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A bill to be entitled
An act relating to insurance; creating s. 627.971, F.S., providing definitions; creating s. 627.972, F.S.; providing organizational and financial requirements for financial guaranty insurance corporations; creating s. 627.973, F.S.; providing limitations under which financial guaranty insurance corporations and certain property and casualty insurers may operate; creating s. 627.974, F.S.; requiring the filing of certain policy forms with the Department of Insurance; prohibiting excessive rates by financial guaranty insurance corporations; providing criteria for determining the adequacy of such rates; providing that certain filings shall be available for public inspection; creating s. 627.975, F.S.; providing that certain financial guaranty insurance corporations shall receive credit for certain reinsurance; creating s. 624.6081, F.S.; defining "residual value insurance"; amending s. 624.606, F.S.; redefining "surety insurance"; creating s. 624.6065, F.S.; defining "fidelity insurance"; amending s. 624.605, F.S.; limiting the definition of casualty insurance as it relates to certain credit insurance; providing for legislative review and repeal; providing an effective date.

Be It Enacted by the Legislature of the State of Florida:

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Section 1. Part XX of chapter 627, Florida Statutes, consisting of sections 627.971, 627.972, 627.973, 627.974 and 627.975, is created to read:

PART XX
FINANCIAL GUARANTRY INSURANCE

627.971 Definitions. — As used in this part:

(1)(a) "Financial guaranty insurance" means a surety bond, insurance policy, an indemnity contract issued by an insurer, or any similar guaranty, under which loss is payable upon proof of occurrence of financial loss to an insured claimant, obligee, or indemnitee as a result of:

1. The failure of an obligor on a debt instrument or other monetary obligation, including common or preferred stock guaranteed under a surety bond, insurance policy, or indemnity contract, to make principal, interest, premium, dividend, or purchase price payments when due, if the failure is the result of a financial default or insolvency, whether such obligation is incurred directly or as guarantor by or on behalf of another obligor who also defaulted;

2. Changes in the levels of interest rates or the differential in interest rates between various markets or products;

3. Changes in the rate of exchange of currency;

4. Changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general; or

5. Other events which the department determines are substantially similar to any of the foregoing.

(b) However, "financial guaranty insurance" shall not include:

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1. Insurance of a loss resulting from an event described in paragraph (a), 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:

   a. A fortuitous physical event;
   b. A failure of or deficiency in the operation of equipment;
   c. An inability to extract or recover a natural resource;

2. An individual or schedule public official bond;

3. A court bond required in connection with judicial, probate, bankruptcy, or equity proceedings, including a waiver, probate, open estate, or life tenant bond;

4. A bond running to a federal, state, county, municipal government, or other political subdivision, as a condition precedent to the granting of a license to engage in a particular business or of a permit to exercise a particular privilege;

5. A loss security bond or utility payment indemnity bond running to a governmental unit, railroad, or charitable organization;

6. A lease, purchase and sale, or concessionaire surety bond;

7. Credit unemployment 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;

8. Credit insurance indemnifying a manufacturer, merchant, or educational institution which extends credit against loss or damage resulting from nonpayment of debts owed...
to him for goods or services provided in the normal course of his business;

9. Guaranteed investment contracts that are issued by life insurance companies and that provide that the life insurer will make specified payments in exchange for specific premiums or contributions;

10. Mortgage guaranty insurance as defined in s. 635.0111(1) or s. 635.0211;

11. Indemnity contracts or similar guaranties, to the extent that they are not otherwise limited or proscribed by this chapter, in which a life insurer guarantees:

   a. Its obligations or indebtedness or the obligations or indebtedness of a subsidiary of which it owns more than 50 percent, other than a financial guaranty insurance corporation, if:

      (I) For any such obligations or indebtedness that are backed by specific assets, such assets are at all times owned by the insurer or the subsidiary; and

      (II) For the obligations or indebtedness of the subsidiary that are not backed by specific assets of the life insurer, the guaranty terminates once the subsidiary ceases to be a subsidiary; or

   b. The 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 subparagraph 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
c. The obligation or indebtedness of an employee or agent of the life insurer;

12. Any form of surety insurance as defined in s. 624.606; or

13. Any other form of insurance covering risks which the department determines to be substantially similar to any of the foregoing.

(2) "Affiliate" means a person that, directly or indirectly, owns at least 10 percent but less than 25 percent of the financial guaranty insurance corporation or that is at least 10 percent but less than 25 percent, directly or indirectly, owned by a financial guaranty insurance corporation.

(3) "Average annual debt service" means the amount of insured unpaid principal and interest on an obligation, multiplied by the number of the insured obligations, each representing a $1,000 par value, divided by an amount equal to the aggregate life of all the obligations. The formula for bonds is:

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

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

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

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

(4) "Collateral" means:

(a) Cash;
(b) The market value of investment grade securities, other than securities evidencing an interest in the projects financed with the proceeds of the insured obligations;

(c) The scheduled cash flow from investment grade obligations scheduled to be received on or prior to the date of scheduled debt service on the insured obligation;

(d) A conveyance or mortgage of real property; or

(e) A letter of credit;

if deposited with or held by the corporation; held in trust by a trustee, acceptable to the department, for the benefit of the corporation; or held in trust, pursuant to the bond indenture, by a trustee acceptable to the department, for the benefit of bondholders in the form of sinking funds or other reserves which may be used solely for the payment of debt service.

(5) "Contingency reserve" means an additional liability reserve established to protect policyholders against the effects of adverse economic cycles or other unforeseen circumstances.

(6) "Financial guaranty insurance corporation" means a stock insurer licensed to transact financial guaranty insurance business in this state.

(7) "Governmental unit" means a state, territory, or possession of the United States, 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.

(8) "Guaranties of consumer debt obligations" means insurance policies indemnifying against loss or damage resulting from nonpayment of debts owed to them for extensions.

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of credit to individuals for nonbusiness purposes. Policies that provide this coverage shall contain a provision that all liability terminates upon the sale or transfer of the underlying obligation to any transferee which is not an insured of the financial guaranty insurance corporation under a similar policy.

(9) "Industrial development bond" means any security, or other instrument 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 payable from the revenues of the project or by any private, for-profit entity.

(10) An obligation is "investment grade" if it has been determined to be in one of the top four generic lettered rating classifications by a securities rating agency acceptable to the department, if it has been identified in writing by such a rating agency as an insurable risk deemed to be of investment grade quality for purposes of insurance, if it has been submitted to such rating agency for review and would be so rated, or if it has been submitted and would be or has been determined to be investment grade as indicated by a "yes" rating by the Securities Valuation Office of the National Association of Insurance Commissioners.

(11) "Letter of credit" means the stated amount of a clean, unconditional, irrevocable letter of credit issued or confirmed by a bank or trust company that is:

(a)1. A member of the Federal Reserve System or chartered by a state of the United States; and

2. Whose debt rating applicable to the term of the insured obligation is in one of the two highest generic
lettered rating classifications by a securities rating agency acceptable to the department.

(b)1. Organized and existing under the laws of a foreign country whose sovereign debt is rated in the highest major rating classification by a securities rating agency acceptable to the department.

2. Has been licensed as a domestic branch or agency by the Federal Government or a state of the United States; and

3. Is part of an institution whose debt rating applicable to the term of the insured obligation is in one of the two highest generic lettered rating classifications by a securities rating agency acceptable to the department; or

(c) Determined by the Securities Valuation Office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of banks and trust companies whose letters of credit will be acceptable to insurance regulatory authorities; provided, that the letter of credit is issued for the full term of the insured obligation, or the insured obligation is subject to mandatory call and redemption to the extent of the amount of the letter of credit from the proceeds of the letter of credit if the letter of credit is not renewed or replaced.

12) "Municipal bonds" means municipal obligation bonds and industrial development bonds.

13) "Municipal obligation bond" means any security or other instrument, including a lease under which a payment obligation is created, other than an industrial development bond, which is issued by or on behalf of or payable or guaranteed by a governmental unit, including certificates of participation evidencing proportionate ownership in payments

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to be made by a governmental unit, or issued by an entity other than a governmental unit if such security or instrument is eligible for issuance by a governmental unit but would not be an industrial development bond if so issued.

(14) "Reinsurance" means cessions qualifying for credit under s. 627.975.

(15) "Total liability of an insurer transacting financial guaranty insurance" means the aggregate amount of the insured unpaid principal, interest, and other monetary payments, if any, of guaranteed obligations insured or assumed, less reinsurance and collateral. However, for guaranteed obligations insured or assumed where acceleration of payment of such obligation is at the sole option of the insurer, such total liability means the aggregate amount of the discounted present value of insured unpaid principal and unpaid interest up to the point of acceleration and other monetary payments, if any, of guaranteed obligations insured or assumed, less reinsurance and collateral. The discount rate to be applied shall be the average rate of return on the admitted assets of the insurer at the time of computation or the face rate of interest of the guaranteed obligation, whichever is less.

627.972 Organization; financial requirements.--

(1) A financial guaranty insurance corporation shall be organized and licensed in the manner prescribed in this code for stock property and casualty insurers except that:

(a) A corporation organized to transact financial guaranty insurance may, subject to the provisions of this code, be licensed to transact:

1. Residual value insurance, as defined by s. 624 60811.

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2. Surety insurance, as defined by s. 624.606; 
3. Credit insurance, as defined by s. 624.605(1)(1); 
and
4. Mortgage guaranty insurance, as defined by s. 635.011, provided that the provisions of chapter 635 are met.

(b)1. Prior to the issuance of a license, a corporation shall submit to the department for approval, a plan of operation detailing:

a. The types and projected diversification of guaranties to be issued;
b. The underwriting procedures to be followed;
c. The managerial oversight methods;
d. The investment policies; and 
e. Any other matters prescribed by the department
2. An insurer which is writing only the types of insurance allowed under this part on the effective date of this part, and otherwise meets the requirements of this part, is exempt from the requirements of this paragraph.

(c) An insurer transacting financial guaranty insurance is subject to all provisions of this code that are applicable to property and casualty insurers to the extent that those provisions are not inconsistent with this part.

(d) The investments of an insurer transacting financial guaranty insurance in any one entity insured by the corporation may not exceed 2 percent of its admitted assets as of the end of the prior calendar year.

(e) An insurer transacting financial guaranty insurance may only assume those lines of insurance for which it is licensed to write direct business.

(2) A financial guaranty insurance corporation may not transact business unless it has surplus to policyholders of at

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least $50 million at the date of initial licensing to do
financial guaranty insurance and maintains a minimum surplus
to policyholders of $35 million.

(3) An insurer may not transact financial guaranty
insurance unless it establishes a contingency reserve, net of
reinsurance, as follows:

(a) A contingency reserve, net of reinsurance, must be
established in a minimum amount calculated by applying the
following percentages to the net principal outstanding each
calendar year of guaranties of:

1. Municipal obligations bonds, 0.6 percent;
2. Investment grade obligations with a term of less
than 3 years, 0.5 percent;
3. All other investment grade obligations, including
investment grade industrial development bonds and investment
grade consumer debt obligations, 1.0 percent;
4. Noninvestment grade consumer debt obligations, 1.5
percent; and
5. All other obligations guaranteed, 2.0 percent;

(b) Quarterly additions to the reserve for
subparagraph (a)(1) must be equal to the greater of 1/80th of
the amounts derived by applying the appropriate contribution
specified in that subparagraph or 50 percent of the quarterly
earned premiums on these guaranties, and must be maintained
for a period of 20 years; and

2. Quarterly additions to the reserve for
subparagraphs (a)(2), (a)(3), and (a)(4) must be equal to the
greater of 1/40th of the amounts derived by applying the
appropriate contribution specified in that subparagraph or 50
percent of the quarterly earned premiums on these guaranties
and must be maintained for a period of 10 years, except that,

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for obligations with a term of less than 3 years, the reserve
must be maintained for a period of at least 5 years;

c) The reserve may be released thereafter in the same
manner, except that a part of the reserve may be released
proportional to the reduction in net total liabilities
resulting from reinsurance if the reinsurer establishes, on
the effective date of the reinsurance, a reserve in an amount
equal to the amount released; and

(d) Withdrawals from the contingency reserve, to the
extent of any excess, may be made with the approval of the
department from the earliest contributions to the reserve
remaining therein.

1. In any year in which the actual incurred losses
exceed 35 percent of earned premiums;
or

2. If the contingency reserve has been in existence
for 40 quarters for reserves subject to subparagraph (b)1.,
and 20 quarters for reserves subject to subparagraph (b)2.,
upon demonstration that the amount carried is excessive in
relation to the insurer's outstanding obligations.

(4) In addition to the contingency reserve, the case
basis method or other method prescribed by the department is
used to determine loss reserves, in a manner consistent with
the requirements of part I of chapter 625, which must include
a reserve for claims reported and unpaid net of collateral. 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 any such reserve. The
discount rate must be adjusted at the end of each calendar
year.

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(5) The insurer shall maintain an unearned premium reserve, net of reinsurance, computed on the monthly pro rata basis, where the premiums are paid on an installment basis. All other such premiums paid must be earned proportionately with the expiration of exposure or by such other method the department prescribes or approves.

627.973 Limitations.--

(1) Financial guaranty insurance shall be transacted in this state only by a corporation licensed for such purpose, except that a property and casualty insurer transacting business pursuant to the provisions of this code may transact financial guaranty insurance in this state if the following conditions are met:

(a) Total policyholders' surplus exceeds $100 million;
(b) Not more than 20 percent of total net premiums written are applicable to or for financial guaranty insurance;
(c) The provisions of this part are applied to the insurer's financial guaranty insurance business;
(d) Not more than 20 percent of the insurer's total policyholders' surplus is applied toward meeting the provisions of this part;
(e) The insurer's policyholders' surplus once utilized to meet the requirements of this part except for subsection (5) shall not be available for meeting any policyholders' surplus requirements for any other type of insurance;
(f) The insurer is licensed to write financial guaranty insurance; and
(g) Unless the insurer is writing financial guaranty insurance as of the effective date of this part and otherwise meets the requirements of this section, prior to the issuance of a license, the insurer must submit to the department for

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approval, a plan of operation complying with section 627.972(1)(b).

(2) Financial guaranty insurance shall be written only to insure obligations defined in s. 627.971(1)(a)1., except that obligations defined in s. 627.971(1)(a)2., 3., 4., and 5. may be written with the prior written approval of the department pursuant to limitations and restrictions promulgated by rule or order that the department deems appropriate and necessary to protect the policyholders of the insurer.

(3) At least 95 percent of a corporation’s outstanding total liability on municipal obligations shall be investment grade.

(4) An insurer transacting financial guaranty insurance must at all times maintain capital, surplus, and contingency reserves subject to the restrictions in paragraph (1)(d), if applicable, in the aggregate no less than the sum of:

(a) 0.333 percent of the total liabilities outstanding under guaranties of municipal obligation bonds.

(b) One percent of the total liabilities outstanding under guaranties of investment grade obligations, including industrial development bonds and investment grade consumer debt obligations.

(c) One and one-third percent of the total liabilities outstanding under guaranties of noninvestment grade consumer debt obligations.

(d) Two percent of the total liabilities outstanding under guaranties of other obligations not of investment grade, other than consumer debt obligations.

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(e) Surplus determined by the department to be adequate to support the writing of residual value insurance, surety insurance, and credit insurance, if the financial guaranty insurance corporation has elected to transact these kinds of insurance pursuant to s. 627.972(1).

(5) An insurer transacting financial guaranty insurance must limit its exposure to loss, net of collateral and reinsurance, as follows:

(a) For municipal bonds:

1. The insured average annual debt service with respect to any one entity and backed by a single revenue source may not exceed 10 percent of the aggregate of the corporation's capital, surplus, and contingency reserves subject to the restrictions of paragraph (1)(d), if applicable; and

2. The insured unpaid principal issued by a single entity and backed by a single revenue source may not exceed 75 percent of the aggregate of the corporation's capital, surplus, and contingency reserves subject to the restrictions of paragraph (1)(d), if applicable; and

(b) For all other financial guaranties, the insured unpaid principal for any one entity may not exceed 10 percent of the aggregate of the corporation's capital, surplus, and contingency reserves subject to the restrictions of paragraph (1)(d), if applicable. Single risk liability shall be defined with respect to any one issuer, except that, if the risk is payable from a specified revenue source or adequately secured by loan obligations or other assets, such risk shall be defined by the revenue source.

(6) If the exposure to loss of an insurer transacting financial guaranty insurance exceeds the limitations in
subsection (4), it may not transact any new business until its
exposure to loss no longer exceeds those limitations.

(7) An insurer which writes financial guaranty
insurance in this state, but which is not licensed to write
financial guaranty insurance in this state or does not meet
the requirements of subsection (1), is subject to this part,
except for s. 627.972(1) and (2), and:

(a) May continue to write financial guaranties
authorized by subsection (2) for not more than 2 years after
the effective date of this act, if within 6 months after such
date it applies to organize a financial guaranty insurance
corporation, controlled by or under common control with such
insurer, which financial guaranty insurance corporation, when
licensed, immediately assumes the insurer's in-force financial
guaranty insurance which was written on or after the effective
date of this act. If the insurer does not apply to organize a
financial guaranty insurance corporation, it shall cease
writing any new financial guaranty insurance business within 6
months after the effective date of this act. The insurer may:

1. Reinsure its net in-force business with a licensed
financial guaranty insurance corporation or an insurer exempt
under subsection (1);

2. Subject to the prior approval of its domiciliary
insurance commissioner, reinsure all or part of its net in-
force business pursuant to s. 627.975(1)(b), except that
subparagraphs 2., 4., and 5., do not apply. The assuming
insurer shall maintain reserves for the reinsured business in
the manner applicable to the ceding insurer under paragraph
(b); or

3. May continue the risks in force and, with 30 days
prior written notice to its domiciliary insurance

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commiss1oner, write new financial guaranty policies if the
writing of those policies is reasonably prudent to mitigate
either the amount of or possibility of loss in connection with
business written prior to the effective date of this act.
However, an insurer must receive the prior approval of its
domiciliary insurance commissioner before writing any new
financial guaranty insurance policies that would increase its
risk of loss.

(b) Shall, for all guaranties in force prior to the
effective date of the act, including those which fall under
the definition of financial guaranty insurance, maintain the
reserves applicable for general obligation municipal bond
guaranties in effect prior to the effective date of this act.
If the insurer's contingency reserves maintained as of the
effective date of this act are less than those required for
municipal bond guaranties, the insurer has 3 years to bring
its reserves into compliance, except that a part of the
reserve may be released proportional to the reduction in net
total liabilities resulting from reinsurance if the reinsurer,
on the effective date of the reinsurance, establishes a
reserve in an amount equal to the amount released, except that
a part of the reserve may be released with departmental
approval, upon demonstration that the amount carried is
excessive in relation to the corporation's outstanding
obligations.

(c) Shall be subject to the reserve requirements
applicable to financial guaranty insurance corporations for
business written on or after the effective date of the act.

This subsection shall not apply to insurers permitted to write
financial guaranty insurance pursuant to the exception set

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forth in subsection (1), and such insurers may write financial
guaranty insurance subject to the requirements of the Florida
Insurance Code.

627.974 Filing of policy forms and rates.--
(1) Policy forms and any amendments thereto shall be
filed with the department within 30 days after their use by
the insurer. No policy shall provide coverage of the
acceleration of payments due under the guaranteed obligations,
including any payment in advance of scheduled maturity to be
made by the issuer of the guaranteed obligations at the sole
option of the owner of the guaranteed obligations, unless the
acceleration is at the sole option of the insurer. Each
policy must disclose that the insurance provided by the policy
is not covered by the Florida Insurance Guaranty Association
created under part II of chapter 631. The department may
prescribe additional minimum policy provisions which are
determined by the department to be necessary or appropriate to
protect policyholders, claimants, obligees, or indemnities.

(2) Rates shall not be excessive, inadequate, unfairly
discriminatory, destructive of competition, or detrimental to
the solvency of the insurer.

(3) Criteria and guidelines used by insurers in
establishing rating categories and ranges of rates to be used
shall be filed with the department for information prior to
their use by the insurer.

(4) All such filings shall be available for public
inspection at the department.

(5) This section is in lieu of the requirements of ss.
627.062 and 627.410.

627.975 Reinsurance.--

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(1) For financial guaranty insurance which takes effect on or after the effective date of this act, an insurer transacting financial guaranty insurance shall receive credit for reinsurance in accordance with the provisions of this code applicable to property and casualty insurers, as an asset or as a reduction from liabilities, if the reinsurance is subject to an agreement that, for its stated term and with respect to any financial guaranty insurance in force, the reinsurance agreement may only be terminated or amended at the option of the reinsurer or of 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 continues until the expiration or cancellation of each such policy, with the consent of the ceding insurer, if the reinsurance agreement provides for a cutoff of the reinsurance in force at the date of termination; or at the request of the ceding company or at the discretion of the department, acting as rehabilitator, liquidator, or receiver of the ceding or assuming company and that such reinsurance:

(a) Is placed with another insurer licensed under this part or an insurer writing financial guaranty insurance as permitted under this part; or

(b) Is placed with another type of insurer licensed to write surety insurance, if such insurer:

1. Has and maintains surplus to policyholders of at least $35 million;

2. Establishes and maintains the reserves required in s. 627.972, for the ceded portion, except that if the reinsurance agreement is not pro rata, the contribution to the contingency reserve shall be equal to 50 percent of the quarterly earned reinsurance premium, and except that the

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reinsurer need not establish and maintain such reserve if the insurer transacting financial guaranty insurance establishes and maintains it:

3. Complies with s. 627.973(4) and (6);

4. Complies with s. 627.973(5); and

5. If it is a parent, subsidiary, or affiliate of the insurer transacting financial guaranty insurance, the provisions of s. 627.973(4) and (5) shall be applied against the combined policyholders' surplus and contingency reserves of such parent, subsidiary, or affiliate reinsurer after elimination of equity investments of the insurer and such reinsurer in each other; and

(c) Is placed with an unauthorized or unaccredited reinsurer which otherwise complies with the provisions of paragraph (a) or subparagraphs (b)1. and 5., in an amount not to exceed the liabilities carried by the ceding insurer for amounts withheld under a reinsurance treaty with the reinsurer 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.

(2) In determining whether the corporation meets the limitations imposed by s. 627.973(4), in addition to credit for other types of qualifying reinsurance, the insurer'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 2. Section 624.6081, Florida Statutes, is created to read:

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624.6081 "Residual value insurance" defined.--For the purposes of part XX of chapter 627, "residual value insurance" means insurance issued in connection with a lease or contract which sets forth a specific termination value at the end of the term of the lease or contract for the property covered by the lease or contract and which insures against loss of economic value of tangible personal property or real property or improvements thereto, except loss due to physical damage to property. However, insurance may not be written as residual value insurance if it may be written as financial guaranty insurance by a financial guaranty insurance corporation pursuant to part XX of chapter 627.

Section 3. Section 624.606, Florida Statutes, is amended to read:

(1) "Surety insurance" includes a contract bond, including a bid, payment, or maintenance bond, or a performance bond, which guarantees the execution of a contract other than a contract of indebtedness or other monetary obligation;

(a) Becoming surety on, or guaranteeing the performance of, any lawful contract where the bond is guaranteeing the execution of a contract other than a contract of indebtedness or other monetary obligation;

(b) An indemnity bond for the benefit of a public body, railroad, or charitable organization or a lost security or utility payment bond;

(c) Becoming surety on, or guaranteeing the performance of, bonds and undertakings required or permitted

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in a judicial proceeding or otherwise allowed by law, including surety bonds accepted by states and municipal authorities in lieu of deposits as security for the performance of insurance contracts;

(e) Fidelity insurance as defined in s. 624.6065 for the purposes of the Florida Insurance Code other than part XX of chapter 627; or

(f) Residual value insurance as defined in s. 624.6081.

(2) "Surety insurance" does not include:

(a) Mortgage guaranty insurance as defined in s. 635.011(1);

(b) Financial guaranty insurance as defined in s. 627.971; or

(c) Any reinsurance contract authorized pursuant to s. 624.610.

Section 4. Section 624.6065, Florida Statutes, is created to read:

624.6065 "Fidelity insurance" defined.--For the purposes of part XX of chapter 627, "fidelity insurance" means:

(1) Insurance guaranteeing the fidelity of persons holding positions of public or private trust, or indemnifying banks, thrifts, brokers, or other financial institutions against loss of money, securities, negotiable instruments, other specified valuable papers, or tangible items of personal property caused by larceny, misplacement, destruction, or other stated perils including loss while being transported in an armored motor vehicle or by messenger and including insurance for loss caused by the forgery of signatures on, or alteration of, specified documents, and valuable papers.

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<td>(2) Insurance against losses that financial institutions become legally obligated to pay by reason of loss of customers' property from safe deposit boxes.</td>
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<td>Section 5. Paragraph (1) of subsection (1) of section 624.605, Florida Statutes, is amended to read: 624.605 &quot;Casualty insurance&quot; defined.— (1) &quot;Casualty insurance&quot; includes: (1) Credit.—Insurance against loss or damage resulting from failure of debtors to pay their obligations to the creditor (including loss or damage resulting from the involuntary unemployment of the debtors), except insurance against loss or damage resulting from the death or disability of the debtors. However, insurance may not be written as credit insurance if it falls within the definition of financial guaranty insurance, as defined in s. 627.971.</td>
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<tr>
<td>Section 6. Sections 627.971, 627.972, 627.973, 627.974, and 627.975, Florida Statutes, are repealed on October 1, 1992, and shall be reviewed by the Legislature pursuant to s. 11.61, Florida Statutes.</td>
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<tr>
<td>Section 7. Sections 624.6065 and 624.6081, Florida Statutes, are repealed on October 1, 1991, and shall be reviewed by the Legislature pursuant to s. 11.61, Florida Statutes.</td>
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<tr>
<td>Section 8. This act shall take effect July 1, 1988, or upon becoming a law, whichever occurs later.</td>
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HOUSE SUMMARY

Creates sections regulating financial guaranty insurance and residual value insurance. Establishes operating requirements for such insurers. (See bill for details)

This publication was produced at an average cost of 1.12 cents per single page in compliance with the Rules and for the information of members of the Legislature and the public.

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A bill to be entitled

An act relating to insurance; creating s. 627.971, F.S., providing definitions; creating s. 627.972, F.S., providing organizational and financial requirements for financial guaranty insurance corporations; creating s. 627.973, F.S., providing limitations under which financial guaranty insurance corporations and certain property and casualty insurers may operate; creating s. 627.974, F.S.; requiring the filing of certain policy forms with the Department of Insurance; prohibiting excessive rates by financial guaranty insurance corporations; providing criteria for determining the adequacy of such rates; providing that such filings shall be available for public inspection; creating s. 627.975, F.S.; providing that certain financial guaranty insurance corporations shall receive credit for certain reinsurance; creating s. 624.6081, F.S., defining "residual value insurance", amending s. 624.606, F.S.; redefining "surety insurance"; creating s. 624.6065, F.S.; defining "fidelity insurance", amending s. 624.605, F.S.; limiting the definition of casualty insurance as it relates to certain credit insurance; providing for legislative review and repeal, providing an effective date

Be It Enacted by the Legislature of the State of Florida:

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Section 1. Part XX of chapter 627, Florida Statutes, consisting of sections 627.971, 627.972, 627.973, 627.974, and 627.975, is created to read:

**PART XX**

**FINANCIAL GUARANTY INSURANCE**

627.971 **Definitions.**—As used in this part:

1. "Financial guaranty insurance" means a surety bond, insurance policy, an indemnity contract issued by an insurer, or any similar guaranty, under which loss is payable upon proof of occurrence of financial loss to an insured claimant, obligee, or indemnitee as a result of:

   1. The failure of an obligor on a debt instrument or other monetary obligation, including common or preferred stock guaranteed under a surety bond, insurance policy, or indemnity contract, to make principal, interest, premium, dividend, or purchase price payments when due, if the failure is the result of a financial default or insolvency, whether such obligation is incurred directly or as guarantor by or on behalf of another obligor who also defaulted;

   2. Changes in the levels of interest rates or the differential in interest rates between various markets or products;

   3. Changes in the rate of exchange of currency;

   4. Changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general; or

   5. Other events which the department determines are substantially similar to any of the foregoing.

(b) However, "financial guaranty insurance" does not include:

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1. Insurance of a loss resulting from an event described in paragraph (a), 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:

   a. A fortuitous physical event;
   b. A failure of or deficiency in the operation of equipment;
   c. An inability to extract or recover a natural resource;

2. An individual or schedule public official bond;

3. A court bond required in connection with judicial, probate, bankruptcy, or equity proceedings, including a waiver, probate, open estate, or life tenant bond;

4. A bond running to a federal, state, county, municipal government, or other political subdivision, as a condition precedent to the granting of a license to engage in a particular business or of a permit to exercise a particular privilege;

5. A loss security bond or utility payment indemnity bond running to a governmental unit, railroad, or charitable organization;

6. A lease, purchase and sale, or concessionaire surety bond;

7. Credit unemployment 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;

8. Credit insurance indemnifying a manufacturer, merchant, or educational institution which extends credit against loss or damage resulting from nonpayment of debts owed...
to him for goods or services provided in the normal course of
his business;

9. Guaranteed investment contracts that are issued by
life insurance companies and that provide that the life
insurer will make specified payments in exchange for specific
premiums or contributions;

10. Mortgage guaranty insurance as defined in s.
635.011(1) or s. 635.021;

11. Indemnity contracts or similar guaranties, to the
extent that they are not otherwise limited or proscribed by
this part, in which a life insurer guarantees:

a. Its obligations or indebtedness or the obligations
or indebtedness of a subsidiary of which it owns more than 50
percent, other than a financial guaranty insurance
 corporation, if:

(I) For any such obligations or indebtedness that are
backed by specific assets, such assets are at all times owned
by the insurer or the subsidiary; and

(II) For the obligations or indebtedness of the
subsidiary that are not backed by specific assets of the life
insurer, the guaranty terminates once the subsidiary ceases to
be a subsidiary; or

b. The 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 so acquired have been:

(I) Acquired by a special purpose entity where the
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

c. The obligations or indebtedness of an employee or agent of the life insurer, or

12. Any form of surety insurance as defined in s. 624.606

13. Any other form of insurance covering risks which the department determines to be substantially similar to any of the foregoing.

(2) "Affiliate" means a person that, directly or indirectly, owns at least 10 percent but less than 25 percent of the financial guaranty insurance corporation or that is at least 10 percent but less than 25 percent, directly or indirectly, owned by a financial guaranty insurance corporation.

(3) "Average annual debt service" means the amount of insured unpaid principal and interest on an issue of obligations, multiplied by the number of the insured obligations in the issue, each obligation representing a $1,000 par value, divided by an amount equal to the aggregate life of all the obligations in the issue. The formula for bonds is:

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

\[
\text{Total Debt Service} = \text{Insured Unpaid Principal + Interest due over the remaining life of the bond}
\]

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

\[
\text{Bond Years} = \frac{\text{Number of Bonds} \times \text{Term in Years}}{100}
\]

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(4) "Collateral" means:

(a) Cash;
(b) The market value of investment grade securities, other than securities evidencing an interest in the projects financed with the proceeds of the insured obligations;
(c) The scheduled cash flow from investment grade obligations scheduled to be received on or prior to the date of scheduled debt service on the insured obligation;
(d) A conveyance or mortgage of real property; or
(e) A letter of credit;

if deposited with or held by the corporation; held in trust by a trustee, acceptable to the department, for the benefit of the corporation; or held in trust, pursuant to the bond indenture, by a trustee acceptable to the department, for the benefit of bondholders in the form of sinking funds or other reserves which may be used solely for the payment of debt service.

(5) "Contingency reserve" means an additional liability reserve established to protect policyholders against the effects of adverse economic cycles or other unforeseen circumstances.

(6) "Financial guaranty insurance corporation" means a stock insurer licensed to transact financial guaranty insurance business in this state.

(7) "Governmental unit" means the United States, Canada, a state, territory, or possession of the United States, 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.

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(8) "Guaranties of consumer debt obligations" means insurance policies indemnifying against loss or damage resulting from nonpayment of debts owed for extensions of credit to individuals for nonbusiness purposes. Such extensions of credit include guaranties of securities backed by obligations of individuals. Policies that provide this coverage must contain a provision that all liability terminates upon the sale or transfer of the underlying obligation to any transferee which is not an insured of the financial guaranty insurance corporation under a similar policy.

(9) "Industrial development bond" means any security, or other instrument 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 payable from the revenues of the project or by any private, for-profit entity.

(10) An "investment grade obligation" means an obligation that:

(a) Has been determined to be in one of the top four generic lettered rating classifications by a securities rating agency acceptable to the department;

(b) Has been identified in writing by such a rating agency as an insurable risk deemed to be of investment grade quality for purposes of insurance;

(c) Has received a "yes" rating by the Securities Valuation Office of the National Association of Insurance Commissioners; or

(d) Has been submitted for review to the appropriate rating agency or Securities Valuation Office and will be qualified pursuant to paragraphs (a), (b), or (c).
1. "Letter of credit" means:
   
   (a) The stated amount of a clean unconditional, irrevocable letter of credit issued by a bank or trust company whose debt rating applicable to the term of the insured obligation is in one of the two highest generic lettered rating classifications by a securities rating agency acceptable to the department; or
   
   (b) Fifty percent of the stated amount of a clean unconditional, irrevocable letter of credit issued by a bank or trust company whose debt rating applicable to the term of the insured obligation is in a rating classification other than as set forth in paragraph (a).
   
   (c) An issuing or confirming bank referred to in paragraph (a) or (b) shall be:
       
       1. Determined by the Securities Valuation office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of banks and trust companies whose letters of credit shall be acceptable to insurance regulatory authorities; provided, that the letter of credit is issued for the full term of the insured obligation, or the insured obligation is subject to mandatory call and redemption from the proceeds of the letter of credit if the letter of credit is not renewed or replaced; and

       2. a. A member of the federal reserve system or chartered by a state of the United States; or

       b. Organized and existing under the laws of a foreign country whose sovereign debt is rated in the highest major rating classification by a securities rating agency acceptable to the department; and which has been licensed as a domestic

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branch or agency by the Federal Government or a state of the United States; and which is regulated, supervised and examined by United States federal or state authorities having regulatory authority over banks and trust companies.

(12) "Municipal bonds" means municipal obligation bonds and industrial development bonds.

(13) "Municipal obligation bond" means any security or other instrument, including a lease, under which a payment obligation is created, other than an industrial development bond, which is issued by or on behalf of or payable or guaranteed by a governmental unit, including certificates of participation evidencing proportionate ownership in payments to be made by a governmental unit, or issued by an entity other than a governmental unit if such security or instrument is eligible for issuance by a governmental unit but would not be an industrial development bond if so issued.

(14) "Reinsurance" means cessions qualifying for credit under s. 627.975.

(15) "Total liability of an insurer transacting financial guaranty insurance" means the aggregate amount of insured unpaid principal, interest, and other monetary payments, if any, of guaranteed obligations insured or assumed, less reinsurance and collateral. However, for guaranteed obligations insured or assumed where acceleration of payment of such obligation is at the sole option of the insurer, such total liability means the aggregate amount of the discounted present value of insured unpaid principal and unpaid interest up to the point of acceleration and other monetary payments, if any, of guaranteed obligations insured or assumed, less reinsurance and collateral. The discount rate to be applied shall be the average rate of return on the
admitted assets of the insurer at the time of computation or
the face rate of interest of the guaranteed obligation,
whichever is less.

627.972 Organization; financial requirements.--
(1) A financial guaranty insurance corporation must be
organized and licensed in the manner prescribed in this code
for stock property and casualty insurers except that:
(a) A corporation organized to transact financial
guaranty insurance may, subject to the provisions of this
code, be licensed to transact:
   1. Residual value insurance, as defined by s. 624.6081;
   2. Surety insurance, as defined by s. 624.6061;
   3. Credit insurance, as defined by s. 624.6051(1)(1); and
   4. Mortgage guaranty insurance as defined in s. 635.011, provided that the provisions of chapter 635 are met.
(b)1. Prior to the issuance of a license, a
   corporation must submit to the department for approval, a plan
   of operation detailing:
      a. The types and projected diversification of
guaranties to be issued;
      b. The underwriting procedures to be followed;
      c. The managerial oversight methods;
      d. The investment policies; and
      e. Any other matters prescribed by the department;
   2. An insurer which is writing only the types of
   insurance allowed under this part on the effective date of
   this part and otherwise meets the requirements of this part,
is exempt from the requirements of this paragraph.

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(c) An insurer transacting financial guaranty insurance is subject to all provisions of this code that are applicable to property and casualty insurers to the extent that those provisions are not inconsistent with this part; and

(d) The investments of an insurer transacting financial guaranty insurance in any entity insured by the corporation may not exceed 2 percent of its admitted assets as of the end of the prior calendar year.

(e) An insurer transacting financial guaranty insurance may only assume those lines of insurance for which it is licensed to write direct business.

(2) An insurer may not transact financial guaranty business unless it has surplus to policyholders of at least $50 million at the date of initial licensing for financial guaranty insurance and maintains a minimum surplus to policyholders of at least $35 million;

(3) An insurer may not transact financial guaranty insurance unless it establishes a contingency reserve, net of reinsurance, as follows:

(a) A contingency reserve, net of reinsurance, must be established in a minimum amount calculated by applying the following percentages to the net principal outstanding each calendar year of guaranties of:

1. Municipal obligation bonds, 0.8 percent;
2. Investment grade obligations with a term of less than 3 years, 1.0 percent;
3. All other investment grade obligations, including investment grade industrial development bonds and investment grade consumer debt obligations, 1.6 percent;
4. Noninvestment grade consumer debt obligations, 2.5 percent; and

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5. All other obligations guaranteed, 3.0 percent.

(b1) Quarterly additions to the reserve for

subparagraph 1. of paragraph (a) must be equal to the greater

of 1/80th of the amounts derived by applying the appropriate

contribution specified in that sub-subparagraph or 50 percent

of the quarterly earned premiums on these guarantees, and must

be maintained for a period of 20 years; and

2. Quarterly additions to the reserve for subparagraph

subparagraph 3., and subparagraph 4. of paragraph (a) must

be equal to the greater of 1/40th of the amounts derived by

applying the appropriate contribution specified in that sub-

subparagraph or 50 percent of the quarterly earned premiums on

these guarantees and must be maintained for a period of 10

years, except that, for obligations with a term of less than 3

years, the reserve must be maintained for a period of at least

5 years;

(c) The reserve may be released thereafter in the same

manner, except that a part of the reserve may be released

proportional to the reduction in net total liabilities

resulting from reinsurance and the reinsurer must, on the

effective date of the reinsurance, establish a reserve in an

amount equal to the amount released, and

(d) Withdrawals from the contingency reserve, to the

extent of any excess, may be made with the approval of the

department from the earliest contributions to the reserve

remaining therein:

1. In any year in which the actual incurred losses

exceed 35 percent of earned premiums, or

2. If the contingency reserve has been in existence

for 40 quarters for reserves subject to subparagraph (b1),

and 20 quarters for reserves subject to subparagraph (b)2.,

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upon demonstration that the amount carried is excessive in relation to the insurer's outstanding obligations.

