CEJ Letter to State Insurance Commissioners

Proposal for Alternative Rating of Residential Mortgage Backed Securities

November 5, 2009

Dear Commissioners,

The Center for Economic Justice urges you NOT to adopt the proposal for alternative ratings for residential mortgage-backed securities (RMBS) for the following reasons.

1. **The proposal cherry-picks only one class of asset-backed securities for alternative treatment – treatment which just happens to provide billions in capital relief to insurers.** There are other types of asset-backed securities – securities backed by auto loans, credit card loans and commercial mortgages – which are not addressed. The questionable ratings of municipal bonds are not addressed. It is dangerous to change the ratings approach for one class of investments – reducing capital requirements – while ignoring other classes of investments for which a change in methodology may increase capital requirements. Simply stated, the proposal picks one class of securities – at the urging of industry – for capital relief while ignoring other types of securities which, utilizing the same alternative methodology, may require more capital. The end result will be less capital protecting consumers than under current rules.
2. **The proposal is being rushed through the NAIC without necessary transparency.** Even today, the actual proposal is not posted on the NAIC web site. Rather, there is a one-page letter from Commissioner Gross, which does not describe the details of a complex proposal. And one of the e-mails announcing the meeting referred to "an industry study" which has not been provided to the public. Surely, the NAIC should not be adopting a major change in solvency regulation without public notice and public disclosure of the actual proposal and any studies supporting the proposal. We greatly appreciate the efforts of Commissioner Gross and Commissioner Wrynn and their staffs on solvency regulation, but the action on this proposal reveals the NAIC's glaring lack of public accountability procedures.
3. **There is no reason for the NAIC to rush to adopt this proposal instead of developing a comprehensive strategy to eliminate regulatory reliance on credit rating agency ratings.** The only reason offered by regulators in support of this proposal is that "it will allow more accurate assessment of the risk of RMBSs." But, that argument is completely compromised by the fact that the new approach is being applied to only one class of securities and leaves the existing, flawed system in place for all other securities – many of which are rated by the credit rating agencies in the same manner as RMBS. Industry estimates that under current rules, they will require an additional $9 billion in risk-based capital because of RBMS downgrades by the credit rating

agency. Industry also states that under the alternative proposal they will hold more risk-based capital at the end of 2009 than at the end of 2008, but less than under current rules. Asking industry to hold a few billion more in capital – compared to a base of over $300 billion – is not a crisis requiring the rushed action before the NAIC today.

4. **RMBS securities are very risky investments and reducing capital requirements related to these investments puts consumers at greater risk.** There has not been improvement in the experience of home mortgages. Rather, mortgage delinquencies and defaults and foreclosures are at record highs. According to the California Attorney General, one million Pay Option Adjustable Rate Mortgages will be reset in the next four years, resulting in massive payment shock and dramatically worsening the foreclosure crisis. With unemployment at the highest levels in 70 years, wages and hours being cut for those with jobs and rising medical costs, the pressure on consumers holding mortgages will increase. It makes no sense to reduce capital requirements related to risk RMBS at this time.
5. **The NAIC needs to shift its focus from providing relief for insurers to providing relief for consumers.** The NAIC has expended incredible efforts and resources since August of 2008 to provide all manners of capital and reserve relief to insurers – all the while telling Congress how financially strong insurance companies have been through the financial crisis. At the same time, the NAIC has done nothing to help consumers who are the victims of the financial crisis and recession. The NAIC should stop its giveaways to insurers and start helping consumers by reining in credit scoring and other abusive risk classifications. If the NAIC had put the same time and effort into helping consumers as it has into helping insurers with relief from the financial crisis and recession, a moratorium on insurance credit scoring and other abusive practices would have been in place a year ago.

CEJ urges regulators to develop a coherent and comprehensive strategy to replace regulatory reliance on credit rating agencies for solvency regulation instead of adopting a piece-meal, ad hoc approach represented by the proposal before you today.

Thanks for your consideration and your efforts on behalf of consumers.

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