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Re: **File No. S7-16-11: Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (Securities and Exchange Commission Release Nos. 33-9204; 34-64372)**

Dear Commissioners:

We are submitting this letter on behalf of the Committee of Annuity Insurers in response to the Securities and Exchange Commission's (the "SEC") and the Commodity Futures Trading Commission's (the "CFTC," and together with the SEC, the "Commissions") request for comments on joint proposed rules and proposed interpretations (the "Proposals") regarding certain definitions of terms contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or "Act"), specifically the fundamental and linchpin term "swap" and the potentially adverse effect the Proposals could have on state-regulated insurance products. The member companies of the Committee of Annuity Insurers have a critical and abiding interest in ensuring that the term "swap" in Title VII of the Dodd-Frank Act is interpreted, applied and further defined in the manner intended by Congress with respect to the business of insurance – that is, that the term "swap" does not improperly and unintentionally encompass the annuities and other guaranteed retirement income products which Committee members issue to broad classes of American workers, savers, investors, retirement plan participants, and other policyholders.

The Committee of Annuity Insurers (the "Committee," or "we")) was formed in 1982 to address Federal legislative and regulatory issues relevant to the annuity industry and to participate in the development of federal securities, banking, and tax policies regarding annuities. For nearly three decades, the Committee has played a prominent role in shaping the Federal Government's policies with respect to annuities. The Committee is a coalition of 32 of the largest and most prominent issuers of annuity contracts. The member companies of the Committee represent over 80% of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.

The Committee is therefore submitting this letter in order to assist the Commissions in interpreting and further defining the term "swap" in furtherance of the goals and policies of Title VII of the Dodd-Frank Act in the manner intended by Congress. The Committee agrees with and supports the Commissions' stated belief that "it is important to clarify the treatment under the definitions of certain types of agreements, contracts, and transactions, such as insurance products"[1] but believes that certain modifications and additional clarifications are necessary to effectuate Congressional intent regarding regulation of annuities and other insurance products.

We appreciate the very hard work reflected in the Proposing Release. The Committee is grateful for the Commissions' recognition of the need to specifically address insurance products and for their efforts to do so appropriately in the context of Title VII of the Dodd-Frank Act.

I. Background and Overview

The Dodd-Frank Act includes within clause (A)(ii) of the new swap definition, any contract that "provides for any purchase, sale, payment, or delivery ... that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence."[2] Notwithstanding the broad scope of this definition of "swap" in the Dodd-Frank Act, both during and following the Dodd-Frank Act legislative process, the insurance industry has taken considerable comfort in the fact that, while the Act gave the CFTC and the SEC rulemaking authority to interpret terms used in the Act, there was absolutely no indication that Congress intended the definition of swap to broadly include state-regulated insurance, annuity, and other guaranteed retirement income products.

In August 2010 the Commissions issued an Advance Notice of Proposed Rulemaking (RIN 3235-AK65; SEC Release No. 34-62717) (the "ANPR") requesting comments on certain definitions contained in Title VII of the Act. In response, several commentators filed letters noting the possibility that the definition of swap could be construed to capture conventional insurance products. Certain commentators (including the Committee) requested that the CFTC and SEC confirm and clarify that Title VII of the Dodd-Frank Act was not intended to (and indeed does not) remove insurance products from state insurance regulation and replace that existing regulatory structure with new federal regulation of insurance products as swaps. (Under section 722(b) of the Dodd-Frank Act, products that are swaps may not be regulated by the states as insurance).

[1] Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Release No. 33-9204, 34-64372, 76 Fed. Reg. 29818, 29821 (May 23, 2011) (the "Proposing Release").

[2] Dodd-Frank Act Section 721(a)(21), amending the Commodity Exchange Act (the "CEA") by adding paragraph 47 to Section 1a of the CEA. This definition of swap in new section 1a(47) of the CEA is cross-referenced in new §3(a)(69) of the Securities Exchange Act of 1934 (the "Exchange Act"), as added by Dodd-Frank section 761(a)(5). The definition of swap also determines the scope of agreements, contracts and transactions that could be "security-based swaps."

Several comment letters submitted in response to the ANPR remain particularly relevant to the issues addressed in this letter. First, the American Council of Life Insurers ("ACLI") submitted a letter that articulates the fundamental premise that the definition of swap set forth in Title VII of Dodd-Frank was never intended to encompass state-regulated insurance and annuity products, and proposed a test setting forth general criteria for identifying insurance products excluded from the definitions of "swap" and "security-based swap" while providing the Commissions with a mechanism for identifying instruments that should be treated as such.[3] Second, on behalf of the Committee, the undersigned submitted a letter dated December 3, 2010, that strongly supported the ACLI letter and that presented additional information about why Congress could never have intended for the definition of swaps to encompass annuity contracts and other state-regulated guaranteed retirement income products.[4] Third, a comment letter submitted by a representative of major U.S. and non-U.S. banks proposed a very narrow "definition" of insurance that would (improperly) result in many conventional insurance products being removed from state insurance regulation and instead being subject to regulation as swaps[5] (contrary to the intent and purposes of Title VII). Fourth, a comment letter submitted by the National Association of Insurance Commissioners proposed a broad exclusion for "insurance products regulated by the states" from the definition of swap and security-based swap.[6]

On April 29, 2011, the Commissions issued and requested comment upon the joint proposed rules and proposed interpretations (the "Proposals").[7] The Proposals address the proper exclusion of insurance products from the definition of "swap" in two separate ways. First, proposed rules would provide that the term *swap* (as used in section 1a(47) of the CEA and section 3(a)(69) of the Exchange Act) does not include an agreement, contract or transaction that meets certain specified criteria. Second, the Proposing Release includes "interpretive guidance" stating very briefly that certain enumerated types of insurance products are outside the scope of the statutory definitions of swap and security-based swap.

The Proposing Release recognizes that swaps and insurance products are subject to fundamentally different and inconsistent regulatory regimes, and that nothing in Title VII suggests that state-regulated insurance products should instead be regulated as swaps; the Committee agrees

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[3] Letter of American Council of Life Insurers, dated November 12, 2010, available at http://www.sec.gov/comments/s7-16-10/s71610-122.pdf.

[4] Letter of Sutherland Asbill & Brennan LLP, on behalf of the Committee of Annuity Insurers dated December 3, 2010 (attached hereto as Appendix B and incorporated herein by reference).

[5] Letter of Cleary Gottlieb Steen & Hamilton, dated September 21, 2010, at http://sec.gov/comments/s7-16-10/s71610-63pdf. The Cleary Gottlieb letter concluded that insurance contracts could fall within the definition of the term "swap."

[6] Letter of the National Association of Insurance Commissioners, dated September 20, 2010, available at http://www.sec.gov/comments/s7-16-10/s71610-43.pdf.

[7] Proposing Release, *supra* note 1.

entirely with these basic concepts. The actual Proposals themselves, however, are not consistent with these basic concepts, since the Proposals, in effect, seem to be based on the assumption that insurance products are swaps unless they fit within the exclusions in the Proposals. That is clearly not what Congress intended. For the reasons stated in the Committee's prior letter (see Appendix B) and the ACLI's letter (see footnote 3), state-regulated insurance products should not be deemed to be swaps unless they are specifically included.

The Committee realizes that a principal concern addressed by Title VII of the Dodd-Frank Act is the largely unregulated market for credit default swaps. We understand that the proposed rules may have been designed with that concern in mind, and the proposed rules may address that concern. However, outside of that particular arena, and especially with regard to annuity products, both the proposed rules and the proposed interpretive guidance have very serious flaws in that both aspects of the Proposals are simply too narrow and would not properly recognize that there are other types of insurance products that, while they may not meet the specific conditions of either the proposed rules or interpretive guidance, nevertheless very clearly are insurance products that are not swaps and are not intended to be and should not be removed from insurance regulation and instead regulated as swaps.

The Committee continues to believe that the approach and test previously recommended by the ACLI, and supported by the Committee in its letter of December 3, 2010, is a fundamentally sound method for determining those insurance products that are not swaps and that should remain subject to state insurance regulation, and is far more appropriate than the Commissions' Proposals. In this regard, we note that the Proposing Release does not discuss that approach or give any reasons why it would not accomplish the purposes of Title VII consistent with Congressional intent. We believe that that approach warrants serious re-consideration, for the reasons stated in the Committee's prior letter. Nevertheless, as discussed in more detail below, the Committee has also examined and considered other possible solutions.

The Committee believes that there is an alternative approach to the Commissions' proposals that more clearly and completely effectuates the intent of Congress and of Title VII of the Dodd-Frank Act. The Committee recommends that, instead of attempting to craft a wholly new "definition" of an insurance product (which, given the breadth of the insurance industry and the wide array of protection and savings products they offer for all sorts of situations and risks, is a daunting if not impossible task), the Commissions should instead rely on existing definitions and boundaries that are already in relevant federal statutes. Specifically, section 3(a)(8) of the Securities Act of 1933 already contains a provision that distinguishes between "insurance" and "securities" and that recognizes, through its long interpretative history, those products which are in the proper and exclusive purview of state insurance regulators. That provision can and should serve very well to also distinguish, for federal law purposes, between insurance and swaps. And Title VII of the Dodd-Frank Act already provides that securities (other than security-based swaps) are not swaps (and, of course, the federal securities laws already define securities).[8] Together, these well-established

[8] See footnote 52 and accompanying text, *infra*.

federal statutory provisions provide a sound basis for identifying insurance products that are distinguishable from, and should not be regulated as, swaps.

The Committee's specific proposals are set forth in Part III below. These proposals include (but are not limited to) expanding the proposed rules to include an alternative exclusion based on section 3(a)(8) of the Securities Act of 1933; modifying and expanding the interpretive guidance; and providing that both the new rules and the interpretive guidance are "safe harbors" that do not define the entire universe of state regulated insurance products that are not swaps.

II. The Proposals Are Not Sufficient or Effective

A. The Proposals

As noted above, with regard to clarifying the distinction between insurance products (to which Title VII of Dodd-Frank clearly does not apply, and leaves subject to state insurance regulation) and swaps (including security-based swaps),[9] the Proposals are, in effect, in two separate parts: (1) proposed rules, and (2) interpretive guidance.

1. *The Proposed Rules*

The proposed rules (rule 1.3(xxx)(4) under the CEA and rule 3a69-1 under the Exchange Act) each consist of two paragraphs. The first paragraph of each proposed rule (paragraph (i) under the CEA rule and paragraph (a) under the Exchange Act rule) is in essence a "product" test, and the second paragraph of each rule (paragraphs (ii) and (b), respectively) is a "provider" (or "issuer") test.

a. **The Product Test.** Unfortunately, the product test is unnecessarily and improperly narrow, since (as discussed below) it would exclude many conventional annuities and guaranteed retirement products (and life insurance products) that should not be treated as swaps. The product test has four criteria (and certain of those four criteria actually have more than one component). First, the beneficiary must have an insurable interest underlying the product, *and* that insurable interest must exist at all times throughout the term. Second, the product must require that a loss occur (and be proved), *and* that any payment (*i.e.,* the insurance amount or benefit) be limited to the value of the insurable interest. Third, the product must not be traded (separately from the insured interest) on an organized market or over-the-counter. The fourth criterion only applies to financial guaranty insurance.

