Kroll BondRatings™
Our name is on the line

KBRA rating: AA+
Outlook: Stable

Insurance

Financial Guaranty Rating Report

Municipal Assurance Corp. (MAC)

Analytical Contacts:

Karen Daly, Senior Managing Director
kdaly@krollbondratings.com, 646-731-2347

Alessandra D'Imperio, Senior Director
adimperio@krollbondratings.com, 646-731-2383

Kate Hackett, Managing Director
khackett@krollbondratings.com, 646-731-2304

Andy Clarke, Director
aclarke@krollbondratings.com, 646-731-2380

Brittni Smith, Analyst
bsmith@krollbondratings.com, 646-731-2352

July 22, 2013

Table of Contents

Kroll
BondRatings™

Executive Summary

Kroll Bond Rating Agency (KBRA) has assigned a AA+, Stable Outlook, insurer financial strength rating to Municipal Assurance Corp. (MAC). The rating reflects Assured Guaranty's intention to establish a municipal only guarantor to write bond insurance for the lower risk categories within the U.S. Public Finance market. An established infrastructure, as well as a seasoned management team and staff, enhance its ability to execute on the business plan. In addition, MAC is expected to benefit from revenues stemming from a ceded portfolio of business from Assured Guaranty Municipal Corp. (AGM) and Assured Guaranty Corp. (AGC), thus providing MAC with an earnings stream as it works to develop its own new book of business.

As noted in KBRA's Financial Guaranty Rating methodology dated June 19, 2013, based on its evaluation of a guarantor's insured portfolio, KBRA tests the ability of an insurer's claims-paying resources to support potential losses through a Monte Carlo simulation. The modeling approach produces a distribution of the insured portfolio's future losses. KBRA focuses on losses in the tail of the loss distribution. The tail losses are then assessed against the company's claims-paying resources in a financial model. The rating level for a guarantor is largely based on its ability to pay claims under KBRA's stress case scenario which places the company in run-off.

KBRA has tested MAC's ceded portfolio in a Monte Carlo stress case. The stress case adjusts certain ratings in the portfolio, detailed later in this report, and tests MAC's ability to pay operating expenses and policy claims in run-off. Based on this assessment, MAC is able to satisfy this test at the highest rating levels.

The rating is based on KBRA's Financial Guaranty Rating Methodology, published on June 19, 2013.

Key Rating Strengths
▪ Conservatively defined business strategy
▪ Seasoned management team and staff
▪ Established infrastructure for credit underwriting and risk management
▪ Expected revenue stream associated with ceded book of business
▪ Best practice enterprise risk management process

Key Rating Concerns
▪ No corporate charter provision ensuring that negative credit drift will not occur in MAC over time
▪ No corporate limitation on dividends out of MAC
▪ Industry risks associated with narrow credit spreads, low interest rates, potential future competition, and an increased loss profile in public finance market

Rating Summary

Assured Guaranty's Municipal Assurance Corp. (MAC) is established as a municipal only guarantor that will benefit from a seasoned management team and well-established policies and procedures adopted in entirety from Assured Guaranty Ltd. (AGL). These policies and procedures include an established underwriting framework, strong corporate governance culture and Enterprise Risk Management (ERM) processes, and robust financial and IT systems.

MAC, as an operating company of AGL, will operate under the same governance framework used by AGL's other affiliates. MAC's policies and procedures relating to risk assessment and risk management will be overseen by its Board of Directors and ultimately, by the Board of Directors of AGL. KBRA views MAC's credit risk management framework as strong. KBRA's assessment of risk management focuses on (i) the firm's stated risk tolerance objectives, (ii) the development of internal policies and procedures that communicate and manage these objectives throughout the organization and (iii) the adequacy of controls that monitor and report on risk exposures. Since MAC will employ existing corporate policies, procedures and resources from its ultimate parent, there is far less uncertainty about its ability to develop and integrate appropriate risk management processes than would normally be expected for a start-up.

AGL has developed a comprehensive ERM plan that KBRA sees as reflecting industry best practices and that KBRA believes will serve MAC well. The plan is well integrated and serves to reinforce and extend the Company's risk focus to all departments within the organization. Furthermore, it provides a framework for identifying and addressing current and emerging risks in a consistent manner. Information generated from the ERM process is used by Senior Management and the Board as a guide in establishing annual risk tolerance limits and for making changes to policies and procedures.

MAC is expected to benefit from a revenue stream stemming from the ceded portfolio. This will provide approximately $ 709 million in net premiums, which can be used to support the development of new business in the near term. KBRA understands that there is no ceding commission expected to be associated with this portfolio. The ceded MAC portfolio has a total of $102.6 billion in gross statutory par outstanding and includes a range of public finance sectors. In terms of security type, KBRA views the portfolio as being fairly conservative, with 57.2% of total par exposure in General Obligation Bonds, followed by Municipal Utility Revenue (16.7%), Tax-Supported (15.6%), Transportation Revenue (4.5%), Education and Higher Education (4.0%), Housing Revenue (0.9%) and a small percentage of miscellaneous Public Finance exposures.

KBRA believes that given management's track record, the established infrastructure supporting risk management and system operations, and the presence of an expected earnings stream from the ceded book of business, MAC is well positioned as a start-up financial guarantor. KBRA will review performance related to MAC's forecasts and industry trends regularly.

Background-Assured Guaranty

AGL, together with its subsidiaries, Assured Guaranty or "Assured", is a Bermuda based holding company incorporated in 2003 that provides financial guaranty products, through its subsidiaries, to the U.S. and international public finance, infrastructure and structured finance markets.

