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SPEAKERS

Sabra Purtill
Assured Guaranty Ltd. - Managing Director, Investor Relations

Sean McCarthy
Assured Guaranty Ltd. – Chief Operating Officer

Stephen Donnarumma
Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

Mary Francoeur
Assured Guaranty Ltd. - Managing Director, Public Finance

Howard Albert
Assured Guaranty Ltd. - Chief Risk Officer

Philip Abelson
Dewey & LeBoeuf - Partner

Russ Brewer
Assured Guaranty Ltd. - Chief Surveillance Officer

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Municipal Credit Tutorial for Equity Investors conference call. My name is Derrick and I will be your operator for today. At this time, all participants are in listen-only mode.

I would now like to turn the conference over to Ms. Sabra Purtill, Managing Director of Investor Relations. Please proceed, ma'am.

Sabra Purtill - Assured Guaranty Ltd. - Managing Director, Investor Relations

Thank you. And thank you all today for joining us for our Municipal Credit Tutorial for Equity Investors.

As you all know, we've received a lot of questions over the course of the last couple of months concerning the fundamentals of municipal credit, and we felt it would be important for you as investors in our stock or as analysts of our Company, to understand better the basics of what we do every day in the municipal credit space and the nature of that business.

Before starting the program I first want to remind everyone that our presentation today is covered under the provisions of the Safe Harbor Act, which is included on the screen. I would also then like to note that I'm going to turn the call over to Sean for a few brief comments, and then I'll go through just the logistics of the call today, since we have a webcast, telephone dial-in call, as well as a formal meeting. And then we'll kick off the presentation itself. Sean?

Sean McCarthy - Assured Guaranty Ltd. – Chief Operating Officer

Thanks, Sabra. I'm Sean McCarthy. I'm the Chief Operating Officer of Assured Guaranty. I thought I'd just make a couple of brief remarks regarding, really, the essentiality of public finance in our industry and for Assured Guaranty in particular.

One of the things that's important and linchpin to know is that the US public finance business itself, that is, the credit enhancement of municipal bonds, has been the cornerstone of the industry dating back to the first policy written in 1971. Within the insured bond category losses, paid losses have been extremely low, averaging about 4 basis points per annum over the last 40 years. In fact, most of the bonds that have defaulted in the municipal space have been non-rated or non-investment-grade, which keeps them out of the category of bonds that have been a credit event.

The purpose of today is really to go over a primer to give you a sense for how we think about what municipal credit, and really what the nature of municipal credit is. We'll cover the types of municipal bonds and we'll also cover really some of the more technical frameworks, which will be something of focus to you in the near future, including Chapter 9. So, the point today is to really make sure that you really get a sense of comfort for this line of business, which is the core business that Assured is writing at the moment.

So, with that, I will turn it over to Sabra to go over the specifics of the agenda. Thank you very much for coming here physically and those of you who are on the phone. Sabra?

Sabra Purtill - Assured Guaranty Ltd. - Managing Director, Investor Relations

Thank you, Sean. We lay out on page 4 the presentation, the basic agenda for today. We're going to go over municipal bonds, their types and structures; talk a little bit about the impact on municipal credit of the recession that we, hopefully, are now through. And then, also have a presentation on Chapter 9 bankruptcy, and then a brief overview of our insured portfolio.

Our speakers today are Stephen Donnarumma, who is Chief Credit Officer of Assured Guaranty Corp. and Assured Guaranty Municipal, as well as Mary Francoeur, who heads up our -- or is Managing Director and Head of our Project Finance and Global Utilities Group within the Public Finance Department. She also is a member of MAGNY and the NFMA. And any way, Mary does a lot of instructional teaching on municipal bonds for municipal credit analysts at an advanced level.

We'll also have Philip Abelson here, who is a partner in bankruptcy practice at Dewey & LeBoeuf, to specifically speak about Chapter 9, and also the differences between Chapter 9 and Chapter 11 bankruptcy, which many of you are more familiar with, perhaps. And then, finally, we have Russ Brewer, our Chief Surveillance Officer, who will talk briefly about our portfolio and how it breaks down in the categories of bonds that we've talked about today, as well as the types of bankruptcy states, and also talk about a public finance surveillance of the portfolio.

I would note, as you can see on the right here, we have a full cast of members of our management team here. We have all of the senior members of our Public Finance Credit team and Credit Committee. We also have many of the senior members of our Public Finance Group, our Fixed Income Investor Relations team, and also the Public Finance Surveillance team.

We're all here to answer questions, so the format of the presentations today will be, obviously, we have a formal presentation to go through, but we strongly encourage you all to ask questions as we go through it, because it is a tutorial. It does -- all the information builds on the presentation. So if you have any questions, please don't hesitate to raise your hand and ask a question.

My one request for you all for the benefit of those who are listening on the telephone or on the webcast is we have a mic that's in the middle of the table. And we'll try to get that to you as quickly as possible. If, for the speakers, however, if there is a question that is asked before a mic is there, if you could just repeat the question.

Also for the benefit of those on the webcast or the telephone call, I regret that it wasn't technically feasible to set this up as an open mic for everyone to ask questions, but I would strongly encourage you if you have a question, to email the question to either myself or Ross Aron. We do have our BlackBerry's here and we'll interject with the questions if we receive them.

Ross Aron's email is raron@assuredguaranty.com, and mine is spurtill@assuredguaranty.com.

With that, I'd like to turn the presentation over to Steve and Mary.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

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30 Woodbourne Avenue, 5th Floor
Hamilton HM 08
Bermuda
main 441 279 5700
fax 441 279 5701
info@assuredguaranty.com
www.assuredguaranty.com

Thank you, Sabra. We're going to -- I'm going to go over some of the fundamentals of the municipal bond market. Mary is going to talk about the products. I'm going to talk about credit, and then have Phil Abelson, who's going to review Chapter 9 bankruptcy issues.

And Chapter 9 has been a topic of discussion for the past few months. And so some of the comments I'll make today is just to sort of give you pointers about Chapter 9, and then Phil will discuss it at length.

The instances of Chapter 9 are very limited and we'll be discussing that as well. We want also, because the municipal markets are very different than the corporate debt markets, to highlight differences between corporate debt and municipal debt. And we'll also give you our credit views on how we underwrite the products.

Now, as Sabra said, we would very much encourage you to ask questions, so I figured to start this off, I would ask a question. And I have three questions and I also have prizes if you answer the questions correctly. And the first question is very easy -- what was the first city in the United States to issue municipal debt? No one on this side of the room is allowed to answer. Anybody take a guess? It's pretty obvious.

New York. So we have our first answer. That is correct -- New York.

The second question, what year? Anybody? We're going to go to hints soon, so don't worry. 19th century. Anybody? Famous year and you can only win once. No? Another famous year in the 1800s. Come on, guys. 1812. Second winner.

And then the third question, which goes to municipal finances, what does the US Constitution say about local government? No hands. All right. Our General Counsel -- nothing.

And basically -- I don't like these collecting things. Okay, fine -- Sabra, does every one of these do every -- can't I just do it one at a time? Okay. And that's right. The US Constitution says nothing about local government. And that's basically the fundamentals of what -- how the municipal bond markets come about.

Local governments have reserve powers, which are things the federal government cannot do. And one of them is to provide services to their inhabitants. And in order to provide those services, they have to pay for them. And how do they pay for them? They pay for them in two ways -- they tax us and they raise debt. And that's the fundamentals of municipal bonds.

Municipal entities are perpetual entities. Unlike a corporation, you don't dissolve the city of Philadelphia -- unlike Enron. Municipal entities usually provide -- usually are the providers of exclusive services. There's only one water system. There's only one fire department. There's only one police force. And so those services are very unique, unlike corporate obligors.

When you think about municipal obligors, they only have one way to access the capital markets, and that is through debt. You can't buy stock in Cleveland. And as such, that access to capital markets is something that is very, very important to state and local governments. And it's something that they guard carefully. And their ability to access capital markets at the most economic -- by the most economic means through the raising of debt, is what drives their ability to finance themselves at the lowest possible cost.

Interest on municipal bonds -- tax-exempt, just -- you hear a lot about BABs these days, or Build America Bonds. Very simply, the Treasury -- and we think it was a brilliant strategy, or I do -- in order to provide liquidity to municipal debt, changed the way that -- decided to pay a subsidy of 35% of the interest on municipal bonds directly to the municipality. The Treasury is indifferent because the tax subsidy versus the interest subsidy is the same for the federal government, but what did it do? It opened up those markets during a period of high stress and illiquidity to taxable investors, notably foreign investors.

What municipal bonds -- notwithstanding now you see a lot of taxable -- they're still unlike corporate bonds. Municipal bonds are exempt from SEC registration and the reporting requirements are different and limited. You have no Sarbanes-Oxley applying to a muni issuer. And the other thing is because of the unique nature of the municipal entity, the provision of services, essential services; they don't behave like corporate obligors in a time of stress. You typically, again, to address financial stress, you're cutting services. You're not renegotiating your debt.

In most, bankruptcy for states is not available. And it is only permitted in about -- municipal bankruptcy is permitted in about half the states. And in the states that do permit bankruptcy of municipal entities, you often require some sort of state overview, some sort of state involvement.

The municipal bond market is very large. It's about $2.8 trillion of debt. Last year, the volume of municipal bonds was about $410 billion. That's the second highest year ever. The highest was $429 billion in '07. That compares to a corporate debt market last year of about $935 billion of issuance with the high point again in '07 of about $1.1 trillion.

Assured Guaranty Ltd. Assured Guaranty Corp. | Assured Guaranty Municipal Corp.

30 Woodbourne Avenue, 5th Floor
Hamilton HM 08
Bermuda

main 441 279 5700
fax 441 279 5701

info@assuredguaranty.com
www.assuredguaranty.com

If you look at other markets, asset-backed to mortgages, mortgages are about three to four times that, and that includes Fannie Mae and Freddie Mac. And asset-backed securities, at the height in '07, were about $750 billion of issuance; now it's running about $150 billion of issuance.