[9] Since the term "swap" determines the scope of "security-based swaps" (*i.e.*, security-based swaps are a subset of swaps), for convenience the term "swap" as used in this letter is also intended to encompass security-based swaps, unless the context otherwise requires. Insurance products are neither swaps nor security-based swaps; any insurance product that is excluded from the meaning of swap is also excluded from security-based swap.

b. **The Provider Test.** The Proposing Release describes the provider test as a single requirement, simply requiring that the product "be provided by a state or Federally regulated insurance company."[10] However, a close reading of the second paragraph of the Proposed Rules reveals that the primary provider test (subparagraph (ii)(A) of proposed rule 1.3(xxx)(4) and subparagraph (b)(1) of proposed rule 3a69-1) also has four separate criteria, specifically: (1) the provider must be "organized as an insurance company;" (2) its "primary and predominant business activity" must be the writing of insurance (or reinsurance); (3) the company must be "subject to supervision by the insurance commissioner" (or similar official); and (4) "such agreement, contract, or transaction" must be "regulated as insurance" under applicable state (or U.S.) laws.[11] (This fourth criterion of the "provider" test is really a hidden or embedded "product" test criterion.)

The proposed rules each include two other, alternative provider tests, one for the U.S. and its agencies and instrumentalities, and one for reinsurance companies located outside the United States (subparagraphs (ii)(B) and (C) of the CEA rule, and (b)(2) and (3) of the Exchange Act rule).

2. *The Interpretive Guidance*

The interpretive guidance consists of one paragraph in the Proposing Release, and is based on the Commissions' recognition "that certain enumerated types of insurance products are outside the scope of the statutory definitions of swap and security-based swap."[12] Like the proposed rules, the interpretive guidance has both a product test and a provider test.

a. **The Product Test.** The product test in the interpretive guidance consists of the <u>enumeration</u> of the following products: "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." The Proposing Release does not provide any further explanation as to why only these products and not others are enumerated, nor does the release explain why only certain annuities (those subject to certain tax treatment) are enumerated, and not other annuities (those subject to different tax treatment).

b. **The Provider Test.** The interpretive guidance states that the enumerated products, in order to be outside the *statutory* definition of swap, would also need to meet the provider test in the proposed *rules* (summarized above).

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[10] Proposing Release, *supra* note 1, at 29824.

[11] The Proposing Release does not discuss the provider test in terms of its four separate criteria, and hence does not explain the rationale or reasoning for each of these four criteria.

[12] Proposing Release, *supra* note 1, at 29824. Of course, the Committee certainly agrees that insurance products are simply outside the intended scope of the statutory definition of swap (see the prior Committee and ACLI letters) ***regardless*** of any action by the Commissions. And while the Committee agrees that the enumerated products are outside the scope of "swaps," as explained below the Committee also believes that the enumerated list of products is too narrow and incomplete.

B. The Proposals Start From the Wrong Presumption and May Not Be Consistent With the Policies of the McCarran-Ferguson Act

The Proposing Release indicates that the Commissions interpret Title VII (correctly, in our view) as *not* applying to insurance products, and therefore as *not* removing insurance products from regulation by state insurance commissioners and replacing that state insurance regulation with federal regulation as swaps. Specifically, the Proposing Release states that "The Commissions do not interpret [CEA section 1a(47)(A)(ii)] to mean that products historically treated as insurance products should be included within the swap or security-based swap definition."[13] That release goes on to state that "[t]he Commissions are aware of nothing in Title VII to suggest that Congress intended for insurance products to be regulated as swaps," and that other provisions of Dodd-Frank reflect that swaps and insurance products are subject to different regulatory regimes. Clearly, Congress intended for these different regulatory regimes to continue.

However, the Proposals, perhaps unintentionally, seem to raise instead a presumption that insurance products are swaps (to be removed from state insurance regulation and subjected to CFTC and/or SEC regulation) ***unless*** they meet the criteria of the proposed rules or interpretive guidance. The Proposing Release states that "[i]n order for an agreement, contract or transaction to qualify as an insurance product" (and not be a swap), it must meet both the product test and the provider test.[14] This is clearly contrary to how Congress intended insurance products to be treated (as discussed in the prior letters of the Committee and the ACLI) and contrary to the Commissions' own statements (quoted above) regarding the intent of Title VII. The operative presumption should be that insurance products are not swaps.[15]

This does not mean, however, that anything labeled "insurance" automatically should be immune from Title VII or that non-insurance companies should be able to purposely position insurance products so as to avoid appropriate regulation. The Committee's proposal, discussed below, recognizes and reflects these principals.

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[13] *Id.* at 29821.

[14] *Id.* at 29822 (text at footnote 31). Similarly, the Release states that the proposing rules and interpretive guidance "would *clarify*" (emphasis added) that insurance products "meeting certain requirements" would be considered insurance and not swaps (*Id.*, text following footnote 28), clearly implying that insurance products that do not meet those requirements are swaps and not "insurance" products. On the other hand, footnotes 28 and 31 of the Proposing Release do acknowledge that certain insurance products are not swaps regardless of the proposed rules.

[15] One way to correctly reflect this Congressional intent would be to treat the rules and interpretive guidance as "safe harbors" for qualifying insurance products, instead of treating them as somehow defining the "outer limits" of insurance products (as the Proposing Release seems to treat them). While a safe harbor approach would certainly improve the Proposals, it would not solve certain significant problems; other changes need to be made to the Proposals. See the discussion of the Committee's recommendations, below.

In addition, the Proposing Release does not seem to acknowledge or recognize the limits reflected in the McCarran-Ferguson Act, which states (in pertinent part) that:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance ... unless such Act specifically relates to the business of insurance.

15 U.S.C. § 1012(b) (emphasis added).

The term "swap" must also be construed in light of the proscription in section 722(b) of the Dodd-Frank Act, which 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."[16] Therefore, a contract or agreement can be either a swap or insurance, but it cannot be (and cannot be regulated as) both a swap and insurance. Construing the term "swap" to include an insurance contract, then, has the very serious effect of removing that product from state insurance regulation–which clearly impairs or supersedes the applicable State law regulating that product as the business of insurance.[17]

To the extent that the proposed rules and interpretive guidance would have the effect of treating insurance products (subject to regulation under state laws as insurance) as swaps, and hence superseding state insurance regulation of such products, such an interpretation of the term swap would not be consistent with the policy underlying the McCarran-Ferguson Act, (as well as the intent of Congress reflected in the Dodd-Frank Act). That policy reflected in the McCarran-Ferguson Act is, simply stated, that the regulation of insurance is to be left to the states (absent a Federal act that specifically relates to insurance). Therefore, the presumption clearly should be that state-regulated insurance products are not swaps. The Committee's original proposal and its alternative proposal, discussed below, are both designed to be consistent with the McCarran-Ferguson Act.

The Committee respectfully submits that this presumption -- that insurance products issued by insurance companies subject to state insurance regulation are not swaps -- will not impose any undue burdens on the Commissions or their staffs. Paragraph (6) of the CFTC's proposed rule 1.3(xxx) is an anti-evasion provision which will operate irrespective of the presumption, providing that an agreement, contract or transaction that is willfully structured to evade Subtitle A of Title VII

[16] Section 722(b) adds these provisions as new section 12(h) of the CEA. Similarly, section 767 of the Dodd-Frank Act amends section 28(a) of the Exchange Act to provide, in relevant part: "A security-based swap may not be regulated as an insurance contract under any provision of State law."

[17] There are, of course, a number of sections of the Dodd-Frank Act that do specifically relate to insurance (indeed, Title V of the Act is "Insurance"). Footnote 26 of the Proposing Release notes various provisions of the Dodd-Frank Act that do address insurance, but the definition of swap is not one of them. The Dodd-Frank "Act" consists of sixteen separate titles (each of which is referred to as an "Act") spanning over 2,400 pages. However, the Commodity Exchange Act is itself an "Act of Congress," and the definition of "swap" in new section 1a(47) of the CEA does not specifically relate to insurance.

shall be deemed a swap. New and innovative products will have to be addressed and analyzed regardless of any presumption, and in that regard there will of course be appropriate judicial deference to the agencies' interpretations of the federal statutes that they are charged with implementing and enforcing. In addition, the consequences to a state-regulated insurance company of selling products that they treat as insurance but that afterwards are determined to be swaps are extremely dire (they would find themselves in material violation of both state insurance regulation and Title VII), so insurers generally will be extremely cautious and careful about products whose status may be uncertain.

C. The Insurance Status of Annuities Should Not Depend On Tax Treatment Under Section 72 of the Internal Revenue Code

Under the proposed interpretive guidance noted above, annuity products would be recognized as insurance, rather than treated as swaps, only if they are subject to taxation under section 72 of the Internal Revenue Code (the "Code").[18] No explanation is given in the Proposing Release as to why annuity products subject to certain federal income tax treatment should continue to be regulated as insurance (by state insurance departments) while annuity products subject to different federal income tax treatment should instead be regulated as swaps (by the CFTC and/or SEC). Footnote 46 of the Proposing Release does state that the list of enumerated products in the interpretive guidance "is generally consistent with" the Gramm-Leach-Bliley Act, which addresses insurance underwriting powers of national banks. But what might be relevant in addressing the powers of national banks should not be determinative with regard to whether an annuity should be regulated a swap.

Code section 72 does not "define" what is and is not an annuity contract. Code section 72 is premised on the fact that the instrument is first an annuity contract; then section 72 requires that the annuity contract meet certain very technical requirements (such as requirements for distribution of the annuity's value on the death of an owner) in order to receive the specified federal income tax treatment. These technical income tax requirements should not be the basis for distinguishing an annuity from a swap. Relying on section 72 to distinguish insurance from swaps is completely arbitrary.

More importantly, there are certain categories of conventional annuities and other guaranteed retirement income products that need not, and typically do not, meet the requirements of section 72 of the Code. Section 72 contains certain complex and technical requirements, and in some situations there is no benefit in qualifying for tax treatment under section 72. For example, treatment under section 72 provides the tax benefit of a deferral of any income recognition on the "inside build-up" but that tax benefit is unnecessary when annuities are sold to (or in connection with) qualified retirement plans (such as IRAs and 401(k) plans) since the plan itself provides the tax deferral. In addition, the income with respect to some variable annuity contracts is not subject to tax under

[18] For the reasons discussed in the prior Committee and ACLI comment letters (see footnotes 3 and 4, *supra*) , certain criteria in the proposed rules would have the improper effect of excluding many conventional annuity and other guaranteed retirement income products.

section 72 in circumstances where the underlying separate account assets do not meet the specific percentage diversification requirements of section 817(h) of the Code. Yet both categories of annuities are subject to the same state insurance regulation as annuities that do qualify under section 72. Accordingly, defining "swap" (as distinguished from insurance) based on the specific requirements for tax treatment under section 72 of the Code is not supported by any public policy considerations or by the purposes of Title VII, and annuities that receive different tax treatment are no more "swaps" than annuities that do qualify under section 72. While the federal income tax treatment (and the contract requirements set forth in section 72) may be relevant to delineating the powers of national banks (*e.g.,* in the Gramm-Leach-Bliley Act), it should not be the basis for identifying "annuity products" that are not swaps and that should remain subject to state insurance regulation.

