

REPORT ON ASSOCIATION EXAMINATION  
OF THE  
FINANCIAL GUARANTY INSURANCE COMPANY  
AS OF  
DECEMBER 31, 1999

<u>EXAMINER</u>	<u>STATE PARTICIPATING</u>	<u>ZONE</u>
MELBA BOLIC, CFE JAMES O' SULLIVAN, CFE	NEW YORK MISSISSIPPI	NORTHEASTERN SOUTHEASTERN

## TABLE OF CONTENTS

<u>ITEM NO.</u>	<u>PAGE NO.</u>
1. Scope of examination	2
2. Description of Company	3
A. Management	4
B. Territory of plan of operation	6
C. Reinsurance	7
D. Holding company system	9
E. Abandoned Property Law	21
F. Significant operating ratios	22
3. Financial Statement	24
A. Balance Sheet	24
B. Underwriting and investment exhibit	27
4. Losses and loss adjustment expenses	28
5. Market conduct activities	29
6. Compliance with prior report on examination	29
7. Summary of comments and recommendations	30

Honorable J. Robert Wooley  
Secretary, Southeastern Zone  
Insurance Commissioner  
Baton Rouge Louisiana LA 70802

Honorable Gregory V. Serio  
Acting Superintendent of Insurance  
State of New York  
Alban, New York 12257

Honorable George Dale  
Commissioner of Insurance  
State of Mississippi  
Jackson, Mississippi 39201

Honorable Diane Koken  
Secretary-Treasurer, Northeastern Zone  
Insurance Commissioner  
Pennsylvania Insurance Department  
1326 Strawberry Square, 13<sup>th</sup> Floor  
Harrisburg, Pennsylvania 17120

Sirs/Madam:

In accordance with your several instructions, an Association Examination has been made as of December 31, 1999, into the financial condition and affairs of the Financial Guaranty Insurance Company and the following report is thereon respectfully submitted.

Where the designation "the Company" appears herein without qualification, it should be understood to mean Financial Guaranty Insurance Company.

Respectfully submitted,

/S/

---

Melba Bolic, CFE  
Associate Insurance Examiner  
New York State Insurance Department  
Representing Zone I, NAIC

/S/

---

James F. O'Sullivan, CFE  
Insurance Examiner  
Mississippi Department of Insurance  
Representing Zone II, NAIC

REPORT ON EXAMINATION  
OF THE  
FINANCIAL GUARANTY INSURANCE COMPANY  
AS OF  
DECEMBER 31, 1999

EXAMINER

MELBA BOLIC

DATE OF REPORT

APRIL 13, 2001



STATE OF NEW YORK  
INSURANCE DEPARTMENT  
25 BEAVER STREET  
NEW YORK, NEW YORK 10004

April 13, 2001

Honorable Gregory V. Serio  
Acting Superintendent of Insurance  
Albany, New York 12257

Sir:

Pursuant of the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 21714 dated April 4, 2001, attached hereto, I have made an examination into the financial condition and affairs of the Financial Guaranty Insurance Company as of December 31, 1999, and submit the following report thereon.

The examination was conducted at the Company's home office located at 115 Broadway, New York, New York 10006.

Where the designation "the Company" appears herein without qualification, it should be understood to indicate the Financial Guaranty Insurance Company.

## 1. SCOPE OF EXAMINATION

The previous examination of the Company was conducted as of December 31, 1995. This examination covered the four-year period from January 1, 1996 through December 31, 1999. Transactions subsequent to this period were reviewed where appropriate by the examiner.

The examination comprised a complete verification of assets and liabilities as of December 31, 1999, a review of income and disbursements deemed necessary to accomplish verification and utilized, to the extent considered appropriate, work performed by the Company's independent public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners:

- History of Company
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Territory and plan of operation
- Market conduct activities
- Growth of Company
- Business in force by states
- Reinsurance
- Accounts and records
- Financial statements

A review was made to ascertain what action was taken by the Company with regard to the comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

## 2. DESCRIPTION OF COMPANY

Switzerland General Insurance Corporation of New York (“SGICNY”) was incorporated on April 10, 1972, under the laws of New York to serve as the corporate vehicle for the domestication of the United States Branch of the Switzerland General Insurance Company, Ltd., Zurich, Switzerland, which entered the United States through the State of New York in 1872. SGICNY was licensed on June 6, 1972 and the domestication became effective on July 1, 1972.

In October 1982, Christiania General Insurance Corporation of New York obtained control of SGICNY. On July 12, 1983, SGICNY’s name was changed to Tarrytown Insurance Company (“Tarrytown”).

On October 31, 1983, Christiania General Insurance Corporation sold Tarrytown to FGIC Corporation, a Delaware domiciled holding company, at which time Tarrytown’s name was changed to Financial Guaranty Insurance Company. FGIC Corporation, which is owned (99.0174%) percent by FGIC Holdings, Inc. and (0.9826%) percent by The Sumitomo Marine and Fire Insurance Company, Ltd., a Japanese corporation, is ultimately controlled by General Electric Company.

During 1997, FGIC Corporation, the parent, made a capital contribution of \$49.5 million to the Company.

During 1996, 1998 and 1999 the Company paid stockholders dividends of \$17,500,000, \$75,000,000 and \$100,000,000, respectively. Subsequent to the examination period, during 2000 the Company declared and paid dividends to stockholders of \$250,000,000. The dividends were paid in accordance with the New York Insurance Law.

