January 14, 2013

Secretariat of the Financial Stability Board

c/o Bank for International Settlements

CH-4002

Basel

Switzerland

Re: Strengthening Oversight and Regulation of Shadow Banking

Ladies and Gentlemen:

This letter is written on behalf of three subsidiaries of MBIA Inc. ("MBIA"), all of which are licensed and regulated monoline financial guarantee insurance companies and fall within the definition of Economic Function iv of the shadow banking function as *Credit Insurance Providers / Financial Guarantors.*

The three entities in question, the scope of their activities and the regulator with primary responsibility in each case are set forth in the table below:

Name of Insurer	**Activity**	**Geographic Focus**	**Current Status**	**Primary Regulatory Responsibility**
National Public Finance Guarantee Corporation*	*Provision of financial guarantees in relation to US Public Finance*	*United States*	*Not actively writing new business*	*New York State Department of Financial Services*

Name of Insurer	Activity	Geographic Focus	Current Status	Primary Regulatory Responsibility
MBIA Insurance Corporation*	*Provision of financial guarantees in respect of Structured Finance and select non US Public Finance*	*Primarily United States but with scope to provide financial guarantee insurance in other jurisdictions*	*Very limited new business activity*	*New York State Department of Financial Services*
MBIA UK Insurance Ltd*	*Provision of financial guarantees in relation to structured finance and public finance with a primary focus on the European Union*	*Primarily the EU with some US structured finance and Asian public and structured finance exposure*	*No new business activity during the past 4 years*	*Financial Services Authority*

**National Public Finance Guarantee Corporation and MBIA Insurance Corporation are wholly owned subsidiaries of MBIA Inc. which is listed on the New York Stock Exchange. MBIA UK Insurance Ltd is a wholly owned subsidiary of MBIA Insurance Corporation.*

We have taken the opportunity to address the questions posed in the Consultative Document and respectfully request that the FSB considers our opinions and views as discussed herein.

Executive Summary:

In its Consultation Document, the FSB poses five questions. We have sought to address all five. However, in the case of questions 3, 4 and 5, we have restricted our comments exclusively to their relevance to Function iv (under which the three entities referred to above have been categorised).

a) **Do you agree that the high-level policy framework effectively addresses shadow banking risks posed by non-bank financial entities other than MMFs? Does the framework address the risk of regulatory arbitrage?**

We believe that the Consultative Document defines and addresses the risks posed by shadow banking in a sensible manner. However its success can only be assessed post implementation.

The high-level policy framework goes some way to addressing regulatory arbitrage; however given fundamental differences in regulation across regions and countries and the scope for local derogations, we believe it is unlikely that this framework presents a complete panacea.

Nonetheless greater information sharing and co-ordination amongst regulators globally should help to ameliorate this risk.

In terms of MBIA's financial guaranty activities we wish to emphasise:

- All three entities referenced in the above table already fall within the regulatory perimeter. Thus, as set out in footnote 18 of the Policy Framework, they should be supervised like other insurance companies and separate tools are not required. Additionally, we consider over-arching and duplicative regulation which creates additional and unnecessary burdens on the industry and/or requirements that exceed those of other regulated entities such as banks who are competing in the same markets as being inappropriate.
- As we will discuss more specifically under questions 3 and 4 (and as acknowledged by the FSB) the policy framework should take into account the degree of existing regulatory oversight. In the case of MBIA's relevant entities this is comprehensive. In particular a number of the tools identified for this activity already exist, are contemplated by pending changes to regulation (e.g., Solvency II in Europe) and/or are within the scope of the regulator's existing powers.
- The FSB also notes that the level of oversight should be proportionate to the risks posed by the activity in question. In the case of the financial guarantee industry, the FSB (as with other activities) appears to focus almost exclusively on the risks that arose during the financial crisis. We submit that the financial guarantee industry and, more specifically, the relevant MBIA entities have gone through a major overhaul of the business strategy and risk framework under which they operate and many of the changes (which are our regulators are conversant with) have resulted in a substantial reduction in the risks posed by this activity. Moreover, MBIA has continued to pay all claims when due since the onset of the financial crisis and has received no government support.

b) Do the five economic functions capture all non-bank financial activities that may pose shadow banking risks in the non-bank financial space?

Whilst the five identified economic functions provide a broad framework we highlight that this has been done on basis of a "look back" approach to the financial crisis.

