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Argentina, the IMF, and Currency Boards

Gary Mescher, Associate Credit Manager, SVO

■ SVO Lowers Argentina's Sovereign Designation to NAIC 6

On November 11, 2001 the SVO lowered the sovereign ceiling designation on Argentina's foreign currency long-term debt to NAIC 6 from NAIC 5. An NAIC 6 designation is assigned to a security that is deemed to be "at or near default". This latest designation continued a trend dating back to the beginning of 2001 when the designation stood at an NAIC 3. The SVO lowered Argentina's sovereign ceiling to an NAIC 5 in July 2001 in the face of rapidly deteriorating credit quality. The major rating agencies have readjusted their ratings on Argentina in a similar fashion, albeit some with a lag.

This is a significant economic event in that Argentina currently has \$132 billion in outstanding public debt, which accounts for nearly a fourth of JP Morgan's emerging market index. The 23 Argentine provinces have an additional \$23 billion in public debt outstanding.

The direct impact on the US insurance industry is not overly damaging. As of the third quarter 2001 reports, US Life and Property/Casualty insurance companies held \$463 million of reported statement value (obviously less in market value terms) in Argentine sovereign debt. This investment was spread over 118 companies, with only one company reporting a holding in excess of 5% of its bond portfolio. What is more significant is the broader implication of the reasons behind the downward spiral of Argentina's designation and the information that may contain for institutional investors actively engaged in foreign sovereign financial investment. In the report that follows, the reasons behind the lowered designations are enumerated, including factors brought on by decisions made by the government of Argentina as well as factors resulting from decisions made by the multinational financial organizations.

■ Background

On November 1, 2001, the Argentine government announced that it could no longer meet the payments on its debt and therefore would be required to restructure a large amount of federal and provincial bonds to substantially lower debt service costs. The restructuring, described in more detail below, will result in a significantly lower value for domestic and international investors who hold the bonds. In addition, although the Argentine government has portrayed the restructuring as voluntary, it is apparent that this is not the case. These two factors led the SVO to assign the 6 designation.

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From the Director

Chris Evangel, SVO Managing Director

*Jargon often develops to explain some thing but then that word or phrase can become overused losing some of the intended reference. The word **paradigm** became popular in the latter 1990s to refer to what was an acceptance in how a business functions without ever questioning the current practices. Many senior managements and their Human Resource departments were calling for trying to “shift” the paradigm in order to re-think their operations “thinking out of the box” in an effort to avoid being trapped in the “old world” economy, particularly as the “new world” economy appeared as the superhighway to economic Shangri-La. The word paradigm perhaps became a word in the late 1990s, as only until we were upgraded from Windows '97 to 2000 could our spell check confirm this as a valid word. My comments here are not to discuss jargon but focus instead on shifting paradigms. A **paradigm shift** can occur at any time, but often one discovers this shift only upon review with only on a rare occasion to pinpoint the actual axis of that shift. Below you will find the axis of a paradigm shift, which includes outside events and a conversation with myself.*

September 10, 2001, Monday. Get coffee from street vendor, *what a relief from that jammed subway ride, especially having to carry that portable computer back to the office.* Make way to office, read headlines in *Wall Street Journal*, review day's schedule. Let's see, associate credit analyst interview at 11:00 a.m., workload meeting with Kansas City at noon, catch-up with managers as we begin, in earnest, the last four months for securities filing, and do not forget to leave by 6:00 p.m. to see wife off at Newark Airport. (*Looking forward to joining her in Berlin on Thursday*) Wife calls, electric power goes off at 2:30 p.m., her car service arrives at 4:00 p.m.; heard Newark airport closed due to a fire at their administration building, but wife says she'll take a chance and go anyway since she's on an international flight. *Let's see, already 3:15 p.m.*, another lunch-less day but I can squeeze in a ten-minute walk (*can't resist on this sunny blue sky day*) through the daily loop of City Hall Park and a cup of coffee to go on the way back. Leave office (6:15 p.m.) running late again, *maybe I'll get lucky with all the connections.* I'll walk across the glass tube from 7 World Trade to save 45 seconds instead of going to the street level with a quick step through the Trade Center concourse downstairs to catch the PATH subway—passing Citibank, *I have to remember to stop by the cash machine tomorrow for the trip.* Great, got to the airport at 7:10 p.m. See wife off, I'll go workout and

then make some dinner. *Looks like another late night, clock radio says 1:15 a.m.—hope I don't sleep through the alarm.*

September 11, 2001, Tuesday. Heard the radio, it's not 5:30 a.m. (!) but 6:30 a.m., *there goes my chance to get there by eight,* I really wanted to get there early given those four scheduled meetings today and my final full day in the office before heading to Europe to meet the wife. Make coffee, feed cats, turn T.V. on, see what the Dow Futures is doing, flip back to weather channel, call (6:59 a.m.) hotel concierge for weekend arrangements, call ends 7:18 a.m. Television's still on, CNBC, Dow Futures flat, *doesn't matter market will go down this fall as usual, must be the lack of daylight, it always makes things seem less rosy.* Turn TV off put radio on for the shave and shower. Grab briefcase, turn house alarm on, and grab Walkman since I'm taking the car with the broken car radio. Car clock reads 8:08 a.m. but I know it's set 10 minutes fast, maybe if the traffic cooperates I'll get to the office at just past nine.