If you look at municipal entities, there are about 89,000 governmental entities. That's a lot of little governments. In our portfolio, we have about 15,000 obligors. And the difference is, given our underwriting standards that we only ensure investment-grade rated obligations, and that's our own ratings, a lot of these small municipalities either don't borrow or don't issue debt or we would not ensure it. And those small, and when they do ensure it, when they do issue debt, it's usually purchased by banks.

And so what kind of, when you think about municipal obligors, what kind of obligors are you talking about? Obviously, in states and local governments and little districts. If you live on Long Island, you know that when you see a property tax, you'll see something for fire districts and sometimes you have community college districts. And then let's not forget the public authorities, which we're all familiar with. And those usually, instead of charging taxes, we pay fees.

So you have things like the Port Authority or Marta or Mass Bay, Massachusetts Bay Transit Authority, The T, O'Hare Airport, Denver Airport, SEPTA, things like that. And those are all municipal entities that provide an essential service, usually on a monopolistic basis and charge fees or taxes for those services.

When we think about -- does anyone have any questions? I mean, it's pretty basic stuff.

When we talk about how municipal entities raise money, it is the big three -- income tax, property tax and sales tax. And that accounts -- for state budgets, about 90% of state budgets in the United States are from income and sales tax. And that's according to a Brookings Institute report that I just pulled out this morning.

Property tax is usually on a local level. There are very few states that actually charge property tax. I think New Hampshire and Vermont -- thank you -- for the people who have vacation homes in New Hampshire and Vermont.

And then the municipal entities are raising these fees and taxes, and what are they doing to it? Well, basically, what does municipal finance boil down to? You're constructing capital projects and paying for them over the course of their life. So when you need to build a bridge or a highway, street improvements, office buildings, prisons, courthouses, you raise funds in the taxes of that market. You build the courthouse, you pay for it over time.

Sometimes you see this alot in New York, you have cross subsidies. So we've been paying tolls for the Lincoln and Holland tunnel for a million years -- those are fully paid for, amortized down to $0, but what does the Port Authority do with that money? They're using it for mass transit. Same thing with the TBTA, the Triborough Bridge and Tunnel is already for people from New York; those tolls subsidize the subways and the Long Island Railroad, and Metro-North.

The other thing that municipalities do with funds is they fund out long-term obligations. And you hear this occasionally with pension bonds or bonds to support OPEP. So you have an unfunded pension liability, which is a long-term liability. You fund it with some debt and that's the money you use to pay your retirees.

Sometimes, and you're seeing this now in the current economic climate, municipalities will bond out current operating deficits. And that's something that happens occasionally; I don't want to say rarely, but it's something that is done very cautiously. Because what you're doing is you're paying your electric bill with your Visa card. And as we know from our personal experiences, that's not a good thing to be doing.

I'm going to, essentially, this is the parts where we talk about who the municipal issuers are and why they issue debt. And now Mary Francoeur is going to come here and talk about the kinds of bonds they issue and how we underwrite them. And then I'm going to talk a little bit about credit in general. Okay, Mary?

Mary Francoeur - Assured Guaranty Ltd. - Managing Director, Public Finance

Thanks, Steve. Welcome to Assured Guaranty. And I'd like to let everyone know that Dominic Frederico, our CEO, is also on the phone and will be available to answer questions, if you have them, if you'd like him to answer.

So I'd like to sort of take what Steve has talked about in terms of the revenue sources that are available to governments, and turn it into how we look at the bond security of the bonds that we insure here at Assured Guaranty. Now, Steve had referenced the 10th Amendment. I know sort of talking about constitutional law can put a lot of people to sleep, but I'd like to use it one more time to just kind of put it in context.

About 62% of the market for municipal bonds is general obligation bonds. And in that instance, you have government units pledging their full faith in credit. Their obligation to take any of their resources available and all of their resources available in order to repay their debt.

One of the things to bear in mind about that kind of constitutional construct is that each state finances itself differently. Going back to the point where New Hampshire and Vermont collect property taxes at the state level, while most other states don't -- most states use an income tax to fund state obligations, but most localities assess a property tax.

And so one of the neat things that you need to understand when you start looking at municipal debt is kind of understanding what the state construct is; what are the authorities that are provided to local governments and things like that. But I'm not going to go through 50 states and tell you what their particular authorities are, because we could be here for months to do that.

But again, a general obligation bond is basically a promise to pay. It's a very simple covenant between the issuer of the debt and the bondholder. And there are two basic types. It's either a limited tax or an unlimited tax. And in an unlimited tax, the municipality, the school district, the municipal utility district, is obligated to raise taxes to the amount necessary in order to cover its debt.

There are instances where we have unlimited debt obligations, where there's usually, if it's a property tax, there's a millage limit. And so, one of the things that we look at at Assured Guaranty when we're underwriting those bonds is, if there is a limit, where are they today in terms of how much -- what their tax rates are; how much room do they have to the extent that they need to raise taxes? And it's one of the things that we take into consideration when we're underwriting a limited tax general obligation bond.

If a bond issuer fails to make a payment under a general obligation bond, it's really simple -- you go to court; you say they've got this obligation but they made me this promise, and you seek to compel them to raise the taxes sufficient. Despite the 100-plus years of experience that these folks in the room have, I don't think any of us has ever been involved in an instance where we've actually had to go to court and tell somebody to raise taxes. I mean, there have been instances, but we've never been involved in one of those situations, I'm pleased to report.

Because of that full facing credit obligation and the limited tax nature of some of these obligations, often a state will require, or within that sort of separation of powers and an individual state's constitution, that might require voter approval in order to be issued. That's the case in California; New Jersey for school districts. It depends upon the local charter and the state constitution.

In instances where there are limitations to the issuance of debt where it might require voter approval. What some jurisdictions will do is issue a lease obligation. And we generally look at a lease obligation in the same way -- it's a general pledge of revenues that's available to secure the debt, but it is linked to a piece of real estate. And so one of the things that we look at when we look at it as a lease obligation is essentiality of the asset being financed.

And it really runs on a continuum. I mean, it's something like a jail facility, where it's going to be very difficult to replicate that or you not have one available. It's a highly essential asset, down to maybe something like a golf course, where it's not absolutely necessary for the provision of your health, safety, and welfare obligations as a municipal corporation.

So that's -- and the other thing to bear in mind is that for leased obligations, they're often subject to appropriations. So you're basically asking the municipality on a year-to-year basis to budget for the money that's necessary in order to repay that debt. And that's why the essentiality of that asset is something that's important and something that we look at when we're underwriting these bonds.

So what do we look at when we look at a general obligation bond?

There are a couple of factors that we take into account and we go through a very rigorous underwriting process with our credit committee members. But probably the single most important thing is, what is this place? Who lives here? Why do they live here? And why are we expecting them to continue to choose to pay taxes in order to get the services they're being provided and to repay the debt?

And so it's looking at things like something as broad or as large as the state of California and something as small as the utility District in Texas. And normally, when we're looking at something like the utility district in Texas, it's going to be fairly close to a major metropolitan center like Dallas or Houston or Austin.

And so it's sort of this range of the size of the tax space, concentration among only a handful of taxpayers versus a very broad, unconcentrated tax space. Some other kind of demographic trends -- what's the education level, the economic drivers, is it a large manufacturing base? Is it a services economy? All those kinds of things are things that we take into account when they look at a general obligation debt.

Then we sort of move into the financial conditions. So we look at both income statement items and balance sheet items. On the income statement, it's what are their sources of revenue? How flexible are they in raising those revenues? What are their expenses? How can they control their expenses? So we look at

Assured Guaranty Ltd. **Assured Guaranty Corp. | Assured Guaranty Municipal Corp.**

30 Woodbourne Avenue, 5th Floor
Hamilton HM 08
Bermuda

main 441 279 5700
fax 441 279 5701

info@assuredguaranty.com

www.assuredguaranty.com

their balance sheet. What's their indebtedness? And indebtedness takes on a lot of forms -- it's not just the bonds they have outstanding; it's whatever other long-term liabilities they might have with respect to pensions, other post-employment benefits and union contracts that have multi-year obligations that might have some implications in the near-term.

These are all sort of very -- we take a very long-term view, right? Because most municipal bonds are somewhere between 25, 30, 35 years in tenure, and our obligation is for the life of that bond. And so we take a very long-term view when we're underwriting a bond. There are some short-term risks associated with municipal bonds, and those are generally catastrophic risks -- hurricanes, earthquakes, those types of things.

But what we've generally found over the years is that those might pose near-term liquidity risk, but they rarely pose a long-term credit stress on a municipality; they usually work through these things. So we're willing to underwrite certain risks in places like Florida, Louisiana, in certain circumstances, as long as we're comfortable with the underlying security.

Municipal bonds sort of run the gamut in terms of the structure. Again, for the most part, they're generally long-term obligations -- 20, 25, 30, 35-year obligations that are a function of state law. They're issued in a variety of types in terms of fixed rate. Most of the debt is fixed rate. Some debt has been issued over the years on a variable rate basis, either through auction rate securities or variable rate demand bonds. But they run the gamut in terms of structure.

The balance of the market, 38%, is revenue bonds. And there are a couple of different types of revenue bonds that I'm going to talk about now.

The two broadest types that are issued by municipal corporations are either special tax bonds or operating entity bonds. I was going to call them enterprise bonds, but we're going to talk about that again in a minute.

The special tax bonds -- when Steve had gone through the list of the different types of revenues, you can have income taxes, sales taxes, gas tax, hotel occupancy taxes, motor vehicle rental taxes; the types of taxes that a municipality or state can have outstanding are various. And any one of those taxes can be securitized -- future flows securitizations, to use an ABS term, although we don't like to use that on the municipal side.

But it's basically taking that revenue and using it to secure a bond issue. But generally, it's a fixed amount. It fluctuates with economic activity and can affect the rate at which the municipality can charge. And so it's got a certain set of factors that we're going to look at when we underwrite it.

The other type of sort of standard municipal revenue bond is for an operating entity. The most common of them is a water and sewer revenue bond. A lot of municipalities will issue debt to improve their water and sewer system, and those bonds will be secured by the net revenues of the water and sewage system.

So, people pay their water and sewer bills; that revenue comes in; the municipality will use it to pay the operations and maintenance of the system, and then the money left over will be used to pay the debt service on the bonds -- a net revenue obligation. And those are the basic structure.

