



## MEMORANDUM

**To:** File  
**From:** Joseph I. Levinson  
**Date:** October 2, 2008  
**RE:** Meeting with representatives of Assured Guaranty and Patton Boggs during which Securities Exchange Act Release No. 57976 (File No. S7-13-08), titled "Proposed Rules for Nationally Recognized Statistical Rating Organizations," was discussed

---

Commission staff met on October 1, 2008 with Neil Baron, Dominic Frederico, Jim Michner, and Michael Schozer of Assured Guaranty and Micah Green of Patton Boggs LLP. The Commission staff members attending the meeting were Daniel Gallagher, Deputy Director; Thomas McGowan, Assistant Director; and Joseph I. Levinson, Special Counsel; Division of Trading and Markets.

Those present generally discussed Securities Exchange Act Release No. 57967.



**Presentation to Erik R. Sirri**  
**Director, Division of Trading and Markets**  
**U.S. Securities and Exchange Commission**  
**October 1, 2008**

**ASSURED  
GUARANTY®**

# Assured Guaranty Attendees



**Dominic Frederico, President and CEO, Assured Guaranty Ltd.**

**Jim Michener, General Counsel and Secretary, Assured Guaranty Ltd.**

**Michael Schozer, President, Assured Guaranty Corp.**

- **Critical role in the financial markets**
- **Flawed ratings process for financial institutions**
  - Inaccurate ratings
  - inconsistent approach
  - Not transparent
  - No accountability
- **Need for a proactive regulatory regime**

