COMMODITY FUTURES TRADING COMMISSION

SECURITIES AND EXCHANGE COMMISSION

Release No. 34-65153; File No. S7-32-11

Acceptance of Public Submissions Regarding the Study of Stable Value Contracts

AGENCIES: Commodity Futures Trading Commission; Securities and Exchange Commission.

ACTION: Request for comment.

SUMMARY: The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was enacted on July 21, 2010. Section 719(d) of the Dodd-Frank Act mandates that the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC" and, together with the CFTC, the "Commissions") jointly conduct a study to determine whether stable value contracts ("SVCs") fall within the definition of a swap. Section 719(d) of the Dodd-Frank Act also requires that the Commissions, in making that determination, jointly consult with the Department of Labor, the Department of the Treasury, and the State entities that regulate the issuers of SVCs. Further, Section 719(d) of the Dodd-Frank Act provides that if the Commissions determine that SVCs fall within the definition of a swap, they jointly shall determine if an exemption for SVCs from the definition of a swap is appropriate and in the public interest. In connection with this study, the Commissions' staffs seek responses of interested parties to the questions set forth below.

DATES: Please submit comments in writing on or before **[INSERT DATE 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: Comments may be submitted by any of the following methods:

CFTC:

- Agency website, via its Comments Online process: http://comments.cftc.gov. Follow the instructions for submitting comments through the website.
- Mail: David A. Stawick, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.
- Hand Delivery/Courier: Same as mail above.
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

Please submit your comments using only one method. "Stable Value Contract Study" must be in the subject field of responses submitted via e-mail, and clearly indicated on written submissions. All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to www.cftc.gov. You should submit only information that you wish to make available publicly. If you wish the CFTC to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in section 145.9 of the CFTC's regulations.[1]

The CFTC reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse, or remove any or all of your submission from www.cftc.gov that it may deem to be inappropriate for publication, including obscene language. All submissions that have been redacted or removed that contain comments on the merits of

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[1] 17 CFR 145.9.

the rulemaking will be retained in the public comment file and will be considered as required under applicable laws, and may be accessible under the Freedom of Information Act.

SEC:

Electronic comments:

Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml);

Send an e-mail to rule-comments@sec.gov. Please include File Number S7-32-11 on the subject line; or

Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.
All submissions should refer to File Number S7-32-11. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The SEC will post all comments on the SEC's Internet website (http://www.sec.gov/rules/other.shtml). Comments are also available for website viewing and printing in the SEC's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the SEC does not edit personal identifying information from

submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: CFTC: Stephen A. Kane, Consultant, Office of the Chief Economist, (202) 418-5911, skane@cftc.gov; or David E. Aron, Counsel, Office of the General Counsel, (202) 418-6621, daron@cftc.gov, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581; SEC: Matthew A. Daigler, Senior Special Counsel, (202) 551-5500, Donna Chambers, Special Counsel, (202) 551-5500, or Leah Drennan, Attorney-Adviser, (202) 551-5500, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

On July 21, 2010, President Obama signed the Dodd-Frank Act into law.[2] Pursuant to section 719(d)(1)(A) of the Dodd-Frank Act, the Commissions jointly must conduct a study, not later than 15 months after the date of enactment of the Dodd-Frank Act, to determine whether SVCs fall within the definition of a swap.[3] Section

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[2] See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act is available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4173enr.txt.pdf.

[3] The term "swap" is defined in Commodity Exchange Act ("CEA") section 1a(47), 7 U.S.C. 1a(47). The term "security-based swap" is defined as an agreement, contract, or transaction that is a "swap" (without regard to the exclusion from that definition for security-based swaps) and that also has certain characteristics specified in the Dodd-Frank Act. See section 3(a)(68) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(68). Thus, a determination regarding whether SVCs fall within the definition of a swap also is relevant to a determination of whether SVCs fall within the definition of the term "security-based swap." These terms are the subject of further definition in joint proposed rulemaking by the Commissions. See Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, File No. S7-16-11, 76 FR 29818 (May 23, 2011) ("Product Definitions Proposing Release"). Citations herein to provisions of the Commodity Exchange Act and the Securities Exchange Act of 1934 refer to the numbering of those provisions after the effective date of Title VII.