(4) In addition to the contingency reserve, the case basis method or other method prescribed by the department is used to determine loss reserves, in a manner consistent with the requirements of part I of chapter 625, which must include a reserve for claims reported and unpaid net of collateral. 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 any such reserve. The discount rate must be adjusted at the end of each calendar year; and

(5) The insurer maintains an unearned premium reserve, net of reinsurance, computed on the monthly pro rata basis, where the premiums are paid on an installment basis. All other such premiums paid must be earned proportionately with the expiration of exposure or by such other method the department prescribes or approves.

627.973 Limitations --

(1) Financial guaranty insurance shall be transacted in this state only by a corporation licensed for such purpose, except that a property and casualty insurer transacting business pursuant to the provisions of this code may transact financial guaranty insurance in this state if the following conditions are met:

(a) Total policyholders' surplus exceeds $100 million;

(b) Not more than 20 percent of total net premiums written are applicable to or for financial guaranty insurance;

(c) The provisions of this part are applied to the insurer's financial guaranty insurance business;

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(d) Not more than 20 percent of the insurer's total policyholder's surplus is applied toward meeting the provisions of this part.

(e) The policyholders' surplus once utilized to meet the requirements of this part shall not be available for meeting any policyholders' surplus requirements for any other type of insurance.

(f) The insurer is licensed to write financial guaranty insurance and

(g) Unless the insurer is transacting financial guaranty insurance prior to the effective date of this part and otherwise meets the requirements of this section, prior to the issuance of a license, the insurer must submit to the department for approval, a plan of operation complying with § 627.972(11)(b).

(2) Financial guaranty insurance shall be written only to insure obligations defined in subparagraph 627.971(1)(a)(1), except that obligations defined in subparagraphs 627.971(1)(a)(2), (3), (4), and (5) may be written with the prior written approval of the department pursuant to limitations and restrictions promulgated by rule that the department deems appropriate and necessary to protect the policyholders of the insurer.

(3) At least 95 percent of the outstanding total liability on municipal obligation bonds of an insurer transacting financial guaranty insurance must be investment grade.

(4) An insurer transacting financial guaranty insurance must at all times maintain capital surplus and contingency reserves, subject to the restrictions in

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subsection (1)(d) if applicable, in the aggregate no less than
the sum of:

(a) 0.3333 percent of the total liabilities
outstanding under guaranties of municipal obligation bonds;
(b) One percent of the total liabilities outstanding
under guaranties of investment grade obligations, including
industrial development bonds and investment grade consumer
debt obligations;
(c) One and one-third percent of the total liabilities
outstanding under guaranties of noninvestment grade consumer
debt obligations;
(d) Two percent of the total liabilities outstanding
under guaranties of other obligations not of investment grade,
other than consumer debt obligations; and
(e) Surplus determined by the department to be
adequate to support the writing of residual value insurance,
surety insurance, and credit insurance, if the corporation has
elected to transact these kinds of insurance pursuant to s.
627.972(1).

(5) An insurer transacting financial guaranty
insurance must limit its exposure to loss, net of collateral
and reinsurance, as follows:

(a) For municipal bonds:
1. The insured average annual debt service with
respect to any one entity and backed by a single revenue
source may not exceed 10 percent of the aggregate of the
corporation's capital, surplus, and contingency reserves,
subject to the restrictions of subsection (1)(d) if
applicable; and
2. The insured unpaid principal issued by a single
entity and backed by a single revenue source may not exceed 75

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percent of the aggregate of the corporation's capital, surplus, and contingency reserves, subject to the restrictions in subsection (1)(d) if applicable; and

(b) For all other financial guaranties, the insured unpaid principal for any one risk may not exceed 10 percent of the aggregate of the corporation's capital, surplus, and contingency reserves, subject to the restrictions in subsection (1)(d) if applicable. Single risk liability shall be defined with respect to any one issuer, except that, if the risk is payable from a specified revenue source or adequately secured by loan obligations or other assets, such risk shall be defined by the revenue source.

(6) If the exposure to loss of an insurer transacting financial guaranty insurance exceeds the limitations in subsection (4), it may not transact any new financial guaranty insurance business until its exposure to loss no longer exceeds those limitations.

(7) An insurer which wrote financial guaranty insurance in this state during the 12-month period immediately preceding the effective date of this act but which does not meet the requirements of subsection (1) or of s. 627.972(2), may, nevertheless, continue to write financial guaranty insurance as authorized by subsection (2) after the effective date of this act, subject to all other provisions of this part, provided:

(a) Within 45 days after such date the insurer files with the department a statement of its intentions to limit its writings to financial guaranty, surety and fidelity insurance. Effective upon such filing, the insurer shall be subject to the requirements of this part except that the surplus to policyholders requirement of s. 627.972(2) shall not apply to

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such insurer until July 1, 1998, at which time such insurer shall have and thereafter maintain the minimum surplus requirement of at least $35 million. Failure of the insurer to meet the conditions of such statement of intent filed with the department, until such time as it meets the requirements of subsection (1), shall be grounds to subject the insurer to the penalties provided under this code, including immediate suspension or revocation of its certificate of authority. If the insurer does not file such statement of intent, it shall cease writing any new financial guaranty insurance business within 6 months after the effective date of this act. The insurer may:

1. Reinsure its net in-force business with a licensed financial guaranty insurance corporation or an insurer exempt under subsection (1);

2. Subject to the prior approval of its domiciliary insurance commissioner, reinsure all or part of its net in-force business pursuant to s. 627.975(1)(b), except that subparagraphs 2. and 4. do not apply. The assuming insurer must maintain reserves for the reinsured business in the manner applicable to the ceding insurer under paragraph (b);

3. May continue the risks in force and, with 30 days prior written notice to its domiciliary insurance commissioner, write new financial guaranty policies if the writing of those policies is reasonably prudent to mitigate either the amount of or possibility of loss in connection with business written prior to the effective date of this act. However, an insurer must receive the prior approval of its domiciliary insurance commissioner before writing any new

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financial guaranty insurance policies that would increase its risk of loss.

(b) Must, for all guaranties in force prior to the effective date of the act, including those which fall under the definition of financial guaranty insurance, maintain the reserves applicable for municipal bond guaranties in effect prior to the effective date of this act. If the insurer's contingency reserves maintained as of the effective date of this act are less than those required for municipal bond guaranties, the insurer has 3 years to bring its reserves into compliance, except that a part of the reserve may be released proportional to the reduction in net total liabilities resulting from reinsurance if the reinsurer, on the effective date of the reinsurance, establishes a reserve in an amount equal to the amount released and except that a part of the reserve may be released with departmental approval, upon demonstration that the amount carried is excessive in relation to the corporation's outstanding obligations.

(c) Shall be subject to the reserve requirements applicable to financial guaranty insurance corporations, for business written on or after the effective date of the act.

(d) This subsection shall not apply to insurers permitted to write financial guaranty insurance pursuant to the exception set forth in subsection (1) and such insurers may write financial guaranty insurance subject to the requirements of the Florida Insurance Code.

627.974 Filing of policy forms and rates.--

(1) Policy forms and any amendments thereto must be filed with the department within 30 days after their use by the insurer. A policy may not provide coverage of the acceleration of payments due under the guaranteed obligations.
including any payment in advance of scheduled maturity to be
made by the issuer of the guaranteed obligations at the sole
option of the owner of the guaranteed obligations, unless the
acceleration is at the sole option of the insurer. Each
policy must disclose that the insurance provided by the policy
is not covered by the Florida Insurance Guaranty Association
created under part II of chapter 631. The department may
prescribe additional minimum policy provisions which are
determined by the department to be necessary or appropriate to
protect policyholders, claimants, obligees, or indemnitees.

(2) Rates may not be excessive, inadequate, unfairly
discriminatory, destructive of competition, or detrimental to
the solvency of the insurer.

(3) Criteria and guidelines used by insurers
transacting financial guaranty insurance in establishing
rating categories and ranges of rates to be used must be filed
with the department for information prior to their use by the
insurer.

(4) All such filings must be available for public
inspection at the department.

(5) This section is in lieu of the requirements of ss.
627.062 and 627.410.

627.975 Reinsurance.--

(1) For financial guaranty insurance which takes
effect on or after the effective date of this act, an insurer
transacting financial guaranty insurance shall receive credit
for reinsurance in accordance with the provisions of this code
applicable to property and casualty insurers, as an asset or
as a reduction from liabilities; if the reinsurance is subject
to an agreement that, for its stated term and with respect to
any financial guaranty insurance in force, the reinsurance

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agreement may only be terminated or amended 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
continues until the expiration or cancellation of each such
policy with the consent of the ceding insurer, if the
reinsurance agreement provides for a cutoff of the reinsurance
in force at the date of termination or at the request of the
ceding company or at the discretion of the department, acting
as rehabilitator, liquidator, or receiver of the ceding or
assuming company; and that such reinsurance:

(a) Is placed with another insurer licensed under this
part or an insurer writing financial guaranty insurance as
permitted under this part;

(b) Is placed with another type of insurer licensed to
write surety insurance, if such insurer:

1. Has and maintains surplus to policyholders of at
least $35 million;

2. Establishes and maintains the reserves required in
s. 627.972, except that if the reinsurance agreement is not
pro rata, the contribution to the contingency reserve must be
equal to 50 percent of the quarterly earned reinsurance
premium;

3. Complies with s. 627.973(4), (5), and (6); and

4. If it is a parent, subsidiary, or affiliate of the
insurer transacting financial guaranty insurance, the
provisions of s. 627.973(4) and (5) shall be applied against
the combined policyholders' surplus and contingency reserves
of such parent, subsidiary, or affiliate reinsurers after
elimination of equity investments of the insurer and such
reinsurers in each other; or

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(c) Is placed with an unauthorized or unaccredited reinsurer which otherwise complies with the provisions of paragraph (a) or subparagraphs (b)(1) and (5), in an amount not to exceed 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.

(2) In determining whether the insurer meets the limitations imposed by s. 627.9731(4), in addition to credit for other types of qualifying reinsurance, the insurer'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 insurer's retention pursuant to the reinsurance agreement.

Section 2. Section 624.6081, Florida Statutes, is created to read:

624.6081 "Residual value insurance" defined.--For the purposes of part XX of chapter 627, the term "residual value insurance" means insurance issued in connection with a lease or contract which sets forth a specific termination value at the end of the term of the lease or contract for the property covered by the lease or contract and which insures against loss of economic value of tangible personal property or real property or improvements thereto, except loss due to physical damage to property. However, insurance may not be written as residual value insurance if it may be written as financial.
guaranty insurance by a financial guaranty insurance corporation pursuant to part XX of chapter 627.

Section 3. Section 624.606, Florida Statutes, is amended to read.

(Substantial rewording of section. See s. 624.606, F.S., for present text.)

624 606 "Surety insurance" defined --

(1) "Surety insurance" includes:

(a) A contract bond, including a bid, payment, or maintenance bond, or a performance bond, which guarantees the execution of a contract other than a contract of indebtedness or other monetary obligation,

(b) An indemnity bond for the benefit of a public body, railroad, or charitable organization or a lost security or utility payment bond;

(c) Becoming surety on, or guaranteeing the performance of, any lawful contract where the bond is guaranteeing the execution of a contract other than a contract of indebtedness or other monetary obligation;

(d) Becoming surety on, or guaranteeing the performance of, bonds and undertakings required or permitted in a judicial proceeding or otherwise allowed by law, including surety bonds accepted by states and municipal authorities in lieu of deposits as security for the performance of insurance contracts;

(e) Fidelity insurance as defined in s. 624.6065 for the purposes of the Florida Insurance Code other than part XX of chapter 627; or

(f) Residual value insurance as defined in s. 624.6081.

(2) "Surety insurance" does not include:

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(a) Mortgage guaranty insurance, as defined in s.
635.011;
(b) Financial guaranty insurance, as defined in s.
627.971; or
(c) Any reinsurance contract authorized pursuant to s.
624.610.

Section 4. Section 624.6065, Florida Statutes, is
created to read:

624.6065 "Fidelity insurance" defined.--For the
purposes of part XX of chapter 627, the term "fidelity
insurance" means:

1) Insurance guaranteeing the fidelity of persons
holding positions of public or private trust, or indemnifying
banks, thrifts, brokers, or other financial institutions
against loss of money, securities, negotiable instruments,
other specified valuable papers, or tangible items of personal
property caused by larceny, misplacement, destruction, or
other stated perils including loss while being transported in
an armored motor vehicle or by messenger and including
insurance for loss caused by the forgery of signatures on, or
alteration of, specified documents, and valuable papers.

2) Insurance against losses that financial
institutions become legally obligated to pay by reason of loss
of customers' property from safe deposit boxes.

Section 5. Paragraph (1) of subsection (1) of section
624.605, Florida Statutes, is amended to read:

624.605 "Casualty insurance" defined.--
(1) "Casualty insurance" includes:

(1) Credit.--Insurance against loss or damage
resulting from failure of debtors to pay their obligations to
the creditor (including loss or damage resulting from the

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involuntary unemployment of the debtors, except insurance
against loss or damage resulting from the death or disability
of the debtors. However, insurance may not be written as
credit insurance if it falls within the definition of
financial guaranty insurance, as defined in s. 627.971.

Section 6 Sections 627.971, 627.972, 627.973,
627.974, and 627.975, Florida Statutes, are repealed on
October 1, 1992, and shall be reviewed by the Legislature
prior to that date pursuant to section 11.61, Florida
Statutes.

Section 7. Sections 624.6065 and 624.6081, Florida
Statutes, are repealed on October 1, 1991, and shall be
reviewed by the Legislature prior to that date pursuant to
section 11.61, Florida Statutes.

Section 8. This act shall take effect July 1, 1988, or
upon becoming a law, whichever occurs later.

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HOUSE SUMMARY

Creates sections regulating financial guaranty insurance
and residual value insurance. Establishes operating
requirements for such insurers. (See bill for details.)

This publication was produced at an average cost of 1.12 cents
per single page in compliance with the Rules and for
the information of members of the Legislature and the public.

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A bill to be entitled

An act relating to insurance; creating s. 627.971, F.S.; providing definitions; creating s. 627.972, F.S.; providing organizational and financial requirements for financial guaranty insurance corporations; creating s. 627.973, F.S.; providing limitations under which financial guaranty insurance corporations and certain property and casualty insurers may operate; creating s. 627.974, F.S.; requiring the filing of certain policy forms with the Department of Insurance; prohibiting excessive rates by financial guaranty insurance corporations; providing criteria for determining the adequacy of such rates; providing that such filings shall be available for public inspection; creating s. 627.975, F.S.; providing that certain financial guaranty insurance corporations shall receive credit for certain reinsurance; creating s. 624.6081, F.S.; defining "residual value insurance"; amending s. 624.606, F.S.; redefining "surety insurance"; creating s. 624.6065, F.S.; defining "fidelity insurance"; amending s. 624.605, F.S.; limiting the definition of casualty insurance as it relates to certain credit insurance; providing for legislative review and repeal; providing an effective date.

Be It Enacted by the Legislature of the State of Florida:

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Section 1. Part XX of chapter 627, Florida Statutes, consisting of sections 627.971, 627.972, 627.973, 627.974, and 627.975, is created to read:

PART XX

FINANCIAL GUARANTY INSURANCE

627.971 Definitions.—As used in this part:

(1)(a) "Financial guaranty insurance" means a surety bond, insurance policy, an indemnity contract issued by an insurer, or any similar guaranty, under which loss is payable upon proof of occurrence of financial loss to an insured claimant, obligee, or indemnitee as a result of:

1. The failure of an obligor on a debt instrument or other monetary obligation, including common or preferred stock guaranteed under a surety bond, insurance policy, or indemnity contract, to make principal, interest, premium, dividend, or purchase price payments when due, if the failure is the result of a financial default or insolvency, whether such obligation is incurred directly or as guarantor by or on behalf of another obligor who also defaulted;

2. Changes in the levels of interest rates or the differential in interest rates between various markets or products;

3. Changes in the rate of exchange of currency;

4. Changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general; or

5. Other events which the department determines are substantially similar to any of the foregoing.

(b) However, "financial guaranty insurance" does not include:

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1. Insurance of a loss resulting from an event described in paragraph (a), 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:
   a. A fortuitous physical event;
   b. A failure of or deficiency in the operation of equipment; or
   c. An inability to extract or recover a natural resource;
2. An individual or schedule public official bond;
3. A court bond required in connection with judicial, probate, bankruptcy, or equity proceedings, including a waiver, probate, open estate, or life tenant bond;
4. A bond running to a federal, state, county, municipal government, or other political subdivision, as a condition precedent to the granting of a license to engage in a particular business or of a permit to exercise a particular privilege;
5. A loss security bond or utility payment indemnity bond running to a governmental unit, railroad, or charitable organization;
6. A lease, purchase and sale, or concessionaire surety bond;
7. Credit unemployment 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;
8. Credit insurance indemnifying a manufacturer, merchant, or educational institution which extends credit against loss or damage resulting from nonpayment of debts owed.

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to him for goods or services provided in the normal course of his business;

9. Guaranteed investment contracts that are issued by life insurance companies and that provide that the life insurer will make specified payments in exchange for specific premiums or contributions;

10. Mortgage guaranty insurance as defined in s. 635.011(1) or s. 635.021;

11. Indemnity contracts or similar guaranties, to the extent that they are not otherwise limited or proscribed by this part, in which a life insurer guarantees:

a. Its obligations or indebtedness or the obligations or indebtedness of a subsidiary of which it owns more than 50 percent, other than a financial guaranty insurance corporation, if:

   (I) For any such obligations or indebtedness that are backed by specific assets, such assets are at all times owned by the insurer or the subsidiary; and

   (II) For the obligations or indebtedness of the subsidiary that are not backed by specific assets of the life insurer, the guaranty terminates once the subsidiary ceases to be a subsidiary; or

b. The 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 so acquired have been:

   (I) Acquired by a special purpose entity where the sole purpose is to acquire specific assets of the life insurer

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or the subsidiary and issue securities or participation certificates backed by such assets; or

(II) Sold to an independent third party; or
c. The obligations or indebtedness of an employee or agent of the life insurer; or

12. Any form of surety insurance as defined in s. 624.606.

13. Any other form of insurance covering risks which the department determines to be substantially similar to any of the foregoing.

(2) "Affiliate" means a person that, directly or indirectly, owns at least 10 percent but less than 25 percent of the financial guaranty insurance corporation or that is at least 10 percent but less than 25 percent, directly or indirectly, owned by a financial guaranty insurance corporation.

(3) "Average annual debt service" means the amount of insured unpaid principal and interest on an issue of obligations, multiplied by the number of the insured obligations in the issue, each obligation representing a $1,000 par value, divided by an amount equal to the aggregate life of all the obligations in the issue. The formula for bonds is:

Average Annual Debt Service =

\[
\text{Total Debt Service} \times \frac{\text{Number of Bonds}}{\text{Bond Years}}
\]

\[
\text{Total Debt Service} = \text{Insured Unpaid Principal + Interest due over the remaining life of the bond}
\]

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

\[
\text{Bond Years} = \frac{\text{Number of Bonds} \times \text{Term in Years}}{\text{Number of Bonds}}
\]

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(4) "Collateral" means:
(a) Cash;
(b) The market value of investment grade securities, other than securities evidencing an interest in the projects financed with the proceeds of the insured obligations;
(c) The scheduled cash flow from investment grade obligations scheduled to be received on or prior to the date of scheduled debt service on the insured obligation;
(d) A conveyance or mortgage of real property; or
(e) A letter of credit;

if deposited with or held by the corporation; held in trust by a trustee, acceptable to the department, for the benefit of the corporation; or held in trust, pursuant to the bond indenture, by a trustee acceptable to the department, for the benefit of bondholders in the form of sinking funds or other reserves which may be used solely for the payment of debt service.

(5) "Contingency reserve" means an additional liability reserve established to protect policyholders against the effects of adverse economic cycles or other unforeseen circumstances.

(6) "Financial guaranty insurance corporation" means a stock insurer licensed to transact financial guaranty insurance business in this state.

(7) "Governmental unit" means the United States, Canada, a state, territory, or possession of the United States, 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.
(8) "Guaranties of consumer debt obligations" means insurance policies indemnifying against loss or damage resulting from nonpayment of debts owed for extensions of credit to individuals for nonbusiness purposes. Such extensions of credit include guaranties of securities backed by obligations of individuals. Policies that provide this coverage must contain a provision that all liability terminates upon the sale or transfer of the underlying obligation to any transferee which is not an insured of the financial guaranty insurance corporation under a similar policy.

(9) "Industrial development bond" means any security, or other instrument 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 payable from the revenues of the project or by any private, for-profit entity.

(10) "Investment grade obligation" means an obligation that:

(a) Has been determined to be in one of the top four generic lettered rating classifications by a securities rating agency acceptable to the department;

(b) Has been identified in writing by such a rating agency as an insurable risk deemed to be of investment grade quality for purposes of insurance;

(c) Received "yes" rating by the Securities Valuation Office of the National Association of Insurance Commissioners;

or

(d) Has been submitted for review to the appropriate rating agency or securities Valuation Office and will be

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qualified pursuant to paragraph (a), paragraph (b), or paragraph (c).

(11) "Letter of credit" means 50 percent of the stated amount of a clean, unconditional, irrevocable letter of credit issued or confirmed by a bank or trust company which:

(a) Is a member of the Federal Reserve System or chartered by a state of the United States, and

2. Has a debt rating applicable to the term of the insured obligation in one of the two highest generic lettered rating classifications by a securities rating agency acceptable to the department;

(b) Is organized and existing under the laws of a foreign country whose sovereign debt is rated in the highest major rating classification by a securities rating agency acceptable to the department,

2. Has been licensed as a domestic branch or agency by the Federal Government or a state of the United States, and

3. Is part of an institution whose debt rating applicable to the term of the insured obligation is in one of the two highest generic lettered rating classifications by a securities rating agency acceptable to the department; or

(c) Is determined by the Securities Valuation office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of banks and trust companies whose letters of credit will be acceptable to insurance regulatory authorities; provided, that the letter of credit is issued for the full term of the insured obligation or the insured obligation is subject to mandatory call and redemption from the proceeds of the letter.
of credit if the letter of credit is not renewed or replaced.

(12) "Municipal bonds" means municipal obligation bonds and industrial development bonds.

(13) "Municipal obligation bond" means any security or other instrument, including a lease, under which a payment obligation is created, other than an industrial development bond, which is issued by or on behalf of or payable or guaranteed by a governmental unit, including certificates of participation evidencing proportionate ownership in payments to be made by a governmental unit, or issued by an entity other than a governmental unit if such security or instrument is eligible for issuance by a governmental unit but would not be an industrial development bond if so issued.

(14) "Reinsurance" means cessions qualifying for credit under s. 627.975.

(15) "Total liability of an insurer transacting financial guaranty insurance" means the aggregate amount of insured unpaid principal, interest, and other monetary payments, if any, of guaranteed obligations insured or assumed, less reinsurance and collateral. However, for guaranteed obligations insured or assumed where acceleration of payment of such obligation is at the sole option of the insurer, such total liability is the aggregate amount of the discounted present value of insured unpaid principal and unpaid interest up to the point of acceleration and other monetary payments, if any, of guaranteed obligations insured or assumed, less reinsurance and collateral. The discount rate to be applied shall be the average rate of return on the admitted assets of the insurer at the time of computation or the face rate of interest of the guaranteed obligation, whichever is less.
627.972 Organization; financial requirements.--

(1) A financial guaranty insurance corporation must be organized and licensed in the manner prescribed in this code for stock property and casualty insurers except that:

(a) A corporation organized to transact financial guaranty insurance may, subject to the provisions of this code, be licensed to transact:

1. Residual value insurance, as defined by s. 624.6081;

2. Surety insurance, as defined by s. 624.606;

3. Credit insurance, as defined by s. 624.605(1)(1);

and

4. Mortgage guaranty insurance as defined in s. 635.011, provided that the provisions of chapter 635 are met.

(b)1. Prior to the issuance of a license, a corporation must submit to the department for approval, a plan of operation detailing:

a. The types and projected diversification of guaranties to be issued;

b. The underwriting procedures to be followed;

c. The managerial oversight methods;

d. The investment policies; and

e. Any other matters prescribed by the department;

2. An insurer which is writing only the types of insurance allowed under this part on the effective date of this part and otherwise meets the requirements of this part, is exempt from the requirements of this paragraph.

(c) An insurer transacting financial guaranty insurance is subject to all provisions of this code that are applicable to property and casualty insurers to the extent
that those provisions are not inconsistent with this part; and

(d) The investments of an insurer transacting financial guaranty insurance in any entity insured by the corporation may not exceed 2 percent of its admitted assets as of the end of the prior calendar year.

(e) An insurer transacting financial guaranty insurance may only assume those lines of insurance for which it is licensed to write direct business.

(2) An insurer may not transact financial guaranty business unless it has surplus to policyholders of at least $50 million at the date of initial licensing for financial guaranty insurance and maintains a minimum surplus to policyholders of at least $35 million;

(3) An insurer may not transact financial guaranty insurance unless it establishes a contingency reserve, net of reinsurance, as follows:

(a) A contingency reserve, net of reinsurance, must be established in a minimum amount calculated by applying the following percentages to the net principal outstanding each calendar year of guarantees of:

1. Municipal obligation bonds, 0.8 percent;
2. Investment grade obligations with a term of less than 3 years, 1.0 percent;
3. All other investment grade obligations, including investment grade industrial development bonds and investment grade consumer debt obligations, 1.6 percent;
4. Noninvestment grade consumer debt obligations, 2.5 percent; and
5. All other obligations guaranteed, 3.0 percent.

(b)1. Quarterly additions to the reserve for subparagraph 1. of paragraph (a) must be equal to the greater

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of 1/80th of the amounts derived by applying the appropriate
contribution specified in that sub-subparagraph or 50 percent
of the quarterly earned premiums on these guaranties, and must
be maintained for a period of 20 years; and

2. Quarterly additions to the reserve for subparagraph
2., subparagraph 3., and subparagraph 4. of paragraph (a) must
be equal to the greater of 1/40th of the amounts derived by
applying the appropriate contribution specified in that sub-
subparagraph or 50 percent of the quarterly earned premiums on
these guaranties and must be maintained for a period of 10
years, except that, for obligations with a term of less than 3
years, the reserve must be maintained for a period of at least
5 years;

(c) The reserve may be released thereafter in the same
manner, except that a part of the reserve may be released
proportional to the reduction in net total liabilities
resulting from reinsurance and the reinsurer must, on the
effective date of the reinsurance, establish a reserve in an
amount equal to the amount released; and

(d) Withdrawals from the contingency reserve, to the
extent of any excess, may be made with the approval of the
department from the earliest contributions to the reserve
remaining therein:

1. In any year in which the actual incurred losses
exceed 35 percent of earned premiums, or

2. If the contingency reserve has been in existence
for 40 quarters for reserves subject to subparagraph (b)1.,
and 20 quarters for reserves subject to subparagraph (b)2.,
upon demonstration that the amount carried is excessive in
relation to the insurer's outstanding obligations;

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(4) In addition to the contingency reserve, the case basis method or other method prescribed by the department is used to determine loss reserves, in a manner consistent with the requirements of part I of chapter 625, which must include a reserve for claims reported and unpaid net of collateral. 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 any such reserve. The discount rate must be adjusted at the end of each calendar year; and

(5) The insurer maintains an unearned premium reserve, net of reinsurance, computed on the monthly pro rata basis, where the premiums are paid on an installment basis. All other such premiums paid must be earned proportionately with the expiration of exposure or by such other method the department prescribes or approves.

627.973 Limitations.--

(1) Financial guaranty insurance shall be transacted in this state only by a corporation licensed for such purpose, except that a property and casualty insurer transacting business pursuant to the provisions of this code may transact financial guaranty insurance in this state if the following conditions are met:

(a) Total policyholders' surplus exceeds $100 million;
(b) Not more than 20 percent of total net premiums written are applicable to or for financial guaranty insurance;
(c) The provisions of this part are applied to the insurer's financial guaranty insurance business;

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(d) Not more than 20 percent of the insurer's total policyholder's surplus is applied toward meeting the provisions of this part;

(e) The policyholders' surplus applied to meet the requirements of this part shall not be available from meeting any policyholders' surplus requirements for any other type of insurance;

(f) The insurer is licensed to write financial guaranty insurance; and

(g) Unless the insurer is transacting financial guaranty insurance prior to the effective date of this part and otherwise meets the requirements of this section, prior to the issuance of a license, the insurer must submit to the department for approval, a plan of operation complying with s. 627.972(1)(b).

(2) Financial guaranty insurance shall be written only to insure obligations defined in subparagraph 627.971(1)(a)1., except that obligations defined in subparagraphs 627.971(1)(a)2., 3., 4., and 5. may be written with the prior written approval of the department pursuant to limitations and restrictions promulgated by rule that the department deems appropriate and necessary to protect the policyholders of the insurer.

(3) At least 95 percent of the outstanding total liability on municipal obligation bonds of an insurer transacting financial guaranty insurance must be investment grade.

(4) An insurer transacting financial guaranty insurance must at all times maintain capital, surplus, and contingency reserves, subject to the restrictions in

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subsection (1)(d) if applicable, in the aggregate no less than the sum of:

(a) 0.3333 percent of the total liabilities outstanding under guaranties of municipal obligation bonds;

(b) One percent of the total liabilities outstanding under guaranties of investment grade obligations, including industrial development bonds and investment grade consumer debt obligations;

(c) One and one-third percent of the total liabilities outstanding under guaranties of noninvestment grade consumer debt obligations;

(d) Two percent of the total liabilities outstanding under guaranties of other obligations not of investment grade, other than consumer debt obligations; and

(e) Surplus determined by the department to be adequate to support the writing of residual value insurance, surety insurance, and credit insurance, if the corporation has elected to transact these kinds of insurance pursuant to s. 627.972(1).

(5) An insurer transacting financial guaranty insurance must limit its exposure to loss, net of collateral and reinsurance, as follows:

(a) For municipal bonds:

1. The insured average annual debt service with respect to any one entity and backed by a single revenue source may not exceed 10 percent of the aggregate of the corporation's capital, surplus, and contingency reserves, subject to the restrictions of subsection (1)(d) if applicable; and

2. The insured unpaid principal issued by a single entity and backed by a single revenue source may not exceed 75%
percent of the aggregate of the corporation's capital, surplus, and contingency reserves, subject to the restrictions in subsection (1)(d) if applicable; and

(b) For all other financial guaranties, the insured unpaid principal for any one risk may not exceed 10 percent of the aggregate of the corporation's capital, surplus, and contingency reserves, subject to the restrictions in subsection (1)(d) if applicable. Single risk liability shall be defined with respect to any one issuer, except that, if the risk is payable from a specified revenue source or adequately secured by loan obligations or other assets, such risk shall be defined by the revenue source.

(6) If the exposure to loss of an insurer transacting financial guaranty insurance exceeds the limitations in subsection (4), it may not transact any new financial guaranty insurance business until its exposure to loss no longer exceeds those limitations.

(7) An insurer which writes financial guaranty insurance in this state, but which is not licensed to write financial guaranty insurance in this state or does not meet the requirements of subsection (1), is subject to this part, except for s. 627.972(1) and (2), and:

(a) May continue to write financial guaranties authorized by subsection (2) for not more than 2 years after the effective date of this act, if within 6 months after such date it applies to organize a financial guaranty insurance corporation, controlled by or under common control with such insurer, which financial guaranty insurance corporation, when licensed, immediately assumes the insurer's in-force financial guaranty insurance which was written on or after the effective date of this act. If the insurer does not apply to organize a

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1 financial guaranty insurance corporation, it must cease
2 writing any new financial guaranty insurance business within 6
3 months after the effective date of this act. The insurer may:
4 1. Reinsure its net in-force business with a licensed
5 financial guaranty insurance corporation or an insurer exempt
6 under subsection (1);
7 2. Subject to the prior approval of its domiciliary
8 insurance commissioner, reinsure all or part of its net in-
9 force business pursuant to s. 627.975(1)(b), except that
10 subparagraphs 2., 4., and 5. do not apply. The assuming
11 insurer must maintain reserves for the reinsured business in
12 the manner applicable to the ceding insurer under paragraph
13 (b); or
14 3. May continue the risks in force and, with 30 days
15 prior written notice to its domiciliary insurance
16 commissioner, write new financial guaranty policies if the
17 writing of those policies is reasonably prudent to mitigate
18 either the amount of or possibility of loss in connection with
19 business written prior to the effective date of this act.
20 However, an insurer must receive the prior approval of its
21 domiciliary insurance commissioner before writing any new
22 financial guaranty insurance policies that would increase its
23 risk of loss.
24 (b) Must, for all guaranties in force prior to the
25 effective date of the act, including those which fall under
26 the definition of financial guaranty insurance, maintain the
27 reserves applicable for municipal bond guaranties in effect
28 prior to the effective date of this act. If the insurer's
29 contingency reserves maintained as of the effective date of
30 this act are less than those required for municipal bond
1 guaranties, the insurer has 3 years to bring its reserves into

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compliance, except that a part of the reserve may be released
proportional to the reduction in net total liabilities
resulting from reinsurance if the reinsurer, on the effective
date of the reinsurance, establishes a reserve in an amount
equal to the amount released and except that a part of the
reserve may be released with departmental approval, upon
demonstration that the amount carried is excessive in relation
to the corporation's outstanding obligations.

(c) Shall be subject to the reserve requirements
applicable to financial guaranty insurance corporations, for
business written on or after the effective date of the act.

(d) This subsection shall not apply to insurers
permitted to write financial guaranty insurance pursuant to
the exception set forth in subsection (1) and such insurers
may write financial guaranty insurance subject to the
requirements of the Florida Insurance Code.

627.974 Filing of policy forms and rates.--

(1) Policy forms and any amendments thereto must be
filed with the department within 30 days after their use by
the insurer. A policy may not provide coverage of the
acceleration of payments due under the guaranteed obligations,
including any payment in advance of scheduled maturity to be
made by the issuer of the guaranteed obligations at the sole
option of the owner of the guaranteed obligations, unless the
acceleration is at the sole option of the insurer. Each
policy must disclose that the insurance provided by the policy
is not covered by the Florida Insurance Guaranty Association
created under part II of chapter 631. The department may
prescribe additional minimum policy provisions which are
determined by the department to be necessary or appropriate to
protect policyholders, claimants, obligees, or indemnitees.
(2) Rates may not be excessive, inadequate, unfairly discriminatory, destructive of competition, or detrimental to the solvency of the insurer.

(3) Criteria and guidelines used by insurers transacting financial guaranty insurance in establishing rating categories and ranges of rates to be used must be filed with the department for information prior to their use by the insurer.

(4) All such filings must be available for public inspection at the department.

(5) This section is in lieu of the requirements of ss. 627.062 and 627.410.

627.975 Reinsurance.--

(1) For financial guaranty insurance which takes effect on or after the effective date of this act, an insurer transacting financial guaranty insurance shall receive credit for reinsurance in accordance with the provisions of this code applicable to property and casualty insurers, as an asset or as a reduction from liabilities, if the reinsurance is subject to an agreement that, for its stated term and with respect to any financial guaranty insurance in force, the reinsurance agreement may only be terminated or amended 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 continues until the expiration or cancellation of each such policy with the consent of the ceding insurer; if the reinsurance agreement provides for a cutoff of the reinsurance in force at the date of termination or at the request of the ceding company or at the discretion of the department, acting

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as rehabilitator, liquidator, or receiver of the ceding or assuming company; and that such reinsurance:

(a) Is placed with another insurer licensed under this part or an insurer writing financial guaranty insurance as permitted under this part;

(b) Is placed with another type of insurer licensed to write surety insurance, if such insurer:

1. Has and maintains surplus to policyholders of at least $35 million;

2. Establishes and maintains the reserves required in s. 627.972, except that if the reinsurance agreement is not pro rata, the contribution to the contingency reserve must be equal to 50 percent of the quarterly earned reinsurance premium;

3. Complies with s. 627.973(4), (5), and (6); and

4. If it is a parent, subsidiary, or affiliate of the insurer transacting financial guaranty insurance, the provisions of s. 627.973(4) and (5) shall be applied against the combined policyholders' surplus and contingency reserves of such parent, subsidiary, or affiliate reinsurers after elimination of equity investments of the insurer and such reinsurers in each other; or

(c) Is placed with an unauthorized or unaccredited reinsurer which otherwise complies with the provisions of paragraph (a) or subparagraphs (b)1. and 5., in an amount not to exceed 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.

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(2) In determining whether the insurer meets the limitations imposed by s. 627.973(4), in addition to credit for other types of qualifying reinsurance, the insurer'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 insurer's retention pursuant to the reinsurance agreement.

Section 2. Section 624.6081, Florida Statutes, is created to read:

624.6081 "Residual value insurance" defined.--For the purposes of part XX of chapter 627, the term "residual value insurance" means insurance issued in connection with a lease or contract which sets forth a specific termination value at the end of the term of the lease or contract for the property covered by the lease or contract and which insures against loss of economic value of tangible personal property or real property or improvements thereto, except loss due to physical damage to property. However, insurance may not be written as residual value insurance if it may be written as financial guaranty insurance by a financial guaranty insurance corporation pursuant to part XX of chapter 627.

Section 3. Section 624.606, Florida Statutes, is amended to read:

(Substantial rewording of section. See s. 624.606, F.S., for present text.)

624.606 "Surety insurance" defined.--

(1) "Surety insurance" includes:

(a) A contract bond, including a bid, payment, or maintenance bond, or a performance bond, which guarantees the

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execution of a contract other than a contract of indebtedness or other monetary obligation;

(b) An indemnity bond for the benefit of a public body, railroad, or charitable organization or a lost security or utility payment bond;

(c) Becoming surety on, or guaranteeing the performance of, any lawful contract where the bond is guaranteeing the execution of a contract other than a contract of indebtedness or other monetary obligation;

(d) Becoming surety on, or guaranteeing the performance of, bonds and undertakings required or permitted in a judicial proceeding or otherwise allowed by law, including surety bonds accepted by states and municipal authorities in lieu of deposits as security for the performance of insurance contracts;

(e) Fidelity insurance as defined in s. 624.6065 for the purposes of the Florida Insurance Code other than part XX of chapter 627; or

(f) Residual value insurance as defined in s. 624.6081.

(2) "Surety insurance" does not include:

(a) Mortgage guaranty insurance, as defined in s. 635.011;

(b) Financial guaranty insurance, as defined in s. 627.971; or

(c) Any reinsurance contract authorized pursuant to s. 624.610.

Section 4. Section 624.6065, Florida Statutes, is created to read:
624.6065 "Fidelity insurance" defined.--For the purposes of part XX of chapter 627, the term "fidelity insurance" means:

(1) Insurance guaranteeing the fidelity of persons holding positions of public or private trust, or indemnifying banks, thrifts, brokers, or other financial institutions against loss of money, securities, negotiable instruments, other specified valuable papers, or tangible items of personal property caused by larceny, misplacement, destruction, or other stated perils including loss while being transported in an armored motor vehicle or by messenger and including insurance for loss caused by the forgery of signatures on, or alteration of, specified documents, and valuable papers.

