March 1, 2011

Mr. Mark Puccia, Criteria Officer
Ms. Colleen Woodell, Chief Credit Officer
Mr. Rodney Clark, Managing Director
Mr. Robert Green, Director
Standard & Poor's
55 Water Street, 33rd fl.
New York, NY 10041-0003

Ladies and Gentlemen:

Thank you for this opportunity to comment on S&P's recently proposed Bond Insurance Criteria (the "Criteria"). We share S&P's desire to establish a clear and well-supported analytical framework for analyzing bond insurance companies. We also believe that investors will benefit from a better understanding of the long term credit characteristics that S&P considers when assigning ratings in this industry.

Having reviewed the recent proposal, we have several significant comments which we believe should be reflected in S&P's final published criteria before they are applied to any specific company.

Proposed Aggregate Leverage Test

Given the obvious benefits of a thoughtful, risk-based capital model, such as that traditionally employed by S&P, we do not believe that applying an arbitrary, par-based leverage test provides useful information to investors. As initially proposed, the leverage test would not distinguish insured risks by quality or tenor, nor would it reflect where an insured risk lies in the capital structure of a particular issuer. For example, two similarly leveraged insurers, one of which insures BBB, subordinated tranches of structured financings and the other of which insures AAA, senior classes of CLO's, would appear to be similar credit risks using this simple measure. Would investors benefit from S&P publishing equivalent leverage ratios for these two companies, or by downgrading the "AAA" insurer to the level of the "BBB?" It would be impossible for a leverage test as simple as the one proposed to reflect important differences among companies, which obviously undermines its usefulness in the rating process. Worse

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

30 Woodbourne Avenue, 5th Floor
Hamilton HM 08
Bermuda

main 441 279 5700
fax 441 279 5701

info@assuredguaranty.com

www.assuredguaranty.com

still, the proposed test would actually encourage the underwriting of lower quality risks and the assumption of subordinated and/or compressed exposures.

In addition, the proposed leverage test excludes a critical component of a financial guarantor's claims paying resources, namely its unearned premium reserve ("UPR"). Unlike property and casualty companies or life insurers, UPR represents a significant source of claims paying ability for a financial guarantor. The cash associated with UPR is an unencumbered asset on an insurer's balance sheet and is available to pay claims as needed. In Assured Guaranty's case, our UPR represents nearly 40% of our total funds available for claims and adds very significantly to our financial strength. As you know, the UPR is earned over the life of our insured risks and therefore mirrors nearly perfectly the potential claims profile of our insured municipal portfolio.

We understand that S&P proposes to exclude UPR from the calculation of its proposed leverage ratio because regulators do not include UPR when determining an insurance company's solvency. Here we would point out two important facts. First, the regulatory leverage limit is approximately 150:1 for municipal bonds (compared to the 75:1 limit S&P proposes). This regulatory limit reflects both the conservative definition of capital and the high quality of insured municipal risks. Second, the primary regulatory motivation for excluding UPR from statutory capital is to limit the dividend capacity of insurance companies in order to maximize their ability to pay claims. This is entirely appropriate as UPR represents premium that has been paid up front (and is not refundable under any circumstances) but which will be earned in future periods – and thus should not be available to pay dividends until the associated risk has been retired.

Interestingly, the value of this important resource is reflected in S&P's risk based capital adequacy model which forecasts theoretical claims patterns over a seven year time horizon. Despite these facts, if S&P decides to retain a simple, par based leverage test in its final criteria, we believe the test should be revised to include UPR as a better measure of total funds available to pay future claims.

On a more technical note, the proposed criteria are not clear with respect to the treatment of international public finance risks under the leverage test. Given that these transactions finance essential public infrastructure and depend, in most cases, on government supervision and support, we believe these exposures should be treated as US municipals under the proposed leverage test, as they are under S&P's capital adequacy model (Criteria, paragraph 42), rather than as structured financings.

