



LETTER OF COMMENT NO. 78

June 20, 2007

Mr. Lawrence W. 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

Re: Proposed Statement of Financial Accounting Standards: Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60

Dear Mr. Smith:

MBIA Insurance Corp. appreciates the opportunity to comment on the above referenced Exposure Draft ("ED"). In general, we support the FASB's objective to address the diversity in practice that has resulted in inconsistent recognition and measurement of claim liabilities accounting for financial guarantee insurance contracts under FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises* (FAS 60). However, as indicated below and in the documents attached, we have some significant substantive and operational concerns about the proposed premium recognition model and balance sheet reporting as well as the practicality of the implementation date. We also look forward to discussing our views on the ED with you at the roundtable meeting on July 16th.

Additionally, we have contributed to the development of the letter dated June 18, 2007 submitted by the Association of Financial Guarantee Insurers (AFGI). We endorse all the points raised in that letter, some of which we have chosen to amplify in this letter, and we also raise additional points that are of specific concern to MBIA. Our comments are summarized as follows:

- **Scope:** The ED applies to all existing and future financial guarantee contracts issued by insurance or reinsurance enterprises included within FAS 60 and cannot be applied or analogized to similar products offered by non-monolines. MBIA writes credit protection in two forms: financial guarantee insurance policies and credit default swaps. Our credit default swap (CDS) contracts are in substance financial guarantee insurance, and should be considered a financial guarantee contract subject to the scope of this ED. We would request the FASB to expand the scope to include an interpretation of the financial guarantee insurance scope exception in paragraph 10 (d) of FAS 133, *Accounting for Derivatives and Hedging Activities* in this Standard, to create consistency between the accounting for these two forms of credit protection. We also believe that this Standard should clarify that financial guarantee policies that insure derivatives or embedded derivatives should not be subject to FAS 155, *Accounting for Hybrid Financial Instruments* (FAS 155). We also note that the International Accounting Standards Board

(IASB) has issued a paper that proposes a significant new accounting model for all insurance companies with an expected effective date in 2010. Given that the FASB intends to pursue a FASB/IASB joint project, we would prefer not to make extensive and expensive process and system changes under the ED when another significant change is on the horizon. As a result, we urge the Board to defer consideration of the revenue recognition and balance sheet reporting issues and not create potential further confusion and divergence with the FASB/IASB joint project.

- **Revenue Recognition Approach:** The ED proposes that premium from all financial guarantee contracts (upfront and installment-based) should be recognized as revenue over the contractual term of the financial guarantee contract in proportion to the contractual debt service payments made by the issuer of the insured obligation. The underlying presumption is that the exposure is only reduced to the extent of the insured contractual payments are made there under. Under the ED, all or a substantial portion of the premium for insured bullet payments, zero coupon bonds and synthetic Collateralized Debt Obligations (CDOs) would be recognized only upon maturity. Further, on infrastructure projects with construction risk early in the contractual term and heavier amortization nearer the end of the term, the ED would require low recognition early and heavier recognition later in the term. The actual pattern of the risk profile is higher during the construction phase and lower following the completion of the construction, which the reverse of the proposed earnings profile.

Our primary concern with the proposed approach is that it does not incorporate the concept of a reduction of risk due to the passage of time, and it is inconsistent with the current insurance accounting models (i.e., short and long duration) in FAS 60. The relationship of risk and time to maturity is reflected in how financial guarantee contracts are priced in the market, and with the way rating agencies assign capital charges for the insured risks we underwrite, both at inception and over time. Investors also consider the time element of risk in the yield they seek for their bond investments. Models regarding the time element of risk already exist in our business, and they would be the most appropriate references for allocating premium revenue to time periods. However, there are practicality and consistency-based reasons to implement a simpler methodology. In addition, we believe that par value provides a better perspective for the amount of insured risk. While our industry's policies provide protection for both principal and interest, defaulted obligations can be settled at par plus accrued interest rather than the total amount of debt service had the deal remained outstanding until its contractual final maturity. (The insurance contracts of the guarantors typically include the right to pay the insured obligations at par plus accrued interest upon an event of default.)

While our strong preference is for the Board to defer a new accounting standard for premium revenue recognition until the FASB/IASB joint project is completed, if the Board decides to proceed with a new standard at this time, we would recommend a level yield approach based on the average insured par outstanding for each reporting time period. This level yield approach would incorporate risk reduction from both the amortization of par and the passage of time and would also meet the Board's objective of consistent treatment of revenue whether the premium is collected up front or on an installment basis over the term of the insured transaction. We have provided further description and support for this level yield approach in our comments on Issue #8 in Appendix A.

- **Contractual vs. Expected Term:** The ED proposes that the contractual period covered by the insured financial obligation should be used in determining the period over which premium revenue should be recognized. We disagree with this approach, and believe that the expected term of an insured obligation is the more appropriate period over which to recognize premium revenue. The expected term is the basis on which premiums for

insured structured finance securities [e.g., Asset-Backed Securities (ABS), Mortgage-Backed Securities (MBS), CDOs] are determined. This is similar to how investors and other market participants analyze and price such transactions. The ED proposed contractual term method would decrease transparency as it would require us to book a larger-than-expected premium receivable. This receivable would not meet the definition of an asset as defined in Concepts Statement 6, *Elements of Financial Statements*) and it is inconsistent with paragraph 12 of Accounting Principles Board Opinions No. 21, *Interest on Receivables and Payables*, (APB Opinion 21). Further, since the actual amortization will typically be different than expected, large ongoing accounting adjustments would be required to “true-up” the initial premium receivable and unearned premium revenue (UPR) (in general, to write-off the receivable over time), and would cause misleading earnings statements and changes to book value, ultimately confusing users of our financial statements, and distorting our financial statements. In Appendix D we show a comparison between contractual and expected term for a sample installment policy transaction to illustrate what we view as unintended consequences of the ED proposed methodology. In this example, more premium is earned in year 1 than is *expected* to be collected over the entire expected life of the transaction, resulting in a severely front-loaded revenue recognition in early years, as well as negative revenue recognition in the later years.

We believe the contractual term measurement approach for revenue recognition is also inconsistent with the proposed guidance on measuring claim liabilities based on expected cash flows. As described in our comments on Issue #11 in Appendix A, expected cash flows can be reasonably projected using available historical and market information, such as the prepayment speed assumptions employed by the marketplace for the given universe of structured finance MBS, ABS, and other securities that are widely traded. Such assumptions have also been developed by the rating agencies in their credit rating assessment process, and by investment banks and investors to price, market and buy and sell bonds. For other classes of assets, the guarantors have sufficient experience with the bonds being underwritten that the expected term can be estimated with reasonable accuracy. Using expected term for installment contracts rather than contractual term is necessary because the difference between expected and contractual term can be very material. The expected term of the installment business (i.e., structured finance) that MBIA insured in 2000, for example, was 4.7 years while the contractual term was 14.2 years. The gap between expected and contractual terms holds true for all annual vintages of installment premiums written by MBIA. For upfront premium business, the expected term is also estimable, but varies much less relative to the contractual term. The expected term of MBIA's upfront premium business (i.e., municipal business) written between 1985 and 2000 is 18 years, while the contractual term is 23 years. We believe the ED proposed “contractual term” method will result in accounting practices that diverge from the market-accepted practice of estimating prepayments for structured finance securities and is inconsistent with FAS 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating and Acquiring Loans and Initial Direct Costs of Leases* (FAS 91). FAS 91 permits estimating prepayments of principal if a reporting entity holds a large number of similar assets for which prepayments can be reasonably estimated.

- **Claims Liability:** The ED requires the recording of claim liabilities when expected losses (based on probability-weighted cash flows) exceed the unearned premium revenue for an insured contract. MBIA's current practice is to recognize claim liabilities for a specific transaction when a loss is probable and estimable, without regard for the amount of unearned premium revenue. The proposed new requirement will result in delays in loss recognition, and would be a particular problem if the unearned premium revenue for installment policies is based on the contractual term. A conservative interpretation of the

ED suggests a requirement of a highly specific, precise calculation of probability-weighted expected losses requiring a minimum number of scenarios. This is not implementable because some transactions are not subject to reliable cash flow analyses at reasonable costs. In some cases, troubled transactions present highly uncertain or non-existent cash flows, and impairments are typically measured by appraisal or other methods. MBIA uses surveillance lists to categorize impaired or problem/concerning credits. Credits where claim liabilities have been established (probable and estimable losses) are assigned to the "Classified List", and credits for which heightened surveillance is necessary are assigned to a "Caution List." Caution List credits are not necessarily likely to suffer a loss, and any cash-flow-analysis-based estimate of claim liabilities on Caution List credit would typically equal zero. We do not agree that disclosing specifics of Caution List credits would be helpful. Indeed, under certain circumstances, the possibility of bringing additional external attention may actually have negative consequences and/or unnecessarily complicate the Company's ability to successfully remediate a problem credit. However, a description of our Caution List assignment methodology and the attribution of non-specific claim liabilities in accordance with the Caution List (which would be based on our accumulated experience) can and should be disclosed. To avoid potential misinterpretations, it would be helpful if the ED described a clear reporting standard to measure probable losses on insured credits based on all available evidence such as the present value of expected cash flows, the nature and creditworthiness of the issuer and the projected cash flows or market value of collateral to support the insured obligation.

- **Bifurcation of Revenue between Premiums and Investment Income:** The ED proposes that the present value of the premium receivable should be determined using a discount rate that reflects the policyholder's credit standing at the inception of the contract. The discount would be accreted separately through investment income over the life of the contract. The premium we charge for a financial guarantee contract is based on the "economic renting" of our balance sheet, and the mode of premium payment is highly dependent on the bond type we insure and typically governed by market conventions outside of our control. Borrowers who pay upfront premiums receive no discount, and those paying on an installment basis do not pay a premium that incorporates a financing concept. The market conventions for premium payments have more to do with the sourcing of the cash to pay the premiums than an explicit financing decision on the part of a borrower (i.e. issuers that are able to include their costs of issuance within their debt issuance are able to pay the bond insurer's premium up front, while issuers that rely upon the generation of cash from underlying collateral performance pay the ongoing costs of the debt issuance over time). Moreover, installment premiums also don't rely upon the negotiation of fixed prepayment rates in determining the premium rate charged for financial guarantees. The amount of premium is a function of a preset premium rate multiplied by the outstanding insured par value for the collection period. (The specific premium rate is a function of the credit quality of the debtor, the asset class or deal type, our capital and return requirements, the expected tenor of the insured obligation, etc..) In our opinion, installment premiums should not be viewed as a form of premium financing.
- **Effective Date:** The ED proposes an effective date of January 1, 2008 for calendar year-end companies such as MBIA. We believe that this does not allow us sufficient time to comply with the proposed Standard. This is a particular problem with the changes required to comply with the revenue recognition Standard, but even a relatively benign interpretation of some of the requirements of the claim liabilities Standard may require extensive changes to business processes and systems, which are described in Appendix A, Issue #17. We already face resource constraints to implement the process and systems changes required under FAS 157, *Fair Value Measurements*, and FAS 159, *Fair*

Value Option which are also becoming effective on January 1, 2008. We also would ask for the Board to be mindful of the cumulative effect of new accounting pronouncements (e.g., this ED, FAS 157, FAS 159) reflected in any particular period and the potential to cause unnecessary confusion to and complications for the users of our financial statements.

In addition to our above concerns, there are several provisions in the ED which need to be clarified or further developed, to facilitate proper implementation of and compliance with the new Standard. These points are discussed in detail in Appendix A, which provides responses to the 18 questions FASB provided in the Notice for Recipients. In our estimation, the following Issues warrant further development and/or clarification:

- Issue 1:** The intended scope needs to be clarified and expanded, as financial guarantors also issue surety bonds and other forms of insurance (CDS). [It would also be helpful to know why the FASB has chosen to elect the scope exception for other forms of credit insurance.]
- Issue 3:** More guidance is needed on how to apply the financial guarantee scope exception, as well as the treatment of embedded derivatives under FAS 155 and their interaction with paragraph 10(d) of FAS 133.
- Issue 7:** Additional guidance is requested for changes in contractual premiums due to events such as changes in interest rates, F/X, or underlying credit ratings.
- Issue 11:** The ED does not address the accounting for the presentation of premiums written for installment premiums on the income statement. We have significant operational concerns, since it is an integral element of how premium production performance is currently measured by the equity investor community. In addition, clarification is required as to how written premiums would be redefined to the extent that a financing element is to be inputted and classified as investment income.
- Issue 12:** We also request clarification as to whether advanced refundings would qualify as a "retirement" for refunding.
- Issue 13:** Further guidance is required to clarify a) claim liabilities recognition when the probability-weighted loss is less than the UPR liability; b) the status of UPR when projected claim liabilities exceed UPR liability; c) the accounting for future premiums on installment policies if UPR is extinguished and d) the status of UPR if the credit improves sufficiently enough such that a loss is no longer expected.
- Issue 16:** Further guidance around disclosures is required regarding premium revenue adjustments for refinancings and refundings, and recoveries to be paid to the holder with regard to salvage and subrogation rights.
- Issue 18:** Additional clarification is requested on the measurement and treatment of a net equity adjustment upon the adoption of this Standard.

