

Assured Guaranty Ltd.'s Comments on Standard & Poor's Proposed Bond Insurance Criteria



February 1, 2011

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GUARANTY**[®]
FAMILY OF COMPANIES

Safe Harbor Disclosure



- Forward-looking statements are being made in this presentation that reflect the current views of Assured Guaranty Ltd. (“AGL” and, together with its subsidiaries, “Assured Guaranty” or the “Company”) with respect to future events and financial performance. They are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Actual results could differ materially or change in out look from these statements. For example, Assured Guaranty’s forward looking statements could be affected by:
 - rating agency action, including a ratings downgrade or change in outlook at any time of Assured Guaranty Ltd. or any of its subsidiaries and/or of transactions that AGL’s subsidiaries have insured, both of which have occurred in the past;
 - developments in the world’s financial and capital markets that adversely affect issuers’ payment rates, Assured Guaranty’s loss experience, its ability to cede exposure to reinsurers, its access to capital, its unrealized (losses) gains on derivative financial instruments or its investment returns;
 - changes in the world ‘s credit markets, segments thereof or general economic conditions;
 - more severe or frequent losses implicating the adequacy of Assured Guaranty’s expected loss estimates;
 - the impact of market volatility on the mark-to-market of its contracts written in credit default swap form;
 - reduction in the amount of reinsurance portfolio opportunities available to Assured Guaranty;
 - deterioration in the financial condition of our reinsurers, the amount and timing of reinsurance recoverable actually received and the risk that reinsurers may dispute amounts owed to us under our reinsurance agreements;
 - the possibility that the Company will not realize insurance loss recoveries or damages from originators, sellers, sponsors, underwriters or servicers of residential mortgage-backed securities transactions;
 - decreased demand or increased competition;
 - changes in applicable accounting policies or practices;
 - changes in applicable laws or regulations, including insurance and tax laws;
 - other governmental actions;
 - difficulties with the execution of Assured Guaranty’s business strategy;
 - contract cancellations;
 - Assured Guaranty’s dependence on customers;
 - loss of key personnel;
 - adverse technological developments;
 - the effects of mergers, acquisitions and divestitures;
 - natural or man-made catastrophes;
 - other risks and uncertainties that have not been identified at this time;
 - management’s response to these factors; and
 - other risk factors identified in Assured Guaranty’s filings with the U.S. Securities and Exchange Commission (the “SEC”).
- See Assured Guaranty’s SEC filings and latest earnings press release and financial supplement, which are available on its website, for more information on factors that could affect its forward-looking statements. Do not place undue reliance on these forward-looking statements, which are made only as of February 1, 2011. Assured Guaranty does not undertake to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Speaker:

Dominic Frederico, *President & Chief Executive Officer*

A replay of this call will be available at 888-286-8010 (in the U.S.) or 617-801-6888 (International), passcode 47220665 until March 1, 2011

- **We support S&P's efforts to update its bond insurance rating process**
- **We believe that a transparent rating process based on supportable assumptions would benefit both insurers and investors**
- **We believe, however, that certain changes are necessary to S&P's draft criteria which would better align the new criteria to market experience and expectations**
- **The proposed rating process would represent the third rating review by S&P for Assured Guaranty in the last 12 months, which is not justified based on the underwriting and financial performance of the company**
- **S&P's proposal includes 49 separate rating criteria, 32 of which are subjective in nature which could raise concerns with consistency**
- **The potential changes outlined by S&P would have done little to avoid the downgrades and defaults of certain bond insurers**

- **The purpose of our call and this presentation is to provide investors with Assured Guaranty’s preliminary views with respect to the new bond insurance criteria outlined by S&P in their January 24, 2011 publication of “Request for Comment: Bond Insurance Criteria.” Our presentation will:**
 - Highlight the major changes contained in S&P’s draft criteria
 - Identify some of the principal issues raised by these proposed changes and
 - Estimate the preliminary results of Assured Guaranty applying several of the quantitative tests

Summary of Proposed Criteria Changes



- **Four fundamental changes in proposed criteria could materially impact required capital levels for Assured Guaranty on a consolidated basis:**
 - Addition of a new aggregate leverage test
 - Significant increases in the capital charges associated with municipal exposures
 - Significant increases in the capital charges for structured finance transactions overall, particularly those rated AAA by S&P
 - Reduction in the single risk limits for municipal exposures