Wouldn't you know it, traffic is pretty bad today, always is this time of year, that first full week after Labor Day everybody's back from vacation. Interstate 78, what a nightmare, I cannot wait until Thanksgiving when the traffic finally lightens up. (8:35 a.m.) Over the hill in Summit, New Jersey, you can see Manhattan; normally it should take only seven minutes to get to my exit at Newark airport but today looks like double-time. Back to flat ground on I-78 east as we crawl along, Manhattan skyline no longer visible. (8:47 a.m.) Just made bend at Newark city limits, lower Manhattan on the horizon. From here, vantage point seems to blend with the Jersey waterfront, which is how that white smoke plumb gives the appearance that the World Trade Center (WTC) is venting steam. Still crawling along (8:48 a.m.), *you know that smoke does appear to be coming from the WTC but I have seen that before.* I can see a jet take off in the distance but the plane make a peculiar bank away from lower Manhattan, which usually does not happen unless the weather is windy but it look pretty clam. (8:49 a.m.) I better call the office just to see what's going on. Senior Business Administrator tells me a plane went into the North Tower and the staff is standing in my office since it provides the best view. *That's not possible, there probably is a fire at Windows on the World, I'm sure they're mistaken, how can you not see those buildings on such a clear sunny morning.* Let me call (8:51 a.m.) Cathy Weatherford and just inform her about this fire but I won't mention this thing about an airplane,

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Argentina, the IMF, and Currency Boards (Continued)

It is important to note that Argentina's current crisis is only the latest in a long history of fiscal and economic problems. As recently as the mid-1980s Argentina suspended payment on a large portion of its debt.

How did Argentina get into its current predicament? A key factor is the country's chronic fiscal mismanagement that has left it in a fiscal trap. Argentina has long been saddled with a large and very inefficient government at both the federal and provincial levels. This is a legacy of the Peron era of the 1940s and 1950s (and again in the 1970s) when the government grew with the nationalization of many industries. This is compounded by a culture of patronage and a view of the government as the employer of last resort. These factors have exerted consistent pressure on fiscal budgets in both good economic times and bad. These problems created by this governmental culture lie hidden during prosperous times such as the booming 1990s. But as the world and regional economy deteriorated in the late 1990s, and revenues fell, the federal and provincial governments have found themselves literally unable to pay their bills. In fact, the Buenos Aires provincial government earlier this year resorted to creating its own currency to pay its bills, as it could not raise enough cash otherwise.

Argentina's latest problems began in 1997 as the emerging market crisis spread from Southeast Asia to South America. Argentina's economy moved into recession in 1998 and has remained there for nearly four full years. At the end of 2001 the recession shows signs of deepening further. Local demand remains weak and exports have lagged because of the world recession. Exports have been hurt further by the strong US dollar to which the peso is pegged through the monetary policies dictated by Argentina's use of a currency board. Argentina's exports remain relatively expensive and unable to compete with neighboring countries such as Brazil, which has let its currency depreciate. The currency board, which was instituted to control inflation (and has), now serves as a straightjacket on Argentina's economy by the rigid peg to the high dollar.

Because of these economic factors, revenue collection in the government budget has been noticeably weak. Tax receipts so far in November 2001 are 16% lower than the year before. At the same time, expenditures remain high because of the bloated nature of the federal bureaucracy and because of large guaranteed tax transfers to provincial governments whose own budgets are experiencing chronic operating deficits. The federal government is required to transfer \$1.4 billion annually to the provinces regardless of

the level of its own receipts. Uncontrolled expenditures have thus outstripped revenues over the past several years and the result has been widening fiscal deficits. To finance these deficits the government has borrowed increasingly in both domestic and foreign markets, at increasingly higher rates. As a result, debt levels have soared and Argentina's debt ratios are now among the highest of all emerging market countries. This debt load has, in turn, put pressure on the budget and has become increasingly difficult for the government to service.

■ The End Game

Over the past year, the government has taken a number of increasingly desperate steps to service its debt, none of which have, to date, provided effective relief.

In late 2000 the International Monetary Fund (IMF) announced a large emergency package of loans to Argentina totaling \$39.5 billion. This large package provided some relief but soon proved to be insufficient at the rate the IMF was disbursing it.

