



January 16, 2015

Standard and Poor's Ratings Services
55 Water Street
New York, NY 10041

Ladies and Gentlemen,

Thank you for the opportunity to comment on Standard & Poor's ("S&P's") proposed "*Methodology For Incorporating Loan Modifications And Extraordinary Expenses Into U.S.RMBS Ratings*".

We understand that S&P is concerned about whether investment grade ratings are appropriate for residential mortgage-backed securities ("RMBS") where, due to modification of the interest rates on a material portion of the underlying mortgage loans, the interest received by the investor, while consistent with the fully disclosed terms of the securities, is less than the original investor may have expected. However, we believe the concern S&P is attempting to address is purely optical, while the damage and confusion the proposed solution would cause is real and vastly outweighs the benefit of the proposed solution.

The sophisticated institutional investors that invest in crisis-era RMBS have at their disposal tools in Intex and Bloomberg that permit them to forecast the cash flow from these securities using their own prepayment and default assumptions, and do not judge the soundness of the investment based on ratings. On the other hand, some investors are restricted in the amount of below investment grade ("BIG") securities they can hold, and a downgrade of these securities to BIG could force those investors to sell into a market that is not highly liquid to other investors who are aware of their requirement to sell, likely resulting in a disadvantageous price. In the case of insured bonds, a downgrade below the rating of the financial guarantor would create confusion in the market as to what the guaranty means, since it may suggest to the market that the guarantor is not honoring its obligation or that the guaranty did not cover the amount promised by the obligation, when neither is true. Additionally, the proposed approach would result in the loss of the information conveyed in the rating about the strength of the promise to pay the instrument in accordance with its terms when comparing a security guaranteed by a 'AA' guarantor such as Assured Guaranty and a security guaranteed by another guarantor rated BIG. Furthermore, the thresholds and method of calculating the proposed ratings levels would require data that is not readily available and is based on flawed logic.

We do not believe a ratings adjustment along the lines proposed is appropriate for securities S&P evaluates as having an investment-grade likelihood of paying out in accordance with their well-disclosed and well-understood terms, whether due to a guaranty from an investment grade financial guarantor or otherwise. We suggest that, if S&P still believes ratings on such securities should convey that the interest now owed is less than expected at closing, a much better and less damaging approach would be either to add a new subscript to the rating indicating that the interest being paid is less than expected at issuance or to use the "P" subscript it already uses in analogous situations.

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Investors are receiving what they were explicitly promised, and have the tools to evaluate the amount they will receive.

The amount of interest an RMBS investor will receive over time is often highly variable. There are several reasons for this variability, all of which are clearly stated in the “Risk Factors” section of typical offering documents and are well-understood by RMBS investors:

1. Prepayment Risk
2. Default Risk
3. Call Risk
4. “Basis Risk”, or Limitations on the Pass-Through rates of the certificates (Net WAC cap).

The variations in collateral composition that have been experienced to date are known to market participants and are represented in the modeling tools that investors use to analyze their investments (Bloomberg, Intex). Investors in the RMBS sector know when RMBS bond coupons are capped at the Net WAC. Additionally, investors have access to the information indicating that a transaction was experiencing a shortfall due to the application of such a cap through the trustee reports or common data sources.

Here are two of the Risk Factors from an example deal (ACE Securities Corp. Mortgage Loan Trust, Series 2007-D1) specifically addressing Basis Risk which is the main focus of S&P’s proposed criteria:

*“Limitations on Pass-Through Rates of the Offered Certificates will affect your yield to maturity. The rate at which interest accrues on each class of Offered Certificates is subject to the Net WAC Rate. If Mortgage Loans with relatively higher Loan Rates prepay, the Net WAC Rate on the Offered Certificates may be lower than otherwise would be the case. In this event, it is possible that the holders of the Offered Certificates would not receive distributions of interest at their respective stated fixed rate or LIBOR rate, as applicable. ... Although holders of the Offered Certificates may be entitled to receive any Basis Risk Shortfall Amount, there is no assurance that sufficient funds would be available on the related or on future Distribution Dates. **The ratings on the Offered Certificates do not address the likelihood of your receipt of any Basis Risk Shortfall Amount** [highlight added for emphasis].”¹*

The effects of modifications were also known to investors and often mentioned in the Risk Factors. In fact, the second risk factor of the example deal states:

