October 28, 2008

Honorable Henry M. Paulson, Jr.
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue
Washington, D.C. 20220

Mr. Neel Kashkari
Assistant Secretary of the
Treasury for Financial Stability
Office of Financial Stability
Department of the Treasury
1500 Pennsylvania Avenue
Washington, D.C. 20220

Re: Request for Comments
Program to Issue Guarantees under the Troubled Asset Relief Program

Dear Secretary Paulson and Assistant Secretary Kashkari:

MBIA Inc. and its wholly owned subsidiary, MBIA Insurance Corp. (together "MBIA"), a financial guarantee insurance company regulated principally by the New York State Insurance Department, welcome the opportunity to provide feedback and perspective on the program, as authorized under Section 102 of the Emergency Economic Stabilization Act of 2008 ("EESA"), to provide guarantees, through the US Treasury, for the benefit of financial institutions and investors currently exposed to or holding troubled financial assets (the "Guarantee Program"). As the world's largest financial guarantor (or "monoline"), with a significant presence in the structured finance market for over 20 years, we are hopeful that our experience, comments and recommendations will provide a meaningful benefit to the Treasury as it works towards a full implementation of this very powerful program over the next several weeks.

As an institution with significant exposure to both residential mortgage-backed securities ("RMBS") and RMBS-related securitizations, we are eager to assist the Treasury in its efforts to achieve stability and confidence within the US capital markets and a reduction in the frequency of mortgage loan defaults and foreclosures. We firmly believe that the various elements of the Troubled Asset Relief Program ("TARP"), both those enacted and currently contemplated, will achieve these goals over time.

We commend Congress and the Treasury for the foresight to establish a contingent Guarantee Program as a complement to the Direct Purchase Program. The benefit of this program will be to assist not just in the liquidity issues facing financial institutions with exposures to troubled assets, but also the uncertainty and potential for loss volatility driven by continued deterioration in the performance of mortgage-related assets. While

we understand the potential applications of such a Guarantee Program across a number of different financial institutions with exposures to troubled assets, we firmly believe that other elements of the TARP, in particular the Direct Purchase Program and Direct Investment Program, will be more efficient and effective in achieving the Treasury's goals. Despite our reservations with respect to a Guarantee Program, we thought it useful to provide our recommendations for its structuring and implementation should the Treasury ultimately utilize this measure.

As requested, we have attached in an Appendix direct responses to the questions posed by the Treasury concerning the Guarantee Program. In summary, we would call the Treasury's attention to the following recommendations, which we believe warrant the highest consideration in your potential implementation:

1. Definition of the Program's Objective: We believe it should be made clear that the Guarantee Program is designed to provide stability to financial institutions with exposures to troubled assets by limiting their ultimate potential loss. Those financial institutions participating in the Guarantee Program should be required to retain an alignment of interest with the Treasury and taxpayers by retaining a material portion of the losses to be incurred on these assets through either the payment of an upfront premium sized against current expected losses, or through the establishment of a deductible after which the Guarantee Program would provide coverage, or some combination thereof.

2. Eligible Assets: We believe that Eligible Assets should be defined as securities backed by financial obligations of US consumers and corporations, or securitizations of securities backed by financial obligations of US consumers and corporations, including but not limited to: RMBS (including first and second lien securitizations), Asset-Backed Collateralized Debt Obligations ("ABS CDOs"), Commercial Mortgage Backed Securities ("CMBS"), as well as securities backed by auto loans, credit cards, student loans, rental car fleets, timeshare loans, trade receivables securitizations (US based originators) and manufactured housing. Financial guarantee insurance policies and/or credit default swaps issued by financial guarantors with respect to pools of such assets should also be accepted.