In June 2001 the government tried to buy time by rescheduling \$30 billion in debt. By lengthening maturities on short-term debt at high rates of interest, the rescheduling had the effect of lowering this year's debt service at the expense of increasing debt service in the coming years as well as increasing the total debt load. The government also raised some import tariffs and subsidized some exports in order to stimulate the economy. These decisions called into question Argentina's commitment to the fixed currency and helped weaken investor confidence further. In response to the deepening crisis, the IMF announced a further \$8 billion loan to help Argentina service its debt.

Later in the summer, as investors became increasingly wary, interest rates rose dramatically and it became prohibitively expensive, and all but impossible, for the government to borrow to meet current operating needs. President De La Rúa announced that Argentina no longer had the credit worthiness to borrow in the international markets.

The government's only option was to institute an austerity plan called the "zero deficit plan" to slash expenditures. After weeks of negotiation a plan was approved that cut federal salaries and pension benefits by 13%. The plan proved to be very unpopular, drawing protests from opposition parties and triggering street demonstrations by workers. Given the shaky nature of the governing coalition and opposition from the powerful Peronist Party, as well as

Argentina, the IMF, and Currency Boards (Continued)

other less powerful smaller parties, it is far from certain that the political will exists to make the austerity program work in the long run.

By early autumn of 2001 Argentine citizens, who had lost confidence in the government, began to remove pesos from the banks at an increasing rate in anticipation of a freeze on accounts by the government. From June through early November, 12% of total bank deposits had been withdrawn.

In October, the de la Rúa administration announced a plan for a further debt restructuring. Critically, it soon became clear that this restructuring would be different than the previous one because, rather than asking investors to defer debt for higher rates and increased values later, it would ask investors to take a loss on the value of their bonds up front. At the same time, the federal government tried to negotiate with the provinces to lower the guaranteed monthly tax transfers. The federal government proposed to restructure provincial debt for savings in return for a reduction in the federal tax transfer.

Throughout October, Argentina negotiated with the IMF for an additional loan. On November 1, for the first time, the IMF turned them down. The IMF also refused to advance a large payment from previous loans forward from December into November. Argentina was turned down as well by the World Bank and the Inter-American Development Bank. The U.S. Treasury also refused to offer any funding as did several European Union countries.

Following these remarkable events, the de la Rúa administration issued a decree on November 1 outlining the details of its latest debt-restructuring program. The plan called for the restructuring of a substantial portion of the country's debt in order to achieve about \$4 to \$5 billion in annual debt service savings needed to balance the budget. In the first phase of this plan, the administration has pressured domestic banks and pension funds to exchange their high yielding debt for new debt at much lower rates of return. This raises concerns that by lowering the value of their assets, these already weak institutions could be further damaged. Despite assurances that this is a voluntary transaction, the administration has made it clear that this is a "take it or leave it" deal. Investors have the choice of absorbing some losses now or even greater losses later. International investors have already been warned to expect a similar deal some time early in 2002.

■ Conclusions and Interesting Points

The IMF finally pulled the plug on Argentina, effectively removing the support provided by preferred creditor status. Why did the IMF, the other multilaterals, and the U.S. Treasury finally let Argentina sink? More than likely, the IMF simply had no credibility left in the international markets. When the IMF loaned the final \$8 billion to Argentina, there was a large outcry in the global financial community accusing the IMF of just protecting, and encouraging, investors that should have lost on their investments in Argentina a long time ago. Another factor may be that the IMF was, in a sense, way behind the markets on their perception of the economic realities facing Argentina and finally realized it. Argentine bonds have been trading at the default level for a while. This gave the IMF the market rationale it needed to pull the plug on further support. In fact, the market reaction to Argentina's default plans was rather muted, suggesting that the market had been expecting such action for some time.

Clearly, Argentina faces a daunting economic and political challenge. The currency board currently in place continues to keep Argentina's exports from being competitive in the world marketplace. If however, the currency board was scrapped, and the peso allowed devaluing, would inflation become a serious problem? Currency boards, i.e. pegging a domestic currency to a particular currency such as the U.S. dollar or a "cocktail" of currencies, became somewhat popular in many developing economies over the last decade as they promised to be an automatic damper on domestic inflation. So long as economies were growing in real terms, this peg was not considered detrimental. As Argentina is finding out, and as other countries are also beginning to find out, during economic recessions, the fiscal "discipline" afforded by a currency board can be a difficult domestic economic pill to swallow. If Argentina and/or other countries abandon the currency board, investors in foreign sovereign debt must then have to consider their exposure to the ability of the borrowing country to be able to acquire dollars for debt service.