We contend that the markets will continue to innovate, that pro-cyclical risk drivers will change over time and that many of the entities undertaking the shadow banking activities which the FSB seeks to monitor / bring within the regulatory perimeter have already modified their business models and behaviours to reflect the risks that arose during the financial crisis..

Hence a static, backward looking and highly prescriptive approach runs the risk of becoming redundant over time. To this end, as discussed under (a) above, ongoing global regulatory dialogue and co-ordination that is targeted towards emerging trends and innovations, and their attendant risks to financial and economic stability, is critical.

c) Are the suggested information items appropriate in capturing the shadow banking risk factors? Are there any additional items authorities should consider?

The information requests, as they relate to financial guarantors, try to fit insurance business asset and liability measures into a bank reporting framework and are therefore inappropriate and relatively high level.

Our existing primary regulators for all three companies have the power to request the information items (and in many cases the information we already provide to them is far more detailed than that contained in the annex).

Looking at the four information items highlighted as most relevant to financial guarantors, we observe that the information requirement definitions are either not specific or detailed enough, which can lead to inconsistent reporting and make comparative analysis challenging from an oversight perspective. Specifically we observe the following:

- Outstanding amount of insurance/guarantees written (the first two items): our existing reporting framework already reports outstanding amount of insurance/guarantees written by a number of parameters including risk type, geography etc.;
- The distinction between "underlying asset class" and "underlying risk" is unclear and requires further definition for consistency and comparative purposes;
- Risk weighted assets (third and fourth items) - this is not a recognised concept for insurance companies' reporting; and
- For the four items noted they are "(compared to capital)". There are differing measures of capital depending on reporting framework, jurisdiction and stakeholder e.g. capital can be defined in terms of GAAP, regulatory, Solvency II, and rating agency requirements. It is unclear what measure of capital would be most appropriate.

We note that Solvency II has developed a quarterly reporting framework for insurance companies, including financial guarantors, that provides a basis for identifying trends, better enabling regulators to hone in on risks they become concerned about. If the FSB wished to impose standardised reporting on financial guarantors and credit insurance providers, we would recommend that the FSB reviews the proposed Solvency II quarterly reporting framework and employs those metrics it deems appropriate for capturing risk factors related to the financial guaranty industry.

For completeness, we observe that in the annex:

- Frequency of reporting is not defined; and
- It is unclear whether the information needs to be certified by the company's auditors.

d) Do you agree with the policy toolkit for each economic function to mitigate systemic risks associated with that function?

The Consultative Document identifies five tools as part of the policy toolkit for the management of the shadow banking risks arising from the identified economic function of facilitation of credit creation. We note that, in the case of MBIA UK Insurance Ltd, Tools 1 to 4 are largely addressed in the pending Solvency II Directive.

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Tool 1:

We endorse the view articulated in the Consultative Document that it is crucial for entities that facilitate credit creation through providing financial guarantees and credit insurance to maintain an "appropriate level of capital… …so they can absorb losses that may result from these activities". [1]

We believe that existing and contemplated regulatory capital requirements are already designed and calibrated to ensure sufficient capitalisation with regard to the topics identified under this Tool.

Tool 2:

The pricing and management of risks is, in our opinion, a core component of any business, not least that of a financial guarantor.

Existing regulation already gives our primary regulators the power to impose restrictions on the scale and scope of our business activities. Furthermore our activities are defined under license permissions and any changes in business outside of the scope of our defined activities would require explicit regulatory approval.

The proposal for a regulator to be required to approve a financial guarantor's entry into any new asset class or market sector which is within the scope of the insurer's existing permissions appears overly prescriptive. We are skeptical that regulators have the capacity or desire to assume the responsibilities of the Board and executive management in a overseeing a company's business activities. We are not aware of an equivalent provision in banking regulation where new business activities are within the scope of existing permissions.

Our regulators already assess a financial guarantor's risk management framework, the competency of its management and the internal control environment employed to facilitate decisions pertaining to new lines of business. The assessment should satisfy itself that the institution in question has the competency to engage in its target business and regulated activities. We believe the scope of existing regulation is effective in this regard.

In order to form a definitive view on the proposal in this Tool it is important for the FSB to add greater definition to what it contemplates by a "new asset class" or "market sector".

Implementing appropriate limits as defined by regulators for various types of covered risks (including by market sector) is unduly prescriptive and we doubt they presently have the resources or technical knowledge to engage in this form of regulation. We believe that it is the responsibility of an institution engaged in such financial guarantee activity to establish its own risk appetite and tolerance and, in doing so, set appropriate limits. A key element of the existing regulatory oversight includes an assessment of the institution's framework for establishing and managing risk appetite and tolerance, which we feel is appropriate.

