

INSURANCE
DEPARTMENT OF BANKING AND INSURANCE
OFFICE OF SOLVENCY REGULATION

Insurance of Municipal Bonds, Asset-Backed Securities and Consumer Debt Obligations

Proposed New Rules: N.J.A.C. 11:7-1.1 and 1.5

Proposed Amendments: N.J.A.C. 11:7-1.1, 1.2, 1.3 and 1.4

Authorized By: Steven M. Goldman, Commissioner, Department of Banking and Insurance

Authority: N.J.S.A. 17:1-8.1, 17:1-15e, 17:17-1, and 17:18-9

Calendar Reference: See Summary below for explanation of exception to calendar requirement

Proposal Number: PRN 2007-118

Submit written comments by July 20, 2007 to:

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The agency proposal follows:

Summary

N.J.S.A. 17:17-1 sets forth the kinds of insurance for which a corporation may be formed to transact in this State. N.J.S.A. 17:17-1g provides that one of the kinds of insurance for which a corporation may be formed to transact in this State is insurance against loss from the defaults of persons in positions of trust, or against loss or damage on account of neglect or breaches of duty or obligations guaranteed by the insurer; and against loss by banks, bankers, brokers, financial or money corporations or associations, of any bills of exchange, notes, checks, drafts, acceptances of drafts, bonds, securities, evidences of debt, deeds, mortgages, and other items.

This is commonly known as financial guaranty insurance. N.J.A.C. 11:7, originally adopted and effective July 23, 1975, sets forth specific requirements for financial guaranty insurers issuing contracts insuring municipal bonds. These requirements include specific capital, surplus and contingency reserve requirements, limitations and restrictions on the amounts of policies to be issued insuring municipal bonds, determination of net liability for purposes of complying with N.J.S.A. 17:18-9, specific reporting requirements for unearned premium reserves and contingency reserves, and prohibitions on conflicts of interest.

The Department of Banking and Insurance (Department) is proposing new rules and amendments to N.J.A.C. 11:7 to provide specific standards for the issuing of insurance contracts covering asset-backed securities and related credit enhancement products by financial guaranty insurers. Currently, there are no New Jersey-domiciled insurers providing contracts on asset-backed securities and consumer debt obligations. The proposed new rules and amendments will provide standards that will enable domestic insurers to offer these products. The proposed changes are consistent with standards established in Article 69 of the New York insurance law governing financial guaranty insurance for asset-backed securities. A summary of the provisions of the proposed new rules and amendments follow.

Proposed new N.J.A.C. 11:7-1.1 sets forth the purpose and scope of the subchapter.

Existing N.J.A.C. 11:7-1.1 is proposed to be recodified at N.J.A.C. 11:7-1.2. This rule sets forth definitions of terms used throughout the subchapter. The amendments provide definitions of “affiliate,” “average annual debt review,” “consumer debt obligations guaranties,” “credit default swap,” “excess spread,” “insurable risk,” “investment grade,” and “reinsurance.” In addition, the existing definition of “contingency reserve” is amended to refer to asset-backed

securities and consumer debt obligations to reflect the application of this term to the provision of such coverages as provided for in the proposed new rules and amendments.

Existing N.J.A.C. 11:7-1.2 is proposed to be recodified at N.J.A.C. 11:7-1.3. This rule sets forth specific requirements for capital, surplus and contingency reserve requirements for financial guaranty insurers issuing contracts insuring municipal bonds. The Department is proposing to amend this rule to refer to insurers issuing contracts insuring asset-backed securities and consumer debt obligations, and to provide specific requirements for the contingency reserve required for insurers providing insurance covering asset-backed securities and consumer debt obligations. The primary change is the addition of N.J.A.C. 11:7-1.3(a)3 through 6, which sets forth requirements regarding the establishment of a contingency reserve related to obligations other than municipal bonds and the amounts of allocations to the contingency reserve related to obligations other than municipal bonds. In addition, the proposed amendments provide that contingency reserves for municipal bonds and other obligations may be established net of collateral and reinsurance, provided specified conditions are met; and must be established in a manner consistent with N.J.S.A. 17:17-18. Moreover, the proposed amendments provide that a deduction from loss reserves for the time value of money shall be allowed by application of a discount rate as meeting the standards set forth in the proposed amendments.

