

## WSJ LETTER TO THE EDITOR 9-25-08

In their op-ed "Insurance Companies Need a Federal Regulator" (Sept. 23), Sens. Sununu and Johnson and Reps. Royce and Bean argue that the collapse of AIG proves the need for federal regulation of the insurance industry. But if the AIG debacle proves anything, it's that state regulation of insurance works remarkably well and that the feds, given their manifest failure to properly regulate the banking and securities sectors, should keep their hands off insurance.

The authors falsely claim that AIG "is not regulated by the federal government." Despite being labeled an "insurance company," AIG is in fact a highly diversified holding company comprising hundreds of subsidiaries. The minority of AIG subsidiaries that are insurance companies are tightly regulated by no fewer than 19 state insurance departments, and every one of those companies is financially sound. Meanwhile, the AIG non-insurance subsidiary responsible for selling the credit default swaps that led to the company's demise was overseen by federal regulators who, according to Sec. Paulsen, provided only "scant" supervision of this highly risky enterprise. The idea that the "world class" federal regulators who presided over the collapse of AIG and much of the rest of Wall Street should now be entrusted with insurance regulation defies logic and common sense.

Consumers should insist that their lawmakers address the root causes of the current financial crisis rather than exploiting it to further their political agendas through false accusations and misleading editorials.

Charles M. Chamness  
President & CEO  
National Association of Mutual Insurance Companies (NAMIC)

September 17, 2008

Dear Member of Congress,

The recent actions taken by the federal government to address the financial turmoil surrounding Bear Stearns, Fannie Mae, Freddie Mac, Lehman Brothers, and American International Group (AIG) raise ongoing questions about the nature and effectiveness of our country's system of financial regulation. Unlike the banking and securities industries that are regulated at the federal level, insurance is regulated by the states. Because of this, some may be tempted to cite the federal government's recent loan to AIG as evidence of the ineffectiveness of state based insurance regulation.

The National Association of Mutual Insurance Companies (NAMIC) believes that it would be a serious mistake to draw this conclusion. To the contrary, the early evidence suggests that among the several entities that have regulatory jurisdiction over AIG, its state insurance regulator – in this case, the New York Department of Insurance – has performed exceptionally well. In evaluating the regulatory implications of the situation, it is important to keep several facts in mind:

- **The AIG units that are subject to state insurance regulation have remained stable and well capitalized.** As insurance commissioners in every state have pointed out in recent days, AIG's insurance subsidiaries are fully capable of meeting their obligation to policyholders to pay claims. State regulators impose rigorous capital requirements on insurers to ensure their ability to pay claims; they also strictly regulate the nature and type of assets in which insurers are allowed to invest.
- **The states have developed an effective system to ensure that policyholder claims are covered in times of financial difficulty.** That system is not imperiled by the recent developments in the financial markets. The property/casualty insurance industry is backed by the strength and integrity of the guaranty fund system, which effectively protects policyholders in the event of an insurer insolvency.
- **The property/casualty insurance market is very diverse and highly competitive.** In traditional property/casualty insurance lines, including homeowners and automobile insurance, no single insurer holds a dominant share of the marketplace. This diversification ensures that a financial crisis for a single insurer does not imperil the entire industry.
- **AIG is far from being a typical insurance company; instead, it is a highly diversified business.** Indeed, the holding company structure under which it operates

consists of many diverse subsidiaries, ranging from conventional insurance companies to an aircraft leasing firm. According to the Wall Street Journal, “AIG was a major seller of ‘credit default swaps,’ essentially, insurance against default on assets tied to corporate debt and mortgage securities.” The Journal notes that these instruments were sold by “a unit separate from [AIG’s] traditional insurance businesses,” and that “AIG’s cash squeeze is driven in large part by losses in [t]hat financial products unit, which has been a part of AIG for years.”

· **Credit default swaps are one of several exotic financial instruments created in the last decade and sold primarily by commercial banks and hedge funds.** AIG is one of a very small number of insurance companies that sell credit default swaps, and they are sold through a separate subsidiary of the holding company rather than through the insurance subsidiary. The vast majority of credit default swaps are sold by commercial banks. According to the New York Times, at the end of the third quarter of 2007, the top 25 banks held credit default swaps worth \$14 trillion. JPMorgan Chase, with \$7.8 trillion, is the largest player; Citibank and Bank of America are behind it with \$3 trillion and \$1.6 trillion, respectively.

· **Credit default swap contracts are not an insurance product in any traditional sense.**

While these contracts are sometimes characterized as a form of insurance, and while they do indeed serve to “insure” purchasers against financial default on various kinds of credit instruments held by the purchaser, the contracts are not technically an insurance product. As indicated above, these contracts are not sold out of the insurance company and are not regulated by state insurance regulators.

· **AIG’s financial products unit is not an insurance company and is not subject to state insurance regulation.** To the extent that AIG’s financial products unit was subject to regulation by any authority, that authority was the federal Office of Thrift Supervision, which has oversight responsibility for AIG at the holding company level.

A strong case can be made that exotic financial instruments and the markets they trade on should be subject to more or better regulation at the federal level. Policymakers should be careful, however, to make certain that any regulatory reform initiatives are narrowly tailored to address specific market problems. They should avoid sweeping measures that, in the name of addressing “systemic risk,” impose new regulations where they are not needed while hindering or dismantling the very regulatory systems – in this case state insurance regulation – that have proven most effective.

NAMIC and its member companies look forward to working with Congress on these matters.

Sincerely,  
Charles M. Chamness  
President and CEO  
National Association of Mutual Insurance Companies (NAMIC)