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Industry Report Card:

Subprime Mortgage Sector Brings Mixed Developments For Bond Insurers

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Industry Report Card:

Subprime Mortgage Sector Brings Mixed Developments For Bond Insurers

Commentary/Key Trends

What a difference a year has made for bond insurers. Last year's industry report card described the credit environment as generally benign, with the industry dealing with tight credit spreads and intense pricing competition. Currently, though, concerns about potential subprime mortgage losses are shaping the industry's operating environment--both for better and worse.

The unseen benefit of the subprime mortgage story is the positive development with respect to premium rates and business economics in the asset-backed sector. With investors now acutely focused on credit risk, credit spreads have widened, and demand in some sectors (notably mortgages and CDOs) has led to better pricing and structuring opportunities for bond insurers in the first half of 2007. In fact, the risk-adjusted pricing index (the weighted average premium rate divided by the weighted average capital charge) for the industry's insured structured transactions was 11.42% for the first half of 2007, the best result in several years. Thanks to this flight to credit quality, volume for insurers in the U.S. asset-backed market for the first six months of 2007 was up by 40.4% from the first six months of 2006. Unfortunately, it is business as usual in the public finance sector, as the repricing of risk has not occurred and spreads remain tight. The risk-adjusted pricing index for the public finance market was 4.71% for the first six months of 2007, the industry's lowest result ever.

Standard & Poor's Ratings Services has not yet viewed potential losses and higher capital charges due to ratings migration in the subprime mortgage and CDO of ABS sectors as being significant enough to affect credit ratings adversely. The results of our most recent stress test analysis ("U.S. Bond Insurers Withstand Subprime Stress," published on Aug. 2, 2007) showed that conservative theoretical deterioration of subprime RMBS as CDO collateral did not impair the respective companies' capital cushions. A capital cushion is the amount of capital that a company has in excess of the minimum capital requirement at its rating level. Nevertheless, as this is an evolving story, Standard & Poor's will continue to monitor, and report on, related developments. In light of our most recent round of rating revisions in the subprime mortgage and CDO of ABS sectors, we are currently reviewing new data in order to test the bond insurers' ability to withstand further subprime stress. Results of that review are forthcoming.

While subprime losses have not yet threatened ratings, they are affecting financial guarantors in other ways. Because credit spreads have widened so dramatically, some companies' third-quarter GAAP net income has been very depressed due to the marking to market of credit default swaps, as required under FASB statement 133. For those insurers with guaranteed investment contract (GIC) company affiliates that have invested in subprime-related investments, marking those investments to market, combined with marking credit default swaps to market, could deliver a solid one-two punch to GAAP equity. (Unrealized gains and losses for GIC assets do not flow through the profit and loss statement, but through the other comprehensive income adjustment to equity.) While this volatility is unpleasant, Standard & Poor's still believes that financial guarantor requirements under FASB 133 do not reflect actual transaction economics, as the bond insurers do not trade the swaps and the marks will zero out over time for the large majority of transactions, with their strong underlying credit quality ultimately yielding no claims. Insurers

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essentially run their GIC companies on a match-funded basis; combined with the very strong credit quality of the assets, this largely precludes any untimely asset sales and realized losses.

This earnings/balance sheet volatility, combined with the general concern of potential subprime losses, has seriously eroded the stock prices of all of the public bond insurers. Percentage declines from the stocks' 52-week highs range from mid-teens to as much as 60%. This somewhat diminishes the industry's financial flexibility, as these companies would be reluctant to have to issue stock at the current depressed prices.

The current cloud over the industry has also affected investors' auction-rate committed trust-preferred securities. These trusts invest in short-term, highly rated investments, and bond insurers use them as soft capital because they're allowed to put, or sell at a preset price, their preferred stock to the trusts. The rate paid on the securities is determined at auction, which generally occurs every 28 days. Several trusts have experienced dysfunctional auctions, with put premium rates increasing to a capped amount, leaving investors unable to liquidate their investments. While this is unfortunate for investors and perhaps indicative of a thinner-than-expected market for these instruments, the trust securities are working as designed; bond insurers do not have an unexpected liquidity obligation, and the instruments continue to provide the soft capital protection of a preferred stock put option.

In late September, Standard & Poor's assigned new 'AAA' ratings to affiliates of MBIA and FSA. MBIA Mexico S.A. de C.V. (MBIA Mexico) and FSA Seguros Mexico S.A. de C. V. (FSA Mexico) were established to allow their respective parent companies to continue to do business in Mexico despite recently enacted financial guaranty regulations. Although they are separate legal entities, Standard & Poor's views these units as consolidated units of MBIA and FSA for analytical purposes. MBIA Mexico and FSA Mexico both benefit from net worth maintenance agreements and reinsurance agreements that cede all insurance business to their larger U.S. affiliates. The U.S. insurers also carry out underwriting, risk management, and other operational responsibilities. Also in September, the Florida Supreme Court issued a ruling calling into question the validity of certificates of participation issued by Florida school districts, in which the bond insurers had several billion dollars of exposure. Fortunately, the court quickly remedied this uncertainty by holding a re-hearing on Sept. 28, 2007, that removed concerns over the validity of those instruments issued before the ruling.