At December 31, 1999, the Company's paid in capital of \$15,000,000 consisted of 10,000 common shares at \$1,500 par value per share. All authorized shares are outstanding. Gross paid in and contributed surplus was \$383,511,360.

A. Management

Pursuant to the Company's charter and by-laws, corporate powers shall be exercised by a board of directors consisting of not less than thirteen and nor more than twenty-one members. As of December 31, 1999, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Joseph L. Campion Bridgewater, NJ	Business Leader, Public Finance, Financial Guaranty Insurance Company
Vernon M. Endo Montclair, NJ	Business Leader, Capital Markets, Financial Guaranty Insurance Company
Rick J. Filippelli Holmdel, NJ	Chief Financial Officer, Financial Guaranty Insurance Company
Chan W. Galbato Severna Park, MD	Chief Executive Officer, Coregis Group, Inc.
Judith B. Herron Croton-on-Hudson, NY	Marketing Leader, Financial Guaranty Insurance Company
Sunita Holzer-Bhatia Rockville Centre, NY	Human Resources Leader, Financial Guaranty Insurance Company
Sharon E. A. Humphreys Brooklyn, NY	Quality Leader, Financial Guaranty Insurance Company
Patrick S. McGuinness Fairfield, CT	Chief Information Officer, Financial Guaranty Insurance Company
James A. Parke Weston, CT	Chief Financial Officer, General Electric Capital Corporation

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Michael A. Shaw Roslyn Heights, NY	Chief Credit Officer, Financial Guaranty Insurance Company
Ann C. Stern New York, NY	Chairman, President and Chief Executive Officer Financial Guaranty Insurance Company
Amedeo E. Turi, III Morris Township, NJ	General Counsel and Secretary, Financial Guaranty Insurance Company
Jeffrey S. Werner Stamford, CT	Treasurer, General Electric Capital Corporation

The board met three times during calendar year 1996 and four times during calendar years 1997 through 1999. A review of the minutes of the board of director's meeting held during the examination period revealed that the meetings were in general well attended and each of the directors had a satisfactory attendance record.

At December 31, 1999, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Ann C. Stern	Chairman, President & Chief Executive
Amedeo E. Turi, III	General Counsel & Secretary
Vernon M. Endo	Business Leader, Capital Markets
Rick J. Filippelli	Chief Financial Officer

The Company's procedure for the disclosure of conflicts of interest by its directors and key employees as of the date of the examination was reviewed. The examiners did not receive copies of conflict of interest questionnaires completed by FGIC's officers, directors and key employees for 1996 and 1998. In addition, conflict of interest questionnaires were not received for the following officers and directors for 1997 and 1999:

	<u>1997</u>	<u>1999</u>
Francisco L. Borges	X	
Chan W. Galbato		X
Patrick McGuinness		X
John V. Ogden	X	
James A. Parke	X	X
Jeffrey S. Werner	X	X

X indicates that the Company did not provide a conflict of interest questionnaire.

It is recommended that the Company ensure that all directors, officers and key employees complete conflict of interest statements on a yearly basis.

#### B. Territory and Plan of Operation

At December 31, 1999, the Company was licensed to transact business in all fifty states, the District of Columbia, the United Kingdom and France.

The following schedule shows direct premiums written in New York State compared to direct business written in the United States for the four years covered by this examination:

<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	<u>Percentage of Premiums Written in New York State</u>
1999	\$37,592,392	\$110,395,989	34%
1998	\$40,446,626	\$111,107,393	36%
1997	\$47,688,448	\$ 95,980,078	50%
1996	\$39,966,203	\$ 96,922,600	41%

As of December 31, 1999, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Kind of Insurance</u>
16 (C,D,E and F)	Fidelity and surety
17 (A)	Credit
25	Financial guaranty

The Company writes only financial guaranty insurance, guaranteeing timely payments of principal and interest payment on municipal securities and non-municipal securities, in particular, structured debt obligations. During 1999, approximately 80.7% of the Company's gross premiums written were for municipal bonds; the remainder was principally for mortgage backed and other asset-based non-municipal bonds.

Based upon the lines of business for which the Company is licensed, and pursuant to the requirements of Articles 13, 41 and 69 of the New York Insurance Law, Financial Guaranty Insurance Company is required to maintain surplus to policyholders of \$66,400,000.

### C. Reinsurance

The Company assumed a relatively minor volume of business compared to its direct writings during 1996 and 1997. During 1998 and 1999, the Company did not assume any business.

Examination review of the Schedule F data as contained in the Company's annual statements filed for the years within the examination period accurately reflected its reinsurance transactions.

