

*This Analysis provides a discussion of the factors underpinning the credit rating/s and should be read in conjunction with our Credit Opinion. The most recent ratings, opinion, and other research specific to this issuer are provided on Moody's.com. [Click here to link.](#)*

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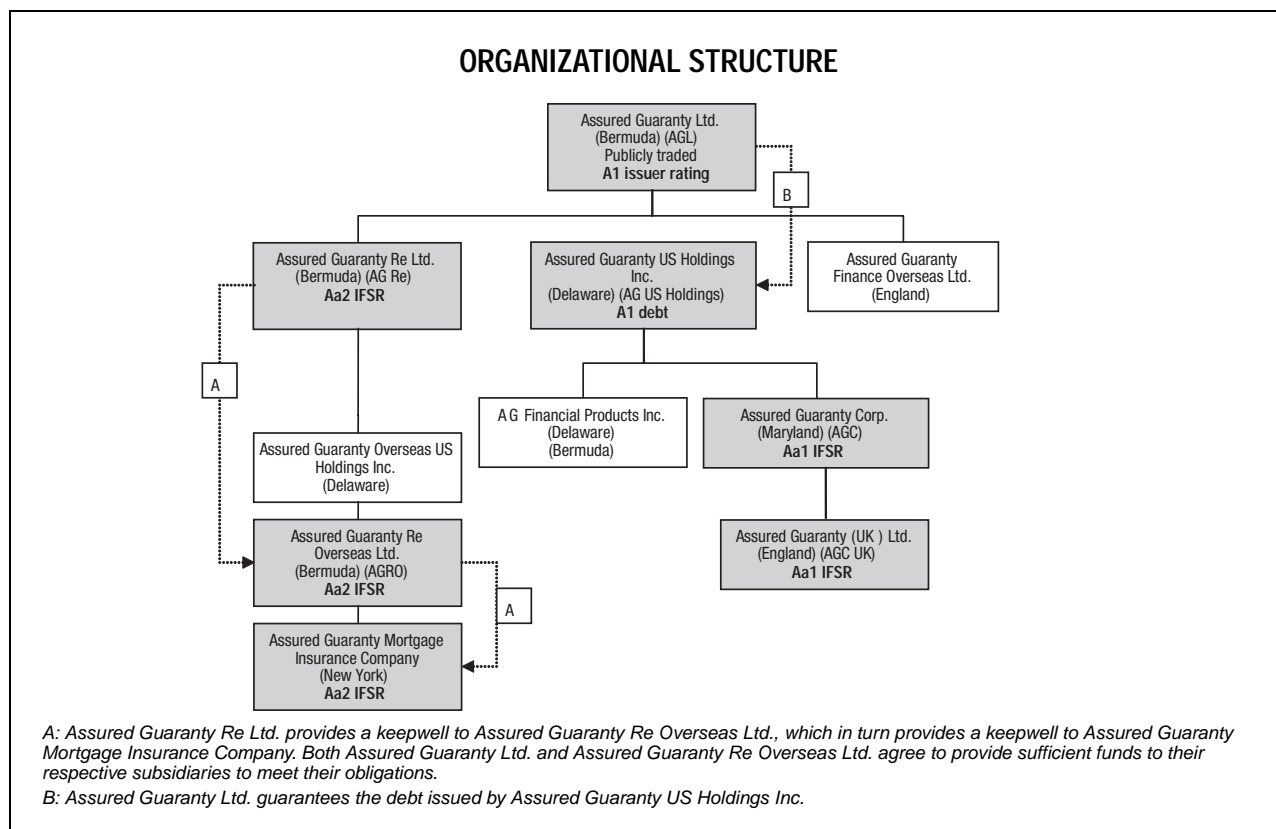
Contact	Phone
<i>New York</i>	
Arlene Isaacs-Lowe	1.212.553.1653
Deven Kapoor	
Jack Dorer	

## Assured Guaranty

### Company Profile

#### BACKGROUND AND PARENT

Assured Guaranty Ltd. (AGL) (A1 issuer rating) is the holding company of Assured Guaranty Re Ltd. (AG Re) (Aa2 IFSR), as well as Assured Guaranty US Holdings Inc. (A1 senior unsecured debt) which, in turn, wholly owns Assured Guaranty Corp. (AGC) (Aa1 IFSR, positive outlook). AGL is domiciled in Bermuda and was listed on the New York Stock Exchange [NYSE: AGO] in April 2004 when the group successfully executed an IPO. The group, through its three operating subsidiaries AGC, AG Re, and Assured Guaranty (UK) Ltd. (AGC UK) (Aa1 IFSR, positive outlook), provides credit enhancement by writing primary financial guaranty policies, credit default swaps (CDS), and financial guaranty reinsurance. The group novated, retroceded or sold the majority of its non-financial guaranty exposures and businesses to subsidiaries of ACE Limited, although it retained its mortgage guaranty reinsurance business, Assured Guaranty Mortgage Insurance Company (Aa2 IFSR), which is a wholly owned indirect subsidiary of AG Re.



## AGC

AGC, previously known as ACE Guaranty Corp prior to the 2004 IPO, began operations in 1988 as a financial guaranty reinsurer under the name Capital Reinsurance Company. Over the years, the company grew to become the largest financial guaranty reinsurer and in 1999, was acquired by ACE Limited, where it remained until the time of the IPO.

The Company expanded its financial guaranty focus beyond a pure monoline reinsurance strategy in 2000 by providing credit enhancement through credit default swaps and, again in 2003, when it started writing financial guaranty policies in the primary market. Today, AGC's new business focus is in the direct credit enhancement market, although it still retains some reinsurance exposure on its books from prior years.

## AGC UK

In 2004 AGC UK was licensed as a wholly owned subsidiary of AGC to write direct financial guaranty policies in Europe. Expansion in the international markets, specifically Europe, will be a critical factor in determining the future health and growth potential for financial guarantors like Assured. AGC UK is licensed and regulated by the Financial Services Authority (FSA), allowing it to underwrite financial guaranty insurance and reinsurance in the United Kingdom and in 26 other countries of the European Economic Area under passport rules for financial institutions.

AGC UK predominantly performs an underwriting function while relying on AGC in NY for other business needs such as accounting, legal and surveillance services. For reasons of capital efficiency, the bulk of AGC UK's claims paying resources are provided by support agreements which transfer substantially all of the risks underwritten to the US-based financial guarantor parent. These support agreements include an excess of loss agreement, a quota share reinsurance treaty, and a net worth maintenance agreement. Taken together, the agreements result in little retained risk at the subsidiary, which is minimally capitalized. Consequentially, Moody's uses a consolidated approach in evaluating the IFSR of AGC and AGC UK.

## AG Re

AG Re acts as the main reinsurer for AGC and AGC UK, and also provides third-party reinsurance to other primary financial guarantors. While AG Re and AGC operate as separate legal entities, their ratings are related, reflecting the strategic relationship and interdependence of the two companies.

## Key Rating Drivers & Expectations

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The following expectations are incorporated into the group's current ratings and the positive rating outlook for AGC and AGC UK:

- AGC prudently executes its strategy of capturing a meaningful share of the global direct financial guaranty market;
- The Assured Group avoids extensive diversification into higher risk businesses;
- AGC continues to exhibit positive trends in the volume and diversity of direct financial guaranty business written while maintaining credit discipline;
- Third party reinsurance relationships are stabilized as the group establishes its primary financial guaranty franchise;
- The group improves its returns over the medium term; and
- AGC's capital ratios remain above 1.5 times.

In our view, the following five interdependent factors form the basis of a financial guarantor's operating dynamics and, in aggregate, provide a comprehensive picture of its overall credit profile. The relationship between each of the five factors can be summarized as follows: A guarantor's franchise value and strategy determine the characteristics of its insured portfolio; these portfolio characteristics, in turn, determine the level of capitalization that is necessary to support its claims-paying ability; the firm's capital requirements impact its core profitability; and the level of profits that can be generated influence its franchise value and, ultimately, its commitment (or lack thereof) to the current business strategy over time. These operating dynamics are further influenced by the firm's financial flexibility, especially its ease and cost of capital access, as well as by certain external factors such as market trends, the competitive and regulatory environment, and other industry-specific risks and constraints.

## FRANCHISE VALUE & STRATEGY

- AGC continues to improve its penetration of the direct financial guaranty market as demonstrated by the volume and diversity of new insurance written. However, the company remains fairly concentrated in a few sectors and CDS execution predominates. AGC has been able to demonstrate good traction in the international markets.
- AG Re is the largest monoline reinsurer, but demand for its product has been tempered by new entrants and the reluctance of primaries to expand or sustain quota share relationships now that AGC is a direct competitor.
- The group has also made significant enhancements to its corporate governance, operating infrastructure and risk management processes since the IPO, although these processes are still somewhat untested.