The IMF's refusal to further assist Argentina, while generally applauded in the financial marketplace, may well raise other issues for foreign investors. In particular, investors may now have to look more closely at how wide and deep IMF support to a particular country's debt may be. Specifically, as described in detail in the April issue of this publication, preferred creditor status is not a legally binding contractual feature of foreign sovereign debt.

Insurer Investment in Foreign Sovereign Securities: Canada

Part two in a series of articles examining insurer investment in the debt of sovereigns.

Julius Vizner, SVO Associate Research Analyst

■ Introduction

The globalization of the financial marketplace continues to expand the number of options available to institutional investors. This means that the insurance industry can invest consumer premium dollars around the globe. Part of the ongoing focus of the articles appearing in this newsletter is the documentation of the insurance industry's global investments, particularly their bond investments. The May issue documented insurer investment in Central and South American government debt. Future articles will focus on insurer investment in European, Asian, and developing economy sovereign government securities as well as global corporate bond investment.

This article focuses on insurer investment in Canadian government bonds. The flow of funds, in terms of public debt held, from the insurance industry to Canadian governments is summarized. The data are taken from Schedule D, part 1 bond investments reported by insurers to the NAIC over the last five years.

■ Background

Since the passage of 1989's Free Trade Agreement, liberalizing trade between Canada and the United States, the trading relationship between the two nations has doubled to \$1 billion per day, making it the largest bi-national trading arrangement in the world. In fact, ten cents of each US dollar invested abroad is invested in Canada. Most US states trade more with Canada as a whole than with each other and the reverse holds for most Canadian provinces. For any number of reasons, US insurers have a long history of investment with Canadian entities.

There are a number of reasons for a domestic investor to diversify a portfolio across geographic and national boundaries. Basic portfolio diversification logically drives investors to reduce the risk of maintaining wealth in just one country. Historically, business cycles have not been perfectly correlated across all countries. However, as recent economic statistics suggest, the economic performance of most developed countries seems to offer a high correlation during the current cycle.

A domestic investor may opt to invest in foreign securities to provide a "natural" foreign exchange hedge. In a world of largely floating exchange rates between currencies, a

Canadian Statistics at a Glance*

Real Gross Domestic Product (M/M change) (9/01)	-0.8%
Consumer Price Index (10/01)	1.9%
Unemployment Rate (10/01)	7.3%
Exchange Rate (C\$/US\$)	1.58
Prime Lending Rate (11/01)	4.00%
90-Day Prime Corporate Paper Rate (11/01)	2.17%
Toronto Stock Exchange (TSE) 300 (Year-to-Date)	-14.1%

* Data as of November 30, 2001. Source: Canada Statistics (www.statcan.ca).

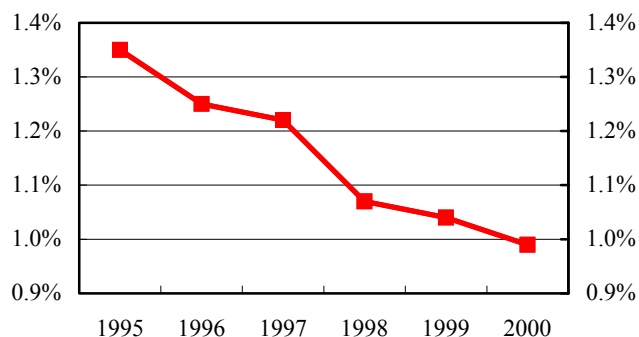
business conducting operations in several countries can face a serious risk if exchange rates "move against them." By investing in securities denominated in the same local currency that affects a business unit, a natural hedge against this risk is obtained.

Additionally, foreign investment can be the result of the opportunity to earn higher rates of return than can be earned in the domestic market on a risk adjusted basis. In this particular case, Canada carries an NAIC sovereign designation of 1. Canada as a sovereign is highly rated by Moody's, Fitch, and Standard & Poor's, and so are most of its provinces.

■ Data

Over the last five years, insurer investment in Canadian government securities, national and provincial, has declined, both in relative terms (Figure 1), as well as in absolute dollar magnitude. At a combined total of

Figure 1. Canadian Sovereigns as a Percentage of Total Bonds, 1995 - 2000



Source: National Association of Insurance Commissioners.

Insurer Investment in Foreign Sovereign Securities: Canada (Continued)

Figure 2. Canada Provinces: Overview

	Investment US\$	NRSRO Rating*		
		Moody's	S&P	Fitch
Canada - Federal	5,726,445,527	Aa1	AAA	AA+
Provinces				
Alberta	142,392,032	Aaa	AAA	
British Columbia	1,116,947,767	Aa2	AA-	
Manitoba	1,520,029,467	Aa3	AA-	
New Brunswick	886,575,783	A1	AA-	
Newfoundland	774,908,559	Baa1	A-	
Nova Scotia	1,251,433,401	A3	A-	
Ontario	3,360,636,898	Aa3	AA	
Prince Edward Island	11,487,446	A3		
Quebec	2,955,596,313	A1	A+	W/D†
Saskatchewan	1,422,370,482	A1	A+	A+
Provincial Subtotal	13,442,378,148			
SUM TOTAL	19,168,823,675			

* NRSRO Denotes Nationally Recognized Statistical Rating Agency, Ratings as of 11/16/01.