Logically, qualifying for tax treatment under section 72 (or any other provision) of the Code should not play a decisive role in affirming that annuities, subject to state insurance regulation, simply are not swaps. The proposed interpretive guidance should be revised to recognize that Congress did not intend for Title VII to remove certain annuities from state insurance regulation and subject them instead to regulation (by the CFTC or SEC, depending on the type of annuity)[19] as swaps, while leaving other annuities subject to their current regulatory scheme, depending on whether the annuities meet the technical requirements of section 72. The guidance should recognize that annuities subject to state insurance regulation simply are not swaps.

In doing so, the Commissions should acknowledge and confirm that various common types of annuity and pension plan products that have long been used by insurance companies in the retirement plan and other institutional markets generally are included in the interpretive guidance and recognized as insurance products. These include guaranteed investment contracts, funding agreements, structured settlements, deposit administration contracts, and immediate participation guarantee contracts.[20]

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[19] Certain annuities are securities within the meaning of the Securities Act of 1933, while many other annuities are not. *See* footnote 31 of the Proposing Release, *supra* note 1.

[20] These types of insurance products, all commonly used in retirement plan arrangements, may not have any need for the benefits of Code section 72 and therefore may not be subject to taxation under that section (and they also may not be based on the risk of loss or an insurable interest; see discussion below). Nevertheless, these types of insurance products have been around for decades and are not "guises" to escape swap (or any other) regulation. For example, the SEC discussed guaranteed investment contracts as far back as 1977, when the SEC stated that, in general, these contracts "provide for the payment of money to a life insurance company (in a single sum or in installments; include promises by the insurer to pay interest at a guaranteed rate with or without the possibility of excess interest; and permit the purchase of an annuity at a future date at an annuity purchase rate which may or may not be guaranteed in the contracts." *Request for Submission of Views With Respect to the Offer and Sale of Certain Contractual Arrangements Issued by Life Insurance Companies*, SEC Release No. 33-5838, n. 4 (June 22, 1977) (42 FR 32861, June 28, 1977). In 1986, the SEC described these contracts, "generally speaking, [as] deferred annuities under which the purchaser agrees to pay money to an insurer (either in a lump sum or in installments) and the insurer promises to pay interest at a guaranteed rate for the life of the contract. In some contracts, the insurer may periodically pay discretionary excess interest over and above the guaranteed rate. In addition, virtually all of these contracts allow the purchaser to buy an annuity with the monies accumulated under the contract. Finally, these contracts are issued on either an individual or a group basis." *Definition*

In short, the Committee believes that the interpretive guidance should be revised to eliminate the limitation regarding annuities to those that are subject to tax treatment under section 72 of the Code. The guidance should also enumerate other recognized categories of insurance products

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of Annuity Contract or Optional Annuity Contract, SEC Release No. 33-6645, n. 1 (May 29, 1986) (51 FR 20254 (June 4, 1986). A very similar statement is in SEC Release No. 33-6558, n. 1 (49 FR 46750, Nov. 28, 1984). More recently, the SEC included similar descriptions of guaranteed investment contracts in SEC Releases 33-8996, *Indexed Annuities and Certain Other Insurance Contracts* (Jan. 8, 2009), 74 FR 3138, at n. 35, (stating that a guaranteed investment contract is "a deferred annuity contract under which the insurer pays interest on the purchaser's payments at a guaranteed rate for the term of the contract. In some cases, the insurer also pays discretionary interest in excess of the guaranteed rate") and 33-8933 (June 25, 2008) (73 FR 37752, July 1, 2008) at n. 35.

The SEC addressed funding agreements in a number of no-action letters in the early to mid-1980s, culminating in State Mutual Life Assurance Co. of. America (pub. avail. Dec. 9, 1985), which described the subject funding agreements as follows: "Under the Funding Agreements , in exchange for the promise of a single purchase payment or a series of payments by the purchaser, the [Insurance] Company promises to pay a guaranteed fixed interest rate and to make payments of either fixed amounts over a specified period or a single fixed amount on a specified future date." *See* The Equitable Life Assurance Society of the United States (pub. avail. Nov. 18, 1983); Mutual Life Insurance Company of New York (pub. avail. Jan. 16, 1985); Massachusetts Mutual Life Insurance Company (pub. avail. Mar. 6, 1985); Crown Life Insurance Company (pub. avail. Mar. 7, 1985). The New York Insurance Department publishes a number of "Life Product Outlines and Checklists" that provide guidance to insurance companies when submitting particular types of life and annuity product filings (available at www.ins.state.ny.us/lifeindx.htm); one such outline is specifically for Funding Agreements, and it states: "Funding agreements generally provide for the accumulation of funds at guaranteed rates for a specified time period with repayment to the holder in lump sum or installments. Funding agreements may be simple interest contracts with interest paid out periodically." There are other varieties of funding agreements.

Similarly, deposit administration contracts and immediate participation guarantee contracts are recognized forms of conventional insurance products, typically utilized in retirement plan markets. For example, the New York Insurance Department's "Life Product Outlines and Checklists" includes, in the Group Annuities category, one for Immediate Participation Guarantee and Deposit Administration Contracts (there is also an Outline and Checklist for Individual and Group Funding Agreements, as noted above, and another for Guaranteed Interest Contracts, also known as guaranteed investment contracts). *See also, e.g.,* Harnholz and Gainor, Offerings of Asset-Backed Securities, §11.01, *The Importance of ERISA Regulation to Issuers of Asset-Backed Securities* (noting that "In the 1970s, insurance companies began to add features to their group annuity contracts, such as deposit administration and immediate participation guarantee contracts, that credited the proportionate share of general account earnings in excess of projected returns to these contracts."); Financial Accounting Standards Board Accounting Standards Codification, *Topic 960: Plan Accounting – Defined Benefit Pension Plan* [(as of March 1, 2010)] (stating that the "deposit administration contract account represents transactions between the company and an insurance company involved in the pension plan. Funds are deposited with the company, earn interest, and can be used to provide for the benefits due to retiring employees. Generally, the funds deposited are used to purchase annuity contracts for retiring employees."); Kenneth Black, Jr. and Harold D. Skipper, Jr., *Life & Health Insurance* (13th Ed. 2000) at 535-537 (discussing deposit administration contracts, immediate participation guarantee contracts, and guaranteed investment contracts).

We note that certain of the types of contracts referred to in this footnote (including, generally, many funding agreements, as well as certain guaranteed investment contracts, deposit administration contracts and immediate participation guarantee contracts) would not, as a threshold matter, even come within the definition of swap in clause (A)(ii) of new section 1a(47) of the CEA and therefore would not need to rely on any exclusionary rule. *See* footnote 28 of the Proposing Release, *supra* n. 1.

(including guaranteed investment contracts, funding agreements, structured settlements, deposit administration contracts, and immediate participation guarantee contracts).[21]

D. The Proposed Rules' Product Test Would Improperly Exclude Many Insurance Products

The proposed product test (in the first paragraph of the proposed rules) may be suitable for many property & casualty insurance products, and it seems to reflect a carefully reasoned and thoughtful approach to distinguishing credit default swaps from insurance products, but outside of that context the proposed product test simply is not suitable or appropriate for many common annuity (or life insurance) products. Many conventional annuity (and life insurance) products, which should clearly remain subject to state insurance regulation, would, unfortunately, fail the proposed product test.

1. The Insurable Interest Test

As noted above, one of the criteria of the product test is that the beneficiary have an insurable interest that is the subject of the contract, and carry the related risk of loss for the duration of the contract. The principle of insurable interest certainly plays an important role with respect to certain insurance products (*e.g.,* life insurance), but it is not a required hallmark of all types of insurance products. In particular, annuity products are simply not based on the concept of risk of loss. While life insurance is based on the risk of loss of a life (and products such as automobile or homeowner's insurance involve the risk of "loss" of or damage to property), annuities do not involve that type of risk, and no "loss" or damage of any kind is needed in order for the insurance company to pay the promised benefits.[22] For life contingent annuities, those benefits may depend on the annuitant *living* (not dying);[23] for period certain annuities, the benefits are based on a specified duration.[24] These types of annuity benefits are not tied to a specific insurable interest or loss (or risk of loss). Moreover, there is no uniform definition of, or standard for, insurable interest that applies to all of the various types of insurance products.

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[21] The Committee's comments contained in this letter with respect to the definition of "swap" should not be regarded as relating to stable value contracts that will be the subject of a study required by the Act within 15 months of enactment. *See* section 719(d) of the Act.

[22] *See ,e.g.,* Vol. 4, Bertram Harnett and Irving I. Lesnick, *The Law of Life and Health Insurance,* §10-02[1] (2010) stating that "Insurable interest is not required in annuities. ... Annuity contracts, however, do not have the insurable interest requirement—they do not have the inducement of murder, nor are they considered wagering contracts." *See also* footnote 20, *supra.*

[23] Life contingent annuities (that guarantee the benefit payments for as long as the annuitant lives) are in essence insurance against *living too long* (longevity risk), whereas life insurance pays a benefit if the insured *dies too soon* (mortality risk).

[24] Similarly, other types of insurance products, such as funding agreements, guaranteed investment contracts, deposit administration contracts and immediate participation guarantee contracts (all commonly used in retirement plan arrangements), are not based on the risk of loss or insurable interest. *See* note 20, *supra.*

In addition, the second part of the proposed insurable interest requirement, that the beneficiary carry that risk of loss "continuously throughout the duration" of the contract or agreement, is also problematic for many common insurance products. For example, an individual has an insurable interest in one's spouse that may or may not continue after a divorce; a company has an insurable interest in key employees that may not continue after the employment ceases.

2. The Loss Occurrence & Payment (Benefit) Limitation Test

The second criterion of the proposed rules' product test is that a loss occur (and be proved), and that any payment or indemnification therefor (the insurance benefit) be limited to "the value" of the insurable interest. Annuity products, however, simply do not provide "indemnity" for a loss, or serve to make an insured "whole" for the loss of something through damage (*e.g.*, from fire or accident) or otherwise. Rather, many annuities are designed and intended to provide retirement income (through fixed and/or variable payments guaranteed for one's lifetime, a joint lifetime, or a period certain[25] or some other period) or other "income" benefits that are not tied to any loss. In addition, of course, ordinary life insurance death benefit payments are not measured by (or limited to) "the value" of the insured life, but instead simply reflect a specified dollar amount selected by the purchaser.[26] Similarly, benefit payments under other types of insurance, such as long-term care insurance and disability income insurance, may not be measured by or limited to the value of any loss or insurable interest.

This test of the proposed rules, then, also would improperly exclude many conventional categories of insurance that are certainly not "swaps" that Congress intended to be regulated under Title VII, rather than to continue to be state regulated insurance products.

3. The Secondary Market Test

The third criterion of the proposed rules' product test is that the product not be traded, separately from the insured interest, on an organized market or over-the-counter. The Proposing Release states that traditionally, insurance products have not been "traded in secondary market transactions," and therefore a lack of trading separately from the insured interest "is useful" in distinguishing insurance from swaps.[27]

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[25] The SEC has recognized that even prior to the enactment of the Securities Act of 1933, "there were certain "traditional" annuity contracts in effect that involved no assumption of mortality or longevity risks by the insurer" because they provided for annuity benefit payments over a stated number of years, rather than for lifetime. Definition of Annuity Contract or Optional Annuity Contract (SEC Release No. 33-6645, 51 Fed. Reg. 20254, 20256 n. 11 and accompanying text (June 4, 1986)) (adopting the Rule 151 safe harbor for certain annuity contracts under section 3(a)(8) of the Securities Act of 1933).

