

## FINANCIAL GUARANTY INSURANCE GUIDELINE

**BILL SECTION 1.** The Insurance Law is amended by adding a new article, to read as follows:

### FINANCIAL GUARANTY INSURANCE

Section 1.	Definitions
Section 2.	Organization; Financial Requirements
Section 3.	Contingency, Loss and Unearned Premium Reserves
Section 4.	Limitations
Section 5.	Filing of Policy Forms and Rates
Section 6.	Reinsurance
Section 7.	Transition Provisions
Section 8.	Applicability of Other Laws
Section 9.	Relationship to Security Fund

#### **Section 1. Definitions**

##### **A. As used in this article:**

- (1) “Financial guaranty insurance” means a surety bond, an insurance policy or, when issued by an insurer or any person doing an insurance business as defined in Section [insert section], an indemnity contract and any guaranty similar to the foregoing types, under which loss is payable upon proof of occurrence of financial loss to an insured claimant, obligee or indemnitee as a result of any of the following events:
  - (a) Failure of any obligor on or issuer of any debt instrument or other monetary obligation (including equity securities guaranteed under a surety bond, insurance policy or indemnity contract) to pay when due [to be paid by the obligor or scheduled at the time insured to be received by the holder of the obligation], principal, interest, premium, dividend or purchase price of or on, or other amounts due or payable with respect to, the instrument or obligation, when the failure is the result of a financial default or insolvency or, provided that such payment source is investment grade, any other failure to make payment, regardless of whether the obligation is incurred directly or as guarantor by or on behalf of another obligor that has also defaulted;
  - (b) Changes in the levels of interest rates, whether short or long term, or the differential in interest rates between various markets or products;
  - (c) Changes in the rate of exchange of currency;
  - (d) Changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general; or
  - (e) Other events which the commissioner determines are substantially similar to any of the foregoing.

**Drafting Note:** This provision was not enacted in the New York and California financial guaranty insurance laws, since such risks are viewed as political risk insurance, rather than financial guaranty insurance.

- (2) Notwithstanding Paragraph one (1) of this subsection, “financial guaranty insurance” shall not include:
- (a) Insurance of any loss resulting from any event described in Subsection A(1) of this section, if the loss is payable only upon the occurrence of any of the following, as specified in a surety bond, insurance policy or indemnity contract:
    - (i) A fortuitous physical event;
    - (ii) A failure of or deficiency in the operation of equipment; or
    - (iii) An inability to extract or recover a natural resource;
  - (b) An individual or schedule public official bond;
  - (c) A contract bond, including bid, payment or maintenance bond, or a performance bond where the bond is guarantying the execution of a contract other than a contract of indebtedness or other monetary obligation;
  - (d) A bond required or permitted in connection with judicial, probate, bankruptcy or equity proceedings, including appeal, injunction, waiver, probate, open estate and life tenant bonds, and bonds otherwise by law allowed including bonds accepted by state or municipal authorities in lieu of deposits as security for the performance of insurance contracts;
  - (e) A bond running to the federal, state, county, municipal government or other political subdivision, as a condition precedent to granting of a license to engage in a particular business or of a permit to exercise a particular privilege;
  - (f) An indemnity bond running to a governmental unit, railroad or charitable organization, or a lost security or utility payment bond;
  - (g) A lease, purchase and sale or concessionaire surety bond; provided that the obligation of the insurer shall not exceed a period of five (5) years, and the bond is not issued directly or indirectly in connection with the sale of securities, a pooling of financial assets or a credit default swap as defined by Section 1(I) of this article;
  - (h) A bond guaranteeing the performance of a contract of indebtedness or other monetary obligation where: (i) the aggregate gross principal, interest and other monetary indebtedness or other monetary obligations of any obligor, whose obligations are guaranteed by the insurer, under all bonds issued to that obligor pursuant to this subparagraph do not exceed \$10,000,000 and; (ii) the bond is not issued directly or indirectly in connection with the sale of securities, a pooling of financial assets or a credit default swap as defined in Section 1(I) of this article; and (iii) the bond by its terms terminates upon any sale or other transfer of the insured obligation in connection

with the sale of securities, a pooling of financial assets or a credit default swap as defined in Section 1(I) of this article;

- (i) A depository bond that insures deposits in financial institutions to the extent of the excess cover over the amount insured by the Federal Deposit Insurance Corporation;
- (j) A bond, which shall not exceed a period of greater than five (5) years, that guarantees the payment of a premium, deductible, or self-insured retention to an insurer issuing a workers' compensation or liability policy;
- (k) Fidelity insurance authorized by Section [insert section];
- (l) Credit unemployment insurance, meaning insurance on a debtor in connection with a specific loan or other credit transaction, to provide payments to a creditor in the event of unemployment of the debtor for the installments or other periodic payments becoming due while a debtor is unemployed;

**Drafting Note:** Subparagraph (l) is to be used by states which do not authorize credit unemployment insurance as a separate line of business but do permit this line to be written.

- (m) Credit insurance, meaning insurance indemnifying manufacturers, merchants or educational institutions extending credit against loss or damage resulting from nonpayment of debts owed to them for goods or services provided in the normal course of their business;

**Drafting Note:** Subparagraph (m) is to be used by states which do not authorize credit insurance as a separate line of business but do permit this line to be written.

- (n) Guaranteed investment contracts issued by life insurance companies which provide that the life insurer itself will make specified payments in exchange for specific premiums or contributions;
- (o) Residual value insurance authorized by Section [insert section];
- (p) Mortgage guaranty insurance authorized by Section [insert section];
- (q) Indemnity contracts or similar guarantees, to the extent that they are not otherwise limited or proscribed by this chapter,
  - (i) In which a life insurer or an insurer subject to Section [ ] guarantees its obligations or indebtedness or the obligations or indebtedness of a subsidiary (as defined in Section [insert section]) other than a financial guaranty insurance corporation; provided that:
    - (I) To the extent that any such obligations or indebtedness are backed by specific assets, the assets must at all times be owned by the insurer or the subsidiary; and

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- (II) In the case of the guaranty of the obligations or indebtedness of the subsidiary that are not backed by specific assets of the insurer, the guaranty terminates once the subsidiary ceases to be a subsidiary; or
- (ii) In which a life insurer guarantees obligations or indebtedness (including the obligation to substitute assets where appropriate) with respect to specific assets acquired by a life insurer in the course of normal investment activities and not for the purpose of resale with credit enhancement, or guarantees obligations or indebtedness acquired by its subsidiary, provided that the assets acquired pursuant to this item (ii) have been:
  - (I) Acquired by a special purpose entity, whose sole purpose is to acquire specific assets of the life insurer or the subsidiary and issue securities or participation certificates backed by such assets; or
  - (II) Sold to an independent third party; or
- (iii) In which a life insurer guarantees obligations or indebtedness of an employee or insurance agent of the life insurer;
- (r) Guarantees of higher education loans, unless written by a financial guaranty insurance corporation;
- (s) Guarantees of insurance contracts, except for:
  - (i) Guarantees of performance of a contract insuring against physical damage to property in favor of mortgagees or other loss payees named in such contract when issued by a surety insurer or an authorized reinsurer;

**Drafting Note:** Subparagraph (i) is to be used by states which have a provision comparable to Section 1114 of the New York Insurance Law authorizing a surety insurer to guaranty insurance contracts.

- (ii) Financial guaranty insurance policies insuring guaranteed investment contracts issued by life insurers, provided that:
  - (I) The obligations under such contracts are not dependent on the continuance of human life;
  - (II) The financial guaranty insurance policies do not guaranty death benefits provided by such contracts;
  - (III) The obligations insured by the financial guaranty insurance policies are investment grade based on the rating of the life insurers or, in the case of separate account guaranteed investment contracts, based on the ratings of such separate accounts;

- (IV) The financial guaranty insurance policies shall not condition or delay payment of a claim with respect to such contracts upon the insured or beneficiary making a claim on the contracts with any insurance guaranty fund under this chapter or of any other jurisdiction; and
    - (V) The financial guaranty insurance policies provide that if, prior to payment by the insurer under the financial guaranty insurance policies, the guaranty fund has paid a claim under such contracts for an amount that, when added to the amount payable under the financial guaranty insurance policies, would exceed the amount owed under such contracts. The financial guaranty insurer shall pay the portion of the amount payable in excess of the contract amounts to the guaranty fund instead of to the beneficiary under such contracts; or
  - (t) Any other form of insurance covering risks which the commissioner determines to be substantially similar to any of the foregoing.
- B. “Affiliate” means a person which, directly or indirectly, owns at least ten (10) but less than fifty percent (50%) of the financial guaranty insurance corporation or which is at least ten percent (10%) but less than fifty percent (50%), directly or indirectly, owned by a financial guaranty insurance corporation.
- C. "Aggregate net liability" means the aggregate amount of insured unpaid principal, interest and other monetary payments, if any, of guaranteed obligations insured or assumed, less reinsurance ceded and less collateral.
- D. "Asset-backed securities" mean:
  - (1) Securities or other financial obligations of an issuer provided that:
    - (a) The issuer is a special purpose corporation, trust or other entity, or (provided that the securities or other financial obligations constitute an insurable risk) is a bank, trust company or other financial institution, deposits in which are insured by the Bank Insurance Fund or the Savings Insurance Fund (or any successor thereto); and
  - (2) A pool of assets:
    - (a) Has been conveyed, pledged or otherwise transferred to or is otherwise owned or acquired by the issuer;
    - (b) That backs the securities or other financial obligations issued; and
    - (c) Where no asset in such pool, other than an asset directly payable by, guaranteed by, or backed by the full faith and credit of the United States government or that otherwise qualifies as collateral under Paragraph One (1) or Two (2) of subsection (F) of this section, has a value exceeding twenty percent (20%) of the pool's aggregate value; or