Examination review of all major ceded reinsurance agreements in effect as of December 31, 1999. These contracts all contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

At December 31, 1999, the Company's major ceded treaties in effect were as follows:

<u>Type of Treaty</u>	<u>Standard &amp; Poors Category</u>	<u>FGIC Gross Par Inforce</u>	<u>Quota Share Percentage Ceded</u>
1999 Proportional Reinsurance (New issue Municipal bonds only) Covers risks located within the United States only 73% Authorized 27% Unauthorized	1	\$0 to 25,000,000	0.00%
		\$ 25,000,000 to \$100,000,000	5.00%
		\$100,000,000 to \$150,000,000	5.00%
		\$150,000,000 to \$250,000,000	10.00%
		\$250,000,000 to unlimited	35.00%
	2	\$0 to \$25,000,000	0.00%
		\$25,000,000 to \$100,000,000	5.00%
		\$100,000,000 to \$150,000,000	10.00%
		\$150,000,000 to \$250,000,000	15.00%
		\$250,000,000 to unlimited	35.00%
	3	\$0 to \$25,000,000	0.00%
		\$25,000,000 to \$100,000,000	5.00%
		\$100,000,000 to \$150,000,000	15.00%
		\$150,000,000 to \$250,000,000	20.00%
		\$250,000,000 to unlimited	35.00%
	4	\$0 to \$25,000,000	0.00%
		\$25,000,000 to \$100,000,000	5.00%
		\$100,000,000 to \$150,000,000	20.00%
		\$150,000,000 to \$250,000,000	25.00%
		\$250,000,000 to unlimited	35.00%
	5	\$0 to \$25,000,000	0.00%
		\$25,000,000 to \$100,000,000	5.00%
		\$100,000,000 to \$150,000,000	25.00%
		\$150,000,000 to \$250,000,000	35.00%
		\$250,000,000 to unlimited	35.00%

In addition, the Company utilizes a semi-automatic reinsurance agreement wherein capacity constrained risks are ceded individually based on negotiated terms. If a transaction meets rating, price and other related

criteria, the Company can cede municipal bonds located within the United States automatically according to the terms of the reinsurance agreement. Coverage is ceded to 60% authorized and 40% unauthorized reinsurers.

Additionally the Company obtains facultative pro-rata reinsurance for municipal bonds and for mortgage backed and other asset-backed non-municipal bond issues exceeding its aggregate and single risk limitations.

The Company also has two excess of loss reinsurance agreements in force for health care and municipal electric utility exposures. These contracts were entered into in 1996. For health care exposures the Company's retention is equal to the first \$135,000,000 in aggregate losses as well as any losses in excess of \$45,000,000 per hospital. For municipal electric utility exposures, the Company's retention is equal to the first \$419,000,000 in aggregate losses.

During 1997, the Company entered into a facultative reinsurance agreement with its affiliate, Luxembourg European Reinsurance S.A. ("LURECO"). Under the terms of the agreement, LURECO reinsured approximately 37% of the Company's obligations in respect to three financial guaranty policies, with a total exposure of FF800,000,000 (approximately U.S. \$131,500,000), issued through the Company's French branch office. This agreement was approved by the Department.

#### D. Holding Company System

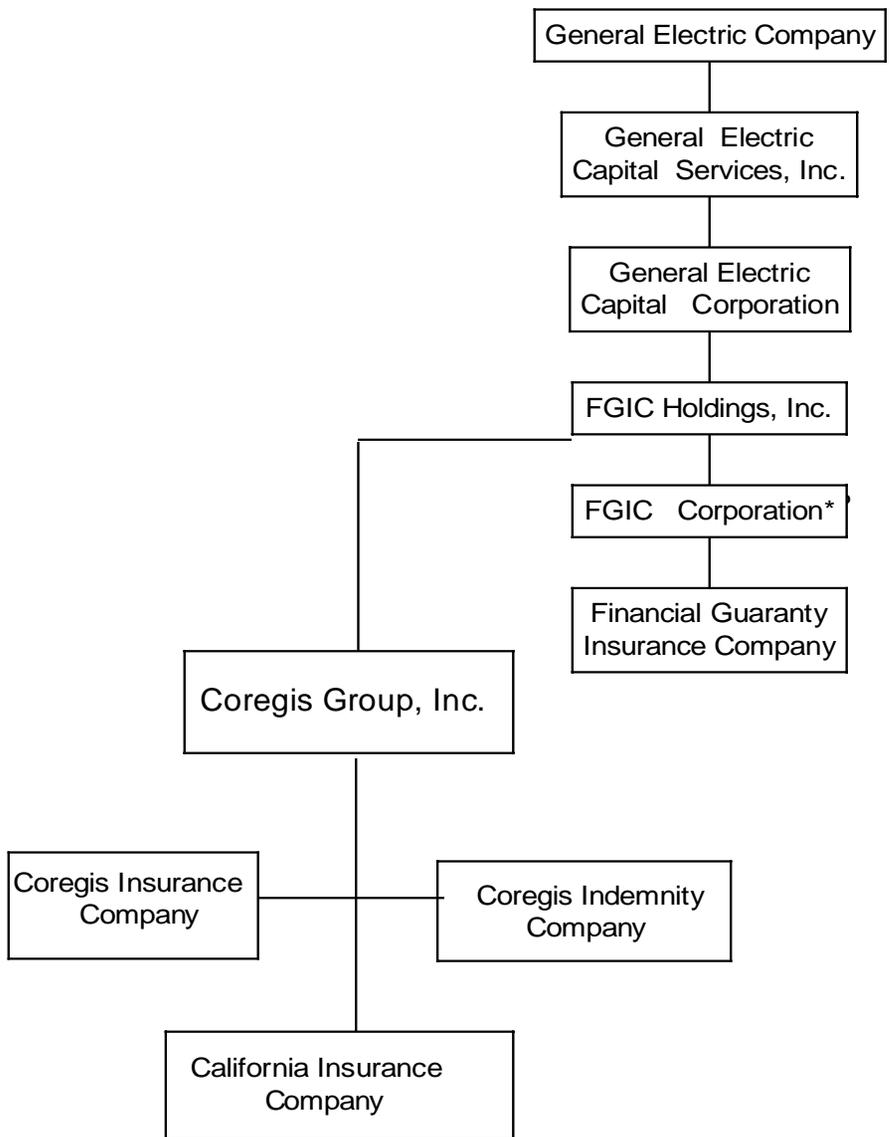
The Company is wholly-owned by FGIC Corporation, a Delaware corporation, which in turn is owned (99.0174%) by FGIC Holdings, Inc. (Delaware) and (0.9826%) by The Sumitomo Marine and Fire Insurance Company, Ltd. (Japan).

