ASSURED GUARANTY LTD
Form 10-Q
November 16, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

ý **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended September 30, 2009

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition Period from to
Commission File No. 001-32141

ASSURED GUARANTY LTD.

(Exact name of registrant as specified in its charter)

Bermuda	**98-0429991**
(State or other jurisdiction of incorporation)	(I.R.S. employer identification no.)

30 Woodbourne Avenue
Hamilton HM 08
Bermuda
(Address of principal executive offices)
(441) 279-5700
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

The number of registrant's Common Shares ($0.01 par value) outstanding as of November 13, 2009 was 156,604,868 (excludes 396,997 unvested restricted shares).

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

ASSURED GUARANTY LTD.
CONSOLIDATED BALANCE SHEETS (unaudited)
(in thousands, except per share and share amounts)

	September 30, 2009	December 31, 2008
ASSETS		
Investment portfolio, available-for-sale:		
Fixed maturity securities, at fair value (amortized cost of $8,151,058 and $3,162,308)	$ 8,448,099	$ 3,154,137
Short-term investments (cost of $1,492,479 and $477,197)	1,492,891	477,197
Total investment portfolio	9,940,990	3,631,334
Assets acquired in refinancing transactions (includes $32,943 at fair value)	159,180	
Cash	260,484	12,305
Premiums receivable, net	1,504,043	15,743
Ceded unearned premium reserve	1,163,110	18,856
Deferred acquisition costs	243,609	288,616
Reinsurance recoverable on paid and unpaid losses	5,857	6,528
Credit derivative assets	462,298	146,959
Committed capital securities, at fair value	38,516	51,062
Deferred tax asset, net	1,093,608	129,118
Goodwill		85,417
Salvage recoverable	184,447	80,207
Financial guaranty variable interest entities' assets	846,945	
Other assets	299,543	89,562
TOTAL ASSETS	$ 16,202,630	$ 4,555,707
LIABILITIES AND SHAREHOLDERS' EQUITY		
Unearned premium reserves	$ 8,632,733	$ 1,233,714
Loss and loss adjustment expense reserve	218,739	196,798
Long-term debt	915,237	347,210
Note payable to related party	155,827	
Credit derivative liabilities	2,100,465	733,766
Funds held under reinsurance contracts	30,178	30,683
Reinsurance balances payable, net	179,258	17,957
Financial guaranty variable interest entities' liabilities	851,390	
Other liabilities	321,671	69,357
TOTAL LIABILITIES	13,405,498	2,629,485
COMMITMENTS AND CONTINGENCIES		
Common stock ($0.01 par value, 500,000,000 shares authorized; 156,604,569 and 90,955,703 shares issued and outstanding in 2009 and 2008)	1,566	910
Additional paid-in capital	2,010,759	1,284,370
Retained earnings	580,239	638,055
Accumulated other comprehensive income (loss), net of deferred tax (benefit) provision of $104,649 and $(1,302)	209,013	2,887
TOTAL SHAREHOLDERS' EQUITY ATTRIBUTABLE TO ASSURED GUARANTY LTD.	2,801,577	1,926,222
Noncontrolling interest of financial guaranty variable interest entities	(4,445)	

TOTAL SHAREHOLDERS' EQUITY		2,797,132		1,926,222
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$	16,202,630	$	4,555,707

The accompanying notes are an integral part of these consolidated financial statements.