N.J.A.C. 11:7-1.3(a)2 and 4 are also proposed to be amended to provide the specific criteria to be utilized for the approval of the withdrawal from the contingency reserve, which incorporate by reference the standards for determining whether to limit payment of dividends and other distributions pursuant to N.J.S.A. 17:27A-4b and c.

Existing N.J.A.C. 11:7-1.3 is proposed to be recodified at N.J.A.C. 11:7-1.4. This rule sets forth limitations and restrictions related to the issuance of contracts insuring municipal

bonds. The substantive provisions of the rule are not proposed to be changed. However, the heading of the section is proposed to be changed to reflect the section's application solely to municipal bonds.

Proposed new N.J.A.C. 11:7-1.5 sets forth limitations and restrictions specifically related to the issuance of contracts insuring asset-backed securities and consumer debt obligations. Specifically, the proposed new rule sets forth the definitions of "asset-backed securities" and "collateral," and provides standards related thereto.

In addition, the proposed new rule provides that consumer debt obligation guaranty policies shall contain a provision that all coverage under the policies terminates upon sale or transfer of the underlying consumer debt obligation to any transferee not insured by the same insurer under a similar policy.

Finally, this proposed new rule sets forth specific requirements for determining the limitation of an insurer's exposure to loss on any one risk or hazard for purposes of complying with the limits on exposure to any one risk set forth in N.J.S.A. 17:18-9.

Existing N.J.A.C. 11:7-1.4 is proposed to be recodified at N.J.A.C. 11:7-1.6. This rule sets forth requirements for financial statements and is proposed to be amended to refer to insurers issuing contracts of asset-backed securities and consumer debt obligations, and to reflect the proper citations of rules within the subchapter. In addition, the Department proposes to delete references in this rule to the specific method by which reserves shall be established. The methods by which reserves are to be established are set forth in guidelines of the Casualty Actuarial Society, to which actuaries must adhere as part of their licensure by the Society. The Department has determined that specifying the particular method for establishing reserves is not

necessary. The Department will continue to be in a position to determine whether the reserves established are adequate through its examination and analysis of insurers pursuant to law.

Finally, existing N.J.A.C. 11:7-1.5 is proposed to be recodified at N.J.A.C. 11:7-1.7 without amendment.

The proposed new rules and amendments provide standards for the issuance of financial guaranty insurance products insuring asset-backed securities and related products to enable New Jersey domestic insurers to offer such products in this State, while providing standards for the issuance of such policies to help ensure the solvency of such insurers. This, in turn, will help ensure that insurers providing such products will be in a position to pay claims when due.

A 60-day comment period is provided for this notice of proposal, and therefore, pursuant to N.J.A.C. 1:30-3.3(a)5, the proposal is not subject to the provisions of N.J.A.C. 1:30-3.1 and 3.2 governing rulemaking calendars.

Social Impact

As noted above, the proposed new rules and amendments set forth standards for the issuance by financial guaranty insurers of contracts insuring asset-backed securities and related credit enhancement products to enable New Jersey domestic insurers to offer such products. By allowing New Jersey domestic insurers to offer these products, the market for such products may be expanded, thus benefiting consumers and the market generally, while providing standards for the issuance of such products to help ensure that insurers will be in a position to pay claims when they are due.

Economic Impact

Financial guaranty insurers seeking to offer contracts insuring asset-backed securities or related credit enhancement products will be required to incur any costs associated with compliance with the standards set forth in the proposed new rules and amendments. These costs include establishment and maintenance of the contingency reserve, compliance with the standards for asset-backed securities to be insured, meeting the standards for collateral, and limits on the insurer's exposure to any one loss or hazard and utilization of appropriate actuarial and financial services. As noted above, the standards are consistent with those established under New York law. In addition, by providing such standards, New Jersey domestic insurers may seek to provide insurance on these types of contracts, thus expanding the availability of such products. This, in turn, will have a beneficial economic impact to consumers of such products and the market generally. The kinds of professional services required for compliance with the proposed new rules and amendments are those generally required for the issuance of financial guaranty insurance products, including actuarial and accounting services.