*“The Servicer will have the authority to modify mortgage loans that are in default, or for which default is reasonably foreseeable, if such modifications are in the best interests of the Certificateholders and the Certificate Insurer and such modifications are done in accordance with the terms of the Pooling and Servicing Agreement. Loan modifications are more likely to be used when borrowers are less able to refinance or sell their homes due to market conditions, and when the potential recovery from a foreclosure is reduced due to lower property values. **A significant number of loan modifications could result in a significant reduction in cash flows to the Trust on an ongoing basis** [highlight added for emphasis].”²*

¹ ACE Securities Corp. Mortgage Loan Trust, Series 2007-D1, Prospectus, page 17

² ACE Securities Corp. Mortgage Loan Trust, Series 2007-D1, Prospectus, page 11

We understand that the high incidence of loan modifications precipitated by the financial crisis has amplified the expected Basis Risk by potentially lowering the interest rate on the underlying collateral. However, loan modifications are only permitted if they are a net benefit to the transaction (versus default). If the loan modifications were not done, the risk of reduced cash-flow would have been transferred to Default Risk. This risk was well known to RMBS investors and clearly stated in the offering documents.

In fact, tools such as Bloomberg and Intex used by RMBS investors to analyze their expected return on RMBS not only have the current WAC incorporated into the models, but also provide the investor with the ability to use the model to forecast the impact of additional modifications and WAC deterioration. So an RMBS investor not only understands that the cash-flows have a significant amount of variability, but has the tools to evaluate the future variability – the variability most important to that investor – with some precision. A rating based primarily on how much past interest rate receipts have varied from those that would have been expected had there been no reduction in the Net WAC Cap does not provide any additional useful information to that investor.

The proposal will damage current investors.

Some investors are restricted in the amount of BIG securities they can hold. If S&P were to downgrade an RMBS currently rated ‘AA’ to ‘D’ solely based upon an imputed promise breach, the result could be forced selling and market dislocation based on the confusion and potential investment guideline violations that it would create. RMBS securities rated ‘AA’ based on Assured Guaranty’s policy are appropriate for investors with rating restrictions, since the return of principal is guaranteed and the interest rate can be projected by the investor based on information readily available in the market. Yet the proposal could have the effect of benefiting hedge funds or other short term traders that are able to trade in below-investment grade securities at the expense of institutional holders that purchased the securities for the longer term, and that fully understand the risk, but are constrained by ratings requirements.

The proposal will cause confusion about Assured Guaranty’s guaranty.

Investors in Assured Guaranty’s insured securities expect to see their bonds rated AA by S&P because Assured Guaranty promises to pay what is owed under the terms of a security if the issuer does not pay. Investors in Assured Guaranty guaranteed bonds have received 100% of the principal and interest they are owed under the terms of the securities. The lowering of an insured bond’s rating under the proposal would not mean that investors are any less likely to receive the amounts owed to them under the terms of their securities. The rating of an insured bond should reflect the probability of an investor receiving the amounts explicitly promised.

Please consider this example: If two otherwise identical securities carried [a low rated Bond Insurer’s] [REDACTED] insurance and Assured Guaranty insurance, S&P’s proposed criteria could potentially result in the downgrade of both securities to ‘D’. All the information contained in the rating about the potential full recovery of contractually owed principal and interest through the insurance policy would be lost. It is doubtful that the change would have benefited anyone but a savvy trader, aware of the ultimate value of the bonds and the predicament of some sellers being unable to hold BIG securities, and able to trade accordingly.

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Rating an insured bond below the insurer's rating will create confusion in the market as to the value of the bonds and potentially the health of the insurer. The insurer is making all payments in accordance with the terms of the RMBS, and therefore, an investor expects the rating on the insured security to be no lower than the credit rating of the insurer.

The data necessary to properly calculate the threshold amounts specified in the criteria are not readily available.

Interest shortfalls in RMBS transactions can arise from multiple causes. From our experience as an investor in billions of dollars' worth of RMBS and with a large surveillance team overseeing hundreds of insured RMBS securities, we know that it will be extremely difficult (if not impossible) to determine if, and what portion of, a reduction in interest rates is due to modifications. In addition to removing the effect of any Relief Act or Prepayment Interest Shortfalls, the exercise would require reviewing the new terms of all modified loans to determine whether or not the loans have a feature where the rate will increase in the future (many rate modifications are stepped-fixed rate loans). Modifications might also have been forbearance modifications, where a significant amount of cash flow may appear in the transaction at some point in the future that currently has no associated bond balance (because the servicer treated the forbearance as a principal loss). These amounts could reimburse prior shortfalls and would need to be accounted for in S&P's analysis. It would also be necessary to analyze what portion of today's Net WAC shortfalls are due to higher rate loans either prepaying or defaulting out of the pool, and netting out such effect as if those loans were still part of the trust. Given the number of RMBS that S&P rates, it is not practical (and probably not possible) to accomplish such an analysis on the scale necessary to be consistent with the criteria proposed.