Prior to establishing MAC, Assured Guaranty conducted its direct financial guaranty business primarily from three companies, Assured Guaranty Municipal Corp. (AGM) Assured Guaranty Corp. (AGC) and Assured Guaranty (Europe) Ltd. (AGE). AGM provides financial guaranty policies exclusively on global public finance and infrastructure debt obligations. AGC provides financial guaranty policies on global structured finance obligations and global infrastructure debt obligations. AGE provides financial guaranty policies on non-U.S. public finance and infrastructure finance debt obligations. Additionally, Assured Guaranty Re Ltd. (AG Re) provides financial guaranty reinsurance.

During 2007, the mortgage crisis developed into a worldwide financial crisis and resulted in a significant downgrade, and subsequent collapse of the financial guaranty industry. By September 2008, most financial guarantors were no longer writing new issue policies. Assured Guaranty, the lone industry survivor, continued to write new financial guaranty policies and has been the most active provider of financial guaranty products in this market from 2008 to 2012.

On July 1, 2009, Assured Guaranty acquired Financial Security Assurance Holdings Ltd., whose principal insurance subsidiary was Financial Security Assurance Inc. (FSA). When acquired, FSA was rated AAA by S&P and Aa3 (on review for downgrade) by Moody's. KBRA understands that the purpose of the acquisition was to enable Assured to expand its franchise in the bond insurance industry. Assured continued to operate FSA under the name AGM and retained its AAA rating from S&P until October 2010 at which point AGM was downgraded to AA+. S&P downgraded AGM in November 2011 to the current rating of AA- with a stable outlook. In January 2013, Moody's took further action on AGM's rating, downgrading it from Aa3 to A2 with a stable outlook.

On May 31, 2012, Assured Guaranty acquired Municipal and Infrastructure Assurance Corporation, a municipal only financial guaranty insurance company, from the Radian Group, which it has renamed Municipal Assurance Corp. (MAC). In January 2013, Assured Guaranty announced its intention to launch MAC as a new financial guaranty insurer that provides insurance only on debt obligations in the U.S. public finance markets. MAC is currently licensed to write financial guaranty insurance on a direct basis in 37 states and the District of Columbia. KBRA understands that management intends to obtain licenses in all 50 states.

Outlook: Stable

The stable outlook reflects KBRA's view that MAC has a defined and conservative business profile which extends to writing financial guaranty policies for the lower risk categories within the public finance market. An established infrastructure as well as a seasoned management team and staff enhance its ability to execute its business plan. In addition, MAC expects to benefit from the runoff of the unearned premium reserve associated with a ceded book of business provided by AGM and AGC. This will provide MAC with an earnings stream as it works to establish its own platform and develop its own book of business.

In KBRA's view, the following factors may contribute to a rating upgrade:

- Market factors that support consistent growth in claims-paying resources that include, for example, widening credits spreads, rising interest rates, and improved market penetration.

- Further development of a low-risk insured portfolio with limited losses relative to claims-paying resources when subjected to KBRA's loss simulation and financial stress model.

In KBRA's view, the following factors may contribute to a rating downgrade:

- Expansion of its risk tolerance profile outside the parameters outlined in the business plan and articulated in this report.

- Significant changes in MAC's senior management team.

- Up-streaming of dividends from the MAC operating subsidiary to the MAC holding company (MAC HoldCo) which negatively impacts claims-paying resources.

- Market factors resulting in the depletion of claims-paying resources that include, for example, narrowing credits spreads, declining interest rates, decreasing market penetration, as well as rising municipal default and severity rates and deterioration in the default and severity rates within MAC's insured portfolio.

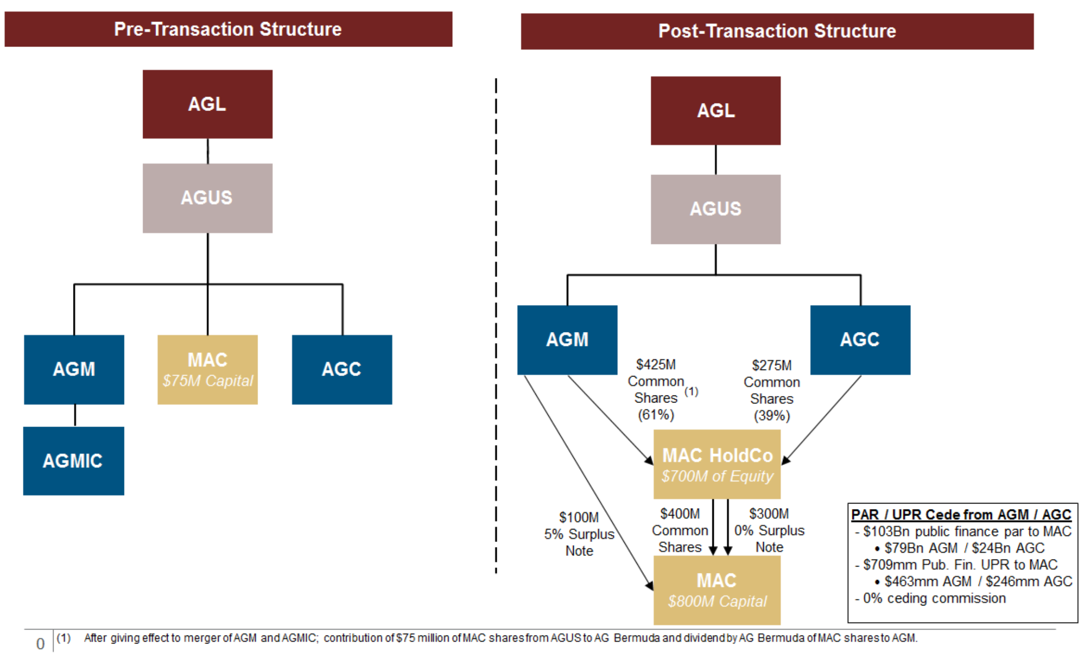
Key Rating Determinants

Rating Determinant 1: Corporate Assessment

Ownership Structure and Governance

Assured Guaranty capitalized MAC by means of a corporate restructuring. MAC is a wholly-owned subsidiary of Municipal Assurance Holdings Inc. (MAC HoldCo), an intermediate holding company. MAC operates as a domestic financial guaranty insurance company in New York State. MAC HoldCo was capitalized with $700 million in common shares from AGM and AGC in aggregate. Both AGM and AGC are indirect subsidiaries of AGL. MAC will operate as a direct subsidiary of MAC HoldCo and an indirect subsidiary of each of AGC and AGM.