We applaud the FASB's objective to create a single Standard that comprehensively clarifies accounting treatment of our industry's financial performance. To the extent that the outcome of this process is a clear set of requirements for accounting for claim liabilities, the application of accounting standards such as FAS 133, FAS 155 and FIN 46R to our business, the result will be enhanced quality and transparency, and the financial statements will be more informative and useful to our stakeholders. The balance sheet and income statement requirements in the proposed revenue recognition model for installment-based policies would result in decreased transparency, and would make the financial statements less informative. As described in the Comment Letters submitted by industry analysts, the proposed balance sheet and income statement requirements would create a need for supplemental disclosures that would provide users of our financial statements with the ability to re-construct a presentation that would be more consistent with the economics of the business. The lack of clarity that would be created by the current version of the ED proposals

would benefit only those users who seek to profit from ineffective and confusing financial statement presentations.

Thank you for the opportunity to provide our comments about the ED. Should you have any questions about our letter, please do not hesitate to contact our Managing Director of Accounting Policy, Huy Tran, at 914-765-3557.

Sincerely,

A handwritten signature in cursive script that reads "C. Edward Chaplin".

C. Edward Chaplin
Chief Financial Officer
MBIA Insurance Corporation

Attach: *Appendix A*: Responses to the 18 Questions FASB Provided
Appendix B: Contractual vs. Actual/Expected Cash Flows - MBIA's 2000 Vintage Insured Structured Finance Business
Appendix C: Default Probability Adjusted (DPA) Exposure Premium Revenue Recognition
Appendix D: Transaction Example – Unintended Consequences of Contractual Cash Flows with P+I-Based Revenue Recognition

APPENDIX A

Issues Identified in the Exposure Draft

General (New Format)

General: This proposed Statement uses a new format in an effort to improve understandability of FASB documents. Do you believe the new format increases the understandability of this proposed Statement? What changes do you like? What changes do you not like? What additional improvements could be made to increase the understandability?

Response:

We generally found the new format to be useful and helpful to us to better understand the proposed Statement. An additional improvement would be to expand the examples, detailing the intended accounting over the term of the exemplified transaction, from its beginning to its final maturity, to illustrate the key principles (e.g., installment premiums, expected prepayments, or for reinsurance) and objectives of the ED.

Scope (Paragraphs 2–6)

Issue 1:

The scope of this proposed Statement defines a financial guarantee insurance contract as a contract issued by insurance enterprises that provides protection to the holder of a financial obligation from a financial loss in the event of a default. The event of a default (insured event) refers to nonpayment (when due) of insured “contractual term” payments by the issuer of the insured financial obligation. Do you agree with the definition used to identify a financial guarantee insurance contract subject to the provisions of this proposed Statement? If not, why not?

Response:

Generally, we agree with the definition used to identify a financial guarantee insurance contract subject to the provisions of this proposed Statement. (However, to be clear, the term “financial obligation” should include other types of payment obligations that we guarantee, including bank loans, interest rate swaps, lease payments, trust certificates and redemption payments on equity securities and other contractual payment obligations). Additionally, we believe the intended scope of the ED needs clarification, as financial guarantee insurance companies also issue surety bonds and other forms of insurance, which are considered to be “financial guarantee insurance contracts.” Article 69 of the New York State Insurance Law defines financial guarantee insurance as “a surety bond or an indemnity contract, and any guarantee similar to the foregoing types, under which loss is payable, upon proof of occurrence of financial loss, to an insured claimant, obligee or indemnitee.” As such, we believe the intended scope of the ED should be consistent with the definition in Article 69.

We define a financial guarantee insurance contract as a contract that provides a guarantee of the payment of the principal and interest or other amounts owing on insured obligations when due or, in the event that we have the right, at our discretion, to accelerate insured obligations on default or otherwise, amounts due upon such acceleration by MBIA. Typically, in our financial guarantee policies and credit default swap contracts for cash bonds, we have the right to accelerate the insured obligation at par after a default.

Issue 2:

This proposed Statement would apply to financial guarantee insurance (and reinsurance) contracts issued by insurance enterprises included within the scope of Statement 60. Do you agree with the scope of the proposed Statement? If not, why not? Should the scope include

other insurance contracts that are similar to financial guarantee insurance contracts issued by insurance enterprises? Should the scope include all financial guarantee contracts (that is, those issued by insurance and noninsurance enterprises)?

Response:

We generally agree with the limited scope. However, we sometimes compete with non-government-related mortgage guarantee insurers for the same business, and we believe the accounting model and disclosure requirements should be the same for the same guarantee transaction. If a mortgage guarantee insurance company is able to provide financial guarantee insurance (and reinsurance) contracts, and they are not governed by this proposed Statement, there is the potential that either those excluded companies or the guarantors could have an unfair competitive advantage and create an accounting arbitrage.

We believe the scope of the Standard should be expanded to address CDS contracts and insured investment-grade obligations issued by Special Purpose Entities (SPEs) under FIN46R as follows:

CDS Contracts: Given that the proposed Standard cannot be applied or analogized to similar products issued by entities other than monoline financial guarantee insurance companies, we also believe the ED should include in its scope CDS issued by our financial guarantee insurance business or its subsidiary as an execution form (e.g., must exclude written CDS in investment replication strategies and purchased protection for hedging purposes). Our CDS-executed guarantees have many similarities to our insurance policies, and also differs from the use of credit derivatives for hedging or asset replication purposes. Guarantors typically present the two types of credit protection in one segment under FAS 131, *Disclosures about Segments of an Enterprise and Related Information*, because they are so similar. Some of the similarities include:

- The credit protection we provide in credit derivative form is essentially the same as the protection that we provide in our financial guarantee product; that is, we compensate the insured party for economic losses caused by credit events, although under our CDS, credit events other than payment defaults generally can trigger an MBIA payment, and borrowers are not required to have legal ownership of the underlying insured obligation throughout the life of the contract.
- We write and hold the CDS to maturity, just as we do with our insurance policies.
- The pricing process, capital requirements and economics of credit derivatives are generally the same as financial guarantee insurance, and we are compensated by premiums identified separately from other cash flows in the documentation.
- Like financial guarantee insurance, there can be no acceleration of settlement by the insured under our policies. In addition, there is no requirement for MBIA to post collateral in advance of settlements.
- The treatment and financial presentation for CDS and financial guarantee insurance policies are the same for statutory accounting.
- Management's view of the two types of business is virtually the same. Most monoline financial guarantee insurance companies write both types of business from the same business units, because management views the businesses as similar from a credit risk management perspective. The only special considerations of the operating

decision makers with respect to these contracts arise from the unique accounting treatment they require under FAS 133.

Therefore, we believe the FASB should expand the ED to resolve the artificial accounting distinction between financial guarantee contracts and CDS, rather than revising FAS 133 paragraph 10(d). One way to do this is to redefine the definition of financial guarantee insurance contracts to include CDS in the new Standard. This is consistent with how rating agencies and equity analysts evaluate, and our senior executives manage, our businesses.

FIN46R: We also request that the Board expand the scope of the ED to exempt insurers from *FIN46R*, *Consolidation of Variable Interest Entities (FIN46R)*, consolidation analysis, when we insure investment-grade obligations issued by SPEs not sponsored by us. In ABS and MBS securitization transactions, the insurer's interest is a senior interest and therefore contains very little variability due to its terms. Generally, there are multiple variable interest holders in the SPE with much greater expected volatility of financial results than a guarantor. We should not be considered the primary beneficiary for consolidation because we are not exposed to the majority of the expected losses or gains due to sufficient third party subordinated exposure. In certain circumstances, the form of the insured obligation is triggering a different accounting treatment where the substance is identical to other policies that are not consolidated. The FASB has recently exempted investment companies from *FIN46R* requirements, as long as they account for their beneficial interests within their standard accounting model. We believe the exemption suggested will enhance transparency of our financial statements and be consistent with the views of users of our financial statements. Therefore, we are requesting the FASB to make this same exemption for our industry by expanding the scope of this ED to allow our financial guarantee insurance and CDS policies to be accounted for under this Standard only.

Issue 3:

The scope of this proposed Statement would not apply to a financial guarantee insurance contract that is a derivative instrument included within the scope of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. Should more guidance be provided regarding paragraph 10(d) of Statement 133 and how to apply that paragraph?

Response:

Rather than provide guidance on how to apply the financial guarantee scope exception under paragraph 10(d) of FAS 133, we believe that the scope should be expanded to include financial guarantee contracts (e.g., insured derivatives and CDS) that do not meet the criteria of paragraph 10(d) of FAS 133 as discussed in our response to Issue #2.

In addition, paragraph 3 of the ED identifies the policyholder as the issuer, which keeps some policies from meeting the current scope exception under FAS 133, paragraph 10(d)(3). The ED should be clarified such that the scope exception applies whether the beneficiary of the policy is the issuer or another party.

Since the accounting guidance of this ED will be limited to financial guarantee insurers, the scope also should be expanded to include an interpretation of the application of FAS 155 to financial guarantee insurance contracts. The FAS 155 interpretation should provide that financial guarantee insurance contracts are not marked to market, even if they are guaranteeing a derivative or an embedded derivative. Under current accounting, we are required to mark-to-market an insurance contract when the insured contract contains a derivative – even if it is an immaterial basis swap between the payment terms of the collateral and the notes issued on which we provided the guarantee. We believe this provides no value to investors.

Unearned Premium Revenue (Paragraphs 7–11)

Issue 4:

This proposed Statement would require that an insurance enterprise recognize a liability for unearned premium revenue at inception of a financial guarantee insurance contract. Further, a premium receivable (asset) would be recognized at inception of the financial guarantee insurance contract for which the premiums are received in installments (since each installment premium is not considered a renewal premium but merely a form of financing). Do you agree? If not, why not?

Response:

Except as noted below, we do not agree with the proposal to recognize on the balance sheet the present value of the installment premiums. Recognizing a premium receivable and unearned premium revenue at the inception of a contract on this basis is inconsistent with the treatment of other installment premiums under FAS 60 and does not meet the definition of an asset under Concepts Statement No. 6, paragraph 25, which requires an asset to provide "probable future economic benefit 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 uncertainty surrounding the existence of the obligation in the future and the amount of obligation outstanding due to the fact that future cash flows are estimates. An appropriate analogy is long duration life insurance contracts under FAS 60. For these contracts, the insurers recognize premium receivable only when those premiums are due and not for the entire life of the insurance contract when issued at inception.

If it is the Board's view that an asset and UPR are indeed created and must therefore be recognized on the balance sheet, we would disagree with the proposed approach to measuring those amounts based on contractual term as this would lead to grossly overstated asset and liability balances and is inconsistent with APB Opinion #21, paragraph 21. MBIA rarely, if ever, receives the full amount of premium that would be based on contractual payment schedules. This is because the underlying assets being securitized can, and on average have, proven to prepay in advance of their contractual terms. As guarantor of the notes issued as part of the securitization process, our insured balances are therefore also prepaid, along with the amount of premium collected. Rating agencies analyses, market practices and historic evidence all support the concept of "prepayment speeds" in structured finance securitizations. Putting assets on the balance sheet without estimating prepayments will overstate MBIA's balance sheet and weaken the quality of the company's financial reporting, making our financial statements more difficult for the rating agencies, investors and analysts to understand.

