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VIA ELECTRONIC SUBMISSION (rule-comments@sec.gov; http://comments.cftc.gov)

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

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1151 21st Street, N.W.
Washington, DC 20581

RE: File Number S7-16-11 – Product Definitions
(Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act)

Dear Ms. Murphy and Mr. Stawick:

The American Insurance Association ("AIA") appreciates the opportunity to submit comments in response to the proposed rules and proposed interpretive guidance included in Release 33-9204/34-64372, entitled "Further Definition of Swap, Security-Based Swap, and Security-Based Swap Agreement; Mixed Swaps; Security-Based Swap Agreement Recordkeeping," as published in the Federal Register on May 23, 2011, and issued jointly by the Securities and Exchange Commission and the Commodity Futures Trading Commission (collectively, the "Commissions").[1] AIA represents approximately 300 major insurance companies that provide all lines of property-casualty insurance and write more than $117 billion annually in premiums. The comments in this letter focus on the proposed requirements for determining if an agreement, contract or transaction is an "insurance product," which, according to the proposed rule, would not fall within the "swap" and "security-based swap" definitions.

We appreciate that the proposed rule and guidance acknowledges that insurance products should not be included in those two definitions. The background section of the rule release states that:

> *The Commissions are aware of nothing in Title VII to suggest that Congress intended for insurance products to be regulated as swaps or security-based swaps. Moreover, that swaps and insurance products are subject to different regulatory regimes is reflected in section 722(b) of the Dodd-Frank Act which, in new section 12(h) of the [Commodity Exchange Act], provides that a swap*

[1] 76 *Fed. Reg.* 29818 - 29900 (May 23, 2011).

> *"shall not be considered to be insurance" and "may not be regulated as an insurance contract under the law of any State*."[2]

The proposed rule and interpretive guidance reflects this understanding by establishing criteria for determining whether an agreement, contract or transaction constitutes an "insurance product," the consequence of which is exclusion from the definition of swaps and security-based swaps. AIA agrees that under the Dodd-Frank Act, insurance products are *not* to be treated as swaps or security-based swaps. Nevertheless, AIA believes that the proposed rule and interpretive guidance must be strengthened to better reflect Congress' clear intent that the existing regulatory system should continue to apply to insurance products, in order to avoid conflicts between the existing state-based insurance regulatory structure and the Commissions' new authority over non-insurance derivative products. As explained in more detail below, we urge the Commissions to state unequivocally in the rule and the interpretive guidance that, where an agreement, contract or transaction is reportable as insurance in the provider's regulatory and financial reports under a state's (or a foreign jurisdiction's) insurance laws, then that agreement, contract or transaction constitutes an insurance product rather than a swap or a security-based swap.

Discussion

A. *Summary of Insurance Products Criteria in the Proposed Rule and Interpretive Guidance*

In order to exclude an insurance product from the definitions of a swap and securities-based swap, the proposed rule and interpretive guidance sets forth an elaborate two-prong analysis for determining if a particular agreement, contract or transaction constitutes "insurance." The first prong requires certain elements to be present in the agreement, contract or transaction:

- the beneficiary must have an ''insurable interest'' underlying the agreement, contract or transaction at every point in time during the term of the agreement, contract, or transaction;

- there must be a requirement that an actual loss occur and be proved to ensure that the beneficiary has a stake in the insurable interest;

- the insurance product is not to be traded separately from the insured interest on an organized market or over-the-counter; and

- for financial guarantee policies, the beneficiary must not be permitted to accelerate the payment of any principal due on the debt securities, in order to further distinguish financial guarantee policies from credit default swaps.[3]

The second prong relates to *the provider* of the agreement, contract or transaction:

- the provider must be organized as an insurance company whose primary and predominant business is the writing of insurance or the reinsuring of risks underwritten by companies whose insurance business is subject to supervision by the insurance commissioner (or similar official or agency) of any state or by the United States or an agency or instrumentality thereof; and

[2] *Id*. at 29821.
[3] *Id*. at 29822, 29888 (17 CFR § 1.3(xxx)(4)(i)), 29898 (17 CFR §240.3a69-1(a))

- the agreement, contract, or transaction is regulated as insurance under the laws of such state or of the United States.[4]

Under the proposed rule, the agreement, contract or transaction must meet the criteria of *both* prongs in order to constitute an insurance product that is excluded from the swap/security-based swap definitions.