MAC's initial capitalization is $800 million. The sources of capital were as follows: (i) $400 million in contributed capital and surplus from MAC HoldCo, (ii) $300 million as proceeds of a surplus note issued by MAC to MAC HoldCo (the "Holding Company Surplus Note") and (iii) $100 million as proceeds of a surplus note issued by MAC to AGM (the "AGM Surplus Note"). The Holding Company Surplus Note carries a 0% interest rate, and provides for no defined principal repayment schedule. The AGM Surplus Note carries a 5% interest rate that can be deferred without penalty, provides for no defined repayment schedule, and matures in 2033. Both surplus notes can be prepaid without a penalty. No repayment of principal (and in the case of the AGM Surplus Note, no payment of interest) may be made without the prior approval of the New York State Department of Financial Services and unless MAC's policyholder's surplus exceeds the applicable statutory minimum requirements after giving effect to such payment. The sources of contributed capital are depicted below.[1]



[1] Please see the Glossary for a listing of the full company names that are abbreviated within the diagram above.

KBRA notes that there are no internal limitations on MAC's ability to dividend earnings to MAC HoldCo. MAC's ability to pay dividends is subject to limitations imposed by New York insurance law, which provides that a New York financial guaranty insurer generally may not pay a dividend except out of the portion of the insurer's surplus that represents the net earnings, gains or profits which that insurer has not otherwise utilized. Additionally, without regulatory approval, a New York financial guaranty insurer may not pay dividends in aggregate during any 12-month period in excess of the lesser of 10% of its surplus and 100% of its adjusted net investment income for such 12-month period. The contingency reserve established by a financial guaranty insurer further limits its dividend capacity. KBRA will view MAC's dividend practice in the context of the operating company's overall capital adequacy.

Management and Strategy

MAC has been created as a municipal-only financial guaranty company, focusing on S&P risk categories 1 and 2.[2] Those sectors include tax-backed general obligation pledges, water-sewer/solid waste, sales/income/gas tax, public universities and FHA insured housing, among others. KBRA understands that the MAC platform is expected to enhance Assured's competitive position by providing a municipal-only affiliate with no legacy structured finance exposures under which it can underwrite new business. MAC also enables Assured to operate a full-service financial guaranty company with outlets for a broad range of transactions within the public finance, structured finance and international markets. KBRA understands that under MAC's business plan, municipal issuers will have a choice between MAC and AGM for transactions falling within MAC's defined risk categories and not exceeding an Assured-determined amount of insured par. The premium will be the same regardless of the platform. Transactions falling within MAC's defined risk categories and exceeding the par limitation will either be insured by AGM or allocated between MAC and AGM.

Given the various platforms and specific business objectives for each affiliate, KBRA does not expect that MAC will expand its risk profile beyond what is currently stated. However, KBRA notes that there is no provision in the MAC charter preventing it from doing so. This is a rating factor, and any changes in MAC's business strategy could impact its financial guaranty rating. MAC's by-laws do, however, prevent MAC from insuring or reinsuring structured products, and further provide that this provision cannot be amended without the approval of both the New York State Department of Financial Services and the unanimous affirmative vote of MAC's Board of Directors.

MAC expects to write financial guaranty policies in both the primary and secondary markets. It is currently licensed to do business in 37 states plus the District of Columbia. KBRA understands that management intends to seek licenses in the remaining 13 states. As part of the overall corporate restructuring, AGM and AGC are expected to cede to MAC a $102.6 billion public finance portfolio and its associated $709 million of unearned premium reserve (UPR). Management reports that there is no ceding commission associated with the ceded portfolio. The ceded book of business is expected to afford MAC a reliable earnings stream as it develops its own new business. The ceded portfolio is high quality, with the majority of portfolio risk from the general obligation sector and more than 90% of the book comprised of single-A and above credit quality, consistent with MAC's business profile.

In addition, MAC will benefit from a seasoned management team and established policies and procedures adopted from Assured in their entirety. These policies and procedures include an established underwriting framework, strong corporate governance culture and ERM processes, and robust financial and IT systems.

[2] Standard and Poor's Bond Insurance Rating Methodology and Assumptions; August 25, 2011.

Corporate Governance

MAC, an operating company of AGL, will operate under the same governance framework used by AGL's other subsidiaries. MAC's policies and procedures relating to risk assessment and risk management will be overseen by its Board of Directors and ultimately, the Board of Directors of AGL. MAC's Board of Directors, like the Boards of AGM and AGC, consists of the seven executive officers of AGL plus its treasurer and chief credit officer. The AGL Board meets regularly for business planning and development of strategic initiatives. There are also frequent off-cycle information sessions to discuss factors that might impact the business. The Board members also play a key role in Assured's Enterprise Risk Management.

Currently, AGL's Board of Directors is composed of 11 members, chaired by Robin Monro-Davies. Mr. Monro-Davies was elected Chairman of AGL in May 2013. He became a director in August 2005. Mr. Monro-Davies was Chief Executive Officer at Fitch Ratings from 1997-2001. Dominic Frederico, AGL's President and Chief Executive Officer, sits on the Board. The AGL Board must maintain an Audit Committee, a Nominating Committee & Governance Committee and a Compensation Committee at all times. The AGL Board also established a Finance Committee and Risk Oversight Committee to oversee areas considered to be critical to the business.