We believe that valuing the asset and corresponding unearned premium revenue on an expected cash flow basis is a more accurate approach to measurement. However, we have serious concerns over the operational complexity and costs associated with doing so. For new transactions and those in the "back-book" portfolio, we would be required to update the prepayment speed assumptions and develop the cash flow projections on a quarterly basis. At inception, as part of the underwriting and pricing process, detailed and robust analysis of expected cash flows is performed. Through this process, each participant in a transaction, including issuers, bankers, investors, guarantors and the rating agencies, arrives at a view of the expected term, taking into account prepayment speed assumptions. These views inform the choices made about pricing and capital requirements. The periodic updates of this estimate are done using a less detailed process, with the involvement of fewer parties. The basis for the prepayment speed assumptions is discussed in more detail in our response to Issue #11. If the ED were implemented as proposed, a conservative interpretation might be that we need to update and maintain the assumptions and cash flow modeling for each

installment policy outstanding over the term of the transactions, which would be a significant cost and compliance issue. At year-end 2006, MBIA had over 2,000 insured transactions outstanding across nearly 100 different asset classes for which premium is paid on an installment basis. These figures increase with each quarter as our portfolio grows. Our company and our industry are currently not staffed for this function nor are our systems equipped to maintain this data. In our view, the costs associated with this process far outweigh the benefits of on-balance sheet reporting for installment premiums.

We believe that the current reporting of the off-balance sheet net present value of future installments as a non-GAAP measure, provided in our quarterly operating supplement, is widely understood, appreciated and utilized by analysts and investors. This reporting has been in place since the fourth quarter of 1994. Several analysts have explicitly noted their comfort with the level of reporting associated with the present value of installment premiums. Additionally, rating agencies require supplemental reporting of installment premium streams for purposes of assigning capital resource credit to these premium resources. They apply additional "haircuts" to the premium receivable, reflecting their conservative approach to assessing MBIA's capital adequacy. If the Board were to require balance sheet reporting for premium receivables, we do not believe that financial reporting would be enhanced beyond the current practice, and the cost of compliance would be substantially higher.

If the Board decides to proceed with a standard for recognition of these "assets," we believe that it is essential that expected term be used in the measurement and that the company's current approach to adjusting the expected future premium receivable be accepted by FASB and the company's auditors. This approach maintains the original expected term assumption developed at inception, and adjusts, or trues up, for any differences between the actual par value balances and the originally estimated par outstanding. Such adjustments are made on a quarterly basis and applied to prospective periods on a "pro rata" basis for each insured credit. In doing so, the net present value of future installment premiums are adjusted to reflect higher or lower balances, but are not explicitly "trued-up" for any associated changes in the prospective prepayment speed expectation which could impact the expected term of the insured risk.

Issue 5:

Under this proposed Statement, the measurement of the initial unearned premium revenue (liability) would be the present value of the contractual premium due pursuant to the terms of the financial guarantee insurance contract. Further, for premiums received in installments, the initial measurement of the unearned premium revenue (liability) would be based on the present value of the contractual premium receivable (asset). Do you agree? If not, why not?

Response:

We do not agree with this proposed use of contractual term payments to establish unearned premium revenue for policies with installment premiums. It is a market convention for premium payments on insured structured finance transactions to be paid on an installment premium basis periodically, typically quarterly or annually. The ultimate premiums earned on these types of transactions rarely, if ever, would equal the amount that would be calculated on a contractual term payment schedule. The basis for this market practice is in direct recognition of the fact that future cash flows for these types of securities are subject to material changes. If these transactions were structured with contractual term payments of principal with no potential for prepayment, then estimating future premiums receivable and related unearned premium revenue would be a much more precise exercise.

By tracking the performance of insured structured finance transactions, MBIA has amassed a vast portfolio of data which validates the use of prepayment speed assumptions. For

example, we have provided you with one such study for the year 2000 vintage of MBIA's insured structured finance portfolio. This study is attached as Appendix B.

MBIA insured \$66.5 billion in structured finance par value during the year 2000. Assuming a contractual term basis of cash flows, the life of this portfolio subset would have been approximately 14.2 years. Under the proposed Standard, then, MBIA would have established a \$717 million unearned premium revenue and offsetting assets. The contractual amortization would have called for 39% of the original par insured, which would have retired by December 2006. However, this contractual term basis of cash flows is dramatically different than the actual payments of principal experienced on the 2000 vintage portfolio through year-end 2006. The actual observed historic experience of the 2000 vintage indicates an average term of 4.7 years. By year-end 2006, 89% of the original par value insured had paid down. The NPV of MBIA's actual and remaining estimated premium stream is \$342 million, less than half what the contractual term basis would have estimated at inception. In contrast, MBIA's initial reported NPV premium stream based on the expected term at inception for the 2000 structured finance vintage was \$402 million. While higher than actual, this estimate would have been far more consistent with the actual receipt of premiums over time. Expected cash flows better reflect the economics of the installment premium streams, and in our view, are the more appropriate basis on which to measure the unearned premium revenues and premium receivables.

Using the contractual term payments to establish the unearned premium revenue amount would result in "adjustments" on the balance sheet to account for differences between the amount we record as receivable and the actual amount collected. If those adjustments are reflected as losses on the income statement, we will be misleading investors and distorting our financial results by suggesting that new business transactions that are performing at expectations may generate losses upon an early maturity. Therefore, and as stated above, the premium receivable for installment deals should be recorded at the expected and not at the full contractual term amount. The expected amount may also need to be updated over time, as the behavior of the contract varies from initial expectations with respect to aspects such as call, prepayment or partial prepayment options. Also, if the Standard requires bifurcation of premiums received into premium and interest income, the accretion of interest income on amounts we do not expect to collect would further distort the transparency of our financial statements.

Beyond the analytic issues and accounting, the proposed contractual term basis raises information systems concerns for us. Given that rating agencies, investors and analysts will continue to view the risk and economics of MBIA's business on an expected basis, we would be required to maintain substantial supplemental disclosure to allow investors to create a view of the actual economics of the business. We would likely have to provide detailed reconciliation schedules between the on-balance sheet unearned premium revenue and the expected unearned premium revenue through non-GAAP reports such as our Quarterly Operating Supplements to create a more accurate depiction of our business economics. We believe that this would utterly defeat one of the fundamental objectives of the ED.

Issue 6:

This proposed Statement would require that the present value of the premium receivable (asset) be determined using a discount rate that reflects the policyholder's credit standing at the inception of the contract. The discount rate would be accreted on the premium receivable (asset) through investment income over the period of the contract in accordance with APB Opinion No. 21, Interest on Receivables and Payables. Do you agree? If not, why not?

Response:

We do not agree with this proposal because we do not believe that we are providing financing as an ancillary part of our product. In a business where we truly offered financing to our policyholders, we would offer the choice of paying our premiums on either an upfront or an installment basis for each issuer, which we do not do. Also, if we incorporated a financing concept into installment premium policies, they might become more expensive for the issuers/policyholders. This is not the practice in our industry. The mode of premium payments under a financial guarantee policy is almost entirely dependent on the bond type being insured and by market convention.

In our municipal business, project budgets and proceeds of bond issues typically include provisions for payment of bond insurance premiums. Paying the premium up front is typically enabled by issuing a greater debt amount to accommodate the payment of the premium. Our structured finance business typically provides for all payments to ongoing service providers to come from a "waterfall" of future revenue, so an installment premium policy is appropriate there. Payment mode is rarely optional to the issuer.

The concept of bifurcating the revenue into premium revenue and investment income is not consistent with the principles of the FAS 60 insurance accounting model. Also, bifurcating the premium component into premium revenue and investment income would distort performance measures that are important to the users of our financial statements, such as loss ratios and investment yields. This is especially true if revenue recognition is based on the contractual term premium receivable that we will never collect. Therefore, users of our financial statements will most likely require that we provide information to enable them to reverse the effect of bifurcation. As a result, if the Standard requires posting a liability to the balance sheet for the present value of future installment premium, we would recommend that the time element should instead flow through premium revenue.

In addition, there are implementation and practical issues with this proposed bifurcation model. We believe there are implementation problems with using a discount rate that reflects the issuer's credit standing at the inception of the contract. First, in many cases there will not be a market-observable rate, i.e., no objective means of determining a discount rate that accurately reflects the issuer's credit standing independent of the insured transaction, which creates subjectivity in setting the discount rate. Many larger transactions today have multiple bond insurers. This subjectivity may lead to different insurers recording the receivable for the same obligation using different discount rates. There are also definitional issues. The Standard is unclear about what party's credit standing is relevant. With respect to public finance deals that we insure at origination, the policy purchaser and issuer are typically, but not always, the same party. It is unclear whose credit rating should be used to choose the discount rate. For originated structured finance deals, the deal's shadow rating may be more relevant than the trustee's (the typical "proxy" policyholder) rating. It is unclear if the discount rate refers to the shadow rating of the insured obligation. When we insure transactions in the secondary market, the policyholder and the credit whose default is being insured are almost always different parties. We recommend that, to the extent that we are to post a risk-adjusted value to the balance sheet, the ED should require a discount rate applicable to the source of payment of the insurance premium, regardless of whether it is the issuer, the structure itself or the policyholder.

There are other problems that suggest simplicity and transparency might be better served by requiring all such discounting to be done at a given rate (like the rate observed in the market for bonds with the credit rating and term of the typical deal in the insurer's portfolio) and keeping it fixed. Lastly, as the risk-free rate and credit spreads fluctuate, the rate applicable to the policyholder's credit standing will change. Therefore, 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 and would not benefit the users of our financial statements.

Issue 7:

This proposed Statement does not provide specific guidance related to changes in contractual premiums, such as changes due to interest rates on a floating-rate insured financial obligation or partial prepayments of an insured financial obligation. How often are floating-rate financial obligations insured by insurance enterprises within the scope of this proposed Statement? How often do partial prepayments of an insured financial obligation occur? Do you believe the Board should provide additional guidance for these changes in contractual premiums? In addition certain issues are multi-currency and premiums are typically determined as a fixed rate applicable to each relevant class - therefore exchange rate fluctuations may be a relevant consideration in determining the absolute amount of unearned premium.

Response:

The premium charged by the guarantor does not change based on whether the interest rate on the bond is fixed or floating, per se. The premium is calculated as a percentage of the par insured and is based on an overall risk assessment (including any interest rate or refinancing risk), tenor and asset type. Once fixed, premiums do not generally change with changes in interest rates. Floating rate financial obligations are insured quite often in both public and structured finance deals. However, in public finance transactions, we are typically paid the full premium up front so there is no change in contractual term premiums. Structured finance premiums are paid on outstanding insured par so the changes in interest rate are irrelevant. Nevertheless, there are occasional contractual changes to premium rates due to step up in premium when the underlying ratings are downgraded.

Partial prepayments occur often in public finance and more so in structured finance where varying provisions may apply, such as full or partial premium make-whole payments (which is predicated upon a minimum period of premium payments that is typically prior to the legal final maturity of the insured obligation and may also be prior to expected maturity). During a declining interest rate environment and creditor-friendly market conditions, issuers will refund or refinance their exposure to benefit from lower interest rate costs and improved terms and conditions. At the same time, mortgage deals see increased prepayment speeds as the mortgagors who comprise the underlying pool of assets refinance their mortgages to benefit from lower interest rates. The pass-through nature of the deals results in rapid loan prepayments.

Additional guidance is requested since these situations do occur as described above, and especially if the Board concludes that premium revenue should be recognized in proportion to total debt service. In addition, to the extent that the value of future installment premiums are to be reflected on the balance sheet, installment transactions denominated in other than U.S. dollars will produce F/X gains or losses due to the mixed measurement attribute of the related asset and liability, i.e., the liability (UPR) will be carried at historical F/X rate while the invested asset would be revalued at the spot rate.

Premium Revenue Recognition (Paragraphs 12–17)

Issue 8:

This proposed Statement would require that an insurance enterprise recognize a premium from a financial guarantee insurance contract as revenue over the period of the contract in proportion to the insured contractual payments made by the issuer of the insured financial obligation. The premium revenue for each reporting period would be determined based on the ratio of (a) the insured contractual payments made on the insured financial obligation

during the reporting period to (b) the total of all insured contractual payments to be made on the insured financial obligation over the period of the contract. During its deliberations, the Board considered measuring at fair value a financial guarantee insurance contract, noting that a fair value measurement would include changes caused by the passage of time. However, the Board did not pursue a fair value measurement because it is unwilling at this time to change to the fair value measurement attribute within the insurance accounting model for only one type of insurance contract. Do you agree with the proposed premium revenue recognition approach? If not, why not? Also, if not, what should be the appropriate determinant of revenue recognition?

