

CDC IXIS Financial Guaranty CDC IXIS Financial Guaranty Europe CDC IXIS Financial Guaranty North America Inc.

Analyst: David Veno, New York (1) 212-438-2108

HOLDING COMPANY

None
DOMICILE
New York
LICENSED
None

Rationale

Outlook

Management and Corporate Strategy

Business Review

Capitalization

Rationale

The financial strength ratings of CDC IXIS Financial Guaranty (CIFG), CDC IXIS Financial Guaranty Europe (CIFG Europe), and CIC IXIS Financial Guaranty North America Inc. (CIFG NA) reflect:

- Underwriting guidelines and overall risk tolerance are in line with a 'AAA' rated company.
- Business volume projections indicate that growth will take place in a controlled and measured fashion.
- Based on Standard & Poor's capital adequacy test, capital levels are comfortably at the 'AAA' level.

Senior management at CDC Finance-CDC IXIS (CDC IXIS), the upstream parent, has gone to great lengths to hire experienced bond insurance professionals to support its financial guarantee initiative. This should provide the companies with immediate technical and underwriting expertise. Furthermore, underwriting will focus on sectors where risk assessment and mitigation practices have long-established histories.

As with any start-up bond insurer, low initial business volume, combined with the deployment of sufficient capital to meet rating agency criteria, tends to generate low returns on equity. However, management's business plan does not include an aggressive use of claims-paying resources. But rather, emphasis will be placed on risk-adjusted returns as opposed to volume or market share.

CIFG's, CIFG Europe's, and CIFG NA's capital adequacy margins of safety were 1.3 times (x)-1.4x, 3.5x-3.6x, and 2.0x-2.1x, respectively, which meet Standard & Poor's 'AAA' requirement. The margin of safety expresses the relationship between the worst-case level of theoretical losses incurred during a simulated depression period in Standard & Poor's capital adequacy model, compared with the company's total claims-paying resources. Management's business plan and modeling assumptions do not consider external reinsurance, which could provide a source of soft capital to support business growth if needed.

[Back to Top](#)

Outlook

The stable outlook reflects CIFG's, CIFG Europe's, and CIFG NA's prudent underwriting strategies and sound capital positions.

[Back to Top](#)

Management and Corporate Strategy

CIFG is a France-domiciled de novo bond reinsurance company, and CIFG Europe is a France-domiciled de novo bond insurance company. CIFG Europe is a subsidiary of CIFG. CIFG is a subsidiary of CDC Holdings, which

is in turn a subsidiary of CDC IXIS. CIFG NA is a U.S.-domiciled bond insurance company that is a subsidiary of CIFG. CIFG's sole customers initially will be CIFG Europe and CIFG NA.

Essentially, the same management team will manage the companies. However, individuals with experience in the bond insurance industry have been hired to meet the specific underwriting needs for each company. In addition, there will be one risk management team to oversee consolidated risk exposure. Management has developed a comprehensive underwriting and risk management policy. These procedures address individual transaction credit standards, country risk, currency risk, liquidity risk, and single-risk standards. More importantly, they follow similar zero-loss underwriting standards that are typical of 'AAA' rated bond insurers.

The European market is a major focus of management's business initiative, with operations based in Paris and, in 2002, an office in London. It is management's belief that there are synergies to be achieved in the European market with other CDC IXIS lines of business. It is likely that CIFG Europe will benefit from immediate name recognition due to CDC IXIS' existing business operations, thus clearing one hurdle presented for any de novo bond insurer. CIFG Europe's underwriting efforts will emphasize structured finance, particularly CBOs, CLOs, and consumer and trade receivables. The company will selectively underwrite project finance and public-private partnership transactions.

CIFG NA plans to initially focus on the enhancement of structured transactions involving consumer assets, commercial assets, and financial structures such as CBOs, CLOs and consumer trade receivables. Municipal activity will target the lower-risk sectors of general obligation, sales tax, and special tax bonds. The company will be active in the secondary market.

[Back to Top](#)

Business Review

As is the case with any start-up company, product acceptance and corresponding business volume projections are speculative. Management's assumptions appear conservative based on what the four 'AAA' rated primary insurers underwrote in the same sectors in 2001. For domestic public finance, domestic structured finance, and international business, management's assumptions are 2%, 2%, and 3%, respectively, of what the four 'AAA' rated primary insurers wrote in 2001. Growth rates in par written, after an understandable initial spike, tend to be in line with industry norms.

