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INSURANCE DEPARTMENT
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Eliot Spitzer
Governor

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February 4, 2008

The Honorable Paul E. Kanjorski
Member of Congress
Chairman of the Subcommittee on Capital Markets,
Insurance and Government Sponsored Entities
2188 Rayburn House Office Building
Washington DC 20515-3811

Dear Chairman Kanjorski:

I appreciate the opportunity to respond to your January 23, 2008 letter and provide you with information to assist the Subcommittee on Capital Markets, Insurance and Government Sponsored Entities ("Subcommittee") in its examination of the challenges currently confronting the bond insurance industry.

New York is the primary regulator for many financial guaranty insurance companies ("FGIs"), which, as you are aware, are regulated by states under their respective insurance laws. While these laws have their differences, the regulatory oversight of the financial guaranty industry is generally consistent among the states. I note that you have sent similar requests for information to Maryland and Wisconsin (the two other states that serve as the domestic regulator for FGIs), and to the National Association of Insurance Commissioners ("NAIC").

Before addressing your requests for information, I offer a few general points.

- This letter endeavors to complement, but not repeat, the information set forth in the submissions from the New York State Insurance Department's counterparts in Maryland and Wisconsin.

- As a regulator, the New York Department's primary interest is to protect policyholders that have insurance contracts with FGIs. There are two primary groups of policyholders: municipalities and other entities that have issued debt (and, by extension, the holders of those instruments); and the banks and securities firms ("counterparties") that have purchased insurance on mortgage-backed and other asset-backed securities. Attached is a chart showing the relative amounts of the types of credits insured by the FGIs. Clearly municipal securities remain the bulk of the FGIs outstanding insurance.

- The New York Department also aims to ensure that all consumers – individuals, businesses, and governments – have access to financial guaranty insurance in a financially healthy and competitive insurance marketplace.

- The Department has for several months been working to implement the following tripartite plan to address the serious problems that the bond insurance industry faces:

    1. <u>Bring in new players and help current companies obtain additional capital.</u> To ensure that state and local governments can continue to find bond insurance necessary to keep down the cost of debt issuances and increase the attractiveness to investors of such offerings, the Department in November not only initiated a discussion with Berkshire Hathaway to open a new bond insurance company in New York, but then licensed the company in record time. The Department is also talking to others interested in entering this market, and has worked with the NAIC to encourage other states to license Berkshire Hathaway quickly and ensure additional capacity for the market. Moreover, the Department approved in record time a capital-raising plan by MBIA. This plan has helped to shore up the company's financial condition and has supplied more capital to support policies.

    2. <u>Protect policyholders by seeking broad solutions to the problems in the bond insurance market.</u> We are working with stakeholders -- bond insurance companies, banks, financial advisors, rating agencies and other government officials -- to develop solutions aimed at strengthening the financial condition of individual companies and the industry.

    3. <u>Develop new rules and regulations for the financial guaranty business.</u> The Department recognizes the need to revisit the current regulatory and statutory framework that governs the operations of FGIs. The United States is the world leader in financial services in no small measure because of its creativity and innovation. We should continue to foster creativity, while ensuring that companies engage in prudent risk-taking. We look forward to discussing these issues with industry, fellow regulators, and members of Congress.

The New York State Insurance Department is actively working to protect policyholders by encouraging FGIs to work with both potential investors and the counterparties holding policies on mortgage-backed securities to develop voluntary and mutually beneficial commercial arrangements designed to preserve the financial strength of the FGIs. Issues of confidentiality and competitive sensitivity preclude us from fully disclosing the details of these voluntary efforts at this time.

I answer each of your requests for information in the order presented in your letter.

I. Describe how bond insurers are regulated, especially with regard to solvency and capital requirements and how such regulation differs from other lines of insurance.

A. Financial Guaranty Insurers Identified

The New York Insurance Law ("Insurance Law") uses the word "domestic" to describe companies incorporated under New York law and primarily regulated by New York. The term "foreign" describes companies, including U.S. companies, incorporated in and primarily regulated by another state. There are currently eight domestic and six foreign FGIs authorized to do financial guaranty business in New York. Ten holding companies own the fourteen FGIs. Most of these companies are licensed to sell insurance in all fifty states, and have large offices in New York.

