



**To:** Congressional Staff and Members  
**From:** Eli Lehrer, the Competitive Enterprise Institute

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You have recently received a letter titled “Federal Insurance Regulation Not a Panacea.” It’s worth reading but, as Congress considers legislation creating a federal insurance regulator, one must keep the facts straight. The recent letter overstates its case. Two particular statements cry out for analysis:

**Statement:** “The fault [for AIG’s collapse] lies not with the direct activities of AIG’s insurance units or the failure of state insurance regulators, but with AIG’s Financial Products unit which was overseen by an array of federal regulators who failed to properly regulate and prevent the activities in question.”

**Analysis:** AIG experienced problems throughout its various businesses including insurance and state-level regulators oversaw some of the most troubled operations. Like all large insurers, AIG was structured as a holding company subject to a variety of federal and state overseers. The chief overseer of AIG’s insurance business solvency— the person who gave it permission to move money from solidly capitalized insurance businesses to its financial products division— was the New York State Superintendent of Insurance. (The New York Fed effectively overruled the State Superintendent by providing AIG with capital of its own.) Although the capital raids on insurance subsidiaries approved by New York State regulators never took place, it’s quite possible that they would have further destabilized AIG. The New York Fed’s actions seem to indicate that at least some people there believe that the New York State regulator had made a mistake.

In any case, AIG’s fragmented structure— the company had far more subsidiaries than similarly-sized competitors— suggests that it may have taken advantage of the confused system of state regulation in ways that damaged both the company’s stockholders and the economy as a whole. Many of the activities that got AIG into trouble involved a securities lending program that, at one time, grew to almost \$100 billion. The capital from this program came, largely, from state-regulated subsidiaries.

Given that AIG’s situation still remains unresolved, furthermore, it remains to be seen how— or if— the various state-regulated subsidiaries actually survived the company’s collapse. To date, AIG has closed the sale of only one of its U.S.-based state-regulated insurance subsidiaries. This could potentially indicate undisclosed problems with the finances of the yet-to-be-sold

subsidiaries. In short, AIG was both state and federally regulated. State regulators made many questionable decisions involving the company and may have contributed to its collapse.

**Statement:** Note who opposes [the idea of a federal regulator]: the National Association of Attorneys General, the National Governors Association, the National Association of Insurance Commissioners, and the National Conference of Insurance Legislators.

**Analysis:** All of these groups would stand to lose power under a federal regulatory regime. Therefore, it's not surprising that they would oppose it. That doesn't mean, of course, that they are wrong, simply that their opposition is to be expected.

If Congress decides that it must create a national systemic regulator, indeed, it seems difficult to understand how fifty separate, competitive jurisdictions could collectively oversee the nation's entire insurance system for systemic risk. Congress has much work to do in making necessary changes to America's insurance regulatory system. Vigorous debate about the merits and deficiencies of various proposals will result in better regulation for the nation as a whole. But such debate needs grounding in the facts.

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