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[1] Consultative Document: Strengthening Oversight and Regulation of Shadow Banking (18 November, 2012): Section 3.2.4

Tool 3:

We emphasise that our entities have not utilised short term funding instruments as a source of liquidity for meeting claims payments.

Management of liquidity risk is a core component of any insurance company's risk management framework. Those regulators supervising the Groups financial guarantee businesses perform a robust assessment of the adequacy of liquidity through the business cycle.

Tool 4:

We support the FSB's recommendations with regard to both periodic loss modeling and stress testing. MBIA's insurance companies presently undertake such scenario analysis in accordance with on-going risk management and planning.

Tool 5:

It is unclear how this is meant to work, as the term "insured" could refer to the issuer of the guaranteed bond or the purchaser of a guaranteed bond (an investor). We comment on both perspectives:

<u>Issuer (or Borrower) of guaranteed debt as the "insured"</u>

If the term "insured" is meant to address the issuer (or the borrower) of a debt instrument, we note that for securitisations, we support an issuing (or asset originating) entity retaining risk; this is consistent with prevailing regulatory convention in the key markets within which we operate. It is also consistent with our own revised risk framework and underwriting criteria that were developed in the aftermath of the financial crisis.

The core of our financial guarantee business is the provision of insurance on debt issued by governmental and quasi-governmental entities such as municipalities. We do not believe that mandatory risk sharing in the form discussed (i.e. through partial risk participation in unguaranteed form by the issuer) is either appropriate or, in certain cases, legal for some of the transactions we insure. Furthermore, many of the issuing entities will not be permitted to invest in their own risk.

The financial guarantee industry also insures debt issued by privately owned entities or projects which have a significant public purpose or high levels of essentiality. Examples include investor-owned utilities, privately owned airports and ports, privately owned higher education facilities, and privately owned hospitals. In these examples the private sector as owners puts capital at risk into these entities via the subscription to equity; this is analogous to risk alignment.

We emphasise that many of these borrowers also raise debt from banks and also directly from institutional investors without the benefit of financial guaranty insurance – in these cases the borrower is not required to take a risk position in the specific debt issued.

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Investor in guaranteed debt as the "insured"

An investor (or lender) makes an investment decision based on the strength of the primary risk that it is taking on the underlying credit, whilst also giving due consideration to the strength of the secondary support received under the financial guarantee policy. We believe that an insured party is already

motivated to perform an analysis of the underlying risks prior to investing and whilst holding the investment; and that interests are sufficiently aligned between parties.

A tenet of the contemplated tool is that there should be appropriate information sharing between the insurer and the insured to ensure that the underlying risk is both understood and that informed investment decisions are made by the insured. We emphasise that:

- It is the issuer of a guaranteed security, or the borrower on a loan, that has the responsibility to provide investors (of insured and uninsured bonds) with necessary disclosures such that informed investment decisions can be made.
- The indenture, or other relevant agreement, will stipulate the reporting available on the debt that is guaranteed.
- The financial guarantor is not responsible for providing information on the underlying risk it has insured to investors, or other holders of the guaranteed risk. It does however provide on-going reporting on its own financial position via its regular reporting (this information is typically available through a website and / or regulatory / statutory filings).

We therefore recommend that Tool 5 focus on requiring the investor to ensure that it has access to the necessary information from the issuer (or borrower) and the financial guarantor both when making its investment decision and subsequently whilst holding such a guaranteed debt investment.

Finally, we note that, when credit enhancement takes the form of a letter of credit provided by a bank, there is no requirement that the investor also take a portion of the risk without such enhancement. Consistent and appropriate rules and regulations for banks and shadow bank entities when undertaking similar activities are, we believe, essential.

e) Are there any costs or unintended consequences from implementing the high-level policy framework?

There remains, in our estimation, considerable uncertainty in the Consultative Document regarding the proposals for regulating financial guarantee -related activities as part of shadow banking. Therefore providing specific quantitative answers to this question would be highly speculative.

The costs and unintended consequences of an inappropriate approach could be significant. Costs might include:

- Duplicate compliance costs;
- Higher costs of funding; and
- Reduced availability of credit to support long-term economic growth

We appreciate this opportunity to comment on the FSB Consultative Document on Shadow Banking. If you have any questions, please do not hesitate to contact the undersigned at +44 (0) 20 7469 1630.

Yours faithfully

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