July 22, 2009

Dear Chairmen Dodd, Frank, Harkin, and Peterson:

As President of the National Conference of Insurance Legislators (NCOIL) and as the Chairman of its Financial Services & Investment Products Committee, we write to apprise you of NCOIL’s latest efforts on the regulation of credit default swaps (CDS) and to offer our input as your Committees continue to schedule hearings on related matters.

After almost a year of discussion and deliberation and receipt of testimony from interested parties, NCOIL has developed draft model state legislation that would regulate certain CDS as insurance products, and ban naked swaps, the impetus for the recent financial crisis.

Specifically, the draft model act would regulate certain “covered” CDS—those that maintain a material interest in an underlying asset—as a new form of insurance, 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. It 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 bill would require strict limitations on permissible credit default insurance (restricting writing of the product to purchasers with a material interest in the asset); set single and aggregate risks limits; and authorize minimum policy and rate standards, among other things. We also included a section that would impose civil and criminal penalties for impermissible credit default insurance.

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. When we next met in March, the NCOIL Executive Committee appointed a Task Force on CDS Regulation and charged it with developing model legislation for our July Summer Meeting.

During our series of hearings and conference calls, we received input from interested parties, including 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). The NCOIL Task Force presented draft NCOIL Credit Default Insurance Model Legislation to the Financial...
Services & Investment Products Committee at the NCOIL Summer Meeting on July 9. To provide for additional discussion—the Committee meeting had already lasted more than two hours—we deferred final consideration of the proposal to our Annual Meeting in November. We have included a current draft of the model legislation for your reference.

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. Instead of reinventing the wheel, NCOIL Task Force 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. In an effort to remain current, our model bill language parallels provisions that the New York State Insurance Department offered to the State Assembly in legislation to update Article 69.

We understand that your Committees will continue to hold hearings on derivatives legislation this month and ongoing with the goal of approving regulatory reform legislation this year. We will update you on our progress as the NCOIL proposal advances and would welcome an opportunity for further dialogue.

Sincerely,

Sen. James Seward (NY)  
NCOIL President

Assem. Joseph Morelle (NY)  
NCOIL Financial Services & Investment Products Committee Chair

cc:  Senate Committee on Agriculture, Nutrition & Forestry  
Senate Committee on Banking, Housing, & Urban Affairs  
House Committee on Agriculture  
House Committee on Financial Services  
NCOIL Legislators

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