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HOUSE BILL NO. 28

Offered January 13, 2010
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A BILL to amend the Code of Virginia by adding in Title 38.2 a chapter numbered 64, consisting of sections numbered 38.2-6400 through 38.2-6409, relating to credit default insurance.

Patron—Marshall, R.G.

Referred to Committee on Commerce and Labor

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia is amended by adding in Title 38.2 a chapter numbered 64, consisting of sections numbered 38.2-6400 through 38.2-6409, as follows:

CHAPTER 64.
CREDIT DEFAULT INSURANCE.

§ 38.2-6400. Definitions.

As used in this chapter:

"Affiliate" means a person that, directly or indirectly, owns at least 10 percent but less than 50 percent of the credit default insurance corporation or that is at least 10 percent but less than 50 percent, directly or indirectly, owned by a credit default insurance corporation.

"Aggregate net liability" means the aggregate amount of insured unpaid principal, interest, and other monetary payments, if any, of guaranteed obligations insured or assumed, less reinsurance ceded and less collateral.

"Asset-backed securities" means securities or other financial obligations of an issuer, provided that:

1. 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 in which deposits are insured; and

2. A pool of assets comprised of securities or other financial obligations expected to generate either cash flow or cash proceeds by the terms of the securities or other financial obligations, or pursuant to leases or other contractual rights, including any expected extensions or renewals thereof, or through a sale in a public or private market for proceeds sufficient to pay the insured obligations: (i) has been conveyed, pledged or otherwise transferred to or is otherwise owned or acquired by the issuer; (ii) such pool of assets backs the securities or other financial obligations issued; and (iii) no asset in such pool, other than an asset directly payable by, guaranteed by, or backed by the full faith and credit of the United States government or that otherwise qualifies as collateral under subdivision 1 or 2 of the definition of collateral in this section, has a value exceeding 20 percent of the pool's aggregate value.

"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:

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

Total Debt Service = Insured Unpaid Principal + Interest

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

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.

"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 as permitted under subdivision B 4 of § 38.2-6403, 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, 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 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; or

4. The face amount of a letter of credit that:

a. Is irrevocable;

b. Provides for payment under the letter of credit in lieu of or as reimbursement to the insurer for payment required under a credit default insurance policy;

c. Is issued, presentable, and payable either (i) at an office of the letter of credit issuer in the United States or (ii) at an office of the letter of credit issuer located in the jurisdiction in which the trustee or paying agent for the insured obligation is located;

d. Contains a statement that either (i) identifies the insurer and any successor by operation of law, including any liquidator, rehabilitator, receiver, or conservator, as the beneficiary or (ii) identifies the trustee or the paying agent for the insured obligation as the beneficiary;

e. Contains a statement to the effect that the obligation of the letter of credit issuer under the letter of credit is an individual obligation of such issuer and is in no way contingent upon reimbursement with respect thereto;

f. Contains an issue date and a date of expiration;

g. Either (i) has a term at least as long as the shorter of the term of the insured obligation or the term of the credit default insurance policy or (ii) provides that the letter of credit shall not expire without 30 days' prior written notice to the beneficiary and allows for drawing under the letter of credit in the event that, prior to expiration, the letter of credit is not renewed or extended or a substitute letter of credit or alternate collateral meeting the requirements of this subdivision is not provided;

h. States that it is governed by the laws of the Commonwealth or by the 1983 or 1993 Revision of the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication 400 or 500) or any successor revision if approved by the Commissioner, and contains a provision for an extension of time, of not less than 30 days after resumption of business, to draw against the letter of credit in the event that one or more of the occurrences described in Article 19 of Publication 400 or 500 occurs; and

i. Is issued by a bank, trust company, or savings institution that:

(1) Is organized and exists under the laws of the United States or any state or, in the case of a nondomestic financial institution, has a branch or agency office licensed under the laws of the United States or any state and is domiciled in a member country of the Organisation for Economic Co-Operation and Development having a sovereign rating in one of the top two generic lettered rating classifications by a securities rating agency acceptable to the Commissioner;

(2) Has, or is the principal operating subsidiary of, a financial institution holding company that has a long-term debt rating of at least investment grade; and

(3) Is not a parent, subsidiary, or affiliate of the trustee or paying agent, if any, with respect to the insured obligation if such trustee or paying agent is the named beneficiary of the letter of credit.

"Commercial real estate" means income-producing real property other than residential property consisting of fewer than five units.

