

June 13, 2007

Mr. Lawrence Smith, Director
Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 7

File Reference No. 1530-100

Dear Mr. Smith,

As a sell-side equity analyst who has been examining and writing research on the financial guaranty sector and individual companies for ten years, I felt that it was important to respond to the Financial Accounting Standards Board ("FASB") Exposure Draft *Accounting for Financial Guarantee Insurance Contracts* ("the ED"). In my capacity as an equity analyst, I provide unbiased analysis and research on the financial guaranty companies and am a heavy user of the financial disclosures provided by these institutions. My interest in sending this letter is not influenced by a financial interest in this group, but rather a desire for these companies to continue to disclose and present financial information in a transparent manner that enables intelligent analysis and understanding of these complex business models.

Summary Comments:

With ten years of perspective on this group, I can tell you that this is one of the most complex businesses in the financial services sector and in-depth understanding of these companies takes a considerable amount of work. This complexity also lends itself to misperceptions in the public markets. To the companies' credits, we have seen them consistently willing to provide additional explanations and disclosures to aid investors' understanding of the companies' risks and business models. At the end of the day, we believe that the financial guaranty companies have delivered a high level of transparency into their business, while also maintaining one of the most conservative accounting models in financials.

Having reviewed the ED, I applaud FASB's efforts to standardize financial guaranty reserving practices, which have historically differed from company to company and created degrees of confusion for investors, and to improve disclosures that are pertinent to investors' understanding and evaluation of these companies. However, I believe that the proposed changes for premium revenue recognition, which is consistently applied in the industry, are flawed in several respects and would only serve to increase the complexity of the financial guarantors' financial presentations, unnecessarily distort the economics of the business, and make these companies more difficult for the investing public to analyze and ultimately understand.

Reserving Methodology:

As highlighted above, we applaud FASB's efforts to standardize reserving methodologies across the group. Implementing what will effectively be a quarterly, bottoms-up analysis of credit, eliminating unallocated reserve provisions and requiring improved disclosures around watch list reporting and movement between active credit (ACR) and case reserves will provide investors with a much clearer picture of loss activity in these business models. We would note that these companies, although often using different reserve methodologies, have tended to provide a significant amount of information around credit developments to aid investors in their analysis. However, standardizing methodologies to the proposed process should

dramatically improve the transparency of credit developments and, in turn, investors' understanding of this aspect of the financial guaranty business model.

Premium Revenue Recognition:

In my opinion, the financial guaranty companies possess one of the more conservative business models in financials and provide a substantial amount of information which, if used properly, yields significant insight into their business models. Conservatism runs at the core of these companies, who need to be consistently focused on the highest credit discipline and the sanctity of their triple-A financial strength ratings. We believe that the accounting for premiums in this business echoes this sentiment. The methodology might not be perfect, as few ever are, but we believe that the current premium recognition practices in the industry are the most appropriate approach for reflecting the real economics of the product in the marketplace.

With respect to transparency, the financial guarantors have strong disclosures regarding the mix of new business production (upfront versus installment premiums), aggregate premium liabilities (both the unearned premium reserve liability that is reflected on the balance sheet as well as the present value (PV) of installment premiums provided in supplemental disclosures) and the schedule of recognition for the aggregated liabilities. We depend heavily on these disclosures and believe that the latter methodology is transparent and reflective of the economics of the business model. In evaluating the ED's proposals, we have fundamental objections to several aspects of the section related to premium revenue recognition.

Suggested Adoption of a Statutory-Like Premium Recognition Methodology:

One proposal in the ED is to recognize premium revenue only as payments are made on a guaranteed obligation, giving no consideration to the influence on risk from the passage of time or the intangible value of the product over that same time period. From our perspective, this is effectively statutory accounting, which, for upfront premium business at least, is already publicly available if we saw any value in it. We believe that the existing premium recognition methodology used by the financial guarantors is more reflective of the economics of the business and that a change to this methodology would only serve to unnecessarily disrupt investors' understanding of these companies.

There is evidence throughout the capital markets that the passage of time is correlated with declining risk. This can be seen in data trends collected and reported by the rating agencies and in daily market activities, where the market tends to require higher compensating yields on longer tenor financial investments. Given this inherent link, we believe that the current revenue recognition methodology, which gives consideration to par insured as well as the passage of time, is much more reflective of the economics of the business than the proposed approach. In addition, we would highlight that a financial guaranty insurance policy provides value daily to an underlying credit in the liquidity it gains in the market and the breadth of investors to which it appeals. Shifting to the proposed premium recognition methodology would completely ignore this value as well.

