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Assured Guaranty Ltd. Operating Companies

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Assured Guaranty Ltd. Operating Companies

Major Rating Factors

Financial Strength Rating
Local Currency
AA-/Stable/--

Strengths:

- Strong competitive advantage in the bond insurance industry.
- Underwriting focus on the low-risk U.S. public finance market.
- Well-capitalized on a combined basis, with a strong capital adequacy ratio.

Weaknesses:

- Weak operating performance in recent years.
- Susceptibility to continued adverse loss development of U.S. nonprime residential mortgage exposure.
- Significant concentration risk, which we measure with Standard & Poor's largest obligor test, in the insured portfolio of the consolidated Assured Guaranty Ltd. companies.

Rationale

The 'AA-' financial strength ratings on Assured Guaranty Municipal Corp. (AGM), Assured Guaranty Corp. (AGC), and Assured Guaranty Re Ltd. (AG Re) (combined, the companies) reflect Standard & Poor's view, based on our updated bond insurance criteria, of a strong competitive position and strong capital. However, the consolidated group of insurance companies, though it maintains strong capital, does not maintain enough capital to mitigate largest obligor (LOT) concentrations for a higher rating. The LOT concentrations could add volatility to the companies' capital and operating performance, and hence limit the rating without additional capital to mitigate this risk. The companies also have a solid market presence and a consistent track record of profitably underwriting U.S. public-finance transactions.

On a combined basis, AGM, AGC, and AG Re are moderately well-capitalized, as we measure with our capital adequacy criteria; they have a combined capital adequacy ratio of 0.80x to 1.0x. We view this capital adequacy ratio as strong, but susceptible to further adverse loss within the residential mortgage-backed securities (RMBS) exposure. We view AGM, AGC, and AG Re as core to Assured Guaranty Ltd., and we rate them as a consolidated group.

Outlook

The stable outlook reflects our expectation that the companies will continue to insure predominately investment-grade U.S. public finance business and maintain their relatively strong competitive position in the financial guarantee market with a strong market presence and a strong distribution channel. We do not expect that the operating performance of the companies will deteriorate significantly, even though adverse development in the RMBS insured portfolio may continue to hamper it. The stable outlook also reflects our view that the companies' financial flexibility will remain strong and supportive of the capital position. We also expect consistency within the companies' risk profile and risk tolerances, without significant changes in terms of investment risk. If our expectations change or if the companies exhibit significant volatility from an earnings or capital perspective, we could lower the ratings. Based on our view of the bond insurance market, we don't believe the competitive position or earnings will dramatically improve and, therefore, don't expect to raise the ratings in the next two years. This assumes there is no significant improvement in capital adequacy that could change the analysis. The companies' management team may consider various capital-creation strategies, and we would evaluate its ability to effectively execute any strategy as well as the timing in our assessment of the companies' capital position for a potentially higher rating.

Framework Scores

The score for the companies' adjusted competitive position is '3' and the industry risk is '2', leading to a business risk profile score of '2'. The companies' final capital adequacy score is '3' and the operating performance score is '3', leading to a financial risk profile score of '3'. There were positive factors that led to a notching of the final rating.

Competitive Position: Strong Market Presence And A Strong Distribution Channel

The companies have a proven track record of credit discipline and we view the competitive position of the companies as strong. AGM and AGC write U.S. and international public finance business; AGC writes global structured finance and both companies cede a portion of their direct writings to AG Re. In terms of investor capacity, by writing U.S. and international business out of AGC and AGM, investors can choose which company they want to accept a financial guaranty policy from so as to meet any customer-specific internal exposure guidelines.

The companies have two offices in the U.S., New York and San Francisco, and international offices in London and Sydney. These offices in key financial centers around the world provide the companies with a solid global footprint from which to write a well-diversified mix of business. The companies have solid relationships with underwriters, advisors, and frequent issuers, all of which support an ongoing flow of business.

The companies' practices and distribution channels help to set it apart from potential new competitors. In addition, its relationship with The Muni Center (TMC) provides the companies with a strong source of secondary market opportunities. TMC is a municipal bond trading platform. AGM was part of the consortium that founded TMC in 2000. This is a retail product focused on small par amount trades for which AGM and AGC offer secondary market insurance.

