

REPORT ON EXAMINATION

OF

FINANCIAL GUARANTY INSURANCE COMPANY

AS OF

DECEMBER 31, 2016

DATE OF REPORT

APRIL 17, 2018

EXAMINER

KAREN GARD

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NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

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Andrew M. Cuomo  
Governor

Maria T. Vullo  
Superintendent

April 17, 2018

Honorable Maria T. Vullo  
Superintendent  
New York State Department of Financial Services  
Albany, New York 12257

Madam:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 31639 dated June 2, 2017, attached hereto, I have made an examination into the condition and affairs of Financial Guaranty Insurance Company as of December 31, 2016, and submit the following report thereon.

Wherever the designations “the Company” or “FGIC” appear herein without qualification, they should be understood to indicate Financial Guaranty Insurance Company.

Wherever the term “Department” appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Company’s home office located at 463 Seventh Avenue, New York, New York 10018.

## **1. SCOPE OF EXAMINATION**

The Department has performed an examination of the Company, a multi-state insurer that emerged from rehabilitation on August 19, 2013. The previous examination was conducted as of December 31, 2004. This examination covered the period from August 19, 2013 through December 31, 2016. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify current and prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with New York Laws, statutory accounting principles, annual statement instructions, and adherence to the terms of the First Amended Plan of Rehabilitation for Financial Guaranty Insurance Company, dated June 4, 2013, together with all exhibits and the plan supplement thereto (collectively, the “Rehabilitation Plan”).

This examination report includes, but is not limited to, the following:

- Company history
- Management and control
- Territory and plan of operation
- Holding company description
- Reinsurance
- Loss review and analysis
- Financial statement presentation
- Significant subsequent events
- Summary of recommendations

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

## 2. DESCRIPTION OF COMPANY

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

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

On October 31, 1983, Christiania sold TIC to FGIC Corporation (“FGIC Corp.”), a Delaware holding company, which then changed TIC’s name to Financial Guaranty Insurance Company.

On December 18, 2003, an investor group acquired FGIC Corp. from a subsidiary of General Electric Capital Corporation.

In January 2008, due to the global financial crisis, the Company voluntarily ceased writing new business. On November 20, 2009, the Company filed its quarterly statement for the period ending September 30, 2009, which reported a policyholders’ surplus deficit of approximately \$866 million and an impairment of the required minimum policyholders’ surplus of approximately \$932 million. Due to this filing, on November 24, 2009, the Department issued an order, pursuant to Section 1310 of the New York Insurance Law (“1310 Order”), which required the Company to suspend payment of all claims and prohibited the Company from writing any new business. The 1310 Order also directed the Company to submit a plan to eliminate the impairment of its policyholders’ surplus. Although the Company developed a surplus restoration plan (which was amended and re-submitted to the Department several times during the years 2010 to 2012), the Company was not able to implement the plan and eliminate its policyholders’ surplus deficit.

On August 3, 2010, FGIC Corp. commenced a proceeding under Chapter 11 of the United States Bankruptcy Code (“FGIC Corp. proceeding”). None of FGIC Corp.’s affiliates or subsidiaries, including the Company, was a debtor in the FGIC Corp. proceeding.

On June 28, 2012, by petition of the Superintendent, the Supreme Court of the State of New York (“Rehabilitation Court”) issued an order of rehabilitation (“Rehabilitation Order”) pursuant to Article 74 of

the New York Insurance Law, placing the Company into rehabilitation. The Rehabilitation Order (i) appointed the Superintendent as the rehabilitator of the Company (ii) directed the rehabilitator to take possession of the Company's property and assets, and to conduct the business thereof, and (iii) directed the rehabilitator to take steps towards the removal of the causes and conditions that made the Company's rehabilitation proceeding necessary. The Company consented to the commencement of the rehabilitation proceeding and, upon such commencement, the Company's board of directors resigned.

As part of the rehabilitation proceeding, the rehabilitator developed a rehabilitation plan, which was subsequently amended. The goal of the rehabilitation plan is to treat FGIC's policyholders in a fair and equitable manner while at the same time removing the causes and conditions that made the rehabilitation proceeding necessary.

On June 11, 2013, the Rehabilitation Court issued an order pursuant to Article 74 of the New York Insurance Law which, among other items, (i) approved the Rehabilitation Plan, and authorized its implementation (ii) approved FGIC's amended and restated charter and amended and restated by-laws (which now constitute FGIC's charter and by-laws) (iii) approved an initial cash payment percentage ("CPP") of 17.25%, subject to adjustment by the rehabilitator (by notice dated August 19, 2013, the rehabilitator set the initial CPP at 17%) and (iv) allowed FGIC to resume possession of its property and conduct of its business subject to the terms of the Rehabilitation Plan.