## INSURANCE PORTFOLIO CHARACTERISTICS

- AGC's portfolio characteristics are in line with the industry average, reflecting its mix of high quality direct structured business and its well-diversified reinsurance portfolio.
- AG Re's portfolio characteristics are better than other monoline reinsurers, reflecting the credit quality of FSA-ceded risks, which account for half of the insured portfolio. However, AGC's use of AG Re as a vehicle for managing single-risk concentrations and higher risk exposures within AGC's portfolio has resulted in the deterioration of AG Re's portfolio quality.

## CAPITAL ADEQUACY

- AGC has very strong capital ratios reflecting the ramp-up stage of its primary business. It is anticipated that these ratios will decline toward the industry mean over time.
- While capital ratios for AG Re are also strong, they have weakened from the prior year due to the company's efforts to deploy capital through portfolio growth, some of which has been in relatively higher-risk sectors.

## PROFITABILITY

- AGC's profitability metrics are below the industry average and are reflective of the firm's investment in an operating infrastructure capable of increased capacity together with its currently under-deployed capital base. The firm's ability to gain wider market acceptance and increase insured volume over time would likely have a positive impact on its profitability ratios.

## FINANCIAL FLEXIBILITY

- The leverage profile for the Assured Guaranty group is conservative and well within our guidelines for A1-rated financial guaranty holding companies.

## Company Analysis

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### BUSINESS STRATEGY - CORE ACTIVITIES

The Assured Guaranty group follows a two-pronged strategy within the financial guaranty industry where the main operating entities of the group, AGC and AG Re, focus on primary financial guaranty and financial guaranty reinsurance, respectively.

AGC is pursuing a fairly traditional primary financial guaranty strategy that comprises municipal and structured finance in the US, as well as international underwriting through its wholly-owned subsidiary, AGC UK. In June, 2006 Moody's revised its rating outlook to positive from stable in recognition of the progress AGC has made in establishing its franchise in the primary guaranty market, enhancing its operating and risk management infrastructure, and improving corporate governance and oversight throughout the group. The company has focused on building its direct financial guaranty business over the last five years, initially by providing credit default swaps. Since the IPO in 2004, AGC began writing financial guaranty policies in the primary market and has demonstrated growth in the volume of insurance written. Furthermore, unlike its pre-2004 direct portfolio that was largely booked in CDS form and which carries distinct mark-to-market and liquidity risks for the firm, more than 60% of the insurance written since 2003 has been executed in financial guaranty form, which we believe to be more supportive of franchise growth. However, AGC continues to face challenges in penetrating the municipal and structured flow market and its direct financial

guaranty activity remains substantially concentrated in a few sectors (mainly CDO and MBS). This is primarily due to the fact that AGC is a new entrant in the primary market and has split ratings which makes competing in certain markets very difficult. Over 40% of AGC's existing insured portfolio consists of reinsurance, which provides revenue and diversification benefits while the firm develops its primary business, although it is anticipated that all new reinsurance business will be underwritten by AG Re. In 2005 AGC transferred a significant portion of its existing reinsurance portfolio to AG Re to centralize the group's reinsurance operations in one entity and to better utilize capital at AG Re.

The strategy of AG Re, which is still the largest monoline reinsurer in the industry, is to pursue reinsurance relationships with established financial guarantors and to provide reinsurance capacity to AGC. The group also pursues a somewhat opportunistic mortgage (re)insurance strategy through Assured Guaranty Mortgage Insurance Company (AGM), which is a wholly owned subsidiary of AG Re. The group has not written any mortgage (re)insurance business since the first half of 2005. The risks in its portfolio are written on an excess of loss basis and are written to investment grade standards. AG Re's financial guaranty portfolio has grown substantially in the past few years, having assumed FSA-originated business that was previously ceded to AGC, and from reinsuring approximately 30% of AGC's financial guaranty originations. While most of the business that AGC cedes to AG Re is quota share, AGC has, on the margin, used its captive reinsurance relationship for portfolio shaping purposes by ceding higher risk business to its affiliate, which has contributed to the deterioration of AG Re's portfolio risk ratios. The reinsurance portfolio provides significant diversification benefits for the group and is an important and stable source of earnings. Reinsurance volume has declined more recently given the cyclical slowdown in new business written by the primaries. In addition, AG Re's reinsurance relationships have shifted from treaty to facultative arrangements over time as the primary companies have come to rely on reinsurance as a tool to manage their portfolio risk concentrations. While facultative relationships give reinsurers more control over the shaping of their own portfolio and return characteristics (in that they have the ability to turn-down deals), premium volumes are generally not as stable as with treaty relationships. Competition in the reinsurance segment has also increased with the emergence of new entrants. Furthermore, the group's growing primary financial guaranty business competes directly with its main reinsurance clients, which may ultimately impact the demand for its reinsurance. However, Moody's expect AG Re to continue to benefit from Assured Group's long history in the financial guaranty reinsurance sector.

## Risk Management & Controls

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### CORPORATE GOVERNANCE

Moody's believes that there is an unusually high degree of alignment of shareholder and creditor interests in the financial guarantor sector because a guarantor's financial strength is so essential to the franchise and, ultimately, the underlying value of the business. This alignment mitigates the overriding governance concern that management will act in the interests of shareholders to the detriment of creditor and policyholder interests. However, it also places a special burden on each financial guarantor's board and management team to act in a manner that gives unusual weight to the interests of creditors. In this context, corporate governance of the Assured Guaranty group is neither a positive nor negative factor in our rating at this time.

Moody's cited improvements to corporate governance and risk management practices in its decision in June, 2006 to change the rating outlook of AGC to positive from stable. The Assured Guaranty group has adapted well to its public company status over the past few years. It has proven since the 2004 IPO by ACE Limited-which remains AGL's largest shareholder-that its controls and systems are effective, although somewhat untested. Governance practices have also shown their resilience and have been adapted to be more in line with the company's mature public company competitors. In three years, the board has modified its composition to increase the sector, financial service and technical skills amongst its members, and to increase board independence.

Governance concerns are more limited than in the past. The Assured Guaranty group continues to operate with a fully outsourced internal audit function, which sets it apart from its major competitors. While Moody's recognizes the inherent benefits in such an approach, such as the access to more qualified technical specialists, we remain of the view that companies gain from having some in-house internal audit resource on call. The Board has concentrated on financial, operational and control issues related to AGL's status as a publicly traded financial guarantor.

Assured has adhered closely to its pre-spin-off strategy, so the board has not needed to deal with major shifts in strategy. That said, if strategic changes became necessary in the future, the board is well-placed to guide and oversee management.

## UNDERWRITING DISCIPLINE & PORTFOLIO RISK MANAGEMENT

Given the industry's modest capital base relative to other financial institutions, the risk profile of the insured portfolio is of utmost importance. Management's objective in writing financial guaranty insurance is to compile a diversified portfolio of profitable, high quality municipal and structured transactions, where the risk of loss is remote. To achieve this objective, the Assured Guaranty group has set up a Portfolio Risk Management Committee comprised of senior management that reviews portfolio composition, establishes limits and sets broad underwriting standards for the group. The company has established single risk, sector, country and servicer limits. Based on the group's limits, sub-limits are derived for AGC and AG Re.

AGC underwrites to an "investment-grade" standard, focusing on sectors where the expected severity of loss in the event of default is low. All transactions at AGC are reviewed and approved by its Credit Committee. At AG Re, facultative reinsurance transactions are approved by a committee, but the company relies on an exclusion list for filtering transactions under its quota share reinsurance arrangements. The initial focus of underwriting is on the credit risk associated with a specific transaction, although portfolio-related issues surrounding single risk concentrations, sector and geographic diversification, and profitability are also key parts of the company's analysis.

## SURVEILLANCE CAPABILITIES

A key ingredient to the success of any financial guaranty company is its surveillance and loss remediation skills. The financial guarantors typically have a greater ability to influence the outcome of workout situations than other investors, given the relative size of their exposures, as well as their broad level of expertise within particular industries and sectors. In addition, many asset-backed transactions can be structured to allow the guarantor to control servicing and capture cash flow if problems arise.

The Assured Guaranty group has set up a centralized risk management system which monitors credit deterioration through quantitative models. All identified problem credits are then remodeled to determine changes to expected loss and implications for loss reserves. Remedial steps are initiated for any transaction that has experienced a material deterioration in credit quality. For the reinsurance book, the primary companies have responsibility for surveillance and workout expertise, however, the company also conducts its own review and analysis, particularly for problem credits.

