ACLI Position on Key Terms in Title VII of the Dodd-Frank Act

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Life insurers are significant *end-users* of derivative instruments that are used to prudently manage the risks of their assets and liabilities, as permitted under state insurance codes and regulations. Life insurers' financial products protect millions of individuals, families, and businesses through guaranteed lifetime income, life insurance, long-term care, and disability income insurance. The long-term nature of these products requires insurers to match long-term obligations with assets of a longer duration than most other financial institutions. Derivatives allow life insurers to prudently manage the credit and market risk of their portfolios and to fulfill their obligations to policy and contract owners. The regulatory status of derivatives, therefore, is critically important to the life insurance industry.

ACLI previously submitted a comment letter in response to the CFTC's and SEC's request for input on key definitions in Title VII of the Dodd-Frank Act, and reiterate some of our key points as follows:

- Major Swap Participant/Major Security-Based Swap Participant (MSP): For each MSP category, a determination of whether an end-user's swap positions are of a magnitude to pose a risk to the U.S. banking system or financial system is key to the regulatory decision as to whether to regulate that end-user as an MSP. Congress has recognized clearing and collateralization as risk mitigants and potential offsetting factors in the risk determination. Quantitative thresholds established for determining what is a "substantial position" and what constitutes "substantial counterparty risk" should therefore be at levels at which such systemic risk is likely to be present as the result of the bankruptcy or failure to perform of a market end-user, taking into consideration the risk mitigation benefits of netting, collateral, and clearing.

- Commercial Risk: The term "commercial risk" should be construed to include risks of financial as well as non-financial end-users of derivatives. This would be consistent with the historic approach that the CFTC has taken in the past, including through its interpretations of the Reg. 1.3(z) definition of "bona fide hedging". In other words, the CFTC and SEC should not operate under a presumption that a company does not hedge or mitigate commercial risk just because a company is a financial company.

- Highly Leveraged: We submit that the concept of "highly leveraged relative to the amount of capital it holds" should not be a mechanical concept but should relate to the types of risk potentially posed by a financial entity. Use of a simple balance sheet test or resort to the capital rules relevant to banks might be ultimately be determined to be workable. However, application of overly simplistic tests to diverse entities with different risk profiles might result in the regulatory net capturing an excessive number of non-systemically risky entities. We therefore urge careful development of this standard, supported by appropriate economic and financial analysis, including without limitation, review of leverage levels and standards prevailing in differing financial market sectors, and the risk posed by different business models and structures, to avoid such unintended consequences.

- Insurance: Some commentators on the "core" definition proposal have observed that a very expansive reading of the "swap" definition could include insurance products and related agreements. We do not agree with this view. Insurance products are not "swaps" in form or substance. Insurance products are governed by a comprehensive regulatory and reporting framework for insurers. This framework include mutually reinforcing accounting standards for reporting financial results and actuarial standards for ongoing evaluation of the proper reserve liability associated with the policies. The definitions of "swaps" and "securities-based swaps" should specify that insurance products are excluded.