§ 6903. Contingency, loss and unearned premium reserves. (a) Contingency reserves. (1) A corporation shall establish and maintain contingency reserves for the protection of insureds and claimants against the effects of excessive losses occurring during adverse economic cycles.

(2) With respect to all financial guaranties written prior to and in force as of the first day of the next calendar quarter commencing after the date that the act enacting this article shall become law:

(A) the insurer shall establish and maintain a contingency reserve consistent with the requirements applicable for municipal bond guaranties in effect prior to the effective date of this article equal to fifty percent of earned premiums on such policies; and

(B) to the extent that the insurer's contingency reserves maintained as of the first day of the next calendar quarter commencing after the date that the act enacting this article shall become law are less than those required for municipal bond guaranties, the insurer shall have three years from such date to bring its contingency reserves into compliance.

(3) With respect to financial guaranties of municipal obligation bonds, special revenue bonds, industrial development bonds and utility first mortgage obligations written on and after the first day of the next calendar quarter commencing after the date that the act enacting this article shall become law:

(A) the insurer shall establish and maintain a contingency reserve for all such insured issues in each calendar year for each category listed in subparagraph (B) of this paragraph;

(B) the total contingency reserve required shall be the greater of fifty percent of premiums written for each such category or the following amount prescribed for each such category:

(i) municipal obligation bonds, 0.55 percent of principal guarantied;

(ii) special revenue bonds, and obligations demonstrated to the satisfaction of the superintendent to be the functional equivalent thereof, 0.85 percent of principal guarantied;

(iii) investment grade industrial development bonds, secured by collateral or having a term of seven years or less, and utility first mortgage obligations, 1.0 percent of principal guarantied;

(iv) other investment grade industrial development bonds, 1.5 percent

of principal guarantied; and

(v) all other industrial development bonds, 2.5 percent of principal guarantied; and

(C) Contributions to the contingency reserve required by this paragraph, equal to one-eightieth of the total reserve required, shall be made each quarter for twenty years, provided, however, that contributions may be discontinued so long as the total reserve for all categories listed in items (i) through (v) of subparagraph (B) of this paragraph exceeds the percentages contained in such items (i) through (v) when applied against unpaid principal.

(4) With respect to all other financial guaranties written on or after the first day of the next calendar quarter commencing after the date that the act enacting this article shall become law:

(A) the insurer shall establish and maintain a contingency reserve for all such insured issues in each calendar year for each such category listed in subparagraph (B) of this paragraph;

(B) the total contingency reserve required shall be the greater of fifty percent of premiums written for each such category or the following amount prescribed for each such category:

(i) investment grade obligations, secured by collateral or having a term of seven years or less, 1.0 percent of principal guarantied;

(ii) other investment grade obligations, 1.5 percent of principal guarantied;

(iii) non-investment grade consumer debt obligations, 2.0 percent of principal guarantied;

(iv) non-investment grade asset-backed securities, 2.0 percent of principal guarantied;

(v) other non-investment grade obligations, 2.5 percent of principal guarantied; and

(C) Contributions to the contingency reserve required by this paragraph, equal to one-sixtieth of the total reserve required, shall be made each quarter for fifteen years, provided, however, that contributions may be discontinued so long as the total reserve for all categories listed in items (i) through (v) of subparagraph (B) of this paragraph exceeds the percentages contained in such items (i) through (v) when applied against unpaid principal.

(5) Contingency reserves required in paragraphs two, three and four of

this subsection may be established and maintained net of collateral and reinsurance, provided that, in the case of reinsurance, the reinsurance agreement requires that the reinsurer shall, on or after the effective date of the reinsurance, establish and maintain a reserve in an amount equal to the amount by which the insurer reduces its contingency reserve, and contingency reserves required in paragraphs three and four of this subsection may be maintained (A) net of refundings and refinancings to the extent the refunded or refinanced issue is paid off or secured by obligations which are directly payable or guarantied by the United States government and (B) net of insured securities in a unit investment trust or mutual fund that have been sold from the trust or fund without insurance.

(6) The contingency reserves may be released thereafter in the same manner in which they were established and withdrawals therefrom, to the extent of any excess, may be made from the earliest contributions to such reserves remaining therein:

(A) with the prior written approval of the superintendent:

(i) if the actual incurred losses for the year, in the case of the categories of guaranties subject to paragraph three of this subsection exceeds thirty-five percent of earned premiums, or in the case of the categories of guaranties subject to paragraph four of this subsection exceed sixty-five percent of earned premiums; or

(ii) if the contingency reserve applicable to the categories of guaranties subject to paragraph three of this subsection has been in existence for less than forty quarters, or for less than thirty quarters for the categories of guaranties subject to paragraph four of this subsection, upon a demonstration satisfactory to the superintendent that the amount carried is excessive in relation to the insurer's outstanding obligations under its financial guaranties.

(B) upon thirty days prior written notice to the superintendent, provided that the contingency reserve applicable to the categories of guaranties subject to paragraph three of this subsection has been in existence for forty quarters, or thirty quarters for categories of guaranties subject to paragraph four of this subsection, upon a demonstration satisfactory to the superintendent that the amount carried is excessive in relation to the insurer's outstanding obligations under its financial guaranties.

(7) An insurer providing financial guaranty insurance may invest the contingency reserve in tax and loss bonds (or similar securities) purchased pursuant to section 832(e) of the Internal Revenue Code (or any successor provision), only to the extent of the tax savings resulting from the deduction for federal income tax purposes of a sum equal to the annual contributions to the contingency reserve. The contingency reserve shall otherwise be invested only in classes of securities or types of investments specified in paragraphs one through three of subsection (b) of section one thousand four hundred two of this chapter and paragraphs one through three of subsection (a) of section one thousand four hundred four of this chapter.

(b) Loss reserves. (1) The case basis method or such other method as may be prescribed by the superintendent shall be used to establish and maintain loss reserves, net of collateral, for claims reported and unpaid, in a manner consistent with section four thousand one hundred seventeen of this chapter. A deduction from loss reserves shall be allowed for the time value of money by application of a discount rate equal to the average rate of return on the admitted assets of the insurer as of the date of the computation of any such reserves. The discount rate shall be adjusted at the end of each calendar year.

(2) If the insured principal and interest on a defaulted issue of obligations due and payable during any three years following the date of default exceeds ten percent of the insurer's surplus to policyholders and contingency reserves, its reserve so established shall be supported by a report from an independent source acceptable to the superintendent.

(c) Unearned premium reserve. An unearned premium reserve shall be established and maintained net of reinsurance and collateral with respect to all financial guaranty premiums. Where financial guaranty insurance premiums are paid on an installment basis, an unearned premium reserve shall be established and maintained, net of reinsurance and collateral, computed on a daily or monthly pro rata basis. All other financial guaranty insurance premiums written shall be earned in proportion with the expiration of exposure, or by such other method as may be prescribed by the superintendent.