

Michael A. Molony

Direct Dial: (843) 724-6631
Direct Fax: (843) 579-1356
E-mail: mmolony@ycrlaw.com

February 26, 2010

The Editor

New York Times

RE: "Financial Perversions Sold During Credit Boom" by Floyd Norris

Gentlemen:

The February 12th article written by Floyd Norris caught my attention since I have been involved in a number of transactions involving the formation of captives for XXX Reserve Relief. Unfortunately, the reason it caught my attention was the number of serious inaccuracies and misconceptions Mr. Norris has about the securitizations involving XXX reserve requirements.

First of all, each of the initial bullet points are inaccurate for several reasons:

1. The assumption that insurance regulators were requiring life insurers to retain too much capital is wrong. The regulators were requiring so-called "excess reserves", to be held against certain types of insurance underwritten by insurance companies in the US. (Excess reserves are reserves held in addition to the "economic reserves" used to fund expected mortality on a specific block of term life business). The writer apparently does not understand that fundamental insurance regulatory requirements set minimum capital requirements to establish any insurance company, particularly the captive underlying the transaction. In the case of the companies in the XXX securitizations, not only were their capital and surplus requirements set by the more than one State insurance regulator, but also this capital was in addition to corresponding amounts of "economic reserves" and "excess reserves".
2. Investors in these XXX securities were required to be "Regulation 144A Investors" who, ostensibly, are sophisticated and experienced in the capital markets. Further, the method for calculating "excess reserves" was mandated by a regulation (Regulation XXX) promulgated by the National Association of

Insurance Commissioners (“NAIC”) and not the insurance companies themselves;

3. The reference to risk-free cash equivalents pertains to the Dutch Auction Market Securities which are, in my experience, are a small percentage of the total amount of securitizations in the programs that I have been involved with in my law practice;
4. The offering prospectuses may be complex in the eye of the reporter but certainly not to those investors who, again are required to meet certain minimum standards before investing in these securities. They were not offered to unsophisticated retail investors.
5. The monolines were brought in to help asses risk and provide protection to investors, which they have done by agreeing to pay out coupons on notes that have missed their payment. In one sense this worked, and investors and the banks benefitted by having their issuers pay for the “Wrap”. The mere fact, however, that a XXX security was insured did not persuade people that there was “nothing to worry about”; in fact, the existence of bond insurers appeared to have made investors complacent in terms of analyzing the underlying assets backing these securities. Lack of due diligence on the part of investors is no reason to vilify an entire segment of a viable market.

Having addressed the points he raised, seriatim, several other points need to be made regarding the XXX securitizations.

First of all, putting aside that the majority of the article addresses auction rate securities, there is a significant difference in the XXX securitizations that need to be brought to the attention of the writer.

Specifically, unlike mortgages and many other asset-backed securities, XXX securitizations involve mortality, which in its purest form is a risk de-linked from the economy. The underlying insurance transaction is heavily regulated, not only by NAIC Regulation XXX but by the various state regulators themselves. Every transaction with which I have been involved was preceded by months of detailed analysis. Further, there is thorough ongoing regulation to ensure the proper performance of the insurance entities involved. The securitizations also require extensive annual reporting to regulators. Most of these items were lacking in the traditional ABS space.

In addition to this XXX regulation, there are ongoing surveillance reviews by rating agencies as well as careful monitoring by the regulators and companies themselves. There is an annual actuarial analysis to ensure that the underlying block of insurance policies is performing as expected. In fact, in virtually every XXX transaction I have been associated with, the liability projections (expected mortality, lapses, etc.) have been accurate based on the projections provided to the regulator and investors. In some cases, these projections are now approaching 9 years and, with each passing year, experience shows them to be even more precise.

Second, the issue with XXX securities, like many other structured asset backed securities, has been deteriorating value on the asset side. This is not unique to the life insurance world. Unlike mortgage securitizations though, XXX securitizations require a very tightly regulated trust instrument which holds the XXX reserves assets. There are also investment guidelines regulating the assets in these trusts. No one could have predicted the absolute meltdown of the value of investments, including those held in the various regulatory trusts. This is particularly true of the one company referenced in the article.

Finally, the writer ends the article writing about the financial guarantors. What the writer fails to observe is that in any of these transactions, there are two sides to the equation: the regulatory side and the capital markets side. To my knowledge to date, there have been no XXX securitization failures as a result of lax or inadequate insurance regulation; in fact, it is my belief that the existence of this regulation of XXX transactions will afford them a unique place in the asset backed securitization market which, inevitably, will come back in some form. The XXX securitization market is the economic engine that provides capital to finance term life insurance products, making them safe, affordable and a sound part of a consumer's financial plan. Misinformation disseminated in articles such as this do nothing but impede the recovery process of this effective and vital source of funding.

With kind regards, I am

Sincerely,

Michael A. Molony
28 Broad Street
Charleston, SC 29401
(843) 724-6631

MAM/cs