Proposed Increases in Municipal Capital Charges

In addition to the new aggregate leverage test, S&P's proposed Bond Insurance Criteria contain substantial increases in the capital charges associated with U.S. municipal exposures. The table below illustrates the magnitude of some of these proposed changes:

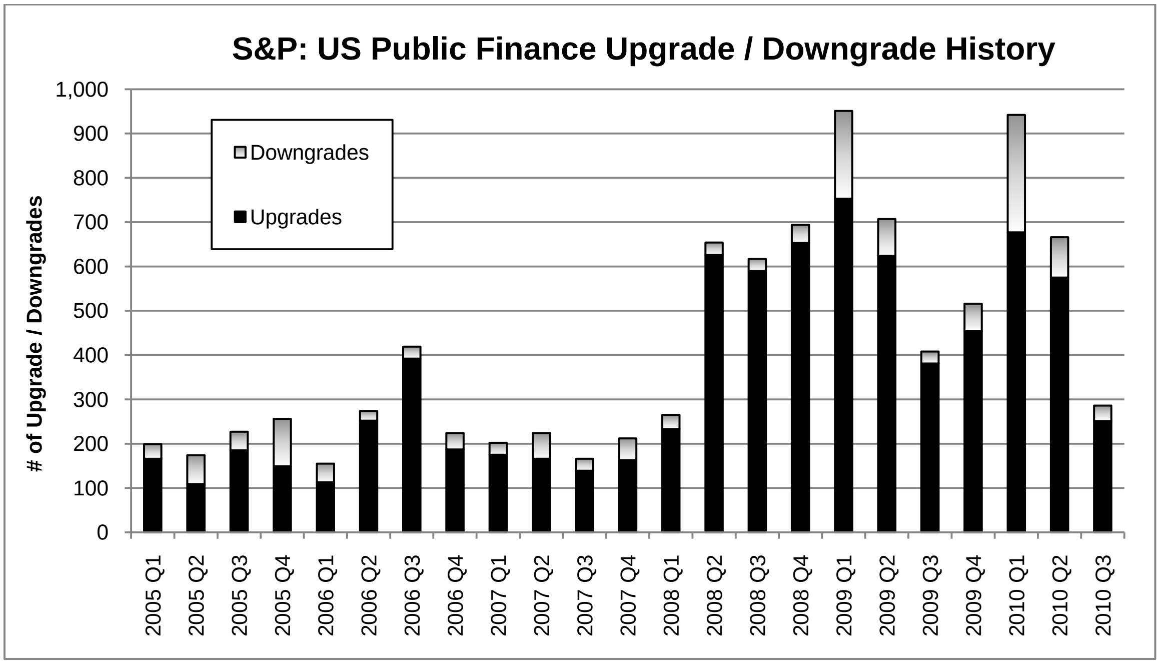
Sector	**Prior Capital Charge (% AADS*)**		**Proposed Capital Charge (% AADS*)**		**% Increase in Capital Charge**	
	BBB	A	BBB	A	BBB	A
State GO's	4	2	21	12	425%	500%
City/County GO's	13	7	21	12	62%	71%
Schools – GO's	5	3	21	12	320%	300%
Water, Sewer (Rev)	16	8	21	12	31%	50%
Public Power	20	11	35	19	75%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

*AADS is the average annual debt service of a municipal security

S&P states that these new capital charges were designed to reflect the default experience of municipal bonds during the Great Depression as described by George Hempel in his 1971 research publication The Post War Quality of State and Local Debt (National Bureau of Economic Research) (the "Hempel Study"). We will discuss the details of the Hempel Study later in this letter, but would first point out that Mr. Hempel's work was first used by S&P over 25 years ago to develop the *original* capital charges used in S&P's capital adequacy model for financial guarantors.[1] These *exact same statistics* are now being used by S&P to support increases of as much as 500% to the capital requirements for insured municipal bonds.

The logical inconsistency resulting from using the same historical statistics to reach two significantly different analytical conclusions is compounded by S&P's recent rating actions in the municipal market. Since the beginning of the current recession in 2007 S&P has upgraded 6,460 municipal ratings and downgraded only 1,050.

[1] S&P's website of historical articles contains a 2003 article entitled "Understanding the Bond Insurance Capital Adequacy Model" which specifically refers to the Hempel default statistics as the basis for S&P's current municipal capital charges.



