

Financial Services and Products ADVISORY

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New York State Insurance Department Defers Regulation of Credit Default Swaps Indefinitely

The New York State Insurance Department (the “Insurance Department”) announced yesterday that it is indefinitely deferring the effective date of measures to regulate credit default swaps (CDS) as insurance contracts. Those measures, originally outlined in the Insurance Department’s Circular 19 (2008) issued on September 22, 2008 (“Circular 19”), provided that CDS in which the buyer of protection “holds, or reasonably expects to hold, a ‘material interest’ in the reference obligation” would be regulated as a form of financial guaranty insurance.¹ Regulation of that category of CDS was to become effective on January 1, 2009. At the time Circular 19 was issued, New York Governor Paterson called on the federal government to regulate the portion of the CDS market that the Insurance Department’s action did not reach.²

In its press release issued yesterday,³ the Insurance Department noted its belief that the best solution to the problems created by the previously unregulated CDS market is to have one CDS market with a single regulatory scheme. Recognizing recent initiatives by the President’s Working Group on Financial Markets (PWG) to strengthen oversight and transparency in the CDS market and to encourage development of central counterparties for CDS, the Insurance Department decided to delay its measures with respect to CDS. The press release referred to (i) PWG support for the development of CDS central counterparties (anticipated to begin operating before year-end); (ii) the Memorandum of Understanding among the Federal Reserve Board of Governors, the Securities and Exchange Commission and the Commodity Futures Trading Commission to cooperate and share information on the supervision of central counterparties; and (iii) the work of the New York Federal Reserve Bank and the New York Banking Department to establish a New York trust company to serve as a clearing house.

In issuing the First Supplement to Circular 19,⁴ the Insurance Department removed the application of insurance regulations to CDS contracts. In its press release, however, the Insurance Department left open the door to consider futures changes in state law as may be necessary because some CDS are insurance.

¹ See Alston & Bird Advisory “New York to Regulate Credit Default Swaps as Insurance; SEC Seeks Legislative Authority to Regulate Credit Default Swaps,” dated September 29, 2008.

² See “Governor Paterson Announces Plan to Limit Harm to Markets from Damaging Speculation,” <http://www.ins.state.ny.us/press/2008/p0809224.pdf> (Sept. 22, 2008); and Circular Letter No. 19, “‘Best Practices’ for financial guaranty insurers,” http://www.ins.state.ny.us/circltr/2008/cl08_19.pdf (Sept. 22, 2008).

³ <http://www.ins.state.ny.us/press/2008/p0811201.htm> (Nov. 20, 2008).

⁴ First Supplement to Circular Letter No. 19 (2008), “‘Best practices’ for financial guaranty insurers,” http://www.ins.state.ny.us/circltr/2008/cl08_19s1.pdf (Nov. 20, 2008).

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Although New York will not regulate CDS as insurance at this time, the Insurance Department described its view as to the necessary elements for effective regulation of CDS:

- maintenance of capital and sufficient trading margins to minimize counterparty risk;
- a guaranty fund so that failure of a seller of protection does not create a domino effect of failures;
- clear and inclusive dispute resolution mechanisms;
- availability of comprehensive market data to promote transparency; and
- mandatory and comprehensive regulatory oversight.

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