

NAIC

Securities Valuation Office

SVO Research**Chris Evangel***Managing Director*

212-386-1920

CEvangel@naic.org

Ray Spudeck, Ph.D.*Research Manager*

212-386-1978

RSpudeck@naic.org

Shanique Hall-Barber*Research Analyst*

212-386-1930

SBarber@naic.org

Julius Vizner*Associate Research Analyst*

212-386-1926

JVizner@naic.org

Anthony Urick*Credit Manager, SVO*

212-386-1938

Pradip Vyas*Credit Manager, SVO*

212-386-1950

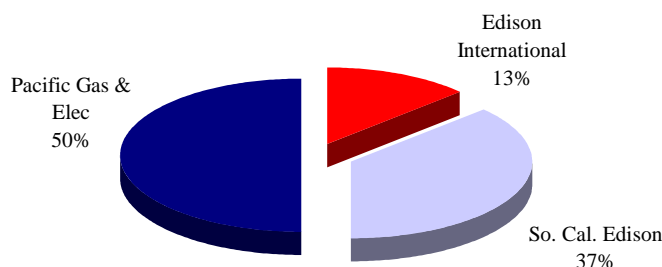
Cathy Weatherford*NAIC Executive Vice President*

816-842-3600

Insurer Investment in Problem California Utility Bonds*Ray Spudeck, Research Manager*

The much publicized defaults by two California public utilities, Pacific Gas and Electric and Southern California Edison, have raised numerous questions about their impact on the financial markets. Of particular concern to insurance regulators is the degree of exposure of insurance company investment portfolios to these defaults. This report examines life and property/casualty insurance company holdings of the bonds of these California utility companies through the 3rd Quarter of 2000¹. The holdings reported below are measured as the par value of bond holdings on a gross basis, with no adjustment for any credit offset positions (e.g. credit derivatives or other specific default risk transference mechanisms). Insurer investment in the commercial paper of these utilities is not considered as these data are not comprehensively reported to the NAIC.

In total, 503 life and property/casualty insurance companies reported positive positions in the bonds of either Pacific Gas and Electric, Southern California Edison, or its parent Edison International. As of third quarter 2000 reporting, the industry held 31 issues of Pacific Gas and Electric bonds, 21 issues of Southern California Edison bonds, and 2 issues of Edison International bonds. Total par value investment for all of these utilities was \$2.862 billion, relative to total Schedule D bond investments for these insurance companies of \$1.046 trillion, resulting in an average default risk exposure of 0.27% of Schedule D bond investment. Of the total problem California utility exposure, roughly half represented investment in Pacific Gas and Electric bonds, 37% in Southern California Edison bonds and 13% in Edison International bonds (see chart below).

*Continued on page 2***Distribution of Problem California Bond Investment**

¹ The reported data are from the 1999 NAIC Annual Statements, Schedule D and subsequent 2000 Quarterly updates of purchases (Schedule D part 3) and sales (Schedule D part 4).

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Web Address:www.naic.org/1svo/index.htm

From the Director

Chris Evangel, SVO Managing Director

Can you see some commonality between the SVO and Federal Reserve? In my narrow perspective, both are engaged in the Predictive Business — the Federal Reserve manages monetary policy primarily through short-term interest rate adjustment, while the SVO manages credit risk opinions through assignment of designations (ratings) to financial securities.

How do we assess the success in this predictive business? Standing here today, we could easily judge prior action, as historical data, by its nature, remains fixed. However, what would be the correct judgement for two years from now?

To the surprise of the financial market, Alan Greenspan in early January lowered short-term interest, in an interim Fed meeting action, by one-half percentage point — the Federal Open Market Committee (FOMC) lowered short-term rates another one-half point at the regular meeting in January, 2001. One full percent point adjustment in less than three weeks.

Did Mr. Greenspan know something, or have access to other (non-public) information beyond that available to the public? Former Federal Reserve Board members state they

really rely on public information. Accepting this premise, did Mr. Greenspan foresee in early January 2001 something not present in May 2000 when the Federal Reserve raised rates by one-half percentage point?

