THE STATE OF THE BOND INSURANCE INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

FEBRUARY 14, 2008

Printed for the use of the Committee on Financial Services

Serial No. 110–91

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THE STATE OF THE BOND INSURANCE INDUSTRY

Thursday, February 14, 2008

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 11:36 a.m., in room 2128, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the subcommittee] presiding.

Members present: Representatives Kanjorski, Sherman, Meeks, Capuano, McCarthy, Scott, Moore of Wisconsin, Davis of Tennessee, Sires, Klein, Perlmutter; Pryce, Castle, Royce, Capito, Feeney, Price, and Bachmann.

Also present: Representatives Maloney and Bachus.

Chairman KANJORSKI. This hearing of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises will come to order.

Without objection, all members' opening statements will be made a part of the record.

Good morning. The Capital Markets Subcommittee meets today to learn about the causes and effects of recent bond insurer ratings downgrades. We will, in particular, focus on the spillover effects for municipalities and the financial services industry.

Bond insurance represents a microscopic segment of the insurance marketplace. In 2006, bond insurers collected less than one-third of a percentage point of the total premiums collected by the insurance industry.

We now know, however, that even though it is very small, the importance of the bond insurance industry is significantly greater. Its recent volatility, unless quickly addressed, could produce many negative consequences and affect the financial stability of the broader economy.

Since the issuance of the first license in the early 1970's, bond insurers have guaranteed a stable risk: the timely payments of principal and interest on municipal bonds. In recent years, many bond insurers expanded into insuring structured finance products, including those backed by subprime mortgages.

These business decisions and the decline in the value of the subprime debt have now resulted in downgrades or the threat of downgrades by credit rating agencies.

It now appears that like a child who finds a book of matches, they have gotten burned. We must hope that they did not ignite our economic house as well.

The ratings downgrades of a few bond insurers has produced spillover effects and caused considerable anxiety. A report or rumor about a bond insurer has already led to swings of several hundred points in the Dow Jones Average.

The limited availability of bond insurance has also led to a number of recent failures in the offerings of auction rate securities. These breakdowns have caused significant problems in the financing of student loans. They have also resulted in some municipalities paying 10 percent or more on their outstanding short-term debts.

Ratings downgrades additionally have the potential to reduce the value of bank holdings and insurer reserves causing them to take write-downs or increase capital levels. Moreover, individual investors holding bonds could feel the impact if they want to sell the bonds they hold. Most troublesome to me is the effect of these downgrades on municipalities. Municipal markets issue approximately $2.6 trillion in bonds, about one-half of which are insured. States and localities often use municipal bonds to operate more efficiently, ease budgeting shortfalls, repair bridges, fix roads, and build schools, among other things.

The recent downgrades could therefore cause cities and towns to make difficult decisions about whether they can afford to pay more for bond insurance, pay higher interest on bonds issued without insurance, or delay much needed projects. In this regard, I am especially pleased that Mayor Tom Leighton of Wilkes-Barre, Pennsylvania, is here today. He can describe how municipalities use bond insurance and what the implications of the ratings downgrades are.

In preparation for today's hearing, I previously contacted key regulators to open discussions about these serious matters and determine the most efficient and responsible manner to act. Today, we will hear from many of them. We will also hear from bond insurers, their critics, market analysts and rating agencies.

Everyone—even State insurance regulators—agrees on the need for regulatory reform. We need to prevent a similar situation from happening again in the future. I am hopeful that as we further our understanding of these issues today, we will also begin to explore what we should do going forward. Some policy options include prohibiting bond insurers from guaranteeing complex structured financial products in order to protect municipal bond insurers and creating a Federal bond insurance corporation modeled after the FDIC.

We could also mandate Federal insurance supervision in this narrow field in order to provide greater stability for our entire financial system. Additionally, we could enact a law allowing the Federal Home Loan Banks to enhance municipal bonds with letters of credit like Fannie Mae and Freddie Mac already do. Moreover, we could work toward better transparency in the municipal bond markets. Other policy options include imposing new requirements for credit rating agencies and addressing the differences between ratings on structured financial products, corporate debt, and municipal bonds.

In closing, I look forward to the opening of dialogue today. I want to thank each of the witnesses for appearing. Your thoughts will help the members of the Capital Markets Subcommittee to understand these issues and to determine the best course of action to ensure that our municipal finance markets remain viable and our financial system stays dynamic and strong.

I would now like to recognize Ms. Pryce for her opening remarks.

Ms. PRYCE. Thank you very much, Mr. Chairman, for holding this hearing today and for your leadership on this issue. It is clear we are facing a crisis of confidence in the bond insurance marketplace.

Dating back to the 1970's, bond insurers have served a very clear cut function, guaranteeing the timely payment of principal and interest on municipal bonds. They have put investors further at ease about the risk of default in a marketplace that has a rate of default of less than 1 percent.

In the 1990's, insurers began to diversify and to guarantee securities backed by pools of auto, mortgage, credit card, and student loans, and they did not stop there. In recent years, they branched out even further into risky debt products backed by some subprime mortgages.

The stability of the industry rested on the assumption that the insurers and the rating agencies who rated them accurately priced the risk of default of these assets. It is clear now that they got it wrong. In recent months, the prediction of record home loan foreclosures moved credit rating agencies to call into question the capital reserve levels of bond insurers. To date, all but one of the major bond insurers has either been downgraded or placed on a negative watch.

We wish we could turn back the clock, increase capital reserves, and restore the reputation of the industry. However, we are left with the future of a once stable industry in limbo. Investors are not the only ones with something to lose.

There are far reaching consequences in our capital markets. Real concern exists that institutional investors required to invest only in Triple A securities will be forced to sell.

I am particularly worried, as is the chairman, about the effects on small towns, cities, and counties and places like my district in central Ohio, which uses municipal bonds to help raise funds for important projects and improvements. Downgrades on existing bonds and pressure on prices moving forward add to the cost of living in small town America.

This hearing is an important step in determining the future of the bond insurance industry. I share the chairman's sentiment that this crisis gives us pause, and his lengthy list of possible solutions is admirable.

We pause to evaluate the regulatory structure of the industry and the need for better oversight.

I look forward to the testimony of all of our witnesses today. Thank you very much for your participation, and I yield back.

Chairman KANJORSKI. Thank you, Ms. Pryce. We will now hear an opening statement from the ranking member of the full committee, Mr. Bachus of Alabama.

Mr. BACHUS. Thank you, Chairman Kanjorski.

Three months ago, very few Americans were familiar with the bond insurance industry and the role that financial institutions play in the capital markets.

This once obscure industry is now at the center of an ongoing credit and liquidity crisis in the financial markets in recent months, causing tens of billions of dollars of losses to investors and financial institutions, and unraveling many secondary debt markets.

Unlike other events that have de-stabilized markets since the credit crunch began last summer, where the pain has been felt largely on Wall Street, the fall out from the troubles in the bond insurance industry is hitting Main Street, our cities, our counties, our States, and our different authorities, government authorities.

Bond insurers guarantee over $2 trillion of debt securities. Roughly 50 percent of municipal bonds and a large number of structured financial vehicles are guaranteed by the bond insurers in order to make them safe investments with a Triple A rating.

This provides the credit markets with increased liquidity and reduced borrowing costs particularly for cities, counties, and States that pay lower interest on debt issued to support their infrastructure needs.

The bond insurers' decision several years ago to expand their business lines beyond municipal issues and into more complex securities, including mortgage pools backed by subprime mortgages, has had disastrous consequences.

Bond insurers fundamentally misjudged the risk associated with the cyclic mortgage markets and lenders' lax subprime underwriting standards.

The credit rating agencies have now downgraded seven of the top nine bond insurers, calling into question their ability to make good on hundreds of billions of dollars in potential mortgage related defaults.

Investors in insured bonds relied heavily on analysis by credit rating agencies that were fundamentally flawed. Too late, the credit rating agencies have recognized the added risk of subprime related guarantees to the thinly capitalized bond insurers, which has served to aggravate the credit crunch and create massive uncertainty among market participants.

Local governments across the country are now facing an unfavorable environment in which to raise funds, with new issues plummeting and many municipalities being forced to pay significantly higher interest rates.

For example, in Jefferson County, Alabama, the rate on their insured sewer bonds issued in 2002, this month has increased from 3 percent to 10 percent, more than a triple increase in their payments.

These costs will inevitably be passed along to local taxpayers in the form of reduced services or higher fees and taxes. The impact is also extended to the credit markets, as new offerings of residential mortgage-backed securities have largely dried up.

Fortunately, our economy is still fundamentally sound and not all market participants roll the dice in subprime markets.

Two bond insurers have had their credit ratings affirmed, providing some measure of stability to the bond markets. Several

other bond insurers are seeking or have obtained private equity financing and quick action by regulators has helped bring new entrance, such as Berkshire Hathaway, into the industry, to support the ongoing viability of the municipal bond insurance markets.

Last year, SEC Chairman Cox presented a vision for increased integrity, transparency, and accountability in the municipal securities market. Chairman Cox's initiative would require meaningful public disclosures that are current and understandable, with a full accounting of all material information at the time of a new municipal bond issuance.

This committee should closely consider Chairman Cox's proposal, keeping in mind that any Federal reforms of the municipal securities market must take into account the legitimate interest of States and municipalities.

Systemic risk relating to the bond insurance marketplace, while remote, is a risk that could have been avoided with prudent oversight by our credit rating agencies and other regulators.

We need to ensure that our regulators maintain a larger perspective on the potential impact of difficulties in one sector of the financial services industry spilling over into others as has happened with bond insurance.

In addition to guarding against risk to the financial system, Congress must make sure that someone is watching out for the taxpayers. Fourteen months ago, well before the subprime crisis called into question the financial soundness of bond insurers, I met with Chairman Cox and communicated my concern about the municipal securities market in a letter to him, a follow-up letter.

I would like to introduce that letter for the record. It is a letter of January 5, 2007, 14 months ago.

Chairman KANJORSKI. Without objection, it is so ordered.

Mr. BACHUS. Now my fears expressed in that letter have been realized as the situation in Jefferson County, Alabama, and throughout the country unfolds. Protecting taxpayers and rate payers as well as investors is a major concern for all of us and will guide our efforts going forward.

Hopefully, Chairman Cox's efforts and forthcoming proposals by the Treasury Department on the need for more comprehensive regulatory oversight of the financial services industry will help to inform the committee on the review of these complex issues.

Thank you again, Chairman Kanjorski, for holding this hearing. I am grateful today to all of the witnesses for joining us and I look forward to their testimony.

Chairman KANJORSKI. Thank you very much, Mr. Bachus.

We will now hear from Mr. Royce of California.

Mr. ROYCE. Thank you very much, Mr. Chairman. I appreciate you holding this hearing, especially given the turmoil that we are seeing in the bond insurance industry. I think it is timely.

From the information that surfaced in recent weeks, it appears that the problems faced by these financial guarantee corporations are largely the result of failed business models, but as we listen to the three panels of witnesses that we are going to hear today, it is worth noting that we are not going to hear from an expert on insurance matters from within the Federal Government because no such position exists in our Federal Government.

Mr. Sirri is here representing the SEC. He is going to provide the committee with insights into the current bond insurance turmoil as it relates to the securities industry.

The Federal Reserve can comment on the banking sector, but because these bond insurers, like all insurers, are overseen solely at the State level, we do not have the same type of Federal representation from the insurance sector that we have from the securities and banking industry here today.

I am, of course, the co-author of the National Insurance Act, along with Representative Melissa Bean, and what that bill would have done and will still do if we pass it is establish a world class regulator for the insured and the insurers of our country.

This Federal regulator would be able to provide Congress with valuable insight into the industry it oversees, whether we are responding to a national crisis or we are formulating tax policy, or we are negotiating a major trade agreement to try to get our insurers into other countries.

It is regrettable frankly that it has taken an incident such as this one being discussed to highlight this point. I believe this point has to be made because we are going to have more problems like this one.

The lack of a world class regulator able to effectively comment on the broader insurance industry as it relates to the national economy and capital markets around the world is going to continue to hamper that industry and it is going to continue to hamper our Nation's economy until Congress acts.

Again, I would like to thank Chairman Kanjorski for holding this timely hearing, and I certainly look forward to hearing from our witnesses, but I look forward to the day when we can really effectively from Congress address this issue with the type of oversight we need, and that requires the National Insurance Act.

Thank you again.

Chairman KANJORSKI. Thank you very much, Mr. Royce.

Are there any other members of the subcommittee who seek recognition for an opening statement?

[No response]

Chairman KANJORSKI. It is time we turn to the witnesses. We will establish the first panel. Without objection, all witnesses' written statements will be made a part of the record, and each will be recognized for a 5-minute summary of their testimony.

For the first panel, we have the Honorable Eliot Spitzer, the Governor of the State of New York, and a long time friend of mine. When he occupied the attorney general position, we worked together on many issues, and now to have him on this issue, I feel at least this committee is supported by a fine equipped mind in the right direction.

Governor, welcome to the committee.

STATEMENT OF THE HONORABLE ELIOT SPITZER, GOVERNOR, STATE OF NEW YORK

Governor SPITZER. Thank you, Mr. Chairman, for your hospitality and your kind words and introduction. All the members of the committee, thank you for permitting me this opportunity to spend a few minutes to explain our concerns and some of the his-

tory that I will relate to you and how this problem/crisis has emerged.

You will hear in the next panel from Eric Dinallo, who is the superintendent of insurance in the State of New York, and is exquisitely schooled in the intricacies, and indeed, Mr. Dinallo is a world class expert on all insurance matters and has done a world class job addressing this issue.

What I want to do is summarize to a certain extent some of the steps that have preceded the emergence and the public perception of this crisis because I think it bears reflection that this is a deeper problem than perhaps is understood.

Let me first frame this as many of you have observed. There are many victims in the current market uncertainty and the unsettled marketplace that is exacting a price upon many different sectors and groups of individuals.

I begin with individual investors, those individuals around the Nation, virtually every individual who invests in a muni fund, in a 401(k), in a mutual market fund of any sort, holds municipal bonds. Those municipal bonds have dropped in value and as a consequence, there has been an asset value lost to virtually every investor in the Nation, and that is the pool of individuals whom I first think about as their life savings are indeed being if not jeopardized, at least put under temporary pressure because of the market uncertainty.

Second, as you have all referred to, governments. Governments are paying an enormous cost for the spike in interest rates that is being forced upon them in terms of their financing. You have referred to several examples.

You will hear from the Mayor of Wilkes-Barre on the next panel.

This is typical of what every government entity across the Nation is going through. Indeed, just yesterday, the auction rate securities, which are vehicles used by many governments, many authorities/agencies around the Nation, some 60 percent, I believe, of the auction rate security bond auctions failed leading to a spike in what is called a "reset" in the interest rates paid.

The Port Authority of New York and New Jersey, which has very significant outstanding debt and uses the auction rate securities, is now paying 20 percent on some debt that of course was in the low single digits before yesterday.

This, I should observe, has absolutely nothing to do with the underlying security of the debt offering. It is merely a consequence of the uncertainty and the unsettled nature of the capital markets.

Third, the third impact we need to think about is to our financial services sector that has needed to take very significant write-downs and although one could say to a certain extent they are responsible for their own willingness to incur this debt, this has had an enormous impact because of their capitalization need, to seek renewed capital and in the intervening period, their inability to extend the liquidity out into the marketplace that we might want has had an enormous impact and not only on their balance sheets and on their market valuation, but also on the economy at large.

Those are the three major entities that have been affected.

Let me quickly run through the sequence of events that got us where we are. I think it is important to remember this data is de-

rived from a great extent from the subprime market, mortgage marketplace.

That is the marketplace where we saw this enormous explosion of debt, debt that is now substantially under pressure, debt that is not and was not, we now understand, affordable by those who incurred it, debt that to a certain extent was marketed with teaser rates that were going to explode, teaser rates that were often not explained, and teaser rates that were unworkable for those who were incurring the long term debt.

There is a fair debate that goes on where the liability and responsibility for incurring that debt should rest, but we should all understand that as an initial matter, much of this derives from the subprime mortgage market, and that is where this debt that is now causing problems comes from.

I will not go through the details but you may have seen a piece that I had in this morning's Washington Post, in which I said that one of the entities that clearly should have been a responsible party in examining the magnitude of the mortgage debt that was being offered and was being incurred and was resting on the balance sheets of many entities was the OCC.

I think it is a very fair question, why the OCC, given its responsibility to ensure that the balance sheets of our banks are stable, did not do much more to examine whether this debt was being issued properly but in fact chose to shut down those of us who were attorneys general at the time in our effort to examine that.

Step two. If step one was the issuance of a debt, step two was the securitization of the debt, this effort to homogenize what was an enormous pool of debt, much of it which was uncertain in its underlying nature, and to somehow transform bad debt into good debt.

As the old cliche goes, garbage in, garbage out. You cannot transform bad debt into good debt simply by homogenizing it through the securitization marketplace. Securitization is of course a critical part of our capital markets. It is necessary. It is good. It has permitted greater liquidity, but it cannot be used to mask the underlying risks of the debt that is outstanding.

The third step was the credit ratings that were applied to much of this debt, and I think it is a critical question that we all must ask, where have the credit rating agencies been.

I think the best way to ask this question quite frankly is have they ever picked up a major inflection point in the debt markets. If you look back over the bubbles, if you look back over the market crises of the past 15 or 20 years, the question I would be tempted to ask, as the SEC as the overseer of these agencies should ask, I believe, is where have they ever been attuned to the underlying realities as opposed to simply following the trend line that the marketplace wants us to follow.

Those trend lines do not continue in one direction forever. If they have missed these inflection points, then are they providing the guidance the marketplace needs.

Step four, as we now are focusing upon, was the insurance of the underlying securities, the insurance of these enormous pools of capital, and the point I would make here, and Mr. Chairman, you alluded to this, the bond insurance companies which are, as you

pointed out, infinitesimal, very small participants in the larger bond marketplace, began, and for most of their lives, served only one purpose, and hence their name, monolines, their purpose was to insure municipal debt.

Municipal debt, which is one of the two big pockets we are talking about here, the other being the securitized, the CDOs and all of those sort of acronyms that have emerged over the past couple of years, the municipal debt market is remarkably secure.

When the bond insurance companies' primary and indeed exclusive responsibility and business model was to insure that debt, those insurers themselves were remarkably secure.

It was only when the bond insurance companies decided that whether for reasons of profitability or interest, whatever the rationale may have been, to expand their jurisdiction and began to veer into the securitized market of the subprime mortgage debt and other more sophisticated instruments that they began to incur exponentially greater risk.

That is why we have the problem we have today. Their expansion from monolines to dual lines is what has generated the crisis that we are faced with and what we must think about.

Let me make one point here having seen that sequence as it has gone from the initial issuance, the origination of the debt, to the insurance of the debt by the bond insurance companies.

We are now seeing this unravel piece by piece, as it is clear that the potential implications of a downgrade for the insurance companies, the bond insurance companies, could be to generate a tsunami of selling and could be to generate the necessity of selling into a marketplace that is not terribly liquid which would then generate additional write-downs through the financial services companies, less liquidity, more cost to governments, and more costs to investors.

We are saying to ourselves, how can we stop this? There are many proposals before us. Mr. Chairman, I think you gave us the array and the spectrum that we should probably consider.

I want to make just two points, if I might. First, the role of the States here is necessary because the Federal Government until now and perhaps even as we look into the future, the Federal Government has hesitated and indeed refused to participate as a regulator in a meaningful way in the insurance sector.

Several years earlier, years back, I was here testifying about some investigations that my then Office of the Attorney General was conducting into improprieties in the insurance sector, and I spent a fair bit of time chatting with Members of Congress on both sides of the House and the Senate to see if we could generate support for the notion of a Federal regulatory role in the insurance sector.

I will tell you there was no interest. Whether this was a consequence of a political dynamic or an economic perspective is a question we could discuss, but there really was no interest in creating at that time a Federal role in the oversight of insurance.

Consequently, it has fallen to the States to do this. I think they have done it by and large extraordinarily well.

I know, Mr. Royce, that you want to create a Federal entity and we could have that conversation, but I think it should not be ig-

nored that the States have done an extraordinary job through most of the market up's and down's in regulating the insurance sector.

I want to say that Mr. Dinallo has really, I think, done yeoman's work trying to resuscitate the capital of the underlying insurance, bond insurance companies, to try to preserve their creditworthiness and their credit rating.

The final point I would make is that as the clock is ticking, and as we are moving forward, we are seeing real harm not only to investors and governments, but to the capital markets.

Therefore, it is time for people to act. It is time either for deals to get done, in which case there would be a recapitalization of the underlying bond insurance companies, which is something we hope for, as Secretary Paulson testified earlier today on the Senate side, those are private transactions. There is only so much a government entity can do to encourage or cajole, but we certainly have been doing what we can do to encourage a recapitalization of those companies.

If that does not happen, given the uncertainty in the auction markets, we will be forced to act sooner rather than later. What that might lead to is what we call the "good book/bad book" structure, where we peel off the municipal piece of business.

There are, as you are well aware, offers to purchase that, whether it is from Berkshire Hathaway or others who have recently stepped into this market void, there are offers that would permit us to essentially restore stability to the municipal part of this business.

If we get to the point where we think the pain to the municipal part is too great, where governments and investors are suffering too much, we will need to move in that direction.

My message to those who are contemplating various transactions that could be done that are frankly preferable, it is not our first choice that we move in that direction. My encouragement to those individuals, entities, banks, investors of any sort, private equity or major financial institutions, is that they move with some increase in rapidity because time is short.

At this moment, I would welcome your questions.

[The prepared statement of Governor Spitzer can be found on page 261 of the appendix.]

Chairman KANJORSKI. Thank you very much, Governor.

I actually took the effort this morning to watch your presentation on CNBC in regard to your evaluation of cause, effect, and responsibility. I tend to agree somewhat but not entirely with you as to the position.

Do you not agree, Governor, that the important thing is in the latter part of your statement, to get to stability as opposed to finding fault at this point?

Governor SPITZER. Absolutely. There is no question. The look back, as it were, and the finger pointing is useful only to the extent that it will be instructive as we look forward to the creation of either an alternative model that Mr. Royce may support in terms of national regulation of the insurance markets, or changes in the way that we look at the underlying credit analysis that we get from S&P, Moody's, and others.

I think the most important thing we need to do right now is to restore stability, which means hopefully not getting to a point where the bond insurance companies themselves suffer the downgrades that could then generate the cascading effect through the capital markets. That is why we are encouraging as we can the infusion of capital into those entities.

Chairman KANJORSKI. If the New York Secretary's suggestion of infusion of capital or investment, new equity investment markets, for some reason or another does not come about, do you agree that it would be pertinent for the Congress to act and create either temporarily or permanently a corporation of some sort to underwrite the municipal bond field, to make sure that it continues to exist and go forward, or to authorize the Federal Home Loan Banks to issue letters of credit? Is it so instrumental, is what my question is, that we set a deadline if we can, and then proceed to tell everyone we are going to act accordingly, or just leave the free market flow as it is flowing?

I am particularly aware of what I consider a cascading effect here when you think it all started in the subprime market, but just in the last 4 or 5 weeks, we have seen different elements of the credit market impacted in a very major way. Now some of the markets are absolutely frozen; I am told there just is not a marketplace out there of investors for corporate bonds at this point. The same is true for rating securities—auction rating securities are not being purchased.

It seems to me that we are flying down a road at a tremendous speed here that could bring into collapse the entire financial market as we know it today, not only in the United States but potentially it could move around the world and metastasize.

I am just disturbed that there are not too many people who are really speaking to the issue, and those who are speaking to the issue are assuming that somebody else is doing something about it. Maybe I would like to know what the Governor of New York and what the superintendent of insurance of New York feel you can do surgically in the areas in which you have jurisdiction?

Governor SPITZER. Yes, sir. I agree with your final conclusion there. I am torn between two objectives. One, as I just said in my opening statement, is to generate a sense of concern such that we can move any potential deals with great rapidity, and on the other hand, not to speak with such dire prognostication that the capital markets begin to sense there is no hope out there, because so much of this is emotional and driven by the analysis of what is likely to happen rather than what actually has happened, not to generate that cascading effect that we are concerned about.

With all due respect to Congress, I am not sure congressional enactment could result with sufficient speed if we believe that sometime in the next 3, 4, or 5 business days we would like to see resolution here, which I think is ideally what we would like to see happen.

I think your notion of a Federal guarantee has been raised in a number of articles and it is a very worthy idea and quite frankly, I think, had a guarantee of this sort been discussed and perhaps extended several weeks or several months ago, it would have cut off the decline in our national economy probably to a much greater

extent than a stimulus package that perhaps will boost consumer spending but does not go to the underlying concerns of the lack of credit flowing through the economy.

I think your analysis is exactly correct. It is because of the capacity to move with greater speed that Eric Dinallo, the superintendent of insurance, has been working with the Fed and with Treasury to generate interest in the recapitalization of these markets.

I would say to add one more aspect to it, it is a fair question whether the State of New York as the State of New York indeed going forward will seek or need or use bond re-insurance, if you look at one of the interesting things out in the marketplace.

Some of the municipal debt that has been offered and is in the marketplace without the so-called Triple A wrap is selling at a higher price than debt without it.

There could be in an odd way right now a negative effect on pricing by merely being involved with some of these bond re-insurance companies.

There will be a transformation of that marketplace but certainly in the near term, we would like to see a recapitalization. If that does not work, a guarantee of some sort certainly would be an interesting approach.

Chairman KANJORSKI. Thank you, Governor. Ms. Pryce?

Ms. PRYCE. Thank you, Mr. Chairman. Thank you, Governor, for your testimony.

There certainly is enough blame to go around. There is no sense, aside from the instructive nature of it, pointing many fingers.

The State of New York certainly has a lot on its plate now. I was very interested to hear you say that in years past, you have been up on the Hill talking about a Federal regulatory role.

I know that this current Congress and this committee has investigated that and has shown much interest in it. I just wonder where you fall on that spectrum of advice you might give this committee as to how well that might work.

Governor SPITZER. I am testifying with the superintendent of insurance of the State of New York sitting behind me, so I am trying to be loyal to him. I do not think he wants me to support limiting his jurisdiction in any way.

I will confess that you may remember, I went through an interesting dance with the other Federal financial services regulators, whether the OCC, the SEC, or the Fed at different times when I was attorney general, arguing that State jurisdiction was critically important to not only fill in but step into the front of the regulatory world when there was a void created by a failure of those Federal regulatory entities that had jurisdiction but failed to exercise it.

I do not want us to fall into the mistaken view that merely creating a Federal regulatory entity will solve the problem. There are many Federal regulatory entities that could have acted that did not act. That has been true in many crises in the past, whether it was the issue of the analysts, which is a crisis that cost investors untold billions of dollars and had its own consequences a number of years ago, or the context of insurance where there were other ways to address this.

Bottom line, I feel there might not be any harm that would result from having a more structured organized national regulator for the insurance sector, but I do not want it to be a regulator that would totally supplant the role of the States.

There is a dualism in the banking system and in many other areas of our financial services that benefits consumers and investors, because where one regulator fails, sometimes somebody else steps in and picks up the pieces.

The notion of a Federal regulatory presence is something that we should consider. I suggested several years ago the SEC expand its portfolio to include insurance, especially given the convergence of so many financial instruments.

It is no longer quite as clear that there are discrete silos, as people call them, of financial instruments. We might as well expand and have one entity that can examine all these products.

Ms. PRYCE. I do not disagree. I think part of the problem is there are so many entities, nobody knows who the ultimate authority and jurisdiction rests with. Your "garbage in/garbage out" analogy, someone is responsible for assessing the risk of the garbage. That did not happen correctly, with these facts, as we have had the luxury of looking at them in hindsight.

The dual nature of a regulatory system, I think, is something that this committee grasps well and has worked and could work.

I just wanted to know if you were willing to go on record.

Governor SPITZER. I certainly think it is something we need to look at. The devil is not only in the details but conceptually, we need to think how this would work.

Frankly, many of the insurance companies, let alone the bond reinsurance companies, which is really as the chairman pointed out, a tiny little subsector of the industry, the insurance industry itself, despite some noises to the contrary, does not support, in my experience, the creation of a Federal entity.

There is a comfort level right now for reasons we could discuss with a de-Balkanized State-led regulatory structure, and I think that may be part of the problem.

It will be a heavy lift, I will tell you, politically, to move this forward. It might be better nonetheless for the markets to move in that direction, but just to pick up on my comment of "garbage in/garbage out" that you picked up on; I am usually for recycling.

The problem is we are recycling this garbage in and out of the financial services sector and it is not helping anybody.

Ms. PRYCE. Thank you very much, Governor.

Chairman KANJORSKI. Thank you, Ms. Pryce. Mr. Capuano?

Mr. CAPUANO. Governor, I want to preface my remarks by simply stating to you that I am a former mayor. I floated municipal bonds and I will tell you that every single time I did, when it came to the credit agencies, we can call them all the nice things they want, it was legal extortion.

Not a single community in Massachusetts has defaulted on a single bond in memory. In memory. Yet, it did not matter. It did not matter one bit. Still needed credit enhancements because I came from a working class city and well, you know, we are not so sure.

So, legal extortion. That is what it was. That is what it is today. I for one will not stand here for 1 minute and defend any of the

bond insurers who took municipal money, good debt, and put it into bad debt.

I know you say they cannot do it, and I agree with you, but they did. This is not the only case. Subprime is part of it. It is a huge animal that we are looking at. We are looking at one little tail today. It is a big one, but it is just a tail.

For me, I think it is a little bit more than just we have a little market problem. We have people who have been engaged in legal extortion for generations, and nobody said a word.

Cities and counties across this State were forced to pay them without adequate reasons. Nobody looked at it and nobody cared until today.

I am glad we are here today. I do not think we can just say we only have to look forward; I do think we have to look back. This is not the beginning. I respectfully disagree with the—I generally agree with everything you said, the big stuff, I agree. It is not the beginning.

Subprime is not the beginning of this. Enron was not the beginning of it. It was the same type of thing. The word "regulation" has become a swear word here in Washington, D.C.—don't regulate anything; let the free market go. I am all for a free market to a certain extent.

I just want to ask, to some extent, you have said there should be Federal regulation. I disagree with you. Some of the insurance companies are now coming to see that. They are trying to get ahead of the curve, which I think is smart.

I agree with you totally that it should be dualistic, but I wonder, do you really think that the State system alone has really worked? If it really worked, why are we here?

If it really worked, how do we get to long term capital? How do we get to Enron? How do we get to all the subprime problems? How do we get credit rating agencies that are doing what they are doing? How do we get all these things if the State system alone really worked?

I am not saying it has not worked well in retrospect. Once they realize a problem, they do act reasonably well. I think your State is a leading example of it on many situations.

Governor SPITZER. I would answer, sir, in the following way. First, to begin with your point about the rating agencies and since they rate New York State bonds and I have to meet with them next week, I will not call it "legal extortion." I will try to be a little more polite than that.

Mr. CAPUANO. You did not have to deal with them as a mayor. I did. I am getting back at them.

Governor SPITZER. I got that sense, I have to say.

[Laughter]

Governor SPITZER. You may want to run for Governor some day and then you will find out—no. We will talk about that.

[Laughter]

Mr. CAPUANO. I already said "no" to that.

Governor SPITZER. I would say this. You heard me say earlier that New York State may not in fact use this re-insurance model in the future because there are many debt offerings out there, municipal debt offerings, and as I pointed out, this is the rock solid

part of the market that are selling at par and above without the insurance where those that have been insured that are selling below par.

We are going to look at that. As you have just articulated, it is not clear what value we get.

I agree with your larger point. It must be at most a dual system. I would not agree to exceed regulatory authority from the State exclusively to the Federal Government. Too often, that is used merely as a vehicle to drop the bar too low and them preempt States from coming in to protect either consumers or government entities or whomever. That, I would certainly not agree with.

I disagree with you only to the extent that when you bring in several of the prior scandals, whether long term capital or Enron or the analyst scandal, those were areas where the Federal Government had existing regulatory authority that was not exercised.

Those were not areas where the State in the first instance would have been viewed as the entity that should have stepped into the void.

I agree with your larger point, and I made this point earlier today on CNBC, when you have Federal regulators who invoke "and ran" as the definition of what the market should be, then we have a problem. When you have Federal regulators who run away from fulfilling their job, which is to ensure that the rules are enforced, there is integrity in the marketplace, we generate these crises.

Mr. CAPUANO. I agree with you, Governor. Thank you.

Governor SPITZER. I think what we have to take away from this, as we should have from prior scandals, is that when regulators are asleep on the job, the ultimate victim is going to be the investor, the taxpayer, and the government.

Mr. CAPUANO. We have had regulators come to this committee and tell us they did not have the authority to do the very things that—I agree with you. I think they had the authority to do all these things. They claim they did not.

I have had them just recently with banks, who have these off the books CDOs, saying oh, no, we do not regulate them because they were not on the books. If they were not on the books, why are they raising money now to pay them off?

I totally agree with you but understand, in Washington lately, regulators are the first to say we do not have any power, which I think is completely back asswards, but it is unfortunately the life we live down here.

Thank you, Governor.

Governor SPITZER. Thank you.

Chairman KANJORSKI. The gentleman from Alabama, Mr. Bachus.

Mr. BACHUS. Thank you, Governor. Governor, in your written testimony and your oral testimony today and in some of your public statements, you have talked about shortcomings at the OCC?

Governor SPITZER. Yes, sir.

Mr. BACHUS. You have talked about investment banks and some things they have failed to do?

Governor SPITZER. Yes, sir.

Mr. BACHUS. You have talked about the SEC, where they should have had greater scrutiny?

Governor SPITZER. Yes, sir.

Mr. BACHUS. And the credit rating agencies. Your testimony today, I did not actually hear you talk about the one entity that regulates the bond insurers, and that is the New York State Insurance Department.

Do you also have some criticism of their shortcomings and their failures?

Governor SPITZER. Certainly not since January 1, 2007, when I became Governor, and when Mr. Dinallo shortly thereafter took over, at which point he has thoroughly and totally revitalized an agency that until then was not exercising the oversight perhaps that it should have.

But understand and that is why I laid out before you the history of how this problem emerged and how it was an accretion of issues and developments within the financial services industry that built upon themselves to the point where then you had the bond re-insurers extending their guarantee and applying their creditworthiness or supposed creditworthiness to entities that should not have been within their domain arguably to insure in the first place or with respect to which they did not have enough capital to extend that insurance.

You will hear Mr. Dinallo testify in the next panel. He will explain to you with some precision precisely what standards his office applies to the re-insurance entities and why they are trying to get them to—

Mr. BACHUS. Let me ask you this. During your tenure, and I think what you are saying is you are acknowledging there was a fundamental failure of the New York Department of Insurance.

Governor SPITZER. No. What I am saying is there was a multitude and a sequence of events that led to the subprime mortgage guarantees—

Mr. BACHUS. Doesn't the New York Department of Insurance—they approved the bond insurers investing in the subprime securitization market which was a risky market.

Governor SPITZER. I think that is a topic of conversation, and as I said, one of the underlying causes here was expansion of their jurisdiction from what used to be monoline businesses into the much more risky area of the securitized market.

Mr. BACHUS. The State Department of Insurance would have to approve their investment.

Governor SPITZER. It is a fair question whether that is a wise business model to embrace and whether in fact, as your colleague from Massachusetts has indicated, whether this has not led to the cross subsidization from the municipal market over to the other side of the business.

Mr. BACHUS. Let me ask you this. Since 2007, when you became Governor, your insurance commissioner who will testify in a few minutes, he approved both regular dividends and special dividends where capital was transferred from the bond insurers to their parent companies, which made them lower their capitalization. Is that true?

Governor SPITZER. I do not know if that is the case or not. I will tell you this, that it was only in the past months that we have seen a subprime crisis that the Bush Administration, the Fed, the Treasury, the SEC, and the OCC failed to address over the last—

Mr. BACHUS. I am not debating that.

Governor SPITZER. Mr. Bachus, you are involved in a finger pointing exercise. I am more than happy, sir, to get involved in that and go through with precise detail where this Administration failed at a regulatory level to stop multiple scandals.

Mr. BACHUS. I will say I actually introduced the first subprime bill into this.

Governor SPITZER. If you wish to hear from us about the Insurance Department in the State of New York, we will explain to you how we have stepped into this breach to save governments, investors, and taxpayers billions of dollars.

Mr. BACHUS. Governor, since you became Governor, you approved special dividends which drained resources from—

Governor SPITZER. No, sir. What the superintendent has done is act diligently to protect investors, governments, and taxpayers and recapitalize these markets where others did not.

Mr. BACHUS. Let me ask you this, Governor. Since 2007, we now all agree there was not adequate capital standards, has your superintendent raised those capital standards since 2007?

Governor SPITZER. We are taking the lead. In fact, if you look at the press, we have done everything possible within our jurisdiction to increase the capitalization—

Mr. BACHUS. When was that done, Governor?

Governor SPITZER. That was done the moment this problem began to emerge.

Mr. BACHUS. And when was that?

Governor SPITZER. We can get you that date, sir.

Mr. BACHUS. Was it in the last month or two?

Governor SPITZER. No, it precedes that. The dividend was approved by the prior Administration, sir.

Mr. BACHUS. There was a special dividend approved in early 2007.

Governor SPITZER. In fact, the dividend was approved by the prior Administration and was cut back when Mr. Dinallo got here because he believed there was an issue here.

If you want to pursue that, you can do so, sir.

Mr. BACHUS. How about the regular dividends, were they suspended or have they been suspended?

Governor SPITZER. You cannot do so.

Mr. BACHUS. Let me ask you this, if we address—

Governor SPITZER. Mr. Bachus, are you saying that the superintendent should be in the position to suspend the dividend payment of a public company?

Mr. BACHUS. No. I am saying if there are not adequate capital requirements, he can—

Governor SPITZER. Do you think the superintendent should be in a position to suspend dividend payments of a publicly traded company, sir? We could do for General Motors. We could do it for Exxon. We could do it for others.

Mr. BACHUS. I believe to protect those that are relying on the bond insurers' capitalization, I believe the superintendent of the New York Insurance Department could have raised the capital standards.

Governor SPITZER. Sir, I think you misapprehend—

Mr. BACHUS. I believe there was inadequate capitalization.

Governor SPITZER. And the role that he has played stepping into the breach when this problem, as the chairman said metastasized because of the meltdown in the subprime mortgage market. That was the causative factor, as I laid out before you, that led to the credit failures that have generated this problem.

Mr. BACHUS. We have had several CEOs of major financial companies who have resigned because they invested in these subprime derivatives. That was a mistake. Those were risky investments.

I am just saying that if we are to say what went wrong, the one entity that regulated, that was the regulator for the bond insurers, it was not the SEC, it was not the credit rating agencies. I am not absolving them.

I am simply saying that to avoid this problem in the future, if New York State is going to continue to regulate these entities, they are going to have to do a much better job. Would you agree?

Governor SPITZER. No, sir. I think the State Insurance Department has done a spectacular job over the last year under Superintendent Dinallo examining not only this problem but a multitude of other problems in the insurance sector that are the consequence of failed national Federal policies which have permitted this debt to ripple through the economy and to metastasize and to generate a credit crisis that should have been addressed much earlier.

Mr. BACHUS. Governor, Mr. Ackman, I have read his testimony, he actually says that 6 years ago, he pointed out—let me see what he said—he pointed out some of the problems with the bond insurers and that actually you launched an investigation of those criticisms and to MBIA.

Did you find his criticisms to be credible?

Governor SPITZER. There is a distinction, I'm sure you will appreciate, between fraud, which is the jurisdiction of the attorney general's office, and there being regulatory risk that perhaps one should not assume.

What we found after an exhaustive inquiry was that there was risk that was within tolerable bounds of business behavior, so we did not, and we would stand by this after a thoroughly exhaustive inquiry, did not believe there was fraud being conducted.

We did that investigation. What we found, and Mr. Ackman, whom I know well from both that set of allegations that he raised and other dealings in New York State, he is a short seller, and I say that not in any critical way, obviously his predictive skills in this one have been correct, but he certainly was for many years now saying there could be inaccuracies here, but that is a different matter than the fraud.

Mr. BACHUS. What I guess I am saying is you have said, and I am not disputing it, that it was only in the last 2 or 3 months that you became aware that the bond insurers may have been inadequately capitalized, but 6 years ago, Mr. Ackman made the representation that they were inadequately capitalized.

As a result of that, the attorney general's office, you actually investigated them for fraud, but—

Governor SPITZER. And we concluded there was none.

Mr. BACHUS. His representations were that they were inadequately capitalized.

Governor SPITZER. The conclusions we drew then in the jurisdiction of the attorney general's office is to pursue fraud and legal impropriety.

Mr. BACHUS. I understand that, Governor.

Governor SPITZER. What we concluded was that there was none, but that the market risks there were real.

Mr. BACHUS. When he said 6 years ago that they were inadequately capitalized, did you see any indication of that 6 years ago?

Governor SPITZER. That was not an issue that we really asked. We do not examine inadequate capitalization at the attorney general's office. What we examine is fraud, impropriety, and failure to disclose to the marketplace. Those are pretty distinct issues.

Mr. BACHUS. Would you agree today they were in fact and are inadequately capitalized?

Governor SPITZER. Back then?

Mr. BACHUS. No, now.

Governor SPITZER. Of course they are now because that is what we have been working diligently and Mr. Dinallo has been working diligently as many people in State government have to recapitalize those companies.

Mr. BACHUS. I very much appreciate that.

Governor SPITZER. That is the critical link that is now being challenged.

Mr. BACHUS. I guess my only point is as we look at these various agencies, the credit rating agencies, the investment banks, I think the State of New York has to accept some responsibility in that they were primarily—the bond insurers—were regulated by the New York Department of Insurance. Whether that was under your watch or someone else's, I think that is a fact.

Governor SPITZER. We are trying to recapitalize these companies because the market conditions that exploded changed the adequacy of the capital sufficiency and the analysis that would go into that.

Mr. BACHUS. Yes, and I compliment you for that. Thank you.

Chairman KANJORSKI. Thank you, Mr. Bachus. Mr. Meeks?

Mr. MEEKS. Thank you, Mr. Chairman. I would like to welcome my Governor from the great State of New York. It is always good to see you and to be with you.

I just have a couple of quick questions for you, Governor, to get your opinion on. How at risk do you believe the municipal bond assets are right now?

Governor SPITZER. I think first it is always great to see you, Mr. Meeks, Congressman. I would say the municipal market is as stable now in terms of the creditworthiness of the underlying securities as it ever has been, and as you will hear repeatedly, the default rate is de minimis within that market, and therefore, I think investors should take great comfort from the fact that their holdings in that area are secure.

Mr. MEEKS. Maybe this happened with Mr. Capuano when I walked in. In your opinion, because I heard you talking about regu-

latory steps, etc., and what the regulatory agencies do or do not do, one of the questions I had for you was what steps do you think the Federal Government should take to support and to address the effects of downgrading for bond insurers?

Governor SPITZER. I think the concern we have about a downgrade for the bond insurance entities is that it would then have a cascading effect of a market evaluation of an enormous volume of bonds that are in the marketplace.

What we therefore think the first and best step to undertake is a recapitalization of the bond re-insurance companies so that they do not themselves get downgraded.

In the absence of that, Chairman Kanjorski has raised at one extreme, the possibility of a Federal guarantee that would come in to reassure the marketplace that these bonds are not in fact going to default.

At the other end of the spectrum, one can imagine lesser steps such as the creation of new insurance entities, and Mr. Dinallo has very effectively sought the entry of other potential participants, whether it is Berkshire Hathaway's offer to buy the muni part of the book of these companies or something between that and a full Federal guarantee.

Mr. MEEKS. Lastly, Governor, Mr. Buffett made an offer the other day about putting in or underwriting re-insurance policies of about $800 billion on municipal bonds.

My question is, good move? Bad move? What do you think of his offer?

Governor SPITZER. I would not want to second guess Mr. Buffett, but I think I would state it this way. The fact of the offer has been very affirmative for the marketplace, because what it has done is demonstrate to municipal bond holders and the municipal marketplace that there is as a backstop always the possibility of this division of the businesses into what is referred to as the good bank/bad bank, so that you could split off the municipal part of it, which is secure and find a guarantor to lend stability to that marketplace.

It is not perhaps the optimal result because it would be preferable to have the entire bond insurance market stabilized without taking away the municipal part of from the other piece of business, making sure, as your colleague from Massachusetts suggested, that there not be a subsidy that goes from municipalities over to the other part of the business is also, I think, a legitimate governmental objective.

While we are happy that there is the offer from Mr. Buffett and arguably others who could step in based upon their own valuation of that business, we are also hopeful that there could be a resolution that does not require that sort of division.

Mr. MEEKS. Thank you, Governor. I yield back.

Chairman KANJORSKI. Thank you, Mr. Meeks. Mr. Feeney?

[No response]

Chairman KANJORSKI. Mr. Castle?

Mr. CASTLE. Thank you, Mr. Chairman. Thank you, Governor, for taking the time to be here and to educate us about these issues.

My question may be a little different but it pertains to the subject of the credit issues in this country. As we all know, we face

an ongoing credit and liquidity crisis that has caused billions of dollars of losses to investors and financial institutions.

I am concerned that recently introduced legislation to regulate the credit card industry has the potential to make the credit crisis much worse.

I raise this issue today, Governor, because it seems that you might agree. In August, you vetoed a bill that would have prohibited credit card issuers from raising the cardholder's interest rate or imposing a fee based solely on the reported delinquency of the cardholder on another creditor's account. This is commonly referred to as "universal default."

You said, "To the extent that this bill might have a practical impact, it would harm rather than benefit New York credit card customers," and then you added, "In particular, a consumer's delinquency on a creditor's account is an indication that the consumer may be at risk of not paying other accounts. This bill would force credit bill issuers to increase interest rates or fees charged to all credit card holders, shifting the financial burden from those who are in default on an account to those who are not."

My question is if the bill or provisions to ban universal default is appropriate right now during these difficult economic times?

Governor SPITZER. I would have to think about that and analyze it more carefully. As you can see from my veto message then, I believe there were also preemption issues that were at play in terms of whether or not the State was empowered to do certain things or the things that were in the bill, if I remember it. I would have to look at the whole veto message.

Also, as you can see from the portion you read, what we were trying to do was determine what the benefits would be to various payers and what the cross subsidy would be between those who had good credit and those who did not have good credit, and whether or not this amounted to a subsidy that we did not want to ask some consumers to foot.

Mr. CASTLE. I thank you. Let me change subjects. I want to talk about the credit rating agencies. This may not be a correct interpretation, but I believe there are discrepancies in how they are paid. Often they are paid by the entity they are doing the rating for.

Also, I am a little concerned about the fact that once something is rated, they are able to go from a bank which has issued a mortgage to a conglomeration putting together a package to be sold. Sometimes these ratings follow the customer, which also concerns me. Are you looking at the general subject of the credit rating agencies in terms of how they go about their business? Should there be any kind of a Federal role in this? I am not saying there should be; I am just asking the question about whether or not all this is being handled correctly.

My suspicion in watching all of this unfold over the last several months is that there is something not quite right in the whole credit rating agency business.

Governor SPITZER. As I think I said earlier and you have heard from some of your colleagues, there is a general perception that the credit rating agencies have not always picked up on those inflection

points and led the market, rather they have followed, which is of course not really their purpose.

The particular issue you point to, which is the potential conflict of interest that derives from the fact that they are paid by the very entities whose ratings they are issuing, is something that has been examined and nobody has yet forced any change in that.

I think it is a fair topic of conversation. There are others who have suggested what I think is called a "subscription model," everybody pays in and therefore there are different ways of generating the funding stream to do the credit analysis.

More particularly, I think just as regulated entities, they go back to the SEC in terms of the SEC having direct oversight of their behavior. I am not sure that means that the SEC should be faulted necessarily for not challenging this particular structure, but I do believe the SEC is examining right now whether the credit rating agencies themselves have been handling those determinations properly.

Mr. CASTLE. Thank you, Governor. I think it is at least a fair subject for examination. I am not sure what the outcome should be.

Governor SPITZER. Critical subject for examination because as I think we would all agree, if you cannot rely upon the value of those ratings which are relied upon for better or for worse by many investors, then a fundamental piece of information in the marketplace is not doing what it should be doing.

Mr. CASTLE. Thank you, Governor. I yield back, Mr. Chairman.

Mr. BACHUS. Mr. Chairman, if I could ask unanimous consent to introduce into the record the Governor's signing statement on the legislation that would have restricted universal default, to offer that into the record.

Chairman KANJORSKI. Is there any objection?

[No response]

Mr. BACHUS. By the way, I totally agree with what you said in that signing statement.

Governor SPITZER. Thanks. I am happy to send you an original.

[Laughter]

Chairman KANJORSKI. Without objection, it is so ordered.

Mrs. McCarthy of New York.

Mrs. MCCARTHY. Thank you. Thank you, Governor, for being here. One of the concerns that I have with all this fallout are my little towns and villages and their ratings and how that is going to be affected.

Certainly, on Long Island, where we are paying high taxes, each one of my villages is really just hanging on by a shoe string in the majority of cases, even when they need the capital improvements.

Following through with my colleague from Massachusetts, Mr. Capuano, when he was talking about when my villages apply for their ratings and basically have to pay extra money to be wrapped up so they can have a better rating, is there any way that the municipalities can get out of dealing with the bond insurance without putting at risk being the history, as my colleague has mentioned, the defaults are very, very, very rare?

Governor SPITZER. We can imagine a different structure but I think as of this moment, the reality is that for those municipalities, villages, towns, authorities, and agencies, the smaller entities

whose creditworthiness is not routinely analyzed by the marketplace at large, it would end up being unfortunately somewhat difficult to float the bonds and gain the liquidity they need and actually get the marketplace to accept their debt offerings unless there is some arbiter of creditworthiness, which at this moment at least is or are the very credit agencies that we are talking about.

I can imagine an alternative structure where government itself, because as I think we have all agreed, the default rate among government issued debt is de minimis at most and really almost negligible and even where there has been technically a default, there has been payment, one can imagine another structure where that role was played by some other type of entity, so you would not necessarily need to go back to those particular entities that now fill that market function.

Mrs. MCCARTHY. Thank you. The other thing that I was curious about, when these bond agencies come into my village and they are basically negotiating, and I understand the bond insurance industry said they are separate, but when they wrap up somebody who might be an A or an A–, and they wrap them up and bring them up to a Triple A, is that not kind of a conflict of interest?

Governor SPITZER. I think the tensions that are there are real and as I said in response to Congressman Castle's questions, I think there are some issues that could be investigated and probed about whether or not that has played any role.

I think the larger problem is whether the underlying credit analysis itself has been proper, whether or not there was a conflict that motivated it, which is always harder to prove. I think there is now some sense that there has not been just the adequate analysis of much of this underlying debt.

Mrs. MCCARTHY. Thank you. Just to mention that I did not want you to think that I was ignoring you. I never do opening statements. I happen to believe that I would rather hear from the witnesses than everybody on the panel.

Thank you.

Governor SPITZER. Thank you.

Chairman KANJORSKI. Mr. Price of Georgia.

Mr. PRICE. Thank you, Mr. Chairman. I appreciate it. Governor, welcome. We thank you for coming today.

I want to remind you and others that the title of this hearing is, "The State of the Bond Insurance Industry." If I might ask a question about the bond insurance industry, and I will delve into the other things in just a moment.

Who is it that regulates the bond insurers?

Governor SPITZER. There are really multiple layers. There is one layer, obviously, the State insurance department, which oversees their solvency and that is something that we have done, which is why we are trying to recapitalize them. There are obviously many other entities that oversee aspects of what they do.

Mr. PRICE. In the area we are talking about right now, it is the States?

Governor SPITZER. We have a role; absolutely.

Mr. PRICE. Do you think that ought to change?

Governor SPITZER. As I said in my conversation with Congressman Royce, I think there is a discussion that could be had about

a duality, that one could imagine an entire Federal overlay of regulation in the insurance sector at large.

I think if you are going to have a conversation about where insurance regulation should reside, Federal or State, the conversation should go way beyond the bond insurance sector.

That is as the chairman pointed out really a tiny subset of the marketplace. It is a subset right now that is critically important, but I think the larger question is does the Federal Government want to intercede and become part of the regulatory environment with respect to insurance.

Mr. PRICE. We got to where we are right now with the States regulating the bond insurers.

Governor SPITZER. No. We got where we are today because of a multitude and a sequence of decisions, and that is why I laid it out as I did in my testimony.

Mr. PRICE. I asked an incorrect question. Up until this point, the States have regulated the bond insurers and we find ourselves in the situation that we find ourselves for a variety of reasons that we could talk about. Would that be accurate?

Governor SPITZER. We could sparse that statement and say as each piece of it is correct, but I think it does not properly capture the causative factors that got us—

Mr. PRICE. I got you. You have had some criticisms, significant criticism for the OCC. Their jurisdiction is truly, in this instance, in this capacity, just over the national banks; is that not accurate?

Governor SPITZER. Their jurisdiction is to examine the creditworthiness and ensure the solvency of national banks but I would point out that was the foundation upon which they argued that we at the State level in an effort that all 50 attorneys general and the 50 State treasurers of both parties sought to participate in, to examine the issuance of much of the subprime debt by subsidiaries of those national banks.

In other words, much of that was issued by subsidiaries of the national banks.

Mr. PRICE. I will get to the subsidiaries in just a second. You are not suggesting that the OCC ought to regulate the State banks?

Governor SPITZER. No, we are not. What we are suggesting is that the OCC, when it sought to preclude, if you were to go back to the litigation where the States sought to overturn the preemptive acts of the OCC, what we sought to argue, unsuccessfully as a matter of law, but I think as a matter of policy, we were correct, that by acting as it did, the OCC prevented States from enforcing laws of general applicability in terms of both consumer fraud and fairness and consumer protection with respect to an entire sector that has now, to use the chairman's phrase, metastasized, such that much of that debt has become toxic in the capital markets.

Mr. PRICE. I think there is some question as to whether or not the preemption actually provided for that to occur or not.

Governor SPITZER. Could I interrupt for just one second? I think you and I might agree on that point, but the preemption that they invoked was deemed sufficient, as a matter of law. They won in the Second Circuit.

Mr. PRICE. I got you. I'm running out of time.

Governor SPITZER. In other words, they succeeded as a matter of law.

Mr. PRICE. It is my understanding of the subprime loans that are out there, that the financial banks were responsible and their subsidiaries for only about 10 percent. Is that a number you would agree with, in that ball park?

Governor SPITZER. I simply do not have that number before me right now. I do not know.

Mr. PRICE. I think that is probably the case. That is my understanding. I would hope that as we concentrate on the issue of the bond insurers and for whom we ought to address a solution, if there is in fact a Federal solution, that the OCC and national banks are probably not the area where the bulk of the problem lies.

Governor SPITZER. Again, I think it would depend on how you measure it. As I said, the preemptive acts and the preemptive efforts by the national banks was read as broadly as possible.

We were successful, the State of New York and many other States, many multi-State actions in changing behavior. One of the early cases was Delta. Then there were a sequence of cases with settlements and change in behavior that totaled hundreds of millions of dollars over the course of the intervening years.

We were pursuing this in a multi-State level with as much breadth as was possible against those non-Federal banks as we could.

Mr. PRICE. One final question, if I may, Governor. I am aware of some press reports that there has been some pressure that has been placed on rating agencies by New York State officials to delay further downgrades of the bond insurers during the bailout discussions organized by your superintendent.

Are you aware of those reports and if so, are they true?

Governor SPITZER. I have seen those reports. In fact, I would say if there are reports which discuss pressure, those would be improper. In other words, it would be wrong for any government entity to pressure a rating agency to do anything one way or the other in terms of an analysis of the creditworthiness of an institution.

There have been conversations with the rating agencies. I have not had any, but I know there have been conversations including Federal officials at many Federal agencies as well as State agencies to keep them informed of what is happening because it is critically important information for them to make their appropriate and relevant determinations.

They have sought information as a part of their effort to ensure the flow of information they are responsible for into the marketplace is accurate.

They have sought and been provided with ongoing information about what is transpiring.

Mr. PRICE. You would not describe those as pressure, those conversations?

Governor SPITZER. As I said, I have not had any of those conversations personally. I have had zero contact with the rating agencies.

I know that Federal entities and individuals have. State entities have as well.

Not having been a party to them, I was not there, but I would say that certainly nobody should or would and that I am aware of, nobody has, done anything that would suggest pressure. It is a question of keeping them informed.

Mr. PRICE. Thank you. Thank you, Mr. Chairman.

Chairman KANJORSKI. Mr. Scott of Georgia.

Mr. SCOTT. Thank you, Mr. Chairman.

Governor, I would like very much to get your thoughts on what Congress has done so far, particularly given the fact that from what I understand, you are saying that so many of our subprime mortgages or the insurance for those are provided by bond insurance companies, costs are going on, there is a direct impact on what is happening from the frontal cause of the subprime mortgage crisis, as you point out in both your testimony and in your statements.

I think it would be very interesting for the committee to know what your thoughts are on the reaction that Congress has given so far to this, and the economic stimulus package.

First of all, is this sufficient? Does it get to where we are? Is there something more we need to do, specifically in the part where we are trying to deal with some stemming of the foreclosure rate in terms of expanding the loan capacities of FHA loans with the Federal Government guarantee, and also this 1-year extension of increasing the loan limits for Freddie Mac and Fannie Mae from about $430,000 level mortgages up to about $785,000 mortgages.

Your thoughts on that. Is what we have done so far sufficient to kind of respond to this, and what would you recommend we do going forward?

Governor SPITZER. I would say the response has been judicious and measured and thoughtful. I think it has all been affirmative but the bottom line, not sufficient.

I think that the inquiry the chairman is conducting today is hugely important and the ideas that the chairman has proposed in terms of using as a final backstop the notion of a Federal guarantee is an important notion to place in the marketplace. Hopefully, we do not need to get there.

Having said that, I think it is a concept that perhaps would have been more important and more useful as a stimulus package than the stimulus package that was actually enacted, which is certainly beneficial and helpful to many consumers and taxpayers and will help and provide some supposedly measurable bump to the economy, but did not address the underlying credit crisis that I think is what is hindering the economic growth at this moment.

I think that the notions of resuscitating credit by relieving the credit markets of some of the overhang of the bad debt would probably be more important in the long run.

Mr. SCOTT. Let me ask your opinion on the national regulator. You may have mentioned that prior to my coming in. Where do you fall down on that and why?

Governor SPITZER. I think it is a notion we should discuss. As I mentioned, it is an issue I raised and a notion I raised several years back when I was involved in another set of inquiries into the insurance sector.

There did not at that point in time seem to be tremendous receptivity for the notion here in D.C., but I think as an overlay on some of the State regulation, it is certainly something we should consider.

As an effort to supplant entirely State regulation, I think you would find significant opposition, and I think you would also find significant opposition if it were an effort to impose regulation and then preempt State regulations with a bar that was too low in terms of the effectiveness of the regulatory framework.

Mr. SCOTT. Let me just get your thoughts on this somewhat complicated issue of the impact on municipal bonds. I am particularly concerned about that because so many of our smaller and rural communities rely on municipal bonding.

I am just concerned about the impact that is being placed on this from these just astronomical higher borrowing costs, and what impact that will have on their capital projects.

Governor SPITZER. It will have unfortunately a very detrimental effect. In my testimony, you will see that I delineate at least three victims, as it were, of the current credit crisis. One of them is the municipal governments whose resources, scarce resources, especially these days, are being forced to be used to pay higher interest rates, and if you look at the auction rate security market, just yesterday, a lot of that debt was reset as high as 20 percent, those are scare dollars that are now being used to pay interest rates that should be much lower if you merely look at the credit risk of the underlying securities.

Mr. SCOTT. Finally, I have a serious problem with these teaser rates. How do you feel about these teaser rates? Should we get to a point where we should just basically outlaw them?

So much of the problem that we have now with our mortgages, these loan originators are going in there knowing full well that these people cannot pay. Their credit is bad. They tease them in. When the adjustable rates come in, you know, there goes the home.

Governor SPITZER. Congressman, I think what we have is a crisis that results from the inappropriate marketing of many mortgages and borrowing by individuals who did not perhaps understand what the transaction was.

It is very hard to define what a teaser rate would be in any individual transaction, in any individual instance, and who can pay what.

What we have focused on more in our effort, whether it was some of the cases I made when I was attorney general, or where we are now crafting legislation at the State level, is to ensure that there be an analysis done to ensure a capacity to pay.

Often what happens with much of the subprime debt is people saw a teaser rate that did, as the term would suggest, seduce them in, but no underlying analysis was done about the capacity of the borrower to pay once that teaser rate expired and there was a significant jump to the rate that would apply for most of the duration of the mortgage.

We have sought to ensure that lenders go through that sort of analysis in order not to create the sorts of problems that we have today.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. PRICE. Mr. Chairman?

Chairman KANJORSKI. Yes, Mr. Price.

Mr. PRICE. Thank you, Mr. Chairman. I ask unanimous consent that a statement from the Comptroller of the Currency, Mr. Dugan, be allowed to be placed into the record.

Chairman KANJORSKI. Without objection, it is so ordered.

Mr. PRICE. Thank you.

Chairman KANJORSKI. Mrs. Capito, you are recognized for 5 minutes.

Mrs. CAPITO. Thank you, Mr. Chairman. Thank you, Governor, for being here today.

I have two questions. First of all, I want to ask with the chairman's permission to insert into the record a letter from my community bankers.

Chairman KANJORSKI. Without objection, it is so ordered.

Ms. CAPITO. I am from the State of West Virginia, a very rural State.

Knowing you were going to be before us when we were talking about bond insurance, they are calling attention to H.R. 2091, which would allow community banks to partner with Federal Home Loan Banks. It is actually not in our jurisdiction but I wanted to highlight that.

They feel that this legislation would allow our banks to assist smaller West Virginia communities, charitable health care facilities and institutions of higher education to raise tax exempt funds where such borrowers are unable to obtain bond insurance or letters of credit from large market players on or at more attractive terms.

Do you find as Governor of your State that you do have these entities that are really sort of left out because of the expense of the bond insurance and other things, and that we need to try to find, for instance, something like this, to be more a more creative backstop for them?

Governor SPITZER. I certainly support the concept of providing greater access to the capital markets in ways that might circumvent the need to get the bond insurance. I am not sure I could say definitively as I sit here that there are entities in New York State that have been precluded from getting the raise in capital they need because of this. I just do not know if that is how the market has played out.

I certainly believe as we look back now at the premiums that are paid and ask what is the value derived for it, that is a fair question, whether government entities are getting fair value or whether or not this is the best mechanism for them to raise capital.

Mrs. CAPITO. I think this is a topic I would like to get into in terms of small community banks.

The other thing I would like to ask you is in our background information on this hearing, I have been reading about this because this is very complicated and most of the bond insurers, I understand, are domiciled in New York? Is that correct, as far as you know?

Governor SPITZER. I think most of them are, yes; that is correct. Some of them are elsewhere in the Nation, but yes, most of them are in New York State.

Mrs. CAPITO. It goes onto say that generally speaking, since they are State regulated, that basically New York State is sort of looked at as the marque.

Do you feel that because most of these entities are domiciled in New York—do you feel like your insurance commissioner or you call him the—

Governor SPITZER. Superintendent.

Mrs. CAPITO. —superintendent, has been a default Federal regulator?

Governor SPITZER. I think it is to a certain extent the case that when there are a limited number of entities that act in a particular sector and they all, as you say, by default or by statute are regulated by one entity, it has a national impact. One could even argue an international impact.

By virtue of that, yes, the superintendent's office in New York has become the regulatory entity that has defined to a certain extent the playing field.

Mrs. CAPITO. Taking that one step forward in defining some of the issues, and I realize that you have lined out several areas where you think maybe to lay the blame or wherever things fell through the cracks or however you want to state it, lessons learned, I guess, through your superintendent being the default Federal supervisor over these bond insurers.

I suppose we could look to New York to help us develop in a very professional way ways that we could avoid this in the future.

Governor SPITZER. I certainly would hope so. The superintendent is sitting right behind me. I think he will be on your next panel. I am sure he will volunteer some ideas that he thinks at least will benefit or could benefit the marketplace as we move forward to try to create that regulatory framework.

Mrs. CAPITO. Thank you, Governor. Lastly, I would like to echo some of the comments of my fellow members from the other side of the aisle.

In representing small communities, it is extremely important for infrastructure development, for clean water, for all the things that maybe big city livers think, you know, everybody has, we still have a great need and I know you do in the State of New York as well.

The stability in this market and affordability is extremely important for us to be able to move forward.

I thank you.

Governor SPITZER. Thank you.

Chairman KANJORSKI. Thank you, Mrs. Capito. Ms. Moore?

Ms. MOORE. Thank you so much, Mr. Chairman, and thank you, Governor.

I have listened very carefully and perused your testimony with great interest. You seem to have laid out really where you think this problem has started, with the subprime miss and the underwriting that was poorly done or fraudulent, whatever the case may be, and then step two, securitization, which you say will continue. We cannot really look at that not being something that we are not going to do.

And then the credit rating agencies, make them appear to be safe, and then finally, the monoline insurers, make them appear to be even more safe.

Here we are talking about more Federal oversight. Do you think that it is possible that these monoline insurers have done a great job with floating municipal bonds?

We all agree it is very little de minimis risk, and this is what they were accustomed to doing, and in order to remain competitive and to have more customers, they sort of ran ahead of their lights.

When they are evaluating the risk, there are three things they look at: Credit risk; market risk; and liquidity risk.

Do you think it is possible that there is something missing? I do not know what it would be called, maybe re-marketing risk. It seems that at the point at which the underwriting is bad and the securitization occurs, that there just seems to be a rubber stamp, rubber stamp, rubber stamp to these monoline insurers.

Is it possible or is there any discussions going on about revamping or re-evaluating how risk is evaluated, particularly as these asset backed securities and credit swaps occur?

I do not know. Maybe this will be a re-marketing or transitory risk added on top of it. Sort of like your mother's favorite recipe. You start adding more stuff in and taking other stuff out. It is not what you are used to in the recipe.

Governor SPITZER. At risk of picking up on your metaphor because I am not a great chef, but I think really what happens is they just completely changed the recipe.

I think what happened was when they were dealing with the municipal debt, basically the market would say got it right, and as you pointed out, they were reasonably effective, and you could argue, and some of your colleagues have said that the towns and villages around the Nation did not necessarily either need them or get full value and they felt somewhat abused by the fee structure, and that is a fair topic of conversation.

I think nobody has yet really challenged the underlying analysis they conducted in that context, whereas when you switch over to the other sectors in which they were active, you do begin to feel that somehow the analysis was lacking and the analysis upon which they relied and which they then projected into the marketplace was inadequate.

Ms. MOORE. My question is, do you know of, or is this another panel's question, is there any conversation about evaluating these indices of risk?

These are very broad generalized indicators. Credit risk, market risk, liquidity risk. When is the last time they have revamped these? We have all these new derivatives and new products.

When is the last time that they have really overhauled how they look at risk?

Governor SPITZER. I think part of the problem is they just got it wrong, when we now look back at some of the analysis that was done about some of the more sophisticated instruments and the underlying debt, people now say wait a minute, it was much more risky than was understood.

I am not sure the methodology was wrong. They just drew the wrong conclusions because they did not look at the data, did not gather the right data. There was this enormous—as I said earlier on, they tried to homogenize a lot of bad debt and somehow by the end claim it was good debt. You cannot do that.

The analysis was wrong. It has come back to bite us.

Ms. MOORE. Without trying to assign more or less guilt, it concerns me that the monoline insurers have a really strong profit incentive, you know, in order to expand their business from their usual municipality bond rating, to not really evaluate the risk.

Did they know that these securitized instruments were as risky as they were? Did they know that the underwriting was tenuous? Were they just bamboozled, lied to?

Governor SPITZER. I have not seen any evidence to suggest that they knowingly misstated risk or that they knowingly took their credit rating by insuring the underlying debt and therefore put themselves at risk.

I think you could argue that if they intended to play that game, they are now the ultimate losers because if there is, and it is an "if," if there is a successful effort to recapitalize themselves, their own companies, there will be significant dilution to current shareholders.

It has not been in their interest to play that game if that is what they understood. I think it is more likely they just got it wrong.

Ms. MOORE. My time is running out. Just one last question. What we have to determine here in Congress is whether to regulate more, get some other bureaucracy in place to regulate again, or have the industry inside to sort of re-assess how they evaluate risk.

Do we do both? Do we do one or the other or what?

Governor SPITZER. We certainly at this point think about doing both. There is no question that the re-insurance companies as well as the credit agencies themselves and all the other entities involved in the steps that preceded are going to have to evaluate what they did and how they did it.

The bottom line answer to your question is certainly the re-insurance companies are looking very hard at what they did and how they extended the re-insurance. The credit analyst companies are doing the same thing.

As the chairman suggested, there is serious thought being given to an overlay of a Federal regulatory structure that could perhaps lend some additional buttressing to this entire effort.

Ms. MOORE. Thank you.

Chairman KANJORSKI. Thank you, Ms. Moore. Mrs. Maloney of New York, one of your constituents, Governor.

Mrs. MALONEY. Thank you very much, Mr. Chairman, for giving me the privilege to ask a question even though I am not a member of this particular subcommittee, but I am a member of the overall committee.

First of all, welcome, Governor, and thank you for your help and your department's help in the passage of TRIA, the reform bill. It is very, very important. It is good to see you here trying to help us with this challenge today.

First of all, very briefly, how did the bond insurance marketplace get to where it is now, and is it possible for this sector to continue as an Triple A business?

Governor SPITZER. Very briefly, it got to where it is today by evolving from what we refer to as the monolines, where they really did limit themselves to the municipal market and expanded their

scope in the insurance they extended to much more sophisticated and what we now know to be much more risky types of investments in securities.

Can they maintain themselves as a Triple A? Of course. Will that necessarily happen? Only the marketplace will let us know hopefully in the next few days as we see what steps are taken to recapitalize either those companies or new companies emerging to step into that void.

Mrs. MALONEY. Governor, what will you do if the financial guarantee insurers are unable to complete their own restructuring deals?

Governor SPITZER. What I have suggested and I think the superintendent will testify to some greater detail about is if the progression is such that there is no opportunity to resuscitate the existing companies by recapitalizing them, it would perhaps—this is not our optimal choice—it would perhaps be necessary to move forward with what have been referred to as a good bank/bad bank structure to protect the municipal marketplace, which is at its core the first marketplace that we should be concerned with.

Mrs. MALONEY. What does the Berkshire Hathaway offer mean to the industry, and would you ever insist or compel a company to accept the Berkshire offer?

Governor SPITZER. I would state it differently. I think one can imagine—first of all, I would say the offer has been beneficial to the marketplace. I think when it became public that offer had been extended, I am not sure there is necessarily causation, but the Dow jumped pretty quickly.

I think the marketplace appears at least to have taken that as a positive sign with respect to the likelihood of the bond reinsurers' underlying economic security.

Having said that, I am not sure that we would in as many words force companies to enter into a transaction where they accepted that offer.

The superintendent has significant regulatory authority and he can explain the scope of it a bit later on.

I am not sure I would use the words "force them" to enter into that transaction.

Mrs. MALONEY. What regulatory lessons have you learned from this experience?

Governor SPITZER. I think once again there was an accretion of market steps, each of which contributed to the situation we are in right now, and that is why I replayed that sequence to make it clear that there were a series of moments where intervention would have been possible, could have been called for, and the due diligence that was done perhaps was not sufficient to prevent our getting to a point where we now have a very significant volume of debt that has been insured where the underlying debt insurer claimed to be Triple A, where the underlying debt is really significantly more at risk.

Mrs. MALONEY. Lastly, the OCC decision, many of us are being criticized now in Congress and regulators are being criticized that we did not act quickly enough in the subprime crisis, that we did not intervene earlier.

What is your view of the decision that really said that attorneys general could not get involved in the subprime problem solving and were preempted by the OCC?

Governor SPITZER. I disagree with the OCC's actions in that regard, in extending their notion of preemption to extend not only to all subsidiaries of national banks but in a way that precluded the application of laws of general applicability in terms of consumer fraud and certain principles of fairness that should be taken as elementary in the capital markets.

Having said that, I think the lesson we take from that is that as we discuss the potential of Federal regulation here, we need to be careful that the mere presence of a Federal regulation does not give us some false sense of comfort, that by the mere presence of a Federal regulatory entity, all problems will be solved.

I think that regulatory entities, whether at the State or Federal level, can be either successful or unsuccessful based upon who runs them and what their view is of the marketplace and whether they have the appropriate decision making capacity.

Mrs. MALONEY. Certainly the question is if someone wants to help a consumer, why in the world would you cut off the opportunity to help the consumer.

Governor SPITZER. In that vein, we were somewhat frustrated, as I said, by the OCC's response, and as we said to them, fine, if your view is you are the exclusive entity that can in fact oversee this area, then at least we would like to see you fulfill that mandate.

What frustrated us was that having invoked preemption, the OCC then stepped away from the problem and permitted it to fester.

Mrs. MALONEY. My time has expired. Thank you very much for being with us today.

Governor SPITZER. Thank you, my good friend, Congresswoman Maloney.

Mrs. MALONEY. Thank you.

Chairman KANJORSKI. Thank you, Mrs. Maloney.

I thank the Governor for participating in today's hearing. We have a vote in process on the House Floor. We are going to stand in recess to make that vote and then come back for the second panel who will be taking their place in the interim.

Governor, I want to thank you for your participation today. We certainly have an issue here that is not only important to this committee and to the Federal Government, but certainly to the State of New York. We hope to work in cooperation to come up with some solutions, I want to say in the plural, to see if we cannot stabilize and increase the faith and support of this great marketplace without further erosion to the American economy.

I thank you very much for coming and participating today.

Governor SPITZER. Thank you, Mr. Chairman.

[Recess]

Chairman KANJORSKI. I cannot say this never happens but it does not happen quite as severely as it happened today.

I was thinking on the Floor, for a hearing that was supposed to start at 10:00, we had a death in the House that interfered with our starting time. Then we had a motion during the memorial serv-

ice that caused a personal privilege question that went on the Floor, and then we had 12 or 14 votes interspersed there.

We actually were—some people would call it "working"—we actually were occupying our time. I am not sure we were working.

This among other panels in the House have been held up severely because of that.

I do not know how I make up for Mr. Sirri's wife and the plane on Valentine's Day. You will just have to tell her that it was because we love you so much that we kept you here.

[Laughter]

Chairman KANJORSKI. We will make it up to her in some way, do something.

I was talking with the Governor. We were talking over some of the testimonies and how much we were looking forward to these two additional panels.

First, let me welcome the second distinguished panel. I see the Mayor is here, too. Very good.

Our first witness will be the Honorable Eric Dinallo, superintendent of the New York State Insurance Department.

Mr. Dinallo?

STATEMENT OF ERIC R. DINALLO, SUPERINTENDENT, NEW YORK STATE INSURANCE DEPARTMENT

Mr. DINALLO. Thank you, Mr. Chairman, it is a pleasure to be here. You obviously heard from the Governor. We have also separately submitted about 30 pages of material to you.

I thought I would just take the time to just go over for you what the Department of Insurance is doing and what our plans are, and a brief chronology of how we got here today I thought would be helpful.

I took office in very late January at the Department. I first became concerned in the early spring when MBIA requested the billion dollar dividend that was referred to previously.

It was within the four corners of the law and had been previously okay'ed by my predecessor, and in fact, even when it was okay'ed by him, the company was Triple A rated by all the rating agencies, and in fact, no monoline insurer had been downgraded, and there was no concern for the subprime area at that time.

I was beginning to have some concerns about the economy and about the subprime area. It was extraordinary but I reversed the decision, so to speak, and I cut it in half is what I did, based on where I thought we were.

That, so to speak, is actually something that I am proud of, not very embarrassed of. I wish Congressman Bachus was here to talk about it, but I thought it was the right decision and it seemed to be the prudent thing to do.

Then they came back in June or July, I do not remember when. I think it was early to mid-summer, requesting another $500 million, the balance of the billion.

At that time, they were still Triple A rated by all the insurers. No monoline had been downgraded. All the senior traunches, in fact, all of the CEOs were at their original ratings, there had been no indication of what was coming, but we denied that request because I just felt and the Department felt and the staff at the De-

partment felt that what looked like on the horizon as a potential for a recession or something around the subprime area made it so that we wanted to decline it and we did.

Obviously, there are regular dividends. We cannot really decline those. Those are in the statute. Indeed, these are publicly traded companies. I think there would be other regulators that would have a problem if we went to court and without the proper basis started to put a request on stopping the dividends.

At that same time, we sent inquiries to the financial guarantee insurance companies concerning their activities in these areas. We also began the process of getting permission to hear directly from the rating agencies about the financial guarantee companies and that the financial guarantee companies would agree to give us sort of real time information about their process with the rating agencies.

We began to have regular meetings with them and almost daily contacts. We began some discussion at the staff level with the Federal Reserve and other regulators.

In the fall, it became apparent that the rating agencies were possibly going to downgrade some of the monolines. We continued to meet with them on a regular basis. The company would keep in daily contact with us. We had a very good dialogue with the rating agencies at this point.

The subprime situation then was starting to deteriorate. We had concerns over the broader financial markets.

That would bring us to about the very beginning of November, maybe late October, and we developed a three point plan at that point.

Here was the three point plan: to inject or seek to inject new capital into preexistent monoline insurers, and to begin to bring other players into the monoline industry who were not encumbered, sort of fresh capital in freshly minted companies, to deal with potentially distressed companies in the monoline area, and to sort of re-write the rules of the road, begin to think about how to re-write the regulations in this area.

We also then send inquiries to the monoline companies concerning exactly where their positions were on structured investment vehicles.

On November 15th, I called Ajit Jain of Berkshire Hathaway and asked him if we could talk about the possibility of Berkshire entering the market, and I sort of promised him we could get him a license in a week or two. My staff fainted apparently when that was communicated to them.

We did proceed at a record pace and we had them licensed by the end of the year, and started the process of having them licensed across the country working with NAIC, and that was the beginning of the execution of point number one of the plan.

We then started to facilitate injection of capital into preexistent players. With MBIA, we very quickly facilitated the senior note that was for, I believe, $1 billion.

We became concerned that Ambac at pretty much the middle of January was potentially going to suffer a downgrade, and we sent examiners to Ambac on January 17th and 18th, I think.

Although it is regulated primarily by Wisconsin, they are in New York City, and I felt that we needed to make sure we were on top of any situation that could be developing.

From January 7th to the 19th, we held daily meetings and calls with the companies, the rating agencies, and some of the Federal authorities. We had lots of internal meetings.

Over the Martin Luther King weekend, I received some very concerned calls from some of the counterparties, some of the insurance companies and some of the representatives of those parties.

I cut my family trip short and had a lot of those conversations and then came in on Martin Luther King Day to meet again with Ajit Jain to ask him if he could give us a price for the municipal side of the book.

The letter that you have heard about, his offer on the municipal side of the book, was something that came out of conversation with him over Martin Luther King Day weekend.

And then we come to Tuesday, January 22nd. We called the rating agencies to get a feel for what kind of capital would be necessary across the whole space, not a company by company discussion, and we got an answer of something in the magnitude of $5 billion currently, but of course, estimates and assumptions could change and it could go as high as an additional $10 billion.

On that same day, I called about 10 or 12 of the investment banks who were counterparties to the insurance companies, asked them to come in. We held a meeting at the Department on the 23rd. At the meeting, I sought their advice and said here is the problem, which I will lay out in a second, and I asked them what they would do with the following concerns that I had.

The concerns were that we were potentially looking at a systemic or credit freeze if there was a downgrade, that there were potential markdowns of the books they were holding if there was such a downgrade, and with a downgrade of one of the insurance companies, would come not just a mark down of their books at the banks, but also a capital call because now instead of holding Triple A, they were holding say Triple B, and that requires a lot more capital to hold those on the books of the investment banks.

I was concerned about the auction rate security market looking sort of down the horizon. I thought the optics were going to be difficult, that if in some way it seemed that Wall Street hurt the municipal side of the book here, it would be a damaging situation.

I was very concerned that downgrades were coming in the next several days and there could be a lack of confidence if we did not come up with a plan.

The solutions we discussed at the meeting were the $5 billion of a potential equity investment with a $10 billion backstop, or a $10 billion line of credit, a backstop rights' offering, or some other kinds of capital infusions where maybe at the beginning if the insurance companies were corrected, they were totally okay, it would be less beneficial to the banks, and if the insurance companies were wrong, more control by the investors would come at that point.

I discussed that the potential outcomes were basically either some kind of a capital infusion or as has been reported, there might be a split of the book. That was talked about way back then.

It is not something that just came up out of desperation. It has been something that we have been discussing for several weeks.

I also told them that I was considering having the Department retain an advisor in the form of Corrella & Weinberg, and they thought that was a good idea, because we would have to communicate about complex deals, etc.

For the next couple of weeks, I sort of felt a little bit like Cassandra or Will Smith in "I Am Legend," because I went around trying to make sure that people understood how serious the problem was potentially.

I spoke to a lot of the banks, their CEOs, whom I had originally called on that day, the insurers and the rating agencies. I also spoke to other sources of potential income, large shareholders in the companies themselves, private equity, large insurers outside of the space, and held constant meetings to sort of begin to determine what the best path is.

Here we are today, I can sort of conclude and just tell you where we are in the three point plan. Obviously, some of the companies are in discussions with their counterparties. There are possible deals. I have optimism. Nothing is a certainty. I do believe that a lot of progress has been made.

But remember, there are several monoline insurers and you could have different outcomes for each one. For some, you could have a split book. For some, you could have a consortium based capital infusion, and for some, you could have some kind of a good book/bad book outcome.

In all of those, you are sort of dealing with what is clearly a distressed situation.

On the rules of the road, we are working very hard on that. We do have the beginnings of drafts of regulations, which I am happy to share and I want expert input on that.

Obviously, on new capital and new players, you see the results with Berkshire Hathaway, and other large institutions, large financial institutions have come in and have applied to begin the process of being a monoline insurer with us.

The hallmark here is that under no circumstances, I think, should the whole book get downgraded. The municipal book should be preserved. That was always the point of having the meeting. It was not about bailing out these insurers or in some ways worrying about the stock price of the companies.

It was always about the policyholders and that you need the Triple A rating to have that across-the-board, and to get to what we did wrong—I am actually proud of what we have done across the year. I am even proud of the Department's work in this historically.

What I think we did wrong, and I can explain more later, is there is a very important distinction between a Triple A rating and the solvency of an insurance company. They are not the same thing. I can explain some more of that in questions and answers.

I think we could regulate more towards the rating in the monoline because it turns out that the rating is maybe as important as the solvency of the company when you are linking everyone's Wall Street activity to it.

Thank you.

[The prepared statement of Mr. Dinallo can be found on page 219 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Dinallo.

Next we will hear from Erik R. Sirri, Director of the Division of Trading and Markets, United States Securities and Exchange Commission.

STATEMENT OF ERIK R. SIRRI, DIRECTOR, DIVISION OF TRADING AND MARKETS, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. SIRRI. Chairman Kanjorski, and members of the subcommittee, thank you for inviting me here to testify on behalf of the SEC about recent events in the financial markets and the implications arising from concerns about the creditworthiness of certain bond insurers.

As a threshold matter, the Commission does not regulate these financial guarantors, commonly known as monoline insurers. However, the securities markets and their participants, which the Commission does regulate, may be affected by the declining creditworthiness of the monoline insurers.

One example of this is the large securities firms or investment banks that the Commission supervises on a consolidated basis through its CSE or Consolidated Supervised Entity Program.

Commission staff has discussed and reviewed the CSE's current and potential exposure to monoline insurers. These exposures fall into three categories: Credit risk; market risk; and liquidity risk.

In terms of credit risk, many CSE's firms execute derivatives trade with monolines, generating direct counterparty credit exposure. For instance, a CSE may purchase a credit default swap from a monoline. In such a transaction, should the credit underlying the credit default swap default, the monoline would be expected to make a protection payment to the CSE.

In terms of market risk, the CSE firms are exposed to the perceived creditworthiness of monolines through wrapped securities they may hold in inventory. These include municipal securities, tender option bonds, auction rate securities, and certain mortgage products.

In addition, most of the CSE firms have trading and hedging positions linked to the monolines' creditworthiness. Finally, the CSE firms may also have an implicit and explicit liquidity risk exposure to monolines through their activities as re-marketing agents for certain products, such as auction rate securities and tender option bonds.

These programs fund longer term obligations such as municipal debt with liabilities that have characteristics of short term paper. Often, monolines wrap the underlying long term obligations. A CSE may be at a liquidity risk explicitly by acting as a liquidity provider for a particular program. For example, for tender option bonds or variable rate demand obligations.

A CSE bears an implicit liquidity risk when acting as the re-marketing agent on a program, as it may decide to support the program and take securities on its balance sheet out of client franchise considerations.

The CSE firms are highly aware and actively manage their exposures to the monoline sector. Although the exposures may in some instances be significant, based on the information available to us through our supervision of the firms, we believe the CSEs have adequate capital and liquidity to deal with the consequences of a downgrade or even default of one or more monoline insurers.

The Credit Rating Agency Reform Act of 2006 permits credit rating agencies to apply to register with the Commission as nationally recognized statistical rating organizations or NRSROs, and establishes a regulatory regime for those that become registered.

Nine credit rating agencies have voluntarily registered as NRSROs, including three that assign ratings to monoline insurers, Fitch, Moody's, and S&P.

Beginning in December 2007, these three rating agencies have undertaken a number of rating actions on monoline insurers. Each of the three has issued downgrades to the ratings of certain monoline insurers and each has placed others on review for possible downgrade.

The rating actions on monoline insurers have primarily been driven by the poor performance of subprime residential mortgage-backed securities and CDOs, for which the monoline insurers have provided guarantees.

Using our new authority, the Commission staff has been examining credit rating agencies to see if they diverge from their stated methodologies and procedures for determining credit ratings, and to see if they follow their stated procedures for managing conflicts of interest.

I expect the findings of these examinations will better inform the Commission's oversight of rating agencies including the ratings of monoline insurers.

The Commission staff is also closely monitoring developments in the municipal securities markets to the concerns about creditworthiness of monoline insurers, and the actual or potential downgrades of bond insurers and associated rating changes on insured municipal securities, which comprise about half of all outstanding municipal bonds.

Downgrades and withdrawals of ratings on many bonds issues result from the downgrades of a bond insurer. Although such downgrades will negatively effect the prices of most bonds insured by the companies that have been downgraded, the issuers with primary responsibility for the payment of these securities generally have been investment grade credits or higher, investment grade credits or equivalent credit string, mitigating the effect of downgrades for other insurance providers.

We are aware of the failures of recent auctions of auction rate securities in the municipal and corporate markets in which too few bidders participated in the auction to establish a clearing rate resulting in higher interest rates on those securities for a period of time.

The Commission staff is closely monitoring these bonds with respect to bond insurers and their actual or potential effects on municipal bond and money market funds.

Investment companies of all types hold 37 percent of the $2.5 trillion municipal securities bonds outstanding. The vast majority

of these municipal bonds that funds hold are in so-called municipal or tax exempt funds. A small percentage of the tax exempt funds primarily invest their assets in municipal bonds that carry insurance issued by the monolines.

These funds generally have the word "insured" in their name and have an investment policy that requires at least 80 percent of their assets be invested in muni bonds, the payment of interest and principal on which is guaranteed by a Triple A rated insurance company.

Although it is difficult to predict the effective declining creditworthiness of bond insurers on municipal bond funds, a downgrade may require many insured funds to change their investment policy with respect to the rating quality of their portfolio holdings.

In addition, portfolio securities held by tax exempt money funds are often wrapped or guaranteed by monoline insurers, and may have liquidity backstops provided by large financial institutions.

In most cases, the liquidity backstops require that the muni bonds maintain certain ratings, which may be threatened by the ratings downgrade of the monolines.

Based on its oversight of the industry, Commission staff is presently unaware of any municipal money market fund currently threatened with breaking the buck as a result of recent downgrading and potential downgrading of the monoline insurers.

In the long term, however, the inability of bond insurers to maintain high credit ratings may restrict the supply of high quality paper for municipal money market funds.

Thank you for the opportunity to testify and I would be happy to answer any questions.

[The prepared statement of Mr. Sirri can be found on page 251 of the appendix.]

Chairman KANJORSKI. Thank you. Next, we will hear from Patrick Parkinson, Deputy Director, Division of Research and Statistics, of the Board of Governors, Federal Reserve System.

The Federal Reserve does not regulate the monoline insurers, but clearly has an interest in the soundness of the overall financial system. As such, we understand it is monitoring the ongoing situation.

Moreover, many of the entities that the Federal Reserve directly regulates use the monolines as counterparties for their transactions.

Mr. Parkinson?

STATEMENT OF PATRICK M. PARKINSON, DEPUTY DIRECTOR, DIVISION OF RESEARCH AND STATISTICS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. PARKINSON. Chairman Kanjorski, and members of the subcommittee, thank you for the opportunity to testify on the potential effects on financial stability of further financial deterioration and ratings downgrades of financial guarantors.

The growing possibility of credit losses on certain collateralized debt obligations of asset backed securities has caused some of the guarantors to report financial losses and the rating agencies to require those guarantors to raise capital to maintain or regain their Triple A ratings.

Those guarantors reportedly are exploring various options for bolstering their financial strength but it is not clear that all of them will succeed. Thus, it is well worth thinking through how further downgrades to some guarantors' credit ratings might affect overall financial stability.

Such downgrades might adversely affect financial stability through several channels. These include: (1) the potential for disruptions to municipal bond markets; (2) potential losses and liquidity pressures on banks and securities firms that have exposures to guarantors; and (3) the potential for further erosion in investor confidence in financial markets generally.

Further downgrades of some guarantors could spark a retreat from a municipal bond market by some retail and institutional investors. Of particular concern is the potential for disruptions to the markets for short term securities based on municipal and other tax exempt debt.

These short term securities include tender option bonds and variable rate demand obligations, which typically have credit support from one of the guarantors and liquidity support from a large bank or securities firm, and auction rate securities, which often have credit support from a guarantor but have no explicit liquidity support.

Some money market funds reportedly have already drawn on liquidity support facilities for some securities insured by those guarantors with significant exposure to CDOs that contain subprime residential mortgage-backed securities.

In addition, earlier this week there was a rash of failures of auctions for student loan auction rate securities or ARS. Although largely unrelated to concerns about the financial guarantors, this development undermined confidence in auction rate securities generally, and subsequently quite a few auctions for municipal ARS have failed.

It appears that financial stress on the guarantors has restrained new issues of municipal bonds in recent weeks, although these effects are difficult to disentangle from the effects of tighter budgets for many municipalities, a deepening concern about the financial condition of some of the guarantors could at least temporarily limit the availability of credit and increase the cost of funding for some lower rated or smaller municipalities.

Over time, however, funding for those municipalities would be restored as the downgraded firms were replaced by the surviving healthy firms and by new entrants.

U.S. banks' direct exposures to losses from downgrades of guarantors' ratings appear to be moderate relative to the banks' capital. However, even if banks' losses from exposures to the guarantors are moderate relative to their capital, banks could experience significant balance sheet and liquidity pressures if they take significant volumes of tender option bonds or variable rate demand obligations onto their balance sheets.

If these banks take on significant enough volume of such securities, the resulting downward pressure on their capital ratios might prompt some of them to raise additional capital or constrain somewhat the growth of their balance sheets to ensure that they remain well-capitalized.

Efforts to constrain the growth of their balance sheets could be reflected in somewhat tighter credit standards and terms for a variety of bank borrowers, which would add to the financial head winds that the economy already is encountering.

In addition to the direct effects of stress of financial guarantors on the municipal bond markets and banks, stress on the guarantors could have adverse indirect effects on investor confidence in the financial markets generally.

If the drop in confidence was sudden, asset markets could become less liquid and asset prices could become more volatile.

However, a sudden drop in confidence seems unlikely. Financial market participants seem well aware of the difficulties the guarantors are facing and of the potential for further ratings downgrades.

The Federal Reserve has been carefully monitoring and assessing the channels through which deterioration in the financial condition of the guarantors could adversely affect financial stability.

As primary supervisor of State chartered banks that are members of the Federal Reserve System and umbrella supervisor for bank holding companies, the Federal Reserve has collected and analyzed information on banking organizations' exposures to the financial guarantors.

We also have been monitoring closely developments in the municipal securities markets and in the markets for residential mortgage-backed securities and asset-backed CDOs, from which the principal pressures on the guarantors have originated.

Thank you. I would be pleased to answer any questions you may have.

[The prepared statement of Mr. Parkinson can be found on page 244 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Parkinson.

Finally, we come to my friend, the Mayor of the City of Wilkes-Barre, Mayor Leighton. Mayor, first I want to apologize. I know you intended to get out of the City by 4:00 today; we may make it if we hurry.

[Laughter]

Chairman KANJORSKI. That is Washington speak.

[Laughter]

Chairman KANJORSKI. If you will, Mr. Mayor. If you could give us the municipal reaction to all of these technical things we have been talking about up to this time.

STATEMENT OF THE HONORABLE THOMAS M. LEIGHTON, MAYOR, WILKES-BARRE, PENNSYLVANIA

Mr. LEIGHTON. Chairman Kanjorski, and members of the House Financial Services' Capital Markets, Insurance, and Government Sponsored Enterprises Subcommittee, thank you for the opportunity to testify today on the need to find a solution to the turmoil in the bond insurance industry.

My name is Thomas M. Leighton and I am the Mayor of the City of Wilkes-Barre, a city in northeastern Pennsylvania. I am a constituent of Chairman Kanjorski who has been a leader in economic development issues in our area.

I would like to thank Chairman Kanjorski for inviting me here today and commend him for taking the initiative on this very important issue.

Wilkes-Barre is the urban core and seat of Luzerne County, welcoming nearly 100,000 people to our City each day. We have the 4th largest downtown workforce in Pennsylvania, but this number drastically decreases after the 9:00 to 5:00 p.m. rush. We face significant challenges providing municipal services for the substantial workforce because only 45,000 residents contribute to the City's tax base.

Upon taking office in 2004, my administration was faced with over $10 million in unpaid bills in a technical bond default by one of the City's authorities. Because of this default in 2002, the City could not utilize traditional bank financing because of our weak credit rating. These circumstances combined with inherent regional economics created a bleak financial outlook for the City of Wilkes-Barre.

After working diligently to re-establish the City's finances and maintain our fiscal responsibility, Ambac Financial Group agreed to insure $40 million of debt restructuring and new money. Without Ambac's willingness to help the City, major layoffs or tax increases would have been necessary. Ambac's confidence in the City's future gave us the opportunity to access the marketplace, allowing the City to continue on a path to a solid financial future.

Despite making great strides financially, the City of Wilkes-Barre still struggles to obtain bond insurance, especially at competitive rates. As a result, turmoil in the municipal bond market is a significant concern for the City of Wilkes-Barre.

Similar to many other mid-sized cities across the Nation, we rely on monolines. When they are faced with volatility in the market, there is volatility for us.

Many small issuers such as the City of Wilkes-Barre are dependent on credit enhancements. Without them, we cannot access much needed capital for public projects, such as street paving, sewer repairs, and other major infrastructure improvements. As we work to advance our City, cutbacks in basic services like these are not an option.

Currently, the economic climate in Wilkes-Barre is weakening due to the growing expenditures and declining revenues. For example, the subprime mortgage crisis has resulted in increased foreclosures and decreasing tax revenues. Increased need for City services are challenged by lower revenues and budget challenges.

Wilkes-Barre, like other cities nationwide, is forced to turn to the debt market to avoid raising taxes, but is unable to do so because of the instability in the market.

Included in the City of Wilkes-Barre's 2008 plan are issuance of $4 million in re-funding to fill budget gaps and a $5 million in economic development for a Coal Street Park renovation project.

Coal Street's renovation will transform a park into ice hockey rings, playgrounds, and athletic fields. Under the current market conditions, this necessary development will be extremely difficult for the City of Wilkes-Barre to complete.

In addition to this venture, the City of Wilkes-Barre will continue to maintain and improve its aging infrastructure. For exam-

ple, work on the remaining two bridges that span Solomon's Creek will be completed. The area surrounding the Creek is prone to severe flooding, devastating thousands of residents and an area hospital 3 times in the past 4 years.

In order to meet the basic needs of our residents, such as preventing flooding and paving roads, we must be able to access the affordable bond insurance market.

One beneficial piece of legislation is H.R. 2091, which would change the Tax Code to allow Federal Home Loan Banks to offer letters of credit to communities like Wilkes-Barre. Chairman Kanjorski, we want to thank you for supporting this helpful legislation.

The City of Wilkes-Barre is undergoing a comprehensive social and economic revitalization. Without access to the capital, we will be unable to continue the progress that we have worked so hard to accomplish over the past 4 years. We will be forced to halt work on major projects such as the Coal Street Recreational Park or limit basic services that we provide to our residents.

Mid-sized cities nationwide must have access to the bond insurance market to improve their credit ratings. Also, there must be stabilization in this market so that Wilkes-Barre and other cities can continue to provide basic quality of life services for their residents and participate in economic development projects.

I want to thank you for the opportunity to address this subcommittee and for considering my perspective as a Mayor of this mid-sized city. Thank you.

[The prepared statement of Mayor Leighton can be found on page 236 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Mayor.

We will now have the questioning. Mr. Dinallo, I am going to ask you one or two questions that have been posed to me several times over the last 2 weeks.

That is, that the holding companies can draw on the insurance companies' dividends. Do you have legal authority to order the suspension of that and to stop it in its entirety or would you need some additional legal authority either on the State level or the Federal level?

Mr. DINALLO. I think the answer is the following, when you are dealing with extraordinary dividends as we discussed, we control those, and we have suspended all of those in the monoline insurance companies.

When you are dealing with regular dividends, they are statutorily able to dividend. One way that one could prevent the dividend from being processed would be give essentially the company an order to bring in more capital, and one way they could do it would be to suspend the dividends.

I think there might be mechanisms to do it. That would be in a certain sense us beginning to control the companies, and that would be like as if we had put them in rehabilitation or taking control of them, we would begin to basically tell management how they are going to run the company.

I think that the answer is on the extraordinary, we have pretty much absolute authority. On the regular dividends, especially when you are dealing with publicly traded companies, I think you would be more likely that you would first get to the point where you

would be doing either orders of capital infusion and if they cannot meet those orders, one could presumably put them into rehabilitation or maybe by then they would already be losing the rating and you would have the possibility of a run off, which we discussed earlier.

Chairman KANJORSKI. So many people have mentioned the fact that they cannot comprehend how a division would be sending dividends up to their holding company when in fact their solvency may be in question, if conditions were to continue as they apparently are.

Mr. DINALLO. I think that is one of the issues, Congressman. There is a difference between solvency and the rating or the share price. Solvency in the insurance world is a fairly simple question. It is the ability to pay claims as they come due.

The rating is a very different question, and here, I think it is very important that we kind of de-link them. The question of regulating the insurance companies and the questions around the dividending process generally goes to the solvency of the company.

We have never regulated, although as I said, I think in the last year we have now started to regulate this particular line of insurance companies on their rating because of course, it does matter.

I will give you an example. There is a theory under which you could put a company into rehabilitation and you could still have a Triple A rated company ironically. It would be a closed book. It would be Triple A because there would be no dispute it was going to pay on the claims as they came due. It probably would not trade very high because it would not have a business plan except just paying off the claims, and it certainly would not have a return on equity and a revenue growth plan, but it would in fact be both solvent and highly rated in the sense that it could pay on its claims.

Chairman KANJORSKI. There seems to be a legitimate fear that because there are two books here, one, the municipal, and then the other, the high flyer risk category, that even though they appear to be solvent, the likely failures will occur on the high risk book and they could drain out all the funds of the corporation. When you get down to the municipalities, there would be nothing left for them.

I am really stuck on the idea and the concept that we have to return trust and faith to the marketplace as fast as possible. I think it is necessary that anything that we can do at a governmental level or a regulatory level to accomplish that probably should be done now rather than being reactive after the circumstances occur.

Mr. DINALLO. Yes.

Chairman KANJORSKI. If there is something that we can do, these are the types of surgical legislation that I would certainly be willing to have the committee put together and submit for very fast action if necessary, as we move towards some sort of resolution of this problem.

Mr. DINALLO. Obviously, if Congress wanted to help re-insure the municipal side of the book as you said today in essence on CNBC, that would be extraordinarily helpful because then you would have a backstop that would certainly help capitalize the companies.

The good book/bad book that you have discussed is done in this instance. If we did it quickly, it would be done to preserve the rating of the good book. You would have a good book of municipal business that would stay Triple A rated, and you would have a stressed book that would be substantially less.

It would not necessarily be done right now because of solvency or claims paying ability. As you said earlier, there is no evidence yet that the claims on the CDO side will exhaust the entirety of the municipal book. All the actions we have taken and the meetings that I have held and the concerns that I have had is they will get downgraded because of the confluence of the two books and that will have a systemic impact and will put the companies into a run off and will have obviously impacts on the economy that we have been discussing.

It is not yet the case, I believe, that they do not have claims paying ability. I think that is an important distinction.

Chairman KANJORSKI. Work with us on it. Because the stimulus moved through as quickly as it did, I am a little bit under the impression that we are going to get unusual cooperation from Treasury and the White House.

Mr. DINALLO. Great.

Chairman KANJORSKI. As a matter of fact, while I was out, I was notified that Secretary Paulson announced that I am formulating a letter requesting support systems for the student loan process.

I understand that as soon as he receives my letter, and we have it being hand carried to Treasury this afternoon, that he is going to take action to shore up that marketplace.

Mr. DINALLO. I will ask if we could have a line of credit not even actually capital, a line of credit of $10 billion, my instinct is that more capital would come in before that, because you would have the line of credit in place, which is what I told the banks in the first place, and I think it would be an increasingly less likelihood you would ever need the line of credit because ironically—

Chairman KANJORSKI. Do these insurance institutions have the rate to participate with Federal Home Loan Banks?

Mr. DINALLO. I am sorry. I did not hear the very last part.

Chairman KANJORSKI. Why could the insurance companies not make an application to the Federal Home Loan Bank system for a line of credit?

Mr. DINALLO. I do not know the answer to that. Certainly, the investment banks that are the counterparties to their policies could make such an application, and you could do the re-insurance that way.

Chairman KANJORSKI. We should look into that. I certainly would be amenable, and that is one way to spread the risk.

Mr. DINALLO. That is right, extremely broadly.

Chairman KANJORSKI. Incidently, while we were over voting, another insurer, FIGC, was downgraded by Moody's, as you may or may not know, from Triple A to A–; that is a big jump, 6 levels.

I guess the equity markets sort of gave some indication of their appreciation of that by dropping 175 points. I think we are into a very volatile situation and things that we should do and can do should be done as quickly as possible and as cleanly as possible.

Mr. DINALLO. I have been trying, Congressman. I will take the brass cup anywhere.

Chairman KANJORSKI. I am saying on our side, and I am sure the Governor would say this would be a bipartisan effort. We want to get this done.

I have a question for our other participants here, both the Federal Reserve and the Securities and Exchange Commission: Is there a working group being put together at the executive level to closely monitor what is happening in the economy so that you are not individually by institutions watching what is happening, but have a cooperative overall working group view of what is happening so that all of us, including the Treasury and the White House and the Congress, can get faster information as to what we can anticipate, and not from a technocrat standpoint?

I do not want to categorize your testimony in any way as technocrat. You all sounded like you were telling us what you could do in normal times. Maybe I am unusual in thinking that these are extraordinary times.

Make the assumption of my foolishness to deal with me. If we are in extraordinary times, what are we doing extraordinarily in the executive and independent agency areas of the government to really come together very quickly so we can have faster responses, legislatively and by executive order if necessary?

Mr. PARKINSON. The SEC, the Fed, Treasury, and CFTC all meet as members of the President's Working Group. We have been at work for some time to produce a diagnosis of the underlying causes of all the problems we are seeing in financial markets and to develop a comprehensive package of reforms to address that.

Chairman KANJORSKI. That is the Working Group and we are awaiting that package of reforms. In the meantime, we could get into some financially disastrous circumstances before the Working Group is over or before the long-term solutions could be put into place.

I am looking at brakes that could be put on as were put on after the 1987 crash on the market that have really worked wonders since 1987 to stop run away situations in the equity markets.

Are we thinking along the lines that in the credit markets, there are things that can be done, sort of in extraordinary circumstances and timeframes that could help us from freezing up?

I was visited last week by issuers of corporate bond instruments. The story that they gave me of what they feared was extraordinary, that there is no market out there and if we do not do something very quickly, what little market is out there is going to disappear and the needs of American business to have a line of credit to operate in 60 or 90 days is going to be fast restricted or disappear.

That sounds to me like extraordinary circumstances. I am not in a position to know whether what they are telling me is true. I have no reason to believe it is their benefit to excite the market in any way. Of course, I have probably now excited the market.

[Laughter]

Chairman KANJORSKI. We have to find ways to talk to each other and to know what is going on.

I was struck, I will be honest that this is the first time in 7 years that I can recall the White House and Treasury coming to Congress and asking for fast bipartisan action. This is the reason I got very involved in the stimulus package these last 2 weeks and the reason this committee got so involved.

The Administration has not even done this for the war, but they did it in the last 2 or 3 weeks. My suspicion is, and it is strictly a suspicion, that they have unproven indicators that really flash tilted extraordinary extreme situations.

I am not going to put the Federal Reserve on the spot to tell us whether you have that hidden box down there of undisclosed indicators, but I suspect you do, or somebody got ahold of this and realized this was something serious and we ought to make every attempt in the world to get in here and put some firewalls up. I think that is what the stimulus package was.

If it was not, then what it means to me is that we have had a genuine re-birth at the White House. That is probably good, too. I do not expect that happened. I expect what happened is the White House got scared, but they have not and we have not disclosed it to the American people. Maybe it cannot be disclosed or maybe it does not have sufficient validity to be disclosed.

Since that precedent-setting action was taken just in the last several weeks between all these important financial institutions of our government, and since the Congress did positively react, I am just wondering if we cannot find a way, because we have not been informed, to my knowledge, no one on the committee, including the chairman, has been informed of this.

We have to find ways of knowing how serious things are out there, whether there is something we can do or should prepare our fellow Members to do, or whether we should just sit around with our thumbs in our mouth and wait until something really serious happens that we cannot correct.

Maybe you can address that.

Mr. PARKINSON. I think both the fiscal stimulus package and the Federal Reserve's monetary policy actions were taken because of the perception there were significant risks coming out of the turmoil in the financial markets to future economic growth.

We have taken both those monetary policy actions to try to insulate the macro economy from some of the things that are going on in the financial system.

As you were talking about circuit breakers, I was trying to think of what the analogy could be in this case, but I was struggling a bit. It seems to me that if firms are concerned about their inability to issue debt and raise funds in the debt markets, putting a floor on the prices of bonds is not going to be helpful to them. That would lead in effect to the same sort of phenomenons we are having in some of these auction rate securities markets where markets have been failing to clear because of the imposition of this kind of speed limit to the system.

So my preliminary analysis is that it is unlikely to be helpful and in fact, might be harmful in the present context.

Chairman KANJORSKI. Is there anybody down there who has been thinking about positive things that could be done that we either do not have authority for or would take some time to legislate

on that we should start thinking about, going through the process of legislation?

Mr. SIRRI. I think there have been some examples of things that have been done recently. Within our own authority, we have been asked to consider certain changes to accounting rules or interpretations of accounting rules.

In this specific instance, it was to allow loans to be renegotiated. The determination we had to come to was the circumstance under which default would be reasonably foreseeable, working with the American Securitization Forum and the FASB, we were able to provide some clarity for that definition, that allowed loans to be renegotiated without having those trusts be brought back onto the balance sheets of the intermediaries, necessitating a large capital charge.

I think another example where we have been changing our policy slightly to accommodate the current environment has been in the area of money market mutual funds.

As you know, there have been some defaults and some impairments of short-term commercial paper, as the funds have held those papers, they have been circumstances where support was needed, where subsidies were needed of various kinds, and through our rulemaking and no action ability, we have been able to facilitate that, allowing the money market mutual funds to stay at a $1 NAB.

Chairman KANJORSKI. Somebody raised the question the other day, that if the SEC just changed the rating on municipal bonds to reflect what the rating is on corporate bonds, that this would free up the two distinctions and many of the municipal bonds could move on without being forced for sale because they have maintained a Triple A. It is Rule 2a-7.

Could that be addressed? Could that simply be done by making that different distinction?

Mr. SIRRI. I think what you are referring to is a portion of 2a-7 that provides that if a piece of a long-term paper held in a trust is rated below a certain level, in this case, AA, then the money market mutual fund would have to sell that paper.

I think the important thing to realize here is why a rule like that was put in place. Money market mutual funds are substitutes for cash. As such, the primary issue associated with them is one of liquidity.

The Rule 2a-7, which is a very complex definitional rule, is all about maintaining liquidity for that money market mutual fund. I think we hold that liquidity is paramount here. We would never want funds to be encouraged to hold instruments that are not very, very liquid. The reason is they could break $1.

Chairman KANJORSKI. Let me understand. It is not that these municipal bonds have lost their value. It is that laws are driving them, because of ratings by rating agencies, to potentially be sold and they are being sold into a market lacking liquidity, and as a result, their prices are falling materially from what their real value is.

Is that not the problem?

Mr. SIRRI. It is part of the problem, but I think you put your finger on it when you talked about liquidity. The thing that is important here is that the instrument be liquid.

It may be as you say that its value is still high, but the securities are only worth what you can sell it for at the moment, especially in the case of a money market mutual fund. We would never want them holding paper that they could not liquidate instantly at the value at which they were incurring it.

Chairman KANJORSKI. Is not one of the potential remedies here if we have a freeze up in the marketplace and we have no buyers, that we potentially would have to authorize the Treasury to be the buyer of last resort, just to stabilize the market?

We would be expending a lot of money and putting the taxpayers' money at tremendous exposure, dollar for dollar exposure, as opposed to just recognizing that we may have a temporary situation that by adjusting the rating score to reflect something different than it does now for municipal bonds and just make them rated at the same way corporate bonds are rated, they would still carry a Triple A corporate rating. They would not be any more or any less at risk than they are today, but they would not have to be spun off by some of these institutions that are under compulsion by law not to hold these securities and to get rid of them.

Even if we did it for 30 or 90 days, it is somewhat analogous to me that at a point, say the subprime market goes into the prime market and rather than looking at 2 million foreclosures, we are going to look at 6 million foreclosures.

Is there any doubt that we would not think about declaring a moratorium on foreclosure at some point? We did it during the depression.

I would certainly be supportive if I saw a tremendous total collapse of the real estate market, which would be a total collapse of the financial market, why not go to a moratorium?

That is an extraordinary measure. We do not want to do it, but by doing some surgical repair, potentially, we could hold back that situation at no greater cost than if we have to move in and do moratoriums or other such remedies that are rather limited, and probably are too complicated for the Congress to participate in.

The time and effort that it would take to get this through and signed into law, I suppose we could do it, but if we got to the point where we could cooperate the way we did last week on the stimulus with the White House and the Congress, I have a feeling it would be a song of doomsday for the country. That is the extreme to which we would be driving. I do not see us coming together too often the way we did last week.

Are there measures that you can all take within the independent agencies and the Executive Branch that could alleviate some of this pressure even on a short term basis?

Mr. DINALLO. I think that the one thing that is important is in the long term, the Triple A rating, the wrap, is an important thing for lots of municipalities, for small municipalities, for the boards of schools and hospitals.

They cannot realistically go forward without a Triple A rating because of the depth of distribution of the money market account point. I think you could do it for a short period of time, but the con-

cept of all these municipalities would sort of go without a Triple A rating is really a difficult world to conceive of when you are dealing with money market accounts and fidelity, etc.

Chairman KANJORSKI. I just want to make a point to the Mayor. I know you have so many projects, Mayor, that are either going in or about to go in or are in development that could be affected by the failure of the bond market to provide the liquidity to continue. I hope that does not happen.

I want to tell you a story. When I come back to Wilkes-Barre and look around, I always look at the cranes and the number of cranes I can see indicates the relative success of the economy at the time.

That also applies down here in Washington. I sit in my office and I look out the window. If I can count something less than seven cranes, we still have a very healthy economy in Washington. When I see more than nine cranes, we are getting close to trouble. It has happened that way for 25 years.

It is very interesting how we tend to go to excess and then we get these jolts in the system.

What we are going to try to do for Wilkes-Barre and other medium sized communities is keep the crane count down to the right number so we do not have those disasters.

Now, Mr. Castle, if you will.