Further, providing standards for the issuance of such contracts will help ensure that insurers providing these products will be in a position to pay claims when they are due, thereby avoiding potential disruptions to policyholders and the market.

Federal Standards Statement

A Federal standards analysis is not required because the proposed new rules and amendments are not subject to any Federal requirements or standards.

Jobs Impact

The Department does not anticipate that any jobs should be generated or lost as a result of the proposed amendments and new rules. As noted above, the proposed new rules and amendments may encourage New Jersey domestic insurers to offer these products, thereby expanding the market for these products. This, in turn, may contribute to a healthy business climate in this State.

The Department invites interested parties to submit any data or studies concerning the jobs impact of the proposed new rule and amendments together with their written comments on other aspects of the proposal.

Agriculture Industry Impact

The proposed new rules and amendments will not have any impact on the agriculture industry.

Regulatory Flexibility Analysis

The Department believes that few, if any, insurers that would be subject to the proposed new rules and amendments are “small businesses” as defined in the Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq. To the extent that the proposed new rules and amendments apply to small businesses, they will apply to insurers authorized to transact financial guaranty insurance seeking to provide contracts insuring asset-backed securities and related credit enhancement products. Generally, many of the requirements applicable to such insurers are those that apply to insurers generally, including financial reporting pursuant to N.J.S.A. 17:23-1. The Department

does not believe that the use of additional professional services will be required in order to comply with the proposed new rules and amendments.

The proposed new rules and amendments provide no different reporting, recordkeeping or other compliance requirements based on business size. The proposed new rules and amendments expand the application of the existing rules governing the issuance of insurance contracts covering municipal bonds to relate to the issuing of contracts covering asset-backed securities, and the determination of appropriate reserves and limits on exposure to risk pursuant to N.J.S.A. 17:18-9. The purpose of the proposed new rules and amendments is to establish standards for the issuance of such contracts to help ensure the solvency of insurers issuing such contracts and thus help ensure that such insurers will be in a position to pay claims when they are due, thus avoiding potential insolvencies and disruptions related thereto. These goals do not vary based on business size. Accordingly, the proposed new rules and amendments provide no differentiation in compliance requirements based on business size.

Smart Growth Impact

The proposed new rules and amendments will not have an impact on the achievement of smart growth or the implementation of the State Development and Redevelopment Plan.

Full text of the proposal follow (additions indicated in boldface thus; deletions indicated in brackets [thus]):

CHAPTER 7

INSURANCE OF MUNICIPAL BONDS, ASSET-BACKED SECURITIES AND CONSUMER DEBT OBLIGATIONS

SUBCHAPTER 1. GENERAL PROVISIONS

11:7-1.1 Purpose and scope

(a) This subchapter sets forth requirements for insurers issuing contracts insuring municipal bonds, asset-backed securities and consumer debt obligations in this State.

(b) This subchapter shall apply to all insurers issuing contracts insuring municipal bonds, asset-backed securities or consumer debt obligations in this State.

11:7-[1.1] 1.2 Definitions

The following words and terms, when used in this [chapter] subchapter, shall have the following meanings unless the context clearly indicates otherwise.

“Affiliate” shall have the same meaning as in N.J.S.A. 17:27A-1.

"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 each obligation represents \$1,000 par value), divided by the amount equal to the aggregate life of all such obligations (assuming each obligation represents \$1,000 par value) This definition, expressed as a formula in regard to bonds, is as follows:

Average Annual Debt Service = (Total Debt Service x Number of Bonds) / Bond Years

Total Debt Service = Insured Unpaid Principal + Interest

Number of Bonds = (Total Principal Insured) / 1000

Bond Years = (Number of Bonds) x (Term in Years)

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

"Consumer debt obligations guaranties" means insurance that indemnifies a purchaser or lender against loss or damage resulting from defaults on a pool of debts owed for extensions of credit (including in respect of installment purchase agreements and leases) to individuals, provided in the normal course of the purchaser's or lender's business.

