

**THE ASSOCIATION OF FINANCIAL
GUARANTY INSURERS**

Mr Fabrice Demarigny
Secretary General
Committee of European Securities Regulators
11 – 13 Avenue de Friedland
75008 Paris
France

23 September 2003

Dear Sir

Prospectus Directive – CESR advice on implementing measures – Monoline Insurance

We refer to our previous letter dated 12 August 2003 commenting on the proposed scope of the disclosure required to be met by monoline insurance policy providers under the EU Prospectus Directive. The purpose of this letter is to provide further detail on the rationale for suggesting bespoke disclosure requirements for monoline providers and to suggest an approach which could be taken by CESR.

Background

As you are aware, the Association of Financial Guaranty Insurers (**AFGI**) is the trade association of the insurers and reinsurers providing financial guarantees of securities and other obligations sold in markets worldwide. In 2002, AFGI members insured and guaranteed \$431.2 billion in par value of bonds and other obligations. AFGI member firms include Ambac Assurance Corporation (**Ambac**), ACE Guaranty Inc. (**ACE**), CDC-Ixis Financial Guaranty (**CDC-Ixis**), Financial Guaranty Insurance Company (**FGIC**), Financial Security Assurance Inc. (**FSA**), MBIA Insurance Corporation (**MBIA**), Radian Reinsurance Inc., RAM Reinsurance Company and XL Capital Assurance (**XL**).

Most of these insurers have affiliates, subsidiaries or branches located in the United Kingdom (Ambac, ACE, FGIC, FSA, Radian and XL) or France (CDC-Ixis and MBIA). Affiliates and subsidiaries of these members provide financial guarantees and related insurance services into the other member countries of the European Union from their home offices in the United Kingdom or France. Each such member or affiliate has an insurance financial strength rating of "triple-A" or "double A" from one or more of the securities ratings agencies.

Regulatory Status and Ratings of Providers of Monoline Guarantees

Affiliates, branches and subsidiaries of AFGI members are regulated as insurers by the UK Financial Services Authority if located in the UK and by the equivalent regulatory authority if located in another European jurisdiction. They are subject to extensive insurance regulations, including solvency measures such as minimum capital, reinsurance limitations, risk assessments and management requirements. In addition, the affiliates or parents located in the United States are subject to substantial regulation under the applicable laws in effect, including the extensive financial guaranty insurance statutes and regulations in effect in California, New York and several other States. Subsidiaries of such US companies located in Europe must also generally comply with such US insurance regulations because of the reinsurance of their European business to their US parents or affiliates, which reinsurance typically provides the support required for these European affiliates and subsidiaries to maintain "triple-A" or "double-A" ratings.

CESR proposed level of disclosure

The CESR Advice on Level 2 Implementing Measures dated July 2003 sets out the disclosure requirements applicable to a provider of a monoline guarantee. Paragraph 3 of the Minimum Disclosure Requirements for Guarantees Building Block requires that the guarantor should disclose information about itself as if it were the issuer of that same type of security that is the subject of the guarantee. The term "guarantor" specifically includes monoline insurance policy providers.

The approach suggested by CESR represents a significant change from current market practice that we respectfully submit would considerably increase the time and expense of executing insured transactions but would not convey a material benefit to investors. The approach suggested by CESR would require monoline providers to disclose the information set out in the Minimum Disclosure Requirements for the Retail Debt or Wholesale Debt Registration Document Building Block (depending on the nature of the security being insured). The thrust of the CESR proposals would make it more expensive and difficult for monoline providers to guaranty issues of securities, and the incremental execution costs and time delays would ultimately be borne by the issuers of the insured obligations. This would increase the cost of raising capital within the EU. At the same time, we respectfully submit that sufficient financial and other information concerning the monoline providers is currently freely available to investors as described in more detail below.

Appropriate level of disclosure

It is our contention that a level of disclosure similar to that currently accepted by regulators, issuers and investors in the European markets is appropriate going forward under the new Prospectus Directive regime. (With our previous letter dated 12 August 2003, we provided CESR with an example of the typical disclosure concerning the monoline guarantor currently used in European transactions and approved by a EU-competent authority.) As a regulated entity under close regulatory control and prudential supervision, different information about the guarantor should be required to be disclosed as the assessment of the relevant credit exposure is significantly changed.

Special recognition has been given to banks, which are similarly under close regulatory control and prudential supervision, in recognition of the fact that the assessment of the relevant credit exposure is significantly changed; one might argue that insurers are subject to more strict regulatory control than are banks. Special treatment should therefore be extended to monoline providers. Monoline providers would otherwise be disadvantaged as they would be subject to greater costs resulting from more onerous disclosure requirements. Onerous disclosure requirements are not appropriate for banks, they are even less appropriate for monoline providers.

We would note that the approach of restricted disclosure is similar to that adopted in the United States and approved of by the US Securities and Exchange Commission. For issuance of US securities, bond insurance policies are exempt from registration under Section 3(a)(8) of the US Securities Act of 1933. The bond insurers and the SEC have agreed to a restricted scope of disclosure for bond insurers, which has, in the case of SEC registered securities, provided, inter alia, that financials may be incorporated by reference to public filings. For U.S. municipal transactions that are not otherwise subject to SEC registration, the scope of disclosure regarding bond insurers is much more narrow, and is generally limited to one paragraph in the offering document.