- (3) A pool of credit default swaps or credit default swaps referencing a pool of obligations, provided that:
- (a) The swap counterparty whose obligations are insured under the credit default swap is a special purpose corporation, special purpose trust or other special purpose legal entity;
  - (b) No reference obligation in such pool, other than an obligation directly payable by, guaranteed by or backed by the full faith and credit of the United States government or that otherwise qualifies as collateral under Paragraph Two (2) of Subsection (F) of this section, has a notional amount exceeding ten percent (10%) of the pool's aggregate notional amount; and
  - (c) The insurer has the benefit of a deductible or other first loss credit protection against claims under its insurance policy.

E. "Average annual debt service" means the amount of insured unpaid principal and interest on an obligation multiplied by the number of insured obligations (assuming that each obligation represents a \$1,000 par value), divided by the amount equal to the aggregate life of all these obligations (assuming that each obligation represents a \$1,000 par value). This definition, expressed as a formula in regard to bonds, is as follows:

$$\text{Average Annual Debt Service} = \frac{\text{Total Debt Service} \times \text{Number of Bonds}}{\text{Bond Years}}$$

$$\text{Total Debt Service} = \text{Insured Unpaid Principal} + \text{Interest}$$

$$\text{Number of Bonds} = \frac{\text{Total Insured Principal}}{\$1,000}$$

$$\text{Bond Years} = \text{Number of Bonds} \times \text{Term in Years}$$

Term in Years = Term to maturity based on scheduled amortization or, in the absence of a scheduled amortization in the case of asset-backed securities or other obligations lacking a scheduled amortization, expected amortization, in each case determined as of the date of issuance of the insurance policy based upon the amortization assumptions employed in pricing the insured obligations or otherwise used by the insurer to determine aggregate net liability.

F. "Collateral" means:

- (1) Cash; or
- (2) The cash flow from specific obligations which are not callable and scheduled to be received based on expected prepayment speed on or prior to the date of scheduled debt service (including scheduled redemptions or prepayments) on the insured obligation provided that (i) such specific obligations are directly payable by, guaranteed by, or backed by the full faith and credit of the United States government; (ii) in the case of insured obligations denominated or payable in foreign currency as permitted under Paragraph (B) of Section Four (4) of this article, such specific obligations are directly payable by, guaranteed by, or backed by the full faith and credit of such foreign government or the

central bank thereof; or (iii) such specific obligations are insured by the same insurer that insures the obligations being collateralized, and the cash flows from such specific obligations are sufficient to cover the insured scheduled payments on the obligations being collateralized; or

- (3) The market value of investment grade securities obligations, other than securities obligations evidencing an interest in the project or projects financed with the proceeds of the insured obligations, in an amount not to exceed the principal amount of the insured obligation.
- (4) The face amount of each letter of credit that:
  - (a) Is irrevocable;
  - (b) Provides for payment under the letter of credit in lieu of or as reimbursement to the insurer for payment required under a financial guaranty insurance policy;
  - (c) Is issued, presentable and payable either:
    - (i) At an office of the letter of credit issuer in the United States; or
    - (ii) At an office of the letter of credit issuer located in the jurisdiction in which the trustee or paying agent for the insured obligation is located;
  - (d) Contains a statement that either:
    - (i) Identifies the insurer and any successor by operation of law, including any liquidator, rehabilitator, receiver, or conservator as the beneficiary; or
    - (ii) Identifies the trustee or the paying agent for the insured obligation as the beneficiary;
  - (e) Contains a statement to the effect that the obligation of the letter of credit issuer under the letter of credit is an individual obligation of such issuer and is in no way contingent upon reimbursement with respect thereto;
  - (f) Contains an issue date and a date of expiration;
  - (g) Either:
    - (i) Has a term at least as long as the shorter of the term of the insured obligation or the term of the financial guaranty policy; or
    - (ii) Provides that the letter of credit shall not expire without thirty (30) days prior written notice to the beneficiary and allows for drawing under the letter of credit in the event that, prior to expiration, the letter of credit is not renewed or

extended or a substitute letter of credit or alternate collateral meeting the requirements of this subsection is not provided;

- (h) States that it is governed by the laws of the state of [insert state] or by the 1983 or 1993 Revision of the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication 400 or 500) or any successor Revision if approved by the commissioner, and contains a provision for an extension of time, of not less than thirty (30) days after resumption of business, to draw against the letter of credit in the event that one or more of the occurrences described in Article 19 of Publication 400 or 500 occurs; and
- (i) Is issued by a bank, trust company, or savings and loan association that:
  - (i) Is organized and existing under the laws of the United States or any state thereof or, in the case of a non-domestic financial institution, has a branch or agency office licensed under the laws of the United States or any state thereof and is domiciled in a member country of the Organization for Economic Co-operation and Development having a sovereign rating in one of the top two (2) generic lettered rating classifications by a securities rating agency acceptable to the commissioner;
  - (ii) Has (or is the principal operating subsidiary of a financial institution holding company that has) a long-term debt rating of at least investment grade; and
  - (iii) Is not a parent, subsidiary or affiliate of the trustee or paying agent, if any, with respect to the insured obligation if such trustee or paying agent is the named beneficiary of the letter of credit; or
- (5) The amount of credit protection available to the insurer (or its nominee) under each credit default swap that:
  - (a) May not be amended without the consent of the insurer and may only be terminated:
    - (i) At the option of the insurer;
    - (ii) At the option of the counterparty to the insurer, or its nominee, if the credit default swap provides for the payment of a termination amount equal to the replacement cost of the terminated credit default swap determined with reference to standard documentation of the International Swap and Derivatives Association, Inc. or otherwise acceptable to the commissioner; or



- (iii) At the discretion of the commissioner acting as a rehabilitator, liquidator or receiver of the insurer upon payment by or on behalf of the insurer of any termination amount due from the insurer.
- (b) Provides for payment under all instances in which payment under a financial guaranty insurance policy is required, except that payment under the credit default swap may be on a first loss, excess of loss or other non-pro-rata basis and may apply on an aggregate basis to more than one policy;
- (c) Is provided by:
  - (i) A counterparty whose obligations under the credit default swap are insured by a financial guaranty insurance corporation licensed under this article or guaranteed by a financial institution referred to in Items (ii) and (iii) of this subparagraph;
  - (ii) A financial institution satisfying the requirements of Items (i) through (iii) of subparagraph (i) of Paragraph Four (4) of this subsection; provided that
    - (I) Obligations of such financial institution on parity with its obligations under the credit default swap are investment grade and
    - (II) If such financial institution is not organized under, or acting through a branch or agency office licensed under, the laws of the United States or any state thereof, then such financial institution is required to collateralize the replacement cost of the credit default swap in the event that it shall fail to maintain such rating; or
  - (iii) Any other financial institution that the commissioner determines to be substantially similar to any of the foregoing.

Collateral must be deposited with the insurer, held in trust by a trustee or custodian acceptable to the commissioner for the benefit of the insurer, or held in trust pursuant to the bond indenture or other trust arrangement for the benefit of security holders in the form of funds for the payment of insured obligations, sinking funds or other reserves which may be used for the payment of insured obligations and trustee and other administrative fees on a first priority basis established and continually maintained pursuant to the bond indenture or other trust arrangement by a trustee acceptable to the commissioner. The commissioner may promulgate regulations to limit the amount of collateral provided by obligations, letters of credit, or credit default swaps or to limit the amount of collateral provided by any single issuer, bank, or counterparty as provided for in this section.

- G. "Commercial real estate" means income producing real property other than residential property consisting of less than five (5) units.

