

November 30, 2020

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Ms. Sally Geisel

New York Department of Financial Services

One State Street

New York, NY 12257

Via e-mail: sally.geisel@dfs.ny.gov

Dear Ms. Geisel,

State Street Global Advisors, the asset management business of State Street Corporation (NYSE: STT), welcomes the opportunity to comment on the New York Department of Financial Services ("Department") proposed amendments to 11 NYCRR 83 ("Proposal" or "Regulation 172"), particularly the 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").

For four decades, State Street Global Advisors has served the world's governments, institutions and financial advisors. With a rigorous, risk-aware approach built on research, analysis and market-tested experience, we build from a breadth of active and index strategies to create cost-effective solutions. As stewards, we help portfolio companies see that what is fair for people and sustainable for the planet can deliver long-term performance. And, as pioneers in index, exchange-traded funds ("ETFs"), and environmental, social and governance ("ESG") investing, we are always inventing new ways to invest. As a result, we have become the world's third-largest asset manager with US \$3.15 trillion under our care¹.

Many insurers in New York use ETFs as part of their portfolio with the understanding that these sections of the AP&P allow them to treat reserve investments in certain fixed income ETFs as investments in bonds rather than as equities. In an effort to minimize disruption to these insurers, we urge the Department to set forth a reasonable forbearance policy that would apply until the Department promulgates additional amendments to Regulation 172 clarifying which highly-rated fixed income ETFs deserve bond treatment.

General Overview of Exchange Traded Funds

An ETF is a fund that holds a basket of securities that seeks to track the performance of a broad or specific market segment and is traded on a public securities exchange. Although they share some characteristics of an index mutual fund such as index tracking, low turnover, and tax efficiency, ETFs, unlike mutual funds, can be bought and sold on an

¹ This figure is presented as of September 30, 2020 and includes approximately \$80.51 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

exchange throughout the day resulting in increased transparency, improved liquidity, and lower costs.

Most SPDR ETFs² are set up as separate investment portfolios under the Investment Company Act of 1940 where their assets are separate and distinct from the assets of the various service providers, such as asset managers, index providers, custodians, etc. Figure 1 below details how an ETF is different than a mutual fund:

Figure 1: How an ETF is different than a Mutual Fund

	ETFs	Mutual Funds
Buying & Selling	ETF shares are bought and sold in the secondary market (i.e., stock exchange) The use of a broker has benefits such as limit orders	Bought and sold directly through a mutual fund company
Pricing	Continuously market priced during the day iNAV calculated every 15 seconds during trading and NAV calculated at close Prices fluctuate like stocks and have bid/offer spreads	Mutual fund shares do not have a market price and do not calculate an iNAV NAV calculated once a day after market close
Trading	Through a broker Can use limits, stock-limit, short-sale orders, and trade on margin	Closed end funds trade on exchanges
Disclosure of Holdings	Daily disclosure of portfolio holdings	Disclosure is required on a monthly or quarterly basis

Growth of Fixed Income ETFs by Insurers

Over the past decade, global fixed income ETF assets have increased to more than \$1 trillion³, but despite their rapid growth, fixed income ETFs still only represent 2.1% of the total investable fixed income universe⁴. This steady growth has created a more centralized and transparent fixed income marketplace. According to S&P Dow Jones Indices research, insurance companies have increased the use of fixed income ETFs over the past 10 years, with insurers based in Illinois, New York, and Texas leading the way⁵.

² SPDR ETFs are a comprehensive family spanning an array of international and domestic asset classes. SPDR ETFs are sponsored by affiliates of State Street Global Advisors. The funds provide investors with the flexibility to select investments that are aligned to their investment strategy.

