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Assured Guaranty Corp. And Financial Security Assurance Inc.

Major Rating Factors

Financial Strength Rating
Local Currency
AAA/Negative/--

Strengths:

- Both companies have a proven track record for credit discipline.
- Underwriting focus on low-risk U.S. public finance market.
- Flexibility within the corporate structure to underwrite different lines of business out of separate subsidiaries.
- Both companies are well-capitalized, with margins of safety well in excess of 'AAA' minimums.

Weaknesses:

- Susceptible to continued adverse loss development of U.S. nonprime residential mortgage exposure.
- Potential impact on market acceptance of Assured's continued, selective insurance of structured finance credits and FSA's structured run-off portfolio.
- Large single risk exposure to Belgium and France.

Rationale

The insurer financial strength ratings on Assured Guaranty Corp. (Assured) and Financial Security Assurance Inc. (FSA) reflect our view of their strong market position in the bond insurance industry and their solid capital position. The acquisition of FSA will provide the combined entity with a flexible platform from which to write business. Assured and FSA have proven track records for credit discipline, as their lack of exposure to the problem credits that have plagued other financial guarantors demonstrates. However, we do not believe that FSA has entirely isolated the risks associated with the financial products business retained by Dexia S.A., so we have applied a capital charge to FSA.

Assured and FSA were effectively the only two bond insurers active in the U.S. public finance market for the first quarter of 2009. Assured wrapped $8.2 billion of par and FSA wrapped $1.2 billion of par, compared with $7.2 billion and $18.4 billion, respectively, in the first quarter of 2008. Assured's ability to write a greater amount of business was constrained more by staffing levels to meet the demand than from lack of opportunities. Assured and FSA should experience an increase in volume as they make efficient use of their combined resources. Both companies should also benefit from a bond insurance landscape that lacks any significant competition in the near term.

Assured is well-capitalized, as measured by Standard & Poor's capital adequacy test, with a margin of safety of 1.5x-1.6x, which we view as strong. FSA's margin of safety is 1.4x-1.5x, which we also view as strong. The margin of safety for FSA did include the residual capital charge for the financial products business. We expect that there will be little change in the company's margins of safety because of the low-risk business they intend to underwrite in the public finance market, combined with a strong pricing environment. We view Assured and FSA as being core to Assured Guaranty Ltd., and we rate them as a consolidated group.

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As part of the sale of FSA, Dexia S.A. has assumed the risk of FSA's guaranteed investment contract (GIC) business. We analyzed the degree to which the structure with Dexia S.A. isolates the GIC business from FSA. Based on our analysis and testing, we found that although the structure does create remoteness from these risks, the company is not totally isolated from them. In October 2011, Dexia must post required collateral to a trust for the benefit of Assured-FSA and the GIC-issuing entities. Until that time, FSA has significant exposure to the performance of Dexia. Belgium and France have guaranteed Dexia's obligation, and our rating on Dexia is dependent on both sovereigns. Therefore, we view FSA as having large single-risk exposure to the two sovereigns.

Outlook

The negative outlook on both entities reflects our view that the proposed separation of Assured-FSA's GIC business does not fully mitigate asset risk and exposes the company to related claims. Most importantly, prior to the required collateral being posted, Assured-FSA would retain a large single-risk concentration exposure to Belgium (AA+/Stable/A-1+) and France (AAA/Stable/A-1+). Unrelated to the acquisition, the outlook also reflects our view that change in the competitive dynamics of the industry—with the potential entrance of new competitors, alternative forms of credit enhancement, and limited insurance penetration in the U.S. public finance market—could hurt the companies' business prospects. The negative outlook also reflects our view of the possibility of adverse loss development within the exposure to domestic nonprime mortgages for each company and stress in other structured finance sectors.

We could revise the outlooks on Assured and FSA to stable once they defease the risk associated with the GICs through the collateral posting process. We would also look for there to be greater clarity in the industry's competitive dynamics and the companies' ability to be successful in that environment and greater certainty of ultimate potential losses in the structured finance portfolios. Alternatively, we could lower the ratings if the structured finance losses exceed our expectations and lower the capital to a level that is no longer consistent with a 'AAA' rating or if the companies' competitive position deteriorates meaningfully. If we do lower the ratings because of the foregoing, it will not likely go below the 'AA' category.

