

Senate Study Bill 3034 - Introduced

SENATE FILE _____
BY (PROPOSED COMMITTEE
ON COMMERCE BILL BY
CHAIRPERSON WARNSTADT)

A BILL FOR

1 An Act regulating the sale of credit default insurance,
2 and including criminal and civil penalties, transition
3 provisions, and applicability provisions.
4 BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:

1 Section 1. NEW SECTION. 522.1 Definitions.

2 As used in this chapter, unless the context otherwise
3 requires:

4 1. "*Affiliate*" means a person which, directly or indirectly,
5 owns at least ten percent but less than fifty percent of a
6 credit default insurance corporation or which is at least ten
7 percent but less than fifty percent, directly or indirectly,
8 owned by a credit default insurance corporation.

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

13 3. "*Asset-backed securities*" means securities or other
14 financial obligations of an issuer provided that all of the
15 following requirements are met:

16 a. The issuer is a special purpose corporation, trust,
17 or other entity, or provided that the securities or other
18 financial obligations constitute an insurable risk, is a bank,
19 trust company, or other financial institution, deposits in
20 which are insured by the full faith and credit of the United
21 States government.

22 b. The securities or other financial obligations are held
23 in a pool of assets expected to generate either cash flow or
24 cash proceeds by the terms of the securities or other financial
25 obligations, or pursuant to leases or other contractual rights,
26 including any expected extensions or renewals thereof, or
27 through a sale in a public or private market for proceeds
28 sufficient to pay the insured obligations which pool meets all
29 of the following requirements:

30 (1) Has been conveyed, pledged, or otherwise transferred to
31 or is otherwise owned or acquired by the issuer.

32 (2) Backs the securities or other financial obligations
33 issued.

34 (3) No asset in such pool, other than an asset directly
35 payable by, guaranteed by or backed by the full faith and

1 credit of the United States government or that otherwise
2 qualifies as collateral under subsection 5, paragraph "a"
3 or "b", has a value exceeding twenty percent of the pool's
4 aggregate value.

5 4. a. "Average annual debt service" means the amount
6 of insured unpaid principal and interest on an obligation,
7 multiplied by the number of such insured obligations, assuming
8 each obligation represents one thousand dollars par value,
9 divided by the amount equal to the aggregate life of all such
10 obligations, assuming each obligation represents one thousand
11 dollars par value.

12 b. This definition, expressed as a formula in regards to
13 bonds, is as follows: average annual debt service equals
14 total debt service times the number of bonds divided by bond
15 years, assuming each bond represents one thousand dollars par
16 value, with the following terms defined as follows:

17 (1) "Bond years" means number of bonds times the term in
18 years.

19 (2) "Number of bonds" means total insured principal.

20 (3) "Term in years" means term to maturity based on
21 scheduled amortization or, in the absence of a scheduled
22 amortization in the case of asset-backed securities or
23 other obligations lacking a scheduled amortization, expected
24 amortization, in each case determined as of the date of
25 issuance of the insurance policy based upon the amortization
26 assumptions employed in pricing the insured obligations or
27 otherwise used by the insurer to determine aggregate net
28 liability.

29 (4) "Total debt service" means insured unpaid principle plus
30 interest.

31 5. "Collateral" means any of the following:

32 a. Cash.

33 b. The cash flow from specific obligations which are
34 not callable and scheduled to be received based on expected
35 prepayment speed on or prior to the date of scheduled debt

1 service, including scheduled redemptions or prepayments, on the
2 insured obligation provided that any of the following applies:

3 (1) Such specific obligations are directly payable by,
4 guaranteed by, or backed by the full faith and credit of the
5 United States government.

6 (2) In the case of insured obligations denominated or
7 payable in foreign currency as permitted under section 522.4,
8 subsection 5, such specific obligations are directly payable
9 by, guaranteed by, or backed by the full faith and credit of
10 such foreign government or the central bank thereof.

11 (3) Such specific obligations are insured by the same
12 insurer that insures the obligations being collateralized, and
13 the cash flows from such specific obligations are sufficient to
14 cover the insured scheduled payments on the obligations being
15 collateralized.

16 *c.* The market value of investment grade obligations, other
17 than obligations evidencing an interest in the project or
18 projects financed with the proceeds of the insured obligations.

19 *d.* The face amount of each letter of credit that meets all
20 of the following criteria:

21 (1) Is irrevocable.

22 (2) Provides for payment under the letter of credit in lieu
23 of or as reimbursement to the insurer for payment required
24 under a credit default insurance policy.

25 (3) Is issued, presentable, and payable at any of the
26 following:

27 (a) At an office of the letter of credit issuer in the
28 United States.

29 (b) At an office of the letter of credit issuer located in
30 the jurisdiction in which the trustee or paying agent for the
31 insured obligation is located.

32 (4) Contains a statement that identifies any of the
33 following:

34 (a) Identifies the insurer and any successor by operation
35 of law, including any liquidator, rehabilitator, receiver, or

1 conservator, as the beneficiary.

2 (b) Identifies the trustee or the paying agent for the
3 insured obligation as the beneficiary.

4 (5) Contains a statement to the effect that the obligation
5 of the letter of credit issuer under the letter of credit
6 is an individual obligation of such issuer and is in no way
7 contingent upon reimbursement with respect thereto.

8 (6) Contains an issue date and a date of expiration.

9 (7) Has a term at least as long as the shorter of the term
10 of the insured obligation or the term of the credit default
11 insurance policy or provides that the letter of credit shall
12 not expire without thirty days' prior written notice to the
13 beneficiary and allows for drawing under the letter of credit
14 in the event that, prior to expiration, the letter of credit
15 is not renewed or extended or a substitute letter of credit or
16 alternate collateral meeting the requirements of this paragraph
17 "d" is not provided.

18 (8) States that it is governed by the laws of the state of
19 Iowa or by the 1983 or 1993 revision of the uniform customs and
20 practice for documentary credits of the international chamber
21 of commerce, publication 400 or 500, or any successor revision
22 if approved by the commissioner and contains a provision for
23 an extension of time, of not less than thirty days after
24 resumption of business, to draw against the letter of credit
25 in the event that one or more of the occurrences described in
26 article 19 of publication 400 or 500 occurs.