## Insured Portfolio

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### OVERVIEW

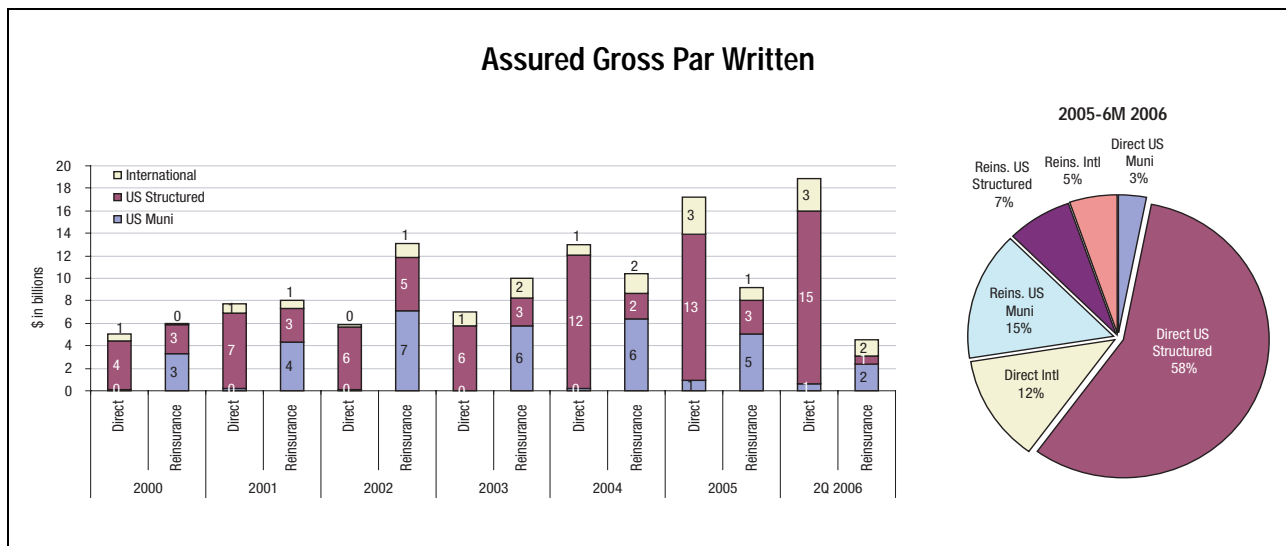
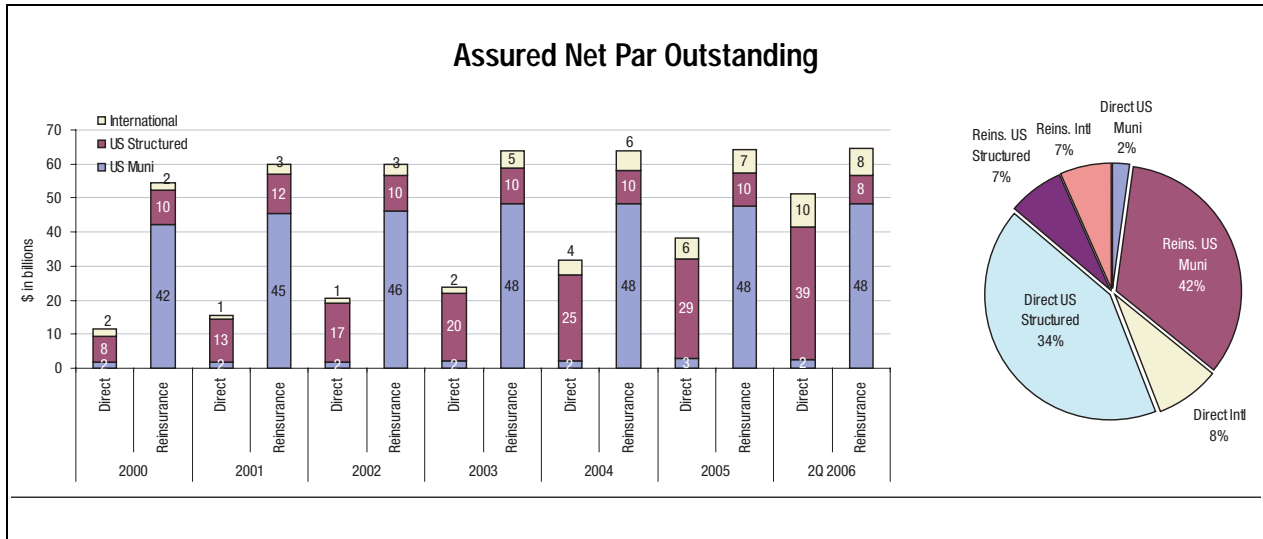
The Assured Guaranty group continues to make progress in strategically repositioning itself as a provider of both direct financial guaranty insurance and financial guaranty reinsurance through its different legal entities. Ceded reinsurance risks still dominate the insured portfolio, accounting for 56% of the group's net par outstanding. However, as of 2Q 2006, nearly three quarters of the group's insured par written during 2005 and the first half of 2006 was through AGC's direct platform.

Growth trends in the volume of AGC's direct business have been impressive since the IPO. In 2006, gross par written through the third quarter was 73% higher than for all of 2005, which was a record production year for the firm. AGC's market share (i.e., gross par written by the firm as a percentage of total gross-par written for the Moody's rated universe) was 7.4% for the first nine months of 2006, versus 3.2% for full-year 2005. While direct par outstanding has nearly doubled since the IPO, AGC's net par outstanding still only represents about 3.5% of the market share of Moody's rated universe at 9/30/06. Moody's does not anticipate that AGC's share of net par outstanding will increase significantly in the short term, but to the extent that it can maintain its growth trajectory in par written over time, the predictability and stability of AGC's earnings should ultimately improve. AG Re remains the largest mono-line reinsurer but reinsurance par written has declined and reinsurance net par outstanding has remained flat. Furthermore, with Ambac deciding not to renew its quota share treaty effective July 1, 2006, reinsurance volumes could deteriorate. AG Re has been writing facultative business but volumes are unpredictable and lumpy.

### *Business Mix*

While AGC's direct financial guaranty business has grown, volume remains concentrated in structured segments, with limited activity in the US public finance markets. CDS execution continues to dominate its new business mix, accounting for the majority of its direct production, which is significantly higher than for other financial guarantors.

The group's consolidated insured portfolio remains well-diversified with US municipal, structured and international exposures accounting for 44%, 41% and 15% of the outstanding portfolio respectively. Going forward, managing risk concentrations will increase in importance for the firm, particularly if direct structured transactions continue to make-up such a large proportion of new business written.



## ASSURED GUARANTY CORP.

The insured portfolio of AGC is transitioning, consistent with the company's shift in business strategy. The company's recent underwriting focus has been on direct structured transactions which account for 87% of its non-municipal portfolio. CDS execution accounted for three quarters of AGC's direct par outstanding and two-thirds of its direct business written during the 18 months ending 6/30/06. The CDS transactions that AGC writes are designed to mimic the terms of a financial guaranty policy and, for the most part, are not subject to broader default definitions and accelerated claims payment. However, they are required to be marked-to-market for financial statement reporting, which results in heightened volatility in reported earnings. As a relatively new primary financial guarantor with split ratings, AGC's ability to penetrate the direct municipal segment has been difficult, accounting for only 5% of the firm's aggregate par written. AGC's direct writings have remained largely restricted to some of the smaller municipal issuers, capacity constrained names, and the auction rate market. However, AGC's reinsurance portfolio, which comprises 41% of its total net par outstanding and is 78.5% concentrated in the municipal sector, provides substantial diversification benefits for the firm. Going forward, AGC will focus almost exclusively on the primary market, with third-party reinsurance written out of AG Re.

## AGC - Par Outstanding and Business Production (\$ millions)

Sector	Par Outstanding (2Q 2006)				Par Written (2005-1H 2006)			
	Reinsurance	Direct FG	Direct CDS	Total	Reinsurance	Direct FG	Direct CDS	Total
<b>US Public Finance:</b>								
General Obligation	4,499	243	-	4,742	17	188	-	205
Healthcare	2,022	397	-	2,419	25	350	-	374
Higher Education	444	270	-	714	5	271	-	276
Housing	378	-	-	378	-	-	-	-
IOU	908	-	-	908	-	-	-	-
Municipal Utilities	4,282	71	-	4,353	25	28	-	53
Other Public Finance	987	9	-	997	-	10	-	10
Tax Backed	2,794	328	-	3,121	142	285	-	427
Transportation	3,066	42	-	3,108	-	-	-	-
<b>Total US Public Finance</b>	<b>19,380</b>	<b>1,360</b>	<b>-</b>	<b>20,740</b>	<b>213</b>	<b>1,131</b>	<b>-</b>	<b>1,344</b>
<b>US Structured Finance:</b>								
Senior Layer CDOs	844	1,775	15,049	17,668	4	1,301	10,628	11,933
Commercial Receivables	494	235	3,243	3,972	-	317	1,856	2,173
Consumer Receivables	285	822	699	1,806	-	820	-	820
Mortgage-backed & home equity	621	2,955	3,240	6,817	3	2,082	2,519	4,603
Other Structured Finance	264	10	126	399	-	24	-	24
<b>Total US Structured Finance</b>	<b>2,508</b>	<b>5,797</b>	<b>22,358</b>	<b>30,663</b>	<b>6</b>	<b>4,543</b>	<b>15,004</b>	<b>19,553</b>
<b>International Public Finance:</b>								
Infrastructure	666	104	534	1,304	12	355	96	463
Other Public Finance	585	1,673	41	2,299	-	863	39	901
<b>Total International Public Finance</b>	<b>1,251</b>	<b>1,777</b>	<b>574</b>	<b>3,603</b>	<b>12</b>	<b>1,218</b>	<b>134</b>	<b>1,364</b>
<b>International Structured Finance:</b>								
CDO's	572	107	1,510	2,189	-	101	686	787
Other Structured Finance	979	806	1,614	3,400	-	749	577	1,325
<b>Total International Structured Finance</b>	<b>1,551</b>	<b>913</b>	<b>3,124</b>	<b>5,589</b>	<b>-</b>	<b>850</b>	<b>1,262</b>	<b>2,113</b>
<b>Total</b>	<b>24,690</b>	<b>9,847</b>	<b>26,056</b>	<b>60,594</b>	<b>232</b>	<b>7,741</b>	<b>16,400</b>	<b>24,373</b>