Separation Of FSA's Financial Products Business

FSA's financial products business comprises three business lines: GICs, a spread business, and a leveraged lease business. The GIC business was the largest of the three businesses, with about $13.5 billion of GIC obligations as of March 31, 2009. FSA had operated a business that issued GICs used predominantly for the investment of proceeds from municipal bond issues, synthetic CDOs, and credit-linked notes. FSA wrote an insurance policy on each of the GICs, which guarantees payment. The insurance policies will remain in place until the GICs mature.

FSA Asset Management and the GIC issuing entities are now part of Dexia. The assets held in FSA Asset Management will be pledged to the collateral agent for the benefit of Assured-FSA and the GIC-issuing entities. Dexia has provided a guarantee for the payment of FSA's obligations under the FSA policies guaranteeing the GICs and the OTC derivative contracts. This guarantee must be satisfied prior to the original guarantee provided by FSA.

The structure creates remoteness from the risks associated with the GIC business. However, in our view, the company is not totally isolated from these risks. Most importantly, prior to required collateral being posted in October of 2011, Assured-FSA would retain large single concentrations of credit exposure to Belgium and France.

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We assess Assured-FSA a capital charge for this risk, which currently is about $215 million.

The company conducted its spread business through FSA Global, and it is in principal match funded. FSA Global funded itself primarily in the European market by issuing FSA-guaranteed medium-term notes in response to reverse inquiries by investors, who specified currencies, payment schedules, and other terms that met their precise needs. It invested the proceeds from the sale of its notes in FSA-insured GICs or other FSA-insured obligations. Approximately $1.7 billion of medium-term notes were outstanding as of March 31, 2009. Dexia has assumed all rights and obligations relating to the spread business and will manage the day-to-day operations of this business. The insurance policies FSA issued will remain in place until the insured obligations mature. Dexia has provided a guarantee for the payment of FSA's obligations under the FSA policies guaranteeing the medium-term note business.

FSA conducted its leveraged lease business through Premier International Funding and FSA Global. The debt portion of the leveraged leases outstanding is $6.2 billion. The equity portion of leveraged leases outstanding is $400 million currently, accreting to a peak of $700 million. Dexia has assumed responsibility for the equity portion of the leveraged lease business with existing FSA insurance policies remaining in place together with a Dexia guarantee. This guarantee must be satisfied prior to the original guarantee provided by FSA. FSA will retain responsibility for the debt portion of the leveraged lease business.

Corporate Strategy And Management

Assured has evolved into a direct primary financial guaranty insurance company, having exited the reinsurance business as well as certain nonfinancial guaranty product lines. The company's corporate strategy is to function as a full-service guarantor with a captive reinsurance affiliate that also has reinsured and will continue to opportunistically reinsure third-party portfolio cessions. Management's stated near-term objectives are to capitalize on its financial strength and secure its lead position as a full-service financial guarantor operating in all approved domestic and international sectors.

Sister company Assured Guaranty Re Ltd. (AG Re; AA/Stable/--) has a long and successful track record of providing dedicated reinsurance capacity to the financial guarantee industry. AG Re believes that it is also in the favorable position of being the only active financial guarantee reinsurer with a 'AA' rating and stable outlook. With the acquisition of FSA, management has a strong belief that the consolidated group should write a diversified book of business, including both public finance and structured finance. The company has the flexibility within its corporate structure to underwrite different lines of business out of separate subsidiaries to respond market needs.

The company is reviewing several underwriting strategies for U.S. and international public finance business that includes both Assured and FSA. Going forward, Assured, AG Re, or both will write structured finance. AG Re will continue to support Assured, FSA, and third-party reinsurance business. With regard to third-party business, the focus over the next few years will be on portfolio opportunities.

Structured finance underwriting will involve transactions relating to basic asset finance and include higher attachment points, with greater structural protections, lower limits, and better returns. In the current environment, management has said there is no need to push the envelope and that it can produce excellent returns at low risk. In the short run, the focus is on secondary and private-market opportunities. The company will continue to use CDS execution, as well as financial guarantee policies, as a form of credit enhancement going forward.