The authorized FGIs, the year in which each was first authorized to do business in New York, and their parent or controlling holding companies, are as follows:

DOMESTIC
1. Berkshire Hathaway Assurance Co. (2007) – Parent: Berkshire Hathaway, Inc.
2. Capital Markets Assurance Corp. (1938) – Parent: MBIA Inc.
3. CIFG Assurance North America, Inc. (formerly known as CDC IXIS Financial Guaranty North America, Inc. (2002) – Parent: CDC IXIS Financial Services, Inc.
4. Financial Guaranty Insurance Co. (1972) – Parent: The PMI Group
5. Financial Security Assurance Inc. (1985) – Parent: Dexia (France)
6. MBIA Insurance Corporation (1986) – Parent: MBIA Inc.
7. Radian Asset Assurance Company (1986) – Parent: Radian Group
8. XL Capital Assurance, Inc. (1999) – Parent: XL Capital Ltd. (through Security Capital Assurance Ltd.)

FOREIGN
1. Assured Guaranty Corporation (1992**,** MD) – Parent: ACE Ltd.
2. AMBAC Assurance Corp. (1985, WI) – Parent: AMBAC Financial Group Inc.
3. Connie Lee Insurance Co. (1982, WI) – Parent: AMBAC Financial Group Inc.
4. ACA Financial Guaranty Corp. (1987, MD) – Parent: ACA Capital Holdings, Inc.
5. MBIA Insurance Company of Illinois (1985, IL) – Parent: MBIA Inc.
6. FSA Insurance Company (1998, OK) – Parent: Dexia (France)

B. Requirements Applicable to All Property/Casualty Insurers, including Financial Guaranty Insurers

The regulation of FGIs in New York is governed by Article 69 of the Insurance Law, which pertains exclusively to FGIs, and by Article 41, to the extent that its provisions applicable to all property/casualty insurance companies do not conflict with the more FGI-specific rules set forth in Article 69. Copies of Article 15, 41 and 69 are attached hereto.

As part of the Department's regulation and review of property/casualty insurers (including FGIs), each insurer submits annual and quarterly financial statements to the Department, which include balance sheets, income statements, cash flow exhibits, income and expense exhibits, and various schedules setting forth items such as real estate owned, mortgage investments, investments in stocks and bonds, reinsurance, and loss reserves. The Insurance Law requires that financial statements rely on statutory, as opposed to generally-accepted accounting principles (GAAP), accounting conventions.

When the annual/quarterly statements are filed, the Department:

1. Verifies that the appropriate amount of capital is invested in high quality assets as required by law (see Ins. Law § 1402);

2. Confirms receipt of all required submissions, including management's view of the operations of the company, actuarial opinions affirming that the reserves for already incurred losses are adequate, and audited financial statements signed by a certified public accountant (see Ins. Law §§ 307 and 4117, plus the annual statement prescribed by the NAIC);

3. Examines capital changes resulting from operations; and

4. Verifies that the company maintains the statutory minimum capital necessary for the protection of its policyholders (see Ins. Law § 4103, 6902).

Further, the Department conducts periodic on-site examinations of all domestic insurers, including property/casualty insurers and FGIs, on a three- to five-year cycle.

Pursuant to Article 15 of the Insurance Law (a copy of which is attached hereto), all transactions between a domestic insurer and any entity in its holding company system must be "fair and equitable." Article 15 is designed to protect against the invasion of the insurance company's capital by its parent or other member of its holding company group. Moreover, Article 15 mandates that certain transactions not related to holding companies be submitted to the Superintendent for prior review and approval. Further, Article 15 requires the insurer to submit an annual registration statement disclosing information concerning the operations of "persons" within the holding company system (including partnerships, firms, associations, or corporations) that may materially affect the operations, management, or financial condition of the insurer.

Because its fundamental goal is to protect policyholders, the Department regulates to ensure solvency (i.e., the ability of the insurer to pay policyholder claims as they are made). The Department measures solvency of the insurer on a statutory accounting basis, and does not regulate to ensure a specific rating by credit rating agencies. Indeed, few insurance companies outside of the FGI market maintain AAA financial strength ratings. Of the 805 insurers that are rated for insurance financial strength, fewer than 30 are AAA, including most FGIs. The FGI business model, however, generally requires FGIs to maintain an AAA rating in order to sell their products widely.