Standard & Poor's recently released a request for comment relating to its approach to assessing the capital adequacy of the bond insurers. Standard & Poor's was the first (and for many years, the only) rating agency to model theoretical worst-case claims and capital resources. That deterministic model, in use since 1986, makes use of capital charges (which are worst-case loss estimates on individual transactions) to estimate worst-case portfolio losses. We also modify financial assets and other sources of revenue and expenses in a worst-case fashion, creating a seven-year pro forma balance sheet and income statement. Beginning in 2008, a new probabilistic capital adequacy model (PCAM) will supplement this model. PCAM will employ the latest Monte Carlo simulation techniques, providing an alternate look at an insured portfolio's theoretical losses at various confidence intervals. This approach will provide greater insight into the benefits of risk diversification while also identifying risk concentrations in an insured portfolio. PCAM's key output is the present value of theoretical losses at the 99.9 percentile confidence level over the entire life of the insurer's portfolio, which the model compares with the insurer's current adjusted capital resources to determine capital adequacy. The Monte Carlo methodology arrives at the 99.9 percentile confidence level by running many trials (in this case, 100,000 simulations) and observing the outcome. Although it is possible to select a higher confidence level, it would not necessarily result in an analytical solution that would provide stable results.

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Analytical Metrics

When most people think of Standard & Poor's rating criteria for bond insurers, capital adequacy measures quickly come to mind. However, issues other than capital--such as weak earnings, business condition deterioration, unsatisfactory governance procedures, unacceptable risk tolerance, and inadequate risk management procedures--have triggered a greater number of rating actions over the years. Standard & Poor's rating process involves both qualitative and quantitative analysis. The use of ratios and other measures facilitates the quantitative analysis of financial, risk, business, and capitalization factors. The qualitative analysis of a company's management--strategic planning or governance, for example--incorporates a different set of metrics used by Standard & Poor's analysis. A sample of some of these metrics follows.

Financial Metrics

Financial performance below peer norms or investor expectations can affect a company's ability to raise or retain equity. The operating return on equity has become an important measure of financial performance, with the traditional return on equity measurement becoming less useful due to the mark-to-market requirements of FASB 133. The numerator is after-tax net income, as reported, with the effects of net realized gains and losses, net gains and losses on derivative instruments and foreign exchange, income and losses from discontinued operations, and other nonrecurring items excluded. The denominator is the average of shareholders' beginning-of-year and end-of-year equity, as reported.

The liquidity ratio measures cash and liquid resources against conservatively defined potential liquidity uses. It should generally exceed 1x.

Resources include:

- Cash and short-term investments;
- Treasury and government agency fixed-income securities, with a 10% haircut;
- Corporate and ABS/MBS bonds, with a 50% haircut;
- Municipal repo line, with a 10% haircut;
- Bank lines of credit; and
- Other resources, with appropriate haircuts.

The denominator (uses) includes (in the coming year):

- The largest municipal default for any performing or nonperforming insured credit;
- The largest bullet maturity default for any performing or nonperforming insured credit;
- The largest debt service reserve draw for any performing or nonperforming insured credit;
- 90 days of payments associated with a company's largest theoretical servicer default;
- The largest potential unscheduled draw on a municipal investment contract;
- The largest individual single-name credit default swap or common single name in defaulted synthetic structures; and
- Holding company debt and dividend servicing needs.

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Risk Management Metrics

These measures, and others, focus on changes in risk profile or risk appetite.

Standard & Poor's assigns capital charges to each insured transaction but also evaluates them collectively, reviewing them both in terms of individual company trends and for peer comparisons. Deviation from historical results could be indicative of a shift in business or risk appetite. The capital charge is Standard & Poor's principal credit risk measure. Capital charges determine losses in our capital adequacy model. Evaluation of capital charges can be on an absolute or relative basis.

Standard & Poor's reviews a company's risk-adjusted pricing index (formerly referred to as the profitability index) for company trends and peer comparisons. The index, which can provide insight into pricing and/or underwriting discipline, is a ratio of the weighted average premiums rate for a book of business in a given period and sector divided by the weighted average capital charge for the same book of business.

Holding Company Financial Risk Metrics

These measures focus on the risk associated with debt and hybrid capital in the overall capitalization of a bond insurance holding company; they also set general limits and expectations.

The hybrid security tolerance ratio (hybrid securities plus contingent capital facilities) generally cannot exceed 20% of a holding company's capital structure. Contingent capital facilities are included in this calculation even though a subsidiary may issue them. The formulaic expression of the total hybrid security tolerance ratio for a bond insurance holding company is (hybrid securities + contingent capital)/(capital + hybrid securities + contingent capital).

Holding company debt/capitalization is generally about 15% for 'AA' rated holding companies. The numerator is total holding company debt, excluding debt associated with variable interest entities (VIEs) and spread lending businesses (including hybrids not qualifying as equity). The denominator is the same value as the numerator, plus shareholders' equity as reported (this includes hybrid securities).

Pretax interest coverage on a GAAP basis is generally expected to be above 15x for 'AA' rated holding companies. The numerator is pretax income plus interest expense, excluding interest on VIE debt and spread lending debt, plus the net put premium on committed capital facilities. The denominator is the same interest expense as the numerator.

Competitive Position Metrics

Competitive position metrics quantify the extent to which a company has a significant business position in core domestic and international markets.

Market position and violability is assessed using a five-year compound growth rate for net par outstanding, gross par written, and adjusted gross premiums written.

Business volume trends are reviewed using gross par written and adjusted gross premiums written, broken down into four segments: U.S. municipal, U.S. structured finance, non-U.S. municipal and project finance, and non-U.S. structured finance.