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Assured's international business platform is subsidiary Assured Guaranty (UK) Ltd. (AAA/Negative/--), and FSA's is Financial Security Assurance (U.K.) Ltd. (AAA/Negative/--). The Financial Services Authority has authorized these companies to write financial guaranty insurance in the U.K. This authority allows each to conduct business in other European Economic Area jurisdictions on a passported basis. The ratings are based on the close operational and financial ties of to each company's parent, including firm-wide risk management regimes; underwriting support; and strong financial support in the form of quota share reinsurance, excess-of-loss reinsurance, and net-worth-maintenance agreements.

Senior management will be led by President and CEO Dominic Frederico and CFO Robert Mills. Sean McCarthy will serve as COO for the direct business lines. Bill Hogan will head U.S. public finance underwriting, and Mike Schozer, president of Assured, will head the structure finance business. Howard Albert will serve as Chief Credit Officer for the consolidated group.

Operational functions at the combined Assured-FSA should benefit from a staff consisting of key individuals from the two organizations who were responsible for the business, underwriting, and risk management of solidly investment-grade public finance books of business. Although the acquisition might result in a smaller combined staff, reductions should not hamper enterprise risk management capabilities. Both companies have strong risk management functions, and the combination of the two and the retention of several key managers from both organizations will further enhance consolidated risk-management activities.

Business Review

The competitive advantage of both companies is that each has a proven track record for credit discipline, as their minimal exposure to 2005-2007 vintage RMBS and CDO of ABS demonstrates. In terms of investor capacity for Assured-wrapped bonds, fixed-income investors have limited exposure to Assured given their recent entry into the direct business. Lastly, under the proposed structure management has a flexible platform from which to write business in a number of sectors and markets.

Table 1

Business Statistics

	--Year ended Dec. 31--				
	FSA	--Assured--			
(Mil. $)	2008	2008	2007	2006	2005
Net par exposure	424,393	111,025	94,127	68,370	52,659
Adjusted gross premiums written*					
U.S. public finance	531.3	431.7	60.1	35.7	23.5
U.S. asset-backed and other	58.5	194.2	264.1	146.8	75.1
U.S. total	589.8	625.9	324.2	182.5	98.6
International public finance	50.4	9.0	84.4	78.0	9.9
International asset-backed and other	24.2	66.1	68.2	41.7	27.7
International total	74.6	75.1	152.6	119.7	37.6
Total adjusted gross premiums written	664.4	701.0	476.8	302.2	136.2
Net premiums written	773.9	433.8	177.6	120.6	92.5

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Table 1

Business Statistics (cont.)					
Gross par written					
U.S. public finance	46,732	30,710	4,281	1,804	1,077
U.S. asset-backed and other	3,897	12,085	31,346	26,843	12,740
U.S. total	50,629	42,795	35,627	28,647	13,816
International public finance	1,342	450	3,736	6,578	501
International asset-backed and other	525	4,323	8,432	6,663	2,800
International total	1,867	4,772	12,167	13,240	3,300
Total gross par written	52,496	47,567	47,794	41,888	17,117
Net par written	41,028	33,680	34,953	28,595	10,737

*Adjusted gross premiums written include upfront and present value of installment premiums and exclude trade credit.

Assured was the only bond insurer where gross par written in 2008 was essentially flat relative to what was written in 2007 while other bond insurers experienced sharp declines par written volume. Assured wrote a total of $47.6 billion of par in 2008 compared with $47.8 billion in 2007. Within that total, however, there were sizable shifts in sector composition, reflecting business conditions in the period. U.S. public finance par written for the company rose to 65% of total par written in 2008 from 9% in 2007.

FSA originated $46.7 billion of gross par in the U.S. public finance market in 2008, down by 17.9% from the prior year. Most of these originations took place in the first half of the year, as the ratings on the company were stable relative to its peers, owing to a material absence of CDO of ABS exposure and less-volatile RMBS exposure. U.S. asset-backed production was $2.4 billion in 2008, down from $40.0 billion in 2007. Asset-backed production was affected by an absence of demand in this market and, in the second half of the year, FSA and Dexia's strategic decision to exit the structured finance market.