(2) Insurance against losses that financial institutions become legally obligated to pay by reason of loss of customers' property from safe deposit boxes.

Section 5. Paragraph (i) of subsection (1) of section 624.605, Florida Statutes, is amended to read:

624.605 "Casualty insurance" defined.--

(1) "Casualty insurance" includes:

(i) Credit.--Insurance against loss or damage resulting from failure of debtors to pay their obligations to the creditor (including loss or damage resulting from the involuntary unemployment of the debtors), except insurance against loss or damage resulting from the death or disability of the debtors. However, insurance may not be written as credit insurance if it falls within the definition of financial guaranty insurance, as defined in s. 627.971.

Section 6. Sections 627.971, 627.972, 627.973, 627.974, and 627.975, Florida Statutes, are repealed on October 1, 1992, and shall be reviewed by the Legislature.

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prior to that date pursuant to section 11.61, Florida Statutes.

Section 7. Sections 624.6065 and 624.6081, Florida Statutes, are repealed on October 1, 1991, and shall be reviewed by the Legislature prior to that date pursuant to section 11.61, Florida Statutes.

Section 8. This act shall take effect July 1, 1988, or upon becoming a law, whichever occurs later.

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SENATE SUMMARY

Creates sections regulating financial guaranty insurance and residual value insurance. Establishes operating requirements for such insurers. (See bill for details.)

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A bill to be entitled

An act relating to insurance; creating s. 627.971, F.S.; providing definitions; creating s. 627.972, F.S.; providing organizational and financial requirements for financial guaranty insurance corporations; creating s. 627.973, F.S.; providing limitations under which financial guaranty insurance corporations and certain property and casualty insurers may operate; creating s. 627.974, F.S.; requiring the filing of certain policy forms with the Department of Insurance; prohibiting excessive rates by financial guaranty insurance corporations; providing criteria for determining the adequacy of such rates; providing that such filings shall be available for public inspection; creating s. 627.975, F.S.; providing that certain financial guaranty insurance corporations shall receive credit for certain reinsurance; creating s. 624.6081, F.S.; defining "residual value insurance"; amending s. 624.606, F.S.; redefining "surety insurance"; creating s. 624.6065, F.S.; defining "fidelity insurance"; amending s. 624.605, F.S.; limiting the definition of casualty insurance as it relates to certain credit insurance; providing for legislative review and repeal; providing an effective date.

Be It Enacted by the Legislature of the State of Florida:

CODING: Words struck are deletions; words underlined are additions.
Section 1. Part XX of chapter 627, Florida Statutes, consisting of sections 627.971, 627.972, 627.973, 627.974, and 627.975, is created to read:

PART XX

FINANCIAL GUARANTY INSURANCE

627.971 Definitions.--As used in this part:

(a) "Financial guaranty insurance" means a surety bond, insurance policy, an indemnity contract issued by an insurer, or any similar guaranty, under which loss is payable upon proof of occurrence of financial loss to an insured claimant, obligee, or indemnitee as a result of:

1. The failure of an obligor on a debt instrument or other monetary obligation, including common or preferred stock guaranteed under a surety bond, insurance policy, or indemnity contract, to make principal, interest, premium, dividend, or purchase price payments when due, if the failure is the result of a financial default or insolvency, whether such obligation is incurred directly or as guarantor by or on behalf of another obligor who also defaulted;

2. Changes in the levels of interest rates or the differential in interest rates between various markets or products;

3. Changes in the rate of exchange of currency;

4. Changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general; or

5. Other events which the department determines are substantially similar to any of the foregoing.

(b) However, "financial guaranty insurance" does not include:

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1. Insurance of a loss resulting from an event described in paragraph (a), 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:

a. A fortuitous physical event;

b. A failure of or deficiency in the operation of equipment; or

c. An inability to extract or recover a natural resource;

2. An individual or schedule public official bond;

3. A court bond required in connection with judicial, probate, bankruptcy, or equity proceedings, including a waiver, probate, open estate, or life tenant bond;

4. A bond running to a federal, state, county, municipal government, or other political subdivision, as a condition precedent to the granting of a license to engage in a particular business or of a permit to exercise a particular privilege;

5. A loss security bond or utility payment indemnity bond running to a governmental unit, railroad, or charitable organization;

6. A lease, purchase and sale, or concessionaire surety bond;

7. Credit unemployment 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;

8. Credit insurance indemnifying a manufacturer, merchant, or educational institution which extends credit against loss or damage resulting from nonpayment of debts owed

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to him for goods or services provided in the normal course of
his business;

9. Guaranteed investment contracts that are issued by
life insurance companies and that provide that the life
insurer will make specified payments in exchange for specific
premiums or contributions;

10. Mortgage guaranty insurance as defined in s.
635.011(1) or s. 635.021;

11. Indemnity contracts or similar guaranties, to the
extent that they are not otherwise limited or proscribed by
this part, in which a life insurer guarantees:

a. Its obligations or indebtedness or the obligations
or indebtedness of a subsidiary of which it owns more than 50
percent, other than a financial guaranty insurance
corporation, if:

(I) For any such obligations or indebtedness that are
backed by specific assets, such assets are at all times owned
by the insurer or the subsidiary; and

(II) For the obligations or indebtedness of the
subsidiary that are not backed by specific assets of the life
insurer, the guaranty terminates once the subsidiary ceases to
be a subsidiary; or

b. The 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 so acquired have been:

(I) Acquired by a special purpose entity where the
sole purpose is to acquire specific assets of the life insurer

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or the subsidiary and issue securities or participation certificates backed by such assets; or

(II) Sold to an independent third party; or

c. The obligations or indebtedness of an employee or agent of the life insurer; or

12. Any form of surety insurance as defined in s. 624.606.

13. Any other form of insurance covering risks which the department determines to be substantially similar to any of the foregoing.

(2) "Affiliate" means a person that, directly or indirectly, owns at least 10 percent but less than 25 percent of the financial guaranty insurance corporation or that is at least 10 percent but less than 25 percent, directly or indirectly, owned by a financial guaranty insurance corporation.

(3) "Average annual debt service" means the amount of insured unpaid principal and interest on an issue of obligations, multiplied by the number of the insured obligations in the issue, each obligation representing a $1,000 par value, divided by an amount equal to the aggregate life of all the obligations in the issue. The formula for bonds is:

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

\[
\text{Total Debt Service} = \text{Insured Unpaid Principal} + \text{Interest due over the remaining life of the bond}
\]

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

\[
\text{Bond Years} = \frac{\text{Number of Bonds}}{\text{Term in Years}}
\]

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(4) "Collateral" means:

(a) Cash;

(b) The market value of investment grade securities, other than securities evidencing an interest in the projects financed with the proceeds of the insured obligations;

(c) The scheduled cash flow from investment grade obligations scheduled to be received on or prior to the date of scheduled debt service on the insured obligation;

(d) A conveyance or mortgage of real property; or

(e) A letter of credit;

if deposited with or held by the corporation; held in trust by a trustee, acceptable to the department, for the benefit of the corporation; or held in trust, pursuant to the bond indenture, by a trustee acceptable to the department, for the benefit of bondholders in the form of sinking funds or other reserves which may be used solely for the payment of debt service.

(5) "Contingency reserve" means an additional liability reserve established to protect policyholders against the effects of adverse economic cycles or other unforeseen circumstances.

(6) "Financial guaranty insurance corporation" means a stock insurer licensed to transact financial guaranty insurance business in this state.

(7) "Governmental unit" means the United States, Canada, a state, territory, or possession of the United States, 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.
(8) "Guaranties of consumer debt obligations" means insurance policies indemnifying against loss or damage resulting from nonpayment of debts owed for extensions of credit to individuals for nonbusiness purposes. Such extensions of credit include guaranties of securities backed by obligations of individuals. Policies that provide this coverage must contain a provision that all liability terminates upon the sale or transfer of the underlying obligation to any transferee which is not an insured of the financial guaranty insurance corporation under a similar policy.

(9) "Industrial development bond" means any security, or other instrument 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 payable from the revenues of the project or by any private, for-profit entity.

(10) An "investment grade obligation" means an obligation that:

(a) Has been determined to be in one of the top four generic lettered rating classifications by a securities rating agency acceptable to the department;

(b) Has been identified in writing by such a rating agency as an insurable risk deemed to be of investment grade quality for purposes of insurance;

(c) Has received a "yes" rating by the Securities Valuation Office of the National Association of Insurance Commissioners; or

(d) Has been submitted for review to the appropriate rating agency or Securities Valuation Office and will be
qualified pursuant to paragraph (a), paragraph (b), or paragraph (c).

(11) "Letter of credit" means:

(a) The stated amount of a clean unconditional, irrevocable letter of credit issued by a bank or trust company whose debt rating applicable to the term of the insured obligation is in one of the two highest generic lettered rating classifications by a securities rating agency acceptable to the department; or

(b) Fifty percent of the stated amount of a clean unconditional, irrevocable letter of credit issued by a bank or trust company whose debt rating applicable to the term of the insured obligation is in a rating classification other than as set forth in paragraph (a).

(c) An issuing or confirming bank referred to in paragraph (a) or paragraph (b) shall be:

1. Determined by the Securities Valuation office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of banks and trust companies whose letters of credit shall be acceptable to insurance regulatory authorities; provided, that the letter of credit is issued for the full term of the insured obligation, or the insured obligation is subject to mandatory call and redemption from the proceeds of the letter of credit if the letter of credit is not renewed or replaced; and

2.a. A member of the federal reserve system or chartered by a state of the United States; or

b. Organized and existing under the laws of a foreign country whose sovereign debt is rated in the highest major

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rating classification by a securities rating agency acceptable to the department; and which has been licensed as a domestic branch or agency by the Federal Government or a state of the United States; and which is regulated, supervised, and examined by United States federal or state authorities having regulatory authority over banks and trust companies.

(12) "Municipal bonds" means municipal obligation bonds and industrial development bonds.

(13) "Municipal obligation bond" means any security or other instrument, including a lease, under which a payment obligation is created, other than an industrial development bond, which is issued by or on behalf of or payable or guaranteed by a governmental unit, including certificates of participation evidencing proportionate ownership in payments to be made by a governmental unit, or issued by an entity other than a governmental unit if such security or instrument is eligible for issuance by a governmental unit but would not be an industrial development bond if so issued.

(14) "Reinsurance" means cessions qualifying for credit under s. 627.975.

(15) "Total liability of an insurer transacting financial guaranty insurance" means the aggregate amount of insured unpaid principal, interest, and other monetary payments, if any, of guaranteed obligations insured or assumed, less reinsurance and collateral. However, for guaranteed obligations insured or assumed where acceleration of payment of such obligation is at the sole option of the insurer, such total liability means the aggregate amount of the discounted present value of insured unpaid principal and unpaid interest up to the point of acceleration and other monetary payments, if any, of guaranteed obligations insured.

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or assumed, less reinsurance and collateral. The discount rate to be applied shall be the average rate of return on the admitted assets of the insurer at the time of computation or the face rate of interest of the guaranteed obligation, whichever is less.

627.972 Organization; financial requirements.--

(1) A financial guaranty insurance corporation must be organized and licensed in the manner prescribed in this code for stock property and casualty insurers except that:

(a) A corporation organized to transact financial guaranty insurance may, subject to the provisions of this code, be licensed to transact:

1. Residual value insurance, as defined by s. 624.6081;

2. Surety insurance, as defined by s. 624.606;

3. Credit insurance, as defined by s. 624.605(1)(i);

and

4. Mortgage guaranty insurance as defined in s. 635.011, provided that the provisions of chapter 635 are met.

(b) Prior to the issuance of a license, a corporation must submit to the department for approval, a plan of operation detailing:

a. The types and projected diversification of guaranties to be issued;

b. The underwriting procedures to be followed;

c. The managerial oversight methods;

d. The investment policies; and

e. Any other matters prescribed by the department;

2. An insurer which is writing only the types of insurance allowed under this part on the effective date of
this part and otherwise meets the requirements of this part, is exempt from the requirements of this paragraph.

(c) An insurer transacting financial guaranty insurance is subject to all provisions of this code that are applicable to property and casualty insurers to the extent that those provisions are not inconsistent with this part; and

(d) The investments of an insurer transacting financial guaranty insurance in any entity insured by the corporation may not exceed 2 percent of its admitted assets as of the end of the prior calendar year.

(e) An insurer transacting financial guaranty insurance may only assume those lines of insurance for which it is licensed to write direct business.

(2) An insurer may not transact financial guaranty business unless it has surplus to policyholders of at least $50 million at the date of initial licensing for financial guaranty insurance and maintains a minimum surplus to policyholders of at least $35 million;

(3) An insurer may not transact financial guaranty insurance unless it establishes a contingency reserve, net of reinsurance, as follows:

(a) A contingency reserve, net of reinsurance, must be established in a minimum amount calculated by applying the following percentages to the net principal outstanding each calendar year of guarantees of:

1. Municipal obligation bonds, 0.8 percent;
2. Investment grade obligations with a term of less than 3 years, 1.0 percent;
3. All other investment grade obligations, including investment grade industrial development bonds and investment grade consumer debt obligations, 1.6 percent:

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4. Noninvestment grade consumer debt obligations, 2.5 percent; and
5. All other obligations guaranteed, 3.0 percent.

(b) 1. Quarterly additions to the reserve for subparagraph 1. of paragraph (a) must be equal to the greater of 1/80th of the amounts derived by applying the appropriate contribution specified in that sub-subparagraph or 50 percent of the quarterly earned premiums on these guaranties, and must be maintained for a period of 20 years; and

2. Quarterly additions to the reserve for subparagraph 2., subparagraph 3., and subparagraph 4. of paragraph (a) must be equal to the greater of 1/40th of the amounts derived by applying the appropriate contribution specified in that sub-subparagraph or 50 percent of the quarterly earned premiums on these guaranties and must be maintained for a period of 10 years, except that, for obligations with a term of less than 3 years, the reserve must be maintained for a period of at least 5 years;

(c) The reserve may be released thereafter in the same manner, except that a part of the reserve may be released proportional to the reduction in net total liabilities resulting from reinsurance and the reinsurer must, on the effective date of the reinsurance, establish a reserve in an amount equal to the amount released; and

(d) Withdrawals from the contingency reserve, to the extent of any excess, may be made with the approval of the department from the earliest contributions to the reserve remaining therein:

1. In any year in which the actual incurred losses exceed 35 percent of earned premiums, or

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2. If the contingency reserve has been in existence
for 40 quarters for reserves subject to subparagraph (b)1.,
and 20 quarters for reserves subject to subparagraph (b)2.,
upon demonstration that the amount carried is excessive in
relation to the insurer's outstanding obligations;

(4) In addition to the contingency reserve, the case
basis method or other method prescribed by the department is
used to determine loss reserves, in a manner consistent with
the requirements of part I of chapter 625, which must include
a reserve for claims reported and unpaid net of collateral. 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 any such reserve. The
discount rate must be adjusted at the end of each calendar
year; and

(5) The insurer maintains an unearned premium reserve,
net of reinsurance, computed on the monthly pro rata basis,
where the premiums are paid on an installment basis. All
other such premiums paid must be earned proportionately with
the expiration of exposure or by such other method the
department prescribes or approves.

627.973 Limitations.--

(1) Financial guaranty insurance shall be transacted
in this state only by a corporation licensed for such purpose,
except that a property and casualty insurer transacting
business pursuant to the provisions of this code may transact
financial guaranty insurance in this state if the following
conditions are met:

(a) Total policyholders' surplus exceeds $100 million;
(b) Not more than 20 percent of total net premiums written are applicable to or for financial guaranty insurance;

(c) The provisions of this part are applied to the insurer's financial guaranty insurance business;

(d) Not more than 20 percent of the insurer's total policyholder's surplus is applied toward meeting the provisions of this part;

(e) The policyholders' surplus once utilized to meet the requirements of this part shall not be available for meeting any policyholders' surplus requirements for any other type of insurance;

(f) The insurer is licensed to write financial guaranty insurance; and

(g) Unless the insurer is transacting financial guaranty insurance prior to the effective date of this part and otherwise meets the requirements of this section, prior to the issuance of a license, the insurer must submit to the department for approval, a plan of operation complying with s. 627.972(1)(b).

(2) Financial guaranty insurance shall be written only to insure obligations defined in subparagraph 627.971(1)(a)1., except that obligations defined in subparagraphs 627.971(1)(a)2., 3., 4., and 5. may be written with the prior written approval of the department pursuant to limitations and restrictions promulgated by rule that the department deems appropriate and necessary to protect the policyholders of the insurer.

(3) At least 95 percent of the outstanding total liability on municipal obligation bonds of an insurer transacting financial guaranty insurance must be investment grade.
(4) An insurer transacting financial guaranty insurance must at all times maintain capital, surplus, and contingency reserves, subject to the restrictions in subsection (1)(d) if applicable, in the aggregate no less than the sum of:

(a) 0.3333 percent of the total liabilities outstanding under guaranties of municipal obligation bonds;

(b) One percent of the total liabilities outstanding under guaranties of investment grade obligations, including industrial development bonds and investment grade consumer debt obligations;

(c) One and one-third percent of the total liabilities outstanding under guaranties of noninvestment grade consumer debt obligations;

(d) Two percent of the total liabilities outstanding under guaranties of other obligations not of investment grade, other than consumer debt obligations; and

(e) Surplus determined by the department to be adequate to support the writing of residual value insurance, surety insurance, and credit insurance, if the corporation has elected to transact these kinds of insurance pursuant to s. 627.972(1).

(5) An insurer transacting financial guaranty insurance must limit its exposure to loss, net of collateral and reinsurance, as follows:

(a) For municipal bonds:

1. The insured average annual debt service with respect to any one entity and backed by a single revenue source may not exceed 10 percent of the aggregate of the corporation's capital, surplus, and contingency reserves,
subject to the restrictions of subsection (1)(d) if applicable; and

2. The insured unpaid principal issued by a single entity and backed by a single revenue source may not exceed 75 percent of the aggregate of the corporation's capital, surplus, and contingency reserves, subject to the restrictions in subsection (1)(d) if applicable; and

(b) For all other financial guaranties, the insured unpaid principal for any one risk may not exceed 10 percent of the aggregate of the corporation's capital, surplus, and contingency reserves, subject to the restrictions in subsection (1)(d) if applicable. Single risk liability shall be defined with respect to any one issuer, except that, if the risk is payable from a specified revenue source or adequately secured by loan obligations or other assets, such risk shall be defined by the revenue source.

(6) If the exposure to loss of an insurer transacting financial guaranty insurance exceeds the limitations in subsection (4), it may not transact any new financial guaranty insurance business until its exposure to loss no longer exceeds those limitations.

(7) An insurer which wrote financial guaranty insurance in this state during the 12-month period immediately preceding the effective date of this act but which does not meet the requirements of subsection (1) or of s. 627.972(2), may, nevertheless, continue to write financial guaranty insurance as authorized by subsection (2) after the effective date of this act, subject to all other provisions of this part, provided:

(a) Within 45 days after such date the insurer files with the department a statement of its intentions to limit its

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writings to financial guaranty, surety and fidelity insurance.

Effective upon such filing, the insurer shall be subject to the requirements of this part except that the surplus to policyholders requirement of s. 627.972(2) shall not apply to such insurer until July 1, 1998, at which time such insurer shall have and thereafter maintain the minimum surplus requirement of at least $35 million. Failure of the insurer to meet the conditions of such statement of intent filed with the department, until such time as it meets the requirements of subsection (1), shall be grounds to subject the insurer to the penalties provided under this code, including immediate suspension or revocation of its certificate of authority. If the insurer does not file such statement of intent, it shall cease writing any new financial guaranty insurance business within 6 months after the effective date of this act. The insurer may:

1. Reinsure its net in-force business with a licensed financial guaranty insurance corporation or an insurer exempt under subsection (1);

2. Subject to the prior approval of its domiciliary insurance commissioner, reinsure all or part of its net in-force business pursuant to s. 627.975(1)(b), except that subparagraphs 2. and 4. do not apply. The assuming insurer must maintain reserves for the reinsured business in the manner applicable to the ceding insurer under paragraph (b);

3. May continue the risks in force and, with 30 days prior written notice to its domiciliary insurance commissioner, write new financial guaranty policies if the writing of those policies is reasonably prudent to mitigate either the amount of or possibility of loss in connection with

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business written prior to the effective date of this act. However, an insurer must receive the prior approval of its domiciliary insurance commissioner before writing any new financial guaranty insurance policies that would increase its risk of loss.

(b) Must, for all guaranties in force prior to the effective date of the act, including those which fall under the definition of financial guaranty insurance, maintain the reserves applicable for municipal bond guaranties in effect prior to the effective date of this act. If the insurer's contingency reserves maintained as of the effective date of this act are less than those required for municipal bond guaranties, the insurer has 3 years to bring its reserves into compliance, except that a part of the reserve may be released proportional to the reduction in net total liabilities resulting from reinsurance if the reinsurer, on the effective date of the reinsurance, establishes a reserve in an amount equal to the amount released and except that a part of the reserve may be released with departmental approval, upon demonstration that the amount carried is excessive in relation to the corporation's outstanding obligations.

(c) Shall be subject to the reserve requirements applicable to financial guaranty insurance corporations, for business written on or after the effective date of the act.

(d) This subsection shall not apply to insurers permitted to write financial guaranty insurance pursuant to the exception set forth in subsection (1) and such insurers may write financial guaranty insurance subject to the requirements of the Florida Insurance Code.

627.974 Filing of policy forms and rates.--

CODING: Words stricken are deletions; words underlined are additions.
(1) Policy forms and any amendments thereto must be filed with the department within 30 days after their use by the insurer. A policy may not provide coverage of the acceleration of payments due under the guaranteed obligations, including any payment in advance of scheduled maturity to be made by the issuer of the guaranteed obligations at the sole option of the owner of the guaranteed obligations, unless the acceleration is at the sole option of the insurer. Each policy must disclose that the insurance provided by the policy is not covered by the Florida Insurance Guaranty Association created under part II of chapter 631. The department may prescribe additional minimum policy provisions which are determined by the department to be necessary or appropriate to protect policyholders, claimants, obligees, or indemnitees.

(2) Rates may not be excessive, inadequate, unfairly discriminatory, destructive of competition, or detrimental to the solvency of the insurer.

(3) Criteria and guidelines used by insurers transacting financial guaranty insurance in establishing rating categories and ranges of rates to be used must be filed with the department for information prior to their use by the insurer.

(4) All such filings must be available for public inspection at the department.

(5) This section is in lieu of the requirements of ss. 627.062 and 627.410.

627.975 Reinsurance.--

(1) For financial guaranty insurance which takes effect on or after the effective date of this act, an insurer transacting financial guaranty insurance shall receive credit for reinsurance in accordance with the provisions of this code.

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applicable to property and casualty insurers, as an asset or as a reduction from liabilities; if the reinsurance is subject to an agreement that, for its stated term and with respect to any financial guaranty insurance in force, the reinsurance agreement may only be terminated or amended 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 continues until the expiration or cancellation of each such policy with the consent of the ceding insurer; if the reinsurance agreement provides for a cutoff of the reinsurance in force at the date of termination or at the request of the ceding company or at the discretion of the department, acting as rehabilitator, liquidator, or receiver of the ceding or assuming company; and that such reinsurance:

(a) Is placed with another insurer licensed under this part or an insurer writing financial guaranty insurance as permitted under this part;

(b) Is placed with another type of insurer licensed to write surety insurance, if such insurer:
   1. Has and maintains surplus to policyholders of at least $35 million;
   2. Establishes and maintains the reserves required in s. 627.972, except that if the reinsurance agreement is not pro rata, the contribution to the contingency reserve must be equal to 50 percent of the quarterly earned reinsurance premium;
   3. Complies with s. 627.973(4), (5), and (6); and
   4. If it is a parent, subsidiary, or affiliate of the insurer transacting financial guaranty insurance, the provisions of s. 627.973(4) and (5) shall be applied against

CODING: Words stricken are deletions; words underlined are additions.
the combined policyholders' surplus and contingency reserves of such parent, subsidiary, or affiliate reinsurers after elimination of equity investments of the insurer and such reinsurers in each other; or

(c) Is placed with an unauthorized or unaccredited reinsurer which otherwise complies with the provisions of paragraph (a) or subparagraphs (b)1. and 5., in an amount not to exceed 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.

(2) In determining whether the insurer meets the limitations imposed by s. 627.973(4), in addition to credit for other types of qualifying reinsurance, the insurer'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 insurer's retention pursuant to the reinsurance agreement.

Section 2. Section 624.6081, Florida Statutes, is created to read:

624.6081 "Residual value insurance" defined.--For the purposes of part XX of chapter 627, the term "residual value insurance" means insurance issued in connection with a lease or contract which sets forth a specific termination value at the end of the term of the lease or contract for the property covered by the lease or contract and which insures against loss of economic value of tangible personal property or real

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property or improvements thereto, except loss due to physical
damage to property. However, insurance may not be written as
residual value insurance if it may be written as financial
guaranty insurance by a financial guaranty insurance
corporation pursuant to part XX of chapter 627.

Section 3. Section 624.606, Florida Statutes, is
amended to read:

(Substantial rewording of section. See
s. 624.606, F.S., for present text.)

624.606 "Surety insurance" defined.--

(1) "Surety insurance" includes:

(a) A contract bond, including a bid, payment, or
maintenance bond, or a performance bond, which guarantees the
execution of a contract other than a contract of indebtedness
or other monetary obligation;

(b) An indemnity bond for the benefit of a public
body, railroad, or charitable organization or a lost security
or utility payment bond;

(c) Becoming surety on, or guaranteeing the
performance of, any lawful contract where the bond is
guaranteeing the execution of a contract other than a contract
of indebtedness or other monetary obligation;

(d) Becoming surety on, or guaranteeing the
performance of, bonds and undertakings required or permitted
in a judicial proceeding or otherwise allowed by law,
including surety bonds accepted by states and municipal
authorities in lieu of deposits as security for the
performance of insurance contracts;

(e) Fidelity insurance as defined in s. 624.6065 for
the purposes of the Florida Insurance Code other than part XX
of chapter 627; or

CODING: Words stricken are deletions; words underlined are additions.
(f) Residual value insurance as defined in s. 624.6081.

(2) "Surety insurance" does not include:

(a) Mortgage guaranty insurance, as defined in s. 635.011;

(b) Financial guaranty insurance, as defined in s. 627.971; or

(c) Any reinsurance contract authorized pursuant to s. 624.610.

Section 4. Section 624.6065, Florida Statutes, is created to read:

624.6065 "Fidelity insurance" defined.--For the purposes of part XX of chapter 627, the term "fidelity insurance" means:

(1) Insurance guaranteeing the fidelity of persons holding positions of public or private trust, or indemnifying banks, thrifts, brokers, or other financial institutions against loss of money, securities, negotiable instruments, other specified valuable papers, or tangible items of personal property caused by larceny, misplacement, destruction, or other stated perils including loss while being transported in an armored motor vehicle or by messenger and including insurance for loss caused by the forgery of signatures on, or alteration of, specified documents, and valuable papers.

(2) Insurance against losses that financial institutions become legally obligated to pay by reason of loss of customers' property from safe deposit boxes.

Section 5. Paragraph (1) of subsection (1) of section 624.605, Florida Statutes, is amended to read:

624.605 "Casualty insurance" defined.--

(1) "Casualty insurance" includes:
(1) Credit.--Insurance against loss or damage resulting from failure of debtors to pay their obligations to the creditor (including loss or damage resulting from the involuntary unemployment of the debtors), except insurance against loss or damage resulting from the death or disability of the debtors. However, insurance may not be written as credit insurance if it falls within the definition of financial guaranty insurance, as defined in s. 627.971.

Section 6. Sections 627.971, 627.972, 627.973, 627.974, and 627.975, Florida Statutes, are repealed on October 1, 1992, and shall be reviewed by the Legislature prior to that date pursuant to section 11.61, Florida Statutes.

Section 7. Sections 624.6065 and 624.6081, Florida Statutes, are repealed on October 1, 1991, and shall be reviewed by the Legislature prior to that date pursuant to section 11.61, Florida Statutes.

Section 8. This act shall take effect July 1, 1988, or upon becoming a law, whichever occurs later.

STATEMENT OF SUBSTANTIAL CHANGES CONTAINED IN COMMITTEE SUBSTITUTE FOR Senate Bill 1140

The committee substitute for SB 1140 redefines the term "letter of credit."

A grandfather clause is added to allow insurers who do not have policyholder surplus of $50 million, to continue to sell financial guaranty insurance. However, by July 1, 1991, such insurers must have $35 million in policyholder surplus or stop writing new financial guaranty insurance policies.

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the project shall consider at least two alternatives before making its decision about the project.

Section 2. Paragraph (a) of subsection (3) of section 339.175, Florida Statutes, is amended to read:

339.175 Transportation planning organization.--

(3)(a) The Governor shall, with the agreement of the affected units of general purpose local government as required by federal rules and regulations, apportion the membership among the various governmental entities within the area on the basis of equitable population ratio and geographic factors and shall prescribe a method for appointing alternate members who may vote at any M.P.O. meeting at which the regular members in attendance do not comprise a quorum. An appointed alternate member must be an elected official serving the same governmental entity or area that the regular member serves. The governing entity so designated shall appoint the appropriate number of members to the M.P.O. from eligible officials. Representatives of the department shall serve as nonvoting members of the M.P.O. Nonvoting advisers may be appointed by the M.P.O. as deemed necessary. The Governor shall review the composition of the M.P.O. membership at least every 5 years and reapportion it as necessary to comply with subsection (2).

Section 3. This act shall take effect upon becoming a law.

Approved by the Governor June 6, 1988.

Filed in Office Secretary of State June 6, 1988.

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An act relating to insurance; creating s. 627.971, F.S.; providing definitions; creating s. 627.972, F.S.; providing organizational and financial requirements for financial guaranty insurance corporations; creating s. 627.973, F.S.; providing limitations under which financial guaranty insurance corporations and certain property and casualty insurers may operate; creating s. 627.974, F.S.; requiring the filing of certain policy forms with the Department of Insurance; prohibiting excessive rates by financial guaranty insurance corporations; providing criteria for determining the adequacy of such rates; providing that such filings shall be available for public inspection; creating s. 627.975, F.S.; providing that certain financial guaranty insurance corporations shall receive credit for certain reinsurance; creating s. 624.6081, F.S.; defining "residual value insurance"; amending s. 624.606, F.S.; redefining "surety insurance"; creating s. 624.6065, F.S.; defining "fidelity insurance"; amending s. 624.605, F.S.; limiting the definition of casualty insurance as it relates to certain credit insurance; providing for legislative review and repeal; providing an effective date.

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Be It Enacted by the Legislature of the State of Florida:

Section 1. Part XX of chapter 627, Florida Statutes, consisting of sections 627.971, 627.972, 627.973, 627.974, and 627.975, is created to read:

PART XX
FINANCIAL GUARANTY INSURANCE

627.971 Definitions.--As used in this part:

(a) "Financial guaranty insurance" means a surety bond, insurance policy, an indemnity contract issued by an insurer, or any similar guaranty, under which loss is payable upon proof of occurrence of financial loss to an insured claimant, obligee, or indemnitee as a result of:

1. The failure of an obligor on a debt instrument or other monetary obligation, including common or preferred stock guaranteed under a surety bond, insurance policy, or indemnity contract, to make principal, interest, premium, dividend, or purchase price payments when due, if the failure is the result of a financial default or insolvency, whether such obligation is incurred directly or as guarantor by or on behalf of another obligor who also defaulted;

2. Changes in the levels of interest rates or the differential in interest rates between various markets or products;

3. Changes in the rate of exchange of currency;

4. Changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general; or

5. Other events which the department determines are substantially similar to any of the foregoing.

(b) However, "financial guaranty insurance" does not include:

1. Insurance of a loss resulting from an event described in paragraph (a), 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:

   a. A fortuitous physical event;
   b. A failure of or deficiency in the operation of equipment; or
   c. An inability to extract or recover a natural resource;

2. An individual or schedule public official bond;

3. A court bond required in connection with judicial, probate, bankruptcy, or equity proceedings, including a waiver, probate, open estate, or life tenant bond;

4. A bond running to a federal, state, county, municipal government, or other political subdivision, as a condition precedent to the granting of a license to engage in a particular business or of a permit to exercise a particular privilege;
5. A loss security bond or utility payment indemnity bond running to a governmental unit, railroad, or charitable organization;

6. A lease, purchase and sale, or concessionaire surety bond;

7. Credit unemployment 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;

8. Credit insurance indemnifying a manufacturer, merchant, or educational institution which extends credit against loss or damage resulting from nonpayment of debts owed to him for goods or services provided in the normal course of his business;

9. Guaranteed investment contracts that are issued by life insurance companies and that provide that the life insurer will make specified payments in exchange for specific premiums or contributions;

10. Mortgage guaranty insurance as defined in s. 635.011(1) or s. 635.021;

11. Indemnity contracts or similar guaranties, to the extent that they are not otherwise limited or proscribed by this part, in which a life insurer guarantees:

   a. Its obligations or indebtedness or the obligations or indebtedness of a subsidiary of which it owns more than 50 percent, other than a financial guaranty insurance corporation, if:

      (I) For any such obligations or indebtedness that are backed by specific assets, such assets are at all times owned by the insurer or the subsidiary; and

      (II) For the obligations or indebtedness of the subsidiary that are not backed by specific assets of the life insurer, the guaranty terminates once the subsidiary ceases to be a subsidiary; or

   b. The 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, guarantees obligations or indebtedness acquired by its subsidiary, provided that the assets so acquired have been:

      (I) Acquired by a special purpose entity where the 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

   c. The obligations or indebtedness of an employee or agent of the life insurer; or

12. Any form of surety insurance as defined in s. 624.606.
13. Any other form of insurance covering risks which the department determines to be substantially similar to any of the foregoing.

(2) "Affiliate" means a person that, directly or indirectly, owns at least 10 percent but less than 25 percent of the financial guaranty insurance corporation or that is at least 10 percent but less than 25 percent, directly or indirectly, owned by a financial guaranty insurance corporation.

(3) "Average annual debt service" means the amount of insured unpaid principal and interest on an issue of obligations, multiplied by the number of the insured obligations in the issue, each obligation representing a $1,000 par value, divided by an amount equal to the aggregate life of all the obligations in the issue. The formula for bonds is:

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

\[
\text{Total Debt Service} = \text{Insured Unpaid Principal + Interest due over the remaining life of the bond}
\]

\[
\text{Number of Bonds} = \text{Total Insured Principal} \div 1,000
\]

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

(4) "Collateral" means:

(a) Cash;

(b) The market value of investment grade securities, other than securities evidencing an interest in the projects financed with the proceeds of the insured obligations;

(c) The scheduled cash flow from investment grade obligations scheduled to be received on or prior to the date of scheduled debt service on the insured obligation;

(d) A conveyance or mortgage of real property; or

(e) A letter of credit;

if deposited with or held by the corporation; held in trust by a trustee, acceptable to the department, for the benefit of the corporation; or held in trust, pursuant to the bond indenture, by a trustee acceptable to the department, for the benefit of bondholders in the form of sinking funds or other reserves which may be used solely for the payment of debt service.

(5) "Contingency reserve" means an additional liability reserve established to protect policyholders against the effects of adverse economic cycles or other unforeseen circumstances.

(6) "Financial guaranty insurance corporation" means a stock insurer licensed to transact financial guaranty insurance business in this state.
(7) "Governmental unit" means the United States, Canada, a state, territory, or possession of the United States, 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.

(8) "Guaranties of consumer debt obligations" means insurance policies indemnifying against loss or damage resulting from nonpayment of debts owed for extensions of credit to individuals for nonbusiness purposes. Such extensions of credit include guaranties of securities backed by obligations of individuals. Policies that provide this coverage must contain a provision that all liability terminates upon the sale or transfer of the underlying obligation to any transferee which is not an insured of the financial guaranty insurance corporation under a similar policy.

(9) "Industrial development bond" means any security, or other instrument 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 payable from the revenues of the project or by any private, for-profit entity.

(10) An "investment grade obligation" means an obligation that:

(a) Has been determined to be in one of the top four generic lettered rating classifications by a securities rating agency acceptable to the department;

(b) Has been identified in writing by such a rating agency as an insurable risk deemed to be of investment grade quality for purposes of insurance;

(c) Has received a "yes" rating by the Securities Valuation Office of the National Association of Insurance Commissioners; or

(d) Has been submitted for review to the appropriate rating agency or Securities Valuation Office and will be qualified pursuant to paragraph (a), paragraph (b), or paragraph (c).

(11) "Letter of credit" means:

(a) The stated amount of a clean unconditional, irrevocable letter of credit issued by a bank or trust company whose debt rating applicable to the term of the insured obligation is in one of the two highest generic lettered rating classifications by a securities rating agency acceptable to the department; or

(b) Fifty percent of the stated amount of a clean unconditional, irrevocable letter of credit issued by a bank or trust company whose debt rating applicable to the term of the insured obligation is in a rating classification other than as set forth in paragraph (a).

(c) An issuing or confirming bank referred to in paragraph (a) or paragraph (b) shall be:

1. Determined by the Securities Valuation office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of banks and trust companies whose letters of credit shall be acceptable to insurance regulatory

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authorities; provided, that the letter of credit is issued for the full term of the insured obligation, or the insured obligation is subject to mandatory call and redemption from the proceeds of the letter of credit if the letter of credit is not renewed or replaced; and

2. a. A member of the federal reserve system or chartered by a state of the United States; or

b. Organized and existing under the laws of a foreign country whose sovereign debt is rated in the highest major rating classification by a securities rating agency acceptable to the department; and which has been licensed as a domestic branch or agency by the Federal Government or a state of the United States; and which is regulated, supervised, and examined by United States federal or state authorities having regulatory authority over banks and trust companies.

(12) "Municipal bonds" means municipal obligation bonds and industrial development bonds.

(13) "Municipal obligation bond" means any security or other instrument, including a lease, under which a payment obligation is created, other than an industrial development bond, which is issued by or on behalf of or payable or guaranteed by a governmental unit, including certificates of participation evidencing proportionate ownership in payments to be made by a governmental unit, or issued by an entity other than a governmental unit if such security or instrument is eligible for issuance by a governmental unit but would not be an industrial development bond if so issued.

(14) "Reinsurance" means cessions qualifying for credit under s. 627.975.

(15) "Total liability of an insurer transacting financial guaranty insurance" means the aggregate amount of insured unpaid principal, interest, and other monetary payments, if any, of guaranteed obligations insured or assumed, less reinsurance and collateral. However, for guaranteed obligations insured or assumed where acceleration of payment of such obligation is at the sole option of the insurer, such total liability means the aggregate amount of the discounted present value of insured unpaid principal and unpaid interest up to the point of acceleration and other monetary payments, if any, of guaranteed obligations insured or assumed, less reinsurance and collateral. The discount rate to be applied shall be the average rate of return on the admitted assets of the insurer at the time of computation or the face rate of interest of the guaranteed obligation, whichever is less.