From the perspective of my former life as a credit analyst, I was only surprised by the timing of the early January action, not the change of view. Mr. Greenspan stated before the Senate Banking Committee, "...have my views changed? Yes, they're changed, they *have* to change." Eight months of data have come forth since the May 2000 interest rate increase. The economic data in early 2000 appeared inconclusive and opinions among those "in-the-know" varied.

While not necessarily carrying the burden of influencing national monetary policy, with implications for international and financial markets, credit analysts face a similar challenge: to offer credit opinions on the future credit risk of a financial instrument. Here at the SVO, or at the rating agencies, analysts are called upon daily to make forecasts through credit opinions expressed as a designation (NAIC 1 though NAIC 6) for the SVO or the alpha rating system by a rating agency.

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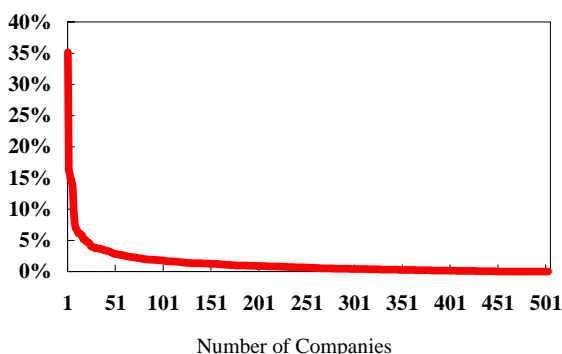
Insurer Investment in Problem California Utility Bonds (Continued)

Looking at individual company exposures, of the 503 companies reporting gross positive positions in problem California utility bonds, 20 reported holdings that were over 5% of their reported Schedule D bond investment. The average holding was 1.26% (median 0.64%) of Schedule D bond investment, with a range of 35.14% to 0.0009%. The chart below shows the distribution of relative holdings in

these bonds. Regulators interested in the investment holdings of these bonds by their domiciliary insurers should contact Ray Spudeck (SVO Research Manager, 212.386.1978 or rspudeck@naic.org).

These results suggest that the California utility defaults, while serious as a whole, do not seem to represent a systemic default problem for the insurance industry. Only a very few insurance companies seem to have a significant exposure to this default risk. Moreover, as the ultimate resolution of the problem facing the California utilities is still uncertain, the actual market prices of these bonds have varied widely and will continue to do so. Until there is resolution of how the utilities will be treated by the State and Federal governments, it is premature to estimate the actual losses insurers will face on these bonds.

Problem CA Utility Bonds to Total Schedule D Bonds

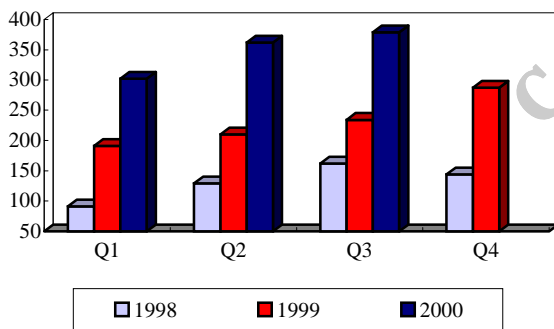


Credit Derivatives

Shanique Hall-Barber, Research Analyst

Credit derivatives are the fastest growing sector of the global derivatives market.¹ Ten years ago the market barely existed. The market came into being partly because new international rules, introduced under the Basle Accord of 1988, required banks to set aside more capital against their loans. These derivatives have grown significantly since their origination, exceeding most forecasts. According to the Office of the Comptroller of the Currency (OCC), the notional amount of credit derivatives in insured U.S. commercial bank portfolios increased from a total of \$526 billion in 1998 to \$1,043 trillion in the first three quarters of 2000 (see figure below). New products are being introduced at a rapid pace, yet this market is still in its infancy relative to other types of derivatives. Once largely confined to banks, the market has expanded to include insurance companies, hedge funds, mutual funds, pension funds, corporate treasuries and other investors looking for yield enhancement or credit risk transference.

Quarterly Credit Derivatives Volume
Notional Value, Billions of Dollars



Source: Office of the Comptroller of the Currency (OCC).