This restricted scope of disclosure for bond insurers has been accepted by market participants in the US in part due to the large volume of insured transactions completed each year, which volume makes redundant the effort of including broad disclosure in duplicative offerings, and in part due to other factors such as the availability of information concerning the monolines in their websites and in reports on the monolines regularly prepared by the rating agencies. These factors are relevant in Europe as well. The volume of monoline transactions completed each year in Europe is substantial with hundreds of such transactions having been consummated in recent years. In addition, as described below, investors in Europe have easy access to regularly updated sources of information on the monolines, including their websites and reports prepared by rating agencies.

Financial Information

Implicit within an adoption by CESR of restricted disclosure would be an acceptance that no financial information provided in respect of a monoline guarantor would have to be restated, reconciled or in any way explained by reference to IAS. The main providers of monoline guarantees in the European markets at present and who are signatories to this letter prepare their relevant accounts according to US GAAP. Although we understand that the issue of IAS accounting is being raised generally by many US and other non-EU corporates, it is clearly imperative from the perspective of the monolines that CESR and/or the Commission confirm that, in the case of monolines, the summary information that is presently, and should going forward, be required of monolines clearly contemplates the provision of financial information by reference to their existing accounting principles and policies.

We would note that the “concession” for issues of €50,000 denomination or more securities is of no help to monolines who have no control over the denomination of the security they are asked to guarantee. However, the acceptance of the fact by

CESR and the Commission that there should be limited requirements for the disclosure of financial information in certain cases should mean that limited requirements should apply in analogous situations including where the Notes will be sold to 'professional' investors only as will generally be the case where a monoline provider is involved. Professional investors are able to make their own assessment of all information especially financial information.

Any requirement to reconcile or restate US GAAP accounts to IAS will significantly increase costs for issuers, including the costs of the initial reconciliation or restatement exercise as well as ongoing compliance costs, and may be impractical. Furthermore, the requirement that financial information must have been audited in accordance with auditing standards equivalent to those applicable in a Member State will further increase costs. A requirement to redo an audit may be prohibitively expensive and may not be possible for practical reasons.

Member States will be required to implement the Prospectus Directive by 2005. Issuers and monoline providers are planning now for their capital requirements in 2005 and beyond. In order to plan efficiently, it is necessary to understand the costs involved and issuers and monolines cannot now do so given the present uncertainty. Given this uncertainty and the requirement to plan now, decisions may be taken on a 'worst case scenario' basis which may result in the withdrawal of monoline providers from the EU market or at least their reduced participation in such market. This would clearly be to the detriment of investors in the EU and the market as a whole. Accordingly, clear guidance is required now.

US GAAP has been accepted in the EU for many years – it is unclear to us why this may now be changed. The UK Listing Authority specifically recognises US GAAP and US auditing standards (Rule 12.42). Professional investors in the EU understand US GAAP and, in many cases, prefer financial information prepared in accordance with US GAAP. A requirement for IAS may therefore be detrimental to investors in some instances.

Other disclosure requirements

In addition to requirements on the inclusion of financial information, there are other provisions of the current Minimum Disclosure Requirements for Retail and Wholesale Debt that should not be required of monoline providers. These requirements should not apply because they are not material to an investor's assessment of the monoline provider's ability to meet its obligations. Requiring such disclosure would create additional and unnecessary costs without any corresponding benefits to investors.

These unnecessary requirements include:

- (i) details on investments (section 5.2);
- (ii) details on the principal markets in which the monoline provider operates (sections 6.2 and 6.3);
- (iii) details on trend information (section 8);

- (iv) details on board practices (section 11);
- (v) details on major shareholders (section 12); and
- (vi) the requirement that documents be put on display for the life of the registration document (section 17).

The references above are to Minimum Disclosure Requirements for Retail Debt Registration Document Building Block.

Suggested Approach

We would suggest that monoline providers should be specifically addressed by preparing a building block of those requirements which apply to monoline providers. The number of monoline providers in the market, their regulatory position and their importance justifies a specialist approach.

Using the existing building block for the Retail Debt Registration Document as a starting point, this could be reduced for monolines by reference to the above list. This would not involve any significant further work by CESR. The requirements in relation to the financial information which can be included on the monoline provider would need to provide that financial information prepared by reference to their existing accounting principles and policies is sufficient. It should be made clear that such financial information can be incorporated by reference into the offering circular.

We would like to suggest a meeting with you to discuss the appropriate treatment of monoline providers further. Given their importance to the market generally and investors in particular, it is imperative that they are dealt with in a way that permits current practice to continue. If monoline providers are discouraged from participating in the EU market by the high costs and impracticality of compliance with unnecessary or inappropriate disclosure requirements, this will be to the detriment of the market as a whole.

Yours faithfully

Bruce E. Stern
General Counsel
Financial Security Assurance Inc.
For and on behalf of Association of Financial Guaranty Insurers

c/o Financial Security Assurance (U.K.) Limited
1 Angel Court
London
EC2R 7AE
Attention: David L. Ridl, Associate General Counsel

cc David Wright
European Commission