627.972 Organization; financial requirements.—

(1) A financial guaranty insurance corporation must be organized and licensed in the manner prescribed in this code for stock property and casualty insurers except that:

(a) A corporation organized to transact financial guaranty insurance may, subject to the provisions of this code, be licensed to transact:

1. Residual value insurance, as defined by s. 624.6081;
2. Surety insurance, as defined by s. 624.606;
3. Credit insurance, as defined by s. 624.605(1)(1), and
4. Mortgage guaranty insurance as defined in s. 635.011, provided that the provisions of chapter 635 are met.

(b)1. Prior to the issuance of a license, a corporation must submit to the department for approval, a plan of operation detailing:
   a. The types and projected diversification of guaranties to be issued;
   b. The underwriting procedures to be followed;
   c. The managerial oversight methods;
   d. The investment policies; and
   e. Any other matters prescribed by the department;

2. An insurer which is writing only the types of insurance allowed under this part on the effective date of this part and otherwise meets the requirements of this part, is exempt from the requirements of this paragraph.

(c) An insurer transacting financial guaranty insurance is subject to all provisions of this code that are applicable to property and casualty insurers to the extent that those provisions are not inconsistent with this part, and

(d) The investments of an insurer transacting financial guaranty insurance in any entity insured by the corporation may not exceed 2 percent of its admitted assets as of the end of the prior calendar year.

(e) An insurer transacting financial guaranty insurance may only assume those lines of insurance for which it is licensed to write direct business.

(2) An insurer may not transact financial guaranty business unless it has surplus to policyholders of at least $50 million at the date of initial licensing for financial guaranty insurance and maintains a minimum surplus to policyholders of at least $35 million;

(3) An insurer may not transact financial guaranty insurance unless it establishes a contingency reserve, net of reinsurance, as follows
   (a) A contingency reserve, net of reinsurance, must be established in a minimum amount calculated by applying the following percentages to the net principal outstanding each calendar year of guaranties of:
      1. Municipal obligation bonds, 0.8 percent,
      2. Investment grade obligations with a term of less than 3 years, 1.0 percent;
3. All other investment grade obligations, including investment grade industrial development bonds and investment grade consumer debt obligations, 1.6 percent;

4. Noninvestment grade consumer debt obligations, 2.5 percent; and

5. All other obligations guaranteed, 3.0 percent.

(b)1. Quarterly additions to the reserve for subparagraph 1. of paragraph (a) must be equal to the greater of 1/80th of the amounts derived by applying the appropriate contribution specified in that sub-subparagraph or 50 percent of the quarterly earned premiums on these guaranties, and must be maintained for a period of 20 years; and

2. Quarterly additions to the reserve for subparagraph 2., subparagraph 3., and subparagraph 4. of paragraph (a) must be equal to the greater of 1/40th of the amounts derived by applying the appropriate contribution specified in that sub-subparagraph or 50 percent of the quarterly earned premiums on these guaranties and must be maintained for a period of 10 years, except that, for obligations with a term of less than 3 years, the reserve must be maintained for a period of at least 5 years;

(c) The reserve may be released thereafter in the same manner, except that a part of the reserve may be released proportional to the reduction in net total liabilities resulting from reinsurance and the reinsurer must, on the effective date of the reinsurance, establish a reserve in an amount equal to the amount released; and

(d) Withdrawals from the contingency reserve, to the extent of any excess, may be made with the approval of the department from the earliest contributions to the reserve remaining therein:

1. In any year in which the actual incurred losses exceed 35 percent of earned premiums, or

2. If the contingency reserve has been in existence for 40 quarters for reserves subject to subparagraph (b)1., and 20 quarters for reserves subject to subparagraph (b)2., upon demonstration that the amount carried is excessive in relation to the insurer's outstanding obligations;

(4) In addition to the contingency reserve, the case basis method or other method prescribed by the department is used to determine loss reserves, in a manner consistent with the requirements of part I of chapter 625, which must include a reserve for claims reported and unpaid net of collateral. 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 any such reserve. The discount rate must be adjusted at the end of each calendar year; and

(5) The insurer maintains an unearned premium reserve, net of reinsurance, computed on the monthly pro rata basis, where the premiums are paid on an installment basis. All other such premiums paid must be earned proportionately with the expiration of exposure or by such other method the department prescribes or approves.

627.973 Limitations.--
(1) Financial guaranty insurance shall be transacted in this state only by a corporation licensed for such purpose, except that a property and casualty insurer transacting business pursuant to the provisions of this code may transact financial guaranty insurance in this state if the following conditions are met:

(a) Total policyholders' surplus exceeds $100 million;

(b) Not more than 20 percent of total net premiums written are applicable to or for financial guaranty insurance;

(c) The provisions of this part are applied to the insurer's financial guaranty insurance business;

(d) Not more than 20 percent of the insurer's total policyholder's surplus is applied toward meeting the provisions of this part;

(e) The policyholders' surplus once utilized to meet the requirements of this part shall not be available for meeting any policyholders' surplus requirements for any other type of insurance;

(f) The insurer is licensed to write financial guaranty insurance; and

(g) Unless the insurer is transacting financial guaranty insurance prior to the effective date of this part and otherwise meets the requirements of this section, prior to the issuance of a license, the insurer must submit to the department for approval, a plan of operation complying with s. 627.972(1)(b).

(2) Financial guaranty insurance shall be written only to insure obligations defined in subparagraph 627.971(1)(a)1., except that obligations defined in subparagraphs 627.971(1)(a)2., 3., 4., and 5. may be written with the prior written approval of the department pursuant to limitations and restrictions promulgated by rule that the department deems appropriate and necessary to protect the policyholders of the insurer.

(3) At least 95 percent of the outstanding total liability on municipal obligation bonds of an insurer transacting financial guaranty insurance must be investment grade.

(4) An insurer transacting financial guaranty insurance must at all times maintain capital, surplus, and contingency reserves, subject to the restrictions in subsection (1)(d) if applicable, in the aggregate no less than the sum of:

(a) 0.3333 percent of the total liabilities outstanding under guaranties of municipal obligation bonds;

(b) One percent of the total liabilities outstanding under guaranties of investment grade obligations, including industrial development bonds and investment grade consumer debt obligations;

(c) One and one-third percent of the total liabilities outstanding under guaranties of noninvestment grade consumer debt obligations;
(d) Two percent of the total liabilities outstanding under guaranties of other obligations not of investment grade, other than consumer debt obligations; and

(e) Surplus determined by the department to be adequate to support the writing of residual value insurance, surety insurance, and credit insurance, if the corporation has elected to transact these kinds of insurance pursuant to s. 627.972(1).

(5) An insurer transacting financial guaranty insurance must limit its exposure to loss, net of collateral and reinsurance, as follows:

(a) For municipal bonds:

1. The insured average annual debt service with respect to any one entity and backed by a single revenue source may not exceed 10 percent of the aggregate of the corporation's capital, surplus, and contingency reserves, subject to the restrictions of subsection (1)(d) if applicable; and

2. The insured unpaid principal issued by a single entity and backed by a single revenue source may not exceed 75 percent of the aggregate of the corporation's capital, surplus, and contingency reserves, subject to the restrictions in subsection (1)(d) if applicable.

(b) For all other financial guaranties, the insured unpaid principal for any one risk may not exceed 10 percent of the aggregate of the corporation's capital, surplus, and contingency reserves, subject to the restrictions in subsection (1)(d) if applicable. Single risk liability shall be defined with respect to any one issuer, except that, if the risk is payable from a specified revenue source or adequately secured by loan obligations or other assets, such risk shall be defined by the revenue source.

(6) If the exposure to loss of an insurer transacting financial guaranty insurance exceeds the limitations in subsection (4), it may not transact any new financial guaranty insurance business until its exposure to loss no longer exceeds those limitations.

(7) An insurer which wrote financial guaranty insurance in this state during the 12-month period immediately preceding the effective date of this act but which does not meet the requirements of subsection (1) or of s. 627.972(2), may, notwithstanding, continue to write financial guaranty insurance as authorized by subsection (2) after the effective date of this act, subject to all other provisions of this part, provided

(a) Within 45 days after such date the insurer files with the department a statement of its intentions to limit its writings to financial guaranty, surety and fidelity insurance. Effective upon such filing, the insurer shall be subject to the requirements of this part except that the surplus to policyholders requirement of s. 627.972(2) shall not apply to such insurer until July 1, 1998, at which time such insurer shall have and thereafter maintain the minimum surplus requirement of at least $35 million. Failure of the insurer to meet the conditions of such statement of intent filed with the department, until such time as it meets the requirements of subsection (1), shall be grounds to subject the insurer to the penalties provided under this code, including immediate suspension or
revocation of its certificate of authority. If the insurer does not file such statement of intent, it shall cease writing any new financial guaranty insurance business within 6 months after the effective date of this act. The insurer may:

1. Reinsure its net in-force business with a licensed financial guaranty insurance corporation or an insurer exempt under subsection (1);

2. Subject to the prior approval of its domiciliary insurance commissioner, reinsure all or part of its net in-force business pursuant to s. 627.975(1)(b), except that subparagraphs 2. and 4. do not apply. The assuming insurer must maintain reserves for the reinsured business in the manner applicable to the ceding insurer under paragraph (b); or

3. May continue the risks in force and, with 30 days prior written notice to its domiciliary insurance commissioner, write new financial guaranty policies if the writing of those policies is reasonably prudent to mitigate either the amount of or possibility of loss in connection with business written prior to the effective date of this act. However, an insurer must receive the prior approval of its domiciliary insurance commissioner before writing any new financial guaranty insurance policies that would increase its risk of loss.

(b) Must, for all guaranties in force prior to the effective date of the act, including those which fall under the definition of financial guaranty insurance, maintain the reserves applicable for municipal bond guaranties in effect prior to the effective date of this act. If the insurer's contingency reserves maintained as of the effective date of this act are less than those required for municipal bond guaranties, the insurer has 3 years to bring its reserves into compliance, except that a part of the reserve may be released proportional to the reduction in net total liabilities resulting from reinsurance if the reinsurer, on the effective date of the reinsurance, establishes a reserve in an amount equal to the amount released and except that a part of the reserve may be released with departmental approval, upon demonstration that the amount carried is excessive in relation to the corporation's outstanding obligations.

(c) Shall be subject to the reserve requirements applicable to financial guaranty insurance corporations, for business written on or after the effective date of the act.

(d) This subsection shall not apply to insurers permitted to write financial guaranty insurance pursuant to the exception set forth in subsection (1) and such insurers may write financial guaranty insurance subject to the requirements of the Florida Insurance Code.

627.974 Filing of policy forms and rates.--

(1) Policy forms and any amendments thereto must be filed with the department within 30 days after their use by the insurer. A policy may not provide coverage of the acceleration of payments due under the guaranteed obligations, including any payment in advance of scheduled maturity to be made by the issuer of the guaranteed obligations at the sole option of the owner of the guaranteed obligations, unless the acceleration is at the sole option of the insurer. Each policy must disclose that the insurance provided by
the policy is not covered by the Florida Insurance Guaranty Association created under part II of chapter 631. The department may prescribe additional minimum policy provisions which are determined by the department to be necessary or appropriate to protect policyholders, claimants, obligees, or indemnitees.

(2) Rates may not be excessive, inadequate, unfairly discriminatory, destructive of competition, or detrimental to the solvency of the insurer.

(3) Criteria and guidelines used by insurers transacting financial guaranty insurance in establishing rating categories and ranges of rates to be used must be filed with the department for information prior to their use by the insurer.

(4) All such filings must be available for public inspection at the department.

(5) This section is in lieu of the requirements of ss. 627.062 and 627.410.

627.975 Reinsurance.--

(1) For financial guaranty insurance which takes effect on or after the effective date of this act, an insurer transacting financial guaranty insurance shall receive credit for reinsurance in accordance with the provisions of this code applicable to property and casualty insurers, as an asset or as a reduction from liabilities; if the reinsurance is subject to an agreement that, for its stated term and with respect to any financial guaranty insurance in force, the reinsurance agreement may only be terminated or amended 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 continues until the expiration or cancellation of each such policy with the consent of the ceding insurer; if the reinsurance agreement provides for a cutoff of the reinsurance in force at the date of termination or at the request of the ceding company or at the discretion of the department, acting as rehabilitator, liquidator, or receiver of the ceding or assuming company; and that such reinsurance:

(a) Is placed with another insurer licensed under this part or an insurer writing financial guaranty insurance as permitted under this part;

(b) Is placed with another type of insurer licensed to write surety insurance, if such insurer:

1. Has and maintains surplus to policyholders of at least $35 million;

2. Establishes and maintains the reserves required in s. 627.972, except that if the reinsurance agreement is not pro rata, the contribution to the contingency reserve must be equal to 50 percent of the quarterly earned reinsurance premium;

3. Complies with s. 627.973(4), (5), and (6); and

4. If it is a parent, subsidiary, or affiliate of the insurer transacting financial guaranty insurance, the provisions of s.
627.973(4) and (5) shall be applied against the combined policyholders' surplus and contingency reserves of such parent, subsidiary, or affiliate reinsurers after elimination of equity investments of the insurer and such reinsurers in each other; or

(c) Is placed with an unauthorized or unaccredited reinsurer which otherwise complies with the provisions of paragraph (a) or subparagraphs (b)(1) and 5., in an amount not to exceed 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.

(2) In determining whether the insurer meets the limitations imposed by s. 627.973(4), in addition to credit for other types of qualifying reinsurance, the insurer'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 insurer's retention pursuant to the reinsurance agreement.

Section 2. Section 624.6081, Florida Statutes, is created to read:

624.6081 "Residual value insurance" defined.--For the purposes of part XX of chapter 627, the term "residual value insurance" means insurance issued in connection with a lease or contract which sets forth a specific termination value at the end of the term of the lease or contract for the property covered by the lease or contract and which insures against loss of economic value of tangible personal property or real property or improvements thereto, except loss due to physical damage to property. However, insurance may not be written as residual value insurance if it may be written as financial guaranty insurance by a financial guaranty insurance corporation pursuant to part XX of chapter 627.

Section 3. Section 624.606, Florida Statutes, is amended to read.

(Substantial rewording of section. See s. 624.606, F.S., for present text.)

624.606 "Surety insurance" defined.--

(1) "Surety insurance" includes:

(a) A contract bond, including a bid, payment, or maintenance bond, or a performance bond, which guarantees the execution of a contract other than a contract of indebtedness or other monetary obligation;

(b) An indemnity bond for the benefit of a public body, railroad, or charitable organization or a lost security or utility payment bond;

(c) Becoming surety on, or guaranteeing the performance of, any lawful contract where the bond is guaranteeing the execution of a contract other than a contract of indebtedness or other monetary obligation;
(d) Becoming surety on, or guaranteeing the performance of, bonds and undertakings required or permitted in a judicial proceeding or otherwise allowed by law, including surety bonds accepted by states and municipal authorities in lieu of deposits as security for the performance of insurance contracts;

(e) Fidelity insurance as defined in s. 624.6065 for the purposes of the Florida Insurance Code other than part XX of chapter 627; or

(f) Residual value insurance as defined in s. 624.6081.

(2) "Surety insurance" does not include:

(a) Mortgage guaranty insurance, as defined in s. 635.011;

(b) Financial guaranty insurance, as defined in s. 627.971; or

(c) Any reinsurance contract authorized pursuant to s. 624.610.

Section 4. Section 624.6065, Florida Statutes, is created to read:

624.6065 "Fidelity insurance" defined.—For the purposes of part XX of chapter 627, the term "fidelity insurance" means:

(1) Insurance guaranteeing the fidelity of persons holding positions of public or private trust, or indemnifying banks, thrifts, brokers, or other financial institutions against loss of money, securities, negotiable instruments, other specified valuable papers, or tangible items of personal property caused by larceny, misplacement, destruction, or other stated perils including loss while being transported in an armored vehicle or by messenger and including insurance for loss caused by the forgery of signatures on, or alteration of, specified documents, and valuable papers.

(2) Insurance against losses that financial institutions become legally obligated to pay by reason of loss of customers’ property from safe deposit boxes.

Section 5. Paragraph (1) of subsection (1) of section 624.605, Florida Statutes, is amended to read:

624.605 "Casualty insurance" defined.—

(1) "Casualty insurance" includes:

(1) Credit.—Insurance against loss or damage resulting from failure of debtors to pay their obligations to the creditor (including loss or damage resulting from the involuntary unemployment of the debtors), except insurance against loss or damage resulting from the death or disability of the debtors. However, insurance may not be written as credit insurance if it falls within the definition of financial guaranty insurance, as defined in s. 627.971.

Section 6. Sections 627.971, 627.972, 627.973, 627.974, and 627.975, Florida Statutes, are repealed on October 1, 1992, and shall be reviewed by the Legislature prior to that date pursuant to section 11.61, Florida Statutes.
Section 7. Sections 624.6065 and 624.6081, Florida Statutes, are repealed on October 1, 1991, and shall be reviewed by the Legislature prior to that date pursuant to section 11 61, Florida Statutes.

Section 8. This act shall take effect July 1, 1988, or upon becoming a law, whichever occurs later.

Approved by the Governor June 6, 1988.

Filed in Office Secretary of State June 6, 1988.

CHAPTER 88-88

An act relating to transportation, amending s. 335.141, F.S.; specifying authority of the Department of Transportation to regulate the speed limits of railroad traffic and establish speed limits by order; specifying authority to enforce orders; providing authority of local governments to enact ordinances relating to blocking of streets by railroad engines and cars; providing an effective date.

Be It Enacted by the Legislature of the State of Florida:

Section 1. Subsections (3) and (4) of section 335.141, Florida Statutes, are amended to read:

335.141 Regulation of public railroad-highway grade crossings; reduction of hazards.--

(3) The department is authorized to regulate the speed limits of railroad traffic on a municipal, county, regional, or statewide basis. Such speed limits shall be established by order of the department, which order is subject to the provisions of chapter 120. The department shall have the authority to adopt reasonable rules to carry out the provisions of this subsection. Such rules shall, at a minimum, provide for public input prior to the issuance of any such order.

(4) Jurisdiction to enforce such orders rules-so-adopted shall be as provided in s. 316.640, and any penalty for violation thereof shall be imposed upon the railroad company guilty of such violation. Nothing herein shall prevent a local governmental entity from enacting ordinances passing-an-ordinance relating to the blocking of streets by railroad engines and cars a-crossing.

Section 2. This act shall take effect July 1, 1988, or upon becoming a law, whichever occurs later.

Approved by the Governor June 6, 1988.

Filed in Office Secretary of State June 6, 1988.
FINANCIAL GUARANTY INSURANCE

By the Staff of
The Florida Senate Committee on Commerce
February 1988
ERRATA SHEET

The following changes should be made to the report:

On page 8, the word "guarantys" should be "guaranties."

On page 9, "municipal bond investors assurance corporation" should be "Municipal Bond Investors Assurance Corporation."

On page 11, "guarantyed" should be "guarantied."

On page 15, the word "not" should be "no."
Financial Guaranty Insurance

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FINANCIAL GUARANTY INSURANCE

I. INTRODUCTION

"Someone once said that financial guarantee insurance is like pornography. You cannot define it but you know it when you see it."¹ Recently, there has been an expansion in the underwriting by insurance companies of financial guaranty insurance. The primary purpose of financial guaranty insurance is to reduce risks to investors.² By insuring a portion of an investment, the risk is transferred to the guarantor. Thus, financial guaranty insurance is issued to minimize loss to insured obligees or indemnities for the payment of principal and interest on various financial instruments.

Financial guaranty insurance is often divided into two broad categories: those that protect against economic loss and those that provide a financial service.³ The first type can be illustrated by mortgage insurance or limited partnership guaranties. These protect the investor against loss by transferring, in the event of default by the original party, economic risks to the guarantor.⁴ The second type can be illustrated by credit enhancement insurance. This type enables an insurance company to lend its credit rating and its reputation to a municipality's bond or corporation's security issue in exchange for a premium.⁵ Credit enhancement insurance allows
the borrower to substantially reduce interest costs on its debt obligations by raising the bond issuer's credit rating and concurrently it protects the bondholders against the risk that the municipality or corporation will default on payment of principal and interest.6

Conceptually, the financial guaranty insurance business is relatively new. However, its ancestor, the surety insurance business, is one of the oldest forms of insurance.7 Financial guaranty insurance is often recorded as surety insurance in the annual financial statement property and casualty insurers file with state regulators.

Due to the fact that financial guaranty insurance is currently written by numerous property and casualty insurers who write multiple lines of insurance, many state regulators are concerned with the effectiveness of their regulatory powers regarding financial guaranty insurance. In fact, during the 1987 Legislative Session in Florida, two bills were filed regarding financial guaranty insurance.8 Neither bill became law.9 However, because of the apparent move for financial guaranty insurance legislation, the Senate Commerce Committee on May 25, 1987, decided to study financial guaranty insurance. This report will encompass the recommendations by the Commerce Committee.
II. EXECUTIVE SUMMARY

A primary purpose of financial guaranty insurance is to reduce risks to investors. By insuring a portion of an investment, the risk is transferred to the guarantor. Thus, financial guaranty insurance is issued to minimize loss to insured obligees or indemnities for the payment of principal and interest on various financial instruments.

Financial guaranty insurance is often divided into two broad categories: those that protect against economic loss and those that provide a financial service. Economic loss is protected by transferring, in the event of default by the original party, economic risks to the guarantor. A financial service is supplied by enabling an insurance company to lend its credit rating and its reputation to a municipality's bond issue or a corporation's security issue in exchange for a premium. This financial service occurs by allowing the borrower to substantially reduce interest costs on its debt obligations by raising the bond issuer's credit rating. The insurance concurrently protects the bondholders against the risk that the municipality or corporation will default on payment of principal and interest.

Financial guaranty insurance has grown at a terrific rate in the past fifteen years. It has been regulated by state regulatory bodies as property/casualty insurance. Under Florida's present regulatory procedure, financial guaranty
insurance is written as surety insurance (a type of casualty insurance) and is not a separately defined line of insurance which prevents implementation of adequate regulation.

The most common type of financial guaranty insurance is insurance on municipal bonds. However, non-municipal bond insurance is also quite common. They differ in that insurance on non-municipal bonds can be obtained not only from insurance companies, but also from banks in the form of standby letters of credit. There appears to be some disparity between insurance companies and banks as to whether an advantage exists for banks "insuring" corporate securities in this manner.

As the financial guaranty insurance business grows, its impact on Florida intensifies. Florida is currently one of the top five states in the nation in terms of total premiums written in financial guaranty insurance. Therefore, there may be a need for clear and precise regulatory authority regarding financial guaranty insurance.

One of the main issues to be decided legislatively, is whether financial guaranty insurance should be sold by a monoline or multiline company. A monoline insurance company only sells financial guaranty insurance and a multiline company sells many different lines of insurance. Currently, there are many pros and cons for both methods of selling financial guaranty insurance. It appears that tighter regulatory schemes need to be enacted to
better regulate financial guaranty insurance regardless of the type of financial guaranty insurance written.

Credit ratings are also a vital element in the financial guaranty insurance industry. Generally, the higher rated insurance companies are the companies in which businesses seek to insure their debt obligations. A triple-A rated insurer is a premier insurer.

Some states have specific statutory or administrative regulations dealing with municipal bond insurance. However, no state currently has enacted broad financial guaranty insurance legislation. The need for some type of legislation in this area appears to exist.
III. HISTORICAL OVERVIEW

Surety insurance is perceived to be the ancestor of financial guaranty insurance and most of the financial guaranty premiums are recorded as surety on annual financial statements insurers file with state regulators.\textsuperscript{10} Suretyship is a three-party contractual relationship in which one party (surety) guaranties another party (obligee) against the default or misperformance of a third party (principal).\textsuperscript{11} The purpose of a surety contract is to guarantee that companies and individuals will perform according to their legal obligations. However, financial guaranty insurance is considered a special type of surety covering the risks involved in financial transactions.\textsuperscript{12}

Financial guaranties initially gained national acceptance in the early 1970's to ensure payment of principal and interest on municipal bonds.\textsuperscript{13} The municipal bond insurance market has grown rapidly in the past 15 years and now accounts for perhaps 20 percent of the total surety industry premiums.\textsuperscript{14} According to one estimate, the municipal bond guaranties that were backed by banks and insurers totaled more than $437 billion in 1984.\textsuperscript{15}

Additional guaranties, other than municipal bonds, have been insured by financial guaranty insurance. Some of the other guaranties are on corporate or limited partnership obligations,
specified pass through securities, installment purchase agreements, consumer debt obligations, and other instruments and obligations. Some of the above are considered more complicated than others to properly underwrite. However, it is generally agreed that municipal bond insurance accounts for the major portion of financial guaranty premiums.16

Even though many different types of instruments and debts are insured by financial guaranty insurance, the definition of financial guaranty insurance continues to be a complex legislative issue.

A. **What is financial guaranty insurance?**

A "financial guarantee" can be defined as "a third party's guarantee that another party's obligations in a financial transaction will be met."17 Financial guaranty insurance is issued to minimize loss to insured obligees or indemnities for the payment of principal and interest on public and private debt, fluctuations in interest rates, fluctuations in currency rates, convertibility of currency, financial or commodity indices or price levels and changes in value of assets.18 Financial guaranty insurance is a new type of coverage which has grown at a phenomenal rate.19 Financial guaranty insurance is currently subject to regulations applicable to property/casualty insurance. However, property/casualty insurance is founded upon the principal of large numbers -- a large group of homogeneous risks joined together to create a pool of premiums to pay for the
losses of a few. Generally, in the property/casualty insurance field there are frequent losses but the severity of the losses is relatively low. However, in financial guaranty insurance, a single loss could result in a potentially catastrophic financial loss affecting large numbers of insured individuals.20 Under the current scheme of state laws, financial guaranty insurance is not a separately defined line of insurance but is written as surety insurance which prevents implementation of adequate regulation.

Currently, financial guaranty insurance can best be divided into two major types. One type of financial guaranty insurance covers municipal bonds and the other covers non-municipal obligations.

B. Municipal Bond Insurance

Municipal bond insurance, as earlier stated, has grown at a tremendous rate.21 Currently, insurers are estimated to have a loss exposure of over $220 billion on municipal bond guaranty's.22 Municipal bond insurance is the most popular form of financial guaranty insurance. The primary purpose of municipal bond insurance is credit enhancement which results from a triple-A rated insurer insuring the bond issue. The issue "gains improved marketability and benefits from reduced costs associated with the insured obligations."23 The premium for the insurance is more than offset by the savings resulting from
the lower interest costs associated with issuing higher rated bonds. Therefore,

"the increased appeal of insured bonds not only gives smaller municipalities with good credit ratings the opportunity to compete in the market with the more prominent municipalities, but may also increase the numbers of bids they receive from underwriters bidding for the bonds."

The first municipal bond insurance company was founded in 1971. (See Appendix A) The American Municipal Bond Assurance Corporation (AMBAC) was financially backed by Citibank, AMBAC employees, Xerox Corporation, and Stephen's Inc. AMBAC was later renamed AMBAC Indemnity Corporation and is now one of the five major municipal bond insurance companies in the nation. In 1973, the Municipal Bond Insurance Association (MBIA) was founded and was financially backed by Aetna Casualty and Surety Company, Fireman's Fund Insurance Company, The Travelers Indemnity Company, Aetna Insurance Company, and The Continental Insurance Company. MBIA was later renamed municipal bond investors assurance corporation (MBIAC). Currently, AMBAC Indemnity and MBIAC are the largest municipal bond insurance companies in the nation.

The percentage of new bond issues that are insured has "skyrocketed." In 1980, only 3 percent of all new issues were insured; but by the end of 1985, more than 25 percent of all new municipal bond issues were
insured. Some of the increased financial guaranty insurance may have been a result of a few major municipal bond failures in the past decade. The three more notable failures have been: New York City, City of Cleveland, and the Washington Public Power Supply System. The Washington failure which occurred in 1983 was a $2.25 billion default. AMBAC insured $23.6 million of the Washington bonds affected by the 1983 default. Thus, AMBAC's total exposure, including interest guaranties of $52.6 million, was $76.2 million.

However, with the exception of industrial development bonds which are similar to corporate obligations issued in the name of municipalities, municipal bonds are generally considered to be low risk. For example, of more than 4,000 issues insured by MBIA in its 12-year history not one has gone into default. Along with the popular, low-risk municipal bond insurance, non-municipal bond insurance has also become a very popular type of financial guaranty insurance.

C. Non-municipal Bond Insurance

Corporations, like municipalities, can benefit by insuring their securities during financial transactions. In recent years financial guaranties have expanded to corporate obligations, limited partnerships, commercial paper and other consumer-type obligations. Banks are now actively
competing with insurance companies in this type of financial guaranty.

Corporate obligations are often "insured" by a corporation either by buying financial guaranty insurance for their securities or obtaining a letter of credit from a bank securing the payment of a debt instrument. Financial guaranties issued by banks provide a cost savings to issuers of the underlying security not available from insurance companies: an exemption from registration under the Securities Act. The Securities Act is designed to provide full and fair disclosure of the character of securities sold to the investing public. The exemption saves the issuer the registration fee (usually two basis points of the offering price of the security) and the costs arising from any delays associated with the registration process. Currently, corporations are required to register their financial guaranty insurance on corporate securities with the Securities Exchange Commission (SEC). Whereas, corporations are not required to register a standby letter of credit backing their corporate securities with the SEC.

This apparent disparity has prompted the SEC in an August 28, 1987, report to recommend that Congress amend Section 3(a)(2) of the Securities Act of 1933 to remove the exemption from registration for securities issued or guaranty by banks. This would help provide an equal
playing field for both banks and insurance companies. The SEC further recommended that Congress provide the SEC with the authority to grant exemptions from the registration requirements of the Securities Act.38

With the possible adoption by Congress of the SEC recommendations, banks and insurance companies may be on an equal playing ground with regard to corporate securities. Currently, banks and insurance companies are on an equal playing ground with regard to municipal obligations. Interestingly, in a limited partnership investor bond insurance scenario, it has been suggested that obtaining insurance is more convenient than obtaining a standby letter of credit. Each investor has to make his own arrangements for the credit support when a letter of credit is sought, but insurance simplifies the transaction because no credit support is needed.39

D. Other Types of Financial Guarantee Insurance

Along with municipal bond insurance and non-municipal bond insurance, such as previously mentioned, many complex and unusual types of debt instruments and obligations are often backed by financial guaranty insurance. Guarantying interest rates and currency rate fluctuations are at the high end of the risk spectrum. At the other end of the spectrum are lower risk instruments
such as industrial development bond insurance, personal loans, student loans and credit card receivables.40

Insurance companies normally use complex underwriting methods to decide which types of instruments and how many of each they choose to insure. Normally an instrument or obligation is a credit risk. However, interest and currency rate fluctuations are most affected by market risks. This makes the underwriting of financial guaranty insurance which insures interest and currency rate fluctuations very difficult. The real difficulty lies in the insurance company's ability to accurately predict losses without loss experience in some of the new, sophisticated products.41
In 1986, there were approximately $683,213,000 of direct premiums written in the United States which were specifically identified as financial guaranty insurance. New York accounted for 19.3 percent of the market share which was the largest nationwide. Florida, which was the second largest nationwide in premiums written, accounted for $88,052,000 in premiums and 12.9 percent of the market share. Therefore, Florida is one of the major financial guaranty insurance markets in the country.

As one of the major financial guaranty insurance markets, the Florida Department of Insurance is interested in adequate statutory controls so that it can regulate the financial guaranty insurance business more effectively and efficiently. During the 1987 legislative session, the department clarified several components of the exclusion of possible financial guaranty insurance failures from being covered by the Florida Insurance Guaranty Association. Prior to the 1987 legislative session, section 631.52, Florida Statutes, exempted surety and credit insurance among many other types of insurance from the guaranty association. However, during the 1987 legislative session, Committee Substitute for Senate Bill 906, (ch. 87-350, Laws of Florida) which became law on July 11, 1987, redefined the
guaranty fund exclusion in the following manner: 1) financial guaranty or other forms of insurance offering protection against investment risks; 2) vendor's single interest insurance, or collateral protection insurance or any similar insurance protecting the interests of a creditor arising out of a creditor-debtor transaction; and 3) any transaction or combination of transactions between a person, including affiliates of such person, and an insurer, including affiliates of such insurer, which involves the transfer of investment or credit risk unaccompanied by the transfer of insurance risk. Thus, a financial guaranty insurance failure clearly cannot affect the Florida Guaranty Fund.

Other regulatory concerns still exist. The major concern appears to be whether financial guaranty insurance should be sold on a monoline only or multiline basis. If sold on a monoline basis, each insurer would only sell financial guaranty insurance and not other lines of insurance. However, if a multiline basis is used, each insurer would sell unlimited lines of insurance including financial guaranty insurance.

A. Monoline vs. Multiline

The National Association of Insurance Commissioners (NAIC) was the first organization to publicly endorse financial guaranty insurance being sold by only monoline companies. This approach, which some companies have already adopted, provides that a monoline company is one which only sells financial
guaranty insurance and no other lines of insurance. The NAIC Model Act which was adopted in June 1986 and later amended in January 1987, provides that only monoline companies which have "paid-in capital of at least 10 million dollars and paid-in surplus of at least 40 million dollars, and shall at all times thereafter maintain a minimum surplus to policyholders of 35 million dollars" shall be allowed to sell financial guaranty insurance.46 (See Appendix C)

The NAIC supports their position (monoline only) with specific findings.47 Their findings support the conclusion that the multiline format creates the following problems:

1) **Potential to bankrupt company.** So far, a few companies have been rendered insolvent by their financial guaranty writings. (Fireman's Fund Insurance Company, Industrial Indemnity Insurance Company, Cal-Farm Insurance Company, and Glacier General Assurance Company). The monoline approach protects property/casualty insurance policyholders from the negative impact of adverse experience of financial guaranty business.

2) **Burdening the guaranty fund.** Even if financial guaranty insurance is not covered by the guaranty fund, an insolvency of a multiline insurance company resulting from financial guaranty losses would expose the fund to claims for all the
property/casualty lines written by the company which are covered by the guaranty fund.

3) **Lack of accountability.** A multiline structure would not enable the regulator to readily identify the risks insured and the capital supporting the business. This identification is necessary because of the unique nature of financial guaranties, which are a hybrid of insurance and investment banking.

4) **Lack of separate line of business reporting.** Since multiline insurers report financial guaranty business as surety, credit or another line of insurance, the premium, total exposure, underwriting experience and types of guaranties covered by financial guaranty insurance are not ascertainable from statements filed with the insurance department or other state regulators.

5) **Diversion of capacity.** At a time when insurance for essential property and casualty coverages is unavailable to many businesses and localities, writing financial guaranty insurance is a misuse of limited multiline insurance capacity.

6) **Lack of expertise.** Few multiline insurers will have the necessary expertise to write financial guaranties, especially of the new and more exotic...
products. The expertise required to underwrite financial guaranties bears no relationship to traditional property/casualty underwriting, which utilizes actuarial and loss experience to evaluate and price a risk. Financial guaranty business requires indepth expertise of investment bankers and economists, as is the case with existing monoline financial guaranty insurers. Some multiline insurers, particularly the smaller ones, in an attempt to enter the market, may be tempted to "borrow" expertise from managing general agents who have a financial interest in placing the business.

7) **Regulatory constraints.** Because of its nature, underwriting financial guaranty insurance in a multiline environment adds undue complexity to the analysis and monitoring of an insurers' financial condition with no discernible benefit. It is an unwarranted diversion from the pressing regulatory responsibilities of the insurance department to expend finite resources in monitoring this line of business in a multiline environment.\textsuperscript{48}

However, many multiline companies feel they can adequately sell financial guaranty insurance and not jeopardize their clients which buy alternate lines of insurance. Most, if not all, multiline insurers do not object to more specific
reporting requirements for premiums, losses and exposures for financial guaranty insurance within the insurer's annual statements. This would allow insurance departments to have more information for effective control and supervision without the need for a multiline insurer to establish a separate monoline company.

Although the multiline insurers still do not support the monoline requirement, it appears that there are three good reasons for requiring monoline insurers. First, it would insulate the insurance business from possible tremendous losses on the financial guaranty exposures. Second, it would allow regulatory bodies to more easily regulate insurance companies which write financial guaranty insurance. Finally, it would allow investors and other insurance buyers to more easily evaluate the strength of the guaranty on the basis of which they may be asked to make investment or other financial decisions, and allow more accurate evaluation of leverage. Whether financial guaranty insurers are monoline or multiline, they often seek to be rated by credit rating agencies and if the individual insurer receives a strong credit rating it is often chosen by a specific municipality or corporation to insure the bond or debt of the entity.
B. The Role of Credit Rating Agencies

Insurers primarily purchase financial guaranty insurance to lower borrowing costs by increasing the apparent safety of a security. To increase the marketability of a financial guaranty insurer, the insurer often seeks to be rated by a credit rating agency. Many insurers have been rated triple-A and these are often considered the most financially stable and secure companies in which to obtain financial guaranty insurance.

Today there are five major organizations which provide ratings on debt security. The two major credit rating agencies are Standard & Poor's Corporation and Moody's Investor Service. The credit rating agencies have established factors in which to evaluate insurers. Some of the factors are the capital adequacy of the guarantor, management structure, and underwriting practices. These factors help assess the company's financial capacity to meet the terms of its financial guaranty insurance contract and allow the issuer to "borrow" the insurer's credit rating.

Standard & Poor's Corporation is not new in the credit rating business. It has been assigning credit ratings to corporate bonds since 1923, to municipal bonds since 1940, and to commercial paper (short-term) since 1969. The first financial guaranty insurer was rated
For insurance companies, Standard & Poor's has two types of ratings. First, a debt rating is a current assessment of the financial status of an obligator with respect to a specific debt obligation. Second, a current assessment of an insurance company's financial capacity to meet its obligations under the terms of the insurance policies it has issued is called a claims-paying rating service.

Both ratings are of vital importance. However, an insurer's obligation to its policyholders appears to be primary to creditors of the insurer. Thus, payment of claims under insurance policies, constitute an insurer's most "senior" liabilities since they take precedence over most other claims. Standard and Poor's considers an insurer's claim-paying ability rating to be its prime or senior rating. It should be noted that "the existence of a rating does not mean that Standard & Poor's has performed an audit, nor does it attest to the authenticity of the information provided by the issuer on which the rating is based."

Both types of financial guaranty insurers, multiline and monoline, are often rated by rating agencies. For a multiline insurance company, its traditional and financial guaranty business are analyzed separately. Usually for a multiline company to receive a triple-A rating, both the traditional and financial guaranty business
should be triple-A. Thus, the entire company is rated, not just one particular segment. Where a consortium is rated, each of the members must be rated triple-A for the guarantor to receive a triple-A rating.

