

**Meeting Between Staff from the Prudential Regulators and  
the American Council of Life Insurers  
January 8, 2015**

**Participants:** Sean Campbell, Anna Harrington, Elizabeth MacDonald, and Victoria Szybillo (Federal Reserve Board)

Kurt Wilhelm, Jamey Basham, Laura Gardy, and Carl Kaminski (OCC)

Bob Bean, Karl Reitz, Jacob Doyle, and Thomas Hearn (FDIC)

Bob Collender and Julie Paller (FHFA)

Richard Katz, Tim Nerdahl, and Jeremy Edelstein (FCA)

Joseph Demetrick (MetLife), Todd Lurie (MetLife), Jason Manske (MetLife), Patricia Merrill (Genworth), Richard Miller (Prudential Insurance Company of America), Gary Neubeck (Prudential Insurance Company of America), Kathleen O'Neill (New York Life), and Carl Wilkerson (American Council of Life Insurers)

**Summary:** The American Council of Life Insurers and certain of its members (the “Representatives”) met with staff from the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency and the Farm Credit Administration (the “Prudential Regulators”) to discuss issues related to the proposed rule issued by the Prudential Regulators on margin requirements for covered swap entities under Title VII of the Dodd-Frank Act.

Among matters discussed in the meeting were the Representatives’ views on certain aspects of the proposal, including: broadening the scope of eligible collateral for purposes of variation margin to include non-cash collateral; the characterization of variation margin as settlement payments; providing additional time for implementation of the margin requirements; and the importance of transparency for initial margin models. A presentation provided by the Representatives that describes these issues in greater detail is attached.

Attachment



# ***Margin Requirements for Uncleared Swaps***

## **Presentation to Staff of:**

- **Office of the Comptroller of the Currency**
- **Board of Governors of the Federal Reserve System**
- **Federal Deposit Insurance Corporation**
- **Federal Housing Finance Agency**
- **Farm Credit Administration**

**January 8, 2015**

## ***American Council of Life Insurers (“ACLI”)***

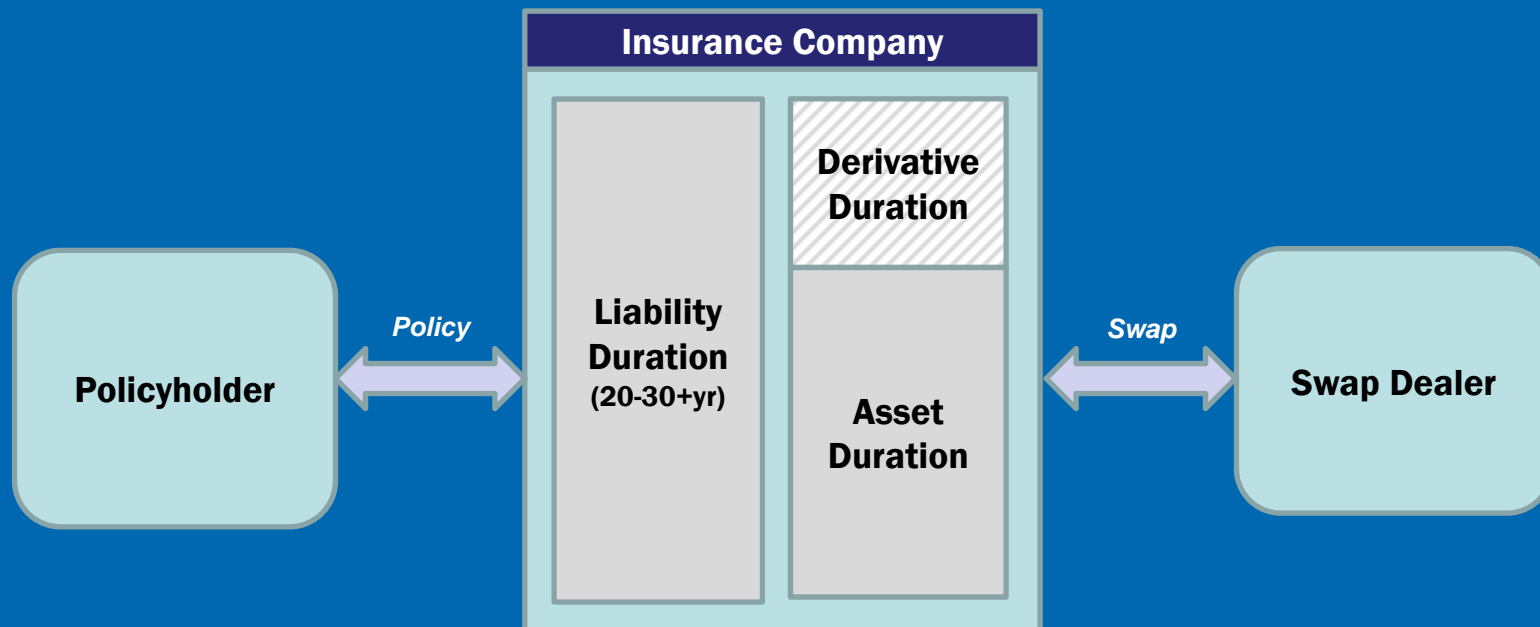
- **ACLI is a national trade association with 300 members representing more than 90 percent of the assets and premiums of the life insurance and annuity industry in the U.S.**
- **ACLI members offer life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, and reinsurance.**
- **Life insurers provide the largest U.S. source of corporate bond financing, holding 20% of total U.S. corporate debt outstanding (\$2.3 trillion at the end of 2013).**
  - **In 2013, approximately 51% of life insurers’ \$6.2 trillion of total assets were held in bonds, divided between corporate bonds (38%) and government bonds (13%).**
  - **Over 37% of bonds purchased by life insurers for their general accounts have maturities in excess of twenty years at the time of purchase.**