We note also that S&P offered no reason for the calculation of thresholds to be mostly backward-looking rather than forward-looking, or for using the original RMBS balance as the standard of measurement. The proposed approach appears to have no relation to how a current investor would evaluate the security.

The logic for calculating the threshold amounts is flawed.

The proposal focusses on the interest *rate* received by investors and how a lowered Net WAC Cap may not have been anticipated at closing. However, RMBS investors evaluate the entire cash flow they expect to receive from a security. Since modifications are offered to borrowers in danger of defaulting, defaults in transactions where no modifications were offered would have been much higher, increasing the total prepayment speed and reducing the nominal amount of interest received by the investor. To truly evaluate whether an investor is receiving the amount of interest (not just the interest rate) of the imputed promise, S&P would also need to include the impact of the extension of the weighted average life caused by the modifications assuming that some large portion of the modified loans would otherwise have defaulted. This type of analysis would further complicate the already nearly impossibly complex task of isolating and quantifying the impact of loan modifications on interest owed to investors.

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If it is necessary to adjust ratings, adding a subscript would be more appropriate.

We believe that straying from the principal of rating debt based on the probability of its repayment in accordance with its explicitly disclosed terms results in all of the problems described above, and we urge S&P to reconsider applying this approach to the reduction of Net WAC caps due to material loan modifications, at least for insured securities.

Using a subscript on the rating of all such securities would solve all of these problems. A subscript would communicate S&P's concern about the amount of interest being paid on these securities but without forcing most investors with ratings requirements to sell and, in the case of Assured Guaranty insured securities, without suggesting that Assured Guaranty will not make full and timely claim payments on all insured bonds. Moreover using a subscript would eliminate the need to develop a justifiable approach to setting and calculating thresholds.

Assured Guaranty believes S&P's rating would be most useful if applied to the probability the issuer will pay the RMBS (both principal and interest) in accordance with their terms, especially where a financial guarantor stands ready to pay claims to cover any shortfalls in amounts owed under the terms of the document. A new subscript indicating payment of interest on the RMBS has been impacted by the Net WAC cap would be useful to the market and would communicate the information S&P is endeavoring to communicate.

Alternatively, if S&P does not want to establish a new subscript, Assured Guaranty notes that insured RMBS with interest rates impacted by loan modifications have a lot in common with some of the other securities for which S&P will assign a subscript of 'P' in accordance with the "*Principles for Rating Debt Issuers Based on Imputed Promises*", dated December 19, 2014. As described above, the impact of loan modifications on a Net WAC cap, especially in light of the presence of stepped interest loan modifications, may in retrospect not be sufficiently measurable to be ratable. Using the 'P' subscript to restrict the rating to the principal portion of the promise is another approach that would both address and S&P's concern and avoid the very real damage S&P's current proposal would cause.

Best regards,



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Russell B. Brewer II
Chief Surveillance Officer

March 11, 2015

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Ladies and Gentlemen,

Thank you for calling to discuss our January 16, 2015 letter ("First Letter") on Standard & Poor's ("S&P's") proposed "*Methodology For Incorporating Loan Modifications And Extraordinary Expenses Into U.S. RMBS Ratings*". We would like to take this opportunity to vigorously renew our request that S&P consider the use of the "p" or similar subscript for insured residential mortgage backed securities ("RMBS") within the scope of the report.

RMBS investors are well aware of the basis risk in some U.S. RMBS whose current interest payments are constrained by Net WAC caps due to loan modifications. The damage and confusion S&P's proposed approach would cause to insured securities holders and Assured Guaranty is very real and vastly outweighs the benefits of the proposed change to S&P's methodology. The subscript approach we propose is consistent with S&P's imputed promise concept, and would minimize real economic damage to U.S. RMBS investors and Assured Guaranty.