† WD Denotes Withdrawn.

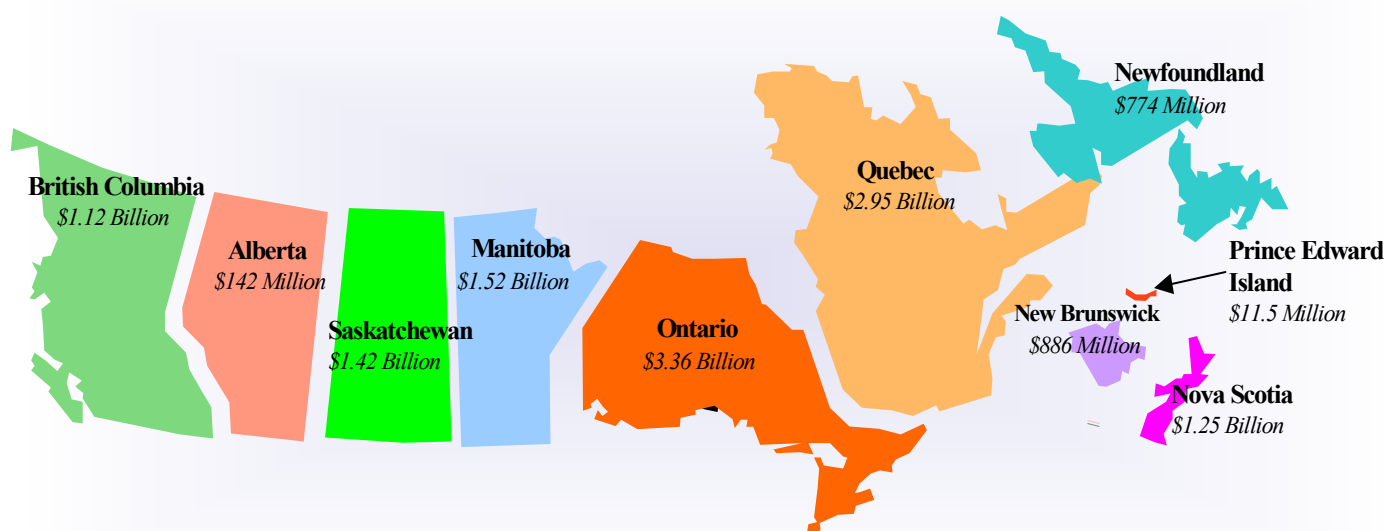
provincial government bonds was about two and a half times that, with a reported total statement value of \$13.5 billion US.

Within the provinces, the bulk of the investment is in Ontario and Quebec, the two provinces with the largest economies as measured by Gross Domestic Product. For the sake of perspective, the US insurance industry owned about \$1.9 billion in Mexican sovereign bonds in 2000. Total investment in all of Central and South America was \$5.9 billion in 2000, roughly the same as the \$5.7 billion invested in Canada's national government alone.

The Aa1 sovereign rating of the national government by Moody's, when compared to the lower ratings of some of the provinces, translates to a lower investor yield on the sovereign debt (Figure 2). Since most provincial debt also carries an NAIC 1 designation it is not surprising that investment is shifted towards the areas where yields are higher. Alberta has the highest NRSRO rating and an NAIC 1 designation, yet it accounts for just 1 percent of total Canadian government debt held. Manitoba's issues, on the other hand, carry largely the same NAIC 1 designation, but make up 6 percent of Canadian government insurer investment (Figure 3). While Alberta's debt is rated AAA/Aaa, Manitoba's debt is rated somewhat lower, at Aa3/AA-.

approximately \$19.2 billion US, combined Canadian government investment now accounts for about 1% of total insurance industry bond investment. Insurer investment in Canadian sovereign bonds totaled about \$5.7 billion US in statement value. Insurer investment in Canadian

Figure 3. Insurer Investment by Canadian Province: 2000



Source: National Association of Insurance Commissioners.