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Capitalization Metrics

These measures address the adequacy and quality of a bond insurer's capital and soft capital. The margin of safety is Standard & Poor's principal measure of capital adequacy. Using output from our capital model at the end of the seven-year modeling period, we define this metric as total cumulative net losses plus ending capital, divided by total cumulative net losses. The numerator is cumulative net losses from over the seven-year modeling period plus the ending pro forma statutory capital position at the end of year seven. The denominator is the cumulative net losses from the numerator. Companies rated 'AAA' should have a minimum margin of safety of 125%, 'AA' rated companies should have a minimum margin of safety of 100%, and 'A' rated companies should have a minimum margin of safety of 80%.

The reliance on soft capital ratio indicates when a company is overly reliant on third-party capital. We calculate this metric as total soft capital divided by total depression capital. The numerator is the sum of drawn and undrawn soft capital, drawn and undrawn owner commitments, and reinsurance claims paid during the capital modeling period. The denominator is ending capital plus gross losses plus undrawn soft capital plus undrawn owner commitments. This ratio should generally be less than 33%.

The alternative margin of safety is a metric that measures the sensitivity of a bond insurer in a worst-case environment to a failure by its largest reinsurer or soft capital provider. The capital adequacy model gives no credit to claims paid or capital infused by that entity. The expectation is for the alternative margin of safety to be above 120% for a 'AAA' rated company, 95% for a 'AA' rated company, and 75% for a 'A' rated company.

Qualitative Metrics

Qualitative analysis can aid in evaluating management and governance quality and determine the quality of a bond insurer's risk management function.

Standard & Poor's does an annual internal assessment of the quality of each company's management and corporate governance practices. Analysts assess approximately 20 factors related to topics in these categories; the results help prioritize and direct further research. Standard & Poor's research of defaulted credits indicates that the presence of weak assessments may be indicative of potential credit deterioration.

Examples of topics considered in this process include:

- History of financial restatements, material restructurings, write-offs, core asset sales, and layoffs; and
- Over-reliance on, or excessive power or domination by, a CEO and/or others, as well as high turnover of senior executives.

The components of our enterprise risk management review include the topics of risk management culture, strategic risk management, risk control process, emerging risk management, and risk and economic capital models. Within the strategic risk management category, for example, we score staffing and organizational structure and the influence of risk management staff as strong, adequate, or weak. In the risk and economic capital model category, we rank risk assessment models and economic models as strong, adequate, or weak.