S&P has stated publicly on many occasions that it has always had a single scale for rating municipal, corporate, and structured finance securities and that its recent upgrade activity has reflected changes to S&P's view of the strength of the individual municipal credits and not a fundamental recalibration of its municipal rating system. If this is true, an upgrade/downgrade ratio of 6:1 since the onset of the recession would seem to signal generally improving municipal credit profiles among municipal issuers and to confirm the robust financial strength of the municipal sector more generally. Such widespread upgrade activity is not consistent with a five-fold increase in municipal capital charges and sends a contradictory message to municipal investors.

Compounding this confusion, S&P's Municipal Department has communicated clearly to the market in recent months that it does not expect the municipal market to experience significant defaults among investment grade issuers. The following comments from S&P's November 8, 2010 article entitled "U.S. States and Municipalities Face Crises More of Policy than Debt" are illustrative of S&P's public (and we believe correct) commentary with respect to the current state of municipal credit:

> "…for states in particular, debt service generally holds a priority status relative to other obligations. Indeed, a state's spending cuts in a recession may actually serve to protect debt service. 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." (page 2)

> "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." (page 6)

> "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…" (page 9)

These statements clearly indicate that large losses are not expected in the municipal market even after experiencing the most severe financial crisis in decades.

Finally, the historical performance of investment grade municipal bonds also supports the retention of the current capital charges. Assured companies have been insuring municipal obligations for over 20 years. During this time, in our direct book, we have insured bonds for over 13,000 unique municipal issuers totaling $675 billion of par and received over $6.2 billion in premiums. During this period of time we have paid claims on 9 municipal transactions and have incurred loss and loss adjustment expense of just $113 million. Compared to similarly rated property and casualty companies which regularly post loss ratios of 60% or more of earned premiums, this is an impressive track record. Furthermore, the entire investment grade segment of the municipal market has had similar results. In S&P's most recent study of municipal defaults it notes only 39 S&P rated issuers since 1986 which have defaulted on their debt from a rated universe (excluding housing) of over 12,970 issuers today. This is a track record of credit strength that distinguishes the municipal bond market from all others that S&P rates.

Given the facts outlined above, we believe the increased capital charges for municipal exposures as outlined in S&P's proposed criteria are not supported by historical data or S&P's own municipal research. If implemented, the proposed Criteria would send a confusing and contradictory message to investors in insured municipal bonds given the historical performance of this sector and S&P's rating actions and public statements over the past several years.

<u>Review of Hempel Study</u>

In its Request for Comment, S&P explains that it calibrated its proposed municipal capital charges to the results of the Hempel Study by attempting to distribute capital charges so that the weighted average "would equal a 16% loss as a percent of average debt service, the figure estimated by Hempel..." (Criteria, paragraph 41) A closer reading of Mr. Hempel's study, however, reveals that missed debt service payments were less than half of the number to which S&P refers, and ultimate losses during the Great Depression were only 5% of annual debt service, or 50 bp of outstanding municipal par. As explained in more detail below, we believe that the capital charges which S&P originally assigned following their review of the Hempel Study 25 years ago are better supported by actual facts than the capital charges outlined in S&P's proposed Criteria.

1. On page 19 of his study, Mr. Hempel notes that the *total indebtedness* of state and local units with recorded defaults between 1929 and 1937 was approximately $2.85 billion. He then assumes an average interest rate of 4.5% and an average maturity of 15 years to conclude that approximately $320 million of debt service was due from defaulted issuers. This amount is estimated to represent 16% of average annual debt service for the whole market. It is this 16% estimate of missed debt service that S&P treats as a *loss* when computing its proposed municipal capital charges. S&P's usage of this estimate is flawed for three reasons:

    a) Mr. Hempel points out that only $1.35 billion of outstanding municipal bonds *actually defaulted* from 1929 through 1937. (Hempel Study, page 21) This is because issuers didn't default on all of their outstanding debt when they defaulted on a single bond. In fact, the observed default rate was less than half of the default rate used by S&P to compute their proposed capital charges.

