

January 30, 2006

Receivership Law and Intergovernmental Working Group
National Association of Insurance Commissioners
c/o Ms. Karen Schutter

Ladies and Gentlemen:

Re: Comments on IRMA Provisions Recommended for Accreditation

The International Swaps and Derivatives Association, Inc. ("ISDA") is pleased to have the opportunity to offer comments with respect to provisions of the Insurer Receivership Model Act ("IRMA") that should be recommended to the Financial Regulation and Accreditation Standards Committee in their consideration of an accreditation standard. In this letter, we will first provide information about ISDA, next explain the importance of bilateral close-out netting and describe relevant Federal netting legislation and finally identify the provisions of IRMA that we believe are very important for uniformity and should be considered as accreditation standards.

ISDA

ISDA is the global trade association representing participants in the privately negotiated derivatives industry, a business covering swaps and options across all asset classes (interest rate, currency, commodity and energy, credit and equity). ISDA was chartered in 1985, and today numbers over 670 member institutions from 50 jurisdictions on six continents. Its members are the leading participants in the privately-negotiated or over-the-counter ("OTC") derivatives industry. The OTC derivatives industry includes interest rate, currency, commodity, credit and equity swaps, options and forwards and related products such as caps, collars, floors and swaptions. The membership includes associated service providers and consultants.

Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business. Among its most notable accomplishments are: developing the ISDA Master Agreements; publishing a wide range of related documentation materials and instruments covering a variety of transaction types; producing legal opinions on the enforceability of netting and collateral arrangements; securing recognition of the risk-reducing effects of netting in determining capital requirements; promoting sound risk management practices; and advancing the understanding and treatment of derivatives and risk management from public policy and regulatory capital perspectives.

Close-out Netting

The ISDA Master Agreements are the leading standard form documentation for OTC derivatives transactions worldwide. The most important credit risk management provisions in those Agreements are the early termination and close-out netting provisions that apply when an event of default (such as bankruptcy or insolvency) occurs with respect to one party. When one party to an ISDA Master Agreement becomes insolvent, the other party can terminate all the OTC derivatives transactions outstanding under that Agreement, calculate a single net amount due by or to the insolvent party and liquidate any pledged collateral. This is particularly important in the financial markets because, unlike loans or many other financial contracts, the value of OTC derivatives is based principally on their fluctuating market value. If one of the parties to a derivatives transaction is placed into bankruptcy or receivership, any stay on termination of OTC derivatives and liquidation of collateral could create escalating losses due to changes in market prices. As a result, the ability to terminate OTC derivatives transactions and net exposures quickly in insolvency can be crucial to limit the losses of the non-defaulting party because such transactions can change in value rapidly due to market fluctuations.

Federal Netting Legislation

ISDA has been involved since 1989 in legal reform efforts in the U.S. and elsewhere to recognize the enforceability in insolvency of the early termination and close-out netting provisions of the ISDA Master Agreements. ISDA's efforts have supported the adoption in 1989 of the "qualified financial contract" provisions found in the Federal Deposit Insurance Act (the "FDIA") and the adoption in 1990 of the "swap agreement" provisions found in the Bankruptcy Code (the "Code").

ISDA worked with The Bond Market Association ("TBMA") to secure approval of additional U.S. netting legislation from 1995 until 2005. After discussions concerning possible improvements in law with an interagency working group organized under the auspices of the President's Working Group on Financial Markets, on April 12, 1996, ISDA and TBMA published a position paper entitled "Financial Transactions in Insolvency: Reducing legal Risk Through Legislative Reform". Many of the legislative provisions proposed in that position paper can be found in similar form in Title IX (the Financial Contract Provisions) of the Bankruptcy Reform Act of 2005 (S.256). S.256 was signed into law by President Bush on April 20, 2005.

Title IX updates, clarifies, and strengthens the existing laws that determine what happens to OTC derivatives transactions and other financial market contracts when a market participant fails. Title IX accomplishes several key goals. First, it comprehensively harmonizes all the principal Federal laws that could come into play in insolvencies of various types of market participants, including banks, thrifts, credit unions, broker-dealers, investment banks, and corporations and partnerships. Second, it updates and modernizes those laws to accommodate innovations in the markets. Third, it expands the availability of the risk-reduction benefits of financial contract netting by ensuring that market participants can net across different types of transactions.¹

The importance of legal certainty for the enforcement of early termination and close-out netting provisions in industry standard master agreements has been recognized repeatedly by the U.S. Congress and legislative bodies in numerous other countries. The agreements involved are not only the ISDA Master Agreements but also agreements published by other trade groups such as the repo master agreements published by TBMA. The importance of the policy issues underlying this legal certainty is evidenced in the April 13, 2005 letter from Chairman Michael Oxley of the House Committee on Financial Services attached as Appendix A. In his letter, Chairman Oxley explained that:

¹ For a comprehensive discussion of Title IX, see M.H. Krimminger, "Adjusting the Rules: What Bankruptcy Reform Will Mean for Financial Market Contracts", at FYI@fdic.gov (October 11, 2005).