AGL's Risk Oversight Committee oversees the underwriting and surveillance of credit risks and the assessment and management of other risks, including, but not limited to, financial, legal and operational risks, as well as other risks concerning the company's reputation and ethical standards. In January 2012, the Risk Oversight Committee, which meets quarterly, added quarterly information sessions for its members to provide more time to review necessary topics.

The Finance Committee oversees Assured's capital structure and financing activities as they relate to execution of the overall financial plan. It is also responsible for overseeing management's investment policies as they relate to the investment portfolio. This includes approving Assured's investment policies and ensuring compliance with such policies as well as reviewing the performance of and retention of its investment managers.

The Audit Committee oversees the integrity of Assured's financial statements and financial reporting process. This includes a review of internal accounting and financial controls, the audit and internal audit processes, and the qualification of its independent auditors. Fraud risk and controls are addressed as part of these discussions. The Audit Committee also oversees compliance with all risk policies, legal and regulatory requirements, ethics programs and Assured's Code of Conduct.

As part of its rating assessment, KBRA also reviewed Assured's compensation structure to inform a view regarding the balance between risk taking and compensation. KBRA notes that Assured conducts regular compensation risk assessments, which involve an independent compensation consultant. This review includes a systemic and qualitative review of all incentive programs. The last review was conducted in 2013. The independent consultant that performed the review in 2011, 2012 and 2013 concluded that Assured's incentive programs were consistent with sound compensation principles and did not encourage behavior that would create material risk for the company.

Management

Both the Executive and Senior Management Teams are highly experienced, having many combined years in the financial guaranty business.

Dominic Frederico, President and CEO of AGL, has held his position since 2003. Prior to his current position, Mr. Frederico was the Chairman of ACE Financial Services and supervised the operations of Assured Guaranty after its acquisition by ACE Limited in 1999. Prior to joining ACE, Mr. Frederico spent 13 years working for various subsidiaries of the American International Group.

Robert Mills, Chief Operating Officer of AGL, joined AGL in 2004 as Chief Financial Officer. Prior to joining Assured Guaranty, Mr. Mills was Managing Director, Chief Financial Officer and Operating Officer of UBS for the Americas and a member of the Board of Directors of UBS Investment Bank. Mr. Mills was previously with KPMG Peat Marwick as a partner and the National Practice Director for Investment Banking and Capital Markets.

James Michener, General Counsel and Secretary of AGL, joined Assured Guaranty in 2004. Mr. Michener was General Counsel and Secretary of Travelers Property Casualty Corp. from 2002-2004.

Robert Bailenson is Chief Financial Officer of AGL. He has been Managing Director and Chief Accounting Officer of AGL since 2005 and has been with Assured Guaranty and its predecessor companies since 1990. Prior to joining Assured Guaranty in 1990, Mr. Bailenson was with Ernst and Young LLP.

Howard Albert is Chief Risk Officer for AGL. Previously, he was Chief Credit Officer of AGL from 2004 to April 2011. He joined Assured Guaranty in September 1999 as Chief Underwriting Officer of AGC. Prior to joining Assured Guaranty, Mr. Albert was with Rothschild Inc. and Financial Guaranty Insurance Company.

Russell Brewer II is Chief Surveillance Officer of AGL. Mr. Brewer manages the risk profile of the insured portfolios of the Assured Guaranty companies and supervises both surveillance and certain risk mitigation activities. Prior to joining Assured Guaranty in 1989, Mr. Brewer was an Associate Director of Moody's Investors Service, Inc.

Bruce Stern has been Executive Officer of Assured Guaranty Corp. and Assured Guaranty Municipal Corp. since 2009. Mr. Stern was General Counsel, Managing Director, Secretary and Executive Committee member of Assured Guaranty Municipal Corp. from 1987 until July 2009. Prior to coming to Assured Guaranty, Mr. Stern was with the law firm of Cravath, Swaine & Moore.

Credit Risk Management

As noted earlier, MAC's credit policy and underwriting procedures will be based upon those of Assured Guaranty, as modified by its sector limitations. KBRA views the credit risk management framework at MAC as strong. KBRA's assessment of risk management focuses on (i) the firm's stated risk tolerance objectives, (ii) the development of internal policies and procedures that communicate and manage these objectives throughout the organization, and (iii) the adequacy of controls that monitor and report on risk exposures. Since MAC will employ existing corporate policies, procedures and resources from its ultimate parent, there is far less uncertainty about its ability to develop and integrate appropriate risk management processes than would normally be expected in a start-up. In addition, senior management has clearly stated its goal of limiting underwriting exposure to low-risk sectors of the U.S. Public Finance market, in particular Standard and Poor's Risk Categories 1 and 2. Exposure and sector limits will be consistent with those used by its current affiliates. KBRA views these risk limits as the basis for development of a well-diversified and low-risk portfolio that is consistent with stated risk objectives. The management and staff of MAC have extensive experience in the financial guaranty industry and the U.S. public finance market. As a result, the team has developed a strong risk culture that is well communicated across the organization and supported by explicit risk controls. At AGL, there are currently two Board-level committees and one management-level committee that ensure frequent review and communication of risk objectives.

As noted above, the Risk Oversight Committee is an AGL Board-level committee that assists the AGL Board in establishing risk tolerance levels and reports to the AGL Board on management's implementation of stated credit and remediation policies. It interacts directly with members of the Portfolio Risk Management Committee (PRMC), which is a management-level committee. The Risk Oversight Committee is also involved in non-credit related matters such as enterprise risk management. The Audit Committee, the second Board-level committee, largely assists the AGL Board in matters regarding financial statements and reporting, but it is also responsible for ensuring that risk controls accurately monitor and allow for reporting against portfolio exposures.