One of the interesting things is that one municipality can have a lot of different bonds outstanding. The City of Los Angeles, for example, has airport revenue bonds, electric revenue bonds, water revenue bonds, and their own general obligation bonds. So you have a single municipality but with a variety of debt secured by different sources of revenue.

The thing to bear in mind about the revenue bonds, though, is that they are nonrecourse back to the municipality, so that if those net water revenues, if the sales taxes, if the motor vehicle rental taxes aren't sufficient to repay the debt, you can’t go back to the municipality and say, hey, raise your property taxes in order to pay this debt. So we look at it sort of on that standalone basis.

So what have we looked at when we look at a revenue bond? Well, first of all, if you've got a revenue bond, it has that rate-making flexibility, like a water and sewer system. We look for a rate covenant to be built into the security features. Going back to when we talked about the general obligation bonds, general obligation bonds come with a very simple covenant package. A single page that says I will raise taxes to the amount necessary in order to cover the debt -- period, end of story.

With a revenue bond, where he's got a specific pledge of revenue, the documentation for the indenture, the resolution, however they've chosen to acknowledge that contract, sets forth a variety of covenants. So one of the basic covenants we look at for an operating entity would be a rate covenant.

And that basically says that on an annual basis, I will set that rate, that water charge, that toll for a toll road or a bridge, the landing fees at an airport, I will set that revenue, that rate, in an amount sufficient to pay my operations and maintenance costs, and generate sufficient net revenues so that I cover my debt service plus some increment -- 1.5 times, 1 ¼ times. And a lot of what we look at depends upon our concerns over the resiliency of that revenue stream. And that will drive what we think about the rate covenant that's built into it.

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30 Woodbourne Avenue, 5th Floor
Hamilton HM 08
Bermuda

main 441 279 5700
fax 441 279 5701

info@assuredguaranty.com

www.assuredguaranty.com

When you don't have rate-making flexibility, when you've got that fixed revenue stream, the thing that's more important to us is the anti-dilution test, which basically says -- it's the additional bond test -- it says that on an annual basis -- I won't issue any more debt than I can cover based upon my existing revenue stream. Because remember, if those monies aren't sufficient in a couple of years, they can't go back and raise the rate. That rate is limited by law. And so what we look for is to make sure that there's enough resiliency in the existing cash flow to be able to cover the debt on a going-forward basis through final maturity.

We also look for liquidity packages, either debt service reserve funds or cash sweeps and cash traps to make sure that in the event that the annual flow isn't sufficient on that revenue bond, that there's enough cash in the bank in order to cover the debt. And we draw on that before there would be a draw on our policy.

And then the other side -- if there is any default, or if there is any short-term -- sort of going back to what Steve had originally said, these are perpetual entities. So on the long end, if there's any shortfall, that the obligation to pay doesn't go away until the debt is fully repaid, even if it's not paid within the state of maturity on the bond. We always that lien; that lien is perpetual until the debt is repaid.

Does anybody have any questions? Great.

The other sector of revenue bonds that's part of our portfolio and part of that 38% of the market that I had referenced earlier, is debt that's issued by not-for-profits. Not-for-profits issue debt in the tax-exempt market -- the 501(c)(3) designation allows them to borrow tax-exempt. These are generally things like hospitals, private colleges and universities, cultural institutions, service organizations like the American Red Cross -- they all might access the capital markets.

They are different in a lot of ways, including the fact that they wouldn't file under Chapter 9 bankruptcy for municipalities; they actually would be subject to Chapter 11 and Chapter 7 of the Bankruptcy Code. And we look at these very differently than we would look at municipal obligations.

And some of the things -- we have a very specialized team at Assured Guaranty that underwrite these bonds, primarily in the healthcare sector. And we look at them with a real eye towards the issues associated with market share; all the kinds of things that you might look at with a more corporate type of bond.

So some of the things that we do look at when we look at a revenue bond and this is specific to one of those with a net operating pledge -- Mesquite, Texas. It's a community east of Dallas and it's where they have the Mesquite Championship Rodeo. And it's got a population of 138,000 people. So it's actually a community of a good size. Assured Guaranty has provided insurance on $56 million of their $71 million in debt outstanding.

And among the things that we looked at when we underwrote these bonds is that they've got a 1.5 times rate covenant, which is actually relatively strong for a water and sewer system. And this means that on an annual basis, their net revenue -- when they sit down and they make up their budget for the coming year for the water and sewer system, they have to demonstrate that the revenues that they anticipate coming in are sufficient to pay their O&M and that the leftover is equal to 1.5 times the debt service.

And so during the course of the year, if revenues are insufficient because -- one of the things that impacts water demand is rainfall. If you have a lot of rain, people don't need to water their lawn; your revenues go down, right? So if you've got a rainy year and people aren't watering the lawn, the revenues may not come in as anticipated.

On the expense side, you might have some chemicals off in your wastewater treatment plant. So you might have to spend more money there or have unexpected capital maintenance. So those are some of the things. So that's why they build in that cushion, to provide the 1.5 times so that -- and then they're obligated on an annual basis to make sure that that's the case for them.

It's an essential service and it's got a generally stable revenue stream. And historically, they've demonstrated that they've covered their debt, not the 1.5 times that's required under the indenture, but at 1.8 times, which provides even further cushion. And they also have good liquidity and debt service reserve funds that are available to cover a shortfall if they should experience one.

Audience Participant

Is the rate covenant forward-looking or is it backward-looking?

Mary Francoeur - Assured Guaranty Ltd. - Managing Director, Public Finance

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30 Woodbourne Avenue, 5th Floor main 441 279 5700 info@assuredguaranty.com www.assuredguaranty.com
Hamilton HM 08 fax 441 279 5701
Bermuda

It's forward-looking in that -- so when they set their budget, they're obligated to make their budget on an annual basis. If during the course of a year -- they're also obligated during the course of the year to potentially -- I would have to go back and check this -- they would have to adjust their rates if they're finding that they're not meeting their rate covenant.

And then if they fail to meet their rate covenant, they're generally required to either bring in a consultant or effectuate rates and charges that are sufficient on a going forward basis in order to make sure that they've got enough cash flow.

Does that answer your question?

Audience Participant

Sure. Do you guys monitor the credits?

Mary Francoeur - Assured Guaranty Ltd. - Managing Director, Public Finance

Yes. And actually, Russ Brewer, who heads up our Surveillance Group, is going to talk a little bit, but we do monitor our portfolio on a continuous basis.

Audience Participant

(Inaudible question)

Mary Francoeur - Assured Guaranty Ltd. - Managing Director, Public Finance

Sure, yes. I mean, the coverage comes into play twice. I mean, annually, they're obligated to set their rates and charges sufficient to meet that rate covenant. But when they go to issue additional bonds, they also have to show that on a pro forma basis, taking into account the additional debt that they can meet -- that they either have met their covenant with the additional debt taken into account or -- and/or that they can cover the additional debt on a going forward basis, that they have enough capacity in their rates and charges to meet the rate covenant -- which I'll sort of bring in another point.

I mean, as Steve alluded to, most of the services that we're talking about are monopolistic. And so when you think about rate-making flexibility, and you think about price elasticity or inelasticity, most municipal services are fairly priced and elastic. You can actually raise your rates and charges because you're providing a monopoly service, right?

There are some instances where your services are less monopolistic, like a toll road, where you might have a free alternative that might cost you a little bit more in terms of time, or gas, or whatever, but as you raise your tolls on that, you might be a little bit more price-elastic so that you would have some diversion. And so that's one of the things when we look at different types of revenue bonds, we take into account the nature of the service, the monopoly of it, or the lack of monopoly, and the pricing flexibility that they would have as a result of the nature of the service.

The same thing sort of goes on the revenue bonds where if there is an event of default, you would have the same rights to compel compliance with the rate covenant -- the obligation to raise rates and charges sufficient, at least with respect to those where they do have rate flexibility.

So some of the things that we look at when we look at a revenue bond. A lot of it, again, goes back to what we had talked about on the general obligation side, which is the nature of the community -- how resilient is it from a demographic standpoint. But specific to the revenues, again, do they have flexibility in the rates? It sort of puts it in one bucket. If they don't have flexibility, it puts it into another bucket in terms of how we analyze it. But then broadly, how broad is that revenue stream? And that's going to drive some of the covenants that we're going to look for.

If it's a very broad revenue stream, like a statewide sales tax, it's going to have more resiliency to a certain extent than if it's a local sales tax or if it's a local hotel occupancy tax or something like that. So the covenant package that we would look for, for a local hotel occupancy tax is probably different from or is different from the one that we would look for in a statewide sales tax, let's say.

Price elasticity, based upon the nature of the service. Again, if we think that there's some competitive pressures here, and that primarily goes for transportation services, we'll take that into account in our underwriting. And then the other part of it is, again, the fundamentals of the economics of where they're located.

And in terms of our own portfolio, most of our portfolio is actually on the revenue bond side, with a slightly smaller portion -- 51% is revenue bonds; 7% fall into that enterprise category of the 501(c)(3)s, and then the balance of 42% is general obligation debt.

And with that -- questions?

Audience Participant

Since we're looking at the revenue bonds with these security features, it seems like there are protections in here that allow the investor or Assured Guaranty to step in before things get really bad. But on the general obligation side, are there similar sorts of things there? I mean, there was a bullet point saying that you can step in if a payment is missed. But is there anything that can happen before that?

Mary Francoeur - Assured Guaranty Ltd. - Managing Director, Public Finance

I think the difference in the credit packages is really a function of the fact that on the revenue bond side you're actually looking at a specific carve-out of a single revenue stream, either on a gross basis with respect to the sales tax type obligation, or a net basis with respect to the operating entities. And because it's a carve-out of that single revenue stream and it's nonrecourse back to the general government, then that's why we would look for a stronger credit package.

On a general obligation, it's a full faith in credit. Any resource of the municipality is available to us, is available and required to be used in order to repay the debt. And even to a certain extent that would include a lot of municipalities on their water and sewer system sort of dividend. Any excess revenues after they've satisfied their debt service and the obligations, any needs that they have for the water and sewage system will actually dividend back to themselves on the general government side, excess revenues from the water and sewer system.