Monoline insurance companies are analyzed a little more closely by rating agencies. A few of the factors given consideration are the management of the company, the capital of the company, underwriting practices, income, reinsurance, and the insurance policy. Of the above factors, an insurer's size weighs heavily in the second factor: the capital of the company. Standard & Poor's currently requires "the insurer to have primary capital of at least $150 million, plus $50 million of reinsurance from strong insurance companies."

Whether a multiline or monoline insurance company, strong credit ratings are perceived to be vitally important. Many companies are currently making decisions as to where to allocate their resources - in the financial guaranty business or some other line of insurance. Some insurers are now discontinuing their financial guaranty insurance line of business. Recently, American Bankers Insurance Group, headquartered in Miami, agreed to pay $43 million to settle a lawsuit over credit insurance on mobile home mortgages in Texas. As a result of the lawsuit, "American Bankers Insurance said it no longer is writing mobile home credit insurance."
Additionally, Lloyds of London refuses as a matter of policy to write any kind of financial guaranty insurance.\(^6\) James Florio, Chairman of the Congressional House Subcommittee on Commerce, recently stated that there were "reports of significant losses and some insolvencies among financial guaranty insurers."\(^7\) Therefore, financial guaranty insurance is potentially a high risk insurance device and by using credit rating agencies to strengthen such insurance policies, the paying ability of the insurance industry seems to have improved.
V. STATE REGULATORY EFFORTS

As previously mentioned, the NAIC has proposed model legislation regarding financial guaranty insurance. During the 1987 legislative year, many states had bills or proposals which were based upon the NAIC Model Act. However, to date, only Iowa has adopted an administrative regulation containing broad financial guaranty requirements and no state has enacted broad financial guaranty legislation. (See Appendix D)

Thus, because no state has enacted broad financial guaranty insurance laws, this type of business is usually written as "surety, inland marine, or credit insurance, under regulations for those types of insurance." The general insurance laws of the state would be the regulatory framework for financial guaranty insurance. These general insurance laws provided for the filing of annual financial statements and restrictions dealing with policy forms and premium rates.

Six states do have specific financial guaranty regulation pertaining to municipal bond insurance. Illinois, New York, Iowa and Wisconsin have adopted administrative regulations to regulate municipal bond insurance. (See Appendices D, E, F, and G) California and Virginia have specific state laws dealing with the subject. (See Appendices H and I) However, the legislation and administrative regulations only aid
the specific state insurance departments to regulate municipal bond insurance. These provisions define municipal bond insurance; establish paid-in capital, surplus, and contingency reserve requirements; and impose single and aggregate risk restrictions and unearned premium and loss reserves.\textsuperscript{79}

The NAIC Model Act goes much further. All financial guaranty insurance could be regulated according to the NAIC Model Act and, if adopted, state insurance departments would have greater regulatory control of this sometimes volatile line of insurance. The NAIC Model Act does limit writing of financial guaranty insurance to monoline companies, along with defining financial guaranty insurance, establishes single and aggregate risk limits and contingency reserve requirements, and excludes financial guaranty insurance from state guaranty or insolvency funds.\textsuperscript{80}
VI. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Currently, one of the largest obstacles to the enactment of financial guaranty legislation in Florida is the monoline/multiline issue. The best aspect of the monoline only concept is increased accountability: regulators would be able to identify the risks insured and the capital supporting that segment of business. However, this greater accountability could be achieved without changing to a monoline structure by requiring the insurance industry to report financial guaranty business separately.

There is an alternative to monoline only insurers selling financial guaranty insurance even with regard to the paid-in capital and paid-in surplus requirements. A possible alternative is to allow certain property/casualty insurers (multiline) to sell financial guaranty insurance in Florida if their total policyholders' surplus exceeds $100 million and not more than 20 percent of the total net premiums written are financial guaranty insurance. This alternative would expand the number of insurance companies writing financial guaranty insurance in Florida but not jeopardize the strong paid-in capital and paid-in surplus requirements. The large multiline companies which would ultimately write financial guaranty insurance have very strong financial cores and would not be rendered insolvent if a financial guaranty loss was to occur.
Florida is one of the fastest growing financial guaranty insurance markets nationwide and legislation appears to be necessary. Financial guaranty insurers face very large risk exposures and are not generally affected by property/casualty insurance cycles that emanate from economic conditions. The Legislature should carefully and thoroughly consider the importance of financial guaranty insurance and enact laws which would allow the Florida Department of Insurance to effectively regulate financial guaranty insurance as a separate line of insurance.
VII. ENDNOTES


3. Id.

4. Id.

5. Insurance Information Institute, supra note 1, at 11.

6. Id.

7. Id. at 7.


Both bills were substantially based on the January 1987 National Association of Insurance Commissioners' Model Bill. However, Senate Bill 907 came before the Senate Commerce Committee as a proposed committee substitute to alleviate many of the insurance industry's concerns. Senate Bill 907 was temporarily postponed on May 25, 1987 by the Senate Commerce Committee and was never reagendaed.

House Bill 1362 was temporarily passed on May 26, 1987 in the House Appropriations Committee. Previous to that date, House Bill 1362 had been reported out of the House Insurance Committee as a Proposed Committee Bill 87-5 on April 15, 1987.

9. Id.

10. Insurance Information Institute, supra note 1, at 7.


12. Insurance Information Institute, supra note 1, at 7.


16. Id. at 10.


19. Id.

20. Id.


22. Supra note 18.

23. Insurance Information Institute, supra note 1, at 9.


27. Insurance Information Institute, supra note 1, at 11.

28. Id.

29. Id. at 12.
30. Id. at 14.
31. Supra note 18.
32. U.S. General Accounting Office Staff Study, supra note 2, at 18.
33. Insurance Information Institute, supra note 1, at 14.
35. Id. at 82.
36. A "standby letter of credit" is different from a "commercial letter of credit." "Commercial letters of credit" are instruments by which a bank authorizes a firm or corporation to draw on the bank up to a certain sum and guaranties to accept all drafts issued according to the terms of the credit agreement. A "standby letter of credit" obligates the issuer to make a payment as a result of any default by the holder in the performance of an obligation. With a standby letter of credit there is no expectation that the beneficiary will draw upon the issuer of the letter of credit; Insurance Information Institute, supra note 1, at 29, footnote 1.
38. Id.
39. Insurance Information Institute, supra note 1, at 40.
40. Id at 38.
41. U.S. General Accounting Office Staff Study, supra note 2, at 22.
42. Supra note 26.
43. Id. at 13.
44. Senate Commerce Committee Staff conversation with staff from AM Best Company on October 30, 1987.
45. Committee Substitute for Senate Bill 906, which became chapter 87-350, Laws of Florida.
47. **Supra** note 18.
48. **Id.**
49. U.S. Securities and Exchange Commission Report, **supra** note 13, at 50.
51. U.S. General Accounting Office Staff Study, **supra** note 2, at 36.
52. **Id.**; U.S. Securities and Exchange Commission Report, **supra** note 13, at 56.
53. Insurance Information Institute, **supra** note 1, at 67.
54. **Id.** at 68.
55. **Id.**; U.S. Securities and Exchange Commission Report, **supra** note 13, at 57.
56. Insurance Information Institute, **supra** note 1, at 68.
57. **Id.** at 69.
58. **Id.**
59. **Id.**
60. **Id.**
61. **Id.** at 72; U.S. Securities and Exchange Commission Report, **supra** note 13, at 58; U.S. General Accounting Office Staff Study, **supra** note 2, at 38.
63. **Id.** at 59; Insurance Information Institute, **supra** note 1, at 78.
64. U.S. General Accounting Office Staff Study, **supra** note 2, at 38.
65. Insurance Information Institute, **supra** note 1, at 81.
66. **Id.**

68. Id.


71. Supra note 46.

72. New York, Florida, Illinois, Massachusetts, Pennsylvania, Texas, California, and Virginia; Regulators Nervous on Financial Guarantees, National Underwriter, 6 (July 20, 1987); Research by the Senate Commerce Committee Staff indicates that North Carolina, Oregon and Iowa also had some type of proposed financial guaranty insurance legislation.


75. Id.

76. Id.


80. Id. at 42; National Association of Insurance Commissioners' Model Financial Guaranty Insurance Act, January 1987 Draft.
APPENDICES

A. Municipal Bond Insurance Industry.

B. Percentage of Long-Term Per Value Insured 1980-85.


F. N.Y. Admin. Code tit. 11, s. 63.0 - 63.5 (1986).

G. Wis. Ins. Admin. Reg. s. 3.08 (1986).


APPENDIX A
Since financial guarantees generally have not been reported separately from sureties, it has not been possible to identify all the insurers involved. Table 1.2 identifies some of the companies involved in the municipal bond insurance industry.

<table>
<thead>
<tr>
<th>Insurer</th>
<th>Year founded</th>
<th>Financial backing</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMBAC Indemnity Corp (formerly American Municipal Bond Assurance Corp.)</td>
<td>1971</td>
<td>Citibank AMBAC employees Xerox Corporation Stephens, Inc</td>
</tr>
<tr>
<td>USF&amp;G Financial Security Company</td>
<td>1985</td>
<td>United States Fidelity &amp; Guaranty</td>
</tr>
</tbody>
</table>

APPENDIX A
Percentage of Long-Term Par Value Insured 1980-85

Source: MBIA and Public Securities Association
Years ending December 31

% Insured
% Insured by MBIA
(a) insurance of any loss resulting from any event described in Paragraph (1) of Subsection A 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) any individual or schedule public official bond;

(c) any contract bond, including bid, payment or maintenance bond, or a performance bond where the bond is guaranteeing the execution of any contract other than a contract of indebtedness or other monetary obligation;

(d) any court bond required in connection with judicial, probate, bankruptcy or equity proceedings, including waiver, probate, open estate and life tenant bond;

(e) any 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) any loss security bond or utility payment indemnity bond running to a governmental unit, railroad or charitable organization;

(g) any lease, purchase and sale or concessionaire surety bond;

(h) 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;

NOTE (h) 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

(i) 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,

(j) 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,

(k) residual value insurance authorized by Paragraph ______ of Section ______ of this chapter.
FINANCIAL GUARANTY INSURANCE MODEL ACT

BILL SECTION 1. The Insurance Law is amended by adding thereto a new Article ____, to read as follows:

Article __________________

FINANCIAL GUARANTY INSURANCE

Section 1. Definitions
Section 2. Organization. Financial Requirements
Section 3. Regulations
Section 4. Filing of Policy Forms and Rates
Section 5. Reinsurance

Section 1. Definitions

A. As used in this article

1) "Financial guaranty insurance" means a surety bond, insurance policy or, when issued by an insurer, 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 any debt instrument or other monetary obligation (including common or preferred stock guaranteed under a surety bond, insurance policy or indemnity contract) to pay when due principal, interest, premium, dividend or purchase price of or on such instrument or obligation, when such failure is the result of a financial default or insolvency, regardless of whether such 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) inconvertibility of one currency into another for any reason, or inability to withdraw funds held in a foreign country resulting from restrictions imposed by a governmental authority;

(e) changes in the value of specific assets or commodities, financial or commodity indices or price levels in general; or

(f) other events which the commissioner determines are substantially similar to any of the foregoing.

2) Notwithstanding Paragraph (1) of this subsection, "financial guaranty insurance" shall not include

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

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

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

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

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

“Collateral” means cash or the market value of investment grade securities, other than securities 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; if

1. deposited with the corporation, or
2. held in trust by a trustee acceptable to the commissioner for the benefit of the corporation; or
3. held in trust, pursuant to the bond indenture, by a trustee acceptable to the commissioner, for the benefit of bondholders in the form of sinking funds or other reserves which may be used solely for the payment of debt service.

“Contingency reserve” means an additional liability reserve established to protect policyholders against the effects of adverse economic cycles or other unforeseen circumstances.

“Financial guaranty insurance corporation” means an insurer licensed to transact the business of financial guaranty insurance in this state.

“Governmental unit” means a 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.

“Guarantees of consumer debt obligations” means insurance policies indemnifying regulated financial institutions against loss or damage resulting from non-payment of debts owed to them for extensions of credit to individuals for non-business purposes provided in the normal course of their business. Policies providing such coverage shall contain a provision that all liability terminates upon sale or transfer of the underlying obligation to any transferee which is not an insured of the financial guaranty insurance corporation under a similar policy.

“Industrial development bond” means any security, or other instrument 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.
(m) indemnity contracts or similar guaranties, to the extent that they are not otherwise limited or proscribed by this chapter, in which a life insurer:

(i) guaranties its obligations or indebtedness or the obligations or indebtedness of a subsidiary (as defined in Section ______ of this chapter) other than a financial guaranty insurance corporation; provided that:

(A) to the extent that any such obligations or indebtedness are backed by specific assets, such assets must at all times be owned by the insurer or the subsidiary; and

(B) in the case of the guaranty of the obligations or indebtedness of the subsidiary that are not backed by specific assets of the life insurer, such guaranty terminates once the subsidiary ceases to be a subsidiary; or

(ii) guaranties 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 guaranties obligations or indebtedness acquired by its subsidiary, provided that the assets acquired pursuant to this item (ii) have been.

(A) 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

(B) sold to an independent third party; or

(iii) guaranties obligations or indebtedness of an employee or agent of the life insurer; or

(n) 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 but less than twenty-five percent of the financial guaranty insurance corporation or which is at least ten percent but less than twenty-five percent, directly or indirectly, owned by a financial guaranty insurance corporation.
"Total liability" of a financial guaranty insurance corporation means the aggregate amount of insured unpaid principal, interest and other monetary payments, if any, of guarantied obligations insured or assumed, less reinsurance and less collateral.

Section 2. Organization; Financial Requirements

A. A financial guaranty insurance corporation may be organized and licensed in the manner prescribed in Section ________, of this chapter, except as modified by the following provisions:

1. A corporation organized for the purpose of transacting financial guaranty insurance may, subject to all the provisions of this chapter applicable thereto, be licensed to transact the following additional kinds of insurance:
   a. residual value insurance, as authorized by Section ________, of this chapter;
   b. surety insurance, as authorized by Section ________, of this chapter; and
   c. credit insurance, as authorized by Section ________, of this chapter;

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, a corporation shall submit for the approval of the commission a plan of operation detailing the types and projected diversification of guaranties 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 corporation 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, and

5. A financial guaranty insurance corporation's investments in any one entity insured by that corporation shall not exceed one percent of its admitted assets as of the end of the prior calendar year.

B. A financial guaranty corporation shall not transact business unless:

1. it has paid-in capital of at least ten million dollars and paid-in surplus of at least forty million dollars, and shall at all times thereafter maintain a minimum surplus to policyholders of thirty-five million dollars,

2. it establishes a contingency reserve, net of reinsurance, as follows:
   a. the contributions to the reserve shall be calculated by applying the following percentages to the net principal written each calendar year of guaranties:
      1. municipal obligation bonds, 0.8 percent.
J. "Investment grade" means that the obligation has been determined to be in one of the top four generic lettered rating classifications by a securities rating agency acceptable to the commissioner, that the obligation has been identified in writing by such a rating agency as an insurable risk deemed to be of investment grade quality for purposes of insurance, or that the obligation has been determined to be investment grade (as indicated by a "yes" rating) by the Securities Valuation Office of the National Association of Insurance Commissioners.

K. "Municipal obligation bond" means any security, or other instrument, including a state lease but not a lease of any other governmental entity, under which a payment obligation is created, issued by or on behalf of a governmental unit to finance a project serving a substantial public purpose, and

(1) payable from tax revenues, but not tax allocations, within the jurisdiction of such governmental unit, or

(2) payable or guaranteed by the United States of America or any agency, department or instrumentality thereof, or by a state housing agency; or

(3) 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

(4) with respect to lease obligations, payable from future appropriations

L. "Reinsurance" means cessions qualifying for credit under Section 5 of this article.

M. "Security" or "secured" means:

(1) a deposit at least equal to the full amount of the principal of the insured obligation; or

(2) collateral, as defined by Subsection D of this section, at least equal to the full amount of the principal of the insured obligation, or the scheduled cash flow from which is equal to or greater than the scheduled debt service on the insured obligation and is due prior to the date when the scheduled debt service is payable; or

(3) property, provided the corporation has possession of evidence of the right, title or authority to claim or foreclose thereon or otherwise dispose of such property for value, the scheduled cash flow from which, or market value thereof, is at least equal to the scheduled debt service on the insured obligation and is due prior to the date when the scheduled debt service is payable.

N. "Special revenue bond" means any security, or other instrument under which a payment obligation is created, issued by or on behalf of a governmental unit to finance a project serving a substantial public purpose and not payable from the sources enumerated in Subsection K of this section in connection with the payment of municipal obligation bonds.
admitted assets of the insurer as of the date of the computation of any such reserve. The discount rate shall be adjusted at the end of each calendar year; and

(4) it shall maintain an unearned premium reserve, net of reinsurance, computed on the monthly pro rata basis, where such premiums are paid on an installment basis. All other such premiums paid shall be earned proportionately with the expiration of exposure, or by such other method as the commissioner may prescribe or approve.

Section 3. Limitations

A. Financial guaranty insurance may be transacted in this state only by a corporation licensed for such purpose.

B. Permissible guaranties

(1) Financial guaranty insurance shall be written only to insure timely payment of contractual obligations, including principal and interest, of:

(a) municipal obligation bonds;

(b) special revenue bonds;

(c) industrial development bonds;

(d) corporate obligations;

(e) limited partnership obligations;

(f) pass through securities, other than those secured by mortgages on real property which are insurable by a mortgage guaranty insurer;

(g) installment purchase agreements executed as a condition of sale;

(h) consumer debt obligations; and

(i) any other debt instrument or monetary obligation which the commissioner determines to be substantially similar to any of the foregoing.

(2) A corporation may only issue a financial guaranty insurance policy to a policyholder who discloses in any prospectus or advertisement that makes mention of the financial guaranty that such insurance is not covered by the guaranty fund specified in Article ___ of this chapter.

C. At least 95% of a corporation's outstanding total liability on the kinds of obligations enumerated in Paragraphs (1), (2) and (3) of Subsection B of this section shall be investment grade.

D. Aggregate risk limits. The corporation must at all times maintain capital, surplus and contingency reserve in the aggregate no less than the sum of:
special revenue bonds, 1.2 percent;
industrial development bonds, 1.6 percent;
secured investment grade obligations, 1.6 percent;
investment grade obligations not secured, 2.5 percent; and
all other obligations guarantied, 3.0 percent;

quarterly additions to the reserve for Items (1), (vi) and (vii) of Subparagraph (a) above shall be equal to the greater of 1/80th of the amounts derived by applying the appropriate contribution specified in Subparagraph (a) or fifty percent of the quarterly earned premiums on such guaranties and shall be maintained for a period of twenty years; and

quarterly additions to the reserve for Items (iv), (v) and (vi) of Subparagraph (a) above shall be equal to the greater of 1/40th of the amounts derived by applying the appropriate contribution specified in Subparagraph (a) or fifty percent of the quarterly earned premiums on such guaranties and shall be maintained for a period of ten years;

the reserve may be released thereafter in the same manner, except that a part of the reserve may be released proportional to the reduction in net total liabilities resulting from reinsurance and the reinsurer shall, on the effective date of the reinsurance, establish a reserve in an amount equal to the amount released; and

withdrawals from the contingency reserve, to the extent of any excess, may be made from the earliest contributions to such reserve remaining therein.

with the approval of the commissioner, in any year in which the actual incurred losses exceed thirty-five percent of earned premiums, or

upon thirty days prior notice to the commissioner, provided that the contingency reserve has been in existence for forty quarters, for reserves subject to Item (i) of Subparagraph (b) of this paragraph, and twenty quarters, for reserves subject to Item (ii) of Subparagraph (b) of this section, upon demonstration that the amount carried is excessive in relation to the corporation's outstanding obligations;

in addition to the contingency reserve, the case basis method or other method as may be prescribed by the commissioner shall be used to determine loss reserves, in a manner consistent with Section _________ of this chapter, which shall include a reserve for claims reported and unpaid net of collateral. 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
F If a corporation's exposure to loss shall at any time exceed the limitations prescribed by Subsection D above, it shall cease transacting any new business until its exposure to loss no longer exceeds said limitations.

G Notwithstanding the provisions of this article, an insurer writing, but which is not licensed to write, financial guaranty insurance in this state shall be subject to all the provisions except for Subsection A and Paragraph (1) of Subsection B of Section 2 of this article, and:

(1) may continue to write financial guaranties of the type authorized by Subsection B of this section:

(a) for a period not to exceed two years from the effective date of this article, provided that within six months of the effective date of this article, application shall be made to the commissioner to organize a financial guaranty insurance corporation, controlled by or under common control with such insurer, which financial guaranty insurance corporation, once licensed, shall immediately assume all of the financial guaranty insurance in force on the books of the insurer which was written on or after the effective date of this article, or

(b) for a period not to exceed twelve 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 has complied with all of the requirements for licensing as a financial guaranty insurer under Section 2 of this article, provided that it makes application to amend its current license to that of a financial guaranty insurance corporation within sixty days of the effective date of this article,

(2) which does not make application for a financial guaranty insurance corporation pursuant to Paragraph (1), shall cease writing any new financial guaranty insurance business within six months of the effective date of this article. Such insurer

(a) may reinsure its net in force business with a licensed financial guaranty insurance corporation, or

(b) may, 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 (2) of Subsection A of Section 5 of this article, except that Subparagraphs (b), (d), (e), (f) and (g) of Paragraph (2) thereof shall not be applicable. The assuming insurer shall maintain reserves for such reinsured business in the manner applicable to the ceding insurer under Paragraph (3) hereof, or

(c) may thereafter continue the risks then in force and, with thirty days prior written notice to its domiciliary commissioner, write new financial guaranty policies provided the writing of such policies is reasonably prudent to mitigate either the amount of or possibility of loss in connection with business written prior to the effective date of this act. Provided, however, that an insurer must receive the prior approval of its domiciliary commissioner before writing any new financial guaranty
(1) 0.2857 percent of the total liabilities outstanding under guaranties of municipal obligation bonds; and

(2) 0.5714 percent of the total liabilities outstanding under guaranties of special revenue bonds; and

(3) 1.0 percent of the total liabilities outstanding under guaranties of:
   
   (a) industrial development bonds;
   
   (b) secured obligations issued by entities which had an investment grade rating independent of the security pledged; and
   
   (c) secured obligations which were given an investment grade rating as a result of the security pledged; provided, however, that if the security is property, it is not property financed with the proceeds of the insured obligations; provided that,
   
   (d) if the amount of security required by Subparagraph (b) or (c) of this paragraph is not maintained, that proportion of the obligation insured which is not so secured shall be subject to the aggregate limits specified in Paragraph (4) of this subsection; and

(4) 4.0 percent of the total liabilities outstanding under guaranties of any other obligations of investment grade and consumer debt obligations; and

(5) 10.0 percent of the total liabilities outstanding under guaranties of other obligations not of investment grade, other than consumer debt obligations, and

(6) surplus 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 such kinds of insurance pursuant to Subsection A of Section 2 of this article.

E Single risk limits A financial guaranty insurance corporation doing business in this state shall limit its exposure to loss, net of collateral and reinsurance, as follows.

(1) for municipal obligation bonds and special revenue bonds:
   
   (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 of the aggregate of the corporation's capital, surplus and contingency reserve; and
   
   (b) the insured unpaid principal issued by a single entity and backed by a single revenue source may not exceed fifty percent of the aggregate of the corporation's capital, surplus and contingency reserve;

(2) for all other financial guaranties, the insured unpaid principal for any one entity may not exceed ten percent of the aggregate of the corporation's capital, surplus and contingency reserve.
B Rates shall not be excessive, inadequate, unfairly discriminatory, destructive of competition or detrimental to the solvency of the insurer.

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

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.

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

Section 5. Reinsurance.

A. For financial guaranty insurance which takes effect on or after the effective date of this article, 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 such reinsurance is subject to an agreement that for its stated term and with respect to any financial guaranty insurance in force, the reinsurance agreement may only be terminated or amended at the request of the ceding company or at the discretion of the commissioner acting as rehabilitator, liquidator or receiver of the ceding or assuming company and that such reinsurance

1. Is placed with another financial guaranty insurance corporation licensed under this article or an insurer writing only financial guaranty insurance as is or would be permitted by this article, or

2. Is placed with another type of insurer licensed to write surety insurance, if such insurer

   a. Has and maintains surplus to policyholder's of at least thirty-five million dollars;

   b. Establishes and maintains the reserves required in Section 2 of this article, except that if the reinsurance agreement is not pro rata the contribution to the contingency reserve shall be equal to fifty percent of the quarterly earned reinsurance premium;

   c. Complies with the provisions of Subsections D and F of Section 3 of this article, except that its maximum aggregate assumed total liability shall be one-half that permitted for a financial guaranty insurance corporation;

   d. Complies with the provisions of Subsection E of Section 3 of this article;

   e. Is not a parent, another subsidiary of the parent of the financial guaranty insurance corporation, or a subsidiary of the financial guaranty insurance corporation. Direct or indirect ownership interest of twenty-five percent or more shall be deemed a parent/subsidiary relationship;

   f. Is an affiliate of the financial guaranty insurance corporation, such affiliate shall not assume a percentage of the corporation's total liability in excess of its equity interest in the corporation, and
insurance policies that would have the effect of increasing its risk of loss;

(3) shall, for all guaranties 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 1 of this article, be subject to the reserve requirements applicable for general obligation municipal bond guaranties in effect prior to the effective date 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 for municipal bond guaranties, the insurer shall have three years to bring its reserves into compliance, except that a part of the reserve may be released proportional to the reduction in net total liabilities 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

NOTE For states which do not currently have municipal bond insurance in effect. Subparagraph (3) should read as follows:

(3) shall, for all guaranties 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 1 of this article, maintain a special reserve which shall consist of allocations of surpluses representing fifty percent of the earned premiums on financial guaranty insurance policies. Allocations to such reserve made during each calendar year shall be maintained for a period of at least 240 months, except that withdrawals may be made by the insurer in any year in which the actual paid losses on the said type of policy exceed thirty percent of the earned premiums thereon, but no such releases shall be made without the prior written approval of the commissioner. Provided that the contingency reserve has been in existence for at least 120 months, the insurer may apply to the commissioner for a release of a reasonable percentage of the reserve upon a demonstration that the amount carried is excessive in relation to the insurer's obligation on financial guaranty insurance policies; and

(4) shall be subject to the reserve requirements applicable to financial guaranty insurance corporations, for business written on and after the effective date of this article.

Section 4. Filing of Policy Forms and Rates.

A. Policy forms and any amendments thereto shall be filed with the commissioner within thirty days of their use by the insurer. Every such policy shall provide that there shall be no acceleration of payments due under the guarantied obligations except as the option of the corporation. The commissioner may prescribe additional minimum policy provisions determined by the commissioner to be necessary or appropriate to protect policyholders, claimants, obligees or indemnitees.
Subsection ________ , provided, however, that no insurance may be written as surety insurance if it falls within the definition of financial guaranty insurance as set forth in Paragraph (1) of Subsection A of Section 1 of Article ________ of this chapter;

SECTION 4 NOTE 2 For those states which combine fidelity and surety authority in a single definition, a clean-up provision is necessary to define them separately. Suggested simplified language follows.

Subsection ________. “Fidelity insurance” means:

A. Guarantying the fidelity of persons holding positions of public or private trust, and indemnifying banks, thrifts, brokers and other financial institutions against loss of money, securities, negotiable instruments, other specified valuable papers and tangible items of personal property caused by larceny, misplacement, destruction or other stated perils including loss while being transported in an armored motor vehicle or by messenger; and insurance for loss caused by the forgery of signatures on, or alteration of, specified documents and valuable papers; and

B. Insurance against losses that financial institutions become legally obligated to pay by reason of loss of customers' property from safe deposit boxes.

Subsection ________. “Surety insurance” means:

A. A contract bond, including a bid, payment or maintenance bond, or a performance bond where the bond is guarantying the execution of any contract other than a contract of indebtedness or other monetary obligation, and

B. An indemnity bond for the benefit of a public body, railroad or charitable organization; a lost security or utility payment bond;

C. Becoming surety on, or guarantying the performance of, any lawful contract not specifically provided for in this paragraph where the bond is guarantying the execution of any contract other than a contract of indebtedness or other monetary obligation, except:

(1) mortgage guaranty insurance, which may only be written by an insurer authorized to write such insurance pursuant to Article ________ of this chapter, or

(2) financial guaranty insurance as defined by Paragraph (1) of Subsection A of Section 1 of Article ________ of this chapter, or

(3) any insurance contract except as authorized pursuant to Section ________ (insert reference to section authorizing reinsurance business), and

D. Becoming surety on, or guarantying the performance of, bonds and undertakings required or permitted in all judicial proceedings or otherwise by law allowed, including surety bonds accepted by states and municipal authorities in lieu of deposits as security for the performance of insurance contracts.
(g) assumes, together with all other reinsurers subject to this paragraph, less than fifty percent of the total liability remaining after deducting any reinsurance placed with another financial guaranty insurance corporation; and

(3) if placed with an unauthorized or unaccredited reinsurer which otherwise complies with the provisions of the opening paragraph, Paragraph (1) or Subparagraphs (a), (e), (f) and (g) of Paragraph (2) of Subsection A of this section, in an amount not exceeding the liabilities carried by the ceding insurer for amounts withheld under a reinsurance treaty with such reinsurer or amounts deposited by such reinsurer as security for the payment of obligations under the treaty, if such 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 limitations imposed by Subsection D of Section 3 of this article, 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 such reinsurance agreement in excess of the corporation's retention pursuant to such reinsurance agreement.

BILL SECTION 2. The Insurance Law is amended by adding thereto a new Subsection _____ to Section _______ , to read as follows:

Subsection _______ . “Residual value insurance” meaning insurance issued in connection with a lease or contract which sets forth a specific termination value at the end of the term of the lease or contract for the property covered by such lease or contract, and which insures against loss of economic value of tangible personal property or real property or improvements thereto except loss due to physical damage to property, provided, however, that no insurance may be written as residual value insurance if it may be written as financial guaranty insurance by a financial guaranty insurance corporation pursuant to Article _______ of this chapter.

SECTION 2 NOTE. To be added by states which do not now specifically authorize residual value insurance as a separate kind of insurance.

BILL SECTION 3. The Insurance Law is amended by adding thereto a new Subsection _____ to Section _______ , to read as follows:

Subsection _______ . “Financial guaranty insurance” meaning the kind of insurance specified in Article _______ of this chapter.

SECTION 3 NOTE. To be added to section of insurance law which authorizes specified kinds of insurance.

BILL SECTION 4. The Insurance Law is amended by amending Subsections _______ and _____ to Section _______ , to read as follows.

SECTION 4 NOTE 1. For those states which have a separate definition of “surety insurance” add to the end of the definition.
Subsection ______. "Credit insurance" means... provided, however, that no insurance may be written as credit insurance if it falls within the definition of financial guaranty insurance as set forth in Paragraph (1) of Subsection A of Section 1 of Article ______ of this chapter;

SECTION 4 NOTE 3 To be added to section of insurance law which authorizes specified kinds of insurance

BILL SECTION 5. This act shall take effect on the first day of January next succeeding the date on which it shall become law; provided, however, that the Commissioner may, prior to such date, promulgate such rules and regulations as are necessary for the timely implementation of this act.

NOTE Section 3 of the POST-ASSESSMENT PROPERTY AND LIABILITY INSURANCE GUARANTY ASSOCIATION MODEL ACT and appropriate provisions of existing state laws defining the scope of their security fund should be amended to exclude the following kinds of insurance

1. surety insurance,
2. mortgage guaranty insurance,
3. residual value insurance,
4. financial guaranty insurance, and
5. credit insurance

Legislative History (all references are to the Proceedings of the NAIC)

1987 Proc I (amended)
APPENDIX D
j. Guarantied 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.

k. Residual value insurance.

l. Mortgage guaranty insurance authorized by Iowa Code chapter 515C.

m. An indemnity contract or similar guaranty in which an insurer guaranties its obligations or indebtedness or the obligations or indebtedness of a subsidiary of which it owns more than 50 percent, other than a financial guaranty insurance corporation.

n. Any other form of insurance covering risks which the commissioner determines to be substantially similar to any of the forms in this subrule.

22.1(3) "Industrial development bond" means a security or other instrument 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 guarantied by a governmental unit.

22.1(4) "Investment grade" means that the obligation has been determined to be in one of the top four generic lettered rating classifications by a securities rating agency acceptable to the commissioner, that the obligation has been identified in writing by such a rating agency as an insurable risk deemed to be of investment grade quality for purposes of insurance, or that the obligation has been determined to be investment grade (as indicated by a "yes" rating) by the securities valuation office of the national association of insurance commissioners.

22.1(5) "Municipal obligation bond" means a security, or other instrument, including a state lease but not a lease of any other governmental entity, under which a payment obligation is created, issued by or on behalf of a governmental unit to finance a project serving a substantial public purpose, and which is one or more of the following:

a. Payable from tax revenues, but not tax allocations, within the jurisdiction of the governmental unit.

b. Payable or guarantied by the United States or any agency, department, or instrumentality of the United States, or by a state housing agency.

c. Payable from rates or charges, but not from levied or collected in respect of a nonnuclear utility project, public transportation facility other than an airport facility, or public higher education facility.

d. With respect to a lease obligation, payable from future appropriations.

22.1(6) "Special revenue bond" means a security, or other instrument under which a payment obligation is created, issued by or on behalf of a governmental unit to finance a project serving a substantial purpose and not payable from the sources enumerated in subrule 22.1(5) in connection with the payment of a municipal obligation bond.

22.1(7) "Security" or "secured" means any or all of the following:

a. A deposit equal to at least the full amount of the principal of the insured obligation.

b. Collateral at least equal to the full amount of the principal of the insured obligation, or the scheduled cash flow from which is equal to or greater than the scheduled debt service on the insured obligation and is due prior to the date when the scheduled debt service is payable.

c. Property, provided the corporation has possession of evidence of the right, title or authority to claim or foreclose on the property or otherwise dispose of such property for value, the scheduled cash flow from which, or market value of which, is at least equal to the scheduled debt service on the insured obligation and is due prior to the date when the scheduled debt service is payable.

191—22.2(515) Financial requirements and reserves. An insurance company otherwise authorized under Iowa Code chapter 515 to write financial guaranty insurance shall do so only when all of the following requirements are satisfied:

22.2(1) It has paid-in capital of at least $1 million and surplus of at least $1 million.

22.2(2) It establishes a contingency reserve, net of reinsur­ance, as follows:

a. The contributions to the reserve shall be calculated by applying the following percent-
CHAPTER 22
FINANCIAL GUARANTY INSURANCE

191—22.1(515C) Definitions.

22.1(1) "Financial guaranty insurance" means a surety bond, insurance policy or, when issued by an insurer, an indemnity contract and any guaranty similar to a surety bond, insurance policy, or insurer-issued indemnity contract, 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 an obligor on a debt instrument or other monetary obligation (including common or preferred stock guarantied under a surety bond, insurance policy, or indemnity contract) to pay when due principal, interest, premium, dividend, or purchase price of or on the debt instrument or monetary obligation, when the failure is the result of a financial default or insolvency, regardless of whether the obligation is incurred directly or as guarantor by or on behalf of another obligor that has also defaulted.

b. A change in the level of interest rates, whether short- or long-term, or the differential in interest rates between various markets or products.

c. A change in the rate of exchange of currency.

d. Inconvertibility of one currency into another for any reason, or inability to withdraw funds held in a foreign country resulting from restrictions imposed by a governmental authority.

e. A change in the value of a specific asset or commodity, financial or commodity index, or price levels in general.

f. Another event which the commissioner determines is substantially similar to any of those in subparagraphs "a" through "e."

22.1(2) "Financial guaranty insurance" does not include:

a. Insurance of a loss resulting from an event described in subrule 22.1(1), 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:

(1) A fortuitous physical event.

(2) A failure of or deficiency in the operation of equipment.

(3) 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 if the bond is guarantying the execution of any contract other than a contract of indebtedness or other monetary obligation.

d. A court bond required in connection with judicial, probate, bankruptcy, or equity proceedings, including a waiver, probate, open estate, and life tenant bond.

e. A bond running to the federal, state, county, or 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. A loss security bond or utility payment indemnity bond running to a governmental unit, railroad, or charitable organization.

g. A lease, purchase and sale, or concessionaire surety bond.

h. 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 a debtor, for the installments or other periodic payments becoming due while a debtor is unemployed.

i. 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.

APPENDIX D
ages to the net principal written each calendar year of guaranties issued or delivered in this state of:

1. Municipal obligation bonds, 0.8 percent.
2. Special revenue bonds, 1.2 percent.
3. Industrial development bonds, 1.6 percent.
4. Secured investment grade obligations, 1.6 percent.
5. Investment grade obligations not secured, 2.5 percent.
6. All other obligations guaranteed, 3.0 percent.

b. (1) Quarterly additions to the reserve for paragraph "a," "1," "2," and "3" above must be equal to the greater of one-eighth of the amounts derived by applying the appropriate contribution specified in paragraph "a" or 50 percent of the quarterly earned premiums on the guaranties and must be maintained for a period of 20 years.
(2) Quarterly additions to the reserve for paragraph "a," "4" to "6" must be equal to the greater of one-fortieth of the amounts derived by applying the appropriate contribution specified in paragraph "a" or 50 percent of the quarterly earned premiums on the guaranties and must be maintained for a period of ten years.

c. The reserve may be released after the expiration of the applicable time period, listed in paragraph "b," subparagraphs (1) and (2), in the same manner, except that a part of the reserve may be released proportional to the reduction in net total liabilities resulting from reinsurance and the reinsurer shall, on the effective date of the reinsurance, establish a reserve in an amount equal to the amount released.

d. A withdrawal from the contingency reserve, to the extent of any excess, may be made from the earliest contributions to the reserve remaining in the reserve:
(1) With the approval of the commissioner, in any year in which the actual incurred losses exceed 35 percent of earned premiums.
(2) Upon 30 days prior notice to the commissioner, provided that the contingency reserve has been in existence for 40 quarters, for reserves subject to paragraph "b," subparagraph (1), and 20 quarters, for reserves subject to paragraph "b," subparagraph (2), upon demonstration that the amount carried is excessive in relation to the corporation's outstanding obligations.

22.2(3) In addition to the contingency reserve, the case basis method or other method as the commissioner may require must be used to determine loss reserve on guaranties issued or delivered in this state. This method shall include a reserve for claims reported and unpaid net of collateral. A deduction from loss reserves must 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.

22.2(4) The insurance company shall maintain an unearned premium reserve on guaranties issued or delivered in this state, net of reinsurance, computed on the month pro rata basis, if financial guaranty premiums are paid on an installment basis. All other financial guaranty premiums paid must be earned proportionately with the expiration of exposure, or by any other method the commissioner requires or approves.

These rules are intended to implement Iowa Code section 515C.6.

[Filed 6/25/87, Notice 5/20/87—published 7/15/87, effective 8/19/87]
§ 205.20  ILLINOIS INSURANCE REGULATIONS

§ 205.20. Purpose

It is the purpose of this Part to regulate the writing and servicing of municipal bond insurance.


