

State Corporation Commission 2010 Fiscal Impact Statement

1. Bill Number: HB 28

House of Origin X Introduced ___ Substitute ___ Engrossed

Second House ___ In Committee ___ Substitute ___ Enrolled

2. Patron: Marshall, R.G.

3. Committee: Commerce and Labor

4. Title: Credit default insurance; definition.

5. Summary/Purpose: Adds a new Chapter 64 in Title 38.2 entitled “Credit Default Insurance,” which sets forth requirements to be met by a domestic or foreign entity in order to conduct the business of credit default insurance in Virginia. These requirements include obtaining a credit default insurance corporation license pursuant to Chapter 10 of Title 38.2, except as modified by the provisions contained in the new chapter. The bill provides for the organization of credit default insurance corporations (corporations), and includes financial requirements. Such corporations are required to become licensed pursuant to Chapter 10 of Title 38.2, with the exception of certain provisions contained in this section. Such corporations are limited to transacting fidelity and surety insurance (§§ 38.2-120 and 38.2-121), or credit insurance (§ 38.2-122). Corporations are required to maintain paid-in capital \$15 million, paid-in surplus of \$165 million, and minimum surplus to policyholders of \$150 million. The bill contains provisions regarding contingency, loss and unearned premium reserves. Credit default insurance may only be transacted in Virginia by corporations licensed for such business. The bill sets forth categories of dollar debt instruments and other monetary obligations that credit default insurance may cover, and requires that insureds/beneficiaries have a material interest in the default or failure of the obligor. This section also provides criteria to be met in order to allow credit default insurance to cover asset-backed securities, and asset-backed securities backed by another pool of asset-backed securities.

6. Fiscal Impact Estimates are unknown (see Line 8).

7. Budget amendment necessary: No

8. Fiscal implications: To administer House Bill 28, the State Corporation Commission Bureau of Insurance would have to hire additional staff and contract with outside consultants in order to have the highly specialized expertise necessary to work with issuers and purchasers of credit default insurance. For example, House Bill 28 requires insurers to submit a plan of operation for approval detailing the types and projected diversification of guarantees that are issued, the underwriting procedures that will be followed, managerial oversight methods, investment policies, etc. Such requirements will require expertise that Bureau of Insurance staff does not currently possess.

9. Specific agency or political subdivisions affected: State Corporation Commission Bureau of Insurance

10. Technical amendment necessary: The Bureau of Insurance suggests the following technical amendments to House Bill 28:

- On Line 109-118, the definition of "credit default insurance" seems broad enough that it would not only includes fidelity and surety insurance, but would appear to include credit insurance (§ 38.2-122) and mortgage guaranty insurance (§ 38.2-128). It may not have been the patron's intention to make these lines of business subject to regulation under the proposed Chapter 64 of House Bill 28.
- Replace "Commissioner" with "Commission" throughout House Bill 28.
- On Line 213, replace "subsection" with "subsections."
- On Lines 469-470, replace "Superintendent" with "Commission."
- On Line 625, replace "Chapter 24" with "Chapter 10."

11. Other comments: The Bureau offers the following comments on House Bill 28:

- HB 28 contains lengthy details regarding requirements and restrictions regarding the issuance and use of a class of derivative securities known as credit default swaps. The bill restricts issuance of such derivatives as credit default insurance and prohibits the transaction of such insurance in the Commonwealth except by a default insurance corporation licensed as an insurer by the State Corporation Commission (SCC). Licensing and product requirements are extremely detailed and tied to the risk exposures and practices of the securities markets and their instruments. The Bureau of Insurance understands that the current proposal is based on model legislation adopted by the National Conference of Insurance Legislators (NCOIL). Bureau staff is unaware of any state that has adopted the NCOIL model and does not know the specific nature and extent of industry, investor and consumer input into the development of the model.
- Currently, the Bureau of Insurance does not possess the detailed knowledge of risk exposures in the securities markets and in the use of financial instruments, particularly credit default swaps. The Bureau, therefore, is unable to assess the full merits and limitations of individual licensing and product requirements contained in this bill. Nor is the Bureau equipped to assess the impact of HB 28

on the availability of credit default protection for specific uses such as hedging and replication transactions by financial institutions. The Bureau would have to hire additional staff and contract with outside consultants in order to have the highly specialized expertise necessary to work with the issuers and purchasers of credit default insurance.

- Because there is no language in the bill that states, for example, that the provisions of HB 28 apply to policies issued or delivered in the Commonwealth, jurisdictional questions may arise as to the authority of the Bureau of Insurance to regulate these CDS products. How would the Bureau determine that a credit default insurance policy is being written in Virginia? Would it be because either the issuer or the buyer is located in Virginia, or some other nexus to the risk. Applicability to contracts issued or delivered in Virginia may provide clarification but would limit the Commission's jurisdiction to contracts issued or delivered within Virginia's borders. Could Virginia residents and persons simply then purchase credit default swaps from an unlicensed entity simply by trading outside Virginia; for example, in North Carolina, New York or the District of Columbia?
- HB 28 requires insurers to invest at least 10% in Virginia securities. Although inclusion of this provision may be meant to encourage the sale of Virginia debt, Virginia securities may not be readily available to insurers.

House Bill 28 is currently assigned to House Commerce and Labor Subcommittee #2.

Date: 02/02/10 V. Tompkins
cc: Secretary of Commerce and Trade
Secretary of Health and Human Resources