In 2010, the companies reported $27.8 billion of U.S. public finance gross par insured and $3.0 billion of structured finance gross par insured. Combined 2010 insured U.S. public finance par was down 41% from 2009. AGM originated an overwhelming proportion of combined insured U.S. public finance par. Within U.S. public finance, general obligation bonds represented 46% of the combined insured par and tax-backed issues were 17%. Reflective of business conditions, the insured U.S. public finance par had an average credit quality of 'A'.

In the first nine months of 2011, the companies insured $10.2 billion of U.S. public finance par, which is down from $20.2 billion in the first nine months of 2010. Overall total market new issue volume was off more than 33% in the first nine months, which hurt the companies' business production somewhat, and insured penetration was under 6%. General obligation bonds represented 57% of U.S. public finance business production, with a weighted-average 'A'credit quality. Tepid demand and a pullback by management impaired structured finance production, and the companies only insured $1.0 billion of par during the period.

The companies' U.S. public finance risk-adjusted pricing index was 8.0% in 2010, compared with 9.7% in 2009. While the pricing index did decline in 2010, it remains well above what AGM or AGC had been able to achieve individually during the more competitive pricing environment prior to 2008.

Management And Corporate Strategy: Successful Implementation Of A Conservative, Well-Defined Strategic Plan

We view the companies' management and corporate strategy as marginally positive to the rating. AGM and AGC are U.S.-based direct primary financial guarantee insurance companies owned by Bermuda-domiciled AGL. AGL's corporate strategy is to function as a full-service guarantor with a captive reinsurance affiliate, AG Re, which has also assumed third-party portfolio cessions. Management's objectives are to capitalize on its financial strength and secure its market share leader position within the financial guarantee market.

Management has a strong belief that the consolidated group should write a diversified book of business, including both public finance and structured finance. AGM and AGC write U.S. and international public finance business, and AGC and AG Re write global structured finance business.

The European business platform is Assured Guaranty (Europe) Ltd. (AGE). The U.K. Financial Services Authority (U.K. FSA) has authorized AGE to write financial guarantee insurance in the U.K. This authority allows it to conduct business in other European Economic Area jurisdictions on a passport basis. We've based our ratings on AGE on their close operational and financial ties to its affiliates, including risk-management policies that the entire group adheres to; underwriting support; and strong financial support in the form of quota share reinsurance, excess-of-loss reinsurance, and net-worth-maintenance agreements. In addition, management has agreed with the U.K. FSA that any new business that AGE writes will be guaranteed using a coinsurance structure--AGE will coinsure municipal and infrastructure transactions with AGM, and structured finance transactions with AGC. AGM or AGC will also issue a second-to-pay guarantee to cover AGE's financial guarantee.

Operational effectiveness

The experienced management team continues to demonstrate a solid understanding of the various risks the company faces. Individuals on the management team have a long history in the financial guarantee industry and the U.S. public finance market.

With regard to the U.S. public finance exposure, the company has insured a predominately investment-grade book of business with a minimal history of adverse loss development. For its structured finance book of business, the company focuses on loss mitigation, which has been a successful strategy as evidenced by the settlement with Bank of America in April 2011.

President and CEO Dominic Frederico, chief operating officer (COO) Bob Mills, general counsel Jim Michener, and chief financial officer Rob Bailenson lead the senior management team. Bill Hogan is head of U.S. public finance underwriting, Paul R. Livingstone is head of the structured finance business, and Nick Proud is head of AGE.

President Kevin Pearson leads the senior management team of AG Re, and he reports to AGL COO Bob Mills. Gary Burnet, managing director and chief credit officer, supports Mr. Pearson. The company has a relatively small staff of six professionals, but it receives administrative and technological support from AGC. However, AG Re in Bermuda makes all underwriting decisions for the company.

Chief surveillance officer Russ Brewer leads a surveillance team that oversees consolidated insurance exposure for the Assured group. Howard Albert, chief risk officer, is responsible for enterprise risk management (ERM) and reports directly to the board of directors independent of management and President and CEO Dominic Frederico. Steve Donnarumma, the chief credit officer, heads up the organizational structure that conducts underwriting and the approval of insured transactions. The company has a robust risk reporting framework and a well-developed risk tolerance statement.

