GOVERNMENT RELATIONS
ISSUE BRIEF

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NAIC
National Association of Insurance Commissioners
& The Center for Insurance Policy and Research

Bond Insurance / Financial Guaranty Insurers

- *Instability in the mortgage and subprime markets has strained some financial guaranty insurers, which has in turn, caused stress elsewhere in the financial markets.*

- *Leading regulators of the financial guarantors have taken a three-pronged approach to (1) address the continued availability of AAA-rated bond insurance for municipalities; (2) deal with distressed companies by working to bolster contingency reserves; and (3) consider new and revised rules and regulations.*

Background

Bond insurers (also known as "financial guarantors" or "monolines") are unique from other property and casualty companies in that their business model is based almost exclusively on selling their own credit rating to other parties. This niche industry developed in the 1970's and initially focused on wrapping their AAA-ratings around lower-rated municipal obligations for a small fee. Bond insurance benefits municipalities by lowering borrowing costs. In the 1990's, the monolines expanded their business to include structured products, such as asset-backed securities, credit default swaps, and collateralized debt obligations.

While the municipal book of business has been stable and profitable, the introduction of more complicated investment vehicles, many of which were tied to sub-prime mortgages, exposed bond insurers to greater risk. The underlying structured products had lax underwriting standards and lax oversight, and the bond insurers are now being forced to cover those losses.

Major bond insurers in the U.S. include Ambac, CIFG, FGIC, AGC, ACA Financial Guaranty Corp., and MBIA Insurance Corporation. In December 2007, Warren Buffett announced that Berkshire Hathaway would start its own bond insurance company, Berkshire Hathaway Assurance (BHA). Through the coordinated efforts of the NAIC and state insurance commissioners, it took only 6 weeks for BHA to become licensed in 49 states.

Key Points

- More transparency and stricter underwriting standards for structured financial products are needed as these instruments, many of which were highly rated by the credit rating agencies, have evolved into a significant source of systemic risk.

- Regulators are committed to a solution that does not burden taxpayers, consumers, and municipalities with the brunt of subprime excesses.

- Any regulatory fix should prevent bond insurers from taking inappropriate risk in the future, while not discouraging the financial creativity essential to maintaining the United States' position as the world's financial leader.

- State regulators are committed to working with and sharing the appropriate information with their counterparts at relevant federal agencies to monitor macroeconomic trends and prevent systemic crises.

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