- H. “Contingency reserve” means an additional liability reserve established to protect policyholders against the effects of adverse economic cycles or other unforeseen circumstances.
- I. "Credit default swap" means an agreement referencing the credit derivative definitions published from time to time by the International Swap and Derivatives Association, Inc. or otherwise acceptable to the commissioner, pursuant to which a party agrees to compensate another party in the event of a payment default by, insolvency of, or other adverse credit event in respect of an issuer of a specified security or other obligation, provided that such agreement does not constitute an insurance contract and the making of such credit default swap does not constitute the doing of an insurance business.
- J. “Financial guaranty insurance corporation” or “corporation” means an insurer licensed to transact the business of financial guaranty insurance in this state.
- K. “Governmental unit” means the United States of America, Canada, a member country of the Organization for Economic Co-operation and Development having a sovereign rating in one of the top two generic lettered rating classifications by a securities rating agency acceptable to the commissioner, state, territory or possession of the United States of America, the District of Columbia, a province of Canada, a municipality, or a political subdivision of any of the foregoing, or any public agency or instrumentality thereof.
- L. "Excess spread" means, with respect to any insured issue of asset-backed securities, the excess of (a) the scheduled cash flow on the underlying assets that is reasonably projected to be available, over the term of the insured securities after payment of the expenses associated with the insured issue, to make debt service payments on the insured securities over (b) the scheduled debt service requirements on the insured securities, provided that such excess is held in the same manner as collateral is required to be held under Subsection (F) of this section.
- M. (1) "Consumer debt obligations" guarantees means financial guaranty insurance that indemnifies a purchaser or lender against loss or damage resulting from defaults on a pool of debts owed for extensions of credit (including in respect of installment purchase agreements and leases) to individuals, provided in the normal course of the purchaser's or lender's business, provided that
- (a) Such pool meets the requirements of Paragraph Two (2) of Subsection (D) of this section; and
  - (b) Such pool has been determined to be investment grade.
- (2) Policies providing this coverage shall contain a provision that all coverage under the policies terminates upon sale or transfer of the underlying consumer debt obligation to any transferee that is not an insured of the financial guaranty insurance corporation under a similar policy.
- N. “Industrial development bond” means any security, or other instrument, other than a utility first mortgage obligation, under which a payment obligation is created, issued by or on behalf of a governmental unit to finance a project serving a private industrial, commercial or manufacturing purpose and not payable or guaranteed by a governmental unit.

- O. "Insurable risk" means, with respect to asset-backed securities, as defined in Subsection (D) of this section, that such obligation on an uninsured basis has been determined to be not less than investment grade based solely on the pool of assets backing the insured obligation or securing the insurer, without consideration of the creditworthiness of the issuer.
- P. "Investment grade" means that
- (1) The obligation or parity obligation of the same issuer has been determined to be in one of the top four generic lettered rating classifications by a securities rating agency acceptable to the commissioner;
  - (2) The obligation or parity obligation of the same issuer has been identified in writing by the rating agency to be of investment grade quality; or
  - (3) If the obligation or parity obligation of the same issuer has not been submitted to any such rating agency, the obligation is determined to be investment grade (as indicated by a rating in Category 1 or 2) by the Securities Valuation Office of the National Association of Insurance Commissioners.
- Q. "Municipal bonds" means municipal obligation bonds and special revenue bonds.
- R. "Municipal obligation bond" means any security or other instrument, including a lease payable or guaranteed by the United States or another national government that qualifies as a governmental unit or any agency, department or instrumentality thereof, or by a state or an equivalent political subdivision of another national government that qualifies as a governmental unit, but not a lease of any other governmental unit, under which a payment obligation is created, issued by or on behalf of or payable or guaranteed by a governmental unit or issued by a special purpose corporation, special purpose trust or other special purpose legal entity to finance a project serving a substantial public purpose, and which is:
- (1)
    - (a) Payable from tax revenues, but not tax allocations, within the jurisdiction of such governmental unit;
    - (b) Payable or guaranteed by the United States or another national government that qualifies as a governmental unit, or any agency, department or instrumentality thereof, or by a housing agency of a state or an equivalent subdivision of another national government that qualifies as a governmental unit;
    - (c) Payable from rates or charges (but not tolls) levied or collected in respect of a non-nuclear utility project, public transportation facility (other than an airport facility) or public higher education facility; or
    - (d) Payable from future appropriations with respect to lease obligations.
  - (2) Provided that, in the case of obligations of a special purpose corporation, special purpose trust or other special purpose legal entity:
    - (a) Such obligations are investment grade at the time of issuance;

- (b) Such obligations are payable from sources enumerated in subparagraph (a), (b), (c) or (d) of paragraph one (1) of this subsection; and
  - (c) The project being financed, or the tolls, tariffs, usage fees or other similar rates or charges for its use are subject to regulation or oversight by a governmental unit.
- S. "Reinsurance" means cessions qualifying for credit under Section 6 (VI) of this Act.
- T. "Special revenue bond" means any security, or other instrument under which a payment obligation is created, issued by or on behalf of, or payable or guaranteed by a governmental unit to finance a project serving a substantial public purpose and not payable from any of the sources enumerated in Subsection R of this section, or securities which are the functional equivalent of the foregoing issued by a not-for-profit corporation or a special purpose corporation, special purpose trust or other special purpose legal entity, provided that, in the case of obligations of a special purpose corporation, special purpose trust or other special purpose legal entity:
  - (1) Such obligations are investment grade at the time of issuance;
  - (2) Such obligations are not payable from the sources enumerated in subparagraph (a), (b), (c) or (d) of paragraph one (1) of subsection (R) of this section; and
  - (3) The project being financed, or the tolls, tariffs, usage fees or other similar rates or charges for its use are subject to regulation or oversight by a governmental unit.
- U. "Utility first mortgage obligation" means any obligation of an issuer secured by a first priority mortgage on utility property owned by or leased to an investor-owned or cooperative-owned utility company and located in the United States, Canada, or a member country of the Organization for Economic Co-operation and Development having a sovereign rating in one of the top two (2) generic lettered rating classifications by a securities rating agency acceptable to the commissioner, provided that the utility or utility property or the usage fees or other similar utility rates or charges are subject to regulation or oversight by a governmental unit.

## **Section 2. Organization; Financial Requirements**

- A. A financial guaranty insurance corporation may be organized and licensed in the manner prescribed in Section [insert section] and a foreign insurer may be licensed in the manner prescribed in Section [insert section], except as modified by the following provisions:
  - (1) A corporation organized for the purpose of transacting financial guaranty insurance may, subject to all the applicable provisions of this chapter, be licensed to transact only the following additional kinds of insurance:
    - (a) Residual value insurance, as authorized by Section [insert section];
    - (b) Surety insurance, as authorized by Section [insert section]; and

- (c) Credit insurance, as authorized by Section [insert section].
- (2) A corporation may only assume those lines of insurance for which it is licensed to write direct business.
- (3) Prior to the issuance of a license, unless a plan of operation has been previously approved by the commissioner, a corporation shall submit for the approval of the commissioner a plan of operation detailing the types and projected diversification of guarantees that will be issued, the underwriting procedures that will be followed, managerial oversight methods, investment policies and such other matters as may be prescribed by the commissioner.
- (4) A financial guaranty insurance corporation's investments in any one entity insured by that corporation shall not exceed four percent (4%) of its admitted assets at last year-end, except that this limit shall not apply to investments payable or guaranteed by a United States governmental unit or [insert state] if such investments payable or guaranteed by the United States governmental unit or [insert state] shall be rated in one of the top two (2) generic lettered rating classifications by a securities rating agency acceptable to the commissioner.
- (5) In addition to any transaction that an insurer [may effect and maintain under any other provision of this chapter], a financial guaranty insurance corporation may effect and maintain transactions in:
  - (a) Contracts for the future delivery or receipt of the currency of a foreign country;
  - (b) Interest rate options;
  - (c) Credit default swaps under which the insurer is acquiring credit protection; and
  - (d) Other products included in the plan referred to in Clause (vii) of this subparagraph, in each case meeting the following requirements:
    - (i) The transaction is used for the purpose of limiting risk of loss under financial guaranty insurance policies or reinsurance contracts covering such policies due to fluctuations in interest rates or currency exchange rates or, in the case of credit default swaps, financial default, insolvency or other credit events;
    - (ii) The transaction shall not exceed a duration of twelve (12) months beyond the term of such policies or reinsurance contracts;
    - (iii) The amount of foreign currencies to be purchased under the transaction shall not exceed the amount guaranteed under such policies or reinsurance contracts that is denominated in foreign currency;

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- (iv) The amount that is subject to interest rate hedging transactions does not exceed the amount guaranteed under such policies or reinsurance contracts that is subject to the risk of interest rate fluctuations;
  - (v) The counterparty to such transaction has, or is the principal operating subsidiary of a holding company that has, a long term unsecured debt rating or claims-paying ability rating that is at least investment grade;
  - (vi) The transaction is not conducted for arbitrage purposes; and
  - (vii) The transaction is entered into pursuant to a plan that has been approved by the board of directors of the financial guaranty insurance corporation and filed with and approved by the commissioner.
- B.
- (1) A financial guaranty corporation shall not transact business unless it has paid-in capital of at least \$2.5 million and paid-in surplus of at least \$72.5 million, and shall at all times thereafter maintain a minimum surplus to policyholders of at least \$65 million;
  - (2) An insurer transacting only financial guaranty insurance prior to the effective date of this article which has a paid-in capital of at least \$2.5 million and maintains surplus to policyholders of at least \$45 million shall have thirty-six (36) months from the effective date of this article to fully comply with the surplus requirements set forth in paragraph one (1) of this subsection.