27 (9) Is issued by a bank, trust company, or savings and loan
28 association that meets all of the following criteria:

29 (a) Is organized under the laws of the United States or
30 any state thereof or, in the case of a nondomestic financial
31 institution, has a branch or agency office licensed under
32 the laws of the United States or any state thereof and is
33 domiciled in a member country of the organisation for economic
34 co-operation and development having a sovereign rating in one
35 of the top two generic lettered rating classifications by a

1 securities rating agency acceptable to the commissioner.

2 (b) Has, or is the principal operating subsidiary of, a
3 financial institution holding company that has a long-term debt
4 of at least investment grade.

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

9 6. "*Commercial real estate*" means income-producing real
10 property other than residential property consisting of less
11 than five units.

12 7. "*Commissioner*" means the commissioner of insurance.

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

17 9. "*Credit default insurance*" means a surety bond or other
18 contract, and any guarantee which is payable upon occurrence
19 of financial loss, as a result of the failure of any obligor on
20 or issuer of any debt instrument or other monetary obligation
21 to pay when due to be paid by the obligor or scheduled at the
22 time insured to be received by the holder of the obligation,
23 principal, interest, premium, dividend, or purchase price of
24 or on, or other amounts due or payable with respect to, such
25 instrument or obligation, when such failure is the result of
26 a financial default or insolvency, or other credit event, or
27 provided that such payment source is investment grade, any
28 other failure to make payment, regardless of whether such
29 obligation is incurred directly or as guarantor by or on
30 behalf of another obligor that has also defaulted. "*Credit*
31 *default insurance*" includes other events which the commissioner
32 determines are substantially similar to any of the events
33 described in this subsection.

34 10. "*Credit default insurance corporation*" or "*corporation*"
35 means an insurer licensed to transact the business of credit

1 default insurance in this state.

2 11. "*Excess spread*" means, with respect to any insured issue
3 of asset-backed securities, the excess of the scheduled cash
4 flow on the underlying assets that is reasonably projected to
5 be available, over the term of the insured securities after
6 payment of the expenses associated with the insured issue, to
7 make debt service payments on the insured securities over the
8 scheduled debt service requirements on the insured securities,
9 provided that such excess is held in the same manner as
10 collateral is required to be held under subsection 5.

11 12. "*Governmental unit*" means the United States of America,
12 Canada, a member country of the organisation for economic
13 co-operation and development having a sovereign rating in one
14 of the top two generic lettered rating classifications by
15 a securities rating agency acceptable to the commissioner,
16 a state, territory, or possession of the United States of
17 America, the District of Columbia, a province of Canada,
18 a municipality, or a political subdivision of any of the
19 foregoing, or any public agency or instrumentality thereof.

20 13. "*Industrial development bond*" means any security
21 or other instrument, other than a utility first mortgage
22 obligation, under which a payment obligation is created, issued
23 by or on behalf of a governmental unit, to finance a project
24 serving a private industrial, commercial, or manufacturing
25 purpose, and not payable or guaranteed by a governmental unit.

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

32 15. "*Investment grade*" means any of the following:

33 a. The obligation or parity obligation of the same issuer
34 has been determined to be in one of the top four generic
35 lettered rating classifications by a securities rating agency

1 acceptable to the commissioner.

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

5 *c.* If the obligation or parity obligation of the same
6 issuer has not been submitted to any such rating agency, the
7 obligation is determined to be investment grade, as indicated
8 by a rating in category 1 or 2, by the securities valuation
9 office of the national association of insurance commissioners.

10 16. "*Municipal bonds*" means municipal bonds and special
11 revenue bonds.

12 17. "*Municipal obligation bond*" means any security or
13 other instrument, including a lease payable or guaranteed
14 by the United States or another national government that
15 qualifies as a governmental unit or any agency, department,
16 or instrumentality thereof, or by a state or an equivalent
17 political subdivision of another national government that
18 qualifies as a governmental unit, but not a lease of any
19 other governmental unit, under which a payment obligation is
20 created, issued by or on behalf of or payable or guaranteed by
21 a governmental unit or issued by a special purpose corporation,
22 special purpose trust, or other special purpose legal entity to
23 finance a project serving a substantial public purpose.

24 *a.* A municipal obligation bond may be any of the following:

25 (1) Payable from tax revenues, but not tax allocations,
26 within the jurisdiction of such governmental unit.

27 (2) Payable or guaranteed by the United States or another
28 national government that qualifies as a governmental unit,
29 or any agency, department, or instrumentality thereof, or by
30 a housing agency of a state or an equivalent subdivision of
31 another national government that qualifies as a governmental
32 unit.

33 (3) Payable from rates or charges, but not tolls, levied or
34 collected in respect of a nonnuclear utility project, public
35 transportation facility other than an airport, or public higher

1 education facility.

2 (4) With respect to lease obligations, payable from future
3 appropriations.

4 *b.* However, in the case of municipal obligation bonds of a
5 special purpose corporation, special purpose trust, or other
6 special purpose legal entity, such obligations are all of the
7 following:

8 (1) Investment grade at the time of issuance.

9 (2) Payable from sources enumerated in paragraph "a".

10 (3) The project being financed or the tolls, tariffs, usage
11 fees, or other similar rates or charges for its use are subject
12 to regulation or oversight by a governmental unit.

13 18. "Reinsurance" means cessions qualifying for credit under
14 section 522.6.

15 19. "Special revenue bond" means any of the following:

16 *a.* Any security or other instrument, under which a payment
17 obligation is created, issued by or on behalf of or payable or
18 guaranteed by a governmental unit to finance a project serving
19 a substantial public purpose, and not payable from any of the
20 sources enumerated in subsection 17, paragraph "a".

