ASSURED GUARANTY

Assured Guaranty Ltd.
30 Woodbourne Avenue – 5th FL
Hamilton Bermuda HM 08
441-296-4004
www.assuredguaranty.com

1530-100

LETTER OF COMMENT NO. 33

June 18, 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

File Reference No. 1530-100

Dear Mr. Smith,

We are writing in response to the recent Financial Accounting Standards Board ("FASB" or "the Board") Exposure Draft *Accounting for Financial Guarantee Insurance Contracts* ("the Exposure Draft"). In addition to our response, included herein, we note that we are members of the Association of Financial Guaranty Insurers ("AFGI"), and we are fully supportive of the comment letter submitted by AFGI on behalf of its members. We would appreciate participating in the round table meeting planned by the Board on July 16th.

Overview:

We commend the FASB for undertaking this project and fully support the objective of reducing any diversity in practice with regard to the accounting for financial guaranty contracts. Clearer and more comparable information will benefit users of the financial statements by reducing the complexity or any lack of transparency that may exist in this specialized industry. We feel that such objectives are best accomplished if the accounting statement reflects the true economics of the underlying business.

The Exposure Draft does provide a reasonable and workable solution for claim liability recognition. We feel this is an area where diversity of practice exists today and the proposed statement addresses this while providing a workable solution. In this regard the proposed guidance addresses the concerns that led the Board to undertake this project.

We do not agree, however, with the additional provisions that address revenue recognition and balance sheet reporting. Within the financial guaranty industry there is no significant diversity in current practice relative to revenue recognition. In addition, we feel that the revenue recognition model proposed digresses from the true economics of our business. Current industry practice is well understood by the principle users of the financial statements, namely, analysts, rating agencies, and equity and debt investors. It is our feeling that such a sweeping change to the revenue recognition model should only be considered in the context of a broader project such as the International Accounting Standards Board ("IASB") project that would propose a significant new accounting model for all insurance companies, which the FASB intends to pursue with a parallel project. As such, we strongly recommend that the Board defer consideration of the revenue recognition and balance sheet reporting issues as they are presented in the exposure draft.

We address our concerns in the body of this letter which is laid out in the new format used by the FASB.

Scope (Paragraphs 2-6)

Issue 1: We agree with the definition of a financial guaranty insurance contract as a contract that provides protection to the holder of a financial obligation from financial loss in the event of default. However, certain economically similar financial contracts, issued by financial guarantors, will still be scoped within accounting models such as FAS 133, FIN 46R or FAS 155. For that reason, and as discussed below, we ask the FASB to consider expanding the scope to address these areas as well.

Issue 2: We believe the scope should be expanded to include all types of financial guaranty contracts issued by insurance companies. With the current Exposure Draft very similar contracts would not be accounted for consistently such as mortgage guarantees, surety contracts or credit default swaps. The same entity may enter into similar types of contracts and account for them far differently. For example, in situations where an insurance enterprise includes mortgage guarantees as well as financial guarantees, there is within the scope of the Exposure Draft the need for two separate accounting measures. In addition to being overly burdensome from a system and financial reporting prospective, consolidated results have the potential to be misleading to investors and the public.

Also, the scope stills leaves uncertainty with regard to contracts issued by insurance enterprises that are economically the same as other financial guaranty contracts but have triggers within the structure that impose accounting models such as derivative accounting or consolidation. Triggers may or may not bring financial guaranty contracts into these accounting models leaving significant complexity and potential inconsistency. Depending on the subtlety in facts of a particular deal, a financial guaranty contract may still be accounted for under no fewer than three different accounting models. We believe the development of a standard specifically for financial guaranty companies provides a significant opportunity to provide uniform accounting treatment for contracts with similar risks.

Issue 3: We do believe more guidance is needed with respect to FAS 133 par 10(d) and the scope exception for financial guaranty companies. There are situations were financial guaranties may inadvertently fall within FAS 133 due to the structure of a deal when in fact they should be either scoped out or bifurcated between a derivative and a financial guaranty. The Exposure Draft as it stands does not provide any guidance in this capacity nor does FAS 155.