And so what you have on the general obligation side is that whole bucket of revenues that's really available. And so it's that very broad pledge and that very broad obligation that makes the security associated with a general obligation bond so strong. But we do, back to your earlier question; we do closely monitor the types of -- our general obligation portfolio and the types of things that we see impacting the ability to raise taxes.

We look at the trends in their assessed valuations. We look at the trends in their sales tax collections. Whatever their revenue sources are, we are closely monitoring it on an annual basis.

Audience Participant

How do you think about putting together the portfolio? Is it a conscious effort to have this balance of revenue bonds, private enterprise bonds and GO bonds? Or does it just happen this way? Is it consistent with the market?

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

I'll take this one, Mary. We actually have our entire credit committee here. And when we evaluate new business, it's always in the context of what the particular risk is as well as how it fits into our portfolio. And we have a very elaborate system where we have set limits by both -- for issuers and for sectors. And then we have developed some very cool analytics for portfolio analysis in the portfolio risk model. And that drives us to certain sectors or away from certain sectors.

Now I will be frank in these sectors, they generally tend to be very low risk. And so the limits we would have don't bind, except for hospitals, because most of our private enterprise bonds are hospital bonds -- are hospitals. And when you look at, with the analytics -- we've described to you from a descriptive basis how we do things, but we haven't drilled down into what you guys do and what we do. There's a lot of analytics behind the decision to insure in our portfolio management.

And when we look at private enterprise bonds and the fact that they are healthcare, those tend to be higher risk, so those imply both a lower per deal limit for a given rating, if you just want to hold rating constant, and certainly, consciously, a lot smaller percentage of our portfolio than would be for general obligations.

Audience Participant

Assured Guaranty Ltd. Assured Guaranty Corp. | Assured Guaranty Municipal Corp.

30 Woodbourne Avenue, 5th Floor
Hamilton HM 08
Bermuda

main 441 279 5700
fax 441 279 5701

info@assuredguaranty.com

www.assuredguaranty.com

So you guys take into consideration the overall portfolio when you insure a bond?

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

Absolutely.

Audience Participant

Do you guys take a look at different limits on certain transactions?

Howard Albert - Assured Guaranty Ltd. - Chief Risk Officer

I'm Howard Albert. I'm the Chief Risk Officer. I think it's important to point out a couple of things. First of all, we serve several masters when it comes to our risk limits. We have our own set of single risk limits, which in almost every case, are more restrictive than any externally imposed limit that we have.

We also have single risk limits that are imposed upon us for our US entities by the New York Insurance Department. And we also have single risk limits that are imposed upon us by S&P.

In addition to that, we've established our own set of sector limits. And it's also important for you to know that when we're looking at various credits that may add up to a single obligor, all of the credits within New York State; all of the credits within Puerto Rico; many credits within the state of California -- we add those and look at a single revenue source, and are aware that that revenue source is responsible for various obligors within that -- aggregate that and impose limits on that as well. So we have a fairly complex set of limits to control all of that.

And then in addition to that, we're looking at things like our portfolio risk model, where we're assigning probabilities and severities and correlations, geographic correlations and other kinds of correlations, to different kinds of risks, and looking at whether we feel that we have an appropriate amount of economic capital for the portfolio at large. We also add in exposure in our investment portfolio and make sure that that's taken into account as well.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

I'm sorry. Does anybody have any -- does anyone have other questions before we go on?

And as I said, we've given you a very -- we're limited; we're already 50 minutes into this. We have not gone through the underwriting technique for each of the sectors we insure. But I assure you there's a lot of analytics that go around each class of business that we do underwrite.

We're going to talk a little bit about the great recession, which hopefully, depending on how you look at it is, we're either into 10% into the great recovery or someplace past the great recession. But it's no secret that state and local government budgets have been challenged. And if you look, state income tax -- personal income tax down by 17% and corporate income tax down by 10%. And those two line items account for 42% of state budgets. So 36% in the US for all the states -- 36% of their budgets is due to personal income taxes and 6.5% due to corporate taxes.

Sales tax generally account for about 46% of state budgets. So you're looking at about a 10% -- an 8.2% decline. So clearly, the revenue side has been stressed. I don't have statistics on property taxes because they're a little too granular; I couldn't find anything that would give you information. But you should keep in mind that on property tax, we have some information about -- they're up 6.1%.

I don't have a figure on what they account for in budget. The reason why property taxes are up is because property taxes are charged on assessed value versus market value. An assessed value generally moves much slower than market value.

You know from your own homes, you don't get assessed -- your assessed value is usually lower than what you can sell the house for. So, they didn't move up as quickly. They won't move down as quickly. And also municipalities have been ticking up the tax rate. So we feel that the property value swings that you've seen in much of the country are going to be muted because of the way property taxes are assessed and charged.

And of course, someone threw in here that alcohol tax is up by 1%. No one needs to ask why about that.

So you see that the budgets are stressed but then you say okay, I'm going to talk about reducing expenses. But you've got to be careful when you are a state and local government about how you reduce expenses; it's always politically charged. You can't do it as easily or as quickly as the private sector.

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30 Woodbourne Avenue, 5th Floor
Hamilton HM 08
Bermuda

main 441 279 5700
fax 441 279 5701

info@assuredguaranty.com

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You're providing essential services for the folks that live in New York City -- what happens every time the city says they're going to close the fire house? It makes every newscast. There's one fire house out in some remote section of Queens and it's on every -- it's the lead story on every newspaper. And that's usually driven because of the essential services and unions. And unions are very well-organized and very well-funded and fight for their members.

And when you think about the municipal workforces, not only do you think about the employees, but you're going to have to think about health insurance. And we know those costs have been rising a lot faster than inflation, as well as pension obligations and OPEB, which is Other Post-Employment Benefits -- retiree health insurance.

And you've seen articles in the general press about pensions and OPEB, and in my opinion, that's going to be the next big news story for municipal finance. But keep in mind those obligations are very, very long-term and they are granular payments. And that's something that in the context of municipal bonds, municipal entities can bond out for. And so we don't think it's going to be the problem that it is for like a GM or for a Chrysler, where they don't have that flexibility in there. And moreover, those obligations were pretty overwhelming.

So municipalities do eliminate services. They do make layoffs. And what they do is to reduce expenses, increase some revenues, and because they need the capital markets, they make sure that they pay their debt. And that's evidenced by when you think about last year in California, last summer, when California started giving out IOUs, I don't remember what they called them, but they called them IOUs, a catchy name there. And they gave the IOUs were paid through a lot of the trade creditors, but the bondholders, I assure you, got cash. And that's the way it generally works.

But when we look at the municipal obligor, Mary described the fundamentals. And the fundamentals of a state or a city or a location are the same as they were before the recession in general. And we underwrite through a cycle. California is still the most populous state. It would be the -- what largest country?

Eight -- eighth largest country. Larger than any other -- than many, many countries. A diverse employment base. California, the notion of California being insolvent or unable to pay its debt is not something that's going to happen. They have the ability to raise taxes. It's an economy that will work through the cycle. And that's how we underwrite those municipal credits.

But the municipalities and the state governments are doing things to cope with the current cash flow or current liquidity issues. And I'd just point out a couple of things. If you read in the New York Times, I think it was yesterday, 58% of the counties in New Jersey, school districts in New Jersey, voted down the school budgets. 58% -- the highest number of declined budgets since the '70s.

And if you read the article in the New York Times, what's going to happen? School budgets are going to get severely cut -- cuts in services, cuts in all kinds of things -- programs, sports. But no one is saying, oh, and by the way, we're going to stop making debt payments. Because they're not; because they need to continue to access the capital markets. And in order to access the capital markets, you need to pay your bondholders.

I have a list from the National League of Cities, just a couple of things. Dallas -- and these are all from '09 -- Dallas, $190 million budget shortfall, lays off 637 full-time positions. Let me just look at -- Los Angeles is laying off something like -- has a $98 million shortfall in 2010 and it's projecting a $409 million shortfall in its budget in 2011. They're eliminating 2,400 municipal positions.

The National League of Cities conducted a poll in 2009 of 1,000 cities and about 40% of them responded. 67% of the respondents said there would be hiring freezes and layoffs. Another 62% said delays in capital projects, cuts in other services, 33%; 25% said modifying or eliminating employee benefits. And that's what you see the response of state and local governments to the current fiscal crisis.

And as we say, if I go to the next slide, making the debt payments is what -- the hallmark of state and local governments to make sure that they can continue to fund those capital projects over time. The recession will pass; unemployment rates will drop. People will get jobs again. Home prices will stabilize. Things will return to normal. And then deferred maintenance will be required; capital projects will resume; access to the capital markets to the tune of $400 million or $500 million -- $500 billion a year is required.

And so we don't see the current economic cycle -- is it causing stress? Yes. Is it causing downgrades? Yes. Have there a couple of missed payments here and there? Yes. But it is not a catastrophic event that, if you just read the newspapers that you're reading about all the time.

Does anybody have any questions?

Okay. The other thing I'd like to point out is that in many instances, especially for the larger cities, the states get involved. If anybody was living in New York City or alive in the '70s -- I have to start saying -- you'll remember that the state of New York established the Municipal Assistance Corporation to help New York through its budget crisis. They were fiscal managers to the state -- to the city, rather. They also enabled the city to raise debt. Pennsylvania has done the same thing for Philadelphia, for PICA.

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30 Woodbourne Avenue, 5th Floor
Hamilton HM 08
Bermuda
main 441 279 5700
fax 441 279 5701
info@assuredguaranty.com
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And we talk a little bit about the Orange County situation; the state of California actually, also helps Orange County during its bankruptcy.

I have one more slide. Pardon? Oh, yes, I'm sorry. Thank you, Sabra. The other thing I just wanted to add because we do have a lot of debt and there a lot -- school districts are frequent issuers of municipal bonds, and we do see that almost every state has some sort of program to ensure that school districts do meet their budgets and their budgets do include their bond payments.

I'm going to turn it over to Phil Abelson, who is a partner at Dewey Ballantine in a moment, to talk about Chapter 9 bankruptcy. But I'd like to make a few comments on it before we do.