719(d)(1)(A) of the Dodd-Frank Act also requires the Commissions, in making such determination, jointly to consult with the Department of Labor, the Department of the Treasury, and the State entities that regulate the issuers of SVCs.

If the Commissions determine that SVCs fall within the definition of a swap, they jointly must determine if an exemption for SVCs from the definition of a swap is appropriate and in the public interest.[4] Until the effective date of any regulations enacted pursuant to Section 719(d) of the Dodd-Frank Act, and notwithstanding any other provision of Title VII of the Dodd-Frank Act, the Title VII requirements will not apply to SVCs.[5]

Section 719(d)(2) of the Dodd-Frank Act defines a "stable value contract" as:

> any contract, agreement, or transaction that provides a crediting interest rate and guaranty or financial assurance of liquidity at contract or book value prior to maturity offered by a bank, insurance company, or other State or federally regulated financial institution for the benefit of any individual or commingled fund available as an investment in an employee benefit plan (as defined in section 3(3) of the Employee Retirement Income Security Act of 1974, including plans described in section 3(32) of such Act) subject to participant direction, an eligible deferred compensation plan (as defined in section 457(b) of the Internal Revenue Code of 1986) that is maintained by an eligible employer described in section 457(e)(1)(A) of such Code, an arrangement described in section

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[4] See section 719(d)(1)(B) of the Dodd-Frank Act. Pursuant to section 719(d)(1)(B) of the Dodd-Frank Act, "The Commissions shall issue regulations implementing the determinations required under this paragraph."

[5] See section 719(d)(1)(C) of the Dodd-Frank Act.

403(b) of such Code, or a qualified tuition program (as defined in section 529 of such Code).[6]

The Commissions' staffs understand that stable value funds ("SVFs") are a type of investment commonly offered through 401(k) and other defined contribution plans with the objective of providing preservation of principal, liquidity, and current income at levels that are typically higher than those provided by money market funds.[7] The Commissions' staffs further understand that SVCs are components of SVFs that SVF sponsors or managers purchase from SVC providers, including banks and insurers, that provide a guarantee, or "wrap," by the service provider to pay plan participants at "book value" should the market value of the SVF be worth less than the amount needed to pay that book value.[8] In furtherance of this SVC study, the Commissions' staffs seek responses to the any or all of the questions below. Commenters are encouraged to provide additional relevant information, including empirical evidence where appropriate and to the extent feasible, beyond that called for by these questions.

Swap Definitional and Exemptive Issues

1. Do SVCs possess characteristics that would cause them to fall within the definition of a swap? If so, please describe those characteristics.

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6 The Commissions understand that a bank, insurance company, or other state or federally regulated financial institution that offers an SVC is commonly referred to as an "SVC provider."

7 See, e.g., U.S. Government Accountability Office, 401(K) Plans: Certain Investment Options and Practices That May Restrict Withdrawals Not Widely Understood, at 10-11, GAO-11-234 (Washington, D.C.: Mar. 10, 2011); Proposed Exemptions From Certain Prohibited Transaction Restrictions, Department of Labor, 75 FR 61932, 61938 (Oct. 6, 2010).

8 See 401(K) Plans: Certain Investment Options and Practices That May Restrict Withdrawals Not Widely Understood, supra note 7, at 11. In the context of an SVC, the staffs understand, based on conversations with market participants, that the term "book value" means investment principal plus interest accrued using the crediting rate formula determined for the SVF and set forth in the SVC.