On April 19, 2013 FGIC Corp. emerged from its bankruptcy proceeding. Four months later, on August 19, 2013, the Rehabilitation Plan became effective, whereupon the Company's rehabilitation proceeding terminated, the 1310 Order was lifted, and the Company resumed possession of its property and conduct of its business subject to the terms of the Rehabilitation Plan. The Company emerged from rehabilitation as a solvent insurer under the New York Insurance Law (with Department-specified statutory accounting guidance, discussed below in section F of this report), with its policies restructured in a manner intended to ensure it remains solvent.

#### A. Corporate Governance

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting seven members (except for vacancies temporarily unfilled). The board meets at least annually during each calendar year. At December 31, 2016, the board of directors was comprised of the following seven members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Cono R. Fusco, CPA New York, New York	Independent Director, Various companies
Timothy R. Graham Greenwich, Connecticut	Principal, Brookwall, LLC
Edward J. Grzybowski Marco Island, Florida	Retired
Frederick W. Kanner Summit, New Jersey	Senior Counsel, Covington & Burling LLP
Paula A. Price Wellesley, Massachusetts	Senior Lecturer, Harvard Business School
Jamie B. Stewart, Jr. Brooklyn, New York	Retired
Timothy S. Travers Holmdel, New Jersey	Chief Executive Officer, Financial Guaranty Insurance Company

As of December 31, 2016, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Timothy S. Travers	Chief Executive Officer
A. Edward Turi, III	Executive Vice President and General Counsel
Michael C. Haines*	Senior Vice President, Chief Financial Officer and Treasurer

\* As of March 31, 2018, Mr. Haines is no longer with the Company.

B. Territory and Plan of Operation

As of December 31, 2016, the Company was licensed to write business in ten states, the District of Columbia, and Puerto Rico.

As of the examination date, 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>Line of Business</u>
16(C,D,E,F)	Surety
17(A)	Credit
25	Financial guaranty

Based upon the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13, 41 and 69 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$66,400,000.

During the examination period, the Company did not assume business. The following schedule shows the gross premiums written by the Company for the period under examination:

<u>Calendar Year</u>	<u>Gross Premiums</u>
2013	\$46,568,886
2014	\$16,195,762
2015	\$11,949,999
2016	\$ 9,067,188

The premiums written consist solely of installment premiums related to legacy business.

When the Company was an active writer, it provided credit enhancement through the issuance of financial guaranty insurance policies in public finance, structured and other financial obligations, including credit default swaps. The financial guaranties issued by the Company provide an unconditional and irrevocable guarantee of payment, when due, of principal, interest or other amounts owing on insured obligations.

As noted above, the Company voluntarily ceased writing financial guaranty policies in January 2008. The deterioration in the U.S. housing and mortgage markets and the global credit markets, which began in 2007, adversely affected the Company's business, results of operations and financial condition. Specifically, the Company incurred significant losses related to its exposure to certain residential mortgage-backed securities (primarily backed by first-lien or second-lien mortgages), and significant losses related to certain collateralized debt obligations of asset-backed securities (primarily backed by sub-prime residential mortgage-backed securities). During 2008 to 2009, FGIC's financial strength and credit ratings were downgraded, and subsequently withdrawn. Based on the Company's statutory insolvency and its inability to eliminate its policyholders' surplus deficit, on June 28, 2012, the Company was placed into rehabilitation.

Effective August 19, 2013, the Company is required to conduct its business in compliance with the terms of the Rehabilitation Plan. The following is a brief description of select aspects of the Rehabilitation Plan (a full description can be found *In the Matter of the Rehabilitation of Financial Guaranty Insurance Company*, Index No. 401265/2012):