[26] Life insurance death benefits can also reflect investment performance, in the case of variable life insurance, and/or be a percentage of the policy's cash value, if required by (and specified in) section 7702 of the Internal Revenue Code.

[27] Proposing Release, *supra* note 1 at 29822.

The problem with this criterion is that it overlooks the fact that many conventional insurance products, such as annuities, can be assigned by the owner, and indeed insurance regulations applicable in many states may require that the contract or policy contain a clause that specifically permits its assignment, or prohibit or restrict limitations on the owner's right to assign the policy.[28] The Proposing Release notes that some life insurance policies may be traded in "life settlements." In addition, annuities and life insurance policies may be assigned (or "traded") to family members (from parent to child, from spouse to spouse, etc.) because of changes in personal, health, financial, or other circumstances (including things such as incapacitation, divorce, etc.). In addition, conventional insurance products are frequently assigned (temporarily) as collateral for loans (collateral assignments). There are untold numbers of common, conventional annuity contracts and life insurance policies outstanding that, by their explicit terms, permit them to be assigned. And even recently (or yet to be) issued annuities and life insurance policies may not be allowed to include restrictions on assignability (depending on state insurance statutes and regulations and the interpretations and applications thereof by state insurance regulators). Conventional annuity and other insurance contracts with traditional assignment provisions are not "swaps" of the kind that Title VII is intended to regulate, and individual assignments of annuities or life insurance policies are certainly not an indication that they are not "insurance." The third criterion, at least as drafted, is not an appropriate criterion for distinguishing insurance products from swaps.[29]

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[28] *See* "Interstate Insurance Product Regulation Compact," National Association of Insurance Commissioners Model Regulation Service (July 2003). The Interstate Insurance Product Regulation Compact, which to date has been adopted by 40 Member States, created the Interstate Insurance Product Regulation Commission (IIPRC) - a public entity treated as an instrumentality of the Compacting Member States. The Core Standards for Individual Deferred Variable Annuity Contracts, the Core Standards for Individual Deferred Non-Variable Annuity Contracts, and the Core Standards for Whole Life Insurance Policies each applies the following standard for "assignments":

> (1) the Contract shall contain an assignment provision. The contract shall not include any restrictions on the availability of contract assignments, except in situations where restrictions are required for purposes of satisfying applicable laws or regulations. (2) The contract shall describe procedures for assignments and shall state that assignments, unless otherwise specified by the owners, shall take effect o n the date the notice of assignment is signed, subject to any payments made or actions taken by the company prior to receipt of this notice. (3) The Contract may state that the company shall not be liable for the validity of the assignment. **Drafting Note:** Restrictions on assignment in contracts such as right of first refusal or first offer provisions are prohibited by Item (1)."

[29] The difficulties in applying a "non-assignability" or secondary trading restriction to conventional insurance products is demonstrated by the comment letters submitted to the SEC regarding what is now paragraph (e) of Rule 12h-7 under the Exchange Act (which, together with paragraph (d) of that Rule, is an attempt to impose a secondary market restriction on certain insurance products). If the Commissions keep a secondary market criterion in any rule distinguishing insurance products from swaps (which the Committee opposes), then the Committee suggests that Rule 12h-7 (which has in recent years undergone the notice and comment process) may be a more appropriate model for such a criterion than the Proposals.

E. Additional Criterion: Not Based On a Price, Rate or Level

The Proposing Release states that the Commissions are considering adding an additional criterion to the product test in the proposed rules. This additional criterion would require that the payment on the agreement, contract or transaction not be based on the price, rate, or level of a financial instrument, asset, or interest or any commodity. The Proposing Release specifically requests comment on whether this should be added as a requirement for an insurance product to not be characterized as a swap (request for comment # 7).

No such requirement should be included in any rules adopted by (or interpretations of) the Commissions. There are several categories of conventional insurance products where a benefit or payment is (or can be viewed as being) tied to (or in some way dependent on) the price, rate or level of a financial instrument, asset, or interest. For example, variable annuities (and variable life insurance) obviously provide benefits that are based the price or level of a financial instrument or asset (typically, the net asset value per share of one or more specified mutual funds). In addition, many fixed annuities (and some fixed life insurance) may set interest crediting rates that are based on U.S. Treasury or corporate bond interest rates, or provide benefits that reflect a "market value adjustment," which is typically based on changes in interest rates on U.S. Treasury bonds or changes in corporate bond indices, or the rate or level of interest declared by the insurance company, or a comparison of market values to book values (other rates may also be used). Moreover, equity indexed annuities may pay benefits based on changes in an index of securities (such as the S&P 500 Index), and there are various other types of fixed indexed insurance products (that also pay benefits based on the price or level of financial or securities indexes).[30] None of these, or other, types of insurance products should be characterized or regulated as swaps (they do not pose the types of systemic risks that Title VII is aimed at, and of course they are insurance products subject to extensive state insurance regulation).[31] Any "price, rate, or level" type of test would improperly exclude these categories of insurance products.

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[30] Another provision of the Dodd-Frank Act, section 989J (known as the "Harkin Amendment"), in effect provides that indexed insurance products meeting certain conditions are insurance or annuity products within the meaning of the exclusion in section 3(a)(8) of the Securities Act of 1933, thus leaving such products subject to state insurance regulation and barring the SEC from characterizing them as securities. The SEC had attempted to characterize equity indexed annuities as securities in Rule 151A, but section 989J of Dodd-Frank is viewed as having nullified Rule 151A (Rule 151A was also vacated by the U.S. Court of Appeals on procedural grounds; see *American Equity Investment Life Ins. Co., et. al., v. Securities and Exchange Commission,* 613 F.3d 166 (D.C. Cir. 2010)). *See generally* Stephen E. Roth and Frederick R. Bellamy, *Securities or Not: Uncertainties Remain For Fixed Insurance Products After Dodd-Frank*, 42 SEC. Reg. & L.Rep. (BNA)1964 (Oct. 18, 2010). As discussed below, since section 989J of the Dodd-Frank Act in effect preserves state insurance regulation of indexed annuities, it would certainly be incongruous at best for the Commissions to adopt rules under (or interpretations of) Title VII of Dodd-Frank that would have the effect of removing such products from state insurance regulation.

[31] *See, e.g.,* National Association Insurance Commissioners "Buyer's Guide to Fixed Deferred Annuities with Appendix for Equity Indexed Annuities", available at http://www.piam.com/Financial_Services/NAIC_BGAnnuities09.pdf.

Moreover, in more general terms, such a test would not properly distinguish insurance products from swaps. The proposing release offers no explanation (and the Committee is aware of no explanation) as to how such a test would help prevent swaps from being executed in the guise of insurance.[32] The types of insurance and annuity products noted above provide life insurance or retirement income benefits, and are not used for "speculative purposes or to influence prices in derivatives markets," purposes that the Proposing Release suggests such a test might help prevent. Indeed, the costs inherent in annuity and insurance products (and other aspects of such products such as insurance underwriting and suitability) generally make them poor choices for such purposes.

For these reasons, the Commissions should not adopt a "price, rate, or level" test.

F. Reinsurance Should Be More Completely Recognized as Insurance

As noted above, the provider tests in the proposed rules include specific subparagraphs addressing reinsurers. The Committee agrees with the Commissions' basic position, as stated in the Proposing Release, that where a product qualifies as insurance, and is therefore excluded from the definition of swap, then the lawful reinsurance of that product similarly should be excluded.[33] However, the Proposals may fail to fully achieve this goal, as noted below.

The Proposals fail to address reinsurance contracts issued with respect to underlying insurance products that were not issued in the United States. Although the reinsurer and reinsurance agreement in such transactions are subject to state insurance regulation, the underlying off-shore insurance product is not, and therefore the underlying insurance product will not fall within the insurance product exclusion in the Proposing Release. The reinsurance of offshore insurance products by a domestic insurer, which is routine in the global reinsurance market, should not be a swap.

The Proposal's acknowledgement and recognition that reinsurance generally should be viewed as insurance, rather than a swap, currently is embodied only in the provider test of the proposed rules. The Proposing Release does not address reinsurance in either the interpretive guidance or the product test of the proposed rules. The Commissions should clarify and confirm that any product test in the rules, and any type of interpretive or other guidance or interpretations addressing the exclusion of insurance, includes and is applicable to reinsurance of excluded insurance products.

With respect to the exclusion of reinsurance agreements, the product test should be expanded to include reinsurance of risks ceded by entities located outside of the United States to insurers meeting the provider test, notwithstanding that the ceding non-US entity and underlying insurance

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[32] The Committee notes that this test for "insurance" was suggested by a commenter on behalf of banks (the Cleary Gottlieb letter, *supra* note 5).

[33] Proposing Release, *supra* note 1 at 29825.

risks are not subject to state (or Federal) insurance regulation. This would expand the exclusion to cover reinsurance agreements where a domestic insurance company provides reinsurance to an entity located outside of the United States for risks underwritten by that off-shore entity.

Finally, the proposals do not account for reinsurance of reinsurance agreements (*i.e.*, retrocession agreements), which are also standard in the insurance industry to further spread insured risk among many insurers. The exclusion for reinsurance should also encompass the transfer of risk from one reinsurer to another reinsurer through retrocession agreements.

G. Interpretive Guidance: Legal Status and Authority

The Committee agrees with the general rationale underlying the interpretive guidance, namely that notwithstanding a potential reading of the literal language of the statutory definition of swap, conventional insurance products issued by insurance companies that are subject to state insurance regulation "are outside the scope of the statutory definitions," and that these insurance products simply "do not bear the characteristics of the transactions that Congress subjected to the regulatory regime for swaps" under the Dodd-Frank Act.[34] Accordingly, regardless of whether such products meet the terms of any new exclusionary rules, such products should remain subject to regulation and treatment as insurance, and regulated as such by the state insurance departments, rather than being removed from insurance regulation and instead regulated as swaps.[35] Nevertheless, particularly if the Commissions determine to adopt a formal rule that sets forth a limiting product test, the Committee agrees with and supports the Commissions' effort to clarify and confirm such conventional products' status as insurance.

However, there may be some uncertainty regarding the precise legal status and authority of the "interpretive guidance" in the Proposing Release. The Committee recognizes that Title VII itself states that any "interpretation of, or guidance by either Commission … shall be effective" only if certain procedures are followed.[36] This certainly indicates that Title VII contemplates the possibility of some type of "guidance" short of formal rules and regulations. However, since the interpretive guidance is not a "rule," it is not clear how the Commissions could "amend" or revise the guidance, or even withdraw it.[37] Procedurally, it is not clear how courts would apply the interpretive guidance,

[34] *Id.* at 29824.

[35] In this regard, the Committee disagrees with the proposition in the Proposing Release that conventional insurance products, which Congress did not intend to be regulated as swaps, and that are enumerated in the interpretive guidance, would nevertheless be treated and regulated as swaps if they did not meet the provider test in the proposed rules.