Assured and FSA were the more active bond insurers in the new issue U.S. public finance market for the first quarter of 2009, constituting 97% of the insured market on a combined basis. Assured wrapped $8.2 billion of par, and FSA wrapped $1.2 billion of par, compared with $7.2 billion and $18.4 billion, respectively, in the first quarter of 2008. Assured's ability to write a greater amount of business was constrained more by staffing levels to meet the demand than from lack of opportunities. Insured penetration was 13% in the first three months of 2009 compared with 25% for the same period in 2008. It is worth noting that letters of credit declined 60% year-over-year and fell to 6% of new issue volume in the first three months of 2009. The use of letters of credit as an enhancement mechanism spiked in 2008 as the financial guarantee industry experienced declines in insurer ratings.

On Jan. 22, 2009, Assured closed on a reinsurance transaction with CIFG Assurance North America Inc. with respect to certain U.S. public finance and infrastructure policies covering approximately $13 billion of par outstanding. The exposure principally consisted of investment-grade credits and did not contain any speculative-grade credits, any credit default swaps, or any credits for which a loss reserve had been established. In connection with the reinsurance, the unearned premium reserve Assured received was approximately $85 million.

Assured's strong market position in 2008 also resulted in pricing improvements. In the U.S. public finance sector, the company's risk-adjusted pricing index (weighted average premium divided by weighted average capital charge) was 7.2% in 2008 compared with 5.6% in 2007. For the U.S. structured finance business, the company's risk-adjusted pricing index of 83.1% was 2.75 times higher than it was in 2007. Both these figures are well above

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what the company had been able to achieve in the past.

FSA's U.S. public finance risk-adjusted pricing index was 9.7% in 2008, mainly the first half of the year, compared with 5.1% in 2007. For the U.S. structured finance business, the company's risk-adjusted pricing index of 17.0% was relatively unchanged from 2007. With limited competitive pressure, we believe both companies should continue to experience strong pricing dynamics in their business lines.

On a pro forma basis, the combined insured portfolio totaled $535.4 billion as of March 31, 2009. Of this, U.S. public finance exposure was $322.1 billion. FSA's U.S. public finance exposure was the less risky of the two, as evidenced by its weighted average capital charge of 7.9% compared with Assured's 11.5%, which is more typical for the industry. Capital charges generate theoretical losses in Standard & Poor's capital adequacy model based on the sector and quality of the issuer.

Table 2

Portfolio Statistics

	--Year ended Dec. 31, 2008--			
	--FSA--		--Assured--	
	% of par	Par (Mil. $)	% of par	Par (Mil. $)
Public finance				
GO	29.5	125,063	8.3	9,163
Utility	11.9	50,340	5.6	6,201
Tax-backed	13.1	55,458	8.5	9,416
Hospitals	2.9	12,185	4.4	4,865
Transportation	5.0	21,304	4.7	5,238
Colleges and universities	1.9	7,902	1.9	2,063
Investor-owned utilities	0.0	37	0.8	839
Housing	1.8	7,434	0.2	237
Other	0.5	2,181	1.9	2,159
Total	66.4	281,905	36.2	40,180
Domestic asset-backed and corporate finance				
MBS	2.5	10,782	11.2	12,483
Home equity loan	1.5	6,298	1.1	1,242
Auto loan	1.3	5,591	0.3	375
Other consumer asset-backed	0.1	448	1.8	1,953
Commercial asset-backed	0.0	0.0	6.0	6,606
Other	16.9	71,746	25.8	28,606
Total	22.4	94,866	46.2	51,265
International				
Public finance	5.8	24,572	5.2	5,801
Asset-backed	5.4	23,050	7.1	7,857
Other	0.0	0.0	5.3	5,922
Total	11.2	47,622	17.6	19,580
Total net par outstanding	100.0	424,393	100.0	111,025

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With regard to problematic and potentially problematic structured finance sectors, Assured's par exposure to 2005–2007 vintage RMBS as of Dec. 31, 2008, was approximately $13.7 billion, and FSA's was $15 billion. Standard & Poor's tested the capital adequacy of both companies against a scenario that applies stressful default assumptions to various RMBS-related transactions that the companies have insured. Neither company had a meaningful exposure to CDO of ABS with 2005–2007 vintage RMBS exposure as part of the pool of assets.