Mr. CASTLE. Thank you, Mr. Chairman. Let me just start by saying a couple of things. Mr. Bachus is at a meeting at the Capitol and could not be here. I also want to enter into the record pursuant to the conversation which he and Governor Spitzer had—there was confusion in that discussion. Governor Spitzer indicated that the blame for the bond insurance crisis lay with any of the regulators other than his department. His department was the only one directly responsible for most of the bond insurers.

He also politely denied there were any special dividends approved for a bond insurer during his administration. I would like to proffer for unanimous consent to enter into the record a Form 8–K filed by MBIA, Inc. with the Securities and Exchange Commission. The document says, "In April 2007, MBIA Insurance Corporation received approval from the New York State Insurance Department to declare and pay a total of $500 million in special dividends to MBIA, Inc. in the second quarter of 2007."

I would note further, for the record, that despite the recording of pre-tax net loss on its financial instruments in that report, the same company actually increased its dividends throughout the entire year of 2007. It also went through an additional $660 million in capital in what is perhaps an ill conceived stock repurchase program.

I would like to proffer for unanimous consent the Form 8–K from the Securities and Exchange Commission. Thank you.

Mr. MEEKS. [presiding] Without objection.

Mr. CASTLE. Let me ask this of you, Mr. Parkinson. I have read about Warren Buffett's offer to reinsure the bond insurers' muni portfolio for a 50 percent fee above the unearned premiums. Nice that he can do that.

I am concerned about this. Would this not really just spin off all of their core good business? I have heard testimony from all of you a little bit today, from their bad business, leaving crippled run off

companies, and while this might benefit New York and other municipal debtors, as well as clear the future muni market business for Buffett's new company, would it not be unfair to the holders of all the other bond insurers' other debts, such as banks and hedge funds that relied on the bond insurers' wrap based on their entire book of business, including the stable portions?

Mr. PARKINSON. I guess as I understand his proposal, it is to reinsure the muni bond portion of the—

Mr. CASTLE. Just that portion; correct.

Mr. PARKINSON. The trouble I have with that is that I don't see how that will solve their current difficulties, how that will improve their rating. To be sure, it would mean they have additional resources to bear any losses that might arise from the muni bond side, and therefore would free up some capital.

But that would come at the price reducing their revenues going forward. Consistent with that analysis, I have read in the press that it would not lead the rating agencies to feel any better about their current financial condition, and if that is the case, it seems to me that it does not solve the fundamental problem that they are facing, and therefore, does not reduce the likelihood that there would be adverse effects on the broader financial markets.

Mr. CASTLE. That was my impression, too. I appreciate your answer on that.

Mr. Sirri, the current crisis in our credit markets has been exacerbated by the overwhelming lack of transparency. For example, a lack of any price reporting mechanism for collateralized debt obligations or credit default swaps.

Do you believe it would be beneficial to our markets to allow investors to see the actual prices for these complex instruments? What steps could you take as a regulator to make that happen?

Mr. SIRRI. The markets you are talking about are over-the-counter markets. They take place as trades between brokers and between dealers. They do not take place on exchanges.

You are quite right. Prices are not generally produced in those transactions that are available to the public.

If you want to consider whether it makes sense to make those prices public, I think it is a difficult analysis and one you have to undertake with care.

These markets are filled with what are known as bistro contracts. They are very customized contracts. They do not trade broadly. They are only held by a small number of people.

In such circumstances, you do not generally think of providing transparency to those markets. If we did come to a determination or if you all came to a determination that would be useful, there are mechanisms to do that.

There is, for example, in the over-the-counter markets for fixed income securities, a system called Trace that is operated by FINRA. It is a mechanism whereby corporate bond trades are reported to and then disseminated publicly within minutes of the trade.

If we thought it was useful to do so, that scheme could be broadened to incorporate other classes of securities. For example, right now things like agency securities and asset backed securities are not covered by Trace. It could be broadened to include those kinds

of securities, including mortgage-backed securities, CDOs, and such.

Mr. CASTLE. I realize we have another panel. I do not want to take any longer. Just sitting through this today, your panel and the one before, and reading some of the testimonies to come later, it occurs to me that there are steps that if we all put our heads together, perhaps we could be taking them, in terms of clarification of regulations, for example. Perhaps the transparency issue and a few other issues, I am not saying it is at the heart of the credit problems right now.

I happen to think a lot of this lies in real estate issues and other areas. I believe we could have perhaps done a better job than we have, and hopefully, when it is all said and done, we can come to some sort of agreement to address all of these issues better.

With that, I yield back, Mr. Chairman.

Mr. MEEKS. Thank you. Let me start first with a question to my superintendent from the State Insurance, Mr. Dinallo.

What do you think the State regulators like yourself did right or wrong with respect to the bond insurers?

Mr. DINALLO. What I think we have done right is we identified an issue and immediately got on top of it, I think well before many other people were confronting the issue. We have done our best this year to highlight the issue and come up with solutions and particularly private side potential solutions in dealing with it.

If we were to criticize what we did wrong, as I said before, I think we emphasized solvency, which is what we are supposed to be doing, but here, it turns out that a Triple A rating is really important. I guess we could regulate more to the rating as opposed to the pure solvency question.

That is not something that historically we have done. I do not think frankly a Federal or State or other regulator would necessarily do that. Here where you have such interconnectivity, it is not just a claims paying question. It does turn out to be a rating question.

If I could just clarify something I said before, I can see we are starting to wind down, in responding to Chairman Kanjorski's question about what the Federal Government could do, and I know he was on CNBC today talking about sort of the FDIC-type backstop, I think we should first, of course, go for a private sector solution. We have been trying to facilitate that. That is what the entirety of my efforts have been about.

Failing that, one goes to sort of a good book/bad book scenario, and then you get to the Berkshire Hathaway question, which is who seeks to reinsure or buy that good side of the book. That is the point.

All I was saying was that if Congress wants to do that or even the States altogether, the municipalities could reinsure themselves technically, certainly Ajit Jain's offer is a very appreciated offer, although any experts will tell you it is a very profitable offer for Berkshire Hathaway, and there might be a better solution, a cheaper solution, to worry about the good side of the book if we cannot get to any other scenario, including what I hope is as we are speaking private side solutions.

Mr. MEEKS. Mr. Mayor, I was listening to your testimony. As you stated, many cities, talking about infrastructure problems now, going into debt because of the foreclosures on homes, and they are limited in what their resources are and what their alternatives are, other than raising taxes, etc.

Off the beaten path just a little bit, but I know that the Senate is doing an investigation into solvent wealth funds, but in Indiana, for some infrastructure problems, they had utilized some solvent wealth funds to do roads and highways, etc., for infrastructure.

I just wanted to get your opinion. Would something like that, given the crisis we have, be an option for cities like yours to look into to try to offset some of the financial debt that the cities are currently in?

Mr. LEIGHTON. We are always looking for different sources to help us with the debt. Just last month, I attended the Conference of Mayors here in Washington and listened to all the mayors talk about the infrastructure across this country, especially about the bridge that collapsed in Minnesota.

What it appears is that throughout the United States, the aging infrastructure is affecting not only smaller cities like Wilkes-Barre, but also bigger cities like Minneapolis. The problem we are having is there is insufficient revenue sources to fix the aging infrastructure. We are always looking for alternative ways of reducing our debt and increasing our revenue sources.

Mr. MEEKS. My last question would be to Mr. Sirri. When we look at this crisis, the question of transparency is a big issue. I would like to know whether or not you think there is a role for a group like the New York Stock Exchange to play in the transparency issue, something they may be able to do in that regard.

Mr. SIRRI. There could be conceivably a role for any number of entities that choose to collect and report, disseminate information.

I think the question you have to ask very carefully is to what extent would dissemination of information help the problem. Largely, in this space, one of the problems were there were simply no trades. In the space of CDOs, starting in early 2007, trades just did not occur. There were no prices.

I think here, although transparency is often helpful, I think it is a difficult analysis and it would take some additional work to determine to what extent that would help solve this exact problem.

I would note there are a number of mechanisms that are available to disseminate such information. The New York Stock Exchange, I think, might be one of them. The Trace system I mentioned earlier would be another. There may yet be some private sector solutions that would fulfill a need like that.

Mr. MEEKS. Thank you. I want to thank all of you, and again, on behalf of the chairman, as he did, apologize for the delay. This panel is now dismissed.

We would like to welcome our third panel. I guess we will hear from Mr. William Ackman first, the managing member of Pershing Square Capital Management.

Mr. Ackman will present for 5 minutes.

STATEMENT OF WILLIAM A. ACKMAN, MANAGING MEMBER, PERSHING SQUARE CAPITAL MANAGEMENT, L.P.

Mr. ACKMAN. Mr. Chairman, and embers of the subcommittee, thank you for the opportunity to share my perspective on the bond insurance industry.

In my remarks, I will introduce my firm, Pershing Square Capital Management. I will explain how the bond insurance industry grew beyond its original roots to its current troubled state, share my views on recent attempts to bail out some of the insurers, and propose solutions to mitigate the potential for systemic risk due to a failure of some or all of the bond insurers.

Briefly, on Pershing Square, we are a registered investment advisor that manages $6 billion of capital, and we are principally value investors. We have large stakes in companies like Target, Barnes & Noble, and Sears. As a result, our success is highly dependent on the strength of the economy and the American consumer.

I am actually here today not to talk about our long investments. I am here to talk about a short position we have in the holding companies for the two largest bond insurers, MBIA and Ambac.

By way of explanation, the holding companies are the publicly traded owners of the regulated insurers, and the insurers are the companies that are the subject of the hearing today.

Just briefly on short selling, because I think it can be somewhat controversial and some people say you cannot rely on short sellers because they are biased. I think the point I would make is that you have to remember that management is also biased. Management owns stock and options, short stock and options. They are long. We are short. We both have, you could argue, a bias.

While our interests are actually adverse to the holding company executives, our interests actually align with the policyholders who are the beneficiaries of the guarantees from the insurer. We want the insurance subsidiaries to retain as much capital as possible so they have a higher probability of making good on their obligations to policyholders.

Just briefly on background on the industry, we have heard a lot about it today, so I will take you through it quickly. The industry began in the 1970's. For 20 years, it was principally a mutual bond insurer. The holding companies went public in the late 1980's/early 1990's. I think that is a significant event in the history of the companies, at which point the holding company executives began to be compensated based on the performance of the holding companies by getting stock options and restricted stock, and then the business became more competitive as there were more entrants, and a desire for greater profits led holding companies to push their subsidiaries into riskier lines of business.

Over time, the interests of the holding company executives, in our opinion, and the bond insurers themselves, diverged. Over the last decade, risk taking accelerated. Massive subprime and derivative exposures developed and we have heard a lot about that today.

Who is responsible for the industry's problems? In our view, the holding companies bear principal responsibility for poor risk management.

We think the rating agencies also share responsibility because they encourage the bond insurers to diversify and to structure fi-

nance. We think they understated the risk and overstated the ratings for that part of the business.

We think regulators overly relied on the rating agencies and the managements, and that contributed to the problem as well.

The problem today, of course, as we have heard, is losses from subprime exposures will likely in our view overwhelm the capital of the bond insurers, leaving policyholders at risk.

We have heard a lot from Superintendent Dinallo. I would like to say listening to what he has been working on over the last several months, I think he has actually done an excellent job managing a very difficult situation.

I think bringing in additional capital into the industry is a positive. We are very supportive of that development. Berkshire Hathaway is a true Triple A rated company. I think that is a very good development.

We do object. We do think it is not good for the capital markets for a bailout to take place where the bailout participants are the counterparty banks to these exposures.

What I mean by this is that if private equity wants to come into the bond insurance business, we think that is a wonderful thing. If a bank that has counterparty risk that they do not want to write down wants to take advantage of the fact that the bond insurers have lower capital requirements than banks, having lower rating agency standards than banks, and they can put a few billion in, to not take $30 or $40 billion of losses, we think that is actually bad for the capital markets because it reduces transparency.

There are some investors that might be hurt as a result of a downgrade to the bond insurers, about $1.5 or $1.6 trillion in mature muni bonds are at risk for downgrades.

We have heard about municipal money market funds that might be forced to sell securities if they get downgraded below the AA. You heard today in the front page headlines on muni auction selling.

Here is why I have an interesting solution that I think is worth considering. The good news, if I can call it that, is that the rating agencies have systematically under rated municipal bonds.

The simple example of that is a Triple B municipal bond has one-fourth the probability of default of a Triple A corporate. That is a stunning fact. It is a fact that is not that well known in the broader investment community.

I guess the best way I would explain it is if you look at all the municipalities in the country and you are in the business of giving ratings, and almost all of them are Triple A, in order to have a business, you have to grade them a little more harshly, so you have various levels that you can address.

There is something called the municipal rating scale, which I think Chairman Kanjorski was touching on, and the corporate rating scale.

We heard the Congressman from Massachusetts talking about the grade of his Massachusetts' community's debt. We think the same scale should be used for corporate ratings and all municipal ratings. What that will do is it will lead to a systematic upgrading of municipalities around the country, and we think—Moody's and S&P have more data on this than we do.

We think the vast majority of municipalities will be AA- or higher on the corporate rating scale, which means even in the event the bond insurers are downgraded, the underlying ratings will qualify for the Rule 2a-7 test and for many fiduciaries, like pension funds, that are only able to hold highly rated bonds.

I want to talk briefly about the Buffett proposal. I think the media has not gotten it quite right. I do think it is a very interesting proposal, if the goal here is to protect the municipal holders.

What Buffett is offering is a private sector solution. In my view, as an American, you do not go to the government for money if there is a private sector alternative. You want to protect bond holders.

Buffett is offering to reinsure the entire municipal books of three of the biggest bond insurers. What he is doing is he is putting the municipal holders at the front of the line, as he calls it.

The concern is that the structured finance risk will burn through the capital of the bond insurers and 5 years from now, there will be nothing left for municipal holders.

What he is doing is he is taking that risk away from them, he is giving them a Triple A rating, and he is charging what he thinks is a market price.

What I think is very interesting about it, if this turns out to be a wonderful deal for Mr. Buffett, he is giving a 30 day period of time where anyone else can put in a bid, so he is creating a ceiling on the maximum price the bond insurers have to pay for this insurance, and if AIG or GE or another well-capitalized company wants to come in and do it at a lower price, and they are free to do it at a lower price, and this is a very efficient way to establish an auction price to reinsure that book of business.

Systemic risk. The other big piece here, of course, from a systemic standpoint, is the structured finance part of the business. Here I am relying on Oppenheimer estimates.

There is $125 billion of CDOs where the banks are counterparties to the bond insurers. The estimates are there will be $35 to as much as $70 billion of losses here. These are exposures that the banks have reinsured with the bond insurers. If the bond insurers go away, the banks will be exposed to this risk, less whatever they collect in terms of claims.

Buffett describes it. He says look, it is poetic justice that the people who sold this kool-aid end up drinking it in the end, so there is a little poetic justice.

That said, we heard from the SEC just on the previous panel that the banks are positioned to absorb these write-downs if they have to. We think if there is going to be a loss and it turns out it hurts a bank, if a bank needs to be recapitalized, we think a bank should be recapitalized directly as opposed to through the mechanism of the bond insurers.

Mr. MEEKS. Could I just ask you to start wrapping up, please?

Mr. ACKMAN. Sure. These are my final remarks.

What should regulators do? We heard about special dividends. MBIA took out $1 billion in special dividends between December of 2006 and April of 2007.

The goal of holding companies is really to take out as much capital as possible so they can pay dividends and buy back stock.

We heard from Superintendent Dinallo that he can stop special dividends, but not ordinary dividends. That really comes down to the fact that the executives themselves determine the amount of statutory capital that an insurer has.

If there is policyholder surplus, they can take out ordinary dividends. What determines policyholder surplus is what the estimates management has for losses. The big debate here is what the losses are going to be.

Our suggestion is that the regulators, and Eliot Spitzer, the Governor, talked about some Federal assistance, I think the best place for Federal assistance here would be for the Federal Reserve, the Comptroller of the Currency, and the Treasury, to help the New York State Insurance Department and other insurance departments to value the exposures of the bond insurers, figure out whether they are adequately capitalized, whether the reserves are adequate, and if not, there is a very simple solution where the State Insurance Department can fix the problem.

We need transparency on what the losses are. We need an independent third party with the resources to evaluate it. I think we have it in the form of our banking regulators.

I thank you for the time.

[The prepared statement of Mr. Ackman can be found on page 86 of the appendix.]

Mr. MEEKS. Thank you. Next we will hear from Mr. Keith Buckley, the group managing director and global head of insurance for Fitch Ratings.

STATEMENT OF KEITH M. BUCKLEY, GROUP MANAGING DIRECTOR AND GLOBAL HEAD OF INSURANCE, FITCH RATINGS

Mr. BUCKLEY. I would like to thank you, Mr. Chairman, for the opportunity for Fitch Ratings to give our views on the bond insurance industry.

What I plan to discuss is Fitch's history of rating the bond insurance industry. I will provide a general overview of our rating methodology, and then I will discuss recent rating actions that we have taken, including downgrades of three of the Triple A bond insurers.

From a historical perspective, Fitch began rating the bond insurers in 1991. We currently rate eight bond insurers including each of the big four bond insurers that together make up about 83 percent of the gross insured power in the industry.

All but one of these eight companies was originally rated Triple A, and all of these companies maintained their original ratings until very recently.

Accordingly, our bond insurer ratings have exhibited high levels of historic stability.

Our methodology is consistent with that which we use for other types of insurance companies and financial institutions, also recognizing the unique attributes of bond insurance. We look at both qualitative and quantitative attributes, with qualitative including such things as management, corporate governance and franchise, and quantitative aspects including things such as capital adequacy, risk management, financial performance, and liquidity.

Although all of the quantitative factors are important, arguably the most important is capital adequacy. We assess that via a proprietary model that we developed earlier last year, where we analyze the relative risk of the municipal structure and infrastructure bonds that are insured by the bond insurers, and based on that analysis, come up with relative amounts of capital they need to maintain in order to meet a Triple A rating threshold.

Generally, the greater the risk in the portfolio, the higher the amount of capital that needs to be held.

A key input into our modeling are the underlying ratings on the deals that are insured by the bond insurers. We generally take into account our own rating, if it exists. If not, we use the lower of the Moody's and S&P ratings.

I think it is also important to note that the bond insurers themselves maintain their own underlying ratings and employ their own credit staffs. They do a lot of work beyond what the rating agencies do to assess their own risks.

The ratings that we assign to the bond insurers are called financial strength ratings. They are assigned at the insurance operating companies that are regulated at the State level.

It is the regulatory protections that in part allow us to assign Triple A ratings because those liabilities are protected by statute.

I think it is very important to recognize that IFS ratings indicate the likelihood that a bond insurer will fail and become insolvent. The ratings do not provide and were never intended to provide any indication as to the likelihood that a bond insurer may be downgraded.

In fact, with most financial institutions and insurance companies, downgrades are common during periods of financial stress and when it comes to the subprime markets that a lot of insurance companies and financial institutions deal with, we are in such a period of stress.

Our recent rating actions came in two phases. Back in the second quarter of 2007, we began to get worried that because of subprime issues, in underlying deals rated by the bond insurers, that there would be downgrades in underlying collateral which would lead to increases in capital requirements, which in turn could put pressure on bond insurers' ratings.

We first did a stress test of this analysis and published it in September of 2007. When things seemed to get worse with subprime, on November 5th, we announced a formal review of the industry.

At that point, we said when we completed our analysis, if companies were shown to have inadequate capital relative to our Triple A standard, we would give them a period of 4 to 6 weeks in order to raise new capital, and if they were unable to do that, we would downgrade their rating consistent with what their credit metrics implied.

We thought it was important to give a timeframe such as 4 to 6 weeks for 2 reasons. One is that we think that Triple A companies, including bond insurers, need to demonstrate financial flexibility during all periods, either stressful periods or good periods. It is important to judge that.

Also, bond insurers have made unflinching representations of their willingness to support their Triple A ratings, and we felt the

willingness of management to act quickly to support Triple A ratings was a very important qualitative factor in maintaining their ratings.

At the conclusion of our analysis, two bond insurers did raise capital or had commitments that allowed us to affirm their ratings, but three companies did not, and those ratings were downgraded.

Two other companies did not have material subprime exposure and their ratings were affirmed and remained stable.

We then announced a second phase of analysis on February 5th, after additional studies were done based on new economic data looking at subprime, that indicated losses were growing even higher.

Based on indications from our residential mortgage-backed securities group, we increased our loss assumptions and that indicated that maybe additional capital would be needed.

Concurrent with that decision, we announced that the ratings of two bond insurers that were previously affirmed were now put on rating watch negative because the capital they raise may not be adequate to cover the shortfall.

That analysis is ongoing. We have not announced a timetable as to when we think that will be completed, but I do think it will be in the relatively near term.

We do think to the extent that additional capital is required and additional downgrades were to occur, we do think the companies would remain solidly in the investment grade category.

In conclusion, I think Fitch's outlook for the bond insurance industry is somewhat uncertain at this point. We think there is a possibility that some companies may decide to voluntarily exit the market if they cannot return to Triple A ratings and retain trading values.

We think it is also likely that other companies may consolidate and thus try to deal with their issues that way.

We also would expect new entrants, and I think Berkshire Hathaway has been spoken about several times.

One thing that is important is because of the escalating losses related to subprime and because we have noticed some companies did not raise capital within the timeframes we set and because there are declines in franchise value, we are not sure the capital raising alone is sufficient to allow downgraded companies to return to Triple A.

At this point, reforming our methodologies as far as what does it take for a downgraded company to come back to Triple A, as far as those parameters and timeframes, and we will clarify that for the market in the near term.

I think what is important to recognize, too, at this stage, consistent with our original Triple A ratings, we are not envisioning solvency problems for the bond insurers. Again, this is a rating downgrade issue, not a solvency issue. I think that is a very important consideration.

Thank you very much for inviting me to testify.

[The prepared statement of Mr. Buckley can be found on page 93 of the appendix.]

Mr. MEEKS. Thank you, Mr. Buckley. Next we will hear from Mr. Richard P. Larkin, senior vice president of Herbert J. Sims & Co., Inc.

STATEMENT OF RICHARD P. LARKIN, SENIOR VICE PRESIDENT, HERBERT J. SIMS & CO., INC.

Mr. LARKIN. I would like to thank the subcommittee for inviting me. I think it would help for you to know that I served 26 years at two major statistical rating agencies over my career.

I would like to spend 2 minutes to answer some questions that have come up several times during the committee.

I am going to talk about low municipal scale ratings. I am going to talk about high corporate equivalent ratings, but also why is there such as thing as bond insurance and why is it needed if there are very few defaults.

In 1971, Ambac was founded. In 1974, MBIA was founded. Both are bond insurance companies. It was a small business. Most people at the time thought it was a novelty. However, in 1975, New York City had their financial crisis which threatened to destroy credit markets across the world, or so people thought. It was a major financial crisis in 1975.

That was followed shortly by Yonkers' almost-bankruptcy, the insolvency of the school boards of Chicago and Philadelphia, and a meltdown in the City of Chicago.

In 1982, a large default by the Washington Public Power System, and in the middle of that, California, Proposition 13, where voters passed and basically eliminated half of the taxation of municipalities that had to pay debt in California.

In those 7 years, there were good reasons for municipal bond investors to worry whether or not their bonds were going to be paid, and a lot of the reason for why municipal bond ratings are as low as they are came out of the 1975 crisis, plus those 7 years where there was a lot of stress.

I would like to say that I believe it is clear that the bond insurance crisis is rating driven. While bond insurers take responsibility for extending their guarantees into volatile and increasingly risky sectors, they could not have maintained their Triple A ratings unless the rating agencies believed that exposure in this sector would not have weakened those ratings.

Any solutions to this crisis will require actions by the NRSROs or changes to the NRSRO system.

In the last week, the three agencies have announced reforms or proposed revisions to their rating process. Because of their newness, it is difficult to determine whether or not they will be able to prevent reoccurrence of a crisis as the one we are witnessing right now.

There have been studies by rating agencies that point out default rates on tax-backed and utility revenue bonds are lower than those for Triple A corporate rated debt. As more people are educated in the history of infrequent municipal bond defaults, I believe demand for municipal bond insurance may be less robust in the future than has been the case.

Despite these low default rates, the median ratings for tax-backed and water and sewer utility bonds are only in the single A category despite low default rates.

In March of 2007, Moody's said their municipal scale rating were not indicators of default and loss, like their other ratings. In the report, Moody's published a map to show that these bonds that I am talking about, which are rated as low as BAA–3 on their municipal scale, would be rated no lower than AA–3 on their global scale.

The default studies used by this March 2007 Moody's report all corroborate what finance professionals and academics have said for years, that municipal bonds are the second safest investment against default after U.S. Treasury obligations.

It is clear, however, that the more conservative municipal scale ratings with a median single A rating play a large part in the usage of municipal bond insurance.

It is my firm belief that ratings which truly reflect low municipal bond defaults, call them global scale or corporate scale type ratings, would allow significantly more debt to carry ratings of AA and Triple A consistent with Rule 2a-7 allowing those investments to be carried by municipal money market funds.

Using this scale for retroactive assignments of underlying ratings on uninsured debt would also allow more securities to be retained by money market funds in the event the bond insurer ratings are downgraded below the AA level.

Here I must disagree with Mr. Ackman in his testimony when he said nearly all municipal bonds would probably be upgraded by moving to this corporate scale.

There are classes of municipal bonds where there would probably be little or no increase in ratings even going to the higher scale. These classes include hospitals, long term care providers, nursing homes, toll roads, private colleges, ports, and airports. These issuers have the greatest need for a viable bond insurance industry and are likely to feel the impact of the bond insurance crisis the most.

To me, the current crisis is primarily bond rating driven. As a former bond rating executive, I would like to offer several ideas that could provide some immediate relief for issuers and investors affected by downgrades to the bond insurers.

One, there could be increased availability of underlying bond ratings for insured debt. Underlying ratings are not issued automatically. These are the ratings on the issuer itself, not including the insurance.

The issuer must separately request an underlying rating if the bond issuing is insured. If underlying ratings were assigned a standard procedure, there could be significantly more bonds that keep ratings of AA or higher after an insurer's downgrade.

This solution is not without its problems, because the issuer pay agency model assigns ratings only upon request, the rating agencies may not be permitted or even required to assign underlying ratings if the issuers want to keep those ratings suppressed.

In addition, it is unknown whether the rating agencies have adequate information on which to assign those accurate underlying

ratings for every insured bond that is right now rated Triple A or AA.

Another suggestion would be rating agency adoption of those global scale or corporate equivalent ratings. As I said before, if this were in place, there would be a large increase in AA and Triple A rated securities eligible for investment by money market funds and could be retained if bond insurers were downgraded.

This, however, assumes that the raters were willing or able to increase the number of underlying ratings where they currently do not exist.

In addition, it is unclear as to whether S&P or Fitch believe there should be a different rating scale from the current system as Moody's does, or whether they are in a position to implement such a dramatic change if they thought it was right.

The chairman has mentioned House Bill 2091 for credit enhancement using Federal Home Loan Banks for a letter of credit. I would support that. I think that could give some quick and immediate relief to issuers that need credit enhancement in the face of downgrades by the bond insurers.

Finally, IRS re-issuance regulations. When a municipality materially changes the terms of a bond issue, tax regulations can trigger negative tax consequences for both issuers and investors.

Today, many States and localities face conditions where their bonds are carrying interest rates far in excess of reasonable rates due to problems with the bond insurers. Some States and localities are prevented by the IRS' re-issuance regulations from negotiating new terms with their bond holders. Market participants have been talking with Treasury and the IRS to address these problems and there may be some relief there.

I would like to thank the committee for the invitation to appear and I would be happy to answer any questions.

[The prepared statement of Mr. Larkin can be found on page 224 of the appendix.]

Mr. MEEKS. Thank you, Mr. Larkin.

Next we will hear from Michael Callen, chairman and chief executive officer of Ambac Financial Group Inc.

STATEMENT OF MICHAEL CALLEN, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, AMBAC FINANCIAL GROUP

Mr. CALLEN. Thank you, Mr. Chairman. I am the interim chief executive officer and chairman of the Ambac Financial Group, and I commend the subcommittee for these hearings and what is going to come out of them.

Ambac and other insurers have a vital but usually obscure corner of the modern financial system. We are crucial to financing of municipal governments, school districts, and other public sector entities, helping them to get capital they need at the lowest possible cost.

We play a similar role in consumer finance where Ambac insured bonds have lowered the cost of financing for homes, education, and automobiles.

Ambac has been in the financial guarantee industry for 35 years. Today, almost a quarter of the insured municipal bonds are guaranteed by Ambac.

Over the past 3½ decades, Ambac and the industry has successfully survived many cycles and challenges, including 9/11 and Hurricane Katrina, Orange County, and multiple recessions. No holder of an Ambac-insured security has ever missed a single payment of interest or principal.

Almost no one questions the ability of Ambac to make good on obligations to holders of our guaranteed debt.

Instead, our challenge is maintaining the stability of the ratings that have supported our business in the past. Ambac is committed to do everything we can to maintain our ratings and restore the market's confidence, including raising substantial additional capital.

If our goal is a strong and viable monoline industry, who are the beneficiaries? First, bond issuers, including States and municipal governments. They want and sometimes they need the bond insurers to continue to provide market access and lower borrowing costs.

Second, bond investors. Investors benefit from the credit analysis that Ambac does prior to closing a transaction. This includes onsite due diligence, documentation review, and numerical analysis, all performed in-house at Ambac.

After closing the transaction, Ambac's surveillance team monitors the transaction actively and in cases of financial stress, can facilitate a restructuring before a default occurs. These are functions that many investors cannot do themselves.

Lastly, the capital markets and the financial system as a whole benefit. One of the roots of the problems facing financial markets today is the proliferation of participants with no skin in the game. These financial intermediaries who have nothing to lose generated and sold low quality assets into the liquid markets of the prior years.

In contrast, Ambac has skin in the game and the proper incentives to strive to generate high quality financing products. Good incentives do not guarantee that mistakes will not be made.

Ambac has made mistakes. We guaranteed overly complex securities by the name of CDO squared's. Four transactions. The structure of these deals has ended up magnifying rather than minimizing the risks involved.

As a result, Ambac announced that we expect to pay $1.1 billion in claims in the future on three of these CDO squared's, and on one CDO. We are not happy about that.

With every mistake comes a silver lining of lessons learned. We will no longer guarantee CDOs or CDO squared's. We have strengthened internal risk controls. We have tightened credit standards and raised rating hurdles.

You may be surprised to hear that actual claim payments to date have been low. In 2007, in fact, we recovered more in past claims than we paid out.

This will change. We are after all in the business of insuring against credit risk. During periods of credit weakness, we should expect to pay claims.

Last year, we took $1.4 billion in reserves and credit impairment charges, which includes the $1.1 billion on the CDOs.

Ambac has claims paying resources of $14.5 billion, and we continue to grow this through earnings on our existing investment portfolio.

I would like to make an important point concerning liquidity. As you know, it is generally liquidity problems that drive failures in the financial industry. Ambac is not exposed to liquidity risk.

When an issuer of an Ambac-insured security defaults, we make their principal and interest payments under the original schedule. Because we pay out over the original life of the bonds and not at the time of default, we know our claim obligations well in advance.

We never have to settle the claims in a lump sum payment as do property, casualty, and life insurance companies.

Let me turn to the possibility that the credit rating agencies may downgrade Ambac. What would such a downgrade mean in practice? Contrary to some media accounts, it would not signify a high risk of default to investors and Ambac-insured securities. At a AA rating, Ambac would still be higher rated than most financial institutions in the United States.

Let me emphasize that our ability to meet capital requirements associated with a Triple A rating has little to do with whether we can handle expected claims. Triple A is not about meeting expected obligations. It is about the ability to weather the 100-year storm and emerge with excess capital.

In conclusion, Ambac's ability to meet our obligations is not in question. What we are striving for goes beyond this to the ongoing viability of this industry, an industry that we believe fulfills a vital public purpose.

Those who benefit from a viable monoline industry are a broad and diverse group. They include States, municipalities, the consumers, and your constituents.

We, therefore, are encouraged by your efforts to take the time to understand our business before taking action that could have unanticipated consequences.

We are grateful that the subcommittee is making this effort, and to Commissioner Dilweg in Wisconsin and New York State Insurance Department, particularly, Eric Dinallo, has been very energetic and knowledgeable in addressing the issues that we have today.

Thank you.

[The prepared statement of Mr. Callen can be found on page 102 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Callen. I guess we move now to Mr. Chaplin, chief financial officer of MBIA Inc.

STATEMENT OF CHARLES CHAPLIN, CHIEF FINANCIAL OFFICER, MBIA INC.

Mr. CHAPLIN. Thank you. Chairman Kanjorski and members of the subcommittee, thank you for inviting me to address you today. I also want to thank you for your stamina, for hanging around until the very last witness.

I am Chuck Chaplin, the vice chair and chief financial officer of MBIA Insurance Corp., and I am pleased to be here on behalf of MBIA to discuss the issues currently facing our company and our industry, and the proactive steps we have taken to address them.

As background, MBIA is an industry leader in bond insurance. We have been in the business for 34 years and we were the first bond insurer to receive a Triple A credit rating.

We currently insure over $1 trillion of total debt service and employ 480 employees in our Armonk, New York, offices and 11 offices around the world.

We have the most claims paying resources in our industry at over $17 billion, and our capital position relative to any solvency measure is unquestioned, and we believe we have in excess of $1 billion of excess capital relative to rating agency current Triple A standards.

Our industry has roots in the public sector where bond insurance has helped finance some of the country's great public works projects, including bridges, ports, utilities, toll roads, and other essential infrastructure.

MBIA has guaranteed financings in all 50 States, and in all of the subcommittee members' districts from JFK Airport in Queens, New York, to the Wyoming Seminary Prep School in Pennsylvania, to the Children's Hospital of Los Angeles, which is a deal that we insured only 2 weeks ago.

Today, municipal finance and essential infrastructure account for about 65 percent of our insured portfolio.

When we insure a bond, we are said to "wrap" it. That simply means we guarantee the timely payment of interest and contracted principal in the event the bond defaults. Our guarantee lends our rating to that of the insured bond and the pool of potential investors for Triple A rated bonds is much larger than that for lower rated paper.

Also, interest rates are generally lower, so issuers save money by borrowing on an insured basis.

There are 87,000 municipal and State governments in the United States, and 50,000 of them have issued debt of which about $1.7 trillion is currently outstanding. About half of that is wrapped by bond insurers.

The motivations for local governments has been compelling. It saves the taxpayers money. For some smaller governments that are less frequent issuers, and we have heard from a couple today, bond insurance also ensures that they have access to cost effective funding that might not be available on an unwrapped basis.

We also provide a service to the investor and 5 million American households own municipal debt. Our guarantee eases the burden on them of needing to understand the idiosyncratic credit risk and jurisdictional issues associated with borrowers in transactions. In effect, the bond insurance commoditizes the municipal debt.

We also provide surveillance and of course, if there are problems, remediation services. In effect, investors have outsourced those analytic and management functions to the bond insurers and we give them a money back guarantee. This broadens the universe of potential investors which again tends to reduce interest costs.

In the early 1990's, MBIA expanded its business into structured finance. These transactions involve bonds backed by assets such as credit card receivables and mortgages. Today, our structured finance business makes up 35 percent of the insured portfolio.

The value proposition for many of our structured finance customers and investors is really much the same as that for the municipal issuers and investors, that is to reduce borrowing costs, provide greater liquidity, to commoditize the product, and to act on investors' behalf to mitigate losses if they occur.

Until 3 months ago, our industry attracted little attention outside of our small community of bankers, regulators, and rating agencies. Of course, that was fine with us. In our view, a good year at MBIA was kind of like a good airplane flight, nothing very exciting happens.

Over the years, we have operated quietly and efficiently, delivering our value proposition to investors and bond issuers, and delivering solid returns to our shareholders.

Of course, that was then. Like many other financial institutions, we have exposure to the deepening credit crisis through a relatively small part of our structured finance business. About 9 percent of our total insurance portfolio is related to the U.S. mortgage market.

We have significant exposure to prime second lien products like home equity loans and to mortgages that have been pooled in investment vehicles called "collateralized debt obligations" or CDOs.

The rapid deterioration of the underlying mortgage loan performance and its impact on mortgage-backed securities in the second half of 2007 created new expectations of loss that were a multiple of any previous market forecast.

Today, analysts are projecting losses on mortgage collateral that have not been seen since the Great Depression.

S&P reported that actual loss rates on subprime securities in December 2007 were 1.4 percent. However, projections of eventual losses are now on the order of 20 percent. I note that these are projected losses, not actual losses.

In the fourth quarter of 2007, when MBIA recognized future claim payments of approximately $1 billion, we had paid net claims equal to $44 million, or far less than 1 percent of our total exposure.

Based on the change in projected losses, we began an aggressive plan to raise capital even before the rating agencies communicated their increased capital requirements to the company.

In less than 8 weeks, we increased our capital position by over $3.1 billion. This level exceeds all worse case stress loss scenarios put forth to date by the rating agencies. Today, our claims paying resources stand at over $17 billion, the highest in the industry.

During our capital raise, our financial reports are risk reports and portfolio details were reviewed in great depth by highly sophisticated investors such as Warburg Pincus, who after doing their analysis, agreed to invest $800 million in our company.

This information was also thoroughly reviewed by the underwriters of our debt and equity security offerings. That is these independent parties got comfortable enough after scrutinizing every detail of our mortgage exposure to invest billions of dollars in our company.

What did go wrong with our portfolio? How did we, along with so many other financial institutions and market participants, miss the warning signs of these losses?

The generally benign credit environment between 2003 and early 2007 lowered the appreciation of and the pricing for credit risk across all of the credit markets.

The environment fostered an erosion of underwriting standards at all levels across the fixed income market. Because of the historically low loss levels and stable performance of mortgage products, we also missed this evolution.

Today, we are paying the price for that. However, we do not believe that any kind of a bailout plan is necessary for our company. There is not one shred of evidence that MBIA is at risk of failing to fully satisfy any and all policyholder claims, and private investors have shown a willingness to capitalize our company for the long haul. They understand the fundamental strengths of our business model and that we are focused on learning from this experience.

We will review our risk management standards and due diligence processes to make sure that we do not make this mistake again.

As we look forward, we see more need than ever for bond insurance. Formal estimates include $1.6 trillion in U.S. infrastructure needs alone over the next 5 years. The needs outside the United States are even larger.

The demand we expect will also be strong for structured finance and the structured finance products will continue to be important in lowering the costs and creating access to credit for consumers and businesses, just as municipal bond insurance does for cities, States, and authorities.

We have been working closely with our primary regulatory, the New York State Insurance Department, to review these lessons learned, to discuss new guidelines on acceptable products and portfolio guidelines.

The Department has been very proactive in support of our effort as Superintendent Dinallo referenced a little bit earlier.

Further, we believe that the Insurance Department is well-suited to continue to provide this oversight and to create and implement any new regulations.

We appreciate and commend Superintendent Dinallo's efforts to date because they will help to ensure the stability of this industry's participants.

In the meantime, we will work to re-build the trust that we have spent decades earning with the hope of restoring order and stability to the vital bond insurance marketplace.

Thank you again for your time and I look forward to responding to your questions.

[The prepared statement of Mr. Chaplin can be found on page 111 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Chaplin.

I guess you get razzed because of your famous name.

Mr. CHAPLIN. Occasionally, it comes up.

[Laughter]

Chairman KANJORSKI. I am old enough to remember that name, but most of the audience is too young to remember.

We probably have bored the rest of the committee to death, but if you do not mind, I am going to bore you a little bit longer.

I spent several days in New York over the last month, month-and-a-half, trying to get briefed on what is happening. It has been interesting. Each time I go up and get briefed, it appears that things are a little more severe, a little more dangerous, and a little more widely distributed in the credit market in particular.

I always ask a couple of questions when I have gone into the investment banking houses, the insurance companies and others: What do they feel caused this credit crunch? I would be interested to know if anybody here wants to volunteer their response, and most particularly, I think I can anticipate what Mr. Ackman's answer will be, but the insurance companies, I really would enjoy hearing whether or not you see any viable responsibility for any of this yourselves.

Mr. CHAPLIN. The short answer is "yes." What we witnessed was a period of benign credit conditions that went on for quite a while, from 2003 through really almost the first half of 2007.

Chairman KANJORSKI. On that point, you were licensed by the State of New York to do monoline insurance?

Mr. CHAPLIN. Correct.

Chairman KANJORSKI. Maybe you can spell out, what does that really mean, "monoline insurance?" I think I know. It is different from what you do; is that correct?

Mr. CHAPLIN. We are in the business of insuring bonds, so it is a monoline in that sense. We insure only fixed-income securities, and we insure fixed-income securities that are issued both by municipalities as well as by structured finance vehicles.

Chairman KANJORSKI. Were you always in the structured finance vehicle line?

Mr. CHAPLIN. MBIA started insuring structured finance vehicles in the early 1990's. We did not insure structured finance—

Chairman KANJORSKI. At that point, you should have been a multi-line business; right?

Mr. CHAPLIN. I am sorry?

Chairman KANJORSKI. It would be a mistake to call you a monoline at that point when you started to do the insurance of other vehicles. You should have been a multi-line.

Mr. CHAPLIN. I think that is a fair point. The term "monoline," I believe, was coined to refer to the fact that we insured bonds only.

Chairman KANJORSKI. Singular targeted business that you were rather expert at. In my other life as a practicing attorney, I had the occasion to use some of your companies with some of my clients when we would be doing projects and issuing bonds.

Do you think the difficulty you find yourself in today has any relationship to the fact that you enlarged or grew your business into other lines of exposure?

Mr. CHAPLIN. It certainly has to do with some poor underwriting judgments that we have made of late.

Chairman KANJORSKI. That is easily said that way. How about if you had never gotten into underwriting any other line but municipalities? Would we have a problem today?

Mr. CHAPLIN. We would have no exposure to the home mortgage market.

Chairman KANJORSKI. Would we have a problem today? It is not a hard question. I am going to try to insist on it because I am trying to drag out of you culpability here.

Mr. CHAPLIN. I am totally willing to agree that we are culpable and that we did in fact expand our business over time.

Chairman KANJORSKI. And is that the reason that you have a difficulty now?

Mr. CHAPLIN. The fact that we have engaged in wrapping the bonds that we have, particularly in the mortgage sector, has resulted in the problems that we are enduring right now.

Chairman KANJORSKI. If you had stayed in your regular course of business that you were licensed to do by the State of New York for 30 years, we probably would not have even have had this hearing today on the threat to municipal bonds; is that correct?

Mr. CHAPLIN. Certainly not over home mortgage exposures; no.

Chairman KANJORSKI. You would not be in it. You would be the strongest insurance company in the world because you would be getting all this premium and insuring things like municipal bonds. I understand some of the testimony today that municipal bonds never fail; is that right?

Mr. CHAPLIN. Mr. Chairman, we believe that our insurance company today is actually very, very strong from a capital and liquidity perspective, and to the extent that we were focused on the municipal bond business itself, as has come up a couple of times today, the general obligation in the municipal bond business, where you really do have a low incidence of defaults—

Chairman KANJORSKI. Mr. Chaplin, I am pressing you because we will not get to a situation where we can really get to the fundamentals here and the corrections that have to be made unless we are sort of straightforward and truthful with ourselves and truthful with the causes.

It is like arguing that something is not your fault because you do not want it to be your fault. I understand that.

The reality here is, I think, can you accept that if you stayed in insuring municipal bonds, wrapping your Triple A rating around municipal bonds, there would be no need for a hearing at all, there would not be a risk to the municipal market at this point?

Mr. CHAPLIN. We certainly would not have this problem. I agree.

Chairman KANJORSKI. Right. When I was in New York, I asked some of the people there, how did these insurance companies that were monoline insurance companies, how did they get in trouble?

I could never get any of them to admit that anybody in New York encouraged them to do this. I have to assume none of the investment houses or anything encouraged your company in an earlier time to expand their business and make some more friends, basically. Make more profits. Make more revenues.

Did that happen or did it not happen?

Mr. CHAPLIN. I actually was not a part of our company at the time, but I am confident that the decision to start wrapping other than municipal bonds was motivated by the desire to expand our revenue and earnings base by using the skills that we had developed in other areas.

Chairman KANJORSKI. Right. Do you think that decision was an internal decision of the board of directors or the people who ran

your company, or did they periodically go to New York and meet with the investment banking houses and have some of them say hey, you are writing this monoline business.

It is boring. There are not going to be big profits in it. Look down here at these people who are putting securitization together and they are making fortunes, why do you not get into that business?

Do you not think that may have happened?

Mr. CHAPLIN. I believe that all the decisions about the expansion into the structured finance business were made at MBIA by MBIA management and the Board of Directors.

Chairman KANJORSKI. And they had no outside influence?

Mr. CHAPLIN. It would not be fair to say that people at MBIA do not interact every day with all other participants in the capital markets, the banks, the broker-dealers, the regulators, and the rating agencies.

There is a very active dialogue there. It would not be fair to say that out of those dialogues, it did not generate ideas.

Chairman KANJORSKI. You know what I am trying to get you to say is that the problem in some of our bond markets and credit markets today is as a result of greed.

Mr. CHAPLIN. Yes, but—

Chairman KANJORSKI. Do you think so?

Mr. CHAPLIN. You are not going to get me to say the devil made me do it.

[Laughter]

Mr. CHAPLIN. It is true. We are in business to make money.

Chairman KANJORSKI. It is better if the devil made you do it than nobody.

[Laughter]

Mr. CHAPLIN. I am afraid we have no one to blame but ourselves. We are a profit-making institution. We exist for the purpose of trying to deliver returns to our shareholders, and the fact is the way we deliver returns to the shareholders is—

Chairman KANJORSKI. We are working on a Federal charter, an optional Federal charter right now. Would you recommend that when we issue a charter to an insurance company, we do not allow them to do any other business except if they are specifically authorized by the Commissioner of Insurance, the Federal Insurance Commissioner, or by their license adjustment? That we just are not going to allow it, based on the experience we are having now.

Mr. CHAPLIN. We have been having just those kinds of conversations with Superintendent Dinallo.

Chairman KANJORSKI. Had he considered restricting your license or calling you back to practice under the original issuance of your license?

Mr. CHAPLIN. We have had conversations with the superintendent and the department about changing the base of business that the bond insurers engage in.

Chairman KANJORSKI. That would mean you would be back in a boring business. It would be a safe business.

Did you all give any consideration to the cascading effect or the whirlpool effect that the credit failure has in affecting much larger pools of money and creating much greater risk out there, or had that not dawned on you?

Mr. CHAPLIN. The fact that the companies are today insurers of a very large portfolio of bonds, over $2 trillion across the bond insurance industry, it does make us an integral part of the capital markets. It does mean we have a responsibility, we believe, to manage the companies in a prudent manner.

The fact is we did make a mistake. There is no two ways about it. We did insure some bonds that we wished we had not insured, because we are taking substantial losses on those bonds.

I want to be clear, those losses do not come anywhere close to threatening the solvency or the very high credit quality.

Chairman KANJORSKI. I understand. We do not want to get into that. I know you have to answer to your stockholders and the public. There is no reason for us to compromise the market. I do not want to do that. We are going to assume that you are going to work yourself through this and that you can.

I am interested, however, in finding some of the root causes, not only for the municipal bond problems that we are having, but others, and getting to the subprime.

Two years ago, I authored a subprime mortgage act that to some extent would have limited what has now happened, if we had passed that act. It was not the best act in the world. There were a lot of compromises in it because we are dealing with 50 States that have different practices.

At least we would have had an organized effort to get our arms around that, and we did not do it as a Congress. Unfortunately, there was this tremendous compulsion in the last 2 or 3 years to package anything that walked and even some things that did not walk. Astounding how the thirst for profit and money will drive people to do extraordinary things.

I think that is sort of what happened. Do you not agree with me, in the subprime market? When people tell me they were surprised in August, I am astounded.

I am going back now to some of my conversations in New York. People said until late July or early August, they had no idea of this problem. I am thinking, man, if only they had known about me because I must be some kind of financial genius. I have been worrying about this for 3 or 4 years. All these Ph.D.'s and accomplished economists and what not, it did not dawn on them until July or August of last year.

I do not think they could be that myopic, but maybe they are. A lot of us have been worried about what ultimately has happened. Now, what we are worried about is what do we not know that may still be out there and how do we get our arms around that, and what do we do about it.

I did not have the occasion to be here, Mr. Ackman, when you testified. I had another problem I had to attend to, which was successful, but it was another occurence that happens in the course of our lives. It has been a tough day for me.

People have been pounding me all day today and yesterday about why people are allowed to sell short and distort the market. I do not know a lot about your business. I do not profess to. I thought that is what capitalism was all about, you could take any side of the transaction in any way you wanted to, and if you were smarter

than most of the other guys, you made money and if you were not smarter than the other guys, you got cleaned.

Is that not what capitalism is about or did I miss the point somewhere?

Mr. ACKMAN. I think that is right.

Chairman KANJORSKI. You would be surprised how many people want to cut you out of doing business.

[Laughter]

Mr. ACKMAN. Actually, I am principally a long investor. If I may, I would love to address the question you asked. I have an answer that may or may not be correct but I think it might interesting. May I?

Chairman KANJORSKI. Yes.

Mr. ACKMAN. I think if you go back to the mortgage lending in the Jimmy Stewart era, which actually carried up right through to the beginning of securitization, you had a local S&L that had a guy who kept a deposit in the bank. The bank manager knew him, knew his wife, knew where he lived, and knew what his job was.

One day he decided to buy a home. He came into the bank for a mortgage and he applied. Character was considered. How he treated other people. There were other factors that went into whether he was a creditworthy borrower.

The mortgage loan was made, secured by the home. It was a pretty simple thing. Maybe 80 percent of the value of the home, the guy put down a substantial downpayment. Over a 30-year life of the mortgage, he hoped to pay it down, some day have a mortgage burning party. That was the old way of doing it.

What happened really in the last 4 to 5 years is the incentives changed a fair amount. What would happen is you would have mortgage brokers who would get paid a fee for finding a borrower and placing a mortgage.

Then you would have seller servicers, and what they would do is they would get a warehouse line of credit from a bank and they would originate as many mortgages as they could, and to make things efficient, you would call them up on the telephone.

You would dial 1–800–MORTGAGE or you would go to mortgage.com. You would give them your Social Security number, your name. They would run a scoring methodology on you. They would approve you for a loan.

The seller servicer would hold the loan for about 60 days until he got a big enough pool of loans in that warehouse that he could then sell them in securitization. You would have the bank that provided the warehouse line of credit would do a securitization.

The mortgage broker would get his fee. The seller servicer would get their fee when they sold the mortgage to the securitization. The banker, the investment bank, would get his fee when he sold the paper from the securitization to the holders.

The problem developed where they had trouble selling some of the lower rated but still investment graded pieces of the securitization, the so-called "Triple B" pieces and sometimes the single A pieces.

They created something. You know, when Wall Street has a problem, they come up with a solution. The solution was a CDO, which

was a place where you could sell things you could not otherwise sell.

Every step along the way, a profit was made and risk was being transferred, but there was not a huge incentive to worry about how the loan was going to perform more than 30 to 60 days, a relatively short period of time.

Then the CDO would be originated by the bank and the bank would sell the pieces to whoever could sell the pieces, then the super senior piece, a lot of those pieces were sold to bond insurers.

What enabled this process to take place all along the way was really the rating agencies. The rating agencies, their traditional business, and it is not dissimilar to what happened to the bond insurers, they started out in the business of really rating corporate obligations.

How are GM's bonds going to perform. They went into a business of rating fairly complex securities where there was very little in the way of actuarial data because it was a relatively new industry, and they used models and they made projections and they were aggressive.

The rating agencies got fees every time there was a securitization done. They did not get their fee unless they gave it a Triple A rating.

I just think human nature is such that if you get $25,000 if you do not do the deal for the work you do or you get $600,000 if you give the Triple A tranche a Triple A rating in a CDO, and incentives fuel a machine where people make money all along the way.

I think that, I would say, is the cause for where we are today. It is just human nature, incentives. I do not know about greed, but people are profit oriented.

I would submit that is the story.

Chairman KANJORSKI. You call it "profit" and not "greed?"

Mr. ACKMAN. They are similar, I would say.

Chairman KANJORSKI. Profit, everybody is entitled to profit for a function that they perform. Excessive profit starts to move toward greed.

In looking at some of these transactions, and I have talked to some of the people who have recently gone into creating these pools, they just could not keep their eyes off the fees and the returns for little or no effort, and no skin in the game. They dumped the risk very quickly.

Mr. ACKMAN. I agree.

Chairman KANJORSKI. To catch them, it had to be catastrophic in timing to get caught. Other than that, they were out of the game and made millions on just some pools.

Mr. ACKMAN. That is right.

Chairman KANJORSKI. One other thing I have associated with this is what you would call the perfect storm in a capitalist system. A capitalist system is supposed to have advocates on both sides of the transaction to protect themselves, to get down to what is the right and fair price. They watch each other.

That is why government does not have to become a regulator. We do not have to get in play because these cats in the private market, they will scratch their eyes out. All we can do is threaten them

with jail. They can kill and they will for a dollar, and that is good. That keeps the market healthy.

Unfortunately, when you study these transactions, as you described it, everybody is on the one side of profit of the transaction. Nobody is on the other side, nobody except the last guy down there who bought these things. Only he did not buy them. He had a money market manager buy them, making a profit by acquiring them. Everybody, even his fiduciary who was buying for him, made a profit, by getting him into a bad deal and keeping it a secret until the whole line of action is over.

My question to you is, is there something that can be constructed to get back to self regulation? If we do that, are they going to distort the market again with the intention of making profits, and moving toward greed?

Are they going to find a way to distort it again, and if they are, how can we prevent it from happening except by doing something that has always been thought of as being anti-capitalistic in this system, and that is requiring everybody at every line to keep exposure or "skin" in the game?

If everybody had to keep an exposure of 5, 10, or 15 percent going down that line, I would have to think human nature would have said, you know, I do not want this thing to come back to me.

When you are out, the way you describe it, you go on line, you sell a bunch of these packages and in 60 days, you are out. It is awfully tempting to do that and continue to do that.

I cannot understand honestly. How do these people get involved in no doc loans? These are people who did not have a job, did not have any prayer in the world of paying this thing back, and they used them as tools to defraud the system basically.

It did not dawn on anybody? There was not any check or balance in all these institutions and an internal auditing process to find out what we are doing out there?

I can begin to believe that there may not have been when I read about how some trader could handle $7 billion in a bank and nobody seems to run a check on what he is doing. That is astounding to me.

But then again, in government, we do the same thing. What is our budget, $3.2 trillion? We do not have a lot of checks on us, either. Maybe I should not be as surprised.

What do we do about it? That is really the ultimate question.

Mr. ACKMAN. Sure.

Chairman KANJORSKI. I feel a little put out because I have been one of these anti-Democrats in terms of regulation. I have been a firm believer that if the marketplace can be balanced and there are checks and balances, you really do not need a regulator.

Now, suddenly, when you look at the rate-making field, the easy way to solve that would be to put them under stringent Federal control and have all kinds of regulators involved or the ultimate rating agency could be a Federal agency, a stamp of approval.

There are some complications with First Amendment rights. Everyone I have talked to says that this can be avoided if we craft it correctly.

The problem is that the average taxpayer does not have skin in the game if he does not have one of these mortgages. That is only

2 or 3 percent of the population that has skin in the game from that side.

What is going to happen if we have a collapsed economic system either in the country or in the world? Then everybody in the world has skin in the game and they had nothing to do with it. They did not even know it was happening.

When you talk to them about it, they are astounded. They are literally astounded that there was such irresponsibility out there.

Does anybody have any idea what we should do? What is the role? It is easy for us to say, well, we can step aside and let this be handled by the private market. A lot of people are urging a private solution.

I tend to agree with them, except what happens if the contagion continues and we have a continued frozen market, and 60 or 90 days from now, we cannot float bonds to the extent of financing operating funds for corporations, very sound corporations? General Motors wants to build another car and they need money to pay their employees for 90 days and they cannot float bonds, and they have to close down.

What do we do?

Mr. ACKMAN. I think what is creating the credit crisis is a lack of transparency. Banks do not want to lend banks to other banks because they do not know what exposures are on their balance sheets.

We and others have concern about bond insurers because we do not know what credit exposures they have. The bond insurers have not provided transparency on which asset-backed securitization deals they have guaranteed, which CDOs they have guaranteed.

Investors have to rely on either the rating agencies or the management of the bond insurer to determine their capital adequacy.

I think the problem came about because people outsourced their due diligence to rating agencies. You can just look at the stock price of Moody's and see what has happened to the reputational equity of that company.

What I think has to happen is companies need to come clean. Banks need to disclose what their exposures are, not just we have "X" dollars of subprime exposure. The markets will work when people provide transparency.

If you look at what is going on in the municipal market right now, one of the big problems is transparency. I am frankly interested in investing in municipal bonds right now because it seems like an interesting—if I can get 20 percent lending to the guy that collects my toll when I cross the G.W., that seems like a pretty good interest rate.

The problem is it is very hard to get documentation on what does the balance sheet of the toll road look like.

Chairman KANJORSKI. For transparency, should we require a repository of inventory on these types of securities that they are recorded and available to the public?

Mr. ACKMAN. Yes. It is an easy solution. You have an EDGAR system, which was one of the most powerful things we did for the capital markets, making on the Internet, companies have to make quarterly filings. You get them instantaneously. They are free and available to everyone.

There is no reason why the same thing could not be available for CDOs, for asset backed securitizations, and for municipal bonds.

We have tiny little companies that no one has ever heard of that you can pull up a 10–K and an 8–K and a proxy and you can do the work. We have microcap companies with $12 million market caps that can trade efficiently because people can do the work, whereas in the municipal bond market, you have a town that is miles away. You cannot do any work on it, so therefore, you need to have bond insurance or you need to have a rating agency.

You do not need those things. It is much better for investors to do their own due diligence, their own analysis.

Chairman KANJORSKI. You are referring to the bond market. How about all the other securities that are out there that with risk involved?

Mr. ACKMAN. No. I think there is no reason not to provide—no competitive reason why you cannot disclose all of the prospectuses for every CDO transaction on the EDGAR system. There is no reason for not having it. Then investors can do the home work.

Chairman KANJORSKI. Let me find out from the rest of the panel. What do you think?

Mr. LARKIN. Mr. Chairman, I want to pick up on something that Mr. Ackman said about outsourcing the credit decisions to the rating agencies. Let me throw out a radical idea.

Perhaps there are too many regulations that write the rating agencies into investment making decisions.

Chairman KANJORSKI. I am sorry. I am going to ask your indulgence for a moment. I have a call from the President. If you will just hold where you are and I will be right back.

[Recess]

Chairman KANJORSKI. Thank you for the indulgence. I have to tell you that you have staff assistants out in the anteroom, some of the staff are starting to rebel. I just heard them say that it is Valentines Day, and it is 6:30, so you better get your act together and get out of here or there is going to be a revolt.

[Laughter]

Chairman KANJORSKI. I could stay here all day, quite frankly. I think it is a vitally important issue. I am looking to panels like this to give us the insight on what to do.

Mr. LARKIN. Mr. Chairman, could I finish the thought?

Chairman KANJORSKI. Yes.

Mr. LARKIN. As Mr. Ackman said, there has been an awful lot of outsourcing of the credit decisions to the rating agencies. You can start with Rule 2a-7 of the Act of 1940. It basically says the rating agencies decide what money market funds can hold and what they cannot hold.

There are things written into bond documents that say if this is rated A but an issuer wants to make a change to a document, it cannot be done without the bond rating agency's approval, otherwise the rating could be downgraded.

Ultimately is the point I made before, the bond insurers, Triple A, they can only do whatever the rating agencies would have allowed them to do to be able to maintain the Triple A. The bond insurers could not have gotten into this without the rating agencies saying it is okay.

Perhaps we do not need more regulation on the raters or the bond insurers. Maybe we have just written the rating agencies into too much regulation, to give them this much power.

Chairman KANJORSKI. We have been looking into that. You cannot imagine the number of statutes and regulations that they are in. It would take us several years to pull the peel off and find out what is there.

I tend to agree. I think some quick action could be taken to allow municipal bonds to be treated like corporate bonds are on a temporary basis. That would solve all the pressure of forcing trustees to sell when there is really no threat to the asset.

I am firmly convinced that this is not a problem of real liquidity. It is a problem of trust and faith. The people in the market have lost faith in the market. We have to get them back.

Once they get a comfort level, just like after you have your first accident, and once you get behind the wheel and you drive again, it all comes back to you. If you stay away from it and you do not drive, you are never going to drive.

If we are going to get investors back into the marketplace, we have to first show them good product. They have to have the transparency to see that product. I think we have to take the effort to make sure that happens and then let them ride with it for 3, 6, or 9 months, and ultimately the market will solve its own problem and be back.

Mr. LARKIN. I think a few people have brought up changes to transparency, at least within the municipal bond industry, the municipal EDGAR system. It is basically providing information and providing disclosure so investors can make those decisions.

Right now, it is very hit or miss as to whether you can get disclosure in the municipal market. The more you can improve things like that, the more you will be able to have investors able to make decisions. I would even go so far as to say maybe you would even have real rating agency competition in the municipal area, because right now, you could not start a rating agency unless you get the cooperation of the issuers because the information is just not readily available.

Chairman KANJORSKI. Right.

Mr. LARKIN. Without the issuers agreeing, and that is why the rating agencies only rate upon request, because without the issuers' cooperation, you cannot rate it.

As more transparency comes into the market, maybe we will get more rating agency competition.

Mr. BUCKLEY. Mr. Chairman, I think Fitch would certainly strongly endorse and support the concept of greater transparency of all the types of transactions we rate.

There is very good disclosure on corporations via Forms 10–K, 10–Q, etc. Certainly, we get much more information than the investing public on structured finance transactions and on municipalities.

We think it would be better for the capital markets if the information that we received was also made available to the general investing public by the issuers and structurer's, because we do not want to necessarily be the only ones looking at the data.

We think transparency is good and healthy and that it allows investors to better understand our ratings and interpret our research and talk to us and understand our process.

Chairman KANJORSKI. What would be the difficulty of actually defining what has to be transparent? It is so simple for various entities, whether they be hedge funds or equity funds, to create new constructs that do not quite fall in the definition of a bond or a share.

How do we force that every financial instrument gets recorded and is part of the inventory?

Mr. BUCKLEY. It certainly would be a process, but if you look at the disclosure requirements for corporations currently, not perfect, but good, robust. If you look at that as sort of a starting point and can think of a structured finance or municipal finance or other types of instruments that are being created, can you bring them to a standard that seems reasonably consistent with what corporations need to disclose, given their own unique needs.

I think that might be at least a starting point. That seems to have worked reasonably well and can we bring other types of instruments to that level playing field.

Chairman KANJORSKI. Normally, for an inventory of that sort, we would have considered putting that in the exchanges. Now that they have gone for profit, where can we find some non-profit entity to hold that inventory?

Mr. ACKMAN. I think it is as straightforward as putting it on the Internet.

Chairman KANJORSKI. Somebody has to be responsible for it. Somebody has to tend to it.

Mr. ACKMAN. There is a fee that comes out of every bond issue of a basis point or less or some small fee, $1,000, that goes towards a national repository of information for the benefit of investors. It will help issuers reduce their issuance costs. I think they would be more than happy to pay such a fee.

It is like a registration fee you pay to the SEC for an equity offering.

In that we are in a hearing about bond insurers, on the transparency side, one very simple thing that could happen immediately and one of the things that we actually did, wrote a letter to Chairman Bernanke and suggested that this would be a good thing for the transparency in the bond insurance industry, is why do not the bond insurers provide on their Web site a list of all their exposures, the underlying ratings for those exposures, and then in particular, they have what they call classified lists, which are lists of credits where there are potential problems. They have different classified, seriously classified or medium classified or just barely classified.

If investors got to see all the riskiest parts that the bond insurers have exposure to, if they had a list of all the CDOs' transactions and all the asset backed securities that they have guaranteed, then investors could do their own due diligence. They would not have to rely on the rating agencies' Triple A.

I find it like a little bit like Alice in Wonderland that we are sitting at a hearing talking about a group of entities that are struggling to raise capital and almost all of them still have Triple A ratings.

Investors clearly do not trust the Triple A, and what would create trust would be transparency from just the bond insurers coming clean, show us all your exposures.

Chairman KANJORSKI. How long would it take to have those disclosures?

Mr. ACKMAN. Maybe we can ask Mr. Chaplin. They have this information at the tip of their fingertips. I am sure they have it in electronic form. They could make it public tomorrow if they chose to.

Chairman KANJORSKI. Is that correct?

Mr. CALLEN. Mr. Chairman, I usually disagree with Mr. Ackman, but on the issue of incentives that he described, I fully agree. I think this was an issue of incentives.

On transparency, I have been the CEO of Ambac for all of a month. You cannot find a better expert. The issue is every time that I have gone to our chief financial officer to ask him a detailed question, he snaps at me to look at our Web site.

Let me make an exception to this. We have it all on the Web site, every municipal exposure. It is one of the most transparent businesses there is.

When you get into something, and here I am talking about in our case, four transactions, CDO squared's, there are several layers.

What I recommended at one point is that we actually publish the QSIPs. The people that know this technically much better than I do came and surrounded me with knives and said are you crazy. If you put the QSIPs on there, you are providing information that can be used very successfully against you. Are there no competitive protections any more?

I would argue and I would point anybody to the Ambac Web site and show me a more transparent Web site anywhere.

I wanted to do this for our major investors who were very injured and very upset and came and pounded on me. The first 3 weeks in the job, I was talking to investors, apologizing for what has happened to them.

I said to them, some of the most professional investors in the world, well, all right, we will put all our QSIPs on, don't go that far because that gives—I agree with you on short sellers. I think they are every bit as much capitalists as the rest of us and there should be short sellers.

Their point is that will give the short sellers the opportunity to go out and take advantage, which I do not think we have the time to go into detail here, but I learned how that could happen.

There is a little bit perhaps, just a distant possibility of self serving in this conversation, but it would have to be examined very carefully.

I am all for transparency. All the rating agencies know everything of ours and they run it through their models.

The last point I would make is we are really talking here—let me give you a view of my own of what is happening in the market now.

When you build an airplane, you build it to the 6th sigma. You design for 100 people. You build it to withstand 400 people. Deterministic.

When you trade in markets, it is probabilistic. You have some probability of loss every time you trade. The markets right now are locked up because they are working to the 6th sigma.

When we talk to Moody's, which we did for 2 hours yesterday about how we are solving the problem they perceive, they are saying we want per our model to give you 99.99 percent confidence level that the worse thing can happen to you, and unless you can do that and then multiply it by 1.3 times, that is the amount of capital we want you to have. If you go to AA, it is 1.2 times that extreme scenario.

Let me leave you with one more thought. I have a theory. Let us see if I am right. You call a hearing again in 3 months, and here is what I believe you are going to find. You are going to find that the mortgage losses we are experiencing today are a pig in a python. Here is what I mean by that. We had very loose underwriting standards in 2006 and 2007, some at the end of 2005. Very loose. All the reasons that have been described. Bill Ackman is absolutely correct on that.

There was a lot of fraud and there were a lot of investor unoccupied buildings that were financed through mortgages. Those, especially the fraud, and the investor transactions, when housing prices started to decline, are the first ones to default.

This is a surreal experience for me and I have been in the financial industry for 45 years. I have been through the LDC stuff, the commercial real estate stuff across the country, Orange County. It was all about the world coming to an end at the time we were dealing with it.

This is the first time I have ever experienced a situation where it is not how much capital you have, it is not how much liquidity you have, it is not what your earnings are, it is what you are projecting to happen. It has not happened yet. It may never happen.

If I am right about the pig in the python, it is not going to happen.

That is a real possibility. I think we have to stay tuned and see how these loss curves might trend down. Thank you.

Chairman KANJORSKI. Does anyone else on the panel have anything to add so we can make friends with your wives and significant others?

Mr. ACKMAN. Can I make one more romantic interjection?

[Laughter]

Mr. ACKMAN. With all due respect to Mr. Callen, I think if providing transparency gives a short seller more information to make his argument, then maybe the information is not so bullish for the company, and maybe that is why investors are concerned.

If a company is not willing to be transparent and to provide the QSIPs so investors can do their own assessment, if it were my company and I thought the losses were only $2 billion and the world was saying $12 billion, I would say open kimono, here is every one of my exposures. Here is every one of my troubled exposures.

You go do the work. I can prove to you I am not going to lose money. When you do not disclose anything and you say, look, the rating agencies say we are Triple A. Our models say we are Triple A. We are just not going to tell you what the exposures are, that

is when investors lose confidence because frankly when a stock is down 80 percent, the market is telling you something.

The solution to the problem is simply transparency. If providing transparency gives the short sellers more arguments, then perhaps the story is not as good as management has been letting on.

I love short sellers. You would not ask Microsoft to publish all of its code. That would be a little silly. When a new structure for Morgan Stanley comes out that is fairly unique and innovative, you would not ask them to show it all.

I love short sellers. I think they are an important part of the market, but I have to remind people that a year ago, Ambac stock was at $96. It closed today at about $12 or $13. We were as transparent back then when everybody loved it as we are today, and the difference is that the housing market, for reasons we could talk about all day, has taken a turn.

We made a big mistake—"correlation." We thought if we had mortgages in California and mortgages in Maine, they would not both go down together. We were wrong.

Chairman KANJORSKI. This is one of the few national markets at this point. It has always been a moving market.

I think I have gained a lot of information. I am not prepared to confess everything that we have learned.

Would the panel be available in the future either on a personal basis when we need additional information or if collectively, we call you back? Would you be interested in participating?

Mr. CHAPLIN. Absolutely.

Mr. CALLEN. Of course.

Mr. LARKIN. Absolutely.

Mr. BUCKLEY. Absolutely.

Mr. ACKMAN. Absolutely.

Chairman KANJORSKI. I appreciate that.

I have to say that the Chair notes that some members may have additional questions for today's witnesses, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to any of today's witnesses, and to place their responses in the record.

Before we adjourn, the following documents will be made a part of the record: The letters that the chairman wrote to the Federal and State regulators and their responses; the written statements of the Association of Financial Guarantee Insurers and the Pennsylvania Higher Educational Facilities Authority; a letter from 35 Pennsylvania bankers; and a letter from the Illinois Finance Authority.

Without objection, it is so ordered.

At this point, the panel is dismissed and this hearing is adjourned. Thank you very much, gentlemen.

[Whereupon, at 6:53 p.m., the hearing was adjourned.]

A P P E N D I X

February 14, 2008

OPENING STATEMENT OF
CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON "THE STATE OF THE BOND INSURANCE INDUSTRY"

THURSDAY, FEBRUARY 14, 2008

Good morning. The Capital Markets Subcommittee meets today to learn about the causes and effects of recent bond insurer ratings downgrades. We will, in particular, focus on the spillover effects for municipalities and the financial services industry.

Bond insurance represents a microscopic segment of the insurance marketplace. In 2006, bond insurers collected less than one-third of a percentage point of the total premiums collected by the insurance industry.

We now know, however, that even though it is very small, the importance of the bond insurance industry is significantly greater. Its recent volatility, unless quickly addressed, could produce many negative consequences and affect the financial stability of the broader economy.

Since the issuance of the first license in the early 1970s, bond insurers have guaranteed a stable risk: the timely payment of principal and interest on municipal bonds. In recent years, many bond insurers expanded into insuring structured finance products, including those backed by subprime mortgages.

These business decisions and the decline of the value of subprime debt have now resulted in downgrades or the threat of downgrades by credit-rating agencies. It now appears that like a child who finds a book of matches, they have gotten burned. We must hope that they did not ignite our economic house, as well.

The ratings downgrades of a few bond insurers has produced spillover effects and caused considerable anxiety. A report or rumor about a bond insurer has already led to swings of several hundred points in the Dow Jones average.

The limited availability of bond insurance has also led to a number of recent failures in the offering of auction rate securities. These breakdowns have caused significant problems in the financing of student loans. They have also resulted in some municipalities paying 10 percent or more on their outstanding short-term debts.

Ratings downgrades additionally have the potential to reduce the value of bank holdings and insurer reserves, causing them to take write-downs or increase capital levels. Moreover, individual investors holding bonds could feel the impact if they want to sell the bonds they hold.

Most troublesome to me is the effect of these downgrades on municipalities. Municipal markets issue approximately $2.6 trillion in bonds, about one-half of which are insured. States and localities often use municipal bonds to operate more efficiently, ease budgeting shortfalls, repair bridges, fix roads, and build schools, among other things.

The recent downgrades could therefore cause cities and towns to make difficult decisions about whether they can afford to pay more for bond insurance, pay higher interest on bonds

issued without insurance, or delay much-needed projects. In this regard, I am especially pleased that Mayor Tom Leighton of Wilkes-Barre, Pennsylvania is here today. He can describe how municipalities use bond insurance and what the implications of the ratings downgrades are.

In preparation for today's hearing, I previously contacted key regulators to open discussions about these serious matters and determine the most efficient and responsible manner to act. Today, we will hear from many of them. We will also hear from bond insurers, their critics, market analysts, and rating agencies.

Everyone, even state insurance regulators, agrees on the need for regulatory reform. We need to prevent a similar situation from happening again in the future. I am hopeful that as we further our understanding of these issues today we will also begin to explore what we should do going forward. Some policy options include prohibiting bond insurers from guaranteeing complex structured financial products in order to protect municipal bond issuers, and creating a federal bond insurance corporation, modeled after the FDIC.

We could also mandate federal insurance supervision in this narrow field in order to provide greater stability for our entire financial system. Additionally, we could enact a law allowing the Federal Home Loan Banks to enhance municipal bonds with letters of credit like Fannie Mae and Freddie Mac already do. Moreover, we could work to better transparency in the municipal bond markets. Other policy options include imposing new requirements for credit rating agencies and addressing the differences between ratings on structured finance products, corporate debt, and municipal bonds.

In closing, I look forward to an open dialogue today. I want to thank each of the witnesses for appearing. Your thoughts will help the Members of the Capital Markets Subcommittee to understand these issues and determine the best course of action to ensure that our municipal finance markets remain viable and our financial system stays dynamic and strong.

Statement of William A. Ackman
Managing Member, Pershing Square Capital Management, L.P.

Before a Hearing of the House Financial Services Committee
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

"The State of the Bond Insurance Industry"
February 14, 2008

Chairman Kanjorski, Ranking Member Pryce and members of the Subcommittee, I thank you for the opportunity to address the Subcommittee and share my perspectives on the Bond Insurance industry. I will explain how the bond insurance industry grew beyond its original roots to its current troubled state, share my views on current attempts to bail out some of the existing insurers, and propose solutions to address the potential for systemic risk due to a failure of some or all of these institutions. As a preliminary matter, I begin with an introduction to my firm, Pershing Square Capital Management, L.P.

Introduction to Pershing Square

Pershing Square is an SEC-registered investment adviser that manages $6 billion of capital.

We are value investors with large stakes in North American companies like Target, Barnes & Noble, Borders, and Sears.

The success of our investments and our funds is highly dependent on the strength of the U.S. economy and consumer.

We are concerned about recent deterioration in the housing market, worldwide equity and credit markets, and the weakness of the U.S. consumer.

I am here today to talk about our only short position, a short investment in MBIA Inc. and Ambac Financial Group, Inc., the owners or, in terms of their legal structure, the holding companies for the two largest bond insurers.

It is important to distinguish between the holding companies, which are the owners of the bond insurers, and the bond insurers themselves, which are operating companies that guarantee bonds for a fee, pay claims to policyholders, and are the focus of today's hearings.

Background on the Bond Insurance Industry

The bond insurance industry began in the 1970s. The insurers were structured as private associations, and for the first 25 years primarily insured municipal bonds.

The holding companies for some of the insurers went public in the late 1980s and early 1990s. Senior management received restricted stock and options in the holding companies. The

interests of policyholders and management teams, compensated based on holding company stock prices, began to diverge over time.

New entrants increased the competitiveness of the business. In response, holding company executives seeking higher profits began to take greater risks with insurance company capital.

Over the last 10 years, risk-taking accelerated, ultimately leading to the guarantees of highly complex structured products like collateralized debt obligations (CDOs) of residential mortgage backed securities (RMBS) backed by subprime mortgages, or translating into English, trusts which owned slices of subprime residential mortgages.

Who is Responsible for the Bond Insurance Industry's Problems?

The poor decisions of holding company executives are the primary cause for the bond insurers' problems, but the rating agencies also share responsibility.

The rating agencies encouraged the bond insurers to diversify into structured finance risks and gave them additional rating credit for doing so. The rating agencies understated the risks of the new strategy while earning much higher fees for rating these structures.

The rating agencies' profits soared along with the growth in structured finance issuance.

Insurance regulators relied on the rating agencies and management teams to assess the risk of these new structures.

The rating agencies were paid by the issuers of these securities and helped in structuring these exotic instruments to meet the ratings agencies' insufficient standards for Triple A ratings. The rating agencies only received their full fees if they approved the Triple A ratings for these transactions.

The combination of aggressive risk taking by management, poor judgment by conflicted rating agencies, and over-reliance by regulatory authorities on rating agency judgment led to the current situation.

Regulatory Response and the Proposed Bank-Led Bailout of the Bond Insurers

The impending losses from CDOs and other mortgage securities will likely overwhelm the capital of the bond insurers, leaving insufficient funds to pay claims to all policyholders.

The New York Insurance Department under Superintendent Eric Dinallo has been working proactively to mitigate the situation. While Superintendent Dinallo has only been in office for a year, the seeds for the insurers' demise were planted years beforehand.

The New York Insurance Department has sought to bring in new providers of capital like Berkshire Hathaway to replace the loss of insurance capacity from existing players. Other well-capitalized players are considering entering the business.

Superintendent Dinallo has also been working on a bailout of existing insurers. While we are supportive of the industry raising additional capital, we believe the current approach to saving existing industry participants will fall short. Moreover, by allowing investment banks that are bond insurer counterparties to artificially prop up ailing insurers, this approach creates even greater risk for the global capital markets.

The insurance regulators have approached the major banking institutions who are the biggest policyholders of the insurers seeking an infusion of capital or credit lines for the insurers.

Given current credit market conditions, one wouldn't expect investment banks to be interested in investing in or lending to new speculative ventures. The banks are, however, interested in preserving the bond insurers' Triple A credit ratings.

Why? Because if the insurers are downgraded, banks will be forced to write down their exposure to the insurers and take losses estimated by respected industry analysts to be as much as $35 to $70 billion.

Banks are trying to take advantage of the lower regulatory capital and rating agency standards for the insurers where magically one dollar of capital in an insurer is deemed to be worth about eight dollars of capital in a bank. If offered the choice, what bank wouldn't invest a billion to avoid eight billion of writedowns?

The problem is that the math doesn't work. The amount of losses doesn't change whether the losses are borne by the banks or the insurers. The maintenance of the bond insurers' Triple A rating with credit lines or capital that is insufficient to pay all of the ultimate claims is simply an artificial loss-deferral exercise. Eventually, losses will come home to roost when the bond insurers ultimately fail.

The banks which did business with the bond insurers made billions of dollars creating CDOs and structured finance securities while hedging the exposures they could not sell with the bond insurers. It seemed too good to be true and it was.

Recently, Warren Buffett summarized the situation: "It's poetic justice in that the people that brewed this toxic Kool Aid found themselves drinking a lot of it in the end."

The banks' coordinated attempts to prop up the bond insurers' overstated Triple A ratings will only continue the fiction. Delaying inevitable writedowns only reduces market transparency and encourages the continuation of risky behavior.

The Potential for Systemic Risk Created by Downgrades of Insured Municipal Bonds

Unfortunately the downgrade of the bond insurers affects constituencies who are not to blame for the problem. I am sensitive to this concern.

The biggest worry is what will happen to the approximately $1.6 trillion of insured municipal bonds which are likely to be downgraded to their underlying ratings, if the bond insurers lose their Triple A ratings.

There is a risk that municipal money market funds and other fiduciaries will be forced to dump these bonds if they are downgraded below Double A.

While the rating agencies overstated the ratings for CDOs and structured finance securities, they have systematically underrated municipal issuers. Taking the opportunity to correct this problem now may actually form the basis for mitigating risk from a bond insurer downgrade.

What Can be Done to Address the Potential for Systemic Risk?

The substantial majority of municipal issues would be Double or Triple A, if rated on the same scale as corporate bonds are rated by the rating agencies.

A Triple B municipal general obligation bond has one fourth the probability of default as a Triple A corporate bond. The rating agencies know this, but they still rate municipal bonds on a tougher scale.

The systematic underrating of municipal bonds created the opportunity for bond insurers to charge insurance premiums to Double A or lower-rated municipalities.

While the bond insurance industry estimates that it has saved issuers billions of dollars over the years, in reality, about $30 billion or so has been spent on municipal bond insurance by taxpayers that would have been unnecessary if these bonds were rated on the same basis as corporate bonds.

The good news is that this practice can be stopped immediately. Rating agencies can be required to grade municipal bonds on the same scale as corporate bonds. According to press reports, Connecticut Attorney General Richard Blumenthal has recently subpoenaed the rating agencies about this practice.

Federal regulators can also take steps to address this issues. For instance, the SEC regulation that requires money market funds to sell securities that have been downgraded below Double A can be clarified to provide that the corporate rating scale should be used to determine the credit ratings for this test. A similar strategy can address the situation of other fiduciaries, such as public pension fund managers, that may have ratings-based triggers in their investment mandates. The potential for systemic risk can be mitigated if the SEC and pension boards act quickly along these lines.

A migration of ratings to the corporate scale will lead to a wholesale upgrading of municipal bond issues, avoid the forced sale of these securities, and reduce the cost of municipal borrowings in the future as investors are better educated about municipal default probability. It will also reduce the need for bond insurance in many instances.

Risk Created by Downgrades of Structured Finance and CDO Securities

Unlike municipal bonds, structured finance issues have been overrated by the rating agencies.

We believe that it is unlikely that the bond insurers will have adequate capital to meet their claims to policyholders on these and other exposures.

The insurers have some capital which will help reduce total losses to policyholders.

Some banks may still lose billions of dollars. The biggest losers will be those that made the most money from issuing CDOs and residential mortgage-backed securities in recent years.

What Should be Done about Downgrades and Losses

Most banks are still sufficiently well capitalized to absorb these losses, although some may have to raise additional capital for these and other exposures.

Banks must recognize their losses and be as transparent as possible to increase market confidence.

If the banks need additional capital or potentially a bailout, it would be much more efficient and transparent to the market to recapitalize or bail out a bank directly than through the indirect method of propping up ailing bond insurers.

If banks put capital in a bond insurer, they are exposing themselves to the risks of other exposures about which they know little.

Moreover, by allowing banks to reinsure their own risks by investing in a bond insurer, systemic risk is increased rather than reduced.

The Bond Insurers Should Retain as Much Capital as Possible

The bond insurers should retain as much capital as possible to meet claims to policyholders. The problem is that holding company executives are trying to take out as much money as possible from the insurers through dividends and otherwise to prop up their stock prices and pay stockholder dividends.

For example, last year MBIA took out $1 billion in special dividends from its insurance subsidiary which it used to buy back stock from shareholders and members of management. $660 million of stock was bought from shareholders and $70 million of stock was bought from insiders at prices four to five times today's stock price. In addition, about $170 million was spent on shareholder dividends. The balance of the funds was used for holding company executives' salaries and other expenses.

MBIA's holding company would have taken out more insurance company dividends if the New York Insurance Department hadn't stopped them this past summer.

The problem is that while the insurance regulators can stop special dividends, they cannot stop ordinary dividends when the insurers have "policyholders' surplus" unless regulators take direct legal action.

Policyholders' surplus is based largely on holding company executives' estimates of future losses. Since the task of determining capital reserves is a self-graded exam, one would not expect executives to give their company a failing grade that will lead to the elimination of policyholders' surplus and dividend capacity. Indeed, despite billions of dollars of recent writedowns, these executives predicted just a few short months ago that they'd suffer no meaningful losses.

We believe that holding executives have and continue to substantially underestimate losses, thereby overstating statutory surplus. As a result, without proactive measures by regulators, holding companies can continue to deplete their insurance subsidiaries' capital through dividends.

The problem is not whether regulators are sufficiently empowered to address this situation. State laws provide insurance commissioners with enormous power and discretion. We urge regulators to exercise their safety and soundness powers now. Anything less will jeopardize the policyholders they are mandated to protect.

MBIA recently announced that it expected to take $540 million in ordinary dividends from its insurance subsidiary beginning in April of 2008. This is a big problem for MBIA policyholders.

It is critically important that independent assessments of the bond insurers' exposures are used to determine capital adequacy.

The Treasury, Comptroller of the Currency, and the Federal Reserve can be very helpful in this regard by working with the state regulators to assess the bond insurers' exposures and capital adequacy.

If the bond insurers' capital is found to be deficient, then the state regulators can seize control of the insurance subsidiaries from the holding companies and work to preserve as much capital as possible to meet policyholder claims.

Summary Thoughts

It is important to hold those responsible accountable for their actions.

Holding company executives that caused the insurers to take on risky new lines of business are principally responsible for the problem.

These same executives continue to control the insurance subsidiaries and have announced their intention to continue to withdraw capital from these regulated subsidiaries.

This practice has to stop in order to protect policyholders.

State regulators, in coordination with their federal counterparts, should assess the complicated exposures of the bond insurers to determine their capital adequacy.

State regulators should continue to encourage well-capitalized entrants to provide insurance for municipalities who need bond insurance to raise funds cost effectively.

All bonds including municipal bonds should be rated on a single, standard scale that is based on their probability of default.

If the same standard that is used for corporate issuers is applied to municipal issuers, nearly all municipal bonds will have upgraded ratings leading to reduced borrowing costs for all municipalities and the reduced need for bond insurance.

Banks should mark their losses to market. If, as a result, banks need additional capital or bailouts, they should raise such funds directly, not through the backdoor propping up of the bond insurers to which they have exposure.

While it would be ideal if no one were to lose money, the nature of the investment business is caveat emptor. One of the great things about this country is that while we make mistakes, we are generally good about admitting them, doing the best we can, and moving forward. That, in my view, is the path to progress.

I welcome any questions you may have.

FitchRatings

Statement of

Keith M. Buckley
Group Managing Director
Fitch Ratings

To

United States House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

The State of the Bond Insurance Industry

February 14, 2008

Introduction

Fitch Ratings traces it roots to the Fitch Publishing Company established in 1913. In the 1920s, Fitch introduced the now familiar "AAA" to "D" rating scale. Fitch was one of the three rating agencies (together with Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's")) first recognized as a nationally recognized statistical rating organization ("NRSRO") by the Securities and Exchanges Commission (the "Commission") in 1975.

Since 1989 when a new management team recapitalized Fitch, the company has experienced dramatic growth. In 1997, Fitch merged with IBCA Limited, another NRSRO headquartered in London, and became owned by Fimalac, a holding company that acquired IBCA in 1992. The merger of Fitch and IBCA represented the first step in our plan to respond to investors' needs for an alternative global, full-service rating agency capable of successfully competing with Moody's and S&P across all products and market segments.

The next step in building Fitch into a global competitor was our acquisition in April 2000 of Duff & Phelps Credit Rating Co., an NRSRO headquartered in Chicago, followed by the acquisition later that year of the rating business of Thomson BankWatch. These acquisitions especially strengthened our coverage in the financial instutions and insurance industries.

Fitch currently covers 6,000 banks, insurance companies and other financial institutions, 1,600 corporations, 103 sovereigns and 93,000 municipal offerings in the United States. In addition, we cover over 7,300 structured finance securities.

Testimony

Set forth below is a summary of our history and methodology of rating bond insurers, as well as a discussion of our recent rating actions.

Rating Coverage & History

Fitch commenced its ratings coverage of the bond insurance industry in 1991 when it assigned an 'AAA' insurer financial strength (IFS) rating to Financial Guaranty Insurance Company (FGIC). By 1997, Fitch covered all of the so-called "big four" bond insurers, which in addition to FGIC included Ambac Assurance Corp. (Ambac), Financial Security Assurance (FSA), and MBIA Insurance Corp. (MBIA), all of whom were initially assigned 'AAA' IFS ratings. Together, Fitch estimates these four bond insurers currently account for approximately 83% of the gross par insured in the industry.

In addition, Fitch currently rates four other smaller, yet still significant bond insurers – Assured Guaranty Ltd. (Assured), CIFG Guaranty (CIFG), Radian Asset Assurance (Radian) and Security Capital Assurance (SCA), the parent company of XL Capital Assurance Inc. (XLCA). All of these companies were initially assigned 'AAA' IFS ratings with the exception of Radian, which strategically operates on a niche basis with an IFS rating below 'AAA'.

The following table summarizes the ratings status as of February 12, 2008 of the bond insurers currently rated by Fitch. The table summarizes each bond insurers' current and prior IFS ratings, the date of any recent rating change (if applicable), the original year in which Fitch assigned a rating to the company, the current Rating Outlook/Rating Watch status, as well as the gross par insured by each company.

Table 1: Fitch Bond Insurer Ratings Summary

Company	IFS Rating Current	IFS Rating Prior	Date Changed	Rated Since	Rating Outlook/Watch	Gross Par ($B) *
Ambac Assurance Corp.	AA	AAA	1/18/08	1994	Negative Watch	$600
Assured Guaranty Ltd.	AAA	---	No change	2005	Stable Outlook	$146
CIFG Guaranty	AAA	---	No change	2002	Negative Watch	$87
Financial Guaranty Ins. Co.	AA	AAA	1/30/08	1991	Negative Watch	$349
Financial Security Assurance	AAA	---	No change	1997	Stable Outlook	$506
MBIA Insurance Corp.	AAA	---	No change	1995	Negative Watch	$731
Radian Asset Assurance	A+	AA	9/5/07	2001	Evolving Watch	$63
Security Capital Assurance	A	AAA	1/24/08	2000	Negative Watch	$153

* As of June 30, 2007

Source: Fitch Rating

We will discuss the rationale behind recent rating actions taken by Fitch later in this testimony.

Though not rated by Fitch since 2004, Fitch at one time maintained rating coverage on ACA Financial Guaranty Corp. (ACA), a niche bond insurer that strategically operated with an IFS rating below 'AAA'. Based on concern with the company's capitalization, strategic direction and risk management, Fitch downgraded its IFS rating of ACA to 'BBB' in 2004, and subsequently withdrew its rating after management ceased providing Fitch information necessary to maintain a rating.

Rating Methodology

The group within Fitch covering the bond insurers is a specialized team within our global insurance group. Because of the intensity of the analysis employed in rating and monitoring bond insurers, the ratio of companies rated relative to the number of analytical staff within the bond insurance team is the lowest within Fitch's broader insurance and financial institutions group.

Fitch's methodology for rating bond insurers is consistent with that used to rate other types of insurance companies, financial institutions and corporate entities, while also recognizing the unique attributes and risks within the bond insurance industry. Our methodology employs a mix of quantitative metrics and qualitative factors. Ratings are ultimately set judgmentally by a Rating Committee, consistent with Fitch policy that includes a mix of industry experts and independent members.

From a qualitative perspective, key factors analyzed include:

- Management
- Corporate Governance
- Ownership & Holding Companies
- Franchise Value
- Strategic Direction
- Ancillary Businesses

Fitch notes that in the current challenging environment facing bond insurers, the impact of these qualitative factors will take on extra importance in our analysis going forward. This will be especially true as we consider the ratings parameters for companies that formerly were rated 'AAA', but have been downgraded below 'AAA'. We are currently considering the question as to the appropriate parameters for these bond insurers to return to 'AAA'. For example, for a number of these companies Fitch believes franchise values may be materially impacted by the loss of investor confidence. We also have observed significant differences in how ownership has impacted financial flexibility, and we have seen material differences in how management has approached both capital raising strategies and the tradeoff between the interests of shareholders versus policyholders.

From the perspectives of quantitative analysis, key factors analyzed include:

- Capital Adequacy
- Risk Management
- Financial Performance
- Reinsurance
- Investment/Liquidity

Though all of the quantitative factors are important and can take on varying weighting within our analysis of a given bond insurer based on unique circumstances, the most important quantitative factor is typically capital adequacy.

Fitch introduced a new capital adequacy model in January of 2007. The model was developed over a two year period working with an outside consultant, and employed a significant investment by Fitch in both development costs and human resources. The model is a stochastic model employing Monte Carlo simulation techniques, and can produce over 500,000 scenarios. While Fitch recognizes that no model is a perfect indicator of future performance, Fitch believes its capital model has served it well during the current period in which subprime credit issues have been impacting the bond insurers.

In the most simple of terms, Fitch's capital model analyzes the relative risk of the various municipal, structured finance and infrastructure bonds insured by the financial guarantors, and based on that analysis indicates a minimum amount of capital the bond insurer should hold to meet what Fitch determines as its 'AAA' IFS rating standard. Generally speaking, the greater the risk assessed in the insured portfolio, the higher the amount of capital that will be indicated by the model. The model then compares this indicated amount of capital to the actual capital held by the bond insurer to judge adequacy.

One of the significant inputs into the model is the underlying credit ratings assigned to each of the bonds in the insured portfolio. Underlying ratings are simply the credit rating assigned to the bond based only on the credit quality of the issuer or structure, before giving any benefit to the ratings uplift from the bond insurance itself.

Fitch will take into account its own underlying ratings when they exist, and if not we monitor the lower of the underlying ratings assigned to the insured bonds by S&P and Moody's. It is important to note too that the credit staff within each bond insurer develops its own underlying ratings on the transactions they choose to insure, and they historically shared these underlying ratings with Fitch. In effect, each bond insurer employs its own internal credit rating process. Fitch's monitoring of these underlying ratings and the overall quality of the credit analysis and risk management process within each guarantor is a critical part of our ratings analysis.

For a variety of reasons that are beyond the scope of today's testimony, Fitch's market share of underlying ratings has historically been modest. For example, Fitch estimates that it rated less than 10% of the subprime-exposed collateralized debt obligations

insured by the bond insurers that are now experiencing the highest degrees of downward ratings migration.

Ultimately, the ratings assigned by Fitch to bond insurers are based on a blending of the various qualitative and quantitative factors highlighted above. It is also important to note that it is generally Fitch's practice not to rate a bond insurer at a given rating, especially 'AAA', if it does not meet the capital adequacy guidelines for that rating. That said, simply meeting capital adequacy guidelines is not sufficient to achieve an 'AAA' rating if the insurer is deficient in other key areas within our methodology. In other words, the bond insurer must have both 'AAA' capital adequacy, and meet other 'AAA' standards, to be rated 'AAA'.

Insurer Financial Strength Ratings and Insured Ratings In Perspective

The ratings assigned to the bond insurers that are the most commonly referred to in the capital markets are IFS ratings. These ratings address the capacity of the bond insurer to meet its policyholder obligations, and it is the IFS rating that then becomes the rating on the insured bond. For example, assume an 'AAA' IFS rated bond insurer guarantees the municipal general obligation bonds issued by a mid-sized city, whose underlying rating is 'A'. Once bond insurance is put in place, those insured bonds will then be rated at 'AAA', based on the IFS rating of the bond insurer.

When the IFS rating of a bond insurer is downgraded, many of the bonds it insurers will also be downgraded to the revised IFS rating. The exception would be the case in which the underlying rating on the bond is higher than that of the IFS rating, in which case the bond would then be rated at its underlying ratings level.

It is important to note that IFS ratings indicate the likelihood that a bond insurer will fail, and become insolvent. The ratings do not provide, and were never intended to provide, any indication as to the likelihood that a bond insurer may be downgraded. In fact, with most financial institutions and insurance companies downgrades are common during periods of financial stress within a sector, and can be expected.

Ratings of 'AAA' have historically only been assigned at the regulated insurance company level within the bond insurance industry. Holding company-level debt ratings, which are most comparable to the credit ratings assigned to most corporations and financial institutions, have historically been in the 'AA' category. The ability to rate the regulated policyholder obligations via the IFS rating at 'AAA' has reflected the seniority afforded policyholder obligations via regulatory protections, and the historic business models of the bond insurers to place protection of policyholder interests far ahead of stakeholder interests, and to underwrite to a "zero loss" standard.

Downgrades among bond insurers have historically been infrequent due to their generally low risk strategies and management's stated commitment to maintain their 'AAA' ratings. However, downgrades have occurred, as indicated by Fitch's previously noted 2004 downgrade of ACA.

Fitch believes the current IFS rating downgrades experienced by and/or facing a number of bond insurers -- at their most basic level -- are due to the significant deterioration in the U.S. real estate market, particularly what is commonly known as the subprime sector, to which several of the bond insurers have significant exposure. The exposure to the subprime sector highlighted certain weaknesses within the insurers' risk management and underwriting practices, coupled with lower than expected financial flexibility and, in the case of some companies, an apparent unwillingness to dilute shareholder interests for the benefit of policyholder interests.

Recent Rating Actions: Phase 1

In the Second Quarter of 2007, it became clear to Fitch that the increasing deterioration in the U.S. subprime mortgage sector would lead to credit deterioration in securities with subprime exposures that were insured by many of the bond insurers. This deterioration in the credit quality of the bond insurers' insured portfolios would, in turn, increase the modeled capital requirements for the bond insurers. With potentially higher amounts of modeled capital indicated at the 'AAA' ratings threshold, it also became clear that the bond insurers could at some point experience capital shortfalls below our 'AAA' ratings standards, thus putting their 'AAA' IFS rating in jeopardy.

In many ways, the situation facing bond insurers today is not dissimilar to that which other types of insurance companies and financial institutions have faced in the past, such as the emergence of asbestos claims that caused property/casualty insurers' capital ratios to weaken in the latter part of the 1990s. As is well known, many property/casualty insurer ratings were ultimately downgraded as a result of emerging asbestos losses.

From a process perspective, Fitch approached the situation with the bond insurers as it would with any other type of insurance company or financial institution. We first conducted analyses which "stress tested" the impact of how hypothetical future downgrades of underlying ratings would impact the various bond insurers' capital adequacy, and published a report in early September 2007 with our findings.

Subsequently, as deterioration in subprime markets became even more pronounced, on November 5, 2007 Fitch issued a public commentary indicating that it was formally reviewing the 'AAA" rated bond insurers in light of credit deterioration in their insured portfolios, with a special focus on structured finance collateralized debt obligations (SF CDOs) that contained subprime collateral.

In this commentary, Fitch stated that if its updated analysis identified a capital shortfall below our 'AAA' standards for a given bond insurer, we would likely place the bond insurer on Rating Watch Negative. For those bond insurers placed on Rating Watch, we stated that we expected the bond insurer to raise capital or otherwise mitigate the risk (such as through reinsurance) to again meet 'AAA' capital standards within a four to six week time period. It was our expectation that a 'AAA' bond insurer ought to have the financial flexibility to raise the capital or mitigate the risk in

such a period. If capital remained below our 'AAA' standards at the end of the four to six week period capital, we stated that we would expect to downgrade the IFS rating. After Fitch's announcement on November 5, similar announcement were subsequently made by Moody's and then S&P.

Fitch believed that the use of a stipulated time period to judge management's ability and willingness to raise capital was important, because part of our historic rationale in assigning 'AAA' ratings to the bond insurers was based on managements' unflinching representations that they would take any measure to maintain their 'AAA' ratings. We also thought that the time period needed to be realistic, but not unduly long because another historic rationale for assigning 'AAA' ratings was the assumption that bond insurers would benefit from ready access to capital and financial flexibility during periods of stress, as we would expect of any 'AAA' rated issuers. Thus, the ability of a bond insurer to execute quickly when facing a capital shortfall was viewed by Fitch as important to our rating conclusion from a qualitative perspective.

When we announced commencement of our review in November, we risk ranked the bond insurers based on their relative exposures to SF CDOs. Two insurers – Assured and FSA – were designated as having minimal exposure, and they are currently the only two 'AAA' bond insurers whose ratings have been affirmed and currently carry "Stable Rating Outlooks" from Fitch.

At the conclusion of our updated capital analysis, on various dates throughout late November through December, all of the remaining bond insurers were identified as having material capital shortfalls relative to our 'AAA' standards.

Two insurers – CIFG and MBIA – were able to secure sufficient capital commitments to avoid downgrades, and Fitch affirmed both companies' IFS ratings. In the case of the other three 'AAA' bond insurers – Ambac, FGIC and SCA – capital was not raised within our stated timeframes, and their ratings were downgraded as reflected in the Table shown earlier in this testimony. In the case of Ambac and SCA both companies issued press releases just prior to Fitch's downgrades stating they were postponing capital raising efforts until market conditions improved. In the case of FGIC, while management was still actively exploring capital raising plans at the time of the downgrade, Fitch lacked confidence in the company's ability to execute on its plans in a reasonable timeframe. The three downgrades occurred at various dates in January of 2008, and the rating of each downgraded company was left on Rating Watch Negative.

Recognizing that Fitch originally rated less than 10% of the subprime SF CDOs insured by the bond insurers, Fitch's CDO rating team developed Fitch ratings assessments on each of the SF CDOs previously unrated by Fitch. These assessments were used by Fitch's bond insurance ratings team in its updated capital modeling. As of September 2007, bond insurers' collective gross exposure to these SF CDOs totaled approximately $114 billion across approximately 130 transactions. In every case but one, the underlying rating of the various insured CDOs was 'AAA' at origination.

The following summarizes the ratings distribution of these 130 SF CDOs after Fitch completed its ratings assessments in November and December of 2007:

- 27 were assessed at AAA
- 29 were assessed at AA or A
- 25 were assessed at BBB
- 40 were assessed at BB or B
- 9 were assessed at CCC

In addition to providing assessments on these SF CDOs with material subprime exposure, Fitch also anticipated future downgrades of certain other sub-prime-exposed and mortgage-exposed securities insured by the bond insurers, and added additional modeling stresses to compensate for this risk.

Recent Rating Actions: Phase 2

In late January 2008, Fitch's Residential Mortgage Backed Securities (RMBS) ratings team announced that it had updated its loss estimates for subprime mortgages based on new default, housing and economic data, including significantly worse projections for the subprime sector. As a result of a prospective analysis using this data and other information, Fitch has more than doubled its loss estimates for 2006 and 2007 vintage subprime mortgages, and has announced that it will be reevaluating its ratings on impacted RMBS and SF CDO transactions during the month of February. Fitch believes that most RMBS tranches originally rated 'A' or lower may default with a 100% loss, and that a number of mezzanine subprime SF CDOs from this vintage, including tranches of the type insured by the bond insurers, may default with material losses. High grade SF CDOs should fair better, but will experience higher expected losses than previously assumed.

Though a material portion of the deterioration implied by Fitch's recently updated subprime loss projections was already factored into our bond insurer IFS rating through the conservatism of our SF CDO ratings assessments and use of other modeling stress factors, Fitch's bond insurance ratings team on February 5, 2008 announced a second phase of subprime analysis with respect the bond insurers. This decision reflects both the speed and magnitude at which the U.S. real estate market, and the subprime sector in particular, appear to be deteriorating, and recognizes that even our very conservative prior assumptions may now be under additional stress.

As part of our February 5 commentary, Fitch stated that it has increased concern as to whether an 'AAA' IFS rating would be appropriate for a bond insurer that has been recently downgraded, even if the bond insurer some day recapitalizes to meet 'AAA' capital standards. This in part reflects Fitch's concern that actual losses ultimately incurred by the bond insurers may prove to be quite significant, and inconsistent with ratings expectations. Fitch's view also reflects previously discussed concerns with respect to franchise values, financial flexibility and the alignment of shareholder and policyholder interests, and management's view with respect both constituencies. Thus, Fitch's newest phase of analysis not only includes an updated capital analysis, but

close scrutiny of the escalation of expected losses and expected future claim payments, as well as various qualitative considerations.

Concurrent with the announcement of the second phase of our review, Fitch placed the IFS ratings of both CIFG and MBIA on Rating Watch Negative, while the ratings of Ambac, FGIC and SCA remained on Watch Negative. The IFS ratings of Assured and FSA remained Stable at 'AAA'.

Fitch has not yet defined its timetable for completion of this next phase of analysis, but we believe it will likely be completed relatively soon. Also, given both the materiality of the deterioration in capital positions we expect to see, together with a generally poor access to capital demonstrated by most of the bond insurers this past January, we will likely not afford capital raising "grace periods" if the analysis indicates that a downgrade be warranted.

Conclusions

Fitch believes the outlook for the bond insurance industry is highly uncertain, and that it is likely that several companies may ultimately exit the market via voluntary runoff. Others bond insurers that remain in business may be challenged to write new business for an extended period of time as they take steps to try and regain 'AAA' ratings and rebuild their franchises. As noted, Fitch is currently reviewing the parameters and timeframes under which a downgraded financial guarantor could potentially be upgraded, and expects to clarify this in the near future.

We also would not be surprised to see consolidation among some of the remaining players, as well as entry into the market of new market participants. Fitch believes too that given the declining confidence many in the capital markets have in the sector, the ultimate level of demand for the industry's product is unclear, especially recognizing that bond insurance may be a helpful, yet nonessential product for the economy.

Positively, at this stage, consistent with our original 'AAA' IFS ratings, Fitch does not envision solvency problems for the bond insurers even at the current level of high projected losses on subprime mortgage loans.

WRITTEN TESTIMONY OF MICHAEL CALLEN

CHAIRMAN AND CHIEF EXECUTIVE OFFICER OF AMBAC FINANCIAL GROUP BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES

February 14, 2008

Let me begin by commending Chairman Kanjorski, Ranking Member Pryce and the members of this Subcommittee for holding this hearing. It is important that the Subcommittee has the complete facts regarding bond insurers so that the issues facing the industry can be properly understood and addressed. I hope that my remarks will contribute constructively to achieving this goal.

I'm Mike Callen. I took the role of Ambac's Chairman and interim CEO last month and have been a member of the Board of Directors since 1991. I grew up in Milwaukee, Wisconsin, joined the Marines after high school and returned to graduate from the University of Wisconsin. After that I started a career in the financial sector, working at Citibank for 27 years. I currently split my time between New York and Washington DC, where I teach in the Masters of Science in Foreign Service program at Georgetown University.

Ambac has written financial guarantee insurance for over 35 years. We founded the industry when we provided the first guarantee of a municipal bond for Juneau, Alaska in 1971. Over the past three and a half decades, Ambac and the industry have successfully survived many economic cycles and challenges including multiple recessions, Hurricane Katrina, 9/11, Orange Country, the Washington Public Power System (a.k.a. Whoops) and others. During that time, no holder of an Ambac insured security has ever missed a single interest or principal payment.

Since going public in 1991, Ambac has insured $1.2 trillion in securities, most of these for state and municipal issuers. Claims paid have totaled $280 million, amounting to 0.024% of the amounts guaranteed and 4.3% of net premiums earned. We expect this loss rate to increase as a result of Ambac's diversification away from pure municipal finance, which began in the early 1990's. At that time, Ambac began guaranteeing bonds which facilitated the flow of funds for consumer financing, including housing, manufactured homes, and autos.

Despite higher expected losses, Ambac has the financial resources to comfortably meet existing obligations even under loss scenarios that are on the pessimistic side of market estimates. Almost no one questions the ability of Ambac to make good on obligations to holders of Ambac guaranteed debt. However, confidence in Ambac's ratings stability, and therefore the business model, is being tested. Ambac is committed to do everything we can to restore and maintain confidence entrusted to us by both issuers and investors so as to continue to provide our product and services in the future.

First, issuers, including states and municipal governments, want Ambac to continue to provide market access and lower borrowing costs. This means that we must not only have the ability to pay existing claims, but also must be able to write new business. New business generation requires investors to have a clear and stable view of Ambac and our ratings.

Second, investors in Ambac guaranteed bonds lose value if Ambac is downgraded below triple-A, even though we remain able to meet obligations. For example, retail funds required to invest in triple-A assets would be forced to sell Ambac guaranteed municipal debt upon a downgrade, and to sell into an illiquid market at reduced prices. Maintaining a triple-A rating is the only way to avoid this.

We therefore see the current issues facing the financial guarantors not as a question of ability to meet obligations, but rather a challenge to maintain the stability of ratings that have supported our business in the past and that will support it going forward.

Bond insurers, also known as monolines, guarantee the timely payment of scheduled interest and principal on bonds. Fifty four percent of Ambac's portfolio consists of US public finance exposures, where we guarantee state and municipal obligations, schools, roads, hospitals, airports, water facilities and provide funds for other essential government functions. For example, Ambac has guaranteed, or "wrapped," bonds for Easton in Columbus, Ohio, allowing the city to attract new development. Also in Ohio, Ambac insurance helped raise money to construct a new hospital in Dublin and a new surgical tower at Grant Hospital in Columbus. Ambac-insured bonds in metropolitan Boston were used to construct headquarters for the public radio station WGBH, the Boston Convention Center, Gillette Stadium for the New England Patriots, and to fund renovations at Dana Farber Cancer Center. In New York City, Ambac-insured bonds have provided financing for the MTA, new courthouses in the Bronx and Brooklyn, and assisted-living residences for citizens with disabilities. In Delaware, Ambac-insured bonds provided funds to renovate Christiana Care Health Services, one of Delaware's leading tertiary care hospital systems.

During times of stress for municipalities, Ambac has been there for our clients. Ambac worked extensively with the city of Wilkes-Barre to help it work through its financial difficulties and to empower the city to issue less-expensive bonds at a time when its market access to capital was severely impaired.

In Jacksonville, Florida, after a cash crisis at the city's sole public safety-net hospital, Ambac took the lead role in arranging the workout that turned around the hospital's operations, stepped in to supply fresh capital, and negotiated for support from the University of Florida and its primary teaching hospital, Shands, bringing new physicians to Jacksonville.

After Hurricane Katrina, Ambac supported restructuring of the municipal debt of Jefferson Parish, Louisiana and Harrison County, Mississippi, in order to grant them short-term cash flow and budgetary relief. Additionally, Ambac provided insurance for $283 million of hurricane recovery program bonds, which were used to jump-start and fund public infrastructure projects for New Orleans, including the city's Sewerage and Water Board.

Ambac evaluates the transactions we underwrite, analyzing credit fundamentals, structure and documentation. We perform a function that an individual investor cannot. Even institutional investors, who buy a small part of a deal, often cannot dedicate the time and resources to the in-depth analysis that monolines perform. Additionally, because Ambac has a staff of over 50 people dedicated to monitoring our exposures, we are able to react quickly to credit deterioration, restructuring or taking other measures that reduce or eliminate losses.

The result is that issuers pay less for financing, ultimately resulting in greater financing flexibility and lower tax rates for municipalities and consumers.

Outside of US municipal financing, 32% of Ambac's book consists of structured finance exposures including US consumer finance transactions, commercial and utilities financing. These exposures have largely performed very well, providing Ambac with diversification and the returns required to attract capital to the business.

The remaining 14% percent of the portfolio is international exposure where Ambac has been successful in exporting capital markets solutions common in the United States to countries such as England, Australia, Germany and Japan.

Although Ambac and the industry enjoy a strong track record of success, in order to write new business, we need investor confidence in the stability of our financial condition and ratings. The current uncertainty surrounding bond insurers' ratings, when combined with illiquid and anxious credit markets, means greatly diminished demand from investors.

Demand from issuers, however, is not diminished. Issuers continue to anxiously await the reopening of the market. For example, one of our clients that builds and sells manufactured homes has reduced production, not because of lack of demand, but due to the lack of financing.

The root of the current market predicament is the deterioration in the US housing market, which has exposed unsavory lending and financing practices. Unlike many of the participants in this market, who had little or no "skin in the game," Ambac's incentives were completely aligned

with those of our constituents, including the bondholders. The right incentives, however, do not assure that losses will not be incurred.

In 2007, Ambac took $1.4 billion in reserves against mortgage exposure, the majority of which backs collateralized debt obligations (CDO's). Direct mortgage backed security (MBS) losses were a small portion of the loss estimate, highlighting how the more complex instruments magnified, not minimized risk. Although claims paid to date have been relatively small, the $1.4 billion reserve represents Ambac's best estimate as of December 31, 2007 of what Ambac will be required to pay over the life of the wrapped securities, some of which go out to 30 years.

Ambac's exposure to MBS is just under 10% the total portfolio, of which 17% (or 1.6% of the total portfolio) is subprime. Ambac reduced its participation in the subprime market dramatically from 2002 to 2007. CDO's represent 5% of Ambac's portfolio and a small group of those exposures are the ones driving the majority of Ambac's expected losses.

While Ambac's loss reserves are based on best estimates and are payable over time, Ambac's capital can absorb losses well in excess of very pessimistic scenarios that are not currently expected. Claims paying resources are $14.5 billion with additional capital generated by Ambac's existing investment portfolio. The losses that would be required to render Ambac unable to meet obligations are losses reminiscent of those experienced during the Great Depression.