21 *b.* Securities, which are the functional equivalent of
22 any security or other instrument described in paragraph "a",
23 issued by a not-for-profit corporation or a special purpose
24 corporation, special purpose trust, or other special purpose
25 legal entity, provided that, in the case of obligations of
26 a special purpose corporation, special purpose trust, or
27 other special purpose legal entity, all of the following are
28 applicable:

29 (1) Such obligations are investment grade at the time of
30 issuance.

31 (2) Such obligations are not payable from any of the sources
32 enumerated in subsection 17, paragraph "a".

33 (3) The project being financed or the tolls, tariffs, usage
34 fees, or other similar rates or charges for its use are subject
35 to regulation or oversight by a governmental unit.

1 20. *“Utility first mortgage obligation”* means any
2 obligation of an issuer secured by a first priority mortgage
3 on utility property owned by or leased to an investor-owned or
4 cooperative-owned utility company and located in the United
5 States, Canada, or a member country of the organisation for
6 economic co-operation and development having a sovereign rating
7 in one of the top two generic lettered rating classifications
8 by a securities rating agency acceptable to the commissioner,
9 provided that the utility or utility property or the usage
10 fees or other similar utility rates or charges are subject to
11 regulation or oversight by a governmental unit.

12 Sec. 2. NEW SECTION. **522.2 Organization — financial**
13 **requirements.**

14 1. A credit default insurance corporation shall be
15 organized and licensed in the manner prescribed by Iowa law and
16 a foreign insurer shall be licensed in the manner prescribed by
17 Iowa law, except as modified by the following provisions:

18 a. A corporation organized for the purpose of transacting
19 credit default insurance shall, subject to the applicable
20 provisions of this chapter, be licensed to transact only the
21 following additional kinds of insurance:

22 (1) Residual value insurance, as defined by law or by rules
23 adopted by the commissioner.

24 (2) Surety insurance, as defined by law or by rules adopted
25 by the commissioner.

26 (3) Credit insurance, as defined by law or by rules adopted
27 by the commissioner.

28 (4) Financial guaranty insurance, as defined by law or by
29 rules adopted by the commissioner.

30 b. A credit default insurance corporation shall only assume
31 those kinds of insurance for which it is licensed to write
32 direct business.

33 c. Prior to the issuance of a license, unless a plan of
34 operation has been previously approved by the commissioner, a
35 corporation shall submit for the approval of the commissioner

1 a plan of operation, detailing the types and projected
2 diversification of guaranties that will be issued, the
3 underwriting procedures that will be followed, managerial
4 oversight methods, investment policies, and such other matters
5 as may be prescribed by the commissioner by rule.

6 *d.* A credit default insurance corporation's investments in
7 any one entity insured by that corporation shall not exceed
8 four percent of its admitted assets at last year end, except
9 that this limit does not apply to investments payable or
10 guaranteed by a United States governmental unit or state if
11 such investments payable or guaranteed by the United States
12 governmental unit or state are rated in one of the top two
13 generic lettered rating classifications by a securities rating
14 agency acceptable to the commissioner.

15 2. A credit default insurance corporation shall not
16 transact business in this state unless it has paid-in capital
17 of at least fifteen million dollars and paid-in surplus of at
18 least one hundred sixty-five million dollars, and shall at all
19 times thereafter maintain a minimum surplus to policyholders of
20 at least one hundred fifty million dollars.

21 3. A credit default insurance corporation shall be deemed to
22 be in compliance with Iowa law if not less than sixty percent
23 of the amount of the required minimum capital or minimum
24 surplus to policyholder investments consists of the types
25 specified by Iowa law and by rules adopted by the commissioner,
26 and direct government obligations of any state of the United
27 States or of any county, district, or municipality thereof,
28 provided such government obligations have been given the
29 highest quality designation of the securities valuation office
30 of the national association of insurance commissioners. Before
31 investing any part of the required minimum capital or surplus
32 in direct government obligations of any other state of the
33 United States or of any county, district, or municipality
34 thereof, such credit default insurance corporation shall have
35 invested at least ten percent of such required minimum in

1 government obligations of Iowa or of any county, district,
2 or municipality thereof. Only for purposes of meeting the
3 required investment in government obligations of Iowa, the
4 insurer may count investments in any government obligation of
5 Iowa, whether direct or otherwise.

6 Sec. 3. NEW SECTION. 522.3 Contingency, loss and unearned
7 premium reserves — collateral.

8 1. *Contingency reserves.*

9 a. A credit default insurance corporation shall establish
10 and maintain contingency reserves for the protection of
11 insureds and claimants against the effects of excessive losses
12 occurring during adverse economic cycles.

13 b. With respect to credit default insurance of municipal
14 obligation bonds, special revenue bonds, industrial development
15 bonds, and utility first mortgage obligations written on or
16 after the first day of the next calendar quarter commencing
17 after the effective date of this Act all of the following
18 apply:

19 (1) The insurer shall establish and maintain a contingency
20 reserve for all such insured issues in each calendar year for
21 each category listed in subparagraph (2).

22 (2) The total contingency reserve required pursuant to
23 this paragraph "b" shall be the greater of fifty percent of
24 premiums written for each such category or the following amount
25 prescribed for each such category:

26 (a) Municipal obligation bonds, fifty-five hundredths of a
27 percent of principal guaranteed.

28 (b) Special revenue bonds, and obligations demonstrated
29 to the satisfaction of the commissioner to be the functional
30 equivalent thereof, eighty-five hundredths of a percent of
31 principal guaranteed.

32 (c) Investment grade industrial development bonds, secured
33 by collateral or having a term of seven years or less, and
34 utility first mortgage obligations, one percent of principal
35 guaranteed.

1 (d) Other investment grade industrial development bonds,
2 one and one-half percent of principal guaranteed.

3 (e) All other industrial development bonds, two and
4 one-half percent of principal guaranteed.

5 (3) Contributions to the contingency reserve required
6 by this paragraph "b", equal to one-eightieth of the total
7 reserve required, shall be made each quarter for twenty years,
8 provided, however, that contributions may be discontinued
9 so long as the total reserve for all categories listed in
10 subparagraph (2), subparagraph divisions (a) through (e),
11 exceeds the percentages contained in such subparagraph
12 divisions (a) through (e) when applied against unpaid
13 principal.

