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## NCOIL ASSEM. MORELLE TO HOUSE COMMITTEE: STATES SHOULD REGULATE CREDIT DEFAULT SWAPS

**Washington, DC, February 4, 2009** — National Conference of Insurance Legislators (NCOIL) Financial Services & Investment Products Committee Chair Assemblyman Joseph D. Morelle (NY) this morning called for state regulation of credit default swaps (CDS)—testifying at a full U.S. House Committee on Agriculture hearing that CDS are “species of insurance” and “best left to the regulatory purview of the states.”

Speaking on the second day of a two-day hearing to review a draft *Derivatives Markets Transparency and Accountability Act of 2009*, circulated by Committee Chair Representative Collin Peterson (D-MN), Assem. Morelle said in his testimony that “Frankly, this discussion is not only appropriate but, perhaps, sadly overdue. It is a discussion with implications beyond even the very broad horizons of its specific subject matter, for it relates to our fundamental notions of the free market system.”

He continued:

In recognition of this, and particularly in the wake of the near collapse of American International Group, Inc. last September, NCOIL has turned its attention to the critical questions surrounding credit default swaps: namely, what manner of financial instrument are they? And once defined, how shall they be subject to the safeguards that are a fact of life for the buyers and sellers of other similar financial instruments?

Assem. Morelle stated that “If we conclude that credit default swaps are a species of insurance, and I would strongly suggest that they are, then authority in relation to CDS must accrue to the states.” It is NCOIL’s position, he said, “that state regulators, with their extensive experience at regulating insurance products, are extremely qualified to regulate covered CDS as insurance products.”

The NCOIL Financial Services Committee Chair said, “It is also NCOIL’s position that Congress erred when it preempted the states from regulating CDS under our gaming and bucket shop laws when it passed the *Commodities Futures Modernization Act of 2000* (CFMA).” He said the CFMA “permitted so-called ‘naked swaps’—those CDS contracts that are speculative in nature and are merely directional bets on market outcomes—to proliferate to the point where they now constitute 80 percent of the CDS market, which has a notional value of around \$54 trillion, with no regulatory framework.”

Assem. Morelle also discussed a recent January 24 NCOIL public hearing in New York City that focused on CDS regulation and said that NCOIL urges that the Committee and Congress consider:

- the question of whether the goals of the transparency and accountability draft would be best realized and enacted by the states
- whether the CFMA of 2000 was overbroad in its intent and application
- whether the powers removed from state government in relation to that act might be restored as an avenue to establish what President Obama in his Inaugural Address called the “watchful eye” of oversight, necessary to ensure that freedom in the financial markets does not degenerate into simple and destructive anarchy

Addressing Section 16 of the draft bill—which would prohibit “naked” swaps—Assem. Morelle said that “as a matter of philosophy, NCOIL believes that this Committee is on the right track” and added that the organization respectfully maintained “that the actual implementation of CDS regulatory mechanism should be at the state rather than federal level.”

In response to extensive questioning from Chairman Peterson regarding implementing state CDS authority, Assem. Morelle said, “Through a compact or model legislation, states could establish strong solvency and reserving requirements that would prevent future crises. NCOIL, working with the states and the NAIC, could provide the expertise to regulate the CDS market.”

In response to Rep. Eric Massa (D-NY), who prefaced his question on the reason for the AIG crisis by saying that he was honored to know Chairman Morelle was on the forefront of the investigation, Morelle said that the AIG financial products division was unregulated by the federal government, which resulted in great exposure and an inability to manage risks. Morelle said New York had \$20 billion in surplus in AIG p-c subsidiaries alone, and he believed that to be similar in states throughout the country. New York, he added, would never allow subsidiary surpluses to flow upward to bolster a failing parent.

Other witnesses at the 15-witness hearing included representatives of IntercontinentalExchange Inc., the International Swaps & Derivatives Association (ISDA), Cargill Incorporated, the Industrial Energy Consumers of America, and the Securities Industry and Financial Markets Association (SIFMA), among others.

The NCOIL Financial Services Committee will discuss the hearing and chart a formal policy course for the organization when it meets February 28, during the upcoming NCOIL Spring Meeting in Washington, DC.

NCOIL is an organization of state legislators whose main area of public policy interest is insurance legislation and regulation. Most legislators active in NCOIL either chair or are members of the committees responsible for insurance legislation in their respective state houses across the country. More information is available at [www.ncoil.org](http://www.ncoil.org).

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