



November 1, 2012

Ms. Sauntia S. Warfield  
Assistant Secretary  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: Acceptance of Public Submissions Regarding the Study of Stable Value Contracts;  
SEC Release No. 34-67927; File No. S7-32-11

Dear Ms. Warfield and Ms. Murphy:

Better Markets, Inc.<sup>1</sup> appreciates the opportunity to provide additional comment on the study that the Commodity Futures Trading Commission (“CFTC”) and the Securities and Exchange Commission (“SEC”) (together, the “Commissions”) are conducting jointly to determine whether stable value contracts fall within the definition of a swap (“Study”). The Study is mandated by Section 719(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). As explained in the release cited above (“Release”), the original comment period for the Study closed on September 26, 2011, but the Commissions are seeking additional comment in light of the recent adoption of final rules further defining the terms “swap” and “security-based swap” (“SBS”).<sup>2</sup>

### **SUMMARY OF COMMENTS**

The product definitions rule has created an additional and compelling reason for defining stable value contracts as swaps and expressly subjecting them to regulation under Title VII of the Dodd-Frank Act. In the product definitions rule, the SEC chose not

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<sup>1</sup> Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

<sup>2</sup> 77 Fed. Reg. 60113 (Oct. 2, 2012).

to adopt an anti-evasion rule. This omission compounds the already substantial risk that unless explicitly brought within the definition of a swap, stable value contracts will be used to evade regulation.

Specifically, market participants will be further incentivized to structure some SBS as stable value contracts to avoid regulation, since the SEC will lack the anti-evasion tools necessary to defeat such strategies. The SEC will be unable to close the loophole for stable value contracts even in cases where the stable value contract is transparently and intentionally nothing more than a restructured SBS. Consequently, not all SBS will be subject to the requirements and protections Congress intended under Title VII of the Dodd-Frank Act.<sup>3</sup> The failure to include anti-evasion language turns a risk of evasion into nothing more than a business choice, with the wrong incentives to use form to defeat substance. This is yet one more compelling reason for concluding that stable value contracts must be regulated as swaps.

## **COMMENTS**

Better Markets previously commented on the Study and it stressed three key points in its letter:<sup>4</sup>

- Stable value contracts clearly satisfy at least two of the separate tests for defining swaps set forth in the Dodd-Frank Act, each of which by itself would justify treating stable value contracts as swaps.
- Regulating stable value contracts as swaps is not only legally necessary and appropriate, but also exceedingly important, given, for example, the widespread use of stable value contracts in 401(k) plans relied upon by retail investors.
- A decision not to include stable value contracts within the definition of a swap, or a decision to exempt them from regulation as swaps, will create an enormous loophole in the regulatory scheme. As we explained: “Transactions that are substantively swaps will be characterized as exempt stable value contracts to avoid the requirements of the law.”<sup>5</sup>

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<sup>3</sup> The concerns expressed in this letter are relevant even though the increased risk of evasion pertains specifically to **SBS**, while the Study focuses on the status of stable value contracts as **swaps**. As explained in the original release regarding the Study, SBS are a subset of swaps, and therefore “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.’” 76 Fed. Reg. at 53162-63 n.3.

<sup>4</sup> See Better Markets comment letter, “Stable Value Contract Study,” Sept. 26, 2011, *available at* <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48225&SearchText=better%20markets>, which is incorporated by reference as if fully set forth here.

<sup>5</sup> *Id.* at 12.

The risk of evasion highlighted in the last point above has now assumed even greater importance in light of the recently released definitions rule. To protect against another crippling financial crisis, Congress mandated strong and comprehensive regulation of swaps and SBS. The product definitions rule is the linchpin of this new regime. Recognizing the importance of establishing definitions with a broad and flexible reach, the CFTC included in its definitions an extremely important anti-evasion provision. It states that any product or transaction “that is **willfully structured to evade** any provision [in the Dodd-Frank Act governing swaps] shall be deemed a swap.”<sup>6</sup> This language gives the CFTC a vitally important regulatory tool that it can use to thwart any attempt to evade regulation through product design.

Unfortunately, the SEC chose not to adopt any anti-evasion provision in its definitions rule. In the final rule release on definitions, the SEC simply noted that “[s]ince existing regulations, including anti-fraud and anti-manipulation provisions, will apply to security-based swaps, the SEC believes that it is unnecessary to adopt additional anti-evasion rules for security-based swaps.”<sup>7</sup>

What is missing from this explanation is an analysis of how “existing regulations” will ensure that SBS structured as other types of unregulated financial instruments like a stable value contract will nevertheless be subject to the SEC’s jurisdiction. It is also not clear how the SEC could assert that a product is fraudulent or manipulative if intentional evasion itself is not prohibited. Indeed, one has to wonder if standard rules of construction will estop the SEC from even making the argument. After all, the SEC knew that the CFTC expressly prohibited evasion in similar circumstances, but the SEC knowingly made the decision not to prohibit such evasion. The better argument would seem to be that the SEC did not prohibit evasion. This of course will incentivize financial engineers to design products that fall outside the SEC’s regulatory reach (even if stable value contracts are expressly included).

The absence of a strong anti-evasion provision in the SEC rule defining SBS will in effect double the risk of evasion **if** stable value contracts are not defined to be swaps. In short, if stable value contracts are left out of the swap definition, or included in the definition but exempted from regulation, there will be no backstop against evasion with respect to SBS. Unlike the CFTC, the SEC will lack the clear authority to regulate any SBS that are structured as stable value contracts, even where such artful design is undertaken “willfully” and for the specific purpose of evading the law. As a consequence, a sector of the SBS market will almost certainly remain exempt from the heightened requirements and protections that Congress intended to apply to all derivatives, swaps and SBS alike.

This heightened threat of evasion arising from the product definitions rule should figure prominently in the Study. Furthermore, these considerations—along with the

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<sup>6</sup> 17 C.F.R. § 1.3(6).

<sup>7</sup> 77 Fed. Reg. at 48303.

other factors explained in our prior letter regarding the Study<sup>8</sup>—should lead the Commissions to conclude that stable value contracts must be defined as swaps and fully regulated as such without exemption.

**CONCLUSION**

We hope these comments are helpful as the Commissions complete the Study and resolve the status of stable value contracts under the Dodd-Frank Act.

Sincerely,



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<sup>8</sup> See *supra* note 4.