FGIC Holdings, Inc. is a wholly-owned subsidiary of General Electric Capital Corporation, which in turn is ultimately controlled by General Electric Company (“GE”). GE is a public company whose shares are listed on the New York Stock Exchange.

Pursuant to Article 15 of the New York Insurance Law, General Electric Company is deemed to be the ultimate holding company of Financial Guaranty Insurance Company.

The Company made annual filings as required by Department Regulation 52.

The following organizational schedule was submitted as part from the Company’s 1999 filed annual statement:



Unless otherwise indicated, all ownership interests are 100%  
 \*FGIC Corporation is 0.9826% owned by Sumitomo Marine & Fire Insurance Company

The NAIC Annual Statement Instructions for Property/Casualty Insurance Companies for Schedule Y – Part 1 – Organization Chart states the following:

“Attach a chart or listing presenting the identities of and interrelationships between the parent, all affiliated insurers and other affiliates, identifying all insurers as such and listing the Federal Employer’s Identification Number for each. The NAIC Company code and two-letter state abbreviation of the state of domicile should be included for all domestic insurers. The relationships of the holding company group to the ultimate controlling person (if such person is outside the reported holding company) should be shown. No non-insurer (excluding the parent company) need be shown if it does not have any activities reported in Schedule Y, Part 2 and its total assets are less than one-half of one percent of the total assets of the largest affiliated insurer.”

Financial Guaranty Insurance Company’s holding company schedule included in its 1999 annual statement was incomplete. The following insurance companies were missing from Financial Guaranty Insurance Company’s 1999 holding company schedule:

Direct Insurance Group

RD Plus S.A.  
 Vie Plus S.A.  
 GE Life, Limited  
 Financial Assurance Company, Limited  
 Financial Insurance Company, Limited  
 Consolidated Marine & General Insurance Company, Limited  
 First Specialty Corporation  
 The Threadneedle Insurance Company, Limited  
 Western Star Insurance Company, Limited  
 Westport Insurance Corporation  
 The Medical Protective Company  
 CORE Insurance Company  
 First Marine Insurance Company  
 HSB Industrial Risk Insurers  
 Elm County Mutual Insurance Company  
 GE Capital Insurance (Australia) Pty., Limited  
 Personal Insurance Limited  
 Housing Loans Insurance Corporation Pty., Limited  
 GE Capital Mortgage Insurance Corporation (Australia) Pty., Limited  
 General Electric Mortgage Insurance Corporation  
 Private Residential Mortgage Insurance Corporation  
 General Electric Mortgage Insurance Corporation of North Carolina  
 GE Residential Mortgage Insurance Corporation of North Carolina  
 General Electric Home Equity Insurance Corporation of North Carolina  
 Verex Assurance, Inc.

GE Mortgage (UK), Limited  
 GE Capital Mortgage Insurance Company (Canada)  
 Maringo Insurance U.S.A., Inc.  
 Viking Insurance Company, Limited  
 Heritage Life Insurance Company  
 Westwood Life Insurance Company  
 GE Capital Casualty Company, Canada  
 GE Capital Canada Extended Services, Inc.  
 Heritage Indemnity Company  
 Westwood Indemnity Company  
 Westlake Insurance Company (Bermuda), Limited  
 GE Edison Life Insurance Company  
 Union Fidelity Life Insurance Company  
 Colonial Penn Insurance Company  
 GE Auto & Home Assurance Company  
 Bayside Casualty Insurance Company  
 Colonial Penn de Mexico Compania de Seguros, S.A. de C.V.  
 Colonial Penn Franklin Insurance Company  
 Colonial Penn Madison Insurance Company  
 General Electric Capital Assurance Company  
 GE Capital Life Assurance Company of NY  
 Federal Home Life Insurance Company  
 Professional Insurance Company  
 First Colony Life Insurance Company  
 American Mayflower Life Insurance Company of NY  
 Jamestown Life Insurance Company  
 GE Life and Annuity Assurance Company  
 Seguros del Centro S.A.  
 Montgomery Ward Insurance Company

#### Reinsurance Group

Consolidated Insurance Espana Compania de Seguros Reaseguros S.A.  
 Consolidated Life Espana Compania de Seguros y Reaseguros de Vida S.A.  
 GE Reinsurance Corporation  
 GE Reinsurance (Bermuda), Limited  
 Employers Reassurance Corporation  
 ERC Life Reinsurance Corporation  
 Luxembourg European Reinsurance S.A.  
 Irish European Reinsurance Company, Limited  
 ERC Frankona Reinsurance Limited  
 ERC Frankona Reinsurance (II) Limited  
 Eagle Star Reinsurance Company, Limited  
 ERC Frankona Reinsurance A/S  
 ERC Frankona Ruckerversicherungs-Altien-Gesellschaft  
 Wurzburger Unfall-Versicherungs Aktiengesellschaft  
 CORE Reinsurance Company, Limited  
 General Electric Capital Reinsurance, Limited  
 FFRL Re Corporation

Subsequent to the examination period, the Company filed its annual statement as of December 31, 2000, which included a complete schedule.