Response:

We do not agree with the proposed premium revenue recognition approach. Our primary concern is that this approach does not reflect the concept of a reduction of risk due to the passage of time.

Recognition of premium earnings based on the expiration of total insured debt service does not faithfully represent the terms of our insurance contracts or the economics of our business. Premium should be recognized in accordance with the reduction of risk. There are models today that estimate the pattern of risk throughout the lives of insured transactions. They are the dynamic capital models developed and maintained by the rating agencies and many of the guarantors. These models would be appropriate for allocating premium earnings to time periods, as they include all known sources of risk. Each of the model designers believes that their proprietary models most accurately depict the pattern of risk profiling. The practical challenge for accounting is that the use of such models would result in substantial diversity of practice.

We believe that a simplified model of exposure will help to illustrate our concerns with the proposed model, and in support of AFGI's and MBIA's proposed alternative method, the level yield method, we will discuss the "Default Probability Adjusted" exposure, or DPA, earnings model below and in Appendix C.

In providing its financial guarantee, MBIA is exposed mainly to the credit risk of the insured obligor. The premium rate we charge for our insurance guarantee is based on a thorough evaluation of the idiosyncratic risks associated with each individual obligor as well as broader portfolio-wide systemic risks associated with the macro-economic cycle. Most succinctly, we evaluate four fundamental credit risk factors in establishing the premium rate: Notional Risk, Tenor, Underlying Rating and Asset Class of Risk. The DPA model incorporates each of these risk elements in determining a premium earnings recognition stream.

Notional Risk is arguably the easiest of the four to measure, notwithstanding the analytics required in estimating expected cash flows for structured finance transactions. The DPA model is based on par value insured and the expected term of cash flows. Tenor is the expected term of the insured risk, typically expressed in years. Like Notional Risk, Tenor is fairly easy to determine, but requires estimates for certain structured finance transactions, as discussed in more detail under Issue #11. Underlying rating is the credit rating of the insured obligor without the benefit of the insurance guarantee. The DPA model references the underlying or "shadow" rating of MBIA's insured risks as determined by Moody's, Standard & Poor's or Fitch. Finally, Asset Class is a classification of the insured risk based on certain common characteristics of an obligor or underlying pool of securitized assets. The broad categorizations of asset classes are Corporate, Structured Finance and Municipal.

To best reflect the time element of risk, the DPA references statistical bond default studies, specifically Moody's Cumulative Bond Default Rate Curves as applied in its capital model for

the financial guarantee companies¹. Appendix C, Exhibit A presents Moody's cumulative default rates by asset class and tenor for an 'A2' rated bond. These default rates are positively sloped, indicating that there is a clear relationship between the passage of time (i.e., tenor) and the risk of obligor default which would give rise to a claim payment for an insured obligation. The curves indicate for example that a 10-year deal has a higher propensity to default over its term than a 5-year deal. Moody's research also suggests that the distribution of default events in a portfolio of 10-year deals will be regularly distributed over the 10 year period, and that when a 10-year deal has five years to maturity, it will exhibit a default propensity similar to a 5-year newly originated transaction. These default rate curves have been consistently applied in the portfolio risk model for financial guarantors since it was first introduced in July of 2000. Since that time, the corporate bond default study has been updated, and new default studies for structured finance and municipal bonds have been released. Appendix C, Exhibits B1-B3 show Moody's most recent cumulative default rate curves for each of these three sectors.

By multiplying the default rates associated with each insured obligor (for a given rating, tenor and asset class) by the par value outstanding results in the "default probability adjusted exposure". This risk basis fully captures the four fundamental elements of risk MBIA considers in making its underwriting decision and the associated premium rate that MBIA charges. Appendix C, Exhibit C provides sample earnings patterns for three types of insured transactions, based on a \$1 million premium. As depicted, bullet maturity structures earn premium on a relatively level basis, reflecting only the amortization of risk over the passage of time. Amortizing par structures recognize premium revenue more heavily in the earlier years of a transaction's life, reflecting risk reduction from both the passage of time and amortization of par value outstanding.

The DPA model presents a more robust approach to measuring exposure reduction over time. However, as a practical matter, we believe the Level Yield method which applies a level premium rate against par value outstanding results in earnings patterns which are very consistent with the DPA model, while at the same time being an easier and more consistent methodology to implement and an easier methodology for analysts and investors to comprehend. The Level Yield method also results in consistent premium revenue recognition regardless of the mode of premium (i.e., up front or installment). Appendix C, Exhibit D compares the DPA model with the Current Method and the alternative Level Yield methods. MBIA, together with AFGI, propose that FASB consider the Level Yield method as the appropriate determinant of revenue recognition. This will meet the Board's objective of consistent treatment of premium revenue recognition whether the premium is collected upfront or on an installment basis over the term of the insured transaction.

Issue 9:

The Board concluded that insured contractual payments of the insured financial obligation are the most appropriate measure of exposure in a financial guarantee insurance contract. Do you agree? If not, why not? Also, if not, what would be a more appropriate measure of exposure and why?

Response:

We do not agree. We do not believe that the contractual term payments are the best measurement of exposure. At MBIA, we define "exposure" to be the maximum amount at risk in a transaction, and "risk" as the exposure, adjusted by the probability that a loss occurs and the severity of the loss, given a default. The two concepts are definitionally independent. For example, a \$100 million bond with 10 years remaining to maturity and a \$100 million bond with 5 years remaining to maturity each have an exposure of \$100 million, but their risks will

¹ See "Moody's Portfolio Risk Model for Financial Guarantors", Moody's Investors Service, July 2000

be very different, even if they are in the same asset class and have the same underlying rating.

Insured debt service (par plus interest) does not provide the best measurement of our exposure. The contracts the guarantors write typically provide that in the event of a default, which may or may not result in a claim payment, the guarantor may pay the periodic interest and contractual term principal payments of the bond over time OR settle the contract by redeeming the bonds at par. The decision to do one or the other is driven primarily by treasury considerations (i.e., if the coupon rate on the bonds is lower than the guarantor's borrowing rate, the guarantor would tend to leave the bonds outstanding; and if the bond's coupon rate is higher, the guarantor would tend to redeem the bonds at par) or marketing considerations (leaving the bonds outstanding when their rate is comparatively high is "investor friendly"). Thus, we believe that a more appropriate measure of exposure is par amount, but it is still not the best measure of risk. The default probability adjusted amount (DPA), as discussed in our comment on Issue #8, combines elements of risk with par amount. When the par amount outstanding over time is used to allocate premium to time periods, the resultant pattern of revenue recognition is similar to the allocation using the DPA. Therefore, we believe that the level yield approach based on par outstanding is a reasonable and cost effective proxy.

Issue 10:

Under the guidance in this proposed Statement, premium revenue would not be recognized for an insured zero coupon bond until the insured contractual payments are made at maturity. Do you agree that the proposed premium revenue recognition approach sufficiently incorporates the passage of time? Why or why not? How are these insured financial obligations affected by the passage of time (that is, how does the premium charged for the financial guarantee insurance contract change over time and what is the ability to subsequently price the contract)? Please provide examples.

Response:

We do not agree with the proposed premium revenue recognition approach. While insured contractual term payments of an insured financial obligation represents a component of risk amortization, they do not directly measure or model risk in totality. As discussed under Issue #8, the ideal measure would incorporate the amount of exposure, the probability of default and the severity of loss in determining risk, all of which may vary over time. We believe that the DPA is an appropriate measure of the reduction of risk with time and principal reduction, and that basing revenue recognition on par amount outstanding is a reasonable proxy for the DPA-determined recognition. Samples of Moody's most recent bond default studies for corporate, structured finance and municipal bonds are attached as Appendix C, Exhibits B1-B3.

The premium rate negotiated at the inception of a transaction between MBIA as the insurer and the bond issuer are directly influenced by the expected tenor of the underlying risk. Most simply stated, MBIA will require a higher rate of premium for longer tenor risks than for shorter tenor risks. The basis for this pricing methodology is stated in the bond default studies which indicate the direct relationship between time and risk of default. Consistent with this approach, the capital charges imposed on MBIA by the rating agencies through the application of the capital model will also increase and decrease in proportion to the tenor of risk.

Issue 11:

The Board concluded that the contractual period covered by the insured financial obligation should be used in determining the period over which premium revenue should be recognized. Do you agree? If not, why not? When prepayment information is available,

should this information be used to adjust the contract term when a homogenous pool of underlying contracts exists and is measurable? If so, please provide examples of these arrangements and a description of how reliable prepayment estimates are.

Response:

As we mentioned in our response to Issue #4, we do not believe the recognition of unearned premium revenue for installment premiums should be reported on the balance sheet, but if it is, it should be recognized on an expected not contractual term basis, and any adjustments to reflect differences between estimated and actual should be made on a "pro rata" basis over the original estimate of the expected term. So, in response to Issue #11, no, we do not agree that the contractual term period covered by the insured financial obligation should be used in determining the period over which premium revenue should be recognized. We believe that when prepayment information is available, this information should be used to adjust the contract term. Reliable prepayment information would include: third party data service providers, such as Bloomberg and Intex; rating agency guidelines; and historical data provided by the issuer for their operations since prepayment may be the result of the issuer's lending practices and/or discretion. Additionally, some infrastructure financings are structured with mandatory prepayments. In these cases, the maturity of the insured financial obligation changes based on the speed of prepayment and reliable prepayment information (amount of mandatory prepayments) is available at any payment date. Therefore, it should be used to adjust the maturity of the insured obligation and the period over which premium revenue is recognized.

For the vast majority of MBIA's structured finance portfolio, there are no contractual term payments of principal for the insured securities. Typically, any cash collected by the Trustee that is in excess of the amount of interest due is used "through the waterfall" to pay down the par balances of the insured obligations. For "pass-through" transactions like Residential Mortgage-Backed Securities (RMBS), the rating agencies have established cash flow assumptions and related Prepayment Speed Assumptions (PSAs) used to assess ratings for RMBS deals. These assumptions are then separately defined based on the underlying deal type (e.g., Home Equity Line of Credit). Assumptions are updated periodically to reflect current market conditions and experience with previously rated transactions.

Expected cash flows can be reasonably and reliably projected using the PSA employed by the market for structured finance MBS, ABS, and other securities that are widely traded and for which prepayment experience is available. Few of these types of MBS and ABS securities actually are outstanding to their contractual term. They generally experience prepayments and defaults consistent with levels used to price the transaction at inception; for publicly traded transactions different prepayment scenarios generally are provided in the offering document and investors generally agree on which prepayment and default scenario is most appropriate when the market prices the transaction. Furthermore, most of these types of securities contain "clean-up calls" where the issuer may repay the securities in full when 85% to 90% of the issued securities have been repaid.

The Financial Guarantors Ratings Groups at Moody's, Standard & Poor's and Fitch also consider the expected term of the insured transactions in their proprietary capital models. Capital charges assessed by the rating agencies are based on the underlying credit quality of the insured risk and the expected term of the transaction. The models make explicit assumptions by asset class to reflect the expected term of each transaction within the structured finance segment of the insured portfolio. Should the rating agencies assume contractual term, our capital charges would be substantially higher than currently assessed. This is based on the fact that there is a direct relationship between time and risk, as measured for instance by various bond default studies undertaken annually by rating agencies and other risk management professionals.

MBIA's own historic experience in insured structured finance transactions provides a basis for the prepayment assumptions associated with expected cash flow estimation and consistent with FAS 91, *Accounting for Non-Refundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* accounting model. A reporting entity may consider prepayments of principal, under FAS 91, if the reporting entity holds a large number of similar homogenous assets for which prepayments can be reasonably estimated.

We also view the proposed relationship between revenue recognition and loss reserving to be illogical and inconsistent. In the proposed loss reserve model, we are required to factor in prepayment speeds to ensure adequate reserving by applying the expected cash flows model as described in paragraph 18 of the ED. However, for purposes of revenue recognition, we are being asked to assume a prepayment speed of zero, which is based on assumptions we know to be unrealistic. Prepayment speed assumptions are supported by third party data, market practices, and our own historic evidence of prepayments in guaranteeing and observing mortgage-backed and asset-backed securitizations in the market. The same analysis and knowledge that would be applied in establishing adequate reserving for impaired insured obligors can be applied to all transactions when originated to establish appropriate unearned premium revenue (in fact, we have much more data and experience to back up our estimates of the expected terms of originated policies than we do the estimated cash flows of cases with probable losses).