- **S&P is proposing an aggregate leverage test that applies a cap on a financial guarantor's overall rating**
- **While we support the addition of an aggregate leverage test, we believe such a test should be further refined to:**
 - Consider all of Assured Guaranty's claims paying resources, in particular statutory unearned premium reserves
 - Distinguish among risks of different credit quality
 - Distinguish among risks of different tenor
 - Employ ratios based on observable default frequency and loss severity factors, and
 - Utilize more refined sector categories

New Leverage Test Unearned Premiums Excluded



- **Unlike other types of insurance products, most financial guaranty premiums are paid up front, are non-refundable, and are, therefore, available to pay claims**

Assured Guaranty Policyholder's Surplus and Reserves (\$mm) (As of Sept. 30, 2010)	
Qualified statutory capital	\$ 4,943
Loss & LAE reserves	<u>1,174</u>
	6,117
Unearned premium reserve ("UPR")	<u>4,196</u>
Total	<u><u>\$10,313</u></u>

- **Financial guarantors are required to pay timely principal and interest by the terms of their policies and therefore the UPR will be earned over the period of time the stressed losses would theoretically be paid.**
- **Most financial analysts (including S&P when utilizing its traditional capital model) include total policyholder's surplus and statutory reserves as well as other elements of claims paying resources when analyzing Assured Guaranty's capital adequacy, as all are available to pay claims**
- **UPR is not included in the regulatory definition of statutory capital to ensure that it is available to pay claims and is ineligible to be paid as a dividend to shareholders**

New Leverage Test Underlying Rating Quality Ignored



- **As proposed, the new leverage test imposes the same leverage limitation for exposures rated AAA as for those rated BBB**
- **Given the high ratings of our insured portfolio, with a AA average underlying rating, such a simplistic test is particularly inappropriate**
- **45% of Assured Guaranty’s insured risks carry ratings of AA or higher on a stand alone basis; S&P’s proposed leverage ratio ignores credit quality – and in fact could encourage the underwriting of lower quality risks**

Assured Guaranty Internal Rating¹	GAAP Net Par Outstanding (\$mm's)	Net Par Outstanding (\$mm's) (at or above rating category)	% of Net Par Outstanding (at or above rating category)
AAA	\$ 96,941	\$ 96,941	16%
AA	\$ 182,560	\$ 279,501	45%
A	\$ 234,950	\$ 514,451	83%
BBB	\$ 75,874	\$ 590,325	96%
BIG	\$ 26,806	\$ 617,131	100%
Total	\$ 617,131		

1. Assured Guaranty’s internal rating scale is similar to that used by the nationally recognized statistical rating organizations, but the ratings in the above table may not be the ratings assigned by any of them.

Leverage Test Results



- **Applying the draft criteria, as is, to our portfolio and capital as of September 30, 2010, the Assured Guaranty companies could require approximately \$1.9 billion of additional statutory capital to maintain a AA rating absent inclusion of UPR and other adjustments¹**
- **If unearned premium reserves were included in the calculation, Assured Guaranty would comply with the draft leverage test at the AAA level**

(\$ in millions)	Net par outstanding	Proposed Maximum AAA leverage
Net par outstanding		
Public finance	\$ 456,135	75:1
Structured finance	<u>159,154</u>	<u>20:1</u>
Total	\$615,289	61:1
Proposed capital required at AAA		\$10,124
Assured Guaranty's policyholders' surplus & reserves		\$10,313
Excess over proposed at AAA		\$189

- **If the present value of future installments and standby lines of credit were included, Assured Guaranty would have over \$2 billion excess over the proposed AAA requirement**

1. Public finance par includes international public finance

- **Understanding the full impact of the capital model changes is a complex process and will take considerable time and effort for Assured Guaranty to complete**
- **S&P's draft criteria for their capital adequacy model uses their long-standing Depression stress model, but with significant increases in capital charges**
- **These higher capital charges, as detailed for municipal risk on the next page, appear inconsistent with observed historical results, including the Great Depression**
- **Our preliminary estimate of the aggregate effect of the proposed modifications to the capital adequacy test is that Assured Guaranty would have a capital shortfall between \$1.0 and \$1.5 billion at the AA level**
 - This estimated shortfall does not include any benefit from estimated future recoveries from breaches of representations and warranties in the residential mortgage portfolio.
 - At September 30, 2010, Assured Guaranty had estimated a benefit of \$1.4 billion related to representations and warranties, which, if applied to the above shortfall, would negate it entirely.

