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Moody's Portfolio Risk Model Results for Financial Guarantors

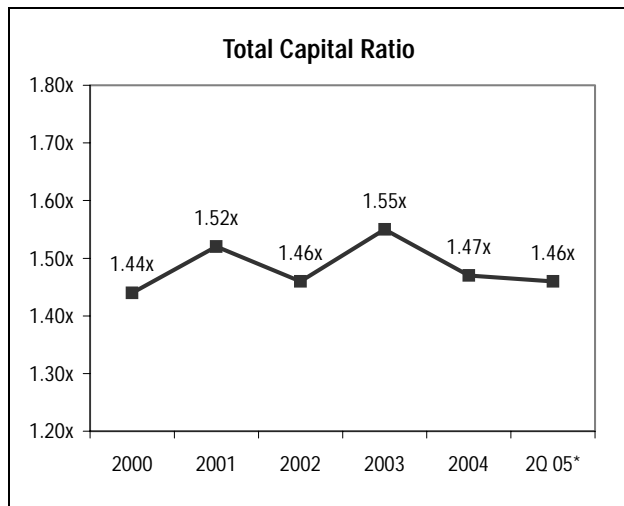
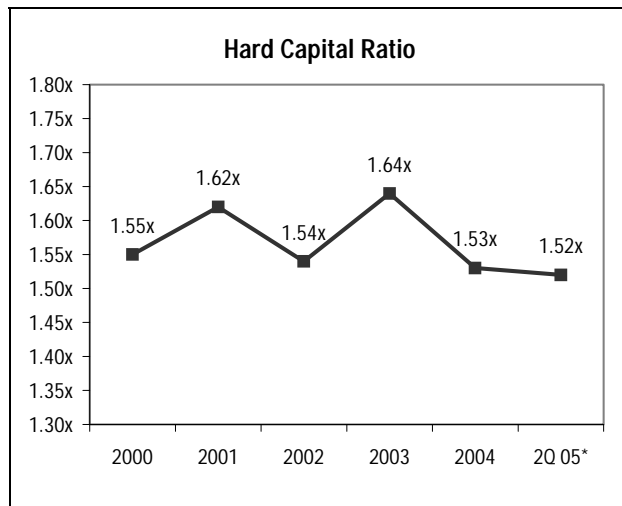
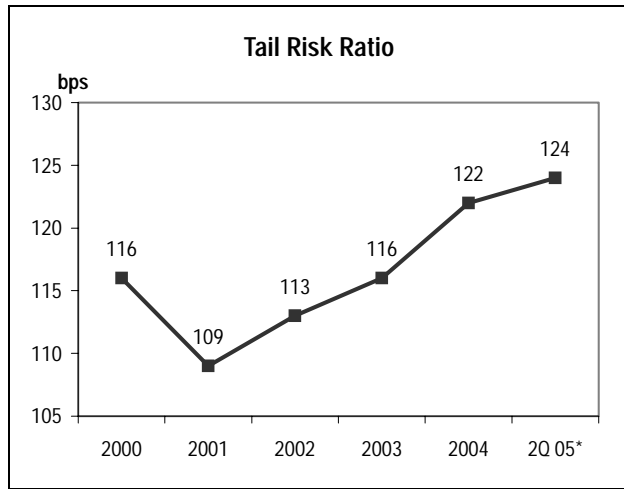
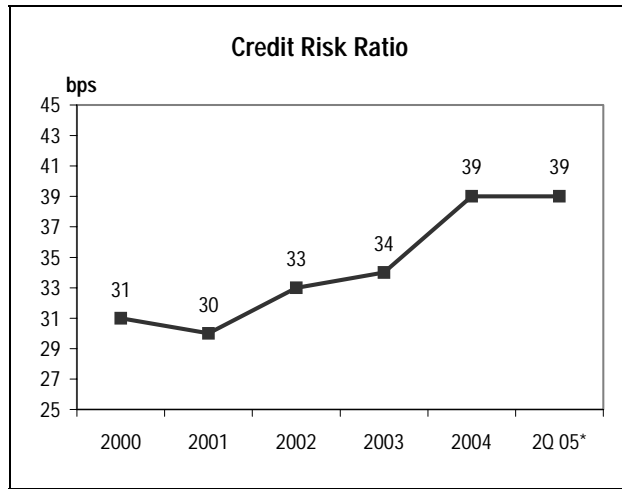
Summary Opinion

Our most recent financial guarantor model results show minor deterioration in the portfolio risk characteristics of the industry overall, while capital adequacy ratios have remained relatively stable. The declining trend in portfolio quality is primarily the result of two factors. The first relates to distress in various asset classes in which the guarantors participate, with US airline Enhanced Equipment Trust Certificates (EETCs), manufactured housing loan ABS, Katrina-related credits and certain MBS exposures having the greatest impact on the model results. Secondly, the guarantors' insured portfolios continue to gradually shift from a low-risk US municipal focus to more risky, but higher premium ABS and international exposure.

For the financial guarantors at large, recent increases in capital levels have been sufficient to absorb the rise in modeled tail losses, as the industry's hard and total capital ratios have remained constant. 2006 underwriting volumes continue to show slower growth in today's tight credit-spread environment, and the guarantors' capital ratios are benefiting from portfolio run-off and refundings, thereby reducing the overall level of risk relative to capital. For some guarantors, however, model results are trending down, which is causing them to tread lightly or altogether avoid new volume in those sectors that have caused them difficulty. Furthermore, those guarantors with hard and total capital ratios closer to 1.30x may feel somewhat more constrained in managing exposure and capital over the coming year.



Model Ratio's - Industry Mean



*Ratings as of Dec 31, 2005.