According to Moody's, both a triple-A rating and a double-A rating require Ambac to be able to demonstrate claims paying resources sufficient to cover any potential claims at a 99.99% confidence level. The only difference is this: to get a triple-A rating, Ambac must not only be able to cover potential claims at a 99.99% confidence level, but also to have a 30% capital cushion left over while double-A requires a 15% cushion. Therefore, the risk of downgrade does not signify a materially higher risk of default.

It appears that the market may be confusing the agencies' extreme stress cases with expected losses. As Fitch notes in a recent release, losses are likely to be closer to those covered at a 50%

confidence level, not the over 99% confidence level everyone seems to be focusing on. If losses even approach the 99% confidence level, the US economy will have a drastically different look.

Ambac's obligations extend over the life of the underlying bonds, up to 40 years. On defaulted bonds, we pay as the obligations come due, providing comfortable predictability of obligations. In an industry where financial failure is generally related to a shortfall in liquidity to meet immediate obligations, the structure of the monoline industry is very advantageous and one of the underpinnings of the high ratings historically enjoyed by the industry.

In addition to its ability to meet obligations to holders of Ambac-wrapped debt, Ambac is in no danger of failing to meet its corporate or holding company obligations. Premiums and investment income from the existing investment portfolio is expected to generate $1.2 billion in revenues in each of 2008 and 2009, less than 20% of which will be required to meet operating expenses. During the same period, the holding company's debt obligations will total less than $90 million per annum—less than 10% of investment income net of operating expenses.

It is undeniable that mistakes have been made by financial industry participants during the benign credit cycle that began in 2003. Ambac has not escaped unscathed. Ambac is a credit risk taking institution. In a perfect storm credit crisis such as the one we are experiencing today, with projected losses on mortgage collateral that have not been experienced since the 1930's, it is to be expected that Ambac will pay claims and experience losses. Although many good decisions were made, we are now paying for the small percentage of impaired transactions on our books.

But financial stress experienced by a small portion of our portfolio does not invalidate an entire business model. Ambac has faced sector problems before such as the stress experienced in 2001 by the California utilities. We managed through that period of uncertainty, selectively increasing exposure to these essential service providers. Ambac continues to be active in guaranteeing the debt of California utilities including Southern California Edison, Pacific Gas & Electric and San Diego Gas & Electric.

Ambac has learned valuable lessons. We have strengthened internal risk controls, tightened credit standards and ratings hurdles, implemented more rigorous capital and returns hurdles for new transactions, and exited some complex asset classes.

Ambac has also learned that the form of the protection we provide matters, even if the substance is identical. Historically Ambac provided coverage in the form of a financial guarantee insurance policy, still the dominant form of protection written. However, Ambac began offering the same coverage with the same financial terms, but in the form of a Credit Default Swap or CDS. There is no economic impact of writing this protection in CDS form versus financial guarantee, but there is an important accounting difference.

Exposure taken in CDS form requires mark-to-market accounting under FASB 133. This means that the CDS written must be revalued quarterly. If the market value of the CDS increases Ambac must take an accounting loss on its exposure. This reflects the loss that Ambac would take if it were to liquidate its position in the CDS. However, Ambac does not trade these positions, so there is no economic impact of marking to market.

Fluctuations in the value of CDS are the result of both illiquidity and perceived credit deterioration. Mark-to-market losses that reflect market conditions reverse themselves over time. This is similar to the fluctuating value of a municipal bond portfolio, which goes down when interest rates go up regardless of the credit quality of the bonds. Assuming no defaults, at maturity investors still get 100% of their principal regardless of fluctuations in market value over time.

Ambac underestimated the magnitude of potential mark-to-markets as well as the market's reaction to them. Ambac took a mark-to-market loss of $6 billion in 2007, of which $1.1 billion is estimated to be credit impairment. We would expect the remaining $4.9 billion to flow back into GAAP income over the life of the CDS.

Ambac and the industry's next critical step is to restore confidence. This requires stable and predictable credit ratings. Investors must both have a clear understanding of what it takes to

maintain stable ratings, and understand why Ambac comfortably meets the ratings criteria. Raising capital is a critical feature of this plan. Additionally, Ambac will continue to offer a high level of transparency and will continue listing our credit exposures on the website and ongoing communication with the market through periodic reporting and quarterly conference calls.

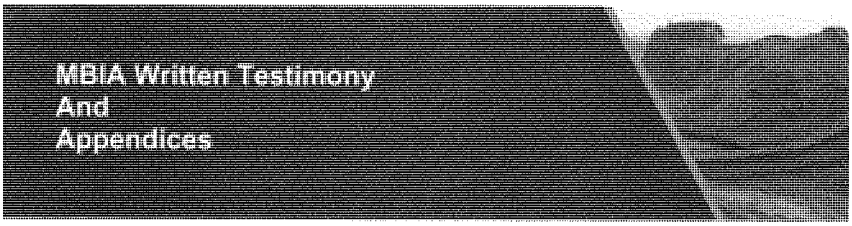
Finally, the rebuilding of confidence will take time. The passage of time will not only reduce the range of forecasts for housing market losses, but will also prove the value of the guarantee. We expect that investors in Ambac-wrapped paper will not experience losses while many unwrapped investors will. Like the homeowner who buys hurricane insurance after the storm, investors will return to the tested and reliable insurance product offered by the monolines.

Ambac is a Wisconsin domiciled company, regulated by the State of Wisconsin Office of the Commissioner of Insurance, led by Sean Dilweg. Additionally, under Wisconsin regulation, Ambac must comply with the laws and regulations of other states in which it is licensed if they exceed the Wisconsin requirements. Article 69 of the New York insurance laws sets standards for financial guarantee insurers with solvency requirements in excess of Wisconsin and therefore Ambac must also comply with New York regulations. Both Commissioner Dilweg and New York's Superintendent of Insurance, Eric Dinallo, have been extremely involved in regulating and guiding Ambac. In particular, the communications that have emanated from their offices and the level of thoughtful and constructive involvement with Ambac and the industry since the inception of the credit market deterioration have been instrumental in sending the balanced signals of concern and support to the market.

During times of declining confidence in the capital markets, it is critical for regulators, government agencies and those in the position of power to project confidence. We are here today to give you the information and knowledge required for you to decide whether such confidence is in order.

It is in the interest of the markets and the economy to have a strong and viable financial guarantee industry. Issuers benefit from market access and lower borrowing costs and investors

benefit from the diligence, structuring and ongoing surveillance performed by the monolines. The capital markets are strengthened by the presence of a risk-taking party with skin in the game. Taxpayers benefit from lower taxes to support the critical spending needs of their local and state governments. The only parties who do not wish to see a viable monoline industry are those with an economic interest in our failure.



February 14, 2008

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Written Testimony - MBIA

The Financial Guarantee Insurance Industry

Financial guarantee insurance companies are referred to as "monolines" because they are legally authorized to sell only one line of insurance: their financial guarantee. This guarantee is unconditional and irrevocable, and it assures the timely payment of contracted principal and interest to investors holding insured bonds. Central to the business strategy of the monoline financial guarantors is the companies' Triple-A ratings. All of the other activities of the financial guarantee companies, including risk management and deal review, portfolio monitoring and remediation activities, are designed to protect it.

Benefits to Issuers and Investors

The financial guarantee industry provides an important service to debt issuers, investors and the global capital markets. For example, both issuers and investors benefit from the transparency and uniformity that MBIA's guarantee brings to an otherwise complex and opaque market, as bond insurance helps "commoditize" municipal securities from different parts of the country under different governing laws and regulations that are both taxable and tax-exempt. For issuers, the Triple-A rating on a bond reduces borrowing costs, makes the bond more marketable, and provides easier and more effective access to the capital markets while ensuring a streamlined execution. Additionally, in the case of municipal bonds, bond insurance benefits taxpayers because it lowers overall borrowing costs and enables local projects to be funded at reduced costs.

Monoline credit enhancement plays an important role in deepening capital market access for complex, large scale, and long tenor funding requirements (typically, infrastructure and public projects) which are traditionally outside the scope of bank or unwrapped financing. In addition the financial guarantee product increases efficiency by providing capital market liquidity for funding of otherwise illiquid credits.

Investors are protected with bond insurance on their investments in at least two ways: they have the insurer's unconditional guarantee of timely payment of interest and contracted principal in the event of a default, and they have added protection from the provisions

monolines negotiate into the transaction, enabling the guarantors to monitor the credit and effectively remediate it. Additionally, the Triple-A "wrap" protects against downgrade and credit losses on the underlying security.

Background on the Industry

The financial guarantee industry has its roots in the public sector, where bond insurance helps finance essential public works projects such as hospitals, bridges, roads, and airports. In the early 1990s, the monoline insurers began providing credit enhancement to structured finance transactions, which are securities backed by assets such as credit card receivables and mortgages, as well as pools of corporate bonds and loans. Today the industry guarantees financings around the world for a wide variety of debt instruments, including projects for private finance initiatives and public-private partnerships. The industry has guaranteed nearly $6 trillion in public- and private-sector debt during its 36-year history, and according to the Association for Financial Guaranty Insurers, has saved U.S. municipalities an estimated $40 billion in interest costs since 1971.

MBIA

MBIA, the world's leading monoline financial guarantee insurance company, began writing financial guarantees for municipal bonds in 1974. MBIA guarantees municipal bonds, structured finance and asset-backed obligations, payments due under credit and other derivative securities, obligations of sovereign and sub-sovereign issuers, and privately issued bonds used for financing public purpose projects overseas. MBIA's structured finance business serves a diverse client base that includes many of the world's leading specialty finance companies, commercial banks, insurance companies and investment banks. MBIA has been an innovator in the structured finance market, as it was the first monoline to guarantee securitizations for a variety of asset classes.

As of December 31, 2007, MBIA insures over $1 trillion of total debt service outstanding, and employs over 480 people in Armonk, New York, and in eleven other locations around the world. The Company has an admirable track record in selecting, underwriting, managing and remediating credit risk. Conservative underwriting is MBIA's hallmark. MBIA's prudent underwriting approach has led to the Company rejecting some of the largest exposures

currently impacting the mortgage market. For example, MBIA ceased doing business with lower quality subprime issuers in 2004 and has written only a low volume of Triple-A-rated deals in the subprime mortgage space, all with underlying Triple-A ratings, since that time. The Company's "remote-loss" underwriting standard anticipates no losses under a worst probable case scenario. Each transaction must meet MBIA's stringent credit structuring and legal criteria and, in virtually all cases, must be rated at least investment-grade by the rating agencies as well as by MBIA's internal standards, prior to MBIA insuring it.

MBIA's portfolio of insured issues is highly diversified with strict limits imposed on its exposure to specific asset classes, sectors, geographies, seller/servicers and deal structures. The portfolio is heavily weighted toward public finance, which comprises 65 percent of the insured book of business as of 12/31/07. Thirty-nine percent of the public finance issues that the Company has insured (25 percent of the total insured portfolio) is in the safest and most predictable category – General Obligation municipal bonds.

MBIA believes that diversification is key to sound credit management: it limits exposure to any particular sector which reduces loss severity to MBIA if a systemic problem were to occur in that sector. (For example, during the California energy crisis, PG&E and SoCal Edison credits came under significant stress, but MBIA's insurance portfolio was able to withstand the higher capital charges assigned to those credits.) Diversification can also reduce correlation risk. As such, the Company utilizes portfolio analysis and constructs sector exposure limits to contain potential risk exposures. Notwithstanding the diversity in the Company's portfolios (insured and investment), MBIA is selective in determining which sectors, countries, markets and structures it will insure; much the same as it culls through the high quality investment-grade-rated universe for attractive deals to wrap.

Structured Finance Products Insured By MBIA

The balance of MBIA's insured portfolio – 35 percent – is in structured finance transactions. MBIA's approach to underwriting structured finance credits follows the same remote loss standards/objectives that underlie the Company's public finance insured business. As part of this, MBIA endeavors to assess the ability and the willingness of the creditor to repay on its obligation. This portfolio consists of, among other sectors, consumer asset-backed and commercial real estate transactions, as well as residential mortgage-backed securities

(RMBS) and collateralized debt obligations (CDOs). The RMBS and asset-backed CDO portfolios, in particular, have received a great deal of focus both internally and externally in recent months, as the U.S. mortgage and housing sectors have rapidly deteriorated.

RMBS

MBIA's direct RMBS portfolio is about $43 billion, net of reinsurance, or approximately 6 percent of MBIA's total book of business. There are two separate types of RMBS-related deals that the Company insures: prime and subprime.

MBIA's prime RMBS business consists of first- and second-lien mortgages to top-tier, high quality borrowers with strong credit scores. This business focuses on two areas: (1) transactions that are backed by Triple-A-rated underlying collateral and are conservatively structured and solid performers, and (2) prime home equity lines of credit (HELOC) and closed-end second (CES) mortgages. Both the HELOCs and CESs are generally second-lien products. HELOCs are floating rate revolving loans that generally require interest-only payments through a period of time before amortizing principal, and CESs are fixed-rate second mortgages that generally amortize principal from the outset.

In contrast to MBIA's prime RMBS business, the Company's subprime business is comprised of mortgages made to lower credit quality borrowers. In response to the weakening underwriting trends MBIA observed in the subprime space during the post-2002 housing boom, MBIA enacted a conservative strategy towards subprime RMBS collateral and issuers, given the material market growth and the potential fragility of the business models of second- and third-tier issuers. Since the beginning of 2004, MBIA has limited its insurance of subprime mortgage transactions to first-lien products with top-tier originators and servicers, and only if the deal was rated Triple-A. Due to substantial subordination and loss protection on these deals and the selective strategy the Company took towards direct subprime exposure, MBIA considers the risk of material loss from this portion of its portfolio to be minimal at this time.

Historically, MBIA has had a very successful track record with prime HELOC and CES mortgage deals, experiencing solid returns and performance for a number of years. HELOC loans in particular were of high quality with very low defaults and highly predictable

performance. This has not been the recent experience, however, as the majority of the loss reserves MBIA established in the fourth quarter of 2007 are for HELOC deals that were insured in 2006 and 2007. It appears that more recent HELOC transactions consisted of greater proportions of borrowers who were more active in speculative purchases and more attracted to an interest-only loan product. The mortgage lenders' relaxed underwriting guidelines were a significant factor as well, as they permitted loans related to non-owner-occupied investor properties, lower documentation and higher Combined Loan-to-Value products. This ultimately decreased the overall quality of the HELOC portfolio, resulting in claims and expectations of future losses. The CES deals are generally a more recent vintage and fixed-rate product. These transactions may well contain more primary residence borrowers and a lower level of investor properties; nonetheless MBIA is keeping a watchful eye on these transactions.

CDOs

Financial institutions use collateralized debt obligations (CDOs), a structured finance tool, to manage credit exposure and capital (regulatory or economic). CDOs involve the transfer of credit risk within large, well-diversified pools of corporate loans and bonds, asset-backed securities and sovereign bonds and loans to special purpose vehicles (SPVs), which in turn issue bonds – the CDOs – that are broadly distributed. Structured properly, CDOs can be of great benefit to the economy as they are an extremely efficient method of distributing risk across the financial system.

Like securitizations of mortgages, auto loans, credit cards, trade receivables and other financial assets, the credit risk associated with a CDO is tranched into several "risk" layers, with investors buying into each of the different levels based on differing appetites for credit risk, liquidity risk and duration risk and, as a consequence, accepting different corresponding levels of return.

CDOs can include both cash assets (bonds or loans) and/or synthetic assets (credit default swaps). Synthetic CDOs are mainly used to transfer credit risk (as is the case in funded CDOs) and/or for arbitrage purposes. They do not own cash assets like bonds or loans. Instead, synthetic CDOs gain credit exposure to a portfolio of fixed-income assets without owning those assets through the use of credit default swaps, a derivatives instrument.

(Under such a swap, the CDO receives periodic premiums in exchange for assuming the risk of loss on an asset.) Synthetic CDOs have the advantage of allowing for the transfer of credit risk without requiring a transfer of ownership of the underlying assets.

MBIA's overall business strategy is to participate in the most senior layer of the CDO capital structure, whether the CDO is funded or synthetic, while creating a balanced book of business across multiple underlying asset classes including investment-grade corporates, high yield loans, asset-backed securities, RMBS, commercial mortgage-backed securities (CMBS) and emerging markets debt.

Post 1999, MBIA has focused on insuring 1) funded CDOs having, at minimum, Double-A shadow ratings by both Moody's and S&P (although almost all funded CDOs the Company has insured in the last five years have been, at minimum, rated Triple-A) and 2) synthetic CDOs at the "Super Triple-A" credit support levels by virtue of a rated Triple-A tranche subordinate to MBIA, or by virtue of a credit support level that is a multiple (most often 1.5 to 2.5 times) of the Triple-A requirement imposed by the rating agencies.

Additionally, MBIA is an active participant in the multi-sector CDO market, which are CDOs backed by diversified asset-backed securities (ABS) collateral pools that could include: RMBS-including subprime, CMBS, consumer (credit cards, autos, manufactured housing, student loans) corporate bonds and loans, as well as other CDOs.

MBIA, along with most market participants, segments this sector into two categories of deals: "High Grade" and "Mezzanine," reflecting the credit ratings and seniority of the underlying structured finance bonds supporting the CDO. High Grade refers to transactions in which the underlying collateral credit ratings on a standalone basis are, with few exceptions, Single-A or higher, and Mezzanine refers to transactions in which the underlying collateral credit ratings on a standalone basis are below Single-A (generally Triple-B).

Beginning in 2004, MBIA elected to insure mezzanine CDOs on a more selective basis due to concerns regarding structural provisions as well as concerns over the underlying collateral and weak pricing. MBIA has been a much more active player in High Grade deals, which are characterized by much stronger collateral, better structural provisions, and more attractive risk-adjusted pricing. Typically, the Company guarantees multi-sector CDOs transacted at

the "Super Triple-A" credit support level, which means that there are tranches of debt that are rated Triple-A below the MBIA-insured tranche.

Whether provided by an insurance policy or by a credit default swap, MBIA's guarantee is not subject to an acceleration of full payment.

In terms of exposure and potential losses, the CDO sector of most concern is the multi-sector CDOs. Multi-sector CDOs are deals that consist of a diverse array of structured finance asset classes, vintages, issuers and servicers in the collateral pool. The collateral backing MBIA's multi-sector CDOs consists of ABS, which are securitizations of auto receivables, credit cards, commercial mortgage tax securities, other CDOs and various types of RMBS including prime and subprime RMBS. However, because the RMBS asset class was a dominant share of the ABS market, these deals contain a large proportion of RMBS collateral, much of which is subprime RMBS.

MBIA's multi-sector CDO book performed as expected through September 2007, but the U.S. residential mortgage market downturn began to directly impact the multi-sector book in the fall of 2007 as the rating agencies downgraded thousands of investment-grade RMBS deals due to deteriorating performance. To date, the majority of MBIA-wrapped multi-sector CDOs and the underlying collateral remain investment-grade-rated. But further deterioration is anticipated based upon projected U.S. housing mortgage trends in 2008. MBIA will continue to monitor and reevaluate the collateral, mindful that additional rating agency downgrades may be ahead.

MBIA's CDOs of CDOs, or CDO^2, are diversified transactions generally anchored by CLOs, which are collateralized loan obligations consisting of investment-grade corporate debt. CDO^2 transactions are a sub-category of multi-sector CDOs. They often contain other collateral, including subprime RMBS, and may include highly rated tranches of CDOs of asset-backed collateral. As of December 2007, there has not been any material rating agency action in this portfolio segment. However, MBIA's own analysis has determined that three deals it insured within this segment will result in permanent losses totaling $200 million.

Development Of Housing Crisis

For several years prior to 2007, the credit markets benefited from a benign loss environment, allowing for greater issuance of ABS and corresponding tighter spreads and pricing. This environment fostered an erosion in underwriting standards by mortgage originators, and less effective security structures and covenant packages across the fixed-income market.

As 2006 came to a close, some signs of stress began to emerge in the subprime mortgage market. This stress accelerated into crisis as 2007 progressed, due to a spike in losses and loss expectations on securities backed by subprime mortgages and the disappearance of liquidity for structured products, including asset-backed commercial paper, and ABS, both of which helped finance the housing boom.

Single-Asset Crisis

Notably, recent issues are attributable to one sector, or asset class, RMBS, rather than being a systemic or multi-asset-class problem. The rapid deterioration of underlying residential mortgage performance and its impact on these securities in the second half of 2007 surprised MBIA as much as it surprised most other market participants. Unfortunately, the Company's underwriting process and procedures did not anticipate the problem or insulate it from the magnitude of losses projected today. While it is conceivable that a slowing economy and a tapped out consumer will lead to some additional stress in other asset classes, given the unique set of circumstances that gave rise to the housing crisis, the Company believes it is unlikely that problems would rise to anywhere near what is being seen in the mortgage sector.

Today MBIA and most other analysts are projecting losses on mortgage collateral that have not been seen since the Great Depression. Note that these are projected losses, not actual losses. Actual cumulative loss rates on subprime securities in December 2007 were 1.4 percent as reported by Standard & Poor's. The projections of eventual losses are now on the order of 20 percent. While the magnitude of projected losses is significant, it does not suggest an overall breakdown in management or controls in the monoline industry or any

failure on the part of the regulators, or even the rating agencies. The magnitude and speed of this housing crisis surprised almost everyone in the market.

Because MBIA's insured exposure sits at the very top of the capital structure in this industry sector (at the Triple-A or Super Triple-A level), as it does in the other sectors, the Company should not experience the loss levels that will be sustained by other players – including banks – who are further down the capital tower.

Financial Impact of Housing Crisis on MBIA

The financial impact on MBIA of the current crisis in the mortgage and housing markets has been substantial, particularly in light of the extremely low level of losses the Company had experienced over the first 33 years of its history. Until the fourth quarter of 2007, MBIA had experienced only 0.04 percent losses on over 93,000 issues insured since inception. In dollar terms, that means on over $2.3 trillion in debt service insured over 33 years, MBIA's losses amounted to just $916 million. Including fourth quarter 2007 losses, MBIA's losses now amount to just 0.07 percent debt service insured.

For the fourth quarter of 2007, the Company announced increases to loss reserves totaling $814 million. Of this amount, $614 million represents losses that the Company has specifically identified in its insured portfolio, while the additional $200 million represents losses that are expected, but have not yet been attributed to specific transactions. Virtually all of these losses were associated with MBIA's exposure to securitizations of prime second lien products.

In addition, MBIA recorded a $3.4 billion mark-to-market loss in connection with its insured credit derivatives portfolio in the fourth quarter of 2007. Of that amount, approximately $3.2 billion of this mark-to-market loss reflects "book" losses required to be recorded under GAAP accounting rules and the Company believes will reverse over time absent further credit impairment. The remaining $200 million represents a permanent impairment in value. The majority of the mark-to-market loss was associated with changes in the fair value of MBIA's insured credit derivatives portfolio, particularly structured finance transactions backed by commercial mortgage backed and residential mortgage backed securities.

Mark-to-Market Losses

Mark-to-market losses as they pertain to bond insurers deserve some additional explanation. Accounting rules, specifically FAS 133, require that changes in the fair value of all derivative exposures be marked-to-market on MBIA's income statement. The mark essentially reflects the profit or loss that would accrue to the holder if the portfolio were sold or unwound at a particular point in time. As such, the concept is perhaps most applicable to portfolios that can be actively traded over time. In the case of the credit derivatives insured by MBIA, like all of its financial guarantees, the Company's obligation runs to the maturity of the instrument and there is no ability or need for MBIA to terminate or sell its obligation early. However, as FAS 133 has no provision for hold-to-maturity portfolios such as the credit derivative exposures that MBIA has insured, the Company must mark these positions to market price each quarter with the expectation that the mark will, in most cases, reverse over time.

The only instances in which the mark would not reverse would be those where a permanent loss is expected, as was the case for $200 million of MBIA's total $3.7 billion mark in the third and fourth quarters of 2007. Most of the companies in the financial guarantee industry have had a similar experience in 2007. While this is analogous to the mark-to-market losses taken by the banks and investment banks, the impact on MBIA is far different. Under no circumstances can the Company be required to pay off these contracts at those prices. Bond insurers cannot trade their positions, and do not guarantee market value. MBIA's insurance policies remain on its books until the bonds mature, and it makes payments only if there are actual defaults on the bonds. This is a case where the accounting requirements do not follow the economics of the business. As a result, credit analysts, including the rating agencies, tend to focus on analysis of the potential for actual losses, not these accounting losses, to assess MBIA's capital adequacy. In fairness, changes in fair values can be indicators of underlying credit performance, but they are by no means dispositive.

Since the mark on MBIA's insured credit derivatives is highly sensitive to changes in market spreads, it can introduce significant short-term volatility into MBIA's reported results even when no ultimate losses are expected.

Liquidity

It is important to note that MBIA's obligation to pay claims on an insured issue is almost exclusively on an "as due" basis. Essentially this means that upon a default of an insured issue MBIA will pay principal and interest to the holder according the original schedule. Thus in the case of a 30-year bond, MBIA would be obligated to pay the principal and interest over the full 30-year life of the bond, and would not be required to pay off the full outstanding balance at the time it defaults. This is an important feature in all of MBIA's insured exposures. It is designed to minimize liquidity exposure and prevent a "run on the bank".

An insurer's exposure under an insurance policy or a credit default swap is virtually identical. Under either form there are no requirements to post collateral, nor any requirements or rights to accelerate payment against MBIA.

The permanent losses estimated by MBIA, and reflected in its financial estimates, are equal to the present value of the expected future claim payments over the life of the bond issue. Consequently, MBIA recorded significant losses in the fourth quarter of 2007, only a small fraction of that ($44 million, net of reinsurance) was actually paid out to date. The remainder will be paid out over the next few years as the underlying transactions continue to pay down.

Role of the Rating Agencies

MBIA carries Triple-A ratings from each of the three major U.S. and one international rating agencies: Standard & Poor's (S&P), Moody's Investors Service and Fitch Ratings, as well as Rating and Investment Information, Inc. The Triple-A ratings are, in the opinion of MBIA's management, important to its business model, and the Company believes that investors who purchase insured bonds are primarily interested in obtaining the highest rating possible – the Triple-A.

Although the specifics behind how each rating agency determines the standard that must be met in order to secure and maintain its respective Triple-A rating differ from agency to agency, there are, not surprisingly, several dominant themes common to all of them. First and foremost is capitalization. As the Triple-A implies that a company has the ability to meet all of its obligations as they come due even under extremely unlikely and stressful

circumstances, the agencies are quite rightly focused on ensuring that each bond insurer has a level of claims paying resources consistent with its Triple-A.

Capital Sufficient to Support Extreme Stress

It is important to note that when the rating agencies are determining the appropriate level of capitalization for a bond insurer, they do so in the context of the monolines' ability to meet extremely stressful theoretical loss scenarios, and not simply its ability to meet an expected level of losses. Therefore, a Triple-A insurer must hold capital in an amount equal to a substantial multiple of the losses that could reasonably be expected to occur, even in the stressful environment that the industry is now experiencing in the mortgage and housing sectors. For this reason, MBIA has raised $2.65 billion in new capital and preserved $500 million within eight weeks. Today, MBIA has $17 billion in claims paying resources. This capital raising effort has been unprecedented and is so far unmatched by any other financial guarantee insurers. The Company continues to explore ways to expand its capitalization and manage its risk exposure.

During the Company's capital raise, its financial reports, risk reports, and portfolio details were reviewed in great depth by highly sophisticated investors such as Warburg Pincus, who analyzed the portfolio at the loan-level, and, after doing so, agreed to invest up to $1 billion. The underwriters of MBIA's debt and equity securities also performed extensive "due diligence" before committing. That is, these independent parties got sufficiently comfortable with MBIA's exposure to the mortgage markets to invest billions of dollars into the Company. Through this process, MBIA has provided greater transparency into the details of its insured exposures, both publicly and privately, than ever before.

Given the rating agencies' Triple-A requirements, the bond insurers have constructed very low risk insured portfolios, with virtually all transactions rated in the investment-grade range, even without the benefit of insurance. Only a very small portion of the total portfolio is rated below investment grade, and virtually all of that represents situations where the credits were investment grade at inception but the credit deteriorated somewhat after closing. In MBIA's case, approximately 82 percent of the insured portfolio was rated Single-A or better as of year-end 2007, and only 1.4 percent was rated below investment grade on an S&P priority basis. (MBIA's below investment grade net par exposure includes $10.6 billion of home

equity lines of credit and closed-end second RMBS and multi-sector CDOs of high grade CDOs, which were not rated below investment grade as of December 31, 2007.)

While strong capitalization represents a threshold standard for the Triple-A rating, it is by no means the only standard. The rating agencies also give substantial consideration to the qualifications and experience of a monoline's management team, the quality and track record of a company's underwriting, the reasonableness of the business plan, the sustainability of the business model over the long-term and other qualitative and quantitative factors.

Recent Events

In response to growing stress in the mortgage and housing markets, the rating agencies have spent substantial time over the past six-to-nine months analyzing the performance of transactions directly or indirectly backed by prime, non-prime and subprime mortgages. Their analysis has focused, in particular, on securitizations of prime and subprime first and second mortgages, prime HELOCs and CDOs backed by ABS that are exposed to these mortgage products. As the crisis in the mortgage and housing sectors continues to unfold, the rating agencies have, on several occasions, upwardly revised their projections of the amount of losses that mortgage market investors can expect to experience. For the bond insurers in general, and MBIA in particular, this has resulted in a gradual escalation in rating agency concern regarding the adequacy of bond insurer capitalization over the same period of time.

All three major rating agencies undertook extensive analyses of bond insurer capital adequacy in the fourth quarter of 2007, and they continue to revise their analyses on an almost weekly basis. In MBIA's case, this frequent reevaluation resulted in the agencies first affirming MBIA's Triple-A ratings in December but changing the outlook to negative, then placing its Triple-A ratings on review for possible downgrade in January and early.

MBIA's Capital Raising Activities

As losses in the mortgage market continued to increase in the third and fourth quarters of 2007 and increasing stress was observed in the transactions insured by MBIA, the Company responded along two fronts: 1) MBIA's Insured Portfolio Management Division, which is

responsible for monitoring MBIA's portfolio of insured credits, stepped up its efforts to identify problem credits, quantify potential losses to MBIA and develop remedial strategies to reduce or eliminate potential future policy claims; and 2) management proactively began the process of raising additional capital to support the Triple-A ratings that are critical to its franchise and of great importance to investors.

To date, MBIA has raised approximately $2.65 billion in incremental capital consisting of:

- a $500 million common stock investment by Warburg Pincus;
- a $1 billion surplus note offering; and
- a $1.15 billion common stock offering

In addition to the $2.65 billion in capital outlined above, the Company preserved an additional $500 million through a reduction in the common stock dividend, additional reinsurance on the insured portfolio and a reduction in new business activity to allow for the natural expiration of policy obligations over time, which frees up capital currently deployed in support of the existing portfolio of business.

The Company's prompt and proactive measures to secure external capital for the benefit of policyholders were critical to the ultimate success in doing so. Others in the industry who may have started the process later have found the market increasingly less receptive and more expensive as mortgage market stress has continued to rise.

Activist Activity: Coincidence or Calculated?

As has been widely reported in the media, certain parties such as Mr. William Ackman of the hedge fund Pershing Square Capital Management LP, also known as "activist short sellers" stand to realize significant financial gains from declines in MBIA's stock price and/or increases in the price of credit default swaps they hold that are connected to MBIA. Ultimately, their goal would be to see MBIA become insolvent, which would maximize their profits by driving the stock price to near zero and triggering payments on the credit default swaps they executed.

To achieve this end, these self-interested parties have gone to substantial effort to undermine the market confidence that is critical to MBIA's business. Their efforts have

included raising questions about MBIA's capitalization, the losses it will likely sustain, its liquidity position, the legality of its operations and the viability of its business model. They have published attacks on MBIA containing material misstatements of fact, used the media to create "noise" around MBIA's solvency and ratings, written letters to regulators and rating agencies seeking action against MBIA, and held meetings with investors with the intent, the Company believes, to dissuade them from purchasing MBIA's debt or equity. They may also have extensively lobbied this committee. MBIA notes that Mr. William Ackman is appearing at the hearing on February 14th as an "industry expert." Mr. Ackman is in fact not involved in the industry in any capacity except that of a short-seller, and accordingly, MBIA questions the characterization of Mr. Ackman's expertise.

While some estimates of MBIA's ultimate losses have been reported in the media as exceeding $10 billion, in reality these estimates are provided to the media by short-sellers and others who are not familiar with the actual deals and do not have the information necessary to estimate losses with any degree of accuracy (they do not have access to the terms and conditions of those deals, such as cash flow diversion triggers, etc.). Instead, they have taken market estimates of the industry, or of a particular financial institution's experience, and applied it to bond insurers' portfolios to derive a loss estimate.

For example, Mr. Ackman developed potential loss estimates through what he refers to as the "Open Source Model." This model uses loss estimates that are a multiple of those estimated by MBIA, the rating agencies and other objective analysts. Mr. Ackman stated that his model is meant to provide greater transparency to the market, when in fact the model is a black box driven by undisclosed loss assumptions derived from the proprietary trading desk of an anonymous "Global Bank." The extreme assumptions in the model produced Mr. Ackman's desired effect of sensational headline loss numbers for the firms evaluated. Mr. Ackman states that the model is a detailed collateral analysis, while it actually uses averages and simplified macro-loss assumptions about certain product types and vintages. This stands in stark contrast to MBIA's approach, which has been a detailed loan-level modeling exercise that more accurately looks at the characteristics of each individual piece of RMBS collateral and the individual loans backing it. Mr. Ackman's model is purported to be a more accurate representation of the risks, but in fact it does not factor in the actual deal structures for any of the ABS CDO, HELOC or CES exposures.

Similarly, a small, upstart rating agency with no information about the deals MBIA insures has been providing commentary to the media that suggests MBIA faces losses in excess of $10 billion. In fact, in a recent online column, an investor reported that he learned in a conversation with a principal from this rating agency that the principal's projections were essentially a "back of the envelope" calculation, with little applicability to MBIA's portfolio.

As MBIA has taken steps over the past two months to raise additional capital for the benefit of policyholders, these same self-interested parties have stepped up their attacks at critical points in each part of the process, with the apparent goal of increasing the cost of capital to MBIA or worse, making it completely unavailable. An attached timeline outlines the activities of Mr. Ackman and others in the short seller community, and demonstrates how their actions were carefully timed to coincide with individual elements of MBIA's capital raising program.

While he has not succeeded to date, there is no question that he has made the capital raising process considerably more difficult and expensive to the detriment of our legitimate investors and policyholders.

Lessons Learned

MBIA's strategies in writing RMBS and CDO business appeared sound at the time, because the Company attached at the highest levels of the capital structure. In retrospect, the Company missed some of the warning signs and is now paying the price, both through expected claims on its policies and through a loss of confidence in the value of its product, the financial guarantee. As an organization, MBIA is responding to the lessons learned from this crisis, as is the whole market, by reviewing its underwriting standards and due diligence processes, by examining for appropriateness the products it underwrites, and by examining how the Company manages its capital so that it is poised to ride out such a credit crisis should it ever happen again.

As the Company examines what it could have done differently, it has thus far arrived at three important lessons learned:

- Investment grade, historically sound loan originators/servicers are as likely as newer, start-up companies to succumb to market pressures to modify loan origination

practices. MBIA's practice was to work with large, investment-grade servicers with historically strong origination and loan performance attributes. Unfortunately in the heat of the recent market, even some of these servicers relaxed their standards.

- Bond insurers guarantee payment of timely interest and contracted principal. They do not post collateral upon downgrade, and their guarantees and premium streams typically are not subject to changes in the insurers' ratings. This has proven to be a key factor in the current crisis as the monolines have not had material liquidity calls on their guarantees. These provisions are essential features of the financial guarantee industry that, for exactly the reasons evidenced today, must be retained for market stability.

- Bond insurers must avoid large concentrations of risk, whether it is risk connected to a single issuer, a single servicer or asset manager, a single asset class, or to a single vintage of collateral.

Where MBIA Is Today

With the most significant parts of MBIA's capital raising plan complete and the remaining components well underway, the Company is currently awaiting feedback from the rating agencies on their respective reviews. The Company expects this process will be largely complete within the next four weeks. Although MBIA believes it has more than sufficiently addressed the capital necessary to support its Triple-A ratings, the standard has been somewhat of a moving target.

There have been numerous media reports of various so-called "bailout" plans for the bond insurers, including some debate about the possibility of a Federal bailout. First, the notion of a "bail out" of highly credit-worthy companies who, at most, are at risk of losing the very highest ratings available, is misplaced. For this reason MBIA does not see the need for a Federal bailout of the financial guarantee industry. The Company believes that MBIA is more than adequately capitalized to meet obligations to policyholders.

Similarly, MBIA does not believe there is a need for Federal oversight of the industry as a result of the current housing and mortgage market dislocation. The Company is confident

that the rigorous oversight it has always been subject to from state regulators and the rating agencies will continue to be more than adequate going forward.

Conclusion

Looking forward, the Company sees more demand than ever for its financial guarantee product, both in the municipal and infrastructure part of the business, and in the structured finance market. The American Society of Civil Engineers has estimated that the U.S. needs to spend $1.6 trillion on infrastructure in the next five years, while the Urban Institute projects that maintenance of surface transportation alone will require $185 billion over the same time period. The needs outside the United States are even larger.

On the structured side, today the American consumer is financed through the ABS market. From the consumer credit cards – to auto loans – to mortgages, the ABS market has been, for well over the last 15 years, the source of liquidity that promoted operating efficiency for banks and other loan originators, and lowered borrowing costs for consumers, the backbone of the nation's economy. The bond insurance product makes financing these enormous needs more cost efficient, and MBIA is working hard to ensure that there's a strong and viable industry here to facilitate.

MBIA has been a Triple-A company for 34 years, and it expects to remain so now and for the foreseeable future. Despite the unexpected and rapid deterioration in the performance of its prime second lien mortgage portfolio, the Company believes that its credit underwriting practices and risk management infrastructure will result in a high quality and well-diversified insurance portfolio over time. As always occurs during such credit cycle downturns, the Company has had opportunities to learn from its mistakes and improve the risk profile of its future portfolio.

MBIA has been working closely with its primary regulator, the New York State Department of Insurance, to review lessons learned, and to discuss new guidelines on acceptable products and portfolio guidelines. MBIA appreciates and commends Superintendent Dinallo for his efforts to date to ensure the stability of the financial guarantee industry's participants.

MBIA will continue to manage its business in a prudent manner, deal forthrightly with any problems that arise in its portfolio, discuss all issues and concerns openly with the rating agencies and regulators, and provide disclosure to the market in the hopes of enhancing the understanding of its business model and its industry. MBIA must continue to manage to a conservative capital position to maintain its Triple-A rating and the confidence of the marketplace. MBIA's Triple-A rating is its most important tool for delivering comfort and protection to policyholders and creditors, and returns to its shareholders. With a steady focus on these principles, the Company is well positioned to continue to be a leader in its industry.

Summary: MBIA and the Financial Guarantee Industry

Historical Context

- Bond insurers provide an essential service to capital markets
  - Enable non Triple-A issuers to broaden their investor universe and reduce their cost of borrowing by accessing Triple-A financing sources
  - Bond insurance enables the financing of municipal, infrastructure and structured financings, which in turn creates jobs

- Historically a highly stable, low loss sector focusing primarily on municipal issuance Until the fourth quarter of 2007, MBIA had experienced just 0.04% losses on over 93,000 insured issues since inception. In dollar terms, that means on over $2.3 trillion in debt service insured over 33 years, MBIA's losses amounted to just $917 million. With fourth quarter 2007 losses, MBIA's losses amount to just 0.07% of debt service insured.

- However, bond insurers made mistakes over the past decade in expanding and diversifying their portfolios into some areas of structured finance (ABS CDOs, Second Lien Mortgage Products) that have encountered unprecedented credit and liquidity stress
  - Structured finance today represents 35% of MBIA's policies outstanding (net par)
  - The asset classes of interest causing the stress in the market represent 10% of MBIA's policies outstanding (net par) or 30% of its structured finance business

Current Context

- Given deteriorating conditions in the U.S. mortgage sector, portions of bond insurers' structured portfolios have begun to perform worse than expected
  - While actual cash losses have been minimal to date, analysts expect losses to accelerate

- These deteriorating market conditions have punished the bond insurers considerably
  - MBIA's stock price is down over 70% in the past year
  - Bond insurers such as MBIA, who have perceived mortgage exposure, are having trouble accessing new municipal business

- Given current environment, rating agencies have increased their capital requirements for bond insurers dramatically
  - Most bond insurers have been told by the rating agencies to raise considerable sums of new capital to maintain their ratings
  - Not a question of solvency, but a question of Triple-A standards
    - Rating agencies require bond insurers to hold enough capital to satisfy the Triple-A rating stress assumptions plus a margin of safety of 25-30%, which is significantly greater than expected losses
    - MBIA has no material liquidity risk; insolvency is not an issue, purely a question of market confidence and capital sufficiency for the Triple-A ratings requirements

- In December 2007, the rating agencies (Moody's, S&P, Fitch) informed MBIA that it would need to raise as much as $2.0 billion (varies by rating agency) in additional claims-paying resources to maintain its Triple-A rating
  - To meet and exceed this guidance, MBIA raised $1.65 billion in common equity and $1 billion in debt (surplus notes)
  - However, shortly after MBIA raised most of this capital, the rating agencies have chosen to undertake further evaluations of the ratings requirements for the bond insurers
  - We've been told by market participants that the actions of the rating agencies have contributed to an erosion in confidence of the bond insurers and the debt markets

- Market fear has also been exacerbated by short sellers which have attacked the financial guarantee industry for purposes of personal profit
  - Have used half-truths and misleading information to destroy confidence in the bond insurers and rating agencies
  - Have contributed to the difficulties and expense for guarantors to raise capital to satisfy Triple-A ratings

MBIA's Positioning

- While losses are greater than anticipated in the RMBS and related CDO transactions, MBIA is well positioned in the current environment as the largest and highest capitalized company in the financial guarantee sector
  - Today, MBIA has over $17 billion in claims-paying resources, which satisfies the latest Triple-A ratings requirement from each rating agency. Given "pay as you go" nature of business model, MBIA has little liquidity and no insolvency risk. Losses are paid out over the life of a policy (up to 30 years or more), thereby minimizing cash outflows in any given year
  - Proactively raised over $2.5 billion in equity and debt over the past two months
    - Over $3 billion in new rating agency claims-paying resources (includes capital relief from expired insurance exposure)

- Not all bond insurers are in the same position
  - A number of its peers have not raised claims-paying resources in sufficient amounts to satisfy Triple-A ratings requirements and have been downgraded

- MBIA intends to maintain a leadership position in the industry and work to restore confidence in the industry
  - Already shown leadership by accessing meaningful new capital

- Access to public and private capital should remain the model for sourcing the industry capital needs
  - Industry-wide bailouts will increase moral hazard, potentially perpetuate problems in the industry and potentially undermine confidence in Triple-A ratings

- MBIA will continue to facilitate access to the capital markets for municipalities and other issuers of debt
  - Enhanced liquidity in the financial markets and infrastructure growth will increase job creation

How Can the Subcommittee on Capital Markets Help?

- Help restore confidence in the financial markets by supporting the capital raising efforts at the financial guarantors
  - While a relatively small industry, the failure of the bond insurers could have far reaching effects on the U.S. and global economies

- Work with industry leaders such as MBIA to help design the new industry paradigm
  - This is a highly necessary industry, but mistakes were made and there needs to be change
  - Not all market players should survive, but those that do should be given the unobstructed opportunity to right themselves and their industry

- Work with the SEC to curtail the unscrupulous and dangerous market manipulation activities of short sellers
  - The practice and dissemination of half-truths and misleading information propagated by self motivated parties should be investigated and curtailed

- Work with the rating agencies on stabilizing their actions
  - Instability of decision making by the rating agencies has damaged the market's confidence in the financial guarantors, thereby destabilizing the broader financial markets
  - The rating agencies' rating systems may need to be revamped; industry leaders such as MBIA should be engaged in working with the agencies to re-design their systems

Bond insurers enable debt issuers to access the capital markets more efficiently and less expensively; and also provide additional credit protection to investors of such debt issuances. The credit analysis and financial backing provided by the bond insurers are value-added propositions for the capital markets, especially in times of greater uncertainty regarding credit risk.

Cmbia
Investment Management
MBIA Overview
February 14, 2008

Safe Harbor Disclosure

This presentation and our remarks may contain forward-looking statements. Important factors such as general market conditions and the competitive environment could cause actual results to differ materially from those projected in these forward-looking statements. Risk factors are detailed in our 10K, which is available on our website, www.mbia.com. The company undertakes no obligation to revise or update any forward-looking statements to reflect changes in events or expectations.

MBIA is the Leading Financial Guarantee Insurance Company

- MBIA Insurance Corporation ("MBIA") is the world's leading "monoline" financial guarantee insurance company
- As a monoline, MBIA offers one insurance product: the financial guarantee, which is also referred to as credit enhancement or credit protection
- MBIA is rated Triple-A by Fitch, Moody's and Standard and Poor's
  - Claims-paying resources at 12/31/07 were $14.6 billion
- The securities we guarantee are rated Triple-A by Standard & Poor's, Moody's and Fitch
- MBIA Inc.
  - Parent company of MBIA Insurance Corp.
  - Holding company for MBIA Asset Management; a leading provider of investment management products and services with over $66 billion in assets under management
  - Publicly owned since July 1, 1987; ticker symbol: MBI
- MBIA has saved taxpayers an estimated $15 billion since inception

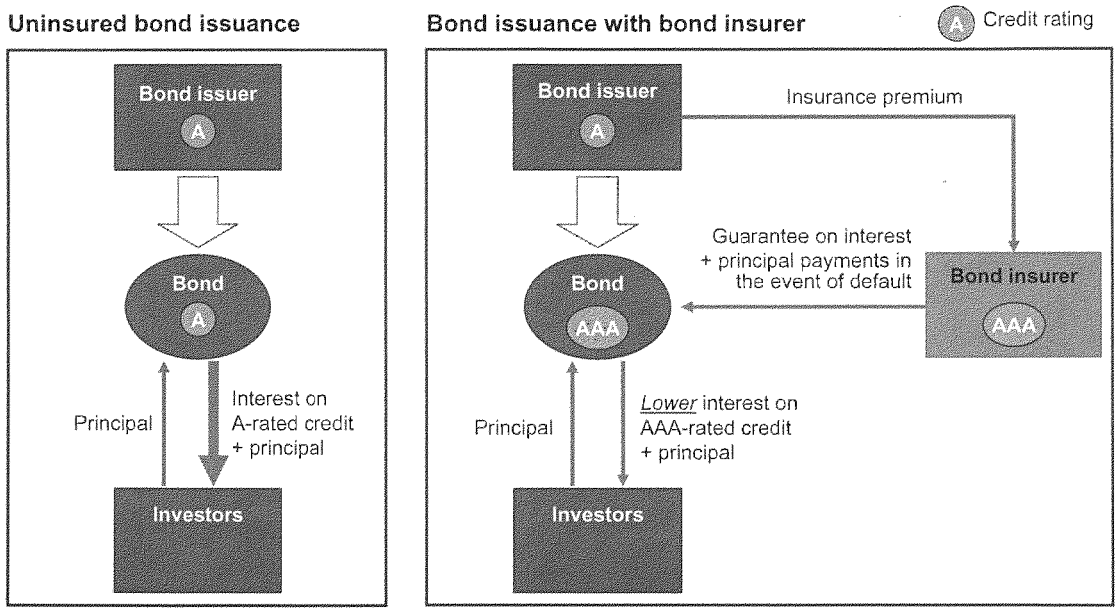
Financial Guarantee Insurance Companies are Long-Term Holders of Credit Risk

- Unconditional and irrevocable guarantee of interest and principal
  - If an issuer defaults, investors can count on receiving insured payments, no matter what
  - Guarantor's payment obligation cannot be accelerated against the guarantor
  - Financial guarantors are not required to post collateral even in the event of a downgrade
- Hold insured risk to maturity
- Obtain control and other rights for remediation of problem credits and loss mitigation
- Highly selective underwriting of investment grade risk
  - Guarantee only municipal, infrastructure and asset-backed securities
- Since inception the financial guarantors have saved municipalities over $40 billion in interest

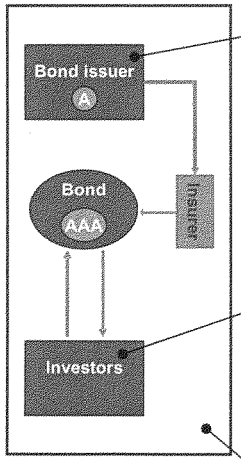
MBIA Provides Efficient Access to Capital Markets and Protection to Investors

- **Benefits to Issuers**
  - Easier and more cost-effective access to the capital markets
  - Access to a wider range of investors
  - Streamlined execution
- **Benefits to Investors**
  - Ensures timely payment of principal and interest
  - Protects against downgrade and credit losses on the underlying security
  - Provides surveillance and management of the underlying credit risk
  - Combination of underlying credit and MBIA's guarantee diversifies investment and increases capacity
    - Diversifies risk and increases investor capacity for issuer's bond
  - Decreases price volatility on the insured security

Bond Insurers guarantee bond payments to investors; cash outflows occur only in an event of default



Bond Insurance creates value for the issuer, the investor and the market overall



Value creation for the issuer

- **Effective signaling device** – The guarantee efficiently reduces investor unfamiliarity with an issuer and uncertainty about its credit quality
- **Broader access to the investor universe** – Allows issuers of varying credit quality to meet the substantial demand for AAA paper

Value creation for investors

- **Increased flexibility of structured debt** – Insurance can be attached at various levels of subordination and can provide different levels of protection and diversification
- **A more complete market** – Insurance enlarges a limited supply of high credit quality securities
- **Efficient method of risk selection** – Insurers can utilize economies of scale that investors lack, performing credit evaluation and monitoring more efficiently than even large institutional investors (often, using information investors do not have)
- **Expert remediation** – Bond insurers' restructuring and reorganization expertise can provide additional sources of value in the event of issuer default

Value creation for "the market"

- **A more efficient market** – Facilitates the transition to a more efficient capital markets model from bank originate-to-hold models (e.g., real estate, auto loans, credit cards, structured credit, etc.)
- **Reduced cost of funding for municipalities** – Insurance reduces the borrowing cost for municipalities, with municipalities retaining a larger portion of funds raised.

Conservative Underwriting – MBIA's "Trademark"

No-Loss underwriting standard; anticipates no losses under a worst probable case scenario

Underwriting

- Each transaction must meet MBIA's stringent credit structuring and legal criteria, and must be at least investment grade by Moody's or S&P (> Baa3/BBB-)

Portfolio Management

- Highly diversified portfolio with exposure limits by asset class, sector, geography, seller servicer and deal structure

Surveillance

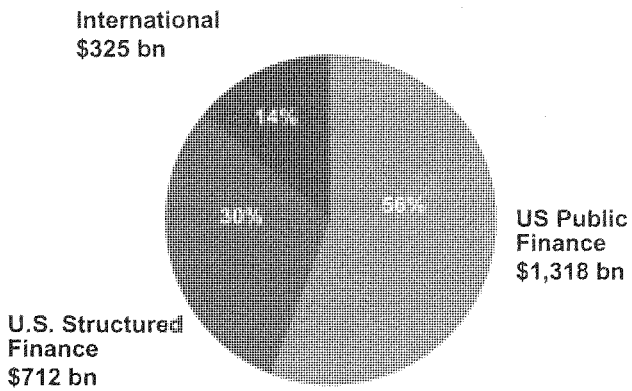
- We actively monitor the insured portfolio and aggressively remediate poorly performing deals

Track Record

- MBIA issued 94,163 policies with over $2.4 trillion of net debt service, and incurred only 0.07% (7 bps) in losses on 124 deals over 34 years

Public Finance is still more than half the market despite growth in Structured & International Finance

Insured net par outstanding by bond type AFGI*, Q3 2007 ($2,355 bn total)



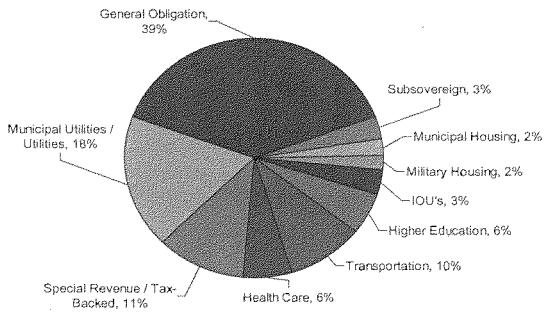
- **Public finance** includes insurance written on bonds issued by states, municipalities and other tax-exempt entities
  - Industry net par outstanding has grown from $806 bn in 2001 to $1,318 bn today (9% CAGR)
  - Par outstanding roughly composed of 1/3 general obligation bonds and 2/3 bonds supported by specific revenue streams (e.g. tax-backed revenue, utility revenue, toll and transportation revenue)
- **Structured finance** includes insurance written on bonds that are tied to the performance of a specified pool of assets (e.g. mortgages, consumer loans, bonds) and on other credit derivatives
  - Industry net par outstanding has grown from $386 bn in 2001 to $712 bn today (12% CAGR)

* Association of Financial Guaranty Insurers, estimated based on 12/06 actuals.

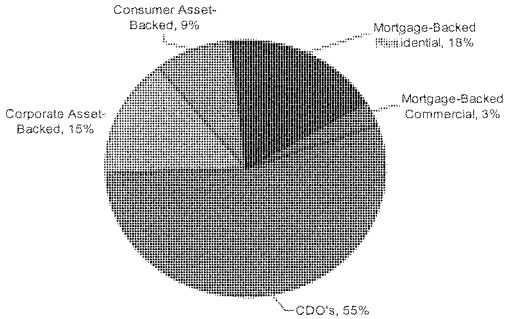
Highly Diverse Insured Portfolio

As of December 31, 2007

$440.9 billion Public Finance
Insured Portfolio
Percent of Net Par Outstanding by Bond Type



$237.8 billion Structured Finance
Insured Portfolio
Percent of Net Par Outstanding by Bond Type

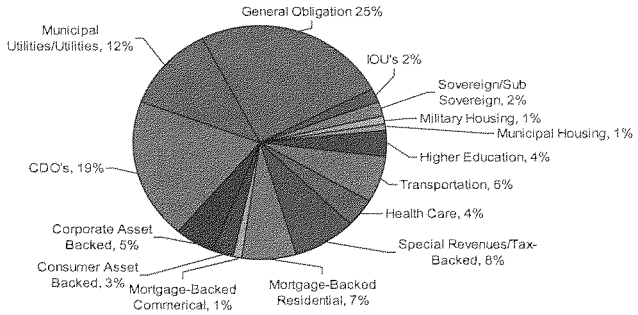


Total = $678.7 billion Net Par Outstanding (net of reinsurance)

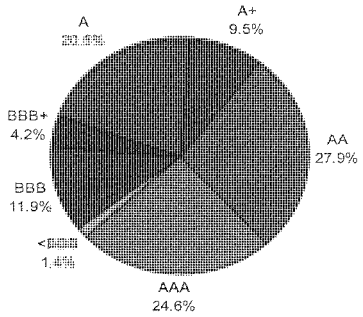
MBIA's Insured Portfolio is Diverse and of High Quality

As of December 31, 2007

Diverse Insured Portfolio
Percent of Net Par Outstanding by Bond Type
65% = Public Finance; 35% = Structured Finance



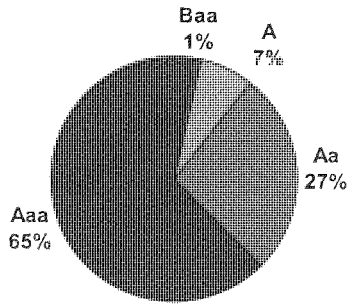
Credit Quality Distribution
MBIA's Net Par Outstanding
82.5% Rated A or Better



Total = $678.7 billion Net Par Outstanding (net of reinsurance)

Claims-Paying Resources Backed by High Quality Investment Portfolio

- $14.6 billion* of claims-paying resources of which $10.7 billion is in liquid investments as of December 31, 2007; balance in premiums due in installments and other facilities
- Weighted average Double-A quality
- Fixed-income securities
- Only investment grade bonds
- Limits by bond sector, issuer, maturity and state
- Effective duration 5.2 years
- Average maturity 9.3 years

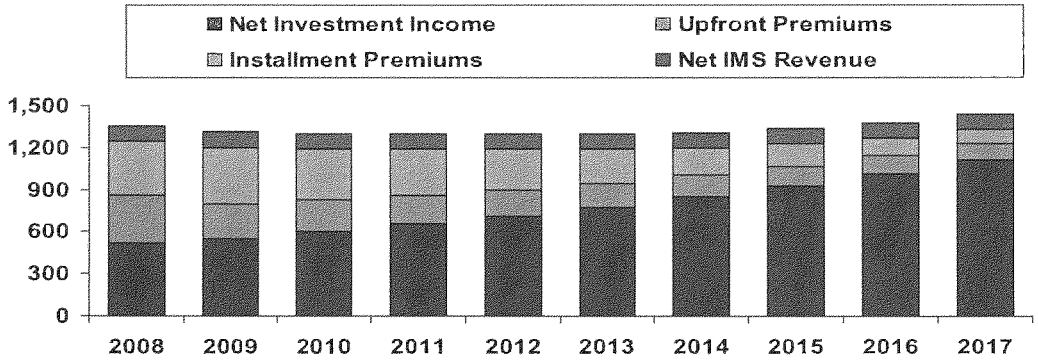


As of 12/31/07

**This does not include $1 billion in surplus notes issued on January 12, 2008; $500 million common stock sold to Warburg Pincus on January 30, 2008; and $1.15 billion common stock sold through a public offering on February 7, 2008.*

MBIA Inc. 10-Year Projected Insurance and IMS Revenues Assuming No New Business

$ Millions



Loss Performance Proves Underwriting Discipline and Remediation Success

Inception to December 31, 2007

Issues insured	**Over 94,000**
Debt Service Insured from Inception	**$ 2.4** Trillion
Aggregate Case Incurred Losses*	**$ 1.7** Billion
Case Loss Reserves	**$ 1.0** Billion
Estimated Salvage	**$126** Million
Net Paid Losses	**$829** Million

Losses Equal to 0.07% of Insured Debt Service Since Inception

*Aggregate Case Incurred Losses = Case Loss Reserves – Estimated Salvage + Net Paid Losses

Conclusion
MBIA Is Well Positioned to Deal With the Current Credit Market

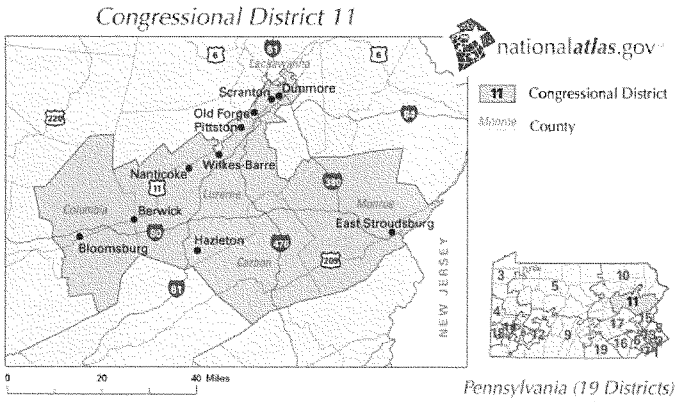
- MBIA provides efficient Access to Capital and Downside Protection to Investors
- Rated Triple-A by Fitch, Moody's and Standard & Poor's
- Leading financial guarantee insurance company
- Conservative underwriting, capital management, and monitoring standards
- Excellent credit quality and diversification of insured portfolio
- Strong financial position
  - $14.6 billion in claims-paying resources
  - Raised $2.65 billion in equity and debt in 8 weeks, despite difficult market conditions
- Highly rated and liquid investment portfolio
- Experienced management team
- Proven track record through periods of economic stress

mbia

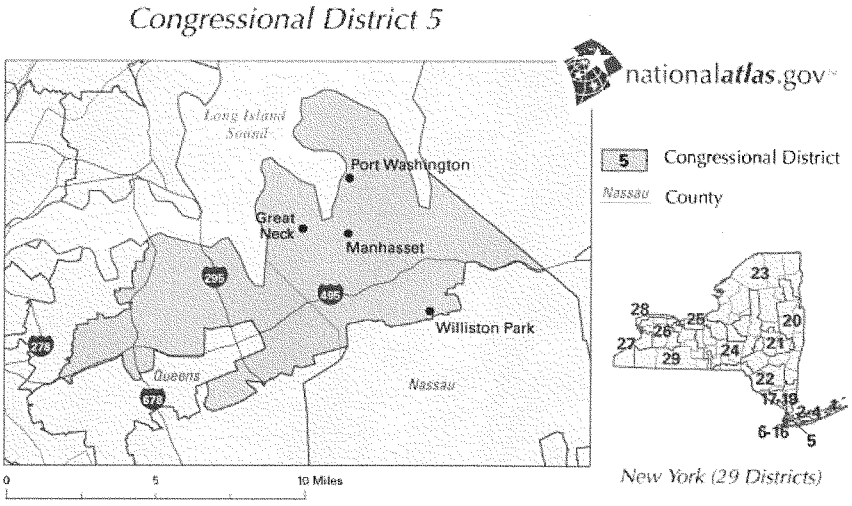
WISDOM IN ACTION[sm]

MBIA and House Subcommittee Districts

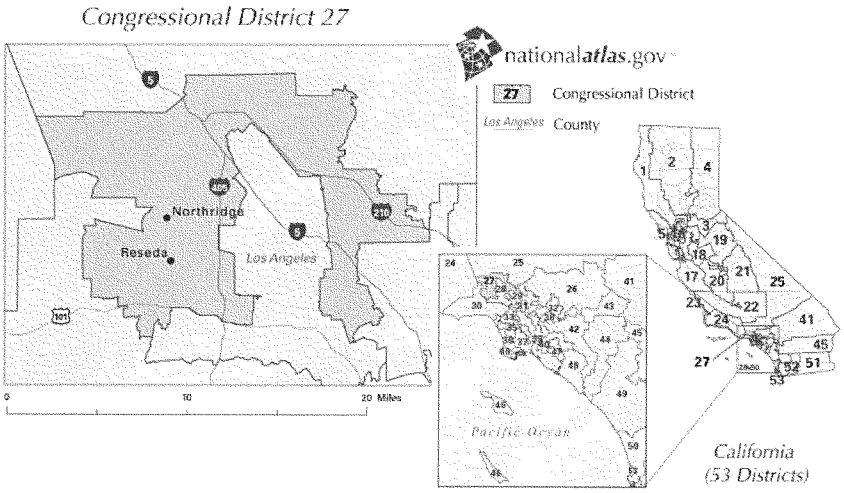
Paul Kanjorski, *Chairman*, Pennsylvania
MBIA insurance in PA District 11: **275 bond issues totaling $1.4 billion**



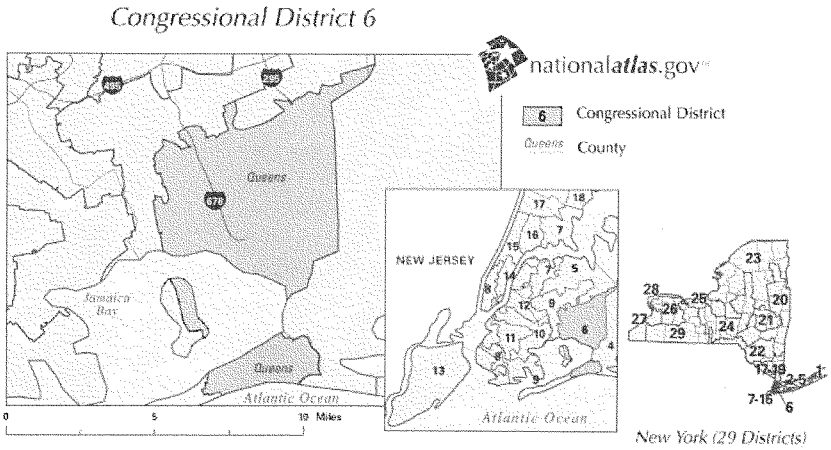
Gary L. Ackerman, New York
MBIA insurance in NY District 5: **480 bond issues totaling $9.1 billion**



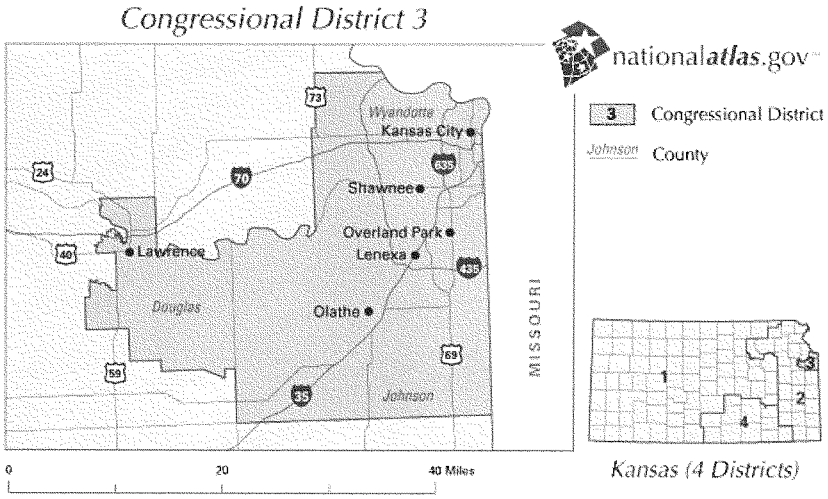
Brad Sherman, California
MBIA insurance in CA District 27: **2,153 bond issues totaling $36.2 billion**



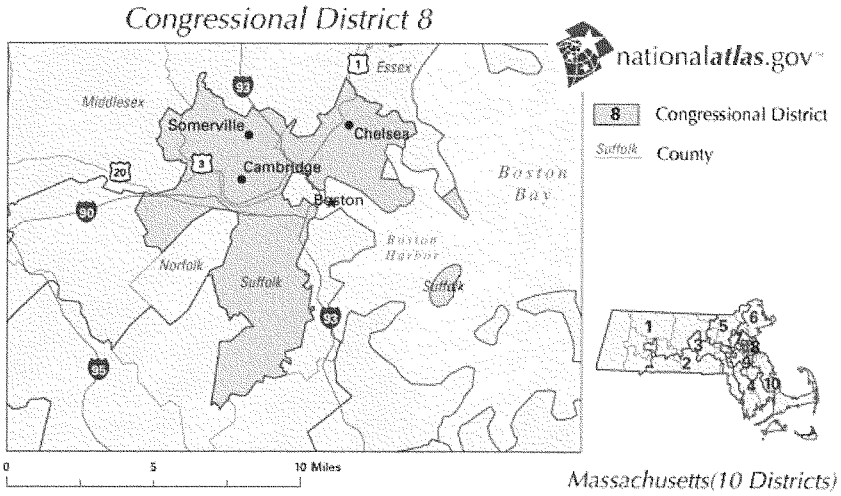
Gregory Meeks, New York
MBIA insurance in NY Districts 4, 6, & 12: **5,000 bond issues totaling $34.6 billion**



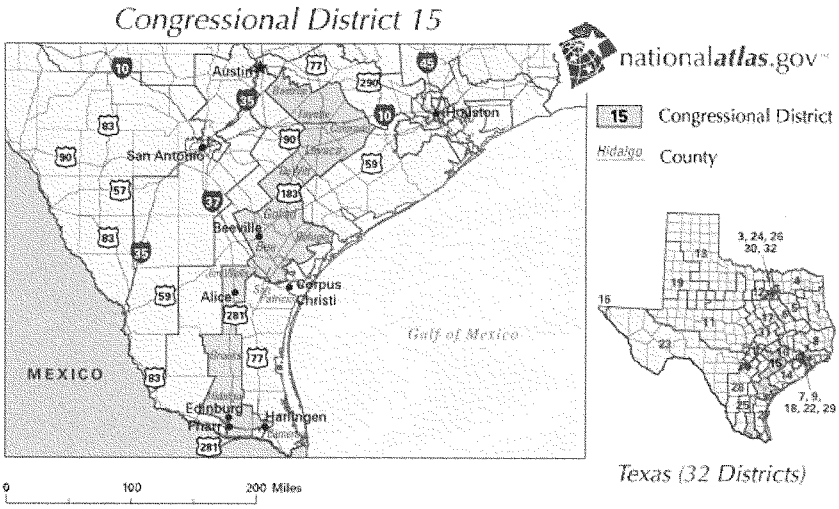
Dennis Moore, Kansas
MBIA insurance in KS District 3: **177 bond issues totaling $2.5 billion**



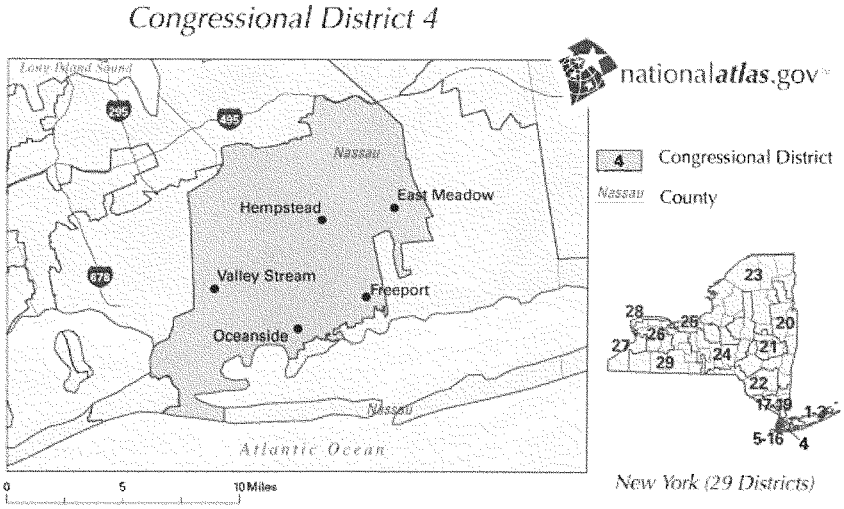
Michael Capuano, Massachusetts
MBIA insurance in MA District 8: **2,136 bond issues totaling $19.7 billion**



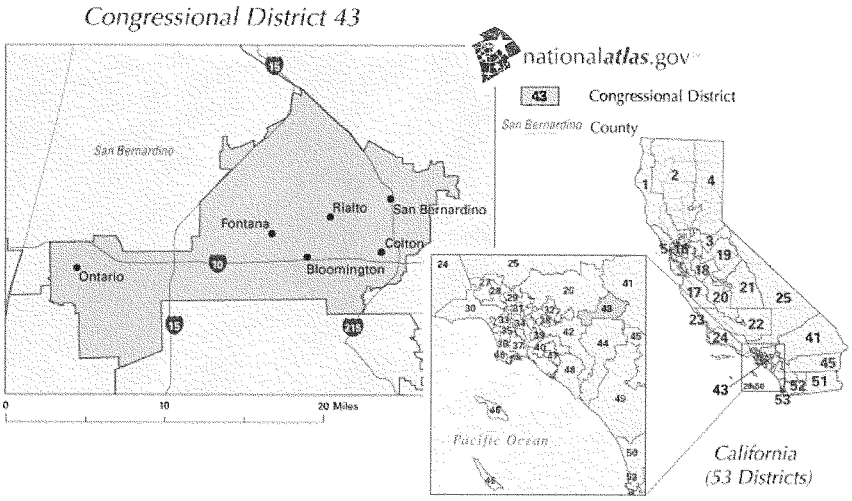
Rubén Hinojosa, Texas
MBIA insurance in TX District 15: **56 bond issues totaling $941.2 million**



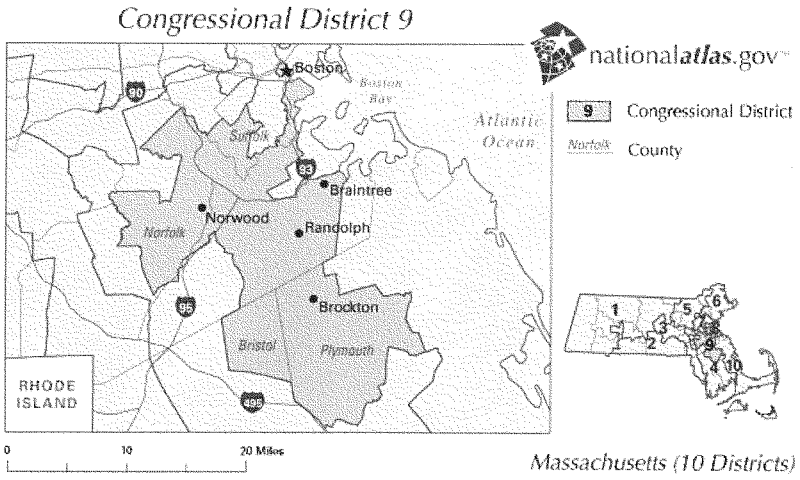
Carolyn McCarthy, New York
MBIA insurance in NY Districts 4, 6, & 12: **5,000 bond issues totaling $34.6 billion**



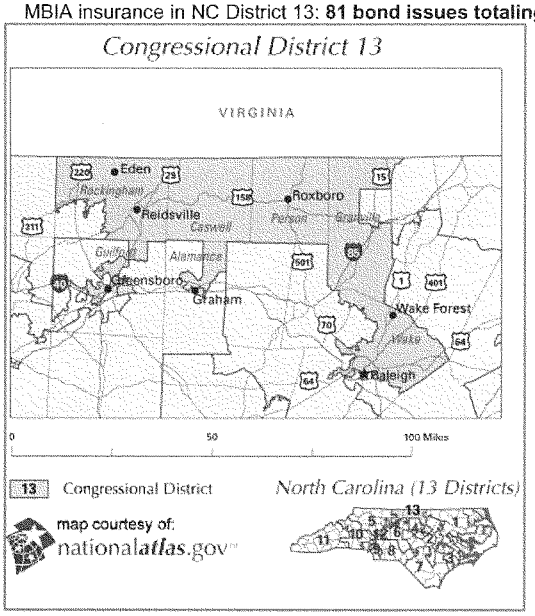
Joe Baca, California
MBIA insurance in CA District 43: **326 bond issues totaling $5.3 billion**



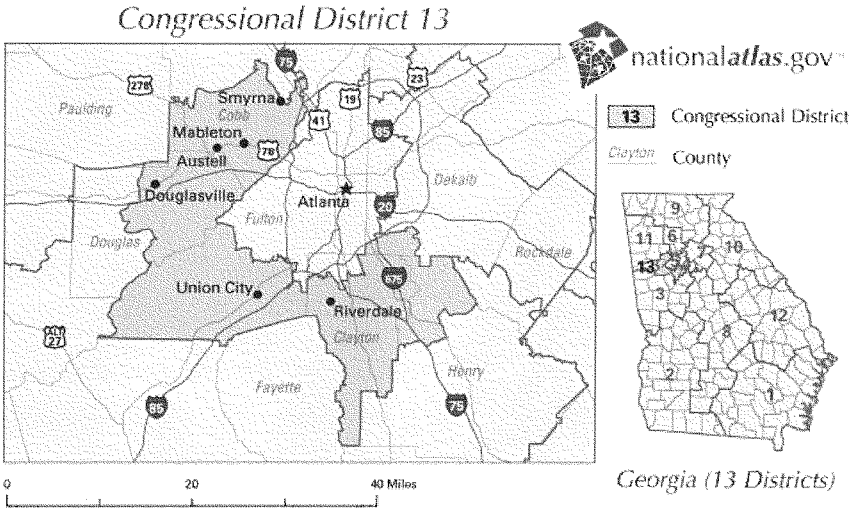
Stephen Lynch, Massachusetts
MBIA insurance in MA District 9: **155 bond issues totaling $1.0 billion**



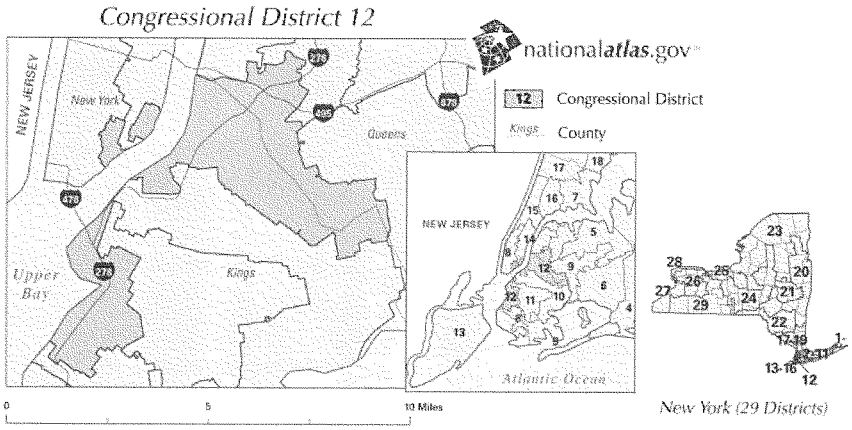
Brad Miller, North Carolina
MBIA insurance in NC District 13: **81 bond issues totaling $1.3 billion**



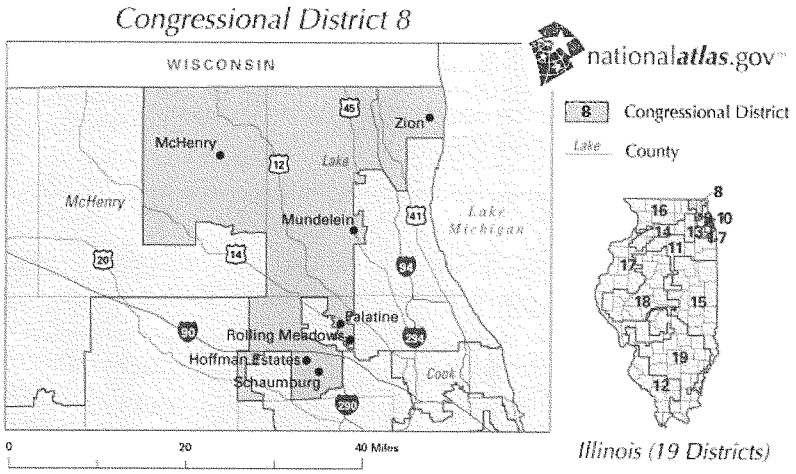
David Scott, Georgia
MBIA insurance in GA District 13: **28 bond issues totaling $355.5 million**



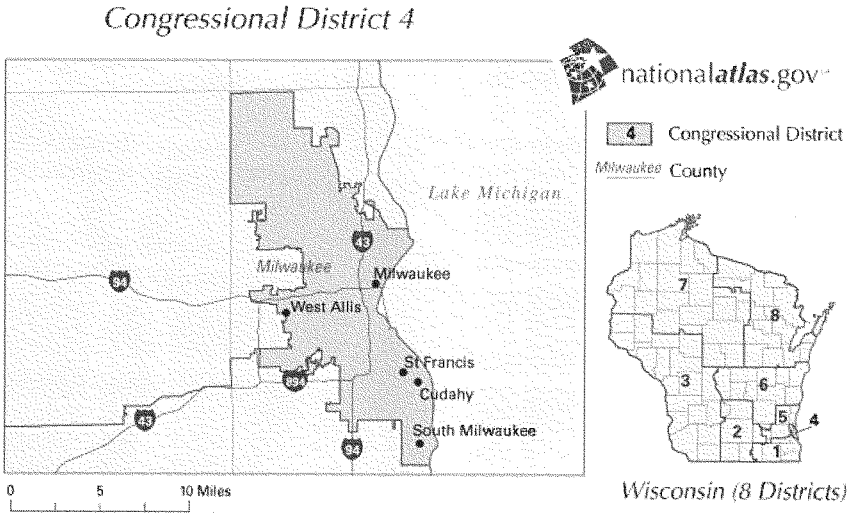
Nydia Velázquez, New York
MBIA insurance in NY Districts 4, 6, & 12: **5,000 bond issues totaling $34.6 billion**



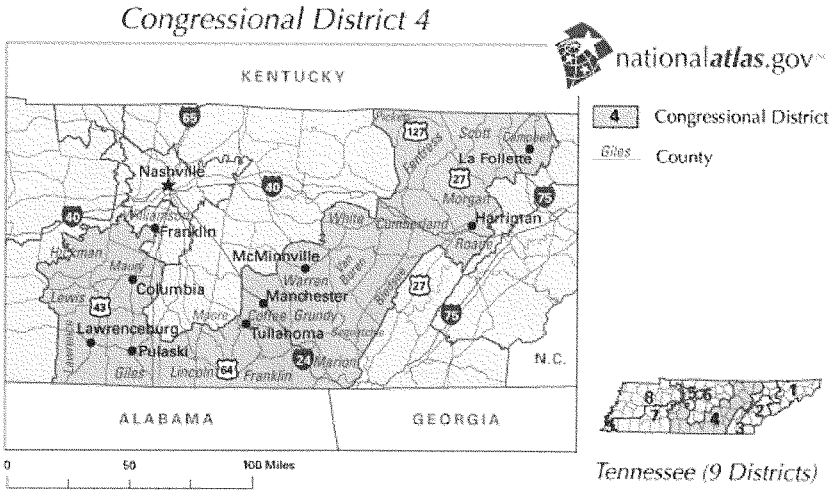
Melissa Bean, Illinois
MBIA insurance in IL District 8: **1,614 bond issues totaling $22.1 billion**



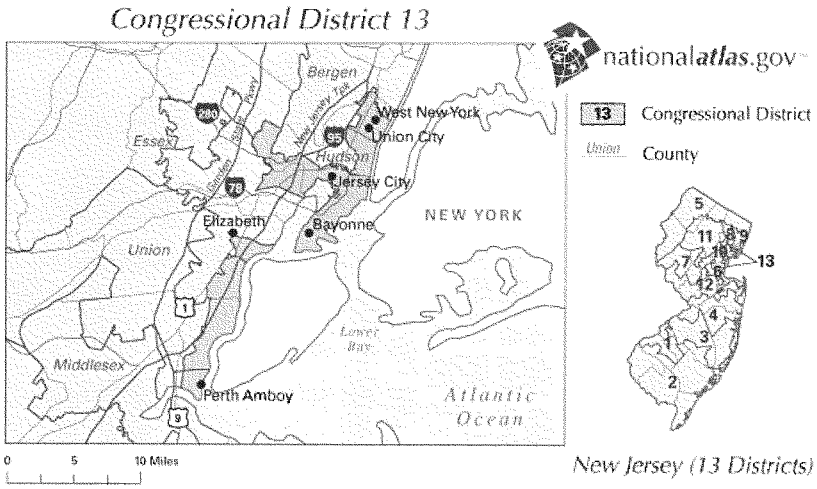
Gwen Moore, Wisconsin
MBIA insurance in WI District 4: **166 bond issues totaling $2.8 billion**



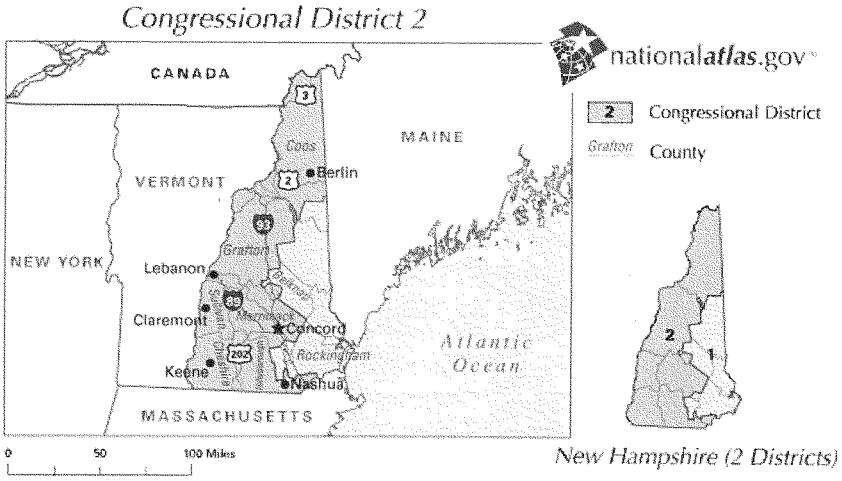
Lincoln Davis, Tennessee
MBIA insurance in KY District 4: **27 bond issues totaling $432.7 million**



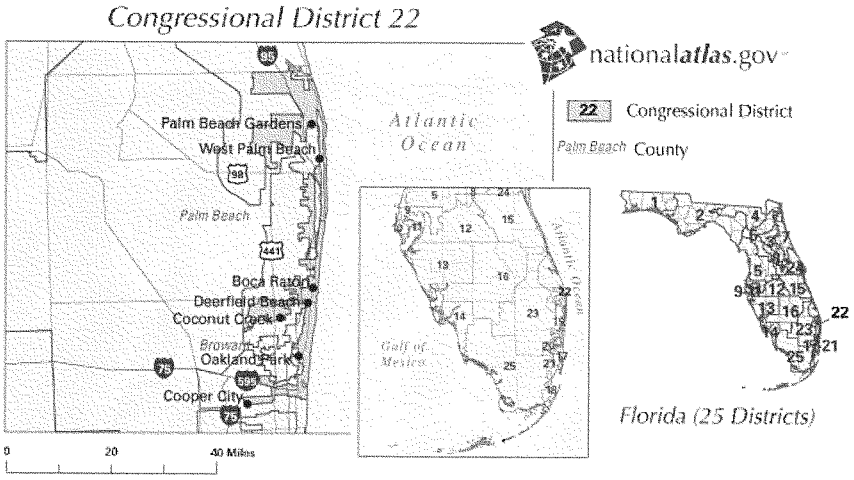
Albio Sires, New Jersey
MBIA insurance in NJ District 13: **1,626 bond issues totaling $10.2 billion**



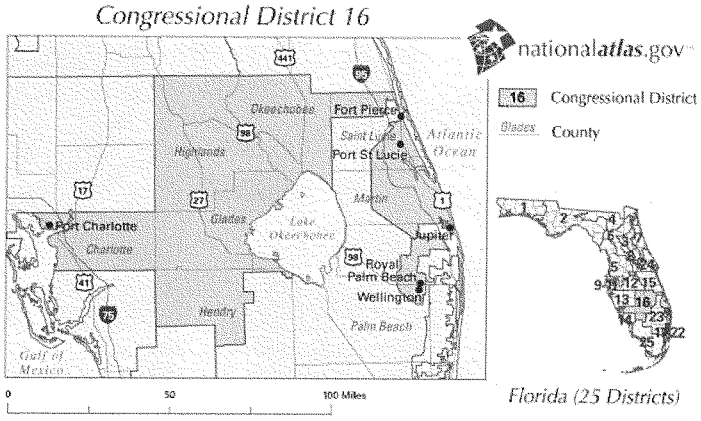
Paul Hodes, New Hampshire
MBIA insurance in NH District 2: **79 bond issues totaling $1.7 billion**



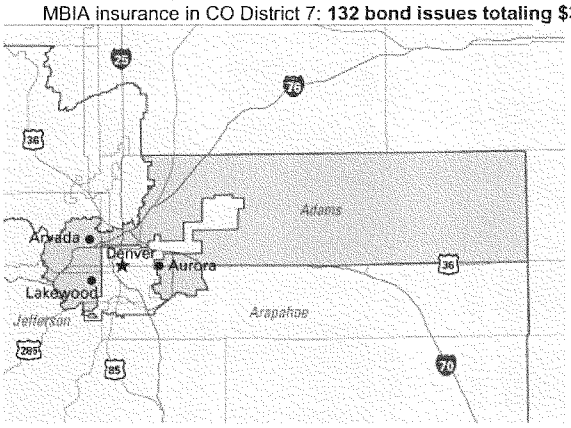
Ron Klein, Florida
MBIA insurance in FL District 22: **16 bond issues totaling $39.1 million**



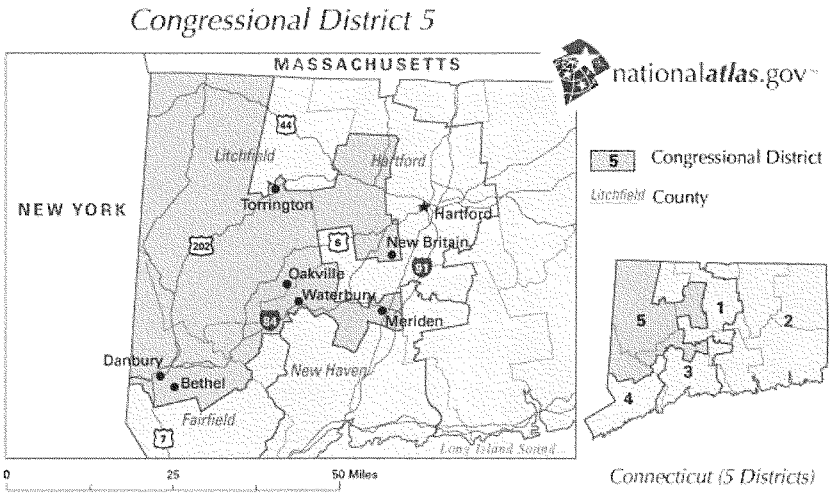
Tim Mahoney, Florida
MBIA insurance in FL District 16: **519 bond issues totaling $5.9 billion**



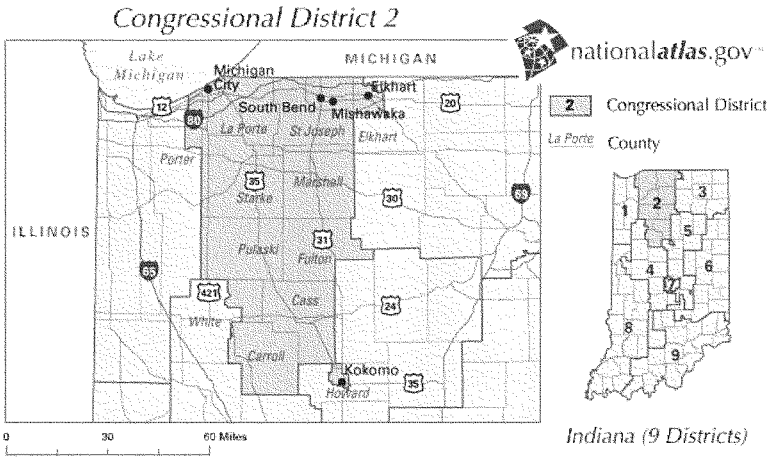
Ed Perlmutter, Colorado
MBIA insurance in CO District 7: **132 bond issues totaling $3.6 billion**



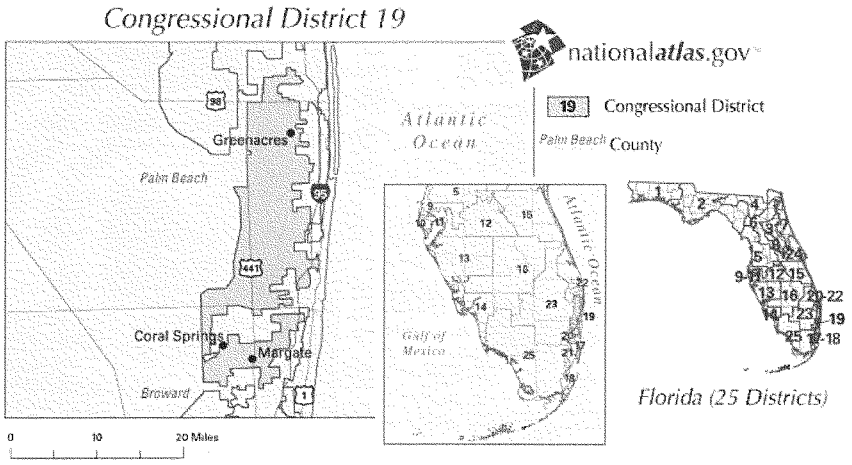
Christopher Murphy, Connecticut
MBIA insurance in CT District 5: **225 bond issues totaling $2.2 billion**



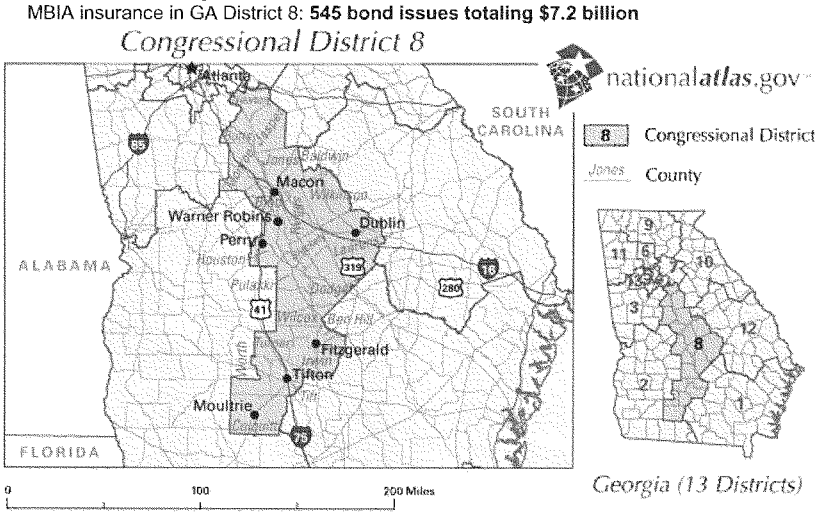
Joe Donnelly, Indiana
MBIA insurance in IN District 2: **18 bond issues totaling $178.9 million**



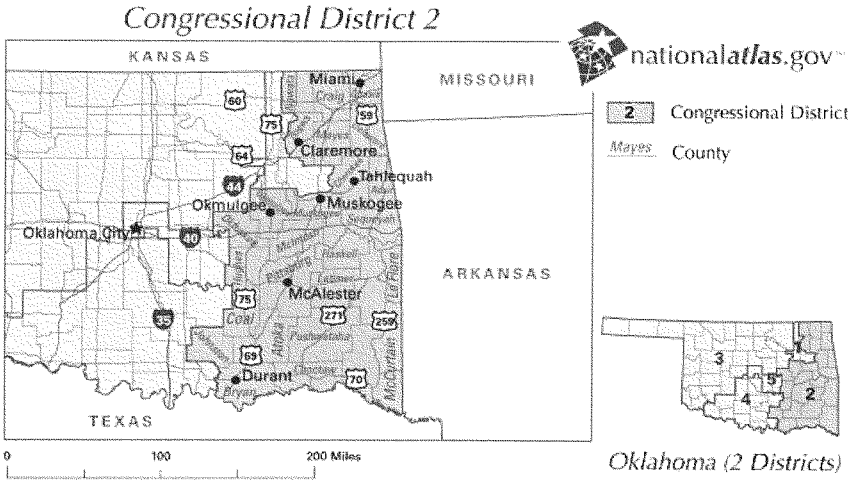
Robert Wexler, Florida
MBIA insurance in FL District 19: **60 bond issues totaling $682.4 million**



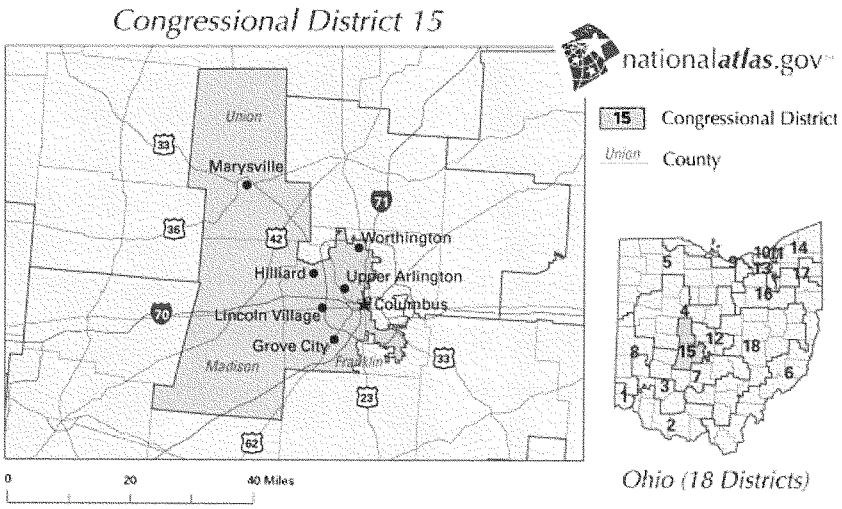
Jim Marshall, Georgia
MBIA insurance in GA District 8: **545 bond issues totaling $7.2 billion**



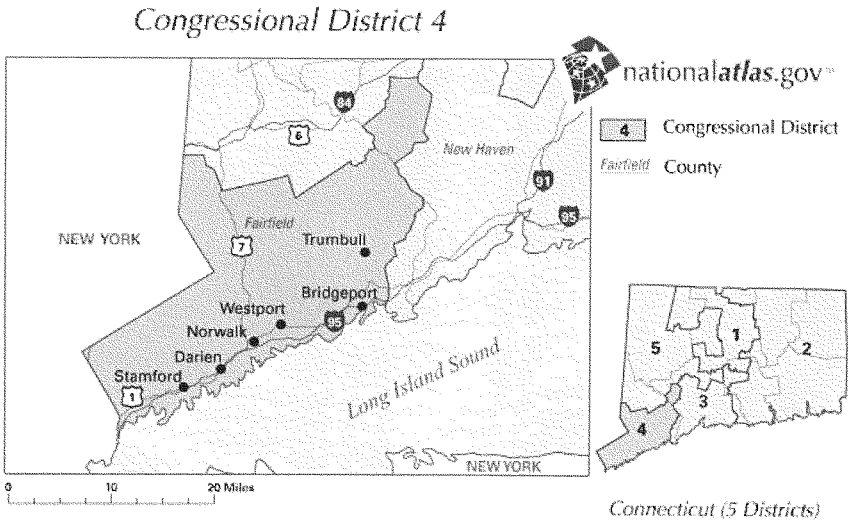
Dan Boren, Oklahoma
MBIA insurance in OK District 2: **140 bond issues totaling $888.4 million**



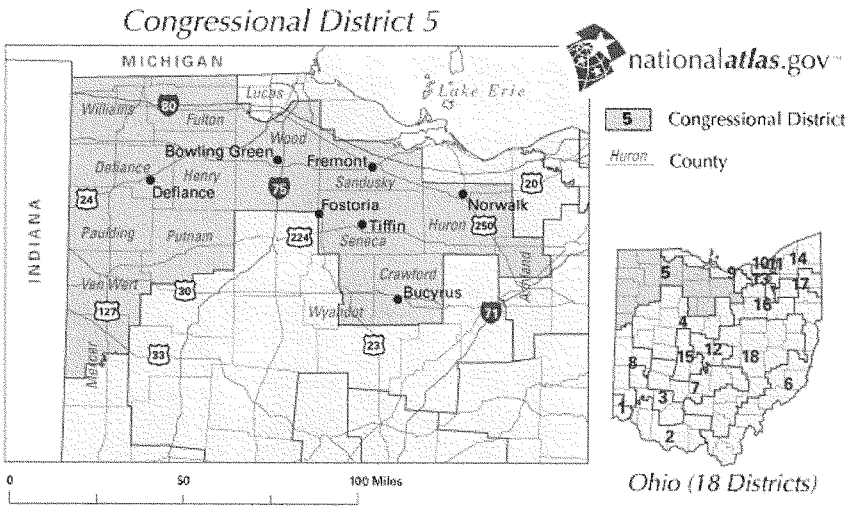
Deborah Pryce, *Ranking Member*, Ohio
MBIA insurance in OH District 15: **857 bond issues totaling $8.4 billion**



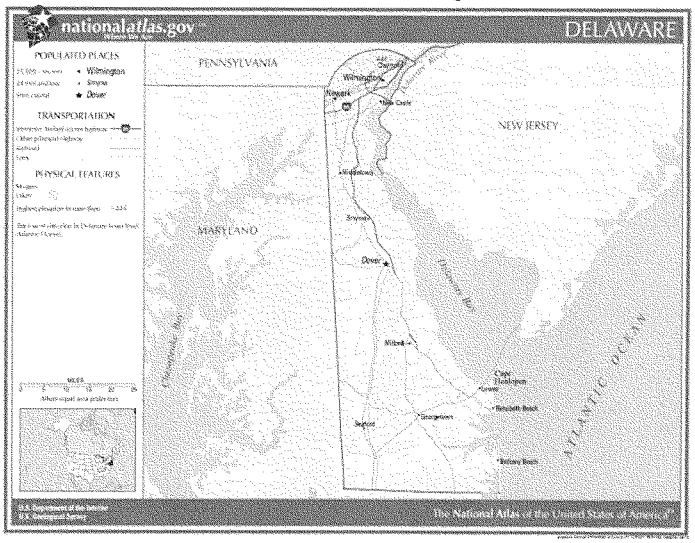
Christopher Shays, Connecticut
MBIA insurance in CT District 4: **141 bond issues totaling $2.2 billion**



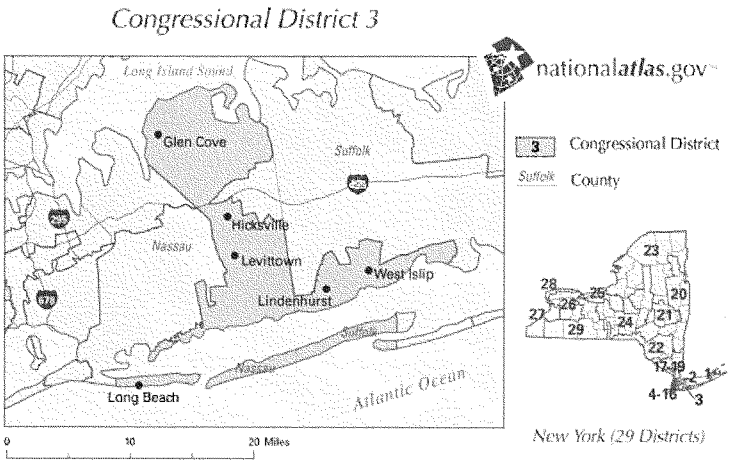
Paul Gillmor, Ohio
MBIA insurance in OH District 5: **571 bond issues totaling $5.5 billion**



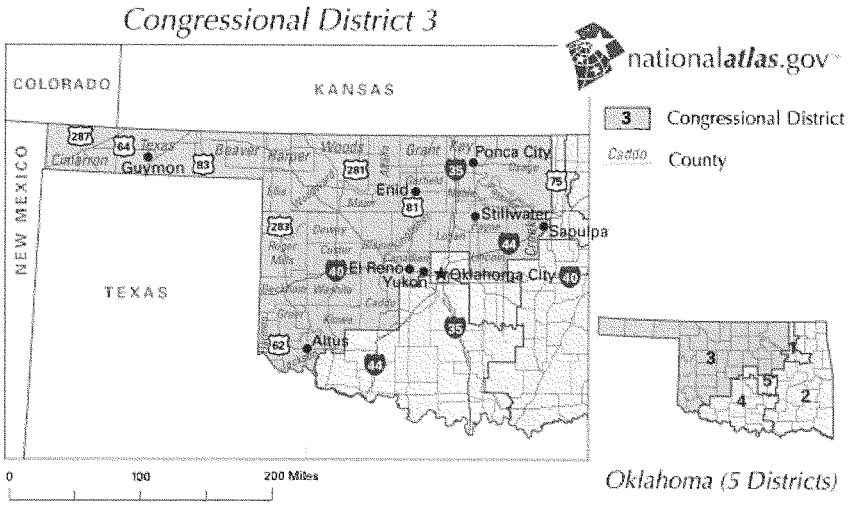
Michael Castle, Delaware
MBIA insurance in DE: **107 bond issues totaling $4.2 billion**



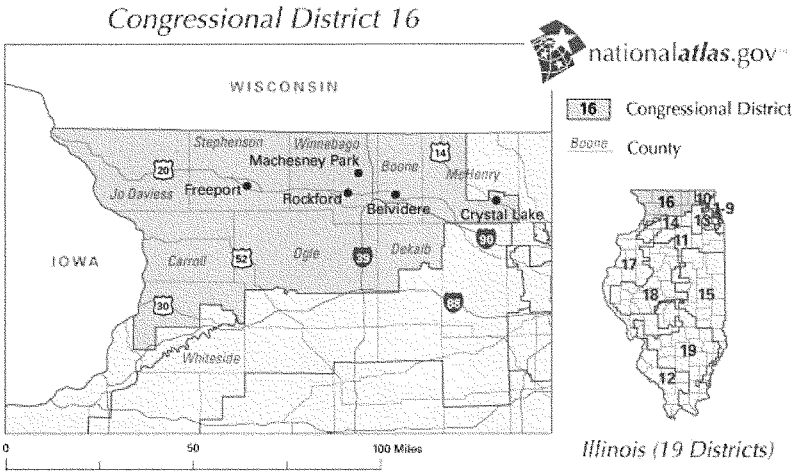
Peter King, New York
MBIA insurance in NY District 3: **467 bond issues totaling $5.5 billion**



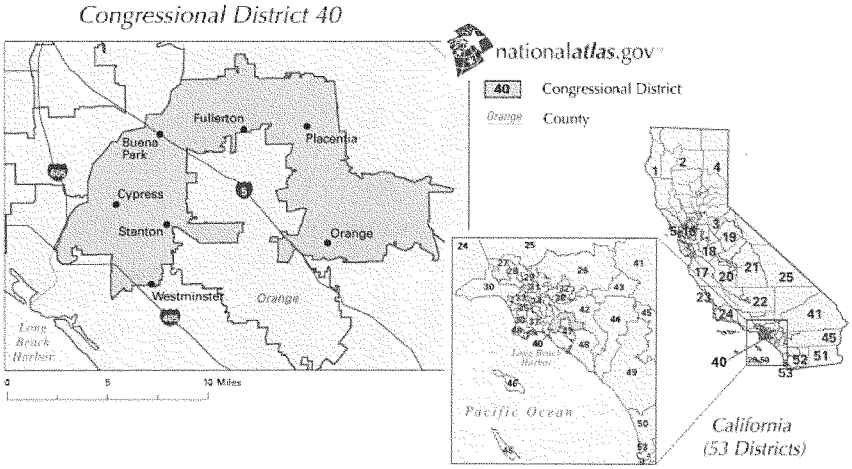
Frank Lucas, Oklahoma
MBIA insurance in OK District 3: **116 bond issues totaling $943.0 million**



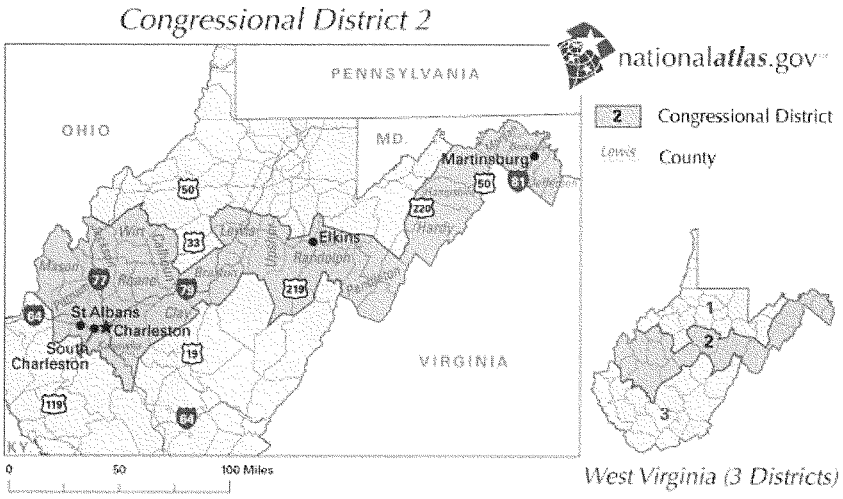
Donald Manzullo, Illinois
MBIA insurance in IL District 16: **189 bond issues totaling $1.0 billion**



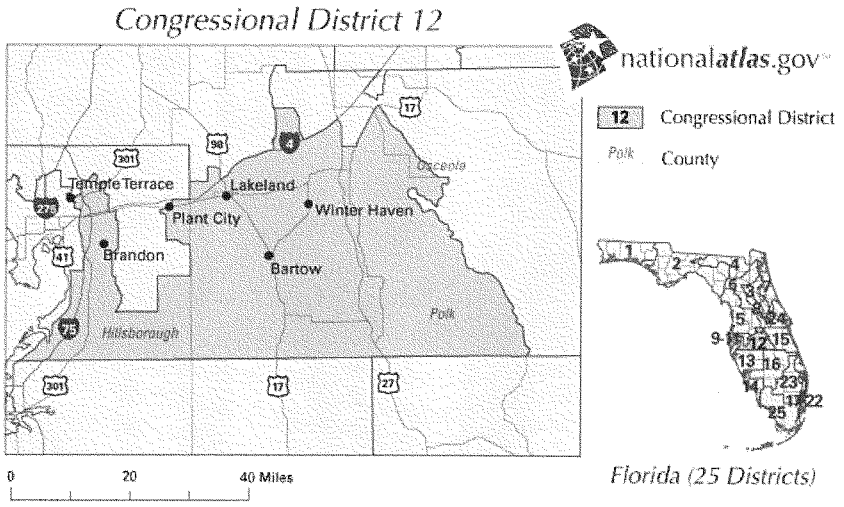
Edward Royce, California
MBIA insurance in CA District 40: **41 bond issues totaling $1.0 billion**



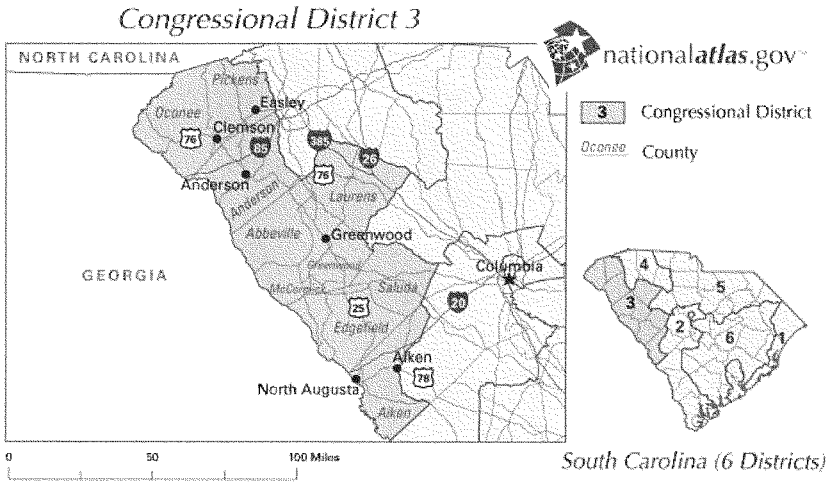
Shelley Moore Capito, West Virginia
MBIA insurance in WV District 2: **281 bond issues totaling $3.4 billion**



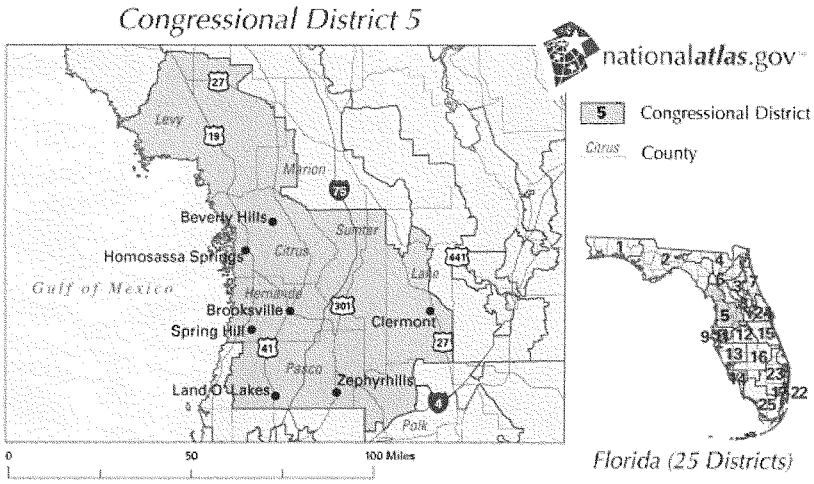
Adam Putnam, Florida
MBIA insurance in FL District 12: **384 bond issues totaling $6.4 billion**



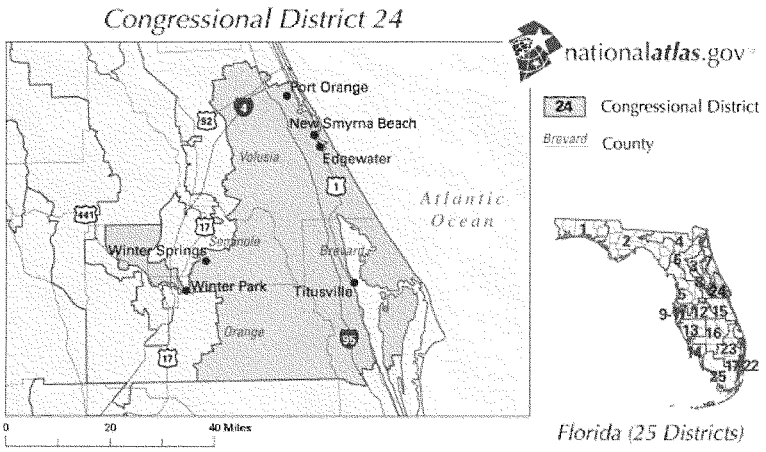
Gresham Barrett, South Carolina
MBIA insurance in SC District 3: **73 bond issues totaling $700.4 million**



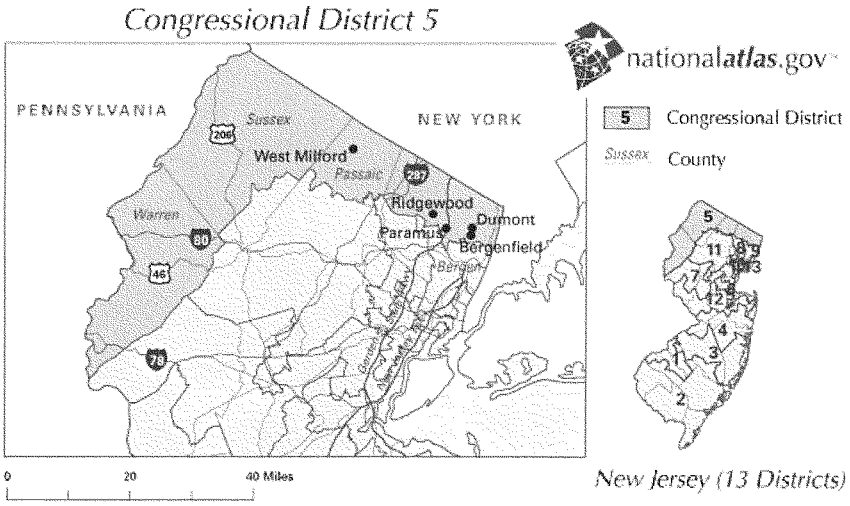
Ginny Brown-Waite, Florida
MBIA insurance in FL District 5: **284 bond issues totaling $4.8 billion**



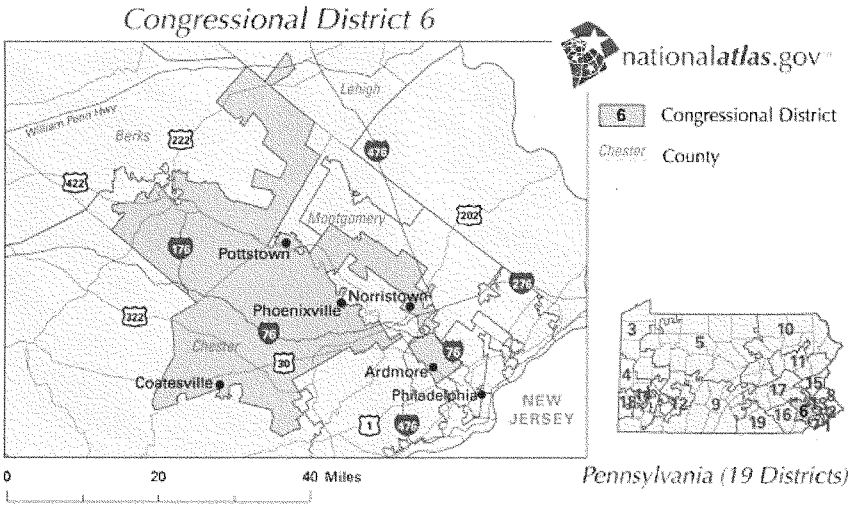
Tom Feeney, Florida
MBIA insurance in FL District 24: **886 bond issues totaling $12.8 billion**



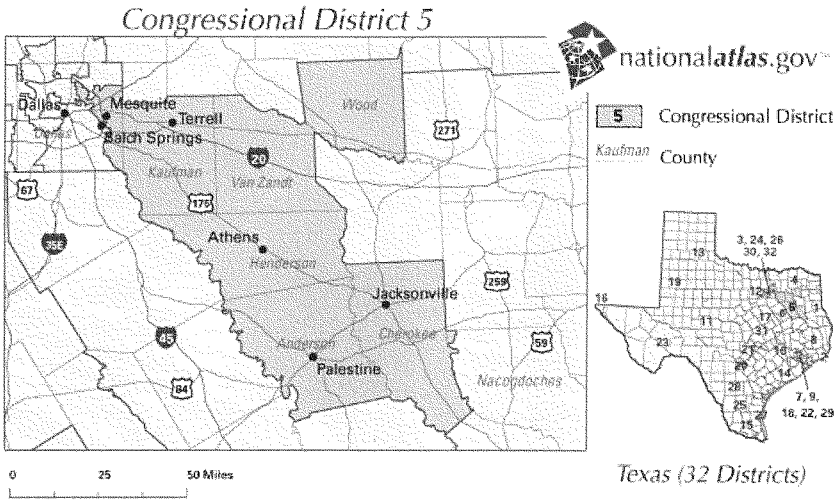
Scott Garrett, New Jersey
MBIA insurance in NJ District 5: **465 bond issues totaling $3.2 billion**



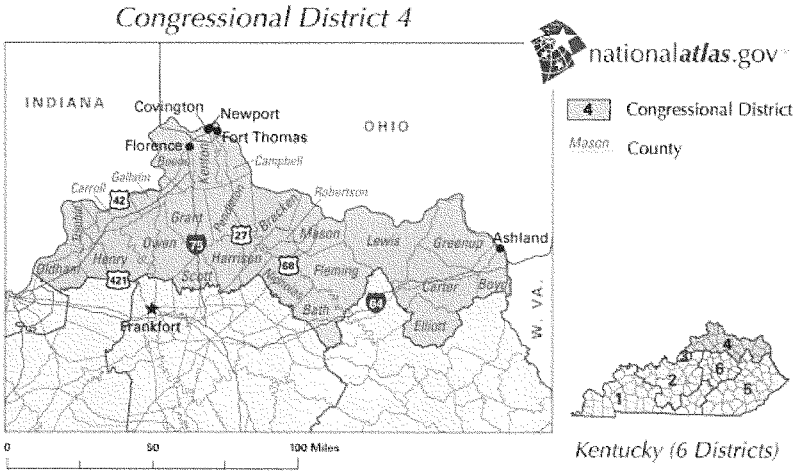
Jim Gerlach, Pennsylvania
MBIA insurance in PA District 6: **1,296 bond issues totaling $8.9 billion**



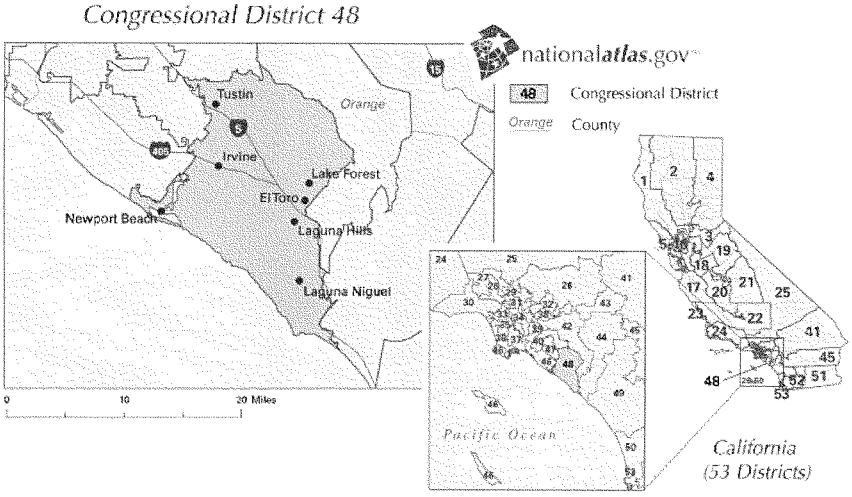
Jeb Hensarling, Texas
MBIA insurance in TX District 5: **50 bond issues totaling $284.3 million**



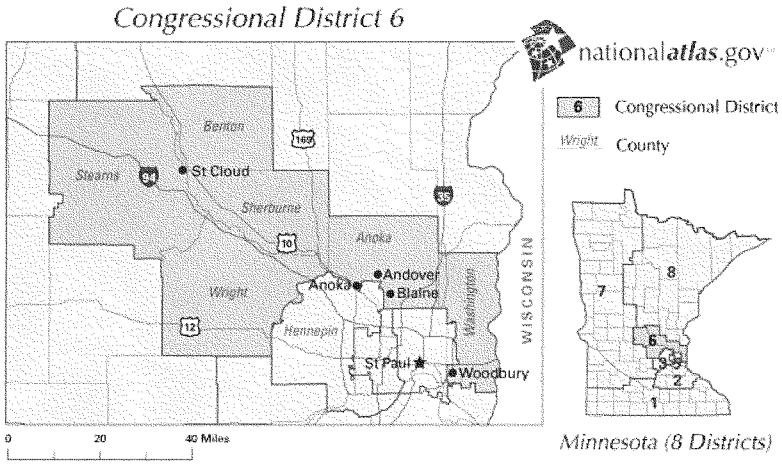
Geoff Davis, Kentucky
MBIA insurance in KY District 4: **126 bond issues totaling $1.6 billion**



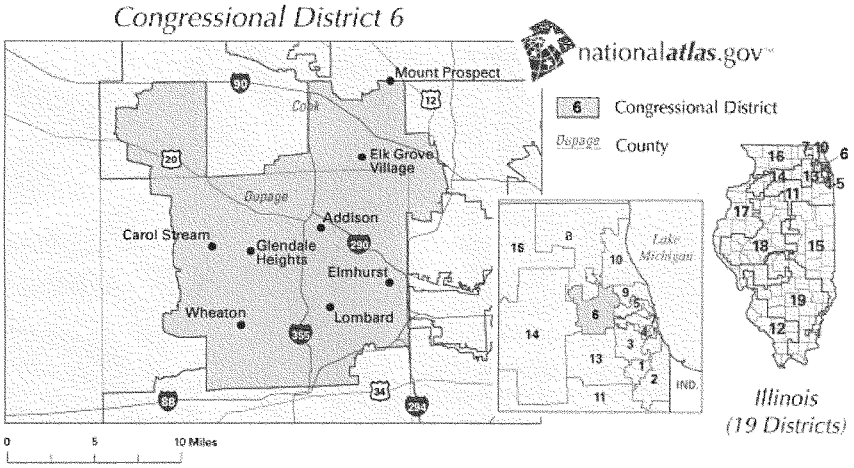
John Campbell III, California
MBIA insurance in CA District 48: **226 bond issues totaling $6.1 billion**



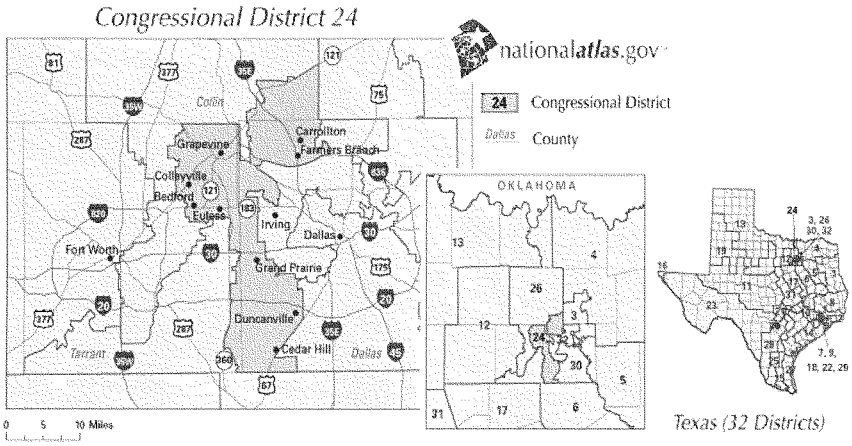
Michele Bachmann, Minnesota
MBIA insurance in IL District 8: **133 bond issues totaling $912.1 billion**



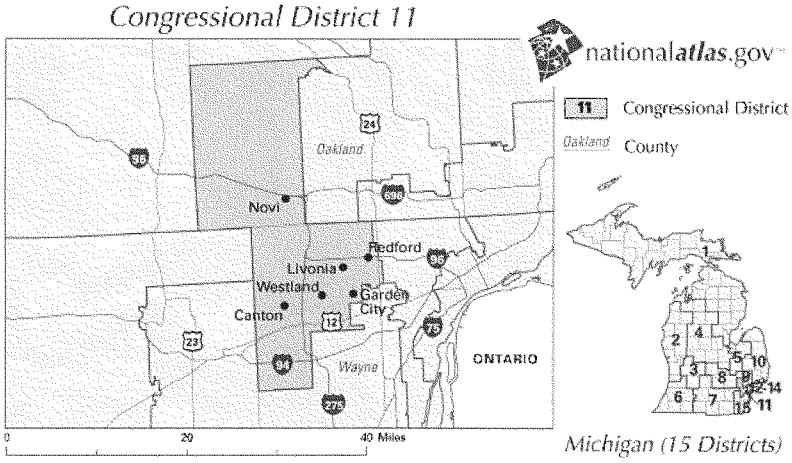
Peter Roskam, Illinois
MBIA insurance in IL District 6: **791 bond issues totaling $6.4 billion**

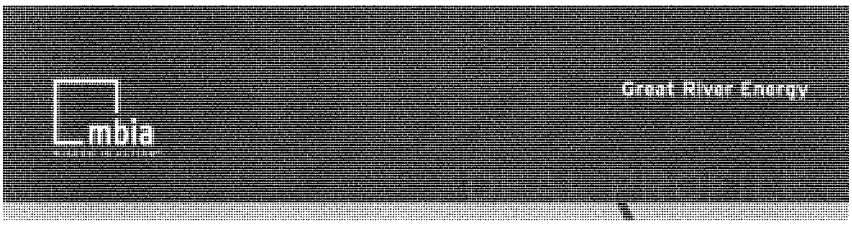


Kenny Marchant, Texas
MBIA insurance in TX District 24: **65 bond issues totaling $447.2 billion**



Thaddeus McCotter, Michigan
MBIA insurance in MI District 11: **688 bond issues totaling $9.8 billion**



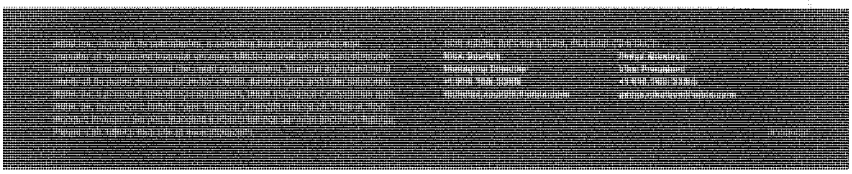


UTILITY

Insurer:	MBIA Insurance Corporation
Transaction Date:	July 2007
Obligor:	Formed in 1998, Great River Energy (GRE) in Elk River, Minnesota, is a not-for-profit electric power generation and transmission (G&T) cooperative that provides wholesale electric service to 28 distribution co-ops serving approximately 1.7 million people across Minnesota and Wisconsin. GRE is the second largest G&T cooperative in the U.S., in terms of miles of transmission (4,500 miles), and fourth largest in terms of generation capacity (2,400 MW).
Financing Issue:	$1.3 billion Great River Energy, Series 2007 First Mortgage Bonds
Term of Financing:	30 years
Use of Proceeds:	This financing will repay existing Rural Utilities Services (RUS) debt and replace it with a first mortgage indenture. RUS is one of the government entities that has traditionally financed the capital needs of electric cooperatives in the U.S.
Transaction Structure and Security:	The obligations are first mortgage bonds secured by substantially all of GRE's assets, in addition to its wholesale power contracts. Other security features include a property pledge, restrictions on distribution to members of the cooperative, a rate covenant and the ability to issue additional bonds.

