

## **Report of SVO Classification Determinations**

Report Number 1, Dated May 16, 2006

### Background

#### Regulatory Concern Expressed on Trust Preferred Securities

Beginning with the 2005 Spring National Meeting, members of the NAIC Valuation of Securities Task Force expressed concern that insurance companies were reporting certain securities as bonds when the nature of the securities and the classification treatment accorded by the Securities Valuation Office (SVO) to them prior to the adoption of the filing exemption suggested the securities should have been reported either as Preferred Stock or as Common Stock for state insurance statutory purposes. This regulatory statement concerned securities typically referred to as trust preferred securities, issued as regulatory capital and sometimes generically called a capital security.

#### Regulatory Instruction to File Hybrids

In the fall of 2005, the New York State Department of Insurance (NYDOI) instructed one of its domiciliary companies to file a new type of capital security with the SVO despite its filing exempt status. The security that was subsequently filed with us is one frequently referred to in the marketplace as a hybrid security because of the way it combines debt and equity characteristics. The SVO was asked to provide a classification analysis and ultimately concluded that the security should be reported as common stock for statutory purposes. Shortly after the SVO communication to the NYDOI, the Department instructed other of its companies to report additional hybrid securities to the SVO for classification analysis.

#### Regulatory Instruction to File Certain Trust Preferred Securities

At the same time that the NYDOI instructed its domiciliary company to file the first hybrid security, it also instructed a number of other of its domiciliary companies to file a number of trust preferred securities for classification analysis.

#### Insurers File Advanced Rating Service/Emerging Investment Vehicle Applications for Some Hybrids

In addition to the hybrid and trust preferred securities that the NYDOI has instructed companies to file with the SVO for classification analysis, many other insurers who were potentially interested in purchasing the security submitted Advanced Rating Service/Emerging Investment Vehicle Applications for other hybrids. ARS/EIV Applications are pre-purchase analysis performed for insurance companies providing our credit assessment (an opinion of credit quality expressed as a NAIC Designation), classification analysis or other regulatory analysis. The ARS/EIV process is intended to provide insurers an early opinion of the probable state regulatory treatment of a security before it is purchased. This permits the insurer to better manage its statutory portfolio. The ARS/EIV process permits an insurer to name an agent, typically an investment bank representative, to provide the SVO with information on the security and to communicate with the SVO during the analytical process. The ARS/EIV process concludes with a letter, sent to the insurer applicant and its agent, (unless the insurance company instructs the SVO not to correspond with the agent) of the decision taken. The letter specifically provides that either the insurer or its agent may show the letter to anyone, provided only that the entire letter is shown. This practice reflects the view that the state insurance regulatory process is well served when insurers have access to these opinions. More practically, it reflects that until an insurance company actually purchase and reports the security to the SVO, the ARS/EIV security would not appear in NAIC Databases.

### Purpose of this Report

This Report relays information on the classification decisions made by the SVO for the population of securities discussed above. It is directed primarily at insurance companies who may have an interest in recently expressed regulatory concerns about hybrid or trust preferred securities as discussed above. This report focuses on hybrids only, (not trust preferred securities).

As the SVO completes its review of hybrids filed with the office, (either those filed by insurers per instruction of the NYDOI and other state regulators or via the ARS/EIV process) we will begin an in depth review of trust preferred securities and this report will be updated accordingly.

**To permit easy identification of an update this report is NUMBER 1 – and is dated as of May 16, 2006. Subsequent reports will be labeled in sequence.**

### Report

#### Securities Filed at Instruction of NYDOI

10 hybrid securities were filed with the SVO as the instruction of the NYDOI. Of these, 4 have been completed, 4 are in process of analysis, 1 has not yet been received and 1 was sold and thereafter withdrawn from the analytical review process by the insurer. The individual transactions deals are identified below because they are owned by insurance companies.

#### Completed

- Lehman ECAP (# 52520YAA5) classified as **common**
- BNSF Funding (#05567SAAA) classified as **common**
- Wachovia Cap Trust III (WITS) (92978AAA0) classified as **common**
- Stanley Works Caps Trust I (#854624AA1) classified as **common**

#### In Process

- Barclays Bank ADR's 6.278
- ECAPS -ZFS Financial USA Trust I
- ECAPS -ZFS Financial USA Trust II
- Den Danske A/S

#### Not Received

- ST George Funding (# 789549AA0)

#### Withdrawn

- IFLC E-CAPS AIG Trust II (#44965TAA5)

### Securities Under Review Via ARS/EIV Process

Out of a total of 8 ARS/EIV submissions received by SVO to date - 5 have been completed and we anticipate completion of the 3 remaining securities by the end of next week. **All of these hybrid securities were also classified as common.** These securities are not identified here because they are not actually owned by insurance companies. However, insurance companies interested in these can determine the classification via the ARS/EIV letter process as discussed above.

### Potential Hybrid Securities Filed by Insurers Awaiting Review

It is possible that as many as 10 additional hybrid securities have or will be filed with the SVO by insurance companies. The name of many of the securities in this population includes the phrase Capital or Capital Trust and their filing with the SVO at this time reflects that the insurers who filed them believe them to be hybrids. These securities seem to have been filed by insurers voluntarily, that is, not at the specific direction of an insurance department. The SVO has not had an opportunity to determine whether this seeming presumption on the part of the filing insurance companies is accurate. We will report on and identify these securities for you when we have completed our analysis.