MEMORANDUM

TO: File No. S7-14-11

FROM: Jay Knight
Special Counsel
Office of Structured Finance
Division of Corporation Finance
U.S. Securities and Exchange Commission

RE: Meeting with Representatives of Assured Guaranty Corp. and the Association of Financial Guaranty Insurers

DATE: May 2, 2011

On April 28, 2011, Katherine Hsu, Jay Knight, Rolaine Bancroft, David Beaning, and Robert Errett of the Division of Corporation Finance met with the following representatives of Assured Guaranty and the Association of Financial Guaranty Insurers (AFGI): Bruce Stern (Assured Guaranty and AFGI), Carolyn Walsh (Patton Boggs LLP), and Matthew Kulkin (Patton Boggs LLP). The discussion included, among other things, the Commission's Proposed Rules for Credit Risk Retention. Handouts are attached to this memorandum.

Attachment

Proposed Rules for Credit Risk Retention under Section 941(b) of the Dodd-Frank Act:

Key Issues for Financial Guaranty Insurers

April 28, 2011

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Overview: Financial guaranty insurance transactions

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- **Financial guaranty insurers guaranty scheduled payments of principal and interest on securities**
  - Financial guaranty insurance is generally unconditional and irrevocable
  - Securities insured by financial guaranty insurers consist primarily of municipal bonds and asset-backed securities
- **Financial guaranty insurers are state licensed insurance companies subject to comprehensive regulation**
  - Issuing insurance policies, refinancing/restructuring insurance policies and terminating/de-risking insurance policies are adequately regulated by state insurance regulators
- **Certain insurance transactions by financial guaranty insurers may resemble securitization transactions**
  - These insurance transactions (described herein) appear to qualify for the resecuritization exemption under the proposed risk retention rules insofar as such transactions are subject to such rules
- **Financial guaranty insurers seek clarification that their insurance transactions are either not subject to the proposed risk retention rules or qualify for the resecuritization exemption under the proposed rules**

Financial guaranty insurers should not be considered securitization sponsors

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- **Financial guaranty insurers are not the type of entities intended to be regulated by the proposed risk retention rules**
- **The proposed rules only regulate “sponsors”**
  - A “sponsor” is a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly to the issuing entity
  - The issuance or termination of a financial guaranty insurance policy does not involve the sale or transfer of assets; hence a financial guaranty insurer should not be considered a sponsor
  - An exception to the requirement of the sale or transfer of an asset applies in the case of an ABCP conduit administrator
    - The activities by financial guaranty insurers described herein do not qualify financial guaranty insurers as ABCP conduit administrators

The provision of insurance should not be considered a securitization transaction

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- **Insuring an obligation should not be considered a securitization transaction**
  - A “securitization transaction” is a transaction involving the offer and sale of asset-backed securities by an issuing entity
    - An asset-backed security is a security where the holder takes the credit risk of recovery on a pool of assets, receiving “payments that depend primarily on the cash flow from the asset”
  - The risk retention rules are intended to enhance the integrity of securitization by requiring the sponsor, particularly in an “originate to distribute” model, to retain “skin in the game” in order to align the interests of sponsors with those of security holders
  - The provision of financial guaranty insurance will not reduce the obligation of a securitization sponsor to retain risk under the proposed rules
    - The true securitization sponsor will retain “skin in the game” as mandated by the proposed rules