The proposed methodology has the unintended consequences of balance sheet overstatement and misleading earnings presentation (to the extent that the "true-ups" are recorded in the income statement) for insurance enterprises. These unintended consequences can be illustrated by way of example. Appendix D, Exhibit A1 provides summary details for a hypothetical \$1 billion structured finance transaction. It has a contractual maturity of 14 years with no scheduled payments of par until final maturity. Based on the contractual term, MBIA would book a NPV premium of \$13.0 million receivable and offsetting unearned premium liability. However, based on the expected basis of cash flows, final maturity and average term are much shorter. The resulting NPV premium would be \$2.3 million. The initial balance sheet overstatement would be \$10.7 million which, over time, would have to be "trued up" to reflect the lowered expectation of future premium receipts. Appendix D, Exhibit A2 illustrates the view of premium receivable/unearned premium revenue over time for the sample transaction. There would be significant adjustments to the balance sheet in the early years of the transaction's life.

Given the initial overstatement of the unearned premium revenue, it is likely that earnings in the early years of these transactions would be over-stated. As prepayments occur, large proportions of the total contractual term debt service would amortize which, in turn, would result in large recognitions of earnings. In later years, as prepayments continue, earnings would have to be adjusted and in certain instances could require reversals of previously recognized premium earnings. Appendix D, Exhibit A3 illustrates this trend based on the sample transaction. In this example, the financial guarantor would recognize more earnings in the first year than would be collected over the entire life of the transaction (resulting in reversal of premium revenue recognition in the later years).

The on-going accounting adjustments required under this proposed approach will cause misleading premium revenue recognition volatility and will confuse users of our financial statements (given the material reductions in subsequent quarters) as well as causing operational difficulty and substantial cost to comply. The proposed use of contractual term payments for installment-based policies could result in overstated earnings in the early years

of the transaction's life, which is the exact issue the ED was originally attempting to address with respect to financial guarantee premium revenue recognition.

Clarification from the FASB is required since the ED does not address how premiums written should be treated in the income statement for installment policies. If written premium is based on contractual payments of the underlying debt obligations and since the vast majority of structured finance business does not have contractual payments until maturity, written premium would be grossly overstated at the inception of the contract. As prepayments actually occur and future premium streams are true-up, subsequent reporting will include negative adjustments to the written premium recorded on these types of contracts. We believe that this will decrease the transparency of our business production/activity and reduce the quality of our financial reporting because we will be required to report written premiums that we know at the outset that we will never collect. In addition, there are significant operational concerns (e.g., bifurcation of premium for the financing element to be classified as investment income), since this is an integral element of how premium revenue is to be recognized.

For MBIA's municipal portfolio, prepayment data (i.e., refunded bond information) is also available and could be used to estimate the expected term of these insured obligations. However, given that the premiums for these types of transactions are typically received on an upfront basis, expected term analysis is not needed to estimate the value of assets and corresponding unearned premium revenue resulting from policy origination. Additionally, differences between the contractual and expected term for municipal transactions are not as dramatic as those for structured finance transactions. Recognizing premium revenue over the contractual period for municipal, upfront premium transactions results in the reporting of accelerated premium revenues when a municipality calls its bonds. The economics associated with municipal prepayments are clearly understood and the current accounting practice of reporting refunded premiums provides the necessary disclosure to rating agencies, analysts and investors.

Issue 12:

In instances where the issuer of an insured financial obligation that had a nonrefundable premium retires an insured financial obligation before its maturity and replaces it with a new financial obligation, this proposed Statement would require that any unearned premium revenue (liability) related to that contract and associated deferred acquisition costs be immediately recognized as premium revenue and expense, respectively. Further, if the insurance enterprise insures the new financial obligation, the insurance enterprise would record a premium on the new financial obligation that is commensurate with the premium it would charge to insure a similar financial obligation in a separate (standalone) transaction. If that premium differs from the premium actually charged, the difference would be recognized in current income. Do you agree? If not, why not?

Response:

Yes, we agree with this proposal in concept. When we insure a new financial obligation, we record the premium on the new financial obligation that is commensurate with the premium we would charge to insure a similar obligation in a separate, standalone transaction. In structured transactions, refunding is not commonplace. Premiums are generally paid on an installment, versus up-front, basis, and make-whole periods are generally short-term in duration. Refunding is more common in global public finance deals. Each new deal (including refunding) is competitively bid, requiring the involvement of unrelated third parties to negotiate a commercially acceptable arms-length transaction. Pricing for each refunded transaction is based on prevailing market conditions, as well as structure (covenants and security package), tenor, and other terms and conditions. By definition, the successful negotiator sets the market premium rate based on prevailing conditions. It is conceivable that

a winning bidder might consider the existing profitable relationship with the issuer in making its bid, but in practice it would be very difficult to assess how much of the deviation between the winner and other bidders was due to the refunding premium. (For instance, there is substantial evidence of significantly varied premium rates on bids provided for new money transactions.)

When an MBIA insured risk is retired early, is called by the issuer, or is defeased, or in substance paid in advance through a refunding accomplished by placing U.S. Government securities in escrow, the remaining deferred premium revenue is earned at that time since there is no longer risk to MBIA. We request clarification from the FASB on whether advanced refundings as described above would qualify as "retirement" for refunding.

Claim Liability (Paragraphs 18–24)

Issue 13:

This proposed Statement would require that an insurance enterprise recognize a claim liability on a financial guarantee insurance contract when the insurance enterprise expects that a claim loss will exceed the unearned premium revenue (liability) for that contract based on expected cash flows rather than when a default (insured event) occurs. Do you agree? If not, why not? Does this provide an appropriate point of recognition for a claim liability related to a financial guarantee insurance contract?

Response:

We do not agree with the proposal in its requirement that a claim liability is only recorded when expected losses exceed the unearned premium revenue for a contract, based on the probability-weighted cash flows. MBIA believes this provision will create a delay and/or understatement in loss recognition. If unearned premium revenue for installment-based policies will be based on contractual term cash flows, then the requirement would more significantly delay loss recognition. Claim liabilities should be recognized when there is evidence of credit deterioration sufficient enough to demonstrate losses to the bond insurer, without regard to the accounting of premium revenues.

The unearned premium revenue (liability) represents the insurance enterprise's stand-ready obligation under a financial guarantee insurance contract at initial recognition. That obligation is adjusted (through the claim liability) to reflect changes in periods after initial recognition of the financial guarantee insurance contract that make a loss more likely than not to occur, the claim liability may be reduced only to the extent that a claim liability exists, and those decreases shall not reduce the claim liability below zero. When a claim liability has been recognized, any associated acquisition costs previously deferred under paragraph 29 of FAS 60 will be expensed. We request clarification of a number of issues in this portion of the ED:

- Should a claim liability be recognized when the probable loss is less than the unearned premium liability?
- When the projected claim liability exceeds the unearned premium liability, is the UPR extinguished?
- If the UPR is extinguished, how should future premiums on installment policies be accounted?
- If the credit later improves, is the UPR re-instated?

Issue 14:

This proposed Statement would require that an insurance enterprise measure a claim liability based on the present value of expected cash flows discounted using a risk-adjusted rate at the time of the initial recognition of the claim liability. For purposes of this proposed Statement, that risk-adjusted rate shall be based on the risk-free rate, adjusted for the credit

standing of the insurance enterprise. The discount rate would be updated only when a default occurs. Do you agree? If not, why not?

Response:

We agree that the present value of expected cash flows is one way to measure a claim liability. However, we suggest that the Board adopt a broader view of the acceptable techniques an insurer may employ to determine a claim liability, and we offer the following suggested language to paragraph 20 of the ED:

'This proposed Statement would require that in measuring the probable losses of an individual credit, the claim liability be developed based on all available evidence including, as appropriate, the present value of expected future cash flows, the nature of the underlying insured obligation, the nature and creditworthiness of the underlying issuer, whether the obligation is secured or unsecured and the expected recovery rates on the insured obligation, the projected cash flow or market value of any assets that support the insured obligation and the historical and projected loss rates on such assets.'

We disagree that expected cash flows should be discounted using a risk-adjusted rate set at the time of the initial recognition of claim liability and adjusted thereafter only when a default occurs. There are several drawbacks to using a risk-adjusted rate based on the risk-free rate adjusted for the credit standing of the insurance enterprise. First, it may not be directly observable and, therefore, carries with it the potential for uncertainties regarding its precision and estimation. Second, lower-rated financial guarantee insurers would have lower claim liability than their higher rated peers for identical credits, because lower-rated financial guarantee insurers would be required to use higher discount rates. This problem is better demonstrated by a credit downgrade for an insurer showing up as an improved loss experience, all things otherwise being equal. Additionally, the proposed method causes lack of comparability between peers on this important metric. Finally, further clarification is required for guarantors that are split rated (i.e., rated at two different levels by two or more rating agencies).

Currently we discount expected cash flows at a rate equal to the actual yield of our fixed-income investment portfolio. This discount rate, which is updated quarterly, measures the prospective lost investment income from liquidating investments to honor claims. As a practical matter it is a reasonable proxy for our holding company borrowing cost as well, given the high credit quality of the investment portfolio. Therefore, we believe we should be permitted to continue to estimate the present cost of future losses using discount rates equal to the actual yield of our fixed-income investment portfolio.

Issue 15:

This proposed Statement would require that in measuring the expected cash flows of the claim liability, the expected cash flows be developed using the insurance enterprise's own assumptions about the likelihood of all possible outcomes based on all information available to the insurance enterprise and those assumptions be consistent with the surveillance list maintained by the insurance enterprise. Do you believe that the surveillance list maintained by the insurance enterprise should affect the measurement of the claim liability? If not, why not and what alternative approach could be used? Do all insurance enterprises maintain a surveillance list and, if so, is the Board's understanding of the maintained surveillance list (as described in paragraph B21) accurate? Do you believe the Board should provide additional guidance about the surveillance list and what it contains? Can (or should) insurance enterprises follow the claim liability approach in this proposed Statement for financial guarantee insurance contracts not included on the surveillance list?

Response:

We believe that it is impractical to calculate expected cash flows based on “all possible outcomes” using stochastic simulation analysis for every problem credit in our portfolio. (We provide an alternative proposal in our response to Issue #14.)

MBIA maintains a surveillance list that includes those credits for which claim liability has been established (a “Classified” category), and for credits where heightened surveillance is deemed necessary as a result of real, perceived, or potential credit deterioration (a “Caution” category). We note that Caution list credits are not likely to suffer a loss. For example, our surveillance list includes credits that are deteriorating but still may be rated investment grade. Moreover, if a Caution list credit deteriorates to the point that a claim liability is probable and estimable, the credit is moved to the Classified category. Caution list credits are not likely to suffer a loss, and any cash-flow-analysis-based estimate of claim liability on Caution list credits would likely be zero. Therefore, we do not believe that our Caution category should affect the measurement of claim liability. Nonetheless, if the FASB requires that “non-specific” reserves be assessed on other than Classified credits based on Caution list characteristics, we can develop assumptions based on the data we have on the few transactions that have had actual losses. We believe it would not be helpful to require disclosure of Caution List credits, but a description of our Caution List methodology and the attribution of claim liability to the level of severity with the Caution List can and should be disclosed. We do not believe the Board needs to provide additional guidance about the surveillance list.

MBIA has a loss reserving process that recognizes that while losses are very infrequent in our portfolio (over our 33-year history, we’ve had approximately 100 losses on over 90,000 insurance policies) they can and do occur. Each period, we record 12% of premiums earned as a contribution to an unallocated loss reserve. As we identify credits for which losses are probable and estimable, we establish case-specific loss reserves by allocating amounts from the unallocated loss reserve to case reserves. Over time, we observe the pattern of realized losses in the portfolio to evaluate the appropriateness of the 12% of earned premium addition to unallocated reserve and the adequacy of the unallocated reserve itself. In this way, we recognize claim liability for probable and estimable losses and also consider the potential for loss on the balance of the portfolio.

The Board asks, *“Can (or should) insurance enterprises follow the claim liability approach in this proposed Statement for financial guarantee insurance contracts not included on the surveillance list?”* If by this, the Board is asking if probable losses should be calculated individually for each credit insured by the enterprise, the answer is no. The enterprise should only calculate losses for each credit where the loss is probable and estimable. To extend the calculation effort to more than 10,000 insured policies, essentially none of which has probable or estimable losses, would be virtually overly burdensome.