Financial management

AGL is conservative, in our opinion, in its use of traditional financial leverage. The insurance operations, we believe, are also conservative in their financial management, with each company employing limited hybrid securities and reasonable reinsurance. From a risk perspective, the company establishes exposure limits and underwriting criteria for sectors, countries, single risks, and--in the case of structured finance obligations--servicers. The companies establish single-risk limits in relation to their capital base and base these limits on management's assessment of potential frequency and severity of loss as well as other factors, such as historical and stressed collateral performance.

The company's standards for operational performance are reasonable for the current market conditions. Management closely monitors risk-adjusted pricing and historically has not underpriced to gain market share.

Industry Risk

For bond insurers, we view the industry risk as low. The primary subfactors for scoring a bond insurer's industry risk are cyclicality and volatility of operating earnings, competitive and growth environment, industry operating and cost structure and risk, capital, funding and liquidity characteristics, and the governmental/legal and regulatory environment.

Capital Adequacy: Strong, Well-Managed Capital Position

The combined capital adequacy of the companies is strong. The companies' capital adequacy ratio was in the 0.80x to 1.00x range. The capital adequacy ratio expresses the relationship between theoretical losses the capital adequacy model generates and capital remaining at the end of a theoretical economic depression. The capital adequacy analysis included higher capital charges on the public finance and structured finance books of business, as a result of the release of Standard & Poor's updated bond insurance criteria on Aug. 25, 2011.

We based the capital analysis on the management's projections of year-end 2011 financial statements, with the first year of business written occurring in 2012. We used our capital adequacy model to form our views of AGC's, AGM's, and AG Re's capital adequacy. The key assumptions embedded in our model are:

- Three years of business written growth followed by four years of stress.
- 15% growth per year in new public finance business in each of the growth years, or the company's higher assumed growth rate.
- 25% growth per year in new structured finance business in each of the growth years, or the company's higher assumed growth rate.
- Capital charges consistent with assumed mix of business.
- Premium rates based on current opportunity in market.

As part of our review, we tested each company's capital adequacy against a scenario that applies stressful default assumptions to various RMBS-related transactions that the companies have insured. We based the default rates for these transactions on stressful cumulative net loss assumptions that our structured finance criteria guidelines supply--these vary by asset type and vintage. We have included the Alternative-A, subprime, closed-end second, home equity line of credit, and net interest margin asset types with 2005, 2006, and 2007 vintages in this analysis. Our stress-case loss projections do not reflect the losses that we expect to occur, but rather they reflect our view of potential losses in an 'AAA' stress environment.

For AGC's and AG Re's commercial mortgage-backed securities (CMBS) exposure, we calculated stress losses based on AGC's position in the capital structure (i.e. the difference between AGC's position plus the credit enhancement in the transaction and our stress loss expectation). We also aggregated stress losses for groups of transactions and subtracted any applicable deductible AGC may have structured.

With regard to the LOT violations, management has presented a number of strategies to improve the capital adequacy scores to mitigate the effect of the LOT violations on the overall rating of the companies. We would evaluate management's ability to effectively execute any strategy as well as the timing in our assessment of the companies' capital position for a potentially higher rating.

Investment Risk: Conservative Investment Presents Low Risk

The companies manage the investment portfolios on a consolidated basis, with the objective of preserving the financial strength of each AGL operating company. The investment strategy is liability-driven and targets sufficient liquidity to cover unexpected stress in the insured portfolio. While external asset managers manage the portfolio, AGL takes ownership of the asset allocation and investment guidelines and has strict risk limits and sublimits by sector and state that apply to the municipal investments.

As of Sept. 30, 2011, the companies invested 28% of the $11.1 billion investment portfolio (fair value) in 'AAA'-rated securities or U.S. government-backed securities; 52% was rated 'AA' and 15% was rated 'A'. The portfolio included 2% speculative-grade securities and 2% nonrated securities. The largest component of the long-term investment portfolio is in tax-exempt securities (48%) and about $1.4 billion of the portfolio is in U.S. agency RMBS. The companies have no collateralized debt obligations (CDOs) of asset-backed securities (ABS) in its investment portfolio.

A significant portion of the self-insured bonds in the investment portfolio were purchased as part of a risk mitigation strategy. Ratings of bonds insured by other bond insurers reflect the ratings of the underlying issuer.