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

"Credit default insurance" means a surety bond or other contract, and any guarantee that is payable upon occurrence of financial loss, as a result of the failure of any obligor on or issuer of any debt instrument or other monetary obligation to pay when due to be paid by the obligor or scheduled at the time insured to be received by the holder of the obligation, principal, interest, premium, dividend or purchase price of or on, or other amounts due or payable with respect to, such instrument or obligation, when such failure is the result of a financial default or insolvency, or other credit event, or, provided that such payment source is investment grade, any other failure to make payment, regardless of whether such obligation is incurred directly or as guarantor by or on behalf of another obligor that has also defaulted, or any other event that the Commissioner determines is substantially similar to any of the foregoing.

"Credit default insurance corporation" or "corporation" means an insurer licensed to transact the business of credit default insurance in the Commonwealth.

"Excess spread" means, with respect to any insured issue of asset-backed securities, the excess of (i) the scheduled cash flow on the underlying assets that is reasonably projected to be available, over the term of the insured securities after payment of the expenses associated with the insured issue, to make debt service payments on the insured securities over (ii) 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 under the definition of collateral in this section.

"Governmental unit" means the United States, Canada, a member country of the Organisation for Economic Co-Operation and Development having a sovereign rating in one of the top two generic lettered rating classifications by a securities rating agency acceptable to the Commissioner, a state, a province of Canada, a locality, a political subdivision of any of the foregoing, or any public agency or instrumentality thereof.

"Industrial development bond" means any security or other instrument, other than a utility first mortgage obligation, 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.

"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.

"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 acceptable to the Commissioner;

2. The obligation or parity obligation of the same issuer has been identified in writing by such rating agency to be of investment grade quality; or

3. If the obligation or parity obligation of the same issuer has not been submitted to any such rating agency, the obligation is determined to be investment grade by the Securities Valuation Office of the National Association of Insurance Commissioners.

"Municipal bonds" means municipal obligation bonds and special revenue bonds.

"Municipal obligation bond" means any security or other instrument, including a lease payable or guaranteed by the United States or another national government that qualifies as a governmental unit or any agency, department, or instrumentality thereof, or by a state or an equivalent political subdivision of another national government that qualifies as a governmental unit, but not a lease of any other governmental unit, under which a payment obligation is created, issued by or on behalf of or payable or guaranteed by a governmental unit or issued by a special purpose corporation, special purpose trust, or other special purpose legal entity to finance a project serving a substantial public purpose, and that is payable:

1. From tax revenues, but not tax allocations, within the jurisdiction of such governmental unit;

2. Or guaranteed by the United States or another national government that qualifies as a governmental unit, or any agency, department, or instrumentality thereof, or by a housing agency of a state or an equivalent subdivision of another national government that qualifies as a governmental unit;

3. 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, or public higher education facility; or

4. With respect to lease obligations, from future appropriations.

In the case of obligations of a special purpose corporation, special purpose trust or other special purpose legal entity, (i) such obligations are investment grade at the time of issuance; (ii) such obligations are payable from sources enumerated in subdivisions 1 through 4 of this definition; and (iii) the project being financed or the tolls, tariffs, usage fees, or other similar rates or charges for its use are subject to regulation or oversight by a governmental unit.

"Reinsurance" means cessions qualifying for credit under § 38.2-6405.

"Special revenue 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 governmental unit to finance a project serving a substantial public purpose, and not payable from any of the sources enumerated in the definition of a municipal obligation bond in this section; or securities that are the functional equivalent of the foregoing issued by a nonprofit corporation or a special purpose corporation, special purpose trust, or other special purpose legal entity; provided that, in the case of obligations of a special purpose corporation, special purpose trust, or other special purpose legal entity, (i) such obligations are investment grade at the time of issuance; (ii) such obligations are not payable from the sources enumerated in subdivisions 1 through 4 of the definition of municipal obligation bond in this section; and (iii) the project being financed or the tolls, tariffs, usage fees, or other similar rates or charges for its use are subject to regulation or oversight by a governmental unit.

"Utility first mortgage obligation" means any obligation of an issuer secured by a first priority

mortgage on utility property owned by or leased to an investor-owned or cooperative-owned utility company and located in the United States, Canada, or a member country of the Organisation for Economic Co-Operation and Development having a sovereign rating in one of the top two generic lettered rating classifications by a securities rating agency acceptable to the Commissioner; provided that the utility or utility property or the usage fees or other similar utility rates or charges are subject to regulation or oversight by a governmental unit.