Transaction Summary and Highlights:
GRE's service territory has been rapidly growing and developing, resulting in greater capital needs for new generation. With traditional governmental financing sources such as RUS experiencing funding limitations and imminent reductions, GRE turned to the capital markets to help manage their capital requirements and position themselves for future growth. In addition, prepaying the RUS allowed GRE to restructure its debt by extending the maturity on a portion of the debt to more closely reflect the useful life of the related property, plant and equipment.

The $1.3 billion transaction is the largest ever completed by a G&T co-op. Proceeds from the transaction, which MBIA insured, permitted GRE to refinance some $1.1 billion of existing debt with RUS. The remaining $200 million will be used to fund future growth. This transaction illustrates how MBIA's involvement facilitated GRE's first entry in the capital markets and provided a low cost solution for financing their extensive capital needs.



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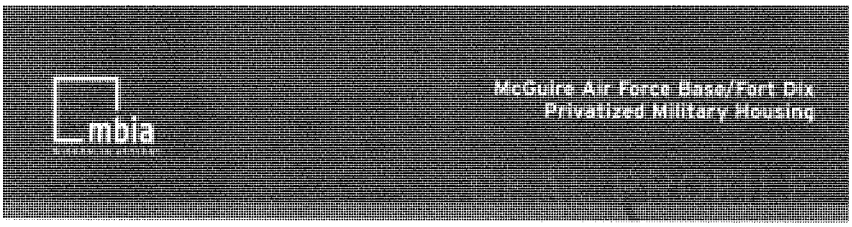
Miami Children's Hospital

HOSPITAL

Insurer:	MBIA Insurance Corporation
Transaction Date:	2006
Obligor:	Miami Children's Hospital (MCH)
Financing Issue:	Series 2006 Revenue and Refunding Bonds $265,475,000. Refunding of approximately $134 million of a 2001 bond and issuance of approximately $120 million of new proceeds.
Term of Financing:	2046
Use of Proceeds:	Refinancing of debt and new debt issuance will allow the hospital to lower its existing cost of capital and proceed with planned expansion to ease overcrowding and expand its neonatal intensive care unit.
Transaction Structure:	The refunding provides savings to the hospital by converting the bonds from fixed to auction rate bonds (swapped to fixed). The new money bonds are structured to wrap around the refunding bonds in order to take advantage of the flat yield curve.
Pledge Security:	The MBIA-insured Notes will be secured by a mortgage, gross revenue pledge, spring-in reserve fund and a strong covenant package.

Transaction Summary and Highlights:
Established in 1950 as a pediatric specialty hospital, Miami Children's Hospital (MCH) is recognized as the leading area facility of its kind offering the only freestanding pediatric trauma center in Miami-Dade County and the State of Florida. It is currently operating at capacity and in late 2006 reached out to the capital markets for financing to ease overcrowding and expand its neonatal intensive care unit. For this necessary financing, MCH wanted a bond insurer that could handle both the refinancing and the new issue without overextending their current budget.

MCH benefits from rising demand, limited competition, and strong private and public support as well as a proven history of sound financial performance. As a result, MBIA is providing an insurance commitment to MCH which will allow the hospital to proceed with expansion and service its growing admissions. While the hospital had experienced a period of financial decline in the late nineties, it maintained strong liquidity throughout while growing market share. This financing is expected to cover the cost of MCH's Capital Improvement Plan, which has received required community and governmental approvals and will be made within the hospital's existing footprint

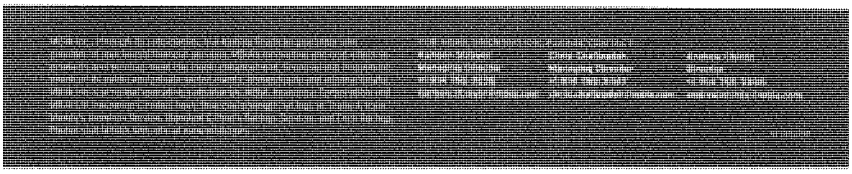


McGuire Air Force Base/Fort Dix Privatized Military Housing

MILITARY HOUSING

Insurer:	MBIA Insurance Corporation
Transaction Date:	September 26, 2006
Obligor:	United Communities LLC, a limited liability company formed to develop military family housing at McGuire AFB and Fort Dix in New Jersey. The members of the company are United Communities, Inc., a New Jersey-based developer and manager of residential properties, and other affiliated entities. United Communities, Inc. is the managing member of the obligor, responsible for constructing, renovating and managing the military family housing units subject to the provisions of a 50-year ground lease of the land and housing between the military and the obligor.
Financing Issue:	$274 million Taxable Military Housing Revenue Bonds, Series 2006 issued in a single class offered under Rule 144A and a direct loan from the Air Force of $46.7 million which is subordinate to the bonds. Project capital costs will also be funded by $17.3 million in cash equity contributions from the obligor, $30.4 million in projected investment earnings during the development period, and $13.4 million in project operating income provided during the development period.
Term of Financing:	45 years
Use of Proceeds:	Development, construction and financing costs of the project
Transaction Structure:	Single class of fixed-rate taxable bonds
Pledged Security:	First leasehold mortgage under the ground lease and a first mortgage on the improvements. All revenues consist primarily of rental payments from military tenants residing in the housing units. The rent is set equal to the military personnel's basic allowance for housing. The bonds are also secured by other project receipts, bond proceeds and investment earnings, and capital contributions from the obligor.

Transaction Summary and Highlights:
In 1996, Congress passed the Military Housing Privatization Initiative, which paved the way for privately financed and built military housing. MBIA has been a leading participant in the privatization effort and McGuire Air Force Base / Fort Dix is the largest Air Force rental privatization project done to date. Located next to each other in southern New Jersey, McGuire AFB is the only AFB located on the coast in the Northeast and Fort Dix is an important training and mobilization installation for all military branches. The revitalization calls for demolition of 1,915 homes (many dating to the 1950's), construction of 1,635 new units, major renovation on 14 historic buildings and minor renovation on 435 homes. At the end of the project, a total of 2,084 homes will provide exceptional amenities compared with comparably priced units in the local market, as well as community centers and infrastructure. The bonds for the transaction were rated AA- by S&P. To increase marketability the bonds were wrapped with MBIA's Triple-A-rated financial guarantee. As a result, they sold very quickly with the lowest spread to the long Treasury bond for any Air Force deal to date.



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Tulane University

HIGHER EDUCATION

Insurer:	MBIA Insurance Corporation
Transaction Date:	May, 2007
Obligor:	Louisiana Public Facilities Authority (Tulane University of LA Project) The Administrators of the Tulane Educational Fund (Tulane University of LA)
Financing Issue:	$193 million Refunding Revenue Bonds $103 million Taxable Refunding Revenue Bonds $62 million Refunding Revenue Bonds $33 million Refunding Revenue Bonds
Term of Financing:	30 years
Use of Proceeds:	Refund almost all outstanding tax-exempt and taxable bonded debt of the University allowing for debt-service relief. Tulane's annual debt service will drop by about $7 million annually, through 2013.
Transaction Structure:	General obligations of Tulane with the full faith and credit of Tulane pledged to the payment of the Bonds. Covenants are an additional bonds test and negative pledge on fees (excluding tuition) and available assets.
Pledged Security:	General obligation of Tulane University

Transaction Summary and Highlights:
MBIA's financial guarantee enabled Tulane to restructure its debt allowing for debt service relief over the next several years. This was necessary due to the financial constraints the University faced caused by the effects of Hurricane Katrina which caused $190 million of physical damage to the campus and another $140 million of losses in research materials and fine art. MBIA had approached Tulane immediately after Katrina to express our willingness to work with senior management to develop an interim borrowing plan. Although Tulane chose a different financing plan at that time, MBIA continued to maintain a strong relationship with the University and its banker. Although Tulane was forced to close for the fall 2005 semester, it reopened for the spring semester in January 2006 as a smaller, re-focused, scaled-back institution with 10,400 students down from 13,000 in 2003. The University has made great strides in reinventing itself and MBIA's long-term positive outlook on Tulane's viability helped to make this possible. By restructuring its debt, Tulane was able to relieve some of its financial stress and today Tulane continues to fare well as one of the country's pre-eminent institutions of higher learning.

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Citizens Property Insurance Corporation, Florida High Risk Account-Senior Secured Refunding Bonds Series 2007A

SPECIAL ASSESSMENT

Insurer:	MBIA Insurance Corporation
Transaction Date:	February 2007
Obligor:	Citizens Property Insurance Corporation; a legislatively created entity established in 2002 to provide residential and commercial property and casualty insurance for property owners in Florida who meet certain statutory requirements. The High Risk Account ("HRA"), one of three separate accounts of Citizens, provides wind-only insurance policies for property owners in designated coastal areas of Florida.
Financing Issue:	$1.06 billion
Use of Proceeds:	Refund $1 billion outstanding Florida Windstorm Underwriting Association ("FWUA") 7.125% Series 1999A Senior Secured Insured Notes ("Series 1999A Notes"), pay a redemption premium, fund a Reserve Account and pay issuance costs. FWUA was a predecessor organization to Citizens.
Transaction Structure:	Tax-exempt fixed-rate serial maturities with final maturity in 2017.
Pledged Security:	Includes premiums and surcharges, reimbursements from the Florida Hurricane Catastrophe Fund, the state-run reinsurer and assessments on property insurance premiums levied on insurers and policyholders state-wide. When Citizens incurs a deficit, it may levy assessments up to 10% in any year for as long as necessary to cover the gap. As a result of the 2005 hurricanes, Citizens incurred a deficit in 2005 and is currently levying an emergency assessment on policyholders of 1.4% per year for 10 years. This is expected to produce sufficient revenues to cover bond debt service in any year.

Transaction Summary and Highlights:
The Series 1999A Notes were issued in that year as fixed-rate taxable securities to provide pre-event funding liquidity to FWUA. Proceeds were invested in higher yielding investments designed to cover the fixed interest-only payments before final maturity in 2019. However, when interest rates declined shortly after issuance, investment earnings were insufficient to cover the interest costs on the notes, creating significant negative arbitrage. Citizens could not eliminate these arbitrage losses by refunding the Series 1999A Notes as their structure included a "make-whole call" provision requiring the issuer to compensate investors for their "losses" should the notes be redeemed before final maturity. The costs of the make-whole payment more than offset the savings, which would have been generated through a taxable refunding. However, when Citizens used the note proceeds to pay claims as a result of the 2005 storms, it provided them with the opportunity to refinance the Notes with tax-exempt bonds. The enhanced economics of this tax-exempt transaction plus MBIA's Triple-A-rated financial guarantee enabled Citizens to realize over $85 million in present value savings after taking into account the make-whole payment, while shortening the final maturity of the debt by two years.

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Missouri Joint Municipal Electric Utility Commission Power Project Revenue Bonds (Plum Point Project)

UTILITY

Insurer:	MBIA Insurance Corporation
Transaction Date:	May 10, 2006
Obligor:	Missouri Joint Municipal Electric Utility Commission (MJMEUC), a joint action agency, acting on behalf of seven of its 62 members. MJMEUC's members are municipal electric utilities that provide electric service to residential, commercial and industrial customers within their boundaries.
Financing Issue:	$279 million of fixed-rate tax-exempt revenue bonds
Term of Financing:	30 years
Use of Proceeds:	To finance the acquisition of a 22% ownership interest in the Plum Point Power Project, a 665 MW base-load coalfired generating station to be constructed in northeastern Arkansas. LS Power, a private developer, is the sponsor and ongoing manager of the Plum Point Project.
Transaction Structure:	The seven participating municipalities each entered into long-term power purchase agreements with MJMEUC to procure power from Plum Point to serve their respective power load requirements. These agreements require the participants to pay all of MJMEUC's costs related to Plum Point (including debt service) as an operating expense of their electric systems.
Pledged Security:	The transaction is secured by a first lien pledge of the revenue received by MJMEUC from the participants pursuant to the purchase power agreements plus all reserves, funds and assets held by the Trustee.

Transaction Summary and Highlights:
This award-winning transaction enabled seven small municipal utilities, through MJMEUC, to acquire an equity stake in a relatively low cost, state-of-the-art base-load coal-fired generating plant in a region dominated by natural gas generated power. Ownership in the plant will reduce the risk of fuel price shock that many of the municipal participants had experienced from buying electricity from existing regional suppliers. The Plum Point financing was MJMEUC's first entry into the capital markets, and MBIA's financial guarantee improved the marketing of the bonds, widened the universe of potential investors and lowered the cost of the debt, ultimately resulting in lower cost power for the participants.

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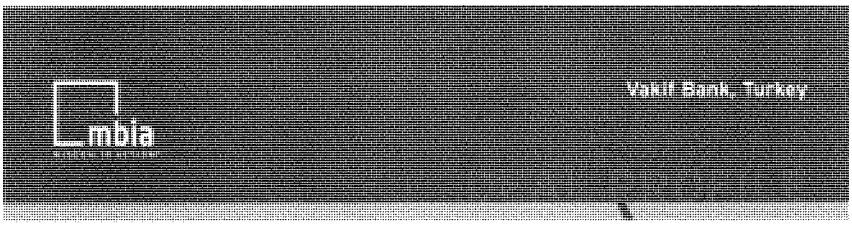
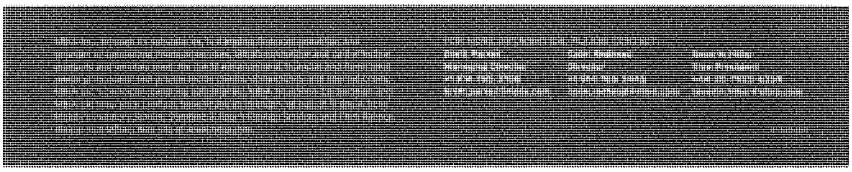
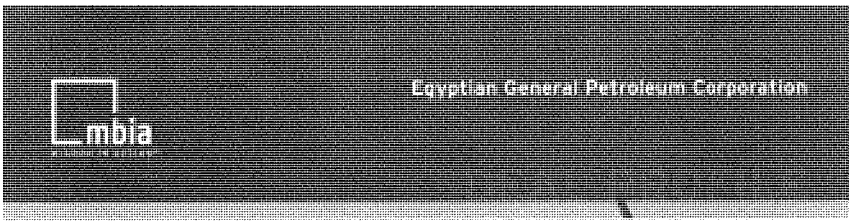


FUTURE FLOW

Insurer:	MBIA Insurance Corporation
Transaction Date:	May 2007
Obligor:	Turkiye Vakiflar Bankasi T.A.O. (Vakif Bank), a leading Turkish bank
Financing Issue:	$200 million in dollar-denominated bonds
Term of Financing:	Final maturity of 10 years with a weighted average life of 7 years
Use of Proceeds:	The financing was used by Vakif for general corporate purposes, which included the disbursement of USD loans to its commercial customers and the diversification of its sources of funding. The transaction also provided term-funding to better match the tenors of assets and liabilities, especially for short- to medium-term loans.
Transaction Structure:	The transaction was similar in structure to other Turkish future flow transactions with risk mitigating provisions including early amortization events, default triggers and covenants. An important aspect of the deal was the creation of an offshore, bankruptcy-remote special purpose vehicle to which Vakif sold its rights to existing and future remittances under a "true sale" provisioned under Turkish law.
Pledged Security:	Secured against diversified payment rights in the form of remittances, export receivables, tourism revenues, and foreign direct investment flows made through various American and European correspondent banks. Payments were made in USD, Euro, GBP and CHF currencies with limited foreign exchange risk. Additional security mechanisms included cash flow triggers, a coverage reserve account, downgrade pricing protection and limitations on additional debt.

Transaction Summary and Highlights:
Prior to this deal, MBIA closed future flow transactions in Turkey, Brazil, Mexico, and Kazakhstan. In fact, in 1998 MBIA was the first monoline to enter the Turkish market, which at over USD 2 billion plus, Turkey represents MBIA's largest exposure in an emerging market. However, there were certain specific challenges associated with this deal. Around the time of the transaction, Vakif was undergoing an ownership transition from a 100% government owned entity to a publicly listed corporation. To secure the best financing terms, Vakif was advised to issue an IPO prior to securing debt financing. In 2005, the Bank successfully sold 25.2% of its shares in an IPO, raising approximately $1.2 billion. In 2007, the bank issued debt of $500 million, which was a large sum, having issued $915 million in debt financing in 2006. To limit any single entity's exposure, the transaction was structured as a club deal with participation from three other monoline insurance companies. Although faced with a relatively stable macroeconomic environment, there was considerable political uncertainty around the impending presidential nomination and parliamentary elections later that year with an expected standoff between the military and the governing political party. However, in the absence of any tangible effect on markets, MBIA remained committed to the transaction, which closed in May of 2007.



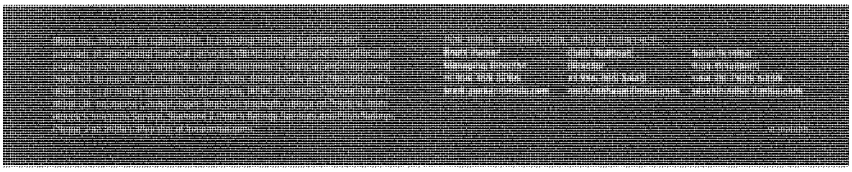


Egyptian General Petroleum Corporation

FUTURE FLOW

Insurer:	MBIA Insurance Corporation
Transaction Date:	July 2005
Obligor:	Petroleum Export Limited (PEL), an SPV incorporated in the Cayman Islands, is the Obligor with limited recourse to the Egyptian General Petroleum Corporation (EGPC). The EGPC is a 100% state-owned petroleum company controlled by the government of Egypt.
Financing Issue:	$400 million in 144A dollar-denominated oil export backed notes, issued by PEL to be paid quarterly at a fixed rate
Term of Financing:	Final maturity of 5 years with a weighted average life of 2.8 years
Use of Proceeds:	General corporate purposes, as well as to fund the Petroleum Ministry's equity investments in the energy sector in Egypt, including lucrative natural gas infrastructure, and to reduce subsidies
Transaction Structure:	This transaction is a forward sale agreement (FSA) of crude oil and naphtha under which the EGPC will deliver a fixed quantity of product in return for an upfront payment or pre-payment for future deliveries by PEL. Under an offtake agreement, Morgan Stanley Capital Group (MSCG) purchases from PEL all product delivered over the life of the deal at market price. In addition, there exists a hedge agreement between MSCG and PEL which guarantees a minimum price floor for each product. The notes will be senior secured obligations of PEL backed by the above agreements and a 3-month debt service reserve account funded at closing. There are also limitations on additional debt.
Pledged Security:	The transaction is secured by the export of crude oil and naphtha to be delivered to PEL by EGPC and export receivables generated by PEL from the sale of these products. In addition, EGPC enjoys special non-bankruptcy status, strong revenues and future resource potential.

Transaction Summary and Highlights:
This was the first future flow transaction in Egypt. By accessing a novel securitization structure using MBIA-wrapped dollar-denominated debt, EGPC and the government of Egypt were able to significantly broaden their investor base while at the same time capture large savings through a lower cost of funding. The money raised was targeted towards short- and medium-term investments in the energy sector including strategic investments in the natural gas infrastructure. MBIA made contributions to the legal and financial structure of the deal to separate corporate risk from sovereign risk. In order to do this, an offshore SPV entity was set up with a claim on export receivables prior to their flow into Egypt. Another highlight of the deal involved the negotiation and structuring of an innovative commodity swap agreement to mitigate the impact of a fall in oil prices. Under this agreement, the obligor was guaranteed a minimum price on all future product sales. Given investor perception of potential instability in the Middle East, this transaction demonstrates MBIA's commitment to analyze difficult situations and develop creative, sustainable solutions.



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The Saggas Company – Planta de Regasificación de Sagunto

UTILITY

Insurer:	MBIA UK Insurance Limited
Transaction Date:	March 21, 2007
Obligor:	The Saggas Company – Planta de Regasificación de Sagunto
Financing Issue:	Total amount: $152 Million divided into the following two tranches: • a $100 million European Investment Bank Loan, and • a $52 million bank loan extended by Caja Madrid
Term of Financing:	Final maturity of 25 years with a weighted average life of 12.6 years
Use of Proceeds:	Expansion of an existing plant also financed by MBIA in 2004
Pledge Security:	Security interest in all of the assets of the plant (Phase I and II)

Transaction Summary and Highlights:
MBIA recently insured a transaction for The Saggas Company, which will fund the expansion of the Sagunto Regasification Plant, located at Saggas' Liquid Natural Gas (LNG) terminal in the Port of Sagunto near Valencia, Spain. The expansion will increase the capacity of the regasification plant, where LNG, which has been liquefied for tanker transportation, is converted back to usable form–natural gas. The expansion will add a third storage tank and a fifth vaporizer at the plant, which is strategically located to receive LNG from producer regions such as the Mediterranean, Africa and the Middle East.

In 2004, MBIA insured the first phase of plant construction when it guaranteed a total amount of $321 million in two tranches: a $292 million European Investment Bank loan and a $29 million additional facility extended by Caja Madrid for the construction of the first phase of the plant.

The first phase went smoothly, with construction completed on time and under budget, and the plant has continued to operate safely and efficiently. In view of this positive experience, as well as the increasing demand for natural gas in Spain, Saggas and the Ministry of Industry decided to extend the financing in order to expand the production capacity of the plant.

The Sagunto Regasification Plant is owned by a consortium of leading users of natural gas in Spain (including three of the largest utilities), principally though not exclusively for power generation. Importantly, Saggas and all other LNG terminals in Spain (including BBG, another regasification plant that MBIA financed in northern Spain) are regulated as part of the gas distribution grid and not as part of the commercial gas supply chain.

The expansion financing was undertaken with the explicit support of the Ministry of Industry and had been highlighted as a key component of the Government's energy infrastructure plans.

[illegible]

MBIA Inc.
Quarterly Operating Supplement
December 31, 2007

Fourth Quarter 2007

MBIA INC. AND SUBSIDIARIES
QUARTERLY OPERATING SUPPLEMENT [1]

Fourth Quarter 2007

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(1) This report is unaudited.

Consolidated Balance Sheets
(dollars in thousands)

	December 31, 2007	December 31, 2006
Assets		
Investments:		
Fixed-Maturity Securities Held as Available-for-Sale, at Fair Value (Amortized Cost $30,199,471 and $27,327,315)(2007 includes hybrid financial instruments at fair value $596,537)	$29,589,098	$27,755,667
Investments Held-To-Maturity, at Amortized Cost (Fair Value $5,036,465 and $5,187,766)	5,053,987	5,213,464
Investments Pledged as Collateral, at Fair Value (Amortized Cost $1,243,245 and $176,179)	1,227,153	175,834
Short-Term Investments, at Amortized Cost	5,464,708	2,960,646
Other Investments	730,711	971,707
Total Investments	42,065,657	37,077,318
Cash and Cash Equivalents	263,732	269,277
Accrued Investment Income	590,060	526,468
Deferred Acquisition Costs	472,516	449,556
Prepaid Reinsurance Premiums	325,555	363,140
Reinsurance Recovarable on Unpaid Losses	82,041	46,941
Goodwill	79,406	79,406
Property and Equipment (Net of Accumulated Depreciation)	104,036	105,950
Receivable for Investments Sold	111,130	77,593
Derivative Assets	1,715,881	521,278
Current Income Taxes	142,763	-
Deferred Income Taxes, Net	1,173,658	-
Other Assets	288,639	246,103
Total Assets	$47,415,074	$39,763,030
Liabilities and Shareholders' Equity		
Liabilities:		
Deferred Premium Revenue	$ 3,138,396	$ 3,129,620
Loss and Loss Adjustment Expense Reserves	1,346,423	537,037
Investment Agreements	16,107,909	12,482,976
Commercial Paper	850,315	745,996
Medium-Term Notes (2007 includes hybrid financial instruments at fair value $374,575)	12,830,777	10,951,378
Variable Interest Entity Floating Rate Notes	1,355,792	1,451,928
Securities Sold Under Agreements to Repurchase	1,163,899	169,432
Short-Term Debt	13,383	40,898
Long-Term Debt	1,225,280	1,215,289
Current Income Taxes	-	6,970
Deferred Income Taxes, Net	-	476,189
Deferred Fee Revenue	15,059	14,862
Payable for Investments Purchased	41,359	319,640
Derivative Liabilities	5,006,549	400,318
Other Liabilities	664,128	616,243
Total Liabilities	43,759,269	32,558,776
Shareholders' Equity:		
Common Stock	160,245	158,330
Additional Paid-in Capital	1,649,511	1,533,102
Retained Earnings	4,301,880	6,399,333
Accumulated Other Comprehensive Income (Loss)	(490,829)	321,293
Treasury Stock	(1,965,002)	(1,207,804)
Total Shareholders' Equity	3,655,805	7,204,254
Total Liabilities and Shareholders' Equity	$47,415,074	$39,763,030

Consolidated Statements of Income
(dollars in thousands except per share)

	Three Months Ended December 31		Years Ended December 31	
Revenues:	**2007**	**2006**	**2007**	**2006**
Gross Premiums Written	$ 256,861	$ 266,730	$ 960,899	$ 885,253
Ceded Premiums	(27,765)	(21,060)	(100,117)	(98,591)
Net Premiums Written	229,096	245,670	860,782	786,662
Scheduled Premiums Earned	183,425	164,119	703,199	663,073
Refunding Premiums Earned	16,918	33,510	120,818	161,515
Premiums Earned	200,343	197,629	824,017	824,588
Net Investment Income	575,155	485,331	2,183,840	1,782,346
Fees and Reimbursements	9,309	13,142	56,841	66,475
Net Realized Gains (Losses)	24,062	(5,055)	51,324	15,438
Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange	(3,028,575)	3,980	(3,404,976)	14,494
Insurance Recoveries	-	-	6,400	-
Total Revenues	(2,219,706)	695,027	(282,554)	2,703,341
Expenses:				
Losses and Loss Adjustment	836,690	20,054	900,345	80,889
Amortization of Deferred Acquisition Costs	16,759	15,850	66,873	66,012
Operating	59,806	71,565	238,872	241,303
Interest Expense	419,966	337,160	1,577,048	1,181,874
Total Expenses	1,333,221	444,629	2,783,138	1,570,078
Income (Loss) from Continuing Operations before Income Taxes	(3,552,927)	250,398	(3,065,692)	1,133,263
Provision (Benefit) for Income Taxes	(1,257,177)	71,914	(1,143,744)	320,080
Income (Loss) from Continuing Operations	(2,295,750)	178,484	(1,921,948)	813,183
Income from Discontinued Operations, Net of Tax	-	2,472	-	6,076
Gain on Sale of Discontinued Operations, Net of Tax	-	29	-	29
Net Income (Loss)	$ (2,295,750)	$ 180,985	$ (1,921,948)	$ 819,288
Net Income (Loss) per Common Share:				
Basic	$ (18.55)	$ 1.36	$ (15.17)	$ 6.17
Diluted	$ (18.55)	$ 1.32	$ (15.17)	$ 5.99
Weighted-Average Number of Common Shares Outstanding:				
Basic	123,739,225	132,898,187	126,670,332	132,794,334
Diluted	123,739,225	137,042,313	126,670,332	136,694,798

	Net Income (Loss) Per Diluted Share Information [1]			
Net Income (Loss)	$ (18.55)	$ 1.32	$ (15.17)	$ 5.99
Income from Discontinued Operations	0.00	0.02	0.00	0.04
Net Income (Loss) from Continuing Operations	(18.55)	1.30	(15.17)	5.95
Net Realized Gain (Losses)	0.13	(0.02)	0.26	0.07
Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange	(15.91)	0.02	(17.47)	0.07
Estimated Credit Impairment on Insured Derivatives [2]	1.05	0.00	1.03	0.00
Operating Income (Loss)	(3.82)	1.31	1.01	5.81
Earnings from Refunded Issues	0.08	0.15	0.57	0.71
Operating Income (Loss) Excluding Refundings	$ (3.90)	$ 1.16	$ 0.44	$ 5.10
Pre-tax Operating Income (Loss) [2]	$ (748,414)	$ 251,473	$ 87,960	$ 1,103,331
After-tax Operating Income (Loss) [2]	$ (472,817)	$ 179,183	$ 127,926	$ 793,727

(1) May not add due to rounding.

(2) In 2007, operating income has been reduced by a pre-tax $200.0 million (after-tax $130.0 million) estimated credit impairment related to three CDO squared transactions.

Segment Results
(dollars in thousands)

	Three Months Ended December 31		Years Ended December 31	
Insurance Operations	2007	2006	2007	2006
Revenues:				
Gross Premiums Written	$ 267,480	$ 275,128	$ 998,863	$ 921,964
Ceded Premiums	(29,239)	(22,853)	(106,474)	(107,287)
Net Premiums Written	238,241	252,275	892,389	814,677
Scheduled Premiums Earned	192,571	170,724	734,806	691,088
Refunding Premiums Earned	16,917	33,510	120,818	161,515
Premiums Earned	209,488	204,234	855,624	852,603
Net Investment Income	146,815	146,624	572,786	581,103
Fees and Reimbursements	1,151	4,259	20,832	33,498
Total Insurance Revenues	357,454	355,117	1,449,242	1,467,204
Expenses:				
Losses and Loss Adjustment	836,690	20,054	900,345	80,889
Amortization of Deferred Acquisition Costs	16,759	15,850	66,873	66,012
Operating	35,130	46,295	133,259	155,863
Interest Expense	19,849	22,561	81,810	76,490
Total Insurance Expenses	908,428	104,760	1,182,287	379,254
Insurance Income (Loss)	(550,974)	250,357	266,955	1,087,950
Investment Management Services				
Revenues	435,541	343,123	1,630,291	1,211,540
Interest Expense	380,148	294,431	1,414,944	1,024,903
Net Revenues	55,393	48,692	215,347	186,637
Expenses	26,997	22,867	105,349	85,419
Investment Management Services Income	28,396	25,825	109,998	101,218
Corporate				
Net Investment Income	(238)	3,715	14,212	13,462
Insurance Recoveries	-	-	6,400	-
Interest Expense	20,193	20,189	80,740	80,685
Corporate Expenses	5,405	8,235	28,865	18,614
Corporate Loss	(25,836)	(24,709)	(88,993)	(85,837)
Gains and Losses				
Net Realized Gains (Losses)	24,062	(5,055)	51,324	15,438
Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange	(3,028,575)	3,980	(3,404,976)	14,494
Net Gains and (Losses)	(3,004,513)	(1,075)	(3,353,652)	29,932
Income (Loss) from Continuing Operations before Income Taxes	$ (3,552,927)	$ 250,398	$ (3,065,692)	$ 1,133,263

Segment Results to Consolidated Income Statement Reconciliation
(dollars in thousands)

	Three Months Ended December 31, 2007					
	Insurance	Investment Management Services	Corporate	Subtotal	Eliminations [1]	Consolidated
Revenues:						
Gross Premiums Written	$ 267,480	$ -	$ -	$ 267,480	$ (10,619)	$ 256,861
Ceded Premiums	(29,239)	-	-	(29,239)	1,474	(27,765)
Net Premiums Written	238,241	-	-	238,241	(9,145)	229,096
Premiums Earned	209,488	-	-	209,488	(9,145)	200,343
Net Investment Income	146,815	424,530	(238)	571,107	4,048	575,155
Fees and Reimbursements	1,151	11,011	-	12,162	(2,853)	9,309
Net Realized Gains	17,189	2,617	4,256	24,062	-	24,062
Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange	(3,258,089)	228,589	925	(3,028,575)	-	(3,028,575)
Insurance Recoveries	-	-	-	-	-	-
Total Revenues	(2,883,446)	666,747	4,943	(2,211,756)	(7,950)	(2,219,706)
Expenses:						
Losses and Loss Adjustment	836,690	-	-	836,690	-	836,690
Amortization of Deferred Acquisition Costs	16,759	-	-	16,759	-	16,759
Operating	35,130	26,997	5,405	67,532	(7,726)	59,806
Interest Expense	19,849	380,148	20,193	420,190	(224)	419,966
Total Expenses	908,428	407,145	25,598	1,341,171	(7,950)	1,333,221
Income (Loss) from Continuing Operations before Income Taxes	$ (3,791,874)	$ 259,602	$ (20,655)	$ (3,552,927)	$ -	(3,552,927)
Benefit for Income Taxes						(1,257,177)
Loss from Continuing Operations						(2,295,750)
Income from Discontinued Operations, Net of Tax						-
Net Loss						$ (2,295,750)

	Three Months Ended December 31, 2006					
	Insurance	Investment Management Services	Corporate	Subtotal	Eliminations [1]	Consolidated
Revenues:						
Gross Premiums Written	$ 275,128	$ -	$ -	$ 275,128	$ (8,398)	$ 266,730
Ceded Premiums	(22,853)	-	-	(22,853)	1,793	(21,060)
Net Premiums Written	252,275	-	-	252,275	(6,605)	245,670
Premiums Earned	204,234	-	-	204,234	(6,605)	197,629
Net Investment Income	146,624	331,307	3,715	481,646	3,685	485,331
Fees and Reimbursements	4,259	11,816	-	16,075	(2,933)	13,142
Net Realized Gains (Losses)	(6,951)	466	1,430	(5,055)	-	(5,055)
Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange	(452)	4,439	(7)	3,980	-	3,980
Insurance Recoveries	-	-	-	-	-	-
Total Revenues	347,714	348,028	5,138	700,880	(5,853)	695,027
Expenses:						
Losses and Loss Adjustment	20,054	-	-	20,054	-	20,054
Amortization of Deferred Acquisition Costs	15,850	-	-	15,850	-	15,850
Operating	46,295	22,867	8,235	77,397	(5,832)	71,565
Interest Expense	22,561	294,431	20,189	337,181	(21)	337,160
Total Expenses	104,760	317,298	28,424	450,482	(5,853)	444,629
Income (Loss) from Continuing Operations before Income Taxes	$ 242,954	$ 30,730	$ (23,286)	$ 250,398	$ -	250,398
Provision for Income Taxes						71,914
Income from Continuing Operations						178,484
Income from Discontinued Operations, Net of Tax						2,472
Gain on Sale of Discontinued Operations, Net of Tax						29
Net Income						$ 180,985

(1) Eliminations include:

(a) Elimination of intercompany premium income and expense.

(b) Elimination of intercompany asset management fees and expenses.

(c) Elimination of intercompany interest income and expense pertaining to intercompany receivables and payables.

Segment Results to Consolidated Income Statement Reconciliation
(dollars in thousands)

	Year Ended December 31, 2007					
	Insurance	Investment Management Services	Corporate	Subtotal	Eliminations [1]	Consolidated
Revenues:						
Gross Premiums Written	$ 998,863	$ -	$ -	$ 998,863	$ (37,964)	$ 960,899
Ceded Premiums	(106,474)	-	-	(106,474)	6,357	(100,117)
Net Premiums Written	892,389	-	-	892,389	(31,607)	860,782
Premiums Earned	855,624	-	-	855,624	(31,607)	824,017
Net Investment Income	572,786	1,582,287	14,212	2,169,285	14,555	2,183,840
Fees and Reimbursements	20,832	48,004	-	68,836	(11,995)	56,841
Net Realized Gains (Losses)	55,644	668	(4,988)	51,324	-	51,324
Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange	(3,605,617)	199,565	1,076	(3,404,976)	-	(3,404,976)
Insurance Recoveries	-	-	6,400	6,400	-	6,400
Total Revenues	(2,100,731)	1,830,524	16,700	(253,507)	(29,047)	(282,554)
Expenses:						
Losses and Loss Adjustment	900,345	-	-	900,345	-	900,345
Amortization of Deferred Acquisition Costs	66,873	-	-	66,873	-	66,873
Operating	133,259	105,349	28,865	267,473	(28,601)	238,872
Interest Expense	81,810	1,414,944	80,740	1,577,494	(446)	1,577,048
Total Expenses	1,182,287	1,520,293	109,605	2,812,185	(29,047)	2,783,138
Income (Loss) from Continuing Operations before Income Taxes	$ (3,283,018)	$ 310,231	$ (92,905)	$ (3,065,692)	$ -	(3,065,692)
Benefit for Income Taxes						(1,143,744)
Loss from Continuing Operations						(1,921,948)
Income from Discontinued Operations, Net of Tax						-
Net Loss						$ (1,921,948)

	Year Ended December 31, 2006					
	Insurance	Investment Management Services	Corporate	Subtotal	Eliminations [1]	Consolidated
Revenues:						
Gross Premiums Written	$ 921,964	$ -	$ -	$ 921,964	$ (36,711)	$ 885,253
Ceded Premiums	(107,287)	-	-	(107,287)	8,696	(98,591)
Net Premiums Written	814,677	-	-	814,677	(28,015)	786,662
Premiums Earned	852,603	-	-	852,603	(28,015)	824,588
Net Investment Income	581,103	1,167,241	13,462	1,761,806	20,540	1,782,346
Fees and Reimbursements	33,498	44,299	-	77,797	(11,322)	66,475
Net Realized Gains	5,615	6,060	3,763	15,438	-	15,438
Net Gains on Financial Instruments at Fair Value and Foreign Exchange	904	13,162	428	14,494	-	14,494
Insurance Recoveries	-	-	-	-	-	-
Total Revenues	1,473,723	1,230,762	17,653	2,722,138	(18,797)	2,703,341
Expenses:						
Losses and Loss Adjustment	80,889	-	-	80,889	-	80,889
Amortization of Deferred Acquisition Costs	66,012	-	-	66,012	-	66,012
Operating	155,863	85,419	18,814	259,896	(18,593)	241,303
Interest Expense	76,490	1,024,903	80,685	1,182,078	(204)	1,181,874
Total Expenses	379,254	1,110,322	99,299	1,588,875	(18,797)	1,570,078
Income (Loss) from Continuing Operations before Income Taxes	$ 1,094,469	$ 120,440	$ (81,646)	$ 1,133,263	$ -	1,133,263
Provision for Income Taxes						320,080
Income from Continuing Operations						813,183
Income from Discontinued Operations, Net of Tax						6,076
Gain on Sale of Discontinued Operations, Net of Tax						29
Net Income						$ 819,288

(1) Eliminations include:

(a) Elimination of intercompany premium income and expense.

(b) Elimination of intercompany asset management fees and expenses.

(c) Elimination of intercompany interest income and expense pertaining to intercompany receivables and payables.

Summary Financial Information
(dollars in thousands except per share)

GAAP Basis	4th Quarter		Year-to-date	
	2007	2006	2007	2006
Financial Ratios				
Loss and LAE Ratio	399.4%	9.8%	105.2%	9.5%
Underwriting Expense Ratio	24.8%	30.4%	23.4%	26.0%
Combined Ratio	424.2%	40.2%	128.6%	35.5%
Share Data				
Book Value	$29.16	$53.43	$29.16	$53.43
Deferred Premium Revenue	16.27	15.09	16.27	15.09
Prepaid Reinsurance Premiums	(1.69)	(1.75)	(1.69)	(1.75)
Deferred Acquisition Costs	(2.45)	(2.17)	(2.45)	(2.17)
Net Deferred Premium Revenue	12.13	11.17	12.13	11.17
Present Value of Installment Premiums[1]	13.68	11.13	13.68	11.13
Asset/Liability Products Adjustment	8.78	2.92	8.78	2.92
Loss Provision [2]	(3.39)	(2.93)	(3.39)	(2.93)
Adjusted Book Value	$60.36	$75.72	$60.36	$75.72
Dividends:				
Declared	$0.340	$0.310	$1.360	$1.240
Paid	$0.340	$0.310	$1.330	$1.210
Common Shares Outstanding				
Weighted-Average (Diluted) (000)	123,739	137,042	126,670	136,695
Actual (000)	125,372	134,835	125,372	134,835
Effective Tax Rates				
Net Investment Income[3]	23.6%	22.5%	23.7%	23.3%
Underwriting and Other Income (Loss)	(34.8)%	38.5%	(34.8)%	35.0%
Total Income (Loss)	(35.4)%	28.7%	(37.3)%	28.2%

Statutory Basis	4th Quarter		Year-to-date	
Financial Ratios	2007	2006	2007	2006
Loss and LAE Ratio	476.4%	41.9%	114.2%	12.6%
Underwriting Expense Ratio	23.7%	30.8%	24.9%	29.8%
Combined Ratio	500.1%	72.7%	139.1%	42.4%

	12/31/2007	12/31/2006
Balance Sheet		
Capital and Surplus	$3,666,089	$4,080,632
Contingency Reserve	2,718,916	2,478,064
Capital Base	6,385,005	6,558,696
Unearned Premium Reserve	3,762,768	3,507,229
Present Value of Installment Premiums[1]	2,638,669	2,309,433
Premium Resources	6,401,437	5,816,662
Loss and LAE Reserves	926,057	100,645
Soft Capital Credit Facilities	850,000	850,000
Total Claims-Paying Resources	$14,562,499	$13,326,003
Net Debt Service Outstanding	$1,021,925,169	$939,968,993
Capital Ratio [4]	160:1	143:1
Claims-Paying Ratio [5]	83:1	83:1

(1) At December 31, 2007 and December 31, 2006 the discount rate was 5.06% and 5.10%, respectively.

(2) The loss provision is calculated by applying 12% to the following items on an after-tax basis: deferred premium revenue; prepaid reinsurance premiums; and the present value of installment premiums.

(3) Includes net investment income and net realized gains or losses from the Insurance, Investment Management Services, and Corporate operations.

(4) Net debt service outstanding divided by the capital base.

(5) Net debt service outstanding divided by the sum of the capital base, unearned premium reserve (after-tax), present value of installment premiums (after-tax), lose and LAE reserves, and soft capital credit facilities.

Annual Financial and Statistical Data [1]
(dollars in millions except per share amounts)

	2007	2006	2005	2004	2003
GAAP Summary Income Statement Data					
Gross Premiums Written	$ 961	$ 885	$ 976	$ 1,110	$ 1,263
Premiums Earned	824	825	834	843	768
Net Investment Income	2,184	1,782	1,367	1,032	845
Net Gains (Losses) on Financial Instruments at Fair Value and Foreign Exchange	(3,405)	14	38	(3)	95
Revenues from Continuing Operations	(283)	2,703	2,296	2,047	1,875
Losses and LAE Incurred	900	81	84	85	77
Interest Expense	1,577	1,182	822	522	400
Expenses from Continuing Operations	2,783	1,570	1,279	876	713
Income From Continuing Operations Before Income Taxes	(3,066)	1,133	1,017	1,171	1,162
Income From Continuing Operations After Income Taxes	(1,922)	813	713	839	822
Net Income	(1,922)	819	711	843	825
Net Income Per Common Share:					
Basic	$ (15.17)	$ 6.17	$ 5.30	$ 5.94	$ 5.75
Diluted	$ (15.17)	$ 5.99	$ 5.18	$ 5.82	$ 5.69
GAAP Summary Balance Sheet Data					
Total Investments	$ 42,066	$ 37,077	$ 32,150	$ 30,614	$ 28,248
Total Assets	47,415	39,763	34,561	33,036	30,301
Deferred Premium Revenue	3,138	3,130	3,185	3,211	3,080
Loss and LAE Reserves	1,346	537	722	749	712
Investment Agreements	16,108	12,483	10,806	8,679	6,959
Commercial Paper	850	746	860	2,599	2,640
Medium-Term Notes	12,831	10,951	7,542	6,944	7,092
Long-Term Debt	1,225	1,215	1,206	1,327	1,016
Shareholders' Equity	3,656	7,204	6,592	6,559	6,150
Book Value Per Share	29.16	53.43	49.17	47.05	42.75
Dividends Declared Per Common Share	$ 1.360	$ 1.240	$ 1.120	$ 0.960	$ 0.800
Statutory Data					
Net Income	$ 171	$ 669	$ 633	$ 769	$ 669
Capital and Surplus	3,666	4,081	3,800	3,280	3,715
Contingency Reserve	2,719	2,478	2,769	2,705	2,368
Capital Base	6,385	6,559	6,569	5,985	6,083
Unearned Premium Reserve	3,763	3,507	3,508	3,391	3,067
Present Value of Installment Premiums	2,639	2,309	2,171	2,170	2,158
Premium Resources	6,402	5,816	5,679	5,561	5,225
Loss and LAE Reserves	926	101	318	272	200
Soft Capital Credit Facilities	850	850	850	1,100	1,236
Total Claims-Paying Resources	14,563	13,326	13,416	12,918	12,744
Financial Ratios					
GAAP					
Loss and LAE Ratio	105.2%	9.5%	9.7%	9.7%	9.9%
Underwriting Expense Ratio	23.4	26.0	24.0	21.0	22.0
Combined Ratio	128.6	35.5	33.8	30.7	31.9
Statutory					
Loss and LAE Ratio	114.2	12.6	25.5	17.1	9.2
Underwriting Expense Ratio	24.9	29.8	21.9	17.9	12.8
Combined Ratio	139.1	42.4	47.4	35.0	22.0
Other Financial Information					
Adjusted Book Value Per Share	$ 60.36	75.72	$ 70.62	$ 66.34	$ 59.84
Net Debt Service Outstanding	$ 1,021,925	939,969	$ 889,019	$ 890,222	$ 835,774
Net Par Amount Outstanding	$ 678,661	617,553	$ 585,003	$ 585,575	$ 541,026

[1] All periods presented exclude discontinued operations, where applicable.

Direct Par Value and Adjusted Direct Premiums [1] [2]
(dollars in millions)

	4th Quarter		Year-to-Date	
Global Public Finance	2007	2006	2007	2006
United States				
Par Value Insured	$16,948	$16,560	$54,997	$46,627
ADP	$147.6	$130.9	$406.7	$320.1
Non-United States				
Par Value Insured	365	3,089	6,424	7,162
ADP	2.7	125.0	190.4	258.8
Total Global Public Finance				
Par Value Insured	17,313	19,649	61,421	53,789
ADP	150.3	255.9	597.1	578.9
Global Structured Finance				
United States				
Par Value Insured	4,883	18,233	87,864	45,767
ADP	84.1	126.7	696.6	290.1
Non-United States				
Par Value Insured	1,593	8,998	18,601	21,955
ADP	28.0	38.6	203.2	161.8
Total Global Structured Finance				
Par Value Insured	6,476	27,231	106,465	67,722
ADP	112.1	165.3	899.8	451.9
United States				
Par Value Insured	21,831	34,793	142,861	92,394
ADP	231.7	257.6	1,103.3	610.2
Non-United States				
Par Value Insured	1,958	12,087	25,025	29,117
ADP	30.7	163.6	393.6	420.6
Grand Totals				
Par Value Insured	23,789	46,880	167,886	$121,511
ADP	$262.4	$421.2	$1,496.9	$1,030.8

Reconciliation of Adjusted Direct Premiums to Net Premiums Earned
(dollars in millions)

	4th Quarter		Year-to-Date	
	2007	2006	2007	2006
Adjusted direct premiums (1)	$262.4	$421.2	$1,496.9	$1,030.8
Adjusted assumed premiums	-	0.8	-	6.5
Adjusted gross premiums	262.4	422.0	1,496.9	1,037.3
Present value of estimated future installment premiums (2)	(161.4)	(305.3)	(1,104.8)	(686.6)
Gross upfront premiums written	101.0	116.7	392.1	350.7
Gross installment premiums written	166.5	158.4	606.8	571.3
Gross premiums written	267.5	275.1	998.9	922.0
Ceded premium written	(29.3)	(22.8)	(106.5)	(107.3)
Net premiums written	238.2	252.3	892.4	814.7
Change in unearned premium reserve (3)	(28.7)	(48.1)	(36.8)	37.9
Net premiums earned	$209.5	$204.2	$855.6	$852.6

(1) Adjusted direct premiums, a non-GAAP measure, represents upfront premiums and the estimated present value of current and future installment premiums for policies issued in the period.
(2) At December 31, 2007 the discount rate was 5.06% and at December 31, 2006 the discount rate was 5.10%.
(3) The change in the unearned premium reserve is the amount by which current period deferred premiums are greater than or less than previously deferred premiums that are now being amortized into earned premium.

Gross Premiums Written
(dollars in millions)

	4th Quarter		Year-to-Date	
Global Public Finance	2007	2006	2007	2006
United States				
Upfront	$ 99.9	$ 85.6	$ 341.5	$ 257.2
Installments	16.6	16.3	36.7	36.4
Total Gross Premiums	116.5	101.9	378.2	293.6
Non-United States				
Upfront	-	31.2	49.4	93.3
Installments	22.5	42.9	110.9	124.7
Total Gross Premiums	22.5	74.1	160.3	218.0
Total Global Public Finance				
Upfront	99.9	116.8	390.9	350.5
Installments	39.1	59.2	147.6	161.1
Total Gross Premiums	139.0	176.0	538.5	511.6
Global Structured Finance				
United States				
Upfront	1.0	-	1.2	0.3
Installments	89.1	65.5	302.0	262.1
Total Gross Premiums	90.1	65.5	303.2	262.4
Non-United States				
Upfront	-	-	-	-
Installments	38.4	33.6	157.2	148.0
Total Gross Premiums	38.4	33.6	157.2	148.0
Total Global Structured Finance				
Upfront	1.0	-	1.2	0.3
Installments	127.5	99.1	459.2	410.1
Total Gross Premiums	128.5	99.1	460.4	410.4
United States				
Upfront	100.9	85.6	342.7	257.5
Installments	105.7	81.8	338.7	298.5
Total Gross Premiums	206.6	167.4	681.4	556.0
Non-United States				
Upfront	-	31.2	49.4	93.3
Installments	60.9	76.5	268.1	272.7
Total Gross Premiums	60.9	107.7	317.5	366.0
Grand Totals				
Upfront	100.9	116.8	392.1	350.8
Installments	166.6	158.3	606.8	571.2
Total Gross Premiums	$ 267.5	$ 275.1	$ 998.9	$ 922.0

Debt Service and Premiums
(dollars in millions)

Debt Service (Principal and Interest)

	Insured			Net	Ending Net
	Gross	Ceded	Net	Retired	Outstanding
4th Qtr. 2007	$41,428	$3,410	$38,018	$24,668	$1,021,925
3rd	75,721	9,648	66,073	35,545	1,008,575
2nd	68,951	8,917	60,034	39,626	978,047
1st	53,890	2,060	51,830	34,160	957,639
4th Qtr. 2006	70,277	6,247	64,030	24,411	939,969
3rd	46,188	2,842	43,346	38,268	900,350
2nd	51,035	4,198	46,837	28,632	895,272
1st	20,847	1,279	19,568	31,520	877,067
YTD 2007	239,990	24,035	215,955	133,999	1,021,925
2006	188,347	14,566	173,781	122,831	939,969
2005	179,050	19,028	160,022	161,225	889,019
2004	155,334	4,627	150,707	96,259	890,222
2003	175,008	19,200	155,808	101,623	835,774
2002	198,624	36,643	161,981	102,800	781,589
2001	171,044	27,623	143,421	101,891	722,408
2000	157,821	30,969	126,852	81,857	680,878
1999	151,122	37,175	113,947	73,959	635,883
1998	183,547	40,400	143,147	60,988	595,895
1997	157,224	18,561	138,663	59,344	513,736
1996	129,715	14,605	115,110	39,868	434,417

Premiums (GAAP Basis)

	Written			Net	Ending Net
	Gross	Ceded (1)	Net (1)	Earned (1)	Unearned (2)
4th Qtr. 2007	$267.5	$29.3	$238.2	$209.5	$2,812.8
3rd	255.2	26.0	229.2	207.2	2,786.7
2nd	252.9	28.1	224.8	224.5	2,759.4
1st	223.3	23.1	200.2	214.4	2,753.4
4th Qtr. 2006	275.1	22.8	252.3	204.2	2,766.5
3rd	207.5	28.4	179.1	215.7	2,711.0
2nd	258.5	29.5	229.0	221.5	2,737.4
1st	180.9	26.6	154.3	211.2	2,721.9
YTD 2007	998.9	106.5	892.4	855.6	2,812.8
2006	922.0	107.3	814.7	852.6	2,766.5
2005	1,018.0	138.5	879.5	864.4	2,777.6
2004	1,151.1	171.9	979.2	870.8	2,776.2
2003	1,278.4	197.6	1,080.8	778.9	2,689.1
2002	951.9	150.0	801.9	618.5	2,376.5
2001	865.2	188.4	676.8	546.9	2,182.5
2000	687.4	153.4	534.0	464.8	2,055.6
1999	624.9	108.0	516.9	457.1	1,990.7
1998	677.1	117.9	559.2	428.7	1,932.6
1997	653.8	116.5	537.3	351.5	1,800.9
1996	535.3	70.0	465.3	294.0	1,618.8

(1) Includes the reversal of amounts ceded to Channel Re in proportion to MBIA's ownership interest, which is carried on an equity-method accounting basis.

(2) Equals deferred premium revenue less prepaid reinsurance premiums.

Net Debt Service Amortization
As of December 31, 2007
(dollars in millions)

	Scheduled Net Debt Service Amortization	Ending Net Debt Service Outstanding
4th Qtr. 2007		$ 1,021,925
1st Qtr. 2008	18,853	1,003,072
2nd Qtr. 2008	16,718	986,354
3rd Qtr. 2008	17,671	968,683
4th Qtr. 2008	16,549	952,134
2009	70,028	882,106
2010	62,028	820,078
2011	69,614	750,464
2012	63,797	686,667
2013-2017	248,330	438,337
2018-2022	175,809	262,528
2023-2027	115,800	146,728
2028 and thereafter	146,728	-
Total	$ 1,021,925	

Net Unearned Premium Amortization
and Estimated Future Installment Premiums
As of December 31, 2007
(dollars in millions)

	Net Unearned Premiums [1]	Net Unearned Premium Amortization		Expected Installments [2]	Total Premium Earnings [3]
		Upfront	Installments		
4th Qtr. 2007	$ 2,812.8				
1st Qtr. 2008	2,688.3	63.7	60.8	62.8	187.3
2nd Qtr. 2008	2,609.3	62.4	16.6	105.2	184.2
3rd Qtr. 2008	2,539.9	60.6	8.8	110.0	179.4
4th Qtr. 2008	2,473.8	59.4	6.7	109.3	175.4
2009	2,227.5	225.4	20.9	404.3	650.6
2010	2,003.1	207.3	17.1	361.3	585.7
2011	1,798.8	189.5	14.8	331.0	535.3
2012	1,613.1	173.1	12.6	291.7	477.4
2013-2017	1,014.9	555.7	42.5	719.7	1,317.9
2018-2022	527.4	450.7	36.8	430.4	917.9
2023-2027	247.3	256.6	23.5	312.9	593.0
2028 and thereafter	-	227.0	20.3	487.3	734.6
Total		$ 2,531.4	$ 281.4	$ 3,725.9	$ 6,538.7

(1) Equals deferred premium revenue less prepaid reinsurance premiums.

(2) Represents installment-based future undiscounted collections.

(3) Actual future premium earnings will differ from the current projection due to the addition of new business, changes in prepayment speeds, early terminations and refundings.

Premiums Earned Analysis
(dollars in thousands)

2007	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Full Year
Global Public Finance					
United States					
Upfront	$92,246	$93,432	$67,643	$71,570	$324,891
Installment	7,383	6,887	9,549	4,826	28,645
Total	99,629	100,319	77,192	76,396	353,536
Non-United States					
Upfront	10,070	9,034	9,087	8,738	36,929
Installment	18,394	19,338	20,916	20,891	79,539
Total	28,464	28,372	30,003	29,629	116,468
Total Global Public Finance					
Upfront	102,316	102,466	76,730	80,308	361,820
Installment	25,777	26,225	30,465	25,717	108,184
Total	128,093	128,691	107,195	106,025	470,004
Global Structured Finance					
United States					
Upfront	1,556	1,037	654	538	3,785
Installment	56,240	59,565	66,321	71,958	254,084
Total	57,796	60,602	66,975	72,496	257,869
Non-United States					
Upfront	1,997	900	833	769	4,499
Installment	26,540	34,275	32,239	30,198	123,252
Total	28,537	35,175	33,072	30,967	127,751
Total Global Structured Finance					
Upfront	3,553	1,937	1,487	1,307	8,284
Installment	82,780	93,840	98,560	102,156	377,336
Total	86,333	95,777	100,047	103,463	385,620
Grand Totals					
Upfront	105,869	104,403	78,217	81,615	370,104
Installment	108,557	120,065	129,025	127,873	485,520
Total	$214,426	$224,468	$207,242	$209,488	$855,624

2006	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Full Year
Global Public Finance					
United States					
Upfront	$84,336	$94,276	$95,193	$89,731	$363,536
Installment	6,286	6,266	6,615	6,789	25,956
Total	90,622	100,542	101,808	96,520	389,492
Non-United States					
Upfront	9,347	19,337	7,336	9,092	45,112
Installment	17,254	17,335	18,624	15,952	69,165
Total	26,601	36,672	25,960	25,044	114,277
Total Global Public Finance					
Upfront	93,683	113,613	102,529	98,823	408,648
Installment	23,540	23,601	25,239	22,741	95,121
Total	117,223	137,214	127,768	121,564	503,769
Global Structured Finance					
United States					
Upfront	1,447	1,653	1,067	1,369	5,536
Installment	56,024	53,985	57,133	53,416	220,558
Total	57,471	55,638	58,200	54,785	226,094
Non-United States					
Upfront	2,857	927	870	902	5,556
Installment	33,637	27,702	28,862	26,982	117,183
Total	36,494	28,629	29,732	27,884	122,739
Total Global Structured Finance					
Upfront	4,304	2,580	1,937	2,271	11,092
Installment	89,661	81,687	85,995	80,398	337,741
Total	93,965	84,267	87,932	82,669	348,833
Grand Totals					
Upfront	97,987	116,193	104,466	101,094	419,740
Installment	113,201	105,288	111,234	103,139	432,862
Total	$211,188	$221,481	$215,700	$204,233	$852,602

Effect of Refundings and Other Accelerations
(dollars in thousands except per share)

	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Full Year
2007					
Refunding Premiums Earned	$39,797	$45,935	$18,169	$16,917	$120,818
Net Income Effect (1)	23,824	27,499	10,877	10,117	72,317
Net Income Per Common Share Effect	$0.18	$0.21	$0.09	$0.08	$0.57
2006					
Refunding Premiums Earned	$38,184	$47,606	$42,215	$33,510	$161,515
Net Income Effect (1)	22,859	28,499	25,272	20,061	96,691
Net Income Per Common Share Effect	$0.17	$0.21	$0.18	$0.15	$0.71

(1) Net of deferred acquisition costs and taxes.

Investment Portfolio
As of December 31, 2007
(dollars in thousands)

Investments	Market Value	% of Market Value	Amortized Cost	Pre-tax Yield (2)	Annualized Income (3)
Fixed-Maturity Securities:					
Tax Exempt	$ 5,490,005	51%	$ 5,347,314	4.70%	$ 251,324
Taxable	3,826,354	36	3,716,915	5.45	202,572
Short-Term	1,353,581	13	1,353,581	4.79	64,672
Total Insurance Fixed Income	10,669,940	100%	$ 10,417,810	4.98%	$ 518,568
Other (1)	730,711				
	11,400,651				
Total Other Fixed Income (4)	25,611,019				
Investments Held-to-Maturity (5)	5,053,987				
Total Investments	$ 42,065,657				

Maturity	Market Value	% of Market Value
Within 1 Year	$ 1,353,581	12.7%
1 to 5 Years	3,455,075	32.4
5 to 10 Years	1,722,038	16.1
10 to 15 Years	825,628	7.7
15 to 20 Years	638,437	6.0
More than 20 Years	2,675,181	25.1
Total Insurance Fixed Income	$ 10,669,940	100.0%

Long-Term average maturity: 9.30 years
Duration: 5.20 years

Quality Distribution of Long-Term Fixed Income Investments	
Rating	% of Market Value
Aaa	65%
Aa	27
A	7
Baa	1
	100%

(1) Primarily equity investments.
(2) Estimated pre-tax yield on assets (based on amortized cost) at the end of the reporting quarter.
(3) Before taxes, if applicable, based on indicated yields.
(4) Includes Investment Agreement and Medium-Term Note portfolios.
(5) Represents Conduit and Variable Interest Entity investments at amortized cost.

Insurance Operations Net Investment Income
(dollars in thousands)

	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Full Year
2007					
Investment income	120,714	122,230	122,287	127,319	492,550
VIE and other investment income (1)	21,464	20,154	19,122	19,496	80,236
Net investment income	$ 142,178	$ 142,384	$ 141,409	$ 146,815	$ 572,786
2006					
Investment income	121,553	123,196	126,489	128,014	499,252
VIE and other investment income (1)	12,274	16,695	34,272	18,610	81,851
Net investment income	$ 133,827	$ 139,891	$ 160,761	$ 146,624	$ 581,103

(1) Includes investment income related to variable interest entities and assets received in connection with a remediation.

Return on Equity

Quarter Ended	Reported [1]	Operating [2]
December 31, 2007	-30.8%	1.9%
September 30	8.2%	11.8%
June 30	12.0%	12.0%
March 31	12.0%	12.2%
December 31, 2006	11.9%	12.1%
September 30	12.1%	12.6%
June 30	11.2%	12.4%
March 31	10.7%	12.4%
December 31, 2005	10.8%	12.5%
December 31, 2004	13.3%	13.4%
December 31, 2003	14.3%	13.7%

(1) Trailing twelve months of Net Income divided by average Shareholders' Equity
(2) Trailing twelve months of Operating Income divided by average Shareholders' Equity (excluding non-operating items). All periods presented exclude the results of discontinued operations.

Investment Management Services
Average Assets Under Management[1]
(dollars in thousands)

	Conduits		Other Assets Under Management		Total Assets Under Management	
	Quarter	Year-to-Date	Quarter	Year-to-Date	Quarter	Year-to-Date
December 31, 2007	$ 4,349,261	$ 4,277,289	$ 60,576,555	$ 61,807,354	$ 64,925,816	$ 66,084,643
September 30	4,592,382	4,253,299	62,543,845	62,217,624	67,136,227	66,470,923
June 30	4,129,690	4,083,758	62,773,841	62,054,512	66,903,531	66,138,270
March 31	4,037,825	4,037,825	61,335,183	61,335,183	65,373,008	65,373,008
December 31, 2006	3,831,317	3,863,602	57,446,556	52,123,358	61,277,873	55,986,960
September 30	3,707,714	3,874,364	52,491,398	50,349,442	56,199,112	54,223,806
June 30	3,782,249	3,957,689	50,435,560	49,275,800	54,217,809	53,233,489
March 31	4,133,129	4,133,129	48,116,040	48,116,040	52,249,169	52,249,169
December 31, 2005		5,665,435		43,508,483		49,173,918
December 31, 2004		6,904,694		37,408,105		44,312,799
December 31, 2003		8,760,814		32,675,546		41,436,360
December 31, 2002				29,441,386		29,441,386
December 31, 2001				27,166,925		27,166,925
December 31, 2000				22,289,303		22,289,303
December 31, 1999				18,297,254		18,297,254
December 31, 1998				15,740,664		15,740,664
December 31, 1997				12,326,177		12,326,177
December 31, 1996				10,238,784		10,238,784
December 31, 1995				4,782,308		4,782,308
December 31, 1994				3,094,391		3,094,391
December 31, 1993				1,182,125		1,182,125
December 31, 1992				630,803		630,803
December 31, 1991				166,437		166,437
January 17, 1991 (inception)						

(1) The Conduits were acquired in September 2003.

Insured Portfolio Losses and Mark-to-Market
(dollars in thousands)

2007	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Full Year
Loss and Loss Adjustment Expense (LAE) Reserves					
Beginning Unallocated Reserves	$ 213,319	$ 199,868	$ 203,224	$ 213,732	$ 213,319
Formula Provision [1]	20,484	20,968	22,203	23,108	86,763
Additional Loss and LAE Incurred[2]	-	-	-	813,582	813,582
Channel Re Elimination[3]	(213)	(267)	(273)	(298)	(1,051)
Case Activity	(33,722)	(17,345)	(11,422)	(615,581)	(678,070)
Ending Unallocated Reserves	199,868	203,224	213,732	434,543	434,543
Beginning Net Case Reserves	276,777	286,281	268,778	280,674	276,777
Case Activity	33,722	17,345	11,422	615,581	678,070
Net (Payments) Recoveries	(24,218)	(34,848)	474	(66,416)	(125,008)
Ending Net Case Reserves	286,281	268,778	280,674	829,839	829,839
Net Loss and LAE Reserves	486,149	472,002	494,406	1,264,382	1,264,382
Ceded Loss and LAE Reserves	47,625	48,078	50,673	82,041	82,041
Gross Loss and LAE Reserves	$ 533,774	$ 520,080	$ 545,079	$ 1,346,423	$ 1,346,423
Insured Derivatives Credit Impairment					
Beginning Net Derivatives Impairment Reserves	$ -	$ -	$ -	$ -	$ -
Credit Impairments [4]	-	-	-	200,000	200,000
Net (Payments) Recoveries	-	-	-	-	-
Ending Net Derivatives Impairment Reserves	-	-	-	200,000	200,000
Ceded Derivatives Impairment Reserves	-	-	-	47,654	47,654
Gross Derivatives Impairment Reserves	$ -	$ -	$ -	$ 247,654	$ 247,654
Total Insured Portfolio Losses					
Total Net Ending Reserves	$ 486,149	$ 472,002	$ 494,406	$ 1,464,382	$ 1,464,382
Total Ceded Ending Reserves	47,625	48,078	50,673	129,695	129,695
Total Gross Ending Reserves	$ 533,774	$ 520,080	$ 545,079	$ 1,594,077	$ 1,594,077

(1) Represents the Company's provision for losses calculated as 12% of scheduled net earned premium.
(2) Represents losses incurred for case basis and non-specific RMBS activity.
(3) Represents the amount of losses and LAE incurred that have been eliminated in proportion to MBIA's ownership interest, which is carried on an equity method accounting basis.
(4) Represents estimated impairments of insured credit default swap contracts.

2007	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Full Year
Insured Derivatives Mark-to-Market					
Beginning Net Derivative Asset/(Liability)	$ 3,240	$ 1,220	$ (13,074)	$ (355,184)	$ 3,240
Unrealized Loss	(2,020)	(14,294)	(342,110)	(3,169,833)	(3,528,257)
Credit Impairments [1]	-	-	-	(200,000)	(200,000)
Income Statement Mark-to-Market	(2,020)	(14,294)	(342,110)	(3,369,833)	(3,728,257)
Ending Net Derivative Asset/(Liability)	$ 1,220	$ (13,074)	$ (355,184)	$ (3,725,017)	$ (3,725,017)

(1) Represents estimated impairments of insured credit default swap contracts.

Insured Portfolio Losses and Mark-to-Market
(dollars in thousands)

2006	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Full Year
Loss and Loss Adjustment Expense (LAE) Reserves					
Beginning Unallocated Reserves	$ 208,614	$ 217,885	$ 256,548	$ 259,371	$ 208,614
Formula Provision [1]	20,126	20,295	20,414	20,054	80,889
Additional Loss and LAE Incurred	-	-	-	-	-
Channel Re Elimination [2]	(205)	(363)	(321)	(290)	(1,179)
Case Activity	(10,650)	18,731	(17,270)	(65,816)	(75,005)
Ending Unallocated Reserves	217,885	256,548	259,371	213,319	213,319
Beginning Net Case Reserves	453,923	453,143	407,273	419,256	453,923
Case Activity	10,650	(18,731) [3]	17,270	65,816	75,005
Net (Payments) Recoveries	(11,430)	(27,139)	(5,287)	(208,295) [4]	(252,151)
Ending Net Case Reserves	453,143	407,273	419,256	276,777	276,777
Net Loss and LAE Reserves	671,028	663,821	678,627	490,096	490,096
Ceded Loss and LAE Reserves	59,324	44,472	47,002	46,941	46,941
Gross Loss and LAE Reserves	$ 730,352	$ 708,293	$ 725,629	$ 537,037	$ 537,037
Insured Derivatives Credit Impairment					
Beginning Net Derivatives Impairment Reserves	$ -	$ -	$ -	$ -	$ -
Credit Impairments [5]	-	-	-	-	-
Net (Payments) Recoveries	-	-	-	-	-
Ending Net Derivatives Impairment Reserves	-	-	-	-	-
Ceded Derivatives Impairment Reserves	-	-	-	-	-
Gross Derivatives Impairment Reserves	$ -	$ -	$ -	$ -	$ -
Total Insured Portfolio Losses					
Total Net Ending Reserves	$ 671,028	$ 663,821	$ 678,627	$ 490,096	$ 490,096
Total Ceded Ending Reserves	59,324	44,472	47,002	46,941	46,941
Total Gross Ending Reserves	$ 730,352	$ 708,293	$ 725,629	$ 537,037	$ 537,037

(1) Represents the Company's provision for losses calculated as 12% of scheduled net earned premium.
(2) Represents the amount of losses and LAE incurred that have been eliminated in proportion to MBIA's ownership interest, which is carried on an equity method accounting basis.
(3) Includes a reduction of case reserves related to Northwest Airlines.
(4) Includes payments related to insured notes backed by tax liens originated by Capital Asset and a CDO transaction for which reserves were previously established.
(5) Represents estimated impairments of insured credit default swap contracts.

2006	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Full Year
Insured Derivatives Mark-to-Market					
Beginning Net Derivative Asset/(Liability)	$ 8,216	$ 12,255	$ 9,364	$ 3,253	$ 8,216
Unrealized Gain/(Loss)	4,039	(2,891)	(6,111)	(13)	(4,976)
Credit Impairments [1]	-	-	-	-	-
Income Statement Mark-to-Market	4,039	(2,891)	(6,111)	(13)	(4,976)
Ending Net Derivative Asset/(Liability)	$ 12,255	$ 9,364	$ 3,253	$ 3,240	$ 3,240

(1) Represents estimated impairments of insured credit default swap contracts.

Insurance Expense Analysis
(dollars in thousands)

2007	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Full Year
Compensation	$ 39,898	$ 39,674	$ 36,123	$ 38,081	$ 153,776
Fees and Professional Services	5,269	4,309	5,936	8,177	23,691
Building and Equipment	5,689	5,857	5,925	5,941	23,412
Loss Prevention Expenses	1,158	1,147	(127)	376	2,554
Premium Taxes	3,027	5,457	5,956	5,050	19,490
Other	6,117	6,449	5,614	6,925	25,105
Gross Insurance Expenses	61,158	62,893	59,427	64,550	248,028
Ceding Commissions (Received)	(5,596)	(6,805)	(6,121)	(7,279)	(25,801)
Net Insurance Expenses	55,562	56,088	53,306	57,271	222,227
Deferred Acquisition Costs	(22,993)	(21,045)	(22,789)	(22,141)	(88,968)
Operating Expenses	$ 32,569	$ 35,043	$ 30,517	$ 35,130	$ 133,259

2006	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Full Year
Compensation	$ 36,665	$ 40,568	$ 39,593	$ 49,414	$ 166,240
Fees and Professional Services	5,810	5,033	4,441	5,985	21,269
Building and Equipment	6,165	6,475	6,149	6,503	25,292
Loss Prevention Expenses	2,954	1,078	3,759	5,064	12,855
Premium Taxes	3,752	4,021	4,021	4,967	16,761
Other	6,486	6,597	5,438	7,416	25,937
Gross Insurance Expenses	61,832	63,772	63,401	79,349	268,354
Ceding Commissions (Received)	(6,503)	(7,018)	(5,911)	(5,506)	(24,938)
Net Insurance Expenses	55,329	56,754	57,490	73,843	243,416
Deferred Acquisition Costs	(18,789)	(21,070)	(20,146)	(27,548)	(87,553)
Operating Expenses	$ 36,540	$ 35,684	$ 37,344	$ 46,295	$ 155,863

Deferred Expenses to Deferred Premiums Ratio
(dollars in thousands)

	2004	2005	2006	2007
Deferred Acquisition Costs	$ 406,035	$ 427,111	$ 449,556	$ 472,516
Deferred Premium Revenue	3,211,181	3,185,200	3,129,620	3,138,396
Prepaid Reinsurance Premiums	(434,968)	(407,614)	(363,140)	(325,555)
Present Value of Future Installment Premiums	2,170,189	2,171,064	2,309,433	2,638,669
Adjusted Deferred Premiums	$ 4,946,402	$ 4,948,650	$ 5,075,913	$ 5,451,510
Ratio	8.2%	8.6%	8.9%	8.7%

Schedule of Outstanding Stock Options

Year of Expiration	Outstanding as of 9/30/07	Granted	Exercised	Cancelled	Outstanding as of 12/31/07	Exercisable as of 12/31/07 Number	Exercisable as of 12/31/07 Average Price
Executive Officers [1]							
2007	22,707	-	-	22,707	-	-	-
2008	155,595	64,525	-	-	220,120	220,120	39.30
2009	662,392	-	-	-	662,392	662,392	41.49
2010	83,415	-	-	-	83,415	83,415	37.31
2011	205,000	-	-	-	205,000	205,000	45.19
2012	314,400	-	-	-	314,400	314,400	52.04
2013	299,500	-	-	-	299,500	279,600	36.69
2014	536,000	-	-	-	536,000	67,800	64.64
2015	522,000	-	-	-	522,000	80,800	58.84
2016	37,500	-	-	-	37,500	-	-
2017	20,000	-	-	-	20,000	-	-
Total	2,858,509	64,525	-	22,707	2,900,327	1,913,527	$ 44.04
Others							
2007	273,951	-	13,870	260,081	-	-	-
2008	48,372	-	-	-	48,372	48,372	43.29
2009	1,745,535	-	1,545	-	1,743,990	1,721,990	42.93
2010	141,051	-	2,355	-	138,696	138,696	47.97
2011	414,500	-	-	-	414,500	414,500	45.51
2012	1,058,225	-	16,450	1,500	1,040,275	1,040,275	46.15
2013	181,449	-	3,900	1,000	176,549	146,579	37.62
2014	197,550	-	2,063	7,135	188,352	133,128	64.39
2015	85,500	-	-	3,300	82,200	30,600	58.84
2016	-	-	-	-	-	-	-
2017	17,800	-	-	-	17,800	-	-
Total	4,163,933	-	40,183	273,016	3,850,734	3,674,140	$ 45.03
Total							
2007	296,658	-	13,870	282,788	-	-	-
2008	203,967	64,525	-	-	268,492	268,492	40.02
2009	2,407,927	-	1,545	-	2,406,382	2,384,382	42.49
2010	224,466	-	2,355	-	222,111	222,111	43.97
2011	619,500	-	-	-	619,500	619,500	45.40
2012	1,372,625	-	16,450	1,500	1,354,675	1,354,675	47.52
2013	480,949	-	3,900	1,000	476,049	426,179	37.03
2014	733,550	-	2,063	7,135	724,352	200,928	64.48
2015	607,500	-	-	3,300	604,200	111,400	58.84
2016	37,500	-	-	-	37,500	-	-
2017	37,800	-	-	-	37,800	-	-
Total	7,022,442	64,525	40,183	295,723	6,751,061	5,587,667	$ 44.69

(1) Executive officers of the Company may exercise stock options under the Company's net settlement procedure. Under this procedure, executive officers purchase the underlying stock, net of shares necessary to pay the option exercise price and meet tax withholding requirements, in order to increase their ownership position in MBIA.

Insured Portfolio Profile By Geographic Distribution
Par Value
(dollars in millions)

	Insured in 2007				Outstanding as of December 31, 2007 (1) (2)			
	Gross Amount	%	Net Amount	%	Gross Amount	%	Net Amount	%
United States								
California	$10,685	6.4%	$10,363	7.0%	$76,420	10.0%	$71,472	10.5%
New York	3,803	2.3	3,716	2.5	43,140	5.7	40,028	5.9
Florida	6,092	3.6	6,028	4.1	31,554	4.1	30,131	4.4
Texas	3,552	2.1	3,552	2.4	24,163	3.2	22,745	3.4
Illinois	2,154	1.3	2,139	1.4	20,169	2.6	18,917	2.8
New Jersey	1,329	0.8	1,329	0.9	19,732	2.6	18,393	2.7
Washington	1,205	0.7	1,204	0.8	13,682	1.8	13,028	1.9
Pennsylvania	829	0.5	829	0.6	13,210	1.7	12,468	1.8
Massachusetts	587	0.3	587	0.4	14,053	1.8	12,366	1.8
Michigan	1,497	0.9	1,462	1.0	13,132	1.7	12,273	1.8
Subtotal	31,733	18.9	31,209	21.1	269,255	35.2	251,821	37.0
Other States & Territories	21,395	12.8	21,018	14.2	163,634	21.6	153,876	22.8
Nationally Diversified	89,733	53.4	75,666	51.1	182,538	23.9	155,490	22.9
Total United States	142,861	85.1	127,893	86.4	615,427	80.7	561,187	82.7
Non-United States								
United Kingdom	2,606	1.6	2,396	1.6	31,264	4.1	26,269	3.9
Germany	2,451	1.5	1,820	1.2	13,556	1.8	11,366	1.7
Australia	2,023	1.2	1,914	1.3	9,667	1.3	7,485	1.1
France	1,787	1.1	1,429	1.0	3,461	0.5	3,070	0.5
Chile	-	-	-	-	3,131	0.4	2,091	0.3
Mexico	1,267	0.7	960	0.6	2,502	0.3	1,964	0.3
Turkey	200	0.1	140	0.1	2,657	0.3	1,864	0.3
Spain	142	0.1	133	0.1	2,358	0.3	1,734	0.3
Italy	-	-	-	-	1,812	0.2	1,720	0.3
Portugal	-	-	-	-	1,864	0.2	1,678	0.2
Subtotal	10,476	6.3	8,792	5.9	72,272	9.4	59,241	8.9
Other (3)	575	0.3	491	0.4	8,526	1.2	6,889	0.8
Internationally Diversified	13,974	8.3	10,870	7.3	66,221	8.7	51,344	7.6
Total Non-United States	25,025	14.9	20,153	13.6	147,019	19.3	117,474	17.3
Total	$167,886	100.0%	$148,046	100.0%	$762,446	100.0%	$678,661	100.0%

(1) Net of refunded issues, reinsurance and other contractual agreements.
(2) Excludes $25.5 billion relating to investment agreements and medium term notes issued by affiliates of MBIA Asset Management and guaranteed by MBIA Insurance Corporation.
(3) Includes some domestic risk denominated in other than U.S.dollars.

Insured Portfolio Profile By Bond Type
Par Value
(dollars in millions)

	Insured in 2007				Outstanding as of December 31, 2007 (1) (2)			
	Gross Amount	%	Net Amount	%	Gross Amount	%	Net Amount	%
Public Finance: United States								
General Obligation	$ 21,008	12.5%	$ 20,742	14.0%	$ 178,333	23.4%	$ 170,824	25.2%
Municipal Utilities	10,300	6.1	10,139	6.8	80,022	10.5	74,872	11.0
Special Revenue	116	0.1	116	0.1	2,952	0.3	2,807	0.4
Tax-Backed	7,697	4.6	7,622	5.1	50,104	6.6	47,310	7.0
Transportation	3,837	2.3	3,706	2.5	37,325	4.9	32,632	4.8
Health Care	2,641	1.6	2,490	1.7	30,349	4.0	26,137	3.9
Higher Education	4,997	3.0	4,947	3.3	25,682	3.4	24,803	3.6
Municipal Housing	580	0.3	580	0.4	9,644	1.3	9,225	1.4
Military Housing	3,210	1.9	3,118	2.1	8,415	1.1	8,092	1.2
Investor Owned Utilities (3)	611	0.4	611	0.5	8,463	1.1	7,663	1.1
Total United States	54,997	32.8	54,071	36.5	431,289	56.8	404,365	59.6
Public Finance: Non-United States								
Sovereign	1,356	0.8	933	0.5	15,822	2.1	13,029	1.9
Transportation	1,787	1.1	1,429	1.0	13,766	1.8	10,214	1.5
Utilities	534	0.3	525	0.4	7,869	1.0	5,820	0.9
Investor Owned Utilities	2,747	1.6	2,626	1.8	7,399	1.0	6,494	1.0
Sub-Sovereign	-	-	-	-	1,133	0.1	703	0.1
Municipal Housing	-	-	-	-	187	-	173	-
Health Care	-	-	-	-	92	-	43	-
Higher Education	-	-	-	-	59	-	55	-
Total Non-United States	6,424	3.8	5,513	3.7	46,327	6.0	36,531	5.4
Total Global Public Finance	61,421	36.6	59,584	40.2	477,616	62.6	440,896	65.0
Structured Finance - United States								
Collateralized Debt Obligations (4)	60,479	36.0	48,640	32.9	101,202	13.3	82,772	12.2
Mortgage Backed Residential	12,286	7.3	11,582	7.8	30,221	4.0	28,209	4.1
Mortgage Backed Commercial	-	-	-	-	1,383	0.2	1,297	0.2
Consumer Asset Backed:								
Auto Loans	5,608	3.3	5,116	3.5	10,783	1.4	9,803	1.4
Student Loans	256	0.1	193	0.1	6,322	0.8	5,885	0.9
Manufactured Housing	-	-	-	-	2,144	0.3	1,898	0.3
Other Consumer Asset Backed	1,105	0.7	873	0.6	3,301	0.4	2,713	0.4
Corporate Asset Backed:								
Operating Assets:								
Aircraft Portfolio Lease Securitizations	100	0.1	100	0.1	2,808	0.4	2,552	0.4
Rental Car Fleets	-	-	-	-	5,212	0.7	4,236	0.6
Secured Airline Equip Securitization (EETC)	-	-	-	-	3,884	0.5	2,729	0.4
Other Operating Assets	1,718	1.0	1,580	1.1	2,098	0.3	1,932	0.3
Structured Insurance Securitizations	2,805	1.7	2,344	1.5	6,061	0.8	4,765	0.7
Franchise Assets	-	-	-	-	2,373	0.3	2,082	0.3
Intellectual Property	2,913	1.7	2,811	1.9	2,268	0.3	2,176	0.3
Other Corporate Asset Backed	594	0.4	582	0.4	4,078	0.5	3,773	0.6
Total United States	87,864	52.3	73,821	49.9	184,138	24.2	156,822	23.1
Structured Finance - Non-United States								
Collateralized Debt Obligations (4)	11,927	7.1	9,432	6.4	61,525	8.1	47,803	7.0
Mortgage Backed Residential	659	0.4	659	0.4	16,890	2.2	15,197	2.2
Mortgage Backed Commercial	2,056	1.2	1,447	1.0	6,390	0.8	5,242	0.8
Consumer Asset Backed:								
Auto Loans	-	-	-	-	377	-	354	0.1
Other Consumer Asset Backed	-	-	-	-	1,193	0.2	752	0.1
Corporate Asset Backed:								
Operating Assets:								
Aircraft Portfolio Lease Securitizations	1,660	1.0	1,268	0.9	2,807	0.4	2,024	0.3
Secured Airline Equip Securitization	-	-	-	-	379	-	375	0.1
Other Operating Assets	-	-	-	-	743	0.1	688	0.1
Structured Insurance Securitizations	100	0.1	100	0.1	100	-	100	-
Franchise Assets	-	-	-	-	1,379	0.2	1,305	0.2
Intellectual Property	-	-	-	-	861	0.1	743	0.1
Future Flow	650	0.4	488	0.3	4,069	0.5	2,890	0.4
Other Corporate Asset Backed	1,549	0.8	1,247	0.8	4,359	0.6	3,470	0.5
Total Non-United States	18,601	11.0	14,641	9.9	100,692	13.2	80,943	11.9
Total Global Structured Finance	106,465	63.4	88,462	59.8	284,830	37.4	237,765	35.0
Total	$ 167,886	100.0%	$ 148,046	100.0%	$ 762,446	100.0%	$ 678,661	100.0%

(1) Net of refunded issues, reinsurance and other contractual agreements.

(2) Excludes $25.5 billion relating to investment agreements and medium term notes issued by affiliates of MBIA Asset Management and guaranteed by MBIA Insurance Corporation.

(3) Includes Investor-Owned Utilities, Industrial Development and Pollution Control Revenue bonds.

(4) Includes transactions (represented by structured pools of primarily investment grade corporate credit risks or commercial real estate assets) that do not include typical CDO structuring characteristics, such as tranched credit risk, cash flow waterfalls, or interest and over-collateralization coverage tests.

MBIA's CDO Exposure [4]
As of December 31, 2007
(dollars in billions)

Underlying Ratings [1] [2] [3]

Net Par Written: January 2007 – December 2007			Total CDO Portfolio	Net Par Outstanding	% of Total
AAA	$ 51.0	88%	AAA	$ 113.6	87%
AA	$ 3.4	6%	AA	9.6	7%
A	$ 1.2	2%	A	2.3	2%
BBB	$ 1.2	2%	BBB	1.2	1%
BIG	$ 1.5	3%	BIG	3.9	3%
	$ 58.2	100%		$ 130.6	100%
94% Rated AA or better			AA or Better	94%	
			A or Better	96%	

Underlying Asset Types - Net Par Outstanding [2] [3]

Collateral Type

	Total		Fiancial Guaranty Insurance Policy		Insured Credit Default Swap	
	Net par	% of Total	Net par	% of Total	Net par	% of Total
Investment Grade	$ 43.2	33%	$ 1.5	11%	$ 41.6	35%
High Yield	13.9	11%	5.1	38%	8.8	8%
Multi-Sector	30.1	23%	3.6	27%	26.5	23%
CMBS	43.2	33%	3.1	23%	40.2	34%
Emerging Market	0.2	0%	-	0%	0.2	0%
Total	$ 130.6	100%	$ 13.3	100%	$ 117.3	100%

Insured Credit Default Swap

Managed Pools	56%
Static Pools	44%

Net Par by Vintage [2] [3]

Year	Written Amount	Written %	Outstanding Amount	Outstanding %	Average Quality Range At Origination
1996	$ 0.9	0%	$ 0.1	0%	Baa1-Baa2
1997	1.3	1%	-	0%	Baa2-Baa3
1998	6.8	3%	0.3	0%	A3
1999	2.7	1%	0.2	0%	Aa2
2000	16.4	8%	1.1	1%	Aa1
2001	13.9	7%	2.7	2%	Aaa-Aa1
2002	29.1	14%	5.4	4%	Aaa-Aa1
2003	13.7	7%	3.3	3%	Aaa-Aa2
2004	15.1	7%	12.4	9%	Aaa-Aa2
2005	15.0	7%	14.7	11%	Aaa-Aa2
2006	32.2	16%	32.9	25%	Aaa-Aa3
2007	58.2	28%	57.5	44%	Aaa
	$ 205.3	100%	$ 130.6	100%	

(1) All ratings are current. Ratings are derived using the most conservative rating from Moody's, S&P or MBIA.
(2) May not agree to the CDO par written in the Insured Portfolio Profile as only current transactions written are reported in this addendum.
(3) Net Par Outstanding includes only drawn amounts. It may not reflect entire insured amount of revolving transactions
(4) includes transactions (represented by structured pools of primarily investment grade corporate credit risks or commercial real estate assets) that do not include typical CDO structuring characteristics, such as tranched credit risk, cash flow waterfalls, or interest and over-collateralization coverage tests

Insured Portfolio - 25 Largest Public Finance Credits
Net Par Outstanding as of December 31, 2007
(dollars in millions)

	Obligor Name	Country	MBIA Rating [1]	Net Par Outstanding
1	California General Obligation	USA	a1	$ 3,735
2	New York City General Obligation	USA	aa3	2,680
3	Illinois General Obligation	USA	aa3	2,282
4	Massachusetts General Obligation	USA	aa3	2,250
5	Puerto Rico General Obligation	USA	bbb2	2,247
6	Sydney Airport Corporation Limited	AUS	bbb2	2,143
7	Citizens Property Insurance Corp	USA	a3	2,093
8	Southern Water Services Limited	GBR	a3	1,957
9	Long Island Power Authority Electric	USA	a3	1,919
10	State of Washington General Obligation	USA	aa2	1,906
11	Wisconsin General Obligation	USA	aa3	1,851
12	New York City Water	USA	aa3	1,807
13	Connecticut General Obligation	USA	aa3	1,744
14	Chicago O'Hare General Airport	USA	a2	1,678
15	Los Angeles Unified School District General Obligation	USA	aa3	1,630
16	New York State Lease	USA	a2	1,618
17	State of California Economic Recovery Bonds	USA	aa3	1,582
18	New Jersey Transportation Trust Fund Authority	USA	aa3	1,573
19	The Port Authority of New York and New Jersey	USA	a1	1,553
20	Pennsylvania General Obligation	USA	aa3	1,462
21	Chicago General Obligation	USA	a1	1,444
22	Puerto Rico Electric Power Authority	USA	a3	1,436
23	Higher Education Student Assistance Authority	USA	a1	1,425
24	New Jersey Economic Development Authority State Pension Obligation Lease	USA	aa2	1,385
25	Florida State General Obligation	USA	aa1	1,375
		Total		$ 46,775
		Total Portfolio Exposure		$ 678,661
		% of Total Portfolio		6.9%

Insured Portfolio - 25 Largest Structured Finance Credits
Net Par Outstanding as of December 31, 2007
(dollars in millions)

	Obligor Name	Country	MBIA Rating [1]	Net Par Outstanding
1	Prime UK Residential Mortgage Super Senior Credit Default Swap	GBR	aaa	$ 3,397
2	Global Super Senior Managed Synthetic CDO	GLB	aaa	2,651
3	Global Super Senior Credit Default Swap Synthetic CLO	GLB	aaa	2,579
4	Static Cash CRE CDO	USA	aaa	2,428
5	Super Senior Credit Default Swap Synthetic CLO	DEU	aaa	2,316
6	Super Senior Static Synthetic CRE CDO	USA	aaa	2,291
7	Regent Street Finance Ltd	GLB	aaa	2,236
8	Menton CDO IV	USA	aaa	2,160
9	Super Senior Synthetic Pooled CMBS	USA	aaa	2,075
10	Global Super Senior Managed Synthetic CLO	GLB	aaa	2,050
11	Prime UK Residential Mortgage Super Senior Credit Default Swap	GBR	aaa	1,988
12	Hertz Vehicle Financing LLC	USA	bbb2	1,841
13	Prime UK Residential Mortgage Super Senior Credit Default Swap	GBR	aaa	1,815
14	Global Super Senior Managed Synthetic CDO	GLB	aaa	1,791
15	Newbury Street CDO Ltd	USA	aaa	1,684
16	Private Synthetic Pooled CMBS Transaction	USA	aaa	1,645
17	Global Super Senior Managed Synthetic CDO	GLB	aaa	1,645
18	Static Cash CRE CDO	USA	aaa	1,640
19	German Multifamily Housing Synthetic CDS	DEU	aaa	1,619
20	Super Senior Static Synthetic CRE CDO	USA	aaa	1,554
21	German Residential Mortgage Synthetic CDS	DEU	aaa	1,551
22	Global Super Senior Managed Synthetic CDO	GLB	aaa	1,547
23	Super Senior Credit Default Swap Investment Grade Corporate Synthetic CDO	GLB	aaa	1,491
24	Global Super Senior Synthetic CDO	GLB	aaa	1,473
25	Capital One Auto Finance Trust 2007-B	USA	bbb2	1,458
		Total		$ 48,925
		Total Portfolio Exposure		$ 678,661
		% of Total Portfolio		7.2%

(1) Internal MBIA credit ratings contained in this Operating Supplement are provided solely to indicate the underlying credit quality of guaranteed obligations based on the view of MBIA Insurance Corporation. They are subject to revision at anytime and do not constitute investment advice. MBIA ratings symbology has a one-to-one correspondence to the ratings symbologies used by S&P and Moody's (e.g. aa3 = AA- = Aa3, bbb2 = BBB = Baa2, etc.).

Top 15 Structured Finance Servicer Exposures [1]

as of September 30, 2007
(dollars in millions)

	Servicer Name [2]	Net Par Outstanding
1	Countrywide Financial Corporation	$ 14,194
2	Residential Capital Corp.	6,769
3	Capital One Financial Corporation	4,699
4	Wells Fargo & Company	2,739
5	AmeriCredit Corporation	2,425
6	Commerzbank, AG	1,966
7	Hertz Corporation, The	1,863
8	GreenTree/Fortress	1,851
9	Vanguard Car Rental USA Inc.	1,582
10	AerCap Ireland Limited	1,508
11	NELnet Inc.	1,476
12	KeyCorp	1,464
13	HSBC Holdings P.L.C.	1,452
14	Avis Budget Group, Inc.	1,350
15	IndyMac Bancorp, Inc.	1,314
	Total	$ 46,652

(1) Excludes servicers where all of the exposure is subject to confidentiality agreements.

(2) Servicer may be an operating subsidiary of the named entity.

Summary of Top 10 Below Investment Grade (BIG) Credits [1] [2] [3]

as of December 31, 2007
(dollars in millions)

	Obligor Name	Below Investment Grade (BIG) Exposure (Net)
1	ARG Funding Corporation Vanguard Car Rental 2005-1	$ 1,216
2	Orkney Holdings LLC	600
3	Cendant Rental Car Funding (AESOP) LLC	572
4	Sagittarius CDO I Ltd.	468
5	San Joaquin Hills Transportation Corridor Agency Toll Road	423
6	Hertz Vehicle Financing LLC	220
7	GreenPoint Savings Bank 1999-3 A1-A7	217
8	GreenPoint Credit Corporation 1998-1 IA & IIA	216
9	US Airways Inc. Pass-Through Trust 2000-2G	215
10	New Orleans City GO	214
	Total	$ 4,361
	Total BIG Exposure	$ 9,236
	Total MBIA Net Par Outstanding	$ 678,661
	Top 10 as % of MBIA Net Par Outstanding	**0.6%**
	Total BIG as % of MBIA Net Par Outstanding	**1.4%**
	Total BIG Exposure **by MBIA rating** as % of MBIA Net Par Outstanding [4]	**2.1%**

(1) All ratings are current. Ratings are derived using the S&P Priority Method. If credits are not rated by S&P, a Moody's equivalent rating is used. If credits are not rated by either agency, an MBIA equivalent rating is used.

(2) Amounts may not match other exposure data, as only the BIG portion of a credit's total exposure is shown here.

(3) During the 4th quarter, AHERF Delaware Valley Obligated Group was removed from the Top 10 list and Sagittarius CDO I Ltd. was added.

(4) MBIA's BIG net par exposure includes $10.6 billion of home equity lines of credit and closed-end second RMBS and diversified (multi-sector) CDOs of high grade CDOs that MBIA added to its Classified List at year-end 2007, which were not rated BIG under the S&P priority basis as of December 31, 2007.

Credit Quality Distribution [1]
as of December 31, 2007
(dollars in millions)

	Net Par Insured in 2007 [2]		Net Par Outstanding	
	Amount	%	Amount	%
Global Public Finance				
United States				
AAA	776	1.4%	$ 10,066	2.5%
AA	24,184	44.8%	171,034	42.3%
A	24,359	45.2%	169,731	42.0%
BBB	4,520	8.4%	50,270	12.4%
<BBB	108	0.2%	3,264	0.8%
Total	$ 53,947	100.0%	$ 404,365	100.0%
Non-United States				
AAA	$ 365	6.6%	$ 1,639	4.5%
AA	0	0.0%	4,834	13.2%
A	2,701	48.4%	13,114	35.9%
BBB	2,509	45.0%	16,824	46.1%
<BBB	0	0.0%	120	0.3%
Total	$ 5,575	100.0%	$ 36,531	100.0%
Global Structured Finance				
United States				
AAA	$ 49,312	66.4%	$ 88,354	56.3%
AA	2,815	3.8%	10,784	6.9%
A	3,562	4.8%	13,901	8.9%
BBB	18,079	24.4%	37,982	24.2%
<BBB	473	0.6%	5,801	3.7%
Total	$ 74,241	100.0%	$ 156,822	100.0%
Non-United States				
AAA	$ 11,665	79.0%	$ 67,221	83.0%
AA	650	4.4%	2,651	3.3%
A	1,254	8.5%	6,622	8.2%
BBB	1,192	8.1%	4,397	5.4%
<BBB	0	0.0%	52	0.1%
Total	$ 14,761	100.0%	$ 80,943	100.0%
Grand Totals				
AAA	$ 62,118	41.8%	$ 167,280	24.6%
AA	27,648	18.6%	189,304	27.9%
A	31,876	21.5%	203,368	30.0%
BBB	26,300	17.7%	109,473	16.1%
<BBB	581	0.4%	9,236	1.4%
Total	$ 148,523	100.0%	$ 678,661	100.0%

[1] All ratings are current. Ratings are derived using the S&P Priority Method. If credits are not rated by S&P, a Moody's equivalent rating is used. If credits are not rated by either agency, an MBIA equivalent rating is used.

[2] May not agree to the par amounts on the Insured Portfolio Profile by Bond Type and by Geographic Distribution exhibits since only transactions in the current period are reported in this exhibit.

