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ASSOCIATION OF FINANCIAL GUARANTY INSURERS

Unconditional, Irrevocable Guaranty

September 11, 2012

Attn: Secretary Jennifer Johnson
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

RE: Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies (Docket No. 1438; RIN 7100-AD-86)

Ladies and Gentlemen:

The Association of Financial Guaranty Insurers ("AFGI"), a trade association representing the unique perspective of financial guaranty insurers and reinsurers, writes to comment on the Board of Governors of the Federal Reserve System's (the "Federal Reserve") proposed rule implementing the enhanced prudential standards and early remediation provisions of Sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1]

Particularly, AFGI is concerned with the single-counterparty credit limits and the counterparty definition proposed in the Federal Reserve rule for systemically important financial institutions ("SIFIs"). Although we believe that regulations limiting risk exposure are necessary for the efficient functioning of the financial markets, rules that are not properly calibrated to the risks they are designed to address increase the likelihood of damage to financial institutions and the broader economy. For this reason, we share the concerns expressed by The Clearinghouse, the American Bankers Association, SIFMA, The Financial Services Roundtable, and the Financial Services Forum regarding the proposed single-counterparty credit limits (applicable to guaranteed transactions such as those insured by AFGI members) and counterparty definition (applicable to U.S. municipal obligations), as highlighted in their letter to the Federal Reserve dated April 27, 2012. Like these organizations, we believe that the Federal Reserve's proposed single-counterparty credit limits and counterparty definition will inevitably result in an extraordinary overstatement of risk exposures.

<u>Risk Exposure to Eligible Protection Providers</u>

In its proposed rule, the Federal Reserve notes that, during the financial crisis, single-borrower lending and investment limits "did not adequately cover credit exposures generated by

[1] Board of Governors of the Federal Reserve System, Proposed Rulemaking, Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 593 (Jan. 5, 2012).

derivatives and some securities financing transactions."[2] To address this risk exposure, the Federal Reserve proposed single-counterparty credit limits for SIFIs. The proposed rule allows SIFIs to reduce credit exposure to a counterparty, for purposes of the single-counterparty credit risk limit, by obtaining credit risk mitigants such as financial guaranty insurance.[3] However, the rule requires that SIFIs buying eligible protection shift the full face amount of the exposure from the reference name to the eligible protection provider.

AFGI submits that such an approach will overstate the exposure that SIFIs have to eligible protection providers such as financial guaranty insurers. Indeed, the proposed rule ignores the reduced likelihood that a SIFI will experience a loss because that would require both the counterparty and the protection provider to fail. Shifting the full face amount of the exposure from the reference name to the eligible protection provider would transform a risk mitigant into a risk exaggeration. Moreover, such shifting requirement could result in higher costs and a significant reduction in the availability of protection products.

For this reason, AFGI proposes that the single-counterparty credit limit requirements be modified to permit a SIFI to make its own good faith determination, subject to written policies and procedures, of the extent, if any, it would shift an exposure from an underlying obligor to an eligible credit protection provider when the SIFI purchases credit protection. Such policies and procedures would of course be subject to examination and review by the Federal Reserve in its capacity as supervisor.

Counterparty Definition

The proposed rule provides that, with respect to a State, "counterparty" means the State and all of its agencies, instrumentalities, and political subdivisions (including any municipalities) collectively.[4] As such, the proposed rule requires the aggregation of exposures to all municipalities in the same State simply because they are in the same State. In fact, the aggregation is done irrespective of the local economy, revenues, or creditworthiness of the agencies, instrumentalities, and political subdivisions of a U.S. State.

AFGI submits that this aggregation method lacks a reasonable justification and in fact links risks that may have no actual connection or correlation. Thus, AFGI believes that SIFIs should be allowed to treat exposures to States, agencies, and municipalities in the same way as the existing lending limits are applied to national banks. This means that, in some cases, a SIFI's exposures would be exempt from the single-counterparty credit risk limits altogether. However, such SIFI's existing credit risk management framework would still provide adequate protection.

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[2] *Id.* at 600.

[3] Of note, financial guaranty insurers are operated as separately capitalized entities that provide guarantees of financial obligations only, ensuring that they cannot affect one another upon an economic downturn and providing an additional level of protection to the marketplace.

[4] Board of Governors of the Federal Reserve System, Proposed Rulemaking, Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 650 (Jan. 5, 2012).

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We thank you for the opportunity to comment on the Federal Reserve's proposed rule and appreciate your attention to the concerns highlighted by AFGI in this letter. If you have any questions, please do not hesitate to contact the undersigned at bstern@assuredguaranty.com or (212) 339-3482.

Sincerely,

Bruce E. Stern, Chairman
Association of Financial Guaranty Insurers