At the management level, there are a number of committees that serve to establish and implement stated risk policies, provide oversight of the insured portfolio and manage remediation as necessary. The primary management-level committee is AGL's PRMC that is responsible for establishing and enforcing Assured Guaranty's risk objectives. This includes setting risk limits, approving policies and procedures for new issue underwriting, surveillance and risk remediation and approving the composition of risk management committees at the other Assured companies. Any exceptions to stated policies or risk limits must be approved by the PRMC.

The PRMC is headed by Howard Albert, the Chief Risk Officer (CRO), and includes representatives from each of Assured Guaranty's operating divisions as well as the President/CEO. Mr. Albert has over 20 years of experience in the Financial Guaranty industry. The CRO function is supported by a Risk Department, which is responsible for providing the PRMC with research and data used to establish, monitor and reassess policies and procedures on a regular basis. The Risk Department is also responsible for the execution of policies established by the PRMC. The PRMC meets at least four times a year to review the insured portfolio and market trends. All decisions made by the PRMC are reported to AGL's Risk Oversight Committee. This ensures that representatives of AGL's Board are adequately informed about risk positions and industry trends.

The other management level committees include the following:

i) The U.S. Management Committee, which establishes strategic policy and reviews implementation of strategic initiatives and business progress in the U.S. This Committee is also responsible for implementing the risk policy established by the PRMC across all U.S. operating companies. It is chaired by the Chief Operating Officer.

ii) The Credit Committee, which manages new issue underwriting and is chaired by the Chief Credit Officer.

iii) The Risk Management Committee, which is responsible for monitoring all transactions in the insured portfolio and is chaired by the Chief Surveillance Officer.

iv) The U.S. Workout Committee, which manages the risk remediation process and is chaired by the Executive Officer.

v) The U.S. Reserve Committee which is responsible for establishing required reserves on the insured portfolio. In its role, the Committee reviews the reserving methodology and assumptions associated with each sector as well as the loss projection and probability scenarios associated with each impaired transaction. It is chaired by the Chief Financial Officer.

The charters for each of the five noted committees encompass all U.S. operating companies and will be expanded to include MAC. There is substantial redundancy in the committee membership, which helps to offset the level of control and influence vested in the role of the CRO. It also provides for the continuous flow of information from the business groups to management and the boards of the U.S. companies so that risk policies can be modified as needed.

As noted above, MAC will adopt the underwriting policies and procedures used by AGM and AGC. These will form the basis for the review and approval processes and the credit guidelines. In KBRA's view, Assured's credit guidelines for bond types in S&P risk categories 1 & 2 are well defined and consistent with industry parameters. The guidelines contain a robust treatment of pertinent credit features for each sector and ample detail on any subsector analysis that is likely to present itself to the company. The guidelines provide a detailed roadmap in terms of approach and thought processes underlying sector fundamentals. The building blocks of credit are outlined well, covering security, structure, debt, economics, financial performance, systems analysis, rate setting methodology and cash flows, where applicable.

Single-risk limits are established based on statutory capital levels and relative risk. MAC has established an internal maximum single risk limit of $600 million, or 75% of statutory capital. Riskier bond types with an expected higher risk of loss will have lower single-risk limits. Each company's single risk limits reflect the lowest of the internally derived limit or any externally imposed limit. Limits are calculated by the Risk Management Department on a quarterly basis and available on Assured Guaranty's intranet site. There are also overall risk limits imposed at the AGL level to manage aggregate risk from the operating companies. In some instances, there are also sector limitations that reflect an internal assessment of intra-sector correlation. The single risk limit associated with average annual debt service is 10% of statutory capital, which is consistent with industry requirements. Since MAC will be operating in sectors with modest risk and lower risk limits, it does not expect to make use of reinsurance, at least initially.

Underwriting policies are required to be reviewed on a regular basis. However, KBRA notes that the public finance underwriting guidelines submitted to KBRA were contained in two separate documents, both of which have not been updated in a number of years. Management has communicated to KBRA that it is working on revisions to its written public finance underwriting manual to reflect underwriting changes it has implemented as a result of the Great Recession.

In KBRA's view, MAC's underwriting policies and credit guidelines are sufficiently detailed and help to ensure the quality and consistency of insured transactions. The underwriting process requires a quorum of voting members from the Credit Committee and must include at least two credit officers. Credit officer designations are made by the PRMC. The underwriting review and approval threshold increases to reflect higher levels of risk exposure. Risk limits reflect both issuer and sector loss assessments. Underwriters and internal legal counsel assigned to a transaction must also certify that the insured transaction is consistent with the transaction that was approved. This increases accountability and reinforces the need to keep management aware of any changes in the portfolio risk profile.

Existing policies also incorporate enterprise risk management and strategic planning. Both are managed by the CRO as part of the PRMC. Enterprise risk management focuses on reviewing governance, committee roles and responsibilities, risk management relative to objectives and capital management. Strategic planning is conducted twice a year with involvement from the AGL Board of Directors.

Surveillance

The insured portfolio is monitored by the surveillance group, which reviews all insured transactions in accordance with a risk matrix. The matrix establishes the frequency and nature of the surveillance review based on the exposure level and type of risk. Those exposures with the greatest potential impact on capital are reviewed more regularly and through in-depth reviews. The surveillance function also prepares sector and topical reviews, as necessary, to keep senior management informed about current trends. The role of surveillance is to identify transactions and/or sectors that are not performing in accordance with expectations and to determine the appropriate course of action. Surveillance personnel work with the legal department and the Workout Committee to develop a loss mitigation strategy and enforce remedies as needed to limit losses. Reserve requirements, to the extent necessary, are established in conjunction with the U.S. Reserve Committee.