Credit derivatives are off-balance-sheet financial instruments that are used to assume or lay off the credit risk of loans and other assets, either in total or sometimes only to a limited extent. They allow one party (the beneficiary) to transfer the credit risk of a “reference asset”, that it often actually owns, to another party (the guarantor).²

Credit derivatives emerged in the early 1990’s as an instrument designed to segregate credit risk from financial instruments and to allow the separate trading of credit risk.

¹ Smith, Clare, “Fastest growing risk protector: Credit Derivatives,” *Financial Times* (May 19, 2000).

² “Credit Derivatives: Risk Management and Internal Controls,” *Board of Governors of the Federal Reserve System, BHC Supervision Manual* (December 1999).

Characteristics and Features of Credit Derivatives¹

In general, credit derivatives have three distinguishing features:

1. The transfer of credit risk associated with a reference asset through contingent payments based on events of default and, usually, the prices of instruments before, at, and shortly after default.
2. The periodic exchange of payments or the payment of a premium rather than the payment of fees customary with other off-balance-sheet credit products.
3. The use of an International Swap Derivatives Association (ISDA) master agreement and the legal format of derivative contracts.

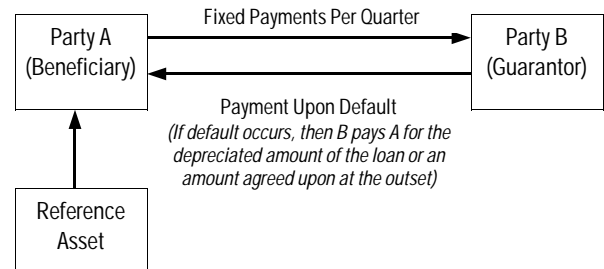
This arrangement allows the guarantor party to assume the credit risk without directly purchasing it. Credit derivatives offer a flexible way of managing credit risk and provide opportunities to enhance yields by purchasing credit synthetically.

Credit derivatives are constantly evolving. Some examples of credit derivatives include Credit Link Notes (CLNs), Total-Rate-of-Return Swaps (TROR), Credit Default Swaps (CDSs), and Credit Spread Options. While they may vary slightly (timing and structure of the cash flows), the economic substance of these arrangements is that they seek to transfer credit risk on the assets referenced in the transaction. The most widely used types of credit derivative to date are credit default swaps and total-rate-of-return swaps.

■ Credit Default Swaps

Credit default swaps provide protection against credit losses associated with default on a specified reference asset. The swap purchaser (the beneficiary) “swaps” the credit risk with the provider of the swap (the guarantor). In a credit default swap, illustrated in the figure below, Party A pays Party B a fixed premium (in a lump sum or periodic payments) for the right to receive a payment from Party B if, at any time

Credit Default Swap Cash-Flow Diagram



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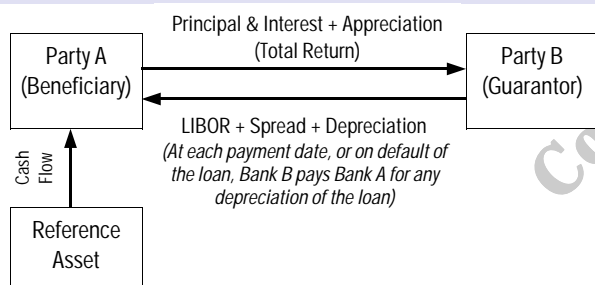
Credit Derivatives (Continued)

during the next year, a specified “credit” event, such as a default, occurs on the reference credit. If a credit event occurs and the value of the reference credit declines below a threshold, Party B pays the difference between the principal amount of the credit and its market value and some other amount specified in the agreement.

■ Total-Rate-of-Return (TROR) Swaps

In a total-rate-of-return swap, illustrated in the figure below, Party A agrees to pay the “total return” on an particular reference asset to Party B, and agrees to receive a rate such as LIBOR (London Interbank Offering Rate), or possibly the return from another credit-sensitive asset. The total return includes any interest payment and capital gains over the swap settlement period. There is typically no exchange of principal. The transaction simply allows the participants to go long or short a particular credit-sensitive asset. Note that market risk is not eliminated since the payment of one leg of the swap is influenced by movements in market rates such as LIBOR.