14 c. With respect to all other credit default insurance
15 written on or after the first day of the next calendar quarter
16 commencing after the effective date of this Act all of the
17 following apply:

18 (1) The insurer shall establish and maintain a contingency
19 reserve for all such insured issues in each calendar year for
20 each such category listed in subparagraph (2).

21 (2) The total contingency reserve required pursuant to
22 this paragraph "c" shall be the greater of fifty percent of
23 premiums written for each such category or the following amount
24 prescribed for each such category:

25 (a) Investment grade obligations, secured by collateral or
26 having a term of seven years or less, one percent of principal
27 guaranteed.

28 (b) Other investment grade obligations, one and one-half
29 percent of principal guaranteed.

30 (c) Noninvestment grade consumer debt obligations, two
31 percent of principal guaranteed.

32 (d) Noninvestment grade asset-backed securities, two
33 percent of principal guaranteed.

34 (e) Other noninvestment grade obligations, two and one-half
35 percent of principal guaranteed.

1 (3) Contributions to the contingency reserve required
2 by this paragraph "c", equal to one-sixtieth of the total
3 reserve required, shall be made each quarter for fifteen years,
4 provided, however, that contributions may be discontinued
5 so long as the total reserve for all categories listed in
6 subparagraph (2), subparagraph divisions (a) through (e),
7 exceeds the percentages contained in such subparagraph
8 divisions (a) through (e) when applied against unpaid
9 principal.

10 d. Contingency reserves required in paragraphs "b" and
11 "c" may be established and maintained net of collateral and
12 reinsurance, provided that, in the case of reinsurance, the
13 reinsurance agreement requires that the reinsurer shall, on
14 or after the effective date of the reinsurance, establish and
15 maintain a reserve in an amount equal to the amount by which
16 the insurer reduces its contingency reserve, and contingency
17 reserves required in paragraphs "b" and "c" may be maintained
18 as follows:

19 (1) Net of refundings and refinancings to the extent
20 the refunded or refinanced issue is paid off or secured by
21 obligations which are directly payable or guaranteed by the
22 United States government.

23 (2) Net of insured securities in a unit investment trust or
24 mutual fund that have been sold from the trust or fund without
25 insurance.

26 e. The contingency reserves may be released thereafter in
27 the same manner in which they were established and withdrawals
28 therefrom, to the extent of any excess, may be made from the
29 earliest contributions to such reserves remaining therein as
30 follows:

31 (1) With the prior written approval of the commissioner if
32 any of the following applies:

33 (a) If the actual incurred losses for the year, in the
34 case of the categories of guaranties subject to paragraph "b"
35 exceeds thirty-five percent of earned premiums, or in the case

1 of the categories of guaranties subject to paragraph "c" exceeds
2 sixty-five percent of earned premiums.

3 (b) If the contingency reserve applicable to the categories
4 of credit default insurance subject to paragraph "b" has been in
5 existence for less than forty quarters, or for less than thirty
6 quarters for the categories of guaranties subject to paragraph
7 "c", upon a demonstration satisfactory to the commissioner that
8 the amount carried is excessive in relation to the insurer's
9 outstanding obligations under its credit default insurance.

10 (2) Upon thirty days' prior written notice to the
11 commissioner, provided that the contingency reserve applicable
12 to the categories of credit default insurance subject to
13 paragraph "b" has been in existence for forty quarters, or
14 thirty quarters for categories of credit default insurance
15 subject to paragraph "c", upon a demonstration satisfactory
16 to the commissioner that the amount carried is excessive in
17 relation to the insurer's outstanding obligations under its
18 credit default insurance.

19 *f.* An insurer providing credit default insurance may
20 invest the contingency reserve in tax and loss bonds, or
21 similar securities, purchased pursuant to section 832(e) of
22 the Internal Revenue Code, or any successor provision, only
23 to the extent of the tax savings resulting from the deduction
24 for federal income tax purposes of a sum equal to the annual
25 contributions to the contingency reserve. The contingency
26 reserve shall otherwise be invested only in classes of
27 securities or types of investments specified by Iowa law or by
28 rules adopted by the commissioner.

29 2. *Loss reserves.*

30 *a.* The case basis method or such other method as may be
31 prescribed by the commissioner shall be used to establish and
32 maintain loss reserves, net of collateral, for claims reported
33 and unpaid, in a manner consistent with Iowa law. A deduction
34 from loss reserves shall be allowed for the time value of money
35 by application of a discount rate equal to the average rate of

1 return on the admitted assets of the insurer as of the date of
2 the computation of any such reserves. The discount rate shall
3 be adjusted at the end of each calendar year.

4 *b.* If the insured principal and interest on a defaulted
5 issue of obligations due and payable during any three years
6 following the date of default exceeds ten percent of the
7 insurer's surplus to policyholders and contingency reserves,
8 its reserve so established shall be supported by a report from
9 an independent source acceptable to the commissioner.

10 3. *Unearned premium reserve.* An unearned premium reserve
11 shall be established and maintained net of reinsurance and
12 collateral with respect to all credit default insurance
13 premiums. Where credit default insurance premiums are paid
14 on an installment basis, an unearned premium reserve shall be
15 established and maintained, net of reinsurance and collateral,
16 computed on a daily or monthly pro rata basis. All other
17 credit default insurance premiums written shall be earned in
18 proportion with the expiration of exposure, or by such other
19 method as may be prescribed by the commissioner.