Recognizing PV Premiums on the Balance Sheet:

I believe that it is readily understood that value is created when a new insurance contract is issued on a transaction structured with installment premiums. And, in fact, the value of this PV installment premium "liability" has been consistently disclosed by the financial guaranty companies. Requiring the recognition of this value on the balance sheet does not provide any incremental information or value to an investor's analysis of one of these companies, as it simply grosses up each side of the balance sheet. Recognizing the PV premiums on the balance sheet does, however, create several issues that actually could distort analysis and foster greater misconceptions about this business in the marketplace. Balance sheet volatility introduced by contractual life estimates, accounting for the discount through an amortization into investment income and conflicts with claim recognition are all real considerations that we believe, if this proposal was implemented, would only detract from investors' analytical abilities and serve to create more misinformation in the market.

Contractual Life Proposal:

If it were possible to accurately assign contractual lives to PV installment business, it is likely that the financial guarantors would be able to use an upfront premium approach on these transactions. However, this is not the case, as varying prepayment speeds and other considerations make assignment of contractual lives to PV installment business effectively a guess. Requiring the financial guarantors to implement contractual life measures on these types of transactions would serve only to add volatility to the balance sheet that is not at all reflective of the economics of the business (many of these transactions would likely require write-downs due to prepay variances), distort investors' understanding of premium recognition (forecasts based on effective lives would likely overstate the true expected premiums if a transaction prepays), and destroy the predictive element that is inherent in the financial guaranty business model and valued by the street.

Accounting for the PV Discount:

The ED suggests that the discounted amount on an installment premium contract should be amortized through investment income over time. From our perspective, leaving the more technical argument regarding embedded financing to either the issuer or the insurer to the industry, the most important aspect of this proposal in our opinion is that it overly complicates a relatively straight forward income statement. Financial guarantors generate, roughly speaking, 40% of their net income from investment income, which is produced by a highly conservative asset base. This line item is stable and fairly predictable and is an important part of the appeal of the financial guaranty investments. Accounting for the PV discount through this line, especially when consideration is given to the volatility of such a PV value in the face of prepayment speed variations, would not add to investors' analysis of these companies, but would in fact unnecessarily complicate this work.

Implementation:

Our final argument against the proposed premium recognition changes is that implementation of this unnecessary methodology shift by January 1, 2008 appears unrealistic. Should FASB approve this premium recognition methodology, we would expect that the financial guarantors would have to make material changes to their systems. These changes would likely carry a notable cost to the guarantors and would likely take a significant amount of time to implement. We believe that a more realistic time frame should be considered if FASB approves this proposal in full.

Conclusion:

As the content of this letter highlights, I am strongly against the ED's proposed changes to financial guaranty premium recognition practices. Unlike reserving, premium methodology in the financial guaranty industry is fairly uniform and straight forward. Existing disclosures provide substantial insight into the expected timing of premium recognition. Finally, I believe that existing practices more adequately reflect the economics of the business, whereas the proposed methodology would materially distort the economics and add accounting volatility that would further aggravate this issue.

Again, I am an unbiased user of the financial guarantors' financial information and depend on their disclosures to complete thorough analysis of their business models. From my perspective, the proposed changes to premium recognition would provide nothing positive, but introduce several negatives. A constant challenge as an equity analyst covering this group is combating the misconceptions in the marketplace and we believe that the proposed revenue recognition methodology would only serve to promote these issues rather than reduce them. If implemented, we would use all available resources, including requesting that the guarantors expand their non-GAAP disclosures, to recreate the existing methodology and recapture what we believe is a more accurate depiction of this business's economics.

I have been asked by FASB for my opinion on accounting issues for this group in the past and hope that this letter is seriously considered as FASB moves toward a decision on this proposal. I understand that a roundtable discussion is preliminarily scheduled for July 16, 2007 and would welcome the chance to

participate and add the perspective of a heavy user of the financial guarantors' financial information and a long-time analyst on this group.

Thank you for your consideration in this matter and please feel free to contact me for any clarifications or expanded conversation.

With respect and regards,

Geoffrey M. Dunn, CFA
Managing Director, Equity Research
Keefe, Bruyette & Woods, Inc.