Banks and other credit providers may have surveillance lists that over time have generated robust default and loss data that enable a claim liability estimation process based on those surveillance categories. MBIA and the guarantors will have insufficient data to estimate expected losses for other than their entire portfolios. We would prefer that claim liability be valued as we have been doing so, where case reserves are recognized in the income statement to the extent that they would render the unallocated reserve inadequate, and that supplemental disclosures be required as to the determination of adequacy. However, we acknowledge the value of creating consistency and clarity of disclosure across the industry by doing it the way it is proposed in the ED.

Disclosures (Paragraphs 25 and 26)

Issue 16:

This proposed Statement would require that specific disclosures be provided about (a) premium revenue recognition accelerated due to early retirement of the insured financial obligation, (b) financial guarantee insurance contracts for which premiums are received in installments, (c) the future contractual runoff of the unearned premium revenue (liability), and (d) the surveillance list used to recognize and measure claim liabilities. Do you agree? If not, why not? Do you believe these disclosures will assist financial statement users in better understanding the financial information for insurance enterprises that issue financial guarantee insurance contracts?

Response:

MBIA is in support of disclosures that increase the usefulness of individual company financial statements, as well as increase transparency and comparability across the financial guarantee industry. In its effort to provide meaningful financial disclosures, MBIA currently discloses, either in its financial statements or as a supplemental to its financial statements, the following information:

- Accelerated premium revenue
- The present value of future installment premiums
- A schedule of the future runoff of the UPR liability
- A schedule of the future expected receipt of undiscounted installment premiums
- A general description of our Caution list and our policy for placing insured obligations on this list

We believe such disclosures are appropriate and, to the extent that the ED will require greater uniformity with respect to the disclosure of these items, transparency will be enhanced. Additionally, we believe that when a company is given discretion over estimates that are highly judgmental, the assumptions leading to those estimates and the potential variability of those assumptions and estimates should be adequately disclosed.

We also believe that there is a strong likelihood that, if adopted without revisions, certain disclosures required by this proposed Statement would be misleading to investors and result in a distorted understanding of our financial statements. Specifically, we believe that disclosure of the premium receivable and unearned premium revenue calculated on the basis of contractual cash flows would not accurately represent the amounts that are expected to be collected and earned as premium. Furthermore, disclosure of the run-off of the unearned premium revenue based on contractual payments by issuers of insured obligations would not represent those that we would expect to collect and earn for installment-based policies and, therefore, would mislead investors as to the amount of expected future premium earnings. Additionally, as described in our response to Issue #15, we do not believe that detailed disclosure of surveillance list information is useful to users of our financial statements.

Current unearned premium revenue disclosures provided to analysts and rating agencies are based on expected cash flows for the aforementioned reasons. Pursuant to recent discussions with analysts and rating agencies, MBIA would continue to provide disclosures on the basis of expected cash flows as a supplement to its financial statements. Therefore, we would be required to keep two sets of disclosures; one to satisfy the proposed ED and the other, presumably non-GAAP, to satisfy analysts and rating agencies requests for what we and the market believe is a more accurate representation of the economics of our business.

We do not believe that the bifurcation of installment premiums between premium revenue and investment income is an appropriate representation of our business and, as a result, it should not be implemented. However, if the FASB does require this bifurcation, it will be necessary to provide additional disclosure that allows investors and users of our financial statements to reconstruct the actual economics of our business.

Additional clarification is required on the following items in this section:

- Do the amounts in paragraph 26(a) include the adjustments made to premium revenue to reflect differences between the premium charged in a refunding or refinancing transaction and the premium that would be charged to insure a similar financial obligation in a separate (standalone) transaction when a company had also insured the refunded or refinanced transaction?
- What recoveries are to be paid to the holder of the insured financial obligation referenced in paragraph 26(d)(4)(d)? Current practice is to establish a claim liability for future claim payments net of expected future recoveries to be collected by the financial guarantor as a result of its salvage and subrogation rights under its insurance policies. If this is what was intended, clarification is necessary.

Effective Date and Transition (Paragraphs 27–30)

Issue 17:

The final Statement is expected to be issued in the third quarter of 2007. The Board concluded that this proposed Statement should be effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Earlier application is not permitted. Do you agree with the Board's conclusions on the effective date? If not, what would be a reasonable period of time for implementation for applying the provisions of this proposed Statement? Also, if not, please provide a description of the process changes necessary to implement this proposed Statement that would require additional time.

Response:

No, as indicated in our cover letter, we do not agree with the proposed effective date of January 1, 2008 given the number of implementation challenges. Some of these challenges include:

- **Technology system development**, such as programming and revising premium earnings algorithms; calculating and tracking bifurcated investment income to be accreted for installment policies; building a facility to change contractual term premiums due to prepayments; calculating the present value of premiums over the installment term; testing/auditing systems for performance accuracy, and complying with the requirements of Sarbanes Oxley.
- **Process development**, such as training staff on to-be-established revised policies and procedures; establishing a process for incorporating unearned premium revenue into the claims methodology.
- **Information requirement issues**, such as having to comply with both the proposed FASB ED information requirements as well as analysts' requests for expanded information on current non-GAAP measures.
- **Resource constraints** to implement simultaneously the process and system changes required under FAS 157, *Fair Value Measurements*, and FAS 159, *Fair Value Option*, as well as potentially the current FASB Exposure Draft on Derivatives Disclosure, all to be effective January 1, 2008.

We believe that the systems and process changes proposed under the ED will be significant and require a lead time after final issuance of a minimum of twelve months.

Issue 18:

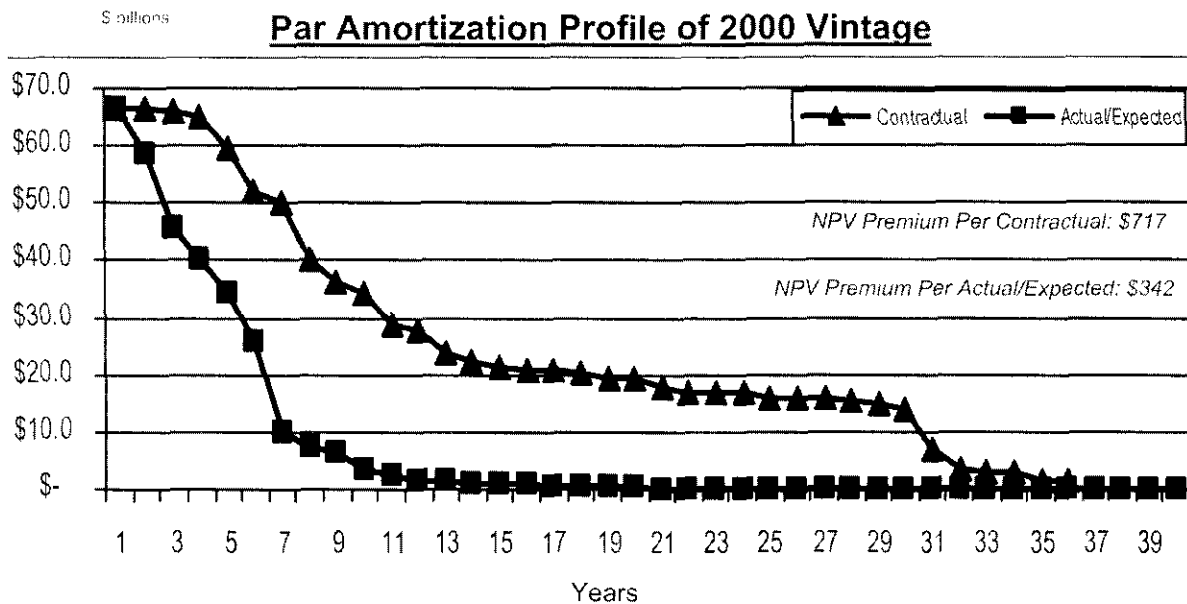
This proposed Statement would require that an insurance enterprise recognize the cumulative effect of initially applying this proposed Statement as an adjustment to the opening balance of retained earnings for that fiscal year. Retrospective application is not permitted. Do you agree with not permitting retrospective application? If not, do you believe that retrospective application is possible and that sufficient information exists so that hindsight would not be used or required in reporting prior-period balances?

Response:

We support a cumulative adjustment to the opening balance of retained earnings. However, we request additional clarification on the net equity impact at the time of adoption, which we expect to include the net effect of reversing previously earned premiums, previously amortized acquisition costs, and previously established non-specific loss reserves net of estimated loss reserves associated with non-case-basis surveillance list policies for which a specific loss reserve would be required under the proposed Standard.

**Appendix B: Contractual v. Actual/Expected Cash Flows –
MBIA's 2000 Vintage Insured Structured Finance Business**

Appendix B: Contractual v. Actual/Expected Cash Flows – MBIA’s 2000 Vintage Insured Structured Finance Business



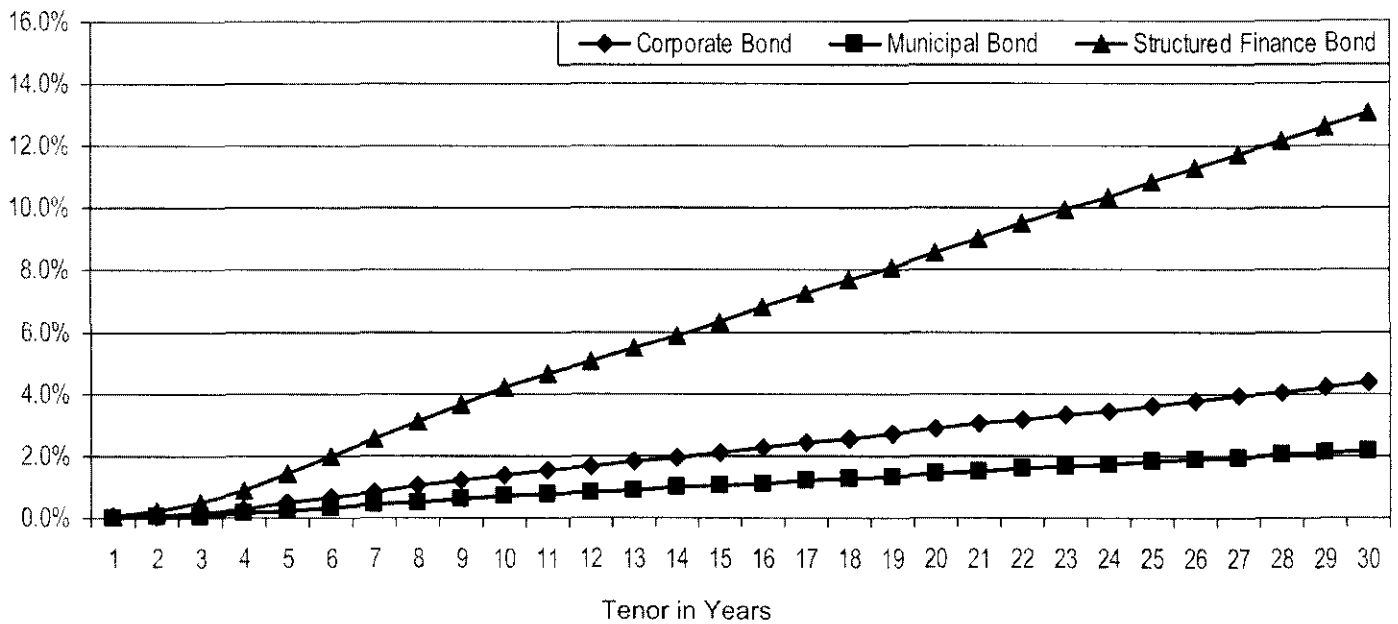
- At year end 2006, 89% of the par had paid down. In comparison, contractual basis would have assumed only 39%
- Contractual basis of cash flow states a 14.2 year average life; actual/estimated cash flows indicate 4.7 year average life
- Contractual would estimate over 2-times the amount of premium receivable (\$717 million) in comparison to the actual/expected cash flows (\$342 million) ^[1]
- Contract basis of cash flows would therefore be subject to frequent and significant true-up's, affecting the balance sheet and potentially the income statement

[1] Assuming a 16.6 basis point constant average premium rate on par outstanding based on the weighted average rate of the 2000 vintage at inception

**Appendix C: Default Probability Adjusted (DPA)
Exposure Premium Revenue Recognition**

Exhibit A: Moody's Default Rate Curve Assumptions Per the Portfolio Risk Model for Financial Guarantors - 'A2' Rated Issuer Example

Moody's Cumulative Default Rate Curves for an 'A2' Rated Issuer [1]