### ***US Municipal Portfolio***

The mix of AGC's municipal portfolio mirrors the average for the industry, with general obligation and tax backed issues (which are considered to be among the safest municipal sectors) accounting for 38% of the firm's municipal par outstanding. Bonds backed by the revenue streams of municipal water and/or sewer projects and electric utilities represent 25% of AGC's municipal portfolio. These transactions are also generally considered to be of low risk, although electric utilities are facing increased competition with the deregulation of the industry. Roughly 26% of AGC's municipal portfolio consists of exposure in relatively riskier sectors such as healthcare and transportation (e.g., airports), which have experienced considerable stress in the past few years.

### ***Structured & International Portfolio***

AGC has substantially expanded its structured finance activities in recent quarters, writing business in a number of sectors, with CDO's continuing to dominate its business mix. The company has not, however, been able to consistently participate in the rotation programs of certain large ABS and MBS originators. Given the current narrow credit spread environment coupled with AGC's trading spread differential, it has not been economical for the firm to compete with the established primaries for plain vanilla consumer ABS/MBS transactions. Consequently, AGC has been focusing its efforts on more complex transactions in less-established asset classes.

Non-US exposure accounts for approximately 15% of AGC's outstanding par and new business production. The company has successfully written insurance for small to mid-sized infrastructure and PFI deals that are not actively targeted by the more established players, although the majority of AGC's international business has involved highly rated structured transactions.

## ASSURED GUARANTY RE LTD.

AG Re's largest counterparties are AGC and FSA, and as a result, its insured portfolio reflects the portfolio composition of those companies. More than 50% of AG Re's insured portfolio consists of municipal transactions, one half of which is made-up of lower-risk general obligations bonds and tax backed transactions. The rest of the municipal portion of the portfolio is comprised of utility (18%), healthcare (12%) and transportation exposures (11%). On the non-municipal side, approximately two-thirds of AG Re's structured and international business comes from AGC, resulting in a relatively high concentration in CDO exposure versus other reinsurers.

AG Re - Par Outstanding and Business Production (\$ million)						
Sector	Par Outstanding (2Q 2006)			Par Written (2005-1H 2006)		
	3rd party reinsurance	Intracompany Reinsurance	Total	3rd party reinsurance	Intracompany Reinsurance	Total
<b>US Public Finance:</b>						
General Obligation	6,926	535	7,461	2,032	69	2,101
Healthcare	3,376	148	3,524	170	133	303
Higher Education	498	90	588	141	90	231
Housing	744	-	744	88	-	88
IOU	555	39	594	348	-	348
Municipal Utilities	5,487	50	5,536	932	9	941
Other Public Finance	450	3	453	79	3	82
Tax Backed	7,744	247	7,990	2,307	121	2,427
Transportation	3,156	-	3,156	1,110	-	1,110
<b>Total US Public Finance</b>	<b>28,936</b>	<b>1,112</b>	<b>30,047</b>	<b>7,206</b>	<b>425</b>	<b>7,631</b>
		-	-		-	-
<b>US Structured Finance:</b>						
Senior Layer CDOs	1,101	6,571	7,672	34	5,169	5,203
Commercial Receivables	1,075	696	1,771	387	724	1,111
Consumer Receivables	727	244	971	444	273	718
Mortgage-backed & home equity	1,787	2,961	4,748	2,265	2,034	4,298
Other Structured Finance	1,114	220	1,334	510	182	691
<b>Total US Structured Finance</b>	<b>5,805</b>	<b>10,691</b>	<b>16,497</b>	<b>3,640</b>	<b>8,382</b>	<b>12,022</b>
		-	-		-	-
<b>International Public Finance:</b>						
Infrastructure	1,519	476	1,995	846	109	955
Other Public Finance	1,984	822	2,807	874	565	1,439
<b>Total International Public Finance</b>	<b>3,504</b>	<b>1,298</b>	<b>4,802</b>	<b>1,720</b>	<b>674</b>	<b>2,394</b>
		-	-		-	-
<b>International Structured Finance:</b>						
CDO's	393	537	929	230	815	1,044
Other Structured Finance	1,159	1,581	2,741	655	1,193	1,848
<b>Total International Structured Finance</b>	<b>1,552</b>	<b>2,118</b>	<b>3,670</b>	<b>885</b>	<b>2,008</b>	<b>2,893</b>
		-	-		-	-
<b>Total</b>	<b>39,796</b>	<b>15,221</b>	<b>55,017</b>	<b>13,451</b>	<b>11,489</b>	<b>24,941</b>

## USE OF REINSURANCE

AGC cedes about 30% of its direct business to AG Re through a variable quota share arrangement, with the amount of reinsurance on individual transactions generally ranging between 25% and 50%. In addition, AGC has been able to shape its retained insured portfolio by ceding a small percentage of higher-risk business to its affiliate. AGC has also entered into facultative reinsurance treaties with RAM Re and BluePoint Re, mainly for reinsuring capacity-constrained names.

## LARGE SINGLE RISKS AND CORRELATED RISKS

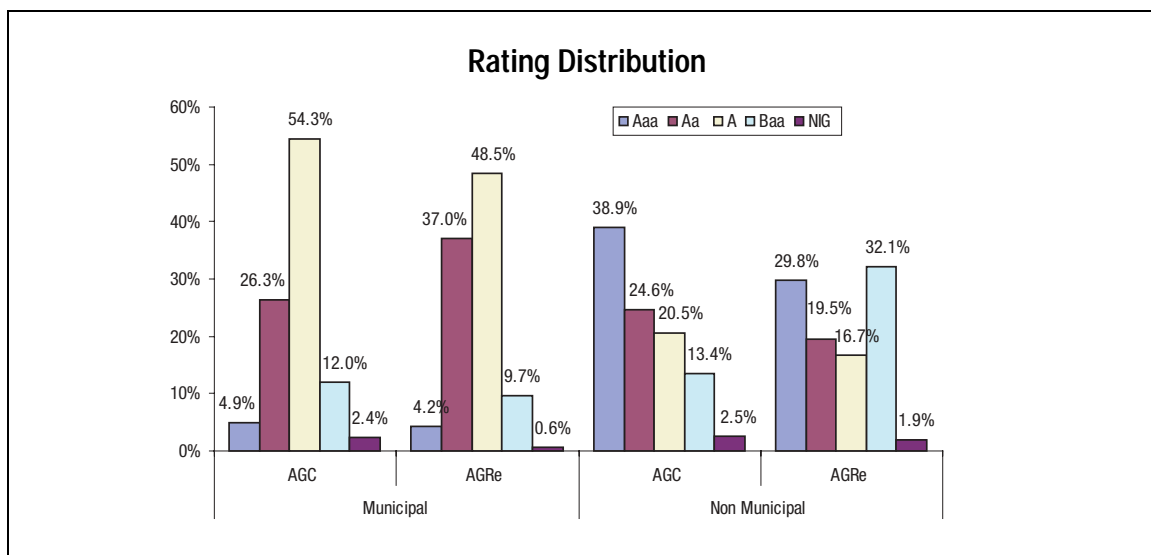
From a portfolio perspective, large single names can measurably contribute to the risks of the overall insured book, depending upon the magnitude, credit quality, and tenor of the exposure. State insurance laws and regulations impose limits on the maximum single risk exposure that a financial guaranty company can assume, although in our opinion, these limits are not overly restrictive in the riskiest sectors. Beyond these limits, the company also operates under its

own internal capacity constraints to avoid excessive risk concentrations within its portfolio. The Assured Guaranty group has established single risk limits at both the individual company level (AGC and AG Re) and at the group level.

At Moody's, we think about the size of individual transactions by calculating the amount of loss that would be experienced assuming the transaction defaults, and that it suffers a severity of loss equal to our worst-case estimate (rather than the expected severity assumption used in our portfolio risk model.) We place particular focus on individual transactions that would result in a loss of greater than 10% of a firm's hard capital under such circumstances. For Assured, there are a few transactions that exceed this threshold, although the number remains manageable in our view.