Operating Performance: Earnings Pressured By Adverse Loss Development In Structured Finance Portfolio

We view the companies' operating performance as a marginal weakness, partly because of a decline in the U.S. public finance risked-adjusted pricing ratio to 8% in 2010 from 9.7% in 2009, and our expectations that it may continue to fall. In addition, continued stress as a result of the 2005-2007 exposure to RMBS may hurt operating performance.

For the first nine months of 2011, on a GAAP basis, AGL reported a 16% decrease from the prior-year period in operating income (a non-GAAP measure) to $430.9 million. Operating income included the effect of lower risk-free rates AGL used to discount the losses it expected, which is not an indication of additional credit impairment in the period. Net premiums earned declined 23% as a result run-off in the structured finance portfolio. Offsetting this decline was an increase in premiums relating to refundings and accelerations. For insured transactions for which risk is eliminated due to refundings or accelerations, any remaining unearned premiums are taken into revenue immediately. The company did experience continued early-stage mortgage delinquencies and higher severities within its RMBS exposure. Operating results for the first nine months of 2011 improved due to the April 2011 representation and warranties settlement with Bank of America.

In 2010, AGM and AGC on a combined basis reported statutory net premiums earned of $504.6 million. Installment premiums on existing U.S structured finance business continue to be the main contributor to total premiums earned, generating almost two-thirds of total earned premiums. We expect this business line's contribution to earned premiums to diminish as the structured finance business runs off rapidly over the next two to three years with little additional business. On Sept. 30, 2011, the present value of installment premiums totaled $1.3 billion.

While the U.S. public finance risk-adjusted pricing index did decline in 2010, it remains well above what AGM or AGC had been able to achieve individually when pricing was more competitive prior to 2008. The implied premium rate within this ratio declined 11% to 67 basis points and the capital charge rose 8% to 8.4%. The decline in pricing indicates a slight deterioration and the rise in capital charges indicates a modest increase in the risk profile of business written.

Regardless of the index decline, strong pricing bodes well for the companies' long-term earnings power. The companies typically collect the premiums associated with this business line upfront and earn them over the life of the underlying transaction, 20 years on average. As for the future earnings power of the companies, on Sept 30, 2011, the unearned premium reserve (UPR) totaled $4.1 billion, largely unchanged from the prior year.

Financial Flexibility: Neutral To The Rating

Through AGL, the companies have a good track record of raising capital. The operating companies have no preferred stock or surplus notes outstanding. AGM has a $109 million bank loan outstanding that it used to refinance an underperforming insured transaction. AGC and AGM each have undrawn contingent capital facilities of $200 million. Reinsurance to third parties is limited, and the reinsurers collateralize a significant portion with high-quality assets they hold in trust for the benefit of AGM or AGC.

Enterprise Risk Management: Strong Risk Culture And Controls

Standard & Poor's continues to score the ERM framework at AGL as strong. Our view is primarily influenced by strong scores in the risk culture, risk control, and strategic risk management categories at AGL. Our assessment that that company's emerging risk management and risk models are adequate partly offset these strengths.

In our view, the risk management culture at AGL is strong, based on our assessment of a powerful and influential chief risk officer (CRO) who reports directly to the board of directors independent of the management, the presence of a robust risk-reporting framework, and a well-developed risk tolerance statement. We think the economic challenges the company faces as a result of the recent financial stress partly offset the aforementioned strengths. The company's business unit management is cognizant of the organization's risk appetite, which it translates into risk limits for underwriting, credit, and investment risks. The office of the CRO reports on and monitors these risk limits and the internal audit department provides supplemental reviews and independent assurance.

Our favorable opinion of risk controls relating to underwriting risks, surveillance, and loss mitigation is influenced by the company's structured process for risk identification, risk monitoring, its detailed set of risk limits and policies, and its system of enforcement through well-defined authorities. A robust surveillance function monitors all insured transactions to assign and maintain internal ratings and identify underperforming transactions for early intervention. The surveillance group, along with the legal and workout groups, enforces remedies and seeks to avoid or mitigate losses. They also close the feedback loop with underwriting so that the company can include the latest information in its underwriting decisions.

In our assessment, strategic risk management at AGL is strong, given its deliberate consideration of risk and risk management in its decision-making framework. The company used risk models and risk/reward considerations in formulating its plans to exit certain sectors, reduce the limits in others, or take capital management actions (dividends/capital raises). In addition, we also favorably view the company's supplementation of economic capital analysis with stress testing, scenario analysis, and other metrics, such as rating agency capital consumption.