The Company was a party to the following agreements with members of its holding company system during the period under examination:

1. Federal Income Tax Allocation Agreement

The Company entered into a tax allocation agreement, effective September 1, 1990, with FGIC Corporation (“FGIC”). The agreement provides for the Company to file a consolidated income tax return with General Electric Capital Corporation, FGIC, and all other consolidated subsidiaries of FGIC. The agreement complies with the requirements of the Department’s Circular Letter 33 (1979). The agreement was approved by the Department.

2. Sub-lease Agreements

- a. Pursuant to an agreement effective March 1, 1994, the Company sub-leased from Employers Re International (a Danish Corporation) two offices located at 19 Avenue de l’Opera, 75001 Paris. This agreement was in effect through March 1998.
- b. Pursuant to an agreement effective March 27, 1998, the Company sub-leases from Societe ERC Frankona three offices and the right to use meeting rooms. The premises are located at 107, Rue Saint-Lazare, 75009 Paris, France.

- c. Pursuant to an agreement effective March 20, 1995, the Company sub-leased from GE Capital Europe, Ltd. (a United Kingdom Corporation) three offices located at 6-12 Clarges Street, London W1 8DH, England. The contract was in effect through August 1996.
  
- d. Pursuant to an agreement effective August 1996, the Company sub-leased from GE Capital Europe Limited certain offices on the second floor of 20 St. James Street, London SW1A 1ES, England. This contract was in effect through December 1999.
  
- e. Pursuant to an agreement effective December 15, 1999, the Company sub-leased from GE Capital Bank Limited certain offices at 6 Agar Street, London WC2 England.

All of the above sub-lease agreements were found to be non-objectionable by the Department in accordance with the provisions Section 1505(d)(3) of the New York Insurance Law.

- f. Effective March 21, 1997, the Company entered into an agreement whereby it leased 600 rentable square feet (“RSF”) of its current office space to Coregis Insurance Company (“Coregis”), an affiliate. The annual lease payment were \$3,000 per year. The agreement terminated in 1999. This agreement was not filed with the Department as required by Section 1505(d)(3) of the New York Insurance Law, which states the following:

“The following transactions between a domestic controlled insurer and any person in its holding company system may not be entered into unless the insurer has notified the superintendent in writing of its intention to enter into any such transactions at least thirty days prior thereto, or such shorter period as he may permit, and he has not disapproved it within such period:...rendering of services on a regular or systematic basis...”

It is recommended that the Company comply with Section 1505(d)(3) of the New York Insurance Law in all future transactions with members of the holding company system.

- g. The Company entered into an agreement with GE Capital Preferred Asset Corporation (“GE Capital”) whereby the Company leases 392 rentable square feet of the premises it currently leases at 115 Broadway in New York City. This agreement was not filed with the Department as required by Section 1505(d)(3) of the New York Insurance Law.

The Company also rents additional office space to GE Capital without a formal written agreement.

It is recommended that the Company comply with Section 1505(d)(3) of the New York Insurance Law and submit the agreement with GE Capital to the Department.

In addition, it is recommended that the Company formalize its agreement with GE Capital to rent additional space and submit it to the Department pursuant to Section 1505(d)(3) of the New York Insurance Law.

### 3. Cost Sharing Agreements

The Company provides actuarial, legal, loss prevention, data processing, accounting, claims, appraisal, collection services, investment advice and any other services related to insurance operations to certain of its subsidiaries pursuant to several cost sharing agreements effective on various dates as follows:

<u>Affiliate</u>	<u>Effective Date</u>
GE Capital Corporation	February 21, 1992
FGIC Securities Purchase Inc.	February 21, 1992
FGIC Capital Market Services, Inc.	August 2, 1993
FGIC Services Inc.	March 9, 1995
FGIC CMRC Corp.	April 21, 1994
FGIC CMSM Corp.	March 27, 1995
FGIC Government Services	September 1, 1995
Coregis Insurance Company	June 1, 1997

The agreements with FGIC Securities Purchase, Inc., FGIC CMRC Corp., and FGIC CMSM Corp. are not currently active.

The Company also has an agreement with FGIC Government Services, Inc., effective February 13, 1998. Under this agreement, FGIC Government Services, Inc. provides the Company with the above referenced services.

The above cost sharing agreements filed with this Department were found to be non-objectionable.

The filed agreements state the following:

“The charges to be paid by the affiliate for the services provided hereunder will represent the actual costs incurred so that neither party shall receive a profit nor suffer a loss thereby. The charges to be paid shall be allocated pursuant to New York Insurance Department Regulation 30. All charges shall be computed on the basis of the actual time spent in the rendering of services... and will include, but not be limited to, an allocation for a portion of the employee’s salary, fringe benefits, office space employed, telephone charges, use of other apparatus and out of pocket expenses for travel, transportation meals, and entertainment.”

“Adequate and properly documented workpapers shall be maintained by FGIC in sufficient detail to enable each party to verify the charges. The workpapers shall be available for inspection by Affiliate during normal business hours.”