C. Article 69 Requirements Specific to Financial Guaranty Insurers

Article 69 of the Insurance Law sets forth a series of special requirements intended to safeguard the financial solvency of FGIs authorized to do business in New York:

- Minimum Capital - The minimum initial capital/surplus requirement for a financial guaranty insurer is $75 million, and at all times the financial guaranty insurer must maintain a policyholders' surplus of at least $65 million. (See Ins. Law § 6902(b).)

- Contingency Reserves - In addition to the minimum surplus to policyholders, a financial guaranty insurer is required to maintain a contingency reserve. This reserve is based upon the greater of 50% of premiums written for each category of security guaranteed or a sum arrived at by multiplying specific factors by the principal amount being guaranteed for each class of security. The amounts are based upon the both the principal guaranteed and the relative risk of the type of bond, with municipal bonds receiving the lowest factor and non-investment grade securities receiving the highest. (See Ins. Law § 6903(a).)

- Aggregate Risk Limitations – A financial guaranty insurer has limitations on the amount and type of securities that it may insure, based upon its surplus to policyholders and contingency reserves. (See Ins. Law § 6904(c).)

- Single Risk Limitations - Exposure on any one risk is limited, net of collateral and reinsurance, to, at most percentage of the aggregate of the insurer's surplus to policyholders and contingency reserves. (See Ins. Law § 6904(d).)

- Limitation on Non-Investment Grade Securities - At least 95% of the municipal obligation bonds, special revenue bonds and industrial development bonds insured by a financial guaranty insurer must be investment grade. (See Ins. Law § 6904(b)(2).)

- Limitation on Investments in Securities Insured - A financial guaranty insurer's investment in any one entity insured by that corporation cannot exceed 4% of its assets. (See Ins. Law § 6902(a)(4).)

- Limitations on Reinsurance – The law imposes limitations on the amount of business that an FGI can cede under a reinsurance agreement, unless the reinsurer is another licensed financial guaranty insurer. (See Ins. Law § 6906.)

D. Credit Default Swaps and Transformers

To understand the current state of the bond insurance industry, one must understand credit default swaps. A credit default swap ("CDS"), a type of a credit "derivative," is a transfer of credit risk on a specific obligation from one counterparty to another. The buyer of a credit default swap receives credit protection against the occurrence of a specific risk (generally, a default of an underlying obligation), while the seller of the swap, in exchange for periodic premium payments, guarantees the payments under the terms of the obligation. Because under this arrangement the risk of default is transferred from the holder of the security to the seller of the swap in exchange for a premium, CDSs are often regarded as similar or equivalent to insurance.

The Insurance Law generally prohibits insurance companies from engaging in derivatives transactions, except for purposes of hedging under a Department-approved Derivatives Use Plan. (See Ins. Law § 1410.) In the late 1990s, FGIs approached the Department and requested permission to use credit default swap forms in place of bond insurance forms. While the Department refused to permit insurers to directly write credit default swaps with counterparties, the Department allowed the insurers to issue insurance policies that guaranteed swaps written by non-subsidiary affiliates (also known as a "special purpose vehicle", "SPV," or "transformer"). This structure is commonly referred to as "back-to-back" insurance. FGIs wanted to offer credit default swaps because their investment bank customers, for accounting reasons, preferred them to bond insurance.

The Department determined that, as a practical matter, there was little difference between the risks undertaken by insuring a credit default swap and issuing direct bond insurance, since in both cases the FGI was committing to make a stream of payments in the event of a default.

In 2004, the New York State Legislature codified the Department's decision by revising Article 69 of the Insurance Law to:

- Amend the definition of "asset-backed securities" set forth in Insurance Law § 6901(e) to include CDSs referencing a pool of obligations and pools of CDSs;
- Add a definition of "credit default swap" in Insurance Law § 6901(j-1);
- Amend Insurance Law § 6902(a)(5) to expressly authorize FGIs to engage in CDS transactions; and
- Amend Insurance Law § 6905(a) to expressly provide that FGI policies can insure payments required pursuant to CDSs.