Surveillance personnel are also responsible for maintaining the integrity of internal ratings on all insured transactions. KBRA understands that to the extent there has been a change in the credit quality underlying a transaction, adjustments are recommended and ratings are updated as needed. This ensures that the capital model accurately reflects the risk in the insured portfolio. Both the Risk Management Committee and the Workout Committee meet on a regular basis. The agenda for these meetings is developed by their chairmen, the Chief Surveillance Officer and Executive Officer, respectively. Any risks or trends identified in the surveillance or remediation process flow up to management through the committee process.

Enterprise Risk Management

Assured has developed a comprehensive ERM plan that KBRA believes reflects best practices in the industry. It is well integrated and it serves to reinforce and extend Assured's risk focus to all departments within the organization. Furthermore, it provides a framework for identifying and addressing current and emerging risks in a consistent manner. Information generated from the ERM process is used by Senior Management and the AGL Board as a guide in establishing annual risk tolerance limits and for making changes to policies and procedures.

The ERM plan formalizes the processes for identifying, reviewing and assessing risks within and across departments. It establishes clear goals and identifies the parties responsible for reviewing specific risks and making recommendations on policy changes. The process is led by the CRO and the Risk Department, but it requires input from the risk owners in each department. Key risks are identified and ranked based on likelihood of occurrence and potential impact. A Risk Register is maintained to reflect each of the risks and where they fall within the organization. The adequacy of current systems to address each risk is assessed, and risks that are not sufficiently offset by existing systems are identified as Key Risk Indicators. The Risk

Department uses these results to create an Own Risk & Solvency Assessment (ORSA), which is presented to the AGL Board on a quarterly basis for use in refining the risk controls and objectives, as necessary.

A key component of the current ERM plan is the development of a Model Governance Policy. The objective of the Model Governance Policy is to provide a process by which all of the company's risk models can be identified, controlled and audited on a regular basis. The process is intended to enhance the ongoing integrity of the models and provide for more consistent management of inputs.

ERM also focuses on capital management. Assured Guaranty reviews capital allocation relative to each operating company and the lines of business within the company. Stress testing is performed on a regular basis to ensure capital adequacy at various confidence levels, given variations to key model assumptions such as loss, correlation and rating changes. Reports on stress testing are provided to the AGL Board Risk Oversight Committee at least annually.

In KBRA's opinion, the integration of ERM policies in Assured's governance structure is a key rating strength. It ensures consistency in the risk management processes and helps to support better risk avoidance and risk mitigation for unforeseen events. In addition, the consistent flow of information from the operating company to the AGL Board provides for more accurate decision-making and strategic planning.

Operating Systems

MAC will employ the existing operating systems of Assured Guaranty. KBRA views Assured's operating systems as well developed and comprehensive. In the last several years, the operating systems have had to accommodate the integration of the legacy AGM book of business as well as changes in FASB accounting rules governing recognition of premiums. Assured's exposure management system includes the tools and capabilities to perform a wide range of exposure tracking and analysis activities. The surveillance process at Assured benefits from a high level of granularity regarding exposure as well as the ability to perform specific exposure analysis. The system that manages the underwriting process includes a feature that captures the underwriting decision as well as the committee membership. The underwriters are primarily responsible for the input of the initial data. Surveillance continues to maintain the integrity of the data as part of the surveillance process.

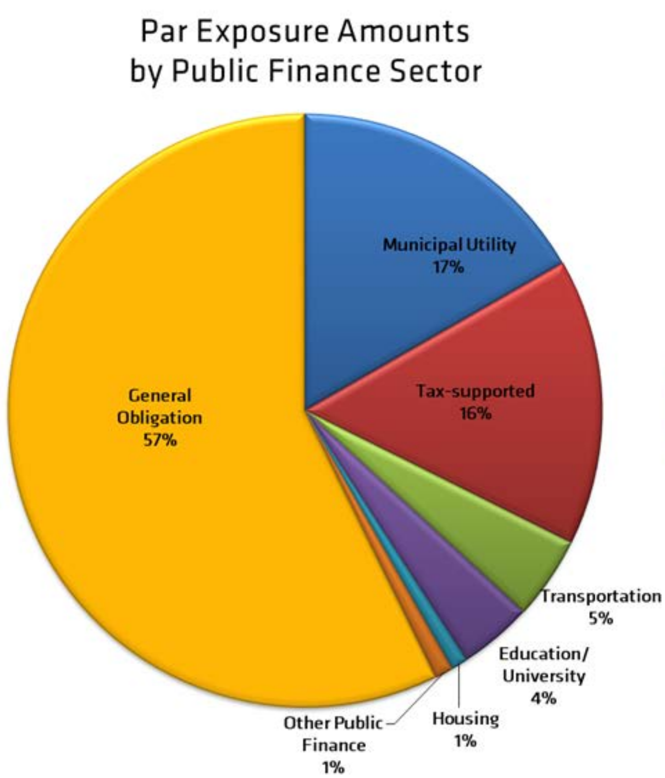
Assured's operating systems also provide strong management controls for monitoring risk management and business limits, including single risk limits and allocation of exposure among business lines. The exposure management system is fully integrated with financial and accounting systems. Assured's primary data center is located in New York City, with the backup being hosted by a vendor in another state. Assured has also contracted with that vendor to provide for contingency facilities at any of the vendor's locations in the U.S. The contingency plan is tested annually and includes recoverability of critical systems and remote access capability.