The Model in the Context of an Overall Assessment

Moody's portfolio risk model is an important element of our comprehensive rating assessments of the financial guarantors. The model estimates a loss distribution that could be experienced by a guarantor based on the default probability, tenor, par exposure, and average loss severity of each obligor's securities to which the guarantor is exposed. When evaluating the ratio of capital levels to estimated stress-level losses, we obtain insight into a guarantor's risk-adjusted capital adequacy¹. The model incorporates the impact of diversification, seller/servicer concentrations, and correlations among assets classes and emerging market economies. Macroeconomic stresses are explicitly accounted for using multiplication factors that are applied to the default probabilities that Moody's derives from our corporate default studies.

Moody's rating metrics call for a financial guarantor to maintain hard and total capital ratios (the capital ratios) above 1.0x loss coverage, measured at a confidence interval that is consistent with its rating level (as outlined in Table 1). Moody's generally expects a guarantor to maintain a cushion of at least 1.3x coverage to absorb potential operational, model and event risk. All of the companies are currently meeting this important hurdle.

While a breach of the 1.3x capital ratio does not present an immediate threat to the rating of a guarantor, it leaves the firm exposed to subsequent capital stresses and, consequently, is not seen as a sustainable capital position over an

1. For mechanics on how Moody's financial guarantor model works, please see Moody's Special Comment, "Moody's Portfolio Risk Model for Financial Guarantors", July 2000.

extended period of time. This means that if actual credit events caused a guarantor's capital ratios to fall below 1.3x coverage, we would expect management to take corrective action to adjust their capital position within six months in order to avoid stress on their rating. Failure to do so would likely have negative rating consequences.

The portfolio risk model is subject to model risk, particularly with regard to loss severity assumptions and newly developed asset classes or structures that may rely on limited history and data. With this point in mind, it is important to note that we consider many additional factors beyond the model in our analysis of the financial guarantors. Companies may differ with respect to risk mitigation, investment portfolio quality, liquidity, operating risk, management and corporate governance quality, the quality, growth, and stability of earnings, access to capital, and financial and operating leverage. As a result, the measures of capital adequacy required for a specific insurance financial strength rating depend on more than the amount of potential credit losses determined by the portfolio risk model.

Table 1								
Portfolio Risk Ratios								
Ratings: Dec 31, 2005 Portfolio: June 30, 2005 Capital: June 30, 2005			Credit Risk Ratio (bps) (lower is better)	Tail Risk Ratio (bps) (lower is better)	Dispersion Ratio (x) (lower is better)	Hard Capital Ratio (x) (higher is better)	Total Capital Ratio (x) (higher is better)	
Primary Companies	IFSR ²	Tail ³						
MBIA	Aaa	Aaa	49.0	140	2.85	1.41	1.35	
Ambac	Aaa	Aaa	43.5	135	3.11	1.54	1.50	
FSA	Aaa	Aaa	20.3	70	3.45	1.84	1.75	
FGIC	Aaa	Aaa	23.1	88	3.81	1.53	1.44	
XLCA/FA	Aaa	Aaa	48.7	160	3.29	1.38	1.39	
AGC	Aa1	Aaa	39.4	117	2.98	1.92	2.08	
CIFG	Aaa	Aaa	30.2	154	5.10	1.94	1.71	
<i>Reinsurers & Hybrids</i>								
AG Re	Aa2	Aa	34.4	129	3.75	2.21	1.93	
Channel Re	Aaa	Aaa	37.5	146	3.90	1.50	1.45	
Radian Asset	Aa3	Aa	68.9	240	3.48	1.49	1.36	
RAM Re	Aa3	Aa	52.2	164	3.14	1.32	1.41	
BluePoint Re	Aa3	Aa	24.8	169	6.80	4.34	3.55	
Definition of Terms								
Credit Risk Ratio	Formula:	Expected Losses / Adjusted Net Par Outstanding						
	Concept:	Expected present value of losses imbedded in the insured portfolio relative to net par outstanding, adjusted for the benefit received from reinsurance (i.e., the average expected loss rate on the portfolio). This ratio indicates a portfolio's average credit quality, which depends upon its distribution across sectors, rating categories and tenors.						
Tail Risk Ratio	Formula:	99.9 Percentile Losses / Adjusted Net Par Outstanding						
	Concept:	The maximum amount of (present value) credit losses with 99.9% probability relative to net par outstanding, adjusted for the benefit received from reinsurance. Measures a portfolio's stress-level losses relative to par, which depends upon its average credit quality, risk concentrations and correlations among credits.						
Dispersion Ratio	Formula:	99.9 Percentile Losses / Expected Losses						
	Concept:	The maximum amount of (present value) credit losses with 99.9% probability relative to the expected losses embedded in the insured portfolio. Measures the impact of large single risks & risk concentrations on portfolio risk for a given expected loss level.						
Hard Capital Ratio	Formula:	Hard Capital / 99.9 Percentile Losses						
	Concept:	Hard capital relative to the maximum, present value of credit losses with 99.9% probability. Measures the ability of a guarantor to meet stress-level losses with hard capital (i.e., qualified statutory capital, unearned premium reserves, & 85% of PV installment premiums, loss and loss adjustment reserves, net a capital charge for non-financial guaranty activities and investment portfolio quality.) <i>Note: The 99.9% loss level is used as the benchmark for Aaa-rated guarantors. For Aa-rated guarantors, a 99.5% confidence interval is applied.</i>						
Total Capital Ratio	Formula:	Total Capital / 99.99 Percentile Losses						
	Concept:	Total capital relative to the maximum amount of credit losses (present value) with 99.99% probability. Measures the ability of a guarantor to meet stress-level losses at a higher probability with total capital (i.e., hard capital plus the discounted value of soft capital facilities.) <i>Note: The 99.99% loss level is used as the benchmark for Aaa-rated guarantors. For Aa-rated guarantors, a 99.9% confidence interval is applied.</i>						

2. Insurance Financial Strength Rating (IFSR) of the company.

3. "Tail" indicates the points on the loss distribution where hard and total capital ratios were measured. For Aa, the points are the 99.5% and 99.9% probabilities for hard and total capital ratios respectively; for Aaa, the points are the 99.9% and 99.99% probabilities.