"Title IX of the bill provides for the orderly unwinding of complex financial instruments between two parties when one of them becomes insolvent. The Committee on Financial Services has approved these so-called "netting" provisions—which are based upon the recommendations of the President's Working Group on Financial Markets—on a free-standing basis on several prior occasions. The provisions will mitigate legal uncertainty, reduce risk to individual banks, address systemic risk by making it less likely that a large default by a single financial institution will have a "domino effect" on other institutions, and enhance the liquidity of the financial markets."

With the passage of S.256, the U.S. legal regime concerning the enforceability of early termination and close-out netting provisions for banks under the FDIA and for corporations and partnerships under the Code is very clear and very strong.

In contrast, counterparties of U.S. insurance companies do not have the benefit of comparable legal certainty with respect to the enforceability of the early termination and close-out netting provisions in the ISDA Master Agreements against U.S. insurance companies under the laws of various U.S. states that govern insurance company insolvency proceedings in the U.S.²

Close-out Netting and IRMA

ISDA recommends that subsections (A) through (I) of Section 711 ("Qualified Financial Contracts") of IRMA as adopted by the NAIC be adopted as accreditation requirements for state insurance departments. ISDA recognizes that other provisions of IRMA are also very important, but ISDA believes it is essential to the competitive position of U.S. insurance companies when they enter into derivatives transactions and other types of qualified financial contracts that their counterparties have legal certainty under the laws governing the insolvencies of insurance companies comparable to the legal certainty now available to counterparties of U.S. banks, corporations and partnerships. If this legal certainty is not available for U.S. insurance companies, their counterparties in OTC derivatives transactions and other financial market transactions will need to reflect their increased credit risk and higher capital costs in the prices offered to U.S. insurance companies. This will mean that U.S. insurance companies will continue to pay higher prices for their hedging activities than almost all other end users of OTC derivatives in the U.S. and elsewhere. The adoption of the netting provisions in Section 711 of IRMA across the U.S. would also promote market stability, reduce systemic risk and enhance market liquidity.

Furthermore, continued uncertainty with respect to early termination and close-out netting provisions will lead to increased litigation costs and use of administrative resources in an insurance receivership. The magnitude of the underlying transactions provides ample incentive for counterparties to litigate for financial advantage. The first priority administrative expense of that litigation will reduce estate assets, and the attention of personnel to the litigation will diminish the receiver's ability to make progress in other areas of the estate. In particular, these expenses and distractions will diminish and delay a receiver's ability to make distributions to policyholders and other creditors.

ISDA has previously commented on the provisions now found in Section 711 of IRMA. Those provisions deal effectively with the enforceability of the early termination and close-out netting provisions of the ISDA Master Agreements.

ISDA does not think that it should comment on the three provisions of IRMA that are least important for uniformity because ISDA's interests are concentrated on close-out netting issues.

² See K.R. Wylie, "Enforceability of OTC Derivative Transactions Against Insolvent Insurance Companies", FORC Quarterly Journal (Fall 1999).

Thank you for the opportunity to comment. We would be pleased to provide any additional information you might require and answer any questions you might have. Please address any questions or requests to Ms. Kimberly Summe at 212-901-6030.

Yours faithfully,

**For the International Swaps
And Derivatives Association, Inc.**

**Kimberly Summe
General Counsel, ISDA**

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April 13, 2005

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S. 256 PROMOTES STABILITY OF U.S. FINANCIAL SYSTEM

Dear Colleague:

Members of the House will have an opportunity later this week to cast an important vote to bolster the stability of the U.S. financial system by voting YES on S. 256, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005."


S. 256 promotes personal responsibility among our citizens and addresses loopholes in the current bankruptcy system that have been exploited by individuals seeking to avoid debts which they are fully capable of repaying. Importantly, the bill preserves the historic function of the bankruptcy system as a legitimate last resort for those individuals who are unable to meet their obligations and need a fresh start in putting their financial houses in order.

Title IX of the bill provides for the orderly unwinding of complex financial instruments between two parties when one of them becomes insolvent. The Committee on Financial Services has approved these so-called "netting" provisions — which are based upon the recommendations of the President's Working Group on Financial Markets — on a free-standing basis on several prior occasions. The provisions will mitigate legal uncertainty, reduce risk to individual banks, address systemic risk by making it less likely that a large default by a single financial institution will have a "domino effect" on other institutions, and enhance the liquidity of the financial markets.

Federal Reserve Chairman Alan Greenspan has warned Congress repeatedly that failure to enact netting legislation could have dire consequences for the U.S. financial system, particularly in the event of an extraordinary disruption such as a large-scale terrorist attack. In a letter to me last September, Chairman Greenspan wrote: "Enactment of the netting provisions would promote market stability by reducing uncertainty for market participants about the disposition of financial contracts in the event of an insolvency of a counter-party to those contracts. Should a terrorist attack result in the insolvency of one or more market participants, such uncertainty would unnecessarily place the financial system at greater risk in what unquestionably would be an especially dangerous period."

I urge you to support balanced bankruptcy reform by voting in favor of S. 256 when it comes to the House floor later this week.

Sincerely,



Michael G. Oxley
 Chairman