<b>Largest Single Risk Exposures</b>				
<b>As of December 31, 2005 (\$ millions)</b>				
<b>AGC</b>				
<b>Issuer</b>	<b>Bond Type</b>	<b>Net Par</b>	<b>Par as a % of Hard Capital</b>	<b>Rating</b>
<b>Municipal</b>				
Denver Colorado Airport System	Airports	393	30%	A2
<b>Structured Finance</b>				
Citibank Omni-S Master Trust 2002-3	Credit Card	400	31%	Aaa
Park Place (Ameriquest) PPSI 2004-MHQ1	Home Equity-LOC	423	32%	Aaa
Ameriquest Mortgage Securities Inc.	Home Equity-LOC	275	21%	Aaa
Countrywide Home Equity Loan Trust 2005-J CI 1-A	Home equity	375	29%	Aa1
Countrywide Home Equity Loan Trust 2005-J CI 2-A	Home equity	375	29%	Aa1
<b>AG Re</b>				
<b>Issuer</b>	<b>Bond Type</b>	<b>Net Par</b>	<b>Par as a % of Hard Capital</b>	<b>Rating</b>
<b>Structured Finance</b>				
California Workers' Compensation Self-Insurers	CDO/CDS	365	34%	A2
Argent Securities Inc.	Home Equity-LOC	252	23%	Aaa
Park Place (Ameriquest) PPSI 2004-MHQ1	Home Equity-LOC	423	39%	Aaa
Ameriquest Mortgage Securities Inc.	Home Equity-LOC	275	26%	Aaa
Countrywide Home Equity Loan Trust 2005-J CI 1-A	Home Improvement	375	35%	Aa1
Countrywide Home Equity Loan Trust 2005-J CI 2-A	Home Improvement	375	35%	Aa1
<b>International Finance</b>				
Spirit Issuer Plc Class A1 Debenture Bonds	ABS-Other	276	26%	Baa2
Graphite Mortgages Plc	Residential First Mortgage	551	51%	Aa2
Lunar Funding I Limited	Utility-Electric&Gas	190	18%	Baa1

## RATING DISTRIBUTION



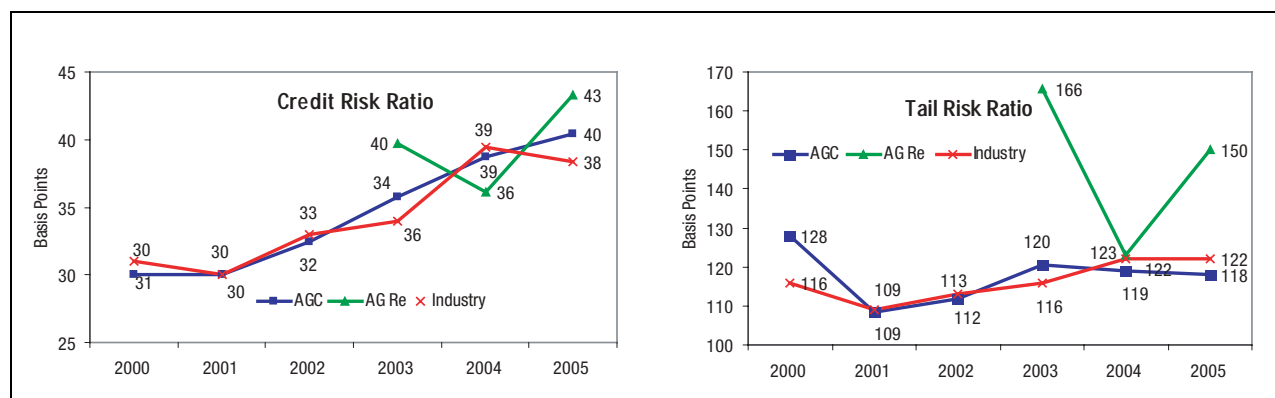
Overall, the insured portfolio of the combined group is of high quality, although there are some noteworthy differences between AGC and AG Re. AG Re's municipal portfolio has a greater proportion of highly-rated transactions than does that of AGC, but for the non-muni book, the reverse is true. The comparative differences are a reflection of the constraints of the split rating, the relative focus of each company and the maturation of the business strategy for the group.

The credit quality distribution of the group's municipal portfolio is virtually unchanged from that of a year ago, with more than 85% of the portfolio rated single-A or higher, although there was a modest increase in the proportion of non-investment-grade for both companies due primarily to Katrina-related downgrades.

Two-thirds of AGC's non municipal portfolio is rated in the Aaa-Aa range which is higher than the industry as a whole, reflecting the firm's underwriting of highly-rated CDS. AG Re's non municipal rating distribution is bi-modal, with both Aaa and Baa transactions accounting for a third of the portfolio. The large Aaa proportion reflects business ceded from FSA and AGC, while the proportion of Baa-rated transaction is more representative of the average credit quality of the industry's structured book. For both AGC and AG Re, the proportion of non-municipal transactions rated below-investment-grade declined from a year ago.

## PORTFOLIO RISK RATIOS

Portfolio risk ratios for AGC and AG Re showed divergent trends in 2005. The credit risk ratio<sup>1</sup> (CRR), which reflects the embedded expected lifetime losses as a percentage of the total portfolio, remained relatively unchanged for AGC at 40 basis points. The ratio for AGC is a blend of higher-risk reinsurance business, offset by the highly rated direct business with an average credit quality of 60 and 16 basis points, respectively. Over the same period AG Re's credit risk ratio deteriorated to 43 bps from 34 bps as it assumed the FSA originated book and certain higher-risk transactions from AGC, including EETC and PFI exposures.

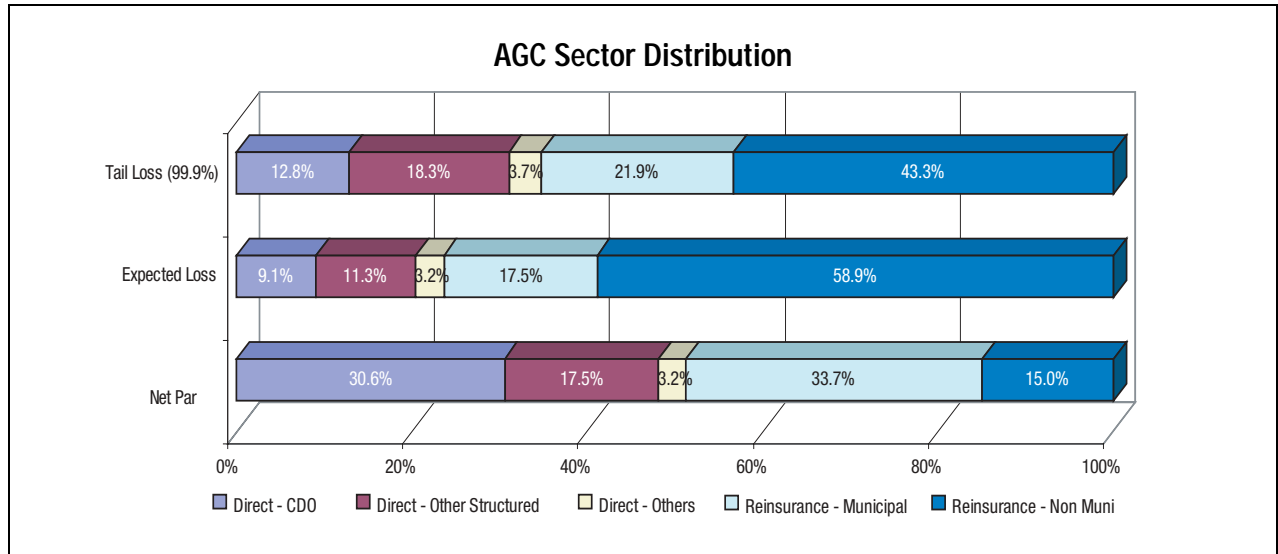


Stress-level loss estimates as calculated under Moody's portfolio risk model are a function of the insured portfolio's credit quality, maturity structure, sector distribution, and portfolio risk concentrations, in addition to broad macroeconomic risk. Stressed losses for AGC declined as it ceded some of its higher-risk NIG credits and single risk exposures to AG Re. AGC's tail risk ratio<sup>2</sup> (TRR) which reflects potential losses in a distress scenario, remained relatively stable at 118 bps while its dispersion ratio<sup>3</sup> declined to 2.93x. AGC's direct portfolio concentrations in the CDO and MBS sectors are somewhat offset by the diversification benefit provided by its reinsurance portfolio. In line with the deterioration in the credit risk ratio, AG Re's, TRR increased to 150 bps and its dispersion ratio increased modestly to 3.47x. While AG Re's portfolio characteristics deteriorated, they remain better than the average for the reinsurance industry, largely due to the risk characteristics of the transactions ceded from FSA, which account for half of its insured portfolio.

