Moody's Investors Service

Summary Opinion: Assured Guaranty Corp

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Opinion

SUMMARY RATING RATIONALE

The Aa2 insurance financial strength rating (IFSR) of Assured Guaranty Corp. and its wholly owned subsidiary, Assured Guaranty (UK) Ltd. (collectively AGC) reflect its strong risk adjusted capitalization, disciplined underwriting and conservative risk management culture, and the company's recent emergence as a leading participant in the financial guaranty industry. These credit positives are offset by AGC's high operating leverage and exposure to weakness inherent in the financial guaranty business model. The recent downgrade of AGC from Aaa resulted from four primary factors. First, we see fewer new business opportunities and weaker confidence in the industry overall. Second, we believe the group's business position and financial flexibility may be quite sensitive to potential changes in its risk profile. Third is the impact that large and potentially correlated risk exposures could have on the company's financial strength should the performance of those exposures deteriorate, particularly in light of the current economic environment. Finally, though somewhat less significant, is Moody's expectation of greater losses on mortgage related exposures, resulting in a modest deterioration of AGC's capital adequacy.

The Assured Group's recently announced acquisition of the financial guaranty business of Financial Security Assurance (FSA) is not expected to have a meaningful impact on the credit profile of AGC. Moody's believes that the acquisition of FSA by Assured Guaranty will, if completed as planned, create a combined entity with substantial financial resources and a strong market position.

In Moody's view, the level of demand for financial guaranty insurance over the near-to-medium-term is less certain than in the past, which has negative implications for the strength and stability of AGC's business franchise. There has been a sharp decline in structured finance business opportunities in the primary market as a result of the current market dislocation, and future structured finance underwriting opportunities are likely to be tempered by concern over the volatility associated with certain structured credits. While there continues to be a market for municipal bond insurance, Moody's believes that prospective opportunities in the municipal sector may also be narrower than in the past given changing perceptions about municipal risk among buyers, lower confidence in the financial guaranty industry broadly and a trend toward alternative forms of execution, including the issuance of uninsured paper. However, while the financial guaranty industry's importance within the US municipal market has declined overall, AGC's relative competitive position in these markets has been favorably affected by its position as one of three primary financial guarantors with limited exposure to higher-risk ABS CDOs.

AGC is a wholly owned subsidiary of the group's intermediate holding company, Assured Guaranty US Holding (A2 senior unsecured rating) which is wholly owned by the ultimate holding company of the group, Assured Guaranty Ltd. (A2 issuer rating). Assured Guaranty Re Ltd., (AG Re), rated Aa3 for insurance financial strength, is an affiliate and acts as the group's main reinsurer but also offers reinsurance to other primary financial guarantors. AGC has been able to shape its insured portfolio by ceding risks to AG Re. The ratings of AGC and AG Re are related, reflecting their strategic relationship and interdependence. As such, Moody's expects the combined capital base of AGC and AG Re to remain strong, and for the group to retain its conservative financial profile.

Credit Strengths

Enhanced competitive position as a leading global provider of financial guaranty insurance

Disciplined underwriting and conservative risk management culture

High quality, well diversified insurance portfolio with nominal liquidity needs

No exposure to recent vintage ABS CDOs and modest exposure to higher risk RMBS

Strong risk adjusted capitalization and embedded earnings

Credit Challenges

Sensitivity of franchise value and financial flexibility to changes in risk profile

Uncertainty about ultimate performance of portions of AGC's RMBS portfolio

Exposure to large single risks and complex structured transactions

Rating Rationale

The stable rating outlook reflects Moody's view that the aggregate capital resources of AGC (including statutory contingency reserves and contingent capital) provide a substantial capital cushion above Moody's expected loss levels. Assured's disciplined underwriting strategy and municipal market expansion have resulted in a generally high-quality and diversified insured portfolio beyond the firm's mortgage-related exposures.

What Could Change the Rating - Up

Clear, sustainable competitive advantages that defend against franchise encroachment

Evidence of highly reliable access to new funding under reasonable terms in stress scenarios

Structural elements that protect against the removal of capital and risk management resources in a run-off scenario

What Could Change the Rating - Down

Deterioration in portfolio credit characteristics

Sustained decrease in hard and total capital ratios below 1.3 times, at the Aa2 confidence level, without corrective action

Extensive diversification into higher-risk business

Deterioration in competitive environment or product demand

Insurance Financial Strength Rating

Moody's rates AGC Aa2 for insurance financial strength, which is in line with the rating indicated by Moody's insurance financial strength rating scorecard. The key factors currently influencing the rating and outlook are:

Factor 1: Franchise Value and Strategy: Aa

Moody's scores AGC Aa for franchise value and strategy to reflect the near term business environment for financial guarantors, with fewer new business opportunities and weaker market confidence for the financial guaranty industry overall. Moody's believes that customer demand for AGC's wraps may be unstable, with a sharp fall-off in demand likely to result from even moderate declines in the guarantor's credit profile. This susceptibility to changes in credit risk profile creates a "demand cliff" beyond that observed in most other industries.

The Aa score also reflects AGC's enhanced competitive position as a result of the company's modest exposure to mortgage related risk, disciplined underwriting strategy and conservative risk management. Although insured penetration rates in the municipal market have fallen significantly in recent quarters, AGC`s competitive position has strengthened, benefiting from reduced competition and improved premium rates in the municipal market. However, the competitive environment may be affected over the medium term by changing perceptions about municipal risk among buyers, lower confidence in the financial guaranty industry broadly and a trend toward alternative forms of execution, including the issuance of uninsured paper. Moody's believes that credit enhancement for smaller and more complex credits and the benefits of third party due diligence and liquidity will continue to influence investors' demand for wrapped transactions in the future, providing ongoing business opportunities for AGC.

Factor 2: Portfolio Characteristics: Aa

As a relatively recent entrant into the primary financial guaranty market, AGC has insured a significant amount of structured finance transactions, which represent more than two-thirds of its insured portfolio. Approximately $30 billion of AGC's portfolio is concentrated in highly rated pooled corporate exposures with substantial subordination. Most non-mortgage exposures are performing well, although the insured portfolio is exposed to transaction or sector deterioration, especially in light of the increased risk of a prolonged and deep recession. Recent portfolio growth primarily in the municipal sector has improved the diversification of AGC's insured portfolio, although single risk concentrations remain high relative to capital.

Factor 3: Capital Adequacy: Aa

AGC's capital position has deteriorated somewhat as a result of portfolio growth and modest increases in tail losses primarily attributable to the performance of the company's RMBS portfolio under Moody's updated RMBS stress scenario. AGC's capital profile falls below Moody's "target" total capital ratio at the Aaa level but is solidly positioned at the Aa level. The company has been able to manage capital by shaping its insured portfolio through risk cessions to AG Re, particularly with respect to large single risks.

Factor 4 - Profitability: A

The embedded premiums in AGC's portfolio, which have been further enhanced with significant volumes of new municipal business written during the first half of 2008, should provide the firm with a strong stream of revenue over the next few years. However, Moody's expected loss estimates for AGC's RMBS exposure suggests that its profitability may experience some pressure.

Factor 5 - Financial Flexibility: Aa

The Aa score for financial flexibility reflects the Assured Group's conservative leverage profile and recent success in accessing capital to fund growth. Moody's believes, however, that the extreme sensitivity of a financial guarantor's franchise value to changes in its risk profile negatively affects financial flexibility, where even the best positioned firms could experience a dramatic constriction of financing options if material losses were to develop.