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Chart 1

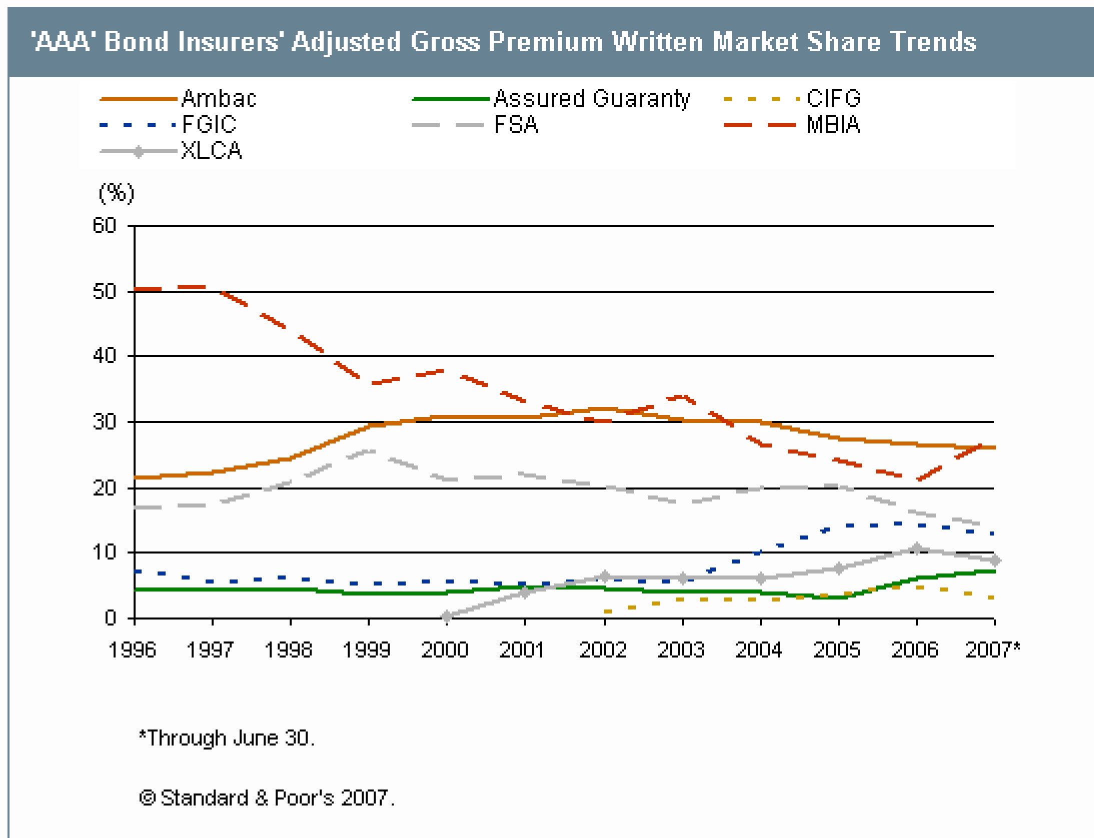

Table 1

Company/Financial Strength Rating/Outlook/Comments	Analyst
Primary Bond Insurers	
ACA Financial Guaranty Corp. (A/Stable) ACA produced significantly improved operating results for the first six months of 2007. However, the company's financial results were affected by significant charges relating to other than temporary impairments of investments in managed CDOs and unrealized market-to-market valuation losses on structured credit transactions that reflect deterioration in the performance and valuation of securities backed by subprime mortgages. Of all the bond insurers, ACA is by far the most exposed to subprime mortgages through the CDOs it insures and through its CDO asset management business. ACA Capital Holdings Inc., ACA's parent, reported a GAAP net loss of $81.9 million for the first six months of 2007, compared with a net income of $26.2 million for the same period in 2006. Contributing to the loss was a $80.7 million negative swing in the pretax value of net unrealized losses on insured credit swaps and a $109.6 million negative swing in pretax value of other than temporary impairments on consolidated CDOs. Some $46.9 million of these impairments are in excess of the company's equity investment in the CDOs and will be recognized as a gain when the related CDO either matures or is deconsolidated. On an operating basis, gross par written was up 116% to $23.2 billion, with the structured credit segment accounting for the vast majority of the year-to-year gain. In the structured finance segment, where gross par written was up 118% to $22.7 billion, the credit quality of the transactions remained quite high (an 'AAA' average). Premium rates were higher, leading to improved transaction economics. In the public finance segment, gross par written totaled $581 million, up 68%. However, the risk level of the transactions rose significantly and premiums rates rose by less than the increase in risk, resulting in sharply lower transaction profitability. For the company's CDO management business, eight CDOs have closed as of June 2007, bringing the total number of managed CDOs to 28. Assets under management grew to $17.9 billion as of June 30, 2007, up from $15.7 billion at year-end 2006. The capital adequacy margin of safety improved to 1.2x-1.3x in 2006 from 1.0x-1.1x in 2005 on the strength of the strong actual and projected highly profitable new business origination in the structured credit segment, along with a reduction in risk in the CDO origination segment due to ACA's lower participation in the equity tranches. The 2006 margin of safety compares favorably with Standard & Poor's minimum requirement of 0.8x for an 'A' rated bond insurer. Higher capital charges and actual losses on subprime-related exposures will erode the strong year-end 2006 capital position in 2007; however, stress test results suggest there is sufficient capital to withstand the assumed higher level of losses without threatening the rating. On Oct. 15,	Dick Smith

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2007, ACA Capital Holdings Inc. reported it had entered into an amendment to its $250 million credit agreement. The effect of the amendment is that borrowings under the agreement will not be currently available and would only be available in the future if the company's net worth exceeds $500 million. The credit facility is a component of the company's liquidity management resources, but was never considered as capital for capital adequacy testing purposes. Current liquidity needs are minimal but would escalate substantially to meet collateral posting requirements if Standard & Poor's lowered ACA's financial strength rating below 'A-' and/or losses on certain structured credit transactions exceed very high thresholds.

Ambac Assurance Corp. (AAA/Stable) Ambac's holding company, Ambac Financial Group, Inc., reported consolidated net income of $25.8 million for the first nine months of 2007, down 96% from the same period the previous year. Net mark-to-market losses on credit and total return derivatives of $756.3 million recorded in the third quarter dominated the nine-month results in 2007. The comparable figure for the full nine months of 2007 is a loss of $816.0 million, representing a $832.5 million negative swing versus the first nine months of 2006. Dramatically lower prices for subprime mortgage securities and for CDOs containing subprime collateral drove the mark-to-market losses. These lower prices reflected the uncertainty regarding the ultimate level of subprime losses that will be realized, as well as reduced liquidity in the market and forced selling by certain investors. Operating income, which excludes the effect of net security gains or losses, was up 1% year over year. New business production showed solid growth, particularly in the third quarter. Gross par insured in the first nine months of 2007 was $103.9 billion, up 8% from the same period in 2006. The U.S. structured finance sector, which accounted for 44% of total par insured, was the only sector to decline; its 12% drop reflected the slowing in the subprime mortgage and CDO segments. The international segment, which represented 15% of total par insured, was strong, posting a 18% increase on the strength of a large Eurotunnel transaction and several other significant transactions across many geographic locations. The U.S. public finance segment, which represented 41% of the 2007 volume, was up 35%, led by strong gains in the GO, utility, and transportation segments. Adjusted gross premiums written ('credit enhancement production' in Ambac terminology) for the first nine months of 2007 were up 13% compared with the same period in 2006, led by a 19% gain for public finance. The greater increase in adjusted premiums written (13%) versus net par written (8%) is partly the result of wider spreads, particularly in the structured finance markets. Financial guaranty underwriting and operating expenses were up 4% for the first nine months of 2007 compared with the same period in 2006. Strong expense controls have contributed to Ambac's consistent ability to produce industry-leading returns on equity. Capital adequacy has been consistently strong, with a margin of safety of 1.3x-1.4x at Dec. 31, 2006. The benefits of slightly lower municipal and asset-backed capital charges were largely offset by increased dividend requirements relating to the parent company's issuance of $400 million of hybrid equity securities in early 2007. Total speculative-grade exposures were $4.7 billion as of Sept. 30, 2007, down from $5.4 billion at Sept. 30, 2006. Moreover, the level of speculative-grade exposure as a percent of statutory capital declined to 67% at Sept. 30, 2007, from 87% a year earlier.	Dick Smith
Ambac Assurance (U.K.) Ltd.(AAA/Stable) Rating largely dependent on affiliate Ambac Assurance Corp.	Dick Smith
Assured Guaranty Corp.(AAA/Stable) Assured Guaranty Corp.'s (AGC) rating reflects improving direct business results, conservative underwriting, and a strong capital position. The present value of premiums written in the first half of 2007 was $187.7 billion, a 34% increase from the first half of 2006. Operating income for the company was $55.7 million for the first half of 2007, a 74% increase from the first half of 2006. Underwriting conservatism is in evidence relative to the company's subprime exposure. The company only has about $453 million in CDO exposure with subprime collateral. Its RMBS subprime exposure of $5.1 billion has a weighted average rating of 'AA+'. A conservative sensitivity analysis that generated theoretical losses and higher capital charges for the 2006 subprime book of business was only a small percentage of the company's capital in excess of 'AAA' requirements. AGC's statutory capital as of June 30, 2007, was $933.8 million. The company's margin of safety fell in a range of 1.5x-1.6x as of Dec. 31, 2006.	Robert Green
Assured Guaranty (U.K.) Ltd.(AAA/Stable) Rating largely dependent on affiliate Assured Guaranty Corp.	Robert Green
CIFG Guaranty(AAA/Negative) For the first six months of 2007, gross par written totaled $11.4 billion, down 28% from the same period in 2006. In the distribution of gross par written for the period, U.S. structured finance represented 33%, U.S. public finance 30%, and international business 37%. The overall decline in gross par insured was driven by a 51% decline in U.S. structured finance gross par insured. While total gross par written was down 28%, total adjusted gross premiums written were down just 23%. The smaller decline in adjusted gross premiums written compared with par written is due to strong pricing trends in the U.S. structured finance business line. The recent move of CIFG Holding Ltd. and CIFG Guaranty Ltd. to Bermuda should improve profitability and strengthen the company's capital base through the greater retention of earnings in the tax-favorable environment. In terms of the company's negative outlook, management has begun to take steps to address concerns relating to the effectiveness and processes of the company's board, corporate governance, appropriate succession planning, and the degree of long-term support to be provided by its parent Natixis S.A. It is worth noting that Natixis has taken over the debt and committed capital facility previously provided by Caisse Nationale des Caisses d'Epargne et de Prevoyance (for a combined funded and unfunded commitment of $200 million) and contributed $100 million in 2007 to support business growth and improve the company's single risk limits. While steps have been taken to address Standard & Poor's concerns, the effectiveness of these changes can only be judged over time.	David Veno