§ 205.30. Definitions

a) Municipal Bond Insurance - Insurance or reinsurance against financial loss by reason of nonpayment of principal, interest or other payment obligations pursuant to the terms of municipal bonds as defined in subsection (b) hereof.

b) Municipal Bond - any security (or other instrument under which a payment obligation is created) issued by or on behalf of, or payable or guaranteed by a state, territory or possession of the United States of America, a municipality, or a political subdivision of any of the foregoing, or by any public agency or instrumentality thereof.

c) Contingency Reserve - an additional premium reserve established for the protection of insureds covered by policies insuring municipal bonds against the effect of excessive losses occurring during adverse economic cycles.

d) Cumulative New Liability - the insured unpaid principal and insured unpaid interest due or to become due covered by in-force policies of municipal bond insurance, reduced by the appropriate allowance for acceptable reinsurance.

e) Average Annual Debt Service - in respect to any issue or part thereof of municipal bonds covered by an in-force policy, the product of the total insured, unpaid principal and insured, unpaid interest thereon times the number of such bonds (assuming that each $1,000 of par value represents one bond), divided by an amount equal to the aggregate life (in years) of such bonds (assuming that each $1,000 of par value represents one bond); i.e.:

\[
\frac{(Unpaid Principal + Unpaid Interest) \times (Number of Bonds)}{(Number of Bond Years)}
\]

f) Industrial Revenue Bonds - municipal bonds issued primarily to finance property for use in a trade or business and without a substantial public purpose, and backed by a revenue source other than a governmental unit described in the definition of municipal bonds above.
It involved the purchase of securities through the exercise of options, so state and give the exercise price per share. If any other purchase or sale was effected otherwise than in the open market, that fact shall be indicated. If the transaction was not a purchase or sale, indicate its character; for example, gift, 6% stock dividend, etc. as the case may be. The foregoing information may be appropriately set forth in the table or under "Remarks" at the end of the table.

12. Inclusion of Additional Information.

A statement may include any additional information or explanation deemed relevant by the person filing the statement.

13. Signature.

If the statement is filed for a corporation, partnership, trust, etc., the name of the organization shall appear over the signature of the officer or other person authorized to sign the statement. If the statement is filed for an individual, it shall be signed by him or specifically on his behalf by a person authorized to sign for him.

In those cases where the statement is signed by someone other than the person whose ownership is being reported, documentary evidence of the signing authority shall be filed with the statement.

In all cases the signature must be duly notarized.

Source.—Filed and effective January 21, 1966; codified at 7 Ill. Reg. 8232.

Part 205. Municipal Bond Insurance

(Authority: Implementing Section 144 and authorized by Section 401 of the Illinois Insurance Code (Ill. Rev. Stat. 1985, ch. 72, pars. 756 and 1013).)

§ 205.10. Authority

Part 205 is promulgated by the Director of Insurance pursuant to Sections 401 and 144 of the Illinois Insurance Code (Ill. Rev. Stat. 1985, ch. 72, pars. 1013 and 756), which empowers the Director to make reasonable rules and regulations as may be necessary for making effective the insurance laws of the State.

§ 205.50   ILLINOIS INSURANCE REGULATIONS

2) In no event, shall the insured unpaid principal (net of the appropriate allowance for acceptable reinsurance and collateral allowable under Section 205.80) in respect to securities backed by a single revenue source, when added to the admitted value of the securities of such source in which the insurer has invested, exceed an amount representing seventy-five percent (75%) of the insurer's policyholders' surplus plus its contingency reserve.

3) In no event, shall twice the outstanding cumulative net liability under policies in force insuring industrial revenue bonds described in subsection 205.30(f) plus the outstanding cumulative net liability under policies in force insuring all other municipal bonds exceed:

A) 800 times the sum of the insurer's policyholders' surplus plus its contingency reserve if the insurer transacts only municipal bond insurance, or

B) 60 times the sum of the insurer's policyholders' surplus plus its contingency reserve if the insurer transacts any insurance in addition to municipal bond insurance.

b) In the event that the requirement of subsection (a)(2) is exceeded because of municipal bond insurance written prior to the effective date of this Part, then

1) the insurer shall not transact any new insurance of securities backed by such a single revenue source as described in subsection (a)(2), and

2) the insurer shall not invest in any additional securities of such single revenue source as described in subsection (a)(2), unless and until the requirement of subsection (a)(2) has been met.

c) In the event that an insurer exceeds the limitation in subsection (a)(3), it shall not transact any new insurance of municipal bonds until such excess no longer exists.

d) No insurer authorized to transact the business of insuring municipal bonds shall pay any commission or make any gift of money, property or other valuable thing to any employee, agent or representative of any issuer of municipal bonds or of any underwriter of any issue of such bonds, as an inducement to the purchase of a policy insuring such bonds, and no such employee, agent or representative of such issuer or underwriter shall receive any such payment or gift. However, violation
DOMESTIC STOCK COMPANIES § 205.50

§ 205.50. Limitations and restrictions

a) In no event, shall the insured average annual debt service (net of the appropriate allowance for acceptable reinsurance and collateral allowable under Section 205.80) in respect to securities, backed by a single revenue source, exceed an amount representing ten percent (10%) of the insurer's policyholders' surplus plus its contingency reserve.

74.1

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Insurer can satisfy the Director that bonds, notes and other fixed income investment, as authorized under Sections 124 through 124.24a of the Illinois Insurance Code (Ill. Rev. Stat. 1985, ch. 73, par. 736 through 737.24a inclusive) sufficient to meet obligations for insured unpaid principal and insured unpaid interest calculated to the redemption of the defaulted issue have been deposited in trust for the purpose of meeting such obligations.

3) If the insured principal and interest on a defaulted issue of bonds due and payable over the period of the next three years exceeds ten percent (10%) of the insurer's policyholders' surplus plus its contingency reserve, and such default is a default in payment of sums due, the insurer's reserve shall be supported by report from a qualified independent source if the reserve is set up for less than the entire unpaid insured principal and unpaid insured interest to redemption.

c) Treatment of Contingency Reserve on Financial Statements

1) The contingency reserve required by subsection 205.40(b) shall be reported as a separate liability in statutory financial statements. Any increase or decrease in the contingency reserve for the period shall be reported as a direct adjustment to surplus and shown separately in the Capital and Surplus Account of the Underwriting and Investment Exhibit.

2) For purposes of determining whether a dividend or distribution is extraordinary pursuant to Section 181.20 of the Illinois Insurance Code (Ill. Rev. Stat. 1985, ch. 73, par. 743.20(3)), the change in the contingency reserve shall be included as net income (loss) for the period.


§ 205.70. Reinsurance

a) An insurer qualified to write municipal bond insurance may, by contract, reinsure any such insurance it transacts, provided that credit in accounting and financial statements for reinsurance ceded shall be allowed only if the reinsurer is either:

1) An insurer, authorized in Illinois to write the kinds of business defined in Class 2(g) and 2(h) of Section 4 of the Illinois Insurance Code (Ill. Rev. Stat. 1985, ch. 73, par. 618), which has policyholders' surplus of not less than twenty-five million dollars ($25,000,000), or

2) An insurer that meets the surplus requirements of subsection 74.4.

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of the provisions of this section shall not have the effect of rendering void the insurance policy issued by the insurer.

c) Any insurer that transacts any insurance other than municipal bond insurance may not have more than twenty percent (20%) of its gross (direct plus assumed) written premiums, net of acceptable reinsurance, in any one year represented by municipal bond premiums.


§ 205.60. Financial statements

a) A municipal bond insurer shall maintain an unearned premium reserve computed to show gross premiums, without any deductions, received and receivable upon all unexpired risks, net of reinsurance, on a monthly pro rata basis, except that in the case of premiums paid more than one (1) year in advance, the premiums shall be earned proportionally with the expiration of exposure, or by such other method which will correlate the expiration of exposure with the premium earned as the Director may prescribe or approve when the company’s exposure to loss does no correlate with the passage of time.

b) In addition to the contingency reserve, a municipal bond insurer shall compute and maintain reserves for losses and loss adjustment expenses for claims reported and unpaid determined by use of the case basis method or, when the requirements of Section 378 of the Insurance Code will not be met by the case basis method, such other methods as the Director may prescribe or approve which produces the reserves required by Section 378 of the Insurance Code. (Ill. Rev. Stat. 1985, ch. 73, par. 990).

1) Except as otherwise permitted by the Director, no deduction shall be made for anticipated salvage in computing case basis loss reserves unless such salvage is held by or under the control of the insurer and would qualify as an admitted asset under Section 3.1 of the Illinois Insurance Code (Ill. Rev. Stat. 1985, ch. 73, par. 615.1) or unless such salvage constitutes or is secured by a clean, irrevocable letter of credit.

2) A deduction from reserves for losses 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 any such reserve. The discount rate shall be adjusted annually on the last day of each year. No deduction from reserves for losses shall be otherwise allowed for the time value of money unless the
§ 205.90  ILLINOIS INSURANCE REGULATIONS

b) This Part does not prohibit any surety or municipal bond insurer from directly obtaining or receiving any form of collateral as security for its protection.


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205.70(a)(1) hereof, but is not licensed in Illinois; however, such credit shall be allowed only to the extent and under the conditions specified in Section 173.1(2) of the Illinois Insurance Code (Ill. Rev. Stat. 1985, ch. 73, par. 7851(2)). The security requirements of such sections shall also cover any contingency reserve established by such reinsurer.

b) The contingency reserve required by subsection 205.40(b) shall not be reduced by reason of any risk ceded unless the risk is ceded to a reinsurer described in subsection (a)(1) or (2) heretofor and provided such reinsurer established the reserves required in subsections 205.40(b) and 205.60 with respect to the ceded portion of the risk.

c) 1) A municipal bond insurer may not reinsure such insurance with affiliated companies unless the limitations of Section 205.50 are measured against the consolidated policyholders' surplus of such affiliated insurers.

2) Subsection 205.70(a) hereof does not diminish the applicability of Section 173.1 of the Illinois Insurance Code (Ill. Rev. Stat. 1985, ch. 73, par. 785.1).


§ 205.80. Collateral security

An insurer transacting municipal bond insurance as defined in Section 205.80 insurer may, for the purposes of Section 205.50, treat the amount of a clean, irrevocable letter of credit or other assets which would qualify under Section 173.1(2) of the Illinois Insurance Code (Ill. Rev. Stat. 1985, ch. 73, par. 171.1(2)) deposited with it or held in trust to secure payment of the insured principal and interest, as a reduction in the amount of exposure insured.


§ 205.90. Applicability of other laws

a) All the applicable provisions of the Illinois Insurance Code and the Illinois Insurance Regulations of the Department of Insurance and of other statutes and regulations of this State, except as the same may be in conflict herewith, shall apply to the operation and conduct of business described herein as municipal bond insurance.
APPENDIX F
(b) *Municipal bonds* as used herein means securities, including revenue obligations, which are issued by or on behalf of:

(1) any state, territory or possession of the United States of America;

(2) any political subdivision of any such state, territory or possession; or

(3) any agency, authority or corporate or other instrumentality of any one or more of the foregoing, or which are guaranteed by any of the foregoing.

(c) *Contingency reserve* means an additional premium reserve established for the protection of policyholders covered by policies insuring municipal bonds against the effect of excessive losses usually occurring during adverse economic cycles.

Stat. Authority.—Insurance Law, § 21, 201, 301.


Parallel Citation.—Regulation 61.

§ 63.2 Capital, surplus and contingency reserve requirements

(a) An insurer shall not issue a contract insuring municipal bonds unless it is authorized to write the kinds of business defined in section 1113(a)(16) of the Insurance Law and unless:

(1) If it is a stock insurance company, it has a paid-in capital and surplus, or, if it is a mutual insurance company, it has a minimum initial surplus, in an amount deemed by the superintendent to be reasonable in relation to the insurer's outstanding liabilities and adequate to its financial needs, but in no case shall such amount be less than that prescribed by applicable provisions of the Insurance Law. Such stock or mutual insurer shall at all times maintain a surplus to policyholders or minimum surplus, as the case may be, in an amount at least equal to the minimum prescribed by the stated provisions for the aforementioned class of business and for such other kinds of business defined in section 46 as it may be authorized to transact; and

(2) (i) It shall establish a contingency reserve which shall consist of allocations of sums representing 50 percent of the earned
§ 63.0 NEW YORK INSURANCE REGULATIONS

corporation all of the capital stock of which is owned by such trust company or other corporation or a corporation the shares of which are listed on a national securities exchange or regularly quoted in over-the-counter market by one or more n.a.s.n.a. of a national or affiliated securities association


Parallel Citation.—Regulation 61.

Part 63

Insurance of Municipal Bonds

(Regulation 61)

§ 63.0 Preamble

Since insurance of municipal bonds is of a character which differs from other forms of guarantees, it is appropriate to establish standards for this class of business.


Parallel Citation.—Regulation 61.

§ 63.1 Definitions

The definitions set forth in this section shall govern the construction of the terms used in this Part:

(a) Insurance of municipal bonds is insurance against financial loss by reason of nonpayment of principal and interest obligations pursuant to the terms of municipal bonds as defined in subdivision (b) of this section.

[Page 365 follows]
amount representing 10 percent of the surplus to policyholders of
the insurer.

(c)(1) In no event shall an insurer have outstanding a cumulative
net liability, under policies in force insuring municipal bonds, in an
amount which exceeds the sum of:

(i) its capital and surplus; plus

(ii) the contingent reserve as defined in section 63.2(a)(2)(i) of this
part.

(2) For the purpose of this subdivision, the term *cumulative net
liability* shall mean one third of one percent of the insured unpaid
principal and the insured unpaid interest covered by policies in force
insuring municipal bonds. In the event that any such insurer has
outstanding a cumulative net liability in excess of the amount as so
computed, it shall not transact any new insurance of municipal bonds
unless and until its cumulative net liability no longer exceeds such
amount.

(d) The principal amount of insured municipal bonds issued
primarily to finance property for use in a trade or business carried
on by any entity (including a nonprofit entity) other than a
governmental unit, the interest on which is exempt from Federal
income taxes, and secured by a pledge of payments to be made by
such entity or of revenues to be derived from such trade or business
shall not total more than 25 percent of the total principal amount of
bonds insured by an insurer.

Stat. Authority—Insurance Law 9 21, 201, 201

History—See filed July 0, 1971; repealed, new filed Feb. 15, 1980 eff. Feb. 15, 1980;

Parallel Citation—Regulation 61.
§ 63.3 NEW YORK INSURANCE REGULATIONS

premiums on policies insuring municipal bonds. Allocations to such reserve made during each calendar year shall be maintained for a period of at least 240 months, except that withdrawals may be made by the company in any year in which the actual paid losses on the said type of policy exceed 25 percent of the earned premiums thereon, but no such releases shall be made without the prior written approval of the superintendent.

(ii) Provided that the contingency reserve has been in existence for at least 120 months, the company may apply to the superintendent for a release of a reasonable percentage of the reserve upon demonstration that the amount carried is excessive in relation to the company’s obligations on policies insuring municipal bonds.

(b) An insurer transacting the insurance of municipal bonds may invest the contingency reserve to tax and loss bonds purchased pursuant to section 832(e) of the Internal Revenue Code, 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 section 1402(b)(1), (2) and (3) and section 1404(a)(1), (2) and (3) of the Insurance Law.

Stat. Authority.—Insurance Law, § 21, 201, 201.


Parallel Citation.—Regulation 61.

§ 63.3 Limitations and restrictions

(a) Policies insuring municipal bonds shall be issued to cover only bonds of the type defined in sections 63.1(b) of this Part.

(b) For the purpose of complying with the provisions of section 1115 of the Insurance Law, the total net liability of an insurer in respect to any one issue of municipal bonds insured shall be the average annual amount due for principal and interest on insured securities of such issue, net of appropriate allowance for reinsurance with an authorized or accredited reinsurer. In no event shall the total net liability in respect to any one issue of municipal bonds exceed an
have the effect of rendering void the insurance policy issued by the insurer.


Parallel Citation.—Regulation 91.
losses and loss adjustment expenses on such policies in all financial statements filed by it with this department. Such reserve shall be computed in a manner consistent with the provisions of section 4117 of the Insurance Law, and shall be based upon either the case basis method or such other method as the superintendent may prescribe. No deduction shall be made for anticipated salvage in computing claim reserves. If the insured principal and interest on a defaulted issue of bonds due and payable over the period of the next three years exceeds 10 percent of the insurer's capital, surplus and contingency reserve, its reserve so established shall be supported by a report from a qualified independent source. In meeting the requirements of section 4117(b)(2) of said law, the contingency reserve shall be added to the incurred but not reported loss reserve in order to determine compliance. If the contingency reserve is not an amount equal to that required by said section, then the company shall establish an incurred but not reported loss reserve in an amount sufficient to make the total of the combined contingency reserve and incurred but not reported loss reserve equal to five percent of net premiums in force. For the purpose of this regulation, net premiums in force include annual premiums on noncancellable installment type policies.

(c) The superintendent may require the filing of appropriate statistics in a form to be prescribed.

Stat. Authority.—Insurance Law, § 21, 201, 301.


Parallel Citation.—Regulation 81.

§ 63.5 Conflicts of interest prohibited

No insurer authorized to transact the business of insuring municipal bonds shall pay any commission or make gift of money, property or any valuable thing to any employee, agent or representative of any insurer of municipal bonds, or to any employee, agent or representative of any underwriter of any issue of such bonds, as an inducement to the purchase of, or at any time there is in force, a policy insuring such bonds, and no such employee, agent or representative of such insurer or underwriter shall receive any such payment or gift. However, violation of the provisions of this section shall not
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protection of policyholders covered by policies insuring municipal bonds against the effect of excessive losses occurring during adverse economic cycles.

(c) "Cumulative net liability" means one-third of one percent of the insured unpaid principal and insured unpaid interest covered by in-force policies of municipal bond insurance.

(d) "Municipal bonds" means securities which are issued by or on behalf of or are paid or guaranteed by:

1. Any state, territory or possession of the United States of America;
2. Any political subdivision of any such state, territory or possession; or
3. Any agency, authority or corporate or other instrumentality of any one or more of the foregoing, or which are guaranteed by any of the foregoing.

(e) "Municipal bond insurance" means a type of surety insurance authorized by s. Ins 6.75(2)(g) which is limited to the guaranteeing of the performance and obligations of municipal bonds.

(f) "Municipal bond insurer" means an insurer which issues municipal bond insurance.

(g) "Total net liability" means the average annual amount due, net of reinsurance, for principal and interest on the insured amount of any one issue of municipal bonds.

(h) "Person" means any individual, corporation for profit or not for profit, association, partnership or any other legal entity.

(i) "Policyholders’ surplus" means an insurer’s net worth, the difference between its assets and liabilities, as reported in its annual statement.

(4) **MINIMUM CAPITAL OR PERMANENT SURPLUS.** The minimum capital or permanent surplus of a municipal bond insurer shall be $2 million for an insurer first authorized to do business in Wisconsin on or before January 1, 1984, or the amount required by statute or administrative order after that date for other municipal bond insurers.

(5) **LIMITATIONS AND RESTRICTIONS.** (a) Policies of municipal bond
Ins 3.01  WISCONSIN INSURANCE REGULATIONS

Ins 3.01 Accumulation benefit riders attached to health and accident policies

Except where such rider is used only on a policy replacing the company's own policy, and so recites, no rider providing for accumulations of benefits will be approved for use upon any policy of health and accident insurance, whether it is proposed to issue such rider with or without an additional premium. Such rider operates as an aid to twisting the policies of another company in such manner as to make it use a direct encouragement of this practice.

History.—1-5-66.

Ins 3.02 Automobile fleets, vehicles not included in

Individually owned motor vehicles cannot be included or covered by fleet rates. The determining factor for inclusion under fleet coverage must be ownership and not management or use.

History.—1-2-66.

Ins 3.04 Dividends not deducted from premiums in computing loss reserves

Premiums returned to policyholders as dividends may not be deducted from the earned premiums in computing loss reserves under s. 623.04, Stats.

History.—1-2-66; emergency, am. eff. 6-22-76; am. Register, Sept., 1976, No. 249, eff. 10-1-76.

Ins 3.08 Municipal bond insurance

(1) PURPOSE. This section implements and interprets as. 601.42, 611.19(1), 618.21, 623.03, 623.04, 627.05, 629.34(2), 632.14, and 632.17, Stats., for the purpose of establishing minimum requirements for the transaction of a type of surety insurance known as municipal bond insurance.

(2) SCOPE. This section shall apply to the underwriting, marketing, rating, accounting and reserving activities of insurers which write municipal bond insurance.

(3) DEFINITIONS. (a) "Annual statement" means the fire and casualty annual statement form specified in s. Ins. 7.01(5)(a).

(b) "Contingency reserve" means a reserve established for the
casualty loss reserves to be reported in the underwriting and investment exhibit, unpaid losses and loss adjustment expenses, of the annual statement. The method used to determine the loss reserve shall accurately reflect loss frequency and loss severity and shall include components for claims reported and unpaid, and for claims incurred but not reported, provided:

1. No deduction may be made for anticipated salvage in computing case basis loss reserves.

2. If the amount of insured principal and interest on a defaulted issue of municipal bonds which is due and payable over the period of the next 3 years exceeds 10% of a municipal bond insurer's capital, surplus and contingency reserve, its case basis reserve so established shall be supported by a report from a qualified independent source.

(8) UNEARNED PREMIUM RESERVE. A municipal bond insurer shall compute and maintain an unearned premium reserve on an annual or on a monthly pro rata basis on all unexpired coverage, except that in the case of premiums paid more than one year in advance, the premium shall be earned proportionally with the expiration of exposure except as provided under sub. (12).

(9) CONTINGENCY RESERVE. (a) A municipal bond insurer shall establish a contingency reserve which shall consist of allocations of sums representing 50% of the earned premium on policies of municipal bond insurance except as provided under sub. (12).

(b) The contingency reserve established by this subsection shall be maintained for 240 months. That portion of the contingency reserve established and maintained for more than 240 months shall be released and may no longer constitute part of the contingency reserve except as provided under sub. (12).

(c) Subject to the approval of the commissioner, withdrawals may be made from the contingency reserve in any year in which the actual incurred losses on municipal bonds insurance policies exceed 85% of the earned premiums on municipal bonds insurance policies except as provided under sub. (12).

(d) A municipal bond insurer may invest the contingency reserve in tax and loss bonds purchased pursuant to 26 U.S.C. 832(e). the
insurance shall be issued only to provide coverage on bonds of the type defined in sub. (3)(d).

(b) A municipal bond insurer may not have total net liability in respect to any one issue of municipal bonds in excess of an amount representing 10% of its policyholders' surplus.

(c) A municipal bond insurer may not have outstanding cumulative net liability, under in-force policies of municipal bond insurance, in an amount which exceeds the sum of:

1. Its capital and surplus, plus

2. The contingency reserve under sub. (9).

(d) A municipal bond insurer may not have more than 25% of the principal amount which it has insured represented by the principal amount of municipal bonds issued primarily to finance property for use in a trade or business carried on by any person other than a governmental unit, and secured by a pledge of payments to be made by the person or of revenues to be derived from the trade or business.

(6) PREMIUM. The total consideration charged for municipal bond insurance policies, including policy and other fees or similar charges, shall be considered premium and shall be subject to the reserve requirements of subs. (8) and (9).

(7) FINANCIAL STATEMENTS AND REPORTING. (a) The financial condition and operations of a municipal bond insurer shall be reported on the annual statement.

(b) The total contingency reserve required by sub. (9) shall be reported as a liability in the annual statement. This liability may be reported as unpaid losses or other appropriately labeled write-in item. Appropriate entries shall be made in the underwriting and investment exhibit statement of income of the annual statement. The change in contingency reserve for the year shall be reported in the annual statement as a reduction of or a deduction from underwriting income. If the contingency reserve is recorded as a loss liability, the change in the reserve shall be excluded from loss development similar to fidelity and surety losses incurred but not reported.

(c) A municipal bond insurer shall compute and maintain adequate
contingency reserve shall otherwise be invested only in classes of securities or types of investments specified in s. 620.22(1), Stats., except as provided under sub. (12).

(10) CONFLICTS OF INTEREST PROHIBITED. No municipal bond insurer may pay any commission or make any gift of money, property or other valuable thing to any employee, agent, or representative of any issuer of municipal bonds or to any employee, agent or representative of any underwriter of an issue of the bonds as an inducement to the purchase of, or at any time there is in force, a policy insuring bonds, and no employee, agent or representative of the insurer or underwriter shall receive any payment or gift. However, violation of the provisions of this subsection does not render void the municipal bond insurance policy.

(11) TRANSITION. Unearned premium reserves and contingency loss reserves shall be computed and maintained on risks insured after the effective date of this section as required by subs. (8) and (9).

(12) LAWS OR REGULATIONS OF OTHER JURISDICTIONS. Whenever the laws or regulations of another jurisdiction in which a municipal bond insurer is licensed, require a larger unearned premium reserve or a larger contingency reserve in the aggregate than that set forth in this section, the establishment and maintenance of the larger aggregated, unearned premium reserve and contingency reserve complies with this rule.

History.—Effective, created eff. 6-5-84, created Register, Oct., 1984, No. 845, eff. 11-1-84; am. (3)(d) intro., (6)(c) and (9)(c), Register, March 1986, No. 869, eff. 4-1-86.

Ins 3.09 Mortgage guaranty insurance

(1) PURPOSE. This section implements and interprets s. Ins 6.75(2)(i) and (j) and ss. 601.42, 611.19(1), 611.24, 618.21, 620.02, 623.02, 623.03, 623.04, 627.05 and 628.34(12), Stats., for the purpose of establishing minimum requirements for the transaction of mortgage guaranty insurance.

(2) SCOPE. This rule shall apply to the underwriting, investment, marketing, rating, accounting and reserving activities of insurers which write the type of insurance authorized by s. Ins 6.75(2)(i) and (j).
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(b) Notwithstanding subdivision (a), Section 117, Section 119, or the provisions of Chapter 2 (commencing with Section 12420) and Chapter 2A (commencing with Section 12640.01) of Part 6 of Division 2, a municipal bond insurer which meets the requirements of Article 5 (commencing with Section 12100) of Chapter 1 of Part 4 of Division 2, may insure obligations in connection with the issuance of municipal bonds as defined in subdivision (b) of Section 12100, where the obligation being guaranteed or insured meets either of the following criteria:

(1) Is, includes, or is secured by a lease or rental payments for the possession, use or occupancy of real estate or any improvements thereon.

(2) Is, includes, or is secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate and any improvements thereon. However, if the mortgage, deed or trust, or other instrument constituting a lien or charge on real estate is upon real estate, the primary improvement on which is a residential building, a condominium unit or other building designed, in each case, for occupancy by one or more families that insurer shall not insure any such obligation unless there is adequate mortgage or mortgage guaranty insurance covering the obligation. The commissioner may prescribe standards as to the mortgage or mortgage guaranty risk which may be undertaken in connection with those obligations. In prescribing the standards, the commissioner shall give due consideration to the market availability of insurance covering the risks, the mortgage guaranty insurance coverage requirement of the national secondary market, and whether that coverage is reasonably available from admitted mortgage or admitted mortgage guaranty insurers.

(c) Insurance against loss resulting from the forgery or alteration of any instrument of any kind or character or of any signature thereon. Nothing in this paragraph shall be deemed to limit any of the powers of title insurers.

(d) Any of the following insurance when included as a part of contract containing any such guarantee of behavior or performance or in a contract indemnifying any bank, banker, broker, financial or moneyed corporation or association, any state, political subdivision, public or municipal corporation, or any officer of any state, political subdivision, public or municipal corporation: Insurance indemnifying the insured named therein against loss or destruction from any cause of any evidences of debt of any kind or character, evidences of ownership of any kind or character, deeds, mortgages, warehouse receipts, bills of lading, certificates of stock, bonds, notes, drafts, checks, instruments of similar character, stamps, documents, money, precious metals of any kind or character, refined or unrefined, and articles made therefrom, jewelry, watches, necklaces, bracelets, gems and precious and semiprecious stones, and also against loss or damage, except by fire, to the insured's premises,
Assembly Bill No. 945

CHAPTER 1014

An act to amend Section 105 of, and to add Article 5 (commencing with Section 12100) to Chapter 1 of Part 4 of Division 2 of, the Insurance Code, relating to insurance, and making an appropriation therefor.

[Approved by Governor September 25, 1985. Filed with Secretary of State September 26, 1985.]

LEGISLATIVE COUNSEL'S DIGEST

AB 945, McAlister. Insurance.

Existing law authorizes various forms of insurance but does not specifically provide for the issuance of municipal bond insurance. This bill would provide for municipal bond insurance. Only insurers authorized to write surety insurance could issue municipal bond insurance. The insurer would be required to be qualified by the Insurance Commissioner and to meet various financial and fiscal requirements.

Among other things, the bill would limit an insurer's total net liability. That limit would become operative on January 1, 1988, unless delayed by the commissioner to not later than January 1, 1989. The bill would require the commissioner to report to the Legislature on this and other specified requirements no later than April 1, 1987.

The bill would establish limits for the total net liability of such an insurer.

The bill would provide for a fee of $1,500 for filing an application for qualification and a fee of $500 for filing an application for release of a percentage of the contingency reserve and of $500 or more for review and determination of the use of specified collateral security in connection with one issue. Since the fees would be deposited in the continuously appropriated Insurance Fund, the imposition of the fee would result in an appropriation.

Appropriation: yes.

The people of the State of California do enact as follows:

SECTION 1. Section 105 of the Insurance Code is amended to read:

105. Surety insurance includes:

(a) The guaranteeing of behavior of persons and the guaranteeing of performance of contracts (including executing or guaranteeing bonds and undertakings required or permitted in all actions or proceedings or by law allowed), other than insurance policies and other than for payments secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate.

APPENDIX H
state unless it complies with the requirements of this article. However, this subdivision shall not become operative until January 1, 1988, except that with regard to municipal bond insurance transacted in this state, any such insurer shall, on and after January 1, 1986, comply with the requirements of this article. The commissioner shall report to the Legislature no later than April 1, 1987, concerning the impact of this subdivision on municipal bond insurers.

(c) On and after January 1, 1986, any insurer seeking a certificate of authority to transact any class of insurance in this state shall comply with this article if that insurer transacts or is authorized to transact municipal bond insurance anywhere.

12102. The insurer shall establish a contingency reserve consisting of allocations from surplus of sums representing 50 percent of the earned premiums on policies insuring municipal bonds. Allocations to the contingency reserve made during each calendar year shall be maintained until the contingency reserve equals or exceeds 1 percent of the total net liability exclusive of unpaid insured interest. These allocations shall be maintained for a period of not less than 240 months and for such additional period of time that is necessary to achieve compliance with the requirement that the contingency reserve equal or exceed 1 percent. Notwithstanding the foregoing, withdrawals may be made by the insurer in any year in which, and to the extent that, the incurred losses exceed 35 percent of the earned premium thereon or as otherwise permitted by the commissioner. The contingency reserve shall be considered a separate liability and shall be reported as such in all statutory financial filings.

12103. The insurer may apply to the commissioner for release of a reasonable percentage of the contingency reserve upon demonstration that the amount carried is excessive in relation to the insurer’s obligations under policies insuring municipal bonds. The filing fee for that application is five hundred dollars ($500).

12104. (a) All municipal bonds that are issued by a single issuer and secured by a single revenue source shall be considered “one issue” for purposes of this section. In no event shall the average annual amount due for unpaid insured principal and unpaid insured interest to maturity on insured securities of such issue, net of appropriate reinsurance, and collateral security as approved by the commissioner, exceed 7½ percent of the insurer’s or reinsurer’s combined capital and surplus and the contingency reserve required by Section 12102, as shown by its last annual statement on file in the office of the commissioner.

(b) In determining whether an insurer meets the limitations of this section, the average annual amount due for unpaid insured principal and unpaid insured interest to maturity on one issue insured by the insurer and its affiliates, in which the insurer has a direct or indirect investment, shall be aggregated, net of reinsurance
furnishings, fixtures, equipment, safes and vaults therein caused by burglary, robbery, holdup, theft or larceny or attempt thereat. No such insurance indemnifying against loss of any property as specified herein shall indemnify against loss of any such property occurring while in the mail or in the exclusive custody or possession of a common carrier for the purpose of transportation, except for the purpose of transportation by an armored motor vehicle.

SEC. 2. Article 5 (commencing with Section 12100) is added to Chapter 1 of Part 4 of Division 2 of the Insurance Code, to read:

Article 5. Municipal Bond Insurance

12100. The definitions set forth in this section shall govern the construction of the terms used in this article but shall not affect any other sections of this code unless specifically referenced therein:

(a) "Municipal bond insurance" means insurance against financial loss by reason of nonpayment of principal, interest, or other payment obligations pursuant to the terms of municipal bonds.

(b) "Municipal bonds" means any security, or other instrument under which a payment obligation is created, issued by or on behalf of, or guaranteed by a state, territory, or possession of the United States of America, a municipality, or a political subdivision of any of the foregoing, or by any public agency or instrumentality thereof.

(c) "Contingency reserve" means an additional reserve account established for the protection of policyholders against the effect of adverse economic cycles.

(d) "Total liability" means the aggregate exposure written on all municipal bond policies on a gross basis which includes unpaid insured principal and unpaid insured interest due or to become due to maturity. "Total net liability" means the total liability net of reinsurance.

(e) "Affiliate" means an affiliate as defined in subdivision (a) of Section 1215.

12101. (a) An admitted insurer shall not transact the business of municipal bond insurance unless it is authorized to write the class of surety insurance set forth in Section 105, and has complied with all of the following requirements:

(1) Filed an application for qualification on a form prescribed by the commissioner accompanied by the applicant’s proposed plan of operation, its financial condition, and any other information deemed appropriate by the commissioner.

(2) Paid a fee in advance of one thousand five hundred dollars ($1,500) to the department for the filing of the application.

(3) Received written qualification to transact municipal bond insurance from the commissioner.

(b) An insurer that anywhere issues contracts insuring municipal bonds is not eligible for a certificate of authority or continuation of a certificate of authority to transact any insurance business in this
combined capital and surplus of twenty-five million dollars ($25,000,000), or, in the case of an unincorporated association of individual alien reinsurers, maintains sufficient assets in the United States, but in no event less than five hundred million dollars ($500,000,000), for the protection of policyholders in the United States and operates its business in such a manner to satisfy the commissioner that it maintains standard and financial conditions reasonably comparable to those required of admitted insurers and that it is able to pay losses in the United States; but, in either case, only to the extent and under the conditions specified in Sections 922.4 and 922.5.

(b) The ceding insurer shall establish and maintain the reserves referred to in Section 12107. The contingency reserve required by Section 12102 shall not be reduced by reason of any risk ceded unless the risk is ceded to an insurer that is described in paragraph (1) or (2) of subdivision (a) and that reinsurer establishes the contingency reserve as provided by Section 12102 with respect to the ceded portion of the risk.

(c) Any insurer or reinsurer meeting the requirements of paragraph (2) or (3) of subdivision (a) shall be authorized to contract for municipal bond reinsurance, but nothing herein contained shall be deemed to permit that insurer or reinsurer to write municipal bond insurance directly.

(d) Any reinsurance allowed pursuant to subdivision (a) may be contracted for by a municipal bond insurer with an affiliate.

12107. For the purposes of this article the following reserves shall be established:

(a) The unearned premium reserve shall be computed to show gross premiums, without any deductions, received and receivable upon all unexpired risks, net of reinsurance, on a monthly pro rata basis, except that in the case of premiums paid more than one year in advance, the premiums shall be earned proportionately with the expiration of exposure, or by such other method as the commissioner may prescribe or approve.

(b) In addition to the contingency reserve required under Section 12102, reserves for losses and loss adjustment expenses for claims reported and unpaid shall be determined using the case basis method or such other method as the commissioner may prescribe. In addition, a reserve component for incurred but not reported claims shall be reasonably estimated.

(c) Except as otherwise permitted by the commissioner, no deduction shall be made for anticipated salvage in computing case basis loss reserves, unless that salvage is held by or under the control of the insurer and would qualify as an admitted asset under Section 1100 and Sections 1170 to 1202, inclusive, or unless that salvage constitutes or is secured by a clean, irrevocable letter of credit as approved by the commissioner.

(d) No deduction from reserves shall be allowed for the time
with nonaffiliates of the insurer and collateral security as approved by the commissioner. However, if the affiliate is not wholly owned directly or indirectly by the insurer, the amount of insured unpaid principal and insured unpaid interest on one issue shall be aggregated in the same percentage as the insurer's direct or indirect investment in the affiliate.

(c) The commissioner shall require payment in advance of five hundred dollars ($500) as a fee for the review and determination under subdivision (b) as to whether or not he or she will approve the use of that collateral security in connection with a single issue as applied for by the insurer. The commissioner shall require the payment of additional amounts from the requesting insurer as may be necessary to defray all costs including, but not limited to, appraisal, administrative, title verification, and legal fees, in excess of five hundred dollars ($500) incurred by the commissioner in making that determination.

12105 (a) In no event shall one-half of 1 percent of the insurer's or reinsurer's total net liability under policies of municipal bond insurance exceed the sum of its capital and surplus and the contingency reserve as required by Section 12102. In the event that one-half of 1 percent of the total net liability is in excess of the amount so computed, the insurer or reinsurer shall cease transacting any new municipal bond insurance or reinsurance until such time as its total net liability is brought into compliance with this section. The commissioner shall report to the Legislature concerning the progress of municipal bond insurers and reinsurers in meeting the requirements of this section no later than April 1, 1987. The requirements imposed by this section shall become operative on January 1, 1988. However, the commissioner may by notice delay that date to not later than January 1, 1989.

(b) In determining whether an insurer meets the limitations of this section, the total liability of the insurer's affiliates, in which the insurer has a direct or indirect investment, net of reinsurance with nonaffiliates of the insurer, shall be aggregated with the total net liability of the insurer. However, if the affiliate is not wholly owned directly or indirectly by the insurer, such total liability shall be aggregated in the same percentage as the insurer's direct or indirect investments in the affiliate.

12106. (a) Any surety insurer qualified to write municipal bond insurance may, by contract, reinsure any such insurance it transacts, provided that credit in accounting and financial statements permitted by this code on account of reinsurance ceded shall be allowed only if that reinsurance shall be with one of the following:

(1) An insurer qualified to write municipal bond insurance pursuant to this article.

(2) A surety insurer or surety reinsurer which is authorized to write any type of surety insurance in this state.

(3) A nonadmitted foreign or alien reinsurer having a minimum
value of money unless the insurer can satisfy the commissioner that bonds, notes, and other fixed income investments, as authorized under the provisions of Articles 3 (commencing with Section 1170) and 4 (commencing with Section 1190) of Chapter 2 of Part 2 of Division 1, relating to general and excess funds investments, sufficient to meet obligations for unpaid principal and unpaid interest calculated to the redemption of the defaulted issue have been identified in the accounts of the insurer, or deposited in trust, as prescribed by the commissioner for the purpose of meeting such obligations.