Total-Rate-of-Return Swap Cash-Flow Diagram



TROR swaps are intended as a means of transferring or acquiring credit exposure without actually completing a cash transaction. Additionally, TROR swaps allow banking organizations to diversify credit risk and maintain the confidentiality of their client’s financial records since the originating lender maintains the borrowers records. These features may be desirable if Party A has credit exposure to a borrower, which it would like to reduce, while retaining the borrower and preserving the relationship.

■ Restructuring as a Credit Event

Defining credit events with sufficient clarity has been the topic of many debates. Recently, the credit derivatives market has been challenged by the customary use of restructuring as a credit event. The issue arose during autumn of last year when Conseqo Inc. was compelled to restructure more than \$3 billion in debt in order to prevent an impending liquidity crisis. Under the terms of the International Swaps and Derivatives Association (ISDA) master agreement, this event triggered payments to the buyers of protection on Conseqo.

According to the ISDA Master Agreement, there are eight events that would result in a credit derivative payment:

1. Bankruptcy
2. Credit Deterioration
3. Cross Acceleration
4. Cross Default
5. A downgrade
6. Failure to pay
7. Repudiation or moratorium
8. Restructuring

* The ISDA is an industry trade group that has developed most of the standard documentation in the credit derivatives industry

Protection buyers petitioned for credit protection payments even though the company was financially secure and had not defaulted on payments. Protection sellers complained that restructuring happens frequently and that it is often not a financial catastrophe, therefore the event should not trigger payment of a default swap.

Faced with large losses, the sellers of protection decided to abandon industry practice by refusing to acknowledge restructuring as a trigger event unless a client specifically asks for it. When restructuring is requested, it is given at a more expensive price. As a result, a two-tier system in the U.S. has emerged, with different prices being quoted in London.³ This new two-tier system has created a decline in liquidity and some confusion in the credit derivatives market.

Restructuring is not the only area of dispute in credit derivatives. Demergers are another. Last year, National Power, a British Utility, split into two separate corporate entities, an integrated UK energy business and an international power business. Dispute arose as to which of the two new entities the sellers of credit-default swaps were now exposed.⁴

■ Risk Management

Proper risk assessment is integral to successfully using credit derivatives. The two primary types of risk faced by firms engaged in credit derivatives are market risk and credit risk. Market risk is the risk that movements in interest rates, exchange rates, stock prices or commodity prices will have an effect on the firm’s value. The prices of credit derivatives fluctuates with changes in interest rates, the shape of the yield curve and credit spreads. The

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³ Boughey, Simon, “Chaos in Credit Derivatives: As a downturn looms, dealers change the rules,” *Investment Dealers Digest* (December 18, 2000).

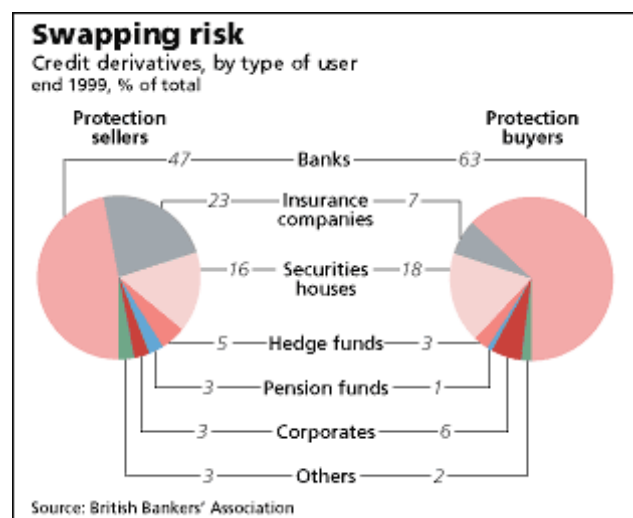
⁴ McCarthy, “The swaps emperor’s new clothes: The uncertainties of credit derivatives: Do credit derivatives work when they are most needed?,” *The Economist* (February 10, 2001).

Credit Derivatives (Continued)

management of market risk is achieved by entering into offsetting or hedging transactions specific to these risks.