Glossary

Adjusted Book Value (ABV)	ABV, a non-GAAP measure, is a measure of the value of the Company adjusted for items that are expected to impact stockholders' equity in future periods. ABV comprises GAAP book value plus the after-tax effects of deferred premium revenue less prepaid reinsurance premiums and deferred acquisition costs, the present value of installment premiums, the present value of the net spread of asset/liability products and a provision for loss and loss adjustment expenses. The Company believes the presentation of ABV provides additional information that gives a comprehensive measure of the value of the Company. Since the Company expects these items to affect future results and, in general, they do not require any additional future performance obligation on the Company's part, ABV provides an indication of the Company's value in the absence of any new business activity. ABV is not a substitute for GAAP book value but does provide investors with additional information when viewed in conjunction with GAAP book value.
ABV Loss Provision Adjustment	The loss provision adjustment included in the calculation of ABV is calculated by applying 12% to the following items on an after-tax basis: deferred premium revenue; prepaid reinsurance premiums; and the present value of installment premiums.
Adjusted Direct Premiums (ADP)	This is a non-GAAP measure, which includes both upfront premiums written and the present value of estimated installment premiums for new business written in the period and excludes premiums assumed or ceded.
Aircraft Portfolio Lease Securitization	Transactions secured by operating leases on fleets of commercial aircraft. The leases generally are diversified pools of international airlines. MBIA has the right to liquidate or re-lease the aircraft upon an Event of Default.
Amortized Cost	The purchase price of a fixed-maturity security, net of any discount received or premium paid. Amortized cost is adjusted each reporting period to reflect the repayment of principal (par) by the issuer of a security and the accretion of a discount or the amortization of a premium.
Below Investment Grade (BIG)	Any security rated below BBB- by Fitch and S&P or Baa3 by Moody's.
Capital Ratio	Net debt service outstanding divided by the capital base.
Collateralized Debt Obligations (CDO)	A debt instrument that is secured (collateralized) by a pool of other securities, typically loans and bonds. CDOs can include all types of loans and bonds, including high-yield bonds, emerging market bonds, asset-backed transactions and middle-market bank loans. Collateralized Bond Obligations (CBOs), Collateralized Loan Obligations (CLOs), and Collateralized Mortgage Obligations (CMOs) are types of CDOs.
CDO Emerging Market	Collateralized Debt Obligation that contains countries that are not members of the Organization for Economic Co-operation and Development (OECD).
CDO^2	Collateralized Debt Obligations (CDOs) where underlying collateral comprises tranches issued by other Collateralized Debt Obligations (CDOs).
CDO- Commercial Mortgage Backed Securities (CMBS)	Collateralized Debt Obligation (CDO) containing commercial mortgage securities that represent mortgage loans for non-residential properties such as office buildings, retail stores, etc.

CDO-High Yield (corporate)	High Yield Corporate Collateralized Debt Obligations (CDOs) are transactions that contain high yield, usually non-investment grade corporate collateral.
CDO-Investment Grade (corporate)	Investment Grade Corporate Collateralized Debt Obligations (CDOs) are transactions that contain investment grade corporate collateral.
CDO-Multi Sector	Multi-Sector Collateralized Debt Obligations (CDOs) are transactions that include a variety of structured finance asset classes in the collateral pools. The collateral in the Company's Multi-Sector CDOs includes asset-backed securities (e.g. securitizations of auto receivables, credit cards, etc.), commercial mortgage-backed securities (CMBS), CDOs and various types of residential mortgage-backed securities (RMBS) including prime and sub prime RMBS.
Claims-Paying Ratio	Net debt service outstanding divided by the sum of the capital base, unearned premium reserve (after-tax), present value of installment premiums (after-tax), loss and loss adjustment expense (LAE) reserves, and soft capital credit facilities.
Commercial Real Estate CDO (CRE)	Transactions secured by a diversified pool of commercial real estate-oriented loans and/or bonds. Transactions are actively managed pools of collateral with a Collateralized Debt Obligation (CDO) structure with first loss positions provided by subordinated tranches. Transactions are usually managed pools with reinvestment permitted subject to Eligibility Criteria.
Commercial Mortgage Backed Securities (CMBS)	A type of mortgage-backed security, the word is used to distinguish it from residential mortgage-backed securities (RMBS). Commercial mortgages represent mortgage loans for non-residential properties such as office buildings, retail stores, etc.
Deferred Acquisition costs	Costs incurred and recorded as deferred charges (asset) that relate primarily to, and vary with, the acquisition of new insurance business, including compensation of employees involved in underwriting and policy issuance functions, certain rating agency fees, state premium taxes and certain other underwriting expenses, reduced by ceding commissions received on premiums ceded to reinsurers. Deferred acquisition costs are amortized as expense over the period in which the related premiums are earned.
Franchise Assets (Commercial Real Estate Secured)	Bonds or financial obligations secured by a diverse pool of loans, leases, and/or receivables to small businesses. Security will include mortgages over commercial real estate. These pools may include franchise loans, but only when secured by the commercial real estate. The underlying debt obligations will be "small ticket" in nature and the pools will be granular. Credit enhancement will be found in the form initial equity underpinning the real estate, over-collateralization and/or excess spread.
Franchise Assets (Not Commercial Real Estate Secured)	Bonds or financial obligations secured by pools of loans, leases and/or receivables where the obligors are small businesses, and the credit obligations are not secured by commercial real estate. These pools may include franchise loans (where security is not commercial real estate, but rather equipment and intellectual property). Credit enhancement will be found in the form over-collateralization and/or excess spread.
Future Flows	Bonds secured by loans, leases, and/or receivables to be generated some time in the future by a large bank or global commodities exporter.

Intellectual Property	Intellectual Property (IP) is the output of creative endeavor in technology, literary, artistic, industrial and scientific fields that can be protected under legislation. The principal legal categories for IP are patents, trademarks and copyrights. Examples of IP are film copyrights, pharmaceutical patents, music copyrights, publishing copyrights and branding and franchising trademarks.
Investment Agreement	A contract specifying the rights and responsibilities of a host [government] and a corporation in the structure and operation of an investment project.
Loss and Loss Adjustment Expense (LAE) Ratio	Measure of insurance portfolio losses relative to premium earnings and is an indicator of portfolio profitability. This ratio provides the percent of premium earnings used to cover losses incurred in a given period (quarter or year). The Loss and Loss Adjusted Expense (LAE) ratio is calculated on both a GAAP and statutory basis. Loss and LAE Ratio is Loss and LAE divided by net premiums earned.
Mezzanine Tranche	A middle layer of risk in a Collateralized Debt Obligation (CDO) or, more generally, a tranched portfolio credit derivative with a risk profile equivalent to a weak investment-grade rating.
Monotranche	A single layer of credit risk referencing a pool of assets or obligors with a specific attachment and detachment. A monotranche is not part of a full capital structure and is custom tailored to meet a risk/return profile. A customized monotranche is a bespoke tranche.
Operating Income (Loss) and Operating Income (Loss) per share	The Company believes operating income (loss) and operating income (loss) per share, non-GAAP measures, are useful measurements of performance because they measure income from operations, unaffected by investment portfolio realized gains and losses, gains and losses on financial instruments at fair value (with the exception of credit impairments on insured derivatives) and foreign exchange and other non-operating items. Operating income (loss) and operating income (loss) per share are also provided to assist research analysts and investors who use this information in their analysis of the Company.
Operating Return on Equity (ROE)	The Company believes operating return on equity, a non-GAAP measure, is a useful measurement of performance because it measures return on equity based upon income from operations and shareholders' equity, unaffected by investment portfolio realized gains and losses, gains and losses on financial instruments at fair value (with the exception of credit impairments on insured derivatives) and foreign exchange, unrealized gains and losses, and non-recurring items. Operating return on equity is also provided to assist research analysts and investors who use this information in their analysis of the Company.
Rental Car Fleets	Transactions secured by operating leases on fleets of rental cars. MBIA has the right to repossess and liquidate the rental car fleet upon default.
Residential Mortgage Backed Securities (RMBS)	A type of mortgage-backed security composed of a wide array of different non-commercial mortgage debts. It securitizes the mortgage payments of non-commercial real estate. Different residential mortgages with varying credit ratings are pooled together and sold in tranches to investors looking to diversify their portfolios or hedge against certain types of risks.
Secured Airline Equipment Securitization (EETC)	A structured transaction that pools senior tranches of leases on specific airplanes. The airplanes may be operated by a single airline or be leases with a number of airlines. The enhanced nature refers to the special treatment such leases get in any bankruptcy proceeding of an airline.

Structured Insurance Securitizations	Bonds secured by the future earnings from pools of various types of insurance/reinsurance policies. These pools specifically include insurance or annuity policies as well as policies issued by property & casualty insurers/reinsurers. Performance analysis of the pools of policies must conform to standard and recognized actuarial techniques.
Synthetic CDO-Managed Pools	A synthetic asset is a derivative which replicates certain payment features of a cash security. For credit derivatives entered into by MBIA, a synthetic execution is an enhancement of a credit product (derivative or not) by means of a credit default swap. In a managed pool, the Collateralized Debt Obligation (CDO) manager can buy/sell underlying securities over the life of the deal.
Synthetic CDO-Static Pools	A synthetic asset is a derivative which replicates certain payment features of a cash security. For credit derivatives entered into by MBIA, a synthetic execution is an enhancement of a credit product (derivative or not) by means of a credit default swap. In a static pool, underlying collateral remains unchanged over the life of the deal.
Variable Interest Entity (VIE)	An entity subject to the requirements of FIN 46, Consolidation of Variable Interest Entities (VIE). A company is required to consolidate a VIE if it absorbs the majority of the expected losses or receives the majority of the expected residual returns, or both, of the VIE.

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MBIA/Pershing Square/Activist Short Seller Timeline

Date	Event	Summary
5/23/2007	Ackman Presentation - "Who's Holding the Bag" at Ira Sohn Conference	• Claims MBIA and Ambac insurance subsidiaries are effectively insolvent
11/28/2007	Ackman Presentation - "How to Save the Bond Insurers" at Value Investing Congress	• Claims bond insurers effectively insolvent
11/28/2007	Ackman holds press conference after Value Investing Congress presentation	• See above
11/28/2007	Ackman appears on CNBC after Value Investing Congress presentation	• See above • Donation of management fees to his charitable foundation
11/29/2007	Whitney Tilson appears on CNBC	• Questions survival of MBIA and Ambac
12/10/2007	MBIA announces $1 billion Warburg Pincus Commitment	
12/14/2007	Ackman sends letters to regulators criticizing Warburg Pincus transaction, among other things;	• Claims disclosure of transaction was misleading and overstated probability of successful closing • Claims undisclosed material closing conditions • Claims MBIA may have violated reps and warranties triggering major indemnification obligation • Claims company lacks adequate capital to meet policyholder obligations
12/17/2007	Copy of 12/14 Ackman letter to regulators is provided to the media;	• Bloomberg
1/8/2008	David Einhorn of Greenlight Capital sends letter to regulators	• Claims MBIA and Ambac have improperly applied FAS 133 and FAS 5
1/9/2008	MBIA announces $1 billion surplus note offering	
1/10/2008	Ackman appears on Bloomberg TV and is critical of MBIA	• Claims MBIA needs in excess of $10 billion in capital • Claims holding company insolvent by end of 2008 • Suggests there will be no dividends to holding company for payment of surplus notes
1/11/2008	MBIA announces pricing of $1 billion surplus note offering	

1/16/2008	MBIA announces closing of $1 billion surplus note offering; Fitch affirms AAA Stable rating	
1/18/2008	Ackman sends letter to rating agencies;	• Questions rating agency analysis of bond insurer capital adequacy
1/18/2008	Herb Greenberg writes article critical of MBIA	• Article apparently prompted by article sent to Greenberg by Whitney Tilson
1/18/2007-1/20/2007	Copy of Ackman letter to the rating agencies is provided to the media;	• Bloomberg
1/30/2008	Ackman notifies media (CNBC) that he will be sending a letter to regulators and accompanying analysis later in the day; CNBC reports Ackman had earlier met with Wilbur Ross (date uncertain) to discuss his potential investment in Ambac; CNBC plays video clip of Ackman criticism of MBIA/Ambac	• Following report on Open Source Letter and Model, On Air Editor Gasparino indicates he has a gut feel that MBIA or Ambac would be downgraded later that day - no sources noted
1/30/2008	Ackman sends letter to regulators with accompanying "Open Source Model"	
1/30/2008	Ackman makes letter to regulators and Open Source Model available to media	
1/30/2008	MBIA announces closing and funding of $500 million Warburg Pincus investment	
1/31/2008	MBIA releases 4Q07 results, holds conference call and indicates that efforts to raise capital will continue	
1/31/2008	Pershing Square issues press release with questions it wants answered on MBIA conference call	• Questions consistent with prior public statements – holding company liquidity, non-investment grade exposures, Channel Re
1/31/2008	Pershing Square issues press release with 1/30/08 letter to regulators and location of Open Source Model download	
2/5/2008	Ackman writes letter to Fed & Treasury	• Claims bond insurers "functionally insolvent" and advises against any bond insurer bailout • Claims breakdown NYID oversight of bond insurers allowed industry to wrap credit default swaps;
2/6/2008 - 2/7/2008	Media obtains 2/5 letter to Fed & Treasury	
2/6/2008	MBIA announces $750 million common stock offering	

2/7/2008	Whitney Tilson publishes article critical of MBIA equity offering	• Questions ability of MBIA to complete stock offering without Warburg stepping in for nearly all of it • Claims capital raise insufficient given "massive losses" MBIA faces
2/7/2008	MBIA announces pricing of $1 billion common stock offering	
2/8/2008	Bankstocks.com sends e-mail with a summary of the "analysis" done by Egan-Jones in estimating potential losses by financial guarantors	• Summarizes Egan-Jones method of estimation of losses for industry • Notes that analysis is entirely back of the envelope and makes no effort to look at actual exposures
2/12/2008	Ackman, Chanos, Egan, Grebeck, Mason presentation at Hudson Institute – "The Ongoing Credit Crunch: What's Next for Struetured Finance, Credit Rating Agencies, and Bond Insurers?"	

Excerpts from letters sent to House Subcommittee on Capital Markets re: Bond Insurers

Ben S. Bernanke, Federal Reserve Chairman

"Ratings downgrades and financial deterioration of the guarantors can make it more costly to issue securities for some municipalities…"

"banks could be required to bring a sizeable volume of assets, especially municipal securities, onto their books" [if financial guarantors are downgraded]

Sandy Praeger, President, National Association of Insurance Commissioners

"The situation with many bond insurers is not so much a solvency issue as it is a rating agency and franchise value issue."

"Bond insurers have been paying and continue to pay all claims. In fact, bond insurers have incurred extremely minimal claims" Recent media reports confused certain companies' ability to write new business with the fact that they have sufficient reserves to cover the current anticipated level of claims."

Sean Dilweg, Commissioner , Wisconsin Insurance Department

"failure of this market [financial guarantee] could have a significant adverse impact on municipalities ability to issue AAA rated debt. This means the cost of financing would increase and the resultant increased cost would be passed on to the citizens....."

"municipal bond insurance market.....provide an important service to the debt financing activity of the country's cities, towns and villages it is important that this market remain stable and active"

"they [the rating agencies] are calling into question, not so much the solvency of these companies [bond insurers], but rather the ongoing franchise value of these insurers"

Eric R. Dinallo, Superintendent, State of New York, Insurance Department

"A move from AAA to AA still leaves a highly solvent, financially strong FGI [financial guarantor], particularly when compared to the vast majority of other regulated insurers."

"Downgrades of the FGIs could have substantial impact on issuers of municipal bonds. Municipalities may find it more difficult or more expensive to secure financial guarantee insurance.....municipalities may have to pay more to borrow."

"downgrades...have implications for the broader economy....can lead to constriction in the lending market place. If these securities are downgraded and banks increase the reserve against them, they will have less capital to support lending.... Moreover, if state and local governments reduce borrowings for capital projects, crucial infrastructure developments may be delayed or deferred. In sum, reduced credit availability could have serious damaging effects at a time when the economy is already perceived to be weak."

John Dugan, Comptroller of the Currency

"National banks have direct and indirect exposures to the financial monocline guarantors.....Downgrades of the monolines make it more likely that.....banks incur price and liquidity risk, as well as increased strain on their capital ratios."

Testimony of the
New York State Insurance Department

Before the
Committee on Financial Services
Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises
United States House of Representatives

Regarding:
Bond Insurance

February 14, 2008

Eric Dinallo
Superintendent of Insurance
New York

I would like to thank Chairman Kanjorski, Ranking Member Pryce and the other members of the Capital Markets Subcommittee of the House Financial Services Committee for allowing me to testify today.

My name is Eric Dinallo and I am New York State Insurance Superintendent.

You have already heard Governor Spitzer discuss the broader issues around bond insurance. Last week I provided a letter that gave detailed answers to some important questions from you office, which I trust was helpful. Now, I would like to review what the New York State Insurance Department has done and is doing. As the primary regulator of this industry, we have a unique perspective.

As insurance regulators, it is our responsibility to protect policyholders and ensure a healthy, competitive market for insurance products. In the case of bond insurance, there are two main groups of policyholders. There are the municipal governments who bought insurance for the bonds they issued and by extension the investors who bought those bonds. Then there are the banks and investment banks who bought insurance for the structured securities, including mortgage-backed securities.

The best way to protect all the policyholders is to preserve the triple-A ratings of some of the bond insurers. So we have been attempting to facilitate additions to the capital strength of the bond insurers, not for their own sake, but to protect first policyholders and second the markets and broader economy.

This is an extraordinarily difficult problem. Every single bond insurer is in a different situation with different strengths and weaknesses. They each have a different group of investors and owners, who have different views. They each must deal with a different set of counterparties; that is banks, broker dealers and investment banks, each of which has a different level of exposure. And there are different potential outside investors with differing types of offers.

Absent a government bailout, which is not planned, it is up to each of these insurers and their counterparties to come to an agreement. This is difficult for some obvious reasons. There are billions of dollars at stake. And there is no agreement on, and indeed no way to know with certainty, just how big the losses from the subprime market will be.

That said, we are working hard with all parties to reach agreements.

This is part of our three-point plan, which, as publicly stated first on January 9th, is:

First, bring in new capital and capacity. We invited Berkshire Hathaway to open a new bond insurer in New York, licensed it in record time and worked with the NAIC to help the company get licenses in all 50 states. In November the Insurance Department approved a $1.5 billion capital infusion into CIFG. We approved MBIA's capital raising plan in record time. Just last week MBIA raised $1 billion in an oversubscribed public offering. The company has now added a total of $2.5 billion in capital in the last two

months.

Second, we are seeking a broader solution by working with all parties, the insurers, banks, financial advisors, private equity investors, rating agencies and federal officials. At the moment, that means facilitating efforts to strengthen each individual bond insurer, while also including plans to deal with possibly chronically distressed companies.

Third, we are working on rewriting the regulations for bond insurance to prevent companies from taking on inappropriate risk in the future, while not discouraging the financial creativity that is essential to maintaining our position as the world financial capital. As part of this effort, we continue to discuss many issues with a wide variety of interested parties, and we have already made significant progress toward new regulations that will govern this industry going forward.

While we are doing all that we can to protect all policy holders and strengthen the bond insurers, if it becomes clear that is not possible, our first priority will be to protect the municipal bondholders and issuers. We cannot allow the millions of individual Americans who invested in what was a low-risk investment lose money because of subprime excesses. Nor should subprime problems cause taxpayers to unnecessarily pay more to borrow for essential capital projects.

We have been actively discussing all of the options with the bond insurers and, if necessary, we will consider allowing the bond insurers to split themselves into two companies. One would have the municipal bond policies and any other healthy parts of the business. And there is no reason to believe that this cannot be a healthy business. The other would have the structured finance and problem parts of the business.

We would ensure that the funds paid by municipal governments would go to support their insurance, and not pay for the problems in structured finance. We believe that this plan could produce enough capital to preserve the ratings of and provide protection for the municipal bonds.

It was to ensure a safety net for the municipal bonds that over the Martin Luther King Day weekend in January we asked Berkshire Hathaway to price the entire municipal bond portfolio of the three largest bond insurers. Earlier this month, Berkshire sent its proposal to the three companies. I believe that there may be other investors who would be interested in investing in the municipal side of the business.

In the course of my testimony so far I have made two assumptions I ought to stop and address.

First, I have been assuming that credit ratings will continue to play an important part in the financial markets. There has been much criticism of the performance of the rating agencies and it is other's responsibility to oversee rating agencies and determine what reforms are needed. But we cannot forget that they play an essential role, if they are doing their job properly, of providing information that makes markets more efficient. It's

not practical for every investor to fully vet every issuer of every stock and bond. The issue now is how to ensure that rating information is accurate, credible and that conflicts are managed properly.

Second, the Insurance Department is working to maintain a healthy competitive market in bond insurance because it is our job to make sure there is a market for the insurance that individuals, companies and governments want and need. Now, some muni issuers have decided they no longer need insurance and there are questions about the accuracy of municipal bond ratings.

Time and the market will determine the how much municipal bond insurance is needed. An AAA rating gives municipal bonds the broadest possible distribution among investors. There is more demand for top-rated AAA securities than supply. Again, it is difficult for investors to fully vet the many small public sector issuers. It is likely that a substantial number of government issuers will want the reduced cost of borrowing that a higher rating produces. Project finance, with its one-time or relatively short-lived issuers, is another area where bond insurance makes sense. We have invited in new companies and will work to make sure bond insurance is available to the government issuers that need it.

As to the future, we have just begun to study how to improve regulation in this area. Our main focus is on the need for immediate action to limit the damage. However, we can offer some broad comments now, with the understanding that we expect to develop more specific proposals soon.

The primary goal of insurance regulation with respect to financial oversight is to ensure that the insurer maintains an adequate level of solvency and is able to honor policyholders' claims. The business model for the financial guaranty insurance companies, however, requires that they hold levels of capital that will allow them to maintain the AAA rating necessary to write new business.

It has become clear that the loss of the AAA rating essentially cripples the company's ability to do business as a going concern and puts the insurer in a "run-off" mode. We now are considering whether the sustainability of the business model should be the regulatory standard going forward. While we of course consider claims paying ability as the benchmark, our goal for the future, for all insurers, is to do higher level risk-based examinations.

Financial guaranty insurance is a complicated business, which is largely based on modeling and underwriting of complex capital market instruments. Total reliance on the rating agencies is not prudent. Rather an independent analysis by regulators of risk positions by FGIs could be more appropriate. It would also require greater transparency between the bond insurers and their regulator, by which I mean, more information and oversight regarding the nature of the risks being insured.

Within the current regulatory framework, other steps can be taken to restrict the FGIs' financial leverage to better protect their solvency, and to restrict activities around products that may be too volatile going forward; for example, guaranties of the CDO squared transactions.

We welcome any suggestions about how to improve our regulations.

I welcome your questions.

STATEMENT OF RICHARD P. LARKIN

SENIOR VICE PRESIDENT

HERBERT J. SIMS & CO., INC

BEFORE A HEARING OF

THE HOUSE FINANCIAL SERVICES COMMITTEE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,

AND GOVERNMENT SPONSORED ENTERPRISES

REGARDING

"THE STATE OF THE BOND INSURANCE INDUSTRY"

WRITTEN TESTIMONY

FEBRUARY 14, 2008

I would like to thank Chairman Kanjorski, ranking member Pryce and other members of the Capital Market Subcommittee of the House Financial Services Committee for inviting me to testify on the State of the Bond Insurance Industry. My name is Richard Larkin, and I am a Senior Vice President for Herbert J. Sims & Co., Inc., headquartered in Southport, Connecticut. H.J. Sims has allowed me to assist this committee with my testimony. In preparing this testimony, I have also had the assistance of some members and staff of the Securities Industry and Financial Markets Association (SIFMA), an organization that represents more than 650 member firms of all sizes, in all financial markets in the U.S the world. The opinions and information that I will share with you is mine, and not necessarily that of H.J. Sims or SIFMA. It may help the committee to know that my prior experience includes 26 years as a senior rating executive and analyst at two Nationally Recognized Statistical Rating Organizations (NRSROs), and 2 years as an independent financial advisor to state and local governments that access the tax-exempt bond market to finance essential infrastructure.

The crisis in the bond insurance industry is already having an impact on the municipal bond market, and appears to be affecting credit markets beyond municipals. It is important for this committee to understand the dynamics, events, and implications of this crisis; it is also important to solicit possible solutions to ameliorate the current crisis, and strengthen credit markets after the crisis has abated. I will attempt to do both today.

The Aaa/AAA ratings assigned to insured municipal bonds have been extremely useful tools, for both debt issuers and investors. State and local governments that have used bond insurance have been able to lower their interest costs. Investors have benefited from the perceived safety against default that bond insurance provides, which in turn has improved the liquidity of their investments if they needed to sell their investment prior to maturity.

Threatened and actual downgrades of the insurers' bond ratings have already had dramatic effects on the municipal bond market. Interest rates and yields on municipal bonds have remained high relative to Treasury bonds, despite dramatic cuts in borrowing rates by the Federal Reserve. Fed cuts usually have a stimulating effect on local government bond issuance for new capital and to refinance previously issued higher cost debt. In the last two months, however, issuance is down dramatically from the prior year's record volume of issuance.

For years, bond insurance backed about 50% of all new debt issuance. In the last two months, only 30% of new debt carries insurance. It is unclear as to

whether the drop is a function of issuers' belief that insurance is not as necessary as it has been in the past, or investors' belief that the credit safety and liquidity value of insurance has weakened. One thing that is clear is that investors do not want debt that loses value because of imminent rating downgrades.

It is also clear that the bond insurance crisis is rating-driven. The disruptions to the insured municipal bond market are precipitated by the rating agencies' threats of downgrades of those insurers. These downgrades are also precipitated by the increasing downgrades on structured subprime mortgage securities. Most observers believe that these securities provide the greatest risk to bond insurer capital adequacy. While bond insurers can take responsibility for extending their guarantees into this suddenly volatile and increasingly risky sector, they could not have maintained their Aaa/AAA ratings unless the rating agencies also believed that exposure in this sector would not weaken those ratings. Going forward, any solutions to this crisis will require actions by the NRSROs, or changes to the NRSRO system. In the last week, the three major NRSROs have announced reforms or proposed revisions to facets of their rating process. Because of their newness, it remains to be seen whether these proposals will help prevent the recurrence of a crisis such as the one we are witnessing right now.

The last time the tax-exempt market faced a crisis as large as this was in 1975, when the threat of bankruptcy by New York City rattled the credit markets. That event was of historical proportions, and I believe that the bond insurance crisis is comparable in its enormity. Yet, the lessons of the New York City crisis strengthened the capital formation process for the tax-exempt credit market:

- Adoption of Generally Accepted Accounting Principles as the standard for governmental financial accounting and reporting;
- Improved disclosure for municipal bonds, at the time of issuance, and in the secondary market;
- Increased hiring, stronger rating criteria, and improved transparency by NRSROs that are so important to the efficient operation of credit markets.

I am optimistic that the current crisis will also result in new structural improvements to the capital formation process, as we all cooperate to solve this crisis and enact safeguards for the future.

IMPACT ON MUNICIPAL MONEY MARKET FUNDS

While investors are concerned that insured municipal debt may lose value because of rating downgrades, of most immediate concern are holdings by municipal money market funds subject to rule 2a-7 of the Investment Company Act of 1940. The rule requires minimum ratings for investment in these money market funds. The collateral used for investing by those funds must be rated in the highest two categories by an NRSRO in order to comply with 2a-7. Insured bonds with Aaa/AAA ratings are a significant component of those investments. Downgrades to those securities may require liquidation and replacement of those investments in order to comply with rule 2a-7.

It is estimated that money market funds hold about $500 billion of highly rated municipal securities. If 50% of those securities are insured (which is the historical proportion of insured debt to total debt in the municipal market), downgrades of insured debt below the Aa/AA category could prompt a short-term sell-off of an estimated $200 billion of municipal securities. In a market that sees average daily trading volume of only about $11 billion, a sell-off of this magnitude would result in a flood of supply, which would reduce the prices of these securities, and increase tax-exempt interest rates. The effects would be felt both by issuers and investors. Reporting by the Bond Buyer indicates that this may already be happening, as money market funds try to anticipate downgrades before their holdings lose value.

In conversations with other market professionals, this appears to be the most immediate concern in the tax-exempt market. Downgrades of insured debt may also require capital adjustments to banks and insurance companies, but I will leave that phenomenon to others that may appear before this panel.

THE BOND INSURANCE CRISIS' IMMEDIATE EFFECTS ON STATE AND LOCAL GOVERNMENT ISSUERS

Related to the dislocations in the municipal money market funds, state and local governments that have issued debt with variable interest rate terms are already experiencing significant increases to the interest costs, which could reduce available funds for essential services in the current fiscal year.

> On Tuesday February 12, Reuters reported that "U.S. municipal bond issuers were hit with "multiple" failures of auctions of their paper on Tuesday, ... as investors were concerned about the safety of the bond insurers backing the debt... ..Rates for auction-rate paper are reset

periodically, and an auction fails when no buyer can be found and the dealer does not take it back."

The immediate impact to these borrowers is that new interest rates have to be set high enough to attract investors to be willing to assume real or perceived risk that the bond insurers may not be able to honor their guarantees. The market also seems to be developing two tiers:

- one for issues that are not tainted by the bond insurance crisis, whose credit is strong and highly rated on its own; and
- one for credits whose ratings are dependent on the rating from bond insurance.

To demonstrate the volatility of the market because of the current crisis, it was reported that the State of California's recent issue of debt is trading with yields on their one-year maturity of only 0.96% per year, because of the strong demand by money market funds for highly rated municipal short-term debt. On the other end, another creditworthy issuer, the Port Authority of New York and New Jersey, saw their interest rate reset from 4.3% to an annualized rate of 20% in one week's time, on February 12th.

RECENT TRENDS IN THE USE OF BOND INSURANCE

In the brief time since the raters first announced downgrades and negative watch and outlook assignments to the ratings of the bond insurers, there has been a dramatic reduction in the use of bond insurance, and a market share shift among the companies that provide insurance. In a market where bond insurance was used for 50% of new debt issuance, that penetration has dropped to 30% in the last two months.

In addition, FSA and Assured Guaranty, the two bond insurers that have not had negative rating actions, are capturing over 65% of new bond insurance business in the last two months, as compared to a combined market share of only 26% for all of 2007.

In November, several firms in the market reminded their clients that downgrades of the bond insurers would not necessarily lead to defaults on insured municipal bonds, pointing out the strong credit strength provided by the underlying issuers of those bonds. Studies of default rates by rating agencies and other observers point out that default rates on traditional tax-backed and utility revenue bonds are lower than those for Aaa/AAA corporate taxable debt.

The bond insurance crisis has highlighted this safety record, a fact well-known by municipal bond professionals, but not as widely known to the average person. In recent weeks, issuers that regularly used bond insurance for some or all of their normal issuance (e.g., Wisconsin, California and the City of New York) have all successfully sold large bond issues without purchasing bond insurance. Although the trend is recent, it is my opinion that as more people are educated to the history of infrequent municipal bond defaults, future demand for municipal bond insurance may be less robust than has been the case for the last 20 years.

CONTROVERSY: MUNICIPAL VS. GLOBAL/CORPORATE SCALE RATINGS

The default studies performed since 1999 by Fitch, Moody's and S&P all point to the long track record of safety against default for most municipal bond issuers. In particular, the long-term default rates on the universe of state, city, county and school district tax-backed debt is as low as or lower than that of Aaa/AAA rated corporate debt. Default rates for water/sewer revenue bond debt are lower still. Yet median ratings for these combined classes of municipal debt are only in the single 'A' category. The raters, in varying degrees, have begun to factor this history of safety into their bond rating systems.

In 2000, Fitch Ratings overhauled their rating criteria, in order to review and produce bond ratings that were more in line with default rates measured in its study. In particular, Fitch put more positive weight on issuers that implemented financial management best practices. As a result, about 26% of Fitch's tax-backed ratings and nearly 50% of water/sewer revenue bond ratings were upgraded. After that review, median ratings for this debt was higher than single "A" yet still below the "AA" category.

Standard & Poor's has done several default studies since 2001. S&P has revised some of its rating criteria and ratings in some sectors, but has not seen a need to alter its current rating scales, which they believe are indicators of default risk.

Since at least 2002, however, Moody's has recognized that their traditional municipal rating scale does not produce ratings that are indicative of actual default rates. In March 2007, Moody's clearly enunciated that their municipal scale ratings were not indicators of default and loss, as were all of its other ratings (which Moody's termed "Global Scale Ratings"). Moody's

municipal scale ratings were said to be indicative of the willingness and ability of an issuer to pay debt service. The difference is significant.

In the 2007 report, Moody's also published a "map" to show what the differences would be between municipal and global scale ratings for various classes of tax-exempt debt. The most visible examples of rating differentials between the two scales are for general obligation bonds and water/sewer revenue bonds. The map indicates that these bonds, rated as low as Baa3 on their municipal scale, would be rated no lower than Aa3 on their Global Scale. The implications of this differential are tremendous, in light of the pressures on money market funds to maintain securities rated in the top two categories under rule 2a-7.

The raters' default studies, capped by Moody's March 2007 report, all corroborated what finance professionals and academics have said for years: that municipal bonds are the second safest investment against default after US Treasury obligations.

It is clear, however, that the custom of using more conservative municipal scale ratings with a median of single "A" play a large part in the usage of municipal bond insurance. That is because the difference in the issuer's borrowing costs between single "A" underlying ratings and "Aaa/AAA" insured rated debt. It is that differential that is the economic basis for bond insurance in the first place.

It is my firm belief that ratings which truly reflect low municipal bond defaults ("Global Scale"-type ratings) would allow significantly more debt to carry ratings of Aa/AA and Aaa/AAA, consistent with rule 2a-7. This might negate the need for costly bond insurance to qualify as money market fund investments, and reduce borrowing costs for local governments. Using this scale for retroactive assignments of underlying ratings on insured debt would also allow more securities to be retained by money market funds, in the event that bond insurer ratings are downgraded below Aa/AA.

That said, there is still a case to be made for maintaining the more conservative scale of municipal bond ratings. State and local government finance is regulated only at the state level, and not consistently regulated or monitored from state to state. The SEC's purview and enforcement powers in the municipal sector are limited to securities-related transactions, and only when there is apparent fraud in issuance or transactions. The NRSROs are, for all practical purposes, de facto "regulators" of public financial management, through their debt rating process. Rating agencies will deny that this is their

role in the market, and they are correct. Municipal ratings are not, and never were, intended to regulate or influence public financial management for state and local governments.

After 33 years in the public finance sector, I believe that the history of rare municipal bond defaults can be partly attributed to the rigorous ratings and systems employed by the NRSROs. The bond raters are leading proponents of management best practices, by their incorporation into municipal bond rating criteria and standards. Good government organizations, such as the Government Finance Officers Association (GFOA), promulgate rating agency standards and practices which can result in higher ratings in their educational programs. In the 1980's, the industry's push to expand local governments' use of Generally Accepted Accounting Principals (GAAP) was aided immeasurably by rating agency positions that bond ratings would be lower for issuers that failed to adopt GAAP as their accounting standard. State and local government budgeting practices have been improved when issuers seek higher bond ratings, and negative financial "gimmickry" has been reduced when an issuer is faced with a downgrade. There is a clear relationship: issuers that see their stronger bond ratings enjoy lower interest costs, while downgrades result in higher borrowing costs. Again, the raters will state that these results are not intended consequences of their rating actions, and they are correct. It is the bond market's reactions to ratings that provide this cause and effect. With no official regulator for state and local governments, the bond raters have been an effective tool for public financial management, and are a significant factor in the history of rare bond defaults and investor losses in the municipal bond sector.

One last observation on the prospects for "Global Scale" ratings versus traditional municipal scale ratings: there are many classes of municipal bonds where there would be little or no increase in ratings if "Global Scale" ratings were employed by all bond raters. These classes include organizations that are still vulnerable to competitive pressures that lead to higher rates of default, despite governmental participation in their financial operations. In varying degrees, these entities (in no particular order) are hospitals, long term care providers and nursing homes, toll roads, private colleges, ports and airports, and local government-sponsored convention centers and sports facilities. In my opinion, these entities would get significant value from a strong and stable bond insurance industry. These issuers, in my opinion, have the greatest need for a viable bond insurance industry, and are likely to most feel the impact of the bond insurance crisis, through higher interest costs and greater difficulty borrowing in the tax exempt market.

POTENTIAL SOLUTIONS TO ALLEVIATE THE IMMEDIATE CONSEQUENCES OF RATING DOWNGRADES ON BOND INSURERS

I take no position on whether financial assistance, either by the private sector or the government, should be provided to bolster the capital positions of bond insurers vulnerable to increased defaults in the structured debt markets. Nor am I taking a position on increased regulation of either the bond insurers or the rating agencies, whose Aaa/AAA ratings supported the creation and expansion of the bond insurance sector. Those issues and answers are being taken up by others with far more experience and knowledge about such matters than I. To me, the current crisis is primarily bond-rating driven, and as a former bond rating executive, I'd like to offer several ideas that might provide the most immediate relief for issuers and investors affected by downgrades to the bond insurers.

- **Increased availability of underlying bond ratings for insured debt.**

Underlying ratings are debt ratings that would be assigned if there were no credit enhancement from bond insurance. In short, it is the rating based on the financial strength or weakness of the issuer. Underlying ratings are not issued automatically. The issuer must separately request one when the bond issue is insured. Although many large issuers carry underlying bond ratings on other debt which is on parity for repayment, there are many more, particularly small infrequent issuers, for which no underlying rating is assigned or published. If underlying ratings were assigned as standard procedure, there could be significantly more bonds that keep ratings of Aa/AA or higher after an insurer's downgrade, allowing them to be retained by the money market funds under rule 2a-7. This proposal would also dramatically increase the transparency of NRSRO bond ratings.

This solution is not without its problems. Because the issuer-pay rating agency model assigns ratings only upon request, rating agencies may not be permitted or required to assign underlying ratings if the issuers want to keep those ratings suppressed. In addition, it is unknown whether the rating agencies have adequate information on which to assign accurate underlying ratings for every insured bond issue rated Aaa/AAA. While raters monitor the underlying quality of an insurer's book of business, they may not have full information on each and every insured issue, despite having been paid a fee to

assign a rating. The rating fee paid when a bond was issued with insurance in many cases was for assigning a rating based on the insurance "wrap" of the bond insurer, and did not cover the assignment of an underlying rating.

- **Rating agency adoption of "Global Scale" or Corporate Equivalent ratings that are indicators of default and loss.**

As I stated earlier, the Moody's "map" of Global Scale" bond ratings is far less conservative than their traditional municipal rating scale. If this system were in place, there would be a large increase in "Aa" & "Aaa" rated securities that would be eligible for money market fund investment under rule 2a-7, and could reduce the amount of bonds that would need to be sold-off by those funds if bond insurers were downgraded. This kind of action, however, assumes that the raters were willing or able to increase the number of underlying ratings where they currently do not exist. It would also require Moody's to reverse its stance that market participants have indicated that maintenance of "municipal scale" ratings is preferred to the more liberal "Global Scale" ratings. In addition, it is unclear as to whether S&P and/or Fitch believe that there should be a different rating scale from their current system, or whether they are in a position to implement such a dramatic change from current custom. And while Moody's took the lead in publishing their municipal and corporate equivalents "map", there is no indication that Moody's would automatically assign "Global Scale" equivalents in exactly the manner envisioned by the map. Implementation could result in exceptions to the mapped correlations. Finally, there is the risk that adoption of higher ratings under a "Global Scale" system could result in a weakening of the financial discipline and strong financial management practices that have evolved in state and local government financial management as a result of the current system of assigning municipal bond ratings.

- **Application of a Rating by Maturity Approach to Insured Bond Ratings**

There are very few instances where the NRSROs assign different debt ratings solely on the basis of a maturity date. All three NRSROs use different symbols for specific types of short-term debt (e.g., commercial paper, tax/revenue anticipation notes, bond anticipation notes, variable rate demand bonds) with maturities of three years or less. But for the most part long-term bond issues are usually assigned only one bond rating, whether that debt matures in 2 years or 50 years.

Bond market professionals realize that although bond insurers and raters agencies are estimating higher losses and potential insurance payments on

structured Collateralized Debt Obligations (CDOs) and Residential Mortgage-Backed Securities (RMBS), the obligation of a bond insurer to immediately pay for all losses is remote. Bond insurance is designed so that payments on defaults are required only when stated principal and interest payments are due, usually on an annual or semi-annual basis. So, even if it was projected for an insurer to pay $20 billion on loss claims, those payments are stretched out over the stated maturities of the debt, according to the original maturity schedule.

In order to provide some immediate relief to money market funds facing large liquidations of insured bonds after a rating downgrade, the raters might consider a bifurcated approach by maturity. As a hypothetical example, take an instance where the bond raters have made their most conservative estimate of claims faced by a bond insurer. Using that "worst-case" scenario, the rating agencies could analyze maturities of projected defaults, and estimate the time period for which current claims-paying reserves could totally cover projected losses according to the maturity. The raters could have a legitimate basis to maintain "Aaa/AAA" ratings on the earlier maturities of outstanding insured debt, while downgrading the remaining maturities of projected structured debt to reflect remaining capital shortfalls. As with the other suggestions, this would require an elemental change in the manner and process by which the NRSROs assign long-term bond ratings. The process would also have to be tested for its rating impact, and an assumption would need to be made about a "worst-case" loss scenario in the subprime CDO/RMBS sectors. In the past few months, those "worst case" scenarios have been moving targets, and it remains unclear as to when a "worst-case" scenario estimate will prove reliable.

FEDERAL HOME LOAN BANKS AS LETTER OF CREDIT PROVIDERS TO ENHANCE STATE AND LOCAL GOVERNMENT DEBT

One repercussion from the downturn of the bond insurers is that credit enhancement is exceedingly hard to obtain for state and local bond issuers. This problem is particularly acute in the current market environment because many bond issuers are attempting to restructure or refinance outstanding bonds where the interest rates have climbed to ridiculously high levels. A potential source for credit enhancement are the Federal Home Loan Banks (FHLBs). However, Section 149 of the Internal Revenue Code prohibits federal guarantees of tax-exempt bonds, and letters of credit from FHLBs are treated as de facto federal guarantees, despite the fact that the federal government does not directly back the obligations of the FHLBs. Bipartisan legislation introduced last year (H.R. 2091) would correct this problem by specifying that credit enhancement provided by the FHLBs would not cause bonds to be

treated as federally guaranteed. This would create a new source of credit enhancement for states and localities suffering as a result of the bond insurers' troubles. I urge members of this committee to support this important legislation.

IRS REISSUANCE REGULATIONS AS AN OBSTACLE FOR ISSUERS THAT NEED TO RESTRUCTURE THEIR DEBT BECAUSE OF BOND INSURER DOWNGRADES

Another problem faced by states and localities as a result of the bond insurers' problems arises from IRS rules that govern when a tax-exempt bond is "reissued." When a state or local issuer, in agreement with bondholders, materially changes the terms of a bond issue, tax regulations specify that the bond under the new terms be treated as a newly issued bond rather than an extension of the outstanding bond.

This can trigger negative tax consequences for both issuers and investors. Today, many states and localities face conditions where, through no fault of their own, their outstanding bonds are carrying interest rates far in excess of reasonable market rates due to problems with the bond insurers. Some states and localities are prevented by the IRS's reissuance regulations from negotiating new terms with their bondholders. Market participants have been talking with the Treasury and the IRS to address these problems, and we are hopeful that a reasonable solution can be reached.

I would like to thank the committee for the invitation to appear on this important problem facing the credit markets, and I invite your questions to the extent that I am able to answer.

WILKES-BARRE CITY

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PENNSYLVANIA

Statement of Mayor Thomas M. Leighton, City of Wilkes-Barre, before the House Financial Services Capital Markets, Insurance, and Government Sponsored Enterprises Subcommittee

Introduction

Chairman Kanjorski and members of the House Financial Services Capital Markets, Insurance, and Government Sponsored Enterprises Subcommittee, thank you for the opportunity to testify today on the need to find a solution to the turmoil in the bond insurance industry.

My name is Thomas M. Leighton and I am the Mayor of the City of Wilkes-Barre, a city in Northeastern Pennsylvania. I am a constituent of Chairman Kanjorski, who has been a leader in economic development issues. I would like to thank Chairman Kanjorski for inviting me here today and commend him for taking the initiative on this very important issue.

Wilkes-Barre is the urban core and seat of Luzerne County, welcoming nearly 100,000 people to our city each day. We have the 4th largest downtown workforce in Pennsylvania, but this number drastically decreases after the 9-5 rush. We face significant challenges providing municipal services for this

substantial workforce because only 45,000 residents contribute to the city's tax base.

In addition, our city is home to many nonprofits, including 2 hospitals, 2 colleges and the regional headquarters of many large organizations. These community assets contribute to the outstanding quality of life in Northeastern Pennsylvania, but are, unfortunately, nontaxable entities.

Upon taking office in 2004, my administration was faced with over $10 million in unpaid bills and a technical bond default by one of the city's authorities. Because of this default in 2002, the city could not utilize traditional bank financing because of our weak credit standing. These circumstances, combined with inherent regional economics, created a bleak financial outlook for the city.

After working diligently to reestablish the city's finances and maintain our fiscal responsibility, AMBAC Financial Group agreed to insure $40 million of debt restructuring and new money. Without AMBAC's willingness to help the city, major layoffs or tax increases would have been necessary. AMBAC's confidence in the city's future gave us the opportunity to access the marketplace, allowing the city continue on our path to a solid financial future.

Despite making great strides financially, the City of Wilkes-Barre still struggles to obtain bond insurance, especially at competitive rates. As a

result, turmoil in the municipal bond market is a significant concern for the City of Wilkes-Barre. Similar to many other mid-sized cities across the nation, we rely on the monolines. When they are faced with volatility in the market, there is inevitably volatility for us.

Many small issuers, such as the City of Wilkes-Barre, are dependent on credit enhancements. Without them, we cannot access much-needed capital for public projects, such as road paving, sewer repairs and other infrastructure improvements. As we work to reinvigorate our city, cutbacks in basic services like these are not an option.

Turmoil in the Marketplace, Struggles in Wilkes-Barre

Currently, the economic climate in Wilkes-Barre is weakening due to growing expenditures and declining revenues. For example, the subprime mortgage crisis has resulted in an increase in the number of foreclosures, removing properties from the tax rolls. As homeowners in the City of Wilkes-Barre strain to make ends meet, we see an increased need for services which can not easily be met due to lower revenues and budget challenges. Wilkes-Barre is not alone in this struggle. Mid-sized governments in Pennsylvania, and around the country, are forced to turn to the debt market to avoid raising taxes, but are unable to do so because of instability in the market.

The City of Wilkes-Barre currently has a BBB credit rating. We are faced with $65 million in outstanding bonds and notes, $43 million of which are AMBAC

insured. All past issuances must have a credit enhancement in order to be attractive to investors. While some governments across the country have been adversely affected by the disruptions in the insured variable rate markets, Wilkes-Barre is extremely fortunate that our variable rate debt is enhanced by a letter of credit from PNC Bank, which has not been affected by the subprime crisis.

Included in the City of Wilkes-Barre's 2008 plan are issuances for $4 million in refunding to fill budget gaps and $5 million in economic development for the Coal Street Park Renovation Project. Coal Street's renovation will transform a blighted park, situated along a gateway to our downtown, into the region's premier recreational facility. The park will include ice hockey rinks, playgrounds and athletic fields. The effects of this project will be far-reaching, removing an eyesore from the city, injecting new energy into the community and bolstering pride in the City of Wilkes-Barre. With a renovated Coal Street Park, both permanent residents and first-time visitors will experience Wilkes-Barre in a very different, yet very positive, way. Under the current market conditions, this necessary development will be extremely difficult for the City of Wilkes-Barre to complete.

In addition to this venture, the City of Wilkes-Barre will continue to maintain and improve its aging infrastructure. For example, work on the remaining two bridges that span Solomons Creek will be completed. The area surrounding the creek is prone to severe flooding, devastating thousands of

residents and an area hospital three times in the past four years. We will also continue paving roads, repairing catch basins and reconstructing sewer systems to improve the quality of life for our residents. In order to meet these basic needs of our residents, we must be able to access affordable bond insurance.

Turmoil in the Marketplace, Struggles Around the Country

Similar to the marketplace conditions facing Wilkes-Barre, state and local governments across the country are also seeing increased bond issuance costs due to market disruption and are finding it difficult to enter the market as they had planned to in 2008. This is due, in part, to the inability to access affordable bond insurance. Many governments – especially small governments - need to purchase insurance either because their own rating is relative low or because they are an infrequent issuer, often without their own credit rating, and secure bond insurance to attract investors. Thus, the predicament Wilkes-Barre and other governments face in this climate are significantly higher issuance costs than what were expected, or postponing projects altogether – the latter choice being, of course, anti-stimulative.

Additionally, many governments with insured debt with rates that are reset on a short-term basis, are experiencing immediate and substantial increases in interest costs due to declining investors' interest in insured bonds[1]. In the case of auction rate debt, when the short term debt is 'reset' (which can be

[1] "Bond Insurance Turns Toxic for Cities, Colleges as Rates Soar," Bloomberg News, 2/11/08.

on a daily, 7-21-28 day, or longer basis) and there are not enough buyers, interest rates are set at a "failed auction rate" or maximum rate that is much higher than the rate which was anticipated when the debt was issued. This is an unexpected cost to many governments, who have to absorb the extra costs nonetheless.

It is very important to note that while these current market conditions are impacting budgets and project financings, these disruptions are not caused by the underlying governmental credits that have been insured. For over 100 years, the municipal bond market has proved to be the best and most efficient way for our country to provide schools, roads, hospitals, and vital infrastructure to its citizens. Indeed, in 2007, a record $427 billion in bonds were issued.[2] This market allows infrastructure and service-needs decision making at the level closest to its citizens – state and local governments. Although it is a fragmented market with tens of thousands of governmental entities issuing tax-exempt debt, historically, investors' appetite for municipal bonds has remained high with a majority of municipal bonds held by households, including money market mutual funds holdings.[3] Investors buy and hold these bonds, knowing that they are one of the safest instruments available, and many of the underlying credits are backed by the full faith and credit of the governmental entity.[4] With half of the municipal bond market being insured, it allows investors a more streamlined way of making an

[2] *Volume at a Record $427.6 Billion* (2007), The Bond Buyer, 1/2/08.
[3] *Flow of Funds Accounts of the United States*, Board of Governors of the Federal Reserve System, 12/6/07, page 44.
[4] Mark Lackritz, "For investors, municipal bonds have an impressive record of safety with a default rate of less than a 0.1% over the past 37 years." 7/26/2007

investment, without having to research each particular bond issuance. Thus, finding a way to stabilize the current market conditions and to enable affordable access to bond insurance is vital for continued state and local government growth in the years ahead.

As Congress, the Federal Government, regulators and the marketplace look to find ways to solve the problems in the municipal bond marketplace, one helpful piece of legislation is H.R. 2091, which would allow bonds guaranteed by the Federal Home Loan Banks to be treated as tax exempt bonds.

In essence, this legislation would change the tax code and allow Federal Home Loan member banks to offer letters of credit to communities like Wilkes-Barre, thus providing access to another AAA financial guarantee source, which will help lower borrowing costs for governments across the country. Chairperson Kanjorski, we want to thank you for supporting this helpful legislation.

Conclusion

The City of Wilkes-Barre is undergoing a comprehensive social and economic revitalization. Without access to capital, we will be unable to continue the progress that we have worked so hard to accomplish over the past four years. We will be forced to halt work on major projects, such as the Coal Street Recreational Park, or limit the basic services that we provide to our

residents. Mid-sized cities nationwide must have access to the bond insurance market to improve their credit ratings. Also, there must be stabilization in this market so that Wilkes-Barre and other cities can continue to provide basic, quality-of-life services for their residents and participate in catalytic economic development projects.

Thank you for the opportunity to address this Subcommittee and for considering my perspective as a Mayor of a mid-sized city.

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Statement of

Patrick M. Parkinson

Deputy Director, Division of Research and Statistics

Board of Governors of the Federal Reserve System

before the

Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

Committee on Financial Services

U.S. House of Representatives

February 14, 2008

Chairman Kanjorski, Ranking Member Pryce, and members of the Subcommittee, thank you for the opportunity to testify on the potential effects on financial stability of further financial deterioration and ratings downgrades of financial guarantors.

Role of the Financial Guarantors in the Financial System

The nine U.S. companies whose business focuses on providing insurance against credit defaults together insure about $2-1/2 trillion of domestic and international securities. Historically, they focused on insuring the timely payment of principal and interest on U.S. municipal bonds. This remains a very important business line. Indeed, as of September 30, 2007, the guarantors insured about $1-1/2 trillion of such bonds, more than half of all U.S. municipal bonds outstanding. The vast majority of the underlying bonds were rated investment grade. However, insurance from AAA-rated guarantors raised the ratings of the insured bonds to AAA, which lowered interest costs to the issuers and made the bonds attractive to a wider range of investors.

In recent years the financial guarantors expanded rapidly into insuring asset-backed securities (ABS), especially collateralized debt obligations (CDOs). By September 30, 2007, they had guaranteed more than $1 trillion of ABS, including over $700 billion of U.S. ABS. The U.S. ABS included about $200 billion of U.S. residential mortgage-backed securities (RMBS) and securities backed by home-equity loans and about $125 billion of CDOs collateralized by ABS (CDOs of ABS) that contained U.S. subprime RMBS. In addition, they have guaranteed more than $300 billion of U.S. and international corporate CDOs.

In the case of CDOs, the guarantors typically used credit derivative contracts to insure the super senior tranches. That is, they insured securities that would suffer credit losses only if the losses on the underlying collateral were so severe that all other tranches, including some tranches

rated AAA, were wiped out. The possibility of such severe credit losses was seen as remote, and these securities indeed have suffered little or no credit losses to date. However, in the case of CDOs collateralized by subprime RMBS that were originated between late 2005 and 2007, the possibility of loss is no longer seen as remote. In many cases, super senior tranches of such CDOs of ABS are trading at substantial discounts to par value. The growing possibility of credit losses on these securities has caused some of the guarantors to report financial losses and the rating agencies to require those guarantors to raise capital to maintain or regain their AAA ratings. Those guarantors reportedly are exploring various options for bolstering their financial strength, but it is not clear that all of them will succeed. Thus, it is well worth thinking through how further downgrades of some guarantors' credit ratings might affect overall financial stability.

Channels Through Which Financial Stability Might Be Adversely Affected

Such downgrades might adversely affect financial stability through several channels. These include: (1) the potential for disruptions to municipal bond markets, (2) potential losses and liquidity pressures on banks and securities firms that have exposures to the guarantors, and (3) the potential for further erosion of investor confidence in financial markets generally.

Further downgrades at some guarantors could spark a retreat from the municipal bond market by some retail and institutional investors. Of particular concern is the potential for disruptions to the markets for short-term securities based on municipal and other tax-exempt debt. In recent years, heavy demand for short-term securities, especially from money market funds and other short-term investment pools, has generated a large market for facilities that transform long-term, tax-exempt bonds into short-term securities. These short-term securities include "tender option bonds" and "variable-rate demand obligations," which typically have

credit support from one of the guarantors and liquidity support from a large bank or security firm, and "auction rate securities," which often have credit support from a guarantor, but no explicit liquidity support. If guarantors are downgraded to below AA-, many money funds will be required to put tender option bonds and variable demand obligations back to the liquidity providers. Investors may also choose to put securities back in advance of potential downgrades. Indeed, some money market funds reportedly have already exercised this option with respect to securities insured by those guarantors with significant exposure to CDOs of subprime RMBS. Finally, earlier this week there was a rash of failures of auctions for student loan auction rate securities (ARS). Although largely unrelated to concerns about financial guarantors, this development undermined confidence in ARS generally, and subsequently quite a few auctions for municipal ARS have failed.

It appears that financial stress at the guarantors has restrained municipal bond issuance in recent weeks, though these effects are difficult to disentangle from the effects of tighter budgets for many municipalities. A deepening concern about the financial condition of some of the guarantors could at least temporarily limit the availability of credit and increase the cost of funding for some lower-rated or smaller municipalities. Over time, however, funding for those municipalities would be restored as the downgraded firms were replaced by the surviving healthy firms and by new entrants. As has been widely reported, a large, well-capitalized insurance group recently has opened a company that has been licensed to enter the business of insuring municipal bonds.

U.S. banks' direct exposures to losses from downgrades of guarantors' ratings appear to be moderate relative to the banks' capital. Although some securities firms also have such exposures, I will leave assessment of the magnitude of those exposures to the witness from the

Securities and Exchange Commission. Banks hold large amounts of municipal bonds in their investment portfolios, but the actual risk exposure is far smaller. As noted previously, the guarantors typically have insured only investment-grade municipal debt. Thus, the credit risk of the underlying securities is low, even without insurance. Likewise, as noted previously, some banks could be obligated to purchase at par tender option bonds and variable-rate demand obligations that have been downgraded as a result of problems at the financial guarantors. Banks may also feel compelled by reputational concerns to purchase ARS that they have marketed to investors, even though they have no legal obligation to do so. Here again, however, losses to the banks would be limited by the relatively strong credit quality of the underlying bonds.

Of greater concern is the potential for losses at banks that have hedged their holdings of super senior tranches of CDOs of ABS with credit protection purchased from the guarantors. These hedges lose value when the financial condition of the guarantors deteriorates. In fact, many banks already have written down the value of their hedges significantly to reflect the market view that some guarantors may not meet their obligations on the protection they sold to the banks. Thus, further downgrades of the guarantors may not necessarily require those banks to write down the value of their hedges significantly further. However, as long as the concerns about the ability of some guarantors to meet their obligations persist, any further declines in the value of the banks' holdings of CDOs of ABS will not be fully offset by increases in the value of their hedges.

Even if banks' losses from exposures to the guarantors are moderate relative to capital, banks could experience significant balance sheet and liquidity pressures if they take significant volumes of tender option bonds, variable-rate demand obligations, or ARS onto their balance sheets. The banks that have these exposures are currently well capitalized. However, if these

banks take on significant-enough volumes of such securities, the resulting downward pressure on capital ratios might prompt some of them to raise additional capital or constrain somewhat the growth of their balance sheets to ensure that they remain well capitalized. Efforts to constrain the growth of their balance sheets could be reflected in somewhat tighter credit standards and terms for a variety of bank borrowers, including households and businesses. Many banks already have tightened lending standards and terms, likely in part because of balance sheet pressures associated with recent turmoil in financial markets. Further tightening would add to the financial headwinds that the economy already is encountering.

In addition to the direct effects of stress at financial guarantors on the municipal bond markets and banks, stress at guarantors could have adverse indirect effects on investor confidence in the financial markets generally. Investors could demand higher risk premiums for holding financial assets, which would place downward pressure on asset prices. If the drop in confidence was sudden, asset markets could become less liquid and asset prices could become more volatile. These effects would increase market risks and counterparty credit risks to banks and other financial market participants, which could prompt a pullback from risk-taking. However, a sudden drop in confidence seems unlikely. Financial market participants seem well aware of the difficulties the guarantors are facing and of the potential for further ratings downgrades. Indeed, spreads on credit default swaps for several of the guarantors exceed 1,000 basis points, which suggests that the market already is expecting further bad news regarding those companies' financial condition.

Federal Reserve's Efforts to Monitor and Assess the Effects on Financial Stability

The Federal Reserve has been carefully monitoring and assessing the channels through which deterioration in the financial condition of the guarantors could adversely affect financial

stability. As primary supervisor of state-chartered banks that are members of the Federal Reserve System and umbrella supervisor for bank holding companies, the Federal Reserve has collected and analyzed information on banking organizations' exposures to the financial guarantors. In these efforts we have worked closely with the Office of the Comptroller of the Currency, which is the primary supervisor of national banks, including the largest U.S. banks. We have also shared information with the Securities and Exchange Commission, which is carefully monitoring and assessing the exposures of securities firms, especially the very large securities firms that it supervises on a consolidated basis.

We also have been monitoring closely developments in municipal securities markets and in the markets for RMBS and CDOs, from which the principal pressures on the guarantors have originated. More generally, we have been analyzing the underlying causes of the recent financial turmoil and contributing to efforts by the President's Working Group on Financial Markets and the Group of Seven's Financial Stability Forum to develop recommendations for addressing the weaknesses in markets and institutions that the financial turmoil has made evident.

TESTIMONY
OF

ERIK R. SIRRI
DIRECTOR, DIVISION OF TRADING AND MARKETS
U.S. SECURITIES AND EXCHANGE COMMISSION

CONCERNING
THE STATE OF THE BOND INSURANCE INDUSTRY

BEFORE THE
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 14, 2008

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Testimony Concerning

The State of the Bond Insurance Industry

by Erik R. Sirri
Director, Division of Trading and Markets
U.S. Securities & Exchange Commission

Before the
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
Committee on Financial Services
U.S. House of Representatives

February 14, 2008

Chairman Kanjorski, Ranking Member Pryce, and Members of the Subcommittee:

Thank you for inviting me to testify on behalf of the Securities and Exchange Commission about recent events in the financial markets and the implications arising from concerns about the credit-worthiness of certain bond insurers.

As a threshold matter, the Commission does not regulate these financial guarantors, known colloquially as monoline insurers; rather this is the domain of state insurance regulators. The Commission does, however, have specified regulatory authority over the credit rating agencies, or nationally recognized statistical rating organizations, that issue credit ratings to monoline insurers. There are also various ways that the securities markets and their participants, which the Commission does regulate, may be impacted by the declining creditworthiness of monoline insurers. Principal among these are certain systemically important securities firms (known as consolidated supervised entities or CSEs), municipal securities issuers and dealers, and municipal bond and money market funds, all of which engage with monoline insurers, either directly or indirectly, and may be affected by recent events.

While the monoline insurers are important market participants with potential impact through a number of different channels, the Commission staff has observed that most market actors are acutely aware of the potential issues and are taking steps to manage their exposures.

There is no question that, over the past year, the default of home purchasers with subprime credit on mortgage obligations has had a broad and significant impact. In addition to the difficulties that this has caused borrowers and others in their communities, the sharp rise in defaults has reverberated through the financial markets. Not surprisingly, a variety of securities that referenced pools of subprime mortgages were directly affected. Moreover, in a demonstration of the degree to which markets are linked, the indirect effects were much more broadly visible. As default levels on subprime mortgages exceeded expectations, market participants began to question the

value of a variety of financial products. And as valuations came into doubt, liquidity in these products fell sharply, which further complicated the task of valuing particularly complex instruments. Derivatives referencing mortgages were not the only investments that experienced an unexpected decline in liquidity. A variety of other complex financial products that involved non-mortgage assets suffered diminished liquidity as well. As liquidity shrank with respect to structured products, market participants needing to raise funds sold less complex financial instruments such as equities and municipal securities, placing downward pressure on prices in those markets. Overall, these dynamics have significantly impacted a wide range of market participants, from individual investors to systemically important financial institutions.

Another area of concern on the part of many market participants is the financial and risk position of some of the bond insurers. These bond insurers began by insuring against defaults on bonds issued by municipalities. During the 1990s, some bond insurers migrated to insuring complex securities backed by home mortgages, including subprime instruments. In insuring such structured products, many of these bond insurers assumed that losses on mortgage-backed securities would stay within historical ranges. As the housing boom continued for many years, defaults were indeed low. However, during 2006, there was increasing evidence of the deterioration in home prices and related rise in mortgage default rates. As the deterioration has continued, market participants are questioning whether such bond insurers will in fact be able to pay on their bond guarantees and credit protection that they underwrote.

Commission Supervision of CSEs and Exposure to Monolines

The Commission supervises certain holding companies of securities firms, known as consolidated supervised entities (CSEs), on a consolidated basis. The focus of this prudential regime is the financial and operational condition of the holding company, and monitoring for risks that might place regulated entities within the group or the broader financial system at risk. At present, five internationally active securities firms are supervised under this regime: Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley.

Each of the CSEs is of potentially systemic importance, trading a wide range of financial products, connected through counterparty relationships to other large institutions and providing services to a variety of market participants. The Commission's supervision of CSEs is primarily concerned with the risks that counterparties and market events potentially pose to the CSE firms specifically and, through the CSEs, to the financial system. This program's aim is to diminish the likelihood that weakness in the holding company itself or any unregulated affiliates would place a regulated entity, such as a bank or broker-dealer, or the broader financial system, at risk.

The Commission's CSE program supervises holding companies in a manner broadly consistent with the Federal Reserve's oversight of bank holding companies. CSEs are subject to a number of requirements under the program, including monthly computation of a capital adequacy measure consistent with the Basel II Standard, maintenance of substantial amounts of liquidity at the holding company, and

documentation of a comprehensive system of internal controls which are subject to Commission inspection. Further, the holding company must provide the Commission on a regular basis with extensive information regarding its capital and risk exposures, including market and credit risk exposures.

Under the CSE program, in addition to adequate capital, liquidity and liquidity risk management are a critical focus of the Commission's review of broker-dealer holding companies. Liquidity is essential to the viability of all financial institutions. The ability of a firm to withstand market, credit, and other types of stress events is linked not just to the amount of capital the firm possesses, but also to the sufficiency of liquid assets to meet obligations as they arise.

Due to the importance of liquidity to the CSE firms, the Commission seeks to determine whether each CSE firm has adopted and follows funding procedures designed to ensure that the holding company has sufficient stand-alone liquidity and sufficient financial resources to meet its expected cash outflows in a stressed liquidity environment for a period of at least one year.

In addition to its focus on liquidity and liquidity risk management, Commission staff meets regularly with senior managers of critical control functions. Specifically, Commission staff meets frequently with senior risk managers focused on market and credit risk exposures, and meets often with senior financial controllers, senior treasury personnel, and senior internal audit personnel. Senior SEC personnel also meet periodically with senior management of the CSEs.

In the course of its constant contact with CSE firms, the Commission staff has discussed and reviewed the CSEs' current and potential exposures to monoline insurers. These exposures fall into three broad categories: credit risk, market risk, and liquidity risk.

In terms of credit risk, many CSE firms execute derivative trades with monolines, generating direct counterparty credit risk exposure. For instance, a CSE may purchase credit default swap protection from a monoline. In such transactions, should the credit underlying the credit default swap contract default, the monoline would be expected to make a protection payment to the CSE. CSE firms also bear indirect counterparty credit risk exposure to monolines through derivative transactions with municipalities that are "wrapped," or guaranteed, by monolines.

In terms of market risk, the CSE firms are exposed to the perceived creditworthiness of monolines through "wrapped" securities they may have in inventory. These include municipal securities, tender option bonds, auction rate securities, and some mortgage products. In addition, most of the CSE firms have trading and hedging positions linked to monolines' creditworthiness, e.g., credit default swaps referencing monoline debt.

Finally, the CSE firms also have implicit and explicit liquidity risk exposure to monolines through their activities as remarketing agents for certain products, such as

auction-rate securities and tender option bonds. These programs fund longer-term obligations, such as municipal debt, with liabilities that have the characteristics of shorter-term paper. Often, monolines wrap the underlying longer-term obligations. Some of these programs are required to have liquidity backstops. Thus, a CSE may bear liquidity risk explicitly by acting as the liquidity provider for a particular program, e.g., for tender option bonds or variable rate demand notes. Even where that liquidity backstop is provided by a third party or where a backstop is not required, a CSE bears implicit liquidity risk when acting as the remarketing agent on a program, as it may decide to support the program and take securities on balance sheet out of client and franchise considerations.

Over the past six months, Commission staff has discussed these exposures to monolines with increasing frequency with CSE firm risk managers, treasurers, and business unit personnel. While the monolines are important market participants with impact through all the channels described above, the CSE firms are highly aware of and actively manage their exposures to the monoline sector. Although the exposures are undoubtedly in some instances material, based on the information available to us through our supervision of the firms, we believe that they have adequate capital and liquidity to deal with the consequences of the downgrade or even default of one or more monoline insurers.

The Commission staff is also in regular communication with other financial services supervisors, particularly the Federal Reserve Board, which directly oversees the holding companies of most of the systemically important commercial banks, the OCC, which oversees nationally charted commercial banks, and the UK's Financial Services Authority. Through a variety of formal and informal channels, the staff has worked with these other supervisors to understand the possible impact of downgrade or financial distress on individual institutions and on the broader financial system.

Municipal Securities Market

The municipal securities market is very significant, with $2.5 trillion of municipal securities outstanding and annual trading volume of $6.6 trillion. For this reason, the Commission staff is closely monitoring developments in the municipal securities markets related to the concerns about the credit-worthiness of the monoline insurers and the actual or potential ratings downgrades of bond insurers and associated ratings changes on insured municipal securities. Since an insured municipal security generally carries the higher of the rating of the insurer or the rating, if any, of the underlying source of repayment, downgrades and withdrawals of ratings on many bond issues result from downgrades of a bond insurer. In recent years, about half of all municipal securities offerings have been insured; insurance is also obtained in the secondary market. Although such downgrades will negatively affect the price of most bonds insured by companies that have been downgraded, the issuers and conduit borrowers with primary responsibility for repayment of these securities generally have investment-grade credit ratings or equivalent credit strength, mitigating the impact of downgrades of insurance providers.

Market participants have informed us that a few auctions of auction-rate securities in the municipal and corporate markets may have attracted too few bidders to establish a clearing rate as a result of turmoil in the credit markets, resulting in higher interest rates on those securities for a period of time. We understand that some municipal issuers and conduit borrowers have expressed an increased interest in converting their auction-rate bonds into variable-rate bonds backed by letters of credit or other types of credit enhancement or fixed rate bonds. However, heavy demand for such credit enhancement instruments and market concerns may have made them more difficult and time consuming to obtain.

We are also concerned about: the potential impact of downgrades of securities held by municipal money market and other funds; possible termination events of liquidity instruments; termination events or collateral posting events of swaps and other derivatives entered into by municipal issuers and conduit borrowers triggered by rating downgrades of either insurers or swap counterparties; and difficulties experienced by some state and local government investment pools. We are maintaining close contact with market participants to keep abreast of market volatility, pricing, and other issues.

The securities laws limit the extent of Commission regulatory authority over states and political subdivisions issuing municipal securities and conduit borrowers that are not public companies. Municipal securities are exempt from the registration and reporting provisions of the federal securities laws, and the Commission cannot specify line-item disclosure requirements or review disclosure documents in connection with offerings of municipal securities. Issuers and other participants in municipal securities offerings are, however, subject to the anti-fraud provisions of the federal securities laws, which prohibit materially misleading disclosures in connection with the offer, purchase, and sale of securities.

The disclosures made by private conduit borrowers with primary responsibility for repayment of many securities in the municipal market are often much less comprehensive than disclosures made by comparable entities in the corporate market. In fact, some conduit borrowers, in offerings backed by letters of credit, bond insurance, or other forms of credit enhancement, make no disclosures about themselves in their offering documents on the theory that the investors are looking solely to the credit enhancer for payment. Although the Commission has expressed the view that the presence of credit enhancements are generally not a substitute for material disclosure concerning the primary obligor on municipal bonds,[1] some offerings do not contain such disclosures.

As previously noted in Chairman Cox's letter to the bipartisan leadership of the House Financial Services Committee and Senate Banking Committee last summer, disclosure in the municipal securities market, particularly in the secondary market, is substantially less comprehensive and less readily available than disclosure by public reporting companies. Despite the size and importance of this market, it lacks a variety of the systemic protections found in many other sectors of the U.S. capital markets. The

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[1] Securities Exchange Act Release No. 26985 (June 28, 1989), 54 FR 28799 (July 10, 1989).

recent problems of municipal bond insurers and the direct and indirect impact on municipal bond investors illustrate once again some of the shortcomings of the regulatory structure of this market.

Credit Rating Agencies

On September 29, 2006, President Bush signed into law the Credit Rating Agency Reform Act of 2006 (the "Rating Agency Act"), which permits credit rating agencies to apply to register with the Commission as nationally recognized statistical rating organizations ("NRSROs") and establishes a regulatory regime for those that become registered. Pursuant to the Act, the Commission issued final rules on NRSRO registration and oversight on June 18, 2007, all of which became effective either on that date or on June 26, 2007, the statutory deadline for issuing final rules. Since then, a total of nine credit rating agencies have voluntarily registered as NRSROs, including three that assign ratings to monoline insurers: Fitch Ratings ("Fitch"), Moody's Investors Service, Inc. ("Moody's"), and Standard & Poor's Ratings Services ("S&P").

Beginning in December 2007, Fitch, Moody's, and S&P have undertaken a number of ratings actions on monoline insurers. Each of the three has issued downgrades to the ratings of several monoline insurers and placed others on review for possible downgrade. Moody's and S&P have placed both MBIA Inc. and Ambac Financial Group Inc. on review for possible downgrade, while Fitch has downgraded Ambac from a triple-A to double-A rating and has added MBIA to its ratings watch negative list.

The ratings actions on monoline insurers have primarily been driven by the poor performance of the subprime residential mortgage-backed securities and collateral debt obligations for which monoline insurers have provided guarantees. As a result, the rating agencies now expect significantly higher levels of losses from those securities, which in turn would raise the potential amount of losses the monoline insurers would be obligated by their guarantees to pay if those losses should occur. As a result, the rating agencies have increased their estimates of the amount of capital required to support the insurers' guarantees and given closer scrutiny to the insurers' risk management and business models, resulting in extensive ratings actions.

The Rating Agency Act requires registered rating agencies to disclose their policies and procedures, including those regarding the ratings process and conflicts of interest. Last summer, using the new statutory authority that became effective in June 2007, the Commission staff began examinations of whether these credit rating agencies diverged from their stated methodologies and procedures for determining credit ratings in order to publish a higher rating. The staff's examinations are also focusing on whether the credit rating agencies followed their stated procedures for managing conflicts of interest inherent in the business of determining credit ratings for residential mortgage-backed securities. In this regard, these ongoing examinations will seek to determine whether the credit rating agencies' role in the process of bringing residential mortgage-backed securities to market impaired their ability to be impartial. I expect the findings from these examinations to result in a final report to follow in the early summer. The

information gathered will better inform the Commission's oversight of the rating agencies, including their ratings of monoline insurers.

Mutual Funds

The Commission staff is closely monitoring developments with respect to bond insurers and their actual or potential effects on municipal money market funds, municipal bond funds, and other types of investments.

Bond Funds

The Commission regulates mutual funds and other investment companies under the Investment Company Act of 1940 and other federal securities laws. Investment companies of all types hold municipal bonds worth more than $850 billion, or 37% of the $2.5 trillion of municipal bonds outstanding. Mutual funds, including money market funds, hold 35% of all municipal bonds, and closed-end investment companies hold 2%. Funds that pursue a variety of investment strategies may hold municipal bonds. However, the vast majority of the municipal bonds that funds hold are in so-called municipal or tax-exempt funds, which are funds that seek to derive most or all of their income from municipal bonds that pay interest that is exempt from federal income tax. The Commission requires funds that call themselves tax-exempt to invest at least 80% of their assets in, or derive 80% of their income from, municipal bonds.

Only a small percentage of tax-exempt funds principally invest their assets in municipal bonds that carry insurance issued by the monolines. These funds generally have the word "insured" in their name and have an investment policy that requires at least 80% of their assets be invested in municipal bonds the payment of interest and principal on which is guaranteed by a AAA rated insurance company. The 36 municipal funds with "insured" in the name account for only 2.3% of all municipal bond mutual fund assets. Insured funds are more prominent among closed-end funds, representing about 28% of all closed-end municipal fund assets.

In total, insured funds hold less than 3% of the reported $1.6 trillion of insured municipal bonds outstanding. In addition, some so-called "non-insured funds," which are municipal bond funds that do not have "insured" in their name, may hold insured municipal bonds. Typically, a non-insured fund is deterred from holding insured municipals because they generally yield less than non-insured municipals with the same rating. However, a non-insured fund may be attracted to insured municipals to the extent they broaden the universe of available investments. For example, the presence of insurance may provide the credit support needed for a bond to be rated AAA or to meet other ratings criteria maintained by a fund.

Money Market Funds

Money market funds are subject to Rule 2a-7 under the Investment Company Act, which generally limits these funds to investing in a diversified portfolio of high quality, short-term dollar-denominated instruments. Fifteen percent (15%) of all money market fund assets belong to municipal or tax-exempt money market funds, which are funds that

invest at least 80% of their assets in short-term municipal securities. Market observers have informed the staff that in 2007 up to 40% of municipal money market fund assets may have been "wrapped" or guaranteed by monoline insurers. These securities include variable rate demand notes and tender option bonds that have liquidity backstops provided by a CSE or other large financial institution. In addition to providing a source of cash to satisfy redemptions by fund shareholders, these liquidity features operate to shorten the municipal bonds' maturity and make them appropriate investments for a money market fund.

In most cases, the liquidity backstops require that the municipal bonds maintain certain ratings, which may be threatened by the ratings downgrades of the monolines. The Commission staff has been in regular contact with fund management companies, which are aware of these risks and have taken steps intended to protect municipal money market funds from the loss of these liquidity backstops. Fund managers have begun to examine the credit quality of the underlying municipal issuers and evaluate the risks of continuing to hold the instruments should they no longer be able to rely on bond insurance. Where the underlying credits are unsatisfactory, some fund managers are attempting to obtain alternative credit support or are selling the instruments. Where the underlying credits are satisfactory, fund managers are seeking amendments to the security's documentation that will preserve the liquidity feature in reliance on ratings issued to the municipal issuer without regard to the ratings issued to the monoline insurer. Fund managers report that they have been discussing their actions with fund boards of directors which are keenly interested in these developments. In the interest of the integrity of the municipal marketplace, we as regulators, and especially in our oversight function, must be careful not to trigger unnecessary sales of securities.

Losses by a money market fund, including a municipal money market fund, would be reflected by the fund re-pricing its securities below $1.00 ("breaking the buck"), an event that has happened only once since the development of money market funds in the 1970s. Based on its oversight of the industry, the Commission staff is presently unaware of any municipal money market fund currently threatened with breaking the buck as a result of recent downgrading and potential downgrading of monoline insurers.

Possible Effect on Funds of Monolines' Creditworthiness

Although it is difficult to predict the effect on municipal bond or money market funds of the declining creditworthiness of bond insurers, some projections can be made.

- A downgrade may require many insured funds to change their investment policy with respect to the ratings quality of portfolio holdings if those holdings are no longer guaranteed by an AAA-rated insurance company.

- Any overall decline in the value of municipal bonds or insured municipal bonds would be reflected in equivalent declines in the value of municipal bond fund shares.

- A more severe downgrade (e.g., from AAA to A) is likely to have a greater effect on the value of municipal bonds and funds than a less severe downgrade (e.g., from AAA to AA).

- A downgrade may present more price risk to an owner of a single municipal bond than to an owner of shares of a diversified municipal bond fund.

- With respect to municipal money market funds, if monoline ratings fall below A, many liquidity puts will terminate, the result of which will be to expose the funds to long-term, lower quality, illiquid debt which would result in lower prices.

- In the long term, the inability of bond insurers to maintain high credit ratings may restrict supply of high quality paper for municipal money market funds.

Thank you for the opportunity to testify before you today. I would be happy to answer any questions you might have.

Testimony of
New York State Governor Eliot Spitzer

Before the
Committee on Financial Services
Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises
United States House of Representatives

Regarding:
Bond Insurance

February 14, 2008

Revised

I would like to thank Chairman Kanjorski, Ranking Member Pryce and the other members of the Capital Markets Subcommittee of the House Financial Services Committee for allowing me to testify today.

My name is Eliot Spitzer and I am Governor of New York State.

In my testimony, I would like to discuss the bond insurance problem, why it is so severe, how we got here and why New York is so involved in trying to structure a resolution. New York State Insurance Superintendent Eric Dinallo will discuss in more detail how we have been dealing with the problem in the next panel.

We start with a fundamental question. How is it that problems, even serious problems, for a small group of relatively small companies conducting a relatively obscure business—insuring bonds—can have such a large impact on our entire economy?

And let's be clear, the problems of the bond insurers are spreading and threaten serious problems well beyond the financial markets. The problems in this market will affect many average Americans. It will affect the cost of college loans. It will affect museum budgets. It will affect state and local taxes.

Let me give you several examples of its far reaching impact:

It will affect the individual investors who own about two-thirds of the municipal bonds either directly or through mutual funds, a total of about $1.6 trillion, most of which are insured. If all of the bond insurers lose their triple-A rating, the value of the insured muni bonds held by investors declines. This has already happened to some insured muni bonds. That means millions of average Americans who viewed them as a low-risk investment, have lost or potentially could lose money, even though the underlying bonds have not defaulted. Many of these investors have already stopped investing in municipal bonds, reducing demand. Since interest rates go up when demand goes down, borrowing costs have sky rocketed.

It will and has had an effect on governments that rely on the municipal bond industry to finance important capital projects. The result of a destabilized bond insurance market is that some governments, already facing reduced income due to the slowing economy, will have higher borrowing costs. That means shifting funds from schools and police to pay interest.

Faced with higher borrowing costs, many governments have put off issuing bonds. At a time when the economy is weak, we do not want to slow the pace of capital construction by the public sector.

Bond insurance is particularly important for small towns and rural communities. They need it to put their bonds on an equal footing with large state authorities and big cities. If they cannot obtain bond insurance or have to pay a higher price for it, it will likely cost them more to borrow the funds they need for important capital projects. Again, that will

mean delay or cancellation of important capital construction, or increases in taxes or fees that pay for these bonds, or less money for vital services.

Another impact has been on the market for auction rate securities which governments use to finance debt.

Auction rate securities are an example of the financial creativity that makes New York the financial capital of the world. They are a way to borrow long term while paying lower short term interest rates. The interest rate on the bond is set weekly or monthly through an auction. But recently many of those auctions have failed, meaning there were not enough buyers. On Tuesday alone I am told at least 100 auctions failed.

New York State has about $4 billion of these securities outstanding. Auctions for our securities are among those that have failed. This has nothing to do with the creditworthiness of the State. The risk of default on a bond backed by any State is virtually non-existent and certainly has never occurred in New York.

The Port Authority of New York and New Jersey, an extremely solid institution, was paying four percent on its auction rate bonds. It is now paying 20 percent. Though it is only paying that rate for a very short time, that is a rate that would normally only be paid by a very risky borrower.

The higher costs have nothing to do with our ability to pay, which is unchanged and solid. It is in good part because of questions about the ratings of the bond insurers and the other effects of the subprime crisis.

And we are all well aware that this crisis has also had an enormous impact on our financial institutions. The write downs and losses that large financial institutions are taking on collateralized mortgage securities related to subprime mortgages are significant. To date, banks and investment banks have had to recognize more than $100 billion in losses and give up substantial amounts of ownership equity to gain infusions of capital, often from foreign investors.

There is a general tightening of credit, which means less money available for companies to borrow so they can expand and consumers to borrow so they can buy homes, cars, appliances and other goods. This comes at a time when the economy is already weak.

In sum, if we do not take effective action, this could be a financial tsunami that causes substantial damage throughout our economy.

So how did we get here?

It is worth remembering that the issue we are discussing is a result of a series of decisions and actions or inactions that begin with the broader subprime mortgage crisis. It also highlights that at each stage of the subprime mortgage transaction structure, there were missed opportunities to identify and avoid this risk.

So let's look at each step of the process.

The first step and the cornerstone of this problem is the mortgage brokers, property appraisers and lenders who reduced their standards—and in some cases threw out any standards—and issued millions of mortgages to borrowers who could not afford them. Since most of these mortgages had very low introductory teaser rates, it was possible for a time to avoid the fact that the borrowers could not afford them, though not for very long.

Now as teaser rates reset, many of those home buyers find they cannot afford the rising adjustable rate payments on homes that are not worth as much as they borrowed. Some are not making mortgage payments, leading to a spike in foreclosures. In addition, the lenders that hold the loans find diminished and sometimes inadequate collateral value as the real estate market continues to decline.

This is causing serious problems around my state and around the country. Hard working people are losing their homes. The growing numbers of vacant houses in communities further reduces home values and impacts the quality of life. This has led to a cascading effect, driving home values down nationwide.

We still do not know how many will ultimately be unable or unwilling to pay, but it is clear that the numbers are quite high. Some estimates are that for some pools of subprime mortgages, as many as one in four or more will default.

Clearly, we would not be here today if the mortgage brokers and lenders and appraisers had maintained reasonable standards. But we would also not be here today if the relevant regulators had stopped these bad lending practices.

The fact is, there were attempts to prevent the bad lending practices early on, before most of the damage was done. Several years ago, state attorneys general and others involved in consumer protection began to notice a marked increase in a wide-range of predatory lending practices by mortgage lenders, including misrepresenting the terms of loans, making loans without regard to the consumer's ability to repay, making loans with deceptive teaser rates that later ballooned astronomically, packing loans with undisclosed charges and fees, paying illegal kickbacks, and other similar practices. These practices were having a devastating effect on home buyers. In addition, we believed at the time that if left unchecked, the widespread nature of these practices threatened to have serious consequences on our financial markets. Little did we know quite how severe.

Individually, and together, state attorneys general of both parties brought litigation or entered into settlements with many subprime lenders who were engaged in predatory lending practices. State legislatures, including New York's, enacted laws aimed at curbing such practices.

But those efforts by States to protect consumers and capital markets were blocked by the Bush Administration. The Office of the Comptroller of the Currency, the federal agency

responsible for regulating federally chartered banks, intervened to prevent any effective regulation at the local level. The OCC invoked a clause from the 1863 National Bank Act to issue formal opinions preempting state predatory lending laws, thereby rendering them inoperative to nationally chartered banks. The OCC also promulgated new rules that prevented states from enforcing any consumer protection laws against national banks. Clearly the OCC was unable or unwilling to take action at the federal level. Remarkably, the OCC acted to preempt State efforts to halt predatory practices but did little to address these serious problems.

The OCC was more than happy to allow the problem to grow and the bubble to inflate.

The best way to stop the subprime mess would have been at step one, at the point of loan origination, before the vast reservoir of bad debt was created. It didn't happen.

Now let's look at step two in the process, which is securitization. Those subprime mortgages were then homogenized, that is, packaged into increasingly complex structured securities, like the CDOs, that we are now reading about. Now there is nothing inherently wrong with securitization. Indeed it has had an enormous upside for the market place and has been done for years with no problems. On the other hand, securitizing bad loans does not make them good loans. Or, to use the relevant cliché: garbage in, garbage out.

The investment banks securitized and marketed enormous volumes of debt as rock solid credits. Federal regulators could have and should have but did not did not stop the poor underwriting practices of the investment banks.

Now step three. These securities were then given top credit ratings by the rating agencies, making them appear once again to be a safe and nearly risk free investments. The rating agencies simply failed to properly understand the risk of the debt that was coursing through the marketplace. I think we would now all accept that greater scrutiny and oversight of the rating agencies by the S.E.C. was called for.

Then, step four. The subprime structured securities were provided with insurance by the bond insurance companies, making them appear even safer. The bond insurers should have and could have done a more independent and better evaluation of risk and refused to provide insurance. The bond insurance companies began as companies which provided only insurance on bonds, hence the term monoline insurer. That portion of their business is still quite significant and virtually default free. But as monolines sought to expand their business opportunities, they began to provide AAA rated insurance to increasingly complex securitized debt instruments. As we have now seen, these insurance companies may not have sufficient capital to cover the potential defaults of some of these instruments and state insurance regulators, who are the primary regulators of these entities, should and could have set higher standards for these insurers, which could have reduced their inappropriate risk taking. Superintendent Dinallo will address this further in his testimony.

Fifth and finally, the securities were sold to investors or held by the banks themselves as an investment. And now here we are.

This whole sequence of transactions has now come unraveled. The bond insurance companies are the thinnest point of defense. Although the insurers believe they have enough capital to pay eventual claims, the securities they insured have been downgraded in expectation of defaults. That requires the companies to add additional capital reserves to maintain their ratings. If they cannot maintain those ratings, a downgrade in the bond insurance company rating would cause the ratings of all of the debt that it has insured to drop accordingly. This cascading effect has rippled through both the municipal side of the business and the more complex securitized side, leaving massive declines in value, market dislocation and write offs. Hence the desire to recapitalize the bond insurance companies presents the first step in the sequence to stop the further spread of the problem.

I want to make three points here.

To those who have raised the issue of federal regulation of insurance, I would note that just creating an agency with the power to act does not guarantee it will in fact act. Creating a national regulator will not make a difference if those appointed to run it choose not to use those powers effectively. Many failures have been caused by the lack of Federal regulatory entities to regulate-- or --worse to block prudent regulation by others. One of the benefits of having 50 state regulators is that it is more likely that someone will recognize a problem and act on it.

Second, securitization is clearly here to stay. Properly used, it can be a valuable tool for raising capital and spreading, and therefore, reducing risk. But we must understand the moral hazard risks that it entails so we can properly identify and control those risks without either reducing appropriate use of securitization, or having to go through massive market dislocations from inappropriate risk taking.

Clearly, there must be a way to ensure that the risks that are packaged are accurately reported through each stage of the process so that underwriters, credit rating agencies, bond insurers and investors all understand the actual risk and make decisions on that basis. This is certainly an area where we should apply that creativity we prize.

Third, every institution involved should be taking a hard look at what happened and instituting reforms. That includes the private sector firms that underestimated the risks they were taking, and the government regulators that took no action.

I know that the New York State Insurance Department, along with insurance departments of other states, is studying how best to improve regulation. Superintendent Dinallo will address that issue when he testifies as part of the next panel. But the fact that the states need to improve does not lead to the conclusion that federal regulation of insurance is the answer, especially given the performance of other federal regulators on this issue.

Now, let me explain why I'm here testifying on this issue and, in fact, why the New York State Insurance Department has been playing a leading role in dealing with the problems in the bond insurance industry. As I stated at the outset, the bond insurance industry's problems have an impact on the American public as investors, through its state and local governments and financial institutions.

Some people say the federal government should be leading the effort. But the facts are that insurance is regulated by the states and most of the bond insurance companies are domiciled in and primarily regulated by New York. Ambac, the major company that is not domiciled in New York, has its actual headquarters around the corner from our Department's office in Manhattan.

As the primary regulator, the New York Insurance Department has the powers and ability to deal with the issue. We license insurers, we review their market conduct, and, if a company should become insolvent, we can rehabilitate or liquidate it.

We are not alone in addressing this problem. We have the assistance of the Wisconsin and Maryland Insurance Departments, which regulate Ambac, ACA and Assured Guaranty. We have the advice and support of the New York Federal Reserve Bank and the U.S. Treasury, with whom we regularly discuss developments. And we have hired a top notch financial advisor, Perella Weinberg, to help us analyze the various proposals and conduct discussions with the parties.

New York has a history of leadership in this area. In the 1980s, New York led the tough fight to prevent property casualty insurance companies from offering bond insurance. We can now see the wisdom of that stand. If the property casualty insurers were suffering from the potential losses in bond insurance, their solvency could be at risk and they could be seeking to raise their premiums in all their other businesses, potentially causing large increases in homeowner, auto and business insurance costs.

And it is New York's statutes for bond insurance, Article 69 of the New York State Insurance Law, that are the standard for state insurance departments around the country.

The bottom line is that over the last few months, it is the New York State Insurance Department that has been working daily with all the stakeholders—the bond insurers, their major stockholders, the banks and investment banks, financial advisors, private equity investors, and the rating agencies—to find solutions to the current problems.

As insurance regulators, it is our responsibility to protect policyholders and ensure a healthy, competitive market for insurance products. In the case of bond insurance, there are two main groups of policyholders. There are the municipal governments who bought insurance for the bonds they issued and the investors who bought those bonds. Then there are the banks and investment banks who bought insurance for the structured securities, including mortgage-backed securities they sold and invested in.

We have been working to facilitate solutions that protect all policyholders. After all, many of the banks and investment banks are New York companies.

From the beginning, we have been working on a parallel track on a range of possible solutions. Our strong preference has been to find ways to strengthen the bond insurers so they could maintain their top triple-A credit rating. But we have been clear from the beginning that municipal investors cannot be allowed to suffer from problems caused by another sector of the market. As one of the alternatives, we have some time ago requested that all of the bond insurers who are in trouble develop plans that will protect the municipal side of the business. We believe these plans should protect the triple-A rating of the municipal bonds. Superintendent Dinallo will describe in more detail our efforts and the results to date.

I hope you will agree that our priority now must be to reduce the harm to investors, governments and our financial institutions that support the American people and our economy from the subprime problems. To achieve viable solutions, it is essential that we continue to work with other regulators, the banks and the rating agencies. As I have already noted, all of us have something to learn from the subprime mess and all of us need to improve our performance going forward. But we cannot afford to let this valuable discussion degenerate into the kind of blame and finger pointing that damages our ability to focus on the essential immediate task.

I welcome your questions.

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ASSOCIATION OF FINANCIAL GUARANTY INSURERS

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Testimony

Submitted By the

Association of Financial Guaranty Insurers

To The

U.S. House of Representatives Committee on Financial Services'

Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises

Hearing On The

"State of the Bond Insurance Industry"

February 14, 2008

The Association of Financial Guaranty Insurers, an association of twelve insurers and reinsurers of municipal bonds and asset-backed and other structured financings, is pleased to submit testimony to the Subcommittee on the state of the industry.

Background:

Financial guaranty insurance provides an unconditional, irrevocable guaranty to pay principal and interest *when due* should the issuer of an insured bond default on its obligation. The financial guaranty insurance policies generally do not allow for acceleration of debt payment except at the will of the insurer. Financial guaranty insurers are generally rated Triple-A, and limit their insurance to investment grade risks.

While most insurance is written in the primary market at the time a bond is issued, there is a significant secondary market. In these cases, a dealer or broker will request insurance on a block of bonds from an issue that was not originally insured. The process for insuring these bonds is otherwise similar to that which occurs in the primary market.

Reinsurance also plays an important role in the financial guaranty industry. The primary insurers often "cede" a portion of their exposure, and a corresponding portion of the premiums they collect, to a financial guaranty reinsurer. This allows the primary insurer to spread the risks it incurs – especially on a large bond issue.

Once a policy is in place, the insurer continually monitors it. This surveillance function ensures early detection of any problems that might affect an issuer's ability to meet its obligations.

In the event of a default, the insurance contract calls for payments of interest and principal to be made to the bondholder without regard to acceleration, thus eliminating liquidity risk to the financial guaranty insurer. While payments to investors are thus secure, the insurer will often work with the issuer to "cure" the default, in order to minimize its own losses.

History, Growth and Regulation

The industry was established in 1971 to serve the U.S. municipal bond sector. Today, the industry serves both public infrastructure and asset-backed global markets. In 2007, the industry insures approximately 47 percent of new issue U.S. municipal bonds. The total net par outstanding on the debt insured by the industry is approximately $2.3 trillion. Of that, the four largest primary insurance providers – Ambac, FGIC, FSA, and MBIA -- insure nearly $2 trillion.

From 2001 through 2006, financial guaranty insurers insured --

- more than $1 trillion of bonds to fund schools, highways, airports, transit systems, hospitals, environmental systems and other projects;

- almost $82 billion of bonds to fund essential public projects outside the U.S.; and

- more than $1 trillion of asset-backed bonds to provide cost efficient funding to corporations and financial institutions around the world.

The industry adheres to strict investment-grade underwriting practices, meaning virtually all insured risks are rated Triple-B or higher. As a result the industry's loss experience has been low. Since inception, the industry has incurred only three basis points (three one-hundredths of one percent) in losses on net debt service. That is far different from banks, which had weighted average annual charge-offs on principal of 60 basis points from 1992 to 2006.

The financial guaranty insurance industry is heavily regulated and highly transparent. It operates under the risk-based capital standards and reserving requirements of Article 69 of the New York Insurance Law (the "Article"). The Article contains stringent single and aggregate risk limits and reserving requirements. The Article requires that financial guaranty insurers be monoline, meaning that they may engage only in financial guaranty insurance and a few related lines of insurance. They may not write traditional property/casualty insurance or life insurance.

The primary regulators are the New York State Department of Insurance and other state insurance departments. Several insurers are owned by public companies subject to SEC regulation. Many insurers have U.K. subsidiaries regulated by the U.K. Financial Services Authority.

The major rating agencies, Standard & Poor's, Moody's, and Fitch, closely monitor the financial guaranty insurers, require ongoing information from the insurers, and issue frequent reports on the industry.

In this environment of strong regulation and conservative underwriting, the industry's claims-paying resources[1] have grown from $10.9 billion in 1995 to $48.8 billion in the first half of 2007.[2]

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[1] Includes statutory capital, unearned premium reserves, installment premiums, soft capital facilities, and loss adjustment expense reserves.

[2] Source: S&P and company operating supplements and financial reports of MBIA, Ambac, FSA, FGIC, XLCA (SCA), CIFG, Radian, Assured and ACA. Reported financials for Radian, CIFG and XLCA (SCA) combine financial guaranty insurance and reinsurance.

The Benefits Provided to Issuers and Investors

Financial guaranty insurance offers concrete benefits for borrowers and investors.

Issuers can achieve Triple-A ratings by attaching insurance to their bonds. The higher ratings mean lower interest costs. Since inception, financial guaranty insurers have saved U.S. state and local governments and their taxpayers more than $40 billion in interest payments. They have increased the economic leverage and funding sources of both large and small government borrowers. For small municipal issuers, access to capital markets is only possible with financial guaranty insurance.

Investors have the ironclad -- irrevocable, unconditional -- guaranty against default on payment of principle and interest. Since the inception of financial guaranty insurance, no holder of an insured bond has failed to receive payment of debt service when due. Financial guaranty insurers also waive all defenses including fraud and non-payment of premium.

Investors have the benefit of enhanced liquidity and of reduced market value volatility. They benefit further from the ongoing surveillance of insured issuers and the application of remedies when and where needed. Unlike a trustee, a financial guaranty insurer has capital at risk and, therefore, its interest aligns with bond holders.

Types of Bonds Insured

There are two main categories of insured bonds -- public finance and structured finance.

Public finance encompasses municipal bonds and infrastructure financings. U.S. municipal bonds are backed by tax and other state or municipal authority revenues and support essential infrastructure, such as transportation and healthcare. Municipal and investor-owned utilities also issue bonds. Additionally, particularly outside the U.S., many essential public infrastructure projects are financed through private finance initiative (PFI) or public-private partnership (PPP) transactions involving long-term government concessions to private developers and operators.

Structured finance bonds include mortgage-backed bonds and asset-backed securities, which are backed by revenue streams including credit card and other consumer loan receivables. Structured finance bonds may also be in the form of pooled debt obligations, e.g., collateralized debt obligations (CDOs), collateralized loan obligations (CLOs), collateralized bond obligations (CBOs) and structured credit.

In addition to providing financial guarantees, financial guaranty insurers also provide surety bonds and credit derivatives, whose terms mirror a financial guaranty insurance policy. These policies generally have pay-as you-go settlement terms, and there is no requirement to post collateral if the underlying credit deteriorates, thus eliminating liquidity risk.

As of year-end 2006, AFGI members insured $2.2 trillion of net par outstanding worldwide, with U.S. public finance bonds accounting for 60 percent of that amount and U.S. structured finance accounting for 26 percent, with the remainder in the international market.

Financial Guaranty Insurer Involvement in U.S. Residential Mortgage Backed Securities (RMBS) and CDOs of Asset-Backed Securities (ABS)

The current market dislocation results from several issues in the primary mortgage market and the CDO market.

There has been unprecedented credit deterioration in the mortgage market that exceeded the most conservative historical loss expectations. Additionally, in the primary mortgage market, increased efforts by financial intermediaries and mortgage originators to introduce affordable products and facilitate homeownership have increased credit risk. Since the Great Depression, there has been no year-over-year decline in home prices for the entire U.S. (There have been only regional declines in successive years.)

The extent of the credit deterioration is reflected in the changes in rating agency requirements for a securitized subprime first-lien residential mortgage loan pool.

- In 2006, rating agencies expected lifetime losses on such pools to be 4.5% to 6% of the original pool balance.
    - By January 2008, rating agencies expected loss on the same pools was 14% to 19%, depending on the transaction.
- In 2006, the financial guaranty insurer Triple-A "attachment point," ranged from 23% to 28%.
    - In January 2008, the rating agency Triple-A attachment point ranged from 36% to 42%.
- In 2006, the financial guaranty insurer attachment point at Triple-B was 8% to 10%.
    - In January 2008, the rating agency attachment point ranged from 14% to 22%.

In the CDO market, financial guaranty attachment at the Triple-A level means that insurers should be able to withstand high levels of collateral losses. However, high grade and so-called mezzanine CDOs of ABS ultimately contain a high percentage of subprime mortgage loans. With regard to credit performance, it can be expected that:

- potential collateral losses will be higher than the original assigned credit rating;
- diversity and correlation assumptions may be low; and
- embedded leverage will magnify the effects of poor collateral performance.

Financial guaranty insurer involvement in the U.S. RMBS and CDOs of ABS amounts to $249 billion net part outstanding.

The sector and underlying rating distributions follow:

Sector distribution:

ABS/CDO High Grade	31%
ABS/CDO Mezzanine	8%
CMBS/CDO	22%
HELOC	26%
SUBPRIME	13%

Underlying rating distribution:

SUPER AAA	28%
AAA	38%
AA	4%
A	7%
BBB	22%
BIG	1%

The allocation of subprime mortgage risks within CDOs is a key factor. To that end, it is important to understand the following points, which are illustrated by the graphic on the next page:

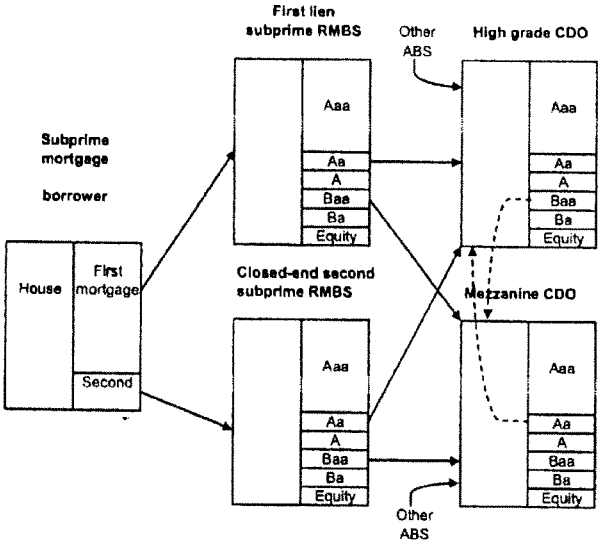
- subprime mortgage loans can be first mortgages, with a first lien on the property serving as collateral to the loan, or second mortgages (generally closed-end loans where the borrower receives a specified amount at closing) that are subordinated to the first mortgage;

- the loans are generally packaged by type into pools of collateral to form the basis of RMBS;

- different tranches, created with varying levels of priority on cash flows generated by the underlying pool, are then sold to third parties, with the AAA tranche having first priority, followed by the AA tranche, etc.;

- CDOs of ABS, in turn, may invest in tranches of RMBS transactions, as well as in other ABS, with Aa or higher tranches classified as "high grade" and Baa or higher tranches classified as "mezzanine"; and

- both types typically have a small allocation within the collateral pool that may be invested in lower-rated collateral.



In order to more fully understand the financial guaranty insurer involvement in the U.S. RMBS and CDO of ABS it is important to know the following:

- Under U.S. GAAP, insurance policies that are in credit default swap form typically must be marked to market through an insurer's income statement.
- Absent any claims under the guaranty, any decreases or increases to income due to marks will sum to zero by the time of each contract's maturity.
- The industry and rating agencies view the large, negative unrealized mark-to-market adjustments taken in the third quarter if 2007 as accounting requirements, not as measurements of capital adequacy. Capital adequacy is concerned with fundamental credit analysis and not mark-to-market losses.
- The mark-to-market accounting requirement has caused a problem of perception. The change in the accounting rules has created a misperception regarding the industry's financial performance as spreads have widened. Mark-to-market losses are very different from actual credit losses.

Implications and Challenges for the Financial Guaranty Insurers That Have Exposure to this Asset Class (i.e., CDOs and ABS)

The financial guaranty insurance business model remains viable, as confirmed by Berkshire Hathaway's entry into the business. At the same time, the industry faces unprecedented stress from a variety of sources, including --

- deteriorating asset performance in the residential mortgage sector;

- declining confidence in the rating agencies and Triple A-ratings;
- rating agency recalibration of the standard needed to maintain Triple A ratings; and
- "activist" short sellers.

In the present situation, financial guaranty insurers are focused on maintaining their Triple-A capital levels and/or having the Triple-A rating restored as soon as practical. In order to restore their Triple-A ratings, financial guaranty insurers facing potential downgrades can --

- reinsure well performing, capital intensive insured financing;
- issue equity, debt, and/or hybrid securities;
- insure higher rated, less capital-intensive deals to limit incremental capital requirements; and
- run off from existing portfolios to generate significant incremental capital annually, and add to capital as exposure amortizes.

Losses incurred by financial guaranty insurers are expected to be manageable. This is not a systemic failure, but a single product issue, insured CDOs of ABS. The insured CDOs of ABS ultimately contained a high percentage of tranches of subprime mortgage loans where the diversity and correlation assumptions may have been too low and the embedded leverage multiplied the effects of poor collateral performance. However, attachment at Triple-A or "super" Triple-A levels should allow these securities to withstand greater collateral losses.

Also, as noted above, the unrealized mark-to-market adjustments that the financial guaranty insurers are required to take through their income statements on insurance policies issued in credit default swap form under U.S. GAAP accounting rules are obscuring the true performance of the industry, absent credit deterioration and given the financial guaranty insurer's intent to hold these contracts until maturity.

The industry's underlying financial strength and claims paying ability, as well as its conservative business model which requires it to pay losses only when due, should enable the industry to withstand deteriorating asset performance in the residential mortgage sector. The industry does not need nor does it want a federal government bailout. The industry is committed to working with its regulators to manage through the current dislocation.

Attached to this testimony is a presentation and summaries of the primary financial guaranty insurers' financial statements that we would like to submit for the hearing record as well

We appreciate the Subcommittee's interest in this important issue and look forward to continuing to work with the Subcommittee as it continues to review these important issues.

* * *

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Business Overview of Primary Bond Insurers and Report on Involvement in U.S. Residential Mortgage-Backed Securities and Collateralized Debt Obligations of Asset-Backed Securities

U.S. House of Representatives Committee on Financial Services' Subcommittee on Capital Markets, Insurance and Government – Sponsored Enterprises

State of the Bond Insurance Industry Hearing

February 14, 2008

Submitted with Testimony by the Association of Financial Guaranty Insurers (AFGI)

AFGI is a trade association of 12 insurers and reinsurers of municipal bonds and asset-backed securities.

Agenda

- Business Overview of Primary Bond Insurers
- Bond Insurer Involvement in U.S. Residential Mortgage-Backed Securities (RMBS) and Collateralized Debt Obligations of Asset-Backed Securities (CDO of ABS) Sector
- Monoline Implications
- Appendix I: Rating Agency Timeline
- Appendix II: Profiles of Primary Bond Insurers

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Business Overview

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Business Overview
Executive Summary

- Financial guaranty is a pure credit business
  - Unconditional and irrevocable guaranty to pay scheduled principal and interest on U.S. municipal, public infrastructure and asset-backed securities; no acceleration
  - Product provides efficiency in capital markets
  - The closest equivalent to financial guaranty is an irrevocable long-term bank letter of credit
- Financial guaranty companies are generally rated AAA
- Policy forms also include surety bonds as well as credit derivatives, whose terms mirror a financial guaranty
  - No liquidity risk
  - No collateral posting
  - Pay-as-you-go settlement terms
- Financial guaranty companies take long-term credit risk
  - Cannot trade out of risk; hold to maturity, but may mitigate risk through reinsurance
  - Control of remedies and remediation is critical to loss mitigation
- Credit is principal driver of long-term profitability
  - Underwrite investment-grade risks only
- Industry is heavily regulated and transparent
  - New York State Insurance Department (or other state insurance departments)
  - Financial Services Authority in the U.K.
  - Rating agencies require ongoing information from the financial guarantors

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Business Overview

Monoline Financial Guaranty Insurance Industry Business Model

- Industry established in 1971 to serve U.S. municipal bond sector; today serves both public infrastructure and asset-backed global markets

- Monolines are specialized insurance companies – participants must operate solely as a separately structured and capitalized entity, providing guarantees of financial obligations only. No other insurance can be written.
  - Monolines do not originate securities or mortgages.

- Regulated by government agencies and rating agencies:
  - Insurance company operating under Article 69 of the New York State Insurance law
  - Three principal agencies: Moody's, Standard & Poor's and Fitch Ratings

- Investment-grade underwriting practice has resulted in low industry loss experience
  - Low probability/low severity/highly diverse credit portfolios
  - Withstand highly strenuous scenarios
  - Decidedly not a banking model
  - Since inception, industry has incurred only 3 bps in losses on net debt service. (Banks had weighted average annual charge-offs on principal of 60 bps from 1992 to 2006.)

- Total industry insured net par outstanding is approximately $2.3 trillion, and approximately 50% of all U.S. municipal bonds are insured. The largest primary providers: AMBAC, FGIC, FSA & MBIA have nearly $2.0 trillion in insured net par outstanding.

- From 2001-2006, monolines have insured:
  - More than $1 trillion of U.S. municipal bonds to fund schools, highways, airports, transit systems, hospitals, environmental systems and other projects.
  - Almost $82 billion of bonds to fund essential public projects outside of the U.S.
  - More than $1 trillion of asset-backed bonds to provide cost efficient funding to corporates and financial institutions throughout the world.

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Business Overview
Financial Guaranty Benefits

- **Benefits to Issuers:**
  - **Allows credit rating of the guarantor to be applied to the bonds**
  - **Reduced cost of funds - since inception, the financial guarantors have saved municipalities over $40 billion.**
  - **Increased economic leverage through efficient structuring**
  - **Broader funding sources**
  - **Streamlined execution**
  - **In case of small municipal issuers, access to capital markets only possible through a financial guaranty.**

- **Benefits to Investors:**
  - **Default protection**
  - **Bond guarantor waives all defenses including fraud and non-payment of premiums**
  - **Enhanced liquidity**
  - **Reduced secondary-market price volatility, particularly if underlying issue is downgraded**
  - **Consolidated analysis, diligence and surveillance; exercise of remedies when necessary**
  - **Unlike a trustee, bond guarantor has capital at risk, therefore its interest aligns with those of bondholders.**

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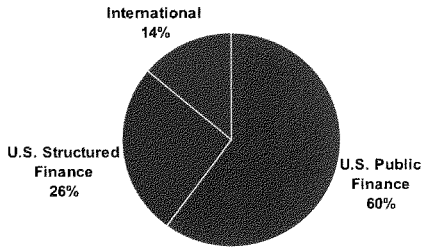
Business Overview
Types of Bonds Insured

- All insured bonds are rated by rating agencies ("shadow rating")
  - Needs to be rated investment grade by at least one rating agency
- Public finance bonds:
  - Backed by tax and other municipal authority revenues
  - Essential infrastructure (transportation, healthcare)
  - Municipal and investor-owned utilities
- Structured finance bonds
  - Mortgage-backed (MBS and home equity)
  - Asset-backed (consumer, franchise, future flows)
  - Pooled debt obligations (CDO, CLO, CBO)
  - Structured credit

Net Par Outstanding
As of December 31, 2006



$2.2 trillion

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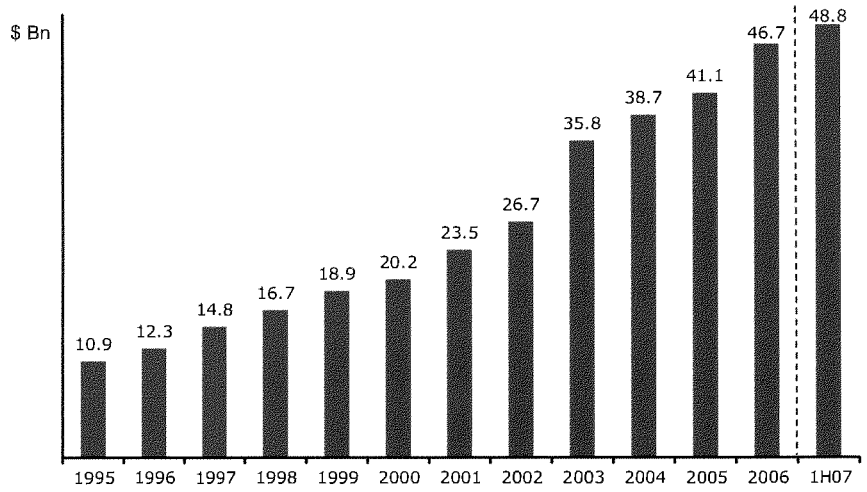
Business Overview

Monoline Financial Guaranty Industry - Total Claims-Paying Resources*



At 6/30/07
Source: S&P and company operating supplements and financial reports of MBIA, AMBAC, FSA, FGIC, XLCA (SCA), CIFG, Radian, Assured & ACA.
Reported financials for Radian, CIFG and XCLA (SCA) combine financial guaranty insurance and reinsurance.
*Includes Statutory Capital, Unearned Premium Reserves, Installment Premiums, Soft Capital Facilities, and Loss and Loss Adjustment Expense (LAE) Reserves.

