

PROJECT HISTORY - 2007

FINANCIAL GUARANTY INSURANCE GUIDELINE (#1626)

1. Description of the Project, Issues Addressed, etc.

The project began on March 1, 2007, when the Financial Guaranty Model Act Revisions (E) Working Group (the “Working Group”) held its first conference call. The project included reviewing the NAIC Financial Guaranty Insurance Model Act (#626) to determine if any updates should be made to the model. The review consisted primarily of comparing the NAIC model, which had not been updated since its original adoption in 1986, with the language included in the New York and California statutes on financial guaranty insurance that had been updated several times since enactment, most recently in 2004 and 2005. The comparison to New York’s statute was considered appropriate as 7 of the 19 financial guaranty insurers that file with the NAIC are domiciled in New York, with many of the other states that have monoline companies utilizing the more detailed New York statute when necessary. The comparison to California was considered appropriate because its statute is considered similar to the New York statute and California is a large market for many of the financial guaranty insurers.

Purpose of the Project

The primary purpose of updating the NAIC model act is to provide a guide for law making bodies setting requirements for monoline financial guaranty insurers. An updated NAIC model allows for consistency with the New York and California statutes, which are seen as the highest standards by the industry, thus encouraging only legislation that is consistent with the best of current practice. To the extent states consider changes to their statutes for monoline financial guaranty insurance in the future; this update does request that such states consider adopting this updated guideline.

Adopted As a Guideline

In May 2007, the NAIC developed a new process for the consideration of model laws which established specific criteria that must be met for an item to be considered an NAIC model. At the onset of this project, NAIC records indicated that only six states had adopted legislation for monoline financial guaranty insurance. Upon review of the criteria, the Working Group determined the criteria had not been met relative to this model or the proposed changes to the model. The Working Group recommends adoption as a guideline.

Significant Changes to the Guideline

Since 1986, New York and California have made significant changes to their statutes to accommodate changes in marketplace practice. The changes to this guideline include numerous changes that bring the guidance in line with the New York and California statutes. The following represents a summary of the more significant changes:

Clarifies financial guaranty insurance definitions; allows the use of credit default swaps as collateral; strengthens the contingency reserve requirements as well as changes to the limitations; includes of transitional language for those states currently without a financial guaranty statute and for licensed multi-line insurers writing financial guaranty insurance.

2. Name of Group Responsible for Drafting the Model and States Participating

Financial Guaranty Model Act Revisions (E) Working Group

States Participating:

New York, Chair	Maryland
California	Wisconsin
New Jersey	

3. Project Authorized by What Charge and Date First Given to the Group

The Financial Condition (E) Committee charged the newly formed Financial Guaranty Model Act Revisions (E) Working Group at the 2006 Winter National Meeting:

Review the Financial Guaranty Insurance Model Act and consider any changes necessary to update the model.

4. A General Description of the Drafting Process (e.g., drafted by a subgroup, interested parties, the full group, etc). Include any parties outside the members that participated

The drafting process began with a document prepared by the Association of Financial Guaranty Insurers (“AFGI”) that showed all of the changes necessary to bring the NAIC model in line with the statutory amendments that New York and California adopted to reflect changes in best practices for monoline financial guaranty insurers. The document prepared by AFGI also explained the specific reason for each particular change.

The document was exposed for comment to interested regulators and interested parties on March 1, 2007 with a 30 day comment deadline. Limited comments were received from the industry interested parties, and those noted were accepted by the Working Group. One representative of AFGI noted on one conference call that the industry views this project as a mechanical process to simply update the model and is not opposed to the project or the changes.

5. A General Description of the Due Process (e.g., exposure periods, public hearings, or any other means by which widespread input from industry, consumers and legislators was solicited)

The Working Group held three conference calls subsequent to the initial meeting, during which the document was revised and redistributed for further discussion after each call. As noted previously, comments from the industry were limited, thus additional exposure time was never considered necessary.

6. A Discussion of the Significant Issues (items of some controversy raised during the due process and the group’s response)

Section 3A(6)(b)-Release of Contingency Reserves

This section has specific language about the release of contingency reserves. One member of the Working Group expressed concern with this language, and requested it be modified to require satisfactory demonstration to the commissioner before the reserves are released. The language was revised and modified as requested.

Section 3B(2) — Contingency, Loss and Unearned Premium Reserves

This section requires an independent review of the claim reserves if the claims experience was unfavorable in the prior three years and exceeded ten percent of surplus. One member of the Working Group questioned how this 10% figure was established and wondered if it should be reduced. Another Working Group member noted

that when this threshold was established in his state, there was no empirical evidence or statistical analysis to support the 10%; however, they thought 10% was a good measure of a material event. The Working Group did not change this provision believing that the independent auditor's separate opinion on the adequacy of the reserves provides an opportunity for the reserves to be challenged on an objective ground and at a more granular level.

Section 4B(1)(g) — Mortgage Guaranty Insurers

This section 4 provides limits on certain asset backed securities. This particular section includes some delineation between financial guaranty insurers and mortgage guaranty insurers, and one of the members questioned if the two types of entities could coexist with similar products. Another member responded that there had not been any issues raised in his state relative to this language. Ultimately the Working Group made no change to this area, with the belief that there were no concerns in this area.

Section 4B(2)-Insured Municipal Obligations

This section requires that 95% of outstanding total liabilities on municipal obligations be investment grade. One member of the Working Group requested language to be added to allow commissioner discretion in this area. A separate member supported this change. However, another member expressed concern with allowing commissioner discretion, as it could result in increased risk. It was noted that the rating agencies generally limit exposure below the level in this guideline to be considered a AAA company, but may be lower if the reporting entity was willing to operate with a lower rating. To the extent such a company existed, and did business in this state, it could either require a change in statute in that state, or some type of action by this state. Ultimately the Working Group maintained this language, although this state abstained from voting on final guideline, therefore this item was particularly controversial.

Section 5 — Filing of Policy Forms and Rates

This section sets out requirements for filing policy forms with a commissioner. One member of the Working Group expressed concern with how this section allows the product to be used immediately and differs from the more typical file-and-use statute. This same member noted that if this model were to become an accreditation standard, his state may not be willing to allow this type of filing. It was noted that this model had been around for nearly two decades, and given there hadn't previously been a push for accreditation it didn't appear that would be an issue. Ultimately the Working Group agreed to adopt the language that allows the product to be used immediately.

7. Any Other Important Information (e.g., amending an accreditation standard).

None