Sources: ACLI tabulations of NAIC data (year-end 2013), used by permission; Federal Reserve Board, Z.1 Financial Accounts of the United States, Second Quarter 2014.

## Summary

- **ACLI submitted comment letters on the Prudential Regulators' and the CFTC's Proposed Margin Rules for Uncleared Swaps in 2014.**
- **Uncleared swaps remain a key component of Life Insurers' hedging programs.**
  - **More effective Asset/Liability matching (ALM)**
  - **Increased flexibility of customer product offerings**
  - **Increased hedge effectiveness**
- **Several aspects of the Proposed Rules have the potential to limit Life Insurers' abilities to manage assets and liabilities in a prudent manner:**
  - **Elimination of non-cash collateral for variation margin (VM)**
  - **Characterization of VM as settlement payments**
  - **Creation of significant operational risk through accelerated implementation**
  - **Lack of consistency and transparency in initial margin (IM) models**
  - **Market fragmentation due to inconsistency with BCBS-IOSCO Framework**

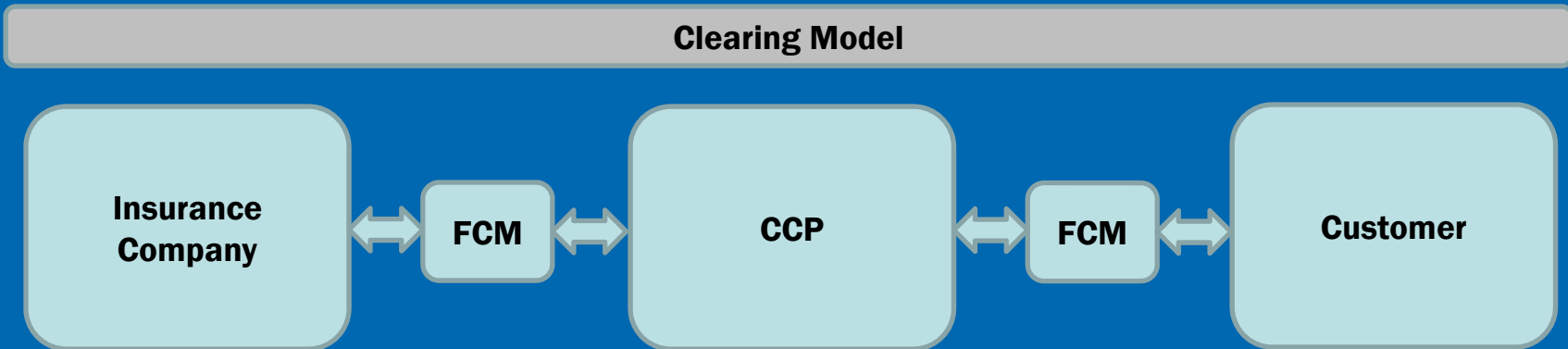
## Eligible Collateral for Variation Margin (VM)