Troubled Sectors/ Credits: Katrina, Airline EETC's, and Eurotunnel

Collectively, the guarantors had about \$14.0 billion in exposure to FEMA designated disaster areas that were impacted by last year's category 4 hurricane, Katrina. Moody's has downgraded about a third of the guarantor's Katrina-related exposure since then, by two notches on average. However, because most of this exposure continues to be rated in the investment grade range and is of a low risk, municipal nature, these downgrades have only marginally hurt the capital adequacy of the insurers. The guarantors have paid few claims to date, most of which have since been reimbursed, although the situation continues to evolve and the rating outlook for many Katrina-impacted issuers remains negative. The guarantors could well face additional claims, particularly if debt service reserve funds for certain credits become depleted later this year, but ultimate losses are expected to remain manageable, with limited effect on the industry's overall capital adequacy.

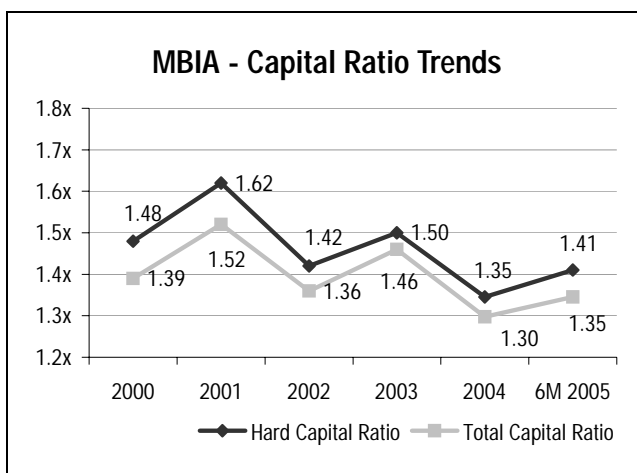
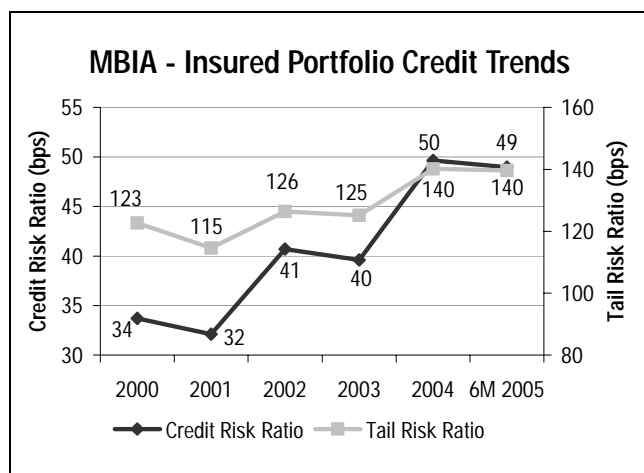
In contrast to Katrina, where industry losses have been minimal, the guarantors have either paid losses or established case reserves on more than \$80 million in insured equipment trust certificates issued by airlines. With a number of airlines filing for bankruptcy, these credits have experienced significant stress. As a result, 60% of the \$9 billion in aggregate insured exposure is currently rated non-investment-grade. These EETC credits, while accounting for less than 0.5% of total par outstanding for the industry, contribute 6% of its aggregate expected losses. In response to continued stress within the sector, the guarantors have scaled back their participation, or are only underwriting new transactions with significant covenants. They have also been actively involved in remediation and occasional restructuring efforts, thereby improving their recovery rates.

Eurotunnel represents another significant troubled-exposure for certain guarantors. The management of Eurotunnel made a request for bankruptcy proceedings last month, which was approved by the Paris Commercial Court on August 2. Under the new 'Safeguard procedure' payments to debt holders will be suspended and the management of Eurotunnel will continue to run the company while a debt restructuring is negotiated with the assistance of two judicial administrators. The guarantors have insured multiple classes of securities in the Eurotunnel capital structure and if the bankruptcy proceedings extend into 2007, it is estimated that some manageable claims will have to be paid on some of the securities. In aggregate, the guarantors wrap approximately \$2.2 billion of Eurotunnel's total debt of GBP 6.2 billion (\$ 11.3 billion). MBIA is the guarantor with the most substantial exposure at \$1.37 billion net of reinsurance, followed by Ambac at \$349 million, Assured Guaranty at \$198 million, and RAM Re at \$63 million. Moody's believes that, even under conservative stress scenarios relating to the enterprise value of Eurotunnel, ultimate losses for the guarantors would likely be a small fraction of their exposure and capital given their seniority in the capital structure.

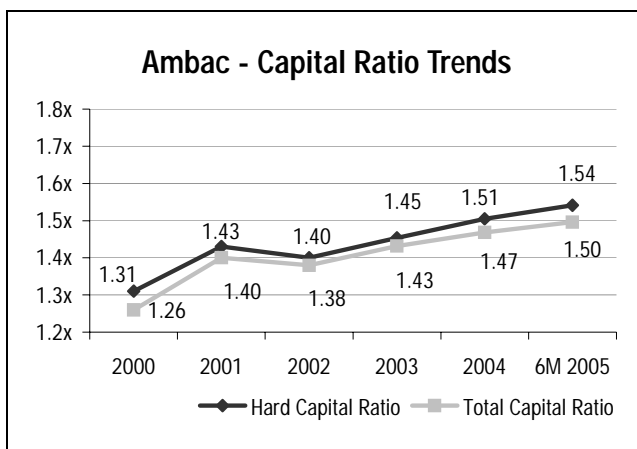
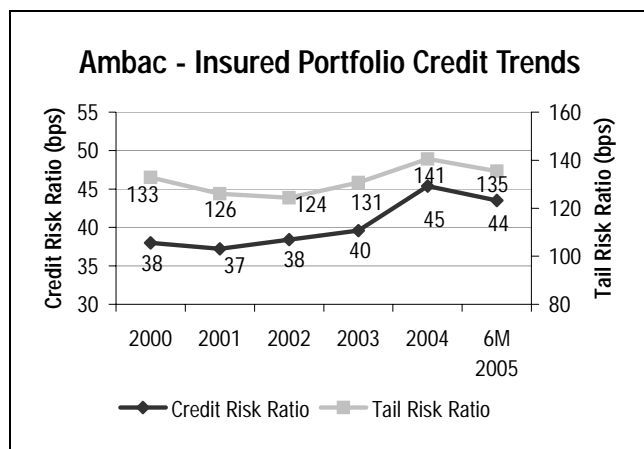
Primary Financial Guarantors