    b) Municipal issuers today have a significantly longer maturity profile for their debt than the 15 years quoted in the Hempel Study. Additionally, during the Depression, debt maturities were commonly balloon payments and sinking fund accumulation for term bonds were largely ignored. Today, most municipalities use serial bonds or term bonds with mandatory sinking fund requirements. The average original maturity of Assured's municipal portfolio, for instance, is approximately 23 years. This longer maturity, combined with the fact that defaulted bonds cannot be accelerated against the insurer (i.e., insurers are only obligated to pay debt service in accordance with the original maturity schedule), significantly reduce the magnitude of potential claims, even during periods of significant stress.

    c) Most importantly, the 16% figure S&P is using to compute assumed municipal *loss* (and required capital) fails to account for the significant recoveries that bondholders received. Mr. Hempel notes that:

        > "Nearly all of the large state and local units in default made complete payment of all due debt service charges within a few years." (Hempel Study, page 23)

        Mr. Hempel later concludes by saying that:

        > "The total loss of principal and interest resulting from recorded defaults during the 1929 depression period is estimated at $100 mm, or about

> 0.5 per cent [50 bp] of the average amount of state and local debt outstanding in the period."

2. In its analysis of the Hempel Study, S&P assumes that the entire municipal bond market in 1929 would have been rated investment grade (and, hence, been eligible for insurance) using today's rating standards (30% BBB, 60% A, 10% AA, from paragraph 41 of the proposed S&P Criteria). S&P also assumes that financial guarantors, had they been in existence during the Depression, would have insured a cross-section of the entire municipal bond market, without any positive effects as a result of their underwriting processes. If these two important assumptions were true, it might be appropriate to include all observed defaults from this period when estimating the stress case defaults that an insurer might suffer.

   It is more likely, however, that the 1929 market included non-investment grade issuers and/or issuers which would not have been approved for insurance, and that a disproportionate share of defaults observed during the 1930's came from that segment of the population. Unfortunately, ratings for the entire municipal bond market in 1929 were not noted in Mr. Hempel's study. It is clear from his description of issuers in the period, however, that many would not be investment grade by today's standards, and hence would not have qualified for bond insurance from the outset, ignoring the positive effects of underwriting. From Mr. Hempel's 1964 dissertation[2] on the subject, for instance:

   > "The growth of municipal units in the 1920's brought a genuine need for added improvement. It also provided an excuse for the use of local credit to further real estate subdivision speculation. The officers of real estate companies often became officials of the municipal units and promoted bond issues to develop their property for sale. Special assessment or local improvement districts were created to permit the improvement of undeveloped and speculative areas. Where there were legal debt limits, nearly all were expressed in terms of a certain ratio of debt to assessed valuation. Changes in assessed values or issuance of debt in the name of an overlapping unit easily made these limits ineffective."

   This description brings to mind present day, non-rated, early stage land secured transactions ("dirt bonds"), such as tax-exempt community development districts or municipal utility districts, that are often backed by special assessments or ad valorem tax pledges. These issues typically do not qualify for insurance until substantial taxable value has developed, leading to an assignment of investment grade underlying issuer ratings. Therefore, S&P's assumption that all Depression losses were attributable to

[2] "The Post War Quality of Municipal Bonds," University of Michigan, Ph.D., 1964. (page 117)

issuers who would be rated investment grade today does not appear justified and overstates Depression losses significantly.

3. It is also important to recognize that the municipal market of today contains significant protections for investors that did not exist during the Great Depression. In particular, Mr. Hempel notes that some municipal defaults during the Depression were executed by way of repudiation based on defects in the legal documents. Additionally, the severity of loss was particularly high for smaller issuers and special districts (see page 24 of the Hempel Study). Also, revenue bonds were virtually non-existent, representing only 2% of municipal debt in 1931. We also believe that the banking crisis of the Depression, which occurred prior to the institution of many bank safeguards that exist today, increased the financial stress placed on governments by causing municipal issuers to lose access to their deposits.