Assured also has exposure to domestic and international CMBS totaling about $4.9 billion. The Assured wraps are on CMBS transactions that initially (and an overwhelming majority currently) have underlying ratings of 'AAA'. Although the deals are performing to expectations, the CMBS group at Standard & Poor's has effected criteria changes that could result in downgrades of these enhanced tranches. As such, higher capital charges are expected, with an incremental increase of approximately $250 million.

Assured's exposure to CDOs of trust preferred securities (TruPS) totaled $7.1 billion as of Dec. 31, 2008. Issued by financial institutions—such as banks, insurance companies, or real estate investment trusts (REITs)—these TruPS typically allow for optional payment deferral of up to five years without triggering a legal default. In general, Standard & Poor's believes that the risk of deferral and default is now heightened in view of deteriorated economic conditions and financial institutions' largely weak operating results.

Of Assured's combined TruPS exposure, about $5.7 billion is U.S. CDOs of TruPS, which fall into these categories:

- Bank TruPS, which are generally issued by small to midsize bank holding companies.
- Insurance TruPS, which small to midsize insurance companies generally issue.
- REIT TruPS, which are generally issued by equity or mortgage REITs.

As of May 11, 2009, 83% of Assured's U.S. and European TruPS CDO portfolio experienced downward rating migration; 58% stayed investment grade, while the remainder moved mostly into the 'BB' range. Two of the four European TruPS CDOs remain at 'AAA'. To date, Assured has paid no claims on any TruPS CDO. In fact, credit enhancement at the Assured exposure level has room for more defaults and deferrals before incurred losses are likely.

The deterioration in Assured's TruPS portfolio is somewhat mitigated in deals where in the event of persistent failed coverage tests, waterfall mechanics allow for cash-flow diversions to pay-down the senior tranches that Assured enhances. About 83% of the TruPS CDO portfolio is experiencing at least one coverage test failure, resulting in Assured's exposure declining each quarterly period with excess spread. Notwithstanding diversion of excess spread to reduce Assured's exposure, the downgrades have resulted in an increase in capital charges for this exposure of approximately $305 million.

As of March 31, 2009, Assured had $5.8 billion of speculative-grade net par exposure, with U.S. structured finance constituting 86% of this exposure. FSA had $14.6 billion of speculative-grade net par exposure, with structured finance accounting for 89% of this exposure. It is important to note that when Assured and FSA insured these transactions, they were investment grade, but they have migrated to speculative grade over time. The total amount of speculative-grade exposure constitutes 3.8% of combined insured net par. Somewhat mitigating this exposure is that each company has a margin of safety well in excess of the 'AAA' minimum, which includes appropriate capital charges for this exposure and the combination of the Assured and FSA provides a greater amount of resources to meet potential claims.

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Finances

Assured was the only bond insurer within the original 'AAA' rated universe to report statutory net income in 2008. Statutory net income was $27.7 million in 2008, down from $71.6 million for 2007. The driver of lower earnings in 2008 were losses of $141.7 million compared with a recovery of $11.7 million in 2007. Most of the former 'AAA' companies reported losses in the billions of dollars. Assured's losses were mostly related to two HELOC transactions, where as Assured former peers' losses were spread among CDOs of ABS and the RMBS sector.

