Please note that the comments expressed herein are solely my personal views

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- 17 CFR Part 240
- File No. S7-16-11
- Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping

Dear Sir.

Thank you for giving us the opportunity to comment on your joint proposed rules and proposed interpretations: Further Definition of "Swap", "Security-Based Swap", and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping.

In accordance with section 712(a)(8), section 712(d)(1), sections 712(d)(2)(B) and (C), sections 721(b) and (c), and section 761(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), the CFTC and the SEC, in consultation with the Board of Governors of the Federal Reserve System (board), are jointly issuing proposed rules and proposed interpretive guidance under the Commodity Exchange Act (CEA) and the Securities Exchange Act of 1934 (Exchange Act) to further define the terms "swap", "security-based swap", and "security-based swap agreement", regarding "mixed swaps", and governing books and records with respect to "security-based swap agreements".

Insurance products

I totally agree that insurance products should not be regulated as swaps or security-based swaps. An appropriate definition of insurance contract is: a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured

event) adversely affects the policyholder. Insurance risk is defined as: risk, other than financial risk, transferred from the holder of a contract to the issuer; and insured event as: an uncertain future event that is covered by an insurance contract and creates insurance risk.[1] The key distinguishing feature from swaps is the inclusion of insurance risk rather than financial risk, and the requirement for a specified uncertain future event to adversely affect the policyholder.

In the commentary you refer to traded insurance contracts: "With limited exceptions, insurance products traditionally have been neither entered into on or subject to the rules of an organized exchange nor traded in secondary market transactions". I would caution that trading of insurance policies is expected to increase in the future. For example the UK has experienced rapid growth in volumes of new traded endowment policies (TEPs) from around $ 40 m in 1990 to $1.8 bn in 2008. I would therefore argue in response to your question 6 that the proposed requirement that the agreement, contract, or transaction is not traded, separately from the insured interest, on an organized market or over-the-counter, is not an effective criterion in determining whether a product is insurance.

In answer to you specific question, in order for an agreement, contract or transaction to be considered insurance pursuant to paragraph (i) of proposed rule 1.3(xxx)(4) under the CEA and paragraph (a) of proposed rule 3a69–1 under the Exchange Act, the CFTC and the SEC should require that payment not be based on the price, rate, or level of a financial instrument, asset, or interest or any commodity (the agreement, contract or transaction should include insurance risk, not just financial risk: see above). Furthermore, variable annuity contracts (VAs) and variable universal life insurance (UL) should be excepted from this requirement. The key point here is that VAs and UL are investments, usually in mutual funds, with some level of minimal life insurance cover or investment guarantee rider on top, which provides the element of insurance risk. Swaps and security-based swaps tend to have a high level of gearing, with volatile returns arising from relatively small investments, and in no way do they resemble such insurance contracts.

Mixed swaps

I generally support your proposals here. In principle I would support the disaggregation of mixed swaps into swap and security-based swap instruments (unbundling), and the separate instruments would then be regulated by the CFTC and SEC respectively. However, such disaggregation becomes very complicated and even arbitrary for complex, non-linear, highly interactive or non-standard mixed swaps. Therefore in response to your question 123 I would argue that the economic goals of mixed swaps cannot reasonably be accomplished using a combination of separate Title VII instruments, none of which would need to constitute a mixed swap.

[1] This is the International Accounting Standards Board definition proposed under Exposure Draft ED/2010/8: Insurance Contracts, July 2010, and the accompanying Basis for Conclusions. See also my comment letter thereon.

Anti-evasion

I agree with the reasoning that: “In light of the myriad methods of potential evasion, any attempt to comprehensively determine what constitutes evasion, or to provide a bright-line test of evasion by rule, would likely not be effective as would-be evaders could simply restructure their transactions or entities to fall outside any rigid boundary”. I therefore support the principles-based approach to anti-evasion that has been proposed here under §1.6. In response to the specific question 143, the CFTC’s proposed rules and interpretive guidance set forth are sufficient to address the evasion concerns in Title VII. In response to the specific question 144, I therefore see no need to further define of the term “swap” etc in order to address transactions that have been structured to evade subtitle A of Title VII. In response to your specific questions 146 and 147 I would recommend that you should adopt rules and interpretive guidance modeled on the CFTC’s proposals.

Yours faithfully

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