"Contingency reserve" means an additional premium reserve established for the protection of policyholders covered by policies insuring municipal bonds, **asset-backed securities or consumer debt obligations** against the effect of excessive losses usually occurring during adverse economic cycles.

"Credit default swap" means an agreement on forms of agreement published from time to time by the International Swap and Derivatives Association, Inc. (360 Madison Avenue-16th Floor, New York, NY 10017, Phone: 212-901-6000) or otherwise acceptable to the Commissioner, pursuant to which a party agrees to compensate another party in the

event of a payment default by, insolvency of, or other adverse credit event in respect of an issuer of a specified security or other obligation; provided that such agreement does not constitute an insurance contract and the making of such credit default swap does not constitute the doing of an insurance business.

"Excess spread" means, with respect to any insured issue of asset-backed securities, the excess of the scheduled cash flow on the underlying assets that is reasonably projected to be available to make debt service payments on the insured securities over the term of the insured securities after payment of the expenses associated with the insured issue, over the scheduled debt service requirements on the insured securities, provided that such excess is held in the same manner as collateral is required to be held as defined below in N.J.A.C. 11:7-1.5.

"Insurable risk" means, with respect to asset-backed securities, that such obligation on an uninsured basis has been determined to be not less than investment grade based solely on the pool of assets backing the insured obligation or securing the insurer, without consideration of the creditworthiness of the issuer.

"Insurance of municipal bonds" means insurance against financial loss by reason of nonpayment of principal and interest obligations pursuant to the terms of municipal bonds as defined in "municipal bonds" below.

"Investment grade" means that:

1. The obligation or parity obligation of the same issuer has been determined to be in one of the top four generic lettered rating classifications by a securities rating agency designated as a Nationally Recognized Securities Rating Organization by the Securities and Exchange Commission;

2. The obligation or parity obligation of the same issuer has been identified in writing by any rating agency set forth in paragraph 1 above to be of investment grade quality; or

3. If the obligation or parity obligation of the same issuer has not been submitted to any rating agency set forth in paragraph 1 above, the obligation or parity obligation has been determined to be investment grade (as indicated by a rating in category 1 or 2) by the Securities Valuation Office of the National Association of Insurance Commissioners.

"Municipal bonds" means obligations issued by a state, territory or possession of the United States of America, or by any municipality, political subdivision (including but not limited to cities, counties, towns, villages, school districts and special districts for fire prevention, water, sewer, irrigation and other municipal public purposes provided for by law) or by any public agency or instrumentality (such as an authority or commission) of one or more of the foregoing, **or obligations issued by any other national government or any state, province, city, town or other political subdivision thereof or any public agency or instrumentality of one or more of the foregoing.**

"Reinsurance" means reinsurance in a company that satisfies the criteria under the New Jersey credit for reinsurance requirements set forth in N.J.S.A. 17:51B-1 et seq. and N.J.A.C. 11:2-28, or as to which credit for reinsurance is allowed pursuant to the credit for reinsurance law of the ceding insurer's state or country of domicile, which law is substantially similar to the New Jersey credit for reinsurance requirements.

11:7-[1.2] **1.3** Capital, surplus and contingency reserve requirements

(a) An insurer shall not issue a contract insuring municipal bonds, **asset-backed securities or consumer debt obligations** unless it is authorized to write the kinds of insurance defined in paragraph (g) of N.J.S.A. 17:17-1, and unless the insurer's license has been amended to indicate that the insurer is authorized to write municipal bond [insurance], **asset-backed securities or consumer debt obligations insurance** under paragraph (g), **and** further provided that:

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 Commissioner 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 insurance defined in N.J.S.A. 17:17-1, as it may be authorized to transact; [and]

2. It shall establish a contingency reserve which shall consist of allocations of sums representing 50 percent of the earned premiums on policies insuring municipal bonds. Allocations to such reserve made during each calendar year shall be maintained for a period of at least 120 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 exceeded 35 percent of the earned premiums thereon, but no such releases shall be made without the prior written approval of the Commissioner of Insurance. **The Commissioner shall disapprove any withdrawal if he or she**

determines that the insurer's surplus as regards policyholders is not reasonable in relation to its outstanding liabilities and adequate to its financial needs pursuant to N.J.S.A. 17:27A-4b, or if the insurer is otherwise found to be in a hazardous financial condition pursuant to N.J.A.C. 11:2-27;

3. It shall establish a contingency reserve which shall consist of sums allocated with respect to policies insuring other obligations, representing the greater of 50 percent of premiums written for each category in (a)3i through v listed below or the following amount prescribed for each such category:

i. Investment grade obligations, secured by collateral or having a term of seven years or less, 1.0 percent of principal guaranteed;

ii. Other investment grade obligations, 1.5 percent of principal guaranteed;

iii. Non-investment grade consumer debt obligations, 2.0 percent of principal guaranteed;

iv. Non-investment grade asset-backed securities, 2.0 percent of principal guaranteed; and

v. Other non-investment grade obligations, 2.5 percent of principal guaranteed.

4. Allocations to a contingency reserve as set forth in (a)3 above, equal to 1/60th of the total reserve required, shall be made each quarter for 15 years and shall be maintained for a period of at least 90 months, provided, however, that allocations may be discontinued so long as the total reserve for all categories listed in (a)3i through v above exceeds the percentages contained in such items when applied against unpaid principal,

and except that withdrawals may be made by the company in any year in which the actual paid losses on the said type of policy exceeded 65 percent of the earned premiums thereon, but no such releases shall be made without the prior written approval of the Commissioner. The Commissioner shall disapprove any withdrawal if he or she determines that the insurer's surplus as regards policyholders is not reasonable in relation to its outstanding liabilities and adequate to its financial needs pursuant to N.J.S.A. 17:27A-4b, or if the insurer is otherwise found to be in a hazardous financial condition pursuant to N.J.A.C. 11:2-27;

5. Contingency reserves required in (a)2 and 3 above may be established and maintained net of collateral and reinsurance, provided that, in the case of reinsurance, the reinsurance agreement requires that the reinsurer shall, on or after the effective date of the reinsurance, establish and maintain a reserve in an amount equal to the amount by which the insurer reduces its contingency reserve. The contingency reserves required in (a) 2 and 3 above may be maintained:

i. Net of refundings and refinancings to the extent the refunded or refinanced issue is paid off or secured by obligations which are directly payable or guaranteed by the United States government (or in the case of an obligation issued outside the United States, net of refundings and refinancings to the extent the refunded or refinanced issue is paid off or secured by obligations which are directly payable or guaranteed by the national government or central bank of the country where the obligation was issued); and

ii. Net of insured securities in a unit investment trust or mutual fund that have been sold from the trust or fund without insurance; and

6. The insurer shall establish and maintain loss reserves, net of collateral, for claims reported and unpaid, in a manner consistent with N.J.S.A. 17:17-18. 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 computation of any such reserves. The discount rate shall be adjusted at the end of each calendar year. The aggregate amount of such deduction from loss reserves shall not exceed the amount of the contingency reserves required to be held by an insurer pursuant to this section, without the prior approval of the Commissioner. The Commissioner shall disapprove any withdrawal if he or she determines that the insurer's surplus as regards policyholders is not reasonable in relation to its outstanding liabilities and adequate to its financial needs pursuant to N.J.S.A. 17:27A-4b, or if the insurer is otherwise found to be in a hazardous financial condition pursuant to N.J.A.C. 11:2-27.

(b) (No change.)

(c) An insurer transacting the insurance of municipal bonds, **asset-backed securities or consumer debt obligations** may invest the contingency reserve in tax and loss bonds purchased pursuant to Section 832(c) 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 paragraphs (a), (c), (d) and (f) of N.J.S.A. 17:24-1.

11:7-[1.3] **1.4** Limitations and restrictions – **municipal bonds**

(a) - (c) (No change.)

