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ASSOCIATION OF FINANCIAL GUARANTY INSURERS

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BY E-MAIL (Comments@FDIC.gov) & FEDERAL EXPRESS

February 22, 2010

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: RIN # 3064–AD55

Dear Mr. Feldman:

The Association of Financial Guaranty Insurers ("AFGI") is writing to comment on the FDIC's Advance Notice of Proposed Rulemaking ("ANPR") relating to *Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation After March 31, 2010.*[1]

In particular, we are writing to express our strong opposition to the notion that pool-level external credit support (Pool-Level Support) should be prohibited in securitizations that rely on the FDIC's safe harbor rule.

**Background**

The Association of Financial Guaranty Insurers ("AFGI") is a trade association of seven insurers and reinsurers of municipal bonds and asset-backed securities. Our members' credit enhancement products include financial guaranties and other types of Pool-Level Support. Their service, financial guaranty insurance, is utilized in the financial markets to assist issuers of bonds reduce the cost of borrowing and to provide investors security and risk management. This service is vital not only to investors in existing securities but also to issuers who only purchase our services if the interest rate savings justify the expense of insurance. The existence of credit enhancement ultimately results in reduced borrowing costs for the issuers of asset-backed securities and municipal bonds, increasing liquidity and in the case of municipal bonds benefiting the state and local taxpayers who will be paying less for new schools, hospitals, roads, bridges or other needed public projects.

A bond or other security insured by an AFGI member has the guarantee that interest and principal will be paid on time and in full. Issuers, taxpayers and investors benefit from the financial guaranty insurance provided by AFGI members:

[1] Federal Register, Vol. 75, p. 934 (January 7, 2010).

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- Benefits to Issuers and Taxpayers:
  - Allows credit rating of the guarantor to be applied to the bonds
  - Reduced cost of funds
  - 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.]

Because an insured issue receives the higher rating of its insurer, municipal issuers and their taxpayers benefit from lower financing costs that result from insurance. AFGI estimates that since the industry's inception in 1971 municipalities and their taxpayers have saved more than $40 billion in interest costs as a result of bond insurance. In the asset-backed markets, insurance reduces borrowing costs for issuers, and offers better market access and greater ease of deal execution. Investors are financially protected against issuer default through the insurer's guarantee of payments.

**ANPR**

The ANPR asks the following questions:

> Should all securitizations be required to have payments of principal and interest on the obligations primarily dependent on the performance of the financial assets supporting the securitization? Should external credit support be prohibited in order to better realign incentives between underwriting and securitization performance? Are there types of external credit support that should be allowed? Which and why?[2]

Our comments are focused on the second question, relating to external credit support. We have no objection to the proposal in the first sentence to limit the safe harbor to securitizations where payments depend primarily on the performance of the underlying financial assets. In our experience, there is no conflict between Pool-Level Support and that requirement.

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[2] P. 937, question 8.

Based on other statements in the ANPR, we understand that the question about prohibiting external credit support is meant to apply only to Pool-Level Support, and we only respond in that context.[3] While there is also some indication in the ANPR that any such prohibition might be limited to RMBS transactions,[4] our discussion below applies equally to RMBS and other ABS.

We see no reason for the FDIC to prohibit Pool-Level Support, which is a legitimate transaction feature that has traditionally improved liquidity of financial assets and benefited U.S. consumers by, among other things:

- facilitating market access for new entrants, thereby increasing competition and lowering borrowing costs for consumers;
- facilitating securitizations of credit extensions to borrowers that may not otherwise have access to the capital markets, thus increasing liquidity of those assets and credit availability for that segment; and
- facilitating lower costs of financing for issuers as compared with alternative uninsured transactions, which translates to reduced costs for consumers.

Although not discussed at length in the ANPR, it appears that the FDIC's reasons for considering a prohibition on Pool-Level Support include one or more of the following beliefs: (i) that payments on obligations issued in securitizations with Pool-Level Support do not depend primarily on the performance of the underlying financial assets; (ii) that prohibiting Pool-Level Support would help to better align incentives between underwriting and securitization performance; or (iii) that Pool-Level Support adds to the complexity of transactions and thus works against market understanding of structures. As discussed below, none of these possible beliefs is correct. In fact, Pool-Level Support (when present in transactions) supports two of the primary goals that the FDIC has identified for the safe harbor: increasing liquidity of financial assets and reducing consumer costs.

*Reliance on Asset Performance*

Pool-Level Support acts as a secondary or tertiary level of credit protection, in the event that collections on the underlying financial assets are not sufficient to make insured payments on the related obligations.[5] Consequently, the presence of Pool-Level Support in a transaction does not remove the primary reliance on performance of the underlying financial assets. The expectation under base case and even reasonably stressed scenarios is that the required payments will be made entirely from collections on the underlying financial assets (including amounts attributable

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[3] The ANPR states "it is appropriate to consider whether external credit support, beyond loan-specific guarantees or other credit support, should be allowed." (p. 936) Also, the sample text attached to the ANPR only prohibits external credit support "at the issuing entity or pool level". (p. 940, par. (b)(1)(ii)(B)) We would also be strongly opposed to any prohibition on mortgage insurance and other external credit support at the loan level.

[4] Par. (b)(1)(ii)(B) of the sample text (p. 940), which sets out possible regulatory text on this point, only applies to RMBS.

to subordinated tranches, excess spread or over-collateralization) or internal transaction cash reserves. As a result, the FDIC should not be concerned that the use of Pool-Level Support is inconsistent with the contemplated safe harbor requirement that payments on the issued obligations depend primarily on the performance of the underlying financial assets.