Unearned Premium Revenue (Paragraphs 7-11)

Issue 4: The Exposure Draft proposes requiring unearned premium liabilities and corresponding premium receivable assets for the contractual premiums under installment contracts. We disagree with this proposed guidance. We believe that recording such assets and liabilities is inconsistent with existing GAAP guidance, is inconsistent with the manner in which other insurance companies record premiums, and will make the financial statements less transparent.

We believe that future installment premiums do not meet the definition of an asset as defined in Concepts Statement No. 6, paragraph 25, which defines assets as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." Installment premiums represent consideration for a service being provided over time. The payments are due on a pay-as-you-go basis owing to the uncertainties surrounding 1) the existence of the obligation in the future and 2) the amount of the obligation outstanding, not for financing purposes. Thus, the event that entitles the insurance enterprise the right to the entire premium has not occurred at inception. The insurer has a contractual right to future premiums only if the obligation remains outstanding. We believe current practice appropriately does not require recognition of assets and liabilities relating to future installment premiums because the transaction or event giving rise to the insurer's right to receive premium is not the issuance of the insurance. An appropriate analogy may be to long-duration life insurance contracts. For these contracts insurers record premiums receivable only when those premiums are due, not for the entire life of the insurance contract when issued.

Issue 5 & 6: The Exposure Draft would require the measurement of initial unearned premium revenue based upon the present value of the contractual payments. Likewise the premium receivable asset would be discounted using a rate based upon the policyholder's credit standing. This liability and the premium receivable asset will be overstated at inception with a release into income over the period of the financial guaranty contract in proportion to the debt service payments. The overstated balances will need to be adjusted to reflect actual activity. These "true-ups" could lead to reduced financial statement transparency and accounting-driven fluctuations in premium earned and investment income. Establishing these accounts with a discounted cash flow projection that will be subject to constant adjustment in each reporting period will result in extensive volatility for fluctuation in interest rates that are beyond the control of the insurance company. This will make analysis by investors of true performance that much more difficult to ascertain. The constant monitoring and adjustment for accounting purposes imposes an unnecessary volatility when this information can be disclosed without the need to flow through the balance sheet and income statement.

We recommend that information regarding the net present value of future premiums are a disclosure item in the financial statement and not be recorded in the balance sheet. To the extent the Board believes it is necessary to record an asset and liability we feel it is critical that these balances reflect the true economic expectation under the contracts. As such, the net present value of future payment streams should be estimated based upon the expected life of the contract and not the contractual life as described below. In addition, the accretion of any interest element should be accreted into premium revenue.

Issue 7: Floating rate interest obligations and partial repayments do occur daily and additional guidance will need to account for the impact if the current exposure draft were to be implemented as drafted.

Premium Revenue Recognition (Paragraphs 12-17)

Issue 8: The proposed revenue recognition model requires revenue to be recognized in proportion to the payments made by the insured to the overall debt insured. This formula does not take into account the reduction of risk due to the passage of time. The extreme example as outlined in the Exposure Draft is that of a zero coupon bond which would not earn any revenue over the life of the contract until the very end when the entire amount is due. There are also a number of other types of transactions such as bullet transactions and certain structured finance transactions which would have delayed revenue recognition features based upon the timing of a disproportionate payment. This does not represent the true mechanics of the risk undertaken by the insurance company. For example, an insurance company may charge 10 basis points of premium for such a contract which will not mature for 10 years. That same insurance company would charge a lower rate if it matured in 5 years or 1 year. There would be a difference in price which would be directly related to the time at risk if all other factors are equal. The proposed revenue model does not incorporate this key concept for a business that enters into contracts which are typically held to maturity.

Rating agency loss statistics fully support the concept of loss reduction decreasing over time. The attached graph of S&P Corporate Default Rates ("Default Graph") for corporate bonds demonstrates how default probabilities slope downward through maturity. This concept is factored in analysis by rating agencies as well as underwriters and should be included in a new revenue model.

To the extent the Board decides to proceed with a new revenue recognition model we would recommend a level yield approach based upon the average principal balance of the insured obligation outstanding for the period. This would achieve consistent treatment for premiums paid either up-front or on an installment basis over the life of the contract.

Issue 9: We do not agree that insured contractual payments are the most appropriate measure of exposure. This does not take into account the duration of the obligation. Default statistics show that duration is a key component for the overall exposure of a financial guarantee instrument. The attached Default Graph demonstrates how the default curve and the reduction of exposure occur over time. The graph highlights how default rates reduce to zero on a sloping curve over the life of an obligation. The linkage between premium revenue and possible claim liability as being equal at inception does not appropriately factor in the entire economic substance of the contract at the time it is written.