20 4. *Collateral.* Collateral shall be deposited with the
21 insurer, held in trust by a trustee or custodian acceptable
22 to the commissioner for the benefit of the insurer, or
23 held in trust pursuant to the bond indenture or other trust
24 arrangement, for the benefit of holders of insured obligations
25 in the form of funds for the payment of insured obligations,
26 sinking funds, or other reserves which may be used for
27 the payment of insured obligations and trustee and other
28 administrative fees on a first priority basis established
29 and continually maintained pursuant to the bond indenture
30 or other trust arrangement by a trustee acceptable to the
31 commissioner. The commissioner may adopt rules to limit the
32 amount of collateral provided by obligations, letters of credit
33 or credit default insurance contracts or to limit the amount of
34 collateral provided by any single issuer, bank, or counterparty
35 as provided for in this subsection.

1 Sec. 4. NEW SECTION. **522.4 Limitations.**

2 1. Credit default insurance may be transacted in this state
3 only by a corporation licensed for such purpose pursuant to
4 section 522.2.

5 2. The commissioner shall not permit the writing of credit
6 default insurance except where the insured or beneficiary under
7 the policy, bond, or contract has, or is expected to have at
8 the time of the default or other failure of the obligor under
9 the debt instrument or other monetary obligation, a material
10 interest in such default or other failure and a corporation
11 may insure the timely payment of United States dollar debt
12 instruments, or other monetary obligations, only in the
13 following categories:

14 *a.* Municipal obligation bonds.

15 *b.* Special revenue bonds.

16 *c.* Industrial development bonds.

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

22 *e.* Obligations of corporations, trusts, or other similar
23 entities established under applicable law.

24 *f.* Partnership obligations.

25 *g.* Asset-backed securities, trust certificates, and trust
26 obligations, provided that any of the following apply:

27 (1) With respect to mortgage-backed securities secured
28 by first mortgages on real property which are insurable by
29 a mortgage guaranty insurer authorized under Iowa law, such
30 mortgages are one of the following:

31 (a) Such mortgages with loan-to-value ratios in excess of
32 eighty percent are any of the following:

33 (i) In the case of mortgages on property located in the
34 state of Iowa, insured by mortgage guaranty insurers authorized
35 under Iowa law.

1 (ii) In the case of mortgages on property located in a state
2 other than the state of Iowa, insured by mortgage guaranty
3 insurers authorized to do business in such other state.

4 (iii) In an aggregate principal amount less than the single
5 risk limits prescribed in subsection 7, paragraph "e".

6 (b) With respect to additional mortgages with principal
7 balances, other collateral with a market value or, provided the
8 insured risk is investment grade, excess spread in an amount
9 in each instance at least equal to the coverage that would
10 otherwise be provided by such mortgage guaranty insurers in
11 accordance with paragraph "g", subparagraph (1), subparagraph
12 division (a), is pledged as additional security for the
13 asset-backed securities.

14 (2) With respect to any asset-backed securities backed
15 by another pool of asset-backed securities, the pool of
16 asset-backed securities shall meet all of the following
17 requirements:

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

23 (b) The credit default insurer shall possess control and
24 remediation rights substantially similar to those held by the
25 most senior class of securities of the issuer of the insured
26 obligations backed by the same pool of assets.

27 (c) The pool of asset-backed securities meets any of the
28 following requirements:

29 (i) The pool consists of asset-backed securities that are
30 issued or guaranteed by a governmental unit, federal national
31 mortgage association, federal home loan mortgage corporation,
32 federal home loan bank, the federal agricultural mortgage
33 corporation, or the federal farm credit system banks as a
34 consolidated debt obligation or a systemwide debt obligation to
35 the extent that the obligations are covered by the farm credit

1 insurance fund.

2 (ii) The pool consists entirely of asset-backed securities
3 insured by the credit default insurer.

4 (iii) The commissioner has determined that insuring the
5 asset-backed securities does not present undue risk to the
6 credit default insurer.

7 *h.* Installment purchase agreements executed as a condition
8 of sale.

9 *i.* Consumer debt obligations.

10 *j.* Utility first mortgage obligations.

11 *k.* Any other debt instrument or financial obligation that
12 the commissioner determines to be substantially similar to any
13 of the debt instruments or financial obligations described
14 in this subsection or that is otherwise approved by the
15 commissioner.

16 3. An insurer may insure obligations enumerated in
17 subsection 2, paragraphs "a", "b", and "c", that are not
18 investment grade so long as at least ninety-five percent of the
19 insurer's aggregate net liability on the kinds of obligations
20 enumerated in those paragraphs is investment grade.

21 4. A corporation may insure the timely payment of monetary
22 obligations in any category designated in this section
23 notwithstanding that such obligation may be insured by an
24 insurance policy issued by another insurer. In the event that
25 any obligation is insured by more than one credit default
26 insurance policy, then each such insurance policy may by its
27 terms specify its priority of payment in the event of a default
28 under the obligation insured or any other insurance policy,
29 provided that an insurer shall be entitled to take into account
30 payment under another policy insuring such obligation for
31 purposes of establishing and maintaining loss reserves only to
32 the extent that the policy issued by such insurer provides for
33 payment only in the event of payment default under both such
34 obligation and the other policy.

35 5. A corporation may also write credit default insurance

1 to insure the timely payment of non-United States dollar debt
2 instruments or other monetary obligations denominated or
3 payable in foreign currency, only for the categories listed in
4 subsection 2, paragraphs "a" through "k", provided that all of
5 the following are applicable:

6 *a.* Such currency is that of an organisation for economic
7 co-operation and development country or such other country
8 whose sovereign rating is investment grade or that is not
9 otherwise disapproved by the commissioner within thirty days
10 following receipt of written notification. The commissioner
11 shall not disapprove such notification upon demonstration
12 that there is no undue risk associated with insuring the
13 timely payment of such instruments or obligations. In making
14 such a determination, the commissioner shall take into
15 consideration the corporation's outstanding liabilities on
16 noninvestment grade instruments and obligations in relation to
17 its outstanding liabilities on all instruments and obligations
18 and in relation to the amount of its surplus to policyholders.

19 *b.* Reserves required pursuant to section 522.3 in regard to
20 such obligations are established and adjusted quarterly based
21 upon the then current foreign exchange rates.

22 *c.* Such obligations do not exceed twenty-five percent of an
23 insurer's aggregate net liability.