The Rehabilitation Plan is the exclusive means for resolving and paying (i) all policy claims, whenever arising (ii) all other claims arising during, or relating to, the period prior the August 19, 2013, and (iii) all equity interests in FGIC in existence as of the date of the Rehabilitation Order. The Rehabilitation Plan designated six categories of claims and equity interests: secured claims; administrative expense claims; policy claims; non-policy claims; late-filed claims and equity interests. Claims arising during or relating to the period on and after August 19, 2013 (other than policy claims) are not covered by the Rehabilitation Plan and are resolved and paid by FGIC in the ordinary course of business. The Company is responsible for administering, reviewing, verifying, reconciling, objecting to, compromising or otherwise resolving all claims, including policy claims, not resolved prior to August 19, 2013, in compliance with the Rehabilitation Plan. With respect to any policy claim permitted by the Company, the Company is obligated to pay in cash to the applicable policy payee only an upfront amount equal to the product of the then-existing CPP and the amount of such permitted policy claim. The portion of such permitted policy claim not paid or deemed to be paid by FGIC will comprise a deferred payment obligation (“DPO”). The DPO with respect to any policy generally represents the aggregate amount of all permitted policy claims under such policy minus the aggregate amount paid, or deemed to be paid, in cash by the Company with respect to such policy (other than DPO Accretion, defined below) from and after August 19, 2013, subject to further adjustments as provided in the Rehabilitation Plan. From and after August 19, 2013, each policy with an outstanding DPO accrues an amount (“DPO Accretion”) based on such DPO at a rate of 3% per annum. DPO Accretion is calculated on a simple basis, and is not added to the DPO. In the absence of an upward adjustment of the CPP, the Company is not obligated to pay any portion of the DPO or DPO Accretion.

In January 2014, the Company made its first payment in cash of approximately \$255,500,000 to policyholders for permitted policy claims related to the period from the 1310 Order through August 19, 2013, utilizing the initial CPP of 17%. Per the Rehabilitation Plan, at least annually, the Company is required to re-evaluate (based on run-off data) the CPP to determine whether the CPP should remain the same or be adjusted upward or downward (“CPP revaluation”). All CPP revaluations require review and approval by the Company’s board of directors. Any change in the CPP requires the Department’s approval. During the examination period, the CPP was approved by the Department as follows: 21% (effective October 8, 2014); 22% (effective October 8, 2015); 25% (effective October 24, 2016).

Based on the magnitude of the Company’s accrued and projected policy claims, the Company expects to make payments in cash pursuant to the Rehabilitation Plan of only a fraction of its permitted policy claims and it does not expect to make any payments pursuant to the Rehabilitation Plan with respect to non-policy claims or equity interest.

C. Reinsurance Ceded

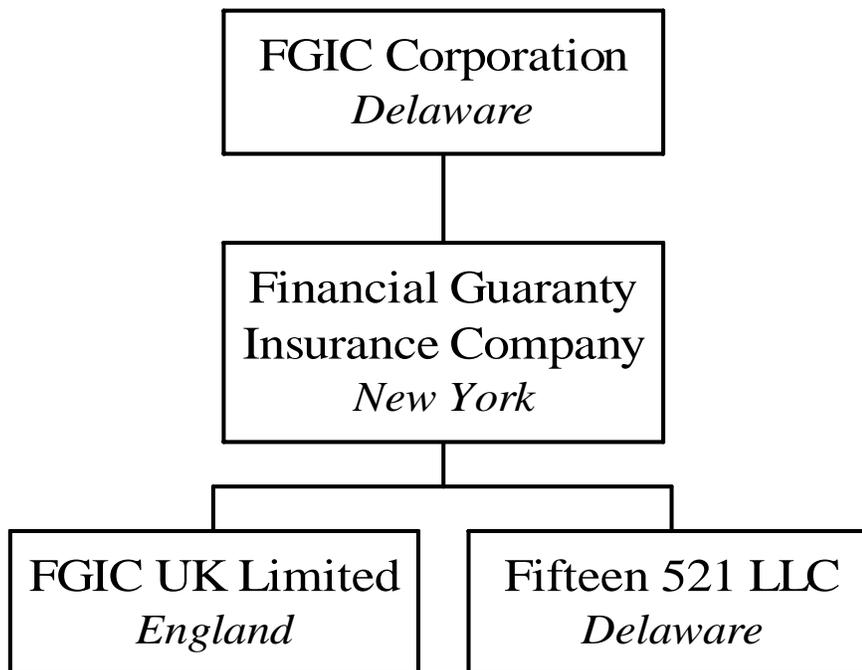
The Company has not written new business since 2008 and has not ceded any business since that time. There are no reinsurance contracts in run-off that have material reinsurance recoverables.

D. Holding Company System

The Company is a New York stock insurance corporation and is wholly owned by FGIC Corp., a privately-held Delaware holding corporation whose only business is to hold the common stock of FGIC. The Company wholly owns FGIC UK Limited, an insurance subsidiary that was engaged in the business of writing financial guarantees in the United Kingdom and the European Union, and is currently in run-off status. The Company also wholly owns Fifteen 521 LLC, a subsidiary that was engaged in the issuance of credit default swaps, and is no longer active.

A review of the Holding Company Registration Statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2016:



### Holding Company Agreements

At December 31, 2016, the Company was party to the following agreements with other members of its holding company system:

#### Amended and Restated Tax Allocation Agreement

The Company is party to a tax allocation agreement, dated April 19, 2013, with FGIC Corp. and its subsidiaries. This agreement was submitted to the Department and was approved on April 17, 2013 as part of the FGIC Corp. proceeding.