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Bond Insurer Involvement in U.S. Residential Mortgage-Backed Securities (RMBS) and Collateralized Debt Obligations of Asset-Backed Securities (CDO of ABS) Sector

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Bond Insurer Involvement in U.S. RMBS and CDOs of ABS

Current Issues Related to Market Dislocation

Primary Mortgage Market

- Unprecedented credit deterioration in mortgage market exceeded the most conservative historical loss expectations
  - Since the Depression there has been no year-over-year decline in home prices for the entire U.S. (only regional declines).
- Increased activity by financial intermediaries and mortgage originators to introduce affordability products, which facilitated greater home ownership, increased credit risk.
- Mortgage deterioration was faster than projected.

CDO Market

- High-grade and mezzanine CDOs of ABS ultimately contain a high percentage of subprime mortgage loans. Some observations about expected credit performance:
  - Potential for collateral losses are higher than the original assigned credit rating
  - Diversity and correlation assumptions may be low
  - Embedded leverage magnifies the effects of poor collateral performance.
- Attachment at Triple-A or higher levels will be able to withstand greater collateral losses.

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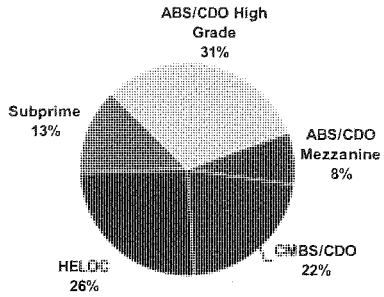
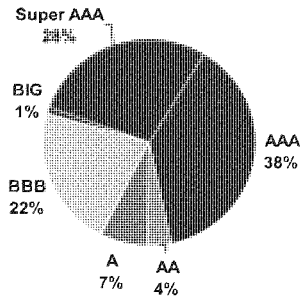
Industry Net Par Outstanding by Sector and Ratings Distribution

Sector Distribution



Underlying Ratings Distribution



$249 Billion
Net Par Outstanding

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Bond Insurer Involvement in U.S. RMBS and CDOs of ABS

First Lien Subprime RMBS Performance Expectations

Subprime First Lien Pool

	2006	January 2008
Rating Agency Expected Losses	4.5%-6.0%	14.0%-19.0%
Monoline Attachment Point at AAA	23.0%-28.0%	36.0%-42.0%
Monoline Attachment Point at BBB	8.0%-10.0%	14.0%-22.0%

Based on rating agency information for vintages 2005 to 2007.

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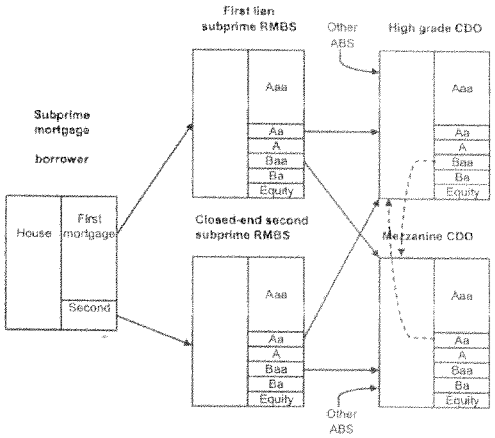
Bond Insurer Involvement in U.S. RMBS and CDOs of ABS

Allocation of Subprime Mortgage Risks in CDOs

- Subprime mortgage loans can be first mortgages, with a first lien on the property serving as collateral to the loan, or second mortgages (generally closed-end loans where the borrower receives a specified amount at closing) that are subordinated to the first mortgage.
- The loans are generally packaged by type into pools of collateral, forming the basis of RMBS.
- Different tranches, created with varying levels of priority on cash flows generated by the underlying pool, are then sold to third parties. The Aaa-rated tranche has first priority, followed by the Aa-rated tranche, etc.
- ABS CDOs, in turn, may invest in tranches of RMBS transactions, as well as in other ABS.
  - Classified as "high-grade"- Aa or higher tranches
  - Classified as "mezzanine"- Baa or higher tranches
- Both types typically have a small allocation within the collateral pool that may be invested in lower-rated collateral.



Source: Moody's, September 2007

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Bond Insurer Involvement in U.S. RMBS and CDOs of ABS

Unrealized Mark-to-Market Losses for Insured Derivative Portfolios

- Under U.S. GAAP, insurance policies issued in credit default swaps form typically must be marked to market through the company's income statement.
- Absent any claims under the guaranty, any decreases or increases to income due to marks will sum to zero by the time of each contract's maturity.
- The industry and rating agencies view the large, negative unrealized mark-to-market adjustments taken in the third quarter of 2007 as accounting requirements. Capital adequacy is concerned with fundamental credit analysis and not mark-to-market losses.
- Perception problem: the accounting effect has created a misperception regarding the industry's financial performance as spread widening due to liquidity and credit deterioration have become rolled into one ball of confusion.

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Monoline Implications

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Monoline Implications

- The monoline financial guaranty business model is viable, as confirmed by Berkshire Hathaway's entrance to business.

- Our industry is facing unprecedented stress from a variety of sources:
  - Deteriorating asset performance in the residential mortgage sector
  - Declining confidence in the rating agencies and Triple-A ratings
  - Rating agencies recalibrating standards to maintain Triple-A ratings
  - Aggressive and vocal short-selling community

- It is imperative for financial guarantors to maintain the Triple-A-rated capital levels.
  - Insured portfolios were underwritten and structured to a remote loss standard and to provide portfolio granularity to mitigate correlation risk, avoid liquidity risk, and generally insulate financial guaranty companies from event risk.
  - New business production will continue to be underwritten at high attachment points to minimize losses, preserve capital and maintain franchises.

- Rating agency downgrades on existing transactions will require increased capital; one or more industry participants may be required to raise additional capital to maintain:
  - Triple-A ratings
  - Investor confidence

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Monoline Implications (Cont'd)

- Capital can be raised through a variety of activities and sources:
  - Reinsure well-performing, capital-intensive insured financings
  - Issue equity, debt, and/or hybrid securities
  - Insure higher rated, less capital-intensive deals to limit incremental capital requirements
  - Run-off from existing portfolio
    - Earnings generate significant incremental capital annually
    - As exposure amortizes, capital is released
- Losses in the financial guaranty insurance industry are expected to be manageable.
- New York Insurance Department actively involved
- These turbulent market conditions present financial guarantors with a significant opportunity to increase profitable business production as a result of:
  - Increased perception of risk, versus real risk, in certain markets
    - Wider/widening credit spreads
    - More leverage to increase pricing and further strengthen structure

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Appendix I:

Rating Agency Timeline

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Subprime Crisis: Timeline of Rating Agency Actions

July 10:	First large-scale rating agency downgrades of RMBS: Moody's and S&P
August 13:	Fitch downgrades $13 Bn of RMBS.
September 25:	Moody's says guarantors' risk from subprime RMBS and ABS CDO potentially significant.
October:	Moody's, S&P and Fitch downgrade numerous tranches of subprime RMBS and ABS CDOs.
October 11:	Moody's downgrades $33.4 Bn of 2006 first-lien subprime RMBS.
November 5:	Fitch details approach to assessing guarantor ABS CDO exposures and assigns probabilities that each may experience erosions in capital cushion.
November 7:	Moody's cuts ratings of $33 Bn of SIV debt.
November 8:	Moody's announces plans to update opinion of financial guarantors and likelihood of rating actions.
November 9:	Moody's downgrades $10.3 Bn of U.S. ABS CDOs linked to subprime mortgages.
November 12:	Fitch downgrades the ratings of $37.2 Bn of global SF ABS CDOs.
November 22:	Fitch affirms CIFG's "AAA" rating with stable outlook following $1.5Bn capital injection.
November 23:	Moody's comments on CIFG's announced capital plan- "..greatly reduces the risk of the firm falling below Moody's target capital ratios for a Aaa."
November 26:	Standard & Poor's announces reviewing bond insurers' subprime transactions.
December 1:	Moody's says it downgraded or put on review debt totaling $119 Bn that was issued by SIVs.
December 5:	Moody's publishes comment & Q&A on monoline review process and re-assigns MBIA to "somewhat likely" to need more capital.
December 11:	Moody's comments on MBIA's $1bn capital injection from Warburg Pincus- "...meaningfully enhanced financial flexibility, supports financial profile of the insurance subsidiary... provided important signal of market support for the franchise."
December 12:	Fitch places SCA (XLCA) on rating watch negative.
December 12:	Fitch affirms Assured Guaranty's ratings.
December 13:	Fitch places 3,375 XLCA-insured issues on rating watch negative.
December 14:	Moody's announces rating actions on financial guarantors and holds a teleconference: FGIC and XLCA put on review for downgrade; MBIA and CIFG ratings outlooks changed to negative. All others affirmed.

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Subprime Crisis: Timeline of Rating Agency Actions (Cont'd)

December 17:	Fitch puts FGIC on negative watch after a review of its RMBS and ABS CDO portfolio.
December 19:	S&P takes rating actions on six bond insurers & holds teleconference: ACA to CCC/WatchDev; Ambac & Connie Lee to AAA/Negative; FGIC to AAA/Watchlist Neg; MBIA to AAA/Negative; XLCA to AAA/Negative. All others affirmed.
December 19:	Moody's places the debt ratings of XL Capital and the insurance strength of its subsidiaries on review for downgrade on pressure from its reinsurance of and investment in SCA.
December 20:	Fitch places MBIA on rating watch negative on CDO & RMBS review and says if MBIA is unable to raise about $1Bn in 4-6 weeks in addition the Warburg Pincus $1Bn, Fitch would expect to downgrade to AA+.
December 21:	Fitch places Ambac on rating watch negative on CDO & RMBS review – indicates that Ambac's capital adequacy falls below AAA guidelines by about $1 Bn and if the company were unable to obtain capital, Fitch would expect to downgrade to AA+.
December 21:	S&P and Fitch reduce CDO ratings on transactions worth $12.4 Bn – all securities previously rated AAA or AA remain investment grade.
December 26:	Fitch places 2005 insured RMBS issues on watch negative (64 Ambac, 35 FGIC, 19 SCA, 87 MBIA).
January 9:	Fitch states it expects to assign a 'AA' rating to MBIA's $1Bn offering.
January 9:	Moody's rates MBIA's surplus notes Aa2, downgrades holding company to Aa3 due to structural subordination. Moody's also comments on MBIA's capital plan- "...capital plans, when fully implemented and absent further deterioration in the insured portfolio, would cover shortfall from Dec 14."
January 11:	S&P suspends its ratings on public finance and corporate transactions insured by ACA that do not have an underlying public rating from S&P.
January 15:	S&P revises its loss expectations for 2006 vintage subprime loans to 19% from 14% based on worsening delinquencies and U.S. housing market conditions.
January 16:	Moody's places Ambac on review for possible downgrade.
January 16:	Fitch affirms MBIA's AAA IFS rating with a stable outlook, removing Rating Watch Negative following the completion of MBIA's $1Bn surplus note offering.
January 17:	Moody's announces MBIA's ratings are on review for downgrade. Moody's reported it downgraded $23 Bn of structured finance CDOs in December, bringing total to $76 Bn of SF CDOs downgraded in all of 2007.

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Subprime Crisis: Timeline of Rating Agency Actions (Cont'd)

January 18:	Fitch downgrades Ambac two notches to AA with Watch Negative following the company's announcement that it chooses not to raise equity capital under current market conditions.
January 24:	Fitch downgraded XLCA to A with Watch Negative
January 24:	Fitch affirmed FSA at AAA with Stable outlook
January 30:	Fitch downgraded FGIC to AA with Watch Negative
January 30:	S&P downgraded, or placed on review, $270 Bn, of U.S. RMBS securities backed by subprime, and $264 Bn of global ABS CDO and CDO of CDO transactions.
January 31:	S&P downgraded FGIC to AA with Watch Developing
January 31:	S&P affirmed ACA at CCC with Watch Developing
January 31:	S&P affirmed Assured Guaranty at AAA with Stable outlook
January 31:	S&P affirmed Ambac at AAA with Watch Negative
January 31:	S&P affirmed CIFG at AAA with Negative outlook
January 31:	S&P affirmed FSA at AAA with Stable outlook
January 31:	S&P placed MBIA on Watch Negative
January 31:	S&P placed XLCA on Watch Negative
February 1:	Fitch placed $139 Bn of U.S. subprime RMBS on Watch Negative on worsening mortgage performance.
February 5:	Fitch placed CIFG on Watch Negative
February 5:	Fitch placed MBIA on Watch Negative
February 7:	Moody's downgraded XLCA to A3 with Negative outlook
February 11:	S&P cut ratings on $7.65 billion in CDOs backed by RMBS, following credit deterioration and downgrades of the RMBS underlying the deals

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Appendix II:

Profiles of Primary Bond Insurers

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Ambac Assurance Corporation

General Information

Date Established	1970
Headquarters	New York
Other Offices	London, Mexico City, Milan, Sydney, Tokyo, Bermuda
Ratings	AA Fitch – Rating Watch Negative Aaa Moody's – Review for Downgrade AAA S&P – Rating Outlook Negative
Ownership Structure	Subsidiary of Ambac Financial Group, Inc. (listed on NYSE)
Principal U.S. Regulators	Wisconsin Insurance Department, New York Insurance Department and other state insurance regulators. SEC

Statutory Financial Information (12/31/07)

Statutory Capital and Reserves	$10.6 billion
Total Claims-Paying Resources	$14.5 billion
Guaranteed Net Par Outstanding	$524.0 billion
U.S. Municipal Net Par Outstanding	$281.0 billion

GAAP Financial Information (Holding Company)

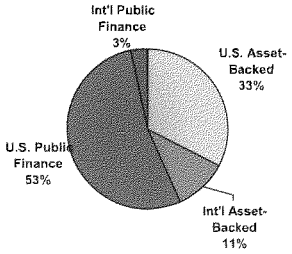
2007 Net Income	($3,229.9) million
2007 Net Operating Income	($23.7) million
2006 Net income (Loss)	$875.9 million
2006 Net Operating Earnings	$828.7 million
2007 Mark to Market Adjustment for Insured Derivatives	($6,016.3) million

Share Price

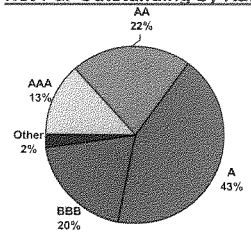
As of 2/8/08	Date	Amount
52-Week High	5/18/07	$96.10
52-Week Low	1/17/08	$4.50
Year-End Market Cap	12/31/07	$2,617 million
Recent Market Cap	2/8/08	$1,117 million

Ambac Assurance Corporation (Cont'd)

Net Par Outstanding by Sector



Net Par Outstanding by Rating



Ten Largest U.S. Municipal Risks (Net Par in $ Millions)

California State – GO	3,109.4
New Jersey Transportation Trust Fund Authority – Transportation System	2,162.2
Washington State – GO	1,878.9
Bay Area Toll Authority, CA Toll Bridge Revenue	1,838.1
MTA, NY, Transportation Revenue (Farebox)	1,723.8
California Department of Water Resources, Power Supply	1,693.9
NYS Thruway Authority, Highway and Bridge Revenue	1,487.9
New Jersey Economic Development Authority – School Facilities Construction	1,439.9
New Jersey Turnpike Authority Revenue	1,373.8
Massachusetts Commonwealth – GO	1,327.1

As of 12/31/07

Ambac Assurance Corporation (Cont'd)

Selected Current Exposures (Net Par Outstanding as of 12/31/07)

Vintage and Type	$MM	% of Total Insured Portfolio	Vintage and Type	$MM	% of Total Insured Portfolio
2005 Subprime RMBS	1,516	0.29	2007 Senior ABS CDO	5,997	1.14
2006 Subprime RMBS	1,026	0.20	2005 Mezzanine ABS CDO	79	0.02
2007 Subprime RMBS	576	0.11	2006 Mezzanine ABS CDO	0	0.00
2005 Senior ABS CDO	6,384	1.22	2007 Mezzanine ABS CDO	2,897	0.55
2006 Senior ABS CDO	12,993	2.48			

Assured Guaranty Ltd.

General Information

Date Established	1985
Headquarters	Bermuda
Other Offices	New York, London, Australia
Ratings	Assured Guaranty Corp.: AAA/Aaa/AAA Assured Guaranty Re: AA/Aa2/AA
Ownership Structure	Publicly-traded on NYSE
Principal U.S. Regulators	Maryland

Statutory Financial Information (12/31/07)

Consolidated Statutory Capital and Reserves	$3.0 billion
Total Claims-Paying Resources	$4.4 billion
Guaranteed Net Par Outstanding	$200.3 billion
U.S. Municipal Net Par Outstanding	$81.9 billion

GAAP Financial Information (Holding Company)

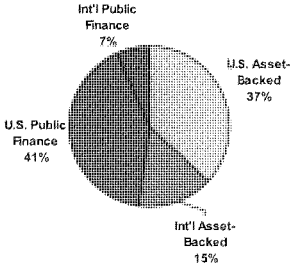
2007 Net Income	$(303.3) million
2007 Net Operating Income	$178.0 million
Fourth Qtr 2007 Net income (Loss)	$(260.1) million
Fourth Qtr 2007 Net Operating Earnings	$37.0 million
Fourth Quarter 2007 After-Tax Mark to Market Adjustment for Insured Derivatives	$(302.9) million

Share Price

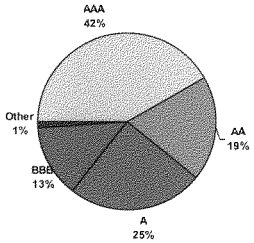
As of 2/11/08	Date	Amount
52-Week High	5/4/07	$31.99
52-Week Low	11/5/07	$13.34
Year-End Market Cap	12/31/06	$1,950 million
Recent Market Cap	1/11/08	$ 1,709 million

Assured Guaranty Ltd. (Cont'd)

Net Par Outstanding by Sector



Net Par Outstanding by Rating



Ten Largest U.S. Municipal Risks (Net Par in $ Millions)

State of California GO & Leases	1,311
City of Chicago GO & Leases	913
New York City GO & Leases	894
Puerto Rico GO & Leases	822
State of Washington GO	803
Denver International Airport System	765
Los Angeles Unified School District	749
State of NJ GO & Leases	687
Massachusetts GO & Bay Transportation	685
State of NY GO & Leases	676

As of 12/31/07

Assured Guaranty Ltd. (Cont'd)

Selected Current Exposures (Net Par Outstanding as of 12/31/07)

Vintage and Type	$MM	% of Total Insured Portfolio	Vintage and Type	$MM	% of Total Insured Portfolio
2005 Subprime RMBS	3,818	1.91	2007 Senior ABS CDO	0	0.00
2006 Subprime RMBS	1,928	0.96	2005 Mezzanine ABS CDO	0	0.00
2007 Subprime RMBS	663	0.03	2006 Mezzanine ABS CDO	0	0.00
2005 Senior ABS CDO	0	0.00	2007 Mezzanine ABS CDO	0	0.00
2006 Senior ABS CDO	0	0.00			

CIFG Holding, Ltd.

General Information

Date Established	2001
Headquarters	Hamilton, Bermuda
Other Offices	New York, San Francisco, Paris & London
Ratings	AAA -S&P Aaa -Moody's AAA -Fitch
Ownership Structure	Privately Held
Principal U.S. Regulators	New York

Notes re CIFG financial information:

• Capital contribution of $1.5 billion made in December 2007 is not reflected in these balances.

•The financial statements are stated in Euros. The translation of Euros in U.S. dollars is presented solely for the convenience of the reader of the financial statements, using the observed exchange rate at December 31, 2006 of $1.31435 to € 1.00. This convenience translation should not be construed as representation that the euro amounts have been, could have been or could in the future be, converted to U.S dollars at this rate or any rate of exchange.

•CIFG NA, CIFG Europe and CIFG Guaranty are combined for purposes of calculating claims paying resources. Amounts are considered pro-forma since the CIFG Group does not file combined U.S. statutory statements.

Statutory Financial Information

Pro-Forma Statutory Capital and Reserves (3/31/2007)	$1.0 billion
Total Claims-Paying Resources (3/31/2007)	$1.4 billion
Guaranteed Net Par Outstanding (9/30/2007)	$90.9 billion
U.S. Municipal Net Par Outstanding (9/30/2007)	$23.9 billion

GAAP Financial Information (Holding Company)

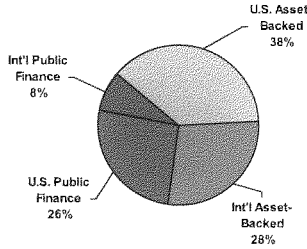
2006 Net Income	$31.0 million
2006 Net Operating Income	$17.7 million
Third Qtr 2007 Net income (Loss)	Not available
Third Qtr 2007 Net Operating Earnings	Not available
Third Quarter 2007 Mark to Market Adjustment for Insured Derivatives	Not available

Share Price

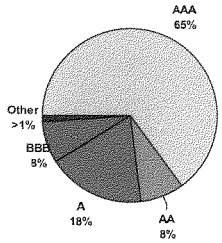
	Date	Amount
52-Week High	00/00/00	Not applicable
52-Week Low	00/00/00	Not applicable
Year-End Market Cap	12/31/07	Not applicable
Recent Market Cap		Not applicable

CIFG Holding, Ltd. (Cont'd)

Net Par Outstanding by Sector



Net Par Outstanding by Rating



Largest U.S. Municipal Risks
(Net Par in $ Millions)

Chicago Board of Education	617,450
New Jersey State General Obligation and Appropriation Credits	598,810
New York City General Obligation	551,883
California State General Obligation	532,085
Miami-Dade County, FL	508,423
New York State General Obligation	501,535
High Speed Railway Funding, Infrastructure Spa (Italy)	479,265
Commonwealth of Puerto Rico General Obligation and Appropriation Credits	458,538
MTA Transportation Revenue Bonds	440,000

As of 9/30/07

CIFG Holding, Ltd. (Cont'd)

Selected Current Exposures (Net Par Outstanding as of 9/30/07)

Vintage and Type	$MM	% of Total Insured Portfolio	Vintage and Type	$MM	% of Total Insured Portfolio
2005 Subprime RMBS	1,453.	1.60	2007 Senior ABS CDO	0.	0.00
2006 Subprime RMBS	361.	0.40	2005 Mezzanine ABS CDO	727.	0.80
2007 Subprime RMBS	0.	0.00	2006 Mezzanine ABS CDO	3,998.	4.39
2005 Senior ABS CDO	400.	0.44	2007 Mezzanine ABS CDO	722.	0.79
2006 Senior ABS CDO	1,198.	1.32			

Financial Guaranty Insurance Company (FGIC)

General Information

Date Established	1983
Headquarters	New York
Other Offices	London, England Sydney, Australia
Ratings	AA Fitch-Rating Watch Negative Aaa Moody's-Review for possible downgrade AA S&P-Credit Watch with developing implications
Ownership Structure	Privately Held
Principal U.S. Regulators	NY State Insurance Dept.; other state insurance regulators For non U.S. subsidiaries: Financial Services Authority in U.K.; Australian Securities & Investments Commission in Australia

Statutory Financial Information (9/30/07)

Statutory Capital and Reserves	$4.0 billion
Total Claims-Paying Resources	$5.1 billion
Guaranteed Net Par Outstanding	$314.8 billion
U.S. Municipal Net Par Outstanding	$224.3 billion

GAAP Financial Information (Holding Company)

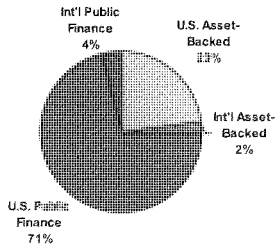
2006 Net Income	$247.8 million
2006 Net Operating Income	$247.1 million
Third Qtr 2007 Net income (Loss)	$(65.3) million
Third Qtr 2007 Net Operating Earnings	$68.7 million
Third Quarter 2007 Mark to Market Adjustment for Insured Derivatives	$(206.2) million

Share Price

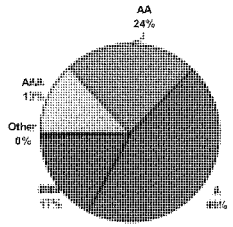
As of 00/00/00	Date	Amount
52-Week High	00/00/00	NOT APPLICABLE
52-Week Low	00/00/00	NOT APPLICABLE
Year-End Market Cap	00/00/00	NOT APPLICABLE
Recent Market Cap	00/00/00	NOT APPLICABLE

Financial Guaranty Insurance Company (FGIC) (Cont'd)

Net Par Outstanding by Sector



Net Par Outstanding by Rating



Ten Largest U.S. Municipal Risks (Net Par in $ Millions)

California State GO	1,369.9
Jefferson County, AL Sewer Rev	1,196.3
Golden State Tobacco Securitiz Corp, CA Lease	1,150.5
Puerto Rico Commonwealth GO	1,131.8
New Jersey Trans Trust Fund Auth	1,065.6
Massachusetts Commonwealth GO	1,060.2
Miami-Dade County, FL Aviation Rev	1,052.8
Los Angeles USD, CA GO	1,052.0
Port Authority of NY and NJ	1,042.4
Double-Wrap Muni Portfolio(DWMP)	1,041.7

As of 9/30/07

Financial Guaranty Insurance Company (FGIC) (Cont'd)

Selected Current Exposures (Net Par Outstanding as of 9/30/07)

Vintage and Type	$MM	% of Total Insured Portfolio	Vintage and Type	$MM	% of Total Insured Portfolio
2005 Subprime RMBS	3,489.3	1.11	2007 Senior ABS CDO	4,958.3	1.57
2006 Subprime RMBS	414.4	0.13	2005 Mezzanine ABS CDO	289.5	0.09
2007 Subprime RMBS	2,152.4	0.68	2006 Mezzanine ABS CDO	2,224.5	0.71
2005 Senior ABS CDO	1,801.4	0.57	2007 Mezzanine ABS CDO	0	0.00
2006 Senior ABS CDO	1,660.0	0.53			

Financial Security Assurance Inc.

General Information

Date Established	1985
Headquarters	New York
Other Offices	San Francisco, Dallas, Mexico City, London, Madrid, Paris, Sydney, Tokyo, Bermuda
Ratings	AAA Fitch Aaa Moody's AAA S&P AAA R&I
Ownership Structure	Subsidiary of Dexia S.A.
Principal Regulators	NY Insurance Dept.; other state insurance regulators; SEC (for holding co.). For non-U.S. subsidiaries: Financial Services Authority in U.K.; Financial Services Authority in Japan; Secretaría de Hacienda y Crédito Público in Mexico

Statutory Financial Information (12/31/07)

Statutory Capital and Reserves	$5.1 billion
Total Claims-Paying Resources	$6.7 billion
Guaranteed Net Par Outstanding	$426.5 billion
U.S. Municipal Net Par Outstanding	$255.4 billion

GAAP Financial Information (Holding Company)

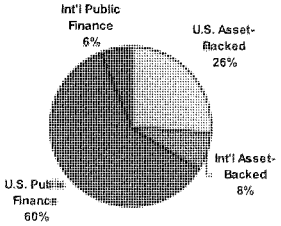
2007 Net Income	$(65.7) million
2007 Net Operating Income	$378.0 million
Fourth Qtr 2007 Net income (Loss)	$(91.9) million
Fourth Qtr 2007 Net Operating Earnings	$94.3 million
Fourth Quarter 2007 Mark to Market Adjustment for Insured Derivatives	$(188.6) million

Share Price

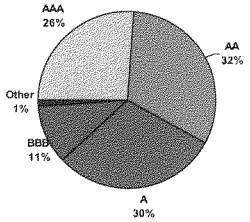
	Date	Amount
52-Week High	00/00/00	NOT APPLICABLE
52-Week Low	00/00/00	NOT APPLICABLE
Year-End Market Cap	12/31/07	NOT APPLICABLE
Recent Market Cap	00/00/00	NOT APPLICABLE

Financial Security Assurance Inc. (Cont'd)

Net Par Outstanding by Sector



Net Par Outstanding by Rating



Ten Largest U.S. Municipal Risks
(Net Par in $ Millions)

Commonwealth of Massachusetts G.O.	1,261.6
New York City Municipal Water Finance Authority, Water and Sewer Revenue Bonds	1,253.5
Port Authority of NY and NJ, Consolidated Bonds	1,250.2
Massachusetts School Building Authority Dedicated Sales Tax Revenue Bonds	1,182.9
Los Angeles Unified School District, CA, G.O.	1,113.4
New Jersey Transportation Trust Fund Authority Transportation System Bonds	1,105.9
State of California, G.O.	1,092.0
New York City, NY, G.O.	1,071.2
Metropolitan Transportation Authority, NY, Transportation Revenue Bonds	1,041.6
Houston Combined Utility System, TX, First Lien Revenues	1,038.6

As of 12/31/07

Financial Security Assurance Inc. (Cont'd)

Selected Current Exposures (Net Par Outstanding as of 12/31/07)*

Vintage and Type	$MM	% of Total Insured Portfolio	Vintage and Type	$MM	% of Total Insured Portfolio
2005 Subprime RMBS	579	0.14	2007 Senior ABS CDO	0	0.00
2006 Subprime RMBS	125	0.03	2005 Mezzanine ABS CDO	0	0.00
2007 Subprime RMBS	2,999	0.70	2006 Mezzanine ABS CDO	0	0.00
2005 Senior ABS CDO	300	0.07	2007 Mezzanine ABS CDO	0	0.00
2006 Senior ABS CDO	0	0.00			

* Includes transactions previously wrapped by other monolines.

MBIA Insurance Corporation

General Information

Date Established	1974
Headquarters	Armonk, NY
Other Offices	London, Paris, Madrid, Mexico City, Milan, San Francisco, Sydney & Tokyo
Ratings – MBIA Insurance Corp.	Fitch – AAA (rating watch negative) Moody's – Aaa (review for downgrade) S&P – AAA (CreditWatch with Negative implications) R&I – AAA (stable outlook)
Ownership Structure	Subsidiary of MBIA Inc.
Principal Regulators	NYSID, other state insurance regulators, and the SEC in the U.S.. Financial Services Authority in the UK and Secretaría de Hacienda y Crédito Público in Mexico

Statutory Financial Information (12/31/07)

Statutory Capital and Reserves	$6.4 billion
Total Claims-Paying Resources	$14.6 billion
Guaranteed Net Par Outstanding	$678.7 billion
U.S. Municipal Net Par Outstanding	$404.4 billion

GAAP Financial Information (MBIA Inc.)

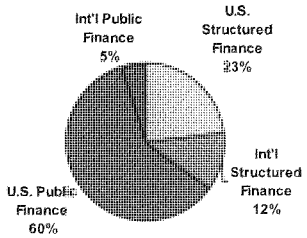
2007 Net Loss	(1,921.9) million
2007 Net Operating Income	$127.9 million
2007 Mark to Market Adjustment for Insured Derivatives	($3,728.3) million

Share Price

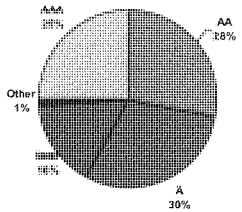
As of 1/22/08	Date	Amount
52-Week High	4/27/07	$71.54
52-Week Low	1/18/08	$8.55
Year-End Market Cap	12/31/06	$9,851 million
Year-End Market Cap	12/31/07	$2,336 million
Recent Market Cap	2/11/08	$3.04 billion

MBIA Insurance Corporation (Cont'd)

Net Par Outstanding by Sector



Net Par Outstanding by Rating



Ten Largest U.S. Municipal Risks
(Net Par in $ Millions)

California General Obligation	3,735
New York City General Obligation	2,680
Illinois General Obligation	2,282
Massachusetts General Obligation	2,250
Puerto Rico General Obligation	2,247
Citizens Property Insurance Corp.	2,093
Long Island Power Authority Electric	1,919
State of Washington General Obligation	1,906
Wisconsin General Obligation	1,851
New York City Water	1,807

As of 12/31/07

MBIA Insurance Corporation (Cont'd)

Selected Current Exposures (Net Par Outstanding as of 12/31/07) MBIA's total net par outstanding is $678, 661.0 MM

Vintage and Type	$MM	% of Total* Insured Subprime Portfolio	Vintage and Type	$MM	% of Total Insured Portfolio
2005 Subprime RMBS	1,216.0	4.77%	2005 Mezz/Euro ABS CDO	254.4	1.00%
2006 Subprime RMBS	1,546.0	6.06%	2006 Mezz/Euro ABS CDO	301.5	1.18%
2007 Subprime RMBS	187.8	0.74%	2007 Mezzanine ABS CDO	467.7	1.83%
2005 High Grade ABS CDO	600.0	2.35%	2005 High Grade CDO^2	1,430.0	5.61%
2006 High Grade ABS CDO	3,273.4	12.84%	2006 High Grade CDO^2	2,151.5	8.44%
2007 Senior ABS CDO	10,919.2	42.83%	2007 High Grade CDO^2	3,149.8	12.35%
			Total	$25,497.3	100%

Radian Asset Assurance Inc.

General Information

Date Established	1985
Headquarters	New York
Other Offices	Philadelphia (Corporate HQ of Parent), London
Ratings	Aa3 (Moody's) AA (S&P) A+ (Fitch)*
Ownership Structure	Subsidiary of Radian Group Inc.
Principal U.S. Regulators	NY Insurance Dept; other state insurance regulators; SEC (for Parent Company). For London: Financial Services Authority

*Fitch currently rates Radian Asset A+ with an evolving outlook.
Radian Group Inc. formally requested that Fitch withdraw its rating of all Radian Group Inc entities on 9/5/07.

Statutory Financial Information (9/30/07)

Statutory Capital and Reserves	$1.6 billion
Total Claims-Paying Resources	$3.1 billion
Guaranteed Net Par Outstanding	$112.8 billion
U.S. Municipal Net Par Outstanding	$55.1 billion

GAAP Financial Info (Radian Asset Assurance Inc.)

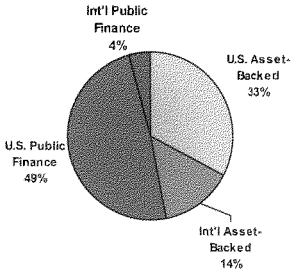
2006 Net Income (FY'06)	$127.3 million
2006 Net Operating Income (FY'06)	$72.5 million
Third Qtr 2007 Net income (Loss)	($152.4 million)
Third Qtr 2007 Net Operating Income	$12.6 million
Third Quarter 2007 Mark to Market Adjustment for Insured Derivatives	($255.6 million)

Share Price (Radian Group Inc. – NYSE: RDN)

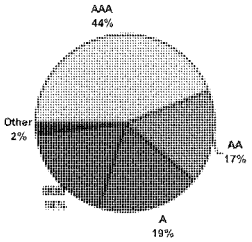
As of 2/8/08	Date	Amount
52-Week High	2/08/07	$64.76
52-Week Low	1/23/08	$5.44
Year-End Market Cap	12/31/06	$4,280.5 million
Recent Market Cap	2/8/08	$669.7 million

Radian Asset Assurance Inc. (Cont'd)

Net Par Outstanding by Sector



Net Par Outstanding by Rating



Ten Largest U.S. Municipal Risks

(Net Par in $ Millions)

New York, NY – G.O.	$ 818
California – G.O.	800
Port Authority of New York & New Jersey	604
Chicago, IL – G.O.	578
Washington – G.O.	450
Massachusetts – G.O.	417
Los Angeles Unified School District, CA	414
Massachusetts School Building Authority	359
New Jersey Transportation Trust Fund Authority	358
Metropolitan Transportation Authority, NY	352

As of 9/30/07

Radian Asset Assurance Inc. (Cont'd)

Selected Current Exposures (Net Par Outstanding as of 9/30/07)—Direct Exposures only

Vintage and Type	$MM	% of Total Insured Portfolio	Vintage and Type	$MM	% of Total Insured Portfolio
2005 Subprime RMBS	0	0.00	2007 Senior ABS CDO	0	0.00
2006 Subprime RMBS	0	0.00	2005 Mezzanine ABS CDO	0	0.00
2007 Subprime RMBS	0	0.00	2006 Mezzanine ABS CDO	0	0.00
2005 Senior ABS CDO	150	0.13	2007 Mezzanine ABS CDO	0	0.00
2006 Senior ABS CDO	510.8	0.45			

Security Capital Assurance

General Information

Date Established	2006
Headquarters	Bermuda
Other Offices	New York; Connecticut; California; London; Singapore; Madrid
Ratings	XLCA and XLFA: AAA by Standard & Poor's Ratings Service A3 by Moody's Investors Service A by Fitch Ratings
Ownership Structure	Holding company of primary financial guarantee insurer (XLCA) and reinsurer (XLFA)
Principal U.S. Regulators	NY Insurance Dept.; SEC (for holding co.). For non-U.S. subsidiaries: Financial Services Authority in U.K

Statutory Financial Information (9/30/07)

Statutory Capital and Reserves	$2.6 billion
Total Claims-Paying Resources	$3.5 billion
Guaranteed Net Par Outstanding	$154.2 billion
U.S. Municipal Net Par Outstanding	$59.6 billion

GAAP Financial Information (Holding Company)

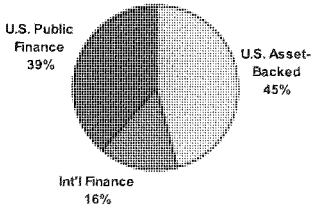
2006 Net Income	$117.4 million
2006 Net Operating Income	$141.9 million
Third Qtr 2007 Net income (Loss)	$(89.9) million
Third Qtr 2007 Net Operating Earnings	$46.0 million
Third Quarter 2007 Mark to Market Adjustment for Insured Derivatives	$(143.0) million

Share Price

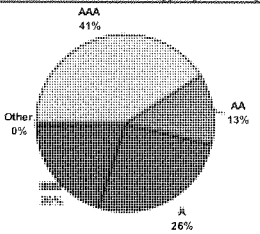
As of 2/11/08	Date	Amount
52-Week High	05/23/07	$ 33.88
52-Week Low	1/18/08	$ 1.65
Year-End Market Cap	12/31/07	$251 million
Recent Market Cap	2/11/08	$ 132 million

Security Capital Assurance (Cont'd)

Net Par Outstanding by Sector



Net Par Outstanding by Rating



Ten Largest U.S. Municipal Risks
(Net Par in $ Millions)

State of New Jersey – Ann'l Appr.	858
City of New York - GO	857
State of Texas - GO	833
Jefferson Co., AL – Wtr/Swr Rev.	811
East Bay MUD, CA – Wtr/Swr Rev.	755
State of California - GO	737
State of New York – Ann'l Appr.	721
Commonwealth of Mass. - GO	690
State of Wisconsin – Ann'l Appr.	689
State of Florida – GO	625

As of 9/30/07

Security Capital Assurance (Cont'd)

Selected Current Exposures (Net Par Outstanding as of 9/30/07)

Vintage and Type	$MM	% of Total Insured Portfolio	Vintage and Type	$MM	% of Total Insured Portfolio
2005 Subprime RMBS	307.7	0.20	2007 Senior ABS CDO	6842.9	4.44
2006 Subprime RMBS	0	0.00	2005 Mezzanine ABS CDO	0	0.00
2007 Subprime RMBS	1,366.5	0.89	2006 Mezzanine ABS CDO	0	0.00
2005 Senior ABS CDO	948.6	0.62	2007 Mezzanine ABS CDO	0	0.00
2006 Senior ABS CDO	7095.8	4.60			

February 14, 2008

Congressman Paul Kanjorski
Chairman
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
2353 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Kanjorski,

As bankers serving the broad range of credit needs in our communities across Pennsylvania, we want to applaud you for your leadership in being an original cosponsor of H.R. 2091. This legislation will provide an important additional tool for community banks to partner with Federal Home Loan Banks in supporting economic development.

While this legislation comes under the jurisdiction of the House Committee on Ways and Means, the expertise of the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises will play an important role during Congressional consideration of this issue.

As your subcommittee explores the many serious issues surrounding the current challenges facing the bond insurance industry, we would point out that H.R. 2091 will allow our banks to serve markets that have been largely ignored by the bond insurers for years. Current market turmoil makes H.R. 2091 even more necessary to expand credit enhancement options for long-underserved markets.

This legislation would allow our banks to assist smaller communities, charitable health care facilities and institutions of higher education raise tax-exempt funds where such borrowers are unable to obtain bond insurance or letters of credit from larger market players or at more attractive terms.

Numerous small, unrated rural hospitals or inner-city facilities would benefit from this credit enhancement as well as many educational institutions. Small communities would see service or greater competition in the market to meet their economic development challenges.

Issuing letters of credit (LOCs) backed by Federal Home Loan Banks is not a new activity for bankers. Community Bank/ Federal Home Loan Bank LOCs are routinely issued throughout the nation for the purpose of supporting housing related bond issues, both taxable and tax-exempt. The problem arises in the area of tax-exempt economic development bonds. The Internal Revenue Service has questioned whether Federal Home Loan Bank LOC's might trigger a loss of the tax exempt status of the bonds. It is for that reason that legislation is needed.

Adding LOCs from Federal Home Loan Banks as an option for municipal governments and issuers of tax-exempt bonds for charitable health care facilities and schools will

increase competition in this field of credit enhancement for tax-exempt finance. It will give many issuers an additional option and help reduce the cost to the taxpayers of municipal bond issues for such projects as water treatment facilities, fire stations, long-term care for the elderly, medical clinics, school buses and infrastructure improvements.

As the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises considers how best to address the challenges raised by the problems facing the bond insurance industry, we would hope that you could work with the House Committee on Ways and Means to seek enactment of H.R 2091. This small but necessary action will help underserved markets and should be part of any comprehensive response.

Sincerely,

Thomas Bailey
President & CEO
Brentwood Bank
Bethel Park, PA

Martin R. Brown
President & CEO
Ambler Savings Bank
Ambler, PA

Donald A. Byerly
President and CEO
West Milton State Bank
West Milton, PA

C. Andrew Cook
President & CEO
Allegiance Bank of
North America
Bala Cynwyd, PA

Frank S. DePaolo
President & CEO
Sharon Savings Bank
Darby, PA

Dick Ehst
Regional President
Sovereign Bank
Reading, PA

Thomas G. Fetsko
Senior VP & CFO
1St Summit Bank
Johnstown, PA

Wayne H. Freed
Vice Chairperson
United American
Savings Bank
Pittsburgh, PA

Tracy Fretz
CRA Officer
Univest Corp of PA
Souderton, PA

Teresa Gregory
Senior VP, Secondary
Market Manager
Fulton Mortgage
Company
Lancaster, PA

Steve Gurgovits
Chairman & CEO
F.N.B. Corporation
Hermitage, PA

Jeffrey Kapsar
President & CEO
Mifflinburg Bank &
Trust
Mifflinburg, PA

Thomas M. Kelly
President & CEO
First Keystone Bank
Media, PA

David H. Krauter
Chief Lending Officer &
VP
Prudential Savings Bank
Philadelphia, PA

Timothy J.
Kronenwetter
President & CEO
Indiana First Bank
Indiana, PA

Richard T. Kuhn
President
Nesquehoning Savings
Bank
Nesquehoning, PA

Richard A. Kunsch
President & CEO
Phoenixville Federal
Bank & Trust
Phoenixville, PA

Craig G. Litchfield
Chairman, President &
CEO
Citizens & Northern
Bank
Wellsboro, PA

Richard L. Meares
President & CEO
Fleetwood Bank
Fleetwood, PA

Jeanine M. McCreary
Community
Development Officer
PNC Bank
Erie, PA

Barry E. Miller
Senior VP & Chief
Administrative Officer
Susquehanna Bank
Lancaster, PA

Gary S. Olson
President & CEO
ESSA Bank & Trust
Stroudsburg, PA

Paul E. Reichart
Chairman
Columbia County
Farmers National Bank
Bloomsburg, PA

William Ritenour
President & CEO
C&G Savings Bank
Altoona, PA

Frederick E. Schea
President & CEO
First Savings Bank of
Perkasie
Perkasie, PA

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Francis W. Yablinsky
Executive VP & CEO
Investment Savings
Bank
Altoona, PA

James D. Ziegler
President
Coatesville Savings
Bank
Coatesville, PA

Tim Zimmerman
President & CEO
Standard Bank
Monroeville, PA

IFA
ILLINOIS FINANCE AUTHORITY

Governor, Rod R. Blagojevich
Executive Director, Kym M. Hubbard

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VIA FAX (202) 225-0764 and FAX (570) 825-8685 (5 pages total)

February 13, 2008

The Honorable Paul Kanjorski
Chairman, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
United States House of Representatives
2188 Rayburn House Office Building
Washington, D.C. 20515-3811

RE: Municipal Bond Insurance Crisis results in greater need for approval of H.R. 2091 (FHLB Letters of Credit to help FHLB Member Banks finance capital projects by (i) Closely-Held Manufacturers and (ii) Non-Rated 501(c)(3) Entities)

Dear Congressman Kanjorski:

Thank you for your leadership in addressing issues relating to the municipal bond insurance crisis and for your co-sponsorship on H.R. 2091 (FHLB Letters of Credit to assist closely-held manufacturers and community-based 501(c)(3) entities).

As background, the Illinois Finance Authority is one of the leading issuers of tax-exempt private activity revenue bonds on behalf of manufacturers and various 501(c)(3) not-for-profit entities. From 1993-2006, the Illinois Finance Authority was the sixth (#6) ranked issuer of municipal bonds in the United States, as reported by Thomson Financial. The Illinois Finance Authority is also a member of both (1) the Council of Development Finance Agencies ("CDFA") and (2) the National Association of Health and Educational Facilities Finance Authorities ("NAHEFFA").

The credit crisis regarding bond insurance is significant to IFA's large, rated 501(c)(3) College/University and 501(c)(3) Hospital and Health Care Borrowers, and particularly for institutions with marginal investment grade ratings. Ongoing access to "Double A"- and "Triple A"-rated municipal bond insurance will help assure that these Borrowers can finance necessary expansions at the lowest possible cost without disruption. The Illinois Finance Authority supports your Subcommittee's examination of the current bond insurance crisis.

Although maintaining access to Double-A- and Triple A-rated bond insurance is important to the Illinois Finance Authority's largest borrowers (i.e., borrowers with their own investment grade credit ratings), we also wish to reiterate our support of H.R. 2091 and its importance in improving existing access to tax-exempt financing to IFA's small manufacturing and non-rated community-based 501(c)(3) borrowers that rely on FHLB Member Banks to finance capital projects.

H.R. 2091 would enable FHLB Member Banks and their small, non-rated borrowers to obtain tax-exempt financing at the same low interest rates available to large, investment grade-rated borrowers. Although these Borrowers currently rely on their FHLB Member Banks to purchase bonds directly, H.R. 2091 would enable the FHLB Members to provide their borrowers access to the national capital markets (at the lowest possible tax-exempt rates). [This reduction in interest rate attributable to the FHLB Standby Letter of Credit would actually help reduce the cost to the U.S. Treasury.]

Just as background, I am firmly convinced based on past experience that the FHLB Letter of Credit will be an effective tool upon passage of H.R. 2091, which has widespread support in Illinois among FHLB Member Banks, closely-held manufacturers, and community-based 501(c)(3) entities.

More specifically, from 1998-2000, I worked with FHLB Member Banks, several bond counsel firms, and both manufacturing companies and community-based 501(c)(3)'s in Illinois to establish a cooperative LOC Program with the Federal Home Loan Bank of Chicago. Attached are the cover pages from two (2) bond issues that are "further secured" by FHLB Letters of Credit (see pages 4-5). Significantly, these Official Statements for the MZG/Coburn Steel Project (p. 4) clearly states that payments on the Bonds are executed by Bond Trustee draws on the non-rated FHLB Member Direct Pay Letter of Credit from Manufacturer's Bank (now FHLB Member MB Financial Bank). As noted, the FHLB Standby LOC provides "further" credit support (i.e., sufficient for the Bonds to be rated Triple A).

These Bonds were issued prior to a blanket 2001 IRS audit that rendered all Bonds secured by FHLB of Chicago Standby LOC's retroactively taxable. Illinois initiated and closed two FHLB Standby LOC enhanced bond issues including: (1) MZG/Coburn Steel, a Harvey, Illinois-based steel company and (2) The Center for Enriched Living, a 501(c)(3) educational facility serving the developmentally disabled.

Significantly, several municipal bond counsel attorneys at national and regional firms (including Chapman and Cutler, Sidley Austin, Ice Miller, and Hopkins & Sutter) had delivered unqualified legal opinions that concluded the FHLB Standby LOC structure did not represent a federal guarantee because, among other reasons (1) the regional FHLB's are owned by their member banks and (2) the underlying Standby structure (and FHLB Standby LOC credit requirements) effectively precluded the need to ever draw on the FHLB Standby LOC as a source of repayment to Bondholders since:

1. Bondholders were to be paid directly by Trustee draws on the underlying FHLB Member Bank's Direct Pay Letter of Credit (*and <u>not</u> the FHLB Standby LOC).*
2. The FHLB of Chicago Standby LOC could only get drawn if both (a) automated wire draws by the Bond Trustee from the FHLB Member were not paid due to FHLB Member Bank insolvency, and (b) FHLB-required collateral/deposits were insufficient to cover the FHLB's Standby LOC exposure on the subject bond issue (a violation of the FHLB's requirements).

H.R. 2091 would override the IRS's previous adverse determination regarding FHLB LOC's thereby enabling FHLB Member Banks to again to provide improved access to tax-exempt bond financing at the lowest possible rate available in the national credit markets for (1) closely-held manufacturing expansion projects such as MZG/Coburn Steel in Harvey, Illinois and (2) non-rated 501(c)(3) social service entities such as The Center for Enriched Living in Riverwoods, Illinois.

I have already discussed H.R. 2091 with several FHLB Member Banks in Illinois and with several prospective manufacturing and community-based 501(c)(3)'s in Illinois and have held meetings with several congressional staff members in Washington, D.C. Both FHLB Member Banks and prospective borrowers have indicated interest to meet with members of Illinois' congressional delegation to discuss further.

In addition to my experience structuring and closing Illinois' previous FHLB Chicago Standby LOC transactions, I have closed over 300 municipal bonds issues totaling over $4.0 million during my career for a variety of small, family-owned manufacturing companies, small 501(c)(3) community-based organizations, 501(c)(3) Private Colleges and Universities, and 501(c)(3) Hospital and Healthcare facilities during my career. I believe I could offer helpful practical insight into credit access issues in the tax-exempt bond market.

As proposed in H.R. 2091, allowing the FHLBs to issue LOCs to support these private activity bonds would neither transfer risk to the federal government nor provide a double federal subsidy. In fact, the risk of non-payment by any borrower would remain at the level of the FHLB Member Bank that would enter into a collateralized loan agreement with the underlying borrower. Bondholders would be paid by the FHLB Member Bank LOC regardless of whether or not an underlying borrower was able to pay. Accordingly, if an underlying borrower were to become insolvent, the FHLB Member Bank would remain unconditionally obligated to make scheduled principal and interest payments to bondholders. (The FHLB Member Bank would also be responsible for negotiating and settlement of any workout with the underlying borrower consistent with the prior FHLB Chicago LOC transactions.)

Finally, H.R. 2091 would enable the FHLBs to further support the lending activities of non-rated local and regional member banks by providing these Banks with a source of cost-effective, investment grade-rated, credit enhancement. This credit enhancement to non-rated local and regional banks is not generally available from the private municipal bond insurers (and will be further exacerbated by the current municipal bond insurance crisis).

As a result, local and regional FHLB Member banks, in addition to prospectively purchasing tax-exempt bonds, would also be able to obtain AAA-rated FHLB Standby LOC's that would provide FHLB Members (and their manufacturing and 501(c)(3) customers) with access to borrowing at the lowest municipal bond interest rates available in the capital markets.

On November 7, 2007, I (along with a local manufacturer, 501(c)(3) borrower, and FHLB Member Bank) met with staff members for (1) Congresswoman Melissa Bean (Subcommittee on Capital Markets, Insurance, and GSE Subcommittee), (2) Congressman Rahm Emanuel (Ways and Means Committee), and (3) Congressman Jerry Weller (Ways and Means Committee) in Washington, D.C., specifically regarding the importance of H.R. 2091 in providing family-owned manufacturers and community-based 501(c)(3) non-profits access to the FHLB's Triple A-rated Standby Letter of Credit.

I intend to continue to work with FHLB Member Banks in Illinois and prospective borrowers to discuss the benefits of the FHLB Standby LOC with members of the Illinois congressional delegation. I can assure you that upon enactment of H.R. 2091, Illinois would quickly work with Illinois FHLB Members Banks to implement a successful program model to again use FHLB LOC's to credit enhance tax-exempt bond issues for small manufacturing and 501(c)(3) capital projects. The Illinois model could easily be replicated nationally.

I would welcome the opportunity to discuss these issues further with members of your Subcommittee and other members of Congress as needed. I am available to discuss either by telephone (312-651-1313) or, with sufficient advance notice, to meet personally in Washington, D.C.

Sincerely,

Richard K. Frampton
Vice President
Illinois Finance Authority
312-651-1313
rframpton@il-fa.com

cc (via Fax): Rep. Melissa Bean, Rep. Rahm Emanuel, Rep. Jerry Weller, Rep. Don Manzullo, Rep. Peter Roskam

Attachments:

- Illinois FHLB Official Statement Covers (pp. 4-5)
  - MZG Associates/Coburn Steel (a Manufacturing Expansion Project in Harvey, Illinois)
  - The Center for Enriched Living (a 501(c)(3) Educational Facility for the Developmentally Disabled in Riverwoods, Illinois)

New Issue - Book-Entry Only

Subject to compliance by the Issuer and the Borrower with certain covenants, in the opinion of Bond Counsel, under present law, interest on the Bonds is not includible in gross income of the owners thereof for federal income tax purposes, except for interest on any Bond for any period during which such Bond is owned by a person who is a substantial user of the Project or any person considered to be related to such person (within the meaning of Section 147(a) of the Internal Revenue Code of 1986, as amended), but such interest is included as an item of tax preference in computing the federal alternative minimum tax for individuals and corporations. See "Tax Exemption" herein for a more complete discussion.

$5,320,000
ILLINOIS DEVELOPMENT FINANCE AUTHORITY
INDUSTRIAL DEVELOPMENT REVENUE BONDS
(MZG ASSOCIATES LLC PROJECT), SERIES 2000

Dated: Date of Delivery Price: 100% Due: June 1, 2030

The Bonds are limited obligations of the Illinois Development Finance Authority (the *"Issuer"*) payable solely from and secured by an assignment of the payments to be made under a Loan Agreement between the Issuer and MZG Associates LLC, an Illinois limited liability company (the *"Borrower"*). From the date of issuance through July 5, 2005 (except upon the earlier occurrence of certain events), the Bonds will be entitled to the benefits of an irrevocable direct pay letter of credit (the *"Initial Letter of Credit"*) issued by

MANUFACTURERS BANK

(the *"Initial Bank"*). The Initial Letter of Credit will permit Amalgamated Bank of Chicago, as trustee (the *"Trustee"*) under the Indenture of Trust (the *"Indenture"*) between the Issuer and the Trustee, to draw up to an amount equal to the principal of the Bonds, or that portion of the purchase price corresponding to principal, plus an amount equal to 45 days' interest accrued on the Bonds (at a maximum rate of 12% per annum), or that portion of the purchase price corresponding to interest, all as described herein.

The Bonds will be further supported by an irrevocable standby letter of credit (the *"Standby Letter of Credit"*) issued by the

FEDERAL HOME LOAN BANK OF CHICAGO

(the "Standby Credit Bank"). The Bonds will bear interest initially at a Weekly Rate as determined from time to time in accordance with the Indenture. The interest rate on the Bonds may be converted to a Flexible Rate at the option of the Borrower at any time in accordance with the Indenture. While the Bonds bear interest at a Weekly Rate, interest will be payable on the first Business Day of each month, commencing on the first Business Day of August, 2000.

The Bonds are subject to redemption prior to maturity as described herein. While the Bonds bear interest at a Weekly Rate, each beneficial owner of Bonds may require, at its option, that its Bonds be purchased on seven calendar days' prior notice, as described herein, at a purchase price of 100% of the principal amount thereof plus accrued interest to the purchase date. In addition, the Bonds and beneficial interests therein are subject to mandatory purchase under certain circumstances as described herein under "The Bonds—Purchase of Bonds—Mandatory Purchase."

The Bonds are issuable as fully registered bonds and, when issued, will be registered to Cede & Co., as nominee of The Depository Trust Company, New York, New York, to which payments of principal and purchase price of, premium, if any, and interest on the Bonds will be made. Individual purchases of beneficial interests in the Bonds will be made in book-entry form only, in the principal amount of $100,000 or any integral multiple of $5,000 in excess thereof. Purchasers of the Bonds will not receive physical delivery of bond certificates so long as the Bonds are in a Book-Entry System. See "The Bonds—Book-Entry System."

THE BONDS AND THE INTEREST THEREON DO NOT CONSTITUTE AN INDEBTEDNESS OR AN OBLIGATION, GENERAL OR MORAL, OR A PLEDGE OF THE FAITH OR LOAN OF CREDIT OF THE ISSUER, THE STATE OF ILLINOIS OR ANY POLITICAL SUBDIVISION THEREOF, WITHIN THE PURVIEW OF ANY CONSTITUTIONAL LIMITATION OR PROVISION. THE ISSUER IS OBLIGATED TO PAY THE PRINCIPAL OF, PREMIUM, IF ANY, AND INTEREST ON THE BONDS AND OTHER COSTS INCIDENTAL THERETO ONLY FROM THE SOURCES SPECIFIED IN THE BONDS AND IN THE INDENTURE. NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER, IF ANY, OF THE ISSUER OR THE STATE OF ILLINOIS OR ANY POLITICAL SUBDIVISION THEREOF IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF, PREMIUM, IF ANY, AND INTEREST ON THE BONDS OR OTHER COSTS INCIDENTAL THERETO, EXCEPT AS OTHERWISE PROVIDED IN THE INDENTURE. NO OWNER OF ANY BOND SHALL HAVE THE RIGHT TO COMPEL THE TAXING POWER, IF ANY, OF THE ISSUER, THE STATE OF ILLINOIS OR ANY POLITICAL SUBDIVISION THEREOF TO PAY THE PRINCIPAL OF, PREMIUM, IF ANY, OR INTEREST ON THE BONDS. THE ISSUER HAS NO TAXING POWER.

THE BONDS ARE BEING OFFERED SOLELY ON THE BASIS OF THE INITIAL LETTER OF CREDIT AND THE STANDYBY LETTER OF CREDIT AND THE FINANCIAL STRENGTH OF THE INITIAL BANK AND THE STANDBY CREDIT BANK AND ARE NOT BEING OFFERED ON THE BASIS OF THE FINANCIAL STRENGTH OF THE BORROWER OR ANY OTHER SECURITY.

The Bonds are offered when, as and if issued, subject to the approval of legality by Chapman and Cutler, Chicago, Illinois, Bond Counsel. Certain legal matters will be passed upon for the Borrower by Buoscio & Buoscio, Lansing, Illinois. Certain legal matters will be passed upon for the Issuer by Kevin Cahill, Esq., Chicago, Illinois. Certain legal matters will be passed on for the Standby Credit Bank by Peter E. Gutzmer, Esq., General Counsel to the Standby Credit Bank. Certain legal matters will be passed on for the Initial Bank and the Underwriter by Altheimer & Gray, Chicago, Illinois. It is expected that beneficial interests in the Bonds will be available through the facilities of The Depository Trust Company on or about June 30, 2000.

DOUGHERTY & COMPANY LLC

The date of this Official Statement is June 30, 2000.

BOOK-ENTRY ONLY

RATING: Standard & Poor's: AAA/A-1+.
See "RATING" herein.

In the opinion of Hopkins & Sutter, Bond Counsel, subject to compliance by the Issuer and the Borrower, as defined herein, with certain covenants, under present laws, interest on the Bonds, as defined herein, will not be includible in gross income of the owners thereof for federal income tax purposes. Interest on the Bonds will not be treated as an item of tax preference in computing the alternative minimum tax, but will be taken into account in computing an adjustment used in determining the alternative minimum tax for certain corporations. Interest on the Bonds is not exempt from income taxation in the State of Illinois. See "TAX EXEMPTION" herein.

$3,400,000
Illinois Development Finance Authority
Variable Rate Demand Revenue Bonds
(The Center for Enriched Living) Series 1999

Dated: Date of Issuance **Price: 100%** **Due: January 1, 2029**

The Bonds will be issued bearing interest at the Weekly Rate, which will be determined weekly by William Blair & Company, L.L.C., as Remarketing Agent, as more fully described herein. The Bonds are subject to conversion to a Monthly Rate, Adjustable Rate or Fixed Rate as more fully described herein. Interest on the Bonds will be payable during any Rate Period in which such bonds bear interest at the Weekly Rate on the first Business Day of each month, commencing August 2, 1999, and interest is payable upon the occurrence of certain other events, all as more fully described herein.

When Bonds bear interest at the Weekly Rate or the Monthly Rate, Bonds are subject to optional tender for purchase upon at least seven days' prior written notice, at an optional tender price equal to the principal amount of the Bond (or authorized portion thereof) tendered plus accrued interest. Additionally, upon the occurrence of certain other events described herein, including the occurrence of a Rate Conversion Date or upon substitution of an Alternate Credit Facility or Alternate Standby Credit Facility as described herein, Bonds are subject to mandatory tender for purchase at a mandatory tender price equal to the principal amount thereof plus accrued interest.

The Bonds are being initially offered for sale in book-entry only form and will be registered in the name of Cede & Co., as nominee for The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Bonds and purchases will be made through DTC participants. Payments of principal of and interest on the Bonds and the purchase price of tendered Bonds will be made by Firstar Bank Milwaukee, N.A., as Trustee (the "Trustee"), to DTC, which in turn will remit such payments to its participants for subsequent disbursement to the beneficial owners of the Bonds. As long as Cede & Co. is the registered owner, payments on the Bonds will be made to such registered owner, and disbursement of such payments to the beneficial owners will be the responsibility of DTC and its participants. See "THE BONDS - Book-Entry Only System" herein.

The Illinois Development Finance Authority (the "Issuer") is issuing the Bonds for the purpose of making a loan to The Center for Enriched Living, an Illinois not-for-profit corporation (the "Borrower"), to (i) finance and reimburse the Borrower for the costs of the construction of an approximately 20,000 square foot community development center for the developmentally disabled to be located at 280 Saunders Road, Riverwoods, Illinois, (ii) refinance outstanding taxable debt of the Borrower, (iii) finance capitalized interest on the Bonds and (iv) pay certain expenses incurred in connection with issuance of the Bonds (the "Project").

THE BONDS AND THE INTEREST THEREON DO NOT CONSTITUTE AN INDEBTEDNESS OR AN OBLIGATION, GENERAL OR MORAL, OR A PLEDGE OF THE FAITH OR LOAN OF CREDIT OF THE ISSUER, THE STATE OF ILLINOIS OR ANY POLITICAL SUBDIVISION THEREOF, WITHIN THE PURVIEW OF ANY CONSTITUTIONAL LIMITATION OR PROVISION. THE ISSUER IS OBLIGATED TO PAY THE PRINCIPAL OF, PREMIUM, IF ANY, AND INTEREST ON THE BONDS AND OTHER COSTS INCIDENTAL THERETO ONLY FROM THE SOURCES SPECIFIED IN THE INDENTURE. NEITHER THE FAITH AND CREDIT NOR THE TAXING POWERS, IF ANY, OF THE ISSUER OR THE STATE OF ILLINOIS OR ANY POLITICAL SUBDIVISION THEREOF IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF, PREMIUM, IF ANY, AND INTEREST ON THE BONDS OR OTHER COSTS INCIDENTAL THERETO, EXCEPT AS OTHERWISE PROVIDED IN THE INDENTURE. NO OWNER OF ANY BOND SHALL HAVE THE RIGHT TO COMPEL THE TAXING POWER, IF ANY, OF THE ISSUER, THE STATE OF ILLINOIS OR ANY POLITICAL SUBDIVISION THEREOF TO PAY THE PRINCIPAL OF, PREMIUM, IF ANY, OR INTEREST ON THE BONDS. THE ISSUER HAS NO TAXING POWER.

The Bonds are payable from the revenues and other moneys assigned under the Indenture to secure payment of the Bonds, which include the loan payments required to be made by the Borrower to the Issuer under the Loan Agreement between such parties and the moneys obtained by the Trustee under an irrevocable transferable direct pay letter of credit (the "Credit Facility") issued by Grand National Bank (the "Credit Entity") in favor of the Trustee and an irrevocable standby letter of credit (the "Standby Credit Facility") issued by the

FEDERAL HOME LOAN BANK OF CHICAGO

The Credit Facility and the Standby Credit Facility each permit the Trustee to draw thereunder in accordance with its terms to pay (a) the principal of the Bonds when due at maturity, upon redemption or acceleration, (b) the purchase price of Bonds tendered for purchase and not remarketed and (c) up to 45 days' accrued interest on the Bonds at an interest rate of 10% per annum (based on a year of 365 days). The Credit Facility and the Standby Credit Facility will each expire on July 15, 2004, unless extended, and under certain circumstances, may be terminated on an earlier date as described herein.

The Bonds are subject to optional and mandatory redemption prior to maturity, in whole or in part, at the redemption prices and under the circumstances more fully described herein. See "THE BONDS-Redemption of the Bonds" herein.

The Official Statement contains information relating to the security for the Bonds prior to a conversion to the Adjustable Rate or Fixed Rate. Owners or purchasers of the Bonds are not to rely on the information herein with respect to security for the Bonds after such conversion.

The Bonds are offered, subject to prior sale, when, as and if issued by the Issuer and accepted by the Underwriter, subject to, among other things, the approving legal opinion of Hopkins & Sutter, Chicago, Illinois, Bond Counsel. Certain legal matters will be passed upon for the Borrower by its counsel, Kubasiak, Cremieux, Fylstra, Reizen & Rotunno, P.C., Chicago, Illinois; for the Issuer by its special counsel, Hart, Southworth & Witsman, Springfield, Illinois; for the Credit Entity by its counsel, Levenfeld Pearlstein Glassberg Tuchman Bright Goldstein & Schwartz, LLC, Chicago, Illinois; for the Federal Home Loan Bank of Chicago by Peter E. Gutzmer, Esq., its general counsel; and for the Underwriter by its counsel, Ice Miller Donadio & Ryan, Chicago, Illinois. Delivery of the Bonds is expected to occur via DTC in New York, New York on or about July 22, 1999.

July 21, 1999

William Blair & Company

PENNSYLVANIA HIGHER EDUCATIONAL FACILITIES AUTHORITY
***PENNSYLVANIA's* STATE PUBLIC SCHOOL BUILDING AUTHORITY**
1035 Mumma Road, Wormleysburg, PA 17043
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www.phefa.org

February 12, 2008

The Honorable Paul E. Kanjorski
Member, U. S. House of Representatives
Chairman, Financial Services Subcommittee
on Capital Markets, Insurance and Government
Sponsored Enterprises
2188 Rayburn House Office Building
Washington, DC 20515-3811

RE: H.R. 2091

Dear Congressman Kanjorski:

It is my pleasure to again thank you for cosponsoring H.R. 2091, which would allow Federal Home Loan Banks (FHLBanks) to partner with their members and issue letters of credit on tax-exempt private activity bonds benefiting important economic and community development projects throughout Pennsylvania.

As Chairman of the HR Capital Markets Subcommittee, we know you have made investor protection a top priority. You have been consistent and we applaud you for planning the upcoming subcommittee hearing on bond insurance, understandably, an important credit enhancement tool for many debt issuers.

As you are aware, the mission of the Pennsylvania Higher Educational Facilities Authority (PHEFA) is to provide a broad range of low-cost financing options and services to our client base. PHEFA has been privileged to be the issuing Authority of tax exempt bonds for a number of the colleges and universities in Pennsylvania, including some in your congressional district. In the last ten years we have issued bonds for projects at **East Stroudsburg University, Kings College, Marywood University, the University of Scranton** and **Wilkes University.** Eleven projects totaled $146,299,000. Seven of the project bond issues were enhanced with letters of credit and four were enhanced with bond insurance.

H.R. 2091 would definitely assist the colleges and universities that we finance by providing them with an additional source of credit enhancement. The current financial turmoil in the credit markets and the municipal bond insurance industry only increases the need for additional sources of credit enhancements.

Email: wbostic@phefa.org

Honorable Paul E. Kanjorski
February 12, 2008
Page 2

As the Commonwealth of Pennsylvania's conduit for tax-exempt higher educational facilities financing, we are always looking for ways to reduce the cost of issuing tax-exempt debt. A triple-A credit enhancement from an FHLBank would be a new option for our users and could result in significant savings.

In addition, this legislation will also be a great resource for the communities where these educational institutions reside. We have multiple reasons to feel that you, as do we, strongly believe that community and economic development, infrastructure and housing are all connected. H.R 2091 is important because it would give many issuers an additional option as they strive to serve their communities. We believe that our clients should support efforts that will improve the places they call home.

Again, thank you for cosponsoring and supporting the passage of H.R. 2091.

Sincerely,

William C. Bostic
Executive Director

c: The Honorable Jim Gerlach
U.S. House of Representatives
Member, Financial Services Subcommittee

Email: wbostic@phefa.org

PAUL E. KANJORSKI
11TH DISTRICT, PENNSYLVANIA

COMMITTEE ON
FINANCIAL SERVICES

CHAIRMAN:
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON OVERSIGHT AND
GOVERNMENT REFORM

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Congress of the United States
Washington, DC 20515-3811

January 30, 2008

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102 POCONO BOULEVARD
MOUNT POCONO, PA 18344-1412
(570) 895-4176

TOLL FREE HELP-LINE
(800) 222-2348

The Honorable Elaine L. Chao
Secretary of Labor
U.S. Department of Labor
200 Constitution Avenue, NW, Room S-2018
Washington, DC 20210

Dear Madam Secretary:

Recently, participants in the financial services sector have raised concerns about the ongoing viability of a number of bond insurers and the implications of their actual or potential ratings downgrades for all participants in the financial marketplace. The House Financial Services Capital Markets Subcommittee has therefore started an examination of these important matters, and I write to request your assistance in these efforts with regard to a possible impact on pension funds.

Specifically, an article in the *Washington Post* on January 18 noted that "[i]nvestors are growing especially concerned about the fate of bond insurers, which have guaranteed $2 trillion of debt securities in portfolios around the world. With these securities now increasingly at risk, the bond insurers are coming under pressure and their own [credit] ratings could suffer. That in turn could trigger a downgrade in the insured securities, sparking a new round of sell-offs and write-downs." I, too, am very concerned about these developments and their spillover effects for pension funds, insured depositories, and municipal governments, among others.

Participants in the financial services industry, including commercial and investment banks, have relied on the financial guarantees issued by entities like Ambac Assurance Corporation, MBIA Insurance Corporation, and ACA Financial Guaranty Corporation to reduce exposure to subprime mortgage debt and other complex securities products tied to these loans. Each of the aforementioned insurers, however, has also recently experienced a cut or the threat of a cut in the ratings that they receive from entities like Fitch, Standard and Poor's, and/or Moody's.

The decisions of these credit rating agencies have already begun to affect the bottom lines of several participants in the financial services marketplace. Merrill Lynch, for example, recently took a $3.1 billion charge on its exposure to a downgraded bond insurer. Citigroup has also reserved $935 million to help protect itself against further turmoil in this sector. Other financial corporations seem likely to face similar situations in the coming weeks and months.

THIS STATIONERY PRINTED ON PAPER MADE WITH RECYCLED FIBERS

The uncertainty in the bond insurance marketplace resulting from exposure to subprime housing products seems likely to spread. I have concerns about the impact on pension funds that must hold investment-grade paper and whether or not the pension fund may need to sell holdings backed by downgraded bond insurers. Moreover, I am also troubled about the implications for state and local governments that rely on bond insurance when putting together deals to pay for roads, schools, and other construction projects. Any increase in the perceived risks in bond insurers or decrease in competition seems likely to raise borrowing costs and slow spending on public infrastructure needs. It could also decrease our municipal employment base.

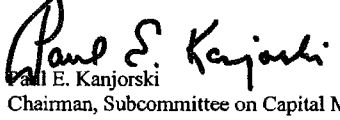
The Capital Markets Subcommittee will convene a hearing on these matters in the near future. In order to assist in the preparations for the hearing and consistent with all applicable law and regulation, I would appreciate receiving responses to the following:

- Detail any concerns you may perceive for the pension fund industry due to problems facing the bond insurance industry, including the potential financial exposure of pension funds to downgraded municipal bonds.
- Examine the implications of these problems for pension funds, as well as the broader economy.
  Outline the laws and regulations governing pension funds and their holdings as they relate to these matters.
- Discuss the adequacy of existing statutory and regulatory tools to address these problems and the need for further reforms.

Because of the urgency of these matters, I would also ask that you respond no later than February 7, 2008.

In sum, thank you for your attention to this important oversight request. If you should have any questions, please contact me directly or have your staff contact the staff of the Capital Markets Subcommittee. I look forward to your timely response.

Sincerely,



Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises

02/13/2008 11:46 FAX 2026534644 OCIA 002/003

U.S. Department of Labor

Assistant Secretary for
Employee Benefits Security Administration
Washington, D.C. 20210

February 11, 2008

The Honorable Paul Kanjorski
Chairman
Subcommittee on Capital Markets,
Committee on Financial Services
United States House of Representatives
Washington, DC 20515-3811

Dear Mr. Chairman:

This responds to your January 30, 2008 inquiry to the Department of Labor (Department) regarding the implications of actual or potential ratings downgrades of bond insurers on participants in the financial marketplace, including pension funds, insured depositories and municipal governments. As the Department regulates employee benefit plans sponsored by private employers, this response will focus on how those plans are regulated, and how they may be affected.

The Employee Benefits Security Administration is responsible for interpreting and enforcing Title I of the Employee Retirement Income Security Act of 1974 (ERISA). ERISA establishes standards of conduct for plan fiduciaries who are responsible for the administration and management of private employee benefit plans. Fiduciaries must invest pension assets solely in the interest of participants and beneficiaries, must invest prudently, and must diversify plan investments so as to minimize the risk of large losses. Fiduciaries are personally liable for any losses resulting from a breach of these duties.

In making investment decisions, plan fiduciaries must take into account all relevant information relating to the plan and the investment. Within this framework, bonds, bond funds and other debt instruments may form part of a prudent and diversified portfolio. It is the responsibility of plan fiduciaries to gather and consider information necessary to determine the prudence of holding any particular investment. Therefore, changing credit market conditions are one of many factors the prudent plan fiduciary must evaluate. Fiduciaries evaluating whether to hold or sell bonds backed by bond insurers must take into account all of these factors and determine what course of action is best, based on the unique facts and circumstances of their plans.

As investors, plans generally are in the same position as other investors with respect to factors affecting the risk of insured bonds. However, it is unlikely that concerns about insured municipal bonds will have any impact on private pension plans. Tax-exempt municipal bonds commonly offer lower returns than taxable bonds. Employee benefit

plans, which are themselves generally not subject to taxation, typically do not invest in these vehicles.

In addition to regulating fiduciary conduct with respect to investment decisions, ERISA prohibits plans from engaging in certain categories of transactions with specified individuals and entities (including fiduciaries) called "parties in interest." As this very broad prohibition captures many activities that would be beneficial to plans and participants, Congress wrote into ERISA a series of statutory exemptions to these rules and also provided the Secretary of Labor with administrative authority to exempt transactions that protect the rights of participants and beneficiaries and that are in the interests of the plan. For example, as the financial markets consolidate and affiliations between service providers result in more "parties in interest" with respect to common plan activities and investments, administrative exemptions with appropriate safeguards have, over time, leveled the playing field for plans to prevent their exclusion from investment opportunities in common assets classes, such as asset-backed securities through pooled investment trusts.

The Department has the statutory and regulatory tools necessary to oversee the conduct of pension and other employee benefit plans investing in insured bonds. As we do not regulate other entities or the financial markets, we defer to the views of other agencies with respect to the adequacy of existing statutory and regulatory tools to address financial market implications of credit downgrades. The Department will continue to monitor developments in the credit markets that may impact ERISA plans.

Thank you for the opportunity to provide this information. Please let me know if we can be of additional assistance.

Sincerely,

Bradford P. Campbell
Assistant Secretary

cc: The Honorable Deborah Pryce
Ranking Member

PAUL E. KANJORSKI
11TH DISTRICT, PENNSYLVANIA

COMMITTEE ON
FINANCIAL SERVICES

CHAIRMAN:
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON OVERSIGHT AND
GOVERNMENT REFORM

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Congress of the United States
Washington, DC 20515–3811

January 23, 2008

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The Honorable Ben S. Bernanke
Chairman, Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, NW, Room 2046
Washington, DC 20551

Dear Mr. Chairman:

In recent weeks, many participants in our financial services sector have raised concerns about the ongoing viability of a number of bond insurers and the implications of their actual or potential ratings downgrades for all participants in the financial marketplace. The House Financial Services Capital Markets Subcommittee has therefore started an examination of these important matters, and I write to request your assistance in these efforts.

Specifically, an article in the *Washington Post* on January 18 noted that "[i]nvestors are growing especially concerned about the fate of bond insurers, which have guaranteed $2 trillion of debt securities in portfolios around the world. With these securities now increasingly at risk, the bond insurers are coming under pressure and their own [credit] ratings could suffer. That in turn could trigger a downgrade in the insured securities, sparking a new round of sell-offs and write-downs." I, too, am very concerned about these developments for insured depositories, pension funds, and municipal governments, among others.

Participants in the financial services industry, including commercial and investment banks, have relied on the financial guarantees issued by entities like Ambac Assurance Corporation, MBIA Insurance Corporation, and ACA Financial Guaranty Corporation to reduce exposure to subprime mortgage debt and other complex securities products tied to these loans. Each of the aforementioned insurers, however, has also recently experienced a cut or the threat of a cut in the ratings that they receive from entities like Fitch, Standard and Poor's, and/or Moody's.

The decisions of these credit rating agencies have already begun to affect the bottom lines of several participants in the financial services marketplace. Merrill Lynch, for example, recently took a $3.1 billion charge on its exposure to a downgraded bond insurer. Citigroup has also reserved $935 million to help protect itself against further turmoil in this sector. Other financial corporations seem likely to face similar situations in the coming weeks and months.

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The uncertainty in the bond insurance marketplace resulting from exposure to subprime housing products seems likely to spread. Pension funds that must hold investment-grade paper may need to sell holdings backed by downgraded bond insurers. Moreover, I am especially concerned about the implications for state and local governments that rely on bond insurance when putting together deals to pay for roads, schools, and other construction projects. Any increase in the perceived risks in bond insurers or decrease in competition seems likely to raise borrowing costs and slow spending on public infrastructure needs.

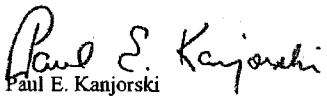
The Capital Markets Subcommittee will convene a hearing on these matters in the near future. In order to assist in the preparations for the hearing and consistent with all applicable law and regulation, I would appreciate receiving responses to the following:

- Outline any concerns you may perceive facing the bond insurance industry.
- Examine the implications of these problems for the entities that you regulate, as well as the broader economy.
- Detail the steps you are taking to monitor developments in the bond insurance marketplace and ensure the continued safety and soundness of banks and/or financial holding companies.
- Discuss the adequacy of existing statutory and regulatory tools to address these problems and the need for further reforms.

Because of the urgency of these matters, I would also ask that you respond no later than February 1, 2008.

In sum, thank you for your attention to this important oversight request. If you should have any questions, please contact me directly or have your staff contact the staff of the Capital Markets Subcommittee. I look forward to your timely response.

Sincerely,



Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

February 4, 2008

BEN S. BERNANKE
CHAIRMAN

The Honorable Paul E. Kanjorski
Chairman
Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I appreciate the opportunity to respond to your letter of January 23, 2008, regarding financial guarantors.

Historically, the financial guarantors mainly provided insurance for municipal securities. In recent years, they expanded into insuring structured financial instruments and vehicles, including residential mortgage-backed securities and collateralized debt obligations (CDOs), including CDOs of asset-backed securities. With the sharp deterioration in the performance of residential subprime mortgages, the expected losses to be borne by the financial guarantors escalated and caused market participants and ratings agencies to reevaluate guarantors' financial strength and particularly the adequacy of their capital. Several financial guarantors have been downgraded by the ratings agencies and a number are currently on review for possible future downgrades.

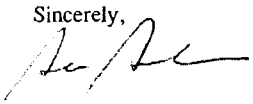
There are several channels through which problems at the financial guarantors could have adverse effects on market functioning and on the banking industry. Ratings downgrades and financial deterioration of the guarantors can make it more costly to issue securities for some municipalities and for certain types of asset-backed securities. Banks have exposure to the financial guarantors through banks' holdings of insured municipal securities and structured securities, through derivative transactions for which the guarantors are a counterparty, and through loans and lines of credit they have extended to the guarantors. Banks also have significant exposures to the financial guarantors through the liquidity support that banks provide for certain types of municipal securities and structures, including variable-rate demand obligations (VRDOs) and tender-option bonds (TOBs), as well as some asset-backed commercial paper conduits. Reduced confidence in the financial guarantors could lead some investors to exercise options to put these securities back to the liquidity providers. Moreover, money market funds, who are major investors

in these securities, can be required to put the securities back to the liquidity providers if the financial guarantor is downgraded significantly. Thus, banks could be required to bring a sizable volume of assets, especially municipal securities, onto their books.

Prices of corporate equity and credit default swaps for the financial guarantors and their counterparties suggest that market participants have factored in a significant degree of stress. Given the adverse effects that problems of financial guarantors can have on financial markets and the economy, we are closely monitoring developments. In addition, we are closely monitoring the potential effect of downgrades of financial guarantors on bank holding companies, state member banks, and other institutions supervised by the Federal Reserve. We believe we have the appropriate tools to assess exposures to bond insurers of the banks that we supervise.

This letter reflects the views of the Federal Reserve Bank of New York as well.

Sincerely,



PAUL E. KANJORSKI
11TH DISTRICT, PENNSYLVANIA

COMMITTEE ON
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CHAIRMAN:
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

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Congress of the United States
Washington, DC 20515–3811

January 23, 2008

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The Honorable John C. Dugan
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 9-1
Washington, DC 20219-0001

Dear Mr. Comptroller:

In recent weeks, many participants in our financial services sector have raised concerns about the ongoing viability of a number of bond insurers and the implications of their actual or potential ratings downgrades for all participants in the financial marketplace. The House Financial Services Capital Markets Subcommittee has therefore started an examination of these important matters, and I write to request your assistance in these efforts.

Specifically, an article in the *Washington Post* on January 18 noted that "[i]nvestors are growing especially concerned about the fate of bond insurers, which have guaranteed $2 trillion of debt securities in portfolios around the world. With these securities now increasingly at risk, the bond insurers are coming under pressure and their own [credit] ratings could suffer. That in turn could trigger a downgrade in the insured securities, sparking a new round of sell-offs and write-downs." I, too, am very concerned about these developments for insured depositories, pension funds, and municipal governments, among others.

Participants in the financial services industry, including commercial and investment banks, have relied on the financial guarantees issued by entities like Ambac Assurance Corporation, MBIA Insurance Corporation, and ACA Financial Guaranty Corporation to reduce exposure to subprime mortgage debt and other complex securities products tied to these loans. Each of the aforementioned insurers, however, has also recently experienced a cut or the threat of a cut in the ratings that they receive from entities like Fitch, Standard and Poor's, and/or Moody's.

The decisions of these credit rating agencies have already begun to affect the bottom lines of several participants in the financial services marketplace. Merrill Lynch, for example, recently took a $3.1 billion charge on its exposure to a downgraded bond insurer. Citigroup has also reserved $935 million to help protect itself against further turmoil in this sector. Other financial corporations seem likely to face similar situations in the coming weeks and months.

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The uncertainty in the bond insurance marketplace resulting from exposure to subprime housing products seems likely to spread. Pension funds that must hold investment-grade paper may need to sell holdings backed by downgraded bond insurers. Moreover, I am especially concerned about the implications for state and local governments that rely on bond insurance when putting together deals to pay for roads, schools, and other construction projects. Any increase in the perceived risks in bond insurers or decrease in competition seems likely to raise borrowing costs and slow spending on public infrastructure needs.

The Capital Markets Subcommittee will convene a hearing on these matters in the near future. In order to assist in the preparations for the hearing and consistent with all applicable law and regulation, I would appreciate receiving responses to the following:

- Outline any concerns you may perceive facing the bond insurance industry.
- Examine the implications of these problems for the entities that you regulate, as well as the broader economy.
- Detail the steps you are taking to monitor developments in the bond insurance marketplace and ensure the continued safety and soundness of banks and/or financial holding companies.
- Discuss the adequacy of existing statutory and regulatory tools to address these problems and the need for further reforms.

Because of the urgency of these matters, I would also ask that you respond no later than February 1, 2008.

In sum, thank you for your attention to this important oversight request. If you should have any questions, please contact me directly or have your staff contact the staff of the Capital Markets Subcommittee. I look forward to your timely response.

Sincerely,

Paul E. Kanjorski

Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

February 1, 2008

The Honorable Paul E. Kanjorski
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Kanjorski:

Your letter dated January 23, 2008 requested information related to the uncertainty in the bond insurance marketplace and the possible effects on the national banking system. Attached is our response to your inquiry. Please be assured that our office appreciates the significance of recent developments in this area and that we are available to work with you and your staff as you address these important issues.

Sincerely,

John C. Dugan
Comptroller of the Currency

Enclosure

1) Outline any concerns you may perceive facing the bond insurance industry.

Historically bond insurers concentrated on insuring debt issued by municipalities. Over the last several years, due to a relatively flat growth rate in municipal markets, several bond insurers expanded into protecting asset-backed securities. Asset-backed securities have accounted for more than half of all insured securities since 2004. As a result, the bond insurers' exposure from protection of real estate related securities and other structured finance increased. Guarantees on mortgage-backed and other asset-backed securities have increased from 18% of outstanding guarantees to 34% (as of 6/30/07). This growth in structured products and mortgage-backed security exposure has significantly increased the risk profile of the bond insurers.

With the reality of a real estate market downturn and subprime problems, bond insurers have been punished in both equity and credit markets as concerns regarding loss exposure have escalated. Concerns over insurers' capability to weather the real estate/subprime storm are widely documented, as described in your letter. The ability to maintain and/or raise sufficient capital in order to maintain AAA credit ratings is the primary concern facing the bond insurance industry. Downgrades may affect future business and earnings performance as well. A downgrade even to AA would adversely affect the ability of the insurer to obtain new business from segments of the market requiring the AAA rating to support bond issuances.

2) Examine the implications of these problems for the entities you regulate, as well as the broader economy.

National banks have direct and indirect exposures to the financial monoline guarantors. The direct exposures currently exist in direct lending activities, counterparty credit risk from derivatives contracts, investment portfolio holdings, assets under management for customers, and remarketing and other indirect activities. Indirect exposures would arise if problems associated with the monoline guarantors gave rise to additional market uncertainty and unlike the direct exposures, we believe the indirect exposures are not ones that can be easily quantified.

In general, based on information derived from onsite supervision at our banks, we believe that direct exposures from counterparty risk and direct lending are relatively moderate. Additionally, while the nominal amount of holdings in national bank investment portfolios is much larger, the actual risk exposure is also relatively modest. Given that the underlying municipal bonds tend to be highly rated on their own, we don't view investment portfolio exposure as representing a serious concern, although rising municipal budget deficits and declining property tax receipts may negatively affect municipal credit quality. Money market mutual funds, particularly tax exempt funds, and other short-term investment funds managed by national banks or their affiliates are also affected by monoline downgrades. The downgrade of a monoline guarantor may result in the downgrade of a holding from Aaa/AAA to some lower level, as well as a decline in the holding's value. A downgraded holding could fall below money market fund eligibility requirements, or for other assets

under management, fall outside the parameters of the fund's investment policy and potentially require divestiture at depreciated prices or other action. The impact of the price adjustment would depend upon the relationship of potential dislocations in the municipal market and the strength of the underlying assets.

In addition, national banks have a number of direct exposures that arise due to remarketing obligations on long-term municipal securities sold to short-term, money market investors. For both tender option bonds (TOB) and variable rate demand bonds (VRDBs), banks are contractually obligated to repurchase municipal securities, at par, from investors. A third product, auction rate securities (ARS), does not impose a contractual obligation to repurchase the securities, but for reputation risk reasons banks may feel compelled to do so. Downgrades of the monolines make it more likely that policy-constrained investors will "put" these securities back to the remarketing banks. If this happens, banks incur price and liquidity risks, as well as increased strain on their capital ratios.

3) **Detail the steps you are taking to monitor developments in the bond insurance marketplace and ensure the continued safety & soundness of banks and/or financial holding companies.**

The OCC, as a part of its safety and soundness supervision, requires national banks to maintain effective risk management processes. In community and midsize banks our supervision includes a review of investment portfolio assets and an assessment of the policies and controls that govern investment decisions. In large national banks, our resident staffs have ongoing access to bank management and key management reports in order to assess the risk profile of their institutions. Examiners continue to evaluate the potential implications of monoline insurer downgrades, and are monitoring the turmoil's potential impact on other bank activities.

Throughout this period of market turbulence we have taken steps to ensure the continued safety and soundness of our banks. In response to general market conditions, we continue to meet with the banks and closely monitor earnings projections and liquidity and capital ratios. We perform periodic stress tests to assess the level of capital cushion available in each bank. We have discussed capital needs and plans with specific bank management as appropriate. We are working closely with bankers to understand their funding and liquidity situations. In addition, we are engaged in regular discussions with the Federal Reserve, SEC, and relevant foreign bank supervisors.

4) **Discuss the adequacy of existing statutory and regulatory tools to address these problems and the need for further reform.**

As discussed above, we recognize and are actively monitoring the exposures to the monoline insurers and the impact to the national banks we regulate. The OCC has a wide variety of statutory and regulatory tools designed to ensure the safety and soundness of national banks and is prepared to utilize those tools to address risks presented by exposures to the bond industry. Such tools range from Matters Requiring Attention reported to bank boards,

informal administrative actions including memoranda of understanding, and formal actions such as cease and desist orders. Our ongoing supervision process allows us to timely identify concerns and utilize our supervisory and enforcement tools if appropriate.

PAUL E. KANJORSKI
11TH DISTRICT, PENNSYLVANIA

COMMITTEE ON
FINANCIAL SERVICES

CHAIRMAN:
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
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Washington, DC 20515-3811

January 23, 2008

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TOLL FREE HELP-LINE
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The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE, Room 10700
Washington, DC 20549

Dear Mr. Chairman:

In recent weeks, many participants in our financial services sector have raised concerns about the ongoing viability of a number of bond insurers and the implications of their actual or potential ratings downgrades for all participants in the financial marketplace. The House Financial Services Capital Markets Subcommittee has therefore started an examination of these important matters, and I write to request your assistance in these efforts.

Specifically, an article in the *Washington Post* on January 18 noted that "[i]nvestors are growing especially concerned about the fate of bond insurers, which have guaranteed $2 trillion of debt securities in portfolios around the world. With these securities now increasingly at risk, the bond insurers are coming under pressure and their own [credit] ratings could suffer. That in turn could trigger a downgrade in the insured securities, sparking a new round of sell-offs and write-downs." I, too, am very concerned about these developments for pension funds, insured depositories, and municipal governments, among others.

Participants in the financial services industry, including investment and commercial banks, have relied on the financial guarantees issued by entities like Ambac Assurance Corporation, MBIA Insurance Corporation, and ACA Financial Guaranty Corporation to reduce exposure to subprime mortgage debt and other complex securities products tied to these loans. Each of the aforementioned insurers, however, has also recently experienced a cut or the threat of a cut in the ratings that they receive from entities like Fitch, Standard and Poor's, and/or Moody's.

The decisions of these credit rating agencies have already begun to affect the bottom lines of several participants in the financial services marketplace. Merrill Lynch, for example, recently took a $3.1 billion charge on its exposure to a downgraded bond insurer. Citigroup has also reserved $935 million to help protect itself against further turmoil in this sector. Other financial corporations seem likely to face similar situations in the coming weeks and months.

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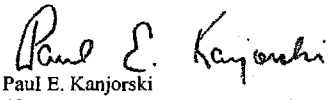
The Capital Markets Subcommittee will convene a hearing on these matters in the near future. In order to assist in the preparations for the hearing and consistent with all applicable law and regulation, I would appreciate receiving responses to the following:

- Outline the problems you perceive facing the bond insurance industry.
- Examine the implications of these problems for the entities and products that you regulate, including publicly traded bond insurers, rating agencies, and consolidated supervisory entities, as well as the broader markets and economy.
- Detail the steps you are taking to monitor developments in the bond insurance marketplace and protect investors.
- Discuss the adequacy of existing statutory and regulatory tools to address these problems and the need for further reforms.

Because of the urgency of these matters, I would also ask that you respond no later than February 1, 2008.

In sum, thank you for your attention to this important oversight request. If you should have any questions, please contact me directly or have your staff contact the staff of the Capital Markets Subcommittee. I look forward to your timely response.

Sincerely,



Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises

CHRISTOPHER COX
CHAIRMAN

HEADQUARTERS
100 F STREET, NE
WASHINGTON, DC 20549

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

REGIONAL OFFICES
ATLANTA, BOSTON, CHICAGO,
DENVER, FORT WORTH,
LOS ANGELES, MIAMI, NEW YORK,
PHILADELPHIA, SALT LAKE CITY,
SAN FRANCISCO

January 31, 2008

The Honorable Paul E. Kanjorski
Chairman
Subcommittee on Capital Markets,
Insurance and Government Sponsored Entities
U.S. House of Representatives
2188 Rayburn House Office Building
Washington, DC 20515-3811

Dear Chairman Kanjorski:

Thank you for your recent letter. In your correspondence, you expressed concern over the recent deterioration in the ratings of monoline insurers and the implications of ratings downgrades for all participants in the financial markets. Further, you inquired about what steps the U.S. Securities and Exchange Commission is taking to understand the scope of the potential impact of such downgrades on the securities markets, their participants, and investors.

You noted in your letter that participants in the financial services industry, including investment and commercial banks, have relied on credit default swap transactions with entities such as Ambac Financial Group and MBIA Inc., among others, to hedge their exposure to subprime mortgage debt and other complex securities products tied to these loans. Similarly, municipalities and tax exempt money market funds rely on bond insurance as a form of credit enhancement.

In response to your inquiry, I am enclosing a memo prepared by the Commission's Division of Trading and Markets that supervises the systemically important financial services firms and the municipal securities markets - both of which would be impacted by ratings downgrades of the monoline insurers.

I hope this information is helpful to you. The Commission's staff will continue to be in close contact with the industry and federal banking regulators to monitor the situation. Please feel free to call me at (202) 551-2126 or to have your staff call Jonathan Burks, Director of our Office of Legislative and Intergovernmental Affairs, at (202) 551-2016 if you would like to discuss the matter further.

Sincerely,

Christopher Cox
Chairman

CHAIRMANOFFICE@SEC.GOV
WWW.SEC.GOV

MEMORANDUM

TO: Chairman Cox

FROM: Erik R. Sirri, Director
Division of Trading and Markets

DATE: January 30, 2008

RE: Monitoring of Monoline Insurers

You have asked the staff to apprise you of how monoline insurers impact the securities markets and what efforts the staff has made to assess and monitor the impact of potential ratings downgrades of such insurers. As a threshold matter, the Commission does not regulate monoline insurers; rather this is the domain of state insurance regulators. However, there are various ways that the securities markets and their participants, which the Commission does regulate, may be impacted by ratings downgrades of monoline insurers. Principal among these are certain systemically important financial services firms (known as CSEs), municipal securities issuers and dealers, and municipal money market funds, all of which engage with monoline insurers, either directly or indirectly, and may be affected by recent events.

Commission Supervision of CSEs and Exposure to Monolines

The Commission supervises certain investment bank holding companies, known as consolidated supervised entities (CSEs), on a consolidated basis. The focus of this prudential regime is the financial and operational condition of the holding company, and monitoring for risks that might place regulated entities within the group or the broader financial system at risk. At present, five internationally active securities firms are supervised under this regime: Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley.

All five of the CSEs are of potentially systemic importance, trading a wide range of financial products, connected through counterparty relationships to other large institutions and providing services to a variety of market participants. The Commission's supervision of CSEs is primarily concerned with the risks that counterparties and market events potentially pose to the CSE firms specifically and, through the CSEs, to the financial system. This program's aim is to diminish the likelihood that weakness in the holding company itself or any unregulated affiliates would place a regulated entity, such as a bank or broker-dealer, or the broader financial system, at risk.

The Commission's CSE program supervises holding companies in a manner similar to the Federal Reserve's oversight of bank holding companies. CSEs are subject to a number of requirements under the program, including monthly computation of a capital adequacy measure consistent with the Basel II Standard, maintenance of substantial amounts of liquidity at the holding company, and documentation of a

comprehensive system of internal controls which are subject to Commission inspection. Further, the holding company must provide the Commission on a regular basis with extensive information regarding its capital and risk exposures, including market and credit risk exposures.

Under the CSE program, in addition to adequate capital, liquidity and liquidity risk management are a critical focus of the Commission's review of broker-dealer holding companies. Liquidity is essential to the viability of all financial institutions. The ability of a firm to withstand market, credit, and other types of stress events is linked not just to the amount of capital the firm possesses, but also to the sufficiency of liquid assets to meet obligations as they arise.

Due to the importance of liquidity to the CSE firms, the Commission seeks to determine whether each CSE firm has adopted and follows funding procedures designed to ensure that the holding company has sufficient stand-alone liquidity and sufficient financial resources to meet its expected cash outflows in a stressed liquidity environment for a period of at least one year.

In addition to its focus on liquidity and liquidity risk management, Commission staff meets regularly with senior managers of critical control functions. Specifically, Commission staff meets monthly with senior risk managers focused on market and credit risk exposures, and meets quarterly with senior financial controllers, senior treasury personnel, and senior internal audit personnel.

In the course of its frequent contact with CSE firms, the Commission staff has discussed and reviewed the CSEs' current and potential exposures to monoline insurers. These exposures fall into three broad categories: credit risk, market risk, and liquidity risk.

In terms of credit risk, many CSE firms execute derivative trades with monolines, generating direct counterparty credit risk exposure. For instance, a CSE may purchase credit default swap protection from a monoline. In such transactions, should the credit underlying the CDS contract default, the monoline would be expected to make a protection payment to the CSE. CSE firms also bear indirect counterparty credit risk exposure to monolines through derivative transactions with municipalities that are "wrapped," or guaranteed, by monolines.

In terms of market risk, the CSE firms are exposed to the perceived creditworthiness of monolines through "wrapped" securities they may have in inventory. These include municipal securities, tender option bonds, auction rate securities, and some mortgage products. In addition, most of the CSE firms have trading and hedging positions linked to monolines' creditworthiness, e.g., credit default swaps referencing monoline debt.

Finally, the CSE firms also have implicit and explicit liquidity risk exposure to monolines through their activities as remarketing agents for certain products, such as

auction rate securities and tender option bonds. These programs fund longer-term obligations, such as municipal debt, with liabilities that have the characteristics of shorter-term paper. Often, monolines wrap the underlying longer-term obligations. Some of these programs are required to have liquidity backstops. Thus, a CSE may bear liquidity risk explicitly by acting as the liquidity provider for a particular program, e.g., for tender option bonds or variable rate demand notes. Even where that liquidity backstop is provided by a third party or where a backstop is not required, a CSE bears implicit liquidity risk when acting as the remarketing agent on a program, as it may be compelled to support the program and take securities on balance sheet out of client and franchise considerations.

Based on Commission staff's recent meetings and discussions with CSE firm risk managers, treasurers, and business unit personnel, the CSE firms are highly aware of and actively managing their exposures to the monoline sector.

The Commission staff is also in regular communication with other financial services regulators, particularly the Federal Reserve Bank, which directly oversees most of the systemically important commercial banks, the OCC, which oversees nationally charted commercial banks, and the UK's Financial Services Authority.

Municipal Securities Market

Commission staff is also monitoring developments in the municipal securities markets related to the actual or potential ratings downgrades of bond insurers and the associated downgrades and withdrawals of ratings on bond issues in the municipal securities market.[1] In recent years, about half of all municipal securities offerings have been insured; insurance is also obtained in the secondary market. Although such downgrades will negatively affect the price of most bonds insured by companies that have been downgraded, the issuers and conduit borrowers with primary responsibility for repayment of these securities generally have investment-grade credit ratings or equivalent credit strength, mitigating the impact of downgrades of insurance providers.

Market participants have informed us that a few auctions of auction-rate securities in the municipal and corporate markets may have attracted too few bidders to establish a clearing rate as a result of turmoil in the credit markets, resulting in higher interest rates on those securities for a period of time. We understand that some municipal issuers and conduit borrowers have expressed an increased interest in converting their auction rate bonds into variable-rate bonds backed by letters of credit or other types of credit enhancement or fixed rate bonds. However, heavy demand for such credit enhancement instruments and market concerns may have made them more difficult and time consuming to obtain.

The National Association of Bond Lawyers recently asked Commission staff for guidance on the potential impact of failures to file material event notices about

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[1] There are approximately $2.4 trillion of municipal securities outstanding. Annual trading volume is about $6 trillion.

downgraded issues pursuant to Exchange Act Rule 15c2-12.[2] Commission staff expects to issue such guidance shortly. We are also concerned about the potential impact of downgrades of securities held by municipal money market and other funds, possible termination events or collateral posting events of swaps and other derivatives entered into by municipal issuers and conduit borrowers triggered by rating downgrades of either insurers or swap counterparties, and problems experienced by some state and local government investment pools. We are maintaining close contact with market participants to keep abreast of market volatility, pricing, and other issues.

The securities laws limit the extent of Commission regulatory authority over states and political subdivisions issuing municipal securities and conduit borrowers that are not public companies. Municipal securities are exempt from the registration and reporting provisions of the federal securities laws, and the Commission cannot specify line-item disclosure requirements or review disclosure documents in connection with offerings of municipal securities. Issuers and other participants in municipal securities offerings are, however, subject to the antifraud provisions of the federal securities laws, which prohibit materially misleading disclosures in connection with the offer, purchase, and sale of securities.

The disclosures made by private conduit borrowers with primary responsibility for repayment of many securities in the municipal market are often much less comprehensive than disclosures made by comparable entities in the corporate market. In fact, some conduit borrowers, in offerings backed by letters of credit, bond insurance, or other forms of credit enhancement, make no disclosures about themselves in their offering documents on the theory that the investors are looking solely to the credit enhancer for payment. Although a prior Commission release expresses the view that the presence of credit enhancements generally would not be a substitute for material disclosure concerning the primary obligor on municipal bonds,[3] some offerings do not contain such disclosures.

As you previously noted in your letter to the heads of several Congressional committees last summer, disclosure in the municipal securities market, particularly in the secondary market, is substantially less comprehensive and less readily available than disclosure by public reporting companies. Despite the size and importance of this market, it lacks a variety of the systemic protections found in many other sectors of the U.S. capital markets. The recent problems of municipal bond insurers and the direct and indirect impact on municipal bond investors illustrate once again some of the shortcomings of the regulatory structure of this market.

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2 We believe that more than 130,000 such notice filings would be required for Fitch's downgrade of Ambac alone.

3 Securities Exchange Act Release No. 26985 (June 28, 1989), 54 FR 28799 (July 10, 1989).

Municipal Money Market Funds

The Division of Investment Management is monitoring the affects on municipal money market funds related to the ratings or potential ratings downgrades of bond insurers. Municipal ("tax-free") money market funds own municipal bonds, about 40 percent of which we estimate are "wrapped," or guaranteed, by monolines. These securities include variable rate demand notes and tender option bonds that have liquidity backstops provided by a CSE or other large financial institution. In addition to providing a source of cash to satisfy redemptions by fund shareholders, these liquidity features operate to shorten the municipal bonds' maturity and make them appropriate investments for a money market fund.

In most cases, the liquidity backstops require that the municipal bonds maintain certain ratings, which may be threatened by the ratings downgrades of the monolines. The Division of Investment Management has been in regular contact with fund management companies, which are aware of these risks and have taken steps intended to protect the funds from the loss of these liquidity backstops. Fund managers have begun to examine the credit quality of the underlying municipal issuers and evaluate the risks of continuing to hold the instruments should they no longer be able to rely on bond insurance. Where the underlying credits are unsatisfactory, some fund managers are attempting to obtain alternative credit support or are selling the instruments (typically to remarketing agents). Where the underlying credits are satisfactory, fund managers are seeking amendments to program documentation that will preserve the liquidity feature in reliance on ratings issued to the municipal issuer (without regard to the ratings issued to the monoline insurer). Fund managers report that they have been discussing their actions with fund boards of directors which are keenly interested in these developments.

Losses by a money market fund, including a municipal money market fund, would be reflected by the fund re-pricing its securities below $1.00 ("breaking the buck"), an event that has occurred only once since the development of money market funds in the 1970s. The Division of Investment Management is unaware of any municipal money market fund currently threatened with breaking the buck as a result of recent downgrading and potential downgrading of monoline insurers.

cc: Peter Uhlmann
Paul Wilkinson
Jonathan Burks

PAUL E. KANJORSKI
11TH DISTRICT, PENNSYLVANIA

COMMITTEE ON
FINANCIAL SERVICES

CHAIRMAN:
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON OVERSIGHT AND
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TOLL FREE HELP-LINE
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January 23, 2008

The Honorable Sandy Praeger
President, National Association of Insurance Commissioners
c/o Kansas Insurance Department
420 SW 9th Street
Topeka, KS 66612-1678

Dear Ms. Praeger:

In recent weeks, many participants in our financial services sector have raised concerns about the ongoing viability of a number of bond insurers and the implications of their actual or potential ratings downgrades for all participants in the financial marketplace. The House Financial Services Capital Markets Subcommittee has therefore started an examination of these important matters, and I write to request your assistance in these efforts.

Specifically, an article in the *Washington Post* on January 18 noted that "[i]nvestors are growing especially concerned about the fate of bond insurers, which have guaranteed $2 trillion of debt securities in portfolios around the world. With these securities now increasingly at risk, the bond insurers are coming under pressure and their own [credit] ratings could suffer. That in turn could trigger a downgrade in the insured securities, sparking a new round of sell-offs and write-downs." I, too, am very concerned about these developments for pension funds, insured depositories, and municipal governments, among others.

Participants in the financial services industry, including commercial and investment banks, have relied on the financial guarantees issued by entities like Ambac Assurance Corporation, MBIA Insurance Corporation, and ACA Financial Guaranty Corporation to reduce exposure to subprime mortgage debt and other complex securities products tied to these loans. Each of the aforementioned insurers, however, has also recently experienced a cut or the threat of a cut in the ratings that they receive from entities like Fitch, Standard and Poor's, and/or Moody's.

The decisions of these credit rating agencies have already begun to affect the bottom lines of several participants in the financial services marketplace. Merrill Lynch, for example, recently took a $3.1 billion charge on its exposure to a downgraded bond insurer. Citigroup has also reserved $935 million to help protect itself against further turmoil in this sector. Other financial corporations seem likely to face similar situations in the coming weeks and months.

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The uncertainty in the bond insurance marketplace resulting from exposure to subprime housing products seems likely to spread. Pension funds that must hold investment-grade paper may need to sell holdings backed by downgraded bond insurers. Moreover, I am especially concerned about the implications for state and local governments that rely on bond insurance when putting together deals to pay for roads, schools, and other construction projects. Any increase in the perceived risks in bond insurers or decrease in competition seems likely to raise borrowing costs and slow spending on public infrastructure needs.

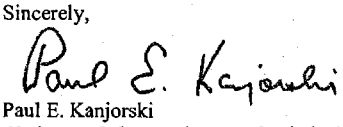
The Capital Markets Subcommittee will convene a hearing on these matters in the near future. In order to assist in the preparations for the hearing and consistent with all applicable law and regulation, I would appreciate receiving responses to the following:

- Describe how bond insurers are regulated, especially with regard to solvency and capital requirements and how such regulation differs from other lines of insurance.
- Outline the problems you presently perceive facing the bond insurance industry.
- Examine the implications of these problems for the entities and products that you regulate, as well as the broader economy.
- Detail the steps you are taking to monitor developments in the bond insurance marketplace and protect the solvency of insurers.
- Discuss the adequacy of existing statutory and regulatory tools, at the State or Federal level, to address these problems and the need for further reforms.
- Comment on the advisability of creating a guarantee fund, like those State funds for life and health insurers and property and casualty insurers, for the bond insurance industry.

Because of the urgency of these matters, I would also ask that you respond no later than February 1, 2008.

In sum, thank you for your attention to this important oversight request. If you should have any questions, please contact me directly or have your staff contact the staff of the Capital Markets Subcommittee. I look forward to your timely response.

Sincerely,



Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises

February 4, 2008

The Honorable Paul Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance, and Government Sponsored Enterprises
House Financial Services Committee
2188 Rayburn House Office Building
Washington, DC 20515-3811

Dear Chairman Kanjorski:

I am writing to respond to your January 23, 2008 letter regarding the financial guarantee insurance market. As President of the National Association of Insurance Commissioners (NAIC), I appreciate the Subcommittee's concerns about the ongoing viability of the financial guaranty insurance market. Individual responses from each of the principal regulators of the financial guaranty insurance market (New York, Wisconsin and Maryland), which respond to the specific questions posed in your letter, are attached to this letter.

The concerns regarding the condition of financial guarantee insurers and condition of the financial markets are two distinct issues, but related. The problems in the market today are partly about insurance, but more about the insured products in the underlying markets. We perform our role, but we do not purport to be the sole or even primary factor in this very complex economy where many markets and regulators are interacting.

It is the responsibility of state insurance regulators to ensure that insurance companies meet obligations to their policyholders. This is accomplished in many ways, one of which is solvency regulation. NAIC Statement of Statutory Accounting Principles No. 60 (Financial Guaranty Insurance) requires financial guaranty insurers, because of the nature of their business, to maintain a contingency reserve in addition to the normal reserves for unpaid losses, loss adjustment expenses, and unearned premiums. The purpose of this (contingency) reserve is to protect policyholders against loss during periods of extreme economic contraction. In addition to these measures, the insurers also have to meet the minimum capital and surplus requirements established by the state. In addition, state regulators proactively monitor the financial condition of insurers domiciled in their state. The situation with many bond insurers is not so much a solvency issue as it is a rating agency and franchise value issue. Using a variety of solvency monitoring tools and active cooperation and coordination among states, the state insurance regulatory regime has worked. Bond insurers have been paying and continue to pay all claims. In fact, bond insurers have incurred extremely minimal claims. Recent media reports confused certain companies' abilities to write new business with the fact that they have sufficient reserves to cover the current anticipated level of claims.

Stock price and rating agency actions are relevant to the financial monitoring of bond insurers by state insurance regulators. Companies comply with state financial standards and their ability to pay its claims to its policyholders is the standard used by state regulators in carrying out their regulatory responsibilities. We believe that the actions taken by state regulators help the market by providing solid solvency regulation. The insurance questions raised by the Committee are important and are answered by the attached materials, but the insurance questions are at the end of a long chain of market transactions. These market issues invite Congressional review because it is clear that both the broader market and insurance regulation could benefit from these issues being addressed.

We look forward to working with you and all of the market regulators to review and improve the regulation of the markets.

Sincerely,

Sandy Praeger
NAIC President

Catherine J. Weatherford
NAIC Executive Vice President and CEO

Attachments:
Letter from Superintendent Dinallo (NY)
Binder attachment from Superintendent Dinallo (NY)
Letter from Commissioner Dilweg (WI)
Letter from Commissioner Tyler (MD)

PAUL E. KANJORSKI
11TH DISTRICT, PENNSYLVANIA

COMMITTEE ON
FINANCIAL SERVICES

CHAIRMAN
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AND GOVERNMENT SPONSORED ENTERPRISES

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Congress of the United States
Washington, DC 20515-3811

January 23, 2008

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TOLL FREE HELP-LINE
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The Honorable Ralph S. Tyler
Maryland Insurance Commissioner
Maryland Insurance Administration
525 Saint Paul Place
Baltimore, MD 21202-2272

Dear Mr. Tyler:

In recent weeks, many participants in our financial services sector have raised concerns about the ongoing viability of a number of bond insurers and the implications of their actual or potential ratings downgrades for all participants in the financial marketplace. The House Financial Services Capital Markets Subcommittee has therefore started an examination of these important matters, and I write to request your assistance in these efforts.