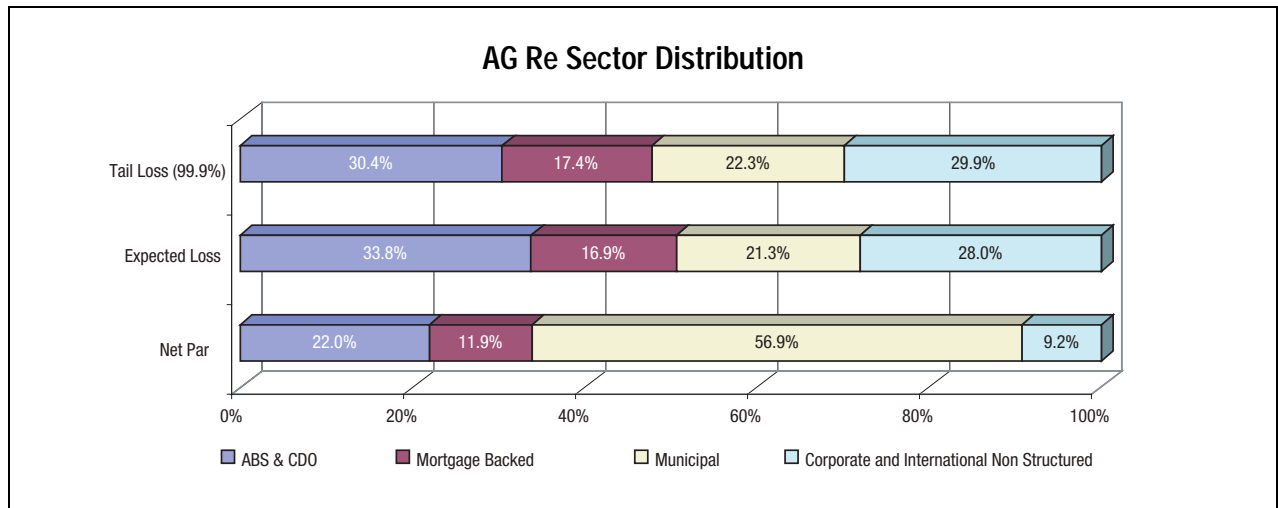
1. Expected present value of losses imbedded in the insured portfolio relative to net par outstanding, adjusted for the benefit received from reinsurance (i.e., the average expected loss rate on the portfolio). This ratio indicates a portfolio's average credit risk, which depends upon its distribution across sectors, rating categories and tenors.

2. The maximum amount of (present value) credit losses with 99.9% confidence relative to net par outstanding, adjusted for the benefit received from reinsurance. The ratio measures portfolio's stress-level losses relative to par, which depends upon its average credit quality, risk concentrations and correlations among credits.

3. The maximum amount of (present value) credit losses with 99.9% confidence relative to the expected losses embedded in the insured portfolio. The ratio measures the impact of large single risks & risk concentrations on portfolio risk for a given expected loss level.



The non-municipal portion of AGC's portfolio contributes the highest proportion of risk although it comprises only 15% of the net par. AGC's exposure to Eurotunnel, EETC and manufactured housing transactions in its reinsurance portfolio account for a substantial portion of the expected loss and tail loss in the insured portfolio. These segments have undergone significant credit deterioration over the past several years. AGC's high credit quality direct CDOs and the municipal reinsurance book have the best net par to expected and tail loss contribution relationship in AGC's portfolio.



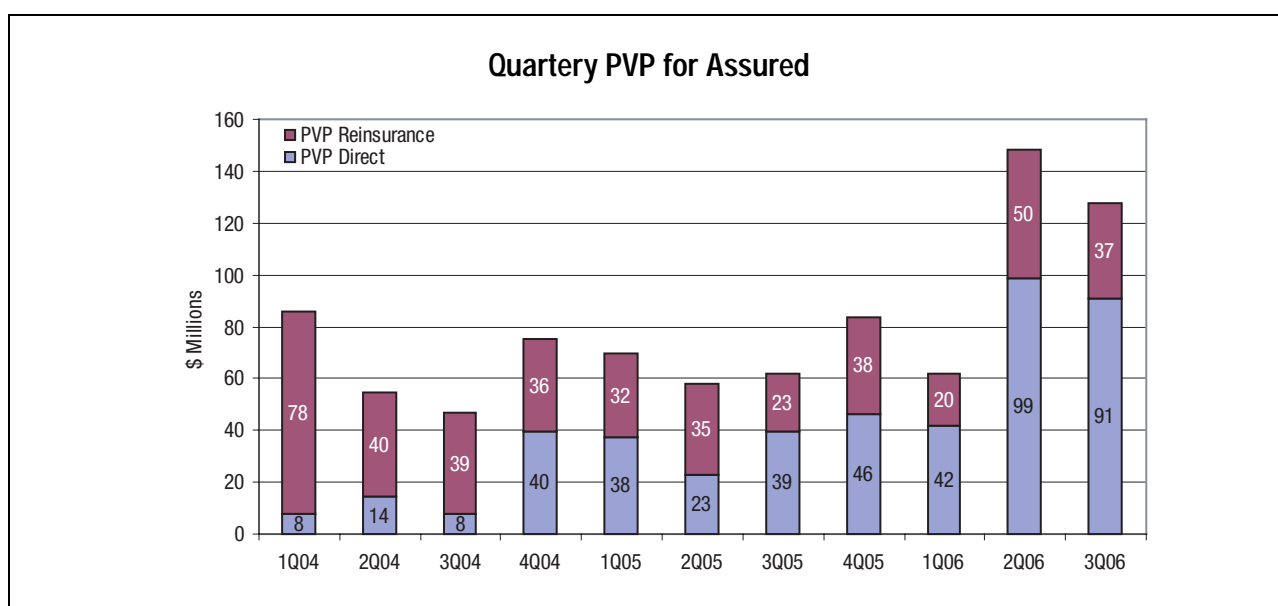
The relative risk contributions of the sectors are evident when observing the relationship between the proportion of net par to the proportion of tail loss contribution. ABS, CDO and the corporate and international non structured segments of the AG Re portfolio account for the largest proportion of the tail loss. The loss contribution of the mortgage backed segments is notable at 22.3% of tail losses despite being only 11.9% of the net par. Conversely, the municipal segment is the largest proportion of the insured portfolio at 56.9% but contributes only 22.3% to the tail losses.

## Financial Profile

### FINANCIAL RESULTS

AGL's operating ROE was 9.3% for the first 9 months of 2006, compared to 12.4% and 10.1% for full year 2005 and 2004 respectively. Operating ROE excludes after-tax realized gains (losses) on investments and after-tax unrealized gains (losses) on derivative financial instruments. AGL's operating income in 2005 increased by 35% over the prior year, benefiting from one-time events such as recovery of prior losses, but operating income for the nine months of 2006 fell by 26%. Profitability is relatively low for Assured, reflecting the firm's transitioning business strategy, its investment in a broad-based operating infrastructure and a capital base that is not yet fully utilized. These factors will continue to inhibit the firm's ROE over the near term.

Quarterly PVP (present value of premiums), which is a key indicator of new business written, increased significantly in the last two quarters. Although the growth is reflective of the increases in the volume of direct financial guaranty, a large portion of the increase can be attributed to AGC writing more direct and AG Re reinsuring more international PVP in each of the second and third quarters of 2006 than during the full year in 2005. However, international production, while highly profitable, tends to be lumpy.



AGL's expense ratios have been volatile, reflecting the trends in earned premiums, although operating expenses have only increased modestly despite the firm's continued build-out of its operating infrastructure. Management expects that the firm's expense ratio will stabilize as higher premiums offset further infrastructure expansion.

