March 2021

UNDERSTANDING
Assured Guaranty Financial Guarantees
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For those unfamiliar with financial guarantees, here are answers to some common questions about the product. In this Note, “Assured Guaranty” refers to Assured Guaranty UK Limited (AGUK) and Assured Guaranty Municipal Corp. (AGM) and “financial guarantee” refers to a financial guarantee issued by Assured Guaranty in accordance with its standard terms and conditions.

1. What is a “wrap”?

AGUK is a financial guarantee insurance company whose single line of business is to guarantee debt obligations. The guarantee is often referred to as a “wrap.” AGUK provides such financial guarantees on a co-insurance basis with its U.S.-based parent AGM, the largest insurance company in the Assured Guaranty Ltd. Group. Beneficiaries of the financial guarantee have recourse to both AGUK and AGM under the terms of the standard form guarantee. The Assured Guaranty standard form guarantee guarantees timely payment of scheduled principal and interest, typically on senior debt. The guaranteed debt may be in the form of a bond or loan, listed or unlisted.

2. What protection does a financial guarantee provide and what are the benefits for beneficiaries?

At its most basic, Assured Guaranty’s financial guarantee provides credit protection to debt providers (investors in the bonds or banks providing a loan). If the issuer or borrower fails to pay all or part of scheduled principal and interest guaranteed under the financial guarantee, then the beneficiary of the financial guarantee (or ‘holder’) receive timely payment from Assured Guaranty instead under the terms and conditions of the financial guarantee.

There are a number of other potential benefits to Assured Guaranty’s financial guarantee for investors and banks:

- **Regulatory capital savings** – Assured Guaranty providing a financial guarantee may uplift the rating of the underlying bond/loan from, typically, the BBB category assigned to infrastructure assets to Assured Guaranty’s own ratings, including its AA with S&P.
- **Expanded universe of potential lenders** – Assured Guaranty’s credit protection may enable certain lenders to access asset classes that they would not be able to invest in otherwise (e.g., projects with construction and/or demand risks) and can therefore open up a universe of sponsors to investors and banks and vice versa.
- **Potentially enhanced market liquidity and transferability** – Assured Guaranty believes that the additional security and typical uplift in rating may improve the market liquidity of the debt instrument.
- **Single point of contact** – Assured Guaranty typically acts as the controlling creditor on transactions it insures at issuance (“primary guarantees”), exercising the voting rights in respect of any intercreditor decisions to be made by the investors/banks (other than express entrenched rights) and provides a single point of contact for sponsors. Assured Guaranty has a very active and experienced risk monitoring department to administer the decision-making required in respect of transactions.

3. What are “primary” and “secondary” financial guarantees?

Assured Guaranty provides primary and secondary financial guarantees. A primary guarantee usually relates to a new debt issuance, whereas a secondary guarantee is usually applied to an existing transaction with an existing bond or loan outstanding.

An example of when a primary financial guarantee would be given is in respect of the debt issued for a new PPP project or by a utility. In a primary transaction, the beneficiary of the Assured Guaranty financial guarantee would typically be a trustee, holding the financial guarantee for the benefit of a number of bondholders or lenders.

The issuer or borrower will typically pay the financial guarantee fee in a primary transaction as it is part of its cost of funding. The protection that investors derive from the financial guarantee can allow them to offer better pricing to issuers/borrowers than would have been the case without the financial guarantee or, in some cases,
can allow them to participate in a transaction where they otherwise would not have been able to (for example, if the investor could not take construction risk without the financial guarantee).

The structure diagram below illustrates a transaction with a primary financial guarantee:

An example of when a secondary guarantee would be given is where a lender or investor is seeking credit protection in respect of an existing exposure that the lender or investor has on its books. In a secondary transaction, the ultimate beneficiary of the Assured Guaranty financial guarantee would be the lender or investor itself and the lender or investor would pay Assured Guaranty’s financial guarantee fee as it is a protection that the bank or investor is buying for itself to mitigate credit risk or to derive regulatory capital savings in respect of those existing exposures or for other reasons.

In Australia, Assured Guaranty could provide a secondary financial guarantee with an investor or a bank via its Transferrable Custody Receipt programme (see question 31 for more details), whereby the beneficiary of the financial guarantee would be Citibank in London in order to provide a more tradable security for the investor.

In some circumstances, a secondary market financial guarantee can be applied straight after a new (unwrapped) issuance of a bond or loan (i.e., even later the same day).

4. Does Assured Guaranty have a direct relationship with the Issuer/Borrower?

In primary transactions, Assured Guaranty will typically have a direct relationship with the issuer or borrower. In a secondary transaction, Assured Guaranty typically deals with the lender or investor instead, and may not have a direct relationship with the issuer or borrower.