24 *d.* The aggregate and single risk limitations prescribed by
25 subsections 6 and 7 are determined by applying the then current
26 foreign exchange rates.

27 6. The corporation shall at all times maintain surplus to
28 policyholders and contingency reserves in the aggregate no less
29 than the sum of all of the following:

30 *a.* The sum of all of the following:

31 (1) Three thousand three hundred thirty-three ten
32 thousandths of one percent or one three hundredths of the
33 aggregate net liability under credit default insurance
34 in which the underlying obligations are municipal bonds
35 including obligations demonstrated to the satisfaction of

1 the commissioner to be the functional equivalent thereof and
2 investment grade utility first mortgage obligations.

3 (2) Six thousand six hundred sixty-six ten thousandths
4 of one percent or one one hundred fiftieths of the aggregate
5 net liability under credit default insurance in which the
6 underlying obligations are investment grade asset-backed
7 securities.

8 (3) One percent or one one hundredth of the aggregate
9 net liability under credit default insurance in which the
10 underlying obligations are secured by collateral or having a
11 term of seven years or less, of all of the following:

12 (a) Investment grade industrial development bonds.

13 (b) Other investment grade obligations.

14 (4) One and one-half percent or one sixty-six and
15 sixty-seven one hundredths of the aggregate net liability under
16 credit default insurance in which the underlying obligations
17 are investment grade obligations.

18 (5) Two percent or one fiftieth of the aggregate net
19 liability under credit default insurance in which the
20 underlying obligations are the sum of all of the following:

21 (a) Noninvestment grade consumer debt obligations.

22 (b) Noninvestment grade asset-backed securities.

23 (6) Two and one-half percent or one fortieth of the
24 aggregate net liability under credit default insurance in which
25 the underlying obligations are noninvestment grade obligations
26 secured by first mortgages on commercial real estate and having
27 loan-to-value ratios of eighty percent or less.

28 (7) Four percent or one twenty-fifth of the aggregate
29 net liability under credit default insurance in which
30 the underlying obligations are other noninvestment grade
31 obligations.

32 (8) If the amount of collateral required by subparagraph
33 (3) is no longer maintained, that proportion of the obligation
34 insured which is not so collateralized shall be subject to the
35 aggregate limits specified in subparagraph (4).

1 *b.* Surplus to policyholders determined by the commissioner
2 to be adequate to support the writing of residual value
3 insurance, surety insurance, and credit insurance, if the
4 corporation has elected to transact such kinds of insurance
5 pursuant to section 522.2, subsection 1.

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

10 *a.* For municipal obligation bonds, special revenue bonds,
11 and obligations demonstrated to the satisfaction of the
12 commissioner to be the functional equivalent of all of the
13 following:

14 (1) The insured average annual debt service with respect to
15 a single entity and backed by a single revenue source shall not
16 exceed ten percent of the aggregate of the insurer's surplus to
17 policyholders and contingency reserve.

18 (2) The insured unpaid principal issued by a single
19 entity and backed by a single revenue source shall not exceed
20 seventy-five percent of the aggregate of the insurer's surplus
21 to policyholders and contingency reserve.

22 *b.* For each issue of asset-backed securities issued by a
23 single entity and for each pool of consumer debt obligations,
24 the lesser of either of the following:

25 (1) Insured average annual debt service.

26 (2) Insured unpaid principal, reduced by the extent to which
27 the unpaid principal of the supporting assets and, provided
28 the insured risk is investment grade, excess spread exceed the
29 insured unpaid principal, divided by nine; shall not exceed
30 ten percent of the aggregate of the insurer's surplus to
31 policyholders and contingency reserve, provided that no asset
32 in the pool supporting the asset-backed securities exceeds the
33 single risk limits prescribed in paragraph "e", if insured;
34 and provided further that, if the issuer of such insured
35 asset-backed securities is a special purpose corporation,

1 trust, or other entity and such issuer shall have indebtedness
2 outstanding with respect to any other pool of assets, either
3 such other indebtedness shall be entitled to the benefits of a
4 credit default insurance policy of the same insurer, or such
5 other indebtedness shall be all of the following:

6 (a) Fully subordinated to the insured obligation, with
7 respect to, or be nonrecourse with respect to, the pool of
8 assets that supports the insured obligation.

9 (b) Be nonrecourse to the issuer other than with respect to
10 the asset pool securing such other indebtedness and proceeds in
11 excess of the proceeds necessary to pay the insured obligation.

12 (c) Not constitute a claim against the issuer to the extent
13 that the asset pool securing such other indebtedness or excess
14 proceeds are insufficient to pay such other indebtedness.

15 (d) Provided further that in the case of asset-backed
16 securities that are subordinate, in right of payment in the
17 event of an issuer insolvency, to any other securities of the
18 issuer backed by the same pool of assets, for purposes of this
19 paragraph "b" only, the insured average annual debt service and
20 insured unpaid principal shall be deemed to be the lesser of
21 either of the following:

22 (i) Three hundred percent of the insured average annual debt
23 service and insured unpaid principal respectively.

24 (ii) The insured average annual debt service and insured
25 unpaid principal respectively if the scheduled principal of
26 and interest on all senior securities of the issuer were
27 included in the amount insured by the insurer for purposes of
28 calculating insured average annual debt service and insured
29 unpaid principal.

30 c. For obligations issued by a single entity and secured
31 by commercial real estate, and not meeting the definition of
32 asset-backed securities, the insured unpaid principal less
33 fifty percent of the appraised value of the underlying real
34 estate shall not exceed ten percent of the aggregate of the
35 insurer's surplus to policyholders and contingency reserve.

1 *d.* For utility first mortgage obligations, the insured
2 average annual debt service shall not exceed ten percent of
3 the aggregate of the insurer's surplus to policyholders and
4 contingency reserve.