The following paragraphs provide additional company-specific commentary on portfolio risk and capital adequacy ratio trends:

MBIA Risk-adjusted capital ratios improved from an historical low as a result of strong capital accumulation, driven by the absence of dividends during the first half of 2005, and a modest reduction in the size of the insured portfolio. These two factors helped to mitigate the negative effect of MBIA's exposures to troubled sectors. The company's credit risk and tail risk ratios strengthened somewhat, indicating a stabilization of its below-investment-grade exposures, which had been trending up in prior periods. MBIA restructured its exposure to Greenpoint manufactured housing transactions but continued to be troubled by the EETC sector. Eurotunnel is MBIA's largest below investment grade exposure at \$1.37 billion, net of reinsurance.

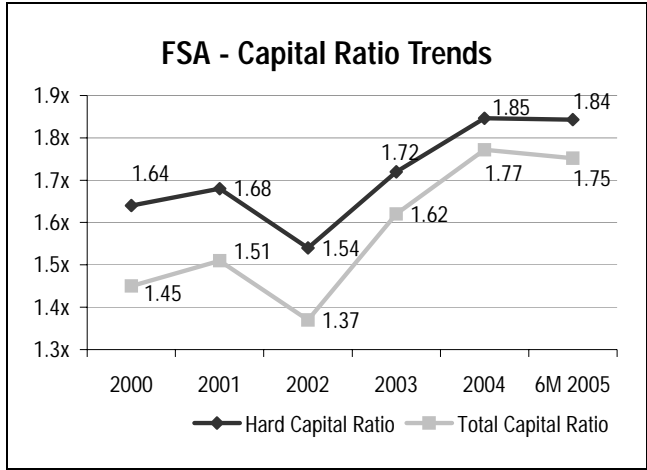
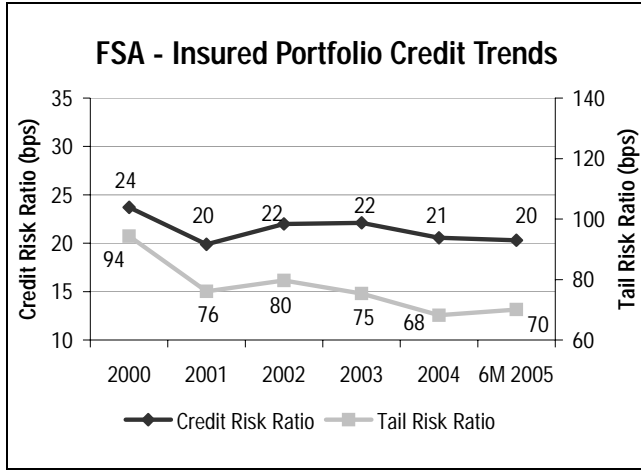


AMBAC The portfolio risk ratios for Ambac showed a slight improvement largely due to upgrades on certain residential mortgage transactions, though the improvement was partially offset by continued weakness in the EETC sector. Ambac's capital ratio trend continued to improve as dividends from the operating company remain modest. Ambac's capital adequacy remains strong with both hard and total capital ratios at levels above 1.50 times.



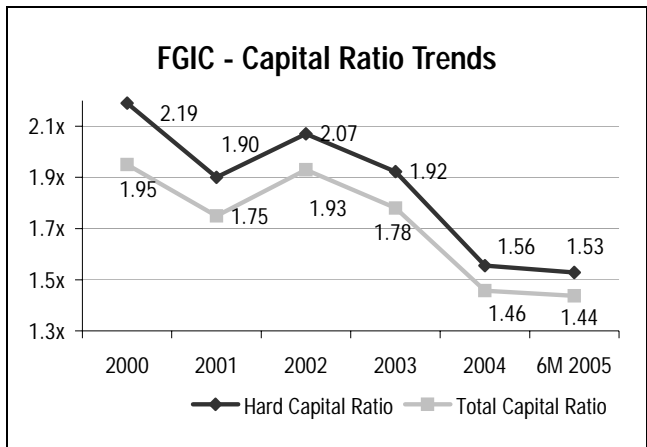
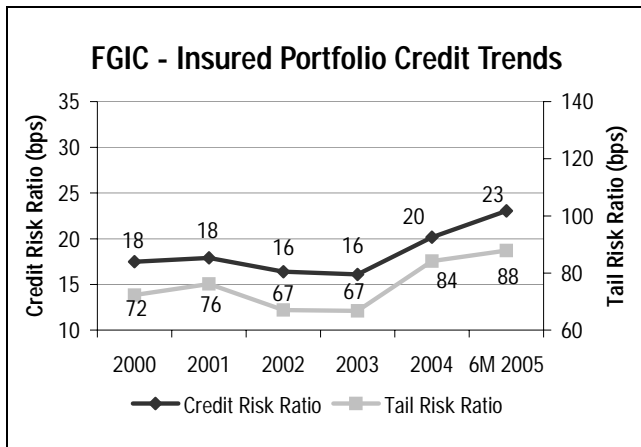
FSA

The credit risk ratio for FSA held steady in the low 20's, which is the strongest in the industry, reflecting the company's focus on lower risk exposures with highly rated CDOs accounting for a quarter of their total insured portfolio. Additionally, FSA has a smaller international non-structured portfolio and virtually no exposure to sectors which have seen significant stress such as EETCs and manufactured housing. Capital ratios remained stable at around 1.8 times, indicating very strong risk-adjusted capitalization⁴.