Specifically, an article in the *Washington Post* on January 18 noted that "[i]nvestors are growing especially concerned about the fate of bond insurers, which have guaranteed $2 trillion of debt securities in portfolios around the world. With these securities now increasingly at risk, the bond insurers are coming under pressure and their own [credit] ratings could suffer. That in turn could trigger a downgrade in the insured securities, sparking a new round of sell-offs and write-downs." I, too, am very concerned about these developments for pension funds, insured depositories, and municipal governments, among others.

Participants in the financial services industry, including commercial and investment banks, have relied on the financial guarantees issued by entities like Ambac Assurance Corporation, MBIA Insurance Corporation, and ACA Financial Guaranty Corporation to reduce exposure to subprime mortgage debt and other complex securities products tied to these loans. Each of the aforementioned insurers, however, has also recently experienced a cut or the threat of a cut in the ratings that they receive from entities like Fitch, Standard and Poor's, and/or Moody's.

The decisions of these credit rating agencies have already begun to affect the bottom lines of several participants in the financial services marketplace. Merrill Lynch, for example, recently took a $3.1 billion charge on its exposure to a downgraded bond insurer. Citigroup has also reserved $935 million to help protect itself against further turmoil in this sector. Other financial corporations seem likely to face similar situations in the coming weeks and months.

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The uncertainty in the bond insurance marketplace resulting from exposure to subprime housing products seems likely to spread. Pension funds that must hold investment-grade paper may need to sell holdings backed by downgraded bond insurers. Moreover, I am especially concerned about the implications for state and local governments that rely on bond insurance when putting together deals to pay for roads, schools, and other construction projects. Any increase in the perceived risks in bond insurers or decrease in competition seems likely to raise borrowing costs and slow spending on public infrastructure needs.

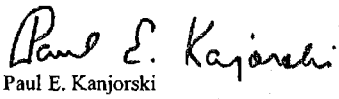
The Capital Markets Subcommittee will convene a hearing on these matters in the near future. In order to assist in the preparations for the hearing and consistent with all applicable law and regulation, I would appreciate receiving responses to the following:

- Describe how bond insurers are regulated, especially with regard to solvency and capital requirements and how such regulation differs from other lines of insurance.
- Outline the problems you presently perceive facing the bond insurance industry.
- Examine the implications of these problems for the entities and products that you regulate, as well as the broader economy.
- Detail the steps you are taking to monitor developments in the bond insurance marketplace and protect the solvency of insurers.
- Discuss the adequacy of existing statutory and regulatory tools, at the State or Federal level, to address these problems and the need for further reforms.
- Comment on the advisability of creating a guarantee fund, like those State funds for life and health insurers and property and casualty insurers, for the bond insurance industry.

Because of the urgency of these matters, I would also ask that you respond no later than February 1, 2008.

In sum, thank you for your attention to this important oversight request. If you should have any questions, please contact me directly or have your staff contact the staff of the Capital Markets Subcommittee. I look forward to your timely response.

Sincerely,



Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises

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Governor

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February 1, 2008

The Honorable Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance, and Government Sponsored Enterprises
2188 Rayburn House Office Building
Washington, D.C. 20515-3811

Dear Congressman Kanjorski:

Thank you for your letter of January 23, 2008. The questions you pose in your letter are of great importance to this agency and, more fundamentally, to consumers and to the industry we are charged with regulating. I wish to assure you of our cooperation as you proceed to consider these issues, and we stand ready to provide further or clarifying information as you may request.

A few prefatory comments may help to put our specific responses in context. The current problems in the economy involve the financial, credit, insurance, and housing markets. These problems are a reminder of the extraordinary complexity of the American economy and the fragmentation of the regulatory structure. No single agency at the state or federal level regulates all of the industries that drive financial services (nor would it be wise or practical for a single agency to do so) and yet the activities in the housing and mortgage industries, for example, impact the securities and insurance industries. Without seeking to avoid our responsibility for regulating the insurance industry, the problems that prompt your inquires are not, at their core, problems of insurance. Rather, they are problems born of failures in the mortgage industry and the related sharp decline in the housing market, for it is the collapse of mortgage-backed securities that has put financial guaranty insurers in jeopardy. Insurance regulation focuses on the solvency of insurance companies, relying heavily on others to evaluate the value underlying these securities. Traditional and accepted notions of the proper scope of insurance regulation would not extend to a separate evaluation of these values.

Further, as I know you understand, there is tension between the drive for innovation in the financial services industry, including insurance, and regulation. Innovation is obviously important to the strength and growth of the American economy. Regulation is no less important.

The task in which you are engaged of trying to figure out where regulatory authority should be located, what should be regulated, and how it should be regulated is exceedingly important and difficult. I am pleased to offer you my full assistance and support. Turning to your specific questions, they are answered below in the order in which you asked them.

Describe how bond insurers are regulated, especially with regard to solvency and capital requirements and how such regulation differs from other lines of insurance.

Insurance regulation is principally a state function. The solvency regulation of insurance companies rests primarily with the insurance regulators in each insurer's state of domicile. As the primary regulator, the state of domicile is responsible for monitoring the insurer's financial condition in order to protect the interests of the insurer's policyholders and creditors.

State insurance regulators have a broad range of tools to assist in solvency regulation. These tools include comprehensive laws and regulations governing the business of insurance, uniform quarterly and annual detailed financial statements, annual actuarial opinions, annual audited financial statements, ongoing financial analysis, periodic financial examinations, and market conduct investigations.

The financial surveillance process has evolved through the cooperative efforts of the various state insurance regulators, often through the National Association of Insurance Commissioners. In this regard, while the current structure is based on each state's having the appropriate procedures and resources in place to effectively regulate the financial solvency of its domestic insurers, it also encourages states to cooperate on matters of common interest. The current situation confronting the financial guaranty insurance industry is just such an example.

This financial surveillance process is applicable to financial guaranty insurers; however, there are notable differences between regulation in this area as compared to other insurance products due to the unique nature of the financial guaranty insurers:

- The capital adequacy of insurers is generally measured by the risk-based capital (RBC) concept, under which appropriate capital needs are determined based upon the unique risk profile of each insurer. The RBC formulas were not developed to apply to financial guaranty insurers due to the unique nature of financial guaranty business.

- A typical insurer issues policies of a relatively short duration, and recognizes losses incurred on those policies during the policy period. In contrast, financial guaranty policies are typically in force for many years (a mortgage, for example, may be for 30 years and, therefore, the guaranty insurance would be of equal duration). Losses on those policies are recognized when there is an event of default, which may occur years or even decades after a policy's inception. In order to help ensure that funds

will be available to pay those claims when they arise, financial guaranty insurers are required to set aside a significant portion of the premiums they receive in a contingency reserve liability. This, too, is unlike other insurers.

- While all insurers are subject to limitations on the amount of exposure they can have to any one insurance risk, financial guaranty insurers' liability exposures are measured on a somewhat different basis. Specifically, financial guaranty insurers may not have unduly high risk exposure to any single issuer of securities (structured credit or municipal), and their aggregate exposure to municipal bonds for which the underlying rating is below investment grade is limited.

- One other difference in the regulation of financial guaranty insurers compared to other insurers that is somewhat unique to Maryland is that Maryland domestic financial guaranty insurers are not required to maintain their home offices in the State of Maryland (i.e., no physical office location is required). This is because legislation was enacted in Maryland exempting financial guaranty insurers from the requirement that they have offices in the State. Maryland's two domestic financial guaranty insurers are headquartered in New York City.

Outline the problems you presently perceive facing the bond insurance industry.

The most significant issues facing financial guaranty insurers have been triggered by downgrades by the Nationally Recognized Statistical Rating Organizations (rating agencies). The ability of financial guaranty insurers to write new business is dependent on their ratings from the rating agencies, since the ratings the insurers receive transfer to the investment vehicles they insure. Therefore, those insurers that have been identified for potential downgrades or been downgraded have seen their ability to write new business severely hampered. For example, on December 19, 2007, Standard & Poor's Corp. (S&P) lowered its financial strength and financial enhancement ratings on ACA Financial Guaranty Corporation (ACAFG), a Maryland domestic insurer, to "CCC," well below investment grade. This downgrade effectively suspended ACAFG's ability to write new business. At the same time, Maryland's other financial guaranty insurer, Assured Guaranty Corp., had its AAA financial strength and financial enhancement ratings affirmed by S&P.

Insurers downgraded or facing downgrades need to develop plans to address the rating agencies' actions. These plans could include raising additional capital, reducing their exposure to certain business, and revising their business models. Raising capital in the public capital markets may be challenging in the current environment. This, too, is a direct result of the perceptions regarding financial guaranty insurers' exposure to potential claims as discussed below, and the ratings agencies' actions discussed above. The actual capital needs of the various

insurers is indeterminate, but certainly substantial. The adequacy of available private capital to meet these needs is uncertain.

In addition, certain financial guaranty insurers are faced with the perception in the capital markets of an increased potential for claims under their current business models. Financial guaranty insurers originally began by insuring the timely payment of principal and interest on bonds issued by municipalities. Historically, the insurers did a good job in this line of business, generating operating gains and experiencing few losses.

However, in the early 2000's financial guaranty insurers began expanding their product lines to include credit protection through insured credit default swaps in the institutional fixed income markets (structured credit insurance products). This business generally involves insured credit default swaps written on highly rated layers of risk associated with pools of assets that were either selected by the insurers or held within collateralized debt obligations (CDOs) of financial assets managed by third parties. The financial assets underlying the insured credit default swaps principally include corporate credits, asset-backed securities and mortgage-backed securities. This business, particularly that portion of which the underlying assets consist of subprime mortgage-backed securities, is the source of the current issues faced by certain financial guaranty insurers. The uncertainty concerning the ultimate performance of subprime mortgage-backed securities, and the resultant potential for future losses, is central to recent rating agency actions.

One Maryland domestic financial guaranty insurer, ACA Financial Guaranty Corporation (ACAFG), faces a unique challenge. Specifically, as the only A-rated financial guaranty insurer (prior to recent adverse rating actions), ACAFG was in a unique position in the marketplace. This A rating was part of ACAFG's niche business strategy that allowed it to serve portions of the public finance market that were not served by ACAFG's more highly-rated competitors. Due to its position in the marketplace, as part of its structured credit business, ACAFG and its affiliates were required to enter into agreements with the counterparties effectively requiring ACAFG to provide collateral to the counterparties in certain circumstances.

Because of S&P's December 19, 2007, downgrade of ACAFG's financial strength and financial enhancement ratings to CCC, ACAFG's affiliates were required, pursuant to pre-existing collateral agreements, to post collateral based on the fair value of the credit swaps as of the date of posting. The failure to post collateral would be an event of default, resulting in a termination payment in an amount approximately equal to the collateral call (well in excess of $1 billion). This termination payment would give rise to a claim under the related ACAFG insurance policy. Based on current fair values, neither ACAFG nor ACA Capital Holdings, its parent company, have the ability to post such collateral or make such termination payments.

ACA Capital Holdings and its direct and indirect subsidiaries, including ACAFG, entered into forbearance agreements with the counterparties. Under the agreements, the counterparties

have temporarily waived all additional collateral posting requirements and termination rights relating to the rating of ACAFG under their respective transaction documents. While operating under the forbearance agreements, ACAFG is working closely with the counterparties to devise and implement a restructuring plan.

Significantly, neither of the two Maryland-domiciled financial guaranty insurers have incurred significant insurance claims, or believe that they will in the near future, from their structured credit business. These two insurers continue to meet or exceed all Maryland financial solvency requirements provided that, in the case of ACAFG, it continues to operate under the forbearance agreement noted above.

Examine the implications of these problems for the entities and products that you regulate, as well as the broader economy.

The insurance of bonds issued by municipalities has historically been and remains a potentially stable and profitable line of business for the financial guaranty insurers. The introduction of structured credit insurance products has resulted in significant uncertainty in the bond insurance marketplace due to the nature of these products.

State regulators need to and are working together to carry out their regulatory responsibilities to ensure the financial viability of insurers. It is crucial that regulators continue to work with their domestic financial guaranty insurers to ensure that management is capable of developing and implementing plans as needed to address the current issues.

Since the municipal bond insurance market has provided, and still does provide, an important service to the debt financing activity of the country's municipalities, it is important that this market remains active and viable. Failure of this market could have a significant adverse impact on municipalities' ability to issue debt instruments. This would mean that the costs of financing would increase and the resultant increased cost would be passed on to citizens and consumers either in the form of increased borrowing costs or, if these costs could not be met, through the loss of public goods and services.

As previously noted, much of the recent focus on financial guaranty insurers stems from the uncertainty concerning the ultimate performance of subprime mortgage-backed securities, and the resultant potential for future losses from those securities. While this has implications for financial guaranty insurers, the subprime mortgage situation has impacted other types of insurers. For example, mortgage guaranty insurers, which insure the payment of mortgages by borrowers, have experienced significant losses related to defaults on subprime mortgages. In addition, title insurers, which insure that clean title to properties is held by current owners, have experienced increased losses, indicating a possible degradation in the quality of work performed in originating mortgages. Also, it has been reported that insurers offering directors' and officers'

insurance may incur significant claims attributable to the subprime situation. Furthermore, while the exposure does not appear to be overly significant, many insurers have mortgage-backed securities, including those backed by subprime mortgages, in their investment portfolios.

These issues point to the broader issue of the quality of mortgages being originated and the impact poorly underwritten subprime mortgages have had throughout the U.S. economy. Certainly the recent downturn in stock market performance has been fueled by losses reported by large originators of and investors in subprime mortgages, and the significant uncertainty surrounding these loans. Given the wide range of entities reporting exposure to and losses from these instruments, it seems clear that much of this problem originated within the mortgage loan origination industry, which is not within the scope of state insurance regulation.

Detail the steps you are taking to monitor developments in the bond insurance marketplace and protect the solvency of insurers.

Beginning with a routinely scheduled financial examination of Assured Guaranty Corp. in 2002, we became aware of what was at the time the relatively new structured credit insurance business. At the time, this was a small but growing business for the company.

By the time of a routinely scheduled examination of ACA Financial Guaranty Corp. (ACAFG) in 2004, structured credit business had become a significant product line. At that time, this agency began a now years-long dialogue with the New York Insurance Department (NYID) and the Wisconsin Department of Insurance (WDI) to better understand these products, the insurance of them, and regulation of the industry. There were also discussions with credit analysts in the bond insurance group at S&P.

The NYID had been approached by the trade association for the financial guarantors with a proposal to modernize its laws governing financial guaranty insurers. This modernization was completed and enacted by the New York legislature in late 2004. Concurrently, ACAFG approached this agency with a request to similarly modernize parts of the Maryland regulations governing financial guaranty insurers to allow them a fair competitive environment and better accommodate their business model. These regulation changes were adopted in June 2006. It should also be noted that in early 2007, the NAIC likewise modernized its model law for financial guaranty insurance through a working group on which Maryland participated.

The exposure to securitized subprime mortgage loans began at approximately the conclusion of our 2004 examination of ACAFG. In the following several years (2004 to present), this exposure increased at a tremendous rate. As issues began to emerge regarding the subprime mortgage market, the next routinely scheduled financial examination (as of December 31, 2006) of AGC began in mid-2007. As we gained an understanding of AGC's exposure in this regard, we began to query ACAFG concerning their exposure. It quickly became apparent

that ACAFG's exposure was much more significant, and we began planning for a limited-scope examination of ACAFG. We held several discussions with staff from the NYID regarding this issue. Our limited-scope examination of ACAFG began in November 2007.

As these events were unfolding, we undertook a review of the subprime mortgage market. Also, we were (and are) continually reviewing materials generated by S&P, other rating agencies, and the financial media, related to the subprime mortgage market, the financial guaranty insurance industry generally, and the Maryland-domiciled companies in particular. Communication with and from the NAIC and its Securities Valuation Office (SVO) was directed at determining the impact of the crisis in the subprime mortgage market not only on the financial guaranty insurers, but also on other insurers that owned securities ultimately tied to subprime mortgage loans and/or securities insured by the financial guaranty insurers. The SVO's analysis included a broad investigation of insurer exposures to subprime mortgage-backed securities in their investment portfolios. Additionally, the NAIC took steps to require greater disclosures by insurers with respect to insured exposure to subprime mortgages.

Our communication with the Maryland domestic companies increased as we monitored developments in the market. We had further discussions with NYID staff regarding their planned analysis of the health of the financial guaranty industry, and invited them to participate in the limited-scope examination of ACAFG. As part of the limited-scope examination of ACAFG, we have engaged expert consultants to evaluate its insured portfolio which is ultimately backed by subprime mortgage loans. The charge to these experts is to determine the probability, extent, and timing of potential losses on this portfolio.

Immediately prior to the downgrade of ACAFG's financial strength and financial enhancement ratings by S&P, we entered into a Consent Order with ACAFG. Under the Consent Agreement ACAFG agreed that it would not object to being placed into receivership in the event that: 1) S&P downgrades ACAFG's financial strength and financial enhancement ratings to "BBB+" or lower (which it now has done); and 2) ACA does not have signed forbearance agreements in place with all of the swap counterparties (which it currently has). A copy of the Consent Order is attached.

At the same time we entered into a Letter of Representations and Agreements (the Letter Agreement) with ACAFG. Under the Letter Agreement, ACAFG agreed to provide certain documentation and other reports to us, and also agreed not to engage in certain activities without providing prior notice and an opportunity for us to object. These activities include the pledging or assigning any assets, paying dividends, and engaging in certain material transactions.

Discuss the adequacy of existing statutory and regulatory tools, at the State or Federal level, to address these problems and the need for further reforms.

Maryland's financial surveillance process places significant emphasis on the ongoing monitoring of the financial condition of Maryland domestic insurers. This is a multi-dimensional process designed to obtain an understanding of the environment in which an insurer operates, the solvency risks it faces, and management's procedures to mitigate those risks. The process focuses on the early detection of financial difficulty so that we can work with management to avoid insolvency. We believe that the process in place is sound and the tools available are adequate.

That being said, whenever we note an insurer confronting financial issues we reconsider our process and seek ways to improve our results. For example, we look for signs that existed which, in hindsight, might have caused us to act differently or intervene sooner. With regard to the financial guaranty insurers, we are certainly reviewing our financial surveillance efforts with an eye towards future improvement.

This situation also warrants further work with the other state regulators of financial guaranty insurers for possible areas for improvement. State regulators need to and are working together to carry out their regulatory responsibilities to ensure the financial viability of financial guaranty insurers. I believe that this effort should consider all aspects of our financial surveillance process, including the adequacy of current financial reporting by the financial guaranty insurers.

We also note that the current issues facing certain financial guaranty insurers stem from their business models which focused on structured credit products. The New York Superintendent of Insurance and Wisconsin Insurance Commissioner have taken the lead in reviewing the overall business operations of financial guaranty insurers and whether reforms should be implemented to help ensure that they operate in a financially sound manner. I have been invited to participate in that process, and have offered my assistance and that of my staff in this important project.

Certainly the extent to which certain financial guaranty insurers have exposure to structured credit product, particularly that portion of which the underlying assets consist of subprime mortgage-backed securities, calls into question the way these insurers limit their risk to various exposures. I intend to work with the New York Superintendent of Insurance and Wisconsin Insurance Commissioner to ensure that this matter is fully addressed. That said, without seeking to avoid our responsibility for the regulation of the insurance industry, the problems that prompt your inquires are not, at their core, problems of insurance. Rather, it is the collapse of mortgage-backed securities that has put financial guaranty insurers in jeopardy. I therefore respectfully suggest that there are opportunities at the federal level for actions relating

to banking and securities regulation that could lessen the likelihood of a repetition of these problems.

Clearly, there were significant abuses in the mortgage banking industry that led to the current crisis in the subprime mortgage market. Reportedly lax underwriting, inappropriately motivated loan originators and lenders, as well as borrowers whose reach exceeded their financial grasp, and an overwhelming desire to feed the capital market's appetite for securitized loan products all contributed to create the crisis faced today.

Further, accounting rules that allowed financial institutions that owned these securitized loan products to create off-balance-sheet risks through the use of credit derivatives and to transfer that risk to third parties (namely, the financial guarantors) may have been significant contributors to the current crisis. There does not appear to us to be significant economic rationale to support this treatment, but it does allow the owners of these instruments to smooth earnings by removing the market volatility risks associated with these products from their financial statements.

In addition, some degree of culpability on the part of the rating agencies must also be acknowledged. There are several probable sources of error from the rating agencies, which, like other market participants, did not proactively challenge downside risk assumptions for structured securities ultimately comprised of subprime mortgage loans until it was obvious that their prior assumptions were no longer valid. At the same time, the financial guaranty insurers (and yes, insurance regulators) relied on the work of the rating agencies in assessing the default risks in securities that the industry insured.

Last, some of the current situation may have been caused by the lack of oversight of CDOs. It is our understanding that there are no requirements to register these securities with the U.S. Securities and Exchange Commission (SEC). The lack of SEC registration may imply less transparency in these securities because of insufficient disclosures regarding their underlying assets. The SEC and others have greater expertise on these assets and should be consulted to determine if our concerns are justified.

Comment on the advisability of creating a guaranty fund, like those State funds for life and health insurers and property and casualty insurers, for the bond insurance industry.

We do not recommend the establishment of a separate guaranty fund for financial guaranty insurers.

Guaranty funds are funded by assessments of the participating insurers. Given that the financial guaranty insurance industry is relatively small in terms of participants, a funding scheme of this nature would likely result in financially unbearable assessments for the insurers.

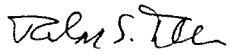
In addition, we note significant issues regarding policyholders and claims that might be covered by a separate guaranty fund for financial guaranty insurers.

For example, under the currently existing guaranty funds coverage is restricted to policyholders under specified net worth thresholds (generally, those with net worth under $25 to $50 million). This serves to alleviate the financial burden on participating insurers by denying coverage to policyholders generally considered able to withstand uninsured losses. Should a separate guaranty fund for financial guaranty insurers be established, decisions on whether to include the financial guaranty industry's high net worth institutional policyholders would need to be made.

In addition, we note that municipal bond insurance is generally underwritten with a "zero loss" expectation (or at least a negligible loss expectation), which is indicative of the industry's historical experience in this business line. This suggests that most of the risk of a claim on a separate guaranty fund for financial guaranty insurers would result from the insurance of non-municipal securities, which have varied and complex events that create an insurable loss that could make the validity of a claim on a guaranty fund disputable.

Again, I appreciate the opportunity to provide these comments on these important subjects. I trust that my comments have been responsive to your request. Should you have any questions on these issues or would like additional information, please do not hesitate to contact me.

Respectfully submitted,



Ralph S. Tyler,
Insurance Commissioner

IN RE:	*	BEFORE THE
ACA FINANCIAL GUARANTY CORPORATION	*	MARYLAND INSURANCE
NAIC NUMBER 22896	*	ADMINISTRATION
140 BROADWAY 47TH FLOOR	*	
NEW YORK, NEW YORK 10005	*	MIA No. MIA-2007-12-037

* * * * * * * * * * * *

CONSENT ORDER

Pursuant to §§ 2-108, 4-113, 9-102 and 9-103 of the Insurance Article, this Consent Order is entered by the Insurance Commissioner for the State of Maryland (the "Commissioner"), with the consent of ACA Financial Guaranty Corporation ("ACA").

FACTUAL FINDINGS

1. The Commissioner is charged with the enforcement of the Insurance Article.

2. ACA is a Maryland domestic property and casualty insurance company that was incorporated under the laws of Maryland on June 25, 1986. ACA obtained its original Certificate of Authority to conduct the business of insurance in the State of Maryland on September 11, 1986. Under it Articles of Incorporation, ACA was formed for the purpose of engaging in the business of issuing financial guaranty insurance, municipal bond insurance and credit enhancement insurance.

3. ACA is an indirect, wholly-owned subsidiary of ACA Capital Holdings, Inc. (ACA Capital), a Delaware-domiciled company. ACA Capital is a publicly-traded company whose stock is currently listed on the New York Stock Exchange (NYSE). Due to current trading conditions and failure to meet NYSE listing maintenance requirements, ACA Capital stock has been delisted from the NYSEand its trading has moved to the over-the-counter market.

4. In order to retain its certificate of authority, ACA is required by §§4-103 to 4-105 to maintain certain capital and surplus.

5. In addition, §9-102 of the Insurance Article specifies the conditions the Commissioner may consider in determining whether the continued operation of an authorized insurer engaging in insurance business in the State would be hazardous to policyholders or creditors of the authorized insurer or the general public.

6. For the third quarter of 2007, ACA Capital reported a GAAP net loss of $1.0 billion, primarily because of $(1.7) billion, or $(1.1) billion after tax, of net

unrealized mark-to-market losses on its portfolio of certain Structured Credit transactions. These unrealized losses were a direct result of the current crisis in the residential mortgage-backed securities markets.

7. Since 2004, ACA has experienced significant growth in its structured credit business. Under this business, ACA issues financial guaranty policies that insure the performance of affiliated Special Purpose Vehicles (SPVs) on credit default swaps written by them on collateralized debt obligations (CDOs) or tranches backed by portfolios of financial assets. As a result, as of September 30, 2007 ACA had insured transactions of this nature with an insured principal in force totaling approximately $69 billion. Of that amount, approximately $22 billion was ultimately backed by subprime mortgages.

8. On November 9, 2007, Standard and Poor's Corporation (S&P), a Nationally Recognized Statistical Ratings Organization (NRSRO), gave notice that it had placed its "A" financial strength and financial enhancement ratings of ACA on CreditWatch with negative implications, meaning that those ratings could be downgraded in the near future. In taking this action, S&P cited its concerns that the losses discussed above may impair ACA's ability to generate a satisfactory level of new business in the future.

9. On certain of its financial guaranty policies that insure the performance of affiliated Special Purpose Vehicles (SPVs) on credit default swaps as described above, ACA entered into Credit Support Annexes (CSAs) with the swap counterparties. Among other things, the CSAs give the swap counterparties the right to require the respective SPVs to post collateral in an amount approximately equal to unrealized mark-to-market losses on the insured derivatives to support its obligations to pay on them in the event that ACA is downgraded to "BBB+" or lower by S&P.

10. If ACA is downgraded to "BBB+" or lower by S&P, the amount of collateral the SPVs would be required to post under the CSAs is approximately $1.7 billion, as of September 30, 2007, which the SPVs would not be able to do. The result of the SPVs failure to post would create an aggregate amount of termination payments under the credit default swaps in the approximate amount of the required collateral post, which payments are insured by ACA. ACA has approximately $426 million of statutory capital (policyholders' surplus and contingency reserves) and approximately $712 million of total admitted assets, as of September 30, 2007.

11. ACA has approached its swap counterparties as a group, proposing to them a short term Forbearance Agreement under which the counterparties would agree to forebear from taking actions related to the CSAs and/or events defined in related documents that would cause ACA to post collateral or terminate the structured credit transactions in the event of its downgrade by S&P. ACA must successfully negotiate this forbearance and a succeeding long term forbearance (together with

the short term forbearance referred to as the "Forbearance Agreement") from all of its swap counterparties to avoid the collateral call issues.

12. ACA has reviewed the terms of this Order and after careful consideration, with the advice of competent counsel, and with full knowledge and awareness of the benefits gained and the obligations incurred herein, ACA, upon resolution of its Board, knowingly and voluntarily consents to the terms, conditions, and requirements of this Order.

NOW, THEREFORE, with the Consent of ACA, **IT IS HEREBY ORDERED THAT**:

A. In the event that S&P downgrades ACA's financial strength and financial enhancement ratings to "BBB+" or lower, and ACA does not have signed forbearance agreements in place with all of the swap counterparties, and in the sole judgment of the Commissioner those events result in insufficient protection to ACA's policyholders and creditors or to the general public, the Commissioner may, in his sole discretion, institute delinquency proceedings in the Circuit Court for Baltimore City. Such proceedings may consist of a request that ACA be placed under conservation, rehabilitation, or liquidation.

B. ACA will not object to and, if requested, will consent to, an Order granting any petition filed by the Commissioner requesting that ACA be placed under conservation, rehabilitation, or liquidation upon occurrence of the events described in Paragraph A above.

C. For purposes of the business of the Administration, for any subsequent and unrelated administrative or civil proceedings concerning ACA, and with regard to requests for information about ACA made under the Maryland Public Information Act or properly made by governmental agencies, this Consent Order will be kept and maintained in the regular course of business by the Maryland Insurance Administration.

D. ACA acknowledges that this Consent Order constitutes a FINAL ORDER of the Commissioner. ACA waives all rights to a hearing on, or judicial review of, this Consent Order.

IT IS SO ORDERED, effective this 19th day of December, 2007.

RALPH S. TYLER
INSURANCE COMMISSIONER

CONSENT OF ACA FINANCIAL GUARANTY CORPORATION

ACA Financial Guaranty Corporation hereby CONSENTS to the terms of the above Consent Order in MIA No. MIA-_____. A copy of the corporate resolution authorizing the Chairman of the Board to consent to this Order on behalf of ACA Financial Guaranty Corporation is attached hereto.

_____ Date *December* ____, *2007*

David King
Chairman of the Board

CERTIFICATE

I, NORA J. DAHLMAN, Secretary of ACA Financial Guaranty Corporation (the "Company"), a Maryland stock insurance company, HEREBY CERTIFY that the following resolutions were adopted by the Board of Directors (the "Board") of the Company at a meeting duly called and held on December 18, 2007 and that they are now in full force and effect without amendment or modification:

WHEREAS, the Board deems it advisable and in the best interest of the Company to enter into or consent to, as applicable, (i) that certain Letter of Representations and Agreements (the "Letter Agreement") by and between the Company and the Insurance Commissioner for the State of Maryland (the "Commissioner") and (ii) that certain Consent Order by the Commissioner (the "Consent Order"), in each case in substantially the form heretofore provided to the Board;

RESOLVED, that each of the President and Chief Executive Officer, Executive Vice President and Chief Financial Officer, and General Counsel and Secretary of the Company (the "Authorized Officers") be, and each of them hereby is, authorized and empowered, in the name of and on behalf of the Company, to execute, acknowledge and deliver (or cause to be executed, acknowledged and delivered) the Letter Agreement and the Consent Order with such changes, amendments, modifications and omissions thereto as such Authorized Officer or any of them shall approve, as in the best interests of the Company and not inconsistent with the terms of this resolution;

FURTHER RESOLVED, that each of the Authorized Officers and the Chief Accounting Officer and the Treasurer of the Company is hereby authorized to pay any and all expenses, fees, costs and taxes incurred by or on behalf of the Company or any of its subsidiaries as such officer may determine to be necessary or advisable in connection with the foregoing resolution (such determination to be conclusively, but not exclusively, evidenced by such payment); and all expenses, fees, costs and taxes paid by or on behalf of the Company in connection with the transactions contemplated by the foregoing resolution are hereby authorized, ratified and confirmed in all respects;

FURTHER RESOLVED, that each Authorized Officer is hereby authorized to take any and all such further actions and to execute, deliver and file such further agreements, instruments, reports and documents, in the name and on behalf of the Company as they shall deem necessary or appropriate to carry out the intent and accomplish the purposes of the foregoing resolution; and

FURTHER RESOLVED, that any and all actions heretofore or hereafter taken by the officers of the Company, or any of them, within the terms of the foregoing resolution hereby are ratified and confirmed in all respects as the act and deed of the Company.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the corporate deal of the Company this 18th day of December, 2007.

(SEAL)

Secretary

PAUL E. KANJORSKI
11TH DISTRICT, PENNSYLVANIA

COMMITTEE ON
FINANCIAL SERVICES

CHAIRMAN:
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON OVERSIGHT AND
GOVERNMENT REFORM

WASHINGTON OFFICE:
2188 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-3811
(202) 225-6511

Website: http://kanjorski.house.gov
E-mail: paul.kanjorski@mail.house.gov

Congress of the United States
Washington, DC 20515-3811

January 23, 2008

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(570) 825-2200

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SCRANTON, PA 18503-1808
(570) 496-1011

102 POCONO BOULEVARD
MOUNT POCONO, PA 18344-1412
(570) 895-4176

TOLL FREE HELP-LINE
(800) 222-2348

The Honorable Eric Dinallo
Superintendent of Insurance
State of New York Department of Insurance
25 Beaver Street
New York, NY 10004-2319

Dear Mr. Dinallo:

In recent weeks, many participants in our financial services sector have raised concerns about the ongoing viability of a number of bond insurers and the implications of their actual or potential ratings downgrades for all participants in the financial marketplace. The House Financial Services Capital Markets Subcommittee has therefore started an examination of these important matters, and I write to request your assistance in these efforts.

Specifically, an article in the *Washington Post* on January 18 noted that "[i]nvestors are growing especially concerned about the fate of bond insurers, which have guaranteed $2 trillion of debt securities in portfolios around the world. With these securities now increasingly at risk, the bond insurers are coming under pressure and their own [credit] ratings could suffer. That in turn could trigger a downgrade in the insured securities, sparking a new round of sell-offs and write-downs." I, too, am very concerned about these developments for pension funds, insured depositories, and municipal governments, among others.

Participants in the financial services industry, including commercial and investment banks, have relied on the financial guarantees issued by entities like Ambac Assurance Corporation, MBIA Insurance Corporation, and ACA Financial Guaranty Corporation to reduce exposure to subprime mortgage debt and other complex securities products tied to these loans. Each of the aforementioned insurers, however, has also recently experienced a cut or the threat of a cut in the ratings that they receive from entities like Fitch, Standard and Poor's, and/or Moody's.

The decisions of these credit rating agencies have already begun to affect the bottom lines of several participants in the financial services marketplace. Merrill Lynch, for example, recently took a $3.1 billion charge on its exposure to a downgraded bond insurer. Citigroup has also reserved $935 million to help protect itself against further turmoil in this sector. Other financial corporations seem likely to face similar situations in the coming weeks and months.

THIS STATIONERY PRINTED ON PAPER MADE WITH RECYCLED FIBERS

The uncertainty in the bond insurance marketplace resulting from exposure to subprime housing products seems likely to spread. Pension funds that must hold investment-grade paper may need to sell holdings backed by downgraded bond insurers. Moreover, I am especially concerned about the implications for state and local governments that rely on bond insurance when putting together deals to pay for roads, schools, and other construction projects. Any increase in the perceived risks in bond insurers or decrease in competition seems likely to raise borrowing costs and slow spending on public infrastructure needs.

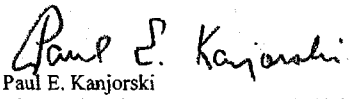
The Capital Markets Subcommittee will convene a hearing on these matters in the near future. In order to assist in the preparations for the hearing and consistent with all applicable law and regulation, I would appreciate receiving responses to the following:

- Describe how bond insurers are regulated, especially with regard to solvency and capital requirements and how such regulation differs from other lines of insurance.
- Outline the problems you presently perceive facing the bond insurance industry.
- Examine the implications of these problems for the entities and products that you regulate, as well as the broader economy.
- Detail the steps you are taking to monitor developments in the bond insurance marketplace and protect the solvency of insurers.
- Discuss the adequacy of existing statutory and regulatory tools, at the State or Federal level, to address these problems and the need for further reforms.
- Comment on the advisability of creating a guarantee fund, like those State funds for life and health insurers and property and casualty insurers, for the bond insurance industry.

Because of the urgency of these matters, I would also ask that you respond no later than February 1, 2008.

In sum, thank you for your attention to this important oversight request. If you should have any questions, please contact me directly or have your staff contact the staff of the Capital Markets Subcommittee. I look forward to your timely response.

Sincerely,



Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises

STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

Eliot Spitzer
Governor

Eric R. Dinallo
Superintendent

February 4, 2008

The Honorable Paul E. Kanjorski
Member of Congress
Chairman of the Subcommittee on Capital Markets,
Insurance and Government Sponsored Entities
2188 Rayburn House Office Building
Washington DC 20515-3811

Dear Chairman Kanjorski:

I appreciate the opportunity to respond to your January 23, 2008 letter and provide you with information to assist the Subcommittee on Capital Markets, Insurance and Government Sponsored Entities ("Subcommittee") in its examination of the challenges currently confronting the bond insurance industry.

New York is the primary regulator for many financial guaranty insurance companies ("FGIs"), which, as you are aware, are regulated by states under their respective insurance laws. While these laws have their differences, the regulatory oversight of the financial guaranty industry is generally consistent among the states. I note that you have sent similar requests for information to Maryland and Wisconsin (the two other states that serve as the domestic regulator for FGIs), and to the National Association of Insurance Commissioners ("NAIC").

Before addressing your requests for information, I offer a few general points.

- This letter endeavors to complement, but not repeat, the information set forth in the submissions from the New York State Insurance Department's counterparts in Maryland and Wisconsin.

- As a regulator, the New York Department's primary interest is to protect policyholders that have insurance contracts with FGIs. There are two primary groups of policyholders: municipalities and other entities that have issued debt (and, by extension, the holders of those instruments); and the banks and securities firms ("counterparties") that have purchased insurance on mortgage-backed and other asset-backed securities. Attached is a chart showing the relative amounts of the types of credits insured by the FGIs. Clearly municipal securities remain the bulk of the FGIs outstanding insurance.

- The New York Department also aims to ensure that all consumers – individuals, businesses, and governments – have access to financial guaranty insurance in a financially healthy and competitive insurance marketplace.

- The Department has for several months been working to implement the following tripartite plan to address the serious problems that the bond insurance industry faces:

    1. Bring in new players and help current companies obtain additional capital. To ensure that state and local governments can continue to find bond insurance necessary to keep down the cost of debt issuances and increase the attractiveness to investors of such offerings, the Department in November not only initiated a discussion with Berkshire Hathaway to open a new bond insurance company in New York, but then licensed the company in record time. The Department is also talking to others interested in entering this market, and has worked with the NAIC to encourage other states to license Berkshire Hathaway quickly and ensure additional capacity for the market. Moreover, the Department approved in record time a capital-raising plan by MBIA. This plan has helped to shore up the company's financial condition and has supplied more capital to support policies.

    2. Protect policyholders by seeking broad solutions to the problems in the bond insurance market. We are working with stakeholders -- bond insurance companies, banks, financial advisors, rating agencies and other government officials -- to develop solutions aimed at strengthening the financial condition of individual companies and the industry.

    3. Develop new rules and regulations for the financial guaranty business. The Department recognizes the need to revisit the current regulatory and statutory framework that governs the operations of FGIs. The United States is the world leader in financial services in no small measure because of its creativity and innovation. We should continue to foster creativity, while ensuring that companies engage in prudent risk-taking. We look forward to discussing these issues with industry, fellow regulators, and members of Congress.

The New York State Insurance Department is actively working to protect policyholders by encouraging FGIs to work with both potential investors and the counterparties holding

policies on mortgage-backed securities to develop voluntary and mutually beneficial commercial arrangements designed to preserve the financial strength of the FGIs. Issues of confidentiality and competitive sensitivity preclude us from fully disclosing the details of these voluntary efforts at this time.

I answer each of your requests for information in the order presented in your letter.

I. Describe how bond insurers are regulated, especially with regard to solvency and capital requirements and how such regulation differs from other lines of insurance.

A. Financial Guaranty Insurers Identified

The New York Insurance Law ("Insurance Law") uses the word "domestic" to describe companies incorporated under New York law and primarily regulated by New York. The term "foreign" describes companies, including U.S. companies, incorporated in and primarily regulated by another state. There are currently eight domestic and six foreign FGIs authorized to do financial guaranty business in New York. Ten holding companies own the fourteen FGIs. Most of these companies are licensed to sell insurance in all fifty states, and have large offices in New York.

The authorized FGIs, the year in which each was first authorized to do business in New York, and their parent or controlling holding companies, are as follows:

DOMESTIC

1. Berkshire Hathaway Assurance Co. (2007) – Parent: Berkshire Hathaway, Inc.
2. Capital Markets Assurance Corp. (1938) – Parent: MBIA Inc.
3. CIFG Assurance North America, Inc. (formerly known as CDC IXIS Financial Guaranty North America, Inc. (2002) – Parent: CDC IXIS Financial Services, Inc.
4. Financial Guaranty Insurance Co. (1972) – Parent: The PMI Group
5. Financial Security Assurance Inc. (1985) – Parent: Dexia (France)
6. MBIA Insurance Corporation (1986) – Parent: MBIA Inc.
7. Radian Asset Assurance Company (1986) – Parent: Radian Group
8. XL Capital Assurance, Inc. (1999) – Parent: XL Capital Ltd. (through Security Capital Assurance Ltd.)

FOREIGN

1. Assured Guaranty Corporation (1992, MD) – Parent: ACE Ltd.
2. AMBAC Assurance Corp. (1985, WI) – Parent: AMBAC Financial Group Inc.
3. Connie Lee Insurance Co. (1982, WI) – Parent: AMBAC Financial Group Inc.
4. ACA Financial Guaranty Corp. (1987, MD) – Parent: ACA Capital Holdings, Inc.
5. MBIA Insurance Company of Illinois (1985, IL) – Parent: MBIA Inc.
6. FSA Insurance Company (1998, OK) – Parent: Dexia (France)

B. Requirements Applicable to All Property/Casualty Insurers, including Financial Guaranty Insurers

The regulation of FGIs in New York is governed by Article 69 of the Insurance Law, which pertains exclusively to FGIs, and by Article 41, to the extent that its provisions applicable to all property/casualty insurance companies do not conflict with the more FGI-specific rules set forth in Article 69. Copies of Article 15, 41 and 69 are attached hereto.

As part of the Department's regulation and review of property/casualty insurers (including FGIs), each insurer submits annual and quarterly financial statements to the Department, which include balance sheets, income statements, cash flow exhibits, income and expense exhibits, and various schedules setting forth items such as real estate owned, mortgage investments, investments in stocks and bonds, reinsurance, and loss reserves. The Insurance Law requires that financial statements rely on statutory, as opposed to generally-accepted accounting principles (GAAP), accounting conventions.

When the annual/quarterly statements are filed, the Department:

1. Verifies that the appropriate amount of capital is invested in high quality assets as required by law (see Ins. Law § 1402);

2. Confirms receipt of all required submissions, including management's view of the operations of the company, actuarial opinions affirming that the reserves for already incurred losses are adequate, and audited financial statements signed by a certified public accountant (see Ins. Law §§ 307 and 4117, plus the annual statement prescribed by the NAIC);

3. Examines capital changes resulting from operations; and

4. Verifies that the company maintains the statutory minimum capital necessary for the protection of its policyholders (see Ins. Law § 4103, 6902).

Further, the Department conducts periodic on-site examinations of all domestic insurers, including property/casualty insurers and FGIs, on a three- to five-year cycle.

Pursuant to Article 15 of the Insurance Law (a copy of which is attached hereto), all transactions between a domestic insurer and any entity in its holding company system must be "fair and equitable." Article 15 is designed to protect against the invasion of the insurance company's capital by its parent or other member of its holding company group. Moreover, Article 15 mandates that certain transactions not related to holding companies be submitted to the Superintendent for prior review and approval. Further, Article 15 requires the insurer to submit an annual registration statement disclosing information concerning the operations of "persons" within the holding company system (including partnerships, firms, associations, or corporations) that may materially affect the operations, management, or financial condition of the insurer.

Because its fundamental goal is to protect policyholders, the Department regulates to ensure solvency (i.e., the ability of the insurer to pay policyholder claims as they are made). The Department measures solvency of the insurer on a statutory accounting basis, and does not regulate to ensure a specific rating by credit rating agencies. Indeed, few insurance companies outside of the FGI market maintain AAA financial strength ratings. Of the 805 insurers that are rated for insurance financial strength, fewer than 30 are AAA, including most FGIs. The FGI business model, however, generally requires FGIs to maintain an AAA rating in order to sell their products widely.

C. Article 69 Requirements Specific to Financial Guaranty Insurers

Article 69 of the Insurance Law sets forth a series of special requirements intended to safeguard the financial solvency of FGIs authorized to do business in New York:

- Minimum Capital - The minimum initial capital/surplus requirement for a financial guaranty insurer is $75 million, and at all times the financial guaranty insurer must maintain a policyholders' surplus of at least $65 million. (See Ins. Law § 6902(b).)

- Contingency Reserves - In addition to the minimum surplus to policyholders, a financial guaranty insurer is required to maintain a contingency reserve. This reserve is based upon the greater of 50% of premiums written for each category of security guaranteed or a sum arrived at by multiplying specific factors by the principal amount being guaranteed for each class of security. The amounts are based upon the both the principal guaranteed and the relative risk of the type of bond, with municipal bonds receiving the lowest factor and non-investment grade securities receiving the highest. (See Ins. Law § 6903(a).)

- Aggregate Risk Limitations – A financial guaranty insurer has limitations on the amount and type of securities that it may insure, based upon its surplus to policyholders and contingency reserves. (See Ins. Law § 6904(c).)

- Single Risk Limitations - Exposure on any one risk is limited, net of collateral and reinsurance, to, at most percentage of the aggregate of the insurer's surplus to policyholders and contingency reserves. (See Ins. Law § 6904(d).)

- Limitation on Non-Investment Grade Securities - At least 95% of the municipal obligation bonds, special revenue bonds and industrial development bonds insured by a financial guaranty insurer must be investment grade. (See Ins. Law § 6904(b)(2).)

- Limitation on Investments in Securities Insured - A financial guaranty insurer's investment in any one entity insured by that corporation cannot exceed 4% of its assets. (See Ins. Law § 6902(a)(4).)

- Limitations on Reinsurance – The law imposes limitations on the amount of business that an FGI can cede under a reinsurance agreement, unless the reinsurer is another licensed financial guaranty insurer. (See Ins. Law § 6906.)

D. Credit Default Swaps and Transformers

To understand the current state of the bond insurance industry, one must understand credit default swaps. A credit default swap ("CDS"), a type of a credit "derivative," is a transfer of credit risk on a specific obligation from one counterparty to another. The buyer of a credit default swap receives credit protection against the occurrence of a specific risk (generally, a default of an underlying obligation), while the seller of the swap, in exchange for periodic premium payments, guarantees the payments under the terms of the obligation. Because under this arrangement the risk of default is transferred from the holder of the security to the seller of the swap in exchange for a premium, CDSs are often regarded as similar or equivalent to insurance.

The Insurance Law generally prohibits insurance companies from engaging in derivatives transactions, except for purposes of hedging under a Department-approved Derivatives Use Plan. (See Ins. Law § 1410.) In the late 1990s, FGIs approached the Department and requested permission to use credit default swap forms in place of bond insurance forms. While the Department refused to permit insurers to directly write credit default swaps with counterparties, the Department allowed the insurers to issue insurance policies that guaranteed swaps written by non-subsidiary affiliates (also known as a "special purpose vehicle", "SPV," or "transformer"). This structure is commonly referred to as "back-to-back" insurance. FGIs wanted to offer credit default swaps because their investment bank customers, for accounting reasons, preferred them to bond insurance.

The Department determined that, as a practical matter, there was little difference between the risks undertaken by insuring a credit default swap and issuing direct bond insurance, since in both cases the FGI was committing to make a stream of payments in the event of a default.

In 2004, the New York State Legislature codified the Department's decision by revising Article 69 of the Insurance Law to:

- Amend the definition of "asset-backed securities" set forth in Insurance Law § 6901(e) to include CDSs referencing a pool of obligations and pools of CDSs;
- Add a definition of "credit default swap" in Insurance Law § 6901(j-1);
- Amend Insurance Law § 6902(a)(5) to expressly authorize FGIs to engage in CDS transactions; and
- Amend Insurance Law § 6905(a) to expressly provide that FGI policies can insure payments required pursuant to CDSs.

II. Outline the problems you presently perceive facing the bond insurance industry.

A. *Stress from subprime loans*

The main difficulty that FGIs face arises from guaranties provided to back securities collateralized by residential real estate loans. In particular, loans made to "sub-prime" borrowers and home equity borrowers have suffered significant defaults and foreclosures. Many sub-prime borrowers appear to have been steered into loans that they could ill afford in the long term. As residential real estate values have declined in large parts of the U.S., distressed borrowers have been unable to accumulate equity, and cannot refinance into more affordable loans. These conditions have generated historically high levels of defaults on mortgages, which in turn have led to losses in the underlying securities that are backed by these loans. Generally, the bond insurers only insured the higher levels, or tranches, of the securitized pools of mortgages and to date there have been very few actual claims made against insurers.

However, the three major credit rating agencies, Standard & Poors, Moody's, and Fitch, have substantially lowered the ratings on many of the individual mortgage-backed securities and many observers believe that there will be significant losses on mortgage-backed securities in the future. This has had an immediate effect on the capital needs of the FGIs. When a security insured by an FGI drops in rating, the FGI must increase the capital that it holds to back its guarantee of that security.

Although the three rating agencies that review the FGIs employ different assumptions and methodologies, the general rule is that an FGI must have on hand adequate capital to pay all future losses under highly stressful market circumstances. As the debt pools and structures upon which they are built are downgraded, the level of capital required under the ratings agencies' stress scenarios increases. In recent months, many of the FGIs have been required to increase their capital in order to maintain their AAA ratings from the ratings agencies.

Given the current conditions in the financial markets, it has been challenging for the FGIs to raise this additional capital.

B. *Structured security complexity and lack of transparency*

There remains considerable uncertainty about the future condition of the real estate market and the economy as a whole. This market risk has been compounded by the complexity of the structured securities that the FGIs insured, particularly collateralized debt obligations ("CDOs"). These highly structured securities are backed by portfolios of of other loan-backed securities. A CDO is divided into tiers, or "tranches." The highest tranches have the most security (i.e., they are paid first from proceeds of the underlying mortgages), the lowest risk of default, and are rated AAA. These tranches also pay the lowest interest rates. While the FGIs only insure the higher tranches, the CDOs' underlying asset-backed securities may have much lower ratings.

The lower tranches have the most risk, and receive a higher return as compensation. However, because the middle and lower tranches were harder to sell, underwriters developed a novel method to market them. The underwriters took the lower rated

tranches from many CDOs (the "inner CDO") and put them together into another structured security called a "CDO-squared." The theory was that if the underlying mortgages were spread around the country, there was little risk that all of them would default at once. The CDO-squared was also tranched, with the higher tranches having in theory less risk because they receive payment from the underlying CDOs ahead of lower tranches. And again, the FGIs only insured the higher tranches, which were theoretically less risky because the lower tiers would absorb the first losses. Nonetheless, each successively structuring has often exposed the insurer to lower quality collateral.

After this restructuring, the risk of default on the insured obligation may not be determined solely by the underlying loan defaults, but also by the actions of other holders of related securities. Although the CDO-squared holds lower-rated tranches of other CDOs, the insurer is unable to control the management of the inner CDO. If the inner CDO collateral deteriorates, the holders of the senior tranches of the inner CDO can liquidate the underlying collateral in order to ensure that they are repaid before any further deterioration. This could lead to immediate losses to the inner CDO's lower-rated securities that comprise the CDO-squared. These liquidations can speed up default in the CDO-squared, and trigger payments by the insurer.

The complexity of these transactions has made it difficult to assess the adequacy of the capital of the FGIs, and led to an erosion of confidence by many market participants.

C. Turmoil affecting pricing of municipal bond issues

Traditionally, FGIs did not insure the sort of structured finance products described in the preceding section. Rather, FGIs provided insurance, or "wraps," for the debt offerings of municipalities, states, or other public entities. This "muni bond" market has been largely unaffected by recent sub-prime turmoil. But since municipalities are highly credit-worthy without insurance, an FGI's participation in the muni bond market depends upon its ability to offer value to issuers through its AAA credit rating.

For example, in the absence of insurance, a municipal bond offering carrying an AA rating (its "shadow" rating) might have to offer a 5% return at issue. With a guaranty from an AAA-rated FGI, the issue would be treated by buyers as an AAA issue, despite its shadow rating, and might be priced to produce a 4.75% return. If the FGI's guaranty's annual cost to the issuer were 10 basis points (0.10%), the issuer would still benefit by paying a total interest rate of 4.85% instead of 5%. The resulting "wrapped" security would be more marketable to risk-averse buyers and fosters liquidity, as potential buyers do not need to assess the creditworthiness of the individual municipal bond issuer (of which there are hundreds, if not thousands). The benefit of the insurance disappears if the FGI's credit rating is reduced to a level closer to the underlying debt's shadow rating.

III. Examine the implications of these problems for the entities and products that you regulate, as well as the broader economy.

A. Downgrades of the FGIs

The fortunes of FGIs appear to be closely linked to the prevailing sense of uncertainty about the U.S. residential housing market. The investing community's lack of confidence in FGIs is caused in part by an inability to independently determine the true ratings of thousands of guaranteed securities and CDS', and compounded by the market's inability or refusal to distinguish between possible downgrade and insolvency. A move from AAA to AA still leaves a highly solvent, financially strong FGI, particularly when compared to the vast majority of other regulated insurers. But these concerns have nevertheless combined erode market confidence in the sector.

B. *Difficulty in Raising Capital*

As noted above, an FGI relies on an AAA rating to continue to write significant new business. Because the ratings of the collateral underlying the securities FGIs insure have declined, most FGIs need more capital to maintain their AAA ratings. With the market uncertainty about the ultimate losses in structured securities backed by the residential real estate mortgages, and in light of the dramatic drop in the value of shares of publicly-traded FGIs, the FGIs face a difficult market for new capital. For example, MBIA issued a surplus note on January 16, 2008, at a 14% yield. That is an unusually high interest rate for a company with an AAA rating. A few days later, the notes' secondary market price declined to the point where the implied yield rose to 20%.

C. *Increased Costs of Municipal Financing*

Downgrades of the FGIs could have a substantial impact on issuers of municipal bonds. Municipalities may find it more difficult or more expensive to secure financial guaranty insurance if the number of AAA-rated FGIs diminishes. For the last decade there have been a number of highly-rated, aggressive competitors for the municipal bond insurance business. If the industry consolidates significantly, the price of financial guaranty insurance is likely to increase. If municipalities forego insurance and the accompanying AAA rating, issuers may have to pay more to borrow, both because a lower rating means a higher interest rate, and because fewer buyers will be willing to bid up the price of the bonds.

The possible consequences do not end there. Investors currently holding municipal securities may have to write down the value of securities or realize a loss on a sale prior to maturity. This could reduce their willingness to invest in new issues of municipal bonds, thereby making it more difficult for governments to raise money. Banks and other financial service institutions holding these securities may have to hold extra capital to support downgraded securities, which could cause them to tighten their lending standards. Mutual funds and other institutions restricted to owning only AAA-rated securities may be forced to quickly sell securities (including municipal securities) if the rating of the guarantor of those securities drops below AAA. This will further depress prices.

D. *Implications for the Economy*

Banks and other financial service institutions are required by tax and accounting rules to mark the value of their holdings to the market's perceived value. These "mark-to-

market" write-downs, as well as downgrades of FGIs, have implications for the broader economy. Structured finance has served in recent years as a major source of financing for mortgages, auto financing, and other forms of consumer credit. Limitations on the ability of FGIs to wrap these securities can lead to constriction in the lending marketplace. If these securities are downgraded and banks increase the reserves against them, they will have less capital to support lending to businesses and individuals. Moreover, if state and local governments reduce borrowing for capital projects, crucial infrastructure development may be delayed or deferred. In sum, reduced credit availability could have serious damaging effects at a time when the economy is already perceived to be weakening.

IV. Detail the steps you are taking to monitor developments in the bond insurance marketplace and protect the solvency of insurers.

For the last several months, the Department has been working intensively on a three-point plan aimed at bringing stability to the bond insurance market:

1. Attract more capital and increase capacity to protect policyholders and ensure continued availability of bond insurance, especially for municipal issuers. Specifically, the Department worked with Berkshire Hathaway to open a new bond insurance company in New York, by expediting the licensing of the new, financially strong carrier to the market. The Department is engaged in discussions with other possible market entrants, and has moved quickly to facilitate plans geared towards infusing FGIs with additional capital.

2. Protect policyholders and find broad solutions to the problems in the bond insurance market.. The Department has daily discussions with insurers, banks, financial advisors, credit rating agencies, other regulators and government officials in an effort to examine and develop measures to help stabilize the market and protect policyholders and investors, especially holders of municipal securities.

3. Develop new rules and regulations for bond insurance. The Department will develop new "rules for the road' with regard to the regulation and oversight of financial guaranty insurers. The Department already has begun to work with interested parties and stakeholders in considering revisions to standards governing bond insurers currently set forth in current statutes and regulations.

The Department has retained the investment banking firm of Perella Weinberg Partners LLP as financial advisor to help analyze options to stabilize the financial guaranty insurance marketplace. The Department expects to retain an outside legal advisor as well.

At the Department's request, FGIs have provided detailed information about their credit exposures, including mark-to-market information that may affect their counterparties. The Department has convened numerous meetings among stakeholder participants as it

endeavors to search for solutions to improve the financial position of FGIs and reduce risk to policyholders

V. Discuss the adequacy of existing statutory and regulatory tools, at the State or Federal level, to address these problems and the need for further reforms.

The fundamental problems afflicting the sub-prime mortgage market are beyond the scope of insurance regulation. Clearly, there is a need for reform in the origination and underwriting of mortgages, as well as increased transparency and risk controls for all securitized debt issues. While we believe that the ratings agencies play a useful role in helping capital markets manage risk, their role in the regulation of FGIs should be critically reviewed going forward.

The Department has just begun to study how to improve regulation of the financial guaranty industry. At present, we have directed our focus on efforts aimed at protecting policyholders and stabilizing the capital position of the market. However, we can offer some broad comments now, with the understanding that we expect to develop more specific proposals soon.

The primary goal of insurance regulation with respect to financial oversight is to ensure that the insurer maintains an adequate level of capital to ensure solvency and honor policyholders' claims. The business model for most FGIs, however, requires that they hold levels of capital that will allow them to maintain the AAA rating necessary to write new business. But financial guaranty insurance is a complicated business, based largely on modeling and underwriting of complex capital market instruments. Rather than relying entirely on the ratings agencies to assess the FGIs ability to continue to write new business, regulators may need to engage in an independent analysis of the risk positions of FGIs. While this would require more and increasingly sophisticated resources, the Department is prepared to make that commitment.

To better protect the financial strength of FGIs, it may be advisable to restrict their activities around risks that may be too volatile or lacking in transparency to evaluate accurately. For example, the Department intends to examine closely whether guaranties of the CDO-squared transactions should be permitted under any circumstances.

VI. Comment on the advisability of creating a guarantee fund, like those State funds for life and health insurers and property and casualty insurers, for the bond insurance industry.

There are a number of drawbacks to creating a guarantee fund for FGIs. Although guarantee funds for life/health insurers and property/casualty insurers spread the risk and cost of insolvency over hundreds of insurers, that type of risk-spreading is not feasible for the financial guarantee marketplace, which is dominated by a small number of insurers. Furthermore, state guarantee funds for conventional lines of insurance limit the amount

that can be claimed by any one person, depending on the nature of the underlying contract. A similar limitation for beneficiaries of FGI policies would offer little real protection, but to increase guarantee fund coverage to meaningful levels could make bond insurance considerably more expensive. And it certainly would not be reasonable or fair to ask the municipal issuer clients of bonds insurers to pay for a guarantee fund that would likely pay claims only related to the structured finance side of the business.

Further, a guarantee fund presents the potential for moral hazard that, in turn, could lead to lower underwriting standards. When counterparties to CDO contracts entered into the arrangements, the parties considered themselves to be sophisticated and knowledgeable, with the ability to evaluate the risks associated with even the most complex instruments. It appears however that the due diligence was not sufficient to prevent the current market upheaval. Spreading the economic consequences of defaults to the remaining industry participants through a guarantee fund could invite future irresponsibility.

Nonetheless, it may be helpful to create a short-term backstop that would share some structural features with a guarantee fund in order to help ease immediate pressures felt by bond insurers. For instance, a line of credit funded by those parties with the most to lose from the deterioration of the FGIs would aid market stability in the event of further ratings agency downgrades.

However, we believe that a revision of the statutory and regulatory "rules of the road" will best minimize a repeat of the situation in which the FGIs currently find themselves, and is preferable to the establishment of a permanent guarantee fund.

VII. In Closing

We in New York are particularly sensitive to the importance of maintaining the United States' position as the financial capital of the world. I strongly believe that we can foster creativity and innovation while maintaining the integrity and fairness of our markets through effective regulation. I know that you will join me in working toward that end.

Sincerely,

Eric R. Dinallo
Superintendent of Insurance

Attachments:
Article 15, New York Insurance Law
Article 41, New York Insurance Law
Article 69, New York Insurance Law

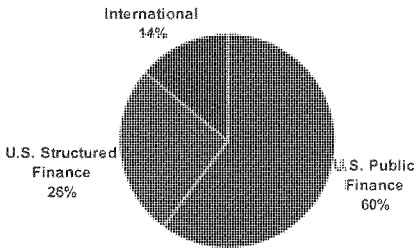
Types of Bonds Insured

All insured bonds are rated by rating agencies ("shadow rating")
- Needs to be rated investment grade by at least one rating agency

Public finance bonds:
- Backed by tax and other municipal authority revenues
- Essential infrastructure (transportation, healthcare)
- Municipal and investor-owned utilities

Structured finance bonds
- Mortgage-backed (MBS and home equity)
- Asset-backed (consumer, franchise, future flows)
- Pooled debt obligations (CDO, CLO, CBO)
- Structured credit

Net Par Outstanding
As of December 31, 2006

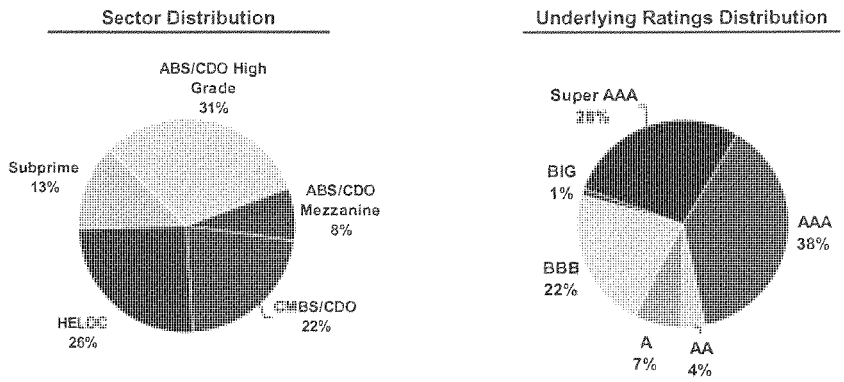


$2.2 trillion

Source: Association of Financial Guaranty Insurers

Bond Insurer Involvement in U.S. RMBS and CDOs of ABS

Industry Net Par Outstanding by Sector and Ratings Distribution



$249 Billion
Net Par Outstanding

Source: Association of Financial Guaranty Insurers

ATTACHMENT

ATTACHMENT

NEW YORK STATE INSURANCE LAW

ARTICLE 15. HOLDING COMPANIES

§ 1501. Definitions; determinations

(a) In this article, unless the context shall otherwise require:

(1) "Person" means an individual, partnership, firm, association, corporation, joint-stock company, trust, any similar entity or any combination of the foregoing acting in concert.

(2) "Control", including the terms "controlling", "controlled by" and "under common control with", means the possession direct or indirect of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract (except a commercial contract for goods or non-management services) or otherwise; but no person shall be deemed to control another person solely by reason of his being an officer or director of such other person. Subject to subsection (c) hereof, control shall be presumed to exist if any person directly or indirectly owns, controls or holds with the power to vote ten percent or more of the voting securities of any other person.

(3) "Holding company" means any person who directly or indirectly controls any authorized insurer.

(4) "Controlled insurer" means an authorized insurer controlled directly or indirectly by a holding company.

(5) "Controlled person" means any person other than a controlled insurer, who is controlled directly or indirectly by a holding company.

(6) "Holding company system" means a holding company together with its controlled insurers and controlled persons.

(b) Notwithstanding the provisions of paragraph two of subsection (a) of this section, the superintendent may determine, after notice and opportunity to be heard, that a person exercises directly or indirectly either alone or pursuant to an agreement with one or more other persons such a controlling influence over the management or policies of an authorized insurer as to make it necessary or appropriate in the public interest or for the protection of the insurer's policyholders or shareholders that the person be deemed to control the insurer.

(c) The superintendent may determine upon application that any person does not or will not upon the taking of some proposed action control another person. Such determination shall be made within thirty days or such further period as the superintendent may prescribe. The filing of the application in good faith by any person shall relieve the applicant from any obligation or liability imposed by this article with respect to the subject of the application, except as contained in section one thousand five hundred six of this article, until the superintendent has acted upon the application. The superintendent may prospectively revoke or modify his determination, after notice and opportunity to be heard, whenever in his judgment revocation or modification is consistent with this article.

(d) For the purposes of this article only, every foreign life insurer which is authorized to do business in this state which is controlled by a person not authorized to do an insurance business in this state, and which, during its three preceding fiscal years taken together, or during any lesser period of time if it has been licensed to transact its business in New York only for such lesser period of time, has written an average of more gross premiums in the state of New York than it has written in its state of domicile during the same period, and such gross premiums written constitute twenty percent or more of its total gross premiums written everywhere in the United States for such three year or lesser period, as reported in its three most recent annual statements, shall be deemed a domestic insurer, provided written notice of the applicability of this subsection is given to such company by the superintendent prior to this article being applicable.

§ 1502. Exemptions

(a) Notwithstanding any other provision of this article the following shall not be deemed holding companies:

(1) authorized insurers, including alien insurers transacting business in this state through United States branches, or their subsidiaries; or

(2) the United States, a state or any political subdivision, agency or instrumentality thereof, or any corporation wholly owned directly or indirectly by one or more of the foregoing.

(b) The superintendent may conditionally or unconditionally exempt any specified person or class of persons from any obligation or liability under this article, if and to the extent he finds the exemption necessary or appropriate in the public interest or not adverse to the interests of policyholders or shareholders and consistent with the purposes of this article.

§ 1503. Registration

(a) Every person who becomes a controlled insurer shall, within thirty days thereafter register with the superintendent and such registration shall be amended within thirty days following any change in the identity of its holding company. The superintendent may grant reasonable extensions of the time to register.

(b) Every registrant shall furnish the superintendent with the following information concerning its holding company:

(1) a copy of its charter or articles of incorporation and by-laws;

(2) the identities of its principal shareholders, officers, directors and controlled persons; and

(3) information as to its capital structure and financial condition, and a description of its principal business activities.

§ 1504. Reporting; examination; publication

(a) Every controlled insurer shall file with the superintendent such reports or material as he may direct for the purpose of disclosing information concerning the operations of persons within the holding company system which may materially affect the operations, management or financial condition of the insurer.

(b) Every holding company and every controlled person within a holding company system shall be subject to examination by order of the superintendent if he has cause to believe that the operations of such persons may materially affect the operations, management or financial condition of any controlled insurer within the system and that he is unable to obtain relevant information from such controlled insurer. The grounds relied upon by the superintendent for such examination shall be stated in his order. Such examination shall be confined to matters specified in the order. The cost of such examination shall be assessed against the person examined and no portion thereof shall thereafter be reimbursed to it directly or indirectly by the controlled insurer.

(c) The superintendent shall keep the contents of each report made pursuant to this article and any information obtained in connection therewith confidential and shall not make the same public without the prior written consent of the controlled insurer to which it pertains unless the superintendent after notice and an opportunity to be heard shall determine that the interests of policyholders, shareholders or the public will be served by the publication thereof. In any action or proceeding by the superintendent against the person examined or any other person within the same holding company system a report of such examination published by him shall be admissible as evidence of the facts stated therein.

§ 1505. Transactions within a holding company system affecting controlled insurers

(a) Transactions within a holding company system to which a controlled insurer is a party shall be subject to the following:

(1) the terms shall be fair and equitable;

(2) charges or fees for services performed shall be reasonable; and

(3) expenses incurred and payments received shall be allocated to the insurer on an equitable basis in conformity with customary insurance accounting practices consistently applied.

(b) The books, accounts and records of each party to all such transactions shall be so maintained as to clearly and accurately disclose the nature and details of the transactions including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties.

(c) The superintendent's prior approval shall be required for the following transactions between a domestic controlled insurer and any person in its holding company system: sales, purchases, exchanges, loans or extensions of credit, or investments, involving five percent or more of the insurer's admitted assets at last year-end.

(d) The following transactions between a domestic controlled insurer and any person in its holding company system may not be entered into unless the insurer has notified the superintendent in writing of its intention to enter into any such transaction at least thirty days prior thereto, or such shorter period as he may permit, and he has not disapproved it within such period:

(1) sales, purchases, exchanges, loans or extensions of credit, or investments, involving more than one-half of one percent but less than five percent of the insurer's admitted assets at last year-end;

(2) reinsurance treaties or agreements;

(3) rendering of services on a regular or systematic basis; or

(4) any material transaction, specified by regulation, which the superintendent determines may adversely affect the interests of the insurer's policyholders or shareholders.

Nothing herein contained shall be deemed to authorize or permit any transaction which, in the case of a non-controlled insurer, would be otherwise contrary to law.

(e) The superintendent, in reviewing transactions pursuant to subsections (c) and (d) hereof, shall consider whether they comply with the standards set forth in subsections (a) and (b) hereof and whether they may adversely affect the interests of policyholders.

(f) This section shall not apply to transactions subject to article sixteen or article seventeen or section one thousand four hundred eight or any sections of this chapter which impose notice or approval requirements greater than those in this section.

§ 1506. Acquisition or retention of control of insurers

(a) No person, other than an authorized insurer, shall acquire control of any domestic insurer, whether by purchase of its securities or otherwise, unless:

(1) it gives twenty days' written notice to the insurer, or such shorter period of notice as the superintendent permits, of its intention to acquire control, and

(2) it receives the superintendent's prior approval.

(b) The superintendent shall disapprove such acquisition if he determines, after notice and an opportunity to be heard, that such action is reasonably necessary to protect the interests of the people of this state. Only the following factors may be considered in making such determination:

(1) the financial condition of the acquiring person and the insurer;

(2) the trustworthiness of the acquiring person or any of its officers or directors;

(3) a plan for the proper and effective conduct of the insurer's operations;

(4) the source of the funds or assets for the acquisition;

(5) the fairness of any exchange of shares, assets, cash or other consideration for the shares or assets to be received;

(6) whether the effect of the acquisition may be substantially to lessen competition in any line of commerce in insurance or to tend to create a monopoly therein; and

(7) whether the acquisition is likely to be hazardous or prejudicial to the insurer's policyholders or shareholders.

(c) (1) The following conditions affecting any controlled insurer, regardless of when such control has been acquired, are violations of this article:

(A) the controlling person or any of its officers or directors have demonstrated untrustworthiness; and

(B) the effect of retention of control, in the case of a domestic controlled insurer, may be substantially to lessen competition in any line of commerce in insurance or to tend to create a monopoly therein, or, in the case of a foreign or alien controlled insurer, may be substantially to lessen competition in any line of commerce in insurance in this state or to tend to create a monopoly therein.

(2) If, after notice and an opportunity to be heard, the superintendent determines that any of the foregoing violations exists, he shall issue an order based on written findings and cause the same to be served upon the insurer and all persons affected thereby directing any person found to be in violation hereof to take appropriate action to cure such violation. Upon the failure of any such person to comply with such order, section one thousand five hundred ten of this article shall become applicable.

(d) The superintendent may require the submission of such information as he deems necessary to determine whether any acquisition or retention of control complies with this article and may require, as a condition of approval of such acquisition or retention of control, that all or any portion of such information be disclosed to the insurer's shareholders.

(e) Unless subject to registration under section one thousand five hundred three of this article, or unless acquisition of its control is subject to subsections (a) and (b) hereof, every authorized insurer shall, within thirty days after any event requiring notice hereunder, notify the superintendent in writing of the identity of any person whom the insurer then knows or has reason to believe controls, or has taken any action, other than preliminary negotiations or discussions, to acquire control of the insurer.

§ 1507. Management of controlled insurers

(a) Notwithstanding the control of an authorized insurer by any person, the insurer's officers and directors shall not thereby be relieved of any obligation or liability to which they would otherwise be subject by law, and the insurer shall be managed so as to assure its separate operating identity consistent with this chapter.

(b) Nothing herein shall preclude an authorized insurer from having or sharing a common management or cooperative or joint use of personnel, property or services with one or more other persons under arrangements meeting the standards of subsection (a) of section one thousand five hundred five of this article.

§ 1508. Acceptance of reports filed with government agencies

To the extent that any information or material is set forth in forms or other matter on file with any government agency or in a registration form filed with the superintendent by another person within the same holding company system, the controlled insurer may comply with the registration or reporting requirements of this article by referring in its registration form or report to such other filed matter and attaching a copy thereof certified by the insurer as a true and complete copy, to such registration form or report or, if such other filed matter is on file with the superintendent, incorporating such matter by reference.

§ 1509. Prohibition of indirect action

No holding company or controlled person shall directly or indirectly or through another person do or cause to be done for or in behalf of the controlled insurer any act intended to affect the insurance operations of the insurer which, if done by the insurer, would violate section four thousand two hundred twenty-eight, four thousand two hundred twenty-nine, four thousand two hundred thirty or any sections specified in section two thousand four hundred two of this chapter.

§ 1510. Violations; penalties; jurisdiction over non-domiciliaries

(a) In addition to any other penalty provided by law, the superintendent may, upon the wilful failure of any person within a holding company system to comply with this article or any regulation or order promulgated hereunder:

(1) proceed under article seventy-four of this chapter with respect to a domestic insurer within the holding company system;

(2) revoke or refuse to renew the authority to do business in this state of an authorized foreign or alien insurer within the holding company system or refuse to issue such authority to any other insurer in the system;

(3) request the attorney general to commence a proceeding utilizing the procedures of sections seven thousand four hundred seventeen and seven thousand four hundred eighteen of this chapter to enforce compliance or, where appropriate, for an order directing the termination of control of a domestic insurer; or

(4) direct that, in addition to any other penalty provided by law, such person forfeit to the people of this state a sum not exceeding five hundred dollars for a first violation and two thousand five hundred dollars for any subsequent violation. An additional sum not exceeding two thousand five hundred dollars shall be imposed for each month during which any such violation shall continue.

(b) If the superintendent finds after notice and opportunity to be heard that any domestic controlled insurer or any policyholder thereof has suffered any loss or damage because of the wilful violation of this article, or of any regulation or order promulgated hereunder, by any person within the insurer's holding company system, he may request the attorney general to maintain a civil action in the name of the people of the state or intervene in an action brought by or on behalf of the insurer or policyholder for the recovery of compensatory damages for the benefit of the insurer or policyholder or for other appropriate relief.

(c) As to any cause of action enumerated in this section a court may exercise personal jurisdiction over any non-domiciliary who controls or is an officer or director of a person who controls a domestic insurer.

ATTACHMENT

NEW YORK STATE INSURANCE LAW

ARTICLE 41. PROPERTY/CASUALTY INSURANCE COMPANIES

§ 4101. Definitions

In this article:

(a) "Basic kinds of insurance" means the kinds of insurance described in the following paragraphs of subsection (a) of section one thousand one hundred thirteen of this chapter numbered therein as set forth in parentheses below:
fire (4);
burglary and theft (7);
glass (8);
boiler and machinery (9);
elevator (10);
animal (11);
personal injury liability (13);
property damage liability (14)--basic as to stock companies only;
workers' compensation and employers' liability (15);
fidelity and surety (16);
credit (17);
marine and inland marine (20);
marine protection and indemnity (21)--basic as to mutual companies only.

(b) "Non-basic kinds of insurance" means the kinds of insurance described in the following paragraphs of subsection (a) of section one thousand one hundred thirteen of this chapter numbered therein as set forth in parentheses below:
accident and health (item (i) of (3));
non-cancellable disability (item (ii) of (3));
miscellaneous property (5);
water damage (6);
collision (12);
property damage liability (14) - non-basic as to mutual companies only;
motor vehicle and aircraft physical damage (19);
inland marine as specified in marine and inland marine (20);
marine protection and indemnity (21) -- non-basic as to stock companies only;
residual value (22);
credit unemployment (24);
gap (26);
prize indemnification (27);
service contract reimbursement (28);
legal services insurance (29);
involuntary unemployment insurance (30) [fig 1] ;
salary protection insurance (31).

§ 4102. Powers

(a) A property/casualty insurance company may be organized and licensed to write any one or more basic kinds of insurance.

(b) A property/casualty insurance company organized and licensed to write any one or more basic kinds of insurance, may be licensed to write non-basic kinds of insurance, subject to the following requirements (ref-

erences are to paragraphs of subsection (a) of section one thousand one hundred thirteen of this chapter describing kinds of insurance):

(1) If licensed to write burglary and theft (7), glass (8), boiler and machinery (9), elevator (10), animal (11), personal injury liability (13), property damage liability (14), workers' compensation and employers' liability (15), fidelity and surety (16) or credit (17), it may be licensed to write accident and health (item (i) of (3)), non-cancellable disability (item (ii) of (3)), water damage (6), collision (12), residual value (22), credit unemployment (24), gap (26) [fig 1] , prize indemnification (27) [fig 2] , service contract reimbursement [fig 3] (28) and involuntary unemployment (30);

(2) If licensed to write fire (4), it may be licensed to write miscellaneous property (5), water damage (6), collision (12), motor vehicle and aircraft physical damage (19) and inland marine as specified in marine and inland marine (20);

(3) If licensed to write marine and inland marine (20), it may be licensed to write collision (12), motor vehicle and aircraft physical damage (19), and marine protection and indemnity (21);

(4) If licensed to write personal injury liability (13) and property damage liability (14), it may be licensed to write motor vehicle and aircraft physical damage (19) and legal services insurance (29); and

(5) In the case of a mutual company licensed to write burglary and theft (7), glass (8), boiler and machinery (9), elevator (10), animal (11), personal injury liability (13), workers' compensation and employers' liability (15), fidelity and surety (16), or credit (17), it may be licensed to write property damage liability (14).

(c) A property/casualty insurance company organized and licensed to write any basic kind of insurance, may be licensed, except with respect to the kinds of insurance defined respectively in the following paragraphs of subsection (a) of section one thousand one hundred thirteen of this chapter: life insurance (1), annuities (2) and title insurance (18), to (i) reinsure risks of every kind or description and (ii) insure property or risks of every kind or description located or resident outside of the United States, its territories and possessions.

(d) A property/casualty insurance company complying with the provisions of this section shall meet all other applicable requirements of this article.

§ 4103. Stock companies; financial requirements

(a) (1) A stock property/casualty insurance company organized in the manner prescribed in subsection (a) of section one thousand two hundred one of this chapter may be licensed under subsection (e) of section one thousand one hundred two of this chapter to write one or more kinds of insurance as specified in TABLE ONE upon meeting the applicable paid-in capital and an additional amount of paid-in surplus for each kind of insurance licensed, in the aggregate at least equal to the requirements specified in TABLE ONE and every such company shall thereafter maintain a minimum capital at least equal to the amount specified in this section and a surplus to policyholders at least equal to the aggregate paid-in capital specified in TABLE ONE for the kind or kinds of insurance licensed.

TABLE ONE

Kind of insurance specified in the following numbered paragraphs of subsection (a) of S 1113:	Paid-in Capital	Paid-in Surplus
Group A:		
7	$ 300,000	$ 150,000
8, 9, 10, 11, or 14 - for each such kind	$ 100,000	$ 50,000
13 or 15 - for each such kind	$ 500,000	$ 250,000
16	$ 900,000	$ 450,000
17	$ 400,000	$ 200,000
Basic additional amount required for any one or more of the above kinds of insurance	$ 100,000	$ 50,000
3(i), 3(ii), 6<1> or 12<2>2 - for each such kind	$ 100,000	$ 50,000
22	$ 2,000,000	$ 1,000,000
24	$ 400,000	$ 200,000
26(B)	$ 200,000	$ 100,000
26(A), 26(C), or 26(D) - for each such kind	$ 600,000	$ 300,000
27	$ 300,000	$ 150,000
28	$ 2,000,000	$ 1,000,000
30	$ 400,000	$ 200,000
31	$ 100,000	$ 50,000
Group B:		
4<3> or 20<4> - for each such kind	$ 500,000	$ 500,000

Notes to TABLE ONE

<1> If licensed to write paragraph 4, no additional paid-in capital and surplus is required.

<2> If licensed to write paragraph 4 or 20, no additional paid-in capital and surplus is required.

<3> If licensed to write paragraph 4, no additional paid-in capital and surplus is required for a license to write paragraphs 5, 6, 12, 19 and 20 (inland marine only).

<4> If licensed to write paragraph 20, no additional paid-in capital and surplus is required for a license to write paragraphs 12, 19 and 21.

(2) A stock property/casualty insurance company licensed to write one or more of the kinds of insurance as specified in TABLE ONE, Group A, and having a minimum capital of one million dollars, may be licensed to write any other kind of insurance specified in TABLE ONE, Group A, upon at least having an initial surplus to policyholders equal to the aggregate of the paid-in capital and paid-in surplus specified in TABLE ONE for the kinds of insurance for which it is to be licensed, and shall thereafter maintain a surplus to policyholders at least equal to the aggregate paid-in capital prescribed in TABLE ONE for the kinds of insurance licensed or one million dollars, whichever is greater.

(3) A stock property/casualty insurance company licensed to write any kind of insurance specified in TABLE ONE, Group A, must have a minimum capital of one million dollars and a surplus to policyholders as specified in this paragraph before being licensed to write either kind of insurance specified in Group B. If licensed to write the kind or kinds of insurance specified in TABLE ONE, Group B, it may, in addition write any one or more kinds of insurance specified in TABLE ONE, Group A, provided it has a minimum capital of one million dollars and a surplus to policyholders as specified in this paragraph before being licensed to write any other kind or kinds of insurance specified in TABLE ONE, Group A. Every such company shall have an initial surplus to policyholders at least equal to the aggregate of the paid-in capital and paid-in surplus specified in TABLE ONE for the kinds of insurance for which it is to be licensed and shall thereafter maintain a surplus to

policyholders at least equal to the aggregate paid-in capital prescribed in TABLE ONE for the kinds of insurance licensed or one million dollars whichever is greater.

(4) A stock property/casualty insurance company licensed under subsection (c) of section four thousand one hundred two of this article to reinsure risks or write insurance on risks outside the United States, its territories and possessions, must maintain a surplus to policyholders of at least thirty-five million dollars.

(5) The dollar amounts set forth in paragraphs one (except the dollar amounts set forth for paragraphs (22), (24) and (26)), two and three of this subsection shall be reduced by fifty percent for a domestic stock property/casualty insurance company initially licensed to do business in this state prior to July first, nineteen hundred eighty-two.

(b) No foreign stock property/casualty insurance company shall be granted a license to do business in this state unless it has a paid-in capital and surplus at least equal, respectively, to the amounts required by subsection (a) hereof for the organization of a domestic company to write the same kind or kinds of insurance which such foreign company is to be licensed to write in this state, and every such company shall thereafter maintain a minimum capital and a surplus to policyholders at least equal to the amount required of a domestic company licensed for the same kind or kinds of insurance.

(c) No alien stock property/casualty insurance company shall be granted a license to write any kind of insurance specified in TABLE ONE, Group A, except as permitted by the provisions of notes <1> and <2> to TABLE ONE, unless it has a trusteed surplus, as defined in section one thousand three hundred twelve of this chapter, at least equal in amount to one hundred fifty percent of the paid-in capital set forth in TABLE ONE for such kind or kinds of insurance, nor to write any kind of insurance specified in TABLE ONE, Group B, unless it has such a trusteed surplus at least equal in amount to two hundred percent of the paid-in capital set forth in TABLE ONE for such kind or kinds of insurance. Every such insurer shall thereafter maintain a trusteed surplus at least equal to the paid-in capital set forth in TABLE ONE for such kind or kinds of insurance.

(d) The financial requirements specified in subsections (b) and (c) hereof shall be reduced by fifty percent for a foreign or alien stock property/casualty insurance company initially licensed to do business in this state prior to July first, nineteen hundred eighty-two, but such reduction shall not apply to such a foreign or alien insurer licensed under subsection (c) of section four thousand one hundred two of this article to reinsure risks or write insurance on risks outside the United States, its territories and possessions. Such reduction shall also not apply to the financial requirements specified in subsection (a) of this section in order to write paragraph twenty-two, twenty-four or twenty-six.

§ 4104. Deposits

(a) Before being licensed to write one or more of the kinds of insurance defined respectively in the following paragraphs of subsection (a) of section one thousand one hundred thirteen of this chapter: burglary and theft (7), glass (8), boiler and machinery (9), elevator (10), animal (11), personal injury liability (13), property damage liability (14), workers' compensation and employers' liability (15), fidelity and surety (16), or credit (17), a domestic property/casualty insurance company shall have made a deposit with the superintendent of eligible securities in an amount of at least five hundred thousand dollars or the amount required as paid-in capital or minimum surplus for the kind or kinds of insurance which such company is to be licensed to write, whichever is the lesser, but in no event shall the amount of the deposit be less than four hundred thousand dollars for any stock company writing any two kinds of insurance designated in this subsection.

(b) Before being licensed pursuant to subsection (c) of section four thousand one hundred two of this article to reinsure risks or to write insurance on risks outside of the United States, its territories and possessions, a domestic property/casualty insurance company shall have made a deposit with the superintendent of eligible securities in an amount of at least three million dollars. Such deposit shall be inclusive of any deposit required by subsection (a) or (c) hereof.

(c) Before being authorized to issue non-assessable policies pursuant to section four thousand one hundred thirteen of this article, a domestic mutual property/casualty insurance company shall have made a deposit with the superintendent of eligible securities in an amount of at least five hundred thousand dollars. Such deposit shall be inclusive of any deposit required by subsection (a) or (b) hereof.

(d) Before being granted any license or renewal license, every foreign property/casualty insurance company shall have made a deposit with the superintendent of eligible securities in an amount not less than the amount required for a similar domestic property/casualty insurance company. The superintendent shall accept in lieu of such deposit a certificate of the proper state officer of the state under whose laws such company is organized showing that such company has deposited with the proper officer of such state, in trust for the benefit and protection of, or for the security of, all of its policyholders, or of all of its policyholders and creditors, securities valued at an amount not less than the amount hereinbefore specified. Such certificate and deposit shall be governed by the provisions of sections one thousand three hundred eighteen and one thousand three hundred nineteen of this chapter.

(e) The dollar amounts of the deposits specified in subsections (a) and (c) hereof shall be reduced by fifty percent for any property/casualty insurance company initially licensed to do business in this state prior to July first, nineteen hundred eighty-two.

§ 4105. Domestic stock companies; declaration and payment of dividends

(a) Except as provided in subsection (c) hereof no domestic stock property/casualty insurance company shall declare or distribute any dividend to shareholders except out of earned surplus. No such company shall declare or distribute any dividend to shareholders which, together with all dividends declared or distributed by it during the next preceding twelve months, exceeds the lesser of ten percent of its surplus to policyholders as shown by its last statement on file with the superintendent, or one hundred percent of adjusted net investment income during such period unless, upon prior application therefor, the superintendent approves a greater dividend distribution based upon his finding that the insurer will retain sufficient surplus to support its obligations and writings.

In this section,

(1) "earned surplus" means the portion of the surplus that represents the net earnings, gains or profits, after deduction of all losses, that have not been distributed to the shareholders as dividends, or transferred to stated capital or capital surplus or applied to other purposes permitted by law but does not include unrealized appreciation of assets;

(2) "adjusted net investment income" means net investment income for the twelve months immediately preceding the declaration or distribution of the current dividend increased by the excess, if any, of net investment income over dividends declared or distributed during the period commencing thirty-six months prior to the declaration or distribution of the current dividend and ending twelve months prior thereto; and

(3) "surplus" means the amount of the insurer's admitted assets in excess of its capital and liabilities, and both "surplus" and "surplus to policyholders" include any voluntary reserves, or any part thereof, which are not required by law.

(b) If the superintendent finds, after notice and hearing, that any such company has distributed any dividend in violation of this section, he may order the company to cease doing any new business until the amount of the dividend has been restored to the company. The directors of any such company who vote in favor of the declaration and distribution of any dividend in violation of this section shall, in addition to all other liabilities or penalties prescribed by law, be jointly and severally liable to the creditors, including policyholder creditors, of the company to the extent of the dividend so declared and distributed, and every shareholder receiving any such dividend shall be liable to the creditors of the company to the extent of the dividend received by such shareholder.

(c) Such company may declare and distribute a stock dividend to its shareholders whenever it shall have a surplus, as defined in subsection (a) hereof, in an amount at least equal to the sum of the dividend and thirty percent of its unearned premium liability as shown by its last statement on file with the superintendent and, for such purpose, the company may increase its capital stock from such surplus in the manner prescribed in section one thousand two hundred six of this chapter, and it shall distribute the additional or increased stock to its shareholders in proportion to the stock held by each, respectively.

§ 4106. Stock companies; participating policies

A stock property/casualty insurance company authorized to do business in this state may include in its charter a provision authorizing the board of directors to permit its policyholders from time to time to participate in the profits of its operations through the payment of dividends to policyholders. For the purpose of carrying into effect this provision, the board of directors may from time to time make reasonable classifications of policies. Every such classification of risks shall be filed with the superintendent and shall not be effective as to policies issued or delivered in this state unless approved by the superintendent as fair and equitable and not unfairly discriminatory. Any classification approved by the superintendent shall remain in effect in this state until disapproved by him or until withdrawn or modified with his approval by the company filing the same. No dividends to policyholders shall be declared or paid by any such company except out of its earned surplus as defined in subsection (a) of section four thousand one hundred five of this article.

§ 4107. Domestic mutual companies; financial and other requirements

(a) (1) A mutual property/casualty insurance company organized in the manner prescribed in subsection (a) of section one thousand two hundred one of this chapter may be licensed pursuant to subsection (e) of section one thousand one hundred two of this chapter to write any one kind (but only one kind except as hereinafter in this section provided) of insurance as specified in TABLE TWO upon at least meeting the requirements set forth therein. In this section, "initial surplus" means the paid-in initial surplus required pursuant to subparagraph (A) of paragraph nine of subsection (a) of section one thousand two hundred one and subparagraph (B) of paragraph one of subsection (e) of section one thousand one hundred two of this chapter, and "minimum surplus" means the surplus required to be maintained unimpaired after a company is licensed to do business.

TABLE TWO

Kind of insurance specified in the following numbered paragraphs of subsection(a) of § 1113	Number of Members	Number of Applications	Number of Separate Risks	Number of Insurance Policies	Initial Surplus	Minimum Surplus to be Maintained	Other Requirements
4	50	300	300	---	$ 300,000<1>	$ 200,000	see note<2>
7	20	20	200	20	$ 300,000	$ 200,000	see note<3>
8	20	20	300	20	$ 150,000	$ 100,000	see note<3>
9	20	20	200	20	$ 300,000	$ 200,000	see note<3>
10	20	20	300	20	$ 150,000	$ 100,000	see note<3>
11	20	20	300	20	$ 150,000	$ 100,000	see note<3>
13	100	100	500<4>	---	$ 500,000<5>	$ 400,000<5>	see note<6>
15	40 <7>	40	2500<7>	---	$ 500,000	$ 400,000	see note<6>
	30 <7>	30	5000<7>	---	$ 500,000	$ 400,000	see note<6>
	20 <7>	20	7500<7>	---	$ 500,000	$ 400,000	see note<6>
	10 <7>	10	10,000<7>	---	$ 500,000	$ 400,000	see note<6>
16	---	---	---	---	$ 1,500,000	$ 1,000,000	
17	20	20	2000	20	$ 750,000	$ 500,000	see note<3>
20	50	300	300	---	$ 1,000,000<8>	$ 500,000<8>	see note<9>
21	20	20<10>	200<11>	---	$ 500,000	$ 500,000	see note<12>

Notes to TABLE TWO

<1> If licensed to write paragraph 4, no additional surplus is required for a license to write paragraphs 5, 6, 12, 19 and 20 (inland marine only).

<2> The aggregate premiums in respect to the separate risks shall be at least $ 100,000 and each applicant shall have paid one-half of the premium payable with the balance due upon the issuance of the policy.

<3> Shall have received cash from each applicant at least equal to 1/2 of the annual premium on the policy.

<4> Not more than 5 risks from any one member.

<5> If licensed to write paragraph 13, no additional surplus is required for a license to write paragraphs 6, 12 and 14.

<6> The aggregate annual premium cost of such insurance shall be at least $ 50,000.

<7> Substitute "employers" for "members" and "employees" for "separate risks".

<8> If licensed to write paragraph 20, no additional surplus is required for a license to write paragraphs 12, 19, and 21.

<9> The aggregate amount of cash received for the premiums on the policies applied for shall be at least $ 150,000.

<10> The 20 applications shall be from persons, firms, corporations, associations or joint stock companies, each owning, operating or chartering one or more vessels.

<11> Applicants shall take insurance covering in the aggregate at least 200 vessels having an aggregate gross tonnage of at least 500,000 tons.

<12> Shall have received cash, from such applicants, on account of the premiums on the respective policies applied for, a sum at least equal to 20 cents per ton upon such aggregate gross tonnage.

(2) A mutual property/casualty insurance company whose membership is limited to hospitals may be organized in the manner prescribed in subsection (a) of section one thousand two hundred one of this chapter and may be licensed pursuant to subsection (e) of section one thousand one hundred two of this chapter to write the kinds of insurance specified in paragraph thirteen or fourteen of subsection (a) of section one thousand one hundred thirteen of this chapter provided (i) it shall have applications from at least forty members on at least forty separate risks, (ii) the total annual premium cost shall be at least seven hundred fifty thousand dollars, (iii) it shall have an initial surplus of at least five hundred thousand dollars and shall maintain a surplus of at least four hundred thousand dollars and (iv) it shall receive from its members advances pursuant to the requirements of section one thousand three hundred seven of this chapter averaging not less than one-third of the average annual indicated premium, but the total thereof shall not be less than the initial minimum surplus.

(b) If licensed to write any kind of insurance specified in TABLE TWO, a mutual property/casualty insurance company may in addition write any one or more of the kinds of insurance specified in Group A and/or Group B of TABLE THREE, and if licensed to write any kind of insurance specified in Group A, it may in addition write any one or more of the kinds of insurance specified in Group C of TABLE THREE, in either case, upon at least meeting the initial surplus requirement prescribed in TABLE THREE for the kinds of insurance for which it is to be licensed. It shall thereafter maintain the minimum surplus prescribed in TABLE THREE for the kinds of insurance licensed.

TABLE THREE

Kind of insurance specified in the following numbered paragraphs of subsection (a) of S 1113:	Initial<1> Surplus	Surplus<1> be Maintained
Group A:		
7 or 9 - for each such kind	$ 100,000	$ 100,000
8, 10 or 11 - for each such kind	$ 50,000	$ 50,000
13<2>,15 or 17 - for each such kind	$ 300,000	$ 300,000
16	$ 900,000	$ 900,000
Group B:		
4<3>	$ 300,000	$ 200,000
20<4>	$ 1,000,000	$ 500,000
Group C:		
3(i) or 3(ii) - for each such kind	$ 100,000	$ 100,000
22	$ 3,000,000	$ 2,000,000
24	$ 300,000	$ 300,000
26(B)	$ 300,000	$ 200,000
26(A), 26(C), or 26(D) - for each such kind	$ 900,000	$ 600,000
28	$ 3,000,000	$ 2,000,000
6<5>, 12<6>or 14<2> - for each such kind	$ 50,000	$ 50,000
27	$ 300,000	$ 150,000
30	$ 300,000	$ 300,000
31	$ 100,000	$ 100,000

Notes to TABLE THREE

<1> The amounts shown in TABLE THREE are added to the initial and minimum surplus for the kind of insurance for which the mutual was organized as set forth in TABLE TWO. In addition, if organized to write paragraphs 4, 20 or 21 the initial and minimum surplus required for paragraphs 7, 8, 9, 10, 11, 13, 15, 16 or

17 shall be determined from TABLE TWO for the kind of insurance with the highest initial surplus requirement as indicated in TABLE TWO. After such determination use TABLE THREE to derive the initial and minimum surplus requirements for all other kinds of insurance.

<2> If licensed to write paragraph 13, no additional surplus is required for a license to write paragraphs 6, 12, and 14.

<3> If licensed to write paragraph 4, no additional surplus is required for a license to write paragraphs 5, 6, 12, 19 and 20 (inland marine only).

<4> If licensed to write paragraph 20, no additional surplus is required for a license to write paragraphs 12, 19, and 21.

<5> If licensed to write paragraph 4 or 13, no additional initial and minimum surplus is required.

<6> If licensed to write paragraphs 4, 13 or 20, no additional initial and minimum surplus is required.

(c) A mutual property/casualty insurance company licensed pursuant to paragraph four of subsection (b) of section four thousand one hundred two of this article to write the kind of insurance specified in paragraph nineteen of subsection (a) of section one thousand one hundred thirteen of this chapter must maintain a minimum surplus of at least six hundred thousand dollars.

(d) A mutual property/casualty insurance company licensed pursuant to subsection (c) of section four thousand one hundred two of this article to reinsure risks or write insurance on risks outside the United States, its territories and possessions, must maintain a surplus to policyholders of at least thirty-five million dollars.

(e) The dollar amounts of initial surplus, minimum surplus and surplus to policyholders set forth in subsections (a), (b) and (c) of this section shall be reduced by fifty percent for any mutual property/ casualty insurance company initially licensed to do business in this state prior to July first, nineteen hundred eighty-two. Such reduction shall not apply to the financial requirements specified in subsection (b) of this section in order to write paragraph twenty-two, twenty-four or twenty-six.

(f) Notwithstanding any provision of this section to the contrary, if licensed to write the kind of insurance specified in paragraph fifteen of subsection (a) of section one thousand one hundred thirteen of this chapter, a mutual property/casualty insurance company may be licensed for the purposes of article nine of the workers' compensation law to write the kind of insurance specified in item (i) of paragraph three of subsection (a) of section one thousand one hundred thirteen of this chapter without having any additional surplus.

§ 4108. Foreign and alien mutual companies; licensing

(a) No foreign or alien mutual property/casualty insurance company shall be granted a license to do business in this state unless it substantially complies with all of the requirements set forth in this chapter for a domestic mutual property/casualty insurance company licensed to write the same kind or kinds of insurance.

(b) No alien mutual property/casualty insurance company shall be authorized to do business in this state unless it maintains a trusteed surplus, as required by section one thousand three hundred twelve of this chapter, at least equal to the surplus to policyholders required to be maintained by a domestic stock property/casualty insurance company licensed to write the same kind or kinds of insurance.

(c) The financial requirements specified in subsections (a) and (b) hereof shall be reduced by fifty percent for a foreign or alien mutual property/casualty insurance company initially licensed to do business in this state prior to July first, nineteen hundred eighty-two, but such reduction shall not apply to such a foreign or alien insurer licensed under subsection (c) of section four thousand one hundred two of this article to reinsure risks or write insurance on risks outside the United States, its territories and possessions. Such reduction

shall also not apply to the amounts required in order to write paragraph twenty-two, twenty-four or twenty-six of subsection (a) of section one thousand one hundred thirteen of this chapter.

§ 4109. Mutual companies; special contingent surplus

(a) A domestic mutual property/casualty insurance company licensed to write any of the kinds of insurance defined respectively in the following paragraphs of subsection (a) of section one thousand one hundred thirteen of this chapter: accident and health (item (i) of (3)), non-cancellable disability (item (ii) of (3)), burglary and theft (7), glass (8), boiler and machinery (9), elevator (10), animal (11), personal injury liability (13), property damage liability (14), workers' compensation and employers' liability (15), fidelity and surety (16) or credit (17), shall establish on its general ledger a special contingent surplus and shall thereafter maintain the same unimpaired so long as it is licensed to write one or more of the foregoing kinds of insurance. An impairment exists in the surplus of any such company at any time when the aggregate value of its admitted assets is less than the amount of all of its liabilities and the special contingent surplus which it is required to maintain at such time.

(b) During each full calendar year except the first two full calendar years next following the calendar year in which such company was licensed to write any kind of insurance specified in subsection (a) hereof, the amount of such contingent surplus shall exceed the required amount thereof at least year-end, by an amount at least equal to one and one-half percent of the net premium income received for the kinds of insurance referred to in subsection (a) hereof during such whole calendar year, until the amount of such contingent surplus shall be at least equal to the amount of surplus to policyholders required under section four thousand one hundred three of this article to be maintained by a similar domestic stock property/casualty insurance company licensed to do any one or more of the kinds of insurance specified in subsection (a) hereof. Such special contingent surplus, by whatever name called, shall be inclusive of the minimum surplus required by the provisions of this chapter and shall be exclusive of any divisible surplus available for the payment of dividends.

(c) No domestic mutual property/casualty insurance company shall declare or pay any dividend to policyholders if, after the payment of such dividend, its special contingent surplus as herein required will be impaired. The declaration and payment of dividends by any such company shall be subject to the provisions of section one thousand two hundred eleven of this chapter.

(d) Any domestic mutual property/casualty insurance company shall be authorized in any year to further increase its special contingent surplus by an amount in excess of the annual accumulation required by this section, and any such excess shall be credited upon the amount which otherwise it would have been required to accumulate by the provisions of this section in any subsequent year or years.

(e) The superintendent may refuse to issue a license or renewal license to do an insurance business in this state to any foreign or alien mutual property/casualty insurance company which does not comply in substance with this section applicable to a similar domestic mutual property/casualty insurance company licensed to write the same kind or kinds of insurance.

§ 4110. Domestic mutual companies; expense limits

(a) No domestic mutual property/casualty insurance company licensed to write a kind of insurance specified in paragraph seven, eight, nine, ten, eleven, thirteen, fourteen, fifteen, sixteen or seventeen of subsection (a) of section one thousand one hundred thirteen of this chapter shall expend in any one calendar year for management expenses a greater amount than thirty percent of the sum of its net premium income and seventy-five percent of its investment income for such year; provided that any insurer whose principal line of business is medical malpractice liability insurance or any insurer who is the subject of a proceeding pursuant to article seventy-four of this chapter shall not expend in any one calendar year for management expenses, a greater amount than thirty percent of its net premium income for such year. Management expenses shall be held to

include all expenses of the company except expenses incurred in the investigation, adjustment and settlement of claims, taxes, fees and expenses of examination, and taxes, repairs and expenses on real estate. In applying the provisions of this section the net premium income of, and expenses of, boiler and machinery insurance or elevator insurance shall not be included.

(b) Subsection (a) hereof shall not apply to a mutual company organized before the effective date of this chapter as a domestic mutual fire or marine or marine protection and indemnity company.

§ 4111. Mutual companies; assessments

(a) Except as provided in section four thousand one hundred thirteen of this article, every domestic mutual property/casualty insurance company shall in its by-laws and policies prescribe the contingent mutual liability of its members for the payment of assessments, in such a way that each member shall be liable to pay the member's proportionate share, subject to the limitations hereinafter specified, of the amount of any assessment or assessments permitted for any purpose under any provisions of this chapter or necessary to make good an impairment of the minimum surplus of such company. The contingent liability of a member may be limited to an amount not less than one additional annual premium on each policy held by a member. The aggregate amount of all assessments whether levied by the board of directors of such insurer or by the superintendent as liquidator or rehabilitator of the insurer, or otherwise, shall be no greater amount than that specified in the by-laws and policies. Except as provided in section four thousand one hundred thirteen of this article, no such insurance company shall make, issue or deliver any policy of insurance, which does not prescribe the contingent liability of the policyholder in clear and explicit language printed in type not smaller than eight point.

(b) If any domestic mutual property/casualty insurance company does not have admitted assets at least equal in amount to the aggregate of its liabilities and its minimum surplus as required by the provisions of this chapter, and if such impairment is not otherwise made good, the board of directors of the company may, with the approval of the superintendent and within such time as he prescribes, order an assessment in the manner specified in the by-laws for an amount which will provide sufficient funds to make good the impairment, except that no member shall be liable for an assessment exceeding the limit specified in his policy in accordance with subsection (a) hereof. All orders of assessment made by the board of directors shall be filed with the superintendent and shall not take effect unless and until approved by him. The superintendent may refuse any such approval if, in his judgment, refusal will best promote the interests of the policyholders and creditors of the company, and of the insuring public. Every assessment shall be made upon all members liable to assessment therefor in the proportion hereinafter specified. Every person, firm or corporation who or which was a member of such company at any time during one year prior to the making of an order of assessment by the board of directors shall be liable to pay and shall pay the member's proportionate share of any assessment which may be made in accordance with law, if the member is notified of the assessment within one year after making of an order of assessment. A member's proportionate part of any assessment shall be determined by applying to the premium earned on the member's policy or policies in force during a period of one year next preceding the order of assessment the ratio of the total assessment to the total premiums earned during such period on all policies subject to assessment.

(c) Unless specifically authorized by the provisions of this chapter to issue non-assessable policies in this state, no foreign mutual property/casualty insurance company shall be or continue to be authorized to do business in this state unless its by-laws and policies issued in this state contain provisions for the levying and collection of assessments upon members, at least for the payment of losses and expenses, which conform in substance to subsection (b) hereof.

(d) In the case of a mutual property/casualty insurance company subject to paragraph two of subsection (a) of section four thousand one hundred seven of this article, an assessment authorized by this section shall be made when, in addition to the grounds set forth in this section, if the ratio of net premium writings to surplus as regards policyholders is four to one or greater, based upon the last annual statement or any quarterly statement projected on an annual basis, subject to the approval of the superintendent, and if, at any time,

upon examination, the superintendent determines that an assessment should be made pursuant to subsection (b) hereof or this subsection the superintendent shall make an appropriate order that the assessment be made.

§ 4112. Mutual companies; protection against assessments

No domestic mutual property/casualty insurance company and no officer or representative thereof shall make any contract whether on behalf of such company or of all or any of its policyholders, whereby the company or the policyholders are insured or indemnified against the imposition or payment of assessments which may be made upon members of the company, if the contract is cancellable or otherwise terminable by any party thereto upon the giving of notice of cancellation or termination within a period of less than one year before the effective date of the cancellation or termination.

§ 4113. Mutual companies; non-assessable policies

(a) Every mutual property/casualty insurance company licensed to do business in this state, if its charter or by-laws permit or are amended to permit the issuance of policies without contingent mutual liability of the policyholder for assessment, may with the permission of the superintendent issue non-assessable policies in this state upon compliance with the following requirements:

(1) It shall maintain a surplus, as determined from its latest filed statement, which together with its unearned premium reserve from its latest filed statement is at least equal to the surplus to policyholders required to be maintained by a domestic stock property/casualty insurance company licensed to write the same kind or kinds of insurance.

(2) It shall have submitted a copy of its proposed non-assessable policy or policies for approval of the superintendent, and shall have obtained his approval.

(b) Every policy issued by any such company shall clearly state whether or not the holder of the policy is subject to a liability for assessment.

(c) Any surplus required for the purposes specified in this section shall be inclusive of any surplus required by any other sections of this chapter.

(d) A mutual property/casualty insurance company subject to paragraph two of subsection (a) of section four thousand one hundred seven of this article and subject to subsection (d) of section four thousand one hundred eleven of this article may with the prior approval of the superintendent amend its charter and by-laws to permit the issuance of policies without contingent mutual liability of the policyholder and may with the permission of the superintendent issue non-assessable policies in this state upon compliance with the requirements of this section.

(e) The financial requirement specified in paragraph one of subsection (a) hereof shall be reduced by fifty percent for a mutual property/casualty insurance company initially licensed to do business in this state prior to July first, nineteen hundred eighty-two.

§ 4114. Mutual companies; dividends

The board of directors of a mutual property/casualty insurance company may from time to time fix and determine an amount to be declared and paid as a dividend or as a return of unused or unabsorbed premiums or premium deposits on policies, retaining such sums as they may deem necessary to meet outstanding policy obligations and for the maintenance of reserves and surplus as herein provided. The determination, declaration and payment of such dividend shall be subject to section one thousand two hundred eleven of this chapter. In declaring any dividend to policyholders, the board of directors may make reasonable classifica-

tions of policies. Every such classification shall be filed with the superintendent and shall not become effective unless approved by the superintendent as fair, equitable, not impracticable in operation and not unfairly discriminatory. Any such classification approved by the superintendent shall remain in effect until disapproved by the superintendent or until withdrawn with the superintendent's approval by the company filing the same. The requirements as to filing and approval, as applied to any foreign or alien mutual property/casualty insurance company, shall apply only to risks located or resident in this state.

§ 4115. Certain mutual companies existing prior to January first, nineteen hundred forty

(a) Notwithstanding the provisions of sections four thousand one hundred eleven, four thousand one hundred thirteen and four thousand one hundred fourteen of this article, any domestic mutual property/casualty insurance company heretofore organized as a domestic mutual marine and fire insurance company under special act of this state and reincorporated pursuant to former section fifty-two of the insurance law in effect immediately before January first, nineteen hundred forty and doing business immediately prior to such date, may continue to issue non-assessable policies in accordance with its charter powers, without making any deposit, if and so long as it maintains a surplus of not less than one million dollars.

(b) Notwithstanding the provisions of sections one thousand two hundred nine and one thousand two hundred eleven of this chapter and section four thousand one hundred fourteen of this article, any such domestic mutual insurance company of the kind specified in subsection (a) hereof, may continue to issue both participating and non-participating policies or contracts of insurance, in accordance with its charter, and may continue to exercise its existing charter powers as to the qualification of its members and trustees and as to the election and powers of its board of trustees.

§ 4116. Domestic mutual companies; voting rights of members

The charter or by-laws of any domestic mutual property/casualty insurance company may, with the approval of the superintendent pursuant to section one thousand two hundred nine of this chapter, provide for the distribution of voting power, at all meetings of the corporation, among the members on the basis of the amount of insurance held, the number of policies held, or the amount of premiums paid, by the member or on any other basis which the superintendent finds to be fair and equitable; but in any event every member whose insurance is in force at the time of the election shall be entitled to at least one vote, and no member shall be entitled to more than ten votes.

§ 4117. Loss and loss expense reserves

(a) In determining the financial condition of any property/casualty insurance company for the purpose of applying the provisions of this chapter, and in any financial statement or report of any such company, there shall be included in the liabilities of such company loss reserves and loss expense reserves at least equal to the amounts required under the provisions of this section, and the amount of such reserves shall be diminished by allowance or credit for reinsurance recoverable from assuming insurers in accordance with paragraph fourteen of subsection (a) of section one thousand three hundred one of this chapter. The date as of which such determination, statement or report is made is hereinafter referred to as the date of determination.

(b) For all outstanding losses and loss expenses, the reserves shall include the following:

(1) the aggregate estimated amounts due or to become due on account of all known losses and claims and loss expenses incurred but not paid, including the estimated liability on any notice received by the company of the occurrence of any event which may result in a loss;

(2) the aggregate amounts of liability for all losses and loss expenses incurred but on which no notice has been received, estimated in accordance with the company's prior experience, if any, otherwise in accordance with the experience of similar companies under similar contracts of insurance. The estimated liabilities

for such losses under all its bonds, policies or contracts of fidelity insurance, shall be not less than ten percent of the net premiums in force thereon, and the estimated liabilities for all such losses under all its surety contracts shall be not less than five percent of the net premiums in force thereon.

(c) Except as provided in subsection (e) hereof the minimum reserves for outstanding losses and loss expenses under policies of personal injury liability insurance and under policies of employers' liability insurance, where the losses were incurred during the three years immediately preceding the date of determination, shall be calculated in accordance with any method adopted or approved by the National Association of Insurance Commissioners and shall be not less than the aggregate of the estimated unpaid losses and loss expenses for claims incurred computed in accordance with subsection (b) hereof.

(d) The minimum reserves for outstanding losses and loss expenses under policies of workers' compensation insurance, except as provided in subsection (e) hereof, shall be computed as follows:

(1) For all such compensation policies where losses were incurred more than three years prior to the date of determination, such reserves shall be the sum of the present values, at percent interest per annum, of the determined and estimated unpaid losses computed on an individual case basis plus the estimated unpaid loss expenses computed in accordance with subsection (b) hereof.

(2) Where losses were incurred during the three years immediately preceding the date of determination, such reserves shall be the sum of the reserves for each year, which shall be calculated in accordance with any method adopted or approved by the National Association of Insurance Commissioners and shall be not less than the sum of the present values, at five percent interest per annum, of the determined and estimated unpaid losses computed on an individual case basis plus the estimated unpaid loss expenses computed in accordance with subsection (b) hereof.

(e) Whenever in the judgment of the superintendent, the loss and loss expense reserves of any property/casualty insurance company doing business in this state calculated in accordance with the foregoing provisions are inadequate or excessive, he may prescribe any other basis which will produce adequate and reasonable reserves.

(f) Every property/casualty insurance company doing business in this state shall keep a complete and itemized record showing all losses and claims on which it has received notices including all notices received by it of the occurrence of any event which may result in a loss.