# Critical Role of Rating Agencies in the Financial Markets

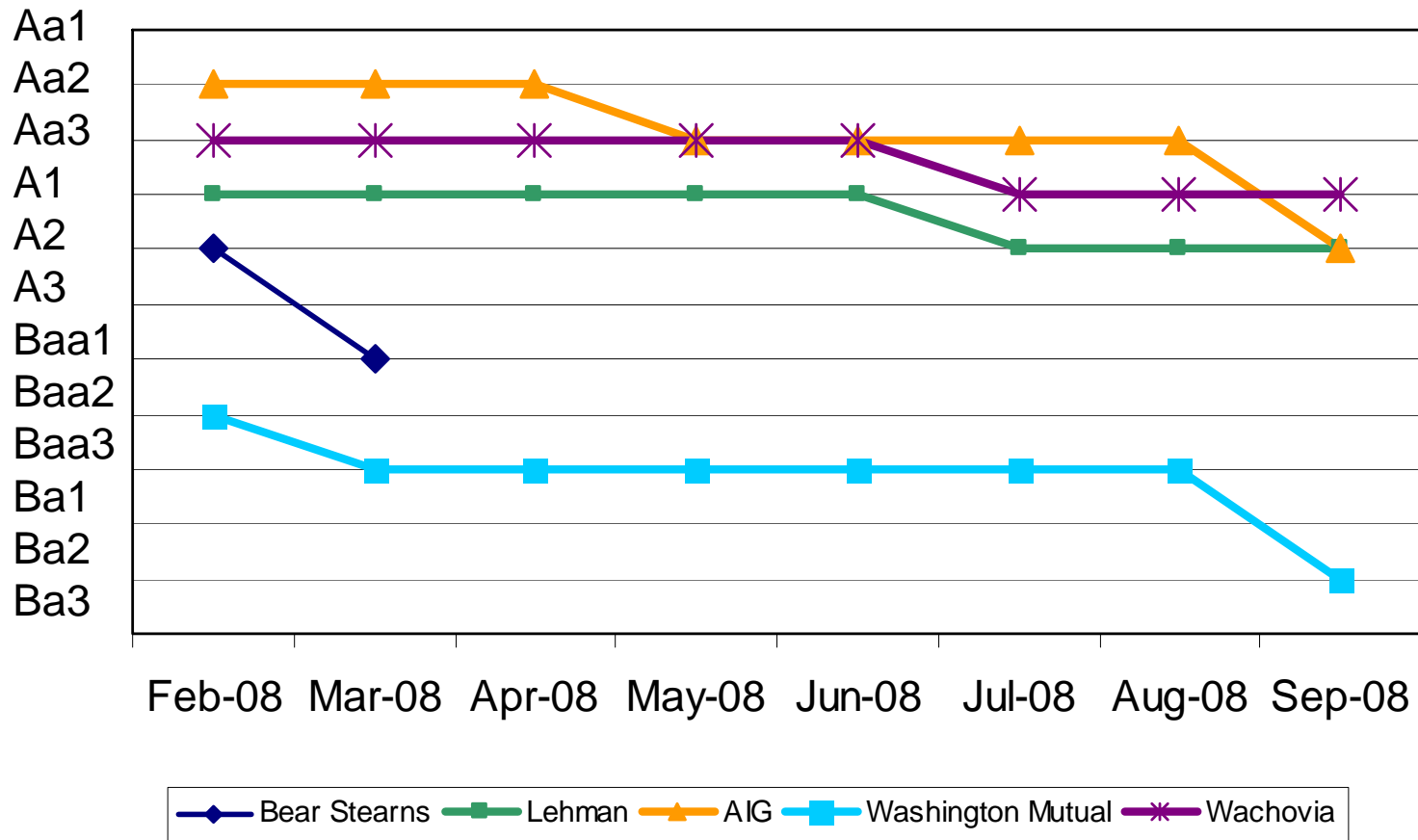


- **Special status of nationally recognized statistical rating agencies**
- **Ratings determine eligibility and participation levels across numerous market sectors**
  - Money market funds
  - Investment criteria of insurance companies and other institutions
  - Markets such as public finance which have a large retail investor component
  - Financial guaranty companies
- **Rating agency actions have been critical in determining**
  - Collateral posting requirements for companies including AIG and Ambac
  - Continued market access, most recently with Lehman and Wachovia
  - Financial guaranty competitiveness

# Flawed Ratings Process for Financial Institutions



Only Bear Stearns and Washington Mutual were rated below A2 at the time of their restructuring/acquisition. Bear Stearns was downgraded to Baa1 only two days



# Rating Agencies and the RMBS and CDO of ABS Markets



- **The Securities and Exchange Commission's Staff examination of Moody's, Standard & Poor's and Fitch published July 8, 2008 reflected the important role the agencies played in the substantial increase in the number and complexity of RMBS and CDO of ABS transactions issued since 2002**
- **The agencies clearly underestimated, by large margins, the potential severity and correlation of these transactions in their rating processes**
- **The growth in these transactions is clearly one of the leading causes of the current capital market upheaval and liquidity crisis**
- **The Staff's Summary Report outlines a number of areas in which the rating agencies were seriously deficient**
  - Agency staffing was inadequate to manage transaction volume
  - Significant aspects of the ratings process were not always disclosed
  - Due diligence with regard to data on the assets underlying the structured transactions was not always performed
  - Potentially serious conflicts of interest were inadequately controlled
- **The Summary Report notes that the performance by the agencies in these products has raised questions about the accuracy of credit ratings and about the integrity of the ratings process as a whole**

# The Financial Guaranty Industry as a Case Study Demonstrating the Need for Rating Agency Reform



- **The industry has served the market for well over 30 years**
  - \$2.6 trillion insured since 2002
- **The industry continues to play a vital role in the U.S. public finance market**
  - \$1.1 trillion insured since 2002
  - Despite the market turmoil of the past year, investors value and continue to purchase bond insurance
  - Credit enhancement usage remains high
  - Financial guaranties lowers municipal financing costs through enhanced market access and liquidity
- **Certain financial guarantors have experienced significant losses due to their guarantees of Aaa-rated collateralized debt obligations of asset-backed securities (CDOs of ABS)**
  - Not all insurers guaranteed CDOs of ABS, and their financial strength continues to meet Aaa requirements
  - Financial guarantors also have exposure to residential mortgage-backed securities (RMBS) secured by home equity line of credits (HELOCs) and subprime mortgages
    - While these assets are also experiencing losses, the losses associated with RMBS (not including CDOs of ABS) would not have seriously impacted the financial strength of the industry
  - Asset-backed securities have been a safe, diversified and profitable business for financial guarantors