The proposed interpretive guidance also provides a separate safe harbor exception from the swap/security-based swap definitions, regardless of the determination under the two-prong analysis. Certain enumerated types of insurance products would be excepted from the swap/security-based swap definitions, as long as the provider requirements of the proposed rule are met and the products are regulated as insurance. The enumerated types of insurance consist of surety bonds; life insurance; health insurance; long-term care insurance; title insurance; property and casualty insurance; and annuity products, the income on which is subject to tax treatment under section 72 of the Internal Revenue Code.[5] This catch-all approach is intended to "appropriately place traditional insurance products outside the scope of the swap and security-based swap definitions."[6]

B. Concerns with Proposed Rules

1. Deference to Existing Insurance Regulatory Framework

By creating the two-prong regulatory hurdle, AIA is concerned that the proposed rule, as currently structured, would effectively prevent property-casualty insurers from offering insurance products developed to meet customers' evolving risk needs, and would preclude existing state insurance authorities from regulating those insurance products. Congress recognized through the McCarran-Ferguson Act that primary regulatory responsibility over the business of insurance rests with the states.[7] Nothing in the Dodd-Frank Act suggests that the Commissions may limit the states' authority to regulate insurance companies and their products, or that the Commissions are empowered to curtail the development of insurance products that address consumers' evolving risks. Under the Dodd-Frank Act, the states continue to have primary regulatory authority over insurance companies and the business of insurance, including the products offered by those companies. The proposed rules should show deference to that statutory scheme.[8]

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[4] *Id*. at 29822, 29888 (17 CFR § 1.3(xxx)(4)(ii)), 29898 (17 CFR §240.3a69-1(b)).

[5] *See, e.g.,* 76 *Fed. Reg.* at 29824, 29871.

[6] *Id.* at 29824.

[7] 15 U.S.C. § 1012 *et seq.*

[8] For example, surety and fidelity bonds are clearly defined as insurance in the definitions of lines of business contained in the appendix to the NAIC Property and Casualty Annual Statement Instructions and such products would meet the outlined criteria in the proposed rule, but they use different terminology than other insurance products. As detailed in our recommendations, we suggest that products be included in the insurance exclusion so long as they are characterized and subject to regulation as insurance under state law. Further, to the extent that the Commissions interpret the definition of swaps to exclude enumerated types of insurance, surety and fidelity bonds should continue to be part of that enumeration.

2. Inappropriate Criteria

The criteria underlying the proposed rule's two-prong analysis are unnecessarily complex, overlapping, and restrictive, and they incorrectly assume that all insurance products operate in the same manner. Inspection of a specific agreement, contract or transaction for specific elements would be inappropriate for determining whether an enterprise is engaged in the business of insurance, since not all existing insurance contracts will have the elements that the proposed rule would require. Further, the bright-line test in the proposed rule could be used in the future to preclude established insurers from developing necessary insurance products to address new and evolving risks.

The Commissions have also indicated that they are considering adding another element to the proposed rule to the effect that a product only qualifies as an insurance contract where the "agreement, contract, or transaction [is] not… based on the price, rate, or level of a financial instrument, asset, or interest or any commodity."[9] Such an additional criterion is unnecessary, and would exacerbate the concerns with the proposed bright-line definitional test.

3. Foreign Regulated Insurers

The proposed rule also does not address or acknowledge insurance products that are offered by insurers that are regulated outside the United States. The buying and selling of insurance products is a global business, given the multi-jurisdictional scope of many commercial enterprises. U.S. insurance regulators cooperate and coordinate with their foreign counterparts with respect to the treatment of insurance products and companies wherever they conduct business. We can appreciate the jurisdictional limits of the Commissions' authority, but it is unclear from the proposed rules if the Commissions intend to treat cross-border insurance transactions as potential swaps in order to interject themselves into these international transactions. Doing so runs the risk of disrupting the global insurance market. The proposed rule should clarify how the definitions for swaps and security-based swaps would be applied to cross-border insurance transactions since the foreign insurer may not be subject to regulation by a state or the United States.

4. Enumerated Excepted Lines of Insurance

The Commissions have signaled a willingness to issue guidance, apart from the exception in the proposed rule, that certain listed traditional lines of insurance (including property-casualty insurance) should be exempted from the swap/security-based swap definitions. We agree with the Commissions' view on this matter, but are concerned any failure to grant those insurance products similar regulatory status to products covered by the proposed rule's exception may lead to confusion about the precise parameters of the swap definitions.

