

Regulators Consider Whether Stable Value Contracts Should Be Subject to Regulation as Swaps under the Dodd-Frank Act and Solicit Public Comment

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In addition to requiring the Commodity Futures Trading Commission (the CFTC) and the Securities and Exchange Commission (the SEC) to promulgate rules further defining the terms “swap” and “security-based swap” under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), Title VII of the Dodd-Frank Act requires the CFTC and the SEC to conduct a study of whether stable value contracts (SVCs) fall within the term “swap.” This study is to be completed by October 21, 2011, 15 months after the enactment of the Dodd-Frank Act. In furtherance of their study, the CFTC and the SEC have published a request for public comment on SVCs (the SVC Joint Release), a copy of which is available [here](#). Comments are due on September 26, 2011.

The definition of swap contained in Section 1a(47) of the Commodity Exchange Act (the CEA), as amended by the Dodd-Frank Act, and the definition of security-based swap contained in Section 3(a)(68) of the Securities Exchange Act (the Exchange Act), as amended by the Dodd-Frank Act, are very broad and could encompass a number of commercial instruments, including insurance and annuity products, that historically have not been considered swaps.¹ The CFTC and the SEC previously issued joint proposed rules and interpretive guidance further defining the terms “swap” and “security-based swap” (the Product Definition Joint Release). A copy of the Product Definition Joint Release is available [here](#), and copies of the public comments received in response to it are available [here](#). Both the proposed rules and the interpretive guidance contained in the Product Definition Joint Release clarify that certain insurance and annuity contracts are not swaps under the CEA or security-based swaps under the Exchange Act, but they do not address SVCs.

The Dodd-Frank Act directs the CFTC and the SEC to (a) determine whether SVCs fall within the definition of swap and (b) if the CFTC and the SEC determine that SVCs fall within the definition of swap, determine whether it is “appropriate and in the public interest” to exempt SVCs from the definition of swap and issue regulations implementing such determinations.² Until the effective date of such regulations, SVCs will not be subject to regulation under Title VII of the Dodd-Frank Act. In addition, the Dodd-Frank Act clarifies that any SVCs in effect prior to the effective date of such regulations will not be considered swaps.³

¹ The term “security-based swap” is defined in Section 3(a)(68) of the Exchange Act 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 Section 3(a)(68) of the Exchange Act.

² Section 719(d)(1) of the Dodd-Frank Act.

³ Section 719(d)(1)(C) of the Dodd-Frank Act.

SVCs are defined in the Dodd-Frank Act 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 Benefit 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 403(b) of such Code, or a qualified tuition program (as defined in section 529 of such Code).”⁴ The SVC Joint Release states the CFTC and SEC staff’s understanding of SVCs as “wraps” purchased by sponsors and managers of stable value funds (SVFs) through which the sellers of the SVCs (typically banks and insurance companies) pay participants in the SVF at “book value” should the market value of the SVF be worth less than the amount needed to pay that book value.

Under the statutory definition, SVCs would not include, for example, SVCs offered outside of the retirement or 529 market and SVCs for ERISA plans that are not subject to participant direction (e.g., defined benefit plans). Accordingly, such products would need to be analyzed under the definitions of “swap” and “security-based swap” in the CEA and the Exchange Act (both as amended by the Dodd-Frank Act) and the final version of the Product Definition Joint Release. Additionally, any such products that are not within the statutory definition of SVCs would not receive the benefit of the delayed effective date for regulation under Title VII that is afforded to SVCs under Section 719(d)(1)(C) of the Dodd-Frank Act.

In the SVC Joint Release, the CFTC and the SEC ask specific questions about the economics and mechanics of SVCs and whether they should be regulated as swaps. One question specifically asks whether the Product Definition Joint Release’s criteria for determining whether insurance products are swaps would be “useful, appropriate and sufficient” for determining whether SVCs are swaps. The CFTC and the SEC also ask about the risks associated with SVCs and how those risks are mitigated by existing regulation of such products and/or existing industry practices. Finally, the CFTC and the SEC ask about the effects that the new requirements for swaps under Title VII of the Dodd-Frank Act would have on SVCs if SVCs were subject to such requirements. The requirements include, *inter alia*, capital and margin requirements, reporting and recordkeeping requirements, mandatory clearing and platform execution, documentation requirements and business conduct standards.



If you are interested in submitting comments in response to the SVC Joint Release or if you have any other questions, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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⁴ Section 719(d)(2) of the Dodd-Frank Act.