Credit risk (sometimes called default risk) is the possibility that a borrower will fail to service or repay a debt on time. Credit risk is much more difficult to manage. The degree of risk is reflected in the borrowers' credit ratings, which defines the premium over the riskless borrowing rate it pays for funds and ultimately the market price for its debt. There are various mechanisms to reduce risk including refusal to make a loan, insurance products, guarantees and letters of credits, but these mechanisms are less effective during periods of economic downturn. Risks that normally offset each other can simultaneously default, causing financial institutions to suffer substantial loan losses.⁵

Credit risk is now being shifted outside the banking sector altogether. According to the British Bankers Association (BBA), insurance companies accounted for 7% of the credit protection bought and 23% of what was sold globally in 1999 (see figure below). The BBA projects that insurance companies will represent 26% of the sell side by 2002, up from only 10% in 1997/1998.⁶



Legal and Regulatory Treatment

As credit derivatives represent a relatively new market, it is not surprising that regulatory and accounting issues are emerging. Among the family of credit derivatives, there is at this point a lack of standardized documentation, although most credit default swaps are based on the ISDA master

agreement. Legislation currently in Congress (the Commodity Futures Act of 2000) would make the market for swap contracts among "qualified" investors (generally, institutional investors with more than \$10 million in assets) largely self-regulated.

For the financial services institutions that are using credit derivatives, the legal status of and regulatory treatment for credit derivatives transactions is evolving. The most significant issue currently under consideration concerns the allocation of balance sheet capital for different credit derivative exposures. The current Basle Accord standards were earlier mentioned as a motivating factor in the development of the market. Currently, a new Basle Accord that may modify the capital requirements for these types of transactions is being circulated for comments (for more information, the proposed new Basle standards are available at the Bank for International Settlements website, www.bis.org).

Within the insurance regulatory community, information on these products is currently being gathered. At the Spring National meeting of the National Association of Insurance Commissioners in Nashville Tennessee, a combined meeting of the Valuation of Securities and Risk Based Capital Task Forces, along with the Securities Valuation Office Oversight and Invested Asset Working Groups is scheduled to get industry input into the nature of these products and their impact on insurer portfolios and operations.

Conclusion

Credit derivatives are another reflection of the continuous development of the financial market that, properly used, may allow investors to more precisely manage and tune their portfolio credit risk exposure. For financial services firms, particularly insurance companies and banks, the ability to transfer unwanted credit risk and to assume other risks in a competitively priced environment should serve to improve not only portfolio returns but financial strength positions as well. This market is experiencing impressive growth as an ever greater diversity of products arrives. As with any new market or family of financial instruments, there are open issues, particularly on the regulatory front. Early concerns relating to market development, such as documentation and general regulation, are declining and have been replaced by more everyday concerns such as liquidity and product knowledge. The regulatory community is responding to these new developments and will continue to do so as the market grows and matures. Over the next few years a number of new participants are expected to come into the market, providing greater liquidity and market depth as both sellers and buyers of credit derivatives.

⁵ Aggrawal, Sunil. Credit Derivatives Move Beyond Plain Vanilla. *The Stern Journal* (Spring 2000).

⁶ British Bankers Association Credit Derivatives Survey, www.bba.org.uk.

When Prizes and Settlements Become Securities

Robert Carcano, Senior Counsel, SVO

[Note: This article is a summary of an SVO Research Report "When Prizes and Settlements Become Securities: SVO Methodology for Lottery, Sweepstakes and Structured Settlement Securities." The full report is available at www.naic.org/lsvo/documents/ArticleonStrucSweepSec.doc]

■ Lotteries, Sweepstakes and Settlements

Sitting in her living room watching the 11:00 p.m. news broadcast, Alice Stone is astounded to hear that she picked the winning numbers in the state lottery. In that moment, Ms. Stone goes from needing a job to needing professional financial advice. She will eventually enter into a loan with a specialty lender and offer one of her annual payments as collateral for the loan. It will be a few days before Ms. Stone meets with state lottery officials and discovers that the payments will be made by an annuity company with an investment grade claims paying ability rating assigned by a nationally recognized statistical rating organization ("NRSRO").

A week later, in the adjoining town, Roland Smith opens the envelope from the Publishing Company and discovers that he has won \$10,000,000 in cash, a new car and an all expense paid vacation for two from the Publishing Company's 2001 Sweepstakes. The notification letter transmits the first annual payment of \$500,000 and explains that the balance of the amount will be paid in 19 annual installments of \$500,000 each, through an annuity. Here also, an insurer with an investment grade claims paying ability rating assigned by an NRSRO will ultimately issue the annuity.