Table 3

Financial Statistics					
	--Year ended Dec. 31--				
	2008	2008	2007	2006	2005
(Mil. $)	--FSA--	--Assured--			
Insurance company*					
Total assets	6,343.0	1,803.1	1,361.5	1,248.3	1,140.7
Cash plus invested assets	6,023.4	1,641.1	1,296.0	1,202.5	1,068.3
Unearned premiums	2,520.0	570.3	302.3	238.9	233.8
Statutory capital	1,992.3	1,090.3	982.0	916.7	854.8
Net premiums earned	455.7	161.4	107.1	109.1	88.9
Losses and loss-adjustment expenses	2,188.3	145.8	(14.5)	4.9	15.6
Underwriting expense	74.4	49.3	84.7	73.6	(17.3)
Investment income including gains	261.8	63.3	57.8	51.9	50.7
Net income	(1,376.7)	27.7	71.6	64.3	100.9
Loss ratio (%)	480.2	90.3	(7.1)	4.5	17.5
	--Pro forma March 31, 2009--				
Holding company (Assured Guaranty Ltd.)¶					
Total assets	16,595	4,556	3,763	2,935	2,677
Stockholders' equity	2,774	1,926	1,667	1,651	1,662
Net income	237	69	(303)	160	188
Debt/capitalization (%)§	6.0	7.2	9.7	10.7	10.6
Hybrid security tolerance ratio (%)**	7.9	5.4	7.3	7.5	0.0
Total hybrid tolerance security ratio (%)¶¶	15.8	11.8	17.3	15.9	0.0
Return on average equity (%)	14.0	3.9	N.M.	9.7	12.4

*U.S. statutory basis of accounting. ¶U.S. GAAP basis. §(Holding company debt + hybrid securities not qualifying as equity)/(holding company debt + shareholders equity + hybrid securities). **Hybrid securities/(capital [debt plus shareholders equity] + hybrid securities). ¶¶(Hybrid securities + contingent capital)/(capital + hybrid securities + contingent capital). N.M.--Not meaningful.

Offsetting the losses to result in the positive net income was a substantial decline in underwriting expenses, and growth in earned premiums and investment income. Underwriting expenses were $49.3 million in 2008, down from $84.7 in 2007, mostly because of ceding commissions received of $48.9 million in 2008 related to business ceded to sister company Assured Guaranty Re Ltd. In addition, premiums earned were $161.4 million in 2008, a 50.7% increase over premiums earned in 2007 because of greater market acceptance that resulted in a larger book of business.

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Investment income—including gains—was also up in 2008 to $63.3 million, a 9.5% gain over 2007. A net realized capital loss of $4.3 million was incurred in 2008 compared with a net realized capital loss in 2007 of about $99,050. Cash and invested assets as of Dec. 31, 2008, totaled $1.6 billion, up from $1.3 billion on Dec. 31, 2007. The growth stemmed from improved business results generating premiums collected net of reinsurance of $427.5 million in 2008 versus $152.8 million in 2007. Also, about $100 million was contributed to Assured as policyholder surplus from the proceeds of a $250 million equity issue by parent company Assured Guaranty Ltd. to W.L. Ross and Co. LLC in April 2008.

The credit rating distribution of the investment portfolio is about 31% 'AAA' rated or U.S. government backed securities, 43.5% 'AA' rated, 22.4% 'A' rated, and 3.1% 'BBB' rated. The portfolio did not include any speculative-grade securities as of Dec. 31, 2008. The majority of the investment portfolio, $1.1 billion, is in tax-exempt securities. Within this total about $617 million are wrapped by other bond insurers. These have an underlying average rating of 'A+'. About $162 million of the portfolio is invested in mortgage-backed securities, but less than $1.0 million are subprime with a 'AAA' average rating. There are no CDOs of ABS in the investment portfolio.

For the three months ended March 31, 2009, Assured reported a 62.6% increase in adjusted gross premiums written to $234.6 million on a 28.6% increase in gross par written. This dynamic illustrates the imbedded annuity-like stream of revenue generated by the in-force book of business. Net income of $18.4 million for the first three months of 2009 was 3.5% higher than net income for the same period in 2008.

FSA reported a statutory net loss of $1.4 billion 2008 because of loss and loss expenses of $2.2 billion. Increased loss estimates for the insured RMBS portfolio were the principle drivers of rise in losses. It also included a write-down for the company's investment in XL Financial Assurance Ltd.

Statutory cash and invested assets totaled $6 billion as of Dec. 31, 2008. Credit-quality guidelines specify that FSA's almost exclusively fixed-income portfolio should have an average credit rating of at least 'AA-' and that generally all securities should be rated 'A-' or higher. About 72% of FSA's investment portfolio is tax-exempt, with 18% taxable and 10% short-term. In terms of credit quality, about 43% of the portfolio was rated 'AAA', and about 36% is rated 'AA'. About $393 million of investments are in the RMBS sector, principally obligations of Fannie Mae, Freddie Mac, or Ginnie Mae.