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CIFG Europe(AAA/Negative)
Rating largely dependent on affiliate CIFG Guaranty. David Veno

CIFG Assurance North America Inc.(AAA/Negative)
Rating largely dependent on affiliate CIFG Guaranty. David Veno

Financial Guaranty Insurance Co.(AAA/Stable)
The 'AAA' financial strength and financial enhancement ratings for Financial Guaranty Insurance Co. (FGIC) reflect (in the context of new owners and an expanded business plan) the solid management team assembled by the company, expectations for continued financial performance improvement, continued conservative underwriting, and adequate capitalization at the rating level. In support of the broader underwriting initiative, expansion and new procedures have been undertaken in the credit and portfolio risk management areas. For the first six months of 2007, the core GAAP net income for holding company FGIC Corp. was $132.0 million, a 27% increase from the first half of 2006. Core net income excludes mark-to-market volatility and net investment gains and losses. In terms of new business production, the adjusted gross premium (AGP) written in the first half of 2007 was $337 million, a 17% decrease from AGP written in the first half of 2006. FGIC's net insured portfolio totaled $314 billion as of June 30, 2007. About 83% of the insured portfolio had underlying credit ratings of 'A' or better. About 0.5% of the insured portfolio had underlying ratings of non-investment grade. Total claims paying resources were $5 billion as of June 30, 2007, compared with $4.7 billion as of Dec. 31, 2006. As of June 30, 2007, FGIC had subprime RMBS exposure of $8.8 billion and CDO net par insured of $10.3 billion with 54% subprime collateral. A sensitivity analysis of FGIC theoretical losses to its capital cushion for its 2006 business indicated that those losses were about 32% of its capital cushion, excess capital at the 'AAA' level. This was the highest such ratio among the 'AAA' primary companies. Robert Green

FGIC UK Ltd.(AAA/Stable)
Rating largely dependent on affiliate Financial Guaranty Insurance Co. Robert Green

Financial Security Assurance Inc.(AAA/Stable)
The 'AAA' financial strength and financial enhancement ratings of Financial Security Assurance Inc. and its related intercompany pool members (FSA Insurance Co. and Financial Security Assurance International Ltd., known together as FSA) reflect the company's strong capital position, conservative underwriting and risk management standards, and business flexibility associated with a global business operating in all financial guaranty sectors. The present value of premiums for holding company Financial Security Assurance Holdings Ltd. was $415 million for the first half of 2007, down slightly from $425 million for the first half of 2006. For the first half of 2007, operating earnings were $193.4 million, an 8% increase from June 30, 2006, results. Operating earnings exclude hedge and credit default swap mark-to-market volatility. The insured portfolio as of June 30, 2007, was $399.2 billion, up from $361.7 billion on June 30, 2006. As of June 30, 2006, the rating distribution of the net insured portfolio was 24.5% rated 'AAA', 32.4% rated 'AA', 30.6% rated 'A', 12.2% rated 'BBB', and 0.3% rated below investment grade. Qualified statutory capital as of June 30, 2007, was $2.6 billion, up from $2.5 billion on Dec. 31, 2006. FSA is well positioned with respect to its subprime exposure. FSA has limited 2006 exposure for its subprime RMBS portfolio; the weighted average rating of this $3.8 billion portfolio is 'AA+'. FSA has generally chosen not to participate in the CDOs of ABS sector; its exposure is a very modest $373 million, and all of its insured tranches have underlying ratings of 'AAA'. Robert Green