On the other side of town, Jose Garcia, the victim of a serious car accident four years earlier, discusses the terms of a proposed settlement with his lawyer. The settlement agreement will obligate the defendant's insurance company to arrange for a highly NRSRO rated annuity company to issue an annuity to Mr. Garcia. The annuity that is eventually issued will provide for a number of different payment streams to be made to Mr. Garcia.

■ Something in Common

Despite the outward differences in the circumstances of the three individuals, they share something in common; each will decide to assign a portion of the payments they would have received in the future from the annuity-company to an insurance company in exchange for a discounted cash payment. Ms. Stone will assign one of her annual payments to a specialty lender, as collateral for a loan and the specialty lender will ultimately sell the loan to an insurer. Mr. Smith

will eventually assign 10 annual payments for the sum of \$2,510,000. Mr. Garcia will eventually assign the right to receive a \$500,000 payment due to be paid in two years in exchange for \$350,000. The purchasing insurance companies will subsequently file these assignments with the Securities Valuation Office ("SVO") for processing as Schedule D assets, and in particular as bonds.

■ What is the Attraction of these Securities?

Simply, these securities offer a combination of relative higher yields and perceived lower credit risk than many other classes of fixed income investment. As the availability of these types of assignment related securities grows, insurance companies are providing a ready market. While these securities are not very liquid, they do offer attractive yields. This is largely because each one of these securities, even with the same guarantor, will be structured differently in terms of timing, rate of interest and other relevant features, allowing some flexibility for the purchaser.

Moreover, these securities should offer a certain degree of economic diversification to an existing bond portfolio as they would be expected to exhibit very low correlations with the market risk of corporate, international or other asset classes. While the credit worthiness of the ultimate payer is still a primary determinant in the designation given these securities, the unique nature of these contracts adds additional elements to the credit analysis decision.

Currently, the NAIC is the only organization that provides credit ratings/designations on these types of transactions. This article summarizes the unique contractual and analytical issues involved in the assignment of an NAIC designation to these securities, and reinforces the need for complete documentation when they are filed by an insurance company.

■ Is it a Bond?

The most vital part of any credit analysis is the determination of the issuer's ability to repay the obligation as promised in the contract. In general terms, this is no different for bond analysis than it is for the analysis of these lottery and settlement assignments. Differences in the nature of the analysis and documentation used for these securities differs from that used in bond analysis only to the extent that the nature of the uncertainties surrounding the repayment promise differ.

As the result of lottery securities being filed with the SVO, the Valuation of Securities Task Force, in December 1999, adopted an analytical procedure for these securities that is

Continued on page 7

When Prizes and Settlements Become Securities (Continued)

related to procedures already in place for analyzing credit substitution agreements. This method of analysis is also used for sweepstakes and settlement securities. For example, a lottery security occurs whenever someone in Ms. Stone's situation assigns one or more annual payments to a purchasing insurance company. When the security is reported to the SVO, the purchasing insurance company wants to remove Ms. Stone's personal credit as the source of repayment in favor of relying on the repayment ability of the state lottery authority or annuity company, and will structure the transaction to make that occur. To assign a reasonable NAIC designation to this security, the analyst must understand and assess a number of risks that could impact the likelihood that the insurer will be paid on time and in full.

■ Is it a Sale or A Secured Loan?

The first stage in the analysis is to determine the nature of the promise that has been made to the purchasing insurance company. The promise can take two forms: a sale of the annuity or as loan collateral. The crux of the issue for the analyst is to determine whether the assignment is an outright sale of the payment, i.e. an absolute assignment, or only collateral for a loan. If, for example, the documents suggest that the assignment made by Mr. Garcia in the introductory paragraphs was the transfer of collateral for a loan, the analysts would conclude that the purchasing insurer has loaned \$350,000 and will receive \$350,000 from the annuity company, not \$500,000. This represents a difference in par value of \$150,000. Even if the analyst concludes that the assignment was intended to be outright, she must also consider how the transaction would appear to a court should a dispute arise over any number of concerns (e.g. personal bankruptcy, estate settlement, etc). To that end, the SVO analyst will examine the purchase and sale agreement, the assignment document, and the terms and conditions under which the assignment or loan occurs to ascertain the nature of the payments that have been assigned, or the loan that is being made. The focus of this analysis is on the rights and obligations in the document and whether these are consistent with either a loan or with an absolute assignment. If the documentation does not support a conclusion that an assignment was intended, the analyst may be forced to reject bond treatment for the transaction and/or consult with the filing insurance company to determine if the transaction should be processed as a secured loan instead of an absolute assignments.