C. Recommendations.

Given the deference to state regulation that currently exists in the United States with respect to insurance and that is reconfirmed in the Dodd-Frank Act, the proposed rule's focus on proving that an insurance product is entitled to exclusion from the swap/security-based swap definitions is inconsistent with that statutory deference. Our principal recommendation is that the Commissions amend the rule so that an agreement, contract or transaction reportable as insurance in the regulatory and financial

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[9] 76 *Fed. Reg.* at 29825.

reports that the provider files under state (or foreign jurisdiction) insurance laws is conclusively excluded from the swap/security-based swap definitions.

In situations involving new risk-bearing products, where it is inconclusive as to whether the provider is a regulated insurer (whether U.S. or non-U.S.) or whether the transaction is reportable as insurance in the provider's regulatory and financial filings under current insurance laws, AIA recommends that the Commissions utilize the first prong in the proposed rule, the product criteria, to assist in determining if the agreement, contract or transaction under review should be regulated as insurance. We would not suggest adding the proposed requirement that the contract not be based on price, rate or level of a financial instrument, asset, or interest or any commodity. We would recommend instead that the Commissions consider whether the agreement, contract, or transaction transfers risk. To the extent the Commissions' review indicates that the criteria have been met, we would expect the Commissions to refer the product (and provider) to the applicable insurance regulator for appropriate regulatory action, such as licensing or enforcement. We believe this approach respects the primary authority of insurance regulators and avoids conflict in jurisdiction between the Commissions and the state insurance regulatory authorities. We therefore suggest that the first prong of criteria should be redrafted as indicators for evaluating new risk-bearing products that may or may not constitute insurance, rather than as requirements for evaluating existing insurance products and services.

Turning to the Commissions' proposed scope of the term "provider," for foreign insurance enterprises that are not regulated by a state or the United States, but offer insurance products to U.S. policyholders, we recommend that the Commissions clarify how the swap/security-based swap definitions would apply to those insurers and their products. The current proposed rule is insufficient for making such a determination, and we believe it may be harmful to the global insurance market to assume these products are swaps/security-based swaps based on the proposed rules.

As we have noted, if the product is regulated as insurance in the United States, that product is being offered by a regulated entity so the "provider" inquiry becomes unnecessary. Further, it should not matter whether the insurance product is offered by a U.S. or foreign insurer, and the Commissions should treat both types of insurers in a similar manner.

Perhaps more importantly, the Commissions' definition of "provider" conflicts with the Nonadmitted and Reinsurance Reform Act ("NRRA") set forth in Part I of Subtitle B of Title V of the Dodd-Frank Act. The NRRA, which was intended in part to modernize and bring aspects of uniformity to the surplus lines insurance market, expressly allows non-U.S. insurers listed by the National Association of Insurance Commissioners' ("NAIC") International Insurers Department ("IID") to write surplus lines insurance in all U.S. jurisdictions.[10]

Further, the provider definition is narrowly limited in at least two other ways. First, the definition only includes those entities that are "organized as an insurance company." While this phrase is not entirely clear, it potentially reinforces the exclusion of non-U.S. providers of insurance, as well as those entities such as syndicates that are not strictly "organized" as an insurance company. Second, the definition does allow a foreign provider component, but only with respect to reinsurance. Taken to its logical conclusion under this definition, the identical insurance policy could be considered either a "swap" or an "insurance contract" depending on whether the policy is offered by a U.S. insurer or a foreign insurer.

[10] Dodd-Frank Act § 524 (2) (15 U.S.C. § 8204(2)).

For these reasons, AIA recommends that the Commissions, at minimum, amend the provider prong of the insurance exception to include foreign insurers, no matter how they are structured. Indeed, if the Commissions conclude that a product is subject to regulation as insurance in the United States, the provider inquiry may very well be unnecessary.

Finally, with respect to the Commissions' planned interpretive guidance excluding certain enumerated categories of insurance from the "swap" definition without regard to the two-prong test, we respectfully suggest, consistent with our primary recommendation, that the guidance be expanded to include all transactions currently reportable as insurance in the provider's regulatory and financial reports under a state's or a foreign jurisdiction's insurance laws, and be folded into the final rule in order to avoid any ambiguity and so that the guidance can be considered in context with the definitional test in the rule.

The purpose of Title VII of Dodd-Frank is not to interfere with areas where products are already regulated, but to cover those financial products that are not regulated. Our proposed recommendations are intended to effectuate that purpose. We look forward to continuing to engage with the Commissions on this important topic, and appreciate the efforts to address our principal concerns.

Respectfully submitted,

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