

**Credit Opinion: Financial Security Assurance Inc.**

**Financial Security Assurance Inc.**

*New York, New York, United States*

**Ratings**

<b>Category</b>	<b>Moody's Rating</b>
Outlook	Stable
Insurance Financial Strength	Aaa
<b>Parent: Financial Security Assurance Holdings Ltd.</b>	
Outlook	Stable
Senior Unsecured	Aa2
Jr Subordinate	Aa3
<b>FSA Seguros Mexico S.A. de C.V.</b>	
Outlook	Stable
Insurance Financial Strength -Dom Curr	Aaa
<b>Financial Security Assurance (U.K.) Limited</b>	
Outlook	Stable
Insurance Financial Strength	Aaa
<b>Financial Security Assurance Intl Ltd.</b>	
Outlook	Stable
Insurance Financial Strength	Aaa

**Contacts**

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**Key Indicators**

**Financial Security Assurance Inc.**

	[1]2006	2005	2004	2003	2002
Gross Par Written (\$ million)	\$93,781	\$103,355	\$107,800	\$80,800	\$107,000
Gross Premiums Written (\$ million)	\$816	\$834	\$832	\$896	\$804
Net Par Outstanding (\$ million)	\$359,560	\$337,483	\$317,742	\$289,200	\$263,270
Hard Capital (\$ million)	\$4,982	\$4,668	\$4,339	\$3,929	\$3,405
Net Income (\$ million)	\$424	\$326	\$379	\$298	\$197
Strategy & Franchise Value					
% of Industry Net Par Outstanding	15.5%	18.1%	17.8%	17.6%	18.6%
% of Industry Gross Par Written	15.6%	na	na	na	na
Portfolio Characteristics					
Credit Risk Ratio	21.5	20.8	20.6	22.1	22.0
Tail Risk Ratio	73.9	71.2	68.2	75.4	79.7
Capital Adequacy					
Hard Capital Ratio	1.78x	1.82x	1.85x	1.72x	1.54x
Total Capital Ratio	1.68x	1.73x	1.77x	1.62x	1.37x
Par Reinsured	25.3%	26.3%	26.9%	25.0%	25.9%
Profitability					
Return on Equity	14.4%	13.5%	14.8%	13.9%	13.0%
Loss Ratio (SAP)	0.0%	2.1%	5.0%	3.7%	15.1%

Expense Ratio (SAP)	<b>29.9%</b>	<b>27.8%</b>	<b>26.8%</b>	<b>21.3%</b>	<b>20.9%</b>
Financial Flexibility					
Earnings Coverage	<b>18.3x</b>	<b>17.3x</b>	<b>21.3x</b>	<b>12.6x</b>	<b>8.9x</b>
Cash Flow Coverage	<b>5.3x</b>	<b>5.6x</b>	<b>3.2x</b>	<b>3.3x</b>	<b>4.3x</b>
Double Leverage	<b>115.6%</b>	<b>111.9%</b>	<b>109.9%</b>	<b>109.9%</b>	<b>108.8%</b>

[1] 2006 values for Credit Risk Ratio, Tail Risk Ratio, Hard Capital Ratio and Total Capital Ratio are as of 6/30/2006

## Opinion

### SUMMARY RATING RATIONALE

The Aaa Insurance Financial Strength rating (IFSR) of Financial Security Assurance Inc. (FSA) reflects the limited risk characteristics of the group's core financial guaranty business, its conservative underwriting strategy, strong surveillance and loss mitigation expertise, and its well-balanced credit enhancement experience in both the municipal finance and structured finance markets. FSA is firmly established as one of the leading participants in the broadening universe of financial guarantors. As a member of the Dexia group, FSA benefits from improved distribution capabilities in the European markets and from its ownership by a strong parent.

FSA's insurance provides an unconditional and irrevocable guaranty to pay interest and principal in the event of an issuer default, which enhances the credit quality and marketability of the underlying credit obligation while lowering the cost of debt for the issuer. FSA participates in all segments of the financial guaranty market, focusing on low risk transactions and, at times, using layered loss reinsurance to further reduce the risk of some exposures. The US municipal and structured markets will continue to represent the bulk of FSA's outstanding insured portfolio, but given the relative maturity of these markets, much of the company's future growth is expected to come from outside of the United States, most notably in Europe. Such international opportunities often comprise large project financings that have higher risk characteristics than FSA's traditional underwriting, but nevertheless remain consistent with the risk tolerance of a Aaa company.

Over the last few years, the financial guaranty industry witnessed lower volume due to a cyclical downturn in demand coupled with an increase in financial guaranty insurance substitutes, although FSA's strong embedded earnings from its outstanding insurance and investment portfolios helped mitigate the earnings consequences of lower business activity. More recently, these business trends appear to be reversing given the ongoing credit market dislocation triggered by stress in the subprime mortgage market. Demand and pricing for credit enhancement is increasing substantially, which is likely to be positive for guarantors such as FSA.