- **S&P’s proposed capital charges for municipal risks include significant increases in municipal credit charges that are not supported by historical fact or expected scenarios:**

Sector	Prior Capital Charge (% AADS ¹)		Proposed Capital Charge (% AADS ¹)		% Increase in Capital Charge	
	BBB	A	BBB	A	BBB	A
State GO’s	4	2	21	12	425%	500%
City/County GO’s	13	7	21	12	62%	71%
Schools – GO’s	5	3	21	12	320%	300%
Water, Sewer (Rev)	16	8	21	12	31%	50%
Public Power	20	11	35	19	75%	73%

- **Assured Guaranty’s municipal depression losses under the draft capital model would equal approximately \$6.7 billion or 1.75% of insured municipal par. This compares with 0.5% municipal par losses observed during the Great Depression years²**

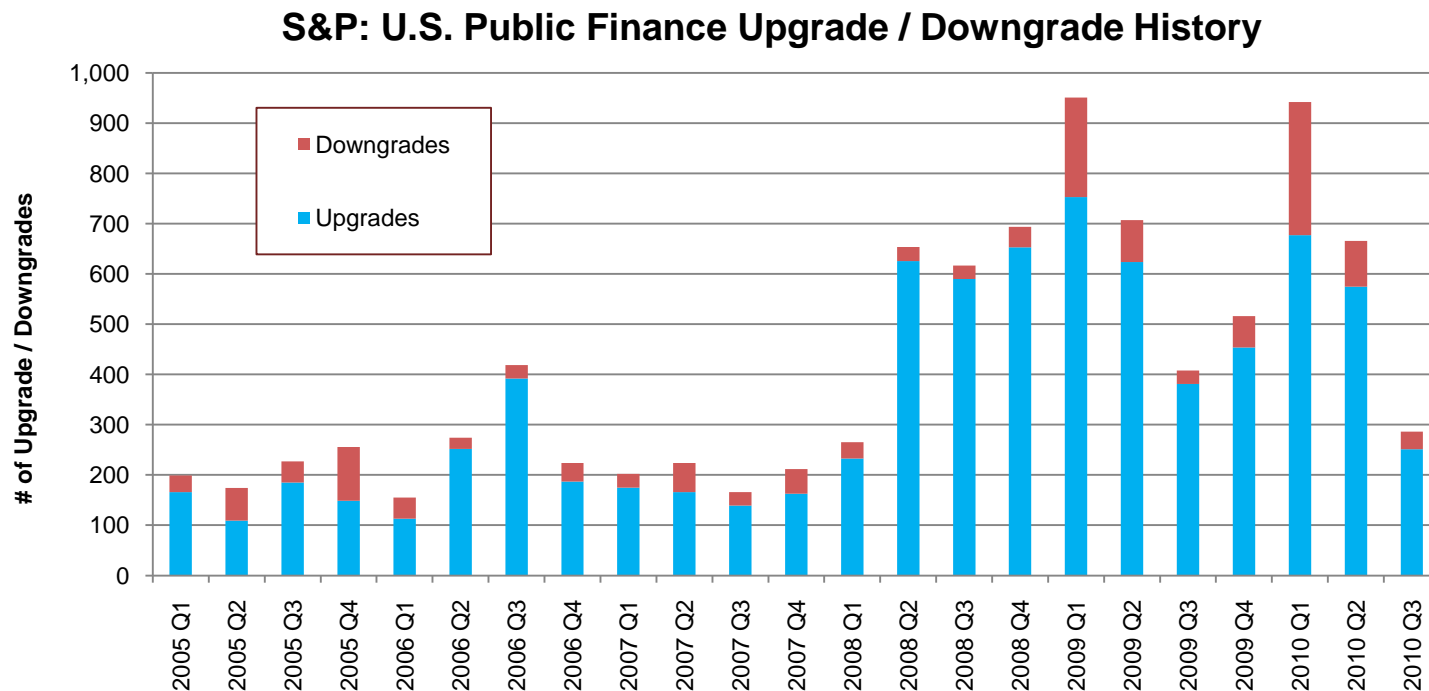
1. AADS is the average annual debt service of a municipal security