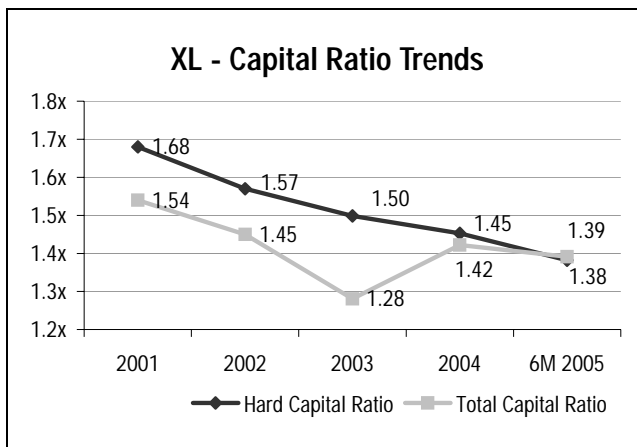
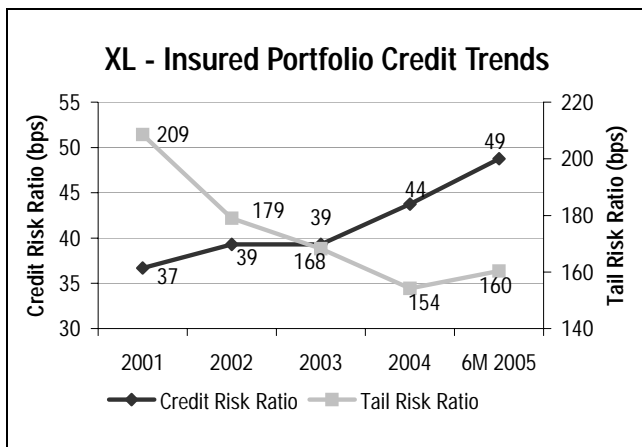
FGIC

In 2005, FGIC continued to make headway on its strategy to broaden its franchise by expanding into new sectors like CDOs and European infrastructure transactions, in addition to reentering certain higher-risk municipal markets such as the healthcare and electric utility sectors where it had been inactive. The company has also increased its activity in the residential mortgage backed market, where a meaningful portion of its insured transactions are rated Baa. While FGIC's continued expansion beyond its historical low risk municipal focus is causing its portfolio risk ratios to weaken, portfolio diversity is improving. These developments were anticipated and planned as part of new ownership's business strategy post the sale by GE in 2003. The company's hard and total capital ratios declined marginally from the prior period, although the rate of change has slowed. New business growth in 2006 has been more moderate given the current tight credit spread environment.

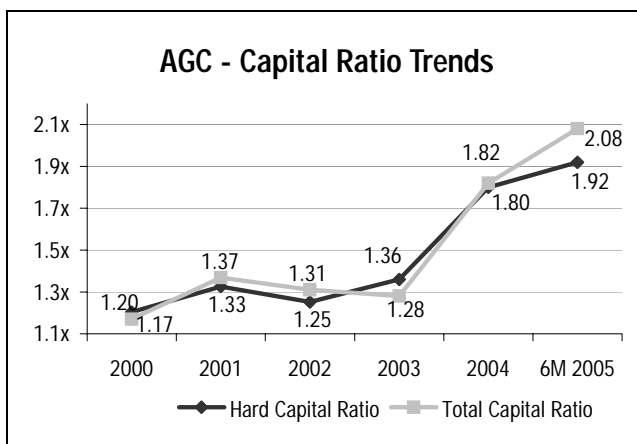
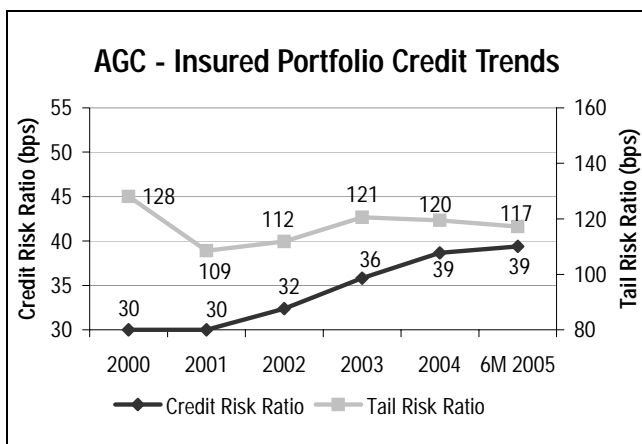


4. Forthcoming changes to Moody's assessment of the capital benefits in Moody's risk model of ceding first loss exposure through layered loss reinsurance will likely result in a modest reduction in FSA's capital ratios.