§ 38.2-6401. Organization; financial requirements.

A. A credit default insurance corporation may be organized and licensed, and a foreign insurer may be licensed, in the manner prescribed in Chapter 10 (§ 38.2-1000 et seq.), except as modified by the following provisions:

1. A corporation organized for the purpose of transacting credit default insurance may, subject to all the applicable provisions of this chapter, be licensed to transact only (i) fidelity and surety insurance as defined in §§ 38.2-120 and 38.2-121 or (ii) credit insurance as defined in § 38.2-122;

2. A credit default insurance corporation may assume only those kinds of insurance for which it is licensed to write direct business;

3. Prior to the issuance of a license, unless a plan of operation has been previously approved by the Commissioner, a corporation shall submit for the approval of the Commissioner a plan of operation detailing the types and projected diversification of guarantees 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; and

4. A credit default insurance corporation's investments in any one entity insured by that corporation shall not exceed four percent of its admitted assets at last year-end, except that this limit shall not apply to investments payable or guaranteed by a United States governmental unit or the Commonwealth if such investments payable or guaranteed by the United States governmental unit or the Commonwealth shall be rated in one of the top two generic lettered rating classifications by a securities rating agency acceptable to the Commissioner.

B. A credit default insurance corporation shall not transact business unless it has paid-in capital of at least $15 million and paid-in surplus of at least $165 million, and shall at all times thereafter maintain a minimum surplus to policyholders of at least $150 million.

C. A credit default insurance company shall be deemed to be in compliance with the requirements of this title if not less than 60 percent of the amount of the required minimum capital or minimum surplus to policyholder investments shall consist of the types specified in subsection A, B, or C of § 38.2-1415 and direct government obligations of any state or of any county, district, or municipality thereof, provided such government obligations have been given the highest quality designation of the Securities Valuation Office of the National Association of Insurance Commissioners. Before investing any part of the required minimum capital or surplus in direct government obligations of any other state or of any county, district, or municipality thereof, such credit default insurance company shall have invested at least 10 percent of such required minimum in government obligations of the Commonwealth or of any locality. Only for purposes of meeting the required investment in government obligations of the Commonwealth, the insurer may count investments in any government obligation of the Commonwealth, whether direct or otherwise.

§ 38.2-6402. Contingency, loss, and unearned premium reserves; collateral.

A. A corporation shall establish and maintain contingency reserves for the protection of insureds and claimants against the effects of excessive losses occurring during adverse economic cycles.

B. With respect to credit default insurance of municipal obligation bonds, special revenue bonds, industrial development bonds and utility first mortgage obligations written on and after the first day of the next calendar quarter commencing after January 1, 2011:

1. The corporation shall establish and maintain a contingency reserve for all such insured issues in each calendar year for each category listed in subdivision 2; and

2. The total contingency reserve required shall be the greater of 50 percent of premiums written for each such category or the following amount prescribed for each such category:

a. Municipal obligation bonds, 0.55 percent of principal guaranteed;

b. Special revenue bonds, and obligations demonstrated to the satisfaction of the Commissioner to be the functional equivalent thereof, 0.85 percent of principal guaranteed;

c. Investment grade industrial development bonds, secured by collateral or having a term of seven years or less, and utility first mortgage obligations, 1.0 percent of principal guaranteed;

d. Other investment grade industrial development bonds, 1.5 percent of principal guaranteed; and

e. All other industrial development bonds, 2.5 percent of principal guaranteed; and

3. Contributions to the contingency reserve required by this section, equal to one-eightieth of the total reserve required, shall be made each quarter for 20 years; however, contributions may be discontinued so long as the total reserve for all categories listed in subdivisions B 2 a through B 2 e exceeds the percentages contained in subdivisions B 2 a through B 2 e when applied against unpaid

principal.

C. With respect to all other credit default insurance written on or after the first day of the next calendar quarter commencing after January 1, 2011:

1. The corporation shall establish and maintain a contingency reserve for all such insured issues in each calendar year for each category listed in subdivision 2;

2. The total contingency reserve required shall be the greater of 50 percent of premiums written for each such category or the following amount prescribed for each such category:

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

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

c. Noninvestment grade consumer debt obligations, 2.0 percent of principal guaranteed;

d. Noninvestment grade asset-backed securities, 2.0 percent of principal guaranteed;

e. Other noninvestment grade obligations, 2.5 percent of principal guaranteed; and

3. Contributions to the contingency reserve required by this subsection, equal to one-sixtieth of the total reserve required, shall be made each quarter for 15 years; however, contributions may be discontinued so long as the total reserve for all categories listed in subdivisions C 2 a through C 2 e exceeds the percentages contained in subdivisions C 2 a through C 2 e when applied against unpaid principal.