Financial Security Assurance (U.K.) Ltd.(AAA/Stable)
This is a dependent rating of Financial Security Assurance Inc. Robert Green

FSA Seguros Mexico S.A. de C.V.(AAA/Stable)
This is a dependent rating of Financial Security Assurance Inc. Robert Green

MBIA Insurance Corp.(AAA/Stable)
For the first nine months of 2007, MBIA reported a 103% increase in adjusted gross premiums written and a 93% increase in gross par written from the same period in 2006, with the company experiencing solid growth in each business line. The competitive pressures that exist in the industry have had varying degrees of impact on the company's risk-adjusted pricing indices. The bright spot for the company is that its U.S. structured finance business line exhibited the strongest growth and economic trends among its four business lines. For this business line, adjusted gross premiums written increased 275% from 2006's level and represented 50% of adjusted gross premiums written. Sectors contributing to this increase in production were CDOs (no CDOs were closed in the first quarter of 2006), aircraft securitization, and commercial mortgages. Due to the amount of high-quality CDO business, MBIA reported a U.S. structured finance risk-adjusted pricing index of 11% for the first six months of 2007, the best in the company's history. MBIA also reported strong growth U.S. public finance business line--the other major contributor to premiums and par written--for the first nine months of 2007. As of Dec. 31, 2006, through the use of Standard & Poor's capital adequacy test, MBIA's margin of safety was in the 1.3x-1.4x range. Although the model results included extraordinary dividends to support the company's $1 billion share repurchase, $500 million of those dividends have not been upstreamed to the holding company. Therefore, the $500 million-$550 million cushion above Standard & Poor's minimum 'AAA' required capital at year-end 2006 was actually in excess of $1 billion. Further strengthening the year-end margin of safety is the retirement of $1.6 billion of speculative-grade Eurotunnel exposure from the insured portfolio in the second quarter of 2007 after implementing the Safeguard Plan. With the level of capital cushion, David Veno

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combined with improvement in the quality of business written in 2007, MBIA should be able to withstand the stress of the subprime market without suffering significant deterioration in its margin of safety. Standard & Poor's has previously commented that MBIA's $342 loss for the third quarter due to mark-to-market on credit derivatives under FASB 133 has introduced an element of earnings volatility that has little bearing on either the likelihood of a potential claim or the intrinsic earnings power of a bond insurer. We believe that insurers' loss reserves are more appropriate indicators of potential claims, and Standard & Poor's capital charge evaluations are more appropriate indicators of changes to the credit profile for any of the bond insurers' insured sectors.

MBIA Assurance S.A.(AAA/Stable)
Rating largely dependent on affiliate MBIA Insurance Corp. — David Veno

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MBIA Insurance U.K. Limited(AAA/Stable)
Rating largely dependent on affiliate MBIA Insurance Corp. — David Veno

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MBIA Mexico S.A. de C.V.(AAA/Stable)
Rating largely dependent on affiliate MBIA Insurance Corp. — David Veno

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PMI Guaranty Co.(AA/CreditWatch Negative)
PMI Guaranty Co.'s (PMIG) 'AA' financial strength and financial enhancement ratings were placed on CreditWatch Negative on Oct. 19, 2007, concurrent with the CreditWatch on parent and affiliate The PMI Group and PMI Insurance Co. The rating actions on PMI Group and PMI Insurance Co. reflect higher-than-expected losses of $350 million incurred in the third quarter, suggesting near-term operating results that are below expectations. PMIG's capitalization includes a guaranty and support agreement from PMI Group and PMI, respectively. The guaranty is uncapped and the support agreement is for a maximum of $650 million. In addition, PMI Insurance Co. is an integral part of the credit and risk management process of PMIG. PMIG is a niche bond surety company providing both direct and reinsurance capacity to the financial guaranty insurance sector. It began operations in late 2006. The ratings will likely be removed from CreditWatch and affirmed with a negative or stable outlook if Standard & Poor's concludes PMI Insurance Co.'s near-term operating performance is not significantly different than its peers and that the group is unlikely to report an underwriting loss in 2009. The rating could be lowered by one notch if Standard & Poor's believes PMI's Insurance Co.'s operating performance compares unfavorably with its peers in the next two years or the group is likely to report an underwriting loss for 2009.

Robert Green

Radian Asset Assurance Inc.(AA/Stable)
Radian Asset Assurance Inc.'s financial strength rating is 'AA' and its outlook is stable. The rating reflects appropriate capital at the rating level, as well as enhancements that the company has made to its underwriting and risk management areas. Business prospects for Radian Asset are being adversely affected by the aborted merger between its parent the Radian Group and the PMI Group, and by the subprime-related losses suffered by Radian Group and its mortgage insurance subsidiaries. On Sept. 25, 2007, the ratings on Radian Group and its mortgage insurance subsidiaries were removed from CreditWatch and affirmed with a negative outlook. Gross premiums written in the first half of 2007 declined to $106.7 million, down from $137.4 million in the first half of 2006. Net income for the June 30, 2007, period was $71.0 million, up from $45.3 million from the same period the previous year. The insured portfolio totaled $110.5 billion as of June 30, 2007, up from $90.6 billion as of June 30, 2006. Consistent with the company's rating and niche market position, about 2.1% of the insured portfolio is rated below investment grade or unrated. Against this risk, the company has a total of $2.8 billion in claims-paying resources, of which the largest component is statutory capital of $1.4 billion. As of Dec. 31, 2006, Radian Asset's margin of safety was in the 1.2x-1.3x range, which is acceptable for 'AA' rated financial guarantors. While the company has nominal subprime exposure of $549 million of RMBS exposure and $765 million of CDO exposure, one of the CDOs has market value risk. Net of equity, the current mark-to-market loss on this transaction is about $40 million. This amount has been offset by a $100 million capital contribution from Radian Group in the third quarter of 2007.