5. How much does it cost?

The financial guarantee fee that Assured Guaranty requires in order to guarantee a specific transaction depends on a number of factors, including (a) the asset class (and associated risks), (b) its assessment of the cost of debt savings generated by the financial guarantee (i.e., the difference between the wrapped debt and unwrapped debt coupons) and (c) the capital it needs to set aside against the exposure (which drives our return on equity for the transaction).

Assured Guaranty’s fee is expressed as a percentage – i.e., a certain amount of basis points per annum, typically with a portion payable upfront on a present value basis, with the remainder payable over time on interest payment dates.

6. Example Financial Guarantees

Example primary and secondary financial guarantees can be provided on request, but each financial guarantee requires tailoring to the specific circumstances of each transaction.
7. Does the wrapped instrument need a separate rating?

Underlying rating

In order for a transaction to qualify for Assured Guaranty’s financial guarantee, the underlying debt needs to have an investment grade (at least BBB-) underlying rating with S&P. This is because S&P would otherwise provide Assured Guaranty with a very high capital charge for the transaction and, as a result, the economics of the transaction would likely not work for Assured Guaranty. Such S&P underlying rating can be public or private.

Insured rating

Assured Guaranty would expect that most of the beneficiaries of the financial guarantee would require the underlying debt guaranteed by the Assured Guaranty financial guarantee to have an insured rating from at least S&P. Such insured rating would reflect AGUK’s and AGM’s own ratings (e.g., AA stable with S&P).

All costs associated with the provision of underlying and insured ratings are expected to be borne by the Issuer (or by the beneficiary in the case of secondary financial guarantees).

8. How long does credit approval usually take?

This very much depends on the complexity of the underlying transaction. By way of example, each of AGUK and AGM were able to achieve credit approval for a recent straightforward Australian credit in 4 weeks, but a new PPP transaction could take longer.

9. How creditworthy is Assured Guaranty?

Assured Guaranty is the leading financial guarantee franchise with more than three decades of experience in the municipal, infrastructure and structured finance markets.

Its main financial guarantee entities in the Assured Guaranty Ltd. Group have strong financial strength ratings, as summarised below:

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* AGC requested that Moody’s withdraw its financial strength ratings of AGC in January 2017, but Moody’s declined that request. Moody’s continues to rate AGC.

As of December 31, 2020, the Assured Guaranty group had:

- $234 billion in guaranteed net par outstanding (US GAAP basis).
- $59.7 billion in global infrastructure and renewable finance and other non-U.S. public finance (US GAAP basis).
- $11.1 billion of consolidated claims-paying resources (US statutory basis).\(^1\)

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\(^1\) Aggregate data for insurance subsidiaries within the Assured Guaranty Ltd. (AGL) group. Claims on each insurance subsidiary’s guarantees are paid from that subsidiary’s separate claims-paying resources. Details in the latest AGL Financial Supplement at assuredguaranty.com/agldata
10. Is there any potential stigma associated with needing a wrap to raise funds?

No, we do not believe so. Assured Guaranty does not provide its financial guarantee to non-creditworthy entities. One benefit to investors of an Assured Guaranty financial guarantee is typically from the reduced capital requirement resulting from the ratings uplift to AA, and not from turning a “bad credit” into a “good credit.” Furthermore, we believe many institutional investors are generally aware of Assured Guaranty’s strong credit ethos, which we believe can provide such investors additional comfort that the issuer or borrower is creditworthy in its own right.

11. What is it like dealing with Assured Guaranty after the close of the transaction?

A key advantage of a wrapped bond or loan from the issuer or borrower’s perspective is that they generally are required to deal with only one counterparty, rather than a disparate group of investors, for routine consents, waivers and amendments. We believe that Assured Guaranty has an excellent reputation, particularly within the European infrastructure market, for being a responsive, proactive and reasonable counterparty as controlling creditor on transactions.

Assured Guaranty is aware that, during and immediately after the global financial crisis in 2008, some of the actions of our former competitors then in “run-off” (unable to write new financial guarantees due to downgrades) were viewed as less than responsive or reasonable. Assured Guaranty believes these actions were responses to unique events at a unique time, and are inconsistent with Assured Guaranty’s ethos and market position.

12. What Due Diligence does AG typically need/conduct? Is it different/more onerous than other lenders?

When Assured Guaranty issues a financial guarantee, it takes on the credit risk that the underlying investor or lender would have been exposed to if it had not been the beneficiary of the financial guarantee. Therefore, Assured Guaranty undertakes the due diligence on the transaction that any similarly situated lender or investor typically would do. Assured Guaranty wants to understand how the transaction has been structured, the documents and the background circumstances of the project or whole business that it would be exposed to.