- **Over 95% of Ins Co's derivative usage is to hedge assets and liabilities\***
- **Long duration high-quality assets can be difficult to source**
- **Large amounts of cash reduces portfolio income and *inhibits* effective ALM**
- **Non risk-free assets enable Ins Co's to offer affordable products to policyholders**

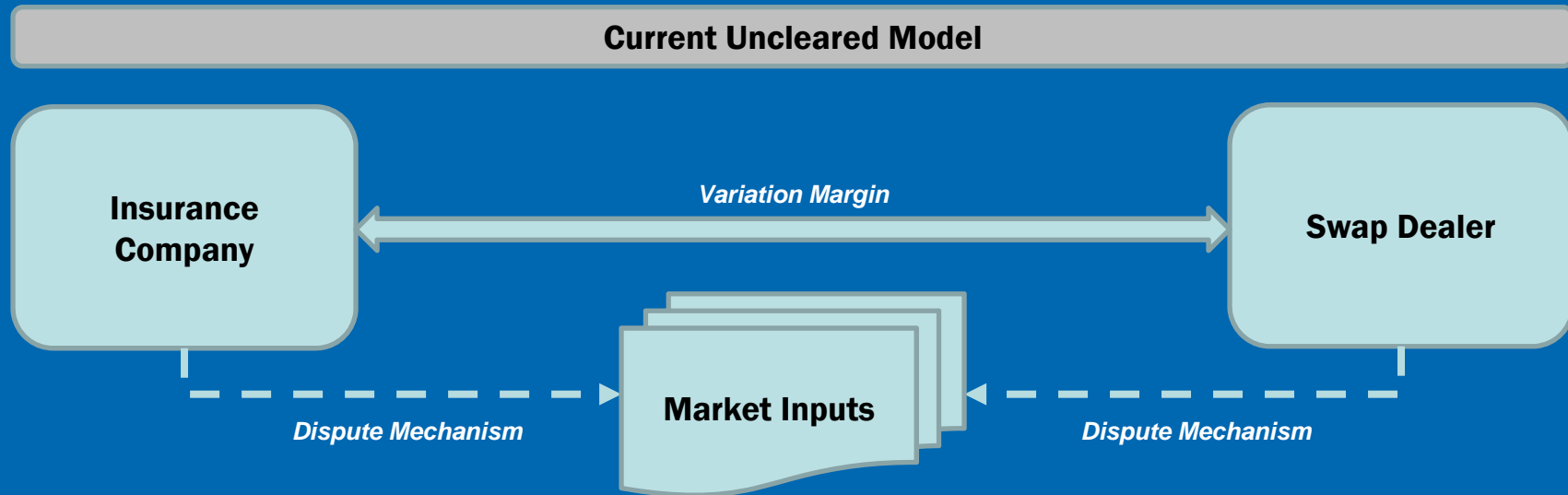
\* Source: 2014 NAIC Capital Markets Special Report on the Insurance Industry's Derivative Exposure at Year-End 2012

## VM Treatment: Clearing Model



- **CCP is a third party to trade, whose functions include:**
  - **Serving as *credit intermediary* to the transaction**
  - **Transferring VM between parties**
  - **Sole arbiter for end of day pricing, IM and VM**
  - **Establishing minimum margin requirements uniformly for participants**