*Aligning Incentives*

Consistent with the statements above, providers of Pool-Level Support (Credit Enhancers) do not stand in a first-loss position vis-à-vis the underlying financial assets. Instead, Credit Enhancers require internal (to the transaction) credit support for their Pool-Level Support exposures, generally including some combination of subordinated tranches, excess spread, over-collateralization or cash reserves. Also, if Pool-Level Support is drawn upon to cover losses on the underlying assets, the sources of reimbursement to the Credit Enhancer are generally limited to collections on the underlying assets and internal credit supports of the types described above. As a result, Credit Enhancers are keenly interested in the underwriting and performance of the underlying exposures and carry out their own due diligence on these matters.

We understand that the FDIC may believe that the market as a whole did not have sufficient incentives to police underwriting practices, but it is our position that Pool-Level Support was not a contributing factor to that situation. The Credit Enhancer's own due diligence acts as a mechanism to police underwriting and thus help align incentives. Further, credit rating agencies carry out significant due diligence on underwriting and related matters in transactions with Pool-Level Support (which we believe is substantially identical to the diligence credit rating agencies carry out in transactions with no Pool-Level Support). In part, this is because Credit Enhancers are required to receive at least shadow ratings on the credit quality of their Pool-Level Support exposures, which is primarily driven by performance of the underlying financial assets. Finally, the disclosure provided to investors about underlying assets is substantially the same, whether or not there is Pool-Level Support, so the RMBS or ABS underwriters have the same securities law due diligence requirements in both types of transaction. Thus, the existence of Pool-Level Support would not impact the quantity or quality of information made available by underwriters.

As a result, a ban on Pool-Level Support would not be necessary or even helpful in properly aligning incentives between underwriting and securitization performance. In a transaction with Pool-Level Support, the Credit Enhancer is an additional party policing originator underwriting practices.

*Complexity*

In our experience, the capital structures of securitizations featuring Pool-Level Support are often simpler than the capital structures of securitizations that do not have Pool-Level Support. This is because, in terms of credit tranching, Pool-Level Support effectively takes the place of what might have been one or more junior or mezzanine classes of obligations, enabling issuers to issue a larger senior tranche that approximates in size what would have been the aggregate of the senior tranche and one or more adjoining junior or mezzanine classes. For instance, if the typical capital structure for an asset class in a transaction without Pool-Level Support involves three

credit tranches (Classes A, B and C), a transaction in the same asset class with Pool-Level Support would often have only one credit tranche of securities (Class A). Consequently, there is no reason to prohibit Pool-Level Support in order to reduce complexity and promote market understanding of capital structures.

*Liquidity and Consumer Costs*

In the transactions where it is present, Pool-Level Support affirmatively promotes two of the goals that the FDIC has identified for the safe harbor – increasing the liquidity of financial assets and reducing consumer costs. Pool-Level Support promotes liquidity of financial assets in at least two ways. First, Pool-Level Support has traditionally been used most frequently in securitizations of financial assets that are viewed as novel or involving higher credit risks By facilitating securitizations of asset classes that the broader market of investors is not prepared to fund without supplemental credit enhancement, Pool-Level Support has increased the liquidity of these financial assets.

Second, Pool-Level Support has sometimes been used to facilitate market access by originators with financial or operational difficulties, as Credit Enhancers have the opportunity to extensively diligence these entities and (when warranted) achieve a level of comfort that is difficult for the broader universe of investors. This increases the liquidity of financial assets held by institutions that need it most. To the extent the distressed originators are insured depository institutions, this continued market access can directly reduce the likelihood of failure and resulting draws on the insurance fund.

Pool-Level Support has tended to reduce borrowing costs for consumers by facilitating market access by new entrants, thereby increasing competition at the consumer level.

*Conclusion*

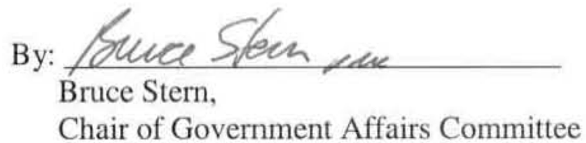
Relying on our significant expertise in this area, we have demonstrated why it is our opinion that none of the possible reasons suggested by the ANPR for prohibiting Pool-Level Support in safe harbor transactions actually support such a prohibition. When considered in light of the customary ways in which Pool-Level Support is written and used, as the industry have done for 25 years, we believe that Pool-Level Support is an effective tool that furthers the FDIC's stated goals for the safe harbor. We therefore strongly oppose any prohibition on the use of Pool-Level Support for securitizations.

In addition, we have reviewed the comment letter on the ANPR submitted by the American Securitization Forum, and we generally support the comments made in that letter.

We appreciate this opportunity to comment on the ANPR. Should you have any questions about the foregoing, please feel free to contact me at 212-339-3482 and bstern@assuredguaranty.com or my associate at Assured Guaranty, Ruth Cove, at 212-261-5543 and rcove@assuredguaranty.com, (our address is Assured Guaranty, 31 West 52nd Street, New York, New York 10019).

Very truly yours,

ASSOCIATION OF FINANCIAL GUARANTY INSURERS

By: 

Bruce Stern,
Chair of Government Affairs Committee

cc: Ruth Cove