Typically, a lead manager leads the process throughout the development of a primary transaction, and Assured Guaranty’s comments on the finance and project documents are limited to provisions impacting Assured Guaranty as financial guarantors, the financial guarantees themselves and terms that would be material to any other underlying senior creditor.

13. Who educates investors on AG? Does the issuer have to do it for a primary transaction?

Assured Guaranty would typically participate in an investor roadshow, but only to discuss matters relating to Assured Guaranty’s guarantor financial strength, guarantees and creditor rights.

Assured Guaranty would provide the section of a public offering or disclosure document which sets out Assured Guaranty’s certain corporate information and its financial position and the terms of its financial guarantee.

14. What is AG’s exposure capacity for a new transaction?

Assured Guaranty is active in both primary and secondary markets with a typical transaction size ranging from $75m up to $1bn. Its financial guarantees can have very long tenors (e.g., Assured Guaranty recently guaranteed debt maturing in 45 years for a student accommodation project in the U.K.).

15. What sectors does AG cover/not cover?

Assured Guaranty’s scope is versatile and past projects include the following:

- Roads/Rail
- University Accommodation
- Regulated Utilities
16. Why hasn’t the product been used recently in Australia?

The product was used successfully in Australia in 2018 on an issuance by Port of Brisbane. However, the typical investor base for an Assured Guaranty wrapped bond is from international investors and thus the FX markets have a material bearing on the cost-competitiveness of the product. In 2019, market conditions were less favourable for the wrapped bond for international investors, but since then market conditions for sales to such investors have improved.

The Assured Guaranty wrapped bond has been used in the U.S., the U.K. and Europe on numerous transactions since the global financial crisis of 2008 and is a mainstream financing option in those markets.

17. Does using a wrap take longer/add execution risk?

Using a financial guarantee does not typically introduce execution risk. Assured Guaranty can move quickly to execute transactions with its dedicated team of underwriting, credit and legal experts.

All transactions need to have an investment grade (at least BBB-) underlying rating with S&P (public or private rating) to qualify for the financial guarantee, so the execution process will include a timeline for the rating process to be achieved.

18. Are there any ancillary costs?

In a primary transaction, issuers or borrowers typically will pay Assured Guaranty’s due diligence costs (e.g., legal fees, cost of technical, insurance, demand adviser) and also the cost of rating the transaction. The bank or investor buying a secondary financial guarantee typically would pay these costs for a secondary transaction.

19. What documentation is involved and who are the parties? What does each additional document/party do?

In a primary transaction, the key financial guarantee documents will be (i) the financial guarantee itself, (ii) a reimbursement and indemnity agreement with the issuer or borrower and (iii) a financial guarantee fee letter. The financial guarantee itself exists so that if an issuer or borrower fails to pay scheduled principal and interest on time, then the holder of the financial guarantee, often a trustee or agent in a primary transaction, is able to claim against Assured Guaranty and receive payment from Assured Guaranty in time to make the payment to the holder on the originally scheduled payment date. The reimbursement and indemnity agreement sets out how Assured Guaranty reclaims amounts it has paid out from the issuer or the borrower. The financial guarantee fee letter sets out the agreement on the financial guarantee fee.

The parties to the financial guarantee will be Assured Guaranty and the beneficiary, often a trustee or agent in a primary transaction. The reimbursement and indemnity agreement will be between Assured Guaranty and the issuer or borrower because the issuer or borrower will be obligated to reimburse Assured Guaranty if Assured Guaranty has had to pay following issuer or borrower failure to pay the underlying guaranteed obligations. The fee letter also will be between Assured Guaranty and the issuer or borrower because the issuer or borrower will pay the financial guarantee fee.

In a secondary transaction, the key documents will be the TCR documents—please see question 31 for more details.
20. **Will there be additional parties versus a standard DCM/loan transaction?**

The only additional party will be Assured Guaranty as the financial guarantor.

21. **Can we use existing program documentation? NPA, EMTN, A$MTN?**

Amendments will be necessary to bring Assured Guaranty into the transaction but Assured Guaranty can work with an issuer/borrower’s own base documents.

22. **Can we use loan format?**

Yes.

23. **Does AG need covenants?**

Assured Guaranty typically does not require a materially different covenant package to any other similarly situated senior creditor.

24. **Is there any change to roles that exist in an unwrapped transaction?**

Not usually.

25. **How is interest withholding tax dealt with?**

Assured Guaranty believes that whether or not interest withholding tax is payable depends on the structuring of the underlying deal and is not attracted simply by introducing a financial guarantee into the transaction. This is a matter for issuers and arrangers to consider with their tax advisors, but Assured Guaranty’s understanding is that these parties will typically seek to ensure that the debt on offer is offered to the market in a way which satisfies the public offer test so that the transaction would be exempt from withholding tax. Assured Guaranty does not cover taxes as part of its financial guarantee coverage. Assured Guaranty does not provide tax advice and the parties are urged to consult with their own tax advisors regarding their specific situation.

