



## MEMORANDUM

April 10, 1991

**TO:** Chief Executive Officers and Chief Agents  
of Federally Registered Property and Casualty  
Insurance Companies

**FROM:** Dick Mabee  
Director General  
Property and Casualty Insurance Division

**SUBJECT:** Financial Guarantee Insurance

---

In recent months there has been increasing interest and activity on the part of federally registered property and casualty insurance companies in providing a form of financial guarantee insurance coverage in respect to loans to corporate borrowers or the issuance of corporate debt instruments. This insurance coverage typically indemnifies lenders or the holders of debt instruments for any financial loss suffered as a result of the failure of borrowers or obligors on the debt instruments to meet principal or interest payments or other obligations when due. The insurance coverage frequently appears to be provided for the purpose of enhancing the credit rating of borrowers or to support lending arrangements that may not otherwise be concluded because of the level of credit risk involved.

The Office is of the view that the risks assumed by insurers that provide such insurance coverage differ considerably from the risks that property and casualty companies have traditionally insured and could lead to catastrophic financial losses. Existing capital and other regulatory requirements have not been designed to deal with these relatively new and higher levels of risk. The threats to solvency posed by them have been of growing concern to the Office. Underwriting these kinds of risks in the absence of an appropriate framework of regulatory oversight could constitute an unsafe or unsound business practice or be materially prejudicial to the interests of a company's policyholders.

Accordingly, the Office is taking measures to ensure appropriate regulation of this kind of business. The amendment of the Classes of Insurance Regulations to establish this kind of business as a separate and distinct class (likely to be designated as Financial Guarantee Insurance or possibly Loan Guarantee Insurance), and the development of special reserve requirements applicable to such business, are expected to be key features of the regulatory regime developed in this regard. In developing the regulatory regime, the Office will also be examining the question of whether it may be necessary to prohibit insurers that transact financial guarantee

insurance from transacting any other class of business. We will also consider the levels of capital that should be required initially and on an ongoing basis for the transaction of this business as well as the need for special provisions relating to reinsurance arrangements, net retention levels, etc. The experience of regulators and insurers in the United States in dealing with many of these areas of concern will be evaluated, and consultation with the insurance industry will be an integral part of the process.

Certain specialized kinds of contracts fall within the definition of financial guarantee insurance in some foreign jurisdictions. These include contracts that provide protection in respect of changes in interest rates, reductions in asset values, fluctuations in currency exchange rates, etc. The Office does not consider the risks covered by such contracts to be proper insurable risks for registered insurers. Accordingly, these kinds of risks will likely continue to be omitted from all authorized classes of business for federally registered insurers.

Pending development of final positions on an appropriate framework for regulating financial guarantee insurance, as well as amendment of the Classes of Insurance Regulations to include financial guarantee insurance as a distinct class of business, all registered insurers should, effective immediately, refrain from entering into contracts or policies of insurance that provide indemnification against financial losses arising from failure on the part of corporate borrowers to make timely payments of principal or interest on loans. In addition, every company that has issued policies of this nature is requested to advise the Office of the volume of business written, loss experience to date, and any special measures taken to deal with the risks assumed.

This memorandum is not intended to interfere with the customary practices of an insurer to provide financial accommodations to facilitate the settlement process, or to minimize the insurer's loss, with respect to claims arising under a traditional form of surety or performance bond issued by it. Additionally, the memorandum is not directed toward requiring insurers to terminate arrangements under which they provide financial assistance, in amounts that are not material, to agents and brokers that generate business for them.

We will make every effort to expedite amendment of the Regulations and to develop an appropriate regulatory framework in respect of financial guarantee insurance business. When that work is completed, the Office should be able to consider, on a case-by-case basis, requests for authority to transact that class of business.

Questions or requests for clarification regarding this memorandum should be directed to me at (613) 990-7763.