Accounting

Standard & Poor's views holding company Assured Guaranty Ltd.'s (AGL) accounting policies to be generally consistent with the industry standards and neutral to the ratings. AGL files consolidated statements according to U.S. GAAP, whereas Assured files financial statements under Statutory Accounting Principles (SAP).

On May 23, 2008, the FASB issued Statement of Financial Accounting Standards (SFAS) 163, which prescribes loss-reserve and revenue-recognition practices for the financial guarantors. Standard & Poor's evaluates the financial strength of the financial guarantors using the financial statements prepared under SAP. Under this accounting method, reserves are booked when a loss is incurred. In addition, Standard & Poor's estimates theoretical losses in a severe economic environment, which could be greater than current losses, to evaluate the adequacy of the claims-paying resources of the bond insurer.

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Revenue recognition is also covered by SFAS 163 and became effective on Jan. 1, 2009. Prior to its implementation, Assured's and FSA's upfront premiums were earned in proportion to the expiration of related principal balance of the insured obligation. Installment premiums are earned ratably over the installment period. The implementation of SFAS 163 is not expected to materially change revenue recognition on installment premiums going forward. However, there is a material impact on the recognition of upfront premiums, which are recorded as written at the inception of the policy. Earnings under SFAS 163 will effectively backload the revenue recognition for upfront premiums compared to current industry methodologies. Although the change in premium recognition under SFAS 163 will affect the financial statements, we do not expect there to be a ratings impact because the fundamental economics of a transaction or bond insurance business model have not changed.

An issue that adds a degree of volatility to AGL's earnings is the CDS mark-to-market accounting under FASB No. 133, which requires derivatives to be marked-to-market at each reporting date. In our opinion, this concept, insofar as it relates to the financial guarantee insurance industry, has introduced an element of earnings volatility that has little bearing on either the likelihood of a potential claim or the intrinsic earnings power of a bond insurer. Unlike other financial sectors for which FASB No. 133 may be more relevant, bond insurers' contracts are not traded, and there is no business intention to realize gains. Therefore, recording a marked-to-market loss because of changing spreads in the marketplace seems inappropriate. Because almost all CDS contracts will expire without a claim, corresponding marked-to-market positions will be zeroed out at maturity. Standard & Poor's believes that the insurers' loss reserves are the more appropriate indicators of potential claims and that our capital charge evaluations are the more appropriate indicators of changes to the credit profile of any of the bond insurers' insured sectors.

Another issue that adds a degree of volatility to AGL's earnings, in our view, is the nonperformance risk marked-to-market accounting for derivative assets and liabilities under SFAS No. 157 "Fair Value Measurement." The valuation of AGL's derivative liabilities must take into account the market's perception of AGL's nonperformance risk by incorporating the spreads of AGL's CDS. From a ratings perspective, the markets perception of AGL's ability to settle its obligations does not relieve it of its obligation to pay on its obligations and neither can it transfer the obligation at the market value. Any gains taken from the deterioration in AGL's own creditworthiness should not be considered as "economic" or "real" for purposes of our ratings analysis. Furthermore, any market-based gyration unrelated to fundamental credit deterioration is reversed for our purposes when considering capital and earnings.

Capitalization

As of Dec. 31, 2008, through the use of Standard & Poor's capital adequacy test, Assured's margin of safety was in the 1.5x–1.6x range and FSA's was in the 1.4x-1.5x range. The margin of safety expresses the relationship between theoretical losses generated by the capital adequacy model and capital remaining at the end of a theoretical economic depression. Both companies' margins of safety exceed Standard & Poor's 1.25x minimum requirement for an 'AAA' rated company.

We used the Standard &Poor's capital adequacy model to form views of Assured's and FSA's capital adequacy. The key assumptions embedded in the model are:

- Three years of growth followed by four years of stress.
- Growth of 15% per year in new public finance business in each of the growth years, or the company's higher assumed growth rate.

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- Growth of 50% per year in new structured finance business in each of the growth years, or the company's higher assumed growth rate.
- Capital charges consistent with assumed mix of business.
- Premium rates based on current opportunity in market.