   Since the Great Depression, a significant number of safeguards have been implemented to protect municipal bondholders. Briefly, these safeguards include:

   a) statutory debt limits to prevent excessive borrowing caused by speculative growth in real estate valuations;

   b) clearly defined bondholder rights upon the occurrence of an event of default supported by dedicated local governmental debt statutes and related case law;

   c) determination by a nationally recognized bond counsel of the legality and validity of the bonds before sale to avoid technical legal defects that could allow the municipal obligor to repudiate the debt;

   d) many local governments and school districts benefit from state oversight programs that offer administrative and/or financial support which positively impacts the default performance of municipal bonds. The S&P default study from 2003 (published in April 2004) observed that municipal crises are typically resolved prior to default as the state typically intervenes in the financial affairs of local issuers either by providing oversight, additional state aid or some other type of outside intervention;

   e) greater supervision by both the Federal and state governments of local debt administration including the creation of the Municipal Securities Rulemaking Board (“MSRB”) by Congress in 1975 to provide oversight of firms in the municipal securities business;

   f) federal supervision of banking institutions, ensuring the credit strength of depository banks that hold municipal obligors’ bond related funds and accounts;

   g) statutory limitations on municipal obligors issuing debt to finance chronic operating deficits;

h) vastly improved debt disclosure and municipal accounting standards including the creation of the Government Accounting, Auditing, and Financial Reporting ("GAAFR") standards and the Governmental Accounting Standards Board ("GASB");

i) constitutional "gift clause" or "lending of credit" prohibitions that prohibit issuing governmental debt for the benefit of private persons or purposes;

j) thorough credit review by many Wall Street investment firms and institutional investors; and

k) greater financial sophistication among public officials and their general recognition of the necessity to meet all contractual obligations, including debt service on their capital markets debt obligations.

Each of the safeguards listed above, which were not in existence during the Great Depression, enhance bondholder credit quality and security significantly, and clearly demonstrate that the municipal bond market of 2011 has a lower vulnerability to economic stress, including lower frequency of default and severity of loss, than the municipal bond market of 1929-37 period.

All three rating agencies (S&P, Moody's and Fitch) have also published default studies all of which show very low default rates for municipal bonds. Moody's study, which covers the longest period of time out of the three studies (1970-2009) and captures some significant economic downturns, shows a ten year cumulative default rate for all Moody's rated municipal bonds of a very low 0.09%. When non-general obligation bond issuers are excluded from these numbers, the 10 year cumulative default rate barely registers at 0.01%.

With respect to bankruptcy, the Federal Municipal Bankruptcy Act of 1937 (the "1937 Act"), the predecessor bankruptcy regime to Chapter 9 of the United States Bankruptcy Code, 11 U.S.C. §§ 901 – 946 ("Chapter 9"), that governed most municipal bankruptcies during the Great Depression, did not include two important features included in today's Chapter 9. First, the 1937 Act did not have a requirement that municipal obligors be "specifically authorized" under State law to file Federal bankruptcy petitions; only "general authorization" was required (unless the consent of the host state was expressly required under State law) and, therefore, any municipal obligor that was generally authorized to execute contracts under State law was considered to be authorized to file a bankruptcy petition under the 1937 Act. In 2011, 23 States do not provide "specific authorization" to their municipalities to file Chapter 9 petitions and most of the other states that provide "specific authorization" require some form of State consent as a condition precedent to a Chapter 9 filing. Second, the 1937 Act did not provide protection to bondholders secured by "special revenues". As a result, the bondholders' lien on pledged revenues could be terminated post-petition, potentially resulting in a higher loss severity for special revenue bondholders. Under Chapter 9, the bondholders' lien on "special revenues" is protected post-petition and survives a bankruptcy filing. The maintenance of the bondholders' lien on the pledged revenues provides significant protection to bondholders during a bankruptcy proceeding and implies a much lower loss severity for revenue bondholders under Chapter 9 than under the 1937 Act.

In summary, given that 1) the Hempel Study clearly shows that losses during the Depression were less than one-third of the level assumed by S&P, 2) that certainly a substantial portion of the observed Depression losses were attributable to non-investment grade risks, and 3) that today's market includes many bondholder protections not present in the 1930's, we believe there is no analytical basis for S&P to increase the capital charges attributable to municipal bonds.