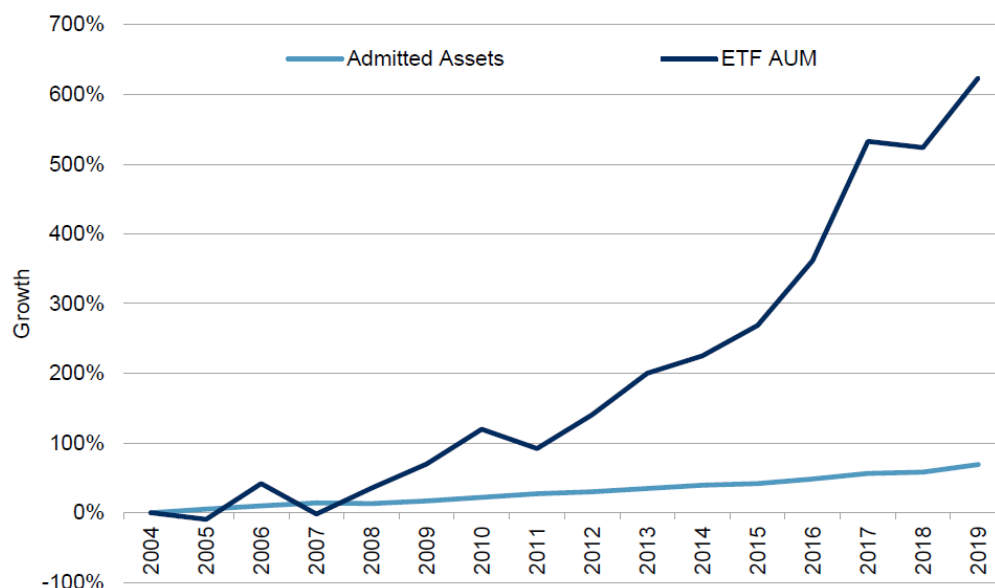
³ Morningstar, as of 05/31/2020.

⁴ State Street GA. Fixed Income ETFs: Fact vs. Fiction (June 2020).

⁵ S&P Dow Jones Indices Research, ETFs in Insurance General Accounts 2020 (March 2020)

The growth in ETF usage exceeded the growth in admitted assets, even though admitted assets in insurance general accounts grew by 6.8%. Over the past 16 years, ETF usage growth has significantly exceeded admitted asset growth in the insurance industry's general accounts (See Figure 2)⁶.

Figure 2: Historic Growth of Admitted Assets and ETF AUM



Source: NAIC via S&P Global Market Intelligence. Data as of Dec. 31, 2019. Chart is provided for illustrative purposes.

Fixed income ETFs have become an increasingly important investment and risk management tool for insurance companies. In a 2018 study by Greenwich Associates⁷, 75% of insurers are investing in fixed income ETFs and are using them for a variety of purposes, from eliminating cash friction within a portfolio, to constructing low-cost equity portfolios, and optimizing asset allocation. Additionally, insurance companies are adopting ETFs to diversify their fixed income exposures and implement liquidity sleeves. As of June 30, 2020, ETF usage by New York domiciled insurers exceeded \$2.77 billion⁸.

The unique structure of a fixed income ETF – which packages a diversified portfolio of bonds into a single, tradeable equity – provides two sources of liquidity for investors. These two sources – “primary,” which can be accessed via an authorized participant, and “secondary,” which can be accessed directly – define a fund’s overall liquidity profile. The ability to invest in an ETF via the primary and/or the secondary market provides greater liquidity compared with alternative approaches to bond investing, such as index and actively managed mutual funds. Insurers are also increasingly accessing ETFs holding a portfolio that includes both preferred stocks and bonds to benefit from the increased

⁶ S&P Dow Jones Indices Research, ETFs in Insurance General Accounts 2020 (March 2020)

⁷ Greenwich Associates 2018 U.S. Insurance ETF Study

⁸ NAIC via S&P Global Market Intelligence (June 30, 2020)

transparency of holdings, intraday liquidity, and their operational efficiencies. Similarly to fixed income ETFs, preferred stock ETFs are valuable tools in the portfolio and risk management processes for insurers.

Absent the option of fixed income and preferred stock ETFs, many insurance companies could continue to struggle to build diversified, liquid bond portfolios.

Fixed Income ETFs during the Global Pandemic

The COVID-19 crisis induced volatility in Q1 2020 and stress in to the fixed income markets, including U.S. Treasuries. However, during this period, fixed income ETFs had record trading volumes. In Q1 2020, U.S. insurance companies increased their ETF usage by \$4.1 billion, as well as the number of transactions that were split evenly between fixed income ETFs and equity ETFs⁹. The transparency of fixed income ETFs in secondary market trading provided price discovery and a liquid tool for transferring risk, when most other risky asset types in the space offered little liquidity. Used to make real-time asset allocation decisions, fixed income ETFs provided liquidity at a time when investors demanded it most¹⁰.