### Section 3. Contingency, Loss and Unearned Premium Reserves

**Drafting Note:** States can either adopt the following from Article 69 of the New York Insurance Law or the section that follows from the California Insurance Code. Both are shown in this guideline to provide alternatives for enactment.

- A. Contingency reserves.
- (1) A corporation shall establish and maintain contingency reserves for the protection of insureds and claimants against the effects of excessive losses occurring during adverse economic cycles.
  - (2) With respect to all financial guarantees written prior to and in force as of the first day of the next calendar quarter commencing after July 1, 1989:
    - (a) The insurer shall establish and maintain a contingency reserve consistent with the requirements applicable for municipal bond guarantees in effect prior to July 1, 1989 equal to fifty percent (50%) of earned premiums on such policies; and
    - (b) To the extent that the insurer's contingency reserves maintained as of the first day of the next calendar quarter commencing after July 1, 1989 are less than those required for municipal bond guarantees, the insurer shall have three (3) years from such date to bring its contingency reserves into compliance.

- (3) With respect to financial guarantees of municipal obligation bonds, special revenue bonds, industrial development bonds and utility first mortgage obligations written on and after the first day of the next calendar quarter commencing after the date that the act enacting this article shall become law:
- (a) The insurer shall establish and maintain a contingency reserve for all such insured issues in each calendar year for each category listed in subparagraph (b) of this paragraph;
  - (b) The total contingency reserve required shall be the greater of fifty percent (50%) of premiums written for each such category or the following amount prescribed for each such category:
    - (i) Municipal obligation bonds, 0.55 percent (55%) of principal guaranteed;
    - (ii) Special revenue bonds, and obligations demonstrated to the satisfaction of the commissioner to be the functional equivalent thereof, 0.85 percent (.85%) of principal guaranteed;
    - (iii) Investment grade industrial development bonds, secured by collateral or having a term of seven (7) years or less, and utility first mortgage obligations, 1.0 percent (1%) of principal guaranteed;
    - (iv) Other investment grade industrial development bonds, 1.5 (1.5%) percent of principal guaranteed; and
    - (v) All other industrial development bonds, 2.5 percent (2.5%) of principal guaranteed; and
  - (c) Contributions to the contingency reserve required by this paragraph, equal to one-eightieth of the total reserve required, shall be made each quarter for twenty (20) years, provided, however, that contributions may be discontinued so long as the total reserve for all categories listed in Items (i) through (v) of Subparagraph (b) of this paragraph exceeds the percentages contained in such Items (i) through (v) when applied against unpaid principal.
- (4) With respect to all other financial guarantees written on or after July 1, 1989
- (a) The insurer shall establish and maintain a contingency reserve for all such insured issues in each calendar year for each such category listed in Subparagraph (b) of this paragraph;
  - (b) The total contingency reserve required shall be the greater of fifty percent (50%) of premiums written for each such category or the following amount prescribed for each such category:
    - (i) Investment grade obligations, secured by collateral or having a term of seven (7) years or less, 1.0 percent (1%) of principal guaranteed;

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- (ii) Other investment grade obligations, 1.5 percent (1.5%) of principal guaranteed;
  - (iii) Non-investment grade consumer debt obligations, 2.0 percent (2%) of principal guaranteed;
  - (iv) Non-investment grade asset-backed securities, 2.0 percent (2%) of principal guaranteed;
  - (v) Other non-investment grade obligations, 2.5 percent (2.5%) of principal guaranteed; and
- (c) Contributions to the contingency reserve required by this paragraph, equal to one-sixtieth of the total reserve required, shall be made each quarter for fifteen (15) years, provided, however, that contributions may be discontinued so long as the total reserve for all categories listed in Items (i) through (v) of Subparagraph (b) of this paragraph exceeds the percentages contained in such Items (i) through (v) when applied against unpaid principal.
- (5) Contingency reserves required in paragraphs two, three and four of this subsection may be established and maintained net of collateral and reinsurance, provided that, in the case of reinsurance, the reinsurance agreement requires that the reinsurer shall, on or after the effective date of the reinsurance, establish and maintain a reserve in an amount equal to the amount by which the insurer reduces its contingency reserve, and contingency reserves required in paragraphs three and four of this subsection may be maintained:
- (a) Net of refunds and refinancing to the extent the refunded or refinanced issue is paid off or secured by obligations which are directly payable or guaranteed by the United States government and
  - (b) Net of insured securities in a unit investment trust or mutual fund that have been sold from the trust or fund without insurance.
- (6) The contingency reserves may be released thereafter in the same manner in which they were established and withdrawals thereof, to the extent of any excess, may be made from the earliest contributions to such reserves remaining therein:
- (a) With the prior written approval of the commissioner:
    - (i) If the actual incurred losses for the year, in the case of the categories of guarantees subject to paragraph three (3) of this subsection exceeds thirty-five percent (35%) of earned premiums, or in the case of the categories of guarantees subject to Paragraph Four (4) of this subsection exceed sixty-five percent (65%) of earned premiums; or
    - (ii) If the contingency reserve applicable to the categories of guarantees subject to paragraph three (3) of this subsection has been in existence for less than forty (40) quarters, or for



less than thirty (30) quarters for the categories of guarantees subject to paragraph four (4) of this subsection, upon a demonstration satisfactory to the commissioner that the amount carried is excessive in relation to the insurer's outstanding obligations under its financial guarantees.

- (b) As shall not otherwise be disapproved by the commissioner within thirty (30) days following receipt of written notification providing a demonstration satisfactory to the commissioner that the amount carried is excessive in relation to the insurer's outstanding obligations under its financial guarantees, provided that the contingency reserve applicable to the categories of guarantees subject to paragraph three (3) of this subsection has been in existence for forty (40) quarters, or thirty (30) quarters for categories of guarantees subject to paragraph four (4) of this subsection.
- (7) An insurer providing financial guaranty insurance may invest the contingency reserve in tax and loss bonds (or similar securities) purchased pursuant to Section 832(e) of the Internal Revenue Code (or any successor provision), only to the extent of the tax savings resulting from the deduction for federal income tax purposes of a sum equal to the annual contributions to the contingency reserve. The contingency reserve shall otherwise be invested only in classes of securities or types of investments specified in [insert statutory reference to permissible investments].

*End of New York Article 69.*

**Drafting Note:** States can either adopt the following from Section 12108 of the California Insurance Code, or the previous section from the New York Insurance Law.

- A. An admitted financial guaranty insurance corporation shall establish and maintain a contingency reserve.
- B. With respect to all financial guarantees written prior to and in force as of July 1, 1989:
  - (1) The financial guaranty insurance corporation shall establish and maintain a contingency reserve consistent with the requirements applicable for municipal bond insurance policies which were in effect prior to July 1, 1989, in an amount equal to 50 percent (50%) of earned premiums on those policies.
  - (2) To the extent that the financial guaranty insurance corporation's contingency reserves maintained as of July 1, 1989, are less than those required for municipal bond insurance policies pursuant to paragraph one (1), the corporation shall have until January 1, 1994, to bring its reserves into compliance.
- C. With respect to financial guarantees of municipal obligation bonds, special revenue bonds and investment grade industrial development bonds written after July 1, 1989:
  - (1) The financial guaranty insurance corporation shall establish and maintain a contingency reserve in accordance with Paragraph Three (3) of Subdivision (D) for all those insured issues in each calendar year for each category listed in paragraph two (2) of this subdivision.

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- (2) The total contingency reserve required shall be the greater of 50 percent (50%) of premiums written for each such category or the following amount prescribed for each such category:
  - (a) Municipal obligation bonds, 0.8 percent (.8%) of principal outstanding.
  - (b) Special revenue bonds, 1.2 percent (1.2%) of principal outstanding.
  - (c) Investment grade industrial development bonds secured by collateral or with a remaining term at the date of insurance of seven (7) years or less and utility first mortgage obligations, 1.4 percent (1.4%) of principal outstanding.
  - (d) All other investment grade industrial development bonds, 1.6 percent (1.6%) of principal outstanding.
- (3) Contributions to the contingency reserve required by this paragraph, equal to one-eightieth of the total reserve required, shall be made each quarter for twenty (20) years, provided, however, that contributions may be discontinued so long as the total reserve for all categories listed in Items (a) through (d) of subparagraph two (2) exceeds the percentages contained in Items (a) through (d) when applied against unpaid principal.