2. What characteristics, if any, distinguish SVCs from swaps?

3. Does the definition of the term "stable value contract" in Section 719(d)(2) of the Dodd-Frank Act encompass all of the products commonly known as SVCs?

4. Are the proposed rules and the interpretive guidance set forth in the Product Definitions Proposing Release[9] useful, appropriate, and sufficient for persons to consider when evaluating whether SVCs fall within the definition of a swap? If not, why not? Would SVCs satisfy the test for insurance provided in the Product Definitions Proposing Release? Why or why not? Is additional guidance necessary with regard to SVCs in this context? If so, what further guidance would be appropriate? Please explain.

5. If the Commissions were to determine that SVCs fall within the definition of a swap, what would be their underlying reference asset?

6. If the Commissions were to determine that SVCs fall within the definition of a swap, what facts and considerations, policy and otherwise, would support exempting SVCs from the definition of a swap? What facts and considerations, policy and otherwise, would not support exempting SVCs from the definition of a swap?

7. If the Commissions were to (a) determine that SVCs fall within the definition of a swap but provide an exemption from the definition of a swap, (b) determine that SVCs fall within the definition of a swap and not provide an exemption from such definition, or (c) determine that such contracts are not swaps, what beneficial or adverse regulatory or legal consequences, if any, could result? For example, could any

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[9] See supra note 3. The Commissions note that any comment submitted in response to this question will be taken into consideration by the Commissions as they consider any final action on the Product Definitions Proposing Release.

of such determinations lead to beneficial or adverse treatment under the Employee Retirement Income Security Act ("ERISA"), bankruptcy law, tax law, or accounting standards, as compared to the regulatory regimes applicable to SVCs, in the event that the Commissions were to determine that SVCs are not swaps or grant an exemption from the definition of a swap?

Market and Product Structure Issues

8. What are the different types of SVCs, how are they structured, and what are their uses? Please describe in detail.

9. Please describe the operation of SVCs and SVFs generally in terms of contract structure, common contract features, investments, market structure, SVC providers, regulatory oversight, investor protection, benefits and drawbacks, risks inherent in SVCs, and any other information that commenters believe the Commissions should be aware of in connection with the SVC study.

10. What provisions of SVCs, if any, allow SVC providers to terminate SVCs that prevent benefit plan investors from transacting at book value? What are the trade-offs, including the costs and benefits of such provisions? Please describe in detail.

11. Describe the benefits and risks of SVCs for SVC providers. How do SVC providers mitigate those risks? Please provide detailed descriptions. How effective are any such measures?

12. Describe the benefits and risks of SVCs for investors in SVFs. Please provide detailed descriptions.

13. The Commissions' staffs understand that SVC providers sometimes negotiate so-called "immunization" provisions with SVF managers and that such

provisions typically allow SVC providers (or SVF managers) to terminate the SVCs based upon negotiated triggers, which can include underperformance of the portfolio against a benchmark. The Commissions' staffs also understand that, once immunization provisions have been triggered and are in effect, the SVF must be managed according to the immunization guidelines, which typically require the liquidation of all securities rated below AAA and in certain cases may require the portfolio to be invested 100% in Treasury securities. What risks, if any, do "immunization" provisions in SVCs pose to investors in SVFs? If immunization provisions in SVCs pose risks to investors in SVFs, are these risks clearly disclosed to investors? Are these risks required to be disclosed to investors? What are the sources of such requirements? How do SVF managers or SVC providers address the risk that immunization will be exercised? How effective are any such measures?

14. The Commissions' staffs understand that some SVCs grant SVC providers the right to limit coverage of employer-driven events or employee benefit plan changes. Such events or changes could cause a decrease in a SVF's value and result in large scale investor withdrawals or redemptions (sometimes called a "run on the fund"). How do SVC providers and SVF managers manage this risk, if at all? How effective are any such measures?

15. The Commissions' staffs understand that SVF managers infuse capital into their funds in certain instances. Please describe the circumstances under which an SVF fund manager would provide such capital support for its fund.