#### Amended and Restated Space and Cost Sharing Agreements

The Company is party to a cost sharing agreement dated April 19, 2013, whereby the Company provides to FGIC Corp the following services at cost: office space, operational and administrative services. These services are provided either directly or through the engagement of third parties, related to FGIC Corp's business as an insurance holding company for FGIC. This agreement was approved by the Department on April 17, 2013 as part of the FGIC Corp. proceeding.

The Company is also party to a cost sharing agreement dated June 5, 2007, whereby the Company provides to FGIC UK the following services at cost: actuarial, legal, loss prevention, office space, data processing, accounting, claims, appraisal, collection services, investment advice, technology, personnel, underwriting, risk management, surveillance, business continuity, disaster recovery, and any other service related to the functions involved in the operation of an insurance business. This agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law.

#### E. Significant Ratios

The Company's operating ratios, as computed by the Insurance Regulatory Information System of the National Association of Insurance Commissioners, and underwriting ratios are not relevant because the Company emerged from rehabilitation with Department-specified statutory accounting guidance (discussed further in section F of this report) that was designed to ensure the Company maintains its statutory minimum surplus to policyholders of \$66,400,000.

The Company, as a financial guarantor, is not subject to the reporting requirements of risk based capital.

F. Accounts and Records

The Rehabilitation Plan states that the Department has “the authority to take such further actions as may be necessary or appropriate in its sole and absolute discretion to carry out the purposes and effects” of the Rehabilitation Plan. Accordingly, effective August 19, 2013, the Department issued statutory accounting guidance, summarized as follows:

- at the applicable reporting date, the Company shall record loss reserves in an amount equal to the excess of (i) the amount of the Company’s admitted assets minus the minimum required statutory surplus to policyholders over (ii) the sum of the Company’s statutory reserves excluding loss reserves (e.g., unearned premium reserves, contingency reserves, loss adjustment expense reserves) and other liabilities. The loss reserve amount shall be comprised of:
  - (i) the claims reserve
  - (ii) the DPO for all policies and
  - (iii) the DPO Accretion for all policies,
 minus an adjustment (known as the Policy Revision Adjustment) in an amount that will permit the Company to report a minimum surplus to policyholders of \$66,400,000.
- the Company shall calculate the claims reserve on a policy-by-policy basis for insured obligations as the sum, net of reinsurance, of (x) the total amount of all policy claims submitted to FGIC in accordance with the Rehabilitation Plan that are unpaid as of the reporting date and (y) the net present value of the policy claims that FGIC expects to receive in the future in accordance with the Rehabilitation Plan determined as of such reporting date (using the prescribed statutory discount rate)
- the claims reserve, DPO, DPO Accretion and Policy Revision Adjustment shall be disclosed in the Notes to Financial Statements
- the Company shall estimate a loss adjustment expense reserve based on the ultimate future net cost, determined using internally developed estimates, of the efforts involved in managing and mitigating existing and future policy claims. The loss adjustment expense reserve is not subject to the Policy Revision Adjustment.

Per Note 25 of the filed Annual Statement, the following amounts comprise the loss reserves as of December 31, 2016:

Claims Reserve	\$1,311,571,000
DPO	1,678,310,000
DPO Accretion	<u>128,836,000</u>
Total	\$3,118,717,000
Policy Revision Adjustment	<u>(1,169,008,000)</u>
Loss Reserve	<u>\$1,949,709,000</u>

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2016 as reported by the Company:

#### Assets

	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$2,128,713,001	\$ 0	\$2,128,713,001
Common stocks	164,308,819	0	164,308,819
Cash, cash equivalents and short-term investments	101,105,926	0	101,105,926
Receivables for securities	44,570,611	0	44,570,611
Other invested assets	20,703,144	0	20,703,144
Investment income due and accrued	22,352,955	0	22,352,955
Amounts recoverable from reinsurers	25,782	0	25,782
Current federal and foreign income tax recoverable and interest thereon	2,101,384	0	2,101,384
Furniture and equipment, including health care delivery assets	685,324	685,324	0
Receivable from parent, subsidiaries and affiliates	465,156	0	465,156
Cash surrender value of life insurance policies	1,087,140	0	1,087,140
Premium taxes and state income tax refunds	116,460	0	116,460
Miscellaneous receivables	<u>107,398</u>	<u>0</u>	<u>107,398</u>
Total assets	<u>\$2,486,343,100</u>	<u>\$685,324</u>	<u>\$2,485,657,776</u>