D. Contingency reserves required in subsections B and C 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, and contingency reserves required in subsections B and C may be maintained (i) net of refundings and refinancings to the extent the refunded or refinanced issue is paid off or secured by obligations that are directly payable or guaranteed by the United States government 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.

E. The contingency reserves may be released thereafter in the same manner in which they were established and withdrawals therefrom, to the extent of any excess, may be made from the earliest contributions to such reserves remaining therein:

1. With the prior written approval of the Commissioner:

a. If the actual incurred losses for the year, in the case of the categories of guarantees subject to subsection B, exceed 35 percent of earned premiums, or in the case of the categories of guarantees subject to subsection C, exceed 65 percent of earned premiums; or

b. If the contingency reserve applicable to the categories of guarantees subject to subsection B has been in existence for less than 40 quarters, or for less than 30 quarters for the categories of guarantees subject to subsection C, upon a demonstration satisfactory to the Commissioner that the amount carried is excessive in relation to the insurer's outstanding obligations under its credit default insurance; or

2. Upon 30 days' prior written notice to the Commissioner, provided that the contingency reserve applicable to the categories of credit default insurance subject to subsection B has been in existence for 40 quarters, or 30 quarters for categories of guarantees subject to subsection C, upon a demonstration satisfactory to the Commissioner that the amount carried is excessive in relation to the insurer's outstanding obligations under its credit default insurance policies.

F. An insurer providing credit default insurance may invest the contingency reserve in tax and loss bonds, or similar securities, purchased pursuant to § 832(e) of the Internal Revenue Code, or any successor provision, 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 subsections A through D of § 38.2-1415.

G. The case basis method or such other method as may be prescribed by the Commissioner shall be used to establish and maintain loss reserves, net of collateral, for claims reported and unpaid, in a manner consistent with the requirements of this title. 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 reserves. The discount rate shall be adjusted at the end of each calendar year. If the insured principal and interest on a defaulted issue of obligations due and payable during any three years following the date of default exceeds 10 percent of the insurer's surplus to policyholders and contingency reserves, its reserve so established shall be supported by a report from an independent source acceptable to the Commissioner.

H. An unearned premium reserve shall be established and maintained net of reinsurance and collateral with respect to all credit default insurance premiums. Where credit default insurance premiums are paid on an installment basis, an unearned premium reserve shall be established and maintained, net of reinsurance and collateral, computed on a daily or monthly pro rata basis. All other

credit default insurance premiums written shall be earned in proportion with the expiration of exposure, or by such other method as may be prescribed by the Commissioner.

I. Collateral shall be (i) deposited with the insurer; (ii) held in trust by a trustee or custodian acceptable to the Commissioner for the benefit of the insurer; or (iii) held in trust pursuant to the bond indenture or other trust arrangement for the benefit of holders of insured obligations 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 acceptable to the Commissioner. The Commission may adopt regulations to limit the amount of collateral provided by obligations, letters of credit or credit default insurance contracts or to limit the amount of collateral provided by any single issuer, bank or counterparty as provided for in this section.

§ 38.2-6403. Limitations.

A. Credit default insurance may be transacted in the Commonwealth only by a corporation licensed for such purpose pursuant to this chapter.

B. The Commissioner shall not permit the writing of credit default insurance except where the insured or beneficiary under the policy, bond or contract has, or is expected to have at the time of the default or other failure of the obligor under the debt instrument or other monetary obligation, a material interest in such default or other failure. In addition:

1. A corporation may insure the timely payment of United States dollar debt instruments, or other monetary obligations, only in the following categories:

a. Municipal obligation bonds;

b. Special revenue bonds;

c. Industrial development bonds;

d. Investment grade obligations of the government of a country, municipality, or a political subdivision of any of the foregoing, or any public agency or instrumentality thereof if that entity does not meet the definition of a governmental unit;

e. Obligations of corporations, trusts, or other similar entities established under applicable law;

f. Partnership obligations;

g. Asset-backed securities, trust certificates, and trust obligations, provided that:

(1) With respect to mortgage-backed securities secured by first mortgages on real property that are insurable by a mortgage guaranty insurer authorized under this title:

(a) Such mortgages with loan-to-value ratios in excess of 80 percent are: (i) in the case of mortgages on property located in the Commonwealth, insured by mortgage guaranty insurers authorized to conduct business in the Commonwealth; (ii) in the case of mortgages on property located in a state other than the Commonwealth, insured by mortgage guaranty insurers authorized to do business in such other state; or (iii) in an aggregate principal amount less than the single risk limits prescribed in subdivision D 5; or

(b) Additional mortgages with principal balances, other collateral with a market value, or, provided the insured risk is investment grade, excess spread in an amount in each instance at least equal to the coverage that would otherwise be provided by such mortgage guaranty insurers in accordance with subdivision 1 g (1) (a) are pledged as additional security for the asset-backed securities; or

(2) With respect to any asset-backed securities backed by another pool of asset-backed securities:

(a) The pool of asset-backed securities shall be comprised of asset-backed securities having a right to payment and rights in insolvency that are not subordinated to any other security of the issuer, in the event of a payment default by, or rehabilitation or insolvency of, the issuer;

(b) The credit default insurance corporation shall possess control and remediation rights substantially similar to those held by the most senior class of securities of the issuer of the insured obligations backed by the same pool of assets;

(c) The pool consists of asset-backed securities that are issued or guaranteed by a governmental unit, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation, or the Federal Farm Credit System Banks as a consolidated debt obligation or a system-wide debt obligation to the extent that the obligations are covered by the Farm Credit Insurance Fund;

(d) The pool consists entirely of asset-backed securities insured by the credit default insurance corporation; or

(e) The Commissioner has determined that insuring the asset-backed securities does not present undue risk to the credit default insurance corporation;

h. Installment purchase agreements executed as a condition of sale;

i. Consumer debt obligations;

j. Utility first mortgage obligations; and

k. Any other debt instrument or financial obligation that the Commissioner determines to be substantially similar to any of the foregoing or shall otherwise be approved by the Commissioner.

2. A corporation may insure obligations enumerated in subdivisions B 1 a, B 1 b, and B 1 c that are not investment grade so long as at least 95 percent of the corporation's aggregate net liability on the kinds of obligations enumerated in subdivisions B 1 a, B 1 b, and B 1 c shall be investment grade.

3. A corporation may insure the timely payment of monetary obligations in any category designated in this subsection notwithstanding that such obligation may be insured by a credit default insurance policy issued by another corporation. In the event that any obligation is insured by more than one credit default insurance policy, then each such insurance policy may by its terms specify its priority of payment in the event of a default under the obligation insured or any other insurance policy; provided that an insurer shall be entitled to take into account payment under another policy insuring such obligation for purposes of establishing and maintaining loss reserves only to the extent that the policy issued by such insurer provides for payment only in the event of payment default under both such obligation and the other policy.

4. A corporation may also write credit default insurance to insure the timely payment of non-United States dollar debt instruments or other monetary obligations denominated or payable in foreign currency, only for the categories listed in subdivisions B 1 a through B 1 k, provided that:

a. Such currency is that of an Organisation for Economic Co-Operation and Development member country or such other country (i) whose sovereign rating is investment grade or (ii) 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 corporation's outstanding liabilities on noninvestment 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;

b. Reserves required pursuant to this chapter in regard to such obligations shall be established and adjusted quarterly based upon the then-current foreign exchange rates;

c. Such obligations shall not exceed 25 percent of a corporation's aggregate net liability; and

d. The aggregate and single risk limitations prescribed by subsections C and D shall be determined by applying the then-current foreign exchange rates.

C. The corporation shall at all times maintain surplus to policyholders and contingency reserves in the aggregate no less than the sum of (i) surplus to policyholders determined by the Commissioner to be adequate to support the writing of fidelity and surety insurance and credit insurance, if the corporation has elected to transact such kinds of insurance, and (ii) the sum of:

1. 0.3333 percent or 1/300th of the aggregate net liability under credit default insurance in which the underlying obligations are municipal bonds including obligations demonstrated to the satisfaction of the Commissioner to be the functional equivalent thereof and investment grade utility first mortgage obligations;

2. 0.6666 percent or 1/150th of the aggregate net liability under credit default insurance in which the underlying obligations are investment grade asset-backed securities;

3. 1.0 percent or 1/100th of the aggregate net liability under credit default insurance in which the underlying obligations are secured by collateral or having a term of seven years or less, of:

a. Investment grade industrial development bonds; and

b. Other investment grade obligations;

4. 1.5 percent or 1/66.67th of the aggregate net liability under credit default insurance in which the underlying obligations are investment grade obligations;

5. 2.0 percent or 1/50th of the aggregate net liability under credit default insurance in which the underlying obligations are:

a. Noninvestment grade consumer debt obligations; and

b. Noninvestment grade asset-backed securities;

6. 2.5 percent or 1/40th of the aggregate net liability under credit default insurance in which the underlying obligations are noninvestment grade obligations secured by first mortgages on commercial real estate and having loan-to-value ratios of 80 percent or less; and

7. 4.0 percent or 1/25th of the aggregate net liability under credit default insurance in which the underlying obligations are other noninvestment grade obligations.