I was alive in the '70s. What can I say? Dewey & LeBoeuf -- I apologize.

You know, there's been reasonable press coverage of Chapter 9 bankruptcy. A couple of things I'd like to make comments on is that it's reasonably rare. And Phil will talk about how rare. But we talked about 89,000 municipalities in the United States; less than 500 Chapter 9 filings since 1934. Four cases in 2008 and actually that number 10 really should be 8, because I misread the chart. So there are eight cases in 2009.

And since 1970, there have only been two cases of rated debt for which there has been a Chapter 9 filing. I don't have a prize for people to guess, so I'll just tell you. It's Orange County and Sierra King's Hospital district in California. You might have heard of Vallejo, which Phil will also talk about, I think. But that debt was not rated by Moody's. So it's not counted. So if you want to throw in Vallejo.

But one of the things I did -- the people at Dewey were kind enough to give me the list of the 16 or so bankruptcy cases that were since 2008. And through the wonders of Google, I started reading up on some of the cases. And I just want to give you three, and these were the more interesting.

One of them is for West Fall Township Pennsylvania. They declared bankruptcy in 2009. The bankruptcy was caused because of a $20 million judgment against the township when a developer sued them for blocking a development in the county. And the judgment would have been $25,000 per homeowner in the township and the township sought bankruptcy protection.

The second one is the city of Gould, Arkansas, and I'll just read a little bit about Gould in Arkansas. The city of Gould decided to seek Chapter 9 bankruptcy protection from its long-standing debts that runs into the hundreds of thousands of dollars. The Mayor is quoted as saying she hopes the court-approved bankruptcy will at least knock off some of the penalties and interest from the $224,000 the city owes the IRS.

The last one I'd like to just highlight is the city of Moffett, Oklahoma. And the city of Moffett, Oklahoma declared bankruptcy in December of 2008 after the Mayor passed away from a heart failure. He had been the Mayor for the town for about a decade. Recent reports include that the Mayor, unbeknownst to the Town Council, had incurred a number of debts, including $4,900 in Lowe's commercial credit card; $95,000 for two vehicles; and $3,200 in Dell computers.

Now the reason why the city ran out of money is because the Oklahoma Department of Public Safety had indefinitely banned the Moffett police from engaging in any traffic enforcement over a four-mile strip on US Highway 64. So, I think that sort of explains a couple of the cases. And that's what characterizes the cases of Chapter 9 that you see. They are idiosyncratic.

They are usually a result from some sort of management problem. They are all a function of some sort of illiquidity. And often is the case, probably of all the cases that you have shown, they are very small, unrated entities and they relate to debts that are not municipal bonds but the Lowe's credit card and the judgment from the IRS.

So when we look at our credits, obviously we're looking at the credit quality of the credits we underwrite, but certainly the credits that we are underwriting which start out as investment grade who are raising tens of millions of dollars in the capital markets are certainly -- and we underwrite them -- are a bit more sophisticated and have financial management in place and controls to pay their bonded debt than the examples that I cited.

And so when we think about Chapter 9, and Phil will talk about it, I'm almost done Sabra I promise. He'll talk about the eligibility requirements, the time, the expense, the stigma and I leave you with that. Who wants to live in a bankrupt town? And the adverse credit market reaction. So with that, before -- does anybody have any questions before -- yes?

Audience Participant

Thanks for taking the questions. Just a couple of general questions. One is, as you pointed out one of the ways that municipalities face an operating deficit is to issue debt.

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Just wondering what sort of outlook of issuance market for the muni bonds? And secondarily, the Build America bonds, to what extent does that represent a competition for bond insurance in terms of they provide credit and liquidity support?

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

Sure, I can tell you that the outlook for municipal bond issuance which was about $410 billion in '09, I would probably ask our public finance -- I'm the credit guy, so I don't make projections about volume. But, Sean, would you say you would expect at least that much in 2010?

Sean McCarthy - Assured Guaranty Ltd. – Chief Operating Officer

On target so far.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

It would be on target 2010. As far as Build America bonds and competition for bond trends, that would not be a question for this call. That would be a question outside of the scope and I'm getting the eyeball from Sabra that that's not something we should be talking about in this context. But if you want to ask that on another call which happens in May, I think you can.

Audience Participant

Thanks.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

Okay, with that, I apologize for taking some extra time, but I will turn it over to Phil Abelson from Dewey and LeBoeuf.

Philip Abelson - Dewey & LeBoeuf - Partner

Thank you Steve. In your defense, we actually merged. It was Dewey, Ballantine and LeBoeuf and we merged about three years ago. So it's fairly recent.

You know, it's funny. Actually I was going to clarify talking about Chapter 9 is extremely rare but I think that's been covered. But I will just point out that I practiced bankruptcy law and a number of my partners who have been practicing it for longer than I have, I will say that frankly I've never come across a Chapter 9 case and polling my other partners who are distinguished in their field and have been practicing 30 years, they also said they've never seen a Chapter 9 case.

When we talk about how rare it is, that's how rare it is. We have some of the better bankruptcy practitioners in the city and they've actually never come across a case.

Just to point out also, it's not taught in law school. In fact, I would say it's probably the forgotten chapter of the bankruptcy code. It's kind of tucked away. It's only about three or four pages actually of a 200 page code.

So Chapter 9 is extremely rare. Let me just emphasize that one more time. And frankly, the jurisprudence on it is so limited that it's tough to really understand how courts will interpret it.

Although we do have some case law to figure out and that's what I'm going to talk about today. I'm going to walk you through kind of a high-level overview of what Chapter 9 is. Let me just point this out at the beginning and I know it's been mentioned before.

The 10th amendment is a significant factor. The overlay of the 10th amendment really limits the rights and the powers of the federal court to jurisdiction over the state.

And because of that, it limits the court's powers over the debtor. And unlike a Chapter 11 debtor which basically has to seek court approval for anything outside the ordinary course, that's not the case in a Chapter 9 because the federal courts have limited jurisdiction over the states and municipalities.

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To file a Chapter 9 case, the debtor must be eligible and really there is a five-part test to eligibility. The first thing they must do is be a municipality. There is a definition in the bankruptcy code for a municipality.

It is a political subdivision or public agency or instrumentality of the state. Now that last part is actually important. In the Bridgeport, Connecticut case where the City of Bridgeport filed for bankruptcy, there were objections raised at the beginning of the case essentially to add to eligibility.

And what the court found amongst other reasons is that -- actually, sorry. Let me go back because that's actually the wrong reference.

The reference I was referring to was Orange County. In Orange County there were two filings. There was one by the county itself and then one by the investment pool.

And the investment pool's petition was challenged on the basis of eligibility and the question was: is the investment pool which is a portion of or related to the county an instrumentality of a state and the answer was no because the county itself is not a state. So taking the words literally, it literally has to be an instrumentality of a state and not a county.

Let's talk about what it means to be a municipality. What constitutes a municipality? Cities, counties, water or school districts, municipal authorities, those are typically the municipalities you are going to see file for Chapter 9. So that's the first requirement.

The second requirement is that it has to be specifically authorized under state law. And this is actually a change, a recent change that was made to the code. It used to have a general authorization provision until basically the Bridgeport case where the congress amended the code to make it a specific authorization under state law.

Now that authorization can be either an enabling statute which says that a municipality can file for Chapter 9 or something that says a municipality can file for Chapter 9 if it satisfies their requirements, goes to a board that then decides. So for instance in Connecticut after the Bridgeport case, the law was changed such that anybody or any municipality that wants to file for bankruptcy in Connecticut has to get the approval of the governor.

And if you look at the chart that's on the slide, those are the states that have either -- that actually have an enabling statute to allow -- specifically authorize municipalities to file for Chapter 11 and the states with the asterisk have that extra level of review such that a municipality that wants to file has to go and actually get approval from some governing board or officer.

Okay, so in addition to having specific authorization, the municipality must be insolvent. Before I touch on this, I just want to point this out.

In chapter 11, for a corporation to file for Chapter 11, they don't have to satisfy anything. You just have to file the petition and the petition has to be in good faith. There is no solvency test like there is for Chapter 9. You don't have to meet a certain definition. You don't have to overcome any of these hurdles.

But for a municipality to file for Chapter 9, you have to satisfy this five-part test. The third part is insolvency. And what is insolvency mean in the Chapter 9 context?

It means the inability to, either the inability to now, either they are now not paying their debts that come due or the inability to pay their debts as they come due in the future. Really what the courts will look to is the cash flows of the municipality.

Do they have the ability to pay? For instance in Bridgeport, the court said the answer was yes. They do have it. You're not insolvent. So the court dismissed the case on the basis of Bridgeport being ineligible because it was not insolvent.

And basically what the court says -- look, for the first year through the end of this fiscal year, I believe you will be able to pay your debts as they come due and basically any projection beyond that was unreliable. But that's not to say that would be true in every case. That would be what the court found in Bridgeport and as far as I'm aware, they never came back. So I think the court was correct in its determination.

Another requirement is that the petition must be voluntary. This is essentially akin to a good-faith requirement. It means that when they filed for bankruptcy, when the municipality filed, it actually has the intention to adjust the debt and is not using it as leverage over creditors.

Also point out different from Chapter 11, incorporation can be put involuntary into bankruptcy. A municipality cannot. So it actually has to be an affirmative step on the municipality itself to go into Chapter 9.

And finally, essentially we titled this slide Attempt to Avoid a Filing. I think that accurately describes what the four different options are.

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fax 441 279 5701

info@assuredguaranty.com

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But you really have -- the municipality has to satisfy one of the four. The first one is it either has to reach an agreement with its creditors over the terms of a plan of adjustment or it needs to show that it tried to in good faith and was unable to find a resolution. Another option is to do the third category which is to show that you are unable to negotiate your plan because it's impractical. Either your creditors aren't organized or they are too numerous or you didn't have time because the financial distress was so acute that you needed to file to protect yourself.

The fourth -- and by the way, that last point was really put in to take into consideration the situation like we had in the 70s in New York where there were so many creditors, it was almost impossible to try to negotiate any sort of resolution out of court, even though they never filed. But that was the idea that in the future, they wanted to make sure there was a protection for that type of situation.