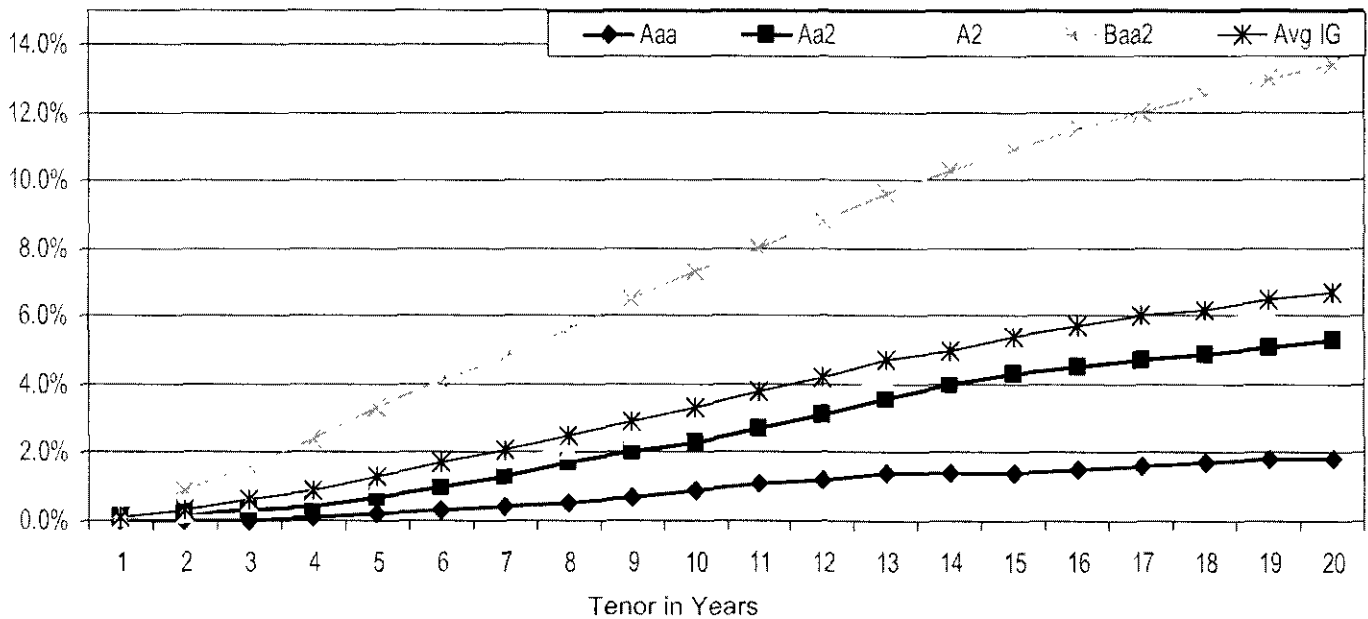


- Moody's cumulative default rate data provide a basis for defining relative level risk
 - Ability to "rank" risk depending upon **tenor**, **underlying rating** and **asset class** of a given bond
- **Moody's cumulative default rates are positively sloped, indicating that there is a direct relationship between time and credit risk**

[1] As deployed in Moody's capital model assessment of financial guarantors, see "Moody's Portfolio Risk Model for Financial Guarantors, July 2000"

Exhibit B1: Moody's Cumulative Corporate Default Rate Curves by Rating

Moody's Cumulative Default Rate Curves: Corporate Bonds [1]



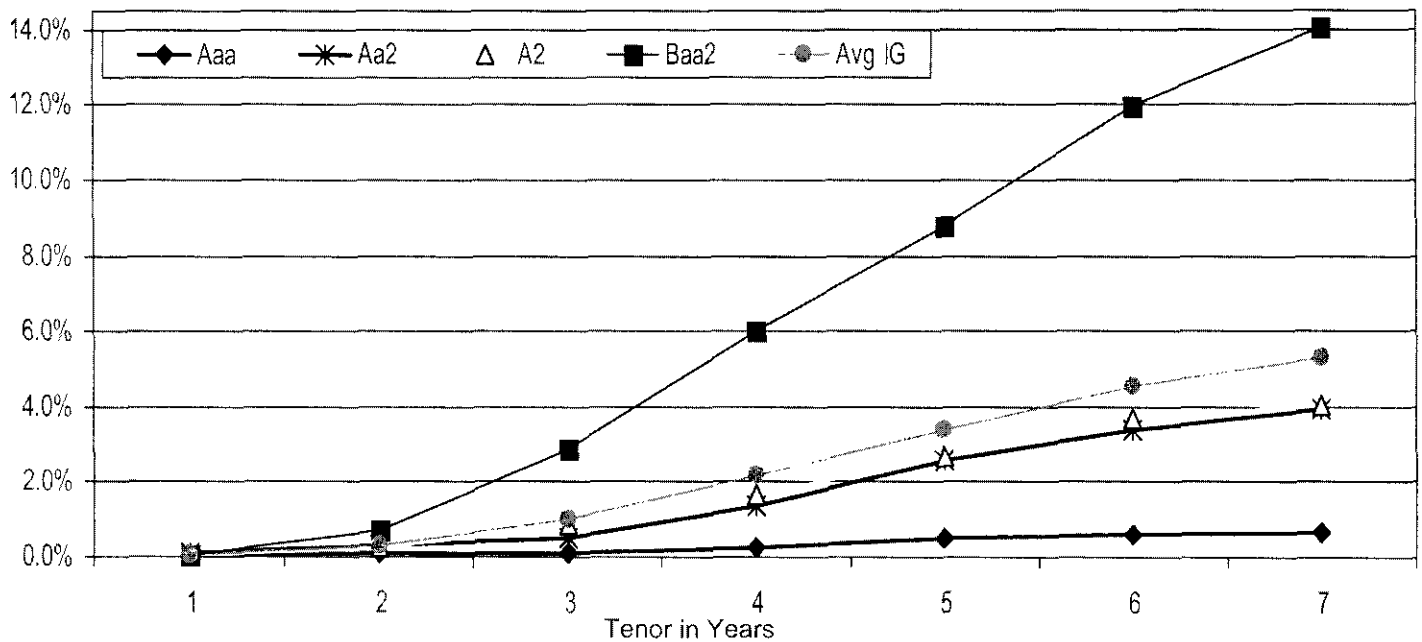
- Moody's cumulative default rates are positively sloped, indicating that there is a direct relationship between time and credit risk
 - This is true across the entire ratings spectrum

[1] "Corporate Default and Recovery Rates, 1920-2006", Moody's Investors Service, February 2007

Exhibit B2:

Moody's Cumulative Structured Finance Default Rate Curves by Rating

Moody's Cumulative Default Rate Curves 1993-2006: Structured Finance [1]



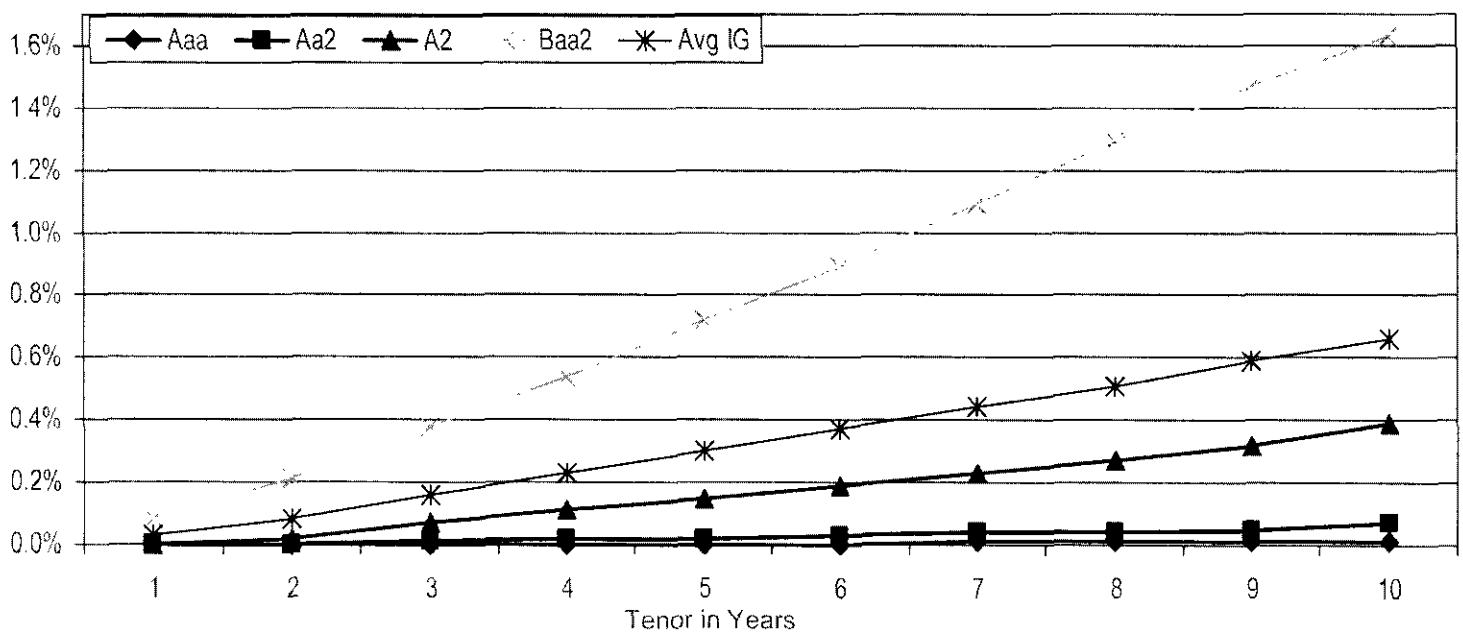
- Moody's cumulative default rates are positively sloped, indicating that there is a direct relationship between time and credit risk
 - This is true across the entire ratings spectrum

[1] "Default & Loss Rate of Structured Finance Securities: 1993-2006", Moody's Investors Service, April 2007

Exhibit B3:

Moody's Cumulative Municipal Default Rate Curves by Rating

Moody's Cumulative Default Rate Curves: Corporate Bonds [1]



- Moody's cumulative default rates are positively sloped, indicating that there is a direct relationship between time and credit risk
 - This is true across the entire ratings spectrum

[1] "The US Municipal Bond Rating Scale: Mapping to the Global Rating Scale And Assigning Global Scale Ratings to Municipal Obligor: Moody's Investors Service, March 2007

Exhibit C: DPA Exposure Premium Revenue Recognition

Earned Year	'A2' Rated Corporate bond, 20 Year bullet maturity, Up Front Premium				'A2' Rated Municipal bond, 30 Year amortizing par, Up Front Premium				'A2' Rated Structured Finance, 8 Year amortizing, Installment Premium			
	Par Outstanding (\$ mil.)	Corp. Default Curve	DPA Exposure	Earnings Recognition Rate	Par Outstanding (\$ mil.)	Muni. Default Curve	DPA Exposure	Earnings Recognition Rate	Par Outstanding (\$ mil.)	StF Default Curve	DPA Exposure	Earnings Recognition Rate
0	100	2.86%	2.86	-	100	2.18%	2.18	-	100.00	3.08%	3.08	-
1	100	2.70%	2.70	5.7%	98	2.10%	2.07	5.0%	55.13	2.53%	1.39	54.8%
2	100	2.56%	2.56	4.9%	97	2.03%	1.97	4.6%	26.17	1.98%	0.52	28.4%
3	100	2.41%	2.41	5.0%	95	1.96%	1.87	4.7%	12.16	1.44%	0.18	11.1%
4	100	2.26%	2.26	5.2%	94	1.88%	1.76	4.8%	5.44	0.91%	0.05	4.1%
5	100	2.11%	2.11	5.4%	92	1.81%	1.66	4.8%	2.22	0.50%	0.01	1.2%
6	100	1.95%	1.95	5.6%	90	1.73%	1.55	4.9%	0.73	0.22%	0.002	0.3%
7	100	1.82%	1.82	4.6%	88	1.66%	1.45	4.5%	0.05	0.08%	0.00003	0.05%
8	100	1.68%	1.68	4.8%	86	1.58%	1.36	4.5%	-	-	-	-
9	100	1.54%	1.54	4.9%	83	1.51%	1.26	4.5%	-	-	-	-
10	100	1.40%	1.40	5.1%	81	1.43%	1.16	4.5%	-	-	-	-
11	100	1.21%	1.21	6.6%	79	1.35%	1.06	4.5%	-	-	-	-
12	100	1.03%	1.03	6.5%	76	1.28%	0.97	4.0%	-	-	-	-
13	100	0.84%	0.84	6.4%	73	1.21%	0.89	4.0%	-	-	-	-
14	100	0.66%	0.66	6.4%	71	1.13%	0.80	4.0%	-	-	-	-
15	100	0.48%	0.48	6.3%	68	1.06%	0.71	3.9%	-	-	-	-
16	100	0.30%	0.30	6.2%	64	0.98%	0.63	3.9%	-	-	-	-
17	100	0.17%	0.17	4.8%	61	0.91%	0.56	3.3%	-	-	-	-
18	100	0.07%	0.07	3.3%	58	0.84%	0.49	3.2%	-	-	-	-
19	100	0.03%	0.03	1.7%	54	0.77%	0.42	3.1%	-	-	-	-
20	-	-	-	0.9%	50	0.70%	0.35	3.0%	-	-	-	-
21	-	-	-	-	46	0.61%	0.28	3.3%	-	-	-	-
22	-	-	-	-	42	0.51%	0.22	3.0%	-	-	-	-
23	-	-	-	-	38	0.42%	0.16	2.8%	-	-	-	-
24	-	-	-	-	33	0.33%	0.11	2.3%	-	-	-	-
25	-	-	-	-	28	0.24%	0.07	1.9%	-	-	-	-
26	-	-	-	-	23	0.15%	0.04	1.5%	-	-	-	-
27	-	-	-	-	18	0.08%	0.01	0.9%	-	-	-	-
28	-	-	-	-	12	0.04%	0.00	0.5%	-	-	-	-
29	-	-	-	-	6	0.01%	0.00	0.2%	-	-	-	-
30	-	-	-	-	-	-	-	0.04%	-	-	-	-
				100%				100%				100%