■ Analytical Checklist

To assure proper analytical treatment SVO analysts focus their credit reviews of these securities on four broad areas: state usury laws, state laws allowing assignments, third party claims, and obligation to pay. A discussion of the general issues involved within each of these areas follows.

- **Loans and State Usury Laws:** If the transaction is structured as a loan, an important concern may be the stated or implied interest rate. Absent any state statute, any rate of interest agreed upon by both borrower and lender is legal and will be enforced. Many states, however, have enacted legislation regulating the interest rate that may be charged. A loan with an interest rate higher than that permitted by such a state law could be void, rendering the contract unenforceable by the insurer. To assess this usury risk, the SVO requires the purchasing insurer to provide a copy of the applicable state usury provisions identifying the interest rate used to define a usurious transaction.
- **State Laws Prohibiting Assignments:** A number of states have laws that prohibit an assignment of lottery prize winnings unless the assignment is the result of a court order. In these states, an assignment of a lottery prize not approved by a court would be unenforceable. Insurers filing lottery securities with the SVO are required to provide a copy of the court order and a copy of the state lottery authority's letter acknowledging the purchasing insurance company as the payee of record.

A number of states have also passed laws prohibiting the assignment of structured settlement payments. A purchasing insurance company that entered into an assignment without the required court order could find that the law permits the annuity insurer to refuse to honor the assignment. Therefore, the SVO requires the purchasing insurance company to provide a copy of a court order authorizing the assignment or a legal opinion to the effect that there is no law in the relevant jurisdiction prohibiting the assignment.

Currently, there does not appear to be any specific state legislation prohibiting a sweepstakes winner from freely assigning prize winnings, or that makes an

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When Prizes and Settlements Become Securities (Continued)

assignment conditional on a court order. The possibility of such laws coming into existence does, of course, exist. To that end, the SVO requires the purchasing insurance company to provide a copy of a court order authorizing the assignment of a sweepstakes prize or a legal opinion to the effect that there is no such restrictive law in the relevant jurisdiction.

Further, it is not uncommon for agreements to contain standard provisions prohibiting the assignment of the rights or obligation under the agreement, or of the agreement itself. The SVO analyst will examine the documents for clauses where an obligor, such as a prize sponsor or a casino, has specifically prohibited the assignment of the prize. Where the provisions exist, the transaction will not be processed unless the obligor acknowledges the assignment or the purchasing insurance company obtains a final court order obligating the prize sponsor or casino to make the payment.

- **Third Party Claims:** In addition to the issues above, the analyst must also assess the quality of the promise to make the payment to the purchasing insurance company. One important consideration in this regard is whether the assigned payments are stated to be free of any encumbrance for third party claims, such as taxes or support payments or maintenance obligations or suits. The analyst will look for evidence that these encumbrances either exist and are recognized or for evidence that previous beneficiary claims have been legally revoked.
- **Obligation to Pay:** The key element of assigning a designation to one of these securities is, of course, the certainty that the annuity insurer is obligation to

make the required payments. The SVO analyst will examine the annuity contract (or other device securing payment to the purchasing insurance company) to assess whether the obligation to make payment is enforceable. The annuity contract, or other device, must clearly identify the claimant in the settlement agreement or the lottery or sweepstakes winner as the beneficiary of the annuity payments. The assigned payments must be specifically identified in the settlement agreement or lottery or sweepstakes notification letter and the annuity company must be obligated to make these payments to the assignor. To mitigate the risk that the annuity company could refuse to pay the assigned payments, the SVO will ask for a copy of the assignor's letter informing the annuity company of the assignment and the annuity company's acknowledgement of the assignment. The SVO will also want evidence that that the annuity company has entered the necessary instructions to make the assigned payment to the purchasing insurance company. This is usually in the form of a certification that the instructions have been entered or a copy of the instruction provided by the annuity company to the paying agent.

