of stable value guarantees have the resource to back up these guarantees.
- 2) The complexity of stable value contracts raises many of the same issues that led to the inclusion of business conduct standards for swaps dealers in the DFA. The Commissions should extend similar business conduct standards to issuers of stable value guarantees.

On the issue of the lack of collateral, in the past many issuers of stable value contracts (or guaranteed investment contracts, wraps, or other guarantees utilized by stable value funds) appear to have in effect been selling their credit rating, without the assurance of sufficient financial resources backing the contracts. The most prominent example here was AIG, which sold numerous guaranteed investment contracts that it was not able to pay off after its bankruptcy. In the taxpayer bailout of AIG financial products, at least \$9.5 billion in public

money was spent paying off these investment contracts.<sup>1</sup> The fact that a taxpayer bailout has already been required for this type of contract should leave no doubt of their significant to the financial system, and that there is a public interest in ensuring collateral backing for stable value contracts.

In addition to the AIG case, guaranteed investment contracts not backed by sufficient financial resources were also tied to the failure of the monoline insurers, which was highly disruptive to the municipal securities market.<sup>2</sup> Both the AIG and monoline insurer cases demonstrate the inadequacy of relying on private credit rating agencies alone to ensure the stability of issuers of financial guarantees such as those involved in stable value contracts. High institutional credit ratings are supposed to ensure that the issuer of a guarantee has the stability and resources to execute on that guarantee, but the experience of the financial crisis (and previous cases, such as Enron) demonstrate conclusively that they cannot be relied on to perform this function. The failings and conflicts of interest of the rating agencies have been amply documented elsewhere, including by the Financial Crisis Inquiry Commission, so we will not discuss them further in this letter.<sup>3</sup> But the conclusion here must be that it is critical to actively regulate issuers of financial guarantees to ensure that they have all the resources necessary to deliver on the guarantees they provide.

As a second point, stable value contracts share with over-the-counter swaps contracts the characteristics of complexity and lack of price transparency. This means that issuers of such contracts have many opportunities to overcharge their customers, to use private information to effectively trade against their customers, or otherwise to engage in exploitative behavior. These are the same issues which led Congress to include business conduct requirements for swaps dealers in the DFA. The fact that a dozen banks and investment firms were or are being investigated for criminal charges associated with bid-rigging for guaranteed investment contracts shows the ability of issuers to exploit their customers in this kind of opaque market.<sup>4</sup> This issue is especially important as regards unsophisticated customers or customers who are managing money for the public or pension investors, such as municipalities or pension funds.

Even if the Commissions feel it is inadvisable to bring all the benefits of exchange trading to the market in stable value contracts, or to define issuers of stable value guarantees as swaps dealers, it is therefore still critical that business conduct standards comparable to those proposed by the CFTC for swaps dealers be extended to issuers of stable value contracts. As these business

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<sup>1</sup> For total payments on AIG guaranteed investment contracts from September 16<sup>th</sup> through December 31<sup>st</sup> of 2008, see Attachment C of American International Group, "[AIG Discloses Counterparties to CDS, GIAs, and Securities Lending Transactions: List of Counterparties](#)", March, 2009.

<sup>2</sup> Scholtes, Saskia, "[Fresh Worry Over Bond Insurers](#)", Financial Times, July 1, 2008

<sup>3</sup> See e.g. John C. Coffee, Jr., "Ratings Reform: the Good, the Bad and the Ugly," Harvard Business Law Review, Vol. 1, pp. 231-278, at 255 (2011); Report of the U.S. Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse."

<sup>4</sup> Bray, Chad, "[Over a Dozen Firms Snared in Probe of Muni Market](#)", Wall Street Journal, March 27 2010.

conduct standards are specifically designed to avoid triggering an ERISA fiduciary duty, issues around incompatibility of the business model with the specific ERISA duty should not restrain the Commissions here.

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We appreciate the opportunity to share our views with the Commission on these important issues. If you have any questions, or need additional information, please do not hesitate to contact Marcus Stanley, AFR's Policy Director, at [marcus@ourfinancialsecurity.org](mailto:marcus@ourfinancialsecurity.org) or (202) 466-3672.

Sincerely,

Americans for Financial Reform

## **Following are the partners of Americans for Financial Reform.**

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

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

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

- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

### *List of State and Local Signers*

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR

- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY



- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

### *Small Businesses*

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