In terms of pricing and risk, management's assumptions are again conservative. In 2001, the primary insurers reported industry average capital charges of 9.2% for domestic public finance, 1.8% for domestic structured finance, and 1.0% for international structured finance. CIFG management assumed a capital charge 9.0%, 1.8%, and 1.8% for the same business lines, respectively. Premium rate assumptions were half what the primary insurers reported for domestic public finance and a third higher than what the primaries reported for domestic and international structured finance. The higher premium rates are understandable given the projected higher capital charge.

[Back to Top](#)

Capitalization

CIFG will be capitalized with \$280 million (300 million euros), of which 32 million euros will represent the investment in CIFG Europe and \$100 million will represent the investment in CIFG NA. CIFG's only other source of claims-

paying resources will be \$220 million of soft capital from CDC IXIS in the form of a subordinated loan agreement. This loan can be drawn upon at any time, with draws convertible to equity at CIFG's option.

In addition to CIFG Europe's 32 million euros of hard capital, the company will have a letter of support from CIFG. The letter of support stipulates that CIFG will maintain capital and surplus to policyholders at all times in an amount of not less than 20 million euros. In addition, there is a stop-loss treaty in place in which CFIG will pay all losses in excess of 20 million euros. CIFG NA will also have a letter of support from CIFG. The letter of support stipulates that CIFG will maintain capital and surplus to policyholders at all times in an amount of not less than \$85 million. In addition, there is a quota-share reinsurance treaty in which 75% of CIFG NA's business is ceded to CIFG.

Based on the support agreements and the different regulatory bodies, the capital in each company was not viewed as fungible. Therefore, a capital adequacy test was performed for each company to measure their financial strength individually and the soundness of the financial relationships. A minimum margin of safety of 1.2x was used as the benchmark in determining each company's 'AAA' level of capital adequacy. This level of margin of safety reflects Standard & Poor's criteria for 'AAA' rated nonpublic companies with high credit quality owners. For testing purposes, at the request of management, the minimum capital level at CIFG NA was maintained at \$115 million, not the \$85 million as stipulated in the letter of support.

In each base case, the companies satisfactorily meet the minimum requirements for a 'AAA' rating. The support agreement for CFIG NA required funds to be distributed in the amount of \$55 million from CIFG over the four-year depression period. In addition, CIFG assumed \$85 million in losses from CIFG Europe relating to the stop-loss treaty between the two companies. With regard to the subordinate loan agreement, CIFG draws the loan in its entirety in years four and five of the capital adequacy test, the two years leading up to the depression years. The capital adequacy test results of the companies highlight the significant role CFIG plays in supporting the financial strength of CIFG NA and CIFG Europe.

CIFG's investment portfolio will be weighted toward U.S. government securities with a small amount in high quality short-term instruments. Similarly, CIFG Europe's and CIFG's investments are expected to comprise French government securities, other high quality euro-denominated fixed-income securities, and a small amount of high quality short-term instruments. Also, management has indicated that no dividends will be upstreamed by any company during the first several years of operation, which further adds to the soundness of each company's liquidity and financial flexibility. Currently, there are no plans to supplement the companies' liquidity resources by entering into any bank line agreements, nor are any lines provided by CDC IXIS. Management feels that initial liquidity needs will be met by cash generated from the investment portfolio. Should the need arise, management has indicated that it will consider tapping the reinsurance market to improve CIFG's financial position. Currently, no external reinsurance arrangements are in place.

Table 1 Capital Statistics			
	CIFG Europe*	CIFG NA†	CIFG‡
Portfolio Risk			
Municipal insurance weighted-average capital charge (% of average annual debt service)	N.A.	9.0	9.0

Asset-backed capital charge (% of par)	1.8	1.8	1.8
Claims-Paying Resources (mil)			
Statutory capital	32.0	100.0	260.0
Contingent capital	0	0	220.0
Owner capital commitment	0	0	0
Stop-loss treaty	20.0	0	0
Unearned premiums	0	0	0
Present value of annual premiums	0	0	0
Total	52.0	100.0	480.0
Capital Adequacy			
Capital remaining at end of depression test (mil)	50-100	100-150	100-150
Margin of safety (x)	3.5-3.6	2.0-2.1	1.3-1.4
*Euros. ¶U.S. dollars.			

[Back to Top](#)

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