II. Outline the problems you presently perceive facing the bond insurance industry.

A. *Stress from subprime loans*

The main difficulty that FGIs face arises from guaranties provided to back securities collateralized by residential real estate loans. In particular, loans made to "sub-prime" borrowers and home equity borrowers have suffered significant defaults and foreclosures. Many sub-prime borrowers appear to have been steered into loans that they could ill afford in the long term. As residential real estate values have declined in large parts of the U.S., distressed borrowers have been unable to accumulate equity, and cannot refinance into more affordable loans. These conditions have generated historically high levels of defaults on mortgages, which in turn have led to losses in the underlying securities that are backed by these loans. Generally, the bond insurers only insured the higher levels, or tranches, of the securitized pools of mortgages and to date there have been very few actual claims made against insurers.

However, the three major credit rating agencies, Standard & Poors, Moody's, and Fitch, have substantially lowered the ratings on many of the individual mortgage-backed securities and many observers believe that there will be significant losses on mortgage-backed securities in the future. This has had an immediate effect on the capital needs of the FGIs. When a security insured by an FGI drops in rating, the FGI must increase the capital that it holds to back its guarantee of that security.

Although the three rating agencies that review the FGIs employ different assumptions and methodologies, the general rule is that an FGI must have on hand adequate capital to pay all future losses under highly stressful market circumstances. As the debt pools and structures upon which they are built are downgraded, the level of capital required under the ratings agencies' stress scenarios increases. In recent months, many of the FGIs have been required to increase their capital in order to maintain their AAA ratings from the ratings agencies.

Given the current conditions in the financial markets, it has been challenging for the FGIs to raise this additional capital.

B. *Structured security complexity and lack of transparency*

There remains considerable uncertainty about the future condition of the real estate market and the economy as a whole. This market risk has been compounded by the complexity of the structured securities that the FGIs insured, particularly collateralized debt obligations ("CDOs"). These highly structured securities are backed by portfolios of of other loan-backed securities**.** A CDO is divided into tiers, or "tranches." The highest tranches have the most security (i.e., they are paid first from proceeds of the underlying mortgages), the lowest risk of default, and are rated AAA. These tranches also pay the lowest interest rates. While the FGIs only insure the higher tranches, the CDOs' underlying asset-backed securities may have much lower ratings.

The lower tranches have the most risk, and receive a higher return as compensation. However, because the middle and lower tranches were harder to sell, underwriters developed a novel method to market them. The underwriters took the lower rated tranches from many CDOs (the "inner CDO") and put them together into another structured security called a "CDO-squared." The theory was that if the underlying mortgages were spread around the country, there was little risk that all of them would default at once. The CDO-squared was also tranched, with the higher tranches having in theory less risk because they receive payment from the underlying CDOs ahead of lower tranches. And again, the FGIs only insured the higher tranches, which were theoretically less risky because the lower tiers would absorb the first losses. Nonetheless, each successively structuring has often exposed the insurer to lower quality collateral.

After this restructuring, the risk of default on the insured obligation may not be determined solely by the underlying loan defaults, but also by the actions of other holders of related securities. Although the CDO-squared holds lower-rated tranches of other CDOs, the insurer is unable to control the management of the inner CDO. If the inner CDO collateral deteriorates, the holders of the senior tranches of the inner CDO can liquidate the underlying collateral in order to ensure that they are repaid before any further deterioration. This could lead to immediate losses to the inner CDO's lower-rated securities that comprise the CDO-squared. These liquidations can speed up default in the CDO-squared, and trigger payments by the insurer.

The complexity of these transactions has made it difficult to assess the adequacy of the capital of the FGIs, and led to an erosion of confidence by many market participants.

C. *<u>Turmoil affecting pricing of municipal bond issues</u>*

Traditionally, FGIs did not insure the sort of structured finance products described in the preceding section. Rather, FGIs provided insurance, or "wraps," for the debt offerings of municipalities, states, or other public entities. This "muni bond" market has been largely unaffected by recent sub-prime turmoil. But since municipalities are highly credit-worthy without insurance, an FGI's participation in the muni bond market depends upon its ability to offer value to issuers through its AAA credit rating.

For example, in the absence of insurance, a municipal bond offering carrying an AA rating (its "shadow" rating) might have to offer a 5% return at issue. With a guaranty from an AAA-rated FGI, the issue would be treated by buyers as an AAA issue, despite its shadow rating, and might be priced to produce a 4.75% return. If the FGI's guaranty's annual cost to the issuer were 10 basis points (0.10%), the issuer would still benefit by paying a total interest rate of 4.85% instead of 5%. The resulting "wrapped" security would be more marketable to risk-averse buyers and fosters liquidity, as potential buyers do not need to assess the creditworthiness of the individual municipal bond issuer (of which there are hundreds, if not thousands). The benefit of the insurance disappears if the FGI's credit rating is reduced to a level closer to the underlying debt's shadow rating.

III. <u>Examine the implications of these problems for the entities and products that you regulate, as well as the broader economy.</u>

A. *<u>Downgrades of the FGIs</u>*

The fortunes of FGIs appear to be closely linked to the prevailing sense of uncertainty about the U.S. residential housing market. The investing community's lack of confidence in FGIs is caused in part by an inability to independently determine the true ratings of thousands of guaranteed securities and CDS', and compounded by the market's inability or refusal to distinguish between possible downgrade and insolvency. A move from AAA to AA still leaves a highly solvent, financially strong FGI, particularly when compared to the vast majority of other regulated insurers. But these concerns have nevertheless combined erode market confidence in the sector.

B. *Difficulty in Raising Capital*

As noted above, an FGI relies on an AAA rating to continue to write significant new business. Because the ratings of the collateral underlying the securities FGIs insure have declined, most FGIs need more capital to maintain their AAA ratings. With the market uncertainty about the ultimate losses in structured securities backed by the residential real estate mortgages, and in light of the dramatic drop in the value of shares of publicly-traded FGIs, the FGIs face a difficult market for new capital. For example, MBIA issued a surplus note on January 16, 2008, at a 14% yield. That is an unusually high interest rate for a company with an AAA rating. A few days later, the notes' secondary market price declined to the point where the implied yield rose to 20%.

C. *Increased Costs of Municipal Financing*

Downgrades of the FGIs could have a substantial impact on issuers of municipal bonds. Municipalities may find it more difficult or more expensive to secure financial guaranty insurance if the number of AAA-rated FGIs diminishes. For the last decade there have been a number of highly-rated, aggressive competitors for the municipal bond insurance business. If the industry consolidates significantly, the price of financial guaranty insurance is likely to increase. If municipalities forego insurance and the accompanying AAA rating, issuers may have to pay more to borrow, both because a lower rating means a higher interest rate, and because fewer buyers will be willing to bid up the price of the bonds.

The possible consequences do not end there. Investors currently holding municipal securities may have to write down the value of securities or realize a loss on a sale prior to maturity. This could reduce their willingness to invest in new issues of municipal bonds, thereby making it more difficult for governments to raise money. Banks and other financial service institutions holding these securities may have to hold extra capital to support downgraded securities, which could cause them to tighten their lending standards. Mutual funds and other institutions restricted to owning only AAA-rated securities may be forced to quickly sell securities (including municipal securities) if the rating of the guarantor of those securities drops below AAA. This will further depress prices.

D. *Implications for the Economy*

Banks and other financial service institutions are required by tax and accounting rules to mark the value of their holdings to the market's perceived value. These "mark-to-market" write-downs, as well as downgrades of FGIs, have implications for the broader economy. Structured finance has served in recent years as a major source of financing for mortgages, auto financing, and other forms of consumer credit. Limitations on the ability of FGIs to wrap these securities can lead to constriction in the lending marketplace. If these securities are downgraded and banks increase the reserves against them, they will have less capital to support lending to businesses and individuals. Moreover, if state and local governments reduce borrowing for capital projects, crucial infrastructure development may be delayed or deferred. In sum, reduced credit availability could have serious damaging effects at a time when the economy is already perceived to be weakening.

IV. Detail the steps you are taking to monitor developments in the bond insurance marketplace and protect the solvency of insurers.

For the last several months, the Department has been working intensively on a three-point plan aimed at bringing stability to the bond insurance market:

1. Attract more capital and increase capacity to protect policyholders and ensure continued availability of bond insurance, especially for municipal issuers. Specifically, the Department worked with Berkshire Hathaway to open a new bond insurance company in New York, by expediting the licensing of the new, financially strong carrier to the market. The Department is engaged in discussions with other possible market entrants, and has moved quickly to facilitate plans geared towards infusing FGIs with additional capital.