   We believe that it is critical that eligible collateral be in securitized or certificated form. Neither "whole loans" nor synthetic exposure on a referenced basis should be accepted. More specifically, synthetic exposure is a position taken in credit default swap form where the party does not have an insurable interest in the underlying asset, but rather only references an asset through their derivative, hence suffering from an inability to deliver under the Direct Purchase Program of TARP. Whole loans are best addressed under the Hope for Homeowners ("HOPE") and Federal Housing Administration ("FHA") programs, while the volume of synthetic assets in the market would quickly exhaust the resources of the EESA program without having a material impact on the real economy or net effect on the worth of the financial sector. (see Appendix 1 - Section 7 for more detail regarding synthetic assets.)

3. Pricing: We believe that the Treasury should price the coverage afforded to financial institutions under the Guarantee Program using methodologies similar in substance and application to those applied under the Direct Purchase Program. As an overarching principle, the provision of the guarantees should be done on a cost neutral basis for US taxpayers. As such, premiums should be set at a level that covers expected payouts by the Treasury over the remaining term of the guaranteed assets.

4. Tenor: To be effective, we believe that the guarantees issued should remain in effect until all remaining principal balances on the troubled assets have been repaid. In the case of RMBS and RMBS-related assets, this concept should apply to the principal balance of the specific security or tranche of the security presented under the program, and not to the principal balances of the underlying mortgage collateral.

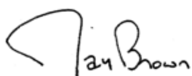
5. Application of Limit Under EESA: We believe that consideration should be given to the "at risk" value of the contingent guarantee as opposed to the notional value when calculating usage under the limits put forth under the EESA. At a minimum, this should net premiums to be paid against actual notional value covered by the guarantees. It should also, over time, allow for usage to be adjusted to reflect performing and/or paid off principal values. Finally, to the extent that the Treasury actually purchases assets collateralizing a guaranteed structure, such assets should be netted against the EESA limit.

6. Optional Termination Provisions: We believe that participants under the Guarantee Program should be provided the option to terminate their coverage through a reassumption of the associated exposure to the troubled assets subject to some objective tests. These tests should be designed to ensure that the reassumption of the risk does not introduce or amplify systemic risk to the financial system or the participating entity's industry. This would result in premium recapture and/or the cessation of premium payments.

7. Eligible Institutions: We believe that participants under the Guarantee Program should be US domiciled financial institutions, subject to regulation by a US federal or state governmental agency. Additionally, participants should be US taxpayers, or part of a US taxpaying group, and not a party to or a beneficiary of any tax sharing arrangements which shelter income derived by the institution from the US taxpayer. We believe these eligibility requirements should apply to both the Direct Purchase Program and the Guarantee Program.

8. Homeowner Relief: We believe that the program should further the goal of reducing the level of foreclosures for US homeowners. Participants within the program, therefore, should be required to work with the Treasury and other agencies to enact and approve appropriate modifications to mortgages to allow for debt relief on owner occupied principal residences facing foreclosure. Such requirements should include the transfer of control rights held by certain parties (including the monolines) over securitized pools, or the agreement to vote as directed by the Treasury on bondholder waivers, amendments and consents.

Sincerely,



Jay Brown
Chairman and CEO
MBIA Inc.

Appendix

MBIA's Response to the US Treasury Department's
Request for Comments – Section 102 Guarantee Program

1. What are the key issues Treasury should address in establishing the guarantee program for troubled assets?

We believe the primary issues to be focused on by the Treasury should be the price charged to users of the program, the tenor of the guarantees issued, the application and methodology around the use of the limits set forth under the EESA, the ability of participants to terminate guarantees, and the eligibility requirements associated with both the assets presented for guarantees and the institutions participating in the program. Most importantly, we believe the objectives of the program - the restoration of stability within the US capital markets and the provision of relief to homeowners facing foreclosure - should guide the terms and conditions set forth by the Treasury.

We also think it is critical that the program be limited to cash assets and securitizations of cash assets. If the Treasury offers coverage (or purchase through the Direct Purchase Program) of synthetic assets that only reference cash assets, the program's financial capacity would be quickly exhausted without any material impact on the real economy. The synthetic asset market is a "zero sum game" that has no net effect on the worth of the financial sector.