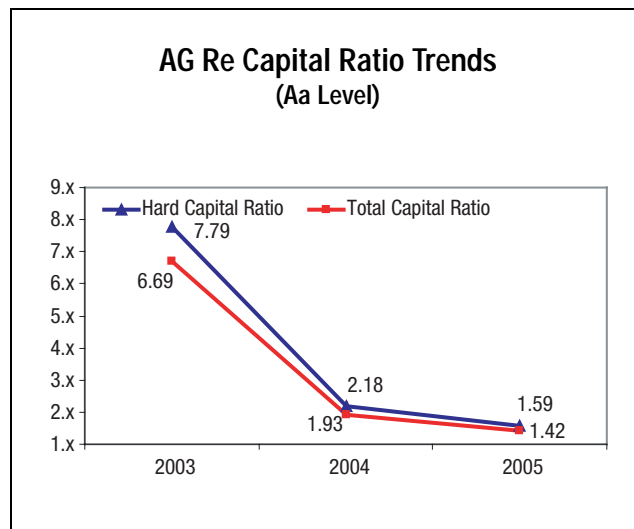
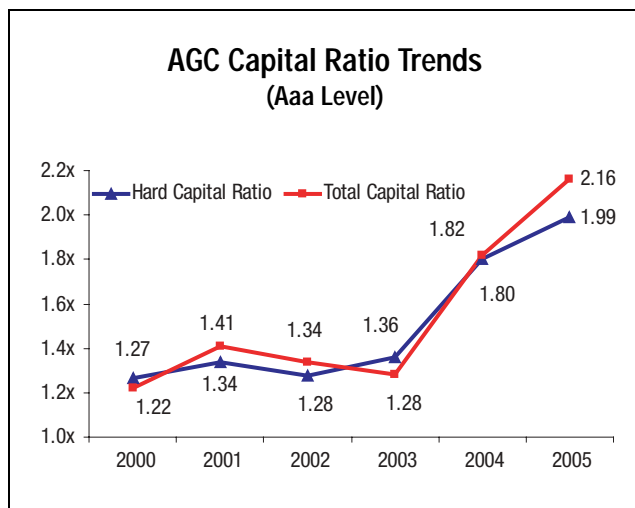
### RISK ADJUSTED CAPITAL ADEQUACY

AGC's hard<sup>4</sup> and total<sup>5</sup> capital ratios as of year-end 2005 (with ratings updated through second quarter 2006), were strong at 2.16x and 1.99x respectively (measured at Moody's threshold for Aaa-rated companies.) The improvement in these ratios reflects under deployed capital at AGC and the transfer of certain higher risk transactions to AG Re.

In contrast, AG Re's capital ratios declined over the last two years, as its portfolio more than doubled with its assumption in 2005 of FSA-originated business previously held by AGC, coupled with reinsuring roughly 30% of AGC's newly-originated business. AG Re remains adequately capitalized as reflected by its year-end hard and total capital ratios (measured at Moody's threshold for Aa-rated companies) of 1.59x and 1.42x, respectively.

4. Measures the ability of a guarantor to meet stress-level losses with hard capital. The ratio is defined as hard capital (i.e., qualified statutory capital, unearned premium reserves, & 85% of PV installment premiums.) relative to the maximum amount of credit losses (present value) with 99.9% confidence (99.5% for Aa companies).

5. Measures the ability of a guarantor to meet stress-level losses at a higher confidence interval with total capital. The ratio is defined as total capital (i.e., hard capital plus the discounted value of soft capital facilities) relative to the maximum amount of credit losses (present value) with 99.99% confidence (99.9% for Aa companies).



## FINANCIAL LEVERAGE

In May, 2004, Assured Guaranty US Holdings Inc. issued \$200 million in 30-year debentures (rated A1 by Moody's), the proceeds of which were used to repay debt owed to a subsidiary of ACE Ltd. incurred in connection with the formation of Assured Guaranty Ltd. The rating on these notes benefits from AGL's corporate guarantee of the debt and its ownership of AG Re and its subsidiaries. AGL's financial leverage at year end 2005 was 10.9% and its double leverage was 112%. In 2005, AGC issued \$200 million in contingent capital securities (rated Aa3 by Moody's), replacing its bank soft capital facilities. In December, 2006 Assured Guaranty US Holdings Inc issued \$150 million hybrid security of junior enhanced subordinated notes that qualified for 75% equity treatment. The proceeds of the offering were used to repurchase stock from ACE Limited, reducing its ownership interest of AGL to 30% from 35%. As a result of the transaction, AGL's financial leverage increased slightly to 12.3%, and double leverage increased to 114.60%. More notably, earnings coverage declined from 15x to 8.4x on a pro-forma basis as the interest payments for the hybrid instrument is still considered a fixed charge obligation to the firm. The consolidated leverage ratios remain within Moody's comfort range of 12-16% for financial leverage and less than 120% for double leverage.

## LIQUIDITY RISK MANAGEMENT

The Assured Guaranty group, like other financial guarantors, actively manages assets and liabilities in order to control market, funding, and liquidity risks. The company's historical liquidity needs have been relatively modest, consisting mostly of scheduled debt service payments and dividend distributions to the parent, and claims payments on insured debt that has defaulted. Assured's exposure to the last category has been and is expected to remain fairly small despite its portfolio expansion strategy, given its high quality insured portfolio coupled with the nature of its financial guaranty policies and many of its CDS contracts, which protect the firm against the acceleration of principal payments in most segments.

In our opinion, the Assured Guaranty group maintains sufficient sources of liquidity to pay unexpected claims as they occur as well as to cover its other expenses. The company's primary source of liquidity is the cash flow generated through its operations. The Assured group's cash flow from operations totaled \$183.7 million as of September 30, 2006.

The Assured group's other sources of liquidity include cash and cash equivalents, securities in the guarantors' investment portfolio and committed liquidity facilities. The group maintains an investment portfolio of liquid government and municipal bonds that totaled \$2.3 billion as of September 30, 2006. In addition, the group has a \$300 million liquidity line with a consortium of banks led by ABN AMRO.

## INVESTMENT PORTFOLIO

The Assured Guaranty group's consolidated investment portfolio contains only nominal credit and moderate interest rate risk. Investments generally consist of high quality, marketable municipal, US agency, or US Treasury securities, thereby minimizing credit risk. Virtually all of its security holdings are in the investment grade range, mostly rated Aaa. Equity and other more risky holdings (including corporate bonds) represent less than 7% of the portfolio.

<b>Assured Guaranty Corp's Cash and Invested Assets</b>		
<i>As of June 30, 2006 (\$ in million)</i>		
<b>Investment</b>	<b>Book Value</b>	<b>% of Total</b>
U.S. Government Bonds	60	5%
Non-U.S. Government Bonds	3	0%
State & Local Bonds	753	65%
Corporate Bonds & Asset-Backed Securities	66	6%
Mortgage-Backed Securities	123	11%
Equity	23	2%
Cash and Short Term Investment	108	9%
Other Invested Assets	15	1%
<b>Total</b>	<b>1151</b>	<b>100%</b>

<b>Assured Guaranty Re's Cash and Invested Assets</b>		
<i>As of June 30, 2006 (\$ in million)</i>		
<b>Investment</b>	<b>Book Value</b>	<b>% of Total</b>
U.S. Government Bonds	229	21%
Non-U.S. Government Bonds	2	0%
State & Local Bonds	54	5%
Corporate Bonds & Asset-Backed Securities	280	25%
Mortgage-Backed Securities	488	44%
Equity	0	0%
Cash and Short Term Investment	60	5%
Other Invested Assets	0	0%
<b>Total</b>	<b>1113</b>	<b>100%</b>

## Related Research

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### **Corporate Governance Assessments**

[Corporate Governance Assessment: Assured Guaranty Corp, November 2006 \(100533\)](#)

### **Financial Reporting Assessments:**

[Financial Reporting Assessment: Assured Guaranty Ltd \(Bermuda\), October 2004 \(89140\)](#)

### **Industry Outlook:**

[Global Financial Guaranty Insurance Industry Outlook, December 2006 \(101095\)](#)

### **Special Comments:**

[Moody's Portfolio Risk Model Results for Financial Guarantors, August 2006 \(98601\)](#)

[Evaluating Financial Guarantor's Exposure to Euro tunnel, August 2006 \(98611\)](#)

[The Effect of Hurricane Katrina on Guarantors' Capital Positions Appears Manageable, September 2005 \(94273\)](#)

### **Rating Methodology:**

[Moody's Rating Methodology for the Financial Guaranty Insurance Industry, September 2006 \(98408\)](#)

*To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.*

## Assured Guaranty Corp.

Financial Strength Rating: Aa1

	H1 2006	2005	2004	2003
<b>Insured Portfolio</b>				
Gross Exposure Outstanding	97,778	89,317	122,602	124,117
Net Exposure Outstanding	78,250	70,769	105,831	117,406
Gross Par Outstanding	77,467	68,880	87,583	83,490
Net Par Outstanding (NPO)	60,594	52,659	74,001	78,399
Adjusted NPO [1]	61,689	53,632	57,447	81,757
Gross Par Written	19,001	17,117	17,807	14,612
Net Par Written	13,600	10,737	7,645	14,587
<b>Capitalization (SAP)</b>				
Policyholders' Surplus	276	256	280	256
Contingency Reserve	602	598	518	400
Qualified Statutory Capital (QSC)	878	854	798	656
Capital Charge [2]	(10)	(14)	(15)	(103)
Unearned Premium Reserve	252	234	234	467
Loss and Loss Adj. Expenses Reserve	17	21	12	55
PV of Installment Premiums, Net of Ceding Commission	288	254	242	293
Hard Capital [3]	1,382	1,310	1,234	1,324
Soft Capital	200	455	255	255
Total Capital [4]	1,582	1,598	1,322	1,411
<b>Key Statutory Data</b>				
Total Assets	1,224	1,141	1,278	1,208
Cash and Invested Assets	1,151	1,086	1,201	1,155
Gross Premiums Written	96	(83)	169	219
Net Premiums Written	64	(83)	60	256
Net Premiums Earned	45	89	121	159
Losses and Loss Adj. Expenses Incurred	5	16	(10)	41
Other Underwriting Expenses Incurred	41	(17)	64	82
Net Underwriting Gain (Loss)	0	90	67	36
Net Investment Income Earned	25	50	51	47
Realized Capital Gains	(1)	1	1	2
Pretax Operating Income	24	141	119	87
Net Income	19	101	103	67
Dividends Paid to Stockholders	-	-	-	10
Operating Cash Flow	42	(88)	55	200
Expense Ratio (%)	64	20.8	107.1	32.0
Loss Ratio (%)	10	18.2	(8.4)	25.9
Combined Ratio (%)	74	39.0	98.7	57.9
Dividends Paid / Net Income (%)	-	-	-	15.0
Pretax Operating Income / Average NPO (bps)	8.6	22.2	15.7	11.5
Net Premiums Earned / Average NPO (bps)	16.0	14.0	15.8	21.1
<b>Liquidity</b>				
Cash and Short Term Investments	108	56	67	68
Liquidity Lines	200	200	250	265
Cash and Invested Assets / Total Assets (%)	94.0	95.2	93.9	95.7
<b>Leverage</b>				
Adjusted Net Par Outstanding / Hard Capital (x)	44.6	40.9	46.5	61.8
Adjusted Net Par Outstanding / Total Capital (x)	39.0	33.6	43.5	57.9

## Assured Guaranty Corp.

### Financial Strength Rating: Aa1

#### Cash and Invested Assets (SAP) (% of Total)

U.S. Government Securities	5	3.8	3.3	3.8
Non-U.S. Government Securities	-	0.2	0.2	0.4
State and Local Government Bonds	65	70.2	64.5	61.6
Corporate Bonds	4	4.9	5.9	7.6
Asset Backed and Mortgage-backed Securities	13	12.3	17.6	18.0
Total Bonds	87	91.4	91.5	91.4
Equity (Common and Preferred Stock)	2	2.0	1.4	1.1
Cash	0	0.2	2.3	2.1
Short Term Investments	9	4.9	3.3	3.8
Other Invested Assets	2	1.4	1.5	1.6

#### Reinsurance (% of Gross Ceded)

Third Party Par Outstanding	1.0	3.9	3.0	6.1
Par Written	28.4	37.3	57.1	0.2
Premiums Written	33.3	0.5	64.5	-16.7

#### Key GAAP Data (Assured Guaranty Ltd.)

Total Assets	2,735	2,677	2,694	2,858
Outstanding Debt	197	197	197	75
Stockholders' Equity	1,683	1,662	1,528	1,438
Net Income	79	188	183	215

#### Expense Ratio (%)

Loss Ratio (%)	60.2	58.9	65.4	37.2
Combined Ratio (%)	(7.2)	-35.0	-17.0	46.5
Return on Average Equity (%) [5]	53	23.9	48.4	83.7
Interest Coverage (x)	9.1	12.5	10.6	10.4
Double Leverage (%)	14.2	18.3	16.8	26.0
Dividend Capacity (x)		112.1		
Financial Leverage (%)	10.5	348.5	12.0	5.2

Note: All figures are in \$millions except percentages and ratios. na = not available.

[1] Adjusted net par outstanding reflects the haircuts assigned to reinsurance provided by other lower-rated reinsurers.

[2] Moody's has assessed capital charges for Assured Guaranty Re International's investment portfolio and mortgage guaranty portfolio.

[3] Hard Capital resources consist of Qualified Statutory Capital, Unearned Premium Reserves, Loss and Loss Adjustment Expense Reserves, 85% Present Value of Future Installment Premiums, and less capital charges for its investment and mortgage guaranty portfolio.

[4] Total Capital resources are the sum of Hard Capital and discounted depression line (discounted to reflect its limited value in certain stress scenarios.)

[5] Operating return on equity = (Net income minus the after-tax impact of accounting for derivatives and foreign exchange) / average equity excluding accumulated other comprehensive income.

## Assured Guaranty Re International Ltd.

### Financial Strength Rating: Aa2

	H1 2006	2005	2004	2003
<b>Insured Portfolio</b>				
Gross Exposure Outstanding	83,089	78,758	36,964	19,370
Net Exposure Outstanding	82,138	74,925	30,288	12,667
Gross Par Outstanding	55,968	53,639	28,266	15,827
Reported Financial Guaranty NPO	55,017	49,806	21,590	9,125
Adjusted Financial Guaranty NPO [1]	55,058	49,849	41,885	9,862
Gross Par Written	9,694	15,260	16,363	2,701
Net Par Written	9,694	15,210	15,479	2,701
<b>Capitalization (SAP)</b>				
Policyholders' Surplus	703	691	545	560
Contingency Reserve	-	-	-	-
Qualified Statutory Capital (QSC)	703	691	545	560
Capital Charge [2]	(127)	(147)	(146)	(141)
Unearned Premium Reserve	402	356	340	233
Loss and Loss Adj. Expenses Reserve	22	26	123	390
PV of Installment Premiums, Net of Ceding Commission	189	174	158	61
Hard Capital [3]	1,161	1,073	996	1,094
Soft Capital	-	-	0	0
Total Capital [4]	1,161	1,073	996	1,094
<b>Key GAAP Data</b>				
Total Assets	1,338	1,331	1,147	1,376
Cash and Invested Assets	1,091	1,139	892	1,016
Gross Premiums Written	99	144	83	140
Net Premiums Written	92	123	18	233
Net Premiums Earned	46	93	64	133
Losses and Loss Adj. Expenses Incurred	(12)	(68)	(32)	90
Other Underwriting Expenses Incurred	22	12	40	45
Net Underwriting Gain (Loss)	36	149	56	(1)
Net Investment Income Earned	27	45	42	49
Realized Capital Gains	(0.6)	2	11	3
Pretax Operating Income	63	167	99	49
Net Income	56	137	102	116
Dividends Paid to Stockholders	25.4	38	13	25
Operating Cash Flow	11.1	206	(95)	12
	47.6	42.2	62.8	33.9
<b>Expense Ratio (%)</b>				
Loss Ratio (%)	(27.0)	(73.6)	(50.6)	67.1
Combined Ratio (%)	20.6	(31.4)	12.2	101.0
Dividends Paid / Net Income (%)	45.1	27.8	12.8	21.6
Pretax Operating Income / Average NPO (bps)	24	46.9	64.6	53.7
Net Premiums Earned / Average NPO (bps)	17	25.9	41.7	146.3
<b>Liquidity</b>				
Cash and Short Term Investments	60	52	107	90
Liquidity Lines	100	100	-	50
Cash and Invested Assets / Total Assets (%)	81.6	85.5	77.8	73.8
<b>Leverage</b>				
Adjusted Net Par Outstanding / Hard Capital (x)	47.4	46.4	42.1	9.0
Adjusted Net Par Outstanding / Total Capital (x)	47.4	46.4	42.1	9.0

## Assured Guaranty Re International Ltd.

### Financial Strength Rating: Aa2

#### Cash and Invested Assets (GAAP) (% of Total)

U.S. Government Securities	21	0.0	24.8	21.8
Non-U.S. Government Securities	-	0.0	0.0	0.0
State and Local Government Bonds	5	0.0	5.1	9.1
Corporate Bonds	9	0.0	10.8	19.3
Asset Backed and Mortgage-backed Securities	60	0.0	47.3	40.8
Total Bonds	95	0.0	88.0	91.0
Equity (Common and Preferred Stock)	-	0.0	0.0	0.0
Cash	-	0.0	0.4	0.9
Short Term Investments	5	0.0	11.6	7.9
Other Invested Assets	-	0.0	0.0	0.1

#### Reinsurance (% of Gross Ceded)

Par Outstanding	1.7	7.1	23.6	28.7
Par Written	0.0	0.3	5.4	0.0
Premiums Written	6.3	14.6	78.5	-66.9

Note: All figures are in \$millions except percentages and ratios. na = not available.

[1] Adjusted net par outstanding reflects the haircuts assigned to reinsurance provided by other lower-rated reinsurers.

[2] Moody's has assessed capital charges for Assured Guaranty Re International's investment portfolio and mortgage guaranty portfolio.

[3] Hard Capital resources consist of Qualified Statutory Capital, Unearned Premium Reserves, Loss and Loss Adjustment Expense Reserves, 85% Present Value of Future Installment Premiums, and less capital charges for its investment and mortgage guaranty portfolio.

[4] Total Capital resources are the sum of Hard Capital and discounted depression line (discounted to reflect its limited value in certain stress scenarios.)

[5] Operating return on equity = (Net income minus the after-tax impact of accounting for derivatives and foreign exchange) / average equity excluding accumulated other comprehensive income.

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**Authors**

*Arlene Isaacs-Lowe, CPA, CFA  
Deven Kapoor*

**Senior Associates**

*Shahed Masud  
Vika Shenderovich*

**Production Specialist**

*Cassina Brooks*

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