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ASSURED GUARANTY LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)
(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
REVENUES				
Net earned premiums	$ 329,970	$ 85,516	$ 557,050	$ 184,034
Net investment income	84,742	43,441	171,643	120,247
Net realized investment gains (losses):				
Other-than-temporary impairment (OTTI) losses	(13,321)	(18,273)	(68,233)	(18,536)
Less: portion of OTTI loss recognized in other comprehensive income	(5,287)		(26,920)	
Other net realized investment gains (losses)	1,937	(1,758)	13,218	585
Net realized investment gains (losses)	(6,097)	(20,031)	(28,095)	(17,951)
Net change in fair value of credit derivatives				
Realized gains and other settlements	71,691	29,960	120,086	89,370
Net unrealized gains (losses)	(205,336)	(116,247)	(432,638)	332,634
Net change in fair value of credit derivatives	(133,645)	(86,287)	(312,552)	422,004
Fair value gain (loss) on committed capital securities	(53,057)	6,912	(93,961)	24,319
Financial guaranty variable interest entities revenues	4,881		4,881	
Other income	58,758	259	60,152	437
TOTAL REVENUES	**285,552**	**29,810**	**359,118**	**733,090**
EXPENSES				
Loss and loss adjustment expenses	133,325	82,542	251,109	175,805
Amortization of deferred acquisition costs	1,308	19,296	41,277	43,004
Other operating expenses	66,233	21,609	116,524	69,912
Financial Security Assurance Holdings Ltd. (FSAH) acquisition-related expenses	51,333		80,179	
Interest expense	25,190	5,821	37,495	17,462
Goodwill and settlement of pre-existing relationship	23,341		23,341	
Financial guaranty variable interest entities expenses	10,152		10,152	
Profit commission expense	223	(1,444)	2,549	758
Other expenses	2,533	1,524	5,801	3,974
TOTAL EXPENSES	**313,638**	**129,348**	**568,427**	**310,915**
INCOME (LOSS) BEFORE INCOME TAXES	(28,086)	(99,538)	(209,309)	422,175
(Benefit) provision for income taxes				
Current	67,116	(13,092)	68,817	4,233
Deferred	(54,901)	(23,106)	(153,310)	105,275
Total (benefit) provision for income taxes	**12,215**	**(36,198)**	**(84,493)**	**109,508**
NET INCOME (LOSS)	**(40,301)**	**(63,340)**	**(124,816)**	**312,667**
Less: Noncontrolling interest of variable interest entities	(5,271)		(5,271)	
NET INCOME (LOSS) ATTRIBUTABLE TO ASSURED GUARANTY LTD.	**$ (35,030)**	**$ (63,340)**	**$ (119,545)**	**$ 312,667**
Earnings per share:				
Basic	$ (0.22)	$ (0.69)	$ (1.05)	$ 3.56

Diluted	$	(0.22)	$	(0.69)	$	(1.05)	$	3.54
Dividends per share	$	0.045	$	0.045	$	0.135	$	0.135

The accompanying notes are an integral part of these consolidated financial statements.

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ASSURED GUARANTY LTD.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)
(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
NET (LOSS) INCOME	**$ (40,301)**	**$ (63,340)**	**$ (124,816)**	**$ 312,667**
Unrealized holding gains (losses) on available-for-sale securities arising during the period, net of deferred income tax provision (benefit) of $93,677, $(24,267), $106,279 and $(40,312)	210,007	(104,137)	259,972	(150,323)
Less: reclassification adjustment for gains (losses) included in net income (loss), net of deferred income tax provision (benefit) of $663, $0, $2,328 and $0	(5,961)	(17,146)	(30,150)	(15,857)
Less: unrealized losses on fixed income securities related to factors other than credit	4,624		24,592	
Change in net unrealized gains on available-for-sale securities	211,344	(86,991)	265,530	(134,466)
Change in cumulative translation adjustment	565	(645)	(1,438)	(746)
Cash flow hedge	(105)	(105)	(314)	(314)
Other comprehensive income (loss)	211,804	(87,741)	263,778	(135,526)
COMPREHENSIVE INCOME (LOSS)	**171,503**	**(151,081)**	**138,962**	**177,141**
Less: Comprehensive income (loss) attributable to noncontrolling interest of variable interest entities	**48**		**48**	
COMPREHENSIVE INCOME (LOSS) OF ASSURED GUARANTY LTD.	**$ 171,455**	**$ (151,081)**	**$ 138,914**	**$ 177,141**

The accompanying notes are an integral part of these consolidated financial statements.

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ASSURED GUARANTY LTD.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (unaudited)
FOR NINE MONTHS ENDED SEPTEMBER 30, 2009
(in thousands, except share data)

	Common Stock							
	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity Attributable to Assured Guaranty Ltd.	Noncontrolling Interest of Financial Guaranty Consolidated Variable Interest Entities	Total Shareholders' Equity
Balance, December 31, 2008	**90,955,703**	**$ 910**	**$ 1,284,370**	**$ 638,055**	**$ 2,887**	**$ 1,926,222**	**$**	**$ 1,926,222**
Cumulative effect of accounting change Adoption of ASC 944-20 effective January 1, 2009				19,443		19,443		19,443
Balance at the beginning of the year, adjusted	90,955,703	910	1,284,370	657,498	2,887	1,945,665		1,945,665
Cumulative effect of accounting change Adoption of ASC 320-10-65-1 effective April 1, 2009				57,652	(57,652)			
Issuance of stock for acquisition of FSