

Impact of the Dodd-Frank Act Derivative Provisions on Financial Guaranty Insurers



September 22, 2010

**ASSURED
GUARANTY**
FAMILY OF COMPANIES

- **Application to Core Financial Guaranty Business:**
 - Financial guaranty insurance policies or surety bonds should not be considered swaps or security-based swaps
- **Application to Financial Guarantors' CDS Business:**
 - *Retroactive Application:* Capital and margin requirements should not be applied retroactively to financial guaranty insurers or their affiliated transformers that entered into credit default swap (“CDS”) transactions
 - *Entity Characterization:* Financial guaranty insurers should not be considered swap dealers or major swap participants as a result of their legacy CDS portfolios
 - *Future Business:* The imposition of margin would be inconsistent with existing insurance regulation and the financial guaranty insurance marketplace and could preclude the participation of financial guarantors in these transactions

Traditional Financial Guaranty Insurance Policies Should Not be Regulated as Swaps



- **The Dodd-Frank Act was not intended to displace current state regulation of insurance**
 - McCarran-Ferguson Act precludes the regulation of insurance under the Dodd-Frank Act
 - Members of Congress referred in colloquies to Title VII's purpose as establishing a regulatory framework for the previously unregulated over-the-counter derivatives market
 - Scope of Federal Insurance Office's preemption and other powers are limited
 - Orderly liquidation authority does not cover insurers generally
 - Bureau of Consumer Financial Protection is generally prohibited from regulating insurance industry
- **Financial guarantors are subject to extensive regulation**
 - Assured Guaranty Municipal Corp. ("AGM") is a New York domiciled insurance company regulated by the New York Insurance Department
 - Assured Guaranty Corp. ("AGC") is a Maryland domiciled insurance company regulated by the Maryland Insurance Administration
 - All financial guaranty insurers incorporated or licensed in New York, including AGM and AGC, are subject to Article 69 of the New York Insurance Law
 - State regulators have been actively engaged during the credit crisis; e.g., the New York Insurance Department's Circular Letter No. 19 (Sept. 2008) was a direct response to concerns raised by the crisis

Traditional Financial Guaranty Insurance Policies Should Not be Regulated as Swaps – Key Differences



	Traditional Financial Guaranty / Surety Policies	Traditional CDS
Purpose:	<p>Core business is the insurance of municipal bonds</p> <p>Municipal bond insurance serves a substantial public purpose by facilitating the ability of municipal issuers to access the capital markets and lowering their borrowing costs</p>	<p>Enables buyers of protection to hedge exposure with sellers of protection and enables buyers to take a speculative position on an obligation without owning it</p>
Ownership of Insured Obligation:	<p>Beneficiaries of insurance policies are required to have an insurable interest</p>	<p>Buyers of protection are not required to hold the insured obligation; ability to execute transaction synthetically results in possibility of outstanding swap notional vastly exceeding principal amount outstanding of reference obligation</p>
Legal Rights:	<p>Insurers typically have direct control, information and inspection rights in transaction documents for insured obligations, including opportunities to participate in workouts, as well as rights as third party beneficiaries of representations and warranties and covenants</p>	<p>Sellers of protection derive their limited rights through the buyers of protection</p>

Traditional Financial Guaranty Insurance Policies Should Not be Regulated as Swaps – Key Differences (continued)



	Traditional Financial Guaranty / Surety Policies	Traditional CDS
Risk of Acceleration:	There can be no acceleration of the payment required to be made under a policy except at the sole option of the insurer	Physical settlement of entire notional amount of swap may be required upon any Failure to Pay (which may relate to a relatively small fraction of the notional amount, such as a single interest payment)
Termination Payments:	Traditional financial guaranty insurance policies do not cover destabilizing mark-to-market termination payments – risk does not apply	Risk of mark-to-market termination payments exists
Accounting Treatment:	ASC 944: “Financial Services – Insurance”	ASC 815: “Derivatives and Hedging” Requirements to apply different methodology, including for revenue recognition and claim liability measurement
Market Perception:	Market participants do not consider financial guaranty insurance policies to be swaps or security-based swaps	

Traditional Financial Guaranty Insurance Policies Should Not be Regulated as Swaps – Conclusion



- **Dodd-Frank Act was not intended to provide for substantive federal regulation of insurance**
- **Extensive existing state regulation and regulatory involvement**
- **Many significant differences between financial guaranty insurance policies and swaps**

Legislation Should Not Be Applied Retroactively to Existing CDS Portfolios



- **How financial guaranty insurers participated in CDS business**

- Financial guaranty insurers did not execute CDS directly, but rather issued financial guaranty insurance policies covering CDS written by affiliated special purpose entities known as “transformers” that had no other business
- Transformers may be specific to a single CDS or counterparty, or may cover multiple CDS or counterparties
- The financial guaranty insurer was the “credit support provider” to the transformer
- Transformers only *sold* credit protection – they did not buy credit protection
- Transformers’ CDS were held until maturity – they did not “trade” or make a market
- Transactions were highly negotiated and, with few exceptions, specifically excluded collateral posting

- **Use of transformers was explicitly regulated by insurance law**

- Article 69 of the New York Insurance Law establishes parameters for the terms of insured CDS
- Circular Letter No. 19 restricts financial guarantors’ insurance of CDS – including by prohibiting the posting of collateral by financial guaranty insurers
- Circular Letter No. 19 constitutes part of the NYID’s plan to address the serious challenges faced by the bond insurance industry; it outlines “best practices” to which the NYID expects financial guaranty insurers to adhere

Legislation Should Not Be Applied Retroactively to Existing CDS Portfolios (continued)