The final one is actually somewhat baffling. There's really nothing out there that describes what this -- what congress intended when it put it in there. But essentially the idea is that the municipality reasonably believes that a creditor will try to obtain a preference.

It's baffling because the code actually includes the ability for a debtor to actually go back and get its preference payments from creditors, except for bondholders which is a very important point. But still, it's broad enough to include people who otherwise would be subject to an avoidance action.

Alright, so the anatomy of the municipal bankruptcy. Essentially, the case is started when a petition is filed. But unlike in Chapter 11 where that is really where it starts and everything kind of kicks in from there, once the petition is filed, certain things happen.

The first one is that it is assigned to a bankruptcy judge. In Chapter 11, the bankruptcy judge is determined usually at random. Literally in some courts, it's a wheel where it's just names and they spin it to see who gets the case.

In Chapter 9 however, it's actually determined by the chief judge of the court of appeals for the circuit in which the case was filed. And the reason for this is to ensure that the decision is apolitical and that the choice of judge is one who is someone who is well-equipped to handle this type of case and they make sure it's not just a random selection and you get the right judge for the assignment.

When the case is filed, a notice will be published in the paper to alert people to the case being filed. Then they will have an opportunity to object to the order for a relief.

So essentially you have a petition being filed by the debtor, the judge being assigned, there's going to be a hearing for an order for relief. At that hearing, people can raise objections to the eligibility requirements or the good faith of the petition and then it will be decided whether the order for relief will be entered.

Okay, so the automatic stay. Probably the most significant power for a debtor, Chapter 11 or otherwise. It applies in Chapter 9. That's the important takeaway.

What it does, essentially, draws a line in the sand between pre-petition and post-petition action. Any act to collect the pre-petition debt is stayed. There is literally an injunction that prevents creditors from trying to collect on debt or collect against employees, municipal employees for debts that the municipality may owe to them.

So the automatic stay is a stop. It does stop creditors from taking certain actions and it does come into play immediately upon the filing of the petition regardless of whether -- when the order for relief is entered, if it is entered at all. Of course once the case is dismissed, the automatic stay goes away and then basically you are free to go after the municipality at your will. When I say that, I say creditors are.

Alright, so the powers of the court. As I noted, the 10th amendment significantly limits the powers of the federal court over municipalities because they are instruments of the state. These limitations actually have pretty significant consequences in that the municipal debtor is able to operate its business without going to court for certain approvals.

It's able to go and get credit from lenders on an administrative expense basis which means that essentially it is a higher priority claim in the bankruptcy case which is essentially the highest priority claim, and essentially able to operate as it did prior to filing. Again, different than a Chapter 11 debtor who if they want to take an action outside the ordinary course of business, they have to send out a notice to the creditors, then have a hearing, go to the judge, get the judge's approval and if any objections are raised, actually fight the objections. So again, for a musical debtor, the Chapter 9 filing is not as restrictive in terms of operating the municipality.

One thing that I will note is that the court cannot appoint a trustee. A trustee is something that you can get in the Chapter 11 case and displace management if management has committed gross mismanagement or committed fraud.

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main 441 279 5700
fax 441 279 5701

info@assuredguaranty.com

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You cannot do that in a municipality. You cannot displace the authorities who are running the municipality. But what you can do is get a trustee to come in and bring the avoidance action such as preferences or fraudulent conveyance actions if the debtors refuse to bring them themselves.

As with the court, the same limitation applies to creditors in Chapter 9. Essentially a creditor has two avenues for complaint in a Chapter 9 case, which is to try to seek dismissal on some eligibility ground or as I'll note later, there is another provision that allows it to seek dismissal or to say that the petition was not filed in good faith.

In fact, this is what happened in Bridgeport where the State of Connecticut came in and objected to the petition on the first day or basically before the order for relief was entered to say that they were not eligible and that as I noted, that objection was successful. The other thing that a creditor can do is to object to the plan of adjustment.

One thing a creditor cannot do which is a significant difference from Chapter 11 is to file a plan itself. So exclusivity, what we call exclusivity, which is the exclusive right for the debtor to file a plan, there are limitations on that right. In Chapter 11, there are no limitations on that right in Chapter 9. Only the municipal debtor has the power to file a plan.

The court can put restrictions and put time limits on when the plan must be filed. There is a creditor's committee in a Chapter 9 case but again, limited rights, limited powers. They generally will interact with the debtor on many large decisions such as what the plan of adjustment will look like because the debtors want to make sure they have the creditors support but it's definitely not the same sort of creditor's committee you'll find in Chapter 11 case where they basically try to worm their way into the debtor's business.

So who can be heard in a Chapter 9 case? It's basically the same as an 11; anybody, frankly; anybody who has a relation to the municipality. Taxpayers, creditors, the SEC, the treasury; basically anybody who has a connection should be able to be heard in a municipal bankruptcy.

Continuing with the theme of the limited power of the court, let's talk about the powers of the debtor. I've mentioned them already but I'll just reemphasize that they can use -- the debtor can use its property, it can raise taxes, make expenditures. It can do what it did outside of bankruptcy.

One thing it can do which is significant and what Chapter 11 debtors can do as well is assume and reject contracts; so obviously again a certain power the debtor has. One thing that a municipal debtor has is the ability to reject a collective bargaining agreement without satisfying the requirements of Chapter 11 and is a significant difference between the two and I would say gives the Chapter 9 debtor municipality a significant advantage over their corporate counterparts.

As I mentioned before, one creditor remedy is to seek dismissal of the case and this is actually after the order for relief has been entered. So just going back again; debtor files petition, judge is appointed, objections come in and the objections are overruled and the debtor is found to be eligible and found in good faith, an order for relief is entered.

At that point now, the case has been commenced essentially, now able to go on. However, if during the case the debtor does certain things that the creditor feels are inequitable or are causing delay, then a creditor can seek to have the case dismissed and as you can tell, these are actually written into the code. There are a number of categories. But again, the essence of them is inequitable treatment by the debtor and delay.

All right, so really the main event which is the plan of adjustment, the plan of adjustment allows a municipal debtor to work out its obligations in a way that gets creditor support and really follows in many ways the rules for confirmation of a plan of reorganization. There are essentially five requirements for an affirmative plan and the code actually says if the five requirements are satisfied, the court shall confirm. So that means that it must it has no discretion. Of course they can decide whether the five actually are satisfied, but still once you find that the conditions are satisfied, the plan must be confirmed.

Basically we don't really need to go through all of them. I'll point out the most significant one in my mind, but just to walk quickly; it has to satisfy the applicable provisions of the bankruptcy code. It's typical, it can't violate other applicable law; need to pay administrative expenses in full. This is what I talked about before, where the debtor can actually go out and get credit on an administrative expense basis. And if it does so, the debtor must make sure in its plan that it pays those claims in full and it can't emerge without paying them in full. When I say in full, I mean in full, meaning cash, unless they can agree to another arrangement.

But the most significant one point is which is that the plan has to be in the "best interest of the creditors" and it has to be feasible. Now the best interest of creditors is a concept in Chapter 11 but it has a different meaning.

Chapter 11, what it means is that the plan of reorganization is different from the plan of adjustment but the plan of reorganization needs to provide a recovery to each creditor that is greater than the recovery they would receive in a liquidation. That doesn't apply here for something that was actually mentioned earlier in the presentation, which is that municipalities cannot liquidate. As one court noted, cities cannot go out of business. So if you can't liquidate them, you wouldn't use that as a test. So what does best interest of creditor mean in this context?

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Bermuda

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fax 441 279 5701

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It means that the creditor has to do as well under the Chapter 9 plan of adjustment as it would outside of the Chapter 9 plan of adjustment, if it were just moving under state law. Very difficult thing to determine because again, outside of the Chapter 9 context, you have people racing to the courthouse to see who can get what.

So it's one of those things that the court will take expert testimony on and try to figure out is this the right or does this satisfy the best interest of creditors. Now, feasibility. What does it mean for the plan to be feasible? This concept is actually the same as in a Chapter 11. What it means is that the court wants to make sure that the debtor is not going to return to bankruptcy within three years, let's say. And the court really figures out the projection period.

But the idea is that it's feasible such that the municipal debtor can continue out of bankruptcy, move on and not have to return again. So basically what it is is a test to determine projection and the debtor would have its financial advisor give expert testimony to describe exactly what those projections are and the business model for the municipality.

A couple of things for those who understand Chapter 11, cram down does apply, exactly as it sounds. Again, administrative expenses need to be paid in full. Lastly, if the plan as proposed by the municipality is not confirmed, the court actually lacks the power to modify it and really the court's remedy at that point is just to dismiss the case.

So, a couple more slides discussing general obligations, general obligation bonds. General obligation bonds are essentially treated like unsecured debt, general unsecured debt. So post-petition interest doesn't get paid. It actually doesn't accrue.

And the general obligations are subject to adjustment in the plan of adjustment. Special revenue bonds are, not surprisingly, treated as secured debt because that's essentially -- they have the same sort of characteristics in that they can receive principal interest during the case, so long as they revenues that are being produced by the system or whatever it is that these special revenue bonds are derivative of, as long as the revenue is enough to satisfy the obligations, they can be paid.

Again because a lot of the special revenue bonds are non-recourse, if that's not the case, it’s not like the people who hold special revenue bonds can look elsewhere for recovery from the municipal debtor. And as with the general obligations, the special revenue bonds are subject to adjustment in the plan.

Okay, so the last slide deals with avoidance powers. I mentioned this a couple times. But the takeaway, the most significant part is there is a specific exception in the bankruptcy code for a payment to a bondholder for preference purposes.

The debtor, as I said, retains the right to go and seek to avoid certain transactions that occur pre-petition. But as to preferential payments made to bondholders that right was taken away by congress. And if anybody wants to know I more about this I can go into great detail, but that’s probably outside of the scope of today’s presentation.

I'll briefly mention Vallejo and I will briefly mention Orange County and Bridgeport. Vallejo is actually an ongoing case. It's one of the more significant cases.