Liabilities, Surplus and Other FundsLiabilities

Losses	\$1,949,709,123
Loss adjustment expenses	24,080,821
Other expenses (excluding taxes, licenses and fees)	23,372,518
Current federal and foreign income taxes	8,959
Unearned premiums	47,876,374
Payable for securities	55,857,016
Contingency reserves	318,256,562
Other liabilities	<u>96,403</u>
 Total liabilities	 \$2,419,257,776

Surplus and other funds

Common capital stock	\$ 15,000,000
Preferred capital stock	300,000,000
Unassigned funds (surplus)	<u>(248,600,000)</u>
 Surplus as regards policyholders	 <u>66,400,000</u>
 Total liabilities, surplus and other funds	 \$ <u>2,485,657,776</u>

Note: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 2013. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2014 through 2016. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

Due to the fact that the Company stopped writing business in 2008, and operates pursuant to the terms of the Rehabilitation Plan, this section is not relevant.

C. Capital and Surplus Account

Due to the fact that the Company stopped writing business in 2008, and operates pursuant to the terms of the Rehabilitation Plan, this section is not relevant.

#### 4. LOSSES AND LOSS ADJUSTMENT EXPENSES

Please see section 2.F for how the loss and loss adjustment expenses are calculated as a result of rehabilitation. As of December 31, 2016, the reported loss reserve and loss adjustment expenses totaled \$1,949,709,000. The original claims reserve used in this calculation was \$1,311,571,000, which was determined to be adequate.

Because of the rehabilitation, the calculation of the CPP is of the most concern to the Department. The CPP was increased to 25% in 2016, a level which allows the retention of sufficient claims paying assets to be used in a more severe loss scenario than that used to calculate claims reserves. The Department found the calculation to be appropriate.

The Department utilized the assistance of an independent financial advisory firm that specializes in complex assets to review the adequacy of the Company's modeling, assumptions, and surveillance policies and procedures as of December 31, 2016, and to determine the Company's reasonableness of the CPP level. The firm reviewed all the obligors insured by the Company that were still extant in 2017, for both structured products (87 distinct obligors with gross par outstanding of \$3.692 billion) and public finance (64 obligors with gross par outstanding of \$4.334 billion), to determine projected losses under a base case (to determine the reasonableness of the claims reserves before adjustments), a stress case, and an extreme stress case (both of which were used to measure an appropriate CPP as compared to that used by the Company). It also projected the value of claims paying assets through the lifetime of the insured obligations under extreme market conditions. It was determined that the claims reserves were adequate and that the CPP was appropriate.

The most significant liability is the Company's exposure to the debt of Puerto Rico and its related authorities and public corporations. In the CPP, both FGIC and the firm assumed that in adverse conditions there is a 100% severity of loss. Under all scenarios, there are sufficient claims paying resources to pay claims related to Puerto Rico.

The Company's estimate of CPP and claims reserves are based on certain assumptions. Changes in such assumptions could materially adversely affect such CPP and claims estimates, including, as a result of more adverse macroeconomic conditions, the bankruptcies of issuers of insured bonds or swap counterparties, and the amount and timing of any claims. Under certain conditions, many of which are event-driven and outside the control of the Company, these exposures may result in significant increases in claims beyond those assumed in the Company's stress scenario (which may or may not result in a decrease

in the CPP and an increase in claims). In addition, the value of the Company's investment portfolio could change and have a materially adverse effect.

## **5. SUBSEQUENT EVENTS**

On November 22, 2017, the Department approved an upward adjustment of the CPP from 25% to 33%, effective December 4, 2017.

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

The prior report on examination was dated November 10, 2005 for the five-year period ending December 31, 2004. Due to the fact that the Company stopped writing business in 2008, and operates pursuant to the terms of the Rehabilitation Plan, this section is not relevant.

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

This report does not contain any comments or recommendations.

Respectfully submitted,

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Karen Gard, CFE  
Associate Insurance Examiner

STATE OF NEW YORK     )  
  )ss:  
COUNTY OF NEW YORK    )

Karen Gard, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

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Karen Gard

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 2018.

***APPOINTMENT NO. 31639***

***NEW YORK STATE***

***DEPARTMENT OF FINANCIAL SERVICES***

*I, Maria T. Vullo, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:*

***Karen Gard***

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

***Financial Guaranty Insurance Company***

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

***COMPANY***

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

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

*this 2nd day of June, 2017*

***MARIA T. VULLO***  
*Superintendent of Financial Services*



By:

*Joan P. Riddell*

*Joan Riddell  
Deputy Bureau Chief*