■ Conclusion

Insurance company investment in lottery, sweepstakes and settlement securities is increasing. Providing a proper designation for them requires analysis of more than just the ability of the paying authority or annuity company. As outlined here, a number of issues regarding state law and contract provisions are crucially important. Complete and proper documentation from the filing insurance company goes a long way to ensuring the assignment of a correct designation is reached. This serves the insurance company, their regulator, and policyholders well.

From the Director (Continued)

A credit opinion's only *true* value by those utilizing these credit assessments lies in its predictive nature – will the expected promise be met between sellers (obligors) and buyers. Credit opinions rely on objective criteria (e.g., trend analysis, historical and projected financial statements, and other items). Nevertheless, the subjective components remain in any analytical process. The subjective component of a credit assessment is where the ultimate value lies. How you interpret the available data is critical for any forecast. Even with historical data varying interpretations exist. Accepting the fact of varying opinions, a key element to arrive at a reasoned judgement rests on the ability to reduce bias in the subjective component. Financial market participants prefer, if not insist, and rely on those independent third-party opinions. Even within third-party credit assessors, two equally qualified analysts can, and do, form different credit judgements. Only time's continuum will serve as the basis to judge the quality/accuracy of those opinions.

Here at the SVO, we seek to achieve our clear goal to assure the most accurate credit assessment by hiring seasoned credit analysts and through our credit committee process. The ability to openly discuss and sometimes challenge each one's assessment can only result in a more accurate credit judgement.

As the Federal Reserve continues to review the flow of economic data to make as accurate as possible to judge the direction of the national economy, we, too, will continue to review individual security submissions to arrive at an appropriate credit judgement. Credit opinions can, and should, change if new information or circumstances change – but today, we must make a decision: that's what our customers expect of us.

SVO Activity

Recently, SVO staff have been active in professional seminars. Tony Urick, Credit Manager, gave a presentation at the Institute for International Research's 14th Annual Private Placements Industry Conference in January here in New York. Frederic Vigneron, Senior Credit Analyst-Structured Securities, participated on a panel discussion of regulatory issues involving securitizations at the Strategic Research Institute's 8th Annual Asset Securitization 2001 Symposium in February in Scottsdale, Arizona. Ray Spudeck, Research Manager, gave a presentation on securitizations and structured finance products to insurance regulators at the 2001 Seminar for Senior Financial Regulators at Drake University in Des Moines in January.

The Research Unit has scheduled financial market training programs with the Massachusetts Division of Insurance in February, the Arizona Department of Insurance in March, and the Michigan Insurance Bureau in September.

A combined meeting of the Valuation of Securities and Risk Based Capital Task Forces, along with the Securities

Valuation Office Oversight and Invested Asset Working Groups, has been scheduled during the Spring NAIC National meeting. The combined meeting is scheduled for Saturday March 24, 2001, from noon to 4 pm in the Governor's Ballroom D of the Opryland Hotel in Nashville, TN. The purpose of the meeting is to get input from industry on credit derivative products and their application to insurer portfolios.

In conjunction with the NAIC Education Department, SVO staff will be presenting the "How to File Securities with the SVO" program on April 26-27th at the Rye Town Hilton in Rye Town NY. Additional information and registration materials can be found on the Education page at the NAIC's website (www.naic.org) under the Public Programs link.

If you have any research, training or other requests that we can help you with, please do not hesitate to call Ray Spudeck, Research Manager at (212)386-1978



NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Executive Headquarters

2301 McGee Street
Suite 800
Kansas City, MO 64108
Phone: 816-842-3600
Fax: 816-783-8175

**Federal and International
Relations**

Hall of the States
444 North Capital Street NW
Suite 701
Washington, DC 20001
Phone: 202-624-7790
Fax: 202-624-8579

Securities Valuation Office

7 World Trade Center
19th Floor
New York, NY 10048
Phone: 212-285-0010
Fax: 212-285-0073

Web Address:

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