The key takeaway here is the City of Vallejo was able to reject its collective bargaining agreement outside of the Code-11-13 standards that a Chapter 11 debtor must satisfy which is obviously a significant power for the debtor. As to Orange County, I mentioned before that there were two filers.

There was the county itself and then its investment pool. The county was found to be eligible. The investment pool was not. In the Chapter 9 case for the county, basically everybody was paid in full, which is obviously a significant data point.

And for Bridgeport, Bridgeport as I noted filed but was ultimately -- the order for relief was never entered because the court found that among other things, that Bridgeport was not insolvent. And so again, these are hurdles that Chapter 11 debtors don't have to deal with but for a municipality filing for Chapter 9, it's much more difficult.

Any questions?

Audience Participant

Is Chapter 9 only heard in Federal Court? If can be heard in State court can you get around 10th Amendment.

Philip Abelson - Dewey & LeBoeuf - Partner

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That's the one question I was afraid to get. So the question was whether a municipal debtor, if it's ineligible to file for Chapter 9, can it go through the state courts and essentially file for the state bankruptcy.

If it's kind of a -- there's two answers. The first answer is that I don't really deal with the state insolvency regime which are not applicable to the types of debtors or corporations we deal with. And so I'm not totally sure what the answer is on A.

B, there is a federal bankruptcy regime which is actually written into the Constitution where it says that the federal government has the power to enact bankruptcy laws. So the answer I would say is no, based on that. But I can't say definitively.

Audience Participant

So is Vallejo, a mechanism for a town to essentially reject bad contracts it has with unions relating to retirement benefits and things like that? And then this could be a case or a model for other towns to follow? And how are basically their bonds going to be treated? How are they suggesting they be treated in this scenario?

Philip Abelson - Dewey & LeBoeuf - Partner

Actually, I don't know if I want to go through what's happening in the case and how they're treating their bonds. But I will just note what the rules are under the bankruptcy code for a rejection of contracts.

The debtor has the ability to reject any burdens from contracts from bargaining agreement. Again in Chapter 11, not including bonds, because bonds are not a certain type of contract. They are financial accommodations, which is an exception to the rule. So they can't reject it.

Now rejection, just to clarify what that means, rejection is just legal breech. So what happens when a debtor rejects a contract is that it breeches it reaches it was court authority and then all the claims under that contract become pre-petition claims. They go basically to the moment before the filing, such that they are just treated as pre-petition claims in the case and will receive whatever the pre-petition creditors receive from the general pool that is available for recovery.

Audience Participant

You had a slide here that said 600 cases have been filed, Chapter 9 cases. Do you know what the typical recovery rate was on those bonds? It looks like for Orange County, people recovered everything. And then secondly, I guess I'm wondering, what was the ability of those municipalities to access the capital markets thereafter?

Philip Abelson - Dewey & LeBoeuf - Partner

Actually, I'll clarify. I'll just answer as frankly as I can. The answer to the first question is, I don't know. Because again, it's not something that we often deal with. And as noted by Steve in his presentation, among those 600, you've got a lot of the Moffett's and the townships, and it's not something that would hit our radar.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

I would refer you to -- we have a bibliography and in the back of the bibliography is a Moody's report that they did in February on municipal defaults.

Now when you say the recovery and how it affects their access to the capital markets, we only know of two municipalities that have rated debt that went through a Chapter 9. Orange County, so that's pretty observable. And then the other one is Sierra Kings Hospital District which is a very small district in California.

I have some information on that as well. That's also an active case. But that case, they had $12 million of muni bonds outstanding and the district filed municipal bankruptcy after discovering proceeds from the bond sales were misused.

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So I don't think you have to -- we don't really have a data point to point to which I guess is a good thing. There is no data point about recovery or re-accessing the capital markets other than Orange County. And arguably, Orange County again looks more like a rogue trader kind of situation than what you think about with Vallejo, which again, I agree with Phil not to comment on that.

But that was the result of a city having burdensome some union contracts and having some debt and trying – seeking to renegotiate those burdensome union contracts. So I guess the way I would look at it, the way we look at it is the fact of the matter is amongst the rated universe of municipal general obligation, the good news is we really don't have any to point to, none.

Audience Participant

Just a question, in terms of interest in arrears on revenue bonds, when a refinancing occurs, what is the subordination on the owed interest, relative to administrative expenses and the other expenses of the municipality? Or is it just specific revenue source?

For instance, if a specific revenue bond defaults, interest accrues in arrears, a refinancing occurs. Is all of that interest accrued and how is it paid out?

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

So the notion of -- I agree with you. If there is a missed payment on a revenue bond, the interest accrues, but I don't know where the second step is where you're saying a refinancing occurs. The interest and principal is still due and owing to the bondholders over time.

There is no -- again, we don't have any examples I could say well, in this instance -- I mean if we were talking about Chapter 11, there's how many cases a year? Thousands of cases.

So we don't have any. But it doesn't necessarily mean, and we're talking theoretically, but then you need to refinance the debt. The debt goes on and we have -- and there's covenants in the debt instrument, rate covenants and debt service reserves that Mary talked about.

The other thing that the documents provide for is that to the extent you use your debt service reserve; you have to set rates and charges to replenish the debt service reserve. So the deal can just go on the way it was.

Audience Participant

Maybe you can talk about an example, just the Triborough Bridge defaults. You were making the interest payments on their behalf in the interim while they're in Chapter 9, so before they can refinance. Upon refinancing, how are you compensated for the interest accrual?

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

Well there are two things going on here. If there is a revenue bond -- and so there is a missed bond payment. That's the first thing. So there's a missed bond payment, we hit the debt service reserve fund. Usually the debt service reserve fund is sized at somewhere around either one year of debt service or 10% of the bond par amount. That's basically a good rule of thumb.

So now we're hitting the debt service reserve while -- and we would know because remember, Mary talked about the rate covenant and maybe you want to go back to the example slide Sabra. So we had a rate covenant -- you just don't wake up tomorrow and you miss a bond payment because you have a rate covenant.

So you are missing -- so the rate covenant is -- you failed the rate covenant, then you missed the bond payment. Then we would be interacting with the issuer to find out why they missed, why they blew through the rate covenant or why we're tapping the debt service reserve.

And then we are seeking to enforce our rights and remedies under that bond deal. And let's just say simultaneously, I guess if there was a Chapter 9 bankruptcy, could happen, the revenue is still protected as a special revenue.

The case is adjudicated and -- I'm sorry, the order of adjustment is in place, the bond deal goes on. It doesn't need to be refinanced. The money -- accrued interest is still owed to the bondholders and we through our subrogation rights would be entitled to recover those monies.

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Mary Francoeur - Assured Guaranty Ltd. - Managing Director, Public Finance

The rate covenant, the obligation to set rates and charges also includes the obligation to set it sufficient to repay any unpaid interest at that point in time. So if there is a default and you have gone through any of your liquidity, you are obligated in a subsequent period to raise the rate sufficient to cover not just the current year's debt service, but the defaulted debt service.

The other thing too, your question is probably when you start thinking about something like a Triborough Bridge and Tunnel Authority where you've got an economic issue where you can't raise your rates sufficient because of diminishing marginal returns, then you are talking about the issue of perpetuity.

You might have defaulted interest and it continues to accrue over time, but at some point, all the debt is going to be retired. And at that point in time, you would continue to have access to the cash flow in order to repay your defaulted debt if there were an issue of the economics associated with the service.

Audience Participant

So I guess in other words, as long as you're not in a sort of negative cash flow position in perpetuity, then the severity on the excess revenue bond would be zero.

Mary Francoeur - Assured Guaranty Ltd. - Managing Director, Public Finance

Loss severity on municipal bonds is near zero. Actually one of the things that Howard has mentioned before, I think it's cited in here, the Hemphill study. Municipalities that have defaulted on their debt with communities over 25,000, there's never been -- there's been 100% recovery.

Recovery on municipal bonds because of the issues -- because they're perpetual in nature and because your lien to a certain extent is perpetual in nature, ultimately you'll get recovery. And there's always an obligation to if you miss a payment, to make sure that in a subsequent period, there's sufficiency there.

Audience Participant

The issue for you guys is not severity, it's frequency of the debtor's inability to pay interest.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

Because unlike a mortgage deal, the house never gets paid off if you don't run out of cash because the mortgage is done, but we still have the right to cash flows. So you fund it in bonds. You pledge this revenue stream. As long as we're owed money, that revenue stream has to keep paying to pay the bondholders and eventually pay us back.

Audience Participant

Sure and how about like present valuing the cash flows.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

It accrues with interest, so…

Audience Participant

Okay, so for missed interest payments…

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

How long do you think -- the calculation you're going to try to do is -- all right, so let's say you have the Triborough Bridge and then let's say everybody is using the 3rd Ave. Bridge and nobody is using -- whatever, they are not using the Triborough Bridge, there's a debt -- actually it's over-levered.

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How long will it take for them to raise rates sufficient to cover debt service at just one times and then how long -- and then they can't issue more debt. Because inflation in time is your friend. So they can't issue more debt because they would be violating the rate covenant and the additional bonds test. So the bonds are amortizing down, you are still getting cash. So for how many years does that occur before it rights itself and then we start collecting the money back?

Audience Participant

You're indifferent as to -- I mean, not indifferent but from a present value of money standpoint, you're compensated on that.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

Yes.

Audience Participant

Why does Warren Buffett think this is not a great business then?

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

I would ask Warren Buffett.

Audience Participant

Talk about moral hazards then and why -- what he publicly said is that he just think the municipalities might say just let the bond insurer eat it.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

Well, first off, notwithstanding that position, he did establish a municipal bond insurance company and decided that I guess there was sufficiently low moral hazard to start writing the business. Clearly, he thinks there is something there.

What's the moral hazard? Let the bonds insurers eat it? Well the bond insurers usually don't stand alone to -- as the sole creditor of the municipality.

And so, you have to -- if you are going to let the bond insurers eat it, you have to make every little old lady with blue hair who is relying upon her municipal bond coupons to pay for groceries eat it. Since we would also be, every other creditor of the city would have to eat it, so the moral hazard is do you want to strap on the suicide bomb to blow up all of the creditors to make just the bond insurers eat it. It's kind of -- it's a little bit harsh.