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

10 8. If an insurer at any time exceeds any limitation
11 prescribed by subsection 5, 6, or 7, the insurer shall within
12 thirty days after the limitations are breached, submit a
13 written plan to the commissioner detailing the steps it will
14 take or has taken to reduce its exposure to loss to no more
15 than the permitted amounts, and if after notice and hearing
16 the commissioner determines that an insurer has exceeded
17 any limitation prescribed by this section, the commissioner
18 may order such insurer to cease transacting any new credit
19 default insurance business until its exposure to loss no longer
20 exceeds said limitations or with respect to the limitations
21 prescribed in subsection 5, may order such insurer to limit
22 its writing of the types of credit default insurance permitted
23 under subsection 2, paragraphs "a", "b", and "c", to investment
24 grade obligations until such time as the insurer shall be in
25 compliance with such limitations.

26 9. An insurer authorized to transact the business of
27 credit default insurance shall not pay any commission or make
28 any gift of money, property, or other valuable thing to any
29 employee, agent, or representative of any potential purchaser
30 of a credit default insurance policy, or as an inducement to
31 the purchase of such a policy, and such an employee, agent, or
32 representative of such a potential purchaser shall not receive
33 any such payment or gift. A violation of the provisions
34 of this subsection, shall not, however, have the effect of
35 rendering void the insurance policy issued by the insurer.

1 Sec. 5. NEW SECTION. **522.5 Policy forms and rates.**

2 1. Policy forms and any amendments thereto shall be filed
3 with the commissioner within thirty days of their use by the
4 insurer if not otherwise filed prior to the effective date of
5 this Act.

6 2. Every credit default insurance policy shall provide
7 that, in the event of a payment default by or insolvency of
8 the obligor, there shall be no acceleration of the payment
9 required to be made under such policy unless the acceleration
10 is permitted by the credit default insurer at its sole option,
11 exercised at the time of the payment.

12 3. A credit default insurance policy shall not provide that
13 commencement of rehabilitation, liquidation, or conservatorship
14 proceedings under Iowa law, bankruptcy, or any other similar
15 proceedings whether under the laws of this state or another
16 state, with respect to a credit default insurer or the insured,
17 accelerates any payment required to be made under the policy,
18 absent a payment default by the obligor or the insurer.

19 4. A credit default insurance policy may provide that either
20 the credit default insurer or the insured may terminate the
21 policy as a consequence of the commencement of rehabilitation,
22 liquidation of conservatorship proceedings under Iowa law,
23 bankruptcy, or any other similar proceedings, whether under the
24 laws of this state or another state, with respect to a credit
25 default insurer or the insured provided that such termination
26 does not do any of the following:

27 a. Accelerate or otherwise increase the obligation of the
28 credit default insurer to make scheduled payments when due
29 under the policy.

30 b. Require the insurer to make any additional payment to the
31 insured by reason of the termination.

32 5. The commissioner by rule may prescribe minimum policy
33 provisions determined by the commissioner to be necessary or
34 appropriate to protect credit default insurers, policyholders,
35 claimants, obligees, or indemnities or the people of Iowa.

1 6. Rates shall not be excessive, inadequate, unfairly
2 discriminatory, destructive of competition, detrimental to
3 the solvency of the insurer, or otherwise unreasonable. In
4 determining whether rates comply with the foregoing standards,
5 the commissioner shall include all income earned by such
6 insurer. Criteria and guidelines utilized by insurers
7 in establishing rating categories and ranges of rates to
8 be utilized shall be filed with the commissioner or for
9 information prior to their use by the insurer if not otherwise
10 filed prior to the effective date of this Act.

11 7. All filing made pursuant to this chapter shall be
12 available for public inspection at the division of insurance
13 of the department of commerce.

14 Sec. 6. NEW SECTION. 522.6 Reinsurance.

15 1. For credit default insurance that takes effect on or
16 after the effective date of this Act, an insurer authorized to
17 transact credit default insurance in this state shall receive
18 credit for reinsurance, in accordance with the provisions of
19 the chapter applicable to property and casualty insurers, as
20 an asset or as a reduction from liabilities provided that such
21 reinsurance is subject to an agreement that, for its stated
22 term and with respect to any such reinsured credit default
23 insurance in force, the reinsurance agreements, facultative or
24 treaty, may only be terminated or amended only as provided in
25 paragraph "a", "b", or "c", but subject to the requirements of
26 paragraph "d":

27 a. At the option of the reinsurer or the ceding insurer, if
28 the reinsurance agreement provides that the liability of the
29 reinsurer with respect to policies in effect at the date of
30 termination shall continue until the expiration or cancellation
31 of such policy.

32 b. With the consent of the ceding company, if the
33 reinsurance agreement provides for a cutoff of the reinsurance
34 in force at the date of termination.

35 c. At the discretion of the commissioner acting as

1 rehabilitator, liquidator, or receiver of the ceding or
2 assuming insurer.

3 *d.* Provided that such reinsurance shall meet any of the
4 following requirements:

5 (1) Be placed with a credit default insurance corporation
6 licensed under this chapter or an insurer writing only credit
7 default insurance as is or would be permitted by this chapter.

8 (2) Be placed with a property and casualty insurer or an
9 accredited reinsurer licensed or accredited to reinsure risks
10 of every kind or description, including municipal obligation
11 bonds, as set forth under state law, if the reinsurance
12 agreement with such insurer requires that such insurer meets
13 all of the following requirements:

14 (a) Have and maintain surplus to policyholders of at least
15 thirty-five million dollars.

16 (b) Establish and maintain the reserves required in section
17 522.3 except that if the reinsurance agreement is not pro
18 rata the contribution to the contingency reserve shall be
19 equal to fifty percent of the quarterly earned reinsurance
20 premium. However, the assuming insurer need not establish and
21 maintain such reserve to the extent that the ceding insurer has
22 established and continues to maintain such reserve.

23 (c) Comply with the provisions of section 522.4, subsection
24 6, except that the maximum total exposures reinsured net
25 of retrocessions and collateral shall be one-half of that
26 permitted for a credit default insurance corporation.