As we noted in our First Letter, it has been clear to investors from day one that "loan modifications could result in a significant reduction in cash flows [due to reduced interest paid by borrowers] to the Trust on an ongoing basis"¹ and that "[t]he ratings ... do not address the likelihood of ... receipt of any Basis Risk Shortfall Amount."² There is no promise beyond the explicit promise of the payment of the Net WAC (and the guarantee of such payment by the insurer) and there was never a basis to expect (impute) anything more from these structures. In fact, investors who are negatively affected by a drastic downgrade to one of these securities in accordance with the proposed criteria may blame S&P for losses they sustain that are not consistent with the disclosed explanation of the ratings, which stated that the ratings do not address basis risk.

S&P's "*Principles for Rating Debt Issues Based on Imputed Promises*", December 19, 2014 ("Imputed Promises Criteria") discuss the use of a traditional rating qualified with a "p" subscript "denoting that the rating addresses only the repayment of principal and not any payments of interest"³. The subscript was created to communicate when the "par amount of principal is protected at all times during the life of the instrument"⁴, but the interest rate is tied to an index that may be at risk of market forces. Because of the strong parallel between this and any insured RMBS experiencing interest basis risk shortfalls, we again urge S&P use this concept to more effectively categorize insured RMBS that may be affected by the proposed criteria. This would preserve the information that the principal of such bonds is protected at the insurer's ratings level, but give additional information to the investor about the potential variability of the investment's yield. The Imputed Promises Criteria contemplates the following example:

¹ ACE Securities Corp. Mortgage Loan Trust, Series 2007-D1, Prospectus, page 11

² ACE Securities Corp. Mortgage Loan Trust, Series 2007-D1, Prospectus, page 17

³ Imputed Promises Criteria, page 4

⁴ Imputed Promises Criteria, page 7

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"A repack issuer issues a \$10 million, principal-protected note that matures in 10 years. The note is priced at par and backed by a \$10 million, zero-coupon, sovereign bond (issued by a sovereign rated 'AA+') that also matures in 10 years, and by the residual tranche of a prime RMBS transaction. The repack note has no stated coupon, but it does promise to pay "supplemental amounts" based on cash flows from the underlying RMBS tranche [emphasis supplied]. Is the repack security ratable? If so, would the rating have a 'p' subscript?"

Yes, the repack security is ratable, and would have a 'p' subscript added. Because the instrument does not promise any interest and the additional amounts are not credit-based (they come from a residual tranche), the assigned rating would be 'AA+p'."

If one applies the same logic to an insured RMBS:

"A ~~repack issuer~~ trust issues a \$10 million, principal-protected note that matures in 10 years. The note is priced at par and backed by a ~~\$10 million, zero-coupon, sovereign bond (issued by a sovereign~~ financial guaranty rated '[AA]') that also matures in 10 years, and by the ~~residual tranche of a prime~~ interest cashflows of an RMBS transaction. The ~~repack~~ note has no ~~static~~ stated coupon, but it does promise to pay "~~supplemental amounts~~" interest at the Net WAC based on cash flows from the underlying ~~RMBS tranche~~ mortgages RMBS tranche. Is the ~~repack~~ security ratable? If so, would the rating have a 'p' subscript?"

The situations above are analogous, which would lead us to believe the answer to the question posed in the second paragraph should be "Yes, the assigned rating would be 'AAp'." If S&P concludes the "p" subscript is not perfectly applicable, perhaps S&P should create a new, but similar subscript.

Following the above to its logical conclusion: If an existing bondholder created a one-bond repack security from an insured RMBS that S&P downgraded to 'D' under the proposed criteria, then had the principal payments of the repack guaranteed by a highly rated insurer, but simply passed through the Net WAC rate on the underlying tranche, it would fall squarely within the example described in the first paragraph above from S&P's own Imputed Promises Criteria. If the issuer brought the new repack security to S&P to be rated under the new criteria, S&P should rate it based on the guarantor's rating, with a "p" subscript. Yet, if the security underlying the repack was insured under identical terms by the same guarantor to begin with it would have identical cashflows but be rated 'D', pointing to a logical inconsistency in S&P's approach that can be cured by using a subscript on the underlying insured RMBS.

In summary, we believe the use of a subscript eliminates or greatly mitigates the economic damage to bond investors and Assured Guaranty that we identified in our First Letter (forced sales, loss of distinction between a security insured by Assured Guaranty and a similar security insured by a defaulting guarantor, and confusion about Assured Guaranty's rating) while still addressing the need for the theoretically consistent application of S&P's imputed promises criteria.

Best regards,



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