11:7-1.5 Limitations and restrictions – asset-backed securities and consumer debt obligations

(a) For purposes of this subchapter, "asset-backed securities" means:

1. Securities or other financial obligations of an issuer, provided that the issuer is a special purpose corporation, trust or other entity, or (provided that the securities or other financial obligations constitute an insurable risk) is a bank, trust company or other financial institution, deposits in which are insured by the Bank Insurance Fund or the Savings Insurance Fund (or any successor thereto), or, in the case of a bank, trust company or other financial institution located outside the United States, deposits in which are insured by a national government-sponsored institution such as the Bank Insurance Fund or the Savings Insurance Fund; and that:

i. A pool of assets as been conveyed, pledged or otherwise transferred to or is otherwise owned or acquired by the issuer;

ii. The pool of assets under (a)1i above backs the securities or other financial obligations issued; and

iii. No asset in the pool under (a)1i above, other than an asset directly payable by, guaranteed by or backed by the full faith and credit of the United States government (or in the case of an asset-backed security issued in a foreign country, backed by the full faith and credit of the national government or central bank of such foreign country) or that otherwise qualifies as collateral, has a value exceeding 20 percent of the pool's aggregate value; or

2. A pool of credit default swaps or credit default swaps referencing a pool of obligations, provided that:

i. The swap counterparty whose obligations are insured under the credit default swap is a special purpose corporation, special purpose trust or other special purpose legal entity;

ii. No reference obligation in the pool under (a)2 above, other than an obligation directly payable by, guaranteed by or backed by the full faith and credit of the United States government (or in the case of an asset-backed security issued in a foreign country, backed by the full faith and credit of the national government or central bank of such foreign country) or that otherwise qualifies as collateral as defined below in this section, has a notional amount exceeding 10 percent of the pool's aggregate notional amount; and

iii. The insurer has the benefit of a deductible or other first loss credit protection against claims under its insurance policy.

(b) For purposes of this subchapter, "collateral" means:

1. Cash;

2. The cash flow from specific obligations which are not callable and scheduled to be received based on expected prepayment speed on or prior to the date of scheduled debt service (including scheduled redemptions or prepayments) on the insured obligation, provided that:

i. Such specific obligations are directly payable by, guaranteed by or backed by the full faith and credit of the United States government;

ii. In the case of insured obligations denominated or payable in foreign currency, such specific obligations are directly payable by, guaranteed by or backed by the full faith and credit of such foreign government or the central bank thereof,

and provided such currency is that of a member country of the Organization for Economic Co-operation and Development having a sovereign rating, or such other country whose sovereign rating is investment grade, or as shall not otherwise be disapproved by the Commissioner within 30 days following receipt of written notification. The Commissioner shall not disapprove such notification upon demonstration that there is no undue risk associated with insuring the timely payment of such instruments or obligations. In making such a determination, the Commissioner shall take into consideration the insurer's outstanding liabilities on non-investment grade instruments and obligations in relation to its outstanding liabilities on all instruments and obligations and in relation to the amount of its surplus to policyholders; or

iii. Such specific obligations are insured by the same insurer that insures the obligations being collateralized, and the cash flows from such specific obligations are sufficient to cover the insured's scheduled payments on the obligations being collateralized;

3. The market value of investment grade obligations, other than obligations evidencing an interest in the project or projects financed with the proceeds of the insured obligations;

4. The face amount of each letter of credit that satisfies the requirements set forth in N.J.A.C. 11:2-28.10(a) through (h); or

5. The amount of credit protection available to the insurer (or its nominee) under each credit default swap that:

i. May not be amended without the consent of the insurer and may only be terminated;

(1) At the option of the insurer;

(2) At the option of the counterparty to the insurer (or its nominee), if the credit default swap provides for the payment of a termination amount equal to the replacement cost of the terminated credit default swap determined with reference to standard documentation of the International Swap and Derivatives Association, Inc. or otherwise acceptable to the Commissioner; or

