TESTIMONY OF THE HON. D. CAMERON FINDLAY
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AON CORPORATION

ON BEHALF OF
THE COUNCIL OF INSURANCE AGENTS AND BROKERS

BEFORE THE COMMITTEE ON FINANCIAL SERVICES

REGARDING:

OVERSIGHT OF IMPLEMENTATION OF THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008 AND OF GOVERNMENT LENDING AND INSURANCE FACILITIES; IMPACT ON ECONOMY AND CREDIT AVAILABILITY

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2128 RAYBURN HOUSE OFFICE BUILDING

Introduction

Thank you, Chairman Frank, Ranking Member Bachus, ladies and gentlemen of the Committee. I am Cam Findlay, Executive Vice President and General Counsel of Aon Corporation, and I am pleased to testify today on behalf of the Council of Insurance Agents and Brokers.

The Council represents the nation's leading insurance agencies and brokerage firms, including Aon. Council members specialize in a wide range of insurance products and risk management services for business, industry, government, and the public. Operating both nationally and internationally, Council members conduct business in more than 3,000 locations, employ more than 120,000 people, and annually place more than 80 percent – well over $200 billion – of all U.S. insurance products and services protecting business, industry, government and the public at-large, and they administer billions of dollars in employee benefits. Since 1913, The Council has worked to secure innovative solutions and create new market opportunities for its members at home and abroad.

Aon Corporation is the leading global risk management services provider, insurance and reinsurance brokerage, and human capital consulting firm. With 36,000 professionals worldwide, Aon delivers distinctive client value through innovative and effective risk management and workforce productivity solutions. We handle approximately $60 billion in annual insurance premiums, more than any other insurance broker in the world.

Insurance plays a fundamental role in the operation of the world's financial markets. Any coordinated effort to combat the turbulence roiling those markets should consider the potential for an insurance component.

Less than a week ago, Secretary Paulson announced that the Treasury Department would not exercise recently acquired authority to directly purchase troubled assets. So, the U.S. Treasury will not be exercising the authority that only six weeks prior was said by some to be the optimal way to restore liquidity to the U.S. financial marketplace.

Treasury has already infused hundreds of billions of dollars of capital into financial institutions, and has indicated that further infusions are coming. However, this approach does not address a primary cause of the liquidity problem – the hundreds of billions of dollars of *illiquid* assets that reside on the ledgers of America's financial institutions.

As long as the problems created by depressed valuation of these assets in the capital markets remain, no mater the volume of capital infusions, financial intuitions will have a difficult time playing their critical role in the functioning of our economy.

That is why the Council of Insurance Agents and Brokers and its members believe that the Department of Treasury should vigorously exercise the authority granted to it in Section 102 of the Emergency Economic Stabilization Act, and establish a program to insure the value of troubled and illiquid financial instruments.

During the frenzied September effort to craft emergency legislation urgently needed to stabilize the financial markets, some parties expressed skepticism regarding the idea of insuring troubled assets. However, the little hindsight afforded by the six weeks that have passed since the bill's enactment have already provided ample evidence that this Committee exercised great foresight by including the authorities outlined in Section 102.

An Insurance Program Solution

One approach, drawing on the precedents established in dealing with other seeming insurmountable risks, including the Price-Anderson Nuclear Industries Indemnity Act, would implement an insurance program that would use a combination of risk retention, risk pooling and government backstop liquidity. Such an approach would benefit taxpayers, financial institutions saddled with illiquid assets, and homeowners. Aon has submitted a proposal to Treasury supporting such an approach.

Such a plan, largely self-funding and drawing inspiration from the Price-Anderson program, involves the sharing of risk by participants in an entity that we refer to as the "asset stabilization pool." Participants in the asset stabilization pool would have a portion of the principle and interest from specific, illiquid assets guaranteed.

Thus, the program would insulate an asset holder from the decline in value resulting from the non-payment, or expected non-payment, of principal and interest. Asset holders would be required to retain a small percentage of the shortfall of principal and interest, subject to a maximum annual payout per asset. Asset holders would be reimbursed from the pool for a shortfall in principal or interest once such amounts exceed their retained amount in a single year.

To receive the benefit of such coverage, participating institutions would have to pay premiums into the pool. Each year, actuaries would calculate the level of premium needed to fund the guarantee payments for the following year. Premium payments to the pool would be capped by the government.

In the event that payments from the pool exceeded premium collections, the government would lend the pool the funds needed to make good on the guarantees. The government would be reimbursed by premium collections in subsequent years. And the Treasury Department could calibrate liquidity by speeding up or slowing down the collection of premiums.

Consider the holder of $1 million in mortgage backed assets. The current lack of confidence in the liquidity of these assets has dropped the market value to, for example, $600,000. This results in a $400,000 loss on the ledgers of the asset holder. This drop in value is a result of the lack of confidence in the ability to measure the true intrinsic value of mortgage related investment income during the current period of correction in the housing market. Hence market value has fallen well below expected intrinsic value.

Let's assume, for our example, that the expected intrinsic value is $800,000. Under certain accounting treatments, an insurance pool that guarantees the principle and interest from specific assets would result in a restatement of the asset holder's loss from $400,000 to only $200,000. Additionally, the out of pocket cash flow from asset holders would be limited to the premium assessed to cover a single year's expected shortfall on principle and interest. In this example, that would suggest that the full $200,000 loss is amortized on a cash flow basis over the life of the mortgage underlying the asset.

Nobel Prize-winning economist Harry M. Markowitz recently published a paper in which he referred to this crisis not as a liquidity crisis but as a transparency crisis. The core of the problem, in his opinion, is the lack of information needed to price illiquid assets. Markowitz recognizes the ultimate resolution of the liquidity crisis to be the development of information and methods needed to accurately price risk.

After some experience working with the proposed asset stabilization pool, we believe actuaries should be able to use the accumulated data about the performance of the insured assets to develop ever-more-accurate premium pricing models, reflecting the intrinsic value of the underlying securities. In this way, the insurance plan would build a bridge to the future.

An insurance mechanism for illiquid assets would also assist homeowners. The plan would create a mechanism for spreading the cost of mortgage defaults among participants over time. In turn, another precondition of participation would be the acceptance of a compulsory loan-modification provision. The government could provide guidance to financial institutions for renegotiating terms or writing-down of individual mortgages.

Benefits of an Insurance Program to Taxpayers, Financial Institutions and Homeowners

An insurance program would have significantly lesser short-term cash requirements than capital infusions, and because such an insurance plan would be largely funded by its direct beneficiaries, it would restore liquidity without requiring massive outlays of government funds to the benefit of taxpayers.

The insurance of illiquid assets would also protect financial institutions and the economy. As an insurance program would provide asset holders the option to hold assets until maturity or until economic conditions permit the restoration of the assets' value, it would not flood the market with distressed assets, which could have the effect of further depressing asset values.

An insurance program would also prevent opportunistic purchases of depressed assets by predatory investors. Furthermore, the plan provides a framework for managing risks from the securitization of assets to helping the financial services sector avoid similar crisis in the future.

Finally, our plan provides a mechanism for the government to restructure individual mortgages with an emphasis on decreasing the number of foreclosures.

Conclusion

On behalf of the CIAB, I want to thank you again for the opportunity to testify today. Aon and the CIAB commend the Committee for demonstrating the leadership and vision to include in the EESA the authority to create an asset guarantee program

Your diligent work on this issue is critical to our clients and most importantly the Nation. I know Aon and the CIAB look forward to working with you and your staff on developing an innovative and sustainable solution to the challenge facing our economy.

I look forward to your questions.