2. Protect policyholders and find broad solutions to the problems in the bond insurance market.. The Department has daily discussions with insurers, banks, financial advisors, credit rating agencies, other regulators and government officials in an effort to examine and develop measures to help stabilize the market and protect policyholders and investors, especially holders of municipal securities.

3. Develop new rules and regulations for bond insurance. The Department will develop new "rules for the road' with regard to the regulation and oversight of financial guaranty insurers. The Department already has begun to work with interested parties and stakeholders in considering revisions to standards governing bond insurers currently set forth in current statutes and regulations.

The Department has retained the investment banking firm of Perella Weinberg Partners LLP as financial advisor to help analyze options to stabilize the financial guaranty insurance marketplace. The Department expects to retain an outside legal advisor as well.

At the Department's request, FGIs have provided detailed information about their credit exposures, including mark-to-market information that may affect their counterparties. The Department has convened numerous meetings among stakeholder participants as it endeavors to search for solutions to improve the financial position of FGIs and reduce risk to policyholders

V. Discuss the adequacy of existing statutory and regulatory tools, at the State or Federal level, to address these problems and the need for further reforms.

The fundamental problems afflicting the sub-prime mortgage market are beyond the scope of insurance regulation. Clearly, there is a need for reform in the origination and underwriting of mortgages, as well as increased transparency and risk controls for all securitized debt issues. While we believe that the ratings agencies play a useful role in helping capital markets manage risk, their role in the regulation of FGIs should be critically reviewed going forward.

The Department has just begun to study how to improve regulation of the financial guaranty industry. At present, we have directed our focus on efforts aimed at protecting policyholders and stabilizing the capital position of the market. However, we can offer some broad comments now, with the understanding that we expect to develop more specific proposals soon.

The primary goal of insurance regulation with respect to financial oversight is to ensure that the insurer maintains an adequate level of capital to ensure solvency and honor policyholders' claims. The business model for most FGIs, however, requires that they hold levels of capital that will allow them to maintain the AAA rating necessary to write new business. But financial guaranty insurance is a complicated business, based largely on modeling and underwriting of complex capital market instruments. Rather than relying entirely on the ratings agencies to assess the FGIs ability to continue to write new business, regulators may need to engage in an independent analysis of the risk positions of FGIs. While this would require more and increasingly sophisticated resources, the Department is prepared to make that commitment.

To better protect the financial strength of FGIs, it may be advisable to restrict their activities around risks that may be too volatile or lacking in transparency to evaluate accurately. For example, the Department intends to examine closely whether guaranties of the CDO-squared transactions should be permitted under any circumstances.

VI. Comment on the advisability of creating a guarantee fund, like those State funds for life and health insurers and property and casualty insurers, for the bond insurance industry.

There are a number of drawbacks to creating a guarantee fund for FGIs. Although guarantee funds for life/health insurers and property/casualty insurers spread the risk and cost of insolvency over hundreds of insurers, that type of risk-spreading is not feasible for the financial guarantee marketplace, which is dominated by a small number of insurers. Furthermore, state guarantee funds for conventional lines of insurance limit the amount that can be claimed by any one person, depending on the nature of the underlying contract. A similar limitation for beneficiaries of FGI policies would offer little real protection, but to increase guarantee fund coverage to meaningful levels could make bond insurance considerably more expensive. And it certainly would not be reasonable or fair to ask the municipal issuer clients of bonds insurers to pay for a guarantee fund that would likely pay claims only related to the structured finance side of the business.

Further, a guarantee fund presents the potential for moral hazard that, in turn, could lead to lower underwriting standards. When counterparties to CDO contracts entered into the arrangements, the parties considered themselves to be sophisticated and knowledgeable, with the ability to evaluate the risks associated with even the most complex instruments. It appears however that the due diligence was not sufficient to prevent the current market upheaval. Spreading the economic consequences of defaults to the remaining industry participants through a guarantee fund could invite future irresponsibility.

Nonetheless, it may be helpful to create a short-term backstop that would share some structural features with a guarantee fund in order to help ease immediate pressures felt by bond insurers. For instance, a line of credit funded by those parties with the most to lose from the deterioration of the FGIs would aid market stability in the event of further ratings agency downgrades.

However, we believe that a revision of the statutory and regulatory “rules of the road” will best minimize a repeat of the situation in which the FGIs currently find themselves, and is preferable to the establishment of a permanent guarantee fund.