Robert Green

Radian Asset Assurance Ltd. (U.K.)(AA/Stable)
Rating largely dependent on affiliate Radian Asset Assurance Inc. — Robert Green

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XL Capital Assurance Inc.(AAA/Stable)
For the first nine months of 2007, XLCA reported $366.4 million in adjusted gross premiums written, a 12% increase from the same period in 2006. Adjusted gross premiums for the U.S. structured finance business line rose 54%, but a 29% decrease in U.S. public finance adjusted gross premiums written suppressed the strong growth in premiums written for this business line. Adjusted gross premiums relating to the international business line rose 22% to $125.3 million, mostly due to strong growth in the third quarter. Activity in the CDO and consumer asset-backed sectors was a major cause of fhe increase in U.S. structured finance volume. Several large U.S. public finance transactions completed in the first half of 2006 and not repeated in 2007, lowered pricing, and decreased spreads were reasons for the reduction in U.S. public finance insured volume. Standard & Poor's does not expect any ratings or outlook changes on XLCA or XL Financial Assurance Ltd. resulting from Security Capital Assurance Ltd.'s (SCA) reported third quarter 2007 mark-to-market loss of $143 million associated with its credit derivatives portfolio under FASB 133. Standard & Poor's has previously commented that mark-to-market losses on credit derivatives introduce an element of earnings volatility that has little bearing on either the likelihood of a potential claim or the intrinsic earnings power of a bond insurer. We believe that insurers' loss reserves are more appropriate indicators of potential claims; in this case, SCA, except for the required mark-to-market accounting treatment, would not have taken any reserves on its credit derivative business in the third quarter. As for changes in quality of the insured portfolio, Standard & Poor's capital charge evaluations are more appropriate indicators of changes to the

David Veno

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credit profile of an insurer's insured portfolio.

XL Capital Assurance (U.K.) Ltd.(AAA/Stable)
Rating largely dependent on affiliate XL Capital Assurance Inc. David Veno

Reinsurers

Assured Guaranty Re Ltd.(AA/Stable)
Assured Guaranty Re Ltd. and its subsidiaries--Assured Guaranty Re Overseas Ltd. and Assured Guaranty Mortgage Insurance Co.--are collectively known as AGR. AGR's strategic relationship with 'AAA' rated sister company Assured Guarantee Corp. (AGC) should provide it with a source of ongoing, diversified investment-grade reinsurance business. According to AGC's business plan, the company will cede about 30% of its annual gross par written to AGR. AGR also benefits from technical and administrative assistance from AGC. Gross premiums written in the first half of 2007 were $73.5 million, down from $98.5 million for the first half of 2006. AGR's net insured portfolio totaled $67.3 million as of June 30, 2007. The underlying rating distribution of the company's insured portfolio was 28.7% in the 'AAA' category, 23.4% in the 'AA' category, 29.2% in the 'A' category, 18.2% in the 'BBB' category, and 0.5% in the non-investment grade category. Total claims-paying resources for the company as of June 30, 2007, were $1.5 billion and included statutory capital of $787 million, unearned premium reserves of $459 million, and the present value of premiums of $219 million. Claims-paying resources were $1.4 billion as of Dec. 31, 2006. David Veno

BluePoint Re Ltd.(AA/Stable)
The rating reflects BluePoint's strong capital position and prudent underwriting and risk-management guidelines, along with strong operating support and oversight provided by the company's 100% owner, Wachovia Corp. BluePoint is a Bermuda-domiciled, financial guarantee reinsurance company founded in November 2004. The company provides treaty and facultative reinsurance capacity to the primary monoline bond insurers. For the first six months of 2007, BluePoint's net par written was $6.7 billion, up 93% from the $3.4 billion written in the first half of 2006. Of the $22.4 billion par outstanding as of June 30, 2007, roughly 47% was from treaties and 53% was in the form of facultative cessions. Over time, the treaty-sourced component of par outstanding has been declining; as of June 30, 2005, treaty business represented 71% of par outstanding. From a sector standpoint, net par outstanding as of June 30, 2007, was 58% public finance and 42% structured finance. The company expects the percentage of public finance business to decline, with structured finance business representing the greater proportion of new business written. For the first six months of 2007, BluePoint had GAAP net income of $7.8 million, compared with $8.3 million for the first six months of 2006. Causing the decrease was $9.1 million of negative marks to market on credit derivatives reflecting the substantial spread widening that took place in the first half of the year, particularly on subprime mortgage-related collateral. These credit derivatives are written on senior tranches of transactions where BluePoint's attachment points are in excess of the 'AAA' level. Assuming that losses in these transactions do not extend into BluePoint's insured layer, all the current negative marks to market will zero out over the remaining lives of the obligations. Exposure to subprime mortgages through individual mortgage transactions or through CDOs that contain subprime collateral is modest, and we do not expect it to become a threat to BluePoint's rating. On an operating basis, BluePoint recorded substantial growth in net premiums earned, reflecting growth in the company's outstanding book of business. Wachovia has demonstrated its strong commitment to the business by agreeing not to take capital or dividends out until October 2009. This retention of earnings contributes to the company's margin of safety of 1.3x-1.4x, a level that is comfortably in excess of the 1.0x minimum for an 'AA' rated bond insurer. BluePoint's underwriting and risk management operating procedures and guidelines are prudent and consistent with its 'AA' rating. The ratings are also consistent with Standard & Poor's current assessment that monoline financial guarantee reinsurers should be rated no higher than 'AA' until they can demonstrate an ability to successfully avoid the adverse selection, lower return, and slower growth that differentiates this industry from the primary bond insurers. Dick Smith

