

**Written Remarks Relating to Oral Presentation to  
National Conference of Insurance Legislators  
on behalf of ISDA and SIFMA  
on June 5, 2009<sup>1</sup>**

First of all on behalf of ISDA and SIFMA I'd like to thank you for the opportunity to provide comments regarding the proposed model legislation.

As we have previously indicated, ISDA and SIFMA both agree that it is important to bring increased regulatory oversight to the CDS market to reduce systemic risk and increase transparency and liquidity of the markets, however, we don't believe that the proposed model legislation achieves this in a way that maximizes CDS' benefits to the general economy while addressing the aforementioned concerns.

We understand that the proposed model legislation was intended to very broadly define 'Credit Default Insurance' in a manner so as to encompass the entire CDS market – including both what have been referred to as 'covered' and 'naked' credit default swaps. The legislation then goes on to prohibit any entity from engaging in Credit Default Insurance unless it is licensed as a Credit Default Insurer, which will then only be permitted to engage in a limited class of what have been referred to by some as 'covered' credit default swaps. Thus, the model legislation would have the effect of entirely eliminating a significant portion of the current CDS market.

Putting aside the practical issues CDS market participants would face under the model legislation, state adoption of the proposed model legislation, which eliminates the so-called 'naked' portion of the CDS market would likely also result in the elimination of the domestic CDS market in its entirety.

The current CDS market – including both so-called 'covered' and 'naked' credit default swaps is a large, complex and fundamentally important part of the national and international economy and financial markets. The CDS market allows banks to loan more money to individuals and corporations than it could without the CDS markets.

For example – similar to how insurance companies utilize reinsurance to isolate and allocate specific risks that they decide they don't want to retain on their books – banks use Credit Default Swaps to isolate and allocate credit risks that they may otherwise be exposed to.

The CDS market also allows banks to engage in more accurate and timely credit monitoring by being able to track and monitor CDS credit spreads of borrowers, which also helps to facilitate the lending market. The CDS market also allows investors – including P&C and Life insurers – to mitigate and diversify the credit risk in their invested asset portfolios – examples of this are noted in the ACLI comment letter submitted to this task force.

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Accordingly, by shutting down the CDS market not only would there be immediate adverse economic impact on current CDS market participants which would result in layoffs and reduced payroll and income taxes in the jurisdictions where the market participants operate, but it would also lead to an increase in credit risk for lenders which would force them to curtail and reduce their lending. This would obviously have an adverse impact on the current fragile economy.

Another point to consider with the current draft of the proposed model legislation is that it is essentially an application of the existing financial guaranty insurance regulation under Article 69 in New York to a complex financial product that we believe is not insurance and is distinguishable in many ways from traditional insurance and financial guaranty insurance. In the current CDS market, credit default swap contracts are not based on the concept of insurable interests and certainly don't require a party to suffer an economic loss in order to receive a payment.

However, by suddenly defining CDS as an insurance product and attempting to regulate it as such, the model legislation will morph CDS into the equivalent of financial guaranty insurance, which will fundamentally change the characteristics and benefits of CDS. In the current market financial guaranty insurance is available in the market, however financial guaranty insurance is currently not used by the market the same way CDS is. The fact that financial guaranty products and credit default swap products are currently being used in very different ways and for very different purposes is an obvious indication of the fact that the products are not synonymous or substitutes for one another. Thus the current model legislation which attempts to regulate CDS using essentially the same regulatory regime that currently applies to financial guaranty insurance without considering the differences or nuances in the products will lead to confusion and ambiguity in the market and as a result the domestic CDS market will simply cease to function under the current proposal.

As I noted earlier, we agree that it is important to bring increased regulatory oversight to the CDS market to reduce systemic risk and increase transparency and liquidity of the markets, however, any such regulatory oversight should be undertaken in a manner that reflects the true nature of the product, and takes into consideration the various benefits and potential risks of the product, so that in the end there isn't a disruption that adversely impacts the economy and financial markets. We believe that the approach recently articulated by Treasury Secretary Geithner reflects this approach. Treasury's proposal addresses the concerns raised by NCOIL and also provides a framework for effective use of CDS, thus maintaining the benefits highlighted above. In contrast, the NCOIL model legislation risks effectively eliminating the domestic CDS market. These competing approaches to derivatives regulation could well lead to regulatory turf battles at a time when cooperation between state and federal regulators is essential.

In light of the timeline and focus of this issue in Congress and at the Federal level, we would encourage the task force to consider deferring the continued development of the proposed model legislation pending the outcome of the Federal legislation.