

2008 SOUTHEASTERN REGULATORS ASSOCIATION



Ratings and Bond Insurers

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Agenda

- **FGIs** (Financial Guaranty Insurers)
- **AIG** (American International Group)
- **CDS** (Credit Default Swaps)
- **Q & A**



FGIs - NY INSURANCE DEPARTMENT'S ROLE

- **Overall**
 - **Protect All Policyholders**
 - **Provide for a Competitive Marketplace**
- **Working Under “Three Part Plan” to Assist in Stabilizing Bond Insurance Marketplace**
 - **Facilitate Additional Capital Raising for Existing Bond Insurers and Licensing of New Ones**
 - **Seek Solutions in Stabilizing Current Bond Insurance Marketplace, on a Company by Company Basis**
 - **Develop New “Rules for the Road” Going Forward**



Problems Facing the Bond Insurance Industry (& Other Financial Services Firms)

- **Stress from Subprime Loans**
- **Lack of Transparency and Structured Security Complexity**
- **Mark-to-Market Uncertainties**
- **Downgrades from the Rating Agencies (“Moving Target” in Needed Capital)**
- **Difficulty in Raising Capital**

Implications of The FGIs Problems



- **Volatility In, and Increased Costs for, Municipal Financing**
- **Pressure on Banks That Are Counterparties**
- **Deteriorating Effect on an Already Fragile Credit Environment**

Impact on Public Finance Market



- Downgrades Wrecked Havoc on Muni Bond Market
- Auction Rate Securities Market Crushed
- Forced Restructuring - Cancellation of Policies – Forfeiting of Premium
- Additional Costs to Taxpayers
- Questioning Need for Bond Insurance for Public Finance Market (or Should there be Alternatives)



Potential Changes to Marketplace/Regulation of Bond Insurers

- **Limitation/Prohibition on the Guarantee of Derivatives (CDSs)**
- **Possible Dual License Authority – Public Finance and Structured Security Business**
- **Substantially Increasing Statutory Capital Requirements**
- **Enhanced Reporting Requirements, Especially on Liability Side**
- **Less Reliance on the Rating Agencies**
- **Consolidation in Marketplace**



Dealing with Stressed Bond Insurers

- **Problems Stem Exclusively from Structured Security Exposure**
- **Counterparties to Structured Deals are Banks/Broker-Dealers**
- **Solutions:**
 - Reduce Exposure via Commutation
 - Restructure Companies
 - Role of TARP
 - Run-Off (w/o munis)



AIG

- **Mark to Market Write-Downs Surprised Market in First Half of 2008**
- **Was Still Able to Raise \$20 Billion in June, 2008**
- **CEO Martin Sullivan Leaves,**
- **AIG Was to Announce Restructuring on in Late September**
- **Not Able to Get There - On Friday September 19th, Standard & Poors Puts AIG on Negative Watch**
- **“Worsening” Weekend**
- **On September 23rd, Fed Announces \$85 Billion Lifeline**



What's Wrong with AIG

- **Non-Insurance Issues – AIG Financial Products**
 - **Credit Default Swaps, Guaranteed Investment Contracts & Commercial Paper – Very Rating Sensitive Products**
- **Securities Lending by Insurance Companies**
- **Mortgage Backed Securities In Insurer's Investment Portfolios**



Credit Default Swaps (CDS)

- A \$60 Trillion “Notional Value” Unregulated Market
- Much of That is “Netted” Out
- Is it “Insurance”
- NY’s Position is Some of It Is
- Federal Regulators Seem to Agree that More Oversight is Needed



Rating Agencies

- **Got It Wrong on Mortgage Backed Securities**
- **So Did A Lot of Others (Investors, Investment Banks, Regulators)**
- **What Is Plan B?**



Who's To Blame?

- **All Driven by US Real Estate “Bubble”**
- **Origination and Underwriting of Mortgages (Lenders and Borrowers)**
- **Securitization of Mortgage Loans**
- **Fannie and Freddie**
- **“Hyper-Finance” of Securitized Loans**
- **Reliance on Rating Agencies**



Concluding Remarks

- Regulatory Landscape Will Change
- Unprecedented String of Events
- State Regulation Did Its Job!!!