(e) If the default for any one issue exceeds 5 percent of the insurer's capital and surplus and contingency reserve, and the reserve is set up for less than the entire unpaid insured principal and unpaid insured interest to redemption, the reserve so established shall be supported by a report from a qualified independent person acceptable to the commissioner.

12108. No insurer authorized to transact municipal bond insurance shall pay any commission or make any gift of money, property, or other valuable thing to any employee, agent, or representative of any issuer of municipal bonds or trustee of any issuer or to any employee, agent, or representative of any underwriter of any issuer of those bonds as an inducement to the purchase of that insurance, and at any time there is in force a policy insuring those bonds, no employee, agent, or representative of the issuer or underwriter shall receive any such payment or gift. Any such payment or gift is an unlawful rebate pursuant to Article 5 (commencing with Section 750) of Chapter 1 of Part 2 of Division 1.

12109. The commissioner may adopt rules and regulations pursuant to Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code to effectively regulate municipal bond insurance business, including but not limited to, types of risks, methods by which business is produced, amounts at risk, reserves, collateral, and other financial requirements as he or she may deem necessary.
APPENDIX I
"Average annual debt service" means the amount of insured unpaid principal and interest on an obligation multiplied by the number of such insured obligations, assuming that each obligation represents a $1,000 par value, divided by the amount equal to the aggregate life of all such obligations. The amount of insured unpaid principal shall be reduced by the amount of deposit of (i) cash, or (ii) the market value of obligations rated in the four highest major rating categories by a securities rating agency recognized by the Commission, or (iii) the stated amount of an unconditional, irrevocable letter of credit issued or confirmed by a bank or trust company that (a) is a member of the federal reserve system or chartered by any state or (b) is organized and existing under the laws of a foreign country, has been licensed as a branch or agency by any state or the federal government and is rated in the two highest major rating categories by a securities ratings agency recognized by the Commission or (c) is otherwise acceptable to the Commission. Such deposit shall be held by the insurer or held in trust for the benefit of the insurer or held in trust for the benefit of holders of the insured obligation whether in the form of debt service, sinking funds or other reserves pursuant to the bond indenture by a trustee acceptable to the Commission.

E. The limitation of risk prescribed in this section for any alien insurer shall apply only to the exposure to risk and the trusted surplus of the alien insurer’s policyholders.

F. This section shall not apply to (i) life insurance, (ii) annuities, (iii) accident and sickness insurance, (iv) insurance of marine risk or marine protection and indemnity risks, (v) workers’ compensation or employers’ liability risks, or (vi) risks covered by title insurance. (Code 1960, §§ 38-167, 38-168; 1952, c. 317, § 38.1-32; 1986, c. 562; 1987, c. 353.)

The 1997 amendment added present subsections C and D, and redesignated former subsections E and F.

§ 38.2-209. Award of insured’s attorney fees in certain cases.

This section does not create cause of action, but merely permits the award of attorney fees where a private cause of action already exists. Baldwin v. Transamerica Occidental Life Ins. Co., 801 F.2d 659 (4th Cir. 1986)


§ 38.2-231. Notice of cancellation, refusal to renew, reduction in coverage or increase in rate of certain liability insurance policies. — A. No cancellation or refusal to renew by an insurer of a policy of insurance as defined in § 38.2-117 or § 38.2-118 insuring a business entity, or a policy of insurance that includes as a part thereof insurance as defined in § 38.2-117 or § 38.2-118 insuring a business entity, shall be effective unless the insurer delivers or mails to the named insured at the address shown on the policy a written notice of cancellation or refusal to renew. Such notice shall:
1. Be in a type size authorized under § 38.2-311;
2. State the date, which shall not be less than forty-five days after the delivery or mailing of the notice of cancellation or refusal to renew, on which such cancellation or refusal to renew shall become effective, except that such effective date may not be less than fifteen days from the date of mailing or delivery when the policy is being cancelled or not renewed for failure of the insured to discharge when due any of his obligations in connection with the payment of premium for the policy;
3. [Repealed.]
§ 38.2-205.1 Temporary contracts of insurance permitted. — A lender engaged in making or servicing real estate mortgage or deed of trust loans on one to four family residences shall accept as evidence of insurance a temporary written contract of insurance meeting the requirements of § 38.2-2112 and issued by any duly licensed agent, broker, or insurance company. Nothing herein prohibits the lender from disapproving such insurer provided such disapproval is reasonable. Such lender need not accept a binder unless such binder (i) includes the name and address of the insured, name and address of the mortgagor, a description of the insured collateral, and a provision that it may not be cancelled within the term of the binder except upon ten days' written notice to the mortgagor; (ii) is accompanied by a paid receipt for one year's premium, except in the case of a policy issued at closing a loan; and (iii) includes an undertaking of agent to use his best efforts to have the company issue a policy within forty-five days, unless the binder is cancelled. The Bureau of Insurance may by administrative letter require binders to contain such additional information as may be necessary to permit such binders to comply with the reasonable requirements of the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation for purchase of mortgage loans. (1987, c. 10.)

§ 38.2-208. Limitation of risks generally. — A. Except as otherwise provided in this title, no insurer transacting business in this Commonwealth shall expose itself to any loss on any one risk or hazard in an amount exceeding ten percent of its surplus to policyholders. Any risk or portion of any risk reinsured by an insurer meeting standards of solvency equal to those set forth in § 38.2-1316 shall be deducted in determining the limitation of risk prescribed in this section.

B. For the purpose of this section, the surplus to policyholders shall be determined from (i) the insurer's last sworn statement filed with the Commission or (ii) the Commission's last report of examination, whichever is more recent at the time the risk is assumed.

C. For the purpose of this section, any one risk or hazard in the case of municipal bond insurance shall mean average annual debt service of insured obligation backed by a single revenue source, provided that the insurance policy does not require any accelerated payment of principal by the insurer upon the event of default.

D. As used in subsection C above:

"Municipal bond insurance" means insurance against loss by reason of nonpayment of principal, interest or other payment obligations pursuant to the terms of municipal bonds.

"Municipal 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 state, a province of Canada, a municipality or political subdivision of any of the foregoing, or any public agency or instrumentality thereof.
An Act to amend and reenact § 38.2-208 of the Code of Virginia, relating to insurer’s limitation of risks.

Be it enacted by the General Assembly of Virginia:

1. That § 38.2-208 of the Code of Virginia is amended and reenacted as follows:

§ 38.2-208. Limitation of risks generally.—A. Except as otherwise provided in this title, no insurer transacting business in this Commonwealth shall expose itself to any loss on any one risk or hazard in an amount exceeding ten percent of its surplus to policyholders. Any risk or portion of any risk reinsured by an insurer meeting standards of solvency equal to those set forth in § 38.2-1316 shall be deducted in determining the limitation of risk prescribed in this section.

B. For the purpose of this section, the surplus to policyholders shall be determined from (i) the insurer’s last sworn statement filed with the Commission or (ii) the Commission’s last report of examination, whichever is more recent at the time the risk is assumed.

B1. For the purpose of this section, any one risk or hazard in the case of municipal bond insurance shall mean average annual debt service of insured obligations backed by a single revenue source, provided that the insurance policy does not require any accelerated payment of principal by the insurer upon the event of default.

2. For the purpose of this subsection, “municipal bond insurance” means insurance against loss by reason of nonpayment of principal, interest or other payment obligations pursuant to the terms of municipal bonds.

3. For the purpose of this subsection, “municipal 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 state, a province of Canada, a municipality or political subdivision of any of the foregoing, or any public agency or instrumentality thereof.

4. For the purpose of this subsection, “average annual debt service” means the amount of insured unpaid principal and interest on an obligation multiplied by the number of such insured obligations, assuming that each obligation represents a $1,000 par value, divided by the amount equal to the aggregate life of all such obligations.

5. For the purpose of this subsection, the amount of insured unpaid principal shall be reduced by the amount of deposit of (i) cash, or (ii) the market value of obligations rated in the four highest major rating categories by a securities rating agency recognized by the Commission, or (iii) the stated amount of an unconditional, irrevocable letter of credit issued or confirmed by a bank or trust company that (a) is a member of the federal reserve system or chartered by any state or (b) is organized and existing under the laws of a foreign country, has been licensed as a branch or agency by any state or the federal government and is rated in the two highest major rating categories by a securities ratings agency recognized by the Commission or (c) is otherwise acceptable to the Commission. Such deposit shall be held by the insurer or held in trust for the benefit of the insurer or held in trust for the benefit of holders of the insured obligation whether in the form of debt service, sinking funds or other reserves pursuant to the bond indenture by a trustee acceptable to the Commission.

C. The limitation of risk prescribed in this section for any alien insurer shall apply only to the exposure to risk and the trusteed surplus of the alien insurer’s policyholders.

D. This section shall not apply to (i) life insurance, (ii) annuities, (iii) accident and sickness insurance, (iv) insurance of marine risks or marine protection and indemnity risks, (v) workers’ compensation or employers’ liability risks, or (vi) risks covered by title insurance.
APPENDIX J
Recently, Fireman's Fund Insurance Company, Industrial Indemnity Insurance Company, Cal. Farm Insurance Company and Glacier General Assurance Company have sustained catastrophic losses on financial guaranties, resulting in the insolvencies of the latter two insurers. In addition, American Municipal Bond Assurance Corp. (AMBAC) insured various unit trusts which held $233.6 million in principal in Washington Public Power Supply System Projects 4 and 5 (WPPSS) bonds which defaulted in 1983. AMBAC's loss exposure, including interest payment guaranties of $52.6 million, is $76.2 million. The premium charged was insignificant compared to the exposure. In addition, four industrial development bond issues insured by AMBAC involving the same Tennessee developer, recently went into default with an aggregate par value of $79 million.

Another recent example is Mutual Fire, Marine and Inland Insurance Company which, from 1983 through August 1984, guaranteed limited partnerships involving tax sheltered oil and gas and real estate ventures. Aggregate gross premium was $13.4 million and potential loss exposure before reinsurance is $435 million. Incurred losses to date exceed premium income. The company has defaulted on these claims, asserting that it was defrauded by the managing general agent, and is now under the protection of the Pennsylvania Insurance Department.

The primary concerns of the insurance regulator in the financial guaranty sector are treated in this bill in a manner which will permit profitable operations and adequate regulation. Multiline insurers would be prohibited from writing financial guaranties after a phase out period because the multiline format creates the following problems:

1. Potential to bankrupt company. When written as a sideline by a multiline insurer, financial guaranty insurance has the potential to bankrupt a company or to so limit its capacity as to prevent it from maintaining its market share for traditional and more essential lines of business. As noted earlier, so far three multiline companies have been rendered insolvent by their financial guaranty writings. The multiline approach protects property/casualty insurance policyholders from the negative impact of adverse experience of financial guaranty business. Multiline insurers would not be tempted to divert currently insufficient resources to financial guaranty business for the enhancement of cash flow.

2. Burdening the guaranty fund. Even if not covered by the guaranty fund, an insolvency of a multiline insurer resulting from financial guaranty losses would expose the fund to claims for all the property/casualty lines written by the insurer which are covered by the guaranty fund. Insurers which did not write financial guaranties and the vast majority of the public who never benefited from the guarantees would be burdened with the cost of losses covered by the guaranty fund.

3. Lack of accountability. In a multiline operation capital supports many lines of business. A monoline structure would enable the regulator to readily identify the risks insured and the capital supporting the business. This identification is necessary because of the unique nature of financial guaranties, which are a hybrid of insurance and investment banking.

4. Lack of line of business reporting. Since multiline insurers report financial guaranty business as surety, credit or another line of insurance, the premium, total exposure, underwriting experience and types of guaranties covered by financial guaranty insurance are not ascertainable from statements filed with the insurance department or other state regulators.

5. Diversification of capacity. At a time when insurance for essential property and casualty coverages is unavailable to many businesses and localities, writing financial guaranty insurance is a misuse of limited multiline insurance capacity. The need for financial guaranties on risks other than municipal bonds, for which monoline insurers are readily available, cannot be viewed as essential.

6. Lack of expertise. Few multiline insurers will have the necessary expertise to write financial guaranties, especially of the new and more exotic products. The expertise required to underwrite financial guaranties bears no relationship to traditional property/casualty underwriting, which utilizes actuarial and loss experience to evaluate and price a risk. Financial guaranty business requires in-depth expertise of investment bankers and economists, as is the case with existing monoline financial guaranty insurers. Some multiline insurers, particularly the smaller ones, in an attempt to enter the market, may be tempted to "borrow" expertise from managing general agents who have a financial interest in placing the business. Reliance upon the expertise of others with diverse financial interests to underwrite business invites disaster, as was the case with Mutual Fire, Marine and Inland Insurance Company.

7. Regulatory constraints. Because of its nature, underwriting financial guaranty insurance in a multiline environment adds undue complexity to the analysis and monitoring of an insurer's financial condition with no discernable benefit. It is an unwarranted diversion from the pressing regulatory responsibilities of the insurance department to expend finite resources in monitoring this line of business in a multiline environment.

Significantly, Municipal Bond Insurance Association (MBIA), the largest financial guaranty insurer (which is currently operated as an underwriting association by five major multiline insurers and is the only significant insurer of municipal bonds not now operating as a monoline insurer) has filed for reorganization. The new company, Municipal Bond Investors Assurance Corporation (MBIAC), whose stock will be owned by four of the five current principals, will operate as a New York domestic monoline financial guaranty insurer. Thus, the only financial guaranty business written by multiline insurers which will be affected by enactment of this bill are the high risk guaranties, such as limited partnerships, consumer debt obligations and corporate debt (which is also written in the monoline market). For limited partnerships, consumer obligations and corporate obligations guaranteed by multiline insurers the premium volume is low and, because
STATEMENT IN SUPPORT

Financial guaranty insurance is a new type of coverage which has grown at a phenomenal rate. Although it was a relatively minor line of business ten years ago, financial guaranty insurance has, in recent years, become a significant marketing factor for the financial community. Financial guaranty insurance is currently subject to rules applicable to property/casualty insurance generally but it is a unique kind of coverage requiring specialized treatment. Property/casualty insurance is based on the law of large numbers—a large group of homogeneous risks joined together to create a pool of money to pay for the losses of a few. The number of losses incurred is generally frequent, and severity in relation to surplus is relatively low. In contrast, under financial guaranty insurance, a single loss, e.g., the failure of a bond issuer to meet its obligations, could result in a potentially catastrophic financial loss affecting large numbers of insured bondholders. It is prudent to project that a severe economic downturn affecting either the general economy or a class thereof (e.g., oil producers and the localities dependent for revenue thereon) would result in more widespread defaults. It is, therefore, necessary that the insurance law define and appropriately regulate this line of business. Under current law financial guaranty insurance is not a defined kind of business, which prevents implementation of necessary regulation.

In its early years, financial guaranty insurance principally was limited to guaranties of municipal bond debt underwritten by monoline companies. Municipal bond insurance has been regulated in New York and Wisconsin by regulation which prescribes reserve and capital requirements and limitations on single risk and aggregate exposure. Recently, California and Illinois have adopted similar rules. There is no body of law or regulations which addresses financial guaranty insurance generally. In recent years, multiline property/casualty companies have been writing municipal bond insurance as well as the non-traditional types of financial guaranties discussed below.

The magnitude of financial guaranty business is substantial. It has been estimated that insurers' current exposure to loss under municipal bond guaranties alone exceeds $220 billion. There is currently no reliable reporting for non-municipal guaranties, but the magnitude of these exposures is unknown. Financial guaranties have been issued to minimize risk of loss to insured obligees or indemnitees for the payment of principal and interest on public and private debt, fluctuations in interest rates, fluctuations in currency rates, convertibility of currency, financial or commodities indices or price levels and changes in value of assets. In the area of publicly traded debt, a principal purpose of the guaranty has been "credit enhancement," which generally results in the "AAA" credit rating of an insurer adhering to a lower rated obligation by virtue of the guaranty. This is financially advantageous to a governmental or corporate borrower because the premium charged by the insurer for "credit enhancement" or the "rated rate" is only one half of the savings generated by the lower interest rate which results from a "AAA" rating. Since the insurer is only charging a portion of the interest differential perceived by the investment community as reflective of the increased risk between lower rated and AAA rated issues, it must be betting that the investors are wrong or be relying on the law of large numbers. A particular insurer's book of business may not be large enough or sufficiently diversified to justify such optimism and reliance.

Guarantees of debt cover a wide spectrum of obligations, from general obligation municipal bonds and industrial development bonds to corporate bonds and limited partnerships. While the insurers point to meticulous analysis of each risk before it is written, in practice, competition for business and severe time limitations may conflict with ideal underwriting. Even with ideal underwriting, the ability to predict the future when evaluating risks, whether municipal or private, is far less than perfect. The longer the term of the debt obligation, the greater the unpredictability of the risk. There are indications that some financial guarantors are becoming less concerned with conservative underwriting and more concerned with increasing their market share with the result that recent months rates charged have begun to erode some so low they no longer cover underwriting expenses. This attitude can turn a good underwriting record into a disaster.

The principal tools used by the insurers to predict risk exposures have been models of the historical experience of the Great Depression. Today's world does not mirror the past. The types of municipal bonds written today are not, for the most part, comparable to the general obligation bonds which were issued before and during the Depression. There is little history or experience for insuring corporate bonds, limited partnerships or industrial development bonds. Thus, the types of obligations issued today and the purposes thereof differ significantly from prior debt obligations which do have a historical track record, and the assumptions made by financial guarantors have yet to weather severe financial strains. In addition, federal tax reform is expected to have serious repercussions for guaranties of industrial development bonds and limited partnerships.

As discussed earlier, some regulation exists prescribing reserves and capital requirements and maximum exposure limits for municipal bond insurance. However, it does not distinguish between the different types of municipal bonds. More importantly, no such safeguards of solvency and claims paying ability currently exist for the much riskier non-municipal bond guaranties. Nor are there any contingency reserve requirements or other limitations on non-municipal guaranties. These newer types of guaranties cover obligations involving such enterprises as oil drilling, fast food, and real estate investment and development (e.g., apartment buildings, hospitals, airports, shopping centers and factories). It is improbable that the concept of a state's economy turning around from boom to bust in a matter of months was built into the analysis made by the financial guaranty insurers when they assumed the risk of covering obligations of those states and municipalities and the business enterprises therein which are now suffering because of the drop in oil prices. These new factors were certainly not built into the premium charged for what are now riskier guaranties. Furthermore, in contrast to property/casualty coverage, where the premium can be adjusted on annual renewal to reflect changing risk factors, the up-front premium charged for financial guaranty insurance covers the life of the obligation, which could be as long as 90 years. There is no opportunity to adjust the premium if the hazard changes.

Even in the "good times" of recent years there have been substantial losses, some of which are discussed below.
this business is ancillary to the traditional property and casualty business of these companies, there is a likelihood that executive oversight will not be commensurate with the loss exposures assumed. In any event, these types of guaranties are not essential coverages and do not warrant putting the traditional multiline operation and stability fund into jeopardy.

It is evident from the amount of capital which has been and is being attracted by the monoline financial guaranty insurers that investors view monoline carriers as attractive investments which will operate profitably. Therefore, monoline underwriting can provide adequate capacity to meet the demand.

Further provisions of the bill would prohibit insurers from issuing certain kinds of contracts such as interest rate guaranties, and currency fluctuations or convertibility of currency guaranties. The insurance department does not consider the subject of these contracts to be insurable risks. These guaranties are at best speculative and should be viewed as gambling contracts. A basic requirement of an insurable risk is that the peril should not produce a loss that will affect a large section of the insured group at the same time. The writing of a large number of the proscribed contracts does not spread the risk. Rather, it increases the potential loss to the insurer and does not reduce the amount of uncertainty since these contracts do not meet the criteria for insurable risks.

The bill also excludes financial guaranty, surety, residual value and non-consumer oriented credit insurance from guaranty fund protection. The purchasers of these products are, or should be, financially astute bankers, investment bankers, and limited partnership syndicators. There is a danger that "risk free investments" will remove discipline from the investment community. Having insurers assume the investor's risk is not the most prudent or socially beneficial use of today's limited multiline insurance capacity. Removing these lines from guaranty fund protection will add discipline to the market. In order to discharge their prudent person responsibilities, purchasers of these products, rather than using price as the primary criterion, will have to more closely evaluate the financial condition and ability of the insurer to meet its obligations, as the guaranty fund will no longer be available.

The typical guaranty fund contains a "per claim" cap which would be applicable today to financial guaranty claims. It is unclear whether the cap applies to each individual investor who has purchased insured obligations or to the aggregate liability of the guaranty fund in the event of default on a particular bond issue or issues in a unit trust. If the cap is per issue or per trust, investors get little protection since it would be divided among many investors, perhaps thousands. If the guaranty fund is liable for up to the amount of the cap for each investor, its exposure is astronomical. In either event, the guaranty fund is not an appropriate vehicle for financial guaranties.

Surety has already been excluded from the guaranty funds of many states because it is a highly specialized line whose losses should not be passed on to the general public. Residual value and non-consumer oriented credit insurance are also inappropriate kinds of coverage for guaranty fund protection.

In sum, this bill will encourage the doing of responsible financial guaranty insurance business in this state, make such business attractive to investors and minimize the financial mishaps which are likely in the absence of the proposed controls and limitations. Its prompt enactment is imperative.
FLORIDA LEGISLATURE

FINAL
LEGISLATIVE BILL
INFORMATION

1987 Special Sessions B, C, D
1988 Regular Session
1988 Special Sessions E, F

(re 88-87)

prepared by:

Joint Legislative Management Committee
Legislative Information Division
Capitol Building, Room 826 — 488-4371
S 1140 GENERAL BILL/CS by Commerce; Crenshaw (Identical H 1554, Similar H 1315)
Financial Guaranty Ins. Corporations, provides organizational & financial requirements for financial guaranty insurance corporations; provides limitations under which such corporations & certain property & casualty insurers may operate; prohibits excessive rates by such corporations; provides criteria for determining adequacy of such rates; provides that such filings shall be available for public inspection, etc. Amends Ch. 624, creates 627.971-975. Effective Date: 07/01/88.
04/11/88 SENATE Filed
04/21/88 SENATE Introduced, referred to Commerce; Finance, Taxation and Claims -SJ 150
04/28/88 SENATE On Committee agenda — Commerce, 05/02/88, 2:00 pm, Room-A
04/29/88 SENATE Extension of time granted Committee Commerce
05/02/88 SENATE Comm. Report: CS by Commerce - SJ 229
05/04/88 SENATE CS read first time — SJ 232; Now in Finance, Taxation and Claims — SJ 229
05/10/88 SENATE Withdrawn from Finance, Taxation and Claims — SJ 253;
Placed on Calendar
05/18/88 SENATE Placed on Consent Calendar — SJ 310; CS passed; YEAS 35 NAYS 0 — SJ 342; Immediately certified — SJ 342
05/18/88 HOUSE In Messages
05/19/88 HOUSE Received, placed on Calendar — HJ 592
05/20/88 HOUSE Placed on Special Order Calendar
05/24/88 HOUSE Substituted for HB 1554; Read second time — HJ 670
05/25/88 HOUSE Read third time; CS passed; YEAS 114 NAYS 0 — HJ 682
05/25/88 HOUSE Signed by Officers and presented to Governor — SJ 548
06/06/88 HOUSE Approved by Governor; Chapter No. 88-87 — SJ 1089

H 1554 GENERAL BILL by Insurance; Simon; McEwan; Wise; Bainter (Identical CS/S 1140, Similar H 1315)
Financial Guaranty Ins. Corporations, provides organizational & financial requirements for financial guaranty insurance corporations; provides limitations under which such corporations & certain property & casualty insurers may operate; prohibits excessive rates by such corporations; provides criteria for determining adequacy of such rates; provides that such filings shall be available for public inspection, etc. Amends Ch. 624, creates 627.971-975. Effective Date: 07/01/88 or upon becoming law, whichever occurs later.
04/26/88 HOUSE Filed
05/02/88 HOUSE Introduced, placed on Calendar — HJ 293
05/19/88 HOUSE Placed on Special Order Calendar
05/24/88 HOUSE Iden./Sim. Senate Bill substituted; Laid on Table under Rule, Iden./Sim./Compare Bill passed, refer to CS/SB 1140 (Ch. 88-87) — HJ 670

H 1315 GENERAL BILL by Young (Similar H 1554, CS/S 1140)
Financial Guaranty Ins. Corporations, provides organizational & financial requirements for such corporations; provides limitations under which financial guaranty insurance corporations & certain property & casualty insurers may operate; prohibits excessive rates by such corporations; provides criteria for determining adequacy of such rates; provides that certain filings shall be available for public inspection, etc. Creates 627 971-975, 624.605-.606. Effective Date: 07/01/88 or upon becoming law, whichever occurs later.
04/06/88 HOUSE Filed
04/12/88 HOUSE Introduced, referred to Insurance; Appropriations — HJ 131
04/26/88 HOUSE On Committee agenda — Insurance, 04/26/88, 8:00 am, 317C — For ratification of subreferral
06/07/88 HOUSE Died in Committee on Insurance, Iden./Sim./Compare bill passed, refer to CS/SB 1140 (Ch. 88-87)
I. SUMMARY:

A. Present Situation:

The present law authorizes the Department of Insurance (department) to regulate insurers which write financial guaranty insurance in the same manner as other property and casualty carriers. Insurers seeking to write financial guaranty insurance are only required to possess $1.75 million in capital and surplus, may seek authority to write other types of insurance, and may participate in the state guaranty association as to other types of insurance written.

B. Effect of Proposed Changes:

The bill establishes statutory regulation as to the formation and operation of corporations which write financial guaranty insurance. Financial guaranty insurance provides protection against the financial loss associated with a debt instrument or other monetary obligation. Financial guaranty insurance corporations will be regulated by the department.

Due to the size of potential claims and the nature of the risk involved with financial guaranty insurance, the bill requires insurers writing this type of insurance to establish $50 million in surplus. Notwithstanding the surplus requirement, insurers presently writing financial guaranty insurance may continue to do so under a grandfather clause.

The bill also requires financial guaranty insurance corporations to maintain contingency reserves in amounts greater than the reserves required for other property and casualty insurers. Restrictions are placed on the types of coverage which may be written by a financial guaranty insurance corporation.

For ease of understanding, a section-by-section analysis follows:

Section 1: Section 627.971, F.S., as created, provides definitions for the following terms: financial guaranty insurance, affiliate, average annual debt service, collateral, contingency reserve, financial guaranty insurance corporation, governmental unit, guaranties of consumer debt obligations, industrial development bond, investment grade obligation, letter of credit, municipal bonds, municipal obligation bond, reinsurance, and total liability of an insurer transacting financial guaranty insurance.

Financial guaranty insurance is defined as an insurance policy or an indemnity contract under which loss is payable upon proof of financial loss to an insured as a result of a variety of events which include:
1. failure of a debtor to pay when due because of a financial default or insolvency;
2. changes in the levels of interest rates;
3. changes in the rate of exchange of currency;
4. changes in the value of specific assets or commodities; or
5. other events which the department determines are substantially similar to the foregoing.

Financial guaranty insurance does not include many types of bonds and insurance. Financial guaranty insurance does not include any individual public official bond, any court bond, any bond running to the federal, state, county, or municipal government as a condition to granting a business license, credit unemployment insurance, credit insurance, mortgage guaranty insurance, or surety insurance.

Section 627.972, F.S., as created, provides that a financial guaranty insurance corporation must be organized and licensed in a manner similar to a stock property and casualty insurer. In addition to writing financial guaranty insurance, a financial guaranty insurer can be licensed to transact residual value insurance, surety insurance, credit insurance, and mortgage guaranty insurance. Prior to the issuance of a license, a financial guaranty insurance corporation must submit to the department a plan of operation. The plan of operation must identify the types and projected diversification of guaranties that will be issued, the proposed underwriting procedures, the methods of managerial oversight, the investment policies, and other matters prescribed by the department.

A financial guaranty insurance corporation is subject to the provisions of the insurance code which are applicable to property and casualty insurers. Investments by a financial guaranty insurance corporation are an entity insured by that corporation must not exceed two percent of its admitted assets. In order to obtain a license, a financial guaranty insurance corporation must have surplus to policyholders of at least $50 million. At all times thereafter, it must maintain a minimum surplus to policyholders of $35 million.

A financial guaranty insurance corporation must also establish a contingency reserve, net of reinsurance. Contributions to the contingency reserve are calculated by applying designated percentages to the net principal outstanding each calendar year of various guaranties. Quarterly additions to the reserve are also required in specified amounts for a designated period of time. Amounts in the reserve may be released in the same manner as contributions were made. A part of the reserve may be released proportional to the reduction in net total liabilities resulting from reinsurance. The reinsurer is required to establish a reserve in an amount equal to the amount released on the effective date of the reinsurance. Withdrawals from the contingency reserve to the extent of any excess, require department approval.

Loss reserves may be determined by the case basis method. A deduction from loss reserves is allowed for the time value of money. A financial guaranty insurance corporation must also maintain an unearned premium reserve, net of reinsurance. The unearned premium reserve must be computed monthly for premiums paid on an installment basis. All other premiums paid to a financial guaranty insurance corporation must be earned proportionately with the expiration of exposure, or by such other method approved by the department.

Section 627.973, F.S., as created, prohibits the transacting of financial guaranty insurance except by a corporation licensed
for that purpose. However, a licensed property and casualty insurer may transact financial guaranty insurance in Florida under the following conditions:

1. total policyholder's surplus exceeds $100 million;

2. not more than 20 percent of total net written premiums are applicable to financial guaranty insurance;

3. not more than 20 percent of the insurer's total policyholder's surplus is applied to meet the $100 million requirement;

4. the policyholder's surplus required by this part must be used exclusively for financial guaranty insurance;

5. a license to write financial guaranty insurance is obtained; and

6. the submission of a plan of operation to the department, if not previously transacting financial guaranty insurance.

Financial guaranty insurance can be written only to insure designated obligations. Prior written approval by the department is required to underwrite specified types of financial guaranty insurance.

At least 95 percent of a financial guaranty insurance corporation's outstanding total liability on municipal obligation bonds, must be investment grade. A financial guaranty insurance corporation must also maintain capital, surplus and contingency reserves in a sum based on a percentage of the total outstanding liabilities for specified guaranties. Adequate surplus must be maintained to support the writing of any residual value insurance, surety insurance and credit insurance.

A financial guaranty insurer must limit its exposure to loss for the types of risks it insures. For municipal bonds, the insured average annual debt service for one entity backed by a single revenue source may not exceed 10 percent of the aggregate of the corporation's capital, surplus and contingency reserves. The insured unpaid principal issued by a single entity and backed by a single revenue source may not exceed 75 percent of the aggregate of the corporation's capital, surplus and contingency reserves. For all other financial guaranties, the insured unpaid principal for any one risk may not exceed 10 percent of the aggregate of the corporation's capital, surplus and contingency reserves. If a corporation's exposure to loss exceeds statutory limitations it must cease transacting new business until its exposure to loss no longer exceeds those limitations.

Insurers which write financial guaranty insurance during the 12-month period immediately preceding the effective date of the act but not having policyholder surplus of $50 million may continue to write financial guaranty insurance if within 45 days a statement of intent is filed with the department. The statement must verify that the insurer will limit its writings to financial guaranty insurance, surety and fidelity insurance. Except for the surplus requirements, such insurer will be subject to the provisions of the act. However, by July 1, 1998, the insurer must have $35 million in surplus to policyholders. Failure to meet the conditions of the statement of intent will subject the insurer to penalties including license suspension or revocation. If an insurer does not file a statement of intent it must cease writing financial guaranty insurance within 6 months after the effective date.

An unlicensed insurer may reinsure its net in-force business with a licensed financial guaranty insurance corporation. With
prior approval of the Insurance Commissioner of its state of domicile, it may reinsure all or part of its net in-force business with an insurer licensed to write surety insurance. The assuming surety insurer must maintain reserves for the reinsured business in the manner applicable to the ceding insurer. In lieu of reinsuring, the insurer may continue the risks then in force.

An unlicensed insurer may write new financial guaranty polices if it will mitigate the possibility of loss. The insurance commissioner of the domiciliary state must approve the writing of any new financial guaranty insurance that would increase its risk of loss. An unlicensed insurer must also maintain reserves in the amounts applicable for municipal bond guaranties for all guaranties in force prior to the effective date of this act. If the insurer's contingency reserves are less than those required for municipal bond guaranties, it will have three years to bring its reserves into compliance.

A part of the unlicensed insurer's contingency reserve may be released in proportion to the reduction in net total liabilities resulting from reinsurance. However, the reinsurer must establish a reserve equal to the amount released. A part of the reserve may also be released with approval of the department. All unlicensed insurers which write financial guaranty insurance, are subject to the reserve requirements applicable to financial guaranty insurance corporations for business written on or after the effective date of this act.

Section 627.974, F.S., as created, requires all insurers writing financial guaranty insurance to file policy forms with the department within 30 days of their use. Policies must provide that there will be no acceleration of payments due under guarantied obligations except at the option of the insurer. Policies must disclose that insurance provided by the policy is not covered by the Florida Insurance Guaranty Association. Rates must not be excessive, inadequate, or unfairly discriminatory. Rating criteria and guidelines must also be filed with the department prior to their use.

Section 627.975, F.S., as created, authorizes an insurer transacting financial guaranty insurance to receive credit for reinsurance if the following conditions are met:

1. the reinsurance is subject to an agreement that may only be terminated or amended by the reinsurer or ceding insurer;
2. the reinsurance agreement provides that the liability of the reinsurer for policies in effect at the date of termination continues until the expiration or cancellation of the policy;
3. the reinsurance agreement provides for a cutoff of the reinsurance in force at the date of termination, at the request of the ceding company, or at the discretion of the department; and
4. the reinsurance is placed with another insurer licensed to write financial guaranty insurance, an insurer writing financial guaranty insurance, a licensed surety insurer, or an unauthorized or unaccredited reinsurer.

The surety insurer assuming reinsurance must have surplus to policyholders of $35 million and maintain reserves in the amounts required of financial guaranty insurance corporations. The surety insurer must limit its exposure to loss as required of a financial guaranty insurance corporation.

A reinsurer assuming reinsurance must be:
1. a licensed financial guaranty insurer;
2. an insurer writing financial guaranty insurance; or
3. maintain $35 million in policyholders surplus and comply with reserving requirements and exposure to loss restrictions if it is a parent, subsidiary, or affiliate.

Reinsurance placed with an unauthorized reinsurer must not exceed the liabilities carried by the ceding insurer for amounts withheld under a reinsurance treaty. The reinsurance must also not exceed the amounts deposited by the reinsurer as security for the payment of obligations.

In order to determine the required amount of capital, surplus and reserves, a financial guaranty insurance corporation may reduce its aggregate risk up to the limit for aggregate excess reinsurance.

Section 2: Section 624.6081, F.S., is created to define the term "residual value insurance" as insurance issued in connection with a lease or contract which provides against loss of economic value of property other than loss due to physical damage.

No insurance can be written as residual value insurance if it can be written as financial guaranty insurance.

Section 3: Section 624.606, F.S., is substantially rewritten to redefine the term "surety insurance" to include a contract bond, indemnity bond for the benefit of a public body, and becoming surety on a contract, other than a contract of indebtedness. "Surety insurance" also includes guarantying the performance of bonds required in judicial proceedings.

However the term "surety insurance" specifically does not include mortgage guaranty insurance, financial guaranty insurance, and any reinsurance contract.

Section 4: Section 624.6065, F.S., is created to define the term "fidelity insurance" as guarantying the fidelity of persons holding positions of public or private trust. "Fidelity insurance" also indemnifies financial institutions against loss of money caused by larceny, misplacement, destruction or other stated perils.

Section 5: Section 624.605, F.S., is amended to redefine the term "credit insurance" to prohibit the writing of insurance as credit insurance if it is defined as financial guaranty insurance.

Section 6: Provides for the repeal of ss. 627.941, 627.942, 627.943, 627.944 and 627.945, F.S., on October 1, 1992, and that they be reviewed by the Legislature prior to that date.

Section 7: Provides for the repeal of ss. 624.6065 and 624.6081, F.S., on October 1, 1991, and that they be reviewed by the Legislature prior to that date.

Section 8: Provides for an effective date of July 1, 1988, or upon becoming a law, whichever occurs later.
II. ECONOMIC IMPACT AND FISCAL NOTE:

A. Public:

Insurance companies which currently write financial guaranty insurance must apply to the department for a certificate of authority. Insurers seeking to write financial guaranty insurance will also be required to obtain a certificate of authority. This bill is intended to protect the policyholders of financial guaranty insurance by requiring insurers to maintain additional capital, surplus and reserves. The added financial requirements on insurers will restrict the writing of this type of insurance to the larger insurance companies. Thus, a few insurance companies will no longer be able to write this type of insurance.

B. Government:

The department will regulate insurance companies which write financial guaranty insurance. The department has advised that it will incur no additional costs associated with this regulation at this time.

III. COMMENTS:

Because Florida is one of the major financial guaranty insurance markets in the country, the department is seeking regulatory authority over insurers which sell these products. Enhanced regulation should allow the department to more effectively regulate financial guaranty insurance.

Early drafts of this bill were initially patterned after the December 1986 financial guaranty insurance model act adopted by the National Association of Insurance Commissioners.

To date, no state has passed legislation providing broad financial guaranty insurance regulation. Four states do have administrative regulations to regulate municipal bond insurance and two states have specific state laws dealing with municipal bond insurance.

IV. AMENDMENTS:

None.
COMMITTEE SUBSTITUTE FOR SENATE BILL 1140 (CHAPTER 88-87) establishes statutory regulation as to the formation and operation of corporations which write financial guaranty insurance. Financial guaranty insurance provides protection against the financial loss associated with a debt instrument or other monetary obligation. Financial guaranty insurance corporations will be regulated by the Department of Insurance.

Due to the size of potential claims and the nature of the risk involved with financial guaranty insurance, the bill requires insurers writing this type of insurance to establish $50 million in surplus. Notwithstanding the surplus requirement, insurers presently writing financial guaranty insurance may continue to do so until 1998 under a grandfather clause.

The bill also requires financial guaranty insurance corporations to maintain contingency reserves in amounts greater than the reserves required for other property and casualty insurers. Restrictions are placed in the types of coverage which may be written by a financial guaranty insurance corporation.
I. SUMMARY:

A. PRESENT SITUATION:

The present law authorizes the Department of Insurance to regulate insurers which write financial guaranty insurance in the same manner as other property and casualty carriers. Insurers seeking to write financial guaranty insurance are only required to possess $1.75 million in capital and surplus, may seek authority to write other types of insurance, and may participate in the state guaranty association as to other types of insurance written.

B. EFFECT OF PROPOSED CHANGES:

The bill establishes statutory regulation as to the formation and operation of corporations which write financial guaranty insurance. Financial guaranty insurance provides protection against the financial loss associated with a debt instrument or other monetary obligation. Financial guaranty insurance corporations will be regulated by the Department of Insurance.