(g) (1) Effective with the nineteen hundred ninety annual statement, every licensed property/casualty insurer required to file such annual statement with the superintendent by the following April first, shall, unless exempted by the superintendent, engage a qualified independent loss reserve specialist for the following year to render an opinion as to the adequacy of its loss and loss adjustment expense reserves when two of three of such insurer's results of its loss and loss adjustment expense ratios as indicated below are outside of the indicated acceptable ranges:

(A) One Year Reserve Development to Surplus

Add the year-end estimate of the losses that were outstanding one year earlier to the payments on those losses made during that year. The difference between that sum and the reserves that were established at the end of the prior year is the one-year reserve development. The ratio of one-year reserve development to prior year's surplus is the deficiency or redundancy. The acceptable range is less than twenty-five percent deficiency. Any redundancy is acceptable.

(B) Two Year Reserve Development to Surplus

Add the year-end estimate of the losses that were outstanding two years earlier to the payments on those losses made during those two years. The difference between that sum and the reserves that were established at the end of the second prior year is the two-year reserve development. The ratio of two-year reserve development to the second prior year's surplus is the deficiency or redundancy. The acceptable range is less than twenty-five percent deficiency. Any redundancy is acceptable.

(C) Estimated Current Reserve Deficiency to Surplus

For the last two years the reserves as stated in those years are adjusted by the one-year or two-year reserve development as calculated in the above two ratios. This total is then divided by the net premium

earned in the appropriate year to obtain the developed reserve to premium ratio. The estimated reserves required is the current net premium earned multiplied by the average ratio between developed reserves and earned premium for the last two years. The estimated deficiency is the difference between the estimated reserves required by the company and the actual reserves maintained. The estimated current reserve deficiency or redundancy is taken as a percentage of surplus and the acceptable range is less than twenty-five percent deficiency. Any redundancy is acceptable.

(2) Such opinion shall be submitted by the qualified loss reserve specialist to the insurer and the superintendent, by such date established by the superintendent. For the purposes of this section, a "qualified independent loss reserve specialist" shall mean a person who is not an employee, principal or director or indirect owner of the insurer and is a member of the Casualty Actuarial Society, or has such other experience as is acceptable to the superintendent to assure a professional opinion on the adequacy of loss and loss adjustment expense ratios.

(3) Nothing in this subsection shall be construed to restrict or diminish any right or power of the superintendent under any other provision of this chapter.

(4) The superintendent shall keep the contents of each report made pursuant to this subsection and any information obtained in connection therewith confidential and shall not make the same public without the prior written consent of the insurer to which it pertains unless the superintendent after notice and an opportunity to be heard shall determine that the interests of policyholders, shareholders or the public will be served by the publication thereof.

§ 4118. Limitation of risks; fidelity and surety; fire; hospital mutuals

(a) (1) In applying the limitation of section one thousand one hundred fifteen of this chapter to fidelity and surety risks the net amount of exposure on any one fidelity or surety risk shall, except as provided in paragraph four hereof, be deemed within the limit of ten percent if the company is protected in excess of that amount by:

(A) reinsurance in a company authorized to write such business in this state or reinsurance in an accredited reinsurer, as defined in subsection (a) of section one hundred seven of this chapter, which is in such form as to enable the obligee or beneficiary to maintain an action thereon against the ceding insurer jointly with the assuming insurer or, where the commencement or prosecution of actions against the ceding insurer has been enjoined by any court of competent jurisdiction or any justice or judge thereof, against the assuming insurer alone, and to have recovery against the assuming insurer for its share of the liability thereunder and in discharge thereof; or

(B) the co-suretyship of any other company authorized to do such business in this state; or

(C) a deposit of property with it in pledge or conveyance of property to it in trust for its protection; or

(D) a conveyance or mortgage of property for its protection; or

(E) in case a suretyship or guaranty obligation was made on behalf or on account of a fiduciary holding property in a trust capacity, by such a deposit or other disposition of a portion of the property so held in trust that no future sale, mortgage, pledge or other disposition can be made thereof except with the consent of the insurance company or by decree or order of a court of competent jurisdiction.

(2) Notwithstanding the provisions of paragraph one hereof, a company may execute bonds of the kind commonly known as transportation or warehousing bonds for United States internal revenue taxes in a net amount not exceeding twenty percent of its surplus to policyholders, determined as provided in paragraph one hereof.

(3) In determining the net amount of exposure on any one risk, the following rules shall be applicable to the kinds of obligations hereinafter described:

(A) When the penalty of a suretyship obligation exceeds the amount of a judgment prescribed therein as appealed from and thereby secured, or exceeds the amount of the subject matter in controversy or of the estate in the hands of the fiduciary for the performance of whose duties it is conditioned, the bond may be executed by such company if the actual amount of the judgment or the subject matter in controversy or estate not subject to supervision or control of the surety, is not in excess of a limitation of ten percent.

(B) When the penalty of a suretyship obligation executed for the performance of a contract exceeds the contract price, the latter amount shall be taken as the basis for estimating the limit of risk within the meaning of this paragraph.

(4) In addition to any other limitation contained in this chapter, no authorized company shall at any one time be exposed to risks on suretyship obligations guaranteeing the deposits of any single financial institution in an aggregate net amount in excess of ten percent of the surplus to policyholders of such company, determined as provided in paragraph one hereof, unless it shall be protected in excess of that amount by security in accordance with the provisions of subparagraphs (A), (B), (C) and (D) of paragraph one hereof.

(b) No insurer authorized to write fire insurance in this state shall expose itself to any loss on any one fire risk, whether located in this state or elsewhere, in an amount exceeding ten percent of its surplus to policyholders, except that in the case of risks adequately protected by automatic sprinklers or risks principally of non-combustible construction and occupancy such insurer may expose itself to any loss on any one risk in an amount not exceeding twenty-five percent of the sum of its unearned premium reserve and its surplus to policyholders. Any risk or portion of any risk reinsured in an assuming insurer authorized to write such business in this state or in an accredited reinsurer, as defined in subsection (a) of section one hundred seven of this chapter, shall be deducted in determining the limitation of risk prescribed in this subsection.

(c) A mutual property/casualty insurance company subject to paragraph two of subsection (a) of section four thousand one hundred seven of this article may be permitted to write coverage on any one risk in excess of the limitation provided by section one thousand one hundred fifteen of this chapter, based upon criteria approved by the superintendent.

§ 4119. Foreign and alien companies; license qualification

No foreign or alien property/casualty insurance company shall be licensed to do business in this state unless it shall have continuously transacted an insurance business in the state or country of its incorporation for at least three years immediately prior to the issuance of such license. The superintendent may waive or reduce the three year requirement, with respect to a license applicant, upon determination that the three year period is not necessary to safeguard the interests of the public or policyholders.

§ 4120. [Repealed]

§ 4121. Security may be required from banking officers and employees

(a) The board of directors or trustees of each bank, trust company, savings bank or savings and loan associations in this state, may require from each officer and employee thereof an individual fidelity bond in favor of the institution in an amount and form approved by such board of directors or trustees.

(b) Such bond shall be accepted only from a corporation authorized to issue fidelity bonds and doing business in this state under the authority of the department.

(c) The premium for such bond may be paid as a necessary expense of any such banking institution.

ATTACHMENT

NEW YORK STATE INSURANCE LAW

ARTICLE 69. FINANCIAL GUARANTY INSURANCE CORPORATIONS

§ 6901. Definitions

As used in this article:

(a) (1) "Financial guaranty insurance" means a surety bond, an insurance policy or, when issued by an insurer or any person doing an insurance business as defined in paragraph one of subsection (b) of section one thousand one hundred one of this chapter, an indemnity contract, and any guaranty similar to the foregoing types, under which loss is payable, upon proof of occurrence of financial loss, to an insured claimant, obligee or indemnitee as a result of any of the following events:

(A) failure of any obligor on or issuer of any debt instrument or other monetary obligation (including equity securities guarantied under a surety bond, insurance policy or indemnity contract) to pay when due to be paid by the obligor or scheduled at the time insured to be received by the holder of the obligation, principal, interest, premium, dividend or purchase price of or on, or other amounts due or payable with respect to, such instrument or obligation, when such failure is the result of a financial default or insolvency or, provided that such payment source is investment grade, any other failure to make payment, regardless of whether such obligation is incurred directly or as guarantor by or on behalf of another obligor that has also defaulted;

(B) changes in the levels of interest rates, whether short or long term or the differential in interest rates between various markets or products;

(C) changes in the rate of exchange of currency;

(D) changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general; or

(E) other events which the superintendent determines are substantially similar to any of the foregoing.

(2) Notwithstanding paragraph one of this subsection, "financial guaranty insurance" shall not include:

(A) insurance of any loss resulting from any event described in paragraph one of this subsection if the loss is payable only upon the occurrence of any of the following, as specified in a surety bond, insurance policy or indemnity contract:

(i) a fortuitous physical event;

(ii) failure of or deficiency in the operation of equipment; or

(iii) an inability to extract or recover a natural resource;

(B) fidelity and surety insurance as defined in paragraph sixteen of subsection (a) of section one thousand one hundred thirteen of this chapter;

(C) credit insurance as defined in paragraph seventeen of subsection (a) of section one thousand one hundred thirteen of this chapter;

(D) credit unemployment insurance as defined in paragraph twenty-four of subsection (a) of section one thousand one hundred thirteen of this chapter;

(E) residual value insurance as defined in paragraph twenty-two of subsection (a) of section one thousand one hundred thirteen of this chapter;

(F) mortgage guaranty insurance as defined in paragraph twenty-three of subsection (a) of section one thousand one hundred thirteen of this chapter and as permitted to be written by a mortgage guaranty insurer under article sixty-five of this chapter;

(G) guaranteed investment contracts issued by life insurance companies which provide that the life insurer itself will make specified payments in exchange for specific premiums or contributions;

(H) indemnity contracts or similar guaranties, to the extent that they are not otherwise limited or proscribed by this chapter:

(i) in which a life insurer or an insurer subject to article forty-three of this chapter guaranties its obligations or indebtedness or the obligations or indebtedness of a subsidiary (as defined in paragraph forty of subsection (a) of section one hundred seven of this chapter), other than a financial guaranty insurance corporation, provided that:

(I) to the extent that any such obligations or indebtedness are backed by specific assets, such assets must at all times be owned by the insurer or the subsidiary; and

(II) in the case of the guaranty of the obligations or indebtedness of the subsidiary that are not backed by specific assets of such insurer, such guaranty terminates once the subsidiary ceases to be a subsidiary; or

(ii) in which a life insurer guaranties obligations or indebtedness (including the obligation to substitute assets where appropriate) with respect to specific assets acquired by such life insurer in the course of its normal investment activities and not for the purpose of resale with credit enhancement, or guaranties obligations or indebtedness acquired by its subsidiary, provided that the assets acquired pursuant to this item (ii) have been:

(I) acquired by a special purpose entity, whose sole purpose is to acquire specific assets of such life insurer or its subsidiary and issue securities or participation certificates backed by such assets; or

(II) sold to an independent third party; or

(iii) in which a life insurer guaranties obligations or indebtedness of an employee or insurance agent of such life insurer; or

(I) guarantees of higher education loans, unless written by a financial guaranty insurance corporation;

(J) guarantees of insurance contracts, except for:

(i) guarantees authorized pursuant to section one thousand one hundred fourteen of this chapter;

(ii) financial guaranty insurance policies insuring guaranteed investment contracts issued by life insurers, provided that:

(I) the obligations under such contracts are not dependent on the continuance of human life;

(II) the financial guaranty insurance policies do not guaranty death benefits provided by such contracts;

(III) the obligations insured by the financial guaranty insurance policies are investment grade based on the rating of the life insurers or, in the case of separate account guaranteed investment contracts, based on the ratings of such separate accounts;

(IV) the financial guaranty insurance policies shall not condition or delay payment of a claim with respect to such contracts upon the insured or beneficiary making a claim on the contracts with any insurance guaranty fund under this chapter or of any other jurisdiction; and

(V) the financial guaranty insurance policies provide that if, prior to payment by the insurer under the financial guaranty insurance policies, the guaranty fund has paid a claim under such contracts for an amount that, when added to the amount payable under the financial guaranty insurance policies, would exceed the amount owed under such contracts, then the financial guaranty insurer shall pay the portion of the amount payable in excess of the contract amounts to the guaranty fund instead of to the beneficiary under such contracts; or

(K) any other form of insurance covering risks which the superintendent determines to be substantially similar to any of the foregoing.

(b) "Financial guaranty insurance corporation" or "corporation" means an insurer licensed to transact the business of financial guaranty insurance in this state.

(c) "Affiliate" means a person which, directly or indirectly, owns at least ten percent but less than fifty percent of the financial guaranty insurance corporation or which is at least ten percent but less than fifty percent, directly or indirectly, owned by a financial guaranty insurance corporation.

(d) "Aggregate net liability" means the aggregate amount of insured unpaid principal, interest and other monetary payments, if any, of guarantied obligations insured or assumed, less reinsurance ceded and less collateral.

(e) "Asset-backed securities" mean:

(1) securities or other financial obligations of an issuer provided that:

(A) the issuer is a special purpose corporation, trust or other entity, or (provided that the securities or other financial obligations constitute an insurable risk) is a bank, trust company or other financial institution, deposits in which are insured by the Bank Insurance Fund or the Savings Insurance Fund (or any successor thereto); and

(B) a pool of assets:

(i) has been conveyed, pledged or otherwise transferred to or is otherwise owned or acquired by the issuer;

(ii) such pool of assets backs the securities or other financial obligations issued; and

(iii) no asset in such pool, other than an asset directly payable by, guaranteed by or backed by the full faith and credit of the United States government or that otherwise qualifies as collateral under paragraph one or two of subsection (g) of this section, has a value exceeding twenty percent of the pool's aggregate value; or

(2) a pool of credit default swaps or credit default swaps referencing a pool of obligations, provided that:

(A) the swap counterparty whose obligations are insured under the credit default swap is a special purpose corporation, special purpose trust or other special purpose legal entity;

(B) no reference obligation in such pool, other than an obligation directly payable by, guaranteed by or backed by the full faith and credit of the United States government or that otherwise qualifies as collateral under paragraph two of subsection (g) of this section, has a notional amount exceeding ten percent of the pool's aggregate notional amount; and

(C) the insurer has the benefit of a deductible or other first loss credit protection against claims under its insurance policy.

(f) "Average annual debt service" means the amount of insured unpaid principal and interest on an obligation, multiplied by the number of such insured obligations (assuming each obligation represents one thousand dollars par value), divided by the amount equal to the aggregate life of all such obligations (assuming each obligation represents one thousand dollars par value). This definition, expressed as a formula in regard to bonds, is as follows:

$$\text{Average Annual Debt Service} = \frac{\text{Total Debt Service X No. of Bonds}}{\text{Bond Years}}$$

Total Debt Service = Insured Unpaid Principal + Interest

Number of Bonds = $\frac{\text{Total Insured Principal}}{\$\ 1{,}000}$

Bond Years = Number of Bonds X Term in Years

Term in Years = Term to maturity based on scheduled amortization or, in the absence of a scheduled amortization in the case of asset-backed securities or other obligations lacking a scheduled amortization, expected amortization, in each case determined as of the date of issuance of the insurance policy based upon the amortization assumptions employed in pricing the insured obligations or otherwise used by the insurer to determine aggregate net liability.

(g) "Collateral" means:

(1) cash;

(2) the cash flow from specific obligations which are not callable and scheduled to be received based on expected prepayment speed on or prior to the date of scheduled debt service (including scheduled redemptions or prepayments) on the insured obligation provided that (i) such specific obligations are directly payable by, guaranteed by or backed by the full faith and credit of the United States government, (ii) in the case of insured obligations denominated or payable in foreign currency as permitted under paragraph four of subsection (b) of section six thousand nine hundred four of this article, such specific obligations are directly payable by, guaranteed by or backed by the full faith and credit of such foreign government or the central bank thereof, or (iii) such specific obligations are insured by the same insurer that insures the obligations being collateralized, and the cash flows from such specific obligations are sufficient to cover the insured scheduled payments on the obligations being collateralized;

(3) the market value of investment grade obligations, other than obligations evidencing an interest in the project or projects financed with the proceeds of the insured obligations;

(4) the face amount of each letter of credit that:

(A) is irrevocable;

(B) provides for payment under the letter of credit in lieu of or as reimbursement to the insurer for payment required under a financial guaranty insurance policy;

(C) is issued, presentable and payable either:

(i) at an office of the letter of credit issuer in the United States; or

(ii) at an office of the letter of credit issuer located in the jurisdiction in which the trustee or paying agent for the insured obligation is located;

(D) contains a statement that either:

(i) identifies the insurer and any successor by operation of law, including any liquidator, rehabilitator, receiver or conservator, as the beneficiary; or

(ii) identifies the trustee or the paying agent for the insured obligation as the beneficiary;

(E) contains a statement to the effect that the obligation of the letter of credit issuer under the letter of credit is an individual obligation of such issuer and is in no way contingent upon reimbursement with respect thereto;

(F) contains an issue date and a date of expiration;

(G) either:

(i) has a term at least as long as the shorter of the term of the insured obligation or the term of the financial guaranty policy; or

(ii) provides that the letter of credit shall not expire without thirty days prior written notice to the beneficiary and allows for drawing under the letter of credit in the event that, prior to expiration, the letter of credit is not renewed or extended or a substitute letter of credit or alternate collateral meeting the requirements of this subsection is not provided;

(H) states that it is governed by the laws of the state of New York or by the 1983 or 1993 Revision of the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication 400 or 500) [n1] or any successor Revision if approved by the superintendent, and contains a provision for an extension of time, of not less than thirty days after resumption of business, to draw against the letter of credit in the event that one or more of the occurrences described in Article 19 of Publication 400 or 500 occurs; and

(I) is issued by a bank, trust company, or savings and loan association that:

(i) is organized and existing under the laws of the United States or any state thereof or, in the case of a non-domestic financial institution, has a branch or agency office licensed under the laws of the United States or any state thereof and is domiciled in a member country of the Organisation for Economic Co-operation and Development having a sovereign rating in one of the top two generic lettered rating classifications by a securities rating agency acceptable to the superintendent;

(ii) has (or is the principal operating subsidiary of a financial institution holding company that has) a long-term debt rating of at least investment grade; and

(iii) is not a parent, subsidiary or affiliate of the trustee or paying agent, if any, with respect to the insured obligation if such trustee of paying agent is the named beneficiary of the letter of credit; or

(5) the amount of credit protection available to the insurer (or its nominee) under each credit default swap that:

(A) may not be amended without the consent of the insurer and may only be terminated: (i) at the option of the insurer; (ii) at the option of the counterparty to the insurer (or its nominee), if the credit default swap provides for the payment of a termination amount equal to the replacement cost of the terminated credit default swap determined with reference to standard documentation of the International Swap and Derivatives Association, Inc. or otherwise acceptable to the superintendent; or (iii) at the discretion of the superintendent acting as a rehabilitator, liquidator or receiver of the insurer upon payment by or on behalf of the insurer of any termination amount due from the insurer;

(B) provides for payment under all instances in which payment under a financial guaranty insurance policy is required, except that payment under the credit default swap may be on a first loss, excess of loss or other non-pro-rata basis and may apply on an aggregate basis to more than one policy;

(C) is provided by:

(i) a counterparty whose obligations under the credit default swap are insured by a financial guaranty insurance corporation licensed under this article or guaranteed by a financial institution referred to in items (ii) and (iii) of this subparagraph;

(ii) a financial institution satisfying the requirements of items (i) through (iii) of subparagraph (I) of paragraph four of this subsection; provided that (A) obligations of such financial institution on parity with its obligations under the credit default swap are investment grade and (B) if such financial institution is not organized under, or acting through a branch or agency office licensed under, the laws of the United States or any state thereof, then such financial institution is required to collateralize the replacement cost of the credit default swap in the event that it shall fail to maintain such rating; or

(iii) any other financial institution that the superintendent determines to be substantially similar to any of the foregoing.

Collateral must be deposited with the insurer; held in trust by a trustee or custodian acceptable to the superintendent for the benefit of the insurer; or held in trust pursuant to the bond indenture or other trust arrangement, for the benefit of security holders in the form of funds for the payment of insured obligations, sinking funds or other reserves which may be used for the payment of insured obligations and trustee and other administrative fees on a first priority basis established and continually maintained pursuant to the bond indenture or other trust arrangement by a trustee acceptable to the superintendent. The superintendent may promulgate regulations to limit the amount of collateral provided by obligations, letters of credit or credit default swaps or to limit the amount of collateral provided by any single issuer, bank or counterparty as provided for in this subsection.

(h) "Commercial real estate" means income producing real property other than residential property consisting of less than five units.

(i) (1) "Consumer debt obligations" guaranties means financial guaranty insurance that indemnifies a purchaser or lender against loss or damage resulting from defaults on a pool of debts owed for extensions of credit (including in respect of installment purchase agreements and leases) to individuals, provided in the normal course of the purchaser's or lender's business, provided that (A) such pool meets the requirements of paragraph two of subsection (e) of this section and (B) such pool has been determined to be investment grade.

(2) Consumer debt obligations guaranty policies shall contain a provision that all coverage under the policies terminates upon sale or transfer of the underlying consumer debt obligation to any transferee not insured by the same insurer under a similar policy.

(j) "Contingency reserve" means an additional liability reserve established to protect policyholders against the effects of adverse economic developments or cycles or other unforeseen circumstances.

(j-1) "Credit default swap" means an agreement referencing the credit derivative definitions published from time to time by the International Swap and Derivatives Association, Inc. or otherwise acceptable to the superintendent, pursuant to which a party agrees to compensate another party in the event of a payment default by, insolvency of, or other adverse credit event in respect of, an issuer of a specified security or other obligation; provided that such agreement does not constitute an insurance contract and the making of such credit default swap does not constitute the doing of an insurance business.

(k) "Governmental unit" means the United States of America, Canada, a member country of the Organisation for Economic Co-operation and Development having a sovereign rating in one of the top two generic lettered rating classifications by a securities rating agency acceptable to the superintendent, a state, territory or possession of the United States of America, the District of Columbia, a province of Canada, a municipality, or a political subdivision of any of the foregoing, or any public agency or instrumentality thereof.

(k-1) "Excess spread" means, with respect to any insured issue of asset-backed securities, the excess of (A) the scheduled cash flow on the underlying assets that is reasonably projected to be available, over the term of the insured securities after payment of the expenses associated with the insured issue, to make debt service payments on the insured securities over (B) the scheduled debt service requirements on the insured securities, provided that such excess is held in the same manner as collateral is required to be held under subsection (g) of this section.

(l) "Industrial development bond" means any security or other instrument, other than a utility first mortgage obligation, under which a payment obligation is created, issued by or on behalf of a governmental unit, to finance a project serving a private industrial, commercial or manufacturing purpose, and not payable or guarantied by a governmental unit.

(m) "Insurable risk" means, with respect to asset-backed securities, as defined in subsection (e) of this section, that such obligation on an uninsured basis has been determined to be not less than investment grade based solely on the pool of assets backing the insured obligation or securing the insurer, without consideration of the creditworthiness of the issuer.

(n) "Investment grade" means that:

(1) the obligation or parity obligation of the same issuer has been determined to be in one of the top four generic lettered rating classifications by a securities rating agency acceptable to the superintendent;

(2) the obligation or parity obligation of the same issuer has been identified in writing by such rating agency to be of investment grade quality; or

(3) if the obligation or parity obligation of the same issuer has not been submitted to any such rating agency, the obligation is determined to be investment grade (as indicated by a rating in category 1 or 2) by the Securities Valuation Office of the National Association of Insurance Commissioners.

(o) "Municipal bonds" means municipal obligation bonds and special revenue bonds.

(p) "Municipal obligation bond" means any security or other instrument, including a lease payable or guaranteed by the United States or another national government that qualifies as a governmental unit or any agency, department or instrumentality thereof, or by a state or an equivalent political subdivision of another national government that qualifies as a governmental unit, but not a lease of any other governmental unit, under which a payment obligation is created, issued by or on behalf of or payable or guaranteed by a governmental unit or issued by a special purpose corporation, special purpose trust or other special purpose legal entity to finance a project serving a substantial public purpose, and which is:

(1) (A) payable from tax revenues, but not tax allocations, within the jurisdiction of such governmental unit;

(B) payable or guaranteed by the United States or another national government that qualifies as a governmental unit, or any agency, department or instrumentality thereof, or by a housing agency of a state or an equivalent subdivision of another national government that qualifies as a governmental unit;

(C) payable from rates or charges (but not tolls) levied or collected in respect of a non-nuclear utility project, public transportation facility (other than an airport), or public higher education facility; or

(D) with respect to lease obligations, payable from future appropriations; and

(2) provided that, in the case of obligations of a special purpose corporation, special purpose trust or other special purpose legal entity, (A) such obligations are investment grade at the time of issuance; (B) such obligations are payable from sources enumerated in subparagraph (A), (B), (C) or (D) of paragraph one of this subsection; and (C) the project being financed or the tolls, tariffs, usage fees or other similar rates or charges for its use are subject to regulation or oversight by a governmental unit.

(q) "Reinsurance" means cessions qualifying for credit under section six thousand nine hundred six of this article.

(r) "Special revenue bond" means any security or other instrument, under which a payment obligation is created, issued by or on behalf of or payable or guaranteed by a governmental unit to finance a project serving a substantial public purpose, and not payable from any of the sources enumerated in subsection (p) of this section; or securities which are the functional equivalent of the foregoing issued by a not-for-profit corporation or a special purpose corporation, special purpose trust or other special purpose legal entity; provided that, in the case of obligations of a special purpose corporation, special purpose trust or other special purpose legal entity, (1) such obligations are investment grade at the time of issuance; (2) such obligations are not payable from the sources enumerated in subparagraph (A), (B), (C) or (D) of paragraph one of subsection (p) of this section; and (3) the project being financed or the tolls, tariffs, usage fees or other similar rates or charges for its use are subject to regulation or oversight by a governmental unit.

(s) "Utility first mortgage obligation" means any obligation of an issuer secured by a first priority mortgage on utility property owned by or leased to an investor-owned or cooperative-owned utility company and located in the United States, Canada or a member country of the Organisation for Economic Co-operation and Development having a sovereign rating in one of the top two generic lettered rating classifications by a securities rating agency acceptable to the superintendent; provided that the utility or utility property or the usage fees or other similar utility rates or charges are subject to regulation or oversight by a governmental unit.

§ 6902. Organization; financial requirements

(a) A financial guaranty insurance corporation may be organized and licensed in the manner prescribed in section one thousand two hundred one of this chapter and a foreign insurer may be licensed in the manner

prescribed in section one thousand one hundred six of this chapter, except as modified by the following provisions:

(1) a corporation organized for the purpose of transacting financial guaranty insurance may, subject to all the applicable provisions of this chapter, be licensed to transact only the following additional kinds of insurance:

(A) residual value insurance, as defined in paragraph twenty-two of subsection (a) of section one thousand one hundred thirteen of this chapter;

(B) surety insurance, as defined in subparagraphs (C), (D), (E), (F), (G), (H) and (I) of paragraph sixteen of subsection (a) of section one thousand one hundred thirteen of this chapter; and

(C) credit insurance, as defined in subparagraph (A) of paragraph seventeen of subsection (a) of section one thousand one hundred thirteen of this chapter;

(2) a financial guaranty insurance corporation may only assume those kinds of insurance for which it is licensed to write direct business;

(3) prior to the issuance of a license, unless a plan of operation has been previously approved by the superintendent, a corporation shall submit for the approval of the superintendent a plan of operation, detailing the types and projected diversification of guaranties that will be issued, the underwriting procedures that will be followed, managerial oversight methods, investment policies, and such other matters as may be prescribed by the superintendent; and

(4) a financial guaranty insurance corporation's investments in any one entity insured by that corporation shall not exceed four percent of its admitted assets at last year-end, except that this limit shall not apply to investments payable or guaranteed by a United States governmental unit or New York state if such investments payable or guaranteed by the United States governmental unit or New York state shall be rated in one of the top two generic lettered rating classifications by a securities rating agency acceptable to the superintendent.

(5) in addition to any transaction that an insurer meeting the requirements of subsection (c) of section one thousand four hundred three of this chapter may effect and maintain under any other provision of this chapter, a financial guaranty insurance corporation may effect and maintain transactions in (A) contracts for the future delivery or receipt of the currency of a foreign country, (B) interest rate options, (C) credit default swaps under which the insurer is acquiring credit protection and (D) other products included in the plan referred to in clause (vii) of this subparagraph, in each case meeting the following requirements:

(i) the transaction is used for the purpose of limiting risk of loss under financial guaranty insurance policies or reinsurance contracts covering such policies due to fluctuations in interest rates or currency exchange rates or, in the case of credit default swaps, financial default, insolvency or other credit events;

(ii) the transaction shall not exceed a duration of twelve months beyond the term of such policies or reinsurance contracts;

(iii) the amount of foreign currencies to be purchased under the transaction shall not exceed the amount guaranteed under such policies or reinsurance contracts that is denominated in foreign currency;

(iv) the amount that is subject to interest rate hedging transactions does not exceed the amount guaranteed under such policies or reinsurance contracts that is subject to the risk of interest rate fluctuations;

(v) the counterparty to such transaction has (or is the principal operating subsidiary of a holding company that has) a long term unsecured debt rating or claims-paying ability rating that is at least investment grade;

(vi) the transaction is not conducted for arbitrage purposes; and

(vii) the transaction is entered into pursuant to a plan that has been approved by the board of directors of the financial guaranty insurance corporation and filed with and approved by the superintendent.

(b) (1) A financial guaranty insurance corporation shall not transact business unless it has paid-in capital of at least two million five hundred thousand dollars and paid-in surplus of at least seventy-two million five hundred thousand dollars, and shall at all times thereafter maintain a minimum surplus to policyholders of at least sixty-five million dollars.

(2) An insurer transacting only financial guaranty insurance prior to the effective date of this article which has a paid-in capital of at least two million five hundred thousand dollars and maintains surplus to policy-

holders of at least forty-five million dollars shall have thirty-six months from the effective date of this article to fully comply with the surplus requirements set forth in paragraph one of this subsection.

(3) A financial guaranty insurance company shall be deemed to be in compliance with paragraphs one and two of subsection (b) of section one thousand four hundred two of this chapter if not less than sixty percent of the amount of the required minimum capital or minimum surplus to policyholder investments shall consist of the types specified in paragraphs one and two of subsection (b) of section one thousand four hundred two of this chapter and direct government obligations of any state of the United States or of any county, district or municipality thereof, provided such government obligations have been given the highest quality designation of the Securities Valuation Office of the National Association of Insurance Commissioners. Before investing any part of the required minimum capital or surplus in direct government obligations of any other state of the United States or of any county, district or municipality thereof, such financial guaranty insurance company shall have invested at least ten percent of such required minimum in government obligations of New York state or of any county, district or municipality thereof. Only for purposes of meeting the required investment in government obligations of New York state, the insurer may count investments in any government obligation of New York state, whether direct or otherwise.

§ 6903. Contingency, loss and unearned premium reserves

(a) Contingency reserves.

(1) A corporation shall establish and maintain contingency reserves for the protection of insureds and claimants against the effects of excessive losses occurring during adverse economic cycles.

(2) With respect to all financial guaranties written prior to and in force as of the first day of the next calendar quarter commencing after the date that the act enacting this article shall become law:

(A) the insurer shall establish and maintain a contingency reserve consistent with the requirements applicable for municipal bond guaranties in effect prior to the effective date of this article equal to fifty percent of earned premiums on such policies; and

(B) to the extent that the insurer's contingency reserves maintained as of the first day of the next calendar quarter commencing after the date that the act enacting this article shall become law are less than those required for municipal bond guaranties, the insurer shall have three years from such date to bring its contingency reserves into compliance.

(3) With respect to financial guaranties of municipal obligation bonds, special revenue bonds, industrial development bonds and utility first mortgage obligations written on and after the first day of the next calendar quarter commencing after the date that the act enacting this article shall become law:

(A) the insurer shall establish and maintain a contingency reserve for all such insured issues in each calendar year for each category listed in subparagraph (B) of this paragraph;

(B) the total contingency reserve required shall be the greater of fifty percent of premiums written for each such category or the following amount prescribed for each such category:

(i) municipal obligation bonds, 0.55 percent of principal guarantied;

(ii) special revenue bonds, and obligations demonstrated to the satisfaction of the superintendent to be the functional equivalent thereof, 0.85 percent of principal guarantied;

(iii) investment grade industrial development bonds, secured by collateral or having a term of seven years or less, and utility first mortgage obligations, 1.0 percent of principal guarantied;

(iv) other investment grade industrial development bonds, 1.5 percent of principal guarantied; and

(v) all other industrial development bonds, 2.5 percent of principal guarantied; and

(C) Contributions to the contingency reserve required by this paragraph, equal to one-eightieth of the total reserve required, shall be made each quarter for twenty years, provided, however, that contributions may be discontinued so long as the total reserve for all categories listed in items (i) through (v) of subparagraph (B) of this paragraph exceeds the percentages contained in such items (i) through (v) when applied against unpaid principal.

(4) With respect to all other financial guaranties written on or after the first day of the next calendar quarter commencing after the date that the act enacting this article shall become law:

(A) the insurer shall establish and maintain a contingency reserve for all such insured issues in each calendar year for each such category listed in subparagraph (B) of this paragraph;

(B) the total contingency reserve required shall be the greater of fifty percent of premiums written for each such category or the following amount prescribed for each such category:

(i) investment grade obligations, secured by collateral or having a term of seven years or less, 1.0 percent of principal guarantied;

(ii) other investment grade obligations, 1.5 percent of principal guarantied;

(iii) non-investment grade consumer debt obligations, 2.0 percent of principal guarantied;

(iv) non-investment grade asset-backed securities, 2.0 percent of principal guarantied;

(v) other non-investment grade obligations, 2.5 percent of principal guarantied; and

(C) Contributions to the contingency reserve required by this paragraph, equal to one-sixtieth of the total reserve required, shall be made each quarter for fifteen years, provided, however, that contributions may be discontinued so long as the total reserve for all categories listed in items (i) through (v) of subparagraph (B) of this paragraph exceeds the percentages contained in such items (i) through (v) when applied against unpaid principal.

(5) Contingency reserves required in paragraphs two, three and four of this subsection may be established and maintained net of collateral and reinsurance, provided that, in the case of reinsurance, the reinsurance agreement requires that the reinsurer shall, on or after the effective date of the reinsurance, establish and maintain a reserve in an amount equal to the amount by which the insurer reduces its contingency reserve, and contingency reserves required in paragraphs three and four of this subsection may be maintained (A) net of refundings and refinancings to the extent the refunded or refinanced issue is paid off or secured by obligations which are directly payable or guarantied by the United States government and (B) net of insured securities in a unit investment trust or mutual fund that have been sold from the trust or fund without insurance.

(6) The contingency reserves may be released thereafter in the same manner in which they were established and withdrawals therefrom, to the extent of any excess, may be made from the earliest contributions to such reserves remaining therein:

(A) with the prior written approval of the superintendent:

(i) if the actual incurred losses for the year, in the case of the categories of guaranties subject to paragraph three of this subsection exceeds thirty-five percent of earned premiums, or in the case of the categories of guaranties subject to paragraph four of this subsection exceed sixty-five percent of earned premiums; or

(ii) if the contingency reserve applicable to the categories of guaranties subject to paragraph three of this subsection has been in existence for less than forty quarters, or for less than thirty quarters for the categories of guaranties subject to paragraph four of this subsection, upon a demonstration satisfactory to the superintendent that the amount carried is excessive in relation to the insurer's outstanding obligations under its financial guaranties.

(B) upon thirty days prior written notice to the superintendent, provided that the contingency reserve applicable to the categories of guaranties subject to paragraph three of this subsection has been in existence for forty quarters, or thirty quarters for categories of guaranties subject to paragraph four of this subsection, upon a demonstration satisfactory to the superintendent that the amount carried is excessive in relation to the insurer's outstanding obligations under its financial guaranties.

(7) An insurer providing financial guaranty insurance may invest the contingency reserve in tax and loss bonds (or similar securities) purchased pursuant to *section 832(e) of the Internal Revenue Code* (or any successor provision), only to the extent of the tax savings resulting from the deduction for federal income tax purposes of a sum equal to the annual contributions to the contingency reserve. The contingency reserve shall otherwise be invested only in classes of securities or types of investments specified in paragraphs one through three of subsection (b) of section one thousand four hundred two of this chapter and paragraphs one through three of subsection (a) of section one thousand four hundred four of this chapter.

(b) Loss reserves.

(1) The case basis method or such other method as may be prescribed by the superintendent shall be used to establish and maintain loss reserves, net of collateral, for claims reported and unpaid, in a manner

consistent with section four thousand one hundred seventeen of this chapter. A deduction from loss reserves shall be allowed for the time value of money by application of a discount rate equal to the average rate of return on the admitted assets of the insurer as of the date of the computation of any such reserves. The discount rate shall be adjusted at the end of each calendar year.

(2) If the insured principal and interest on a defaulted issue of obligations due and payable during any three years following the date of default exceeds ten percent of the insurer's surplus to policyholders and contingency reserves, its reserve so established shall be supported by a report from an independent source acceptable to the superintendent.

(c) Unearned premium reserve. An unearned premium reserve shall be established and maintained net of reinsurance and collateral with respect to all financial guaranty premiums. Where financial guaranty insurance premiums are paid on an installment basis, an unearned premium reserve shall be established and maintained, net of reinsurance and collateral, computed on a daily or monthly pro rata basis. All other financial guaranty insurance premiums written shall be earned in proportion with the expiration of exposure, or by such other method as may be prescribed by the superintendent.

§ 6904. Limitations

(a) Financial guaranty insurance may be transacted in this state only by a corporation licensed for such purpose pursuant to section six thousand nine hundred two of this article.

(b) Permissible guarantees.

(1) The superintendent shall not permit the writing of financial guaranty insurance except as defined in subparagraph (A) of paragraph one of subsection (a) of section six thousand nine hundred one of this article, and a corporation may insure the timely payment of United States dollar debt instruments, or other monetary obligations, only in the following categories:

(A) municipal obligation bonds;

(B) special revenue bonds;

(C) industrial development bonds;

(D) obligations of corporations, trusts or other similar entities established under applicable law;

(E) partnership obligations;

(F) asset-backed securities, trust certificates and trust obligations other than mortgage-backed securities secured by first mortgages on real property which are insurable by a mortgage guaranty insurer authorized under paragraph twenty-three of subsection (a) of section one thousand one hundred thirteen of this chapter, unless:

(i) such mortgages with loan-to-value ratios in excess of eighty percent are:

(I) in the case of mortgages on property located in the state of New York, insured by mortgage guaranty insurers authorized under paragraph twenty-three of subsection (a) of section one thousand one hundred thirteen of this chapter;

(II) in the case of mortgages on property located in a state other than the state of New York, insured by mortgage guaranty insurers authorized to do business in such other state; or

(III) in an aggregate principal amount less than the single risk limits prescribed in paragraph five of subsection (d) of this section; or

(ii) additional mortgages with principal balances, other collateral with a market value, or (provided the insured risk is investment grade) excess spread in an amount, in each instance at least equal to the coverage that would otherwise be provided by such mortgage guaranty insurers in accordance with item (i) of this subparagraph are pledged as additional security for the asset-backed securities;

(G) installment purchase agreements executed as a condition of sale;

(H) consumer debt obligations;

(I) utility first mortgage obligations; and

(J) any other debt instrument or financial obligation that the superintendent determines to be substantially similar to any of the foregoing or shall otherwise be approved by the superintendent.

(2) An insurer may insure obligations enumerated in subparagraphs (A), (B), and (C) of paragraph one of this subsection that are not investment grade so long as at least ninety-five percent of the insurer's aggregate net liability on the kinds of obligations enumerated in subparagraphs (A), (B) and (C) of paragraph one of this subsection shall be investment grade.

(3) A corporation may insure the timely payment of monetary obligations in any category designated in this subsection notwithstanding that such obligation may be insured by a financial guaranty insurance policy issued by another insurer. In the event that any obligation is insured by more than one financial guaranty insurance policy, then each such insurance policy may by its terms specify its priority of payment in the event of a default under the obligation insured or any other insurance policy; provided that an insurer shall be entitled to take into account payment under another policy insuring such obligation for purposes of establishing and maintaining loss reserves only to the extent that the policy issued by such insurer provides for payment only in the event of payment default under both such obligation and the other policy.

(4) A corporation may also write financial guaranty insurance as defined in subparagraph (A) of paragraph one of subsection (a) of section six thousand nine hundred one of this article to insure the timely payment of non-United States dollar debt instruments or other monetary obligations denominated or payable in foreign currency, only for the categories listed in subparagraphs (A) through (J) of paragraph one of this subsection, provided that:

(A) such currency is that of an Organisation for Economic Co-operation and Development country or such other country (i) whose sovereign rating is investment grade or (ii) as shall not otherwise be disapproved by the superintendent within thirty days following receipt of written notification. The superintendent shall not disapprove such notification upon demonstration that there is no undue risk associated with insuring the timely payment of such instruments or obligations. In making such a determination the superintendent shall take into consideration the corporation's outstanding liabilities on non-investment grade instruments and obligations in relation to its outstanding liabilities on all instruments and obligations and in relation to the amount of its surplus to policyholders;

(B) reserves required pursuant to section six thousand nine hundred three of this article in regard to such obligations shall be established and adjusted quarterly based upon the then current foreign exchange rates;

(C) such obligations shall not exceed twenty-five percent of an insurer's aggregate net liability; and

(D) the aggregate and single risk limitations prescribed by subsections (c) and (d) of this section shall be determined by applying the then current foreign exchange rates.

(c) Aggregate risk limits. The corporation must at all times maintain surplus to policyholders and contingency reserves in the aggregate no less than the sum of:

(1) (A) 0.3333 percent or 1/300th of the aggregate net liability under guaranties of municipal bonds including obligations demonstrated to the satisfaction of the superintendent to be the functional equivalent thereof and investment grade utility first mortgage obligations; plus

(B) 0.6666 percent or 1/150th of the aggregate net liability under guaranties of investment grade asset-backed securities; plus

(C) 1.0 percent or 1/100th of the aggregate net liability under guaranties, secured by collateral or having a term of seven years or less, of:

(i) investment grade industrial development bonds,

(ii) other investment grade obligations; plus

(D) 1.5 percent or 1/66.67th of the aggregate net liability under guaranties of other investment grade obligations; plus

(E) 2.0 percent or 1/50th of the aggregate net liability under guaranties of:

(i) non-investment grade consumer debt obligations, and

(ii) non-investment grade asset-backed securities; plus

(F) 2.5 percent or 1/40th of the aggregate net liability under guaranties of non-investment grade obligations secured by first mortgages on commercial real estate and having loan-to-value ratios of eighty percent or less; plus

(G) 4.0 percent or 1/25th of the aggregate net liability under guaranties of other non-investment grade obligations; and

(H) if the amount of collateral required by subparagraph (C) of this paragraph is no longer maintained, that proportion of the obligation insured which is not so collateralized shall be subject to the aggregate limits specified in subparagraph (D) of this paragraph; and

(2) surplus to policyholders determined by the superintendent to be adequate to support the writing of residual value insurance, surety insurance and credit insurance, if the corporation has elected to transact such kinds of insurance pursuant to subsection (a) of section six thousand nine hundred two of this article.

(d) Single risk limits. A financial guaranty insurance corporation shall limit its exposure to loss on any one risk insured by policies providing financial guaranty insurance, net of collateral and reinsurance, as follows:

(1) for municipal obligation bonds, special revenue bonds, and obligations demonstrated to the satisfaction of the superintendent to be the functional equivalent thereof:
(A) the insured average annual debt service with respect to a single entity and backed by a single revenue source shall not exceed ten percent of the aggregate of the insurer's surplus to policyholders and contingency reserve; and
(B) the insured unpaid principal issued by a single entity and backed by a single revenue source shall not exceed seventy-five percent of the aggregate of the insurer's surplus to policyholders and contingency reserve;

(2) for each issue of asset-backed securities issued by a single entity and for each pool of consumer debt obligations, the lesser of:
(A) insured average annual debt service; or
(B) insured unpaid principal (reduced by the extent to which the unpaid principal of the supporting assets and, provided the insured risk is investment grade, excess spread exceed the insured unpaid principal) divided by nine;

shall not exceed ten percent of the aggregate of the insurer's surplus to policyholders and contingency reserve, provided that no asset in the pool supporting the asset-backed securities exceeds the single risk limits prescribed in paragraph five of this subsection, if directly guaranteed; and provided further that, if the issuer of such insured asset-backed securities is a special purpose corporation, trust or other entity and such issuer shall have indebtedness outstanding with respect to any other pool of assets, either such other indebtedness shall be entitled to the benefits of a financial guaranty policy of the same insurer, or such other indebtedness shall: (i) be fully subordinated to the insured obligation, with respect to, or be non-recourse with respect to, the pool of assets that supports the insured obligation, (ii) be non-recourse to the issuer other than with respect to the asset pool securing such other indebtedness and proceeds in excess of the proceeds necessary to pay the insured obligation ("excess proceeds") and (iii) not constitute a claim against the issuer to the extent that the asset pool securing such other indebtedness or excess proceeds are insufficient to pay such other indebtedness;

(3) for obligations issued by a single entity and secured by commercial real estate, and not meeting the definition of asset-backed securities, the insured unpaid principal less fifty percent of the appraised value of the underlying real estate shall not exceed ten percent of the aggregate of the insurer's surplus to policyholders and contingency reserve;

(4) for utility first mortgage obligations, the insured average annual debt service shall not exceed ten percent of the aggregate of the insurer's surplus to policyholders and contingency reserve; and

(5) for all other policies providing financial guaranty insurance with respect to obligations issued by a single entity and backed by a single revenue source, the insured unpaid principal shall not exceed ten percent of the aggregate of the insurer's surplus to policyholders and contingency reserve.

(e) Except as provided in subsection (f) of this section, if an insurer at any time exceeds any limitation prescribed by subsection (c) or (d) of this section or the last sentence of paragraph one of subsection (b) of this section, the insurer shall within thirty days after the limitations are breached, submit a written plan to the superintendent detailing the steps that it will take or has taken to reduce its exposure to loss to no more than the permitted amounts, and if after notice and hearing the superintendent determines that an insurer has exceeded any limitation prescribed by this section, he may order such insurer to cease transacting any new financial guaranty insurance business until its exposure to loss no longer exceeds said limitations or with re-

spect to the limitations prescribed in the last sentence of paragraph one of subsection (b) of this section, may order such insurer to limit its writing of the types of guaranties permitted under subparagraphs (A), (B) and (C) of paragraph one of subsection (b) of this section to investment grade obligations until such time as it shall be in compliance with such limitations.

(f) An insurer shall not be deemed in violation of any limitation prescribed by subsection (d) of this section with respect to any financial guaranty insurance outstanding prior to the effective date of this article, if the insurer was in compliance with the applicable single risk limit in effect in this state at the time that the financial guaranty insurance policy was issued. If the insurer was not so in compliance, such financial guaranty insurance shall comply with the limitations prescribed by subsection (d) of this section no later than three years after the effective date of this article.

(g) No insurer authorized to transact the business of financial guaranty insurance shall pay any commission or make any gift of money, property or other valuable thing to any employee, agent or representative of any potential purchaser of a financial guaranty insurance policy, as an inducement to the purchase of such a policy, and no such employee, agent or representative of such potential purchaser shall receive any such payment or gift. Violation of the provisions of this section shall not, however, have the effect of rendering void the insurance policy issued by the insurer.

§ 6905. Policy forms and rates

(a) Policy forms and any amendments thereto shall be filed with the superintendent within thirty days of their use by the insurer if not otherwise filed prior to the effective date of this article. Every such policy shall provide that, in the event of a payment default by or insolvency of the obligor, there shall be no acceleration of the payment required to be made under such policy unless such acceleration is at the sole option of the corporation; provided that (1) policies may insure amounts payable under a credit default swap or interest rate, currency or other swap upon a credit event or termination event if the expected amount payable on an accelerated basis in respect of any individual obligation referenced by a credit default swap or in the aggregate under an interest rate, currency or other swap does not exceed the single risk limits prescribed in paragraph five of subsection (d) of section six thousand nine hundred four of this article and (2) policies insuring credit default swaps referencing an obligation shall be treated as if the insurer had directly insured the referenced obligation for all other purposes of this article, except that the currency of amounts owed under the credit default swap, rather than the currency of the obligations referenced by the credit default swap, shall apply for purposes of determining whether the obligation is a permissible guaranty under subsection (b) of section six thousand nine hundred four of this article. The superintendent may prescribe minimum policy provisions determined by the superintendent to be necessary or appropriate to protect policyholders, claimants, obligees or indemnitees.

(b) Rates shall not be excessive, inadequate, unfairly discriminatory, destructive of competition, detrimental to the solvency of the insurer, or otherwise unreasonable. In determining whether rates comply with the foregoing standards, the superintendent shall include all income earned by such insurer. Criteria and guidelines utilized by insurers in establishing rating categories and ranges of rates to be utilized shall be filed with the superintendent for information prior to their use by the insurer if not otherwise filed prior to the effective date of this article.

(c) All such filings shall be available for public inspection at the insurance department.

§ 6906. Reinsurance

(a) For financial guaranty insurance that takes effect on or after the effective date of this article, an insurer authorized to transact financial guaranty insurance shall receive credit for reinsurance, in accordance with the provisions of this chapter applicable to property/casualty insurers, as an asset or as a reduction from liabilities provided that such reinsurance is subject to an agreement that, for its stated term and with respect to

any such reinsured financial guaranty insurance in force, the reinsurance agreement (facultative or treaty) may only be terminated or amended (i) at the option of the reinsurer or the ceding insurer, if the reinsurance agreement provides that the liability of the reinsurer with respect to policies in effect at the date of termination shall continue until the expiration or cancellation of each such policy, or (ii) with the consent of the ceding company, if the reinsurance agreement provides for a cutoff of the reinsurance in force at the date of termination, or (iii) at the discretion of the superintendent acting as rehabilitator, liquidator or receiver of the ceding or assuming insurer; and provided that such reinsurance is:

(1) placed with a financial guaranty insurance corporation licensed under this article or an insurer writing only financial guaranty insurance as is or would be permitted by this article; or

(2) placed with a property/casualty insurer or an accredited reinsurer licensed or accredited to reinsure risks of every kind or description (including municipal obligation bonds), as set forth in subsection (c) of section four thousand one hundred two of this chapter, if the reinsurance agreement with such insurer requires that such insurer:

(A) have and maintain surplus to policyholders of at least thirty-five million dollars;

(B) establish and maintain the reserves required in section six thousand nine hundred three of this article, except that if the reinsurance agreement is not pro rata the contribution to the contingency reserve shall be equal to fifty percent of the quarterly earned reinsurance premium. However, the assuming insurer need not establish and maintain such reserve to the extent that the ceding insurer has established and continues to maintain such reserve;

(C) comply with the provisions of subsection (c) of section six thousand nine hundred four of this article, except that the maximum total exposures reinsured net of retrocessions and collateral shall be one-half of that permitted for a financial guaranty insurance corporation;

(D) if a parent of the insurer, another subsidiary of the parent of the insurer, or a subsidiary of the insurer, then the aggregate of all risks assumed by such reinsurers shall not exceed ten percent of the insurer's exposures, net of retrocessions and collateral. Direct or indirect ownership interests of fifty percent or more shall be deemed a parent/subsidiary relationship;

(E) if an affiliate of the insurer, such affiliate shall not assume a percentage of the insurer's total exposures insured net of retrocessions and collateral in excess of its percentage of equity interest in the insurer; and

(F) assumes from the financial guaranty insurer and any affiliate,parent of the insurer, another subsidiary of the parent of the insurer, or subsidiary of the insurer that is a financial guaranty insurance corporation or an insurer writing only financial guaranty insurance as is or would be permitted by this article and such other kinds of insurance that a financial guaranty insurance corporation may write in this state, together with all other reinsurers subject to this paragraph, less than fifty percent of the total exposures insured by the financial guaranty insurer and such affiliates, parents or subsidiaries of the insurer, net of collateral, remaining after deducting any reinsurance placed with another financial guaranty insurance corporation that is not an affiliate, a parent of the financial guaranty insurer, another subsidiary of the parent of the insurer, or a subsidiary of the insurer or a financial guaranty insurer writing only financial guaranty insurance as is or would be permitted by this article that is not an affiliate, a parent of the financial guaranty insurer, another subsidiary of the parent of the insurer, or a subsidiary of the insurer; or

(3) if placed with an unauthorized or unaccredited reinsurer which otherwise meets the requirements of either the opening paragraph of this subsection and paragraph one of this subsection, or the opening paragraph of this subsection and subparagraphs (A), (D), (E) and (F) of paragraph two of this subsection, in an amount not exceeding the liabilities carried by the ceding insurer for amounts withheld under a reinsurance treaty with such reinsurer or amounts deposited by such reinsurer as security for the payment of obligations under the treaty if such funds or deposit are held subject to withdrawal by, and under the control of, the ceding insurer.

(b) In determining whether the insurer meets the aggregate risk limitations, in addition to credit for other types of qualifying reinsurance, the insurer's aggregate risk may be reduced to the extent of the limit for aggregate excess reinsurance, but in no event in an amount greater than the amount of the aggregate risks which will become due during the unexpired term of such reinsurance agreement in excess of the insurer's retention pursuant to such reinsurance agreement.

§ 6907. Transition provisions

A licensed insurer writing financial guaranty insurance prior to the effective date of this article, but which is not authorized to write financial guaranty insurance in this state, shall be subject to all the provisions of this article, except section six thousand nine hundred two of this article, and:

(a) may, unless the superintendent determines after notice and an opportunity to be heard that such activity poses a hazard to the insurer, its policyholders or to the public, continue to write financial guaranties (except guaranties of municipal bonds) of the types authorized by subsection (b) of section six thousand nine hundred four of this article applicable to financial guaranty insurance corporations, subject to the following conditions:

(1) For a transition period not to exceed sixty months from the effective date of this article, if the insurer has and maintains surplus to policyholders of at least seventy-five million dollars (for the purpose of this paragraph, if the insurer is a foreign insurer, its surplus to policyholders shall be computed as if it were a domestic insurer); provided that:

(A) during the sixty month transition period, the amount of surplus to policyholders needed to meet the single and aggregate risk limitations imposed by this article must be less than four percent of the insurer's surplus to policyholders;

(B) within nine months of the effective date of this article, the insurer shall file a reasonable plan of operation, acceptable to the superintendent, which shall contain:

(i) a reasonable timetable and appropriate procedures to implement that timetable to make a determination as to whether or not the insurer will make application to organize a financial guaranty insurance corporation during the aforesaid sixty month period;

(ii) the types and projected diversification of guaranties that will be issued during the transition period;

(iii) the underwriting procedures that will be followed;

(iv) oversight methods;

(v) investment policies; and

(vi) such other matters as may be prescribed by the superintendent.

The plan of operation shall be deemed acceptable unless, within sixty days of its filing, the superintendent notifies the insurer of any specific objections to such plan. The plan shall be updated in the event of a material change with respect to the foregoing and at least annually;

(C) if the insurer has determined that it will not organize a financial guaranty insurance corporation, within thirty days after that determination it shall notify the superintendent, cease writing policies of financial guaranty insurance and comply with the provisions of paragraph four of this subsection; and

(D) the insurer shall file such additional statements or reports as may be required by the superintendent.

(2) For a transition period not to exceed ninety-six months from the effective date of this article, if the insurer has and maintains surplus to policyholders of at least one hundred fifty million dollars (for the purpose of this section, surplus to policyholders means the aggregate surplus to policyholders of said insurer and other member companies of an inter-company pool, and if the insurer is a foreign insurer its surplus to policyholders shall be computed as if it were a domestic insurer) and the aggregate financial guaranty written premium of said insurer and other member companies of an inter-company pool shall have been at least one million dollars in any one of the five years ending December thirty-first, nineteen hundred eighty-eight, provided that:

(A) during the first sixty months of the transition period, the amount of surplus to policyholders needed to meet the aggregate risk limitations imposed by this article must be less than four percent of the insurer's surplus to policyholders. After such sixty month period, provided the insurer complies with subparagraph (D) of this paragraph, the amount of surplus to policyholders needed to meet such aggregate risk limitations must be less than five percent of the insurer's surplus to policyholders for the succeeding twelve month period and less than six percent for the next succeeding twenty-four month period;

(B) during the transition period, the amount of surplus to policyholders needed to meet the single risk limitations imposed by paragraphs two through five of subsection (d) of section six thousand nine hundred four of this article must be less than twenty percent of the insurer's surplus to policyholders, except that the

single risk limitation with respect to investment grade obligations under such paragraph five shall be the lesser of eighty million dollars or seven percent of the insurer's surplus to policyholders;

(C) during the transition period, notwithstanding the last sentence of paragraph one of subsection (b) of section six thousand nine hundred four, industrial development bonds shall not be included in the investment grade requirements set forth in such sentence.

(D) during the transition period, reinsurance in the form of intercompany pooling agreements, shall not be subject to subparagraphs (C), (D), (E) and (F) of paragraph two of subsection (a) of section six thousand nine hundred six of this article, if such intercompany pooling agreements were in effect on January first, nineteen hundred eighty-nine, and reinsurance placed with insurers which are subject to the provisions of paragraph two of subsection (a) of section six thousand nine hundred six and are not members of the ceding company's intercompany pooling agreement may not exceed sixty percent of the total exposures insured net of collateral remaining after deducting any reinsurance placed with another financial guaranty insurance corporation or an insurer writing only financial guaranty insurance as is or would be permitted by this article;

(E) within sixty months of the effective date of this article, the insurer shall file a reasonable plan of operation, acceptable to the superintendent, which shall contain:

(i) a reasonable timetable and appropriate procedures to implement that timetable to make a determination as to whether or not the insurer will make application to organize a financial guaranty insurance corporation during the aforesaid ninety-six month period;

(ii) the types and projected diversification of guaranties that will be issued during the transition period;

(iii) the underwriting procedures that will be followed;

(iv) oversight methods;

(v) investment policies; and

(vi) such other matters as may be prescribed by the superintendent.

The plan of operation shall be deemed acceptable unless, within sixty days of its filing, the superintendent notifies the insurer of any specific objections to such plan. The plan shall be updated in the event of a material change with respect to the foregoing and at least annually;

(F) if the insurer has determined that it will not organize a financial guaranty insurance corporation, within thirty days after that determination it shall notify the superintendent, cease writing policies of financial guaranty insurance and comply with the provisions of paragraph four of this subsection; and

(G) the insurer shall file such additional statements or reports as may be required by the superintendent.

(3) For a transition period not to exceed twelve months from the effective date of this article, in the case of an insurer transacting only financial guaranty insurance prior to the effective date of this article and which qualifies for licensing as a financial guaranty insurance corporation under section six thousand nine hundred two of this article, provided that it makes application to amend its current license to that of a financial guaranty insurance corporation licensed to transact only those kinds of insurance permitted pursuant to section six thousand nine hundred two of this article within sixty days of the effective date of this article, and provided that, for purposes of this paragraph, an insurer shall be deemed to be transacting only financial guaranty insurance prior to the effective date of this article if, with the approval of the superintendent, it has reinsured all of any other insurance liabilities with one or more authorized insurers or has otherwise made provision for such liabilities.

(4) For a transition period not to exceed nine months, in the case of an insurer that does not qualify under either paragraph one, two or three of this subsection or does not file a plan of operation pursuant to paragraph one or two of this subsection, such insurer shall cease writing any new financial guaranty insurance business and may:

(A) reinsure its net in force business with a licensed financial guaranty insurance corporation; or

(B) subject to the prior approval of its domiciliary commissioner, reinsure all or part of its net in force business in accordance with the requirements of paragraph two of subsection (a) of section six thousand nine hundred six of this article, except that subparagraphs (D), (E) and (F) of paragraph two of such subsection shall not be applicable. The assuming insurer shall maintain reserves of such reinsured business in the manner applicable to the ceding insurer under this paragraph; or

(C) thereafter continue the risks then in force and, with thirty days prior written notice to its domiciliary commissioner, issue new financial guaranty policies, provided that the issuing of such policies is reasonably prudent to mitigate either the amount of or possibility of loss in connection with business transacted prior to the effective date of this article. Provided, however, an insurer must receive the prior approval of its domicili-

ary commissioner before issuing any new financial guaranty insurance policies that would have the effect of increasing its risk of loss;

(b) shall, for all guaranties in force prior to the effective date of this article, including those which fall under the definition of financial guaranty insurance contained in subsection (a) of section six thousand nine hundred one of this article, be subject to the reserve requirements applicable for municipal bond guaranties in effect prior to the effective date of this article. To the extent that the insurer's contingency reserves maintained as of the effective date of this article are less than those required for municipal bond guaranties, the insurer shall have three years to bring its reserves into compliance, except that a part of the reserve may be released proportional to the reduction in aggregate net liability resulting from reinsurance, provided that the reinsurer shall, on the effective date of the reinsurance, establish a reserve in an amount equal to the amount released and, in addition, a part of the reserve may be released with the approval of the superintendent upon demonstration that the amount carried is excessive in relation to the corporation's outstanding obligations; and

(c) shall be subject to the reserve requirements specified in section six thousand nine hundred three of this article for all policies of financial guaranty insurance issued on or after the effective date of this article.

§ 6908. Applicability of other laws

An insurer issuing policies of financial guaranty insurance shall be subject to all of the provisions of this chapter applicable to property/casualty insurers to the extent that such provisions are not inconsistent with the provisions of this article.

§ 6909. Relationship to security fund

No insurer or agent of an insurer may deliver a policy of financial guaranty insurance unless such policy and any prospectus delivered on or after the effective date of this article with respect to the insured obligations clearly discloses that the policy is not covered by the property/casualty insurance security fund specified in article seventy-six of this chapter.

PAUL E. KANJORSKI
11TH DISTRICT, PENNSYLVANIA

COMMITTEE ON
FINANCIAL SERVICES

CHAIRMAN:
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

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January 23, 2008

The Honorable Sean Dilweg
Wisconsin Commissioner of Insurance
Office of the Commissioner of Insurance
GEF-III, Second Floor
125 South Webster Street
Madison, WI 53702

Dear Mr. Dilweg:

In recent weeks, many participants in our financial services sector have raised concerns about the ongoing viability of a number of bond insurers and the implications of their actual or potential ratings downgrades for all participants in the financial marketplace. The House Financial Services Capital Markets Subcommittee has therefore started an examination of these important matters, and I write to request your assistance in these efforts.

Specifically, an article in the *Washington Post* on January 18 noted that "[i]nvestors are growing especially concerned about the fate of bond insurers, which have guaranteed $2 trillion of debt securities in portfolios around the world. With these securities now increasingly at risk, the bond insurers are coming under pressure and their own [credit] ratings could suffer. That in turn could trigger a downgrade in the insured securities, sparking a new round of sell-offs and write-downs." I, too, am very concerned about these developments for pension funds, insured depositories, and municipal governments, among others.

Participants in the financial services industry, including commercial and investment banks, have relied on the financial guarantees issued by entities like Ambac Assurance Corporation, MBIA Insurance Corporation, and ACA Financial Guaranty Corporation to reduce exposure to subprime mortgage debt and other complex securities products tied to these loans. Each of the aforementioned insurers, however, has also recently experienced a cut or the threat of a cut in the ratings that they receive from entities like Fitch, Standard and Poor's, and/or Moody's.

The decisions of these credit rating agencies have already begun to affect the bottom lines of several participants in the financial services marketplace. Merrill Lynch, for example, recently took a $3.1 billion charge on its exposure to a downgraded bond insurer. Citigroup has

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also reserved $935 million to help protect itself against further turmoil in this sector. Other financial corporations seem likely to face similar situations in the coming weeks and months.

The uncertainty in the bond insurance marketplace resulting from exposure to subprime housing products seems likely to spread. Pension funds that must hold investment-grade paper may need to sell holdings backed by downgraded bond insurers. Moreover, I am especially concerned about the implications for state and local governments that rely on bond insurance when putting together deals to pay for roads, schools, and other construction projects. Any increase in the perceived risks in bond insurers or decrease in competition seems likely to raise borrowing costs and slow spending on public infrastructure needs.

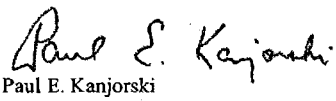
The Capital Markets Subcommittee will convene a hearing on these matters in the near future. In order to assist in the preparations for the hearing and consistent with all applicable law and regulation, I would appreciate receiving responses to the following:

- Describe how bond insurers are regulated, especially with regard to solvency and capital requirements and how such regulation differs from other lines of insurance.
- Outline the problems you presently perceive facing the bond insurance industry.
- Examine the implications of these problems for the entities and products that you regulate, as well as the broader economy.
- Detail the steps you are taking to monitor developments in the bond insurance marketplace and protect the solvency of insurers.
- Discuss the adequacy of existing statutory and regulatory tools, at the State or Federal level, to address these problems and the need for further reforms.
- Comment on the advisability of creating a guarantee fund, like those State funds for life and health insurers and property and casualty insurers, for the bond insurance industry.

Because of the urgency of these matters, I would also ask that you respond no later than February 1, 2008.

In sum, thank you for your attention to this important oversight request. If you should have any questions, please contact me directly or have your staff contact the staff of the Capital Markets Subcommittee. I look forward to your timely response.

Sincerely,



Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

***Jim Doyle**, Governor*
***Sean Dilweg,** Commissioner*

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February 4, 2008

THE HONORABLE PAUL E KANJORSKI
MEMBER OF CONGRESS
CHAIRMAN SUBCOMMITTEE ON CAPITAL MARKETS
INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES
2188 RAYBURN HOUSE OFFICE BUILDING
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Dear Congressman Kanjorski:

Thank you for your January 23, 2008, letter concerning bond insurers and the recent events affecting the bond insurance market. I am pleased to respond to the specific requests made in your letter.

As you may know, financial guaranty insurance is regulated by the individual states' insurance departments. Although there may be some differences between states in the regulations pertaining to financial guaranty insurance, the substantive regulatory requirements are generally consistent.

I will respond to your questions in the order you presented them:

Describe how bond insurers are regulated, especially with regard to solvency and capital requirements and how such regulation differs from other lines of insurance.

In Wisconsin, bond insurance is considered a type of surety business. We have a specific administrative rule pertaining to municipal bond insurance, section INS 3.08, Wis. Adm. Code. Section INS 3.08, Wis. Adm. Code sets forth minimum standards for underwriting, marketing, rating, accounting, and reserving activities of insurers that write municipal bond insurance. There are also other statutes and rules that pertain to all insurers, municipal bond insurers included. I will reference these in later sections and will also attach them to this letter.

In Wisconsin, there are three legs to solvency regulation that pertain to financial guaranty insurers. They are: a) the statutory contingency reserve; b) the compulsory and security surplus calculation; and c) Article 69 of the New York financial guaranty law.

The statutory contingency reserve requirement is contained in section INS 3.08(9), Wis. Adm. Code. This is a reserve, in addition to its claim reserves, that a bond insurer must establish. The statutory contingency reserve is an above the line reserve (a liability) and is calculated by taking 50% of the earned premium and setting it aside in the statutory contingency reserve. The statutory contingency reserve is maintained for 240 months (20 years). That portion of the contingency reserve that has been established and maintained for more than 240 months is released into income. Subject to the approval of the Commissioner, withdrawals may be made from the contingency reserve in any year in which the actual incurred losses exceed 35% of the earned premium. In addition, section INS 3.08(5)(c), Wis. Adm. Code limits a bond insurer's cumulative net liability under in-force policies of municipal bond insurance to the sum of its capital and surplus, plus the statutory contingency reserve.

Sections 623.11 and 623.12, Wis. Stats. and section INS 51.80, Wis. Adm. Code establishes compulsory and security surplus requirements for insurers doing business in Wisconsin. For municipal bond insurers the compulsory surplus standard is 20% of premium. The security surplus standard ranges from 110% to 140% of compulsory surplus depending on the insurer's premium volume. What this means is that a municipal bond insurer that writes $1 billion in premium must have at least $200 million in capital and surplus to meet the compulsory surplus standard and $220 million to meet the security surplus standard. Failure to meet the compulsory surplus standard is grounds for rehabilitation or liquidation under Wisconsin law. Failure to meet the security surplus standard categorizes the company as a restricted insurer that places some restrictions on the company's investment activity.

Section INS 3.08(12), Wis. Adm. Code states that whenever the laws and regulations of another state in which the insurer is licensed exceed the requirements of Wisconsin, compliance with that state's standards are required to comply with Wisconsin law. Article 69 of the New York insurance laws sets standards for financial guaranty insurers including bond insurers. The solvency requirements of the New York law result in larger reserve requirements than the Wisconsin law. Therefore, a company like Ambac, domiciled in Wisconsin, but licensed in New York must meet both the Wisconsin requirements and the New York requirements. And, if the New York requirements result in a higher capital and surplus amount, Ambac must meet that requirement under the above-referenced Wisconsin administrative rule.

The major difference between solvency regulation of financial guaranty insurers and other insurers (health, automobile, homeowners, etc.) is the statutory contingency reserve requirement, not found in the financial requirements of other types of insurance companies. The concept behind the statutory contingency reserve is the recognition of the nature of risk being assumed by the company. Risks taken on by companies like Ambac are macro-economic risks sensitive to the performance and condition of the economy. Since this

type of risk cannot be accurately forecasted as part of the typical claim reserving process, the statutory contingency reserve provides an extra measure of cushion to the company's claim reserves and is a reflection of the conservative nature of Statutory Accounting Principles.

I am attaching the relevant Wisconsin Statutes and administrative rules for your information.

Outline the problems you presently perceive facing the bond insurance industry.

I have been very much involved in the bond insurance issues because of the impact they are having on my domestic financial guaranty insurer, Ambac Assurance Corp. As you know, this business is very dependent on the rating agencies since the rating the insurers receive transfers to the investment vehicles they insure. Therefore, when Ambac was identified by the rating agencies for potential downgrades and then recently downgraded by one of the rating agencies, the ability for the company to write new business was severely hampered. The company needs to develop a plan to address the rating agency activity.

The next logical question would be; why the adverse rating agency activity? The municipal bond business of Ambac currently is and all signs point to a continued stable, profitable line of business. However, the securitized investment business that Ambac and most other bond insurers began writing in the '90's has more volatility. As the sub-prime housing crisis evolved with its resultant credit crunch, it affected some of the securitized investment vehicles insured by these companies increasing the potential for claim. Hence, the reserve adjustment of $1.1 billion by Ambac in the 4th quarter of 2007 concerning certain of these products. I think the combination of the uncertainty in the financial guaranty and credit markets with the increased potential claims on some of these securitized investments has resulted in the rating agency's actions. They are calling into question, not so much the solvency of these companies, but rather the ongoing franchise value of these insurers.

I currently view the situation with Ambac as a franchise value issue rather than a solvency issue. The most recent statutory financial statements of Ambac and all the information we have from the company show a financially strong company that has sufficient ability to meet its obligations to its policyholders, on both an incurred and cash-flow basis. It meets or exceeds all of the financial solvency requirements referred to in my earlier response, above.

Examine the implications of these problems for the entities and products you regulate, as well as the broader economy.

While municipal bond insurance has been a stable and profitable line of business, the introduction of more complicated investment vehicles insured by many of the insurers has now resulted in significant uncertainty in the bond insurance marketplace due to the nature of these products, including the claim triggers in the insurance contracts. In my opinion, this uncertainty has resulted, in part, in the recent actions taken by the rating agencies. The municipal bond market remains stable but is being adversely affected by the introduction of these other investments.

State regulators need to and are working together to carry out their regulatory responsibility to ensure the financial viability of the insurers in the market. It is crucial that regulators continue to work with their domestic financial guaranty insurers to ensure that management is capable of developing and implementing a plan to address these concerns and that the plan, once submitted to the regulator for review and approval, satisfies all statutory requirements.

Since the municipal bond insurance market has provided and still does provide an important service to the debt financing activity of the country's cities, towns and villages, it is important that this market remain active and viable. These are the policyholders that we are charged to protect by state law.

Failure of this market could have a significant adverse impact on the municipalities' ability to issue AAA rated debt instruments. This means that the costs of financing would increase and the resultant increased cost would be passed on to the citizens of those communities or certain municipal projects would need to be curtailed or not done at all.

Detail the steps you are taking to monitor developments in the bond insurance marketplace and protect the solvency of insurers.

Key members of my staff and I have been following the developments in the bond insurance market very closely through various means including communications with the bond insurers, internal analysis, discussions with market experts and discussions with other state regulators. We are well aware of the ever-changing bond insurance landscape.

Ambac Assurance Corp. (Ambac) is a Wisconsin domestic financial guaranty insurer and is one of the largest municipal bond insurers in the country. We have been following events in the bond insurance market as they specifically relate to and affect Ambac. I have personally met with the executive management team of Ambac as recently as January 22. We are in daily contact with the company and have established a reporting and communication process with top management. We are also prepared to engage the services of an investment banking firm and a law firm if necessary to assist with new developments.

Finally, I am in close contact with my fellow regulators, individually and through the National Association of Insurance Commissioners, to keep them apprised of the situation and to get their input where appropriate. We are working especially closely with the New York Insurance Department because of the number of bond insurers domiciled in that state.

Discuss the adequacy of existing statutory and regulatory tools, at the state and federal level, to address these problems and the need for further reforms.

The solvency regulations I outlined above have been and will continue to be adequate. In addition, there are holding company statutes and regulations, change of control regulations and other statutory and regulatory safeguards that protect policyholders and the company. I am attaching these statutes and regulations for your information.

We are concerned about the change in the business mix of the bond insurers as most have moved into investment guaranties other than municipal bonds. Over time, these other investments evolved and became more complicated and riskier. While the legal ability of bond insurers to pursue these other types of investment guaranties has been available, public policy may be better served by considering limiting the exposures to risks other than municipal bond risks. These types of policy decisions need to be made carefully and thoughtfully as the experience of current events becomes clearer.

State regulation of financial guaranty insurers has worked well in the past and will continue to work into the future. The solvency standards I outlined above, along with the other policyholder and company protections have been developed under state regulation. These standards have been vigorously enforced by state regulators and have been proven to work appropriately.

Finally, the abrupt and, from the perspective of many of the participants, including rating agencies in the collateral debt obligation (CDO) market, unexpected development of expected CDO losses suggests lack of transparency and discipline in that market. It is too early to suggest the nature of federal reform addressing the responsibility of lenders, issuers and other participants in the CDO market. However careful study of this issue is warranted.

Comment on the advisability of creating a guaranty fund, like those State funds for life and health insurers and property and casualty insurers, for the bond insurance industry.

While the concept of a guaranty fund for bond insurers may look enticing on the surface, I am not sure if this would work effectively. First, guaranty funds are funded by the insurers who write the business. While there are thousands of property and casualty and life and health insurers, there are only a handful of bond insurers.

Second, what would be guaranteed? In more traditional types of insurance, there is an insurable event that can be rather easily defined. In the bond insurance market, especially with the non-municipal bond risks, the insurable event is much more difficult to define and to determine how it is triggered.

Finally, the coverage under all the current guaranty funds is limited to a certain amount per claim in order to cap the exposure to the fund. If this were not done, the obligations of the funds would be exorbitantly high. Capping the exposure for a financial guaranty product would not adequately protect the policyholder.

The financial guaranty insurance business is unique. The nature of the business varies widely from the business of traditional insurance. Because of the differences in business practices, a guaranty fund may not be workable.

I appreciate being able to respond to your questions. Should you require further information or clarification, do not hesitate to contact me.

Sincerely,

Sean Dilweg
Commissioner

Attachments:

1. Section INS 3.08, Wis. Adm. Code
2. Sections 623.11 and 623.12, Wis. Stats.
3. Section INS 51.80, Wis. Adm. Code
4. Chapter 617, Wis. Stats.
5. Chapter INS 40, Wis. Adm. Code
6. Sections 611.61, Wis. Stats.
7. Sections 611.72 and 611.78, Wis. Stats.

PAUL E. KANJORSKI
11TH DISTRICT, PENNSYLVANIA

COMMITTEE ON
FINANCIAL SERVICES

CHAIRMAN:
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON OVERSIGHT AND
GOVERNMENT REFORM

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Congress of the United States
Washington, DC 20515-3811

January 23, 2008

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TOLL FREE HELP-LINE
(800) 222-2346

The Honorable Timothy F. Geithner
President and CEO
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Dear Mr. Geithner:

In recent weeks, many participants in our financial services sector have raised concerns about the ongoing viability of a number of bond insurers and the implications of their actual or potential ratings downgrades for all participants in the financial marketplace. The House Financial Services Capital Markets Subcommittee has therefore started an examination of these important matters, and I write to request your assistance in these efforts.

Specifically, an article in the *Washington Post* on January 18 noted that "[i]nvestors are growing especially concerned about the fate of bond insurers, which have guaranteed $2 trillion of debt securities in portfolios around the world. With these securities now increasingly at risk, the bond insurers are coming under pressure and their own [credit] ratings could suffer. That in turn could trigger a downgrade in the insured securities, sparking a new round of sell-offs and write-downs." I, too, am very concerned about these developments for insured depositories, pension funds, and municipal governments, among others.

Participants in the financial services industry, including commercial and investment banks, have relied on the financial guarantees issued by entities like Ambac Assurance Corporation, MBIA Insurance Corporation, and ACA Financial Guaranty Corporation to reduce exposure to subprime mortgage debt and other complex securities products tied to these loans. Each of the aforementioned insurers, however, has also recently experienced a cut or the threat of a cut in the ratings that they receive from entities like Fitch, Standard and Poor's, and/or Moody's.

The decisions of these credit rating agencies have already begun to affect the bottom lines of several participants in the financial services marketplace. Merrill Lynch, for example, recently took a $3.1 billion charge on its exposure to a downgraded bond insurer. Citigroup has also reserved $935 million to help protect itself against further turmoil in this sector. Other financial corporations seem likely to face similar situations in the coming weeks and months.

THIS STATIONERY PRINTED ON PAPER MADE WITH RECYCLED FIBERS

The uncertainty in the bond insurance marketplace resulting from exposure to subprime housing products seems likely to spread. Pension funds that must hold investment-grade paper may need to sell holdings backed by downgraded bond insurers. Moreover, I am especially concerned about the implications for state and local governments that rely on bond insurance when putting together deals to pay for roads, schools, and other construction projects. Any increase in the perceived risks in bond insurers or decrease in competition seems likely to raise borrowing costs and slow spending on public infrastructure needs.

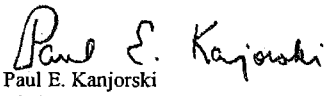
The Capital Markets Subcommittee will convene a hearing on these matters in the near future. In order to assist in the preparations for the hearing and consistent with all applicable law and regulation, I would appreciate receiving responses to the following:

- Outline any concerns you may perceive facing the bond insurance industry.
- Examine the implications of these problems for the entities that you regulate, as well as the broader economy.
- Detail the steps you are taking to monitor developments in the bond insurance marketplace and ensure the continued safety and soundness of banks and/or financial holding companies.
- Discuss the adequacy of existing statutory and regulatory tools to address these problems and the need for further reforms.

Because of the urgency of these matters, I would also ask that you respond no later than February 1, 2008.

In sum, thank you for your attention to this important oversight request. If you should have any questions, please contact me directly or have your staff contact the staff of the Capital Markets Subcommittee. I look forward to your timely response.

Sincerely,



Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance and Government Sponsored Enterprises

SPENCER BACHUS
6TH DISTRICT, ALABAMA

COMMITTEES:
FINANCIAL SERVICES,
RANKING REPUBLICAN MEMBER

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House of Representatives
Washington, DC

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January 23, 2007

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-2000

Dear Chairman Cox,

It was a pleasure to speak with you and your staff in my office on January 5. As we discussed during that meeting, I am forwarding you materials about municipal bonded indebtedness in Jefferson County, Alabama. This matter has been of interest to me for a number of years during which I have gathered this file of information about swaps in general and Jefferson County in particular.

Included in these materials is a 1997 letter sent by a local commissioner to then-SEC Chairman Arthur Levitt. Since this letter is now almost ten years old and there have been two chairmen in the interim, I wanted to bring it specifically to your attention.

The SEC has initiated a swaps investigation into transactions that occurred in Jefferson County in the 1990's. Although it is not certain that false representations were made in those transactions, my view is that the cost of water and sewer services in the county has risen as a result of these swaps.

Therefore, this is an issue of significant concern to my constituents and to me. While a primary mandate of the SEC is to protect investors and the integrity of capital markets, I hope damages to the taxpayers and utility rate payers will also be considered as this case moves forward. Penalties are certainly appropriate to send a message to the industry, but disgorgement is also suitable in a case where the damages may not have been to investors, but to taxpayers.

Thank you for your consideration. I look forward to your response and to working with you throughout the 110th Congress. Please have your staff contact Kevin Edgar or Michael Borden if they have any questions.

Sincerely,

Spencer Bachus
Member of Congress

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VETO MESSAGE - No. 109

TO THE SENATE:

I am returning herewith, without my approval, the following bill:

Senate Bill Number 2969-B, entitled:

"AN ACT to amend the general business law, in relation to prohibiting certain agreements between the issuers and the holders of credit cards and debit cards"

NOT APPROVED

This bill prohibits credit card issuers from raising a cardholder's interest rate or imposing a fee based solely on the reported delinquency of the cardholder on another creditor's account. Under the bill, issuers would be permitted to consider a prospective cardholder's credit score only when initially issuing the credit card, or for the purpose of increasing credit limits. The bill voids any provision or waiver by the cardholder that violates these restrictions, and would apply to all existing credit card agreements.

This bill clearly has a commendable goal -- to "prohibit credit card issuers from increasing the interest rates they charge on their credit cards based on irrelevant financial activity of the credit card holder." However, I am constrained to disapprove this bill because it will not further that goal, and instead could have a detrimental impact on New York consumers.

Under federal law, the permissible terms and conditions of credit card agreements relating to interest and fee charges are determined by the laws of the state in which the credit card issuer is headquartered. In addition, the issuer may apply these terms to borrowers residing in other states.

Over 90% of the credit issued to New York residents through credit

cards is issued by out-of-state financial institutions, which are exempt from the restrictions set forth in this bill. In addition, according to the Banking Department, no state-chartered banking institutions are self-issuers of credit cards, and federally-chartered banks headquartered in New York typically use subsidiaries or affiliates headquartered outside New York to issue credit cards to New York residents. Therefore, this bill will have no practical effect, because few if any New York residents hold credit cards issued by New York banks.

Moreover, to the extent that this bill might have a practical impact, it would harm, rather than benefit, New York credit card customers. In particular, a consumer's delinquency on a creditor's account is an indication that the consumer may be at risk of not paying other accounts. Typically, credit card issuers increase the interest rates or fees charged to consumers at a greater risk of nonpayment. By prohibiting that response, this bill would force credit card issuers to increase interest rates or fees charged to all of their credit card holders -- thereby shifting the financial burden from those who are in default on an account, to those who are not.

In addition, this bill permits issuers to consider credit scores only when "issuing an initial credit card" to an account holder, or when increasing a line of credit. Thus, if a customer's credit score improves, the financial institution would be prohibited from using that information to provide a lower-rate credit card to the customer, or to offer any other types of upgrades.

In sum, while well-intentioned, this bill ignores the reality that few if any credit cards are issued by New York banks, and thus the restrictions set forth in this bill will not provide benefits to New

York credit card holders. Instead, the bill will simply cause confusion among the millions of New Yorkers who will believe, incorrectly, that this new law grants them greater protections against their credit card companies.

The bill is disapproved. (signed) ELIOT SPITZER

February 14, 2008

Congresswoman Shelley Moore Capito
US House of Representatives
1431 Longworth House Office Building
Washington, DC 20515-4802

Dear Congresswoman Capito,

As bankers serving the broad range of credit needs in our communities across West Virginia, we want to applaud you for your leadership in being a cosponsor of H.R. 2091. This legislation will provide an important additional tool for community banks to partner with Federal Home Loan Banks in supporting economic development.

While this legislation comes under the jurisdiction of the House Committee on Ways and Means, the expertise of the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises will play an important role during Congressional consideration of this issue.

As your subcommittee explores the many serious issues surrounding the current challenges facing the bond insurance industry, we would point out that H.R. 2091 will allow our banks to serve markets that have been largely ignored by the bond insurers for years. Current market turmoil makes H.R. 2091 even more necessary to expand credit enhancement options for long-underserved markets.

This legislation would allow our banks to assist smaller West Virginia communities, charitable health care facilities and institutions of higher education raise tax-exempt funds where such borrowers are unable to obtain bond insurance or letters of credit from larger market players or at more attractive terms.

Numerous small, unrated rural hospitals or inner-city facilities would benefit from this credit enhancement as well as many educational institutions. Small communities would see service or greater competition in the market to meet their economic development challenges.

Issuing letters of credit (LOCs) backed by Federal Home Loan Banks is not a new activity for bankers. Community Bank/ Federal Home Loan Bank LOCs are routinely issued throughout the nation for the purpose of supporting housing related bond issues, both taxable and tax-exempt. The problem arises in the area of tax-exempt economic development bonds. The Internal Revenue Service has questioned whether Federal Home Loan Bank LOC's might trigger a loss of the tax exempt status of the bonds. It is for that reason that legislation is needed.

Adding LOCs from Federal Home Loan Banks as an option for municipal governments and issuers of tax-exempt bonds for charitable health care facilities and schools will increase competition in this field of credit enhancement for tax-exempt finance. It will give many issuers an additional option and help reduce the cost to the taxpayers of

municipal bond issues for such projects as water treatment facilities, fire stations, long-term care for the elderly, medical clinics, school buses and infrastructure improvements.

As the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises considers how best to address the challenges raised by the problems facing the bond insurance industry, we would hope that you could work with the House Committee on Ways and Means to seek enactment of H.R 2091. This small but necessary action will help underserved markets and should be part of any comprehensive response.

Sincerely,

Harry A. Comm
President & CEO
Hancock County Savings Bank, FSB
Chester, WV

Lois Fish Beam
Managing Officer
First Federal Savings & Loan
Association of Ravenswood
Ravenswood, WV

Stanley M. Kiser
President
First Federal Savings Bank
Sistersville, WV

Kevin Lemley
CFO
Centra Bank, Inc.
Morgantown, WV

W.A. ("Bill") Loving, Jr.
Executive Vice President & CEO
Pendleton Community Bank
Franklin, WV

H. Charles Maddy
President
Summit Financial Group
Moorefield, WV

Randall E. Snider
President
Community Bank of Parkersburg
Parkersburg, WV

Robert H. Young
Executive VP & CFO
WesBanco, Inc.
Wheeling, WV

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of
the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): April 26, 2007

MBIA INC.

(Exact name of registrant as specified in its charter)

Connecticut	1-9583	06-1185706
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

113 King Street,
Armonk, New York 10504

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code:
914-273-4545

Not Applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

|_| Written communications pursuant to Rule 425 under the Securities Act

(17 CFR 230.425)

|_| Soliciting material pursuant to Rule 14a-12 under the Exchange Act

(17 CFR 240.14a-12)

|_| Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

|_| Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.02. RESULTS OF OPERATIONS AND FINANCIAL CONDITION.

The following information, including the Exhibit to this Form 8-K, is being furnished pursuant to Item 2.02 - Results of Operations and Financial Condition of Form 8-K.

On April 26, 2007, MBIA Inc. issued a press release announcing its results of operations for the quarter ended March 31, 2007. A copy of the press release is attached as Exhibit 99.1 to this Form 8-K and is incorporated by reference to this Item 2.02 as if fully set forth herein.

Item 9.01. FINANCIAL STATEMENTS AND EXHIBITS.

99.1 Press Release issued by MBIA Inc. dated April 26, 2007.

This information is not deemed to be "filed" for the purposes of Section 18 of the Securities Exchange Act of 1934 and is not incorporated by reference into any Securities Act registration statements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

MBIA INC.

By: /s/Ram D. Wertheim

Ram D. Wertheim
General Counsel

Date: April 26, 2007

EXHIBIT INDEX TO CURRENT REPORT ON FORM 8-K
Dated April 26, 2007

Exhibit 99.1 Press Release issued by MBIA Inc. dated April 26, 2007.

Exhibit 99.1

MBIA Inc. Reports Net Income of $1.46 Per Share for First Quarter 2007; Operating Income Per Share up 2 Percent

ARMONK, New York--(BUSINESS WIRE)--April 26, 2007--MBIA Inc. (NYSE: MBI), the holding company for MBIA Insurance Corporation, reported today that first quarter 2007 net income per share was $1.46, the same as in the first quarter of 2006. Net income for the first quarter of 2007 was $198.6 million compared to $199.0 million in the first quarter of 2006.

Operating income per share, a non-GAAP measure (which is defined in the attached Explanation of Non-GAAP Financial Measures), rose 2 percent to $1.48 in the first quarter of 2007 compared with $1.45 in the first quarter of 2006. Excluding accelerated income from refunded issues, first quarter 2007 operating income per share rose 2 percent to $1.30 from $1.28 in the same period of 2006.

Diluted earnings per share information

	Three Months Ended March 31	
	2007	2006
Net income	$1.46	$1.46
Income from discontinued operations	0.00	0.01
Net income from continuing operations	1.46	1.45
Net realized gains	0.06	0.00
Net gains (losses) on financial instruments at fair value and foreign exchange	(0.08)	0.01
Operating income	$1.48	$1.45

(Numbers may not add due to rounding)

Gary Dunton, MBIA Chief Executive Officer, said, "We were pleased with solid new business production in our insurance segment during the first quarter. Although narrow spreads continue to challenge the market, the pipeline of deals is encouraging as spreads widen in some sectors. In addition, we strengthened our back book of business through successful remediations, and our investment management business continued its steady growth in assets under management. We

remain committed to our rigorous risk management practices with the goal of building shareholder value for the long term."

Insurance Operations

Adjusted direct premium (ADP), a non-GAAP measure (which is defined in the attached Explanation of Non-GAAP Financial Measures) increased 135 percent to $272.9 million in the first quarter of 2007 from $116.0 million in the first quarter of 2006. The increase was due to strong business production in the U.S. and non-U.S. public finance and U.S. structured finance markets.

Adjusted Direct Premium (ADP)

($ in millions)	Three Months Ended March 31		
	2007	2006	% Change
Global Public Finance			
United States	$62.7	$48.0	31%
Non-United States	62.0	0.0	N/A
Total	124.7	48.0	160%
Global Structured Finance			
United States	122.0	15.8	672%
Non-United States	26.2	52.2	(50%)
Total	148.2	68.0	118%
Total	$272.9	$116.0	135%

Global public finance ADP increased 160 percent in the first quarter of 2007 compared to the first quarter of 2006. Overall, the general obligation, tax-backed and water segments of the market were the strongest contributors to ADP for the quarter. Despite continuing tight credit spreads and intense competition, U.S. public finance production was up 31 percent, with significant ADP generated in the transportation, tax-backed and education sectors. Non-U.S. public finance production was solid in the first quarter of 2007, particularly from utility-related transactions. In two notable first quarter transactions, MBIA insured bonds for Anglian Water Services in the United Kingdom and the Comision Federal de Electricidad (CFE) in Mexico. The transaction for CFE, a government-owned electric company in Mexico, provided financing for the acquisition of a hydroelectric power plant to be built under Mexico's public-private partnership program.

Global structured finance ADP increased 118 percent in the first quarter of 2007. Business production in U.S. structured finance also grew sharply, with significant contributions from CDOs and mortgage-backed securities asset classes. The CDOs included investment grade corporate CDOs, as well as multi-sector transactions. MBIA's insurance policies attached at

either Triple-A or super Triple-A ratings for all of the CDOs insured in the quarter. All multi-sector CDO deals had super Triple-A underlying ratings, where MBIA's insurance typically attached at two times the base Triple-A rating. These deals are managed portfolios and the Company's credit analysts review each piece of collateral that is included in the transaction.

While the Company continues to explore opportunities within the subprime mortgage sector, first quarter 2007 subprime mortgage activity was limited to a modest ($59 million net par) secondary market transaction that was rated Triple-A prior to MBIA's insurance. All of the other mortgage-backed deals insured in the first quarter were either home equity lines of credit or second mortgage transactions for prime borrowers. Three Countrywide home equity securitizations, totaling $3.3 billion of par value, figured prominently among mortgage-backed activity in the quarter. Structured finance ADP in non-U.S. markets was down 50 percent compared to relatively strong production for the first quarter of 2006.

Total premiums earned, which include scheduled premiums earned and refunding premiums earned, in the first quarter of 2007 were up 2 percent to $210.5 million from $205.9 million in the first quarter of 2006. Scheduled premiums earned also increased 2 percent to $170.7 million in the first quarter of 2007 from $167.7 million in the first quarter of 2006. Accelerated premiums earned from refundings were up 4 percent for the quarter at $39.8 million compared with $38.2 million in the first quarter of 2006.

Pre-tax net investment income in the first quarter of 2007, excluding net realized gains, was $146.1 million, reflecting a 5 percent increase from $139.1 million for the same period of 2006. Excluding interest received on Variable Interest Entities (VIEs) and on Northwest Airlines equipment trust certificates, pre-tax net investment income was down 2 percent, primarily due to lower average invested assets resulting from the $500 million special dividend transferred from MBIA Insurance Corporation to MBIA Inc. in December 2006 and the $294 million in payments made in the fourth quarter of 2006 to call two MBIA-insured transactions, a tax lien securitization and a CDO.

MBIA's fees and reimbursements in the first quarter of 2007 were up 24 percent to $10.2 million in the first quarter of 2007 from $8.2 million during the first quarter of 2006. The increase is a result of larger expense reimbursements received in the first quarter of 2007 for the MBIA-insured Eurotunnel transaction compared to those received in the same period a year ago.

Total insurance expenses were up 6 percent in the first quarter of 2007 to $91.4 million from $85.9 million in the first quarter of 2006. The increase primarily resulted from higher interest expense for VIEs and interest expense related to the financing of the referenced Northwest Airlines assets, although operating expenses were 11 percent lower. Gross insurance expenses, which are prior to any expense deferrals, were down 1 percent for the quarter.

The Company incurred $20.5 million in loss and loss adjustment expenses (LAE) in the first quarter of 2007, a 2 percent increase compared to $20.1 million in last year's first quarter. Loss and LAE for both periods are based on the Company's formula of reserving 12 percent of scheduled net premiums earned. During the first quarter of 2007, the net effect of MBIA's formula-based loss reserving and case loss reserve activity resulted in a $13.5 million decrease to

its unallocated loss reserve. The Company's unallocated loss reserve was $199.9 million at March 31, 2007.

Net case loss activity for the first quarter totaled $33.7 million. The largest contributors to case loss activity were the Student Finance Corporation (SFC) student loan securitization, which resulted from the previously announced settlement with Royal Indemnity Company (Royal) and a multi-sector CDO. MBIA incurred $19.9 million of case losses in the first quarter as a result of settling with Royal. The loss represents a reduction to MBIA's expected recoveries for claims it had paid to date under its SFC insurance policies. The Company also increased its case loss reserve for a CDO, which has been under remediation for several years. During the first quarter of 2007, the Company reversed its remaining case losses for its Northwest Airlines Enhanced Equipment Trust Certificates exposure as it no longer expects to incur any losses due to additional remediation efforts.

The overall credit quality in the insured portfolio remained high with 82 percent of the total book of business rated A or better compared with 81 percent in the first quarter of 2006. The percentage of the portfolio rated below-investment grade decreased to 1.9 percent from 2.1 percent in the same period-end last year.

MBIA's pre-tax operating income from insurance operations, which excludes the effects of net realized gains and losses, and net gains and losses on financial instruments at fair value and foreign exchange, was up 3 percent at $275.4 million in the first quarter of 2007 compared to $267.3 million in the same period of 2006.

On April 18, 2007, the Financial Accounting Standards Board issued an exposure draft on accounting for financial guarantee insurance contracts, which proposes requirements relating to reserves for claims liability, premium revenue recognition and related disclosures. The exposure draft is subject to a 60-day comment period and may be subsequently modified. Until final guidance is issued and effective, the Company will continue to apply its current accounting practices to its financial guarantee insurance contracts.

Investment Management Services

Pre-tax operating income from MBIA's investment management businesses, which excludes the effects of net realized gains and losses, and net gains and losses on financial instruments at fair value and foreign exchange, increased 4 percent in the first quarter of 2007 to $24.9 million from $23.9 million in first quarter of 2006. The Company's asset/liability products segment experienced solid growth in its investment agreement and medium-term note business. Additionally, assets under management in the third-party/advisory services segment grew sharply. The average market value of assets under management was $64.5 billion, including $4.0 billion of conduit assets, in the first quarter of 2007, up 23 percent from $52.2 billion, including $4.1 billion of conduit assets, in the first quarter of 2006.

Corporate

The pre-tax operating loss for the corporate segment, which includes net investment income, insurance recoveries, interest expense and corporate expense, increased 2 percent in first quarter 2007 to $19.2 million compared with $18.9 million in the first quarter of 2006. The increase is primarily a result of increased legal expenses related to the previously disclosed regulatory investigations and the related settlements, which were partially offset by higher net investment income and insurance recoveries. The greater net investment income resulted from higher average assets due to the $500 million special dividend paid from MBIA Insurance Corporation to MBIA Inc. in December 2006. The insurance recoveries represent a payment under the Company's directors' and officers' insurance policies, which reimbursed MBIA for a portion of the expenses it has incurred for the regulatory investigations and the related litigation.

Gains and Losses

In the first quarter of 2007, MBIA recorded a net realized gain of $12.1 million for all business operations, compared to a net realized loss of $0.9 million in the first quarter of 2006. The favorable comparison over the prior year is primarily due to a first quarter 2006 write-down of $13.9 million for a receivable balance that the Company recorded under salvage and subrogation rights.

The Company recorded a pre-tax net loss on financial instruments at fair value and foreign exchange of $16.0 million for all business operations in the first quarter of 2007, compared to a pre-tax net gain of $1.8 million in the first quarter of 2006.

FAS 155 Adoption

The Company adopted Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Financial Instruments" (SFAS 155) on January 1, 2007. In connection with the adoption of SFAS 155, the change in fair value of certain hybrid financial instruments is recorded in the Company's income statement as part of net gains (losses) on financial instruments at fair value and foreign exchange. The adoption of SFAS 155 did not have a material effect on the Company's financial results.

Operating Return On Equity

For the first quarter of 2007, MBIA's operating return on equity, a non-GAAP measure (which is defined in the attached Explanation of Non-GAAP Financial Measures), was 12.2 percent compared to 12.4 percent for the same period in 2006.

Book Value and Adjusted Book Value

MBIA's book value per share at the end of the first quarter of 2007 was $53.77, up slightly from $53.43 at December 31, 2006. Book value increased because of the effect of net income from operations offset by an increase in treasury stock from share repurchases. Adjusted book value (ABV) per share at March 31, 2007 rose 2 percent to $77.36 from $75.72 at December 31, 2006. ABV is a non-GAAP measure (which is defined in the attached Explanation of Non-GAAP Financial Measures).

Share Repurchase

During the first quarter of 2007, on a trading date basis, the Company repurchased 4.5 million shares at an average price of $67.09. Approximately $700 million remains available under the Company's $1 billion share buyback program, which was authorized by the Company's board of directors in February 2007.

Second Quarter Insurance Company Dividends

In April 2007, MBIA Insurance Corporation received approval from the New York State Insurance Department to declare and pay a total of $500 million in special dividends to MBIA Inc. in the second quarter of 2007.

Conference Call

MBIA will host a conference call for investors today at 11 a.m. EDT. The conference call will consist of comments by Mr. C. Edward Chaplin, MBIA Chief Financial Officer, followed by a question and answer session. The dial-in number for the call is (877) 694-4769 in the U.S. and (973) 582-2849 from outside the U.S. The conference call code is 8650079. The conference call will also be broadcast live on MBIA's Web site at www.mbia.com. Those who are unable to participate in the conference call may listen to a replay by dialing (877) 519-4471 in the U.S. or (973) 341-3080 from outside the U.S. The replay call code is also 8650079. The replay will be available on MBIA's Web site approximately two hours after the end of the conference call.

MBIA Inc., through its subsidiaries, is a leading financial guarantor and provider of specialized financial services. MBIA's innovative and cost-effective products and services meet the credit enhancement, financial and investment needs of its public and private sector clients, domestically and internationally. MBIA Inc.'s principal operating subsidiary, MBIA Insurance Corporation, has a financial strength rating of Triple-A from Moody's Investors Service, Standard & Poor's Ratings Services, Fitch Ratings, and Rating and Investment Information, Inc. Please visit MBIA's Web site at http://www.mbia.com.

This news release contains forward-looking statements. Important factors such as general market conditions and the competitive environment could cause actual results to differ materially from those projected in these forward-looking statements. The Company undertakes no obligation to revise or update any forward-looking statements to reflect changes in events or expectations.

Explanation of Non-GAAP Financial Measures

The following are explanations of why MBIA believes that the non-GAAP financial measures used in this press release, which serve to supplement GAAP information, are meaningful to investors.

Operating Income: The Company believes operating income is a useful measurement of performance because it measures income from operations, unaffected by investment portfolio realized gains and losses, gains and losses on financial instruments at fair value and foreign

exchange and non-recurring items. Trends in the underlying profitability of the Company's businesses can be more clearly identified without the fluctuating effects of the items noted above.

Adjusted Direct Premiums: Adjusted direct premiums include both upfront premiums written and the present value of estimated future installment premiums for new business writings and excludes premiums assumed or ceded. The Company believes adjusted direct premiums are a meaningful measure of the total value of the insurance business written during a reporting period since they represent the present value of all premiums collected and expected to be collected on policies closed during the period. As such, it gives investors an opportunity to measure the value of new business activities in a given period and compare it to new business activities in other periods. Other measures, such as premiums written and premiums earned, include the value of premiums resulting from business closed in prior periods and do not provide the same information to investors.

Operating Return on Equity: The Company believes operating return on equity is a useful measurement of performance because it measures return on equity based upon income from operations and shareholders' equity, unaffected by investment portfolio realized gains and losses, gains and losses on financial instruments at fair value and foreign exchange, unrealized gains and losses, and non-recurring items. Operating return on equity is also provided to assist research analysts and investors who use this information in their analysis of the Company.

Adjusted Book Value: Adjusted Book Value includes the after-tax effects of deferred premium revenue less prepaid reinsurance premiums and deferred acquisition costs, the present value of installment premiums, the present value of the net spread of asset/liability products and a provision for loss and loss adjustment expenses. The Company believes the presentation of adjusted book value, which includes items that are expected to be realized in future periods, provides additional information that gives a comprehensive measure of the value of the Company. Since the Company expects these items to affect future results and, in general, they do not require any additional future performance obligation on the Company's part, ABV provides an indication of the Company's value in the absence of any new business activity. ABV is not a substitute for GAAP book value but does provide investors with additional information when viewed in conjunction with GAAP book value.

MBIA INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(dollars in thousands)

	March 31, 2007	December 31, 2006
Assets		
Investments:		
Fixed-maturity securities held as available-for-sale, at fair		

value (amortized cost $28,588,001 and $27,327,315)(2007 includes hybrid financial instruments at fair value $669,374)	$28,966,168	$27,755,667
Investments held-to-maturity, at amortized cost (fair value $5,019,523 and $5,187,766)	5,047,718	5,213,464
Investment agreement portfolio pledged as collateral, at fair value (amortized cost $698,713 and $176,179)	694,805	175,834
Short-term investments, at amortized cost (which approximates fair value)	2,856,023	2,960,646
Other investments	866,202	971,707
Total investments	38,430,916	37,077,318
Cash and cash equivalents	235,654	269,277
Accrued investment income	555,548	526,468
Deferred acquisition costs	456,105	449,556
Prepaid reinsurance premiums	347,883	363,140
Reinsurance recoverable on unpaid losses	47,625	46,941
Goodwill	79,406	79,406
Property and equipment (net of accumulated depreciation)	100,776	105,950
Receivable for investments sold	204,552	77,593
Derivative assets	501,972	521,278
Other assets	267,049	246,103
Total assets	$41,227,486	$39,763,030
Liabilities and Shareholders' Equity		
Liabilities:		
Deferred premium revenue	$3,101,278	$3,129,620
Loss and loss adjustment expense reserves	533,773	537,037
Investment agreements	12,300,127	12,482,976
Commercial paper	723,072	745,996
Medium-term notes (2007 includes hybrid financial instruments at fair value $188,200)	12,174,588	10,951,378
Variable interest entity floating rate notes	1,413,203	1,451,928
Securities sold under agreements to repurchase	649,209	169,432
Short-term debt	40,898	40,898
Long-term debt	1,214,985	1,215,289
Current income taxes	56,548	6,970
Deferred income taxes, net	462,881	476,189
Deferred fee revenue	14,628	14,862

Payable for investments purchased	537,799	319,640
Derivative liabilities	423,394	400,318
Other liabilities	533,676	616,243
Total liabilities	34,180,059	32,558,776
Shareholders' Equity:		
Common stock	159,751	158,330
Additional paid-in capital	1,588,438	1,533,102
Retained earnings	6,550,849	6,399,333
Accumulated other comprehensive income	309,108	321,293
Treasury stock	(1,560,719)	(1,207,804)
Total shareholders' equity	7,047,427	7,204,254
Total liabilities and shareholders' equity	$41,227,486	$39,763,030

MBIA INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands except per share amounts)

	Three Months Ended March 31		Year Ended December 31
	2007	2006	2006
Insurance operations			
Revenues:			
Gross premiums written	$ 217,626	$ 172,872	$ 896,258
Ceded premiums	(21,369)	(23,905)	(98,591)
Net premiums written	196,257	148,967	797,667
Scheduled premiums earned	170,701	167,715	674,078
Refunding premiums earned	39,797	38,184	161,515
Premiums earned	210,498	205,899	835,593
Net investment income	146,106	139,116	598,113
Fees and reimbursements	10,168	8,174	33,498
Net realized gains (losses)	992	(7,044)	5,615
Net gains (losses) on financial instruments at fair value and foreign exchange	1,847	4,757	904

Total insurance revenues	369,611	350,902	1,473,723
Expenses:			
Losses and loss adjustment	20,484	20,126	80,889
Amortization of deferred acquisition costs	16,629	16,266	66,012
Operating	32,569	36,540	155,863
Interest expense	21,736	12,918	76,490
Total insurance expenses	91,418	85,850	379,254
Insurance income	278,193	265,052	1,094,469
Investment management services			
Revenues	362,079	258,206	1,201,658
Net realized gains (losses)	10,121	5,528	6,060
Net gains (losses) on financial instruments at fair value and foreign exchange	(18,029)	(2,950)	13,162
Total investment management services revenues	354,171	260,784	1,220,880
Interest expense	314,495	216,747	1,024,903
Expenses	22,663	17,590	75,537
Total investment management services expenses	337,158	234,337	1,100,440
Investment management services income	17,013	26,447	120,440
Corporate			
Net investment income	5,990	3,564	13,462
Insurance recoveries	3,400	-	-
Net realized gains (losses)	942	626	3,763
Net gains (losses) on financial instruments at fair value and foreign exchange	137	-	428
Interest expense	20,179	20,131	80,685
Corporate expenses	8,455	2,308	18,614
Corporate loss	(18,165)	(18,249)	(81,646)
Income from continuing operations before income taxes	277,041	273,250	1,133,263

Provision for income taxes	78,430	75,047	320,080
Income from continuing operations	198,611	198,203	813,183
Income (loss) from discontinued operations, net of tax	-	791	6,076
Gain on sale of discontinued operations, net of tax	-	-	29
Net income	$ 198,611	$ 198,994	$ 819,288
Net income per common share:			
Basic	$ 1.50	$ 1.50	$ 6.17
Diluted	$ 1.46	$ 1.46	$ 5.99
Weighted-average number of common shares outstanding:			
Basic	131,972,954	132,717,298	132,794,334
Diluted	136,090,503	136,547,417	136,694,798

MBIA INC. AND SUBSIDIARIES

Reconciliation of Adjusted Direct Premiums to Gross Premiums Written
(dollars in millions)

	Three Months Ended March 31	
	2007	2006
Adjusted direct premiums (1)	$272.9	$116.0
Adjusted assumed premiums	0.0	0.0
Adjusted gross premiums	272.9	116.0
Present value of estimated future installment premiums (2)	(181.3)	(67.7)
Gross upfront premiums written	91.6	48.3
Gross installment premiums written	126.0	124.6

Gross premiums written	$217.6	$172.9

(1) A non-GAAP measure.
(2) At March 31, 2007 and March 31, 2006 the discount rate was 5.10% and 5.02%, respectively.

Components of Net Income per Share

	Three Months Ended March 31	
	2007	2006
Net income	$1.46	$1.46
Income from discontinued operations	0.00	0.01
Net income from continuing operations	1.46	1.45
Net realized gains	0.06	0.00
Net gains (losses) on financial instruments at fair value and foreign exchange	(0.08)	0.01
Operating income (1)	$1.48	$1.45

(1)A non-GAAP measure.

MBIA INC. AND SUBSIDIARIES

Components of Adjusted Book Value per Share

	March 31, 2007		December 31, 2006	
Book value		$53.77		$53.43
After-tax value of:				
Deferred premium revenue	15.39		15.09	
Prepaid reinsurance premiums	(1.73)		(1.75)	
Deferred acquisition costs	(2.26)		(2.17)	
Net deferred premium				

revenue	11.40	11.17
Present value of installment premiums (1)	11.85	11.13
Asset/liability products adjustment	3.39	2.92
Loss provision (2)	(3.05)	(2.93)
Adjusted book value (3)	$77.36	$75.72

(1) At March 31, 2007 and December 31, 2006 the discount rate was 5.10% and 5.10%, respectively.
(2) The loss provision is calculated by applying 12% to the following items on an after-tax basis: (a) deferred premium revenue; (b) prepaid reinsurance premiums; and, (c) the present value of installment premiums.
(3) A non-GAAP measure.

CONSOLIDATED INSURANCE OPERATIONS

Selected Financial Data Computed on a Statutory Basis

(dollars in millions)

	March 31, 2007	December 31, 2006
Capital and surplus	$4,214.5	$4,080.7
Contingency reserve	2,536.8	2,478.0
Capital base	6,751.3	6,558.7
Unearned premium reserve	3,665.6	3,507.2
Present value of installment premiums (1)	2,388.4	2,309.5
Premium resources	6,054.0	5,816.7
Loss and loss adjustment expense reserves	107.9	100.6
Soft capital credit facilities	850.0	850.0
Total claims-paying resources	$13,763.2	$13,326.0
Net debt service outstanding	$957,639.4	$939,969.0

Capital ratio (2)	142:1	143:1
Claims-paying ratio (3)	82:1	83:1

(1) At March 31, 2007 and December 31, 2006 the discount rate was 5.10% and 5.10%, respectively.
(2) Net debt service outstanding divided by the capital base.
(3) Net debt service outstanding divided by the sum of the capital base, unearned premium reserve (after-tax), present value of installment premiums (after-tax), loss and loss adjustment expense reserves and soft capital credit facilities.

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Statement of Comptroller of the Currency John C. Dugan
Responding to New York Gov. Eliot Spitzer

Almost everyone who has paid attention to the subprime lending crisis has concluded that OCC-regulated national banks were not the problem. Instead, the worst abuses came from loans originated by state-licensed mortgage brokers and lenders that are exclusively the responsibility of state regulators.

However, rather than accept responsibility for problems that are clearly within his jurisdiction to solve, New York Gov. Eliot Spitzer has tried to shift the blame to others. He argues that the OCC and national bank preemption have prevented the states from taking action against predatory or abusive lenders.

The OCC extensively regulates the activities of national banks, including mortgage lending. The OCC established strong protections against predatory lending practices years ago, and has applied those standards through examinations of every national bank. As a result, predatory mortgage lenders have avoided national banks like the plague. The abuses consumers have complained about most — such as loan flipping and equity stripping — are not tolerated in the national banking system. And the looser lending practices of the subprime market simply have not gravitated to national banks: They originated just 10% of subprime loans in 2006, when underwriting standards were weakest, and delinquency rates on those loans are well below the national average.

Nothing the OCC has done has prevented the states from regulating and preventing abuses among the lenders that they license – lenders that are the source of most of today's problems. The states have ample authority – as well as clear responsibility – to set standards for these lenders and enforce them. It defies logic to argue that preemption was an impediment. National banks are bound to obey the strict standards enforced by the OCC everywhere they operate – even in states that had far less rigorous standards. The states should have applied equally rigorous standards to the non-bank lenders that were responsible for the bulk of the problems

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