Analysis of certain insurance transactions: Custody receipt programs

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- **Financial guaranty insurers employ custodial arrangements to insure securities in the secondary market**
  - A security and an insurance policy guarantying the security are placed into a custody arrangement with a custodian who issues a custody receipt representing ownership of the security and policy
  - The custody receipt is provided its own CUSIP number and generally trades like an insured security
  - The insurer is paid a premium for its insurance through an up-front payment or through a diversion of a portion of the interest coupon on the security held in custody otherwise due to the custody receipt holder
  - A March 30, 1988 SEC no-action letter to Financial Security Assurance Inc. indicated that the staff would not consider the custody receipt to represent a new security requiring registration under the Securities Act of 1933 and would not require registration of the custody arrangement under the Investment Company Act of 1940
- **The issuance of custody receipts for securities insured in the secondary market should not constitute securitization transactions subject to the proposed risk retention rules or should qualify for the resecuritization exemption under the proposed rules**
  - Analysis consistent with the March 30,1988 no-action letter
  - The transaction should qualify for the “resecuritization exemption” under the proposed rules insofar as the rules apply
    - The insurance premium should be considered “expenses” of the issuing entity
    - Technical correction: The resecuritization exemption should apply to all resecuritizations rather than only asset-backed security resecuritizations

Analysis of certain insurance transactions: Alternative secondary guaranties

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- **Financial guaranty insurers employ special purpose issuers to insure securities in the secondary market**
  - A security and an insurance policy guarantying the security are delivered to a special purpose issuer that issues an insured security back-to-back with the underlying security
    - The insurer's premium may be paid out of the coupon on the underlying security
  - Special purpose issuers (as opposed to custodians) are typically employed in jurisdictions where there are impediments to employing custodial arrangements
- **Secondary market insurance transactions should not constitute securitization transactions subject to the proposed risk retention rules or should qualify for the resecuritization exemption under the proposed rules**
  - The transaction should qualify for the "resecuritization exemption" under the proposed rules insofar as the rules apply
    - The insurance premium should be considered "expenses" of the issuing entity
    - Technical correction: The resecuritization exemption should apply to all resecuritizations rather than only asset-backed security resecuritizations

Analysis of certain insurance transactions: Refinancings for loss mitigation

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- **Financial guaranty insurers may arrange for the issuance of new insured securities to refinance outstanding insured securities for loss mitigation purposes**
  - A special purpose issuer issues insured securities (the “new securities”), the proceeds of which are used to reimburse the insurer for insurance policy claims paying all remaining principal and interest on outstanding insured securities (the “old securities”)
  - In exchange for reimbursement of its policy payments by the new securities issuer, the insurer assigns to the new securities issuer all subrogation and other rights of the insurer against the old securities issuer
- **Issuance of the new securities should not constitute a securitization transaction subject to the proposed risk retention rules or should qualify for the resecuritization exemption under the proposed rules**
  - The transaction should qualify for the “resecuritization exemption” under the proposed rules insofar as the rules apply
    - Technical correction: The resecuritization exemption should apply to all resecuritizations rather than only asset-backed security resecuritizations
  - The old securities, if ABS issued subsequent to the effective date of the proposed risk retention rules, would provide for risk retention by the initial sponsor of the old securitization transaction
  - Loss mitigation transactions are not subject to the abuses intended to be addressed by Section 941(b) of the Dodd-Frank Act

Analysis of certain insurance transactions: Terminating insurance on insured securities

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- **Financial guaranty insurers employ trust arrangements to terminate insurance on insured securities originally issued in the primary market**
  - An insured security is placed into a trust arrangement with a trustee
  - The trustee issues a trust certificate representing ownership of the proceeds from the underlying security and a trust certificate representing proceeds from the related insurance policy
  - The trust certificate representing proceeds from the related insurance policy is delivered to the insurer, financially terminating the insurance on the related security
- **Transactions to terminate insurance on outstanding securities should not constitute securitization transactions subject to the proposed risk retention rules or should qualify for the resecuritization exemption under the proposed rules**
  - Transaction should qualify for the "resecuritization exemption" under the proposed rules
    - Insurance proceeds should not be considered principal and interest payments on the underlying asset-backed securities
    - Technical correction: The resecuritization exemption should apply to all resecuritizations rather than only asset-backed security resecuritizations
  - Terminating insurance on outstanding transactions is an important tool for de-risking or winding down financial guaranty insurers
  - From a policy vantage point, neither providing insurance nor terminating insurance are the types of transactions intended to be addressed by the risk retention rules under the Dodd-Frank Act

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April 28, 2011