D. With respect to all other financial guarantees written on or after July 1, 1989:

- (1) The financial guaranty insurance corporation shall establish and maintain a contingency reserve in accordance with paragraph three (3) for all those insured issues in each calendar year for each such category listed in paragraph two (2).
- (2) The total contingency reserve required shall be the greater of 50 percent (50%) of premiums written for each such category or the following amount prescribed for each such category:
  - (a) Investment grade obligations, secured by collateral, or with a remaining term at the date of insurance of seven (7) years or less, 1.2 percent (1.2%) of principal outstanding.
  - (b) Other investment grade obligations, 1.7 percent (1.7%) of principal outstanding.
  - (c) Non-investment grade obligations secured by collateral, 2.5 percent (2.5%) of principal outstanding.
  - (d) Other non-investment grade obligations, 3.0 percent (3.0%) of principal outstanding.
- (3) Contributions to the contingency reserve required by subparagraphs (a) and (b) of paragraph two (2), equal to one-sixtieth of the total reserve required, shall be made each quarter for fifteen (15) years, and contributions to the contingency reserve required by subparagraphs (c) and (d) of paragraph two (2), equal to one-fortieth of the total reserve required, shall be made each

quarter for ten (10) years provided, however, that contributions may be discontinued so long as the total reserve for all categories listed in subparagraphs (a) through (d) of paragraph two (2) exceeds the percentages contained in subparagraphs (a) through (d) when applied against unpaid principal.

- E. Contingency reserves required in Subdivisions (B), (C), and (D) may be established and maintained net of collateral and reinsurance, provided that, in the case of reinsurance, the reinsurance agreement requires that the reinsurer shall, on or after the effective date of the reinsurance, establish and maintain a reserve in an amount equal to the amount by which the financial guaranty insurance corporation reduces its contingency reserve. In addition, contingency reserves required in Subdivisions (C) and (D) may be maintained net of refunds and refinancing to the extent the refunded or refinanced issue is paid off or secured by obligations that are directly payable or guaranteed by the United States government, and net of insured securities in a unit investment trust or mutual fund that have been sold from the trust or fund without insurance.
- F. The contingency reserves may be released thereafter in the same manner in which they were established and withdrawals thereof, to the extent of any excess, may be made from the earliest contributions to such reserves remaining therein:
- (1) With the prior written approval of the commissioner, if the actual incurred losses for the year, in the case of the categories of guarantees subject to Subdivision (C) exceeds 35 percent (35%) of earned premiums, or in the case of the categories of guarantees subject to Subdivision (D) exceed 65 percent (65%) of earned premiums.
  - (2) Upon thirty (30) days prior written notice to the commissioner, provided that the contingency reserve has been in existence for forty (40) quarters, for reserves subject to Subdivision (C), and thirty (30) quarters, for reserves subject to Subdivision (D), upon demonstration that the amount carried is in excess of required amounts or excessive in relation to the financial guaranty insurance corporation's outstanding obligations.
  - (3) A financial guaranty insurance corporation may invest the contingency reserve in tax and loss bonds or similar securities purchased pursuant to Section 832(e) of the Internal Revenue Code (or any successor provision), only to the extent of the tax savings resulting from the deduction for federal income tax purposes of a sum equal to the annual contributions to the contingency reserve. The contingency reserve shall otherwise be invested only in classes of securities or types of investments specified in [insert applicable reserve investment statutory reference].

*End of California Contingency Reserve Language.*

B. Loss reserves.

- (1) In addition to the contingency reserve, the case basis method or other method as may be prescribed by the commissioner shall be used to establish and maintain loss reserves, net of collateral, for claims reported and unpaid, in a manner consistent with Section [insert section], A deduction from loss reserves shall be allowed for the time value of money by application of a

discount rate equal to the average rate of return on the admitted assets of the insurer as of the date of the computation of the reserve. The discount rate shall be adjusted at the end of each calendar year.

- (2) If the insured principal and interest on a defaulted issue of obligations due and payable during any three (3) years following the date of default exceeds ten percent (10%) of the insurer's surplus to policyholders and contingency reserves, its reserve so established shall be supported by a report from an independent source acceptable to the commissioner.

- C. Unearned premium reserve. An unearned premium reserve shall be established and maintained net of reinsurance and collateral with respect to all financial guaranty premiums. Where financial guaranty insurance premiums are paid on an installment basis, an unearned premium reserve shall be established and maintained, net of reinsurance and collateral, computed on a daily or monthly pro rata basis. All other financial guaranty insurance premiums written shall be earned in proportion with the expiration of exposure, or by such other method as may be prescribed by the commissioner.

#### **Section 4. Limitations**

- A. Financial guaranty insurance may be transacted in this state only by a corporation licensed for that purpose pursuant to Section 2 (II) of this act.
- B. Permissible guarantees.
  - (1) The commissioner shall not permit the writing of financial guaranty insurance except as defined in Subparagraph (a) of Paragraph One (1) of Subsection (A) of section one of this article, and a corporation may insure the timely payment of United States dollar debt instruments, or other monetary obligations, only in the following categories:
    - (a) Municipal obligation bonds;
    - (b) Special revenue bonds;
    - (c) Industrial development bonds;
    - (d) Obligations of the governments of a country not qualifying as a governmental unit or a municipality, a political subdivision, or any public agency or instrumentality thereof;
    - (e) Obligations of corporations, trusts or other similar entities established under applicable law;
    - (f) Partnership obligations;
    - (g) Asset-backed securities, trust certificates and trust obligations other than mortgage-backed securities secured by first mortgages on real property which are insurable by a mortgage guaranty insurer authorized under Section [insert section], unless:

- (i) Such mortgages with loan-to-value ratios in excess of eighty percent (80%) are:
    - (I) In the case of mortgages on property located in the state of [insert state], insured by mortgage guaranty insurers authorized under Section [insert section];
    - (II) In the case of mortgages on property located in a state other than the state of [insert state], insured by mortgage guaranty insurers authorized to do business in such other state; or
    - (III) In an aggregate principal amount less than the single risk limits prescribed in paragraph five (5) of subsection (D) of this section; or
  - (ii) Additional mortgages with principal balances, other collateral with a market value, or (provided the insured risk is investment grade) excess spread in an amount, in each instance at least equal to the coverage that would otherwise be provided by such mortgage guaranty insurers in accordance with Item (i) of this subparagraph are pledged as additional security for the asset-backed securities;
  - (h) Installment purchase agreements executed as a condition of sale;
  - (i) Consumer debt obligations;
  - (j) Utility first mortgage obligations; and
  - (k) Any other debt instrument or financial obligation which the commissioner determines to be substantially similar to any of the foregoing.
- (2) An insurer may insure obligations enumerated in Subparagraphs (a), (b) and (c) of Subsection B(1) that are not investment grade so long as at least ninety-five percent (95%), or such lower percentage as shall be acceptable to the commissioner of the insurer's aggregate net liability on the kinds of obligations enumerated in Subparagraphs (a), (b) and (c) of Subsection B(1) shall be investment grade. The commissioner may accept a lower percentage of the insurer's aggregate net liability to be investment grade upon determination that there is no undue risk to the insurer's policyholders associated with so doing. In making such a determination, the commissioner shall take into consideration, among other factors, the corporation's outstanding liabilities on non-investment grade instruments and obligations and in relation to the amount of its surplus to policyholders.
- (3) A corporation may insure the timely payment of monetary obligations in any category designated in this subsection notwithstanding that such obligation may be insured by a financial guaranty insurance policy issued by another insurer. In the event that any obligation is insured by more than one financial guaranty insurance policy, then each such insurance policy may by its terms specify its priority of payment in the event of a default under the

obligation insured or any other insurance policy, provided that an insurer shall be entitled to take into account payment under another policy insuring such obligation for purposes of (i) determining compliance with single risk limits in Subsection D of this section and (ii) establishing and maintaining loss reserves only to the extent that the policy issued by such insurer provides for payment only in the event of payment default under both such obligation and the other policy.

(4) A corporation may also write financial guaranty insurance as defined in Subparagraph (a) of Paragraph One (1) of Subsection (A) of Section One (I) of this article to insure the timely payment of non-United States dollar debt instruments or other monetary obligations denominated or payable in foreign currency, only for the categories listed in subparagraphs (a) through (k) of paragraph one (1) of this subsection, provided that:

(a) Such currency is that of an Organization for Economic Co-operation and Development country or such other country

(i) Whose sovereign rating is investment grade; or

(ii) As shall not otherwise be disapproved by the commissioner within thirty (30) days following receipt of written notification. The commissioner shall not disapprove such notification upon demonstration that there is no undue risk associated with insuring the timely payment of such instruments or obligations. In making such a determination the commissioner shall take into consideration the corporation's outstanding liabilities on non-investment grade instruments and obligations in relation to its outstanding liabilities on all instruments and obligations and in relation to the amount of its surplus to policyholders.

(b) Reserves required pursuant to Section Three of this article in regard to such obligations shall be established and adjusted quarterly based upon the then current foreign exchange rates;

(c) Such obligations shall not exceed twenty-five percent (25%) of an insurer's aggregate net liability; and

(d) The aggregate and single risk limitations prescribed by Subsections (C) and (D) of this section shall be determined by applying the then current foreign exchange rates.