1.1 Should the program offer insurance against losses for both individual whole loans and individual mortgage backed securities (MBS)?

Financial institutions across the US have taken exposure to troubled residential mortgages in a variety of forms, including whole loans, RMBS and repackagings of RMBS. While it would seem a fair and equitable application of the Guarantee Program to allow for individual whole loans to be eligible for guarantees, we believe that the Treasury and the homeowner is better served by having institutions with troubled whole loans work within the parameters of the previously enacted HOPE and FHA programs. As the holder of the underlying whole loans, these financial institutions are better able to work with the borrowers to arrive at a loan structure that is both financially suitable for the mortgagee and qualifies for participation in the HOPE and FHA programs, allowing those government guarantee programs to provide the relief needed for the troubled assets.

As such, we believe that the Guarantee Program is best suited for RMBS and resecuritizations of RMBS (ABS CDOs), where the holder of the troubled assets retains an interest and loss potential in the underlying security (and therefore the mortgage loans). This provides an alignment of interest between the beneficiary of the insurance and the Treasury as the provider of the coverage. By focusing on securities and financial guarantee policies (and credit default swaps collateralized by a pool of Eligible Assets), the Treasury can obtain unique control rights over the entire asset pool, broadening the scope of modification possibilities. The programs should be made available for both first and second (junior) lien products, as well as for senior and subordinated tranches of related securitizations.

1.2 What is the appropriate structure for such a program? How should the program accommodate various classes of troubled assets? Should the program differ by the degree to which an asset is troubled?

We believe that the appropriate structure for the program would include the following elements:

- An insurable interest in the underlying securities: participants in the program should be required to have a direct financial interest (either through ownership or a financial guarantee) in the troubled assets subject to the guarantee.
- Realization of losses prior to application: participants in the program should be required to have incurred and reported direct losses on the troubled assets (either through a writedown in value or through actual claim payments) prior to the application for a guarantee. This provision would serve to mitigate the potential for arbitrage activities designed to take advantage of differences between market pricing and the pricing associated with the guarantee program.
- Payouts under the program should be matched to principal and interest when due on the guaranteed troubled assets: no acceleration of claims should be permitted. Payments under the guarantee, other than for certain resecuritizations subject to liquidation rights and requirements, should only be made upon the exhaustion of any associated reserves or deductibles as described later herein.
- The government should not offer collateral to counterparties.
- Payouts under the program should be made net of expected premiums: an acceleration of losses in excess of those projected under the expected case when applying for the guarantee would not reduce the overall premiums due to guarantee the troubled asset.
- Centralized monitoring of exposures, pricing and performance: as it is possible for multiple financial institutions to seek a guarantee on different securities ultimately backed by the same pool of underlying assets, centralized monitoring by the Treasury (or its assigned asset/insurance managers) of the exposures, including associated delinquencies, defaults and prepayments will be necessary to ensure that payouts are made on a consistent basis. Likewise, pricing established for the risk of specific assets should be consistent, adjusted only for deductibles/reserves taken by the participating financial institution. This centralized monitoring should provide both the Treasury and Fed with substantial performance data with respect to securitized pools of mortgages and other asset backed securities, and should provide an important feedback loop for the deployment of additional resources/remediation efforts within the associated markets. By focusing on financial guarantee policies (and credit default swaps collateralized by a pool of Eligible Assets), which generally cover all senior securities in a pool, we believe the Treasury can minimize many of these difficulties.

How should the program accommodate various classes of assets?

The structural recommendations made above should not differ by the underlying securitized asset (mortgage, auto, credit cards, student loans, etc). We support the availability of the program to pools of US consumer and corporate backed financial assets as a means of capping the volatility experienced in the ABS markets, and more

importantly, as a means of ensuring that the lending markets reopen to these critical elements of the US economy.