XLCA/FA XL's credit risk ratio has continued to increase and is among the highest of the Aaa-rated guarantors, in part reflecting a greater proportion of structured business in its portfolio.. Its tail risk ratio, which had previously been improving due to increased portfolio diversification, deteriorated marginally during the period, as greater portfolio risk outweighed any incremental diversification benefit. XL's portfolio has grown rapidly with its NPO rising to \$74 billion at 2Q 2005, a 48% increase over the \$50 billion in NPO reported at 2Q 2004. The company's capital base has failed to keep pace, however, increasing at only half that rate. Consequently, the company's capital ratios have declined to levels that require additional capital infusions to support its rapid growth. The company plans to raise an estimated \$300 to \$350 million of additional capital as part of its proposed IPO, which should alleviate the capital strain. However, given the positive underwriting trend, the company will need to continue monitoring capital adequacy closely. The capital ratios of XL benefit from a significant support agreement between XLFA and its parent, XL Insurance (Bermuda) Ltd (XLI). The agreement is an excess of loss policy that attaches at any single loss amount above 10% of XLFA's policy holders' surplus up to an aggregate limit of \$500 million over its life. No other intra-company support agreements are explicitly modeled.

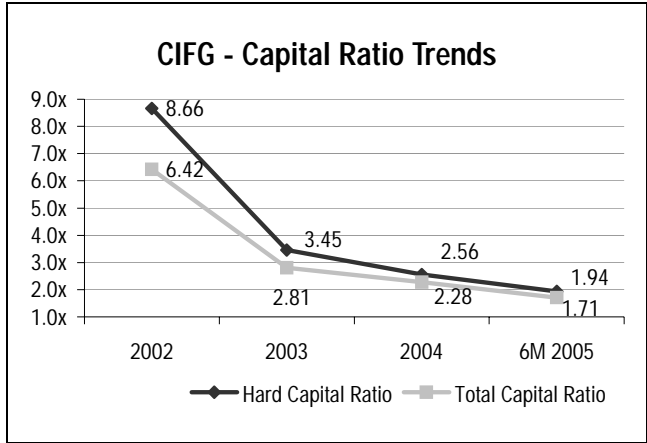
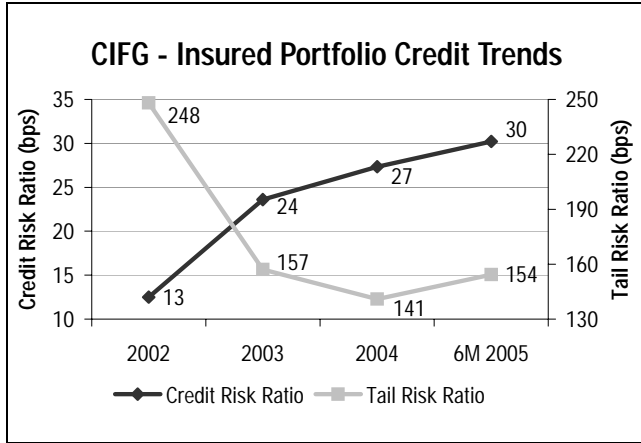


AGC AGC's tail risk ratio improved marginally as it ceded some large credits to its reinsurance affiliate while its credit risk ratio remained stable. At 39 bps, AGC's credit risk ratio is a blend of its low risk direct portfolio with an average credit risk ratio of 12 bps and its reinsurance portfolio with an average credit risk ratio of 64 bps. AGC's capital ratios are extremely strong, although these ratios will trend down over time as the company continues to deploy its capital by underwriting financial guaranty transactions in the primary market.



CIFG

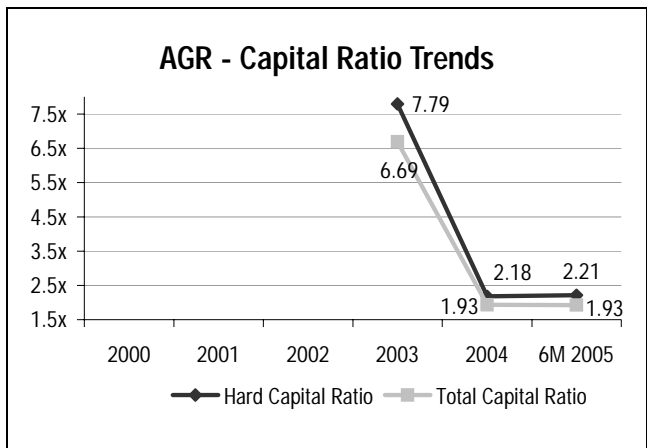
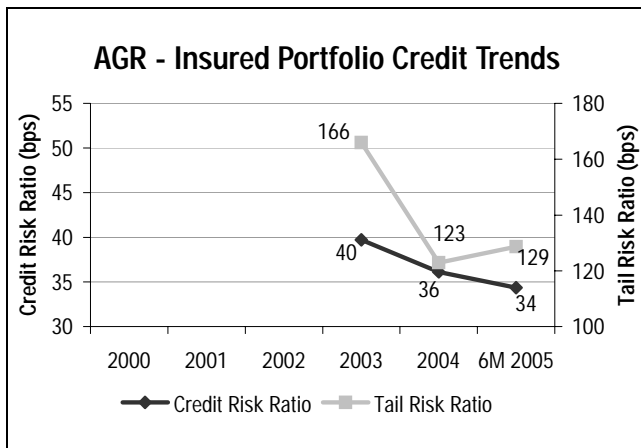
CIFG's portfolio risk ratios exhibit trends characteristic of companies in their development phase. The credit risk ratio has continued to trend higher but remains below the industry average, reflecting a greater proportion of highly rated and pre-insured transactions (where CIFG wraps a transaction that has already been insured by another monoline.) The tail risk ratio deteriorated somewhat through mid 2005, reversing recent improvements, due to the higher credit risk ratio noted above and more subdued portfolio growth during that period. However, since mid 2005, portfolio growth has been more robust. It should also be noted that the Company has no direct exposure to EETC's, Eurotunnel, manufactured housing or Katrina-related credits. As is typical for a recent entrant, CIFG's capital ratios continue to be very strong, although these ratios will continue to trend down as the portfolio grows.



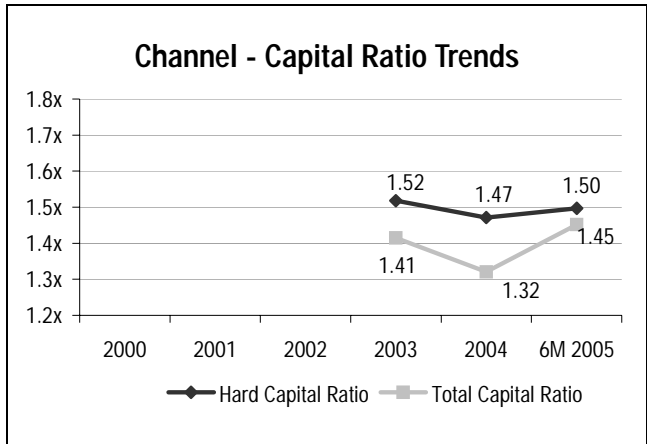
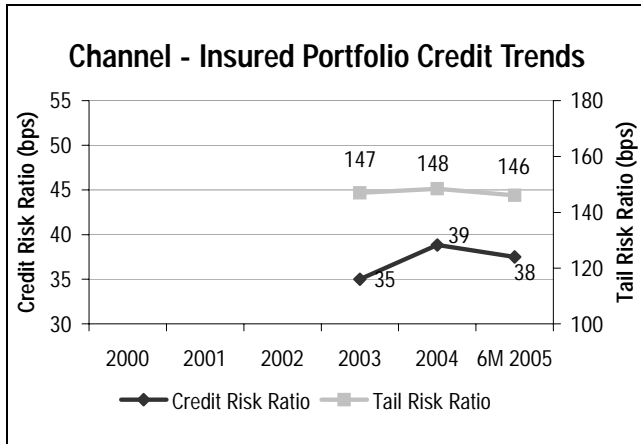
Reinsurers and Hybrid Companies

AGRe

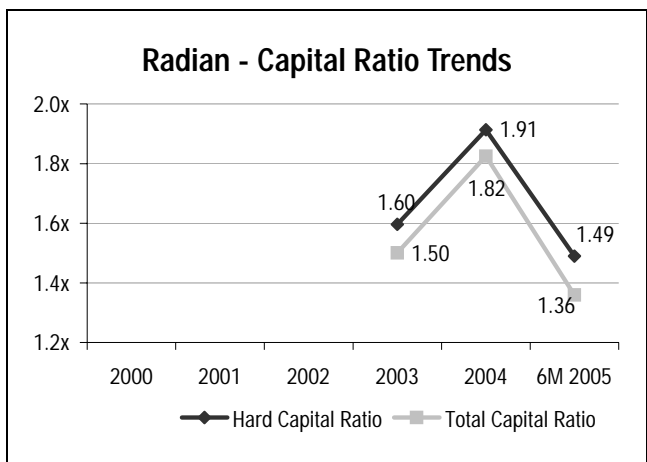
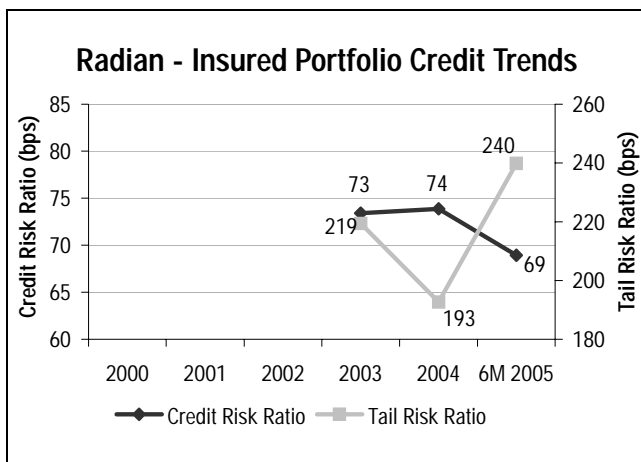
AGRe's credit quality ratio improved marginally while its tail risk ratio weakened as the insurer assumed some large credits from its primary affiliate. Portfolio risk ratios for AGR are slightly better than the industry average, reflecting the company's disproportionate share of high quality business ceded from FSA and its affiliate, AGC. Capital ratios remain very strong, reflecting the fact that AGRe currently maintains capital that has yet to be deployed. These capital ratios are expected to decline over time as AGC's direct business grows, given that AGRe typically reinsures roughly 30% of the new business generated by AGC.



Channel Re As a reinsurer with a single customer, Channel Re's portfolio reflects the same trends as MBIA's, with marginal improvement in its portfolio characteristics. Limited growth in net par outstanding, in combination with capital accumulation, led to improved capital adequacy ratios. Channel Re's credit risk ratio is better than MBIA's reflecting fewer below-investment-grade exposures, as its initial portfolio excluded many of the weakest transactions in MBIA's portfolio. The tail risk ratio is slightly weaker than MBIA's due to limited diversification and larger exposures relative to its capital base.

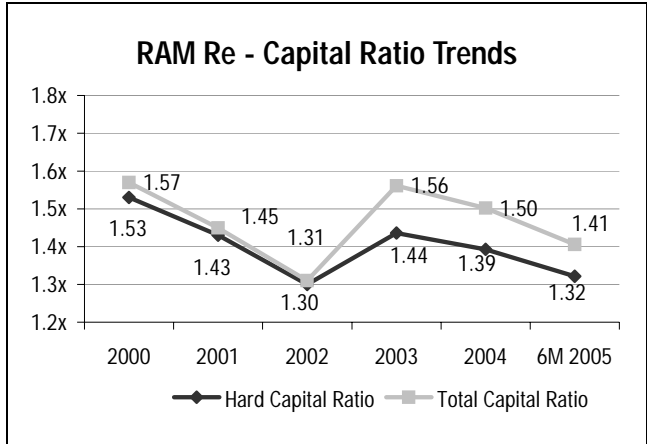
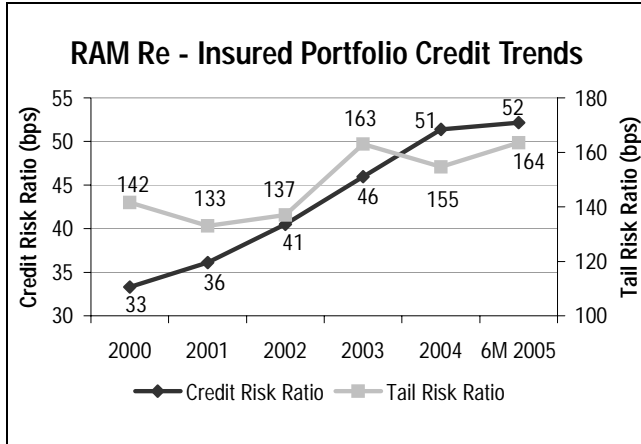