Expenses of the holding company were not allocated pursuant to Regulation 30 as required in the agreements. The agreements filed with the Department require that all charges be computed on the basis of actual time. The Company did not complete the appropriate time studies. Instead, expenses were allocated to and from the Company based on questionnaires completed by the department heads of the affiliates within the Holding Company structure. In order to complete the questionnaire the department heads estimate the percentage of their department's time spent on the difference affiliates within the Holding Company structure. This fails to comply with the provisions of the cost sharing agreements filed with the Department.

It is recommended that the Company comply with the expense allocation requirement and documentation requirements, quoted above, contained in its various cost sharing agreements that were approved by the Department.

#### 4. Space Sharing Agreements

The Company provides office space to certain of its subsidiaries pursuant to several space sharing agreements effective on various dates as follows:

<u>Affiliate</u>	<u>Effective date</u>
FGIC Securities Purchase, Inc.	February 21, 1992
FGIC Capital Market Services	August 3, 1993
FGIC CMRC Corp.	April 21, 1994
FGIC Services, Inc.	March 9, 1995
FGIC CMSM Corp.	March 27, 1995
FGIC Government Services	September 1, 1995

The agreements with FGIC Securities Purchase, Inc., FGIC CMRC Corp., and FGIC CMSM Corp. are not currently active.

Each of the agreements is identical in terms and conditions and each has been submitted to and approved by the Department.

The filed agreements state the following:

“Reimbursements to Financial Guaranty Insurance Company by affiliate shall be made on the basis of an allocation of total leasehold expenses determined by the actual portion of the leasehold used by each party.”

“The charges to be paid by the affiliate for these expenses will represent the actual costs incurred so that neither party shall receive a profit nor suffer a loss thereby. The charges to be paid by affiliate shall be allocated pursuant to New York Insurance Department Regulation 30. All charges shall be computed on the basis of the actual usage and may include, but not be limited to, an allocation for a portion of office space employed, and telephone equipment charges.”

“Adequate and properly documented workpapers shall be maintained by the parties hereto in sufficient detail to enable each party to verify the charges”

The Company did not provide evidence indicating that they allocated expenses in accordance with a documented study of actual usage.

It is recommended that the Company comply with the expense allocation and documentation requirements, quoted above, contained in its various space sharing agreements that were approved by the Department.

##### 5. Liquidity Facility Agreement

Effective February 3, 1993, General Electric Capital Corporation (“GE Capital”) agrees to provide loans to the Company from time to time as needed. The minimum amount of each loan is \$100,000 or any multiple thereof and the maximum aggregate principal outstanding at any time may not exceed \$100,000,000. The Company agrees to pay interest to GE Capital at a floating rate equal to the GE Capital Commercial paper portfolio rate plus 100 basis points. The purpose of the agreement is to

enable the Company to limit the amount of short-term investments in its portfolio. The Company has never utilized this agreement. The agreement was submitted to the Department and was not disapproved.

#### 6. Benefits and Payroll Services Agreement

The Company entered into an agreement, effective June 3, 1998, with GELCO Corporation d/b/a GE Capital Fleet Services (“GECFS”). Under the terms of the agreement GECFS provides payroll processing as well as employee benefit services such as pension 401K administration and W-2 processing. The agreement was not disapproved by the Department.

#### 7. Investment Management Agreements

- a. The Company entered into an investment management agreement, effective July 15, 1991, with its affiliate General Electric Capital Corporation (“GECC”). Under this agreement, GECC has been delegated as one of the managers of the Company’s investments located in the U.S. During the period under examination, GECC managed short-term assets averaging between 0.12% and 0.42% of the Company’s U.S. investments. The agreement was not submitted to the Department pursuant to Section 1505(d)(3) of the New York Insurance Law.

Section 1505(d)(3) states:

“The following transactions between a domestic controlled insurer and any person in its holding company system may not entered into unless the insurer has notified the superintendent in writing of its intention to enter into any such transactions at least thirty days prior thereto, or such shorter period as he may permit, and he has not disapproved it within such period.

...(3) rendering of services on a regular or systematic basis...”

It is recommended that the Company comply with Section 1505(d)(3) of the New York Insurance Law and submit to the Department the investment management agreement entered into with its affiliate GECC.

- b. The Company also has an investment management agreement in place with Financial Group Services Limited (“FIGSL”). This agreement, effective February 7, 1997, provides for FIGSL to manage the company’s investments maintained in the United Kingdom. This agreement was submitted to and found to be non-objectionable by the Department, pursuant to section 1505(d)(3) of the New York Insurance Law.

#### 8. Service Level Agreements

The Company entered into two service level agreements with GE Client Business Services Europe. Under these agreements GE Client Business Services Europe provided accounts payable services to the Company’s branch offices in the United Kingdom and France. These agreements were submitted to and found to be non-objectionable by the Department pursuant to Section 1505(d)(3) of the New York Insurance Law. Subsequent to the examination period, in December 2000, the Company closed its two branch offices and terminated the agreements.

#### E. Abandoned Property Law

Section 1316 of the New York Abandoned Property Law states in part:

“Any amount (except an amount upon which an instrument has been issued which upon its face is non-negotiable by the insured) payable to a resident of this state on or because of a policy of insurance other than life insurance...shall be deemed abandoned property if unclaimed for three years by the person untitled thereto...such abandoned property shall be reported to the comptroller...on or before the first day of April in each succeeding year.”

