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November 25, 2020

Ms. Sally Geisel
New York State Department of Financial Services
Via e-mail: Sally.Geisel@dfs.ny.gov

Re: SIFMA AMG Comments on Proposed Regulation 172 (11 NYCRR 83)

Dear Ms. Geisel:

The Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**" or "**AMG**")[1] appreciates the opportunity to comment on the Department of Financial Services' (the "**Department**" or "**DFS**") proposed amendments to 11 NYCRR 83 ("**Regulation 172**")[2].

AMG is concerned with the Department's proposed exception to parts of the Statement of Statutory Accounting Principles ("**SSAP**") No. 26R and SSAP No. 97 in the NAIC Accounting Practices and Procedures Manual ("**AP&P Manual**") included in proposed Regulation 172. Bond Exchange Traded Funds ("**ETFs**") have become an increasingly important investment and risk management tool for insurance companies in recent years, especially in times of market volatility. In fact, when the Department last promulgated Regulation 172 in 2017, it adopted into law the NAIC AP&P Manual without exception to the fixed income classification of NAIC designated bond ETFs. In light of this, and because many insurers in New York seek to use bond ETFs as part of their portfolios, we are requesting the Department quickly promulgate additional amendments to Regulation 172 to ensure that insurers can continue to treat reserve investments in certain bond ETFs as investments in bonds instead of as equities.

Bond ETFs: An Important Investment Option and Risk Management Tool

Bond ETFs have become an increasingly important investment and risk management tool for insurance companies, especially since the 2008 global financial crisis, after which it has been challenging for investors to access a diversified portfolio of bonds with the necessary duration, yield and risk and other characteristics that appropriately match the insurers' liabilities. Bond ETFs provide a way for insurance companies of all sizes to access bond investment exposure in an efficient, cost-effective manner, ultimately benefitting insurers' policy-holders.

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[1] SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.

[2] *See* State of New York Department of Financial Services Proposed Fifteenth Amendment to Insurance Regulation 172 (September 15, 2020), available at https://www.dfs.ny.gov/system/files/documents/2020/09/reg_proposed_172a15_text.pdf.

Liquidity in the bond market has diminished relative to what it was pre-financial crisis, and as a result, sourcing individual bonds has become a costly and time-consuming effort. Meanwhile, liquidity in bond ETFs has steadily grown, and fixed income ETFs have proven time and again that they are able to weather liquidity challenges. Insurance companies have come to rely upon bond ETFs for other uses, such as portfolio diversification, low-cost core fixed income exposure, and portfolio completion for smaller portfolios. Additionally, insurers with large amounts of cash in a low yield environment have benefitted from putting cashflows to work more quickly to reduce the impact of cash drag.

Should insurers no longer have access to bond ETF investment options, many companies who struggle to gain access to the bond markets and are currently benefiting from the low cost, liquidity and diversification of NAIC-designated bond ETFs will face greater concentration risk and reduced liquidity on their balance sheets. In fact, the ambiguity surrounding the Department's position on the regulatory treatment of ETFs has led to relatively limited use. With additional regulatory certainty provided by the Department, many more insurers will be able to utilize bond ETFs to maintain affordable, liquid portfolio diversification.

The utility and benefits of bond ETFs were highlighted during the COVID-19 induced market volatility that occurred in February and March of this year. While liquidity conditions in the OTC bond market sharply deteriorated, many bond ETFs traded in record volumes on exchange while generally maintaining tight bid/ask spreads.[3] Bond ETFs provided deep liquidity, continuous price transparency and lower transaction costs than were available in individual bonds. The ability to buy and sell portfolios of bonds on exchange through ETFs helped investors navigate extreme price dislocations and sidestep a legacy bond market that remains fragmented and comparatively difficult to access, even for many institutional investors. Investors of all types utilized bond ETFs as a complement or an alternative to individual bonds during this period of volatility to help reposition portfolios, manage risk and obtain real-time price transparency when liquidity had sharply deteriorated in individual bonds.

Given the benefits described above, and to minimize disruption to existing investors, we urge the Department to swiftly promulgate an additional amendment to Regulation 172 determining its own subset of bond ETFs deserving of bond treatment. Additionally, AMG is requesting the Department set forth a reasonable forbearance policy that would apply until the Department promulgates the additional regulation.

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[3] As an example, the bid/ask spread on the iShares iBoxx $ High Yield Corporate Bond ETF ("HYG") remained in a 1-2 bps range throughout March while bid/ask spreads in the underlying corporate bond market widened to several percentage points, or in some cases hundreds of times more. Source: Bloomberg, BlackRock (as of March 31, 2020).

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We appreciate the opportunity to share our views and we would be happy to arrange a conference call or video conference to discuss our comments in further detail. Please do not hesitate to contact Lindsey Keljo at 202-962-7312 or LKeljo@sifma.org, or Andrew Ruggiero at 212-313-1128 or aruggiero@sifma.org to discuss the above.

Respectfully submitted,

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