If the amount of collateral required by subdivision 3 is no longer maintained, that proportion of the obligation insured that is not so collateralized shall be subject to the aggregate limits specified in subdivision 4.

D. A credit default insurance corporation shall limit its exposure to loss on any one risk insured by policies providing credit default insurance, net of collateral and reinsurance, as follows:

1. For municipal obligation bonds, special revenue bonds, and obligations demonstrated to the satisfaction of the Commissioner to be the functional equivalent thereof:

a. The insured average annual debt service with respect to a single entity and backed by a single

revenue source shall not exceed 10 percent of the aggregate of the corporation's surplus to policyholders and contingency reserve; and

b. The insured unpaid principal issued by a single entity and backed by a single revenue source shall not exceed 75 percent of the aggregate of the corporation's surplus to policyholders and contingency reserve;

2. For each issue of asset-backed securities issued by a single entity and for each pool of consumer debt obligations, the lesser of:

a. Insured average annual debt service; or

b. 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; shall not exceed 10 percent of the aggregate of the insurer's surplus to policyholders and contingency reserve, provided that no asset in the pool supporting the asset-backed securities exceeds the single risk limits prescribed in subdivision D 5, if insured; 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 a credit default 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 (which excess is referred to herein as "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 and provided further that, in the case of asset-backed securities that are subordinate, in right of payment in the event of an issuer insolvency, to any other securities of the issuer backed by the same pool of assets, for purposes of this subdivision D 2 only, the insured average annual debt service and insured unpaid principal shall be deemed to be the lesser of: (a) 300 percent of the insured average annual debt service and insured unpaid principal respectively or (b) the insured average annual debt service and insured unpaid principal respectively if the scheduled principal of and interest on all senior securities of the issuer were included in the amount insured by the insurer for purposes of calculating insured average annual debt service and insured unpaid principal;

3. For obligations issued by a single entity and secured by commercial real estate, and not meeting the definition of asset-backed securities, the insured unpaid principal less 50 percent of the appraised value of the underlying real estate shall not exceed 10 percent of the aggregate of the corporation's surplus to policyholders and contingency reserve;

4. For utility first mortgage obligations, the insured average annual debt service shall not exceed 10 percent of the aggregate of the corporation's surplus to policyholders and contingency reserve; and

5. For all other policies providing credit default insurance with respect to obligations issued by a single entity and backed by a single revenue source, the insured unpaid principal shall not exceed 10 percent of the aggregate of the corporation's surplus to policyholders and contingency reserve.

E. If a corporation at any time exceeds any limitation prescribed by subdivision B 1 or subsection C or D, the corporation shall within 30 days after the limitations are breached, submit a written plan to the superintendent detailing the steps that it will take or has taken to reduce its exposure to loss to no more than the permitted amounts, and if after notice and hearing the superintendent determines that a corporation has exceeded any limitation prescribed by this section, he may order the corporation to cease transacting any new credit default insurance business until its exposure to loss no longer exceeds said limitations or with respect to the limitations prescribed in subdivision B 1, may order such insurer to limit its writing of the types of credit default insurance permitted under subdivisions B 1 a, B 1 b, and B 1 c to investment grade obligations until such time as it shall be in compliance with such limitations.

F. No corporation authorized to transact the business of credit default insurance shall pay any commission or make any gift of money, property, or other valuable thing to any employee, agent, or representative of any potential purchaser of a credit default insurance policy, as an inducement to the purchase of such a policy, and no such employee, agent, or representative of such potential purchaser shall receive any such payment or gift. Violation of the provisions of this section shall not, however, have the effect of rendering void the insurance policy issued by the corporation.

§ 38.2-6404. Policy forms and rates.

A. Policy forms and any amendments thereto shall be filed with the Commissioner within 30 days of their use by the corporation if not otherwise filed prior to January 1, 2011.