The Company did not provide documentation evidencing that the abandoned property reports were filed with the Office of the New York State Comptroller. Management indicated that during the period under examination, it had no abandoned property to report. Insurance companies which neither hold nor owe abandoned property are nevertheless required to submit abandoned property reports pursuant to the provisions of the New York Abandoned Property Law.

It is recommended that the Company comply with Section 1316 of the New York Abandoned Property Law and file the requisite abandoned property reports with the office of the New York State Comptroller on a yearly basis.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 1999, based upon the results of this examination:

Net premiums written in 1999 to surplus as regards policyholders	.08 to 1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	53.37%
Premiums in course of collection to surplus as regards policyholders	*

\*The Company does not report any premiums in course of collection. The majority of the premium income is received on policies insuring municipal bonds. Such premiums are paid at the inception of the policy. The premium income on non-municipal bond policies is recorded on a cash basis.

The above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on an earned/incurred basis and encompass the four-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses incurred	\$ 5,438,456	1.27%
Loss adjustment expenses incurred	753,057	.18
Other underwriting expenses incurred	115,933,438	27.17
Net underwriting gain	<u>304,519,937</u>	<u>71.38</u>
 Premiums earned	 <u>\$426,644,889</u>	 <u>100.00%</u>

Note: The amounts included as losses incurred are case reserves only. The Company is required to establish a contingency reserve in lieu of incurred but not reported losses.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 1999. The statement is the same as the balance sheet filed by the Company:

<u>Assets</u>	<u>Ledger Assets</u>	<u>Non-Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$2,479,982,777	\$	\$	\$2,479,982,777
Preferred stocks	3,298,600			3,298,600
Cash and short-term investments	115,699,878			115,699,878
Others invested assets	74,059,166			74,059,166
Receivables for securities	9,627			9,627
Premiums and agents' balances in course of collection	(2,310,314)			(2,310,314)
Reinsurance recoverable on loss and loss adjustment expense payments	43,887			43,887
Electronic data processing equipment	172,444			172,444
Interest, dividends and real estate income due and accrued		38,677,023		38,677,023
Receivable from parent, subsidiaries and affiliates	8,568,894			8,568,894
Furniture, equipment and supplies	794,871		794,871	
Miscellaneous fees receivable:				
Funds held by the United Kingdom	895,530			895,530
Deposits	<u>11,250</u>	<u>                    </u>	<u>11,250</u>	<u>                    </u>
Total assets	<u>\$2,681,226,610</u>	<u>\$38,677,023</u>	<u>\$806,121</u>	<u>\$2,719,097,512</u>

Liabilities

Losses		\$10,791,096
Loss adjustment expenses		1,613,427
Other expenses (excluding taxes, licenses and fees)		13,105,035
Taxes, licenses and fees		3,112,789
Federal and foreign income taxes		50,166,297
Unearned premiums		639,616,241
Provisions for reinsurance		87,479
Net adjustments in assets and liabilities due to foreign exchange rates		(422,682)
Payable for securities		7,893,563
Contingency reserve		<u>721,427,222</u>
 Total liabilities		 <u>\$1,447,390,467</u>
 Common capital stock	\$ 15,000,000	
Gross paid in and contributed surplus	383,511,360	
Unassigned funds	<u>873,195,685</u>	
 Surplus as regards policyholders		 <u>\$1,271,707,045</u>
 Total liabilities and surplus		 <u>\$2,719,097,512</u>

Note: The Internal Revenue Service has not performed any audits of the Company's federal income tax returns through tax year 1989. Effective September 1, 1990, the Company files a consolidated income tax return with General Electric Capital Corporation, FGIC Corporation and all other consolidated subsidiaries of FGIC Corporation. Audits covering tax years 1990 through 1998 are currently in progress. The examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$270,185,551 during the four-year examination period, (January 1, 1996, through December 31, 1999) and is detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$426,644,889
Deductions:		
Losses expenses incurred	\$5,438,456	
Loss adjustment expenses incurred	753,057	
Other underwriting expenses incurred	<u>115,933,438</u>	
Total underwriting deductions		<u>122,124,952</u>
Net underwriting gain		\$304,519,937

Investment Income

Net investment income earned	\$520,754,385	
Net realized capital gains	<u>93,959,747</u>	
Net investment gain		<u>614,714,132</u>
Net income before federal and foreign income taxes		\$919,234,068
Federal and foreign income taxes incurred		<u>175,191,284</u>
Net income		<u>\$744,042,784</u>

Capital and Surplus Account

Surplus as regards policyholders, per report on examination as of December 31, 1995			\$1,001,521,494
	<u>Increases in Surplus</u>	<u>Decreases in Surplus</u>	
Net income	\$744,042,784	\$	
Change in non-admitted assets	4,925,209		
Change in foreign exchange adjustment	2,728,400		
Change in contingency reserve		334,863,528	
Change in provision for reinsurance		87,479	
Paid in surplus	49,500,000		
Tax and loss bonds		3,559,835	
Dividends to stockholders	<u>                    </u>	<u>192,500,000</u>	
Total increases and decreases	<u>\$801,196,393</u>	<u>\$531,010,842</u>	
Net increase to surplus as regards Policyholders			<u>\$270,185,551</u>
Surplus as regards policyholders, per report on examination as of December 31, 1999			<u>\$1,271,707,045</u>