Channel Reinsurance Ltd.(AAA/Stable)
Channel Re is a Bermuda-based financial guaranty reinsurance company established to provide stable, highly-rated reinsurance capacity to MBIA Insurance Corp. (MBIA). The company's investors include Renaissance Re Holdings Ltd., MBIA, Partner Reinsurance Company Ltd., and Koch Financial Re Ltd. Channel Re's only source of business is a share of MBIA's treaty, as well as transactions ceded on a facultative basis. For the first six months of 2007, the global structured finance business line represented 92% of adjusted gross premiums written. Premiums related to CDO business represented approximately 77% of global structured finance adjusted gross premiums written. Because all CDO business is written on a facultative basis, management has been selective in what it will insure and has only assumed transactions that are 'AAA' layers of risk. As for the public finance business line, U.S. public Finance volume dropped by 29% from 2006 while international public finance business line remained stable. In fact, the $2.6 million of international public finance adjusted gross premiums written was more than twice the amount of premiums written for the U.S. public finance business line. The reason for the decline in U.S. public finance volume is that MBIA raised the attachment point of its treaty in 2006 so that many of the transactions are no longer available to any reinsurer, although a few transactions did come through the treaty. The company's risk-adjusted pricing index for each business provides an indication of how successful management has been at protecting the company from adverse selection. Each business line's profitability, as measured by Standard & Poor's risk-adjusted pricing index, was higher than the industry average. David Veno

RAM Reinsurance Co. Ltd.(AAA/Negative)
Financial results for the first half of 2007 for RAM Reinsurance Co.'s holding company, RAM Holdings Ltd., reflect higher premiums Dick Smith

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earned and net investment income, recoveries on previously defaulted transactions, and reduced levels of operating expenses, offset to a degree by higher interest expenses. This resulted in net income of $23.4 million, up 25% from the $18.8 million reported in the same period in 2006. The greatest contributors to the gain in net income were a 25% increase in premiums earned, reflecting the growing book of business, and a 44% increase in net investment income, reflecting a $75 million increase in invested assets from the sale of hybrid equity late in 2006. Although recoveries on previously defaulted bonds were lower in 2007 than in 2006, restraining the year-to-year growth in net income, they nevertheless contributed to the level of net income, since it is unusual and not sustainable for insurers to be reporting recoveries rather than losses. The higher interest expenses reflect the servicing costs of the new hybrid equity. The solid gain in net income for the first half of 2007 is a step in the right direction for the company in addressing its historically below-average earnings and returns on equity, which led to the outlook being revised to negative in July 2006. On an operating basis, adjusted gross premium written in the first half of 2007 totaled $70.5 million, up 106%, with non-U.S. public finance the greatest contributor to the increase. RAM Re's capital adequacy is strong, as reflected in a margin of safety of 1.7x-1.8x as of Dec. 31, 2006, up from 1.3x-1.4x one year earlier. The improvement was largely the result of a $73.9 million capital infusion funded by the issuance of $75 million of hybrid equity in December 2006. The 2006 result is not expected to be sustained since the company had not had an opportunity to leverage the new capital through increased business volume. RAM Re has very modest exposure to subprime mortgages through individual mortgage transactions or through CDOs that contain subprime collateral. Therefore, any losses that could develop from those situations will not have a material effect on the company's capital adequacy. Total speculative-grade exposures were $146 million, down from $237 million as of Dec. 31, 2006. Moreover, the level of speculative-grade exposure as a percent of statutory capital declined to 35% as of June 30, 2007, from 59% at year-end 2006.

XL Financial Assurance Ltd.(AAA/Stable)

XL Financial Assurance's (XLFA) financial results are closely linked to the fortunes of XLCA because approximately 75% of the business written by XLCA is ceded to XLFA. Although XLFA does assume business from other 'AAA' rated primary bond insurers, this business represents a small fraction of its overall business (less than 10% of XLFA's total insured par). For the first nine months of 2007, the amount of adjusted gross premiums assumed from other insurers totaled $27.1 million, almost entirely international business from Financial Security Assurance Inc. (FSA). XLFA benefits from a strategic relationship with FSA, a preferred shareholder of XLFA, which adds a degree of diversity to XLFA's business. XL Capital Ltd. continues to provide support to XLFA through a $200 million capital commitment.

David Veno

Table 2

Recent Rating/Outlook/CreditWatch Actions*

Insurer	To	From	Date	Reason
CIFG Group	AAA/Negative	AAA/Stable	June 7, 2007	Concerns about below-average returns, board effectiveness, and parental support.
Channel Reinsurance Ltd.	AAA/Stable	AAA/Negative	June 12, 2007	Enhancements to the board process and staffing.
MBIA Mexico S.A. de C.V.	AAA/Stable		Sept. 25, 2007	New company rating.
FSA Seguros Mexico S.A. de C.V.	AAA/Stable		Sept. 28, 2007	New company rating.
PMI Guaranty Co.	AA/CreditWatch negative	AA/Stable	Oct. 19, 2007	Losses at parent and affiliate which provide guaranty and support agreement.

*Actions taken since last report card dated Nov. 1, 2006.

Table 3

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