

**Testimony of
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to the
Subcommittee on Capital Markets, Insurance,
and Government Sponsored Enterprises
Committee on Financial Services
United States House of Representatives**

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Recent Innovations in Securitization**

Introduction

Problems with securitizations in the mortgage and credit markets contributed significantly to the recent global financial crisis. As the financial markets continue to recover, it is critical that policy makers, regulators and market participants understand what went wrong and take appropriate action to ensure that past mistakes are not repeated. At the same time, however, it is important to recognize that our financial markets thrive on innovation. A regulatory environment that prohibits the development of new investment products will ultimately impede rather than enhance the economy's return to good health.

Fostering innovation while limiting unnecessary risk is a delicate task. DBRS commends the Subcommittee for tackling this challenge, and we are pleased to have the opportunity to answer your questions about the securitization of life insurance settlements. My testimony this afternoon will focus on three broad areas: (1) an overview of life settlement securitizations; (2) the role of rating agencies in this market, including DBRS's preliminary activities in this area; and (3) our suggestions for prudent regulation of life settlement transactions. Before I get to those issues, however, I would like to begin with a brief description of our company.

Overview of DBRS

DBRS is a Toronto-based credit rating agency established in 1976 and still privately owned by its founders. With a U.S. affiliate located in New York and Chicago, DBRS analyzes and rates a wide variety of issuers and instruments, including financial institutions, insurance companies, corporate issuers, issuers of government and municipal securities and various structured transactions. The firm currently maintains ratings on more than 43,000 securities in approximately 35 countries around the globe. DBRS was first designated as a Nationally Recognized Statistical Rating Organization (NRSRO) in 2003, and has been registered in that capacity since 2007.

DBRS is committed to ensuring the objectivity and integrity of its ratings and the transparency of its operations. To this end, the firm has adopted a wide range of internal controls designed to eliminate conflicts of interest wherever possible, and to disclose and manage those conflicts that cannot be eliminated. In addition to displaying all of its current public credit ratings and selected ratings history, DBRS's public Web site also discloses the firm's ratings policies and methodologies as well as extensive information about how its ratings have performed over time.

With that background, I would like to turn my attention to life settlement securitizations.

Overview of the Life Settlements Market

The sale of life insurance policies by insured parties is not a new phenomenon. Indeed, an insured's right to sell or otherwise assign the rights to his policy was confirmed by the U.S. Supreme Court almost one hundred years ago. The structured life settlement industry is a result of the evolution of the mid-1990s' viatical settlements market, which bought and sold life insurance policies of the terminally ill. In a structured life settlement transaction, an issuer buys and pools hundreds of insurance policies and securitizes the

resulting cash flows. In acquiring insurance policies for a structured product, the issuer pays the insured party an amount greater than the policy cash surrender value, but less than the death benefit. In order to receive the ultimate death benefit, the issuer/trustee must pay the associated premiums on the pooled policies until the deaths of the insured, as well as transaction expenses.

Most life settlement securitizations are private placements, so definitive data on the number of deals is hard to tally. To the best of our knowledge, the volume of these deals has been relatively low and the deal flow, sporadic. However, there are several factors which may stimulate growth in the sales of life insurance policies in the coming years. These factors include longer life spans, the decrease in defined-benefit retirement plans and other factors that may force older Americans to seek alternative sources of cash. Growth of the structured life settlement market may also be spurred by increased awareness among policy holders that they can realize value from policies they otherwise would allow to lapse, as well as by increased interest in such products by institutional investors.

From a regulatory standpoint, control of the life settlement industry is primarily a creature of state law. Over the past several years, most states have enacted legislation in this area. The primary aim of these laws is to protect consumers by mandating disclosure standards, providing the means to ensure that consumers receive fair prices, and imposing licensing requirements on companies who seek to buy life settlements from policy holders. Although the state statutes are not identical, many are based on one of two model laws crafted by associations of regulators and industry participants. Life settlement securitizations are also subject to the applicable provisions of the Securities Act of 1933 and related rules, particularly those pertaining to private placements.

Until now, DBRS has not had any interactions with federal or state regulators regarding life insurance settlements or the securitizations thereof. That, of course, may change as a result of today's hearings.

