NEW YORK STATE INSURANCE DEPARTMENT TO REGULATE CERTAIN CREDIT DEFAULT SWAPS AS INSURANCE

New York State Governor David A. Paterson announced on September 22, 2008 in a press release that New York State will, beginning on January 1, 2009, regulate part of the credit default swap ("CDS") market as insurance. In revised Circular Letter No. 19 (2008), dated September 22, 2008 (the "Circular Letter"), the New York State Insurance Department (the "Department") stated that it would issue new guidance to address when a CDS may constitute "the doing of an insurance business" by distinguishing (1) a CDS purchased by a person who holds, or is reasonably expected to hold, a "material interest" in the referenced obligation from (2) a CDS purchased by a person who does not own the underlying securities. The new directive is expected to establish that when the buyer owns the underlying securities for which a CDS was purchased, such CDS is an insurance contract. Accordingly, such CDS would be subject to regulation by the Department as an insurance contract, which may be issued only by a licensed insurance company.

The Circular Letter is a component of the Department's plan, announced in the fall of 2007, to address challenges faced by the financial guaranty insurance industry. It principally establishes best practices for financial guaranty insurance companies subject to the Department's regulation. As set forth in the Circular Letter, beginning January 1, 2009, such insurers are expected to adhere to such best practices, on a prospective basis. Legislative and regulatory amendments will be required to implement certain elements of the Circular Letter.

In the Circular Letter, the Department significantly restricts the ability of a financial guaranty insurer to issue policies that back collateralized debt obligations of asset-backed securities ("ABS") by prohibiting such insurer from insuring pools of ABS that are comprised, or include portions, of other pools of ABS unless (1) the insurer holds an unsubordinated, senior position with an investment rating of "single-A" or above; (2) the underlying collateral pool consists solely of ABS issued or guaranteed by a government-sponsored enterprise; (3) the collateral pool consists entirely of ABS already insured by such insurer; or (4) the Superintendent of the Department determines that the insurance is without undue risk to the insurer, its policyholders and the people of the State of New York.

The Department also expects financial guaranty insurers to limit their issuance of policies that cover payment obligations under a CDS to transactions, with respect to which (1) the financial guaranty insurer guarantees only those risks involving failure to pay obligations when such failure is the result of a financial default or insolvency; (2) neither the CDS nor the related policy defines a credit event, termination event or event of default to include a change in the credit quality, rehabilitation, liquidation or insolvency of the financial guaranty insurer issuing the related policy; and (3) neither the terms of the CDS nor those of the related policy require the financial guaranty insurer to post collateral.

In addition, the Department requires financial guaranty insurers, in calculating their risk exposure limits, to take into consideration not only the issuer of the debt, but also the identity of the initial lender and the servicer of each category of obligation. The Department will also closely monitor the level of non-investment grade credit risk in financial guaranty insurers' investment portfolios. Moreover, the Department intends to increase the amount of statutory minimum capital and surplus required for financial guaranty insurers. The Department will also impose additional reporting requirements on financial guaranty insurers.

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