

September 16, 2008

**Research Update:**

# Customer Asset Protection Co. 'A+' Ratings Placed On CreditWatch Negative

**Primary Credit Analyst:**

James Brender, New York (1) 212-438-3128; james\_brender@standardandpoors.com

**Secondary Credit Analyst:**

Rodney A Clark, FSA, New York (1) 212-438-7245; rodney\_clark@standardandpoors.com

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## Rationale

On Sept. 16, 2008, Standard & Poor's Ratings Services placed its 'A+' counterparty credit and financial strength ratings on Customer Asset Protection Co. (CAPCO) on CreditWatch with negative implications.

This rating action follows the announcement by Lehman Brothers Holdings Inc. (Lehman) that it filed a petition under Chapter 11 of the U.S. bankruptcy code. However, the decision to place the ratings on CAPCO on CreditWatch reflects other concerns besides the challenges confronting Lehman. Standard & Poor's revised its outlook on CAPCO to negative on March 26, 2008, because of the potential for deterioration in the credit quality and risk-management capabilities of CAPCO's members.

CAPCO provides excess SIPC (Securities Investors Protection Corp.) coverage for its members, which are broker/dealers. Broker/dealers are regulated entities, where customer assets are required to be segregated from the firm's assets and may not be used in the ongoing business of the firm or affected by a broker/dealer's own trading losses or own subprime-related losses. For an excess SIPC claim to occur, all of the following must happen: a broker/dealer must be deemed insolvent; client assets must be found to be missing, lost, or stolen; and customer property, SIPC advances, fidelity bond proceeds, if any, and distributions from the general estate of the member, if any, to customers are insufficient to satisfy customer account obligations. Neither SIPC nor excess SIPC cover a decline in the market value of a client's investments.

Lehman's bankruptcy filing by itself will not create an excess SIPC claim. SIPC announced today that it appears all customer cash, stocks, and other securities are accounted for, and SIPC does not anticipate initiating a liquidation proceeding against Lehman's U.S broker/dealers. Lehman is the holding company for three broker/dealers that are members of CAPCO. None of those brokers have filed for bankruptcy protection, but Lehman Brothers International (Europe) was placed under administration by its regulator.

The current environment for broker/dealers and their parents is very challenging. The problems include mounting losses from residential mortgage-backed securities, a weak U.S. economy, and strains on financial institutions' liquidity. Consequently, Standard & Poor's has a negative outlook on the majority of CAPCO's members. Several members have also been downgraded since the disruption in the mortgage and housing markets began in early 2007. The capital of CAPCO's members and--in some cases--their parents is an important resource for mitigating CAPCO's potential payments for its excess SIPC coverage.

Standard & Poor's will resolve the CreditWatch status of the ratings by assessing CAPCO's ability to satisfy its policyholder obligations. The insurer financial strength rating on CAPCO depends on its ability to pass two tests

used by Standard & Poor's to assess its claims-paying ability. One test assumes the misappropriation of \$3 billion of client's funds. The other test assumes the broker/dealer becomes insolvent and there is a misappropriation of a small portion of clients' funds. A broker's loss of capital or lack of liquidity would hurt CAPCO's performance under these tests because a broker/dealer's capital (and sometimes even that of its parents) is a resource to pay claims. Excess SIPC claims are very rare, and the probability of one occurring at a major broker/dealer is extremely rare.

The ratings on CAPCO are based on the company's strong claims-paying ability, niche competitive position serving many of the leading broker/dealers in the U.S. and U.K., high liquidity, low investment risk, and an underwriting standard intended to result in an expected zero loss ratio. Offsetting factors include the company's modest scope of operations, short operating history (since December 2003), and reliance on highly rated reinsurers for remotely possible, extremely large losses.

## Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Customer Asset Protection Co.		
Counterparty Credit Rating		
Local Currency	A+/Watch Neg/--	A+/Negative/--
Financial Strength Rating		
Local Currency	A+/Watch Neg/--	A+/Negative/--

Complete ratings information is available to subscribers of RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com); select your preferred country or region, then Ratings in the left navigation bar, followed by Credit Ratings Search.

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