## VM Treatment: Current Uncleared Model



- **VM is not characterized as a settlement payment**
- **Collateral *pledged as security interest* against performance**
- **Market Mid Prices are agreed to by both parties with dispute rights**
- **Values do not reflect actual execution levels in a close-out situation**

# ***Eligible VM Requirements should be phased-in per the Initial Margin Schedule***

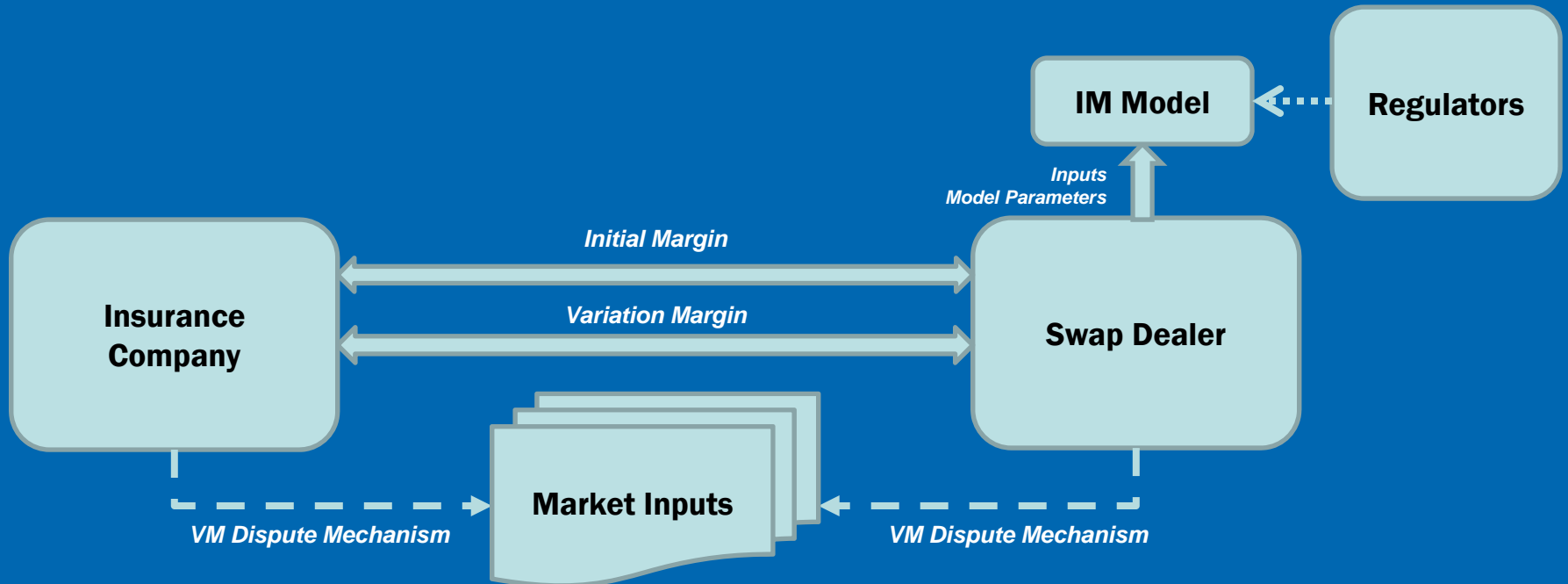
<b>ACLI Proposed VM Phase-In Schedule</b>	
<b>December 2015</b>	<b>IM Phase-In Schedule</b>
<b>Broad Requirement that VM is exchanged between parties</b>	<b>Any Restrictions on VM Collateral Types Incorporate EMNAs Thresholds Minimum Transfer Amounts</b>

- **Currently, exchanging VM is broad based among market participants**
- **However, the Proposed Rules will require:**
  - **Legal documentation changes requiring bi-lateral negotiation**
  - **Changes to portfolio asset allocation**
  - **Changes to trading & collateral management systems**
- **Separate phase-in for IM will require multiple sets of changes**



