MEMORANDUM

TO: File No. S7-18-11

FROM: Timothy Fox
Division of Trading and Markets

DATE: April 18, 2012

SUBJECT: Meeting with Assured Guaranty

On April 18, 2012, staff of the Securities and Exchange Commission ("Commission") met with representatives of Assured Guaranty, Ltd. and its counsel. During the meeting representatives from Assured Guaranty discussed the Commission's proposed rules and rule amendments in accordance with Title IX, Subtitle C of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Release No. 34-64514). Participating on behalf of the Commission were Randall Roy and Timothy Fox from the Division of Trading and Markets and Abraham Losice and Jon Hertzke from the Office of Compliance Inspections and Examinations. Attending from Assured Guaranty was Bruce Stern. Also in attendance were Micah S. Green, Carolyn Walsh and Mara Giorgio from Patton Boggs LLP.

The topics of discussion included the matters covered in the presentation attached to this memorandum.

Assured Guaranty Meeting
Regarding Moody's Investors Service

April 18, 2012

ASSURED GUARANTY®
FAMILY OF COMPANIES

Overview

- **Need for oversight of securities rating agencies**
  - **Impact on investors in financial assets**
  - **Impact on issuers of financial assets, including municipal issuers**

- **Premise of rating agency oversight**
  - **A rational process is more likely to result in proper ratings**
  - **A rational process includes proper internal controls and transparency**

- **Objective of rating agency oversight**
  - **Properly derived ratings consistently applied**

- **Appropriate corrective actions**
  - **What is the role of the regulator when improper rating actions are taken?**

Background: Only Active Bond Insurer

- **Assured Guaranty is the only active participant in the financial guaranty insurance business**
  - **Primarily engaged in the insurance of municipal bonds**
  - **Business is originated through Assured Guaranty Municipal Corp. (“AGM”) and Assured Guaranty Corp. (“AGC”)**

- **The business of financial guaranty insurance is significantly dependent on its ratings**
  - **An insured security generally receives ratings equal to the higher of (a) the insurer’s ratings and (b) the ratings of the security on an uninsured basis**
  - **AGM’s and AGC’s ratings are currently “AA-/stable” from S&P and “Aa3/on review for possible downgrade” from Moody’s**

Background: 2011 Process and Outcome with S&P

AGM and AGC spent much of 2011 on S&P credit watch, as S&P developed and implemented new "Bond Insurance Criteria":

- **In Jan 2011, S&P solicited comments on proposed Bond Insurance Criteria**
  - **S&P stated that, if implemented, the new criteria were expected to result in multi-category rating downgrades for investment grade financial guaranty insurers**
  - ***Announcing a rating conclusion prior to a ratings analysis and an opportunity for rebuttal appears improper***
- **Extensive comments were received on the proposed criteria**
  - **S&P published a summary of the comments that were largely critical of the severity of the proposed criteria**
- **In Aug 2011, S&P adopted final criteria that did not relax the proposed criteria but instead added additional severe criteria (including a "large obligors test") not previously proposed**
  - ***Failure to address comments on proposed criteria and adoption of new criteria without an opportunity for comment appear improper***
- **In Sept 2011, S&P lowered AGM's and AGC's ratings from "AA+" to "AA-"**

Potential Impact of an Assured Downgrade

- **In March 2012, Moody's placed AGM's and AGC's ratings on review for possible downgrade**
- **More than $500 billion of AGM and AGC-insured securities would be subject to downgrade in the event of a downgrade of AGM and AGC**
- **A downgrade of AGM and AGC may decrease the "value-added" to municipal issuers that employ financial guaranty insurance in terms of market access and liquidity**

Moody's Process

- **On March 20, 2012, Moody's placed AGM's and AGC's ratings on review for possible downgrade, citing:**
  - **"Constrained business opportunities, reflecting lower origination volume and reduced demand for financial guaranty insurance across sectors**
  - **Continued economic stress in the U.S. (e.g. mortgage and municipal finance) and in Europe resulting in an elevated portion of Assured Guaranty's portfolio in risks assessed as below investment grade**
  - **Pressure on new business margins due to low interest rates and tight credit spreads"**

