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Rating Action: **Moody's downgrades FSA to Aa3 from Aaa, with developing outlook**

Global Credit Research - 21 Nov 2008

New York, November 21, 2008 -- Moody's Investors Service has downgraded to Aa3 from Aaa the insurance financial strength rating of Financial Security Assurance, Inc. (FSA) and supported insurance companies. In the same rating action, Moody's downgraded the debt ratings of Financial Security Assurance Holdings, Ltd. (senior unsecured debt to A3 from Aa2) and related financing trusts. Today's rating action reflects Moody's view of FSA's diminished business and financial profile resulting from its exposure to losses on US mortgage risks and disruption in the financial guaranty business more broadly. The rating action concludes a review for possible downgrade that was initiated on July 21, 2008. The company's rating outlook is developing.

As a result of today's rating action, the Moody's-rated securities that are guaranteed or "wrapped" by FSA are also downgraded to Aa3 under review direction uncertain, except those with higher published underlying ratings (and for structured finance securities, except those with higher published or unpublished underlying ratings). A list of these securities will be made available under "Ratings Lists" at www.moody.com/guarantors.

The downgrade results from four primary factors. First is Moody's expectation of greater losses on mortgage related exposure, reflecting continued adverse delinquency trends and the likelihood of material losses stemming from FSA's second lien and Alt-A portfolios, as well as the risk of further losses in its mortgage portfolio should conditions worsen. Second is the negative impact of these higher loss expectations on FSA's capital position, despite recent capital infusions from parent Dexia and the announced plan by the French and Belgian governments to support FSA's financial products segment. Third is Moody's view that the operating environment for financial guaranty insurers, including FSA, has fundamentally changed over the past year, with fewer new business opportunities and weaker confidence in the industry overall. Fourth is FSA's loss of prospective support from its government-supported banking parent Dexia, although the recently announced acquisition of FSA's financial guaranty business by Assured Guaranty Ltd. (Assured Guaranty) should provide an alternative source of support assuming the transaction closes as planned. The rating agency added that the acquisition of FSA by Assured Guaranty would create a combined entity with substantial financial resources and a strong market position.

Moody's said that the developing rating outlook for FSA reflects both (a) potential positive movement in the company's financial and business profile post-acquisition assuming FSA is capitalized and positioned as an ongoing writer of high-quality financial guaranty insurance within the group; and (b) potential negative rating pressure should the acquisition fail to close or should Assured Guaranty pursue a different strategy for FSA. Additionally, Moody's noted that FSA currently retains substantial exposure to contingent liquidity risk associated with its financial products business, although this risk will be eliminated once the announced support from the French and Belgian governments becomes effective.

In Moody's view, the level of demand for financial guaranty insurance over the near-to-medium-term is less certain than in the past, which has negative implications for the strength and stability of FSA's business franchise. While there continues to be a market for municipal bond insurance, Moody's said that prospective opportunities in the municipal sector may be narrower than in the past given changing perceptions about municipal risk among buyers, lower confidence in the financial guaranty industry broadly and a trend toward alternative forms of execution, including the issuance of uninsured paper. Moody's noted, however, that while the financial guaranty industry's importance within the US municipal market has declined overall, FSA's relative competitive position in these markets has been favorably affected by its position as one of three primary financial guarantors with limited exposure to higher risk ABS CDOs.

Moody's also believes that customer demand may be inherently unstable, with a very sharp fall-off in demand likely to result from even moderate declines in a guarantor's credit profile. This susceptibility to changes in credit risk profile creates a "demand cliff" beyond that observed in most other industries. Furthermore, the extreme sensitivity of a financial guarantor's franchise value to changes in its risk profile also affects financial flexibility, where even the best positioned firm could experience a dramatic constriction of financing options if material losses were to develop.

Related Issuers +

- [Assured Guaranty \(Bermuda\) Ltd.](#)
- [Assured Guaranty \(Europe\) Ltd.](#)
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- [Credit Opinion: Financial Security Assurance Holdings Ltd.](#)
- [Issuer Comment: Puerto Rico Public Finance Corporation's Default Is Credit Negative for MBIA and Assured Guaranty](#)

FSA's Aa3 insurance financial strength rating reflects Moody's view that the guarantor's aggregate resources (including statutory contingency reserves and contingent capital) provide a very substantial capital cushion above expected loss levels. Moreover, the announced French and Belgian government support of FSA's financial products business will, once in place, free-up capital resources and eliminate liquidity concerns stemming from potential investment agreement terminations or collateral posting requirements. FSA's disciplined underwriting strategy and active participation in the municipal market have resulted in a generally high-quality and diversified insured portfolio beyond the firm's mortgage-related exposures. Most non-mortgage exposures are performing well, although the insured portfolio is exposed to transaction or sector deterioration, especially in light of the increased risk of a prolonged and deep recession.

On November 20, 2008, Moody's released a report titled "The Changing Business of Financial Guaranty Insurance." The report, which can be accessed on Moodys.com, explores the above mentioned industry challenges and vulnerabilities in the context of Moody's financial guaranty rating methodology.

LIST OF RATING ACTIONS

The following ratings have been downgraded:

Financial Security Assurance Inc. -- insurance financial strength to Aa3, from Aaa;

Financial Security Assurance (U.K.) Limited -- insurance financial strength to Aa3, from Aaa;

Financial Security Assurance Intl Ltd. -- insurance financial strength to Aa3, from Aaa;

Financial Security Assurance Holdings Ltd. -- senior unsecured debt to A3, from Aa2, junior subordinated debt at Baa1, from Aa3, provisional senior debt to (P) A3, from (P)Aa2, provisional subordinated debt to (P)Baa1, from (P)Aa3, and provisional preferred stock to (P)Baa2, from (P)A1;

FSA Seguros Mexico S.A. de C.V. -- insurance financial strength to Aa3, from Aaa (the firm's Aaa.mx national scale rating was affirmed); and

Sutton Capital Trusts I, II, III and IV -- contingent capital securities to A3, from Aa2.

Financial Security Assurance, Inc. is the main operating company of Financial Security Assurance Holdings Ltd. and the parent of other wholly-owned financial guaranty insurers in a stacked structure. FSA Holdings is a subsidiary of Dexia Credit Local (senior debt at Aa3, BFSR at C-, under review for downgrade), which is the largest operating company within the Dexia Banking Group.

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