Issue 10: As explained above and the attached exhibits demonstrate how risk is reduced due to the passage of time. This is a factor taken into account for both long and short duration contracts under FAS 60 and should be included in a revenue recognition model for financial guarantee contracts. We believe par value outstanding and tenor is a more relevant measure of exposure or as a basis for revenue recognition, as typically insured defaulted obligations may be settled at par.

Issue 11: We strongly believe that expected lives should be included in the formula of revenue recognition to reflect the true economics of the contract. The contractual term is the maximum contractual term which assumes a zero prepayment rate. This is unrealistic for this industry based on past performance. Data regarding prepayment history is available and can be estimated. This data is already used as part of the underwriting process and is used by third parties such as rating agencies. We believe that investors and rating agencies will not consider full contractual cash flows as useful information.

Issue 12: We agree with the treatment of refundings.

Claim Liability (Paragraphs 18-24)

Issue 13: We do not agree that a claim liability should be linked with expected unearned premium in such a manner. As mentioned above unearned premium revenue should be regarded as unearned revenue in the sense of cash, which has been received prior to being earned, and not a measure of future possible claims. The linkage adds unnecessary confusion to the premium written versus earned concepts of insurance accounting and will undoubtly make financial statements less transparent

Issue 14: We agree with the proposed measure of a claim liability.

Issue 15: We agree with the use of a survallence list as a measure of claim liability. Our company uses such a list and it is our understanding most FG companies do the same.

Disclosures

Issue 16: We agree with the proposed additional disclosures required by the statements.

Effective Date and Transition (Paragraphs 27-30)

Issue 17: Since the final exposure draft will not be issued until the third quarter of 2007 we do not agree that a January1, 2008 implementation date is reasonable. This is due to the fact that many of the suggested accounting considerations will require significant system technology change to implement. Adopting this statement by the first quarter of 2008 will not provide sufficient time and we would ask the FASB to delay implementation for at least 9-12 months.

Issue 18:

We agree with adopting this statement on a prospective basis through retained earnings but believe additional guidance is needed for the transition.

Other Issues:

Implementation - We believe the Exposure Draft, if finalized, would give rise to significant issues with regard to implementation.

- In the case of prepayments, would the premium receivable and unearned premium revenue balances be adjusted through bad debt expense or earned premium?
- If expected losses fluctuate over time such that they exceed unearned premium revenue in one year but later reverse, should unearned premium revenue be reinstated?
- DAC is currently established by vintage year rather than at a policy specific level. Some policies take more than one year to close. Does this standard require policy level capitalization of costs? This would represent a change in process that requires significant system changes.
- Applying a unique issuer discount rate to each installment receivable estimate is impractical and will be costly to implement as it would require the determination of thousands of individual discount rates.
- Non-dollar installment transactions will produce foreign exchange gains and losses due to the mixed measurement of related asset and liability, i.e., the liability will be carried at a historical foreign exchange rate while asset would be revalued at the spot rate. Is this the intended result?

Reinsurance - We feel that additional guidance is needed for reinsurance transactions if the exposure draft were to be issued as written. There are a number of issues which will require significant deliberation and development of guidance. In particular, how will ceding commissions be treated under the statement as well as how will the transfer of unearned premium receivable balances occur? If such items are discounted how would gains or losses be recognized by the ceding company or the reinsurer? There would be operational issues associated with the accounting that would need to be addressed from both perspectives (i.e. the insured and the reinsurer). Should ceding commissions on installments to be based on contractual life as well? What ceding commissions would be included in the DAC asset account? How should the account be discounted i.e. what interest rate should be used?

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We also encourage the Board to speak with the financial statement user community, primarily the equity analysts and rating agencies which cover the financial guaranty industry. Through recent discussions with this user community, we believe they share many of the concerns outlined in this letter. We would very much appreciate the opportunity to discuss this at the round table meeting scheduled for July 16th.

Very truly yours,

Robert B. Mills
Chief Financial Officer

Robert Bailenson
Chief Accounting Officer

ATTACHMENT I