Insurer Investment in Foreign Sovereign Securities: Canada (Continued)

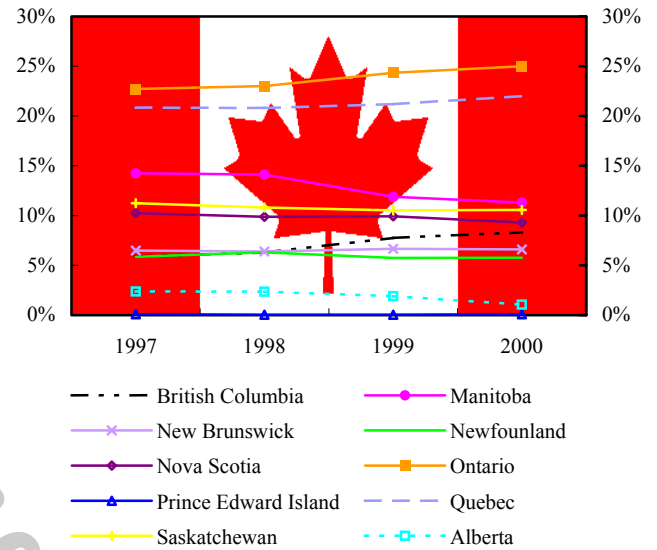
The distribution of investment within the aggregate provincial debt portfolio has remained substantially unchanged over the last few years (Figure 4), although there is some trend toward increased investment in Ontario and Quebec at the expense of the other provinces.

■ Summary

US insurers have been investing in Canadian securities for a long time. For statement year 2000, investment in Canadian sovereign and provincial debt exceeded \$19 billion US, or about 1% of the total bond investment of the industry. The majority of that investment (\$13.4 billion US) was directed toward the provinces. The amount of investment in Canadian governments has declined somewhat over the last five years, both in relative and absolute terms. As the financial market continues to expand and offer new outlets, markets and opportunities for investors, this decline is perhaps not too surprising.

As the amount of insurance industry global investment continues to grow, more detailed reports of the amounts and types of investments held is warranted. Future articles will focus on investment in different geographic regions, as well as investment in non-US corporate securities.

**Figure 4. Composition of Aggregate Provincial Portfolio
1997 - 2000**



Source: National Association of Insurance Commissioners.

Changes in the VOS Database: 3rd Quarter 2001

Ray Spudeck, Research Manager, SVO

As part of the ongoing monitoring of insurance industry investments, this report describes the 3rd Quarter, 2001 VOS database (the CD-ROM) and compares it to the composition of the database as reported at year-end 2000 (the Addendum 2000 CD-ROM) and 1st Quarter of 2001.

■ Number of Securities on the Database

As shown in Chart 1, the 3rd quarter data contains records on 288,619 securities, up 29.5% from the 222,937 securities contained in the first quarter data and up 52% from the Addendum 2000 data. The number of securities not claimed as provisionally exempt rose 33% from the first quarter to 220,759, up 47% from the Addendum 2000 period. The increases were noticeable across all NAIC designations. The number of NAIC 1 designated securities increased from the first quarter by over 35% (up over 50% from the Addendum 2000 period). This increase is the result of not only an increased number of US Treasury and domestic Federal Agency securities being added, but as well from a noticeable increase in the number of highly rated securities from corporate and municipal borrowers.

As Chart 1 also shows, the number of securities rated NAIC 3 or lower has risen since the first quarter and the Addendum period as well. Given the economic slowdown and resulting increase in rating downgrades and instances of financial distress reported this year, it is likely the case that most of the increase in the number of securities with these designations is not the result of new insurer purchases, but rather the result of the general credit deterioration currently occurring in our economy.

■ Provisionally Exempt Securities

Chart 1 also shows the distribution of securities outstanding claimed by insurers as provisionally exempt at the end of the 3rd quarter. The number of securities claimed as being 1 PE has risen to 54,729 (up almost 28% from the 42,817 reported at the end of the first quarter and up almost 89% from the 28,988 reported in the Addendum). In contrast, the number of securities claimed as 2 PE rose less than 2% from the end of the first quarter (from 3,050 to 3,107) and up less than 15% from the Addendum period (where 2,709 were claimed as provisionally exempt).

Designation	Q3 2001	Addendum	Change
1	198,107	146,317	131,558
1PE	54,729	42,817	28,988
Subtotal 1's:	252,836	189,134	160,546
2	13,274	11,809	10,977
2PE	3,107	3,050	2,709
Subtotal 2's	16,381	14,859	13,686
3	3,463	2,908	2,761
4	2,816	2,360	2,260
5	1,508	1,170	1,286
5*	521	440	381
6	1,052	848	629
6*	18	17	17
W	9,040	10,348	7,114
1W	345	355	720
2W	452	392	258
3W	148	89	48
4W	21	17	12
5W	8	—	—
6W	10	—	—
Subtotal W's	10,024	11,201	8,152
Subtotal Non-PE Securities	220,759	165,869	149,869
TOTAL	288,619	222,937	189,718

Source: National Association of Insurance Commissioners.