Table 4

Capital Statistics

	--Year ended Dec. 31--				
	2008	**2008**	**2007**	**2006**	**2005**
(Mil $)	**--FSA--**	**--Assured--**			
Portfolio risk					
Municipal insurance weighted average capital charge (% of average annual debt service)	7.9	11.5	11.5	11.9	12.4
Asset-backed capital charge (% of par)	0.8	1.1	0.6	0.9	1.4
Claims-paying resources					
Statutory capital	1,992.3	1,090.3	982.0	916.7	854.8
Letters/lines of credit	350.0	-	-	-	-
Contingent capital	200.0	200.0	200.0	200.0	200.0
Stop-loss treaty*	0.0	0.0	0.0	80.0	80.0
Unearned premiums	2,520.0	570.3	302.3	238.9	233.8
Present value of annual premiums	962.6	565.6	554.0	356.9	254.0
Total	6,024.9	2,433.2	2,038.3	1,792.5	1,622.6
Capital adequacy					
Capital remaining at end of depression test	1,750-1,800	1,050-1,100	600-650	500-550	500-550
Margin of safety (x)	1.4-1.5	1.5-1.6	1.4-1.5	1.5-1.6	1.5-1.6
Reliance on soft capital (%)	25.9	19.8	19.6	24.7	30.6

As part of the review of capital adequacy, Standard & Poor's tested the capital adequacy of each company against a scenario that applies stressful default assumptions to various RMBS-related transactions that the companies have insured. The insured direct RMBS transactions and tranches of uninsured RMBS transactions are components of the collateral backing insured CDOs. We based the default rates for these transactions on stressful cumulative net loss assumptions supplied by our Structured Finance department that vary by asset type and vintage. We have included the Alt-A, subprime, closed-end second, HELOC, and NIM asset types with 2005, 2006, and 2007 vintages in this analysis. For Assured, these loss assumptions generated $386 million of direct RMBS losses and $3 million of CDO of ABS losses. For FSA, the loss assumption was $1.6 billion of direct RMBS and $6 million of CDO of ABS.

Assured's capital adequacy test included higher capital charges for its TruPS portfolio. FSA's capital adequacy test included a capital charge for the residual exposure to the financial products business.

Table 5

Liquidity Analysis

		FSA	Assured
	Haircut (%)	**Amount (Mil. $)**	**Amount (Mil. $)**
Assets/resources as of Dec. 31 of prior year			
Cash and short-term investments	-	856	118

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Table 5

Liquidity Analysis (cont.)			
Treasury and government agency fixed-income securities	10	102	57
Corporate and ABS/MBS bonds	50	314	138
Bank lines of credit	-	150	200
Sovereign foreign denominated	50	142	
Municipal repo line	-	222	
Other	-	-	
Total		1,785	513
Municipal bonds (informational only)			
Potential Uses (Occurring in current full year)			
Largest net payments relating to a municipal obligor default		213	87
Largest net bullet maturity default		209	8
Largest debt service reserve draw		85	28
90 days of payments relating to largest servicer default		23	29
Largest unscheduled draw on a municipal investment contract			
Largest individual "single name" credit default swap			
Holding company debt and dividend servicing needs		50	24
Total		581	176
Liquidity ratio (x)		3.1	2.9

Related Research

- "Bond Insurance Industry Overview And Analytical Focus," June 29, 2006.

Ratings Detail (As Of July 17, 2009)*	
Assured Guaranty Corp	
Financial Strength Rating	
Local Currency	AAA/Negative/--
Counterparty Credit Rating	
Local Currency	AAA/Negative/--
Financial Enhancement Rating	
Local Currency	AAA/--/--
Related Entities	
Financial Security Assurance Inc.	
Financial Strength Rating	
Local Currency	AAA/Negative/--
Issuer Credit Rating	
Local Currency	AAA/Negative/--
Financial Enhancement Rating	
Local Currency	AAA/--/--
Senior Unsecured (2 Issues)	AAA
Holding Company	Assured Guaranty, LTD.
Domicile	Maryland

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Ratings Detail (As Of July 17, 2009)***(cont.)**

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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