Due to the size of potential claims and the nature of the risk involved with financial guaranty insurance, the bill requires insurers writing this type of insurance to establish $50 million in surplus. Notwithstanding the surplus requirement, insurers presently writing financial guaranty insurance may continue to do so under a grandfather clause.
The bill also requires financial guaranty insurance corporations to maintain contingency reserves in amounts greater than the reserves required for other property and casualty insurers. Restrictions are placed on the types of coverage which may be written by a financial guaranty insurance corporation.

C. SECTION-BY-SECTION ANALYSIS:

Section 1:

627.971: Provides definitions for the following terms: financial guaranty insurance, affiliate, average annual debt service, collateral, contingency reserve, financial guaranty insurance corporation, governmental unit, guaranties of consumer debt obligations, industrial development bond, investment grade obligation, letter of credit, municipal bonds, municipal obligation bond, reinsurance, and total liability of an insurer transacting financial guaranty insurance.

Financial guaranty insurance is defined as an insurance policy or an indemnity contract under which loss is payable upon proof of financial loss to an insured as a result of a variety of events which include:

1. failure of a debtor to pay when due because of a financial default or insolvency;
2. changes in the levels of interest rates;
3. changes in the rate of exchange of currency;
4. changes in the value of specific assets or commodities; or
5. other events which the department determines are substantially similar to the foregoing.

Financial guaranty insurance does not include many types of bonds and insurance. Financial guaranty insurance does not include any individual public official bond, any court bond, any bond running to the federal, state, county, or municipal government as a condition to granting a business license, credit unemployment insurance, credit insurance, mortgage guaranty insurance, or surety insurance.

627.972: Provides that a financial guaranty insurance corporation must be organized and licensed in a manner similar to a stock property and casualty insurer. In addition to writing financial guaranty insurance, a financial guaranty insurer can be licensed to transact residual value insurance, surety insurance, credit insurance, and mortgage guaranty insurance. Prior to the issuance of a license, a financial guaranty insurance corporation must submit to the department a plan of operation. The plan of operation must identify the types and projected diversification of guaranties that will be issued, the proposed underwriting procedures, the methods of
managerial oversight, the investment policies, and other matters prescribed by the department.

A financial guaranty insurance corporation is subject to the provisions of the insurance code which are applicable to property and casualty insurers. Investments by a financial guaranty insurance corporation in an entity insured by that corporation must not exceed two percent of its admitted assets. In order to obtain a license, a financial guaranty insurance corporation must have surplus to policyholders of at least $50 million. At all times thereafter, it must maintain a minimum surplus to policyholders of $35 million.

A financial guaranty insurance corporation must also establish a contingency reserve, net of reinsurance. Contributions to the contingency reserve are calculated by applying designated percentages to the net principal outstanding each calendar year of various guaranties. Quarterly additions to the reserve are also required in specified amounts for a designated period of time. Amounts in the reserve may be released in the same manner as contributions were made. A part of the reserve may be released proportional to the reduction in net total liabilities resulting from reinsurance. The reinsurer is required to establish a reserve in an amount equal to the amount released on the effective date of the reinsurance. Withdrawals from the contingency reserve to the extent of any excess, require departmental approval.

Loss reserves may be determined by the case basis method. A deduction from loss reserves is allowed for the time value of money. A financial guaranty insurance corporation must also maintain an unearned premium reserve, net of reinsurance. The unearned premium reserve must be computed monthly for premiums paid on an installment basis. All other premiums paid to a financial guaranty insurance corporation must be earned proportionately with the expiration of exposure, or by such other method approved by the department.

627.973: Prohibits the transacting of financial guaranty insurance except by a corporation licensed for that purpose. However, a licensed property and casualty insurer may transact financial guaranty insurance in Florida under the following conditions:

1. total policyholder's surplus exceeds $100 million;
2. not more than 20 percent of total net written premiums are applicable to financial guaranty insurers;
3. not more than 20 percent of the insurer's total policyholder's surplus is applied to meet the $100 million requirement;
4. the policyholder's surplus required by this part must be used exclusively for financial guaranty insurance;
5. a license to write financial guaranty insurance is obtained; and

6. the submission of a plan of operation to the department, if not previously transacting financial guaranty insurance.

Financial guaranty insurance can be written only to insure designated obligations. Prior written approval by the department is required to underwrite specified types of financial guaranty insurance.

At least 95 percent of a financial guaranty insurance corporation's outstanding total liability on municipal obligation bonds, must be investment grade. A financial guaranty insurance corporation must also maintain capital, surplus and contingency reserves in a sum based on a percentage of the total outstanding liabilities for specified guaranties. Adequate surplus must be maintained to support the writing of any residual value insurance, surety insurance and credit insurance.

A financial guaranty insurer must limit its exposure to loss for the types of risks it insures. For municipal bonds, the insured average annual debt service for one entity backed by a single revenue source may not exceed 10 percent of the aggregate of the corporation's capital, surplus and contingency reserves. The insured unpaid principal issued by a single entity and backed by a single revenue source may not exceed 75 percent of the aggregate of the corporation's capital, surplus and contingency reserves. For all other financial guaranties, the insured unpaid principal for any one risk may not exceed 10 percent of the aggregate of the corporation's capital, surplus and contingency reserves. If a corporation's exposure to loss exceeds statutory limitations it must cease transacting new business until its exposure to loss no longer exceeds those limitations.

Insurers which write financial guaranty insurance during the 12-month period immediately preceding the effective date of the act but not having policyholder surplus of $50 million may continue to write financial guaranty insurance if within 45 days a statement of intent is filed with the department. The statement must verify that the insurer will limit its writings to financial guaranty insurance, surety and fidelity insurance. Except for the surplus requirements, such insurer will be subject to the provisions of the act. However, by July 1, 1998, the insurer must have $35 million in surplus to policyholders. Failure to meet the conditions of the statement of intent will subject the insurer to penalties including license suspension or revocation. If an insurer does not file a statement of intent it must cease writing financial guaranty insurance within 6 months after the effective date.

An unlicensed insurer may reinsure its net in-force business with a licensed financial guaranty insurance corporation. With
prior approval of the insurance commissioner of its state of domicile, it may reinsure all or part of its net in-force business with an insurer licensed to write surety insurance. The assuming surety insurer must maintain reserves for the reinsured business in the manner applicable to the ceding insurer. In lieu of reinsuring, the insurer may continue the risks then in force.

An unlicensed insurer may write new financial guaranty policies if it will mitigate the possibility of loss. The insurance commissioner of the domiciliary state must approve the writing of any new financial guaranty insurance that would increase its risk of loss. An unlicensed insurer must also maintain reserves in the amounts applicable for municipal bond guaranties for all guaranties in force prior to the effective date of this act. If the insurer's contingency reserves are less than those required for municipal bond guaranties, it will have three years to bring its reserves into compliance.

A part of the unlicensed insurer's contingency reserve may be released in proportion to the reduction in net total liabilities resulting from reinsurance. However, the reinsurer must establish a reserve equal to the amount released. A part of the reserve may also be released with approval of the department. All unlicensed insurers which write financial guaranty insurance, are subject to the reserve requirements applicable to financial guaranty insurance corporations for business written on or after the effective date of this act.

627.974: Requires all insurers writing financial guaranty insurance to file policy forms with the department within 30 days of their use. Policies must provide that there will be no acceleration of payments due under guarantied obligations except at the option of the insurer. Policies must disclose that insurance provided by the policy is not covered by the Florida Insurance Guaranty Association. Rates must not be excessive, inadequate, or unfairly discriminatory. Rating criteria and guidelines must also be filed with the department prior to their use.

627.975: Authorizes an insurer transacting financial guaranty insurance to receive credit for reinsurance if the following conditions are met:

1. the reinsurance is subject to an agreement that may only be terminated or amended by the reinsurer or ceding insurer;

2. the reinsurance agreement provides that the liability of the reinsurer for policies in effect at the date of termination continues until the expiration or cancellation of the policy;

3. the reinsurance agreement provides for a cutoff of the reinsurance in force at the date of termination, at the request of the ceding company, or at the discretion of the department; and
4. the reinsurance is placed with another insurer licensed to write financial guaranty insurance, an insurer writing financial guaranty insurance, a licensed surety insurer, or an unauthorized or unaccredited reinsurer.

The surety insurer assuming reinsurance must have surplus to policyholders of $35 million and maintain reserves in the amounts required of financial guaranty insurance corporations. The surety insurer must limit its exposure to loss as required of a financial guaranty insurance corporation.

A reinsurer assuming reinsurance must be:

1. a licensed financial guaranty insurer;
2. an insurer writing financial guaranty insurance; or
3. maintain $35 million in policyholders surplus and comply with reserving requirements and exposure to loss restrictions if it is a parent, subsidiary, or affiliate.

Reinsurance placed with an unauthorized reinsurer must not exceed the liabilities carried by the ceding insurer for amounts withheld under a reinsurance treaty. The reinsurance must also not exceed the amounts deposited by the reinsurer as security for the payment of obligations.

In order to determine the required amount of capital, surplus and reserves, a financial guaranty insurance corporation may reduce its aggregate risk up to the limit for aggregate excess reinsurance.

Section 2: Defines the term "residual value insurance" as insurance issued in connection with a lease or contract which provides against loss of economic value of property other than loss due to physical damage.

No insurance can be written as residual value insurance if it can be written as financial guaranty insurance.

Section 3: Redefines the term "surety insurance" to include a contract bond, an indemnity bond for the benefit of a public body, becoming surety on designated contracts and bonds, fidelity insurance and residual value insurance. Surety insurance does not include mortgage guaranty insurance, financial guaranty insurance or reinsurance contracts.

Section 4: Defines the term "fidelity insurance" as guarantying the fidelity of persons holding positions of public or private trust. Fidelity insurance also indemnifies financial institutions against loss of money caused by larceny, destruction or other stated perils.
Section 5: Redefines the "credit insurance" to prohibit the writing of insurance as credit insurance if it can be defined as financial guaranty insurance.

Section 6: Provides for the repeal of the statutes discussed in section 1 of the bill on October 1, 1992, and that they be reviewed by the Legislature prior to that date.

Section 7: Provides for the repeal of ss. 624.6065 and 624.6081, F.S., on October 1, 1991, and they be reviewed by the Legislature prior to that date.

Section 8: Provides for an effective date of July 1, 1988, or upon becoming a law, whichever occurs later.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE AGENCIES/STATE FUNDS:

1. Non-recurring or First Year Start-Up Effects: None

2. Recurring or Annualized Continuation Effects: None

3. Long Run Effects Other Than Normal Growth: None

4. Appropriations Consequences: None

B. FISCAL IMPACT ON LOCAL GOVERNMENTS AS A WHOLE:

1. Non-recurring or First Year Start-Up Effects: None

2. Recurring or Annualized Continuation Effects: None

3. Long Run Effects Other Than Normal Growth: None
C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

1. Direct Private Sector Costs:

None

2. Direct Private Sector Benefits:

Only financially large insurers will be able to obtain a certificate of authority to write financial guaranty insurance. Thus the threat of insolvency may be reduced for policyholders.

3. Effects on Competition, Private Enterprise, and Employment Markets:

Unless presently writing financial guaranty insurance, insurers must have an initial surplus of $50 million in order to write financial guaranty insurance. As a result, the writing of this type of insurance will be restricted to financially large insurers.

All companies writing financial guaranty insurance in Florida will be required to obtain a certificate of authority unless exempt from specified qualifications. Companies required to obtain a certificate of authority will incur costs associated with the licensing process.

D. FISCAL COMMENTS:

III. LONG RANGE CONSEQUENCES:

Because Florida is one of the major financial guaranty insurance markets in the country, the Department of Insurance is seeking regulatory authority over insurers which sell these products. Enhanced regulation should allow the department to more effectively regulate financial guaranty insurance.

IV. COMMENTS:

In 1987 a similar bill, HB 1362, was passed by the House Insurance Committee but was temporarily passed in the Appropriations Committee.

V. LEGISLATIVE HISTORY:

A. Enacted Bill:

On 5/2/88, the Commerce Committee adopted a committee substitute for SB 1140. The bill was withdrawn from the Finance, Taxation and Claims Committee and placed on the Calendar. The Senate passed the bill by a vote of 35-0 on 5/18/88.
On 5/24/88, CS/SB 1140 was substituted for HB 1554. On 5/25/88, the bill was passed by the House by a vote of 114-0.

On 5/30/88, the bill was presented to the Governor. On 6/10/88, the Governor signed the bill into law.

B. Disposition of Companion:

On 4/19/88, PCB INS 88-03 was reported favorably by the Subcommittee on Property & Casualty Insurance with 1 amendment. On 4/20/88, the bill was reported favorably by the Insurance Committee.

PCB INS 88-03 was filed as HB 1554 on 4/26/88 and placed on the Calendar. CS/SB 1140 was substituted for HB 1554 on 5/24/88 and on 5/25/88 passed the House by a vote of 114-0.

V. SIGNATURES:

INSURANCE COMMITTEE:
Prepared by: Robert Henderson

FINANCE & TAXATION:
Prepared by: William Leary

APPROPRIATIONS:
Prepared by: William Leary

STANDARD FORM 5/88
I. SUMMARY:

A. PRESENT SITUATION:

The present law authorizes the Department of Insurance to regulate insurers which write financial guaranty insurance in the same manner as other property and casualty carriers. Insurers seeking to write financial guaranty insurance are only required to possess $1.75 million in capital and surplus, may seek authority to write other types of insurance, and may participate in the state guaranty association as to other types of insurance written.

B. EFFECT OF PROPOSED CHANGES:

The bill establishes statutory regulation as to the formation and operation of corporations which write financial guaranty insurance. Financial guaranty insurance provides protection against the financial loss associated with a debt instrument or other monetary obligation. Financial guaranty insurance corporations will be regulated by the Department of Insurance.

Due to the size of potential claims and the nature of the risk involved with financial guaranty insurance, the bill requires insurers writing this type of insurance to establish $50 million in surplus. Notwithstanding the surplus requirement, insurers presently writing financial guaranty insurance may continue to do so under a grandfather clause.

The bill also requires financial guaranty insurance corporations to maintain contingency reserves in amounts greater than the reserves required for other property and casualty insurers. Restrictions are placed on the types of coverage which may be written by a financial guaranty insurance corporation.
C. SECTION-BY-SECTION ANALYSIS:

Section 1:

627.971: Provides definitions for the following terms: financial guaranty insurance, affiliate, average annual debt service, collateral, contingency reserve, financial guaranty insurance corporation, governmental unit, guaranties of consumer debt obligations, industrial development bond, investment grade obligation, letter of credit, municipal bonds, municipal obligation bond, reinsurance, and total liability of an insurer transacting financial guaranty insurance.

Financial guaranty insurance is defined as an insurance policy or an indemnity contract under which loss is payable upon proof of financial loss to an insured as a result of a variety of events which include:

1. failure of a debtor to pay when due because of a financial default or insolvency;
2. changes in the levels of interest rates;
3. changes in the rate of exchange of currency;
4. changes in the value of specific assets or commodities; or
5. other events which the department determines are substantially similar to the foregoing.

Financial guaranty insurance does not include many types of bonds and insurance. Financial guaranty insurance does not include any individual public official bond, any court bond, any bond running to the federal, state, county, or municipal government as a condition to granting a business license, credit unemployment insurance, credit insurance, mortgage guaranty insurance, or surety insurance.

627.972: Provides that a financial guaranty insurance corporation must be organized and licensed in a manner similar to a stock property and casualty insurer. In addition to writing financial guaranty insurance, a financial guaranty insurer can be licensed to transact residual value insurance, surety insurance, credit insurance, and mortgage guaranty insurance. Prior to the issuance of a license, a financial guaranty insurance corporation must submit to the department a plan of operation. The plan of operation must identify the types and projected diversification of guaranties that will be issued, the proposed underwriting procedures, the methods of managerial oversight, the investment policies, and other matters prescribed by the department.

A financial guaranty insurance corporation is subject to the provisions of the insurance code which are applicable to property and casualty insurers. Investments by a financial guaranty insurance corporation in an entity insured by that
corporation must not exceed two percent of its admitted assets. In order to obtain a license, a financial guaranty insurance corporation must have surplus to policyholders of at least $50 million. At all times thereafter, it must maintain a minimum surplus to policyholders of $35 million.

A financial guaranty insurance corporation must also establish a contingency reserve, net of reinsurance. Contributions to the contingency reserve are calculated by applying designated percentages to the net principal outstanding each calendar year of various guaranties. Quarterly additions to the reserve are also required in specified amounts for a designated period of time. Amounts in the reserve may be released in the same manner as contributions were made. A part of the reserve may be released proportional to the reduction in net total liabilities resulting from reinsurance. The reinsurer is required to establish a reserve in an amount equal to the amount released on the effective date of the reinsurance. Withdrawals from the contingency reserve to the extent of any excess, require department approval.

Loss reserves may be determined by the case basis method. A deduction from loss reserves is allowed for the time value of money. A financial guaranty insurance corporation must also maintain an unearned premium reserve, net of reinsurance. The unearned premium reserve must be computed monthly for premiums paid on an installment basis. All other premiums paid to a financial guaranty insurance corporation must be earned proportionately with the expiration of exposure, or by such other method approved by the department.

627.973: Prohibits the transacting of financial guaranty insurance except by a corporation licensed for that purpose. However, a licensed property and casualty insurer may transact financial guaranty insurance in Florida under the following conditions:

1. total policyholder's surplus exceeds $100 million;
2. not more than 20 percent of total net written premiums are applicable to financial guaranty insurers;
3. not more than 20 percent of the insurer's total policyholder's surplus is applied to meet the $100 million requirement;
4. the policyholder's surplus required by this part must be used exclusively for financial guaranty insurance;
5. a license to write financial guaranty insurance is obtained; and
6. the submission of a plan of operation to the department, if not previously transacting financial guaranty insurance.
Financial guaranty insurance can be written only to insure designated obligations. Prior written approval by the department is required to underwrite specified types of financial guaranty insurance.

At least 95 percent of a financial guaranty insurance corporation's outstanding total liability on municipal obligation bonds, must be investment grade. A financial guaranty insurance corporation must also maintain capital, surplus and contingency reserves in a sum based on a percentage of the total outstanding liabilities for specified guaranties. Adequate surplus must be maintained to support the writing of any residual value insurance, surety insurance and credit insurance.

A financial guaranty insurer must limit its exposure to loss for the types of risks it insures. For municipal bonds, the insured average annual debt service for one entity backed by a single revenue source may not exceed 10 percent of the aggregate of the corporation's capital, surplus and contingency reserves. The insured unpaid principal issued by a single entity and backed by a single revenue source may not exceed 75 percent of the aggregate of the corporation's capital, surplus and contingency reserves. For all other financial guaranties, the insured unpaid principal for any one risk may not exceed 10 percent of the aggregate of the corporation's capital, surplus and contingency reserves. If a corporation's exposure to loss exceeds statutory limitations it must cease transacting new business until its exposure to loss no longer exceeds those limitations.

Insurers which write financial guaranty insurance during the 12-month period immediately preceding the effective date of the act but not having policyholder surplus of $50 million may continue to write financial guaranty insurance if within 45 days a statement of intent is filed with the department. The statement must verify that the insurer will limit its writings to financial guaranty insurance, surety and fidelity insurance. Except for the surplus requirements, such insurer will be subject to the provisions of the act. However, by July 1, 1998, the insurer must have $35 million in surplus to policyholders. Failure to meet the conditions of the statement of intent will subject the insurer to penalties including license suspension or revocation. If an insurer does not file a statement of intent it must cease writing financial guaranty insurance within 6 months after the effective date.

An unlicensed insurer may reinsure its net in-force business with a licensed financial guaranty insurance corporation. With prior approval of the insurance commissioner of its state of domicile, it may reinsure all or part of its net in-force business with an insurer licensed to write surety insurance. The assuming surety insurer must maintain reserves for the reinsured business in the manner applicable to the ceding insurer. In lieu of reinsuring, the insurer may continue the risks then in force.
An unlicensed insurer may write new financial guaranty policies if it will mitigate the possibility of loss. The insurance commissioner of the domiciliary state must approve the writing of any new financial guaranty insurance that would increase its risk of loss. An unlicensed insurer must also maintain reserves in the amounts applicable for municipal bond guaranties for all guaranties in force prior to the effective date of this act. If the insurer's contingency reserves are less than those required for municipal bond guaranties, it will have three years to bring its reserves into compliance.

A part of the unlicensed insurer's contingency reserve may be released in proportion to the reduction in net total liabilities resulting from reinsurance. However, the reinsurer must establish a reserve equal to the amount released. A part of the reserve may also be released with approval of the department. All unlicensed insurers which write financial guaranty insurance, are subject to the reserve requirements applicable to financial guaranty insurance corporations for business written on or after the effective date of this act.

627.974: Requires all insurers writing financial guaranty insurance to file policy forms with the department within 30 days of their use. Policies must provide that there will be no acceleration of payments due under guarantied obligations except at the option of the insurer. Policies must disclose that insurance provided by the policy is not covered by the Florida Insurance Guaranty Association. Rates must not be excessive, inadequate, or unfairly discriminatory. Rating criteria and guidelines must also be filed with the department prior to their use.

627.975: Authorizes an insurer transacting financial guaranty insurance to receive credit for reinsurance if the following conditions are met:

1. the reinsurance is subject to an agreement that may only be terminated or amended by the reinsurer or ceding insurer;

2. the reinsurance agreement provides that the liability of the reinsurer for policies in effect at the date of termination continues until the expiration or cancellation of the policy;

3. the reinsurance agreement provides for a cutoff of the reinsurance in force at the date of termination, at the request of the ceding company, or at the discretion of the department; and

4. the reinsurance is placed with another insurer licensed to write financial guaranty insurance, an insurer writing financial guaranty insurance, a licensed surety insurer, or an unauthorized or unaccredited reinsurer.

The surety insurer assuming reinsurance must have surplus to policyholders of $35 million and maintain reserves in the
amounts required of financial guaranty insurance corporations. The surety insurer must limit its exposure to loss as required of a financial guaranty insurance corporation.

A reinsurer assuming reinsurance must be:

1. a licensed financial guaranty insurer;
2. an insurer writing financial guaranty insurance; or
3. maintain $35 million in policyholders surplus and comply with reserving requirements and exposure to loss restrictions if it is a parent, subsidiary, or affiliate.

Reinsurance placed with an unauthorized reinsurer must not exceed the liabilities carried by the ceding insurer for amounts withheld under a reinsurance treaty. The reinsurance must also not exceed the amounts deposited by the reinsurer as security for the payment of obligations.

In order to determine the required amount of capital, surplus and reserves, a financial guaranty insurance corporation may reduce its aggregate risk up to the limit for aggregate excess reinsurance.

Section 2: Defines the term "residual value insurance" as insurance issued in connection with a lease or contract which provides against loss of economic value of property other than loss due to physical damage.

No insurance can be written as residual value insurance if it can be written as financial guaranty insurance.

Section 3: Redefines the term "surety insurance" to include a contract bond, an indemnity bond for the benefit of a public body, becoming surety on designated contracts and bonds, fidelity insurance and residual value insurance. Surety insurance does not include mortgage guaranty insurance, financial guaranty insurance or reinsurance contracts.

Section 4: Defines the term "fidelity insurance" as guarantying the fidelity of persons holding positions of public or private trust. Fidelity insurance also indemnifies financial institutions against loss of money caused by larceny, destruction or other stated perils.

Section 5: Redefines the "credit insurance" to prohibit the writing of insurance as credit insurance if it can be defined as financial guaranty insurance.

Section 6: Provides for the repeal of the statutes discussed in section 1 of the bill on October 1, 1992, and that they be reviewed by the Legislature prior to that date.
Section 7: Provides for the repeal of ss. 624.6065 and 624.6081, F.S., on October 1, 1991, and they shall be reviewed by the Legislature prior to that date.

Section 8: Provides for an effective date of July 1, 1988, or upon becoming a law, whichever occurs later.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE AGENCIES/STATE FUNDS:

1. Non-recurring or First Year Start-Up Effects:
   None

2. Recurring or Annualized Continuation Effects:
   None

3. Long Run Effects Other Than Normal Growth:
   None

4. Appropriations Consequences:
   None

B. FISCAL IMPACT ON LOCAL GOVERNMENTS AS A WHOLE:

1. Non-recurring or First Year Start-Up Effects:
   None

2. Recurring or Annualized Continuation Effects:
   None

3. Long Run Effects Other Than Normal Growth:
   None
C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

1. Direct Private Sector Costs:

None

2. Direct Private Sector Benefits:

Only financially large insurers will be able to obtain a certificate of authority to write financial guaranty insurance. Thus the threat of insolvency may be reduced for policyholders.

3. Effects on Competition, Private Enterprise, and Employment Markets:

Unless presently writing financial guaranty insurance, insurers must have an initial surplus of $50 million in order to write financial guaranty insurance. As a result, the writing of this type of insurance will be restricted to financially large insurers.

All companies writing financial guaranty insurance in Florida will be required to obtain a certificate of authority unless exempt from specified qualifications. Companies required to obtain a certificate of authority will incur costs associated with the licensing process.

D. FISCAL COMMENTS:

III. LONG RANGE CONSEQUENCES:

Because Florida is one of the major financial guaranty insurance markets in the country, the Department of Insurance is seeking regulatory authority over insurers which sell these products. Enhanced regulation should allow the department to more effectively regulate financial guaranty insurance.

IV. COMMENTS:

In 1987 a similar bill, HB 1362, was passed by the House Insurance Committee but was temporarily passed in the Appropriations Committee.

V. AMENDMENTS:
VI. SIGNATURES:

INSURANCE COMMITTEE:
Prepared by:

[Signature]
Robert A. Henderson

FINANCE & TAXATION:
Prepared by:

[Signature]

APPROPRIATIONS:
Prepared by:

[Signature]
I. SUMMARY:

A. Present Situation:

The present law authorizes the Department of Insurance (department) to regulate insurers which write financial guaranty insurance in the same manner as other property and casualty carriers. Insurers seeking to write financial guaranty insurance are only required to possess $1.75 million in capital and surplus, may seek authority to write other types of insurance, and may participate in the state guaranty association as to other types of insurance written.

B. Effect of Proposed Changes:

The bill establishes statutory regulation as to the formation and operation of corporations which write financial guaranty insurance. Financial guaranty insurance provides protection against the financial loss associated with a debt instrument or other monetary obligation. Financial guaranty insurance corporations will be regulated by the department.

Due to the size of potential claims and the nature of the risk involved with financial guaranty insurance, the bill requires insurers writing this type of insurance to establish $50 million in surplus. Notwithstanding the surplus requirement, insurers presently writing financial guaranty insurance may continue to do so under a grandfather clause.

The bill also requires financial guaranty insurance corporations to maintain contingency reserves in amounts greater than the reserves required for other property and casualty insurers. Restrictions are placed on the types of coverage which may be written by a financial guaranty insurance corporation.

For ease of understanding, a section-by-section analysis follows:

Section 1: Section 627.971, F.S., as created, provides definitions for the following terms: financial guaranty insurance, affiliate, average annual debt service, collateral, contingency reserve, financial guaranty insurance corporation, governmental unit, guaranties of consumer debt obligations, industrial development bond, investment grade obligation, letter of credit, municipal bonds, municipal obligation bond, reinsurance, and total liability of an insurer transacting financial guaranty insurance.

Financial guaranty insurance is defined as an insurance policy or an indemnity contract under which loss is payable upon proof of financial loss to an insured as a result of a variety of events which include:
1. failure of a debtor to pay when due because of a financial default or insolvency;

2. changes in the levels of interest rates;

3. changes in the rate of exchange of currency;

4. changes in the value of specific assets or commodities; or

5. other events which the department determines are substantially similar to the foregoing.

Financial guaranty insurance does not include many types of bonds and insurance. Financial guaranty insurance does not include any individual public official bond, any court bond, any bond running to the federal, state, county, or municipal government as a condition to granting a business license, credit unemployment insurance, credit insurance, mortgage guaranty insurance, or surety insurance.

Section 627.972, F.S., as created, provides that a financial guaranty insurance corporation must be organized and licensed in a manner similar to a stock property and casualty insurer. In addition to writing financial guaranty insurance, a financial guaranty insurer can be licensed to transact residual value insurance, surety insurance, credit insurance, and mortgage guaranty insurance. Prior to the issuance of a license, a financial guaranty insurance corporation must submit to the department a plan of operation. The plan of operation must identify the types and projected diversification of guarantees that will be issued, the proposed underwriting procedures, the methods of managerial oversight, the investment policies, and other matters prescribed by the department.

A financial guaranty insurance corporation is subject to the provisions of the insurance code which are applicable to property and casualty insurers. Investments by a financial guaranty insurance corporation is an entity insured by that corporation must not exceed two percent of its admitted assets. In order to obtain a license, a financial guaranty insurance corporation must have surplus to policyholders of at least $50 million. At all times thereafter, it must maintain a minimum surplus to policyholders of $35 million.

A financial guaranty insurance corporation must also establish a contingency reserve, net of reinsurance. Contributions to the contingency reserve are calculated by applying designated percentages to the net principal outstanding each calendar year of various guaranties. Quarterly additions to the reserve are also required in specified amounts for a designated period of time. Amounts in the reserve may be released in the same manner as contributions were made. A part of the reserve may be released proportional to the reduction in net total liabilities resulting from reinsurance. The reinsurer is required to establish a reserve in an amount equal to the amount released on the effective date of the reinsurance. Withdrawals from the contingency reserve to the extent of any excess, require department approval.

Loss reserves may be determined by the case basis method. A deduction from loss reserves is allowed for the time value of money. A financial guaranty insurance corporation must also maintain an unearned premium reserve, net of reinsurance. The unearned premium reserve must be computed monthly for premiums paid on an installment basis. All other premiums paid to a financial guaranty insurance corporation must be earned proportionately with the expiration of exposure, or by such other method approved by the department.

Section 627.973, F.S., as created, prohibits the transacting of financial guaranty insurance except by a corporation licensed
for that purpose. However, a licensed property and casualty insurer may transact financial guaranty insurance in Florida under the following conditions:

1. total policyholder's surplus exceeds $100 million;

2. not more than 20 percent of total net written premiums are applicable to financial guaranty insurance;

3. not more than 20 percent of the insurer's total policyholder's surplus is applied to meet the $100 million requirement;

4. the policyholder's surplus required by this part must be used exclusively for financial guaranty insurance;

5. a license to write financial guaranty insurance is obtained; and

6. the submission of a plan of operation to the department, if not previously transacting financial guaranty insurance.

Financial guaranty insurance can be written only to insure designated obligations. Prior written approval by the department is required to underwrite specified types of financial guaranty insurance.

At least 95 percent of a financial guaranty insurance corporation's outstanding total liability on municipal obligation bonds, must be investment grade. A financial guaranty insurance corporation must also maintain capital, surplus and contingency reserves in a sum based on a percentage of the total outstanding liabilities for specified guaranties. Adequate surplus must be maintained to support the writing of any residual value insurance, surety insurance and credit insurance.

A financial guaranty insurer must limit its exposure to loss for the types of risks it insures. For municipal bonds, the insured average annual debt service for one entity backed by a single revenue source may not exceed 10 percent of the aggregate of the corporation's capital, surplus and contingency reserves. The insured unpaid principal issued by a single entity and backed by a single revenue source may not exceed 75 percent of the aggregate of the corporation's capital, surplus and contingency reserves. For all other financial guaranties, the insured unpaid principal for any one risk may not exceed 10 percent of the aggregate of the corporation's capital, surplus and contingency reserves. If a corporation's exposure to loss exceeds statutory limitations it must cease transacting new business until its exposure to loss no longer exceeds those limitations.

Insurers which write financial guaranty insurance during the 12-month period immediately preceding the effective date of the act but not having policyholder surplus of $50 million may continue to write financial guaranty insurance if within 45 days a statement of intent is filed with the department. The statement must verify that the insurer will limit its writings to financial guaranty insurance, surety and fidelity insurance. Except for the surplus requirements, such insurer will be subject to the provisions of the act. However, by July 1, 1998, the insurer must have $35 million in surplus to policyholders. Failure to meet the conditions of the statement of intent will subject the insurer to penalties including license suspension or revocation. If an insurer does not file a statement of intent it must cease writing financial guaranty insurance within 6 months after the effective date.

An unlicensed insurer may reinsure its net in-force business with a licensed financial guaranty insurance corporation. With
prior approval of the Insurance Commissioner of its state of domicile, it may reinsure all or part of its net in-force business with an insurer licensed to write surety insurance. The assuming surety insurer must maintain reserves for the reinsured business in the manner applicable to the ceding insurer. In lieu of reinsuring, the insurer may continue the risks then in force.

An unlicensed insurer may write new financial guaranty policies if it will mitigate the possibility of loss. The insurance commissioner of the domiciliary state must approve the writing of any new financial guaranty insurance that would increase its risk of loss. An unlicensed insurer must also maintain reserves in the amounts applicable for municipal bond guarantees for all guaranties in force prior to the effective date of this act. If the insurer's contingency reserves are less than those required for municipal bond guaranties, it will have three years to bring its reserves into compliance.

A part of the unlicensed insurer's contingency reserve may be released in proportion to the reduction in net total liabilities resulting from reinsurance. However, the reinsurer must establish a reserve equal to the amount released. A part of the reserve may also be released with approval of the department. All unlicensed insurers which write financial guaranty insurance, are subject to the reserve requirements applicable to financial guaranty insurance corporations for business written on or after the effective date of this act.

Section 627.974, F.S., as created, requires all insurers writing financial guaranty insurance to file policy forms with the department within 30 days of their use. Policies must provide that there will be no acceleration of payments due under guarantied obligations except at the option of the insurer. Policies must disclose that insurance provided by the policy is not covered by the Florida Insurance Guaranty Association. Rates must not be excessive, inadequate, or unfairly discriminatory. Rating criteria and guidelines must also be filed with the department prior to their use.

Section 627.975, F.S., as created, authorizes an insurer transacting financial guaranty insurance to receive credit for reinsurance if the following conditions are met:

1. the reinsurance is subject to an agreement that may only be terminated or amended by the reinsurer or ceding insurer;
2. the reinsurance agreement provides that the liability of the reinsurer for policies in effect at the date of termination continues until the expiration or cancellation of the policy;
3. the reinsurance agreement provides for a cutoff of the reinsurance in force at the date of termination, at the request of the ceding company, or at the discretion of the department; and
4. the reinsurance is placed with another insurer licensed to write financial guaranty insurance, an insurer writing financial guaranty insurance, a licensed surety insurer, or an unauthorized or unaccredited reinsurer.

The surety insurer assuming reinsurance must have surplus to policyholders of $35 million and maintain reserves in the amounts required of financial guaranty insurance corporations. The surety insurer must limit its exposure to loss as required of a financial guaranty insurance corporation.

A reinsurer assuming reinsurance must be:
1. a licensed financial guaranty insurer;
2. an insurer writing financial guaranty insurance; or
3. maintain $35 million in policyholders surplus and comply with reserving requirements and exposure to loss restrictions if it is a parent, subsidiary, or affiliate.

Reinsurance placed with an unauthorized reinsurer must not exceed the liabilities carried by the ceding insurer for amounts withheld under a reinsurance treaty. The reinsurance must also not exceed the amounts deposited by the reinsurer as security for the payment of obligations.

In order to determine the required amount of capital, surplus and reserves, a financial guaranty insurance corporation may reduce its aggregate risk up to the limit for aggregate excess reinsurance.

Section 2: Section 624.6081, F.S., is created to define the term "residual value insurance" as insurance issued in connection with a lease or contract which provides against loss of economic value of property other than loss due to physical damage.

No insurance can be written as residual value insurance if it can be written as financial guaranty insurance.

Section 3: Section 624.606, F.S., is substantially rewritten to redefine the term "surety insurance" to include a contract bond, indemnity bond for the benefit of a public body, and becoming surety on a contract, other than a contract of indebtedness. "Surety insurance" also includes guarantying the performance of bonds required in judicial proceedings.

However the term "surety insurance" specifically does not include mortgage guaranty insurance, financial guaranty insurance, and any reinsurance contract.

Section 4: Section 624.6065, F.S., is created to define the term "fidelity insurance" as guarantying the fidelity of persons holding positions of public or private trust. "Fidelity insurance" also indemnifies financial institutions against loss of money caused by larceny, misplacement, destruction or other stated perils.

Section 5: Section 624.605, F.S., is amended to redefine the term "credit insurance" to prohibit the writing of insurance as credit insurance if it is defined as financial guaranty insurance.

Section 6: Provides for the repeal of ss. 627.941, 627.942, 627.943, 627.944 and 627.945, F.S., on October 1, 1992, and that they be reviewed by the Legislature prior to that date.

Section 7: Provides for the repeal of ss. 624.6065 and 624.6081, F.S., on October 1, 1991, and that they be reviewed by the Legislature prior to that date.

Section 8: Provides for an effective date of July 1, 1988, or upon becoming a law, whichever occurs later.
II. ECONOMIC IMPACT AND FISCAL NOTE:

A. Public:

Insurance companies which currently write financial guaranty insurance must apply to the department for a certificate of authority. Insurers seeking to write financial guaranty insurance will also be required to obtain a certificate of authority. This bill is intended to protect the policyholders of financial guaranty insurance by requiring insurers to maintain additional capital, surplus and reserves. The added financial requirements on insurers will restrict the writing of this type of insurance to the larger insurance companies. Thus, a few insurance companies will no longer be able to write this type of insurance.

B. Government:

The department will regulate insurance companies which write financial guaranty insurance. The department has advised that it will incur no additional costs associated with this regulation at this time.

III. COMMENTS:

Because Florida is one of the major financial guaranty insurance markets in the country, the department is seeking regulatory authority over insurers which sell these products. Enhanced regulation should allow the department to more effectively regulate financial guaranty insurance.

Early drafts of this bill were initially patterned after the December 1986 financial guaranty insurance model act adopted by the National Association of Insurance Commissioners.

To date, no state has passed legislation providing broad financial guaranty insurance regulation. Four states do have administrative regulations to regulate municipal bond insurance and two states have specific state laws dealing with municipal bond insurance.

IV. AMENDMENTS:

None.
CS/SB 1140

COMMITTEE SUBSTITUTE FOR SENATE BILL 1140 (CHAPTER 88-87) establishes statutory regulation as to the formation and operation of corporations which write financial guaranty insurance. Financial guaranty insurance provides protection against the financial loss associated with a debt instrument or other monetary obligation. Financial guaranty insurance corporations will be regulated by the Department of Insurance.

Due to the size of potential claims and the nature of the risk involved with financial guaranty insurance, the bill requires insurers writing this type of insurance to establish $50 million in surplus. Notwithstanding the surplus requirement, insurers presently writing financial guaranty insurance may continue to do so until 1998 under a grandfather clause.

The bill also requires financial guaranty insurance corporations to maintain contingency reserves in amounts greater than the reserves required for other property and casualty insurers. Restrictions are placed in the types of coverage which may be written by a financial guaranty insurance corporation.