Single Risk Limits

S&P's proposed single risk limits are designed to compare the stress loss for a given issuer to a measure of an insurer's loss tolerance, whether defined as two years of adjusted earnings or 25% of capital. This logical framework, as described in Table 15 in S&P's proposed Criteria, is dependent on several critical assumptions which we believe should be adjusted to reflect actual market experience:

1. In single risk Category 1 (which includes general obligation bonds), S&P's assumed loss equals 25% of insured par. We are not aware of any validly issued, investment grade, GO bond which has experienced an ultimate loss of 25% of par in the history of the municipal bond market. Referring again to the Hempel Study, losses on *all* defaulted securities (not just GO bonds) equaled only 7.4% of defaulted par ($100 million/$1,350 million). Given S&P's stated goals of using the Great Depression as its guidepost, assuming a loss severity 3.5 times worse than that observed during the 1930's seems excessive. We believe an assumed loss severity of 7.5 – 10% of par for Category 1 risks (including GO's) would better reflect the actual Depression experience and still leave a margin for possible error.

2. While the proposed Criteria are somewhat vague, in the event that a specific risk exceeds the single risk tolerance, S&P appears to suggest that the insurer's capital be reduced by the *par* amount of the "overage". Given the substantial recovery experience of the municipal bond market, it would only seem reasonable to limit this capital reduction to the *loss* associated with the "overage" (7.4% from the Hempel Study).

3. We believe the proposed single risk guidelines should be modified to allow larger single risk limits for higher rated exposures. In the extreme, it would seem illogical to downgrade an insurer for having "excess" exposure to a credit whose underlying rating is equal to or higher than the insurer's claims paying rating.

Other Comments

1. Paragraph 59 – Investments

   S&P proposes to assume that all investments rated below A are "worthless" for purposes of the capital adequacy model. We do not believe this treatment of assets is consistent with S&P's view of asset quality when analyzing similarly rated banks and insurance companies, all of whom own large portfolios of equities, high yield bonds, unrated securities, and direct loans. Given S&P's goal of achieving consistency in its ratings across sectors, we believe such assets should be included in claims paying resources when running the capital adequacy model.

2. Paragraph 88 – Insured Investments

   S&P's proposed criteria suggest certain limits on insured bonds held in a financial guarantor's investment portfolio. We believe such limits should not apply to bonds rated higher than the rating of the guarantor, as these bonds trade on the basis of their own credit quality, not that of the insurer. An obvious example of this type of security would be pre-refunded bonds which are secured by an escrow account and are among the highest quality and most liquid securities in the municipal market.

3. Paragraph 129 – Liquid Assets

   As part of its liquidity analysis, S&P proposes to compare cash and assets maturing within 12 months to anticipated claims over a similar period. We believe this test should be expanded to include highly liquid investments of a longer maturity such as Treasury and Agency securities and pre-refunded municipal bonds.

4. Subjective Measures

   While comprehensive, the proposed S&P Criteria rely significantly on subjective judgments covering important components of an insurer's ratings, such as risk management and business strategy. While we agree that subjective judgments can add important color to the rating process, we believe that valid, quantitative elements should be the principal drivers of an insurer's financial strength rating.

Conclusion

We support S&P's efforts to improve the analytical foundation and transparency of their ratings and understand that over time some evolution of rating criteria is to be expected. We believe, however, that any proposed new criteria should be shown to provide meaningful incremental information to investors. Based on our discussion above, we do not believe that the proposed leverage test, as currently formulated, allows investors to draw analytical distinctions between companies, and is therefore not a useful tool in the rating process.

In addition, proposed changes to the capital charges associated with municipal risks are not supported by either a careful reading of the Hempel Study or by the actual default experience observed in the municipal market over the past 80 years. Absent material new information, we believe the existing capital charges should be retained.

We look forward to discussing these ideas in greater detail with you in the weeks ahead.

Sincerely,

Walter A. Scott
Chairman of the Board of Directors

Dominic J. Frederico
Chief Executive Officer