2. The Postwar Quality of State and Local Debt, George H. Hempel, National Bureau of Economic Research, 1971

Capital Adequacy Model

Increase in Capital Charges Vs. Municipal Ratings

- These dramatic increases in proposed capital charges contrast starkly with S&P's recent rating actions, which have largely upgraded municipal credits:



- Since the beginning of the current economic downturn (2007), S&P upgraded 6,460 municipal risks and downgraded only 1,050

S&P's Recent Published Comments on Municipal Credit



- In an article entitled *U.S. States and Municipalities Face Crises More of Policy than Debt*, dated November 8, 2010, S&P stated:
 - “The revenue declines that we think would likely cause default in many instances would need to be double what they were during the Great Depression.”
 - “Considering California’s senior payments, and using audited 2009 data, we estimate that a 45% revenue loss (annualized) would place material pressure on the state’s ability to fund its debt service. This level of revenue deterioration would be approximately 2.5 times the average among states during the Great Depression.”
 - “Given [Detroit’s] variety of revenue sources and spending commitments, we believe a default in the normal course of business would be unlikely. Even when pension and OPEB payments are included, fixed costs rise to only a quarter of the budget...”

Capital Adequacy Model

Use of Hempel Study

- **S&P ties its municipal capital charges to the Hempel Study**
 - A 40 year-old study with 75 year-old data
 - Based on less than \$20 billion of municipal bonds outstanding versus \$2.9 trillion today
 - Legal and regulatory reforms have vastly improved the quality of municipal debt
- **S&P says Hempel estimated a 16% “loss” as a percentage of average debt service. When recoveries are included, however, the net loss was reduced to 5% of average annual debt service**
 - As a percentage of par, losses during the Depression were 0.50% versus 1.75% assumed by S&P
- **Debt burdens on municipalities are much lower today**
 - In 1922, debt service represented 12.7% of state and local revenues, rising to 19.7% in 1932
 - Examples of debt service as a percentage of revenues today:
 - Texas 1.32%
 - New York State 3.73%
 - California 6.32%
 - Illinois 6.24%
 - Las Vegas 5.26%

Capital Adequacy Model

Structured Finance Capital Charge



- **S&P's proposed capital charges increase the capital allocation to AAA rated structured financings from 10 basis points to 100 basis points, a 10x increase on all types of structured finance, regardless of asset type (investment grade CLOs, which performed well during the recent crisis, are treated the same as U.S. RMBS)**
- **In Assured Guaranty's portfolio, over 70% of structured finance par is rated AA or better, with \$88 billion, or 59%, rated AAA. The capital allocation for this sector would increase 41% under the proposed capital charge regime, a \$600 million increase**

- **S&P proposes to lower monolines' single risk limits and reduce the number of categories from 6 to 4**
- **Assured Guaranty's internal limits reflect the credit quality (internal rating) and potential loss severity of each risk**
- **The amount of capital insurers should hold against any excess single risk position should be based on the potential loss severity of the risk and should not require insurers to hold dollar for dollar capital against the par amount of any excess**

Assured Guaranty's Response to S&P's Proposed Criteria Changes



- **Our principal concerns regarding the S&P's proposed bond insurance criteria changes, which we encourage investors to comment on, are:**
 - If a leverage test is to be used, it must be a more detailed model that takes into account total claims paying resources and a more finely defined leverage limit reflecting important differences between insured risks, including their individual rating, tenor, loss frequency and loss severity characteristics
 - Changes in the capital charges in the capital adequacy model must be tied to actual or stressed experience, not just arbitrary increases
 - Single risk limits should be tied to a stronger quantitative model correlated with loss frequency and loss severity by type of issuer and revenue stream
 - Credit should be given for recoveries under representation and warranty claims for RMBS securities

- **S&P's draft criteria include several important changes which could significantly affect the municipal bond market**
- **The addition of an aggregate leverage test, while not unreasonable, should reflect both differences in credit quality among portfolios and the total claims paying resources of the insurer**
- **S&P's revised capital charges for municipal risks do not appear consistent with observed performance or with S&P's recent comments or ratings actions with respect to the sector**
- **The potential changes outlined by S&P would have done little to avoid the downgrades and defaults of certain bond insurers. These events were caused by poor underwriting at the insurers, inaccurate ratings assigned by the rating agencies to certain structured financings, and misrepresentations by securitizers and the underlying lenders and borrowers in residential mortgage loans.**

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