Should the program differ by the degree to which an asset is troubled?

Differences in program application should be limited to the deductibles assigned to the given asset and pricing required to assume the risk.

1.2.1 What are the key issues to consider with respect to guaranteeing whole first mortgages?

As noted earlier, we believe that holders of whole first mortgages should utilize other elements of the government's efforts to reduce losses within the mortgage market, including the HOPE and FHA programs, as well as the authority in Section 109 of EESA. Encouraging use of the Guarantee Program by direct holders of mortgages will reduce their incentive to work with borrowers on modifications and rate reductions necessary to prevent foreclosures. More importantly, it could create a moral hazard where the government backstop is used to cap losses, leading institutions to neglect their underlying loan pools rather than investing in the programs and servicing needed to reduce defaults.

The Guarantee Program, we believe, will best benefit the financial markets and ultimately the homeowners exposed to foreclosure when applied to pools of securitized mortgages, or pools of securities backed by securitized mortgages.

1.2.2 What are the key issues to consider with respect to guaranteeing HELOCs and other junior liens?

HELOCs and other junior or second lien products represent financial obligations of the borrowers which need to be respected and upheld under any government Guarantee Program or any HOPE or FHA program. Release of the second lien should only be permitted upon payment of fair consideration given the combined loan to value of the property and expected recovery on the first lien mortgage given modification through a government program.

Pools of HELOCs and other junior lien products securitized and presented to the Treasury for guarantee should be evaluated for loss potential taking into account the recoveries that should accrue given the application of the above principle. An assumption of 100% loss severity given the pending implementation of these programs would not be appropriate.

Likewise, originators of second lien products are currently subject to various lawsuits, alleging breaches of various representations and warranties in the origination and securitization process. Recoveries on losses taken by owners or guarantors of second lien products should accrue to them up to the amount of the deductible in the applicable guarantee from the Guarantee Program.

Finally, HELOCs and second lien products are subject to enforcement and foreclosure statues that differ by state. Issues specific to recoveries against properties versus actual obligors should be considered in the structure and implementation of the program.

1.2.3 What are the key issues to consider with respect to guaranteeing MBS?

The Treasury's ability to enhance recoveries (and reduce possible loss severity on its guarantees) on RMBS will be driven in large part by the exercise of control over the underlying mortgages. The ability to adequately exercise control will be driven by two factors: i) the agreement by participants to deliver control rights relative to the underlying troubled RMBS subject to the Guarantee Program and ii) the aggregation by the Treasury, across participants, of a super majority of a given securitization. As the Treasury seeks to minimize the potential losses associated with such a program, and more importantly, seeks to unlock loans held in trust through securitization so that they can benefit from government mortgage relief programs, managing the program to maximize Treasury's control across various issuers, vintages and securitizations will be critical.

In the case of guarantees applied for by providers of financial guarantee insurance (including the monolines like MBIA), control rights retained as a result of its insurance of a given transaction should be provided as a condition of delivery of a guarantee under the Guarantee Program and is a uniquely effective way for the Treasury to acquire control rights over an entire asset pool from a single party.

1.2.4 What are the key issues associated with guaranteeing financial instruments other than mortgage related assets originated or issued before March 14, 2008 that could be important for promoting financial market stability?

The Treasury must recognize that the spillover from the RMBS market has hit other critical segments of the ABS market, including auto, student loan and credit card securitizations. While performance of these sectors to date has not demonstrated the same level of stress as that of RMBS, the lack of liquidity and stress loss scenarios posed for these asset classes has served to diminish their value, closing down both secondary trading and more importantly, primary issuance. We would argue that the observed decline in auto sales and consumer demand is in many ways directly correlated to this reduction in available credit. We would therefore argue that the program should be made available across these and other asset classes financing US consumer and corporate financial assets to ensure that the stability inherent in the availability of these guarantees is permitted to have a halo effect over the balance of the market.