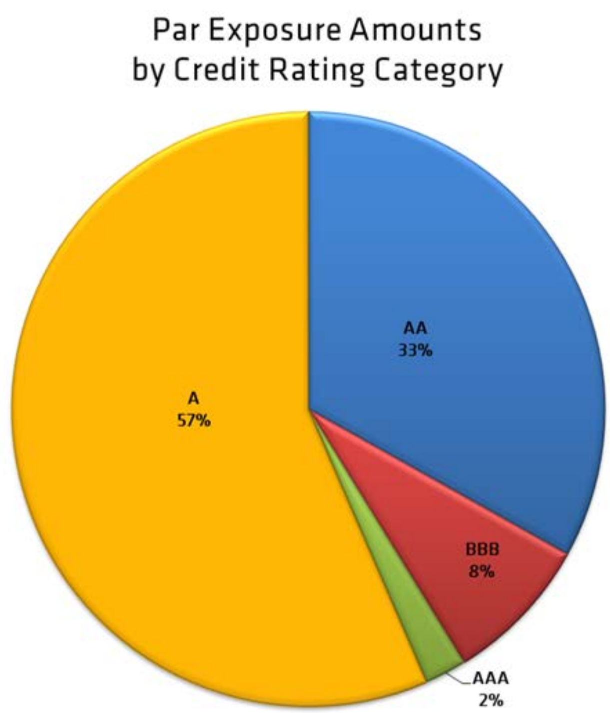
MAC will utilize the operating systems of Assured in the same way that the AGC and AGM systems operate as separate platforms of the larger Assured system. All information on a potential MAC insured issue will be entered into the overall database and identified as a MAC issue. Although the credit process occurs and certain exposure capacity decisions are made on an Assured-wide basis, all exposure related information is ultimately segregated within each operating company. This credit process assures that information on credit or rating events will be communicated among operating companies. Management states that, after the acquisition of AGM, the decision was made to move the existing Assured companies to the legacy AGM system for exposure management.

Rating Determinant 2: Insured Portfolio and Modeling Analysis

Insured Portfolio

KBRA views the risk that MAC will pay significant claims on the ceded portfolio to be fairly low. The ceded MAC Insured Portfolio has a total of $102.6 billion in gross statutory par outstanding and includes a range of public finance sectors. In terms of security type, KBRA views the portfolio as being fairly conservative, with 57.2% of total par exposure in General Obligation Bonds, followed by Municipal Utility Revenue (16.7%), Tax-Supported (15.6%), Transportation Revenue (4.5%), Education and Higher Education (4.0%), Housing Revenue (0.9%), and a small percentage of miscellaneous public finance exposures. The ceded portfolio is consistent with the risk parameters of MAC.





In the ceded portfolio, 91.9% of the par exposures have credit ratings that are within the single 'A' rated category or above, as indicated by Assured's internal rating assessment. Currently, 56.5% of par falls within the single 'A' credit rating category, 33.1% within the 'AA' credit rating category and 2.3% within the 'AAA' rated category. A total of 8.1% of par insured falls within the 'BBB' credit rating category. Based on a review of the portfolio, KBRA views the Assured internal rating determinations as being generally conservative.

KBRA also considers the ceded portfolio to be geographically diverse. The largest area of geographic exposure concentration is the state of California (14.9%), followed by Texas (9.3%), Pennsylvania (8.5%), New York

(5.7%), and Illinois (5.7%). The top five single exposures across all geographic regions total $ 759.6 million in gross par amount outstanding and represent a modest 0.7% of total par exposure.

As discussed in KBRA's Financial Guaranty Rating Methodology, KBRA typically performs a quantitative analysis of the insured portfolio risk by applying a Monte Carlo simulation model that produces a distribution of loss outcomes for that portfolio. KBRA views this as the most appropriate approach for modeling the large, diverse portfolios typical of the financial guaranty industry. KBRA ran MAC's ceded portfolio through the KBRA Monte Carlo loss simulation model and produced expected claims due in each year and found that, at the highest stress levels, MAC can cover modeled claims and expenses. As further contemplated in KBRA's Financial Guaranty Rating Methodology, KBRA also applied a stress test to the MAC portfolio by adjusting default probabilities of selected exposures in the existing portfolio and re-running the Monte Carlo simulation model. KBRA stressed selected exposures in the portfolio by increasing default probabilities by assigning lower credit ratings to certain exposures and thus a higher probability of default. KBRA identified certain exposures in the MAC portfolio as experiencing credit stress, or being vulnerable to future credit stress. KBRA reviewed both specific sectors that are currently subject to uncertainty, such as redevelopment agencies in California and specific exposures that are known to be under stress, as well as a number of exposures in the BBB rating category. Based on KBRA's credit assessment of these identified names and sectors, KBRA adjusted the existing internal Assured ratings of individual exposures in the portfolio to reflect KBRA's view of the possibility of increased default risk under a stress scenario. Beyond the review of specific exposures, KBRA also adjusted the internal ratings for certain exposures currently rated BBB- , given the proximity to non-investment grade and the increased default probability this represents. KBRA incorporated the adjusted ratings into the Monte Carlo simulation model stress scenario and produced expected claims due in each year and found that at the highest stress levels, MAC can cover modeled claims and expenses.

As discussed in KBRA's Financial Guaranty Methodology, KBRA's financial model tests the ability of the guarantor's claims-paying resources to pay both operating expenses and policy claims in run-off. Operating expenses are adjusted for a particular assumed corporate distress scenario. Investment income reflects the drawdown of assets to pay claims. The guarantor's financial resources must be able to pay all claims at the subject rating level on a timely basis, in full, to satisfy the loss modeling test at the applicable rating level.