26. **Does the underlying instrument need to be: listed, in physical form, set up in a clearing system?**

Assured Guaranty does not require the underlying instrument to be listed or cleared. For example, Assured Guaranty has wrapped registered bonds in the past.

27. **What rights does AG have? Does it vote? Receive reports? How does it decide how to vote?**

Assured Guaranty’s funding solution provides a single point of contact (Assured Guaranty in its capacity as controlling creditor), with decision-making authority over a range of activities that could impact the underlying risk of the project.

This means that Assured Guaranty takes over the voting rights of the underlying investors or lenders and will therefore vote and receive reports and any other rights given to senior creditors in the transaction, but no more than any other lender or investor. Such decision-making authority is typically subject to a standard set of entrenched rights, retained by investors or lenders as applicable.

Assured Guaranty will decide how to vote depending on the prevailing circumstances of the project or business and the nature of the request that is being made at the time. It will do so on its own, based on its own interests as guarantor, without recourse to underlying investors or lenders as applicable.
28. If AG gets to vote for wrapped investors, how does that fit in with any existing creditor arrangements?

The existing intercreditor arrangements (if any) typically will not be disturbed. Assured Guaranty takes over the voting rights of any investors or lenders who are beneficiaries of its financial guarantee.

29. What happens if AG doesn’t vote?

Assured Guaranty will typically vote on any matters that it is entitled to vote on, as it has a dedicated staff monitoring transactions that are subject to its issued financial guarantees and as guarantor, has an underlying interest in the repayment by the issuer or the Borrower and in the transaction succeeding. The underlying transaction documents contain voting procedures that govern what happens should Assured Guaranty (exceptionally) not vote, so the consequences would vary from transaction to transaction.

30. What regulatory rules cover AG’s activities in Australia? Do they operate under an exemption?

Assured Guaranty has been advised that its activities as presently structured do not currently require it to be licensed as an insurer or a financial services provider in Australia. Assured Guaranty is considering the recent changes to Australian financial services and insurance regulation and will take steps to ensure that it remains in a position to provide financial guarantees under the new regime.

31. What is a TCR? How does it work, who is involved, why is it different?

Assured Guaranty can provide insurance to investors/banks on bonds/loans that they have already purchased in the primary market through a repackaging structure, which it refers to as a Transferable Custody Receipt (TCR) programme. This structure works as follows:

- The investor/bank transfers (deposits) the underlying securities (typically rated in the BBB category) to a custodian, Citibank London, which holds the bond in a custody account.
- Immediately following such transfer, AGUK and AGM each issue a financial guarantee to the custodian bank covering their respective portion (based on the co-insurance structure) of the timely payment of principal and interest on the underlying bond or loan.
- Upon receipt of both the underlying bond or loan and the financial guarantees, the custodian bank issues a TCR to the investor/bank. The TCR is a separate transferrable instrument, which bears the rating of AGUK and AGM (AA from S&P)

A structure diagram of a TCR transaction is below:
The main advantages of the TCR structure (compared to a secondary guarantee) are:

- Efficient way for the investor/bank to benefit from the AA S&P rating of AGUK and AGM and therefore optimise regulatory capital savings.
- The TCR is a fully tradable instrument (with an ISIN number), so the guarantee follows the underlying instrument upon a sale.

The TCR may also be a convenient way of delivering the Assured Guaranty financial guarantee for regulatory reasons depending on the location of the beneficiary or the risk being covered.

Assured Guaranty has executed many TCR transactions since Q1 2017:

- In the regulated utility (UK and Scandinavia), Australian port and UK PFI sectors.
- Both for institutional investors and banks.
- Assured Guaranty believes Solvency II and Basel regulations have been a key driver for these transactions.

32. Who pays for any additional legal work required?

Assured Guaranty’s legal fees are typically paid for by the issuer/borrower in a primary transaction and by the bank/investor in a secondary transaction.

33. Who pays for any additional rating costs?

Rating costs are typically paid for by the issuer/borrower in a primary transaction and by the bank/investor in a secondary transaction.

34. Is the policy different from the policies provided by other insurers?

Assured Guaranty is a financial guarantee insurance company providing a single line of business, financial guarantee insurance. Financial guarantee insurance is not to be confused with similar-sounding products provided by some other insurance companies, typically called “non-payment insurance.” Assured Guaranty’s financial guarantee is unconditional and irrevocable, providing timely principal & interest coverage to bondholders or lenders for the full duration of the debt instrument, which are important attributes typical competing insurance products do not possess. In addition, Assured Guaranty can and does guarantee debt for long tenors – for example, it recently guaranteed debt maturing in 45 years for a student accommodation project.