

Fitch Downgrades CIFG's IFS to 'A-'; Outlook Negative [Ratings](#)

31 Mar 2008 2:44 PM (EDT)

Fitch Ratings-New York-31 March 2008: Fitch Ratings has downgraded the following Insurer Financial Strength (IFS) ratings of CIFG Guaranty (CIFG) and its affiliates to 'A-' from 'AA-':

CIFG Guaranty

CIFG Assurance North America, Inc.

CIFG Europe

--IFS to 'A-' from 'AA-'.

Fitch has also removed CIFG from Rating Watch Negative, where it was originally placed on Feb. 5, 2008. The Rating Outlook is Negative.

The downgrade of CIFG and its affiliates is based on Fitch's updated assessment of CIFG's capital position, a review by Fitch of CIFG's updated business plan, consideration of various qualitative ratings factors, and an update on Fitch's current views of U.S. subprime related risks.

Fitch believes that CIFG's proforma claims paying resources, which include the \$1.5 billion capital infusion in late-2007 from its shareholders Caisse Nationale des Caisses d'Epargne et Prevoyance (CNCE) and Banque Federale des Banques Populaires (BFBP), are consistent with Fitch's updated standard for an 'A' category level of capital. However, claims paying resources fall below Fitch's 'AA' capital target by \$1.2 to \$1.7 billion.

Fitch will continue to monitor developments in the residential mortgage-backed securities (RMBS) markets for its impact on direct exposure to that asset class as well as implications on structured finance collateralized debt obligations (SF CDOs) insured by CIFG.

While CIFG's future business plans will include an emphasis on municipal finance and several improvements to its risk management framework, including the exit from several higher-risk capital intensive structured finance business lines, Fitch believes that CIFG may be extremely challenged in achieving these goals. CIFG's business platform has historically emphasized structured finance business, with a concentration in insuring CDOs. CIFG has not been able to establish a strong municipal franchise to date. Further, Fitch is unclear whether CIFG can maintain its franchise and business model with an 'A' category IFS rating, a level at which it currently sits with all three major rating agencies. Given its current rating and the potential losses the company is likely to experience; it may become even more difficult for the company to attain trading values on par with stronger financial guaranty competitors. Given these uncertainties, CIFG has decided to temporarily cease underwriting new business until the company can stabilize its financial and ratings position.

Fitch believes that it will be very difficult to stabilize the ratings of CIFG until the company can more effectively limit the downside risk from its SF CDOs through reinsurance or other risk mitigation initiatives. Fitch does not anticipate removing the Negative Rating Outlook over the near- to intermediate-term until the ultimate risk of loss on the SF CDO portfolio can be more definitively quantified.

Also influencing the Negative Rating Outlook for CIFG is Fitch's view that CIFG's shareholders may be less willing to provide further capital support to CIFG in the future than in the past. In addition, while shareholders have given no indication they would plan to remove capital from CIFG, Fitch recognizes that if CIFG is ultimately unable to successfully resume underwriting new business, that may create economic incentives for shareholders to consider doing so, which could further pressure ratings.

Unquestioned capital support from large, strong shareholders has been a key qualitative aspect of CIFG's 'AAA' IFS rating historically, and played a tangible role in Fitch's maintenance of CIFG's 'AAA' rating following deterioration in CIFG's insured portfolio due to subprime exposures. CIFG's shareholders have indicated commitment to the business and will help to facilitate negotiations with counterparties.

Finally, today's action factors in Fitch's updated analysis of CIFG's \$9.2 billion exposure to SF CDOs, and the implications this analysis has on Fitch's view of CIFG's overall capital adequacy position.

Fitch currently believes that expected losses on CIFG's insured SF CDO will ultimately fall within a range of \$1.7 to \$2.4 billion. These totals reflect Fitch's current estimates of the range of future losses that CIFG would be expected to incur over the life of these transactions, stated on a present value basis. The range of outcomes reflects the unknown magnitude of U.S. residential mortgage losses on SF CDOs insured by CIFG. From a present value perspective, Fitch discounts the expected future loss rates by 5% over a two-year period for CDO-squareds, five years for mezzanine SF CDOs and seven years for high-grade SF CDOs.

Fitch's analysis of expected losses includes an assumption that underlying cumulative loss rates on U.S. residential mortgages supporting outstanding subprime residential mortgage-backed securities (RMBS) pools will average 21% in the 2006 vintage year and 26% for the 2007 vintage year. These assumed cumulative loss rates are consistent with those currently used by Fitch for its ratings of outstanding RMBS transactions. Fitch notes that when it discusses 'expected losses' this is an analytical concept based on Fitch assumptions, and no inferences should be made with respect to the applicability of these projections to CIFG's loss provisioning.

Given Fitch's current projected loss estimates for 2006-2007 vintage subprime RMBS, it is expected that a high percentage of the underlying tranches that were originally rated below 'AAA' will potentially default and suffer significant losses. This development is expected to result in losses elevating high into the capital structure for many SF CDOs. Only those RMBS and SF CDO transactions from the 2006-2007 vintages that maintained very healthy levels of initial subordination are expected to avoid experiencing losses in the future.

Fitch believes for modeling purposes that its expected loss estimates for SF CDOs fall approximately to an 'A' level ratings stress. Accordingly, in order to address the necessary level of capital to support a financial guarantor at the highest rating levels, expected losses are further stressed to arrive at 'AA' and 'AAA' capital requirements. This is done to capture the risk that losses could grow higher than expected due to a more severe downturn in the economy, sharper than expected declines in home prices, higher than expected loan defaults, or other adverse developments beyond expectations.

CIFG Guaranty, CIFG Assurance North America, Inc. and CIFG Europe are subsidiaries of CIFG Holding. CIFG Holding is directly owned by Banque Federale des Banques Populaires and Caisse Nationale des Caisses d'Epargne et Prevoyance, two large French banking groups.

Contact: Joo-Yung Lee +1-212-908-0560 or Thomas J. Abruzzo +1-212-908-0793, New York.

Media Relations: Kenneth Reed, New York, Tel: +1 212-908-0540.

Fitch's rating definitions and the terms of use of such ratings are available on the agency's public site, 'www.fitchratings.com'. Published ratings, criteria and methodologies are available from this site, at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance and other relevant policies and procedures are also available from the 'Code of Conduct' section of this site.

Copyright © 2008 by Fitch, Inc., Fitch Ratings Ltd. and its subsidiaries.