Radian⁵ The credit risk ratio for Radian Asset Assurance, at 69 bps, is the highest the industry. The company writes both direct and reinsurance business, and as a result, this ratio is a blend of its reinsurance portfolio, which has a credit risk ratio of 31 bps, and its much riskier direct portfolio where the credit risk ratio is an industry high 115 bps. The hard and total capital ratios, at 1.49 times and 1.36 times the Aa level, reflect a modest capital cushion for the firm. Earlier this year, Radian suffered large losses on two mezzanine CDO's which negatively impacted the credit quality of its direct portfolio. Furthermore, a substantial proportion of Radian's structured transactions represent mezzanine risks, which we believe have higher severity in the event of default. Consequently, our assessment of the tail losses related to these transactions has increased, which accounts for much of the trends in our portfolio and capital adequacy measures.

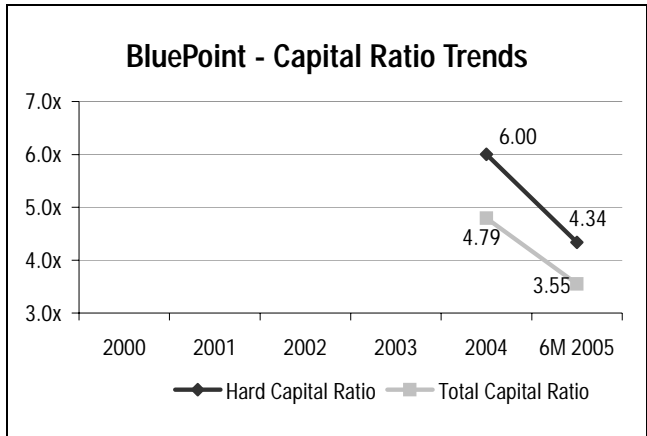
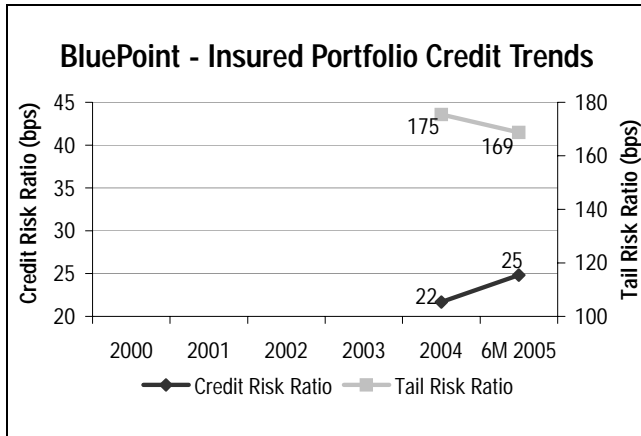


5. Portfolio risk & capital adequacy results for Radian are not directly comparable from period to period as we recently adopted a higher severity for mezzanine structured exposures, which significantly increases our assumption for stressed losses should these transactions experience a default. In addition a significant portion of Radian Asset's portfolio is unrated by Moody's. We have applied conservative rating estimates for these transactions. Should these transactions become rated this could have an impact on the trends of Radian's model ratios.

RAM Re RAM Re's credit risk ratio remained stable at 52 bps, which is the highest among the pure monoline reinsurers. Like other reinsurers, RAM Re's portfolio ratios are closely aligned with those of the three largest primaries from which it assumes business, with some evidence of adverse selection. The capital ratios for the company have come down significantly, reflecting exposure growth of 32% from 2Q04 to 2Q05, which far outpaced capital growth of 10% over the same period. As part of its recent IPO, RAM Re raised an additional \$14 million of capital, which partially addresses some of the potential capital concerns.



BluePoint Re BluePoint Re, a financial guaranty reinsurance company sponsored by Wachovia Corp, entered the industry in late 2004. As of mid year 2005, the company had \$5.6 billion of net par outstanding. The low credit quality ratio of 22bps is in part influenced by the high proportion of municipal risk in the portfolio (94% of the \$3.3 billion jump-start portfolio that had been ceded by FSA consisted of US municipal risk). Another significant factor is that highly rated direct CDS exposures account for 8% of the portfolio. The dispersion ratio for BluePoint Re is considerably higher than most of its peers due to the lower level of diversity in the portfolio. As of mid year 2005, the company had reinsurance treaties with three primary companies - a fourth treaty was added in 2006. With these relationships in place, Bluepoint Re's dispersion ratio is expected to trend toward the industry average as its portfolio continues to grow. Capital ratios are expectedly high but are likely to trend lower as risk exposure increases with portfolio growth.



Related Research

Special Comment:

[Moody's Portfolio Risk Model for Financial Guarantors, July 2000 \(58299\)](#)

Industry Outlook:

[Moody's Financial Guaranty Industry Outlook, June 2005 \(93125\)](#)

Rating Methodology:

[Moody's Rating Methodology for Financial Guaranty Insurance Companies, December 2003\(80806\)](#)

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