16. The Commissions' staffs understand that "pull to par" provisions of SVCs provide that SVCs will not terminate (absent the application of another contract

termination provision) until the gap between the market value of the wrapped assets and the SVC book value is closed, however long that takes. The Commissions' staffs also understand that pull to par provisions are standard for SVCs. Are these understandings correct? Please describe pull to par provisions and how prevalent such provisions are in SVCs.

17. How have SVFs and SVCs been affected by the recent financial crisis? How many SVC providers are in the market today? Is the number of SVC providers higher or lower than prior to the financial crisis that began in 2008? Are fees now higher or lower than prior to the financial crisis?

18. Do investors have incentives to make a run on a SVF when its market-to-book ratio is substantially below one? What protections, if any, do SVCs provide to protect fund investors who do not redeem their fund shares amid a run on the fund? How effective are any such protections?

19. How do market risk measures assess the risk of a run on a SVF? To the extent that SVC providers use value-at-risk ("VaR") models, do such VaR models adequately assess the risk of loss resulting from such events or other possible but extremely unlikely events? Do other loss models more adequately assess the risk of loss, such as the expected value of a loss or the expected value given a loss, which employs the entire loss probability distribution without excluding events in the extreme tail of the loss distribution?

20. Are certain SVC providers more likely, as a result of credit cyclicality, to become financially distressed? If so, is such financial distress likely to occur

concurrently with financial distress of SVFs? If so, can the risk of such concurrent financial distress be mitigated? How effective are any such measures?

21. Do SVC providers pose systemic risk concerns? Are there concerns with entities that may be systemically important institutions providing SVCs? What are the consequences for SVFs, employee benefit/retirement plans, and the financial system should an SVC provider fail?

22. Are there issues specific to financial institutions providing SVCs, including institutions that are systemically significant, that the Commissions should consider in connection with the SVC study? If so, please describe.

Regulatory Issues

23. What disclosures to benefit plan investors in SVFs currently are required, and what are the sources of such requirements? What additional disclosure typically is provided, either voluntarily or on request? What additional disclosure, if any, would be warranted and why would it be warranted? Please explain in detail.

24. What financial and regulatory protections currently exist that are designed to ensure that SVC providers can meet their obligations to investors, and what are the sources of such protections? Does the level of protection vary depending on the SVC provider? How effective are any such measures?

25. Currently, do entities other than state-regulated insurance companies and federally- or state-regulated banks provide SVCs? If so, what kinds of entities do so and how are they regulated? If not, are there any barriers to the provision of SVCs by entities other than state-regulated insurance companies and federally- or state-regulated banks?

26. What role do SVF managers play in protecting the interests of plan participants with respect to SVFs? How effective are any such measures?

Compliance Issues if the Commissions Were to Determine SVCs Were Swaps

27. If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, should the regulatory regime for SVCs be limited or tailored in any way? If so, how? Please explain in detail. Should any of the requirements for capital and margin for SVCs differ from those for swaps that are not SVCs? Why or why not? If the requirements for capital and margin should differ, please explain in detail what those differences should be.

28. If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, would the requirements of any regulatory regime for swaps impact fee structures or fees charged by SVC providers? Please describe (quantitatively, if possible) the relationship of any new federal regulation under the Dodd-Frank Act to possible changes in fee structures or fees, to the extent feasible, and state any assumptions used in quantifying such relationship.

29. If the Commissions were to determine that SVCs fall within the definition of a swap and should not be exempted from such definition, would this decision influence the availability of SVFs to investors? Would this designation affect existing SVFs and the ability of SVFs to purchase SVCs? If so, how and why?

By the Commodity Futures Trading Commission.

David A. Stawick
Secretary

Date: August 18, 2011

By the Securities and Exchange Commission.

Elizabeth M. Murphy
Secretary

Date: August 18, 2011