C. Aggregate risk limits. The corporation must at all times maintain surplus to policyholders and contingency reserves in the aggregate no less than the sum of:

(1) (a) 0.3333 percent (.3333%) or 1/300th of the aggregate net liability under guarantees of municipal bonds including obligations demonstrated to the satisfaction of the commissioner to be the functional equivalent thereof and investment grade utility first mortgage obligations; plus

- (b) 0.6666 percent (.6666%) or 1/150th of the aggregate net liability under guarantees of investment grade asset-backed securities; plus
  - (c) 1.0 percent (1%) or 1/100th of the aggregate net liability under guarantees, secured by collateral or having a term of seven (7) years or less, of:
    - (i) Investment grade industrial development bonds,
    - (ii) Other investment grade obligations; plus
  - (d) 1.5 percent (1.5%) or 1/66.67th of the aggregate net liability under guarantees of other investment grade obligations; plus
  - (e) 2.0 percent (2%) or 1/50th of the aggregate net liability under guarantees of:
    - (i) Non-investment grade consumer debt obligations, and
    - (ii) Non-investment grade asset-backed securities; plus
  - (f) 2.5 percent (2.5%) or 1/40th of the aggregate net liability under guarantees of non-investment grade obligations secured by first mortgages on commercial real estate and having loan-to-value ratios of eighty percent (80%) or less; plus
  - (g) 4.0 percent (4%) or 1/25th of the aggregate net liability under guarantees of other non-investment grade obligations; and
  - (h) If the amount of collateral required by subparagraph (c) of this paragraph is no longer maintained, that proportion of the obligation insured which is not so collateralized shall be subject to the aggregate limits specified in subparagraph (d) of this paragraph; and
- (2) Surplus to policyholders determined by the commissioner to be adequate to support the writing of residual value insurance, surety insurance and credit insurance, if the corporation has elected to transact those kinds of insurance pursuant to Section 2(A) of this Act.
- D. Single risk limits. A financial guaranty insurance corporation shall limit its exposure to loss, net of collateral and reinsurance, as follows:
- (1) For municipal obligation bonds, special revenue bonds and obligations demonstrated to the satisfaction of the commissioner to be the functional equivalent thereof:
    - (a) The insured average annual debt service with respect to any one entity and backed by a single revenue source may not exceed ten percent (10%) of the aggregate of the corporation's surplus to policyholders and contingency reserve; and

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- (b) The insured unpaid principal issued by a single entity and backed by a single revenue source may not exceed seventy-five percent (75%) of the aggregate of the corporation's surplus to policyholders and contingency reserve;
- (2) For each issue of asset-backed securities issued by a single entity and for each pool of consumer debt obligations, the lesser of:
- (a) Insured average annual debt service; or
  - (b) Insured unpaid principal (reduced by the extent to which the unpaid principal of the supporting assets and, provided the insured risk is investment grade, excess spread exceed the insured unpaid principal) divided by nine; shall not exceed ten percent (10%) of the aggregate of the insurer's surplus to policyholders and contingency reserve, provided that no asset in the pool supporting the asset-backed securities exceeds the single risk limits prescribed in paragraph five (5) of this subsection, if directly guaranteed; and provided further that, if the issuer of such insured asset-backed securities is a special purpose corporation, trust or other entity and such issuer shall have indebtedness outstanding with respect to any other pool of assets, either such other indebtedness shall be entitled to the benefits of a financial guaranty policy of the same insurer, or such other indebtedness shall:
    - (i) Be fully subordinated to the insured obligation, with respect to, or be non-recourse with respect to, the pool of assets that supports the insured obligation;
    - (ii) Be non-recourse to the issuer other than with respect to the asset pool securing such other indebtedness and proceeds in excess of the proceeds necessary to pay the insured obligation ("excess proceeds"); and
    - (iii) Not constitute a claim against the issuer to the extent that the asset pool securing such other indebtedness or excess proceeds are insufficient to pay such other indebtedness.
- (3) For obligations issued by a single entity and secured by commercial real estate, and not meeting the definition of asset-backed securities, the insured unpaid principal less fifty percent (50%) of the appraised value of the underlying real estate shall not exceed ten percent (10%) of the aggregate of the insurer's surplus to policyholders and contingency reserve;
- (4) For utility first mortgage obligations, the insured average annual debt service shall not exceed ten percent (10%) of the aggregate of the insurer's surplus to policyholders and contingency reserve; and
- (5) For all other policies providing financial guaranty insurance with respect to obligations issued by a single entity and backed by a single revenue source, the insured unpaid principal shall not exceed ten percent (10%) of the aggregate of the insurer's surplus to policyholders and contingency reserve.



- E. Except as provided in Subsection (F) of this section, if an insurer at any time exceeds any limitation prescribed by Subsection (C) or (D) of this section or the last sentence of paragraph one (1) of subsection (B) of this section, the insurer shall within thirty (30) days after the limitations are breached, submit a written plan to the commissioner detailing the steps that it will take or has taken to reduce its exposure to loss to no more than the permitted amounts, and if after notice and hearing the commissioner determines that an insurer has exceeded any limitation prescribed by this section, he may order such insurer to cease transacting any new financial guaranty insurance business until its exposure to loss no longer exceeds said limitations or with respect to the limitations prescribed in the last sentence of paragraph one (1) of subsection (B) of this section, may order such insurer to limit its writing of the types of guarantees permitted under subparagraphs (a), (b) and (c) of paragraph one (1) of subsection (B) of this section to investment grade obligations until such time as it shall be in compliance with such limitations.
- F. An insurer shall not be deemed in violation of any limitation prescribed by Subsection (D) of this section with respect to any financial guaranty insurance outstanding prior to the effective date of this article, if the insurer was in compliance with the applicable single risk limit in effect in this state at the time that the financial guaranty insurance policy was issued. If the insurer was not so in compliance, such financial guaranty insurance shall comply with the limitations prescribed by Subsection (D) of this section no later than three (3) years after the effective date of this article.
- G. No insurer authorized to transact the business of financial guaranty insurance shall pay any commission or make any gift of money, property or other valuable thing to any employee, agent, or representative of any potential purchaser of a financial guaranty insurance policy as an inducement to the purchase of such a policy, and no such employee, agent, or representative of such potential purchaser shall receive any such payment or gift. Violation of the provisions of this section shall not, however, have the effect of rendering void the insurance policy issued by the insurer.

## **Section 5. Filing of Policy Forms and Rates**

- A. Policy forms and any amendments thereto shall be filed with the commissioner within thirty (30) days of their use by the insurer if not otherwise filed prior to the effective date of this article. Every such policy shall provide that, in the event of a payment default by or insolvency of the obligor, there shall be no acceleration of the payment required to be made under such policy unless such acceleration is at the sole option of the corporation provided that:
- (1) Policies may insure amounts payable under a credit default swap or interest rate, currency, or other swap upon a credit event or termination event if the expected amount payable on an accelerated basis in respect of any individual obligation referenced by a credit default swap or in the aggregate under an interest rate, currency or other swap does not exceed the single risk limits prescribed in Paragraph Five (5) of Subsection (D) of Section Four (4) of this article; and
  - (2) Policies insuring credit default swaps referencing an obligation shall be treated as if the insurer had directly insured the referenced obligation for all other purposes of this article, except that the currency of amounts owed under the credit default swap, rather than the currency of the obligations

referenced by the credit default swap, shall apply for purposes of determining whether the obligation is a permissible guaranty under Subsection (B) of Section Four of this article. The commissioner may prescribe minimum policy provisions determined by the commissioner to be necessary or appropriate to protect policyholders, claimants, obligees or indemnitees.

- B. Rates shall not be excessive, inadequate, unfairly discriminatory, destructive of competition, detrimental to the solvency of the insurer or otherwise unreasonable. In determining whether rates comply with the foregoing standards, the commissioner shall include all income earned by such insurer. Criteria and guidelines utilized by insurers in establishing rating categories and ranges of rates to be utilized shall be filed with the commissioner for information prior to their use by the insurer if not otherwise filed prior to the effective date of this article.

**Drafting Note:** If this standard is contained in the state's insurance law, a section reference may be substituted.

- C. All filings shall be available for public inspection at the insurance department.