B. Every credit default insurance policy shall provide that, in the event of a payment default by or insolvency of the obligor, there shall be no acceleration of the payment required to be made under such policy unless such acceleration is permitted by the credit default insurance corporation at its sole option, exercised at the time of the payment.

C. A credit default insurance policy shall not provide that commencement of rehabilitation, liquidation, or conservatorship proceedings under the laws of the Commonwealth, bankruptcy, or any other similar proceedings whether under the laws of the Commonwealth or another state, with respect to a credit default insurer or the insured accelerates any payment required to be made under the policy, absent a payment default by the obligor or the insurer.

D. A credit default insurance policy may provide that either the credit default insurance corporation or the insured may terminate the policy as a consequence of the commencement of rehabilitation, liquidation or conservatorship proceedings under the laws of the Commonwealth, bankruptcy, or any other similar proceedings, whether under the laws of the Commonwealth or another state, with respect to a credit default insurer or the insured, provided that the termination:

1. Does not accelerate or otherwise increase the obligation of the credit default insurance corporation to make scheduled payments when due under the policy; and

2. Does not require the corporation to make any additional payment to the insured by reason of the termination.

E. The Commission by regulation may prescribe minimum policy provisions determined to be necessary or appropriate to protect credit default insurance corporations, policyholders, claimants, obligees, or indemnitees or the citizens of the Commonwealth.

F. Rates shall not be excessive, inadequate, unfairly discriminatory, destructive of competition, detrimental to the solvency of the corporation, or otherwise unreasonable. In determining whether rates comply with the foregoing standards, the Commission shall include all income earned by such corporation. Criteria and guidelines utilized by corporations in establishing rating categories and ranges of rates to be utilized shall be filed with the Commission for information prior to their use by the corporation.

G. All such filings shall be available for public inspection at the offices of the Commission.

§ 38.2-6405. Reinsurance.

A. For credit default insurance that takes effect on or after January 1, 2011, a corporation authorized to transact credit default insurance 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 such reinsured credit default insurance in force, the reinsurance agreement, whether facultative or treaty, may only be terminated or amended (i) 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 shall continue until the expiration or cancellation of each such policy, (ii) with the consent of the ceding company, if the reinsurance agreement provides for a cutoff of the reinsurance in force at the date of termination, or (iii) at the discretion of the Commissioner acting as rehabilitator, liquidator, or receiver of the ceding or assuming insurer; and provided that such reinsurance is:

1. Placed with a credit default insurance corporation licensed under this chapter or an insurer writing only credit default insurance as is or would be permitted by this chapter; or

2. Placed with a property and casualty insurer or an accredited reinsurer licensed or accredited to reinsure risks of every kind or description, including municipal obligation bonds, as may be permitted by this title, if the reinsurance agreement with such insurer requires that such insurer:

a. Have and maintain surplus to policyholders of at least $35 million;

b. Establish and maintain the reserves required by § 38.2-6402, 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. However, the assuming insurer need not establish and maintain such reserve to the extent that the ceding insurer has established and continues to maintain such reserve;

c. Comply with the provisions of subsection C of § 38.2-6403, except that the maximum total exposures reinsured net of retrocessions and collateral shall be one-half of that permitted for a credit default insurance corporation;

d. If a parent of the corporation, another subsidiary of the parent of the corporation, or a subsidiary of the corporation, then the aggregate of all risks assumed by such reinsurers shall not exceed 10 percent of the corporation's exposures, net of retrocessions and collateral. Direct or indirect ownership interests of 50 percent or more shall be deemed a parent-subsidiary relationship;

e. If an affiliate of the corporation, such affiliate shall not assume a percentage of the corporation's total exposures insured net of retrocessions and collateral in excess of its percentage of equity interest in the corporation; and

f. Assume from the credit default insurance corporation and any affiliate, parent of the corporation, another subsidiary of the parent of the corporation, or subsidiary of the corporation that is a credit default insurance corporation or a corporation writing only credit default insurance as is or would be

permitted by this chapter, together with all other reinsurers subject to this subsection, less than 50 percent of the total exposures insured by the corporation and such affiliates, parents, or subsidiaries of the corporation, net of collateral, remaining after deducting any reinsurance placed with another credit default insurance corporation that is not an affiliate, a parent of the corporation, another subsidiary of the parent of the corporation, or a subsidiary of the corporation or a corporation writing only credit default insurance as is or would be permitted by this chapter that is not an affiliate, a parent of the credit default insurance corporation, another subsidiary of the parent of the corporation, or a subsidiary of the corporation; or

3. If placed with an unauthorized or unaccredited reinsurer that otherwise meets the requirements of either the opening paragraph of subsection A and subdivision A 1, or the opening paragraph of subsection A and subdivisions A 2 a, A 2 d, A 2 e, and A 2 f, 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 deposits are held subject to withdrawal by, and under the control of, the ceding insurer.

