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News Concerning Recent Insurance Corporate and Regulatory Issues

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STATE AND FEDERAL DEVELOPMENTS IN THE REGULATION OF BOND INSURERS

At year-end 2007, the New York Insurance Department ("Department") created headlines by expediting the licensing of Berkshire Hathaway Assurance, an insurer formed by Warren Buffet to write financial guaranty insurance for municipal bond offerings. Now, as problems spawned by the subprime mortgage market are threatening the financial stability of major bond insurers, the Department has continued its proactive approach with a plan to attract financial support for stressed bond insurers. As announced in a January 22, 2008 Department News Release:

The Department has implemented a three-part plan:

> 1. Attract more capital and increase capacity to protect policyholders and ensure continued availability of bond insurance, especially for municipal issuers. Specifically, the Department successfully invited Berkshire Hathaway to open a new bond insurance company in New York and quickly approved the capital-raising plan for MBIA. The Department is currently in discussions with other parties about possible future capital investments.
>
> 2. Facilitate solutions to current market challenges. The Department is engaged with insurers, banks, financial advisors, credit rating agencies, other regulators and government officials, and other stakeholders in examining and developing measures to help stabilize the market.
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> 3. Develop stronger regulation for bond insurance. Since it is clearly time to develop new rules for the road, the Department is drafting new regulations that would redefine the future activities of bond insurers. The Department welcomes any input on this project.

Developments over the past few weeks have highlighted the effects of a decline in bond insurers' financial condition, and have called into question the states' regulatory approach to these matters. Major bond insurer Ambac Financial Group announced a $3.26 billon third quarter 2007 loss and is searching for investors to shore up its balance sheet.[1] MBIA, another major bond insurer mentioned in the Department's New Release, sold a $1 billion stake to Warburg Pincus in December, 2007. [2]

1. *Ambac Looks at 'Alternatives' After $3.26 Billion Loss*, by Michael J. de la Merced, *New York Times*, January 23, 2008.
2. *Id*.

In late December, 2007, the Maryland Insurance Administration ("MIA") entered into a consent order with ACA Capital Holding, another major player in the bond insurance scene. Spurred by a $1 billion third quarter 2007 loss, Maryland's action requires ACA Capital Holding to obtain MIA's permission before pledging or assigning assets, paying dividends and engaging in certain material transactions.[3]

Most recently, House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Entities Chairman Rep. Paul Kanjorski (D-Pa) initiated an examination of the bond insurance industry, focusing on "its strength, the resulting implications for the financial marketplace and municipalities of ratings downgrades, and the potential need for regulatory reforms."[4] As part of this investigation, the Chairman reached out to key regulators in the Federal Reserve, the Federal Reserve Bank of New York, the Office of the Comptroller of the Currency, the Securities and Exchange Commission, the National Association of Insurance Commissioners, and insurance regulators in Maryland, New York and Wisconsin. The Chairman requested feedback by February 1.

On the same day, New York Insurance Superintendent Eric Dinallo issued the following statement:

> Clearly it is important to resolve issues related to the bond insurers as soon as possible. However, it must be understood that these are complicated issues involving a number of parties and any effective plan will take some time to finalize. In the meantime, we will not respond to the inevitable rumors. We believe it is important that the goals of market stability, protection for policyholders and a healthy and competitive bond insurance market be realized in the near future.[5]

In planning their investment strategies, financial institutions rely heavily on the guarantees afforded by the insurers of municipal bonds, and invest in securities that have top ratings due, in part, to the guarantees from bond insurers. Without adequate cash to satisfy existing and future obligations, bond insurers may be unable to maintain top credit ratings. A downgrade of the bond insurers would force the banks to write-down the value of bonds guaranteed by such insurers to reflect the higher risk. The recent initiatives by insurance regulators to promote the financial strength of bond insurers are aimed at reducing the negative effect on the U.S. economy that the potential failure of bond insurers could bring about.

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3. *ACA Unit Taken Over by Maryland Regulators,* by Reuters, CNBC.com, December 27, 2007.

4. Press Release, Congressman Paul E. Kanjorski, Kanjorski Advances Examination of Bond Insurance Industry (Jan. 24, 2008), *available at* http://kanjorski.house.gov/index.php?option=content&task=view&id=1026 .

5. News Release, New York State Insurance Department, Statement By New York Insurance Superintendent Eric Dinallo on Bond Insurers (Jan. 24, 2008), *available at* http://www.ins.state.ny.us/press/2008/p0801241.htm .

NEW YORK: MODERNIZATION OF FINANCIAL SERVICES REGULATION

In 2007, Governor Elliot Spitzer signed Executive Order No. 15,[6] establishing a new commission to examine the current system of financial services regulation in New York State and to make recommendations for reform and modernization of New York's regulatory scheme. The New York State Commission to Modernize the Regulation of Financial Services (the "Commission") is comprised of members of the state legislature, the heads of major insurance, banking, and securities firms, business community and consumer advocates, counsel and regulators. New York State Insurance Superintendent Eric Dinallo chairs the Commission, and in November 2007, the Superintendent appointed Scott H. Rothstein (formerly the Executive Director in the Legal and Compliance Division at Morgan Stanley) as the Executive Director of the Commission.

The Commission met for the first time on January 18, 2008, to discuss a variety of approaches for reforming New York's burdensome regulatory structure. The Commission will consider proposals to, *inter alia,* integrate the regulation of financial services in New York under a single regulator, and institute a "principles-guided" regulatory approach in New York.

Principles-guided regulation uses designated principles as guidance for interpreting existing regulations and statutes to reduce unnecessary regulatory and administrative burdens, ensure the transparency, consistency, and reasonableness of regulations and enforcement thereof, and create more efficient markets. This outcome-focused, principles-based approach is not new to Mr. Dinallo, who as Superintendent of Insurance, released a draft regulation in 2007 that would make the New York Insurance Department the first in the nation to establish principles-based regulation.[7]

The Commission will continue its review of New York's financial services regulatory framework through various working groups, and is charged with issuing its final report and recommendations by December 31, 2008 to the Governor as well as leaders of the New York State Senate and Assembly.

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[6] Exec. Order No. 15, 29 N.Y. Reg. 64 (June 20, 2007).

[7] Proposed Regulation No. 185 (11 NYCRR 5), *Principles Applicable to Insurers and Other Entities subject to the Insurance Law.*

If you would like more information on this or any other insurance, reinsurance or insolvency regulatory actions, please feel free to contact Francine L. Semaya, Esq., Chair, Insurance Corporate and Regulatory Practice Group, (212.908.1270, fsemaya@cozen.com), William K. Broudy, Esq. (212.908.1289, wbroudy@cozen.com), or Laurance D. Shapiro, Esq. (212.908.1363, lshapiro@cozen.com). Comments in this Insurance Corporate and Regulatory Alert! are not intended to provide legal advice. Readers should not act or rely on information in the Alert! without seeking specific legal advice.