[36] These procedural requirements apply if Title VII requires joint rulemaking to implement the provision. Section 712(d)(4) of the Act.

[37] On the one hand, it appears that the Commissions are treating the interpretive guidance as having the effect of regulations, by strictly defining and limiting what is "insurance," and indeed the interpretive guidance states that compliance with a portion of the formal proposed rules is necessary to come within the "guidance." In this case, it would seem that the interpretive guidance, once "adopted," could only be revised, amended, or withdrawn by following

or what degree of deference they would afford it,[38] particularly if the Commissions also determine to adopt formal rules containing narrow, limiting product tests that many conventional insurance products fitting within the interpretive guidance would not meet. At the very least, the dual approach of adopting formal rules together with interpretive guidance, when the rules and guidance are not completely consistent with one another, is confusing.

Substantively, the interpretive guidance, as it now stands, could be viewed as having the effect of a "rule" that by negative implication, provides that anything not enumerated (for example, annuities that are not subject to tax treatment under section 72 of the Internal Revenue Code) are now swaps rather than insurance. The Committee submits that it would be improper, and inconsistent with what Congress intended, to apply the interpretive guidance in that manner. At a minimum, the Commissions should clarify and confirm that any such guidance (in whatever form it takes) is only a "safe harbor" that confirms the exclusion of any enumerated products, but that does not preclude the exclusion of other products (as a matter of statutory interpretation).[39]

H. The Provider Test: Potential for Abuse

The Committee agrees in principle with the "provider" proposition inherent in the proposals, that is, that the insurance "exclusion" should only be available to insurance companies that are subject to the full panoply of state insurance regulation.[40] However, there is a possibility that the

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formal notice and comment procedures. On the other hand, the guidance may more properly be viewed as just an interpretation of the statutes themselves, in which case formal notice and comment procedures may not apply to the guidance (but statutory interpretations by an agency could be afforded a different degree of deference by courts than a formal agency rule).

[38] The Proposing Release does not state the Commissions' views or intent on this issue.

[39] As noted above, the Committee submits that the list of enumerated products is both too narrow and incomplete. Whether or not annuities are regulated as swaps, and therefore removed from state insurance regulation, should not be dependent on whether they are subject to tax treatment under section 72 of the Code but on whether they are subject to state insurance regulation. In addition, there should be no inference that products that might be classified in other categories, including funding agreements, guaranteed investment contracts, deposit administration contracts, immediate participation guarantee contracts or other guaranteed retirement products, are swaps rather than insurance. *See* note 20, *supra.* In addition, there may not be generally accepted "definitions" for these categories; it may not be clear and parties may disagree as to which category "label" best applies to a particular product. The Committee's recommendation avoids the issue inherent in relying on product labels.

The Committee also notes that the interpretive guidance refers to "health insurance," without any discussion of what is meant by this term. The Committee is concerned that this could result in ambiguity for certain categories of insurance that should be, and may very well have been intended to be covered, such as disability, accidental death, dental, and other forms of insurance that are included in the "accident & health" line of business. Therefore, the term "health insurance" should be changed to "accident & health insurance," a term of art that includes these lines of insurance products.

[40] As noted above, however, legitimate reinsurance contracts should not be treated as swaps.

provider test in the proposed rules could lead to significant, and in the Committee's view, abusive unintended consequences.

Specifically, a non-insurance company could issue a financial product that is truly insurance and that unquestionably should be, and currently is, subject to state insurance regulation of the issuer and the product (perhaps in commercial or institutional markets). However, the non-insurance company, because it would not meet one or more of the four criteria in the provider test, would fail the provider test, and therefore under the proposals the insurance policy would then be deemed to be a swap. This in turn would mean that the pre-emption provision in section 722(b) of Dodd-Frank applies, so the insurance policy – deemed to be a swap – "shall not be considered to be insurance" and "may not be regulated as an insurance contract under the law of any state."[41] Accordingly, the provider test, in conjunction with the Title VII insurance pre-emption provision, could be used improperly to evade state insurance regulation. This would deprive state insurance regulators of the ability to properly regulate both the insurance policy as insurance and the issuer thereof as an insurance company. It would, in effect, result in the CFTC (or the SEC in the context of a security-based swap) regulating the insurance policy.

The Committee submits that this is an egregious unintended consequence of the proposals as they are currently drafted. Indeed, that the proposals could be manipulated in this manner further heightens the Committee's concerns about the proposals' legality under the McCarran-Ferguson Act. Clearly, the standards for distinguishing insurance from swaps should not allow for the possibility of abusive manipulation in this manner to avoid appropriate state insurance regulation.

I. <u>"Grandfather" Provisions</u>

The Proposing Release asks for comment regarding a "grandfather" clause or provision, that would provide that any product regulated as insurance before July 21, 2010 would be considered insurance and not fall within the swap definition, *provided* that the provider test in the proposed rules is met.[42] The Committee believes that the final rule should include a grandfather provision, to provide that any type of product regulated as insurance before July 21, 2010 be considered insurance and not fall in the swap definition. This product based grandfather provision would reduce confusion and uncertainty that would arise in applying the swap definition to products historically regulated as insurance products, while also addressing the Commissions' stated concern about contracts that are swaps being intentionally characterized as insurance products to evade the regulatory regime under

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[41] New section 12(h) of the CEA. The new pre-emption provision in section 28(a) of the Exchange Act (*see* section 767 of Dodd-Frank) would apply to security-based swaps.

[42] *See* Proposing Release, *supra* note 1, at 76 FR 29827 (request for comment number 20). The Dodd-Frank Act was signed into law on that date.

Title VII. Products regulated as insurance prior to the Dodd-Frank Act becoming law clearly were not characterized as insurance to avoid the new regulatory regime for derivatives.[43]

In addition to a product based grandfather provision, the final rules should include an effective date based grandfather provision, which provides that any contract or transaction (subject to state insurance regulation) entered into prior to the effective date of any final rules necessary to implement Title VII, including rules further defining "swap," shall not be considered swaps. An effective date based grandfather provision is needed to address the continuous nature of product development and innovation in the insurance marketplace. In other words, it may not be clear if a product based grandfather provision alone would encompass all product variations and development occurring after the Dodd-Frank Act was adopted and before final rules are effective. Certain product development may be adequately addressed by the final insurance product carve out set forth in the final rule, but until the rule is final and adopted there will be uncertainly about its scope and coverage. Transactions executed and regulated as insurance before any final rule is in place should be grandfathered to address this concern.

III. Recommended Solution

Title VII of the Dodd-Frank Act is designed to bring regulatory oversight to what was an unregulated market in over-the-counter derivatives and related transactions. However, it was certainly not intended to replace the well-established system of state regulation of insurance products. The objective, then, is to define the distinction between insurance products that already are subject to robust state regulation, and those previously unregulated financial products that should be regulated as swaps pursuant to Title VII. That line should, of course, be identified in such a way that prevents agreements, contracts or transactions that are in reality swaps from escaping regulation by using the guise of insurance. As stated above, the Committee continues to believe that the approach supported in its prior letter is the best way of achieving these objectives.

[43] The Committee's other recommendations, if adopted by the Commissions and reflected in final rules and interpretive guidance, would resolve the vast majority of issues identified by the Committee, but may not sufficiently cover all varieties of insurance products that should be grandfathered. However, whether a product is grandfathered, based on the date of signing of the Dodd-Frank Act, should not be dependent on meeting the technical requirements of the provider requirements in the proposed rules – which requirements were not even proposed until some ten months *after* enactment of the Dodd-Frank Act. It should be enough that the product was regulated as insurance (which also means it was provided by an insurance company).

As reflected in the various issues noted above, the Committee recognizes the extreme difficulty in attempting to create a single definition of "insurance" that will both capture the vast variety of different types of insurance (subject to regulation as such) while still being sufficiently precise so as to prevent the improper use of an "insurance" label as a guise to avoid appropriate regulation. This task is daunting.[44] But the Committee believes that the Commissions need not undertake this very difficult, perhaps impossible, endeavor. Instead, if the Commissions do not adopt the approach supported by the Committee in its prior comment letter (an exclusion based on state insurance regulation of the product), then the Committee suggests that the Commissions can largely achieve their goals – properly regulating the swaps markets, recognizing and giving effect to the clear Congressional intent that insurance products remain subject to state insurance regulation, while preventing the improper use of an insurance guise to evade proper regulation – principally by relying on definitions and terms that already exist in applicable federal statutes.

As discussed in more detail below, the Commissions should adopt rules that provide certainty and clarity that insurance products described in those are rules are not swaps (or security-based swaps). These rules should clearly be non-exclusive "safe harbors" since the statutory scheme itself is not intended to treat insurance products as swaps or security-based swaps.

A. The Section 3(a)(8) Exclusion: Insurance and Annuity Contracts

Since its enactment, the Securities Act of 1933 (the "1933 Act") has included a provision that defines the scope of "insurance" and "annuity" products that Congress determined should be left to state insurance regulation. Specifically, section 3(a)(8) of the 1933 Act provides:

> Except as hereinafter expressly provided the provisions of this title [the 1933 Act] shall not apply to ... Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any state or territory of the United States or the District of Columbia.

This provision reflects a clear congressional understanding that certain insurance and annuity contracts simply were not regarded as securities in the commercial world, notwithstanding the broad, general definition of "security" in section 2(a)(1) of the 1933 Act, and excludes them from federal regulation under the 1933 Act. For the reasons set forth below, the Committee believes that those insurance and annuity products that fall within the section 3(a)(8) exclusion can and should be

[44] A 2006 report from the Government Accountability Office (GAO-06-424R "Definitions of Insurance") found that (1) there is no universal agreement on a definition of insurance, (2) state regulators and insurance industry participants develop definitions for different purposes, and (3) these definitions are dynamic, changing due to evolution of thinking in subject areas, product innovations, and changes in statutes, regulations, and court interpretations (see slides 4 and 5). In this regard, the Committee recognizes that there are virtues to the use of "interpretive guidance" and that it is very helpful although it does present certain problems (some of which are discussed above).

excluded from the definition of swap and therefore not treated as swaps or security-based swaps subject to federal regulation.