- Bullet structures earn premium on a relatively level basis overtime
 - Reflects expiration of risk based on passage of time only (default rate curve)
- Amortizing structures earn premium on a “front loaded” basis
 - Reflects both passage of time (default rate curve) and periodic pay down of principal (amortization)

Exhibit D:

Strong Consistency Between the DPA Model and the Level Yield Model

Earned Year	'A2' Rated Corporate bond, 20 Year bullet maturity, Up Front Premium			'A2' Rated Municipal bond, 30 Year amortizing par, Up Front Premium			'A2' Rated Structured Finance, 8 Year amortizing, Installment Premium		
	DPA Model	Current Model	Level Yield Model	DPA Model	Current Model	Level Yield Model	DPA Model	Current Model	Level Yield Model
	Earnings Rate	Earnings Rate	Earnings Rate	Earnings Rate	Earnings Rate	Earnings Rate	Earnings Rate	Earnings Rate	Earnings Rate
1	5.7%	5.0%	5.0%	5.0%	9.0%	5.4%	54.8%	51.1%	51.1%
2	4.9%	5.0%	5.0%	4.6%	7.5%	5.3%	28.4%	26.8%	26.8%
3	5.0%	5.0%	5.0%	4.7%	6.7%	5.2%	11.1%	12.6%	12.6%
4	5.2%	5.0%	5.0%	4.8%	6.1%	5.1%	4.1%	5.8%	5.8%
5	5.4%	5.0%	5.0%	4.8%	5.7%	5.0%	1.2%	2.5%	2.5%
6	5.6%	5.0%	5.0%	4.9%	5.3%	4.9%	0.3%	1.0%	1.0%
7	4.6%	5.0%	5.0%	4.5%	5.0%	4.8%	0.05%	0.3%	0.3%
8	4.8%	5.0%	5.0%	4.5%	4.7%	4.7%	0.001%	0.02%	0.02%
9	4.9%	5.0%	5.0%	4.5%	4.5%	4.6%	-	-	-
10	5.1%	5.0%	5.0%	4.5%	4.2%	4.4%	-	-	-
11	6.6%	5.0%	5.0%	4.5%	4.0%	4.3%	-	-	-
12	6.5%	5.0%	5.0%	4.0%	3.7%	4.2%	-	-	-
13	6.4%	5.0%	5.0%	4.0%	3.5%	4.0%	-	-	-
14	6.4%	5.0%	5.0%	4.0%	3.3%	3.9%	-	-	-
15	6.3%	5.0%	5.0%	3.9%	3.1%	3.7%	-	-	-
16	6.2%	5.0%	5.0%	3.9%	2.9%	3.6%	-	-	-
17	4.8%	5.0%	5.0%	3.3%	2.7%	3.4%	-	-	-
18	3.3%	5.0%	5.0%	3.2%	2.5%	3.2%	-	-	-
19	1.7%	5.0%	5.0%	3.1%	2.3%	3.0%	-	-	-
20	0.9%	5.0%	5.0%	3.0%	2.2%	2.8%	-	-	-
21	-	-	-	3.3%	2.0%	2.6%	-	-	-
22	-	-	-	3.0%	1.8%	2.4%	-	-	-
23	-	-	-	2.6%	1.6%	2.2%	-	-	-
24	-	-	-	2.3%	1.4%	1.9%	-	-	-
25	-	-	-	1.9%	1.2%	1.7%	-	-	-
26	-	-	-	1.5%	1.0%	1.4%	-	-	-
27	-	-	-	0.9%	0.8%	1.1%	-	-	-
28	-	-	-	0.5%	0.6%	0.8%	-	-	-
29	-	-	-	0.2%	0.4%	0.5%	-	-	-
30	-	-	-	0.04%	0.2%	0.2%	-	-	-
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

- The DPA Exposure earnings model supports the Level Yield method proposed by MBIA and AFGI

Appendix D: Unintended Consequences of Contractual Basis Cash Flows with P+I Based Revenue Recognition

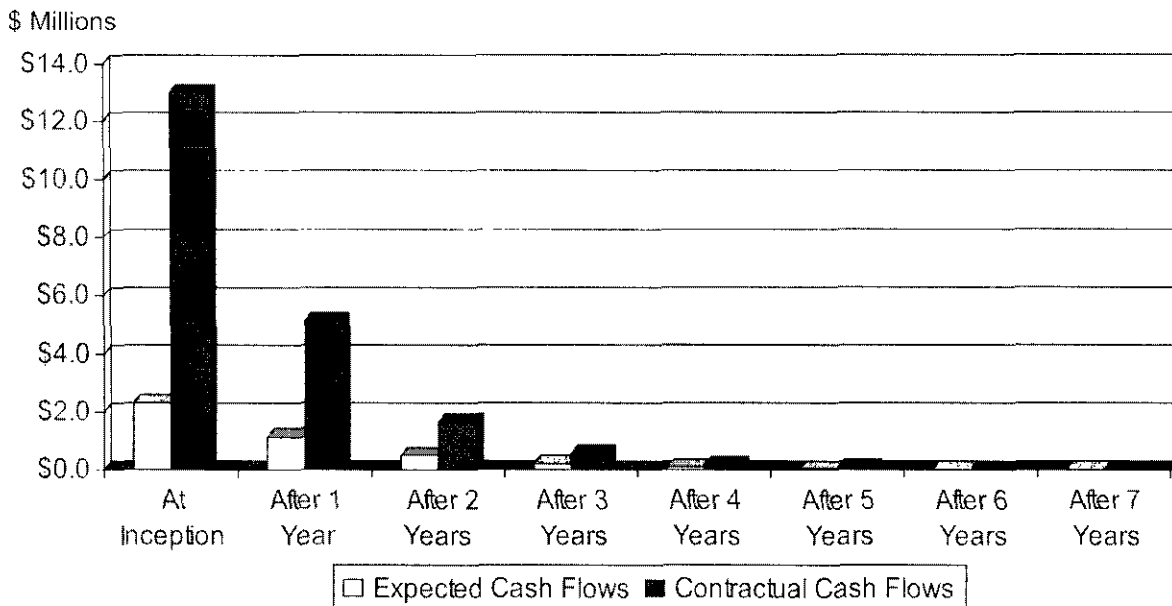
Exhibit A1: Sample Installment Payment Transaction

Deal Parameters:	
Par Insured	\$1 Billion
Coupon Rate	5.7%
Contractual Final Maturity	14 Years
Contractual Average Life	14 Years
Expected Final Maturity	8 Years
Expected Average Life	2 Years
Premium Type	Installment
Premium Rate	12 bps per annum
Initial NPV @ 5.1% per Contractual	\$13.0 million
Initial NPV @ 5.1% per Expected	\$2.3 million

- For most structured finance transactions there is a significant difference between the legal final maturity and the expected maturity
- Transactions will pay down far more quickly than the contractual payment of principal (i.e. at maturity)
 - **This is highlighted by the expected average life**
- Initial NPV between contractual and expected maturities will be dramatically different

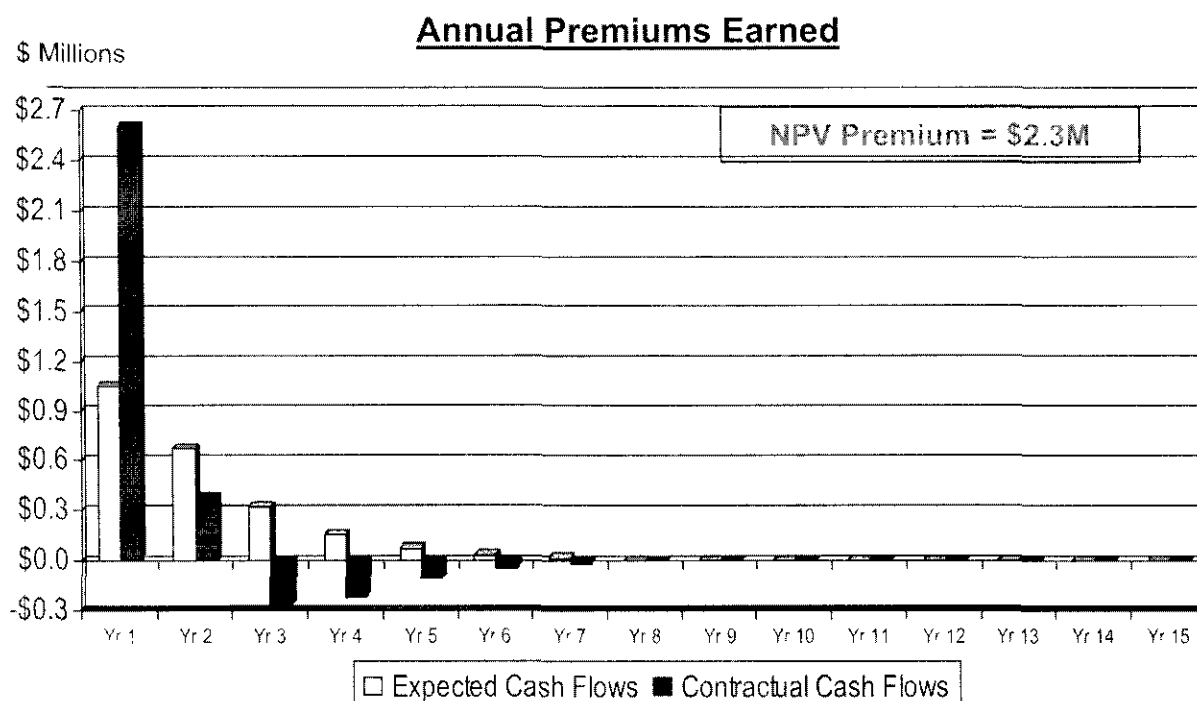
Exhibit A2: Impact Contractual Cash Flows on Receivable and UPR Reporting – *Balance Sheet Overstatements*

Premium Receivable / Unearned Premium Reserve



- Determining Premium Receivable and related Unearned Premium Reserve for installment premium transactions based on Contractual Payments would overstate Balance Sheet Reporting
 - Reduces the reliability of the financial statements and weakens the value of balance sheet metrics such as Adjusted Book Value

Exhibit A3: Impact of Contractual Cash Flows on Earnings Recognition – *Income Statement Reporting Weakened*



- Basing earnings off of Contractual Payments would distort earnings recognition as actual payments of principal are realized over time (i.e. notes pay down “as expected”, not per contract)
- Earnings would be severely front-loaded and less reliable, characteristics that the FASB set out to address in the Exposure Draft
 - In this example, the financial guarantor would recognize more earnings in the first year than would be collected over the entire life of the transaction (resulting in reversal of earning in the out years)