### Credit Strengths

Leading global provider of financial guaranty insurance

High quality, well diversified insurance portfolio with nominal liquidity needs

No exposure to recent vintage ABS CDOs

Strong risk adjusted capitalization and predictable core earnings

Strong parent helps franchise and provides implied support

Management's commitment to Aaa rating reflects sensitivity of franchise to rating

### Credit Challenges

Mature US market could hurt longer term demand for credit enhancement

Sensitivity of insurance portfolio to credit cycle with some large single risk exposures

Some risk concentration in certain sectors such as pooled corporate risks and consumer ABS

### Rating Outlook

Moody's outlook for FSA's Aaa Insurance financial strength rating and FSA Holding's Aa2 senior debt rating is stable.

## What Could Change the Rating - Down

A substantial deterioration of portfolio characteristics or underwriting practices

A sustained decrease in hard and total capital ratios below 1.3 times without corrective action

Failure to maintain three-year average holding company operating ROE above 12%

An extensive diversification into higher risk businesses

Deterioration in the competitive environment or product demand.

## Notching Considerations

The spread between FSA Holding's senior debt rating and the IFSR of its primary operating subsidiary is two notches and is consistent with Moody's standard notching practices for financial guarantor holding company structures.

## Insurance Financial Strength Rating

Moody's rates FSA Aaa for insurance financial strength, which is in line with the adjusted rating indicated by the Moody's insurance financial strength rating scorecard. The key factors currently influencing the rating and outlook are:

Factor 1 - Franchise Value and Strategy: Aaa

FSA is one of the four largest global financial guarantors. The company is an established player in the municipal and structured finance sectors, with a growing international presence. It has more recently been a leader in US municipal underwriting. In addition, FSA has strong embedded earnings, as measured by the ABV to BV ratio. On the governance side, FSA's structure is very strong for a wholly owned subsidiary.

Factor 2 - Portfolio Characteristics: Aaa

FSA maintains a high-quality insured portfolio, both relative to its peers and in absolute terms. This translates into credit and tail risk ratios that are among the best in the industry. Similarly, its percentage of below-investment-grade exposure is modest relative to its peers. This reflects the company's strategic focus on low risk underwriting and its use of first-loss reinsurance on select transactions.

Factor 3 - Capital Adequacy: Aaa

FSA has the strongest capital ratios of the established guarantors despite its higher operational leverage, reflecting the aforementioned quality of its insurance portfolio. The firm is, however, the largest user of reinsurance, creating a relatively high degree of dependence on third party capital, mitigated in part by the collateral it has obtained from many of its reinsurers.

Factor 4 - Profitability: Aaa

FSA has strong core profitability with a reported 3-year operating ROE in excess of our 12% benchmark for Aaa-rated firms. When compared to its peers, this figure is negatively affected by the firm's stronger-than-average risk adjusted capital position, coupled with the effect of accounting conventions for incentive compensation.

Factor 5 - Financial Flexibility: Aaa

FSA's recent hybrid capital issuance has somewhat weakened its strong financial flexibility given the added holding company fixed charges associated with this junior subordinated debt. Earnings coverage and leverage (adjusted for the equity content of the hybrid) remain strong, and the firm benefits from its ownership by the highly rated Dexia group.

## Rating Factors

**Financial Security Assurance Inc.**

Financial Strength Rating Scorecard [1]	Aaa	Aa	A	Baa	Score	[2]Adjusted
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							Score	
<b>Factor 1: Strategy &amp; Franchise Value (25%)</b>							<b>Aaa</b>	<b>Aaa</b>
% of Industry Net Par Outstanding	15.5%							
% of Industry Gross Par Written	15.6%							
Moody's Adjusted Book Value/Book Value	1.49x							
Client Concentration	x							
Management, Governance & Risk Management Oversight	x							
<b>Factor 2: Portfolio Characteristics (20%)</b>							<b>Aaa</b>	<b>Aaa</b>
Credit Risk Ratio	21.5							
Tail Risk Ratio	73.9							
% Below Investment Grade	1.6%							
S (WCL > 10% of HC) / HC	31.3%							
<b>Factor 3: Capital Adequacy (30%)</b>							<b>Aaa</b>	<b>Aaa</b>
Hard Capital Ratio	1.78x							
Total Capital Ratio	1.68x							
Par Reinsured			25.3%					
<b>Factor 4: Profitability (15%)</b>							<b>Aaa</b>	<b>Aaa</b>
Return on Equity - 3 year average	14.2%							
Loss Ratio (SAP) - 3-year average	2.4%							
Expense Ratio (SAP) - 3-year average			28.2%					
<b>Factor 5: Financial Flexibility (10%)</b>							<b>Aaa</b>	<b>Aaa</b>
Earnings Coverage	18.3x							
Cash Flow Coverage			5.3x					
Double Leverage	115.6%							
Ease of Access to Capital	x							
<b>Aggregate profile</b>							<b>Aaa</b>	<b>Aaa</b>

[1] Values for Credit Risk Ratio, Tail Risk Ratio, Hard Capital Ratio and Total Capital Ratio are as of 6/30/2006. All other values are as of 12/31/2006. [2] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis.

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