Section 3(a)(8) has the benefit of decades of both judicial and SEC interpretations, which serve to define and circumscribe the products that are included within its scope. While a full description of those cases and SEC interpretations is beyond the scope of this letter, there are certain basic principles inherent in the jurisprudence relating to section 3(a)(8) that make it singularly appropriate as one basis for identifying insurance and annuity contracts that are not swaps or security-based swaps. First, section 3(a)(8) is an exclusion from the 1933 Act, not merely an exemption from the registration requirements.[45] Second, not all contracts that are labeled "insurance", "annuity", "optional annuity" or "endowment" come within section 3(a)(8) (they must be the type of product that Congress intended to exclude from the protections of the 1933 Act, based on the factors noted in footnote 49 below). Third, the fact that the product might be treated as an annuity (or insurance) product under state insurance laws is not, in itself, sufficient to qualify under section 3(a)(8). Fourth, a "provider" test is already embedded in section 3(a)(8), since the insurance or annuity product must be issued by a corporation that meets a specific test – it must be subject to the jurisdiction of the insurance commissioner. Fifth, the interpretation or definition of the terms used in section 3(a)(8) – including the terms "annuity" and "insurance" – is a *federal* question, not a state law question. These principles and related section 3(a)(8) jurisprudence make section 3(a)(8) particularly appropriate for use by the Commissions in determining the scope of "insurance" that is not a swap or security-based swap. [46]

But apart from these principles and the convenience of utilizing the federal exclusion set forth in section 3(a)(8) as a basis for defining the insurance exclusion from the definition of swap, Congress itself clearly intended that no insurance products falling within the section 3(a)(8) exclusion should be treated as swaps. Specifically, another provision of the Dodd-Frank Act, section 989J (known as the "Harkin Amendment"), in effect provides that insurance and annuity products meeting certain conditions are insurance or annuity products within the meaning of the exclusion in section 3(a)(8) of the 1933 Act, thus leaving such products subject to state insurance regulation. This

[45] The SEC recognizes this meaning of section 3(a)(8). *See* Definition of "Annuity Contract or Optional Annuity Contract," SEC Release No. 33-6558, 49 Fed. Reg. 46750, 46753 (Nov. 28, 1984), ("Congress intended any insurance contract ... falling within section 3(a)(8) of the [1933] Act to be excluded from all provisions of the Act, notwithstanding the plain language of the Act that section 3(a)(8) is an "exemption" from the registration but not the antifraud provisions").

[46] Most of these key principles regarding section 3(a)(8), and what products it covers, were established in two seminal Supreme Court cases (*see* SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959) (*"VALIC")* and SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967) (*"United Benefit")*) and have been followed and applied for decades by the SEC and the courts. In *VALIC*, the Court said that "[w]e deal, however, with federal statutes where the words "insurance" and "annuity" are federal terms. ... the meaning of "insurance" or "annuity" under these Federal Acts is a federal question." 359 U.S. at 69. Justice Brennan's concurring opinion in *VALIC* states that "if a brand-new form of investment arrangement emerges which is labeled "insurance" or "annuity" by its promoters, the functional distinction that Congress set up in 1933 ... must be examined to test whether the contract falls within the sort of investment form that Congress was then willing to leave exclusively to the State Insurance Commissioners" (359 U.S. at 76).

provision prevents the SEC from characterizing these products as securities, provided that the products meet three basic conditions: (1) the value of the products cannot vary according to the investment experience of a separate account; (2) the products must comply with applicable state nonforfeiture laws or similar requirements; and (3) the products must be offered by insurance companies that are subject to specified suitability requirements set forth in the NAIC Suitability in Annuity Transactions Model Regulation.[47]

Section 989J of the Dodd-Frank Act does two things. First, it sets forth this tripartite test which, if satisfied, mandates that the SEC treat such products as falling within the section 3(a)(8) exemption. Second, section 989J also reaffirms the decades long jurisprudence that had previously defined the scope of the section 3(a)(8) exclusion as a "rule of construction."[48]

It is inconceivable that Congress could in one provision of the Dodd-Frank Act reaffirm and expand an exemption from federal regulation, and in another title of the Act subject those very same products to CFTC or SEC regulation as swaps or securities-based swaps. Since section 989J of the Dodd-Frank Act in effect preserves state insurance regulation of the products covered by section 3(a)(8), it would certainly be incongruous at best for the Commissions to adopt rules under (or interpretations of) Title VII of Dodd-Frank that would have the effect of removing such products from state insurance regulation. Indeed, the Committee respectfully submits that not including all insurance products that qualify under section 3(a)(8), in the insurance exclusion from the definition of swap in Title VII of the Act would fly in the face of the clear Congressional intent that all such products remain within the exclusive jurisdiction of state insurance regulators.

B. Insurance Products That Are Also Securities (Not Within Section 3(a)(8))

The jurisprudence of section 3(a)(8) shows that there are certain categories of annuities (and other insurance products) that, while they may truly be insurance or annuities (fully subject to state insurance regulation as such), are nevertheless not within the section 3(a)(8) exclusion and are instead also securities subject to both the 1933 Act and the Exchange Act. The *VALIC* and *United Benefit* cases established that variable annuities are such a type of insurance product that, while subject to the full panoply of state insurance regulation, are securities that are not excluded by section 3(a)(8).[49] Variable life insurance also comes within this category,[50] and there are other types

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[47] Paragraphs (a)(1), (2), and (3) of section 989J of the Dodd-Frank Act..

[48] Paragraph (b) of section 989J provides that section 989J shall not be construed to affect whether an insurance product that is not described in that section (*i.e.*, that does not meet its terms) is or is not an exempt security under section 3(a)(8). In effect, then, the Harkin Amendment is a "safe harbor" under section 3(a)(8), and products that do not meet its terms can still qualify under section 3(a)(8) based on the prior jurisprudence of that section.

[49] These cases, and subsequent court cases and SEC interpretations, have established that whether insurance or annuity products qualify for the 3(a)(8) exclusion depends on (1) the allocation of investment risk between the insurance company and the policy owner, (2) whether the product is marketed primarily as an investment, or as insurance; and (3) to a lesser extent, the assumption of mortality risk.

of state insurance-regulated products that are also securities (such as certain products with market value adjustment or other significant features that pass substantial investment risk to the purchasers of those products).[51] These insurance and annuity products would not be within an exclusion from the definition of swap that was based solely on section 3(a)(8).

However, the Proposing Release states that "[t]he Dodd-Frank Act excludes purchases and sales of securities from the definitions of swap and security-based swap in a number of different clauses," citing CEA sections 1a(47)(B)(ii), (v), and (vi).[52] More specifically, the Proposing Release also states 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," citing CEA section 1a(47)(B)(v) and the *VALIC* and *United Benefit* cases (holding that the variable annuity contracts at issue were not entitled to the section 3(a)(8) exclusion).[53] These statutory exclusions are self-effectuating, and clearly operate to exclude insurance products, that are securities within the meaning of the 1933 Act and the Exchange Act, from the definitions of swap and security-based swap.

The statutory exclusions noted above refer to securities that are <u>subject to</u> the 1933 Act and the Exchange Act, or that are securities <u>as defined in</u> section 2(a)(1) of the 1933 Act. These statutory provisions are not limited to (or defined in terms of) only securities that are registered under the 1933 Act. Many conventional insurance products (such as certain variable annuities) are securities that are not registered under the 1933 Act, in reliance on statutory exemptive provisions in the 1933 Act (such as section 3(a)(2), for sales to qualified retirement plans, or section 4(2), for sales not involving any public offering). Although not registered under the 1933 Act, these securities are certainly subject to certain very important provisions of the 1933 Act and the Exchange Act (*e.g.*, the anti-fraud provisions) and are securities as defined in the 1933 Act. The Commissions should clarify and confirm that these statutory exclusions, and any implementing rules that further define the terms swap and security-based swap, appropriately exclude unregistered as well as registered securities (that are also insurance products).

Accordingly, the Committee recommends that the Commissions clarify and confirm that insurance products that fall within section 3(a)(8) **or** that are insurance products that are also securities (*i.e.*, that are securities that do not fit within section 3(a)(8), based on the *VALIC* and

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[50] *See* rules 6e-2 and 6e-3(T) under the Investment Company Act of 1940.

[51] However, in *VALIC, supra* note 46, the Supreme Court said that "[w]e realize that life insurance is an evolving institution. Common knowledge tells us that the forms have greatly changed even in a generation. And we would not undertake to freeze the concepts of "insurance" or "annuity" into the mold they fitted when these Federal Acts were passed," referring to the 1933 Act, the McCarran-Ferguson Act, and the Investment Company Act of 1940 (359 U.S. at 71).

[52] Proposing Release, *supra* note 1, at 29830. *See also* CEA section 1a(47)(B)(vii).

[53] Proposing Release, *supra* note 1, at 29822, footnote 31.

United Benefit jurisprudence), whether or not registered under the Securities Act of 1933, are excluded from the definitions of swap and security-based swap.

C. Implementing the Committee's Comments

The Committee recommends that its proposal and comments be implemented in accordance with the following. [54]

First, the Commissions should re-affirm what is stated in the Proposing Release, namely that "[t]o the extent an insurance product does not fall within the language of the [statutory] swap definition by its terms, it would not need to satisfy the requirements under the proposed rules in order to avoid being considered a swap or security-based swap."[55]

Second, it should be made clear that any exclusionary rules for insurance products are only "safe harbors" and that they do not raise any presumption or inference that products that do not meet the terms of the rules are necessarily swaps (or security-based swaps).[56]

Third, the Commissions should revise the proposed rules to add a new exclusion which provides that products qualifying for the section 3(a)(8) exemption are not swaps.[57] Because section 3(a)(8) includes both a product and provider dimension, this new exclusion should be separate from, and framed as an alternative to, the exclusion in the proposed rules.[58]

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[54] The Committee's comments and the implementation steps recommended herein are not inconsistent with the proposal advocated by the ACLI in its letter of November 12 and supported by the Committee in its letter of December 3, 2010; the Committee continues to support that approach, but the Committee has developed and recommends this approach as an alternative that should also achieve the Commissions' goals while properly treating insurance products as such.

[55] Proposing Release, *supra* note 1 at 29822 n. 28.

[56] This "safe harbor" approach can easily be modeled after the safe harbor approach used by the SEC in adopting Rule 151 under section 3(a)(8) under the 1933 Act. *See* SEC Release No. 33-6645, *supra* note 24. A safe harbor approach regarding section 3(a)(8) also has precedent in section 989J of the Dodd-Frank Act (the Harkin Amendment); see footnote 48, *supra.*

[57] The proposed rules in the Proposing Release may or may not be appropriate for property-casualty products (the Committee expresses no opinion on that matter), but for the reasons discussed above those proposed rules are not appropriate for life and annuity products. However, the Commissions' proposed rules and the provision recommended herein can both be adopted.

[58] In the proposed SEC rule, both paragraphs (a) (the product test) and paragraph (b) (the provider test) of rule 3a69-1 must be met. The Committee's recommended exclusion based on section 3(a)(8) could be structured as a new paragraph (c), where the rule would require that either paragraphs (a) and (b) must be met, **or** paragraph (c) must be met. Similarly, the proposed CFTC rule requires that paragraphs (i) and (ii) (of rule 1.3(xxx)(4)) must be met; the Committee's recommended exclusion based on section 3(a)(8) could be added as a new paragraph (iii), so that either (i) and (ii) must be met, **or** (iii) must be met.

Fourth, as interpretive guidance, the Commissions should include an expanded but non-exclusive enumeration of insurance products that are not swaps or security-based swaps. The non-exclusive nature of any enumeration would be consistent with the safe harbor nature of further definitional rules. For the reasons discussed above, an enumeration should include annuities regardless of their tax treatment (*i.e.,* without regard to being subject to tax under section 72 of the Code). The safe harbor nature of the definitional rules, coupled with making it clear that an enumeration of certain types of products is non-exclusive and does not indicate that non-enumerated products are swaps, should eliminate the principal concerns expressed above with the interpretive guidance as proposed.