## **Section 6. Reinsurance**

- A. For financial guaranty insurance that takes effect on or after the effective date of this Act, a financial guaranty insurance corporation shall receive credit for reinsurance in accordance with the provisions of this chapter applicable to property and casualty insurers as an asset or as a reduction from liabilities provided that the reinsurance is subject to an agreement that for its stated term and with respect to any such reinsured financial guaranty insurance in force, the reinsurance agreement (facultative or treaty) may only be terminated or amended (i) at the option of the reinsurer or the ceding insurer, if the reinsurance agreement provides that the liability of the reinsurer with respect to policies in effect at the date of termination shall continue until the expiration or cancellation of each such policy; or (ii) with the consent of the ceding company, if the reinsurance agreement provides for a cutoff of the reinsurance in force at the date of termination; or (iii) at the discretion of the commissioner acting as rehabilitator, liquidator or receiver of the ceding or assuming insurer; and provided that such reinsurance is:
  - (1) Placed with another financial guaranty insurance corporation licensed under this Act or an insurer writing only financial guaranty insurance as is or would be permitted by this Act; or
  - (2) Placed with a property and casualty insurer or an accredited reinsurer licensed or accredited to reinsure risks of every kind or description (including municipal obligation bonds), as set forth in [insert section authorizing property and casualty reinsurance], if the reinsurance agreement with such insurer requires that such insurer:
    - (a) Have and maintain surplus to policyholders of at least \$35 million;
    - (b) Establish and maintain the reserves required in Section 3 (III) of this guideline, except that if the reinsurance agreement is not pro rata the contribution to the contingency reserve shall be equal to fifty percent (50%) of the quarterly earned reinsurance premium. However, the assuming insurer need not establish and maintain such reserve to the extent that the ceding insurer has established and continues to maintain such reserve;

- (c) Comply with the provisions of Subsection C of Section 4 (IV) of this act, except that its maximum total exposures reinsured net of retrocessions and collateral shall be one-half that permitted for a financial guaranty insurance corporation;
  - (d) If a parent of the insurer, another subsidiary of the parent of the insurer, or a subsidiary of the insurer, then the aggregate of all risks assumed by such reinsurers shall not exceed ten percent (10%) of the insurer's exposures, net of retrocessions and collateral. Direct or indirect ownership interests of fifty percent (50%) or more shall be deemed a parent/subsidiary relationship;
  - (e) If an affiliate of the financial guaranty insurance corporation, the affiliate shall not assume a percentage of the corporation's total exposures insured net of retrocessions and collateral in excess of its percentage of equity interest in the corporation; and
  - (f) Assumes from the financial guaranty insurer and any affiliate, parent of the insurer, another subsidiary of the parent of the insurer, or subsidiary of the insurer that is a financial guaranty insurance corporation or an insurer writing only financial guaranty insurance as is or would be permitted by this article and such other kinds of insurance that a financial guaranty insurance corporation may write in this state, together with all other reinsurers subject to this paragraph, less than fifty percent (50%) of the total exposures insured by the financial guaranty insurer and such affiliates, parents or subsidiaries of the insurer, net of collateral, remaining after deducting any reinsurance placed with another financial guaranty insurance corporation that is not an affiliate, a parent of the financial guaranty insurer, another subsidiary of the parent of the insurer, or a subsidiary of the insurer or a financial guaranty insurer writing only financial guaranty insurance as is or would be permitted by this article that is not an affiliate, a parent of the financial guaranty insurer, another subsidiary of the parent of the insurer, or a subsidiary of the insurer; or
- (3) If placed with an unauthorized or unaccredited reinsurer which otherwise meets the requirements of either the opening paragraph of this subsection and paragraph one (1) of this subsection, or the opening paragraph of this subsection and subparagraphs (a), (d), (e) and (f) of paragraph two (2) of this subsection, in an amount not exceeding the liabilities carried by the ceding insurer for amounts withheld under a reinsurance treaty with the reinsurer or amounts deposited by the reinsurer as security for the payment of obligations under the treaty, if the funds or deposit are held subject to withdrawal by, and under the control of the ceding insurer.
- B. In determining whether the corporation meets the aggregate risk limitations, in addition to credit for other types of qualifying reinsurance, the corporation's aggregate risk may be reduced to the extent of the limit for aggregate excess reinsurance but, in no event, in an amount greater than the amount of the aggregate risk which will become due during the unexpired term of the reinsurance agreement in excess of the corporation's retention pursuant to the reinsurance agreement.

## Section 7. Transition Provisions

A licensed insurer writing financial guaranty insurance prior to the effective date of this article, but which is not authorized to write financial guaranty insurance in this state, shall be subject to all the provisions of this article, except Section Two of this article, and:

- A. May, unless the commissioner determines after notice and an opportunity to be heard that such activity poses a hazard to the insurer, its policyholders or to the public, continue to write financial guarantees (except guarantees of municipal bonds) of the types authorized by Subsection (B) of Section Four of this article applicable to financial guaranty insurance corporations, subject to the following conditions:
  - (1) For a transition period not to exceed sixty (60) months from the effective date of this article, if the insurer has and maintains surplus to policyholders of at least \$75 million (for the purpose of this paragraph, if the insurer is a foreign insurer, its surplus to policyholders shall be computed as if it were a domestic insurer); provided that:
    - (a) During the sixty (60) month transition period, the amount of surplus to policyholders needed to meet the single and aggregate risk limitations imposed by this article must be less than four percent (4%) of the insurer's surplus to policyholders;
    - (b) Within nine (9) months of the effective date of this article, the insurer shall file a reasonable plan of operation, acceptable to the commissioner, which shall contain:
      - (i) A reasonable timetable and appropriate procedures to implement that timetable to make a determination as to whether or not the insurer will make application to organize a financial guaranty insurance corporation during the aforesaid sixty (60) month period;
      - (ii) The types and projected diversification of guarantees that will be issued during the transition period;
      - (iii) The underwriting procedures that will be followed;
      - (iv) Oversight methods;
      - (v) Investment policies; and
      - (vi) Such other matters as may be prescribed by the commissioner.

The plan of operation shall be deemed acceptable unless, within sixty (60) days of its filing, the commissioner notifies the insurer of any specific objections to such plan. The plan shall be updated in the event of a material change with respect to the foregoing and at least annually:

- (c) If the insurer has determined that it will not organize a financial guaranty insurance corporation, within thirty (30) days after that determination it shall notify the commissioner, cease writing policies of financial guaranty insurance and comply with the provisions of paragraph four (4) of this subsection; and
  - (d) The insurer shall file such additional statements or reports as may be required by the commissioner.
- (2) For a transition period not to exceed ninety-six (96) months from the effective date of this article, if the insurer has and maintains surplus to policyholders of at least \$150 million (for the purpose of this section, surplus to policyholders means the aggregate surplus to policyholders of said insurer and other member companies of an inter-company pool, and if the insurer is a foreign insurer its surplus to policyholders shall be computed as if it were a domestic insurer) and the aggregate financial guaranty written premium of said insurer and other member companies of an inter-company pool shall have been at least \$1 million in any one of the five (5) years ending December thirty-first (31) of the year prior to this article becoming law, provided that:
  - (a) During the first sixty (60) months of the transition period, the amount of surplus to policyholders needed to meet the aggregate risk limitations imposed by this article must be less than four percent (4%) of the insurer's surplus to policyholders. After such sixty (60) month period, provided the insurer complies with subparagraph (d) of this paragraph, the amount of surplus to policyholders needed to meet such aggregate risk limitations must be less than five percent (5%) of the insurer's surplus to policyholders for the succeeding twelve (12) month period and less than six percent (6%) for the next succeeding twenty-four (24) month period;
  - (b) During the transition period, the amount of surplus to policyholders needed to meet the single risk limitations imposed by Paragraphs Two through Five of Subsection (D) of Section Four of this article must be less than twenty percent (20%) of the insurer's surplus to policyholders, except that the single risk limitation with respect to investment grade obligations under such paragraph five (5) shall be the lesser of \$80 million or seven percent (7%) of the insurer's surplus to policyholders;
  - (c) During the transition period, notwithstanding the last sentence of Paragraph One (1) of Subsection (B) of Section Four, industrial development bonds shall not be included in the investment grade requirements set forth in such sentence;
  - (d) During the transition period, reinsurance in the form of inter-company pooling agreements, shall not be subject to Subparagraphs (c), (d), (e) and (f) of Paragraph Two (2) of Subsection (A) of Section Six of this article, if such inter-company pooling agreements were in effect on January first (1), of the year in which this article becomes effective, and reinsurance placed with insurers which are subject to the provisions of Paragraph Two (2) of Subsection (A) of Section Six and are not members of the ceding company's inter-company pooling

agreement may not exceed sixty percent (60%) of the total exposures insured net of collateral remaining after deducting any reinsurance placed with another financial guaranty insurance corporation or an insurer writing only financial guaranty insurance as is or would be permitted by this article;

- (e) Within sixty (60) months of the effective date of this article, the insurer shall file a reasonable plan of operation, acceptable to the commissioner, which shall contain:
  - (i) A reasonable timetable and appropriate procedures to implement that timetable to make a determination as to whether or not the insurer will make application to organize a financial guaranty insurance corporation during the aforesaid ninety-six (96) month period;
  - (ii) The types and projected diversification of guarantees that will be issued during the transition period;
  - (iii) The underwriting procedures that will be followed;
  - (iv) Oversight methods;
  - (v) Investment policies; and
  - (vi) Such other matters as may be prescribed by the commissioner.

