October 6, 2008

The Honorable Henry Waxman
Chairman, Committee on Oversight and Government Reform
U.S. House of Representatives
2204 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Tom Davis
Ranking Member, Committee on Oversight and Government Reform
U.S. House of Representatives
2348 Rayburn House Office Building
Washington, D.C. 20515

Dear Representatives Waxman and Davis:

As President of the National Association of Insurance Commissioners (NAIC)[1], I write today to commend you for holding a series of hearings to examine the policies and decisions that have contributed to the instability in our financial markets. In particular, we appreciate your leadership on the House Committee on Oversight and Government Reform in examining American International Group (AIG). Eric Dinallo, Superintendent of Insurance for the State of New York, has the support and confidence of his colleagues at the NAIC and we support his testimony before your Committee. In light of these hearings, it is imperative that Members of the Committee consider the actions of State insurance regulators, and have a full understanding of the scope of their authority as it relates to AIG. Likewise, it is also imperative that any legislative actions resulting from these important hearings build upon, and not undermine, the expertise and strengths of State insurance regulators.

Much has been written in the press about the turmoil affecting AIG. As the insurance regulator for the people of Kansas, and as representative for my colleagues around the country, I feel it is necessary to ensure you have all the facts regarding the situation. Although AIG is generally known to the public as the world's largest insurer, in truth, AIG is a financial holding company that owns 71 U.S. insurance entities and 176 other financial services companies throughout the world, including banks, securities firms, and non-U.S. insurers. Only the 71 U.S. insurance entities are regulated by State insurance commissioners.

AIG's U.S. Insurance Companies are Solvent

The problems at AIG necessitating a Federal loan are not with its insurance subsidiaries. The problems stem from the operations of AIG's holding company, its financial products division,

[1] The NAIC is the oldest association of State officials, and is comprised of the chief insurance regulators in the fifty States, the District of Columbia, and the U.S. Territories. State insurance regulators created the NAIC in 1871 to provide a forum for the development and coordination of insurance regulatory policy.

and its securities lending division, regulated at the Federal level by the Office of Thrift Supervision (OTS). The State regulated insurance subsidiaries remain solvent and able to pay claims. Throughout the liquidity crisis at the AIG holding company level, consumers remained protected by State rules preventing the holding company from simply raiding capital from its profitable and well-capitalized insurance subsidiaries. Even if the conservative accounting and solvency requirements of State regulation had not been sufficient to protect the AIG insurers and they became insolvent, covered policyholders would have remained protected up to specified limits by the State network of guaranty funds.

When it became clear to AIG management that they would not be able to raise capital privately to address problems with the holding company, they negotiated a loan with the Federal government, and State insurance regulators were involved in that process to attest to the financial strength of AIG's insurers.

The conservative financial supervision and accounting requirements of State insurance regulators have proven crucial to AIG's insurance subsidiaries in ensuring they have the ability to honor their commitments to policyholders, despite the turmoil at the holding company level. Indeed, it is the strength of the insurers that provided confidence for the Federal government to extend a loan to the holding company.

As AIG works to repay the Federal loan, we are closely monitoring any proposed transactions involving the sale of AIG insurers so that policyholders will be protected and claims will be honored.

What happened at AIG?

The AIG financial products division invested heavily in collateralized debt instruments, such as credit default swaps on mortgage-backed securities. It is important to note these types of investments are not State-regulated insurance products. When the U.S. housing markets experienced a downturn, these investments lost a significant amount of value for the AIG financial holding company.

How Are State Insurance Regulators Involved in the Solution?

While the AIG insurance businesses and their State regulators were not part of the problem, they will be a key part of the solution. AIG's insurance businesses are valuable assets and most outside of the core p/c business and foreign life insurance will be sold to raise capital to repay the Federal loan. The main change for policyholders will be the address and name of the new insurance entity; the contractual terms of their policies will remain in place. Insurance companies are bought and sold all the time, and State regulators review those transactions to ensure the sale protects the interests of the policyholders. If there is a concern that cannot be resolved with a proposed sale, insurance regulators will reject the proposal.

Insurance regulators from every State — but especially those regulators in New York and Pennsylvania who oversee a large number of AIG insurance subsidiaries — have been involved in every step of resolving AIG's holding company problems. State regulators have worked closely with the AIG management team, the Federal Reserve Bank of New York, and the U.S. Department of the Treasury to find a solution that will protect policyholders and taxpayers alike.

The NAIC has created several task forces of regulators to ensure that any sales protect policyholders, and to continue working with AIG management as it works to repay the Federal loan. We also have been working hard to keep consumers informed about the AIG situation, with consumer bulletins in the States and through local and national media coverage.

Regulatory Coordination and Next Steps

Effective oversight of complex enterprises requires coordination and communication between regulators. State insurance regulators regularly collaborate with and provide information to our State and Federal banking and securities counterparts, but those efforts should be formalized and strengthened. We appreciate the collaboration we have had with the Federal Reserve Bank of New York, Treasury, and others in dealing with AIG, but the complex holding company model of AIG illustrates the need for ongoing dialogue between State and Federal regulators. Likewise, since AIG is a multinational company, we have worked closely with our international counterparts at the International Association of Insurance Supervisors (IAIS) to assist them in gaining the necessary information to properly oversee AIG's non-U.S. insurance companies.

Effective oversight also demands regulators have the tools necessary to carry out their obligations. State insurance regulators suggest that Federal banking regulators look at whether it might be appropriate to apply State insurance regulatory tools in certain areas, such as restrictions on derivative activities; limits on high concentrations in investment types; and appropriate minimum capital and surplus requirements.

Going forward, the AIG issue illustrates the need for better market transparency, particularly of complex securities and derivatives products which have ballooned into an enormous influence in the economy. Illuminating the markets is the best way to keep all market participants — and all market regulators — informed with the best available information to make the best financial decisions.

The Politicizing of AIG by Some Insurance Lobbyists

Some insurance lobbyists hope to politicize and mislead policymakers by suggesting AIG's problems are a result of State insurance supervision, and could have been averted by Federal oversight. On the contrary, conservative State regulation ensured that while the federally regulated holding company was failing, the insurance businesses were appropriately capitalized and the interests of policyholders were placed ahead of shareholders. If the proposed optional Federal charter (OFC) for insurers had existed, and some or all of AIG's insurance companies had chosen that Federal charter, the problems at the AIG holding company would still have fallen outside the jurisdiction of that Federal insurance regulator.

The OFC proposal would create a new Federal bureaucracy built on a hollow foundation of extreme deregulation. Supporters of the OFC proposal routinely cite their desire to have a system akin to the banking system, which is the very model that has led to the problems taxpayers must now bail out. We urge all Members of Congress to reject an OFC and instead work for targeted reforms that will result in meaningful, coordinated financial oversight that balances competitive market principles with transparency and disciplined prudential supervision.

Conclusion

Given the national search to find the underlying causes behind the financial challenges facing Wall Street and Main Street, I wanted you to hear the facts about AIG directly from the State officials who work every day to protect constituents like yours. Like you, I am a public servant, and I take my responsibility to protect insurance consumers very seriously. If you would like to discuss AIG, regulatory modernization or any other insurance matter affecting the States, please do not hesitate to contact me directly. I look forward to working with you and others Member of Congress on these important issues.

Sincerely,

Sandy Praeger

The Honorable Sandy Praeger
Kansas Commissioner of Insurance
President, NAIC

cc: Members of the House Committee on Oversight and Government Reform