Fifth, although it may not be necessary, the final rules could include a "fail-safe" provision, to the effect that the exclusion(s) for insurance products would only apply to products that the CFTC and SEC have not determined by rule or regulation or order, after notice and opportunity for comment or a hearing on the record, to be a swap or security-based swap.[59]

Sixth, any rules and the Commissions' adopting releases should make it clear that insurance and annuity products are neither swaps *nor security-based swaps.* The Committee recognizes that the definition of a security-based swap in the Exchange Act is a "swap" that meets certain additional conditions,[60] and that accordingly the Proposing Release states that "[t]he statutory definition of the term "swap" also determines the scope of agreements, contracts, and transactions that could be security-based swaps."[61] However, both the proposed CFTC rule and the proposed SEC rule provide only that "[t]he term *swap* ... does not include" the specified agreements, contracts, and transactions. The proposed rules do not directly exclude insurance products from the term "security-based swap." Moreover, there appears to be a certain circularity to the statutory definitions of swap and security-based swap, since (a) the definition of a swap excludes a security-based swap, and (b) a security-based swap is a swap, without regard to the exclusion from the definition of swap for security-based swaps, that has certain additional characteristics. Because security-based swaps will be securities, the exclusion for insurance products that are also securities could add potential confusion.[62]

[59] Similarly, new rules further defining swap to clarify insurance products that are not swaps could certainly exclude identified products that are of particular concern, such as credit default swaps. This type of provision was included in the recommendations made in the ACLI's letter of November 12, 2010, *supra* note 3.

The Committee recognizes that the Proposing Release notes that section 712(d)(4) of the Dodd-Frank Act provides flexibility to address the facts and circumstances of new insurance products through joint interpretations. Proposing Release, *supra* note 1, at 29822 n.32. However, any rules adopted by the Commissions should not have the effect of requiring joint CFTC and SEC approval (or the individual approval of either agency) for new insurance products. Dodd-Frank does not replace state regulation of insurance with federal insurance regulation.

[60] Section 3(a)(68) of the Exchange Act.

[61] Proposing Release, *supra* note 1, at 29821.

[62] Although a security-based swap is now a security, it should be made clear that a security, at least as defined before the enactment of the Dodd-Frank Act, is not a swap.

Therefore, any new SEC rule or guidance should clearly and directly exclude the covered insurance products from both the term swap ***and*** the term security-based swap.

Seventh, the Committee supports the adoption of a grandfather clause, to provide certainty with respect to the types of products regulated by the states as insurance before the Dodd-Frank Act was signed, and for all insurance contracts outstanding before the effective date of final regulations further defining the terms swap and security-based swap.

Eighth, new definitional, exclusionary rules should include reinsurance by domestic insurers for all covered insurance products. In addition, the final definitional and exclusionary rules must be expanded to exclude (from the definition of swap) reinsurance agreements written by domestic insurance companies to persons located outside of the United States.

IV. Conclusion

The Committee recognizes that the Dodd-Frank Act imposed tremendous rule-making burdens on the Commissions (and hence their staffs), and that a great deal of very hard work has gone into implementing Title VII. The Committee submits its views and recommendations in hopes that they further the common goals of implementing Title VII in a way that is effective and reflects Congressional intent, and the Committee hopes that the Commissions find these views useful and helpful. We stand ready to provide whatever additional assistance may be helpful.

* * * * *

The members of the Committee very much appreciate your consideration of the views expressed above. If you have any questions, please feel free to contact the undersigned.

Respectfully submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: Stephen E. Roth
Stephen E. Roth

BY: Fred R. Bellamy
Frederick R. Bellamy

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James M. Cain

FOR THE COMMITTEE OF ANNUITY INSURERS

Attachments: Appendix A
Appendix B

FRB/mq

cc: Julian E. Hammar
Mark FajFar
David E. Aron
Matthew A. Daigler
Cristie L. March
Leah M. Drennan
Michael J. Reedich
Tamara Brightwell
Susan Nash
William Kotapish

Appendix A

THE COMMITTEE OF ANNUITY INSURERS
MEMBER LIST
July 2011

AEGON Group of Companies
Allstate Financial
AVIVA USA Corporation
AXA Equitable Life Insurance Company
Commonwealth Annuity and Life Insurance Company
(a Goldman Sachs company)
CNO Financial Group, Inc.
Fidelity Investments Life Insurance Company
Genworth Financial
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Hartford Life Insurance Company
ING North America Insurance Corporation
Jackson National Life Insurance Company
John Hancock Life Insurance Company
Life Insurance Company of the Southwest
Lincoln Financial Group
MassMutual Financial Group
Metropolitan Life Insurance Company
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
RiverSource Life Insurance Company
(an Ameriprise Financial company)
SunAmerica Financial Group
Sun Life Financial
Symetra Financial
The Phoenix Life Insurance Company
TIAA-CREF
USAA Life Insurance Company

Appendix B

THE COMMITTEE'S COMMENT LETTER OF DECEMBER 3, 2010

SUTHERLAND

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December 3, 2010

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Secretary
Commodity Futures Trading Commission
Three Lafayette Center
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Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **Definitions Contained in Title VII of Dodd-Frank Wall Street Reform And Consumer Protection Act: Clarifying the Status of Insurance Products under the Definition of "Swap" in Title VII of the Dodd-Frank Act (Securities and Exchange Commission File No. S7-16-10)**

We are submitting this letter on behalf of the Committee of Annuity Insurers in response to the Securities and Exchange Commission's (the "SEC") and the Commodity Futures Trading Commission's (the "CFTC," and together with the SEC, the "Commissions") ongoing request for comments on certain definitions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or "Act") and in anticipation of proposed rulemakings by the Commissions. The Committee of Annuity Insurers was formed in 1982 to address Federal legislative and regulatory issues relevant to the annuity industry and to participate in the development of federal securities, banking, and tax policies regarding annuities. Over the past 28 years, the Committee has played a prominent role in shaping the Federal Government's policies with respect to annuities. The Committee is a coalition of 31 of the largest and most prominent issuers of annuity contracts. The member companies of the Committee represent over 80% of the annuity business in the United States. A list of the Committee's member companies is attached as Appendix A.

Committee members have a fundamental interest in ensuring that the term "swap" in Title VII of the Dodd-Frank Act is defined in the manner intended by Congress with respect to their businesses – that is, that the term "swap" not unintentionally encompass the annuities and other guaranteed retirement income products which Committee members issue to broad classes of savers, investors, retirement plan participants, and other policyholders. It is therefore submitting this letter in order to assist the Commissions in this regard.

Background and Overview

The Dodd-Frank Act included within clause (A)(ii) of the swap definition any contract that "provides for any purchase, sale, payment, or delivery ... that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence."[1] Notwithstanding the broad scope of this definition of "swap" in the Dodd-Frank Act, both during and following the Dodd-Frank Act legislative process, the insurance industry has taken considerable comfort in the fact that, while the Act gave the CFTC and the SEC rulemaking authority to interpret terms used in the Act, there was absolutely no indication that Congress intended the definition of swap to broadly include state-regulated insurance, annuity, and other guaranteed retirement income products.

In late September, in response to an Advance Notice of Proposed Rulemaking (RIN 3235-AK65; Release No. 34-62717) issued by the Commissions requesting comments on certain definitions contained in Title VII of the Act, several commentators filed letters noting that the definition of swap could be construed to capture traditional insurance products. These commentators requested that the CFTC and SEC clarify that the Dodd-Frank Act was not intended to cover insurance products.

Regrettably, one of these commentators proposed certain parameters to define which insurance products should be regulated as swaps, which parameters could have the unintended consequence of sweeping in a number of products currently regulated as insurance.[2] The Committee believes that the formulation included in this comment is entirely unworkable and that the flawed parameters offered to exclude insurance from the definition of "swap" would create confusion, severe disruption, and significant unintended consequences in the annuity and retirement income marketplace – all at a time when both Congress and the Obama administration have recognized the importance of providing broad accessibility to the substantial protections these products afford consumers saving and planning for retirement. Moreover, insofar as numerous commentators, notably including the National Association of Insurance Commissioners, have acknowledged the uncertainty about the scope of the definition of swap and its potential application to insurance and annuity products, it is important that the SEC and CFTC now provide legal certainty.

As leading issuers of annuity and other guaranteed retirement income products, Committee members strongly support the American Council of Life Insurers' ("ACLI") letter, which articulates the fundamental premise that the definition of swap set forth in Title VII of Dodd-Frank was never intended to encompass state-regulated insurance and annuity products.[3] In that regard, the Committee offers additional information about why Congress could never have intended for the definition of swaps to encompass annuity contracts and other state-regulated guaranteed retirement income products. Especially given the unnecessary disruption that would be created by any lingering uncertainty related to the scope of the "swap" definition as it relates to state-regulated annuity and other guaranteed retirement income products, the Committee believes that additional

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[1] Dodd-Frank Act Section 721(a)(21), amending Commodity Exchange Act (the "CEA") by adding paragraph 47 to Section 1a. of the CEA.

[2] Letter of Cleary Gottlieb Steen & Hamilton, dated September 21, 2010, at http://sec.gov/comments/s7-16-10/s71610-63pdf. The Cleary Gottlieb letter concluded that insurance contracts could fall within the definition of the term "swap."

[3] Letter of American Council of Life Insurers, dated November 12, 2010, at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/derivative21sub111210-acli.pdf.

clarification would be very helpful.[4]

Summary and Support of Comments Submitted by the ACLI

The ACLI's recent comment letter to the CFTC urged the CFTC and the SEC to issue parallel guidance drawing an explicit line between swaps, on the one hand, and insurance, on the other. The ACLI explained that such guidance was necessary and appropriate because the broad definition of "swap" contained in the Dodd-Frank Act has been argued by some observers to have injected a degree of uncertainty concerning the application of this definition of "swap" to life insurance products. The ACLI noted that the Act's very clear preemption of the authority of states to regulate swaps as insurance further increases the demand for clarity.[5] The ACLI asserted, among other things, that the seemingly broad definition of "swap" contained in Dodd-Frank should be read in light of Congress's need to react to the severity of the financial crisis of 2008-2010 by developing in some cases deliberatively overly-broad definitions, with the expectation that the appropriate agencies would further hone and narrow such definitions.

The ACLI recommended that the CFTC and SEC clarify the definition of swap in order to exclude insurance contracts or transactions from the definitions of swap and security-based swap based on a three part test premised on state-level authorization and regulation of insurance products and life insurers. Specifically, under the proposed test, the contract first must be issued by an insurance company and subject to state insurance regulation; second, the contract must be a type of contract as described in the exclusion; and third, the insurance contract must not be a type of contract that the CFTC or the SEC has affirmatively decided to regulate.[6] The ACLI also explained why the multi-part definition of insurance proposed by the commentator noted above, which relies on linking payments to loss contingencies and insurable interests, is unworkable and falls well short of covering a wide range of common insurance products, particularly those used in the retirement markets.

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[4] The Committee's comments contained in this letter with respect to the definition of "swap" should in no way be regarded as relating to any existing exclusions provided by the Dodd-Frank Act to that definition or to stable value contracts that will be the subject of a study required by the Act within 15 months of enactment.

[5] Dodd-Frank Act Section 722(b). As explained below, any instrument deemed to fall within the swap definition would fall out of the state regulatory scheme, come within the Commission's regulations, and could be deemed an unlawful insurance contract.