- **Capital and margin requirements**

- If retroactively applied to existing swap portfolios, the financial condition and liquidity of financial guaranty insurers could be adversely affected
- Collateral posting would subordinate insured municipal bondholders and other insurance policyholders to CDS counterparties, which historically were mostly investment banks and large commercial banks
- Such requirements would conflict with existing state insurance law requirements
- Insurance regulators have been extensively involved in restructuring the financial guaranty insurers that were severely impaired by the financial crisis
- Legacy portfolios have never presented any meaningful systemic risk and the risk presented to individual institutions has significantly diminished as a result of the passage of time without additional new business and the restructurings that have taken place

- **Existing CDS portfolios**

- Assured Guaranty's CDS portfolio, \$112.2 billion in net par outstanding as of the end of Q2 2010, has been amortizing and is expected to run off by approximately three quarters by the end of 2015, compared to the balance at the end of Q2 2010
- Neither Assured Guaranty, nor, to our knowledge, any other financial guaranty insurer has insured any CDS transactions since early 2009 (other than in connection with loss mitigation)

Legislation Should Not Be Applied Retroactively to Existing CDS Portfolios - Conclusion



- **Prior CDS activity of financial guarantors has been and is governed by insurance law**
- **Retroactive application could have an adverse impact on financial condition and liquidity of financial guarantors**

Conflicting Regulations and Market Structure



- **Current insurance regulatory policy as expressed in, e.g., the New York Insurance Department's Circular No. 19 (2008), prohibits financial guaranty insurers' posting of collateral in connection with insured CDS**
- **Collateral posting would subordinate insured municipal bondholders and other insurance policyholders to CDS counterparties**

Assured Guaranty Overview



Assured Guaranty Today



	As of June 30, 2010
Net par insured	\$627.5 B
Total investment portfolio	\$10.5 B
Total assets	\$17.6 B
Claims paying resources	\$13.3 B

- **We are the leading financial guaranty franchise**
 - We are a publicly traded holding company (NYSE: AGO) that makes 10-K, 10-Q and other periodic filings with the Securities and Exchange Commission
 - We have maintained financial strength ratings acceptable to the market
 - Our core business is the insurance of municipal bonds
- **Our sole focus is financial guaranty insurance**
 - Extensive quarterly financial disclosures provide transparency to all investors
 - 20+ year track record in financial guaranty insurance market
- **We serve the U.S. capital markets through two platforms:**
 - AGM guarantees public finance and infrastructure transactions
 - AGC guarantees public finance, infrastructure and structured finance transactions

High Financial Strength Ratings



- **We have the highest ratings of any active financial guaranty insurer today:**
 - Moody's confirmed AGC's and AGM's Aa3 financial strength ratings in fourth quarter 2009
 - Standard & Poor's confirmed AGC's and AGM's AAA rating in second quarter 2010
- **We have been able to maintain our ratings because our underwriting standards did not permit us to guarantee asset-backed securities backed by mezzanine tranches of residential mortgage-backed securities**

Financial Strength Ratings

As of September 17, 2010

	Moody's (rating/outlook)	S&P (rating/outlook)
AGC	Aa3 / negative	AAA / negative
AGM	Aa3 / negative	AAA / negative

Net Par Outstanding Diversified By Sector

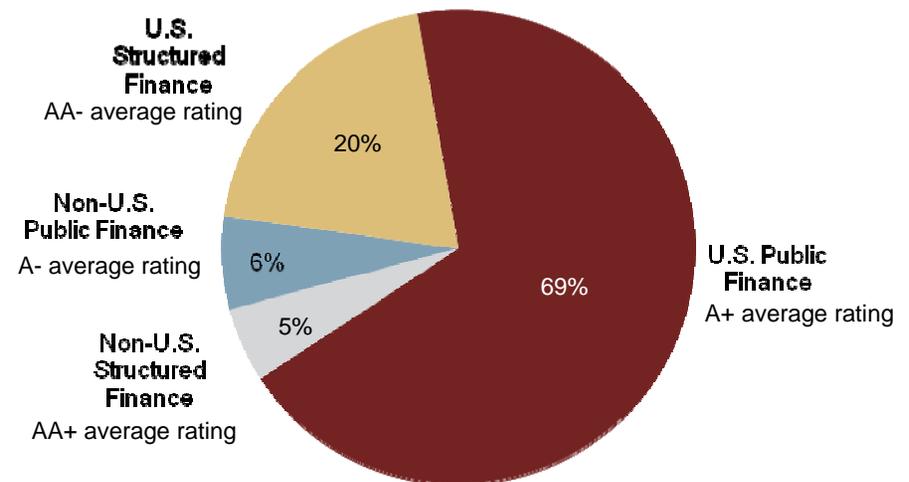


- **Assured Guaranty's portfolio is largely concentrated in U.S. public finance**
 - 69% U.S. public finance
 - 20% U.S. structured finance
 - 11% International
- **Our portfolio has an A+ average internal credit rating**
- **In 2009, Assured Guaranty's gross par written for U.S. public finance totaled \$41.1 billion**
- **New business originations are almost exclusively U.S. public finance**
 - Clarity is necessary for investors in municipal bonds insured by Assured Guaranty
- **CDS constitutes approximately 18% of net par insured**
 - All CDS were written pursuant to a comprehensive regulatory scheme

Consolidated Net Par Outstanding

As of June 30, 2010

(\$ in billions)



\$627.5 billion, A+ average rating

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 from these statements. For example, Assured Guaranty’s forward-looking statements could be affected by:
 - rating agency action, including a ratings downgrade at any time of Assured Guaranty Ltd. or any of its subsidiaries and/or of transactions insured by AGL’s subsidiaries, 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 credit markets, segments thereof or general economic conditions;
 - more severe or frequent losses implicating the adequacy of Assured Guaranty’s loss reserve;
 - 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;
 - 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 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 September 21, 2010. 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.

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