On March 23, 2020, the U.S. Federal Reserve (“Fed”) announced that it would begin purchasing individual bonds of U.S. investment-grade-rated firms with a maturity of five years or less, as well as broad corporate bond ETFs under the Federal Reserve Secondary Market Corporate Credit Facility (SMCCF) in an effort to offer stability and improve liquidity in the corporate credit market. The marked the first time in Fed’s 107-year history that it purchased it purchased ETFs providing broad market access to a diverse set of firms through a single investment with trading flexibility and transparency. The broad access to credit across a wide array of industries and issuers, flexibility to be bought or sold on the secondary market or created/redeemed in the primary market, daily disclosure of holdings, and stability of fixed income ETFs facilitated the Fed’s decision to include fixed income ETFs in the SMCCF program¹¹.

Fixed income ETFs continue to be used to position portfolios for an uncertain and low-yielding world. Since the onset of the pandemic, investors have gravitated toward the ETF structure for bond exposure, thanks to the low cost, transparency, market coverage, and liquidity afforded by the vehicle. The flows are partly secular, as more investors gravitate towards the vehicle, but also partly tactical as investors search for ways to buffer equity risk or obtain yield in a precise and efficient manner¹².

⁹ S&P Dow Jones Indices, ETF Transactions by U.S. Insurers in Q1 2020 (June 2020)

¹⁰ State Street Global Advisors, Fixed Income ETFs: Fact vs. Fiction (June 2020).

¹¹ State Street Global Advisors, Fixed Income ETFs: Fact vs. Fiction (June 2020)

¹² State Street Global Advisors SPDR Insights, October ETF Flows: This is the Way (November 5, 2020)

Recommendations for analyzing investments in fixed income and preferred stock ETFs

As the Department has noted in its Regulatory Impact Statement “that certain investments in ETFs and mutual funds may warrant treatment that is different from the common stock treatment currently required by 11 NYCRR 83 for those investments”¹³, State Street Global Advisors offers the following suggestions for your consideration:

1. The Department should include all the requirements of the most recent NAIC AP&P Manual, including the utilization of the NAIC Fixed Income-like SEC Registered Funds list.
2. The Department should use the following criteria to determine which subset of fixed income ETFs deserve bond treatment:
 - Its shares must be maintained and listed on a national securities exchange;
 - It must have a minimum assts under management (AUM) of \$300 million at the time of investment;
 - Its portfolio must be index-based where the principal investment objective of the fixed income ETF is to track a rules-based bond index;
 - It must provide for in-kind redemptions through an Authorized Participant;
 - Its portfolio must be transparent by publishing a list of all its holdings on a daily or quarterly basis.
3. Finally, the Department should exclude any fixed income ETF that has embedded structural features designed to deliver a return other than the full unlevered positive return of the underlying index or exposure. For example, products that seek to provide a leverage or inverse return (i.e., a return with caps on upside or downside performance or “knock-out” features) should be excluded from the subset.

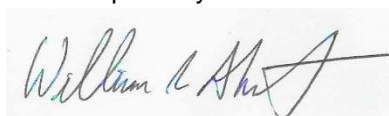
Conclusion

Fixed income and preferred stock ETFs are becoming mainstream components of insurance companies portfolios and provide a way for insurers of all sizes to achieve access to bond investment exposure, ultimately benefitting insurers’ policy-holders. If insurers no longer have access to highly-rated fixed income ETF investment options, many insurance companies who struggle to gain access to the bond markets and are currently benefitting from the low cost, liquidity and diversification of fixed income ETFs will face greater concentration risk and reduced liquidity.

¹³ New York State Register (September 30, 2020)

State Street Global Advisors appreciates the efforts by the Department in putting forth the Proposal, and we thank you for your consideration of our perspective. We would welcome the opportunity to further discuss any specific questions the Department may have around bond-like regulatory treatment of certain fixed income ETFs and are happy to provide additional information to help develop an approach that strikes an appropriate balance.

Respectfully

A handwritten signature in blue ink, appearing to read "William C. Ahmuty", with a stylized flourish at the end.

Bill Ahmuty