B. In determining whether the corporation meets the aggregate risk limitations, 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 risks that will become due during the unexpired term of such reinsurance agreement in excess of the corporation's retention pursuant to such reinsurance agreement.

§ 38.2-6406. Applicability of other laws.

A corporation issuing policies of credit default insurance shall be subject to all of the provisions of this title applicable to property and casualty insurers to the extent that such provisions are not inconsistent with the provisions of this chapter.

§ 38.2-6407. Relationship to security fund.

No corporation or agent of a corporation may deliver a policy of credit default insurance unless such policy and any prospectus delivered on or after January 1, 2011, with respect to the insured obligations clearly discloses that the policy is not covered by the Property and Casualty Insurance Guaranty Association fund specified in Chapter 16 (§ 38.2-1600 et seq.).

§ 38.2-6408. Penalties.

A. It is a violation of this chapter for any credit default insurance corporation, affiliate, or any other party related to the business of credit default insurance to sell credit default insurance not permissible under § 38.2-6403.

B. Every violation of any provision of this chapter shall be punishable as provided in § 38.2-218.

C. The license of a person licensed under this chapter that sells credit default insurance not permissible under § 38.2-6403 shall be subject to suspension or revocation as provided in § 38.2-1040.

§ 38.2-6409. Transition provisions.

A. An insurer organized for the purpose of transacting financial guaranty insurance in its state of domicile or any other state on January 1, 2011, and licensed and operating in the Commonwealth as a provider of surety insurance on January 1, 2011, upon application by such company prior to January 1, 2012, shall be issued a license pursuant to § 38.2-6401 and, before and after such license is issued, may engage in the business of credit default insurance, provided that such insurer meets all requirements of this chapter, except the requirements described in subsection B, before January 1, 2011, to transact business as a credit default insurance corporation in this Commonwealth.

B. An insurer described in subsection A shall meet all of the requirements of this chapter, with the following exceptions:

1. The insurer shall not be deemed to be in violation of any provision of this chapter with respect to credit default insurance policies outstanding prior to the effective date of this chapter, if the insurer was in compliance with the applicable provisions relating to financial guaranty insurance in its state of domicile at the time that the credit default insurance policy was issued, provided that this chapter shall apply to such policies that are amended or replaced on or after January 1, 2011, if such amendment of the original policy extends the term or the replacement policy provides a new term that extends beyond the term of the original policy in effect on January 1, 2011, unless such amendment or replacement complies with subdivision B 2;

2. The insurer shall not be deemed to be in violation of any provision of this chapter with respect to any amendment or replacement of a credit default insurance policy issued prior to January 1, 2011, provided that:

a. The amendment or replacement of the original policy is executed in good faith to mitigate losses or reduce exposure to future losses under the original policy; and

b. The insurer provides notice to the Commission of such amendment or replacement within 10 business days of the amendment or replacement;

3. Before January 1, 2011, the following requirements of this chapter shall not apply to such insurer:

a. Subsection B of § 38.2-6401 regarding paid-in capital and surplus requirements and minimum

surplus to policyholders; and

b. Subsections C, D, and E of § 38.2-6403 regarding aggregate and single risk limits.

C. The Commissioner may:

1. Extend the transition time permitted in subdivision B 3 an additional six months if the Commissioner determines that it would not pose a hazard to the insurer, its policyholders, or the public and there are unusual or unique circumstances that justify the extension; or

2. Decrease the transition time permitted in subdivision B 3 if the Commissioner determines, after notice and an opportunity to be heard, that permitting an insurer to continue transacting credit default insurance poses a hazard to the insurer, its policyholders, or the public.

D. An insurer that does not comply with subsections A or B shall cease writing any new credit default insurance.

E. An insurer not licensed as an insurance company in the Commonwealth pursuant to Chapter 24 (§ 38.2-2400 et seq.) on January 1, 2011, shall not engage in the business of credit default insurance until such date as the company shall have received a license from this state pursuant to § 38.2-6401.

2. That the provisions of this act shall become effective on January 1, 2011.