- **The announcement placing AGM's and AGC's ratings on review:**
  - ***Focused on origination volume rather than claims-paying ability***
  - ***Cited the impact of economic stress prior to sharing any analysis measuring stress losses against claims-paying resources***

Moody's Process (continued)

- **On March 26, 2012, Moody's published new "credit opinions" on AGM and AGC that appear to conclude that AGM and AGC satisfy Moody's "Aa" standards under Moody's rating methodology**
  - **Moody's last published its methodology for rating financial guaranty insurers in 2006**
  - **Moody's claims that it has not changed its rating methodology for financial guaranty insurers**

- **The March 26, 2012 "credit opinions" conclude as follows:**
  - **"What Could Change the Rating-Down:**
    - **Substantial narrowing of the firm's business opportunities**
    - **Greater acceptance of alternatives to bond insurance (including uninsured ori gination)**
    - **Material exposure, relative to capital, to sectors adversely affected by the financial crisis and current economic stress"**

- **The reasons expressed for possible downgrade:**
  - ***Appear inconsistent with Moody's published rating methodology***
  - ***Appear inconsistent with standards applied for other financial institutions***
  - ***Have not been published for comment as part of a proposed change in methodology***
  - ***Are not entirely consistent with the reasons cited 10 days earlier in Moody's March 20 announcement placing the ratings of AGM and AGC on review for possible downgrade***

Assured's Response to Moody's Announcement

- **On April 13, 2012, Assured published on its website a response to Moody's announcement concerning AGM's and AGC's ratings**
- **Assured's response included a review of all relevant metrics under Moody's existing rating methodology for financial guaranty insurers**
- **Assured's analysis supports rating AGM and AGC in the "Aa" range**
  - **Assured based its analysis on S&P's assumed losses on RMBS, since Moody's has not yet prepared its analysis of this sector**
  - **Assured provides data addressing Moody's concerns regarding market share, business opportunities, and premium rates**
- **Notably, since the onset of the financial crisis:**
- **Assured's claims-paying resources have grown from $11.2 billion to over $12.8 billion despite paying more than $4 billion in claims**
- **Assured's leverage (ratio of insured risks to capital or claims-paying resources) has declined significantly**

Rating Standards

- **To be useful to investors, ratings should be:**
  - **Based on valid and reasonable analytical principles**
  - **Supported by historical data or facts**
  - **Communicated in an open and transparent manner**
  - **Applied consistently throughout the universe of the rating agency's ratings**

Legal Standards That Apply to Ratings

- **The Dodd-Frank Act requires that rating agencies be consistent and transparent and act within their internal controls**
- **Rating agencies must act with “good faith and fair dealing” under applicable law**
- **Rating agencies are liable for their gross negligence or willful misconduct**

Requirements under the Dodd-Frank Act

- **<u>Consistency</u>: Material changes to rating methodologies must be applied consistently to all applicable credit ratings (Exchange Act § 15E(r)(2)(A); proposed Rule 17g-8(a)(3)(i))**

- **<u>Transparency</u>: Material changes to rating methodologies and the reasoning for such changes must be publicly disclosed (Exchange Act §§ 15E(r)(2)(C) & 15E(r)(3)(D); proposed Rule 17g-8(a)(4)(i))**

- **<u>Internal Controls</u>: Rating agencies must maintain an effective, well-documented internal control structure (Exchange Act § 15E(c)(3))**

Moody's is Neglecting its Legal Ratings Obligations

- Although early in the process, Moody's has published directional rating outlooks prior to