1.3 What are the key issues to consider with respect to setting the payout of the guarantee?

Guarantees should cover timely interest and principal payments according to the expected payout schedule agreed to at the time of guarantee under the program. No acceleration of payments should be permitted. Premiums should be paid according to the expected payment schedule as well, and not adjusted for acceleration or extension of the underlying risk.

1.3.1 Should the payout be equal to principal and interest at the time the asset was originated or to some other value? What should that value be? What would be the impact of offering guarantees of less than 100 percent of original principal and interest?

The payout should cover the remaining principal and interest due at the time of guarantee, less any deductible agreed to by the participant and the Treasury. The deductible should be sized to reflect expected losses as of the date of guarantee and take the form of subordination and/or a funded reserve.

1.3.2 Should payout vary by asset class? If so, please describe using the same asset classes as enumerated under 1.21-1.24.

We do not believe that payouts should vary by asset class. We do believe that the tranching and subordination mechanics inherent in the underlying securitizations should be upheld, with no payouts made by the Treasury on subordinated classes of a securitization until such time as the senior class has either matured or paid out through the Treasury guarantee.

1.4 What event should trigger the payout under the guarantee? Should the holder be able to present the claim at will or should there be a set date? Should this date differ by asset class? Should this date differ by the degree to which the asset is troubled?

Payouts should be tied to principal and interest when due on the underlying RMBS or ABS subject to the guarantee. For ease of servicing, the Treasury may require that notice and proof of claim be provided at the time a payout would be triggered, with actual payments made by the Treasury either on a monthly, quarterly or semi-annual basis to follow. Once payout is made by the Treasury, subsequent recoveries accruing to the holder of the troubled asset, or guarantor of the troubled asset, in excess of the original deductible or reserves taken should be recaptured by the Treasury to reduce loss severity on the Guarantee Program.

1.5 Should the holder be permitted to sell the troubled asset with the program guarantee? If appropriate, should asset sales be restricted to eligible financial institutions or should there be no restrictions to promote liquidity in the market place?

We appreciate that the liquidity needs of participants within the Guarantee Program may differ substantially. In that light, we would recommend that the insurable interest clause noted in section 1.2 be a condition of any sale of any contingent exposure or asset covered by the Guarantee Program. Likewise, the sale must contemplate the counterparty risk associated with any premiums that would be payable over time rather than from asset cash flow. As such, to the extent that premiums remain unpaid from sources other than asset cash flows, sales should only be permitted to financial institutions subject to regulation by US Federal or State regulatory bodies. Finally, the government should be allowed the right of first refusal on the purchase of any asset subject to the guarantee to ensure that the Treasury has the right to capture any substantial capital gains or associated improvements in asset performance post guarantee, particularly those improvements stemming from other government programs (i.e., HOPE and FHA) as discussed herein.

1.6 What are the key issues the Treasury should consider in determining the possible losses to which the government would be exposed in offering the guarantee? What methodology should be used to determine possible losses? Does it differ by asset class? If so, please describe using the same asset classes as enumerated under 1.21- 1.24. Does it differ by the degree to which the asset is troubled?

The Treasury should assess the risk of loss given the collateral, cash flow, vintage and recovery characteristics of the individual pools presented. We believe that the methodology applied to the loss, and therefore by extension pricing, assumptions should be consistent with the methodology applied under the Direct Purchase Program of the TARP.

A fundamental disconnect has occurred in the market between fair (or market) values, which have been impacted by the complete disappearance of liquidity, and cash flow value, which reflects expected cash flows over the remaining life of the troubled asset. We strongly believe that a value reflecting expected cash flow is a more fair and stabilizing measure than one that is impacted by the illiquidity, speculation and fear inherent in the ABS markets today.

1.7 What are the key elements the Treasury should consider in setting premiums for this program? Is it feasible or appropriate to set premiums reflecting the prices of similar assets purchased under Section 101 of the EESA?