27 (d) If a parent of the insurer, another subsidiary of
28 the parent of the insurer, or a subsidiary of the insurer,
29 then the aggregate of all risks assumed by such reinsurers
30 shall not exceed ten percent of the insurer's exposures,
31 net of retrocessions and collateral. Direct or indirect
32 ownership interests of fifty percent or more shall be deemed a
33 parent-subsidiary relationship.

34 (e) If an affiliate of the insurer, such affiliate shall not
35 assume a percentage of the insurer's total exposures insured

1 net of retrocessions and collateral in excess of its percentage
2 of equity interest in the insurer.

3 (f) Assumes from the credit default insurance corporation
4 and any affiliate, parent of the insurer, another subsidiary of
5 the parent of the insurer, or subsidiary of the insurer that is
6 a credit default insurance corporation or an insurer writing
7 only credit default insurance as is or would be permitted by
8 this chapter, together with all other reinsurers subject to
9 this subparagraph (2), less than fifty percent of the total
10 exposures insured by the credit default insurance corporation
11 and such affiliates, parents, or subsidiaries of the insurer,
12 net of collateral, remaining after deducting any reinsurance
13 placed with another credit default insurance corporation that
14 is not an affiliate, a parent of the credit default insurance
15 corporation, another subsidiary of the parent of the insurer,
16 or a subsidiary of the insurer or a credit default insurance
17 corporation writing only credit default insurance as is or
18 would be permitted by this chapter that is not an affiliate,
19 a parent of the credit default insurance corporation, another
20 subsidiary of the parent of the insurer, or a subsidiary of the
21 insurer.

22 (3) If placed with an unauthorized or unaccredited
23 reinsurer which otherwise meets the requirements of either
24 subsection 1, paragraph "d", or subparagraph (2), subparagraph
25 divisions (a), (d), (e), and (f), in an amount not exceeding
26 the liabilities carried by the ceding insurer for amounts
27 withheld under a reinsurance treaty with such reinsurer or
28 amounts deposited by such reinsurer as security for the payment
29 of obligations under the treaty if such funds or deposit are
30 held subject to withdrawal by, and under the control of, the
31 ceding insurer.

32 2. In determining whether an insurer meets the aggregate
33 risk limitations, in addition to credit for other types of
34 qualifying reinsurance, the insurer's aggregate risk may
35 be reduced to the extent of the limit for aggregate excess

1 reinsurance, but in no event in an amount greater than the
2 amount of the aggregate risks which will become due during the
3 unexpired term of such reinsurance agreement in excess of the
4 insurer's retention pursuant to such reinsurance agreement.

5 **Sec. 7. NEW SECTION. 522.7 Applicability of other laws.**

6 An insurer issuing policies of credit default insurance
7 shall be subject to all of the provisions applicable to
8 property and casualty insurers to the extent that such
9 provisions are not inconsistent with the provisions of this
10 chapter.

11 **Sec. 8. NEW SECTION. 522.8 Penalties.**

12 1. It is a violation of this chapter for any credit default
13 insurance corporation, affiliate, or any other party related to
14 the business of credit default insurance to sell credit default
15 insurance not permissible under section 522.4.

16 2. For criminal liability purposes, every violation of any
17 provision of this chapter shall, unless the same constitutes a
18 felony, be a misdemeanor.

19 3. The commissioner shall be empowered to levy a civil
20 penalty not exceeding one thousand dollars and the amount of
21 the claim for each violation upon any person who is found to
22 have violated any provision of this chapter.

23 4. The license of a person that sells credit default
24 insurance in violation of section 522.4 shall be revoked for a
25 period of at least three years.

26 **Sec. 9. NEW SECTION. 522.9 Transition provisions.**

27 1. A company organized for the purpose of transacting
28 financial guaranty insurance in its state of domicile or any
29 other state on the effective date of this Act and licensed and
30 operating in this state as a provider of surety insurance on
31 the effective date of this Act must meet all requirements of
32 this chapter, except the requirements described in subsection
33 2, before the effective date of this Act to transact business
34 as a credit default insurance corporation in this state.

35 2. A company as described in subsection 1 shall meet all

1 of the following requirements before July 1, 2017, to transact
2 business as a credit default insurance corporation in this
3 state:

4 *a.* Paid-in capital and surplus requirements and minimum
5 surplus to policyholders as set forth in section 522.2,
6 subsection 2.

7 *b.* Aggregate and single risk limits as set forth in section
8 522.4, subsections 6, 7, and 8.

9 3. The commissioner may do any of the following:

10 *a.* Extend the transition time permitted in subsection 2 an
11 additional twelve months if the commissioner determines that it
12 would not pose a hazard to the insurer, its policyholders, or
13 to the public, and there are unusual or unique circumstances
14 that justify the extension.

15 *b.* Decrease the transition time permitted in subsection 2
16 if the commissioner determines, after notice and hearing, that
17 permitting a company to continue to transact credit default
18 insurance in the state poses a hazard to the insurer, its
19 policyholders, or the public.

20 4. A company that does not comply with the provisions of
21 subsections 1 and 2 shall cease writing any new credit default
22 insurance.

23 5. A company not licensed as an insurance company in this
24 state pursuant to applicable state law on the effective date
25 of this Act shall not engage in the business of credit default
26 insurance until such time as the company has received a license
27 from this state pursuant to section 522.2.

28 Sec. 10. APPLICABILITY. This Act applies to policies
29 of credit default insurance delivered, issued for delivery,
30 continued, or renewed in this state on or after July 1, 2010.

31

EXPLANATION

32 This bill creates new Code chapter 522, which regulates
33 the sale of credit default insurance in this state. The bill
34 stipulates the organizational and financial requirements that
35 a credit default insurance corporation must meet to transact

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1 such business in this state, including required reserves and
2 collateral, limitations on categories of obligations insured,
3 policy form and rate requirements, reinsurance of credit
4 default insurance, civil and criminal penalties for violation
5 of the new chapter, and transition provisions for allowing the
6 sale of such insurance.

7 The new chapter is applicable to policies of credit default
8 insurance delivered, issued for delivery, continued, or renewed
9 in this state on or after July 1, 2010.