Audience Participant

Can you talk about subrogation to the bondholder?

Philip Abelson - Dewey & LeBoeuf - Partner

You're subrogated to the right, so essentially (inaudible) as the bondholders. So you have the same rights as the bondholders (inaudible) subrogated.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

It's a good question but quite frankly.

Audience Participant

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Does Warren know this?

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

We're scheduled to have lunch next week and he hasn't returned my phone calls.

Audience Participant

This is probably a question for Phil. Question on the GO bonds. You said during the litigation process, the bankruptcy filing process, the debtors don't have to pay the interest or the principle. Now how long does that process take and can any municipals just kind of file it just to buy time?

Philip Abelson - Dewey & LeBoeuf - Partner

That's exactly why the eligibility requirements are there and that's why there is this voluntary good faith requirement, which ensures that the municipality is not using it as both a sword and a shield to essentially use it as leverage against its creditors.

The idea is you go in with a plan of adjustment in mind and in fact if you look at the four requirements that were there, one of them of course is you reach an agreement or you try to reach an agreement in good faith or you can't because it's impractical. Essentially it's you have got to try, the municipality has to try to work it out with its creditors before going in.

Basically the idea being Chapter 9 is the last resort. It's not -- it's different than Chapter 11. Chapter 11 at this point as I said before, the stigma has kind of been erased.

It can be a good business strategy, not a good business strategy for a municipality to file for bankruptcy. These people lose faith in service and the people they have elected and it's just -- obviously it's not a good business strategy the way that Chapter 11 is.

Audience Participant

I guess just in terms of general municipal health, kind of what percentage of the bonds that you cover are currently tapping their debt service reserves or have reached their covenants?

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

I'm being told that that's --

Sabra Purtill - Assured Guaranty Ltd. - Managing Director, Investor Relations

That's a question I would save for the call because in our blackout period, we're going to strictly limit this information as of December 31. But I can tell you it's not a material number at all.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

Okay, well then -- we will move. Thank you, Phil. We're going to move to Russ Brewer, who is the head of surveillance for the Company and he'll try to apply what we've talked about in terms of the kinds of bonds and trying -- to our portfolio.

Russ Brewer - Assured Guaranty Ltd. - Chief Surveillance Officer

Thanks, Steve. I'll be very brief. We've got a couple of slides here to describe our portfolio. I think the point to note on the first one is just that only about one third of our muni portfolio is even eligible for Chapter 9.

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I think the bigger point is that, as Phil just said, Chapter 9 has proven to be a very ineffective tool. Our experience with it is virtually zero because of that. We've had an excellent experience with our municipal portfolio as you know.

Moving on, the bulk of our portfolio, 78% of our book, is in tax-backed GO muni utility credits, considered the lowest risk sectors. I think you are familiar with that.

We have an average rating of A+ on the portfolio. Again, a very high credit quality portfolio. One of the questions we had earlier was how do we monitor this book.

It's, as Steve mentioned, we've got 14,000 or 15,000 different entities to look at and really what surveillance is, and I'm sure this is true in each of your operations as well. Surveillance is focused on trying to pay attention to the most important things, drill down there the most.

And so we group our exposures in various ways and look at them during the course of the year. Municipal credits are usually quite slow moving.

It's not -- there's not tremendous new credit activity each year. So getting to them each once a year is deemed more than satisfactory. We look at our top 250 credits in great detail, top 250 largest obligors. That covers about 45% of the par of our portfolio. Those are looked at in detail.

Then we do sector studies, the second thing we do where we will look at all infrastructure projects or our entire healthcare portfolio, things like that where we are drilling down in particular areas of the business that we think are important to evaluate. Third, we look at all below investment grade exposures that we have every quarter.

So those are reviewed, they're reviewed with our internal risk management committee and they are reviewed with our board every quarter. So that is a pretty effective tool, again being used on those credits that are most sensitive to their changing circumstances.

Fourth, in the course of a year, we get a lot of credits that are new and so a lot of our surveillance activity is actually performed by the underwriting function of the Company, where I think -- where the new business teams in the underwriting department will review credits in our book.

And finally, in the course of a year, we get something we call TAWACs or a transaction consent and amendments that we're asked to perform. In the course of a year, we will get 200 or 300 requests for amendments to transactions that we have and that's another way for us to keep in touch with stressed borrowers and what is going on in their particular circumstances.

You don't hear from borrowers that everything is going fine. You're usually hearing from borrowers that have something going on and they bring that to our attention. They need relief from a covenant or something has happened. They want to issue additional bonds and they're going to be in violation of additional bond testing, things like that.

We break our -- these requests into three categories as we show here. Ministerial where you are just changing a remarketing agent or a trustee, something that the bond insurer would frequently have to consent to. Those are about two thirds of the requests that we get in the course of year. So most of these requests are pretty minor.

We get some minor transaction modifications. There may be a breach of a covenant, something that we don't think is particularly adverse to our interest but gives us a greater degree of control. And third, our remediation questions and those number about 2% of the requests we get in the course of the year and that could be something quite a bit more serious where we are going to take specific action. An example might be a hospital that violates its days cash on hand covenants, it's draining its cash somewhat.

And in exchange for that, we do a couple of things usually. We make sure that they bring in consultants to get their operations back on track and we may take a mortgage on property that they have if they didn't already have that mortgage or take other remediation’s.

It's important that we take those steps actively during -- as soon as we're aware of these things and that's why we have covenants and that's why we have the reporting that we do and that's why we have monitoring the portfolio that we have. The monitoring takes place in various forms, some of which are very -- by hand reviews, if you will, where we're looking at the annual audits of our large credits.

And then as we get down into the smaller credits and more plain-vanilla sectors like GOs, we're getting data from outside sources. We have all the credit scope data, we have data from the municipal databases and sources like that.

We're doing as much of this electronically as we can and the idea of course is to raise the attention of the risk management team here, those transactions that are developing adversely in the course of the year. That's really our focus and again, we try to touch each of our credits in some way over the course of the year, looking for adverse developments. Steve, I think I'll leave it with you somewhat.

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Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

We have about eight presentations up here now, so. I guess in summary, and I promised I wouldn't read slides but this one I'll break my promise. I hope we've explained to you why in the municipal bonds market, the municipal bond debt is different than that of corporate.

And basically the two principal reasons are the issuers are perpetual and usually monopolistic and they have the ability to raise taxes and fees on monopoly services which you don't see with corporate obligors. I think we have shown you that the event of municipal bankruptcy is infrequent, unlikely and at least as far as we can tell, idiosyncratic.

You haven't seen wholesale municipal bankruptcy caused by either the revenue or debt. The cases that you see are event risks that sort of come up and we think that is really grounded in the fundamentals of municipal finance and municipal credit and municipal operations or perpetual entities.

And the financial troubles that you read about are more -- think of them instead of credit, I would ask you to think of them more in terms of liquidity because that's what they really are. The City of New York, the State of California will be here long after all of us.

But this recession will end and the people will go back to work and houses will go up in value over time. So the issue that municipal entities face is that of liquidity, not truly credit.

And finally, you know as we say in the last bullet point, while we expect some deterioration, the nature of our exposures and the protections we have and the excellent job we do at monitoring our portfolio makes us very, very comfortable and is a testament to the fact that as Sean said at the very beginning, the losses that we have incurred on this -- our industry has incurred on this part of our book of business which is by far the largest, have -- rounds off to sub 5 basis points over a 25 year period. And with that I will thank you for all coming.

I would strongly encourage you to ask questions. I would like to acknowledge -- you met Howard Albert. We also Kevin Lyons who is the General Counsel of our public finance business as well as Frank Coughlin and Dave Penchoff who are the Co-Chief Credit Officers for our public finance business. Any of them could answer probably more questions than me.

So with that, anymore questions? One? Sabra? I got a Sabra question. Is this from the Internet?

The question from the Internet was in an instance of Chapter 9 bankruptcy, can the plan of adjustment include the cancellation of obligations like union contracts or bonds? So that I guess basically debt forgiveness or obligation forgiveness and I would think the answer to that is no. Well, Phil, I'm going to let you answer that.

Philip Abelson - Dewey & LeBoeuf - Partner

In order to adjust the debts the municipality satisfies the confirmation standard which is in the slides. Included with that as I said is the power to cram down. So if the municipality is unable to reach an agreement with one class of impaired creditors, but it's able to reach an agreement with at least one other class of impaired creditors, it can try to cram down the plan on the other class of impaired creditors.

Now that has a whole bunch of different requirements that need to be satisfied. But the answer to the question on the special revenue bonds is that it's complicated because you have to satisfy one of the tests for cram down of the secured debt which is essentially three of them and it's not like you can just go in and wipe it out.

Even rejection of a collective bargaining agreement doesn't wipe out obligations. It just creates them back into claims and those claims are then dealt with in the bankruptcy as part of the plan of adjustment. And so you'll get the recovery that the other general obligations would get or general unsecured debt.

Stephen Donnarumma - Assured Guaranty Corp. and Assured Guaranty Municipal Corp. - Chief Credit Officer

Anyone else in the room? Anyone any more e-mails? Okay, well, Sabra, if you want to --

Sabra Purtill - Assured Guaranty Ltd. - Managing Director, Investor Relations

I'd like to thank everybody for attending and also for listening in on the call. I apologize if there was too much static due to electronic interference on the call.

I would note that there will be a transcript available and hopefully the dial-in number is a little bit clearer. But please contact us specifically if you want a copy of that transcript to review in a written form.

I also wanted to note that we will be -- our earnings, obviously we are in a quiet period right now because of the earnings process -- we will be reporting earnings in about two weeks and filing our 10-Q as well.

So I would encourage all of you that had questions more related to the current business or credit performance to ask those questions on our earnings conference call in about two weeks. And then just as a final note, we have a little gift on the side for everybody who attended today. We hope you find it useful in your electronic communication. Thank you very much.

Assured Guaranty Ltd. **Assured Guaranty Corp. | Assured Guaranty Municipal Corp.**

30 Woodbourne Avenue, 5th Floor
Hamilton HM 08
Bermuda

main 441 279 5700
fax 441 279 5701

info@assuredguaranty.com

www.assuredguaranty.com