The plan of operation shall be deemed acceptable unless, within sixty (60) days of its filing, the commissioner notifies the insurer of any specific objections to such plan. The plan shall be updated in the event of a material change with respect to the foregoing and at least annually:

- (f) If the insurer has determined that it will not organize a financial guaranty insurance corporation, within thirty (30) days after that determination it shall notify the commissioner, cease writing policies of financial guaranty insurance and comply with the provisions of paragraph four (4) of this subsection; and
  - (g) The insurer shall file such additional statements or reports as may be required by the commissioner.
- (3) For a transition period not to exceed twelve (12) months from the effective date of this article, in the case of an insurer transacting only financial guaranty insurance prior to the effective date of this article and which qualifies for licensing as a financial guaranty insurance corporation under Section Two of this article, provided that it makes application to amend its current license to that of a financial guaranty insurance corporation licensed to transact only those kinds of insurance permitted pursuant to Section Two of this article within sixty (60) days of the effective date of this article, and provided that, for purposes of this paragraph, an insurer shall be deemed to be transacting only financial guaranty insurance prior to the effective date of this article if, with the approval of the commissioner, it has reinsured all of

any other insurance liabilities with one or more authorized insurers or has otherwise made provision for such liabilities.

- (4) For a transition period not to exceed nine (9) months, in the case of an insurer that does not qualify under either paragraph one (1), two (2) or three (3) of this subsection or does not file a plan of operation pursuant to paragraph one (1) or two (2) of this subsection, such insurer shall cease writing any new financial guaranty insurance business and may:
  - (a) Reinsure its net in force business with a licensed financial guaranty insurance corporation; or
  - (b) Subject to the prior approval of its domiciliary commissioner, reinsure all or part of its net in force business in accordance with the requirements of Paragraph Two (2) of Subsection (A) of Section Six of this article, except that Subparagraphs (d), (e) and (f) of Paragraph Two (2) of such subsection shall not be applicable. The assuming insurer shall maintain reserves of such reinsured business in the manner applicable to the ceding insurer under this paragraph; or
  - (c) Thereafter continue the risks then in force and, with thirty (30) days prior written notice to its domiciliary commissioner, issue new financial guaranty policies, provided that the issuing of such policies is reasonably prudent to mitigate either the amount of or possibility of loss in connection with business transacted prior to the effective date of this article. However, an insurer must receive the prior approval of its domiciliary commissioner before issuing any new financial guaranty insurance policies that would have the effect of increasing its risk of loss.
- B. Shall, for all guarantees in force prior to the effective date of this article, including those which fall under the definition of financial guaranty insurance contained in Subsection (A) of Section One of this article, be subject to the reserve requirements in Section 3 (III) of this article. To the extent that the insurer's contingency reserves maintained as of the effective date of this article are less than those required by Section 3 (III) of this article, the insurer shall have three (3) years to bring its reserves into compliance, except that a part of the reserve may be released proportional to the reduction in aggregate net liability resulting from reinsurance, provided that the reinsurer shall, on the effective date of the reinsurance, establish a reserve in an amount equal to the amount released and, in addition, a part of the reserve may be released with the approval of the commissioner upon demonstration that the amount carried is excessive in relation to the corporation's outstanding obligations; and
- C. Shall be subject to the reserve requirements specified in Section Three of this article for all policies of financial guaranty insurance issued on or after the effective date of this article.

**Drafting Note:** This section contains transitional provisions for those states currently without a financial guaranty insurance statute and with licensed multiline insurers currently writing financial guaranty insurance. The transition provisions permit such insurers to continue to write financial insurance for the specified time period, subject to certain conditions, while the insurer determines whether to form a monoline financial guaranty insurer to continue writing business after expiration of the transition period.

**Section 8. Applicability of Other Laws**

An insurer issuing policies of financial guaranty insurance shall be subject to all of the provisions of this chapter applicable to property and casualty insurers to the extent that such provisions are not inconsistent with the provisions of this article.

**Section 9. Relationship to Security Fund**

No insurer or agent of an insurer may deliver a policy of financial guaranty insurance unless such policy and any prospectus delivered on or after the effective date of this article with respect to the insured obligations clearly discloses that the policy is not covered by the [property and casualty insurance security fund or guaranty association] specified in Article [insert article].

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*Chronological Summary of Actions (all references are to the Proceedings of the NAIC)*

*2007 Proc. 4<sup>th</sup> Quarter, Vol. I 116, 137, 143, 190-194 (adopted).*



## FINANCIAL GUARANTY INSURANCE GUIDELINE

**This chart is intended to provide readers with additional information to more easily access state statutes, regulations, bulletins or administrative rulings related to the NAIC model. Such guidance provides readers with a starting point from which they may review how each state has addressed the model and the topic being covered. The NAIC Legal Division has reviewed each state's activity in this area and has determined whether the citation most appropriately fits in the Model Adoption column or Related State Activity column based on the definitions listed below. The NAIC's interpretation may or may not be shared by the individual states or by interested readers.**

**This chart does not constitute a formal legal opinion by the NAIC staff on the provisions of state law and should not be relied upon as such. Nor does this state page reflect a determination as to whether a state meets any applicable accreditation standards. Every effort has been made to provide correct and accurate summaries to assist readers in locating useful information. Readers should consult state law for further details and for the most current information.**

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**FINANCIAL GUARANTY INSURANCE GUIDELINE**

<b>NAIC MEMBER</b>	<b>RELATED STATE ACTIVITY</b>
Alabama	NO CURRENT ACTIVITY
Alaska	Order No. 90-2 (1990).
American Samoa	NO CURRENT ACTIVITY
Arizona	NO CURRENT ACTIVITY
Arkansas	NO CURRENT ACTIVITY
California	CAL. INS. CODE §§ 12100 to 12122 (1991/2006).
Colorado	NO CURRENT ACTIVITY
Connecticut	CONN. GEN. STAT. §§ 38a-92a to 38a-92n (1993/2014).
Delaware	NO CURRENT ACTIVITY
District of Columbia	NO CURRENT ACTIVITY
Florida	FLA. STAT. §§ 627.971 to 627.975 (1988).
Georgia	NO CURRENT ACTIVITY
Guam	NO CURRENT ACTIVITY
Hawaii	NO CURRENT ACTIVITY
Idaho	NO CURRENT ACTIVITY
Illinois	ILL. ADMIN. CODE tit. 50, §§ 205.10 to 205.90 (1987) (Municipal bond insurance).
Indiana	NO CURRENT ACTIVITY
Iowa	IOWA ADMIN. CODE r. 191-22.1 to 191.22.2 (1987).
Kansas	NO CURRENT ACTIVITY

**FINANCIAL GUARANTY INSURANCE GUIDELINE**

<b>NAIC MEMBER</b>	<b>RELATED STATE ACTIVITY</b>
Kentucky	NO CURRENT ACTIVITY
Louisiana	NO CURRENT ACTIVITY
Maine	NO CURRENT ACTIVITY
Maryland	MD. CODE REGS. 5.1005 (1999) (Authority to set risk limitations for financial guaranty insurance by regulation); 31.05.10.01 to 31.05.10.08 (2003/2006).
Massachusetts	NO CURRENT ACTIVITY
Michigan	NO CURRENT ACTIVITY
Minnesota	NO CURRENT ACTIVITY
Mississippi	NO CURRENT ACTIVITY
Missouri	NO CURRENT ACTIVITY
Montana	NO CURRENT ACTIVITY
Nebraska	NO CURRENT ACTIVITY
Nevada	NO CURRENT ACTIVITY
New Hampshire	NO CURRENT ACTIVITY
New Jersey	N.J. ADMIN. CODE §§ 11:7-1.1 to 11:7-1.5 (1975/2003) (Municipal bonds only).
New Mexico	NO CURRENT ACTIVITY
New York	N.Y. INS. LAW §§ 6901 to 6909 (1989/2004); N.Y. COMP. CODES R. & REGS. tit. 11, §§ 63.0 to 63.5 (Regulation 61) (1980/1997) (Municipal bonds only); Circular Letter No. 12 (1989).
North Carolina	NO CURRENT ACTIVITY
North Dakota	NO CURRENT ACTIVITY
Northern Marianas	NO CURRENT ACTIVITY
Ohio	NO CURRENT ACTIVITY

**FINANCIAL GUARANTY INSURANCE GUIDELINE**

<b>NAIC MEMBER</b>	<b>RELATED STATE ACTIVITY</b>
Oklahoma	NO CURRENT ACTIVITY
Oregon	NO CURRENT ACTIVITY
Pennsylvania	NO CURRENT ACTIVITY
Puerto Rico	NO CURRENT ACTIVITY
Rhode Island	NO CURRENT ACTIVITY
South Carolina	NO CURRENT ACTIVITY
South Dakota	NO CURRENT ACTIVITY
Tennessee	NO CURRENT ACTIVITY
Texas	NO CURRENT ACTIVITY
Utah	NO CURRENT ACTIVITY
Vermont	NO CURRENT ACTIVITY
Virgin Islands	NO CURRENT ACTIVITY
Virginia	NO CURRENT ACTIVITY
Washington	NO CURRENT ACTIVITY
West Virginia	NO CURRENT ACTIVITY
Wisconsin	Wis. ADMIN. CODE INS. § 3.08 (1984/1986) (Municipal bonds only).
Wyoming	NO CURRENT ACTIVITY

**FINANCIAL GUARANTY INSURANCE GUIDELINE**

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