#### **4. LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liabilities of \$10,791,096 and \$1,613,427 for losses and loss adjustment expenses, respectively, is the same as the liabilities reported by the Company in its 1999 filed annual statement. The Company establishes a case basis reserve for the present value of an estimated loss when, in management's opinion, the likelihood of a future loss is probable and determinable at the balance sheet date. Pursuant to Section 6903(b) of the New York Insurance Law, financial guaranty companies are allowed to discount their loss reserves by a rate equal to the average rate of return on the admitted assets of the insurer as of the day of the calculation of such reserves. As of the examination date, the discount to account for time value of money included as a reduction in the Company's loss reserves was \$5,934,000. The Company discounted its loss reserves at a rate of 5%. This rate corresponds to the discount rate permitted by statute.

In addition to case reserves, Financial Guaranty Insurance Company is required to establish and maintain contingency reserve for the protection of insureds and claimants against the effect of excessive losses occurring during adverse economic cycles. The amounts required for these reserves depend on the types of bonds being insured and are established according to Section 6903(a) of the New York Insurance Law. As of December 31, 1999, the Company reported contingency reserves of \$721,427,222.

## **5. MARKET CONDUCT ACTIVITIES**

In the course of this examination, a review was made of the manner in which the Financial Guaranty Insurance Company conducts its business and fulfills its contractual obligations to policyholders and claimants.

The review was directed at practices of the Company in the following areas:

- A. Underwriting
- B. Policy Forms
- C. Complaint log

No problem areas were encountered.

## **6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION**

The prior report on examination contained the following recommendations: (page numbers refer to the prior report)

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. It was recommended that the Company remit its portion of its federal income tax liability on a timely basis pursuant to the Federal Income Tax Allocation Agreement and Department Circular Letter 33 (1979).</p> <p>The Company complied with this recommendation.</p>	13
<p>B. It was recommended that the Company enter into an agreement with its affiliates which includes provision for the allocation of service fees to the companies and the timely payment of outstanding balances, pursuant to the provisions of Section 1505(d)(3) of the New York Insurance Law.</p> <p>On January 1, 1998, the Company entered into a payroll services agreement with an affiliated company to include only employees who devote all or substantial amounts of their time to the Company business.</p> <p>This recommendation no longer applies.</p>	15
<p>C. It was recommended that the Company amend its custodial agreement to include the required protective covenants and provisions.</p>	16

The Company complied with this recommendation.

## **7. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
It is recommended that the Company ensure that all directors, officers and key employees complete conflict of interest statements on a yearly basis.	6
B. <u>Holding Company System</u>	
<u>Sub-lease Agreements</u>	
It is recommended that the Company comply with Section 1505(d)(3) of the New York Insurance Law in all future transactions with members of the holding company system.	15
It is recommended that the Company formalize its sub-lease agreements with GE Capital Preferred Asset Corporation (“GE Capital”) and pursuant to Section 1505(d)(3) of the New York Insurance Law submit them to the Department.	16
<u>Cost Sharing Agreements and Space Sharing Agreements</u>	
It is recommended that the Company comply with the expense allocation and documentation requirements contained in its various cost sharing and space sharing agreements filed with the Department.	18-19
<u>Investment Management Agreement</u>	
It is recommended that the Company submit the investment management agreement entered into with its affiliate GECC, to this Department pursuant to Section 1505(d)(3) of the New York Insurance Law.	21
C. <u>Abandoned Property Law</u>	
It is recommended that the Company comply with Section 1316 of the New York Abandoned Property Law and file on a yearly basis, the required abandoned property reports with the Office of the New York State Comptroller.	22





State of New York  
County of New York

EXAMINER'S AFFIDAVIT AS TO STANDARDS AND PROCEDURES  
USED IN AN EXAMINATION

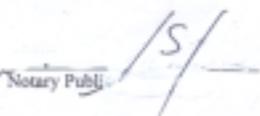
James F. O'Sullivan, BEING DULY SWORN, STATES AS FOLLOWS:

1. I have authority to represent the State of Mississippi in the examination of Financial Guaranty Insurance Company.
2. Mississippi is accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.
3. I have reviewed the examination work papers and examination report and the examination of Financial Guaranty Insurance Company was performed in a manner consistent with the standards and procedures required by the State of Mississippi.

The affiant says nothing further.

  
Examiner's Signature

Subscribed and sworn before me by James F. O'Sullivan on this 27<sup>th</sup> day of August 2001.

  
Notary Public

My commission expires 2/3/02 (date).

CHRISTINE A. MENENDEZ  
Notary Public, State of New York  
No. 01ME4991448  
Qualified in Queens County  
Commission Expires Feb. 3, 2002

Appointment No. 21714

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, GREGORY V. SERIO, First Deputy Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

**Melba Bolic**

*as proper person to examine into the affairs of the*

**FINANCIAL GUARANTY INSURANCE COMPANY**

*and to make a report to me in writing of the condition of the said*

**Company**

*with such other information as she shall deem requisite.*

*In Witness Whereof, I have hereunto subscribed by the name and affixed the official Seal of this Department, at the City of New York,*

*this 4th day of April, 2001*



A handwritten signature in black ink, appearing to read "Gregory V. Serio", written over a horizontal line.

GREGORY V. SERIO  
*First Deputy Superintendent of Insurance*