VII. <u>In Closing</u>

We in New York are particularly sensitive to the importance of maintaining the United States’ position as the financial capital of the world. I strongly believe that we can foster creativity and innovation while maintaining the integrity and fairness of our markets through effective regulation. I know that you will join me in working toward that end.

Sincerely,

Eric R. Dinallo
Superintendent of Insurance

Attachments:
Article 15, New York Insurance Law
Article 41, New York Insurance Law
Article 69, New York Insurance Law

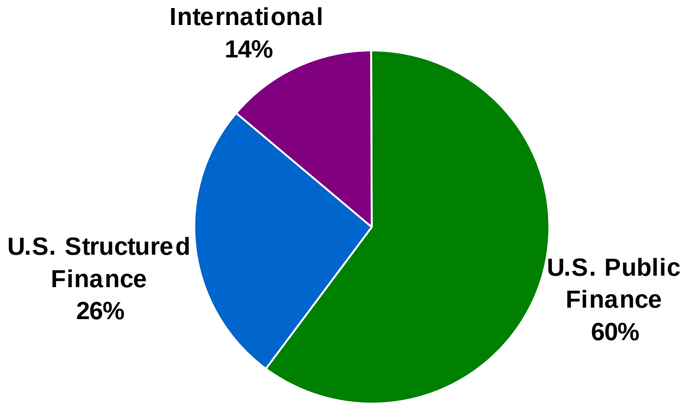
Types of Bonds Insured

All insured bonds are rated by rating agencies ("shadow rating")
- **Needs to be rated investment grade by at least one rating agency**

Public finance bonds:
- **Backed by tax and other municipal authority revenues**
- **Essential infrastructure (transportation, healthcare)**
- **Municipal and investor-owned utilities**

Structured finance bonds
- **Mortgage-backed (MBS and home equity)**
- **Asset-backed (consumer, franchise, future flows)**
- **Pooled debt obligations (CDO, CLO, CBO)**
- **Structured credit**

Net Par Outstanding
As of December 31, 2006



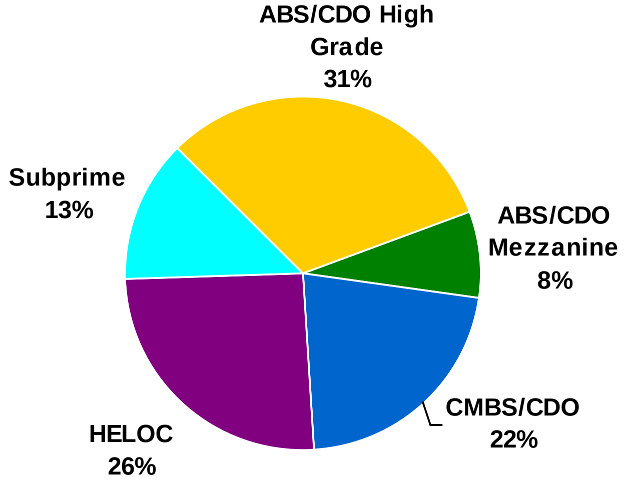
$2.2 trillion

Source: Association of Financial Guaranty Insurers

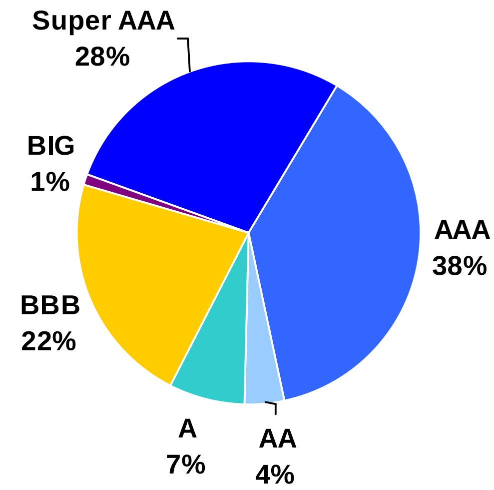
Bond Insurer Involvement in U.S. RMBS and CDOs of ABS

Industry Net Par Outstanding by Sector and Ratings Distribution

Sector Distribution



Underlying Ratings Distribution



$249 Billion
Net Par Outstanding

Source: Association of Financial Guaranty Insurers

ATTACHMENT