The number of securities claimed as provisionally exempt that could not be verified to the SVO by the rating agencies fell a bit over 10% between the first quarter and the third quarter (from 11,201 to 10,024). This can be seen by looking at the summary number for securities showing the administrative symbol of W in their designation field reported in Chart 1. What the chart does not show, however, is the increase in the number of “numbered” W's (in particular the number of 2W's, 3W's, 4W's, and the first appearance of 5W's and 6W's) resulting from the third quarter ratings checks. Again, this is likely the result of the general credit deterioration observed in the market over the year. As a result, it is likely that a number of these securities will ultimately be filed with the SVO for a designation.

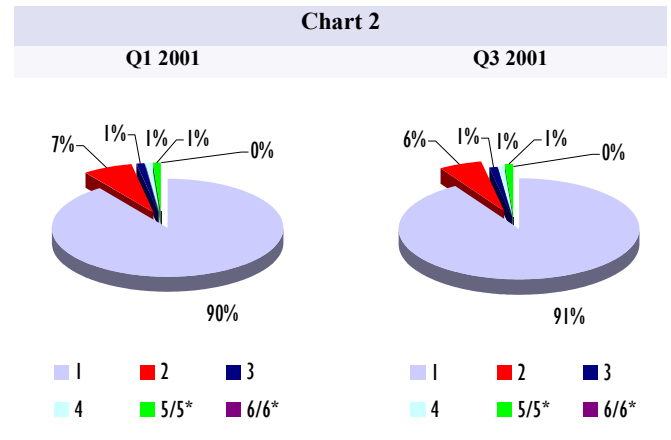
Changes in the VOS Database: 3rd Quarter 2001 (Continued)

■ Overall Distribution of Credit Risk

As suggested by Chart 2, the overall composition of the credit risk represented by the securities contained on the 3rd quarter VOS database changed very little from the 1st quarter data. Securities with NAIC 1 designations or 1PE designation comprised 91% of the securities on the database, up very slightly from 90% in the 1st quarter. The number of securities designated NAIC 2 or claimed as 2PE fell slightly to 6%, and the remaining designation percentages remained unchanged from the first quarter results.

In sum, insurers continue to invest in predominantly high quality investment grade securities, and this investment pattern shows even in the light of the difficulties being observed in the bond market this year.

When the end-of-year data are available through the Addendum 2001 version of the VOS-CD-ROM, these results will be updated again.



From the Director (Continued)

they'll think I'm exaggerating. I wish I took the car with the working radio so I could hear the news. Time 9:04 a.m., traffic is still awful just at base of exiting I-78—flash, a fireball from the other (south) tower, a surreal look. Quickly, time to rethink that plane reference: if a plane did hit the north tower, how do you get a fireball on the other tower (?), particularly since they really have some distance between them. Three seconds pass. Maybe this is 1993 all over again and some terrorist got into the towers overnight and planted incinerator bombs up at Windows (in the North Tower) and on the concourse level of the 77th floor in the South Tower. Let me call the office again: no answer, jumps to voicemail, leave message for Senior Business Administrator, call all exchanges I can remember 1950 (Credit Manager-Pradip Vyas), 1927 (old Moody's number, also Roberta Freifeld's), 1966 (Gary Mescher), and Nicole Thomas (receptionist), left same message "I don't know what is going on over there but I do hope everyone has the sense to get out of the building, I tried to call on my cell phone to know you all got out."

Off the interstate, finally! I can now take back streets through Jersey City to speed me to the PATH (trans-Hudson subway) but *let me stop at Dad's house to see what they're reporting on TV. Time 9:10 a.m. Television is on to witness the broadcast of plane striking South Tower, the thinkable only in my imagination now played out in real time. Have to call wife in Berlin to let her know I'm okay, don't want her to see this on CNN without hearing from me first, I'll use Dad's phone to call her and the cell phone to call Kansas City.*

A paradigm shift occurred on September 11th somewhere between 8:45 a.m. and 9:05 a.m. In those 20 minutes I was changed. I know my colleagues here at the SVO, the NAIC, those employed in the financial services industry, and ordinary citizens have experienced a shift, a great paradigm one. We cannot today say with certainty where this shift will take us but our deeply imbedded values can only allow us to pursue the future with eternal optimism rooted in our American Spirit.

SVO Activity

To say that a lot has transpired since the last issue of the *SVO Research Monthly* is an understatement at the very least. As with many other members of the financial community, our world was turned inside out on Tuesday, September 11. The good news is that as of late October the SVO has a new home. Our new offices are located at 1411 Broadway, 9th Floor, New York, NY, 10018. The better news for our readers and those that work with the SVO is that our direct phone numbers are unchanged from before September 11. The only noticeable change to you, our clients, is that our main office number has changed to 212.398.9000.

