

Could A.I.G. Happen Again?

EDITORIAL

The United States government recently sold the last of its shares in the American International Group, more than four years after it bailed out the insurance giant with a package of assistance that eventually totaled \$180 billion. In announcing the sale, the Treasury Department also [said](#) that the government had a “positive return” of \$22.7 billion — a sum that fails to take into account tax breaks A.I.G. received as a ward of the state. But whether the government profited from the bailout is not important. The truly vital issue is this: Could this happen again? Unfortunately, the troubling answer is yes.

A.I.G., whose chief business is insuring consumers and businesses, collapsed in 2008 because of reckless speculation by a subsidiary, A.I.G. Financial Products. That unit bet big on the housing and credit boom with credit-default swaps, which are financial instruments that mimic insurance. By the time it collapsed, the division had guaranteed nearly \$80 billion in mortgage securities, often for large investment banks and hedge funds. The government stepped in to bail out A.I.G. because its failure could have dealt mortal blows to other financial institutions that the company had agreed to protect from losses.

In the aftermath of the financial crisis, policy makers in Washington, London and elsewhere began working to address the shortcomings exposed by A.I.G. Congress passed the Dodd-Frank reform law that imposes new controls on financial activity but leaves it to regulatory agencies, such as the Securities and Exchange Commission and the Commodity Futures Trading Commission, to fill in the details.

While those agencies have made some progress, like requiring derivative trades to be more transparently traded and reported, they have completed just [one-third of the rules](#) required by the law. The things regulators have yet to finish include imposing limits on the size of bets investors can make using credit default swaps and other exotic financial instruments, and also requiring investors to maintain sufficient reserves to make good on all of those bets.

Another cause for concern is that American, European and Asian policy makers have not sufficiently coordinated their regulation of financial derivatives. That means investors looking to

escape regulations in one country can do so by moving their trades to another part of the world. The derivatives business is global and its regulation must also be international. One of the reasons the A.I.G. Financial Products unit escaped the notice of regulators was that it was based in London, where it operated under a French banking license. At the very least, U.S. agencies must regulate the trading activities of the foreign branches and subsidiaries of American financial institutions.

The blame for regulatory delays falls, in part, on an unrepentant financial industry that has fought against regulation at every turn, on Capitol Hill or in the courts. It has, for instance, sued the C.F.T.C. to block a rule that would have limited the size of investors' positions in certain derivatives.

Such shortsighted opposition hinders rules that would help restore long-term confidence in the financial system and the economy, which is in everybody's interest, including banks and investors. But ultimately, the blame for the slow progress rests with the Obama administration and policy makers in Europe and Asia, too.

After the Depression hit, the United States created several regulatory agencies like the Securities and Exchange Commission and the Federal Deposit Insurance Corporation that helped maintain relative financial stability and prosperity for almost seven decades before deregulation chipped away at their effectiveness. It is imperative that policy makers speed up the rules to help correct critical vulnerabilities in the financial system.