We expect AGL to continue to fine-tune its existing risk models and emerging risk management. In addition, we anticipate that the company will maintain and enhance its control environment and strategic risk management practices to keep a strong ERM score.

Liquidity: Liquidity Strategy Has Protected The Companies' Financial Position

The companies' liquidity is supported by $1.0 billion in cash and short-term investments. AGL's conservative investment strategy, which focuses on high-credit-quality securities, is likely to continue and should adequately support the operating companies' future liquidity needs.

Under a limited number of CDS contracts, AGC may be required to post eligible securities as collateral--generally cash or U.S. government or agency securities. For certain of such contracts, this requirement is based on a mark-to-market valuation, as determined under the relevant documentation, in excess of contractual thresholds that decline or are eliminated if AGC's ratings decline. Under other contracts, the company has negotiated caps such that the posting requirement cannot exceed a certain amount.

Operating cash flow and the underwriting cash flow ratio have suffered in recent years because of claim payments relating to insured 2005-2007 vintage RMBS. The April 2011 R&W settlement with Bank of America included cash it paid at closing ($850 million) and cash it paid over the following four quarters ($250 million). This settlement helped to improve AGC's and AGM's liquidity position and also requires Bank of America to pay 80% of future claims relating to $6.6 billion of collateral losses on certain RMBS transactions. Additional success with regards to R&W putback settlements should strengthen the companies' liquidity position.

Accounting

Standard & Poor's views AGL's accounting policies as generally consistent with industry standards and neutral to the ratings. AGL files consolidated statements according to U.S. GAAP, whereas AGC and AGM file financial statements under Statutory Accounting Principles (SAP).

Related Criteria And Research

- Bond Insurance Rating Methodology And Assumptions, Aug. 25, 2011
- Group Methodology, April 22, 2009

Ratings Detail (As Of December 29, 2011)	
Assured Guaranty Municipal Corp.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Counterparty Credit Rating	
Local Currency	AA-/Stable/--
Financial Enhancement Rating	
Local Currency	AA-/Stable/--
Related Entities	
Assured Guaranty (Bermuda) Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Financial Enhancement Rating	
Local Currency	AA-/Stable/--
Assured Guaranty Corp	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Financial Enhancement Rating	
Local Currency	AA-/Stable/--
Assured Guaranty (Europe) Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Financial Enhancement Rating	
Local Currency	AA-/Stable/--
Assured Guaranty Ltd.	
Issuer Credit Rating	A-/Stable/--
Junior Subordinated (1 Issue)	BBB
Senior Unsecured (2 Issues)	A-
Assured Guaranty Mortgage Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--

Ratings Detail (As Of December 29, 2011) **(cont.)**	
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Assured Guaranty Municipal Holdings Inc.	
Issuer Credit Rating	
Local Currency	A-/Stable/--
Junior Subordinated (1 Issue)	BBB
Senior Unsecured (3 Issues)	A-
Assured Guaranty Municipal Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Financial Enhancement Rating	
Local Currency	AA-/Stable/--
Assured Guaranty Re Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Financial Enhancement Rating	
Local Currency	AA-/Stable/--
Assured Guaranty Re Overseas Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Financial Enhancement Rating	
Local Currency	AA-/Stable/--
Assured Guaranty (UK) Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	AA-/Stable/--
Financial Enhancement Rating	
Local Currency	AA-/Stable/--
Sutton Capital Trust I	
Preferred Stock (1 Issue)	A
Sutton Capital Trust II	
Preference Stock (1 Issue)	A
Sutton Capital Trust III	
Preferred Stock (1 Issue)	A
Sutton Capital Trust IV	
Preferred Stock (1 Issue)	A
Woodbourne Capital Trust I	
Preferred Stock (1 Issue)	A

Ratings Detail (As Of December 29, 2011) **(cont.)**	
Woodbourne Capital Trust II	
Preferred Stock (1 Issue)	A
Woodbourne Capital Trust III	
Preferred Stock (1 Issue)	A
Woodbourne Capital Trust IV	
Preferred Stock (1 Issue)	A
Holding Company	Assured Guaranty Ltd.
Domicile	New York

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.