Now that we are in our new home with all of our systems and technology back in place, the Research Unit is working

to get back up to speed on our publications. In addition to this issue, the December issue will be out shortly. As well, the back issues that were missed during our involuntary dislocation are being rewritten to focus on issues likely of more interest since September 11 and to update the data with the most recent available. These back issues will be coming to you as soon as we can process them, while keeping up our current publications.

We would also like to take this opportunity to thank all of our friends in both the regulatory community and within the insurance industry for their concern and kind words during the days and weeks that followed that horrible Tuesday in September. We appreciate your thoughts more than you can imagine.

SVO Lost Office On September 11th But Did Not Destroy Operations

Chris Evangel, SVO Managing Director

The Securities Valuation Office (SVO) lost their offices at 7 WTC but not their operating capabilities and as of this early December, the SVO appears poised to continue meeting the demands of the insurance industry's securities reporting requirements, despite this unheralded disaster.

On September 11th at 8:46 a.m. a shock waved through lower Manhattan, at 9:04 a.m. life changed in New York City and America. The SVO occupied 7 World Trade Center (WTC), located about 200 yards from the North Tower. Only through the quick response of the SVO staff were all our people evacuated safely; however, exiting 7 WTC was only the opening chapter.

On September 11th the SVO had 45 employees on staff with an additional two staff members from our Kansas City Information Systems (IS) department upgrading our computers to Windows 2000. According to our office schedule, we knew that two employees had planned to be out that day, 21 were en-route, and another 23 were already at the SVO. Assuring to the physical safety of each employee required heroic acts and quick responses from many NAIC corners.

Upon the second attack, the SVO staff present made the correct decision to evacuate immediately. Getting people out would prove a challenge. At the same time, an SVO employee, James Mitchell, was heading to the office when the first plane hit. Jim found himself against the glass pane of 5 WTC along with a stranger with shrapnel in his calf. Opposite the glass was a day care center, Jim made it through the door and with others helped evacuate all the children and teachers to a safe location. Across the concourse, just opposite the day care center was Ronald Stuart, our mailroom operator, taking his smoking break as he witnessed the first attack and then the rain of debris. Ronald then proceeded back to the SVO office when he could have remained outside.

Inside the SVO, those present witnessed the horrific event unfolding before them. There were many with military service that have not witnessed this sort of close-range attack. Few would be hardened to put these events into an acceptable context. Meanwhile, the SVO staff of Ed Eyring, Gary Mescher and Eleanor Sottilaro served as "search and rescue" to assure that no one was left before leaving themselves, the time was somewhere around 9:25 a.m. With stairwells filled with other exiting 7 WTC personnel, a member of the SVO stood frozen.

Stan Nisnevich, an associate credit analyst and a former member of the Russian army, helped a coworker down 19 flights of stairs. Outside of the building, three teams of people met at Chambers Street and West Broadway to conduct a head count of all those known to be within 7 WTC. The collapse of the South Tower would occur in less than 30 minutes.

Simultaneous to the events unfolding at the SVO, Cathy Weatherford, our Executive Vice President, mobilized the NAIC staff in Kansas City and a direct link was established almost immediately. The NAIC staff acted quickly on two fronts: our people and our operations. While the SVO had back-up computer capacity in KC, the Windows 2000 upgrade occurring over the prior weekend proved fortunate in preserving SVO data integrity. On September 11th, the IS staff moved to preserve the system almost immediately and relied on our Year 2000 millennium recovery plan. Meanwhile, Cathy and her team worked to track down and account for each SVO employee, a process that began just about 9:30 a.m. eastern time and completed at 7:30 p.m. eastern

The collapse of both WTC towers complicated the accountability efforts in requiring initial assurance that everyone evacuated 7 WTC safely. Another added hurdle was tracking those SVO employees scheduled for duty that day but still en-route to the office, could they still be in the subway? We could only be assured of each person's safety if they would arrive back to their homes, a task made more daunting with the lockdown of Manhattan island. Painfully slow, the tally of accountable staff slowly increased from seven at 10:15 a.m., to 11 by 11 a.m., 18 by noon, and 23 by 1 p.m. Just another 22 to go. By 4 p.m., there were eight people still not confirmed home or their whereabouts known. At approximately 5:30 p.m., 7 WTC collapsed following the endurance of nearly seven hours of fire which begun with the collapse of the WTC's north tower.

Over the next two hours, the NAIC, heard from each SVO employee and/or their family that they were safe, although, due to the lockdown of Manhattan, not everyone was able to return to their home that evening.

The SVO's survival and recovery reflects a combination of emergency response and human compassion. The physical presence of the SVO was lost in 7 WTC but not the operational capabilities. Within the week, the SVO had begun to mobilize staff to the NAIC headquarters in Kansas City to begin the recovery process.

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