# Initial Margin Models Require Transparency

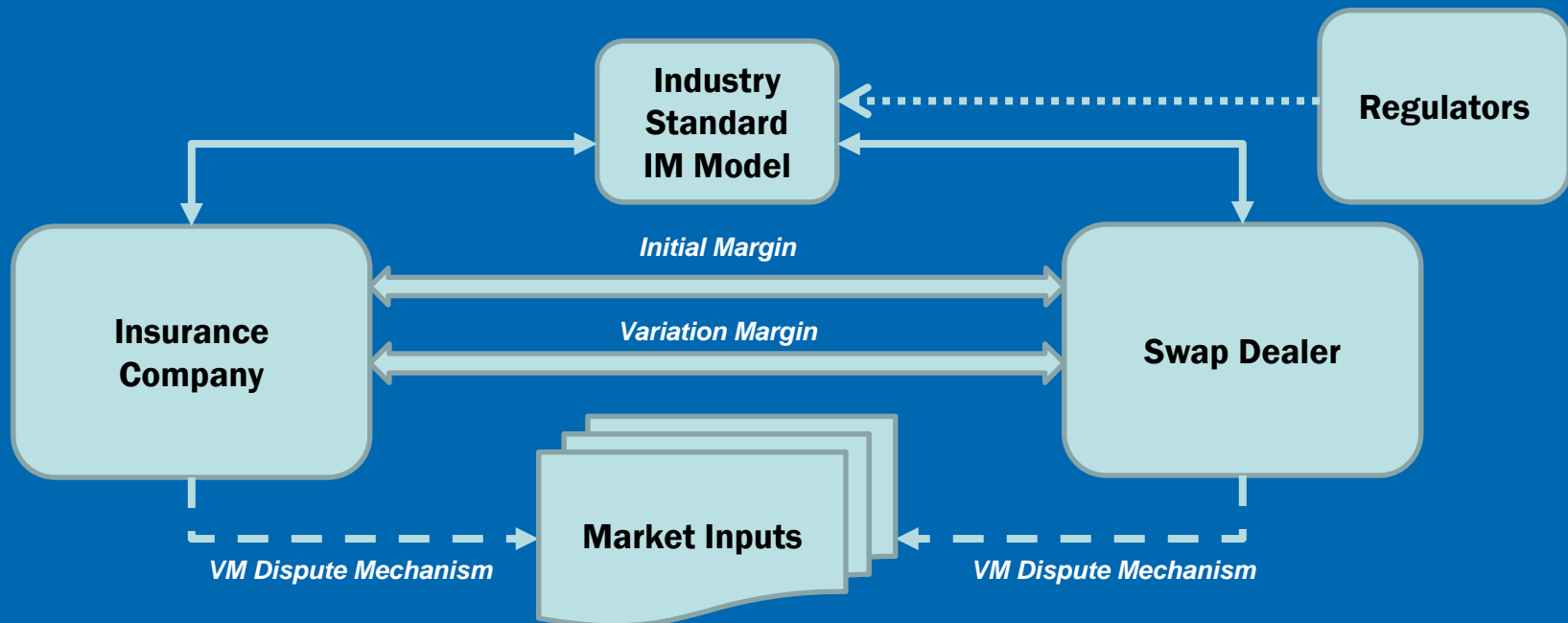
Prudential Regulators' & CFTC's Proposed Uncleared Model with Initial Margin



- Ins Cos have no mandated *transparency* into IM Models
- Ins Cos have no specific *dispute rights* in regards to IM calculation
- IM Model *consistency and transparency* is essential

# Initial Margin Models Require Transparency

## ACLI Proposed Uncleared Model with Initial Margin



### Advantages:

- One consistent model for all market participants
- IM model transparency to all facilitates dispute resolution

## **Conclusions**

- **Eligible Collateral for Variation Margin should include non-cash collateral consistent with the BCBS-IOSCO Framework.**
- **Variation Margin for uncleared swaps should continue to be characterized as a pledge/security interest.**
- **Any restrictions on collateral types should be phased-in concurrently with IM requirements.**
- **Initial Margin Models should be consistent and transparent to all market participants.**