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NCOIL TO CONGRESS: STATES DEVELOPING CDS FRAMEWORK

Washington, DC, July 22, 2009 — As Congress moves to revamp the derivatives market, leaders of the National Conference of Insurance Legislators (NCOIL) apprised key U.S. House and Senate Committee Chairs this morning of NCOIL efforts to guard against credit default swap (CDS) abuse. The letter, signed by NCOIL President Sen. James Seward (NY) and Financial Services & Investment Products Committee Chair Assem. Joseph Morelle (NY), pointed to NCOIL development of draft *Credit Default Insurance Model Legislation*—a year-long process grounded in the belief that certain CDS are insurance.

In speaking of the letter, Sen. Seward said, “As Congress grapples with how to address an under-regulated market, we feel it essential to alert federal lawmakers of the progress we have made to protect consumers from the widespread economic fallout of controversial CDS transactions. The premise of our draft model act—that credit default swaps with material interest are insurance—means consumers would be protected by the safeguards inherent in state-regulated coverage.”

The letter explains that the proposed model act, which is scheduled for final NCOIL review in November, would regulate certain “covered” CDS—those that maintain a material interest in an underlying asset—as a new form of insurance, known as credit default insurance (CDI), and would prohibit so-called “naked” CDS, or swaps in which a party has no material interest in the underlying asset.

“Our efforts to address this complicated issue,” Assem. Morelle said recently, “indicate our desire to make sense of a market that contributed significantly to our nation’s financial crisis. We as state legislators feel an obligation to examine an area that has jeopardized our constituent’s well-being.”

As stated in the letter, the proposed NCOIL model would mandate licensing of credit default insurers and impose solvency standards, such as minimum capital and surplus, as well as contingency, loss, and unearned premium reserve requirements on such insurers. The draft model would require strict limitations on permissible credit default insurance—restricting writing of the product to purchasers with a material interest in the asset. The draft also would set single and aggregate risks limits and authorize minimum policy and rate standards, among other things.

The NCOIL legislators wrote, “The definition of CDI, the explanation of permissible CDI, and other regulatory requirements included in our draft model bill mirror financial requirements imposed on a similar credit default instrument—financial guaranty insurance.” They wrote, “Instead of reinventing the

wheel, NCOIL Task Force [on CDS Regulation] members based the model bill on New York State Article 69—the 1989 law governing financial guaranty insurance—and drew into its scope the CDS that most resembles insurance.”

Providing context to NCOIL efforts, Sen. Seward and Assem. Morelle highlighted the intense NCOIL process, writing, “NCOIL has hosted one full-day public hearing, two Committee meetings, and six conference calls to consider regulation of CDS. At our public hearing in January, NCOIL legislators concluded that certain CDS are insurance and should be subject to regulation by the states.” They said that the Task Force had been working on the proposal since March and on July 9 presented the draft bill to the Financial Services Committee—which debated the model for more than two hours before deferring it for additional discussion and final consideration at the Annual Meeting in November.

The letter recognized the New York State Insurance Department, the International Swaps & Derivatives Association (ISDA) and the Securities Industry & Financial Markets Association (SIFMA), as well as the American Academy of Actuaries, the American Council of Life Insurers (ACLI), the National Association of Mutual Insurance Companies (NAMIC), and the Association of Financial Guaranty Insurers (AFGI) as interested parties in the NCOIL process.

The letter was addressed to Senators Christopher Dodd (D-CT), Senate Banking Committee Chair, and Tom Harkin (D-IA), Senate Agriculture Committee Chair, and to Congressmen Barney Frank (D-MA) and Collin Peterson (D-MN)—House Chairmen of the Committees on Financial Services and Agriculture, respectively. Copies were distributed to members of the four Committees.

The November 19 through 22 NCOIL Annual Meeting will take place in New Orleans, Louisiana.

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.

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