The Role of Credit Rating Agencies in the Life Settlements Market

The role of a credit rating agency in a life settlement securitization is to issue an opinion about the ability of an issuer to repay, in a timely manner, principal and interest on bonds backed by pools of life settlements. Rating agencies do not purchase or arrange for the purchase of life insurance policies; nor do they structure, underwrite or sell life settlement securitization transactions.

Because responding to transaction proposals is a core part of the services we provide, in 2008, DBRS published a methodology for rating U.S. life settlement securitizations. This methodology, which is publicly available on DBRS's website (www.dbrs.com), calls for both qualitative and quantitative approaches to reviewing a life settlement securitization transaction. From a qualitative standpoint, DBRS's ratings methodology focuses on the operational risk associated with the sourcing, origination and underwriting of the life insurance policies serving as collateral for the rated debt. The rating process also includes an assessment of the financial strength of the insurers, a review of the representations and warranties made in the transaction and a review of the legal structure and opinions. As for the quantitative component, DBRS has developed a proprietary model to evaluate each major dimension of the life insurance policy assets, as well as to review stresses of a transaction's priority of payments, based on a set of cash flow assumptions. The cash flow stresses address the issuer's ability to meet its obligations.

DBRS's rating methodology does not include the creation of any mortality indices. Instead, the company relies on publicly available mortality tables, such as those

promulgated by the Society of Actuaries. The use of such independent, public information contributes to the integrity and transparency of the DBRS ratings process.

Although DBRS has reviewed approximately 14 proposals for life settlement transactions, we have not rated any of these deals and our market share remains at zero percent. Two of these transactions are still under review, while the others failed to meet our rating criteria or did not go forward for other reasons.

Establishing a Framework for Prudent Regulation

The financial turmoil in the structured finance market over the past 12 - 18 months arose from a confluence of factors, including fraudulent behavior on the part of mortgage brokers, appraisers and home buyers; loose underwriting standards fostered by the complete transfer of risk away from the lending institutions; and the decline in home prices. For their part, issuers and arrangers failed to make sufficient information about their deals available so that investors could make informed decisions. This, in turn, led investors to over-rely on credit ratings. Rating agencies, too, bear some of the blame, as ratings methodologies and models failed to keep pace with changes in the products being rated, and the ratings process, at times, lacked transparency.

DBRS believes that the lessons learned from the past year and a half can form the basis for a prudent regulatory framework applicable to life settlement securitizations. First and foremost, there must be a focus on consumer protection to ensure that parties who buy life insurance policies do not take advantage of the elderly and infirm, who are the most likely sources of such policies. In this regard, DBRS supports states' efforts to license those who acquire life settlements from policy holders and to mandate the disclosure of fair and reliable information to consumers about the disposition of their life insurance policies. In order to avoid a balkanized system of regulation, DBRS

encourages the state insurance regulators to work together to develop a uniform system of requirements in this area.

On the securitization front, DBRS believes that steps should be taken to ensure that those who structure life settlement transactions retain a portion of the risk arising from such deals. Requiring issuers/trustees to have "skin in the game" aligns their interests with the interests of investors, and enhances the safety and soundness of the structured finance markets.

DBRS also believes that it is critical to provide investors with the information they need to make informed investment decisions. Thus, issuers should be required to supply potential investors with sufficient information about the structure, risk and collateral of all the deals they sponsor. We encourage the SEC to amend its existing regulations as necessary to make this happen, or to seek additional Congressional authority if it sees the need to do so.

Finally, with regard to credit rating agencies that are registered as NRSROs, we believe that the regulatory regime established and still being refined under the Credit Rating Agency Reform Act of 2006 is well suited to ensure the quality, integrity and transparency of ratings on life settlement products. For example, NRSROs are prohibited from rating deals they helped structure; are required to separate the analysis and business development sides of their operations; and must disclose and manage other types of conflicts of interest related to their ratings activities. They also are obliged to publish their ratings methodologies and to maintain records for SEC inspection of the rationale for certain deviations from those methodologies.

In order to permit investors to compare the quality of ratings issued by various rating agencies, NRSROs must make ratings history information publicly available in a

machine-readable format, and they also must publish default and transition studies on an annual basis to reveal how their ratings perform over time.

DBRS believes that establishing a regulatory framework along the lines I just described will permit healthy innovation of the securitization markets to continue without sowing the seeds of another financial crisis.

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I appreciate having the opportunity to present DBRS's views on life settlement securitizations and I look forward to answering any questions you may have.