As noted in its methodology, KBRA typically subjects a financial guarantor to stresses consistent with a AAA rating. At this stress level, MAC can cover modeled claims and expenses. However, given the recent past performance of the financial guaranty industry, KBRA will take a measured approach to rating new and existing entities. That said, as and when the industry demonstrates a track record of prudent underwriting and sustainable losses, KBRA can foresee a return to AAA levels for select companies.

Rating Determinant 3: Claims-Paying Resources and Financial Profile

MAC Financial Profile

The following discussion is based on financial projections provided by Assured Guaranty's management. As a start-up, there is no history from which to derive expectations for future performance. As part of the financial review, KBRA has assessed the reasonableness of assumptions used to derive these projections relative to historic industry trends and current issues affecting the market. MAC is expected to benefit from a revenue stream stemming from the ceded portfolio. This portfolio will provide approximately $709 million in net premiums which can be used to support the development of its new business in the near term. There is no ceding commission associated with this portfolio.

KBRA notes that MAC's financial projections can be affected by a number of factors. These include (i) declines in overall municipal volumes; (ii) changes in market demand for the financial guaranty product; (iii) continued tight credit spreads; (iv) increases in competition that affect market share, pricing and/or the risk/return profile; and (v) changes in the management team that affect the ability of the company to effectively execute its business plan. However, KBRA believes that, given management's track record, the established infrastructure supporting risk management and system operations, and the presence of an established earnings stream from the ceded book of business, MAC is in a good position to achieve its financial projections. KBRA will review performance related to these forecasts and industry trends on a regular basis. Any material changes to plan will be noted. In addition, as indicated in its Financial Guaranty Rating Methodology, KBRA will review what effect, if any, future business conditions will have on MAC's business profile and the sufficiency of its claims-paying resources to satisfy claims as part of KBRA's run-off scenario.

Claims-Paying Resources

MAC's claims-paying resources are expected to grow over time in line with growth in new business and profitability. Claims-paying resources will be driven by the unearned premium on new business outpacing the rate of earnings on the reinsured book of business. Contingency reserves will also grow as new business is written.

No dividends from the insurance company to the Holding Company are assumed over the five year projected period, so that claims-paying resources are not expected to be depleted through dividends. As no dividends are being paid, growth in claims-paying resources is reflected in growth in investment assets. This, in turn, creates additional investment income over the projection period that would also decline should a dividend be paid.

Yields on invested assets are assumed to increase over the forecast period. Given the unprecedented low interest rate environment at present, KBRA recognizes that increasing yields are in line with market expectations. The investment portfolio will be comprised of a diverse mix of fixed income securities that is of a high quality and provides liquidity in the event claims payments were to increase suddenly.

Capital Structure

MAC's capital structure is comprised of equity and surplus notes. The absence of any other external debt helps keep the demands on the insurance company's resources related primarily to claims payments. This is reflected in the increasing claims-paying resources.

While payment of interest on the AGM surplus notes is subject to insurance regulatory approval, for the purposes of assessing the capital structure, interest is assumed to be paid on the surplus notes on a timely basis. This impact is $5m per year in interest expense.

Investments

MAC will follow the same investment guidelines as the other Assured Guaranty subsidiaries. These guidelines allow for diversification while limiting the potential concentration of risks by asset class and issuer. Minimum standards are included for the credit quality of securities within the portfolio, as well as guidelines around the duration of the portfolio. The MAC portfolio is expected to be comprised primarily of short and medium duration securities in order to provide sufficient liquidity for any potential loss payments. Funds will be predominantly invested in high quality municipal securities, along with smaller positions in corporates, U.S. government and asset-backed securities. This will represent a more conservative portfolio than the existing Assured Guaranty portfolio, which has more significant holdings of residential and commercial mortgage-backed securities primarily due to loss mitigation efforts. KBRA also notes that the investment policy requires the approval of the CFO or Treasurer for purchases of self-insured bonds, and that such purchases are generally restricted for use in risk mitigation, or specifically approved by the AGL Board.

MAC HoldCo

Municipal Assurance Holdings Inc, (MAC HoldCo) is an intermediate holding company of AGM and AGC. Both AGM and AGC are indirect subsidiaries of AGL, a Bermuda-based holding company. MAC HoldCo was capitalized entirely from common shares issued to AGM and AGC. MAC HoldCo in turn, capitalized a regulated financial guaranty operating subsidiary. The operating performance of MAC HoldCo will be completely dependent upon the ability of its operating subsidiary to pay dividends. At this time, there is no debt associated with the Holding Company capital structure, and there are limited operating expenses associated with the MAC HoldCo. Any changes to the capital structure or business profile of MAC HoldCo will be considered a rating factor that could affect the MAC HoldCo rating. KBRA notes, however, that as a regulated financial guaranty company, dividends from the operating subsidiary are subordinate to policy-holder claims. Therefore, KBRA has assigned an issuer rating of AA, Stable Outlook, to MAC HoldCo. This is one notch below the operating company rating level, which reflects the structural subordination of cash flows to the MAC HoldCo.

Conclusion

MAC is expected to benefit from a seasoned management team, well established policies and procedures adopted from Assured, a ceded portfolio providing a reliable earnings stream and coverage of modeled claims and expenses at the highest stress level.

Glossary

Assured Guaranty Company Name Glossary	
Company Abbreviation	**Company Name**
AGL:	Assured Guaranty Ltd., a Bermuda based holding company.
AGUS:	Assured Guaranty US Holdings Inc.
AGC:	Assured Guaranty Corp.
AGM:	Assured Guaranty Municipal Corp.
AGMIC:	Assured Guaranty Municipal Insurance Company
Assured / Assured Guaranty	All of the Assured Companies
MAC:	Municipal Assurance Corp.
MAC HoldCo:	Municipal Assurance Holdings Inc.

Kroll BondRatings™