[6] Under the ACLI's proposed test, the terms "swap" and "security-based" swap would not include any agreement, contract or transaction that:

(i) Is issued or engaged in by an insurance company . . . in respect of which the sale, reserving, payment of performance of such agreement, contract or transaction is subject to supervision by an insurance commissioner or similar official or agency of a State, or any receiver or similar official or liquidating agent for such company, in his capacity as such;

(ii) Is an insurance contract, including, without limitation, a life insurance contract, annuity contract, endowment, funding agreement, guaranteed investment contract, settlement option, long-term care insurance contract, disability insurance contract, or any reinsurance contract in respect thereof, that is issued on an individual, group or other basis, whether fixed, variable or otherwise, and is supported by such insurance company's general assets or separate accounts, as permitted under state insurance law; and

(iii) The CFTC or the SEC has not determined by rule or regulation to be a swap or security-based swap, based on an individual determination that state regulation of the contract is insufficient to warrant the exclusion following a notice and opportunity for a hearing on the record under the Administrative Procedure Act.

The Committee fully supports the ACLI's proposed clarification of the definition of swap and shares the serious concerns the ACLI has expressed regarding the commentator's suggested multi-part definition of insurance.

Why Congress Could Not Have Intended That Annuity and Other State Regulated Guaranteed Retirement Income Products Be Included within the Definition of "Swaps"

General Observations. Congress passed Title VII of the Dodd-Frank Act to provide regulatory oversight for over-the-counter derivatives and related transactions, a marketplace that due to certain regulatory compromises and other historical reasons has been largely unregulated over the past several decades. However, there is no indication that Congress meant for Title VII to replace 150 years of extensive and pervasive state regulation of insurance with a federal system of insurance regulation. Other titles of the Act confirmed this intent. For example, Title X expressly provided that the business of insurance is specifically excluded from regulation by the newly-established Bureau of Consumer Financial Protection. When structuring the Federal Office of Insurance under Title V, Congress specifically provided that the Office not be imbued with general supervisory or regulatory authority over the business of insurance and limited the Office's federal preemption authority over state insurance laws.

Significantly, the Act's definition of "swap" does not expressly list insurance, annuity or other insurance products as swaps.[7] The absence of these products from the listed items preserves the longstanding recognition under federal law that the insurance business and its products are to be regulated by the states unless Congress has expressly indicated that federal law shall apply.[8]

Moreover, as discussed in more detail below, state laws impose a multitude of regulatory requirements on insurance, annuity, and other guaranteed retirement income products that relate to licensing, accounting, investment, solvency, minimum capital, reporting, and consumer protection. These longstanding regulatory requirements and protections go to the heart of what Congress found generally absent in the derivatives marketplace.

Why the Congressional Concerns and Reforms Related to the Swaps Marketplace Are Inapposite in the Insurance Product Context. As noted, for several decades the enormous swaps market has largely operated without significant regulation. Excessive risk taking by some firms and poor counterparty credit risk management by certain market participants, saddled the financial system with an enormous unrecognized level of risk. During the ensuing financial crisis, the sheer volume of bad mortgage-backed securities and the supposed guarantee of these securities by credit default swaps overwhelmed some firms and left institutions with losses they believed they had

[7] The conclusion that insurance products were to be generally excluded from the scope of Title VII is not inconsistent with the title's jurisdictional provisions that amended the Commodity Exchange Act to provide that "[a] swap ...shall not be considered insurance.....and may not be regulated as an insurance contract under the law of any State." That provision was included in the Act to assure that products that were widely used in the derivatives market, particularly credit default swaps, were not regulated by state insurance regulators as insurance. It is inconceivable that Congress, by including the foregoing provision and not expressly stating the contrary, i.e., that all insurance products are not swaps, intended to give the CFTC and the SEC unfettered discretion to regulate insurance products.

[8] See the McCarran-Ferguson Act, which states that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance. . . unless such Act ***specifically relates*** to the business of insurance (emphasis added)." 15 U.S.C. § 1012(b) ("McCarran Ferguson").

protected against. Regulators, lacking authority over this marketplace, were unable to identify or mitigate the enormous systemic threat to the U.S. and global financial system.

In response, Title VII of the Dodd-Frank Act brought three critical types of reform to the previously unregulated swaps marketplace that are intended to lower interconnectedness and risk in the financial system while promoting transparency. It accomplishes these three goals by imposing new requirements on:

- The *instruments* that are traded (swaps and security-based swaps);
- The *dealers* (swap and security-based swap dealers) and *major swap market participants* who are the intermediaries and primary obligors in the swap market; and
- The *facilities* where the trades are executed, cleared and reported (designated contract markets, swap execution facilities and security-based swap execution facilities, derivatives clearing organizations, and swap and security-based swap data repositories).

State insurance laws and regulations impose a multitude of regulatory requirements relating to licensing, accounting, investment, solvency, minimum capital, reporting, and consumer protection. The extensive regulation that already exists in the annuity marketplace provides longstanding protections that obviate the need for the protections provided by the Act, including:

- In adopting state insurance laws and regulations, state legislatures and insurance departments have been able to draw upon a multitude of model laws and regulations that carefully define all major types of life insurance, annuity, and retirement products and apply the protections provided by the laws and regulations described above as appropriate to each such type of insurance, annuity, or retirement product. These laws and regulations significantly limit the derivatives investments and related activities of insurers, including their ability to engage in over-the-counter swaps. In short, there is no reason to define annuity or other insurance contracts as swaps or security-based swaps or to apply the protections that will be afforded by Title VII of the Dodd-Frank Act, when such definitions and protections already exist under state insurance regulation.

- The financial integrity of insurers and the manner in which they distribute their products is highly regulated. Most significantly, state insurance regulators have well-defined capital and reserve requirements applicable to insurance companies that are tailored to the specific lines of insurance businesses conducted by a company, as well as extensive financial reporting requirements and well-defined monitoring systems to identify solvency issues before they become ungovernable. Accordingly, it is highly unlikely that adverse economic or financial developments could mushroom to uncontrollable panic situations for annuity contracts and other insurance and retirement products.

- Clearinghouses to be created in accordance with the Act are intended to mitigate credit risks posed by individual counterparties by interposition of the clearinghouses between buyers and sellers that undertake to take on each party's respective financial obligations. However, the diverse nature of the risks protected by insurers are not the sort of risks that can be prudently assumed by a clearinghouse. Purchasers of annuity and other state-regulated insurance products rely on extensive solvency regulations, reserve requirements and regulation of permissible insurer investments, rendering it unnecessary for any clearinghouse to step into the shoes of the issuer of annuity or other insurance products to ensure that the contract owner's benefits are fully paid by the issuing insurance company, or for other requirements such as the establishment of swap and security-based data repositories to be imposed given the extensive reporting and accounting requirements already imposed by state insurance law.

Why Congress Could Never Have Intended the Severe Disruption to Insurers, Their Customers, and the Existing State Regulatory Framework Resulting from Applying the Definition of "Swap" to Annuity and Other Insurance Products. As explained above, insurance, annuity and other guaranteed retirement income products are extensively regulated under state insurance laws. For example, the form of a contract being issued generally must be filed with and approved by a state insurance regulator before being sold in the state. In addition, these contracts are subject to state insurance laws regulating the reserves a life insurer must maintain to support its obligations under the contract. However, if any of these contracts were determined to be a swap and the Dodd-Frank Act § 722(b) state law preemption were triggered, then no state could regulate the contract as an insurance contract. As a result, policy form approval laws and reserve requirements that are applicable to that contract would be preempted. Such preemption would therefore deprive states of their core functions of supervising the solvency of insurance companies and determining the sufficiency of assets supporting insurance company contract obligations, which in turn could force states to prohibit insurers from issuing products that the states could no longer regulate.

Moreover, if an annuity or other insurance contract offered by a life insurer were deemed to be a "swap" and as a result, regulation of the contract was shifted from state law (as an insurance contract) to federal law (as a swap), such a characterization could have the unintended result that the sale of the contract would become an unauthorized and impermissible use of derivatives by a life insurer under state insurance law.[9] In addition, the alternative of federal regulation of this market is not viable since the vast majority of an insurer's insurance and annuity customers would not meet the standards of being "eligible contract participants" and engaging in individually tailored, non traded, annuity and life insurance transactions deemed to be swaps with such customers would be illegal.[10] As a result, a determination that annuity and other retirement products issued by insurers are swaps could bar life insurers from issuing such products altogether under state law, thereby freezing life insurers out of their annuity, guaranteed retirement income, and other traditional insurance lines of business, and under the new federal law would be drastically limit the availability of these products to the retirement markets and the public generally.

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[9] New York Insurance Law Section 1410 (with applicable definitions found in Section 1401(a)) is illustrative, especially since New York imposes its derivative regulation on not just New York domestic insurers but all insurers licensed to do insurance business in New York. Under New York law, a "swap" is a permitted derivative instrument (Section 1401(a)(7)), but it can only be used in a hedging transaction (Section 1401(a)(12)), a replication transaction (Section 1401(a)(18)) or limited kinds of income generation transactions (*see* Sections 1410(c), 1410(l), and 1410(d), respectively). The sale of a contract deemed to be a swap would not constitute any of these permissible kinds of derivative transactions, so that as a result the sale of such a contract would not be an authorized use of derivatives under New York law and the sale could be held to violate New York law.

[10] See Section 723(a)(2) Swaps; limitation on participation, providing as follows: "Section 2 of the Commodity Exchange Act (*7 U.S.C. 2*) (as amended by paragraph (1)) is amended by inserting ...(e) Limitation on Participation.--It shall be unlawful for any person, other than an eligible contract participant, to enter into a swap unless the swap is entered into on, or subject to the rules of, a board of trade designated as a contract market under section 5."

In sum, the framework imposed by the Dodd-Frank Act would be incredibly disruptive of the manner in which insurers operate their annuity business, and would operate to adversely affect the availability of annuity and other guaranteed retirement income products at a time when Congress and the Obama administration are encouraging retirement savings and have recognized the critical importance of annuity products to the retirement markets.

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The members of the Committee very much appreciate your consideration of the views expressed above. If you have any questions, please feel free to contact the undersigned.

Respectfully submitted,

SUTHERLAND ASBILL & BRENNAN LLP

BY: Stephen E. Roth
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BY: James M. Cain
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FOR THE COMMITTEE OF ANNUITY INSURERS

cc: Julian Hammar, Esquire
Commodities Futures Trading Commission (by electronic mail and hand delivery)

Attachments: Appendix A

Appendix A

THE COMMITTEE OF ANNUITY INSURERS

AEGON Group of Companies
Allstate Financial
AVIVA USA Corporation
AXA Equitable Life Insurance Company
Commonwealth Annuity and Life Insurance Company
CNO Financial Group, Inc.
Fidelity Investments Life Insurance Company
Genworth Financial
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Hartford Life Insurance Company
ING North America Insurance Corporation
Jackson National Life Insurance Company
John Hancock Life Insurance Company (USA)
Life Insurance Company of the Southwest
Lincoln Financial Group
Massachusetts Mutual Life Insurance Company
Metropolitan Life Insurance Company
Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
RiverSource Life Insurance Company
(an Ameriprise Financial company)
SunAmerica Financial Group
Sun Life Financial
Symetra Financial
TIAA-CREF
USAA Life Insurance Company