



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

**David A. Paterson
Governor**

**Eric R. Dinallo
Superintendent**

Circular Letter No. 12 (2008)

May 9, 2008

TO: All Financial Guaranty Insurers

RE: Cancellation of Municipal Bond Insurance Policies

STATUTORY REFERENCE: New York Insurance Law Article 69

It has come to the Insurance Department's attention that, due to recent downgrades or potential downgrades in the credit ratings of financial guaranty insurers (FGIs), some issuers of municipal bonds^[1] are seeking to cancel or terminate in-force bond insurance policies with the consent of all bondholders (or their duly authorized representatives). The issuers' requests may be based, in part, upon the concern that liquidity facilities^[2] for municipal auction-rate bonds contain events of termination that may be triggered by a downgrade in the credit rating of the bonds' FGI, regardless of the issuer's credit rating. The loss of a liquidity facility caused by an FGI's credit rating downgrade could create separate, and possibly more severe, consequences for an issuer than the loss of the bond insurance itself. Specifically, the loss of a liquidity facility could depress the market for insured auction-rate municipal bonds, thereby making it likely that interest rate setting auctions will fail, which in turn could force municipalities to pay higher interest rates than they would otherwise pay if the bonds were unaffected by instability in the insurers' credit ratings.

Under Section 6905(a) of the Insurance Law, policy forms are "use and file," meaning that an insurer must file the policy forms with the Insurance Department within 30 days of the forms' use. Some municipal bond insurance policies contain "non-cancellation" provisions. For example, some policies provide that "[t]his Policy is non-cancellable for any reason" or that "this Policy may not be cancelled or revoked." These provisions protect bondholders by ensuring municipal bond insurance will remain available throughout the term of the bond to pay the principal and interest due on the bonds if the municipality fails to do so.

Some FGIs recently have refused or been reluctant to cancel or terminate policies with "non-cancellation" provisions either on the belief that cancellation or termination might violate the New York Insurance Law or simply because the insurance policies state that they are non-cancellable. In each of those situations that has come to the Insurance Department's attention, the issuers have not sought repayment of any unearned premium.

The purpose of this Circular Letter is to advise FGIs and the purchasers of FGI policies that, in view of the recent downgrades and potential downgrades in the ratings of FGIs, and notwithstanding any "non-cancellation" provisions of a bond insurance policy, the Insurance Department will not object to the

cancellation or termination of such policies on the basis that cancellation involves a deviation from the filed policy form in violation of the Insurance Law, provided that the municipality, FGI and bondholders (or their duly authorized representatives) all consent to the cancellation or termination.

In the event that a municipality seeks to cancel or terminate its bond insurance policy and the insurer and bondholders (or their duly authorized representatives) agree to do so, the Insurance Department suggests that the insurer work with the issuer and bondholders to ensure that cancellation or termination is not completed precipitously and is accomplished in a manner that provides the parties with the opportunity to evaluate the merits of the proposed cancellation or termination. Moreover, the Insurance Department expects that each FGI will apply a single set of non-discriminatory criteria in determining whether to consent to cancellation or termination of policies. Any modification of existing policy forms must be filed with the Insurance Department, pursuant to Section 6905 of the Insurance Law.

Nothing in this Circular Letter should be construed as the Insurance Department advocating or requiring the cancellation or termination of bond insurance policies, obligating bond insurers to cancel or terminate such policies, or reforming or impairing the performance of any existing agreement.

Very truly yours,

Robert H. Easton
Deputy Superintendent & General Counsel

[1] "Municipal bond" is defined in Insurance Law § 6901(o) as municipal obligation bonds and special revenue bonds (terms that are further defined elsewhere in Insurance Law § 6901).

[2] In this context, a liquidity facility is an agreement by which a third-party agrees to repurchase outstanding bonds that have been tendered to the municipality and the municipality has been unable to locate a buyer for such bonds.