(3) At the discretion of the Commissioner acting as a rehabilitator, liquidator or receiver of the insurer, upon payment by or on behalf of the insurer of any termination amount due from the insurer;

ii Provides for payment under all instances in which payment under an insurance policy is required, except that payment under the credit default swap may be on a first loss, excess of loss or other non-pro-rata basis and may apply on an aggregate basis to more than one policy; and

iii. Is provided by:

(1) A counterparty whose obligations under the credit default swap are insured by a licensed insurer or guaranteed by a financial institution referred to in this subparagraph;

(2) A financial institution satisfying the requirements referenced in (b)4 above, provided that obligations of such financial institution on parity with its obligations under the credit default swap are investment grade, and if such financial institution is not organized under, or acting through a branch or agency office licensed under, the laws of the United States or any state thereof, then such financial

institution is required to collateralize the replacement cost of the credit default swap in the event that it shall fail to maintain such rating; or

(3) Any other financial institution that the Commissioner determines to be substantially similar to any of the foregoing set forth in this subparagraph.

(c) Collateral shall be deposited with the insurer; held in trust by a trustee or custodian that satisfies the requirements set forth in N.J.S.A. 17:24-12g(5) for the benefit of the insurer; or held in trust pursuant to the bond indenture or other trust arrangement, for the benefit of security holders in the form of funds for the payment of insured obligations, sinking funds or other reserves which may be used for the payment of insured obligations and trustee and other administrative fees on a first priority basis established and continually maintained pursuant to the bond indenture or other trust arrangement by a trustee that satisfies the requirements set forth in N.J.S.A. 17:24-12g(5).

(d) Consumer debt obligations guaranty policies shall contain a provision that all coverage under the policies terminates upon sale or transfer of the underlying consumer debt obligation to any transferee not insured by the same insurer under a similar policy.

(e) For the purpose of complying with the provisions of N.J.S.A. 17:18-9, an insurer's exposure to any loss on any one risk or hazard with respect to each issue of asset-backed securities issued by a single entity and for each pool of consumer debt obligations shall not exceed 10 percent of the aggregate of the insurer's surplus to policyholders and contingency reserve.

(f) For the purpose of (e) above, an insurer's exposure to any loss on any one risk or hazard, net of collateral and reinsurance, shall be the lesser of:

1. Insured average annual debt service; or

2. Insured unpaid principal (reduced by the extent to which the unpaid principal of the supporting assets and, provided the insured risk is investment grade, excess spread exceed the insured unpaid principal) divided by nine; provided that no asset in the pool supporting the asset-backed securities exceeds the single risk limit prescribed in N.J.S.A. 17:18-9, if such asset were directly guaranteed; and provided further that, if the issuer of such insured asset-backed securities is a special purpose corporation, trust or other entity and such issuer shall have indebtedness outstanding with respect to any other pool of assets, either such other indebtedness shall be entitled to the benefits of an insurance policy of the same insurer, or such other indebtedness shall:

i. Be fully subordinated to the insured obligation, with respect to, or be non-recourse with respect to, the pool of assets that supports the insured obligation;

ii. Be non-recourse to the issuer other than with respect to the asset pool securing such other indebtedness and proceeds in excess of the proceeds necessary to pay the insured obligation (excess proceeds); and

iii. Not constitute a claim against the issuer to the extent that the asset pool securing such other indebtedness or excess proceeds are insufficient to pay such other indebtedness.

11:7-[1.4] **1.6** Financial statements

(a) The reserve for unearned premiums shall be computed as required by the provisions of N.J.S.A. 17:23-1 [or by such other method as the Commissioner may prescribe].

(b) In addition to the contingency reserve required by N.J.A.C. 11:7-[1.2(a)2] **1.3(a)**, each insurer engaging in the issuance of policies insuring municipal bonds, **asset-backed securities or consumer debt obligations** shall provide a reserve for unpaid losses and loss adjustment expenses **net of collateral as defined in N.J.A.C. 11:7-1.5(b)** 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 N.J.S.A. 17:23-1 [and shall be based upon either the case basis method or such other method as the Commissioner may prescribe].

11:7-[1.5] **1.7** Conflicts of interest prohibited

(No change.)

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