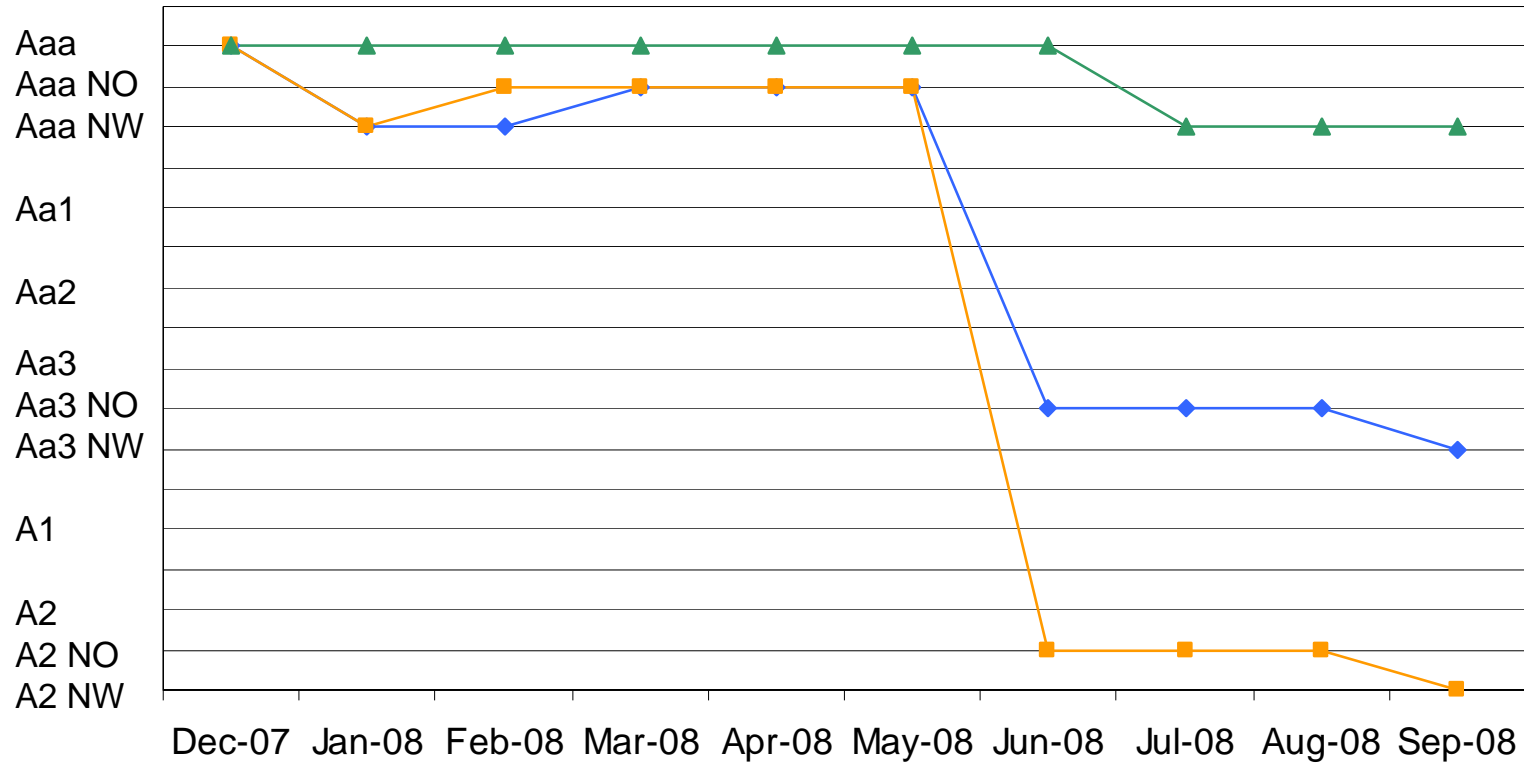


# Moody's Financial Guaranty Ratings Criteria



<u>Ratings Factors and Selected Sub-Factors</u>	<u>Weighting</u>	<u>Aaa Standard</u>
<b>Capital Adequacy</b> Hard Capital Ratio	30%	1.3-2.0
<b>Strategy and Franchise Value</b> % of Industry Gross Par Written Client Concentration	25%	10-20% Broadly Diversified
<b>Portfolio Characteristics</b> % of Below Investment Grade Exposure	20%	0-3%
<b>Profitability</b> Return on Equity	15%	12-16%
<b>Financial Flexibility</b> Ease of Access to Capital	10%	Demonstrated consistent market access

# Financial Guaranty Industry Ratings



◆ Ambac     
 ■ MBIA     
 ▲ Assured & FSA

NO – Negative Outlook

NW – Negative Watch

# Industry Loss Estimates from CDOs of RMBS & RMBS



\$ in millions

	<b>AGC</b>	<b>Ambac</b>	<b>CIFG</b>	<b>FGIC</b>	<b>FSA</b>	<b>MBIA</b>	<b>XLCA</b>
<b>Estimated CDOs of RMBS losses <sup>(1)</sup></b>	0	9,528	6,918	8,614	11	8,251	4,228
<b>Estimated RMBS losses <sup>(1)</sup></b>	196	2,744	277	3,958	657	3,361	846
<b>Total estimated losses <sup>(1)</sup></b>	196	12,271	7,195	12,572	668	11,612	5,074
<b>CDOs of RMBS as % of total losses <sup>(1)</sup></b>	0%	78%	96%	69%	2%	71%	83%
<b>Statutory capital <sup>(2)</sup></b>	1,110	6,700	679	732	2,066	7,119	(51)
<b>Net statutory capital (capital - total losses)</b>	914	(5,571)	(6,516)	(11,840)	1,398	(4,493)	(5,125)
<b>Moody's rating <sup>(3)</sup></b>	Aaa	Aa3	Ba2	B1	Aaa	A2	B2

(1) Consensus Estimates based on reports from Goldman Sachs (April 23, 2008), Lehman Brothers (April 11, 2008), JP Morgan (April 25, 2008) and Bank of America (January 18, 2008)

(2) Data as of 6/30/08, except for CIFG which is as of 3/31/07

(3) For Moody's rating definitions please see following page

- **Aaa** Insurance companies rated Aaa offer exceptional financial security. While the credit profile of these companies is likely to change, such changes as can be visualized are most unlikely to impair their fundamentally strong position.
- **Aa** Insurance companies rated Aa offer excellent financial security. Together with the Aaa group, they constitute what are generally known as high-grade companies. They are rated lower than Aaa companies because long-term risks appear somewhat larger.
- **A** Insurance companies rated A offer good financial security. However, elements may be present which suggest a susceptibility to impairment sometime in the future.
- **Baa** Insurance companies rated Baa offer adequate financial security. However, certain protective elements may be lacking or may be characteristically unreliable over any great length of time.
- **Ba** Insurance companies rated Ba offer questionable financial security. Often the ability of these companies to meet policyholder obligations may be very moderate and thereby not well safeguarded in the future.
- **B** Insurance companies rated B offer poor financial security. Assurance of punctual payment of policyholder obligations over any long period of time is small.

*Note: Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa. Numeric modifiers are used to refer to the ranking within a group with 1 being the highest and 3 being the lowest. However, the financial strength of companies within a generic rating symbol (Aa, for example) is broadly the same.*

- **Assured's ratings were affirmed March 2008; reaffirmed May 2008**
- **On July 21, Assured (and FSA) were placed on review for possible downgrade by Moody's. Prior to the Moody's press release:**
  - No negative material credit event affecting Assured occurred between May and July
  - No notification from Moody's as to a change in Assured's credit quality assessment
  - No specific issues were identified
  - No cure period was offered

- **The July 21 press release announcing the review for possible downgrade**
  - Confirmed that Assured continued to maintain Aaa-level capital
  - Noted limited exposure to CDOs of ABS
  - Acknowledged Assured's conservative underwriting strategy
  - Primary concerns cited included
    - Exposure to large single and sectoral risk concentrations
    - The leverage and complexity of some of Assured's structured finance transactions, particularly the \$40 billion corporate loan obligation (CLO) portfolio
- **The issues raised by Moody's appeared to have been addressed**
  - The Moody's capital model includes stresses which adequately model for large single and sectoral risk concentrations
  - Shortly after stating that Assured's CLO portfolio was a concern, Moody's CLO group reviewed the portfolio and found no cause for concern

- **The rating review process remains subject to poor analysis and communication**
  - Continued speculation at Moody's as to Assured's future business prospects
    - The head of the Moody's public finance business stated that her department had not been asked for an opinion and, if asked, had not done sufficient research to have a position
  - Continued questioning of Assured's ability to raise capital
    - Two capital raises amounting to \$550 million have been completed in the past year
  - Speculation as to the next area of credit weakness in the portfolio
  
- **Moody's has been unwilling to provide guidance concerning**
  - Potential capital levels and business mix adjustments that would be consistent with a Aaa rating
  - The development of a municipal-only guarantor

- **The principles reflected in the rule amendments proposed by the Commission in June will improve the quality of credit ratings by increasing transparency and encouraging competition**
  - Increase disclosure of information used in determining ratings
  - Require complete documentation of the rationale for differences between actual ratings and ratings implied by agency models
  - Improve surveillance of existing ratings
  - Limit conflicts of interest
- **Assured's experience confirms that Moody's has not implemented these recommendations**
  - Insufficient staffing
  - Poor communication
  - Lack of disclosure and consistency in ratings criteria and decisions
  - Failure to do homework or analysis before taking action



- **A proactive regulatory regime is urgently needed**
- **Ratings need to have a defined rationale**
  - Probability of default
  - Company ratings versus industry outlooks
  - Distinguish between a company's financial strength and market standing
- **All financial guaranty companies must be held to consistent criteria**
- **The financial guaranty industry needs specific rating criteria that are consistently and fairly applied**
  - Ratings are more than “opinions”
    - Agencies should be held accountable
  - Quantitative and objective criteria
  - Transparency is critical - Any changes in model and/or assumptions should be discussed and supported by broad industry constituents
  - Other closely related industries (e.g., derivative product companies) must be treated consistently

**For more information about Assured Guaranty, please contact:**

Sabra R. Purtill  
Managing Director  
Global Communications and Investor Relations  
Direct: 212 408 6044  
spurtill@assuredguaranty.com

**Presentation to Erik R. Sirri  
Director, Division of Trading and Markets  
U.S. Securities and Exchange Commission  
October 1, 2008**

**ASSURED  
GUARANTY®**