  - Moody's states that Assured's ratings could change *downwards* if there is meaningful exposure, relative to capital, to sectors adversely affected by the financial crises
  - Moody's implicitly states that Assured's ratings could not change *upwards* if Assured's capital is more than sufficient to cover any meaningful exposures

- Moody's indications with respect to the ratings' significance of market share, acceptance of alternatives to bond insurance, headline risk and earnings volatility are
  - Inconsistent with published rating criteria
  - Inconsistent with prior ratings history
  - Inconsistent with ratings applied to other financial institutions

Moody's Does Not Appear to Be Complying with Dodd-Frank Act Requirements

- **<u>Consistency</u>: Material changes to rating methodologies must be applied consistently to all applicable credit ratings (Exchange Act § 15E(r)(2)(A); proposed Rule 17g-8(a)(3)(i))**
  - ***Moody's appears to be applying criteria for rating financial guaranty insurers that Moody's is not consistently applying to other financial institutions***

- **<u>Transparency</u>: Material changes to rating methodologies and the reasoning for such changes must be publicly disclosed (Exchange Act §§ 15E(r)(2)(C) & 15E(r)(3)(D); proposed Rule 17g-8(a)(4)(i))**
  - ***Moody's appears to have implemented changes to its published methodology for rating financial guaranty insurers without prior public disclosure***

- **<u>Internal Controls</u>: Rating agencies must maintain an effective, well-documented internal control structure (Exchange Act § 15E(c)(3))**
  - ***Moody's internal control structure remains opaque and hence not subject to review by Assured***

Appendix: Table of Contents

Safe Harbor Disclosure

- Forward-looking statements are being made in this presentation that reflect the current views of Assured Guaranty Ltd. ("AGL" and, together with its subsidiaries, "Assured Guaranty" or the "Company") with respect to future events and financial performance. They are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Actual results could differ materially or change in out look from these statements. For example, Assured Guaranty's forward looking statements could be affected by:
  - rating agency action, including a ratings downgrade or change in outlook at any time of Assured Guaranty Ltd. or any of its subsidiaries and/or of transactions that AGL's subsidiaries have insured, both of which have occurred in the past;
  - developments in the world's financial and capital markets that adversely affect issuers' payment rates, Assured Guaranty's loss experience, its ability to cede exposure to reinsurers, its access to capital, its unrealized (losses) gains on derivative financial instruments or its investment returns;
  - changes in the world 's credit markets, segments thereof or general economic conditions;
  - more severe or frequent losses implicating the adequacy of Assured Guaranty's expected loss estimates;
  - the impact ofmar ket volatility on the mark-to-market of its contracts written in credit default swap form;
  - reduction in the amount of reinsurance portfolio opportunities available to Assured Guaranty;
  - deterioration in the financial condition of our reinsurers, the amount and timing of reinsurance recoverable actually received and the risk that reinsurers may dispute amounts owed to us under our reinsurance agreements;
  - the possibility that the Company will not realize insurance loss recoveries or damages from originators, sellers, sponsors, underwriters or servicers of residential mortgage-backed securities transactions;
  - decreased demand or increased competition;
  - changes in applicable accounting policies or practices;
  - changes in applicable laws or regulations, including insurance and tax laws;
  - other governmental actions;
  - difficulties with the execution of Assured Guaranty's business strategy;
  - contract cancellations;
  - Assured Guaranty's dependence on customers;
  - loss of key personnel;
  - adverse technological developments;
  - the effects of mergers, acquisitions and divestitures;
  - natural or man-made catastrophes;
  - other risks and uncertainties that have not been identified at this time;
  - management's response to these factors; and
  - other risk factors identified in Assured Guaranty's filings with the U.S. Securities and Exchange Commission (the "SEC").
- See Assured Guaranty's SEC filings and latest earnings press release and financial supplement, which are available on its website, for more information on factors that could affect its forward-looking statements. Do not place undue reliance on these forward-looking statements, which are made only as of April 18, 2012. Assured Guaranty does not undertake to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

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April 18, 2012