The core objective should be to set premiums under the program at a level that covers, on a present value basis, expected losses on the underlying troubled assets subject to the guarantee, in order to make the program taxpayer neutral.

We believe it critical in assessing such prices, that loss expectations be set based on an analysis of the underlying pool, including delinquency, default and loss given default trends for various vintages, as well as performance deviation given the associated seller servicer/geographic content.

We would urge the Treasury not to use index derivatives as a means of projecting loss, given the volatility and level of speculation inherent in those measures, but rather to evaluate each pool individually.

1.7.1 If use of prices of similar assets purchased under Section 101 of the EESA are not feasible or appropriate, should premiums be set by use of market mechanisms similar to (but separate from) those contemplated for the troubled assets purchase program? How would this be implemented? If not feasible or appropriate, what methodologies should be used to set premiums?

See answer in section 1.7.

1.7.2 Do these considerations of feasibility or appropriateness vary by asset class? If so, please describe using the same asset classes as enumerated under 1.21-1.24. Should the premiums vary by the degree to which the asset is troubled?

We do not believe that the considerations or feasibility should materially differ by asset class.

Premiums would justifiably vary based on the degree to which an asset is troubled. The greater the loss potential an asset would appear to exhibit, the higher the premium (or deductible) would need to be set to cover the potential risk of loss under the Treasury's guarantee.

1.8 How and in what form should payment of premiums be scheduled?

The Treasury is best protected against counterparty risk to the extent that the premiums associated with the Guarantee Program are paid on an upfront basis. Given that many counterparties are already suffering from a level of illiquidity derived from the instability in the markets and loss of value on these troubled assets, we would support an option to pay on an upfront and or ongoing basis, assuming that i) no more than 50% of the premium due is paid over time and ii) the premium due the Treasury becomes pari-passu with all senior obligations of the financial institution.

2. How should a guarantee program be designed to minimize adverse selection, given that the program must be voluntary? Is there a way to limit adverse selection that avoids individually analyzing assets?

Absent requiring financial institutions to provide a horizontal slice of all exposures to troubled asset classes, irrespective of whether an asset is troubled or not, we believe it is difficult to avoid adverse selection under such a program. Controls around pricing, eligibility and the maintenance of an insurable interest, therefore, become critical to the proper implementation of the Guarantee Program.

While it is possible to develop term sheets based on certain characteristics common among RMBS and RMBS-related securitizations which will aid in benchmarking and standardizing loss expectation and therefore premium costs, we believe that the Treasury should review specific pools, using independent or in-house experts, to ensure that these parameters do not create opportunities to arbitrage the government's coverage against pool specific idiosyncratic risks.

3. What legal, accounting, or regulatory issues would such a guarantee program raise?

Legal:

- To optimize control rights as discussed earlier, the government will need to document the appropriate conveyance of these rights, or the obligations to vote as directed, from participants to the Treasury.

- For financial guarantors, regulators will need to determine if the guarantee becomes an asset for the benefit of all policyholders or solely those exposed to the monoline's guarantee of the specific security presented under the Guarantee Program.
- Documentation and bifurcation of recoveries between those accruing to the financial institution and those either arising from efforts undertaken after the implementation of the guarantee or in excess of the deductible set forth under the guarantee need to be addressed.

Regulatory:

- Priority of premium payments within the regulated entities.
- Use of the program by unregulated entities to support assets ultimately backstopping insurance company obligations.
- Avoidance of insurance nexus for the program.

Accounting:

- Relief provided by the Guarantee Programs should be considered in the calculations of changes in fair value under FAS 133, as well as the determination of Other Than Temporary Impairments, relative to the assets subject to the guarantee, as appropriate.

4. What administrative and/or operational challenges would such a guarantee program create?

It is clear that the Treasury will need to establish two important processes, both of which will require either internal or outsourced infrastructure. First, the review, analysis and pricing of the exposures will require expert opinion. This is true of the Direct Purchase Program as well, where we understand outside asset managers are already engaged in establishing the ground rules and process for the purchase of assets. On an ongoing basis, monitoring of asset performance, premium payments, exposure levels and recoveries will need to be undertaken. Though the guaranteed counterparties should take the lead in providing this service, it is clear that an independent, unbiased and centralized source for such information and ongoing analysis is critical.

Given MBIA's leadership and experience in the financial guarantee industry, we would be more than willing to consider the provision of certain administrative, monitoring and remediation servicers to the Treasury if this program should be fully implemented. We encourage the Treasury to consider the outsourcing of these activities to parties who are likewise exposed to the performance of these troubled assets as a means of leveraging their experience and efforts, while ensuring an alignment of interests.

4.1. What expertise would Treasury need to operate such a guarantee program? Please describe for all facets of the program.

See note above in section 4. Advanced quantitative analytics for the projections of loss and determination of prices, coupled with significant data processing and monitoring capabilities will be key. Payment review, approval and processing will also be critical. We do believe that significant elements needed, however, exist within Fannie Mae and Freddie Mac, and can be leveraged to ensure a quick and cost efficient implementation.

5. What are the key issues to be considered in determining the eligibility of a given type of financial institution to participate in this program? Should these eligibility provisions differ from those of the troubled asset purchase program?

Participating financial institutions should be US domiciled financial institutions, be regulated by a US Federal or State regulatory body and a US taxpaying entity, or a member of a US taxpaying group. Entities formed with holding companies in tax advantaged jurisdictions should not be permitted to benefit from the US taxpayers support of the financial markets at this time. These requirements should apply to both the section 102 Guarantee Program as well as to the Direct Purchase Program.

6. What are the key issues to be considered in determining the eligibility of a given asset to be guaranteed by this program? Should eligibility provisions of assets to be guaranteed under this program differ from those of the troubled asset purchase program?

The key determination should tie back to the overall objectives of the EESA - the stabilization of the US capital markets and the protection of US homeowners currently facing foreclosure due to mortgages that, with the benefit of some form of modification, could otherwise be afforded. In order to optimize the use of the limits of this program, Eligible Assets should either be determined to have been impaired, or be at risk of impairment, in order to qualify.

7. Assuming the guarantee is priced to cover expected claims, are there situations (perhaps created by regulatory or accounting considerations) in which financial institutions would prefer this program to the troubled asset purchase program? Please describe.

We would strongly recommend that this program not be extended to those financial institutions who have taken exposure to troubled assets through synthetic credit default swaps (i.e., where they do not have an insurable interest in the underlying asset, but rather only reference an asset through their derivative, hence suffering from an inability to deliver under the Direct Purchase Program of the TARP). Failure to close this loophole may in fact create arbitrage opportunities and issues surrounding moral hazard which would run contrary to the Treasury's goal of avoiding unwarranted enrichment.

The volume of synthetic assets created, transacted and insured among market participants could easily overwhelm the capacity of this program. In addition, guaranteeing positions in these contracts has no direct impact on the real economy. When these contracts settle in the ordinary course or as a result of losses in the reference portfolios, no wealth is created or destroyed – it is merely a "zero sum" game. MBIA has been a participant in this part of the market, guaranteeing over $100 billion of such contracts. Nevertheless, we strongly urge that the Treasury avoid extending the Guarantee Program to synthetically referenced assets. If the performance of underlying mortgages improves, the synthetic assets and derivatives based on them will take care of themselves.

7.1 Does this preference differ by type and condition of the asset? For what troubled assets might financial institutions choose to participate in the guarantee program rather than sell under the troubled asset purchase program? Is accommodating this choice likely to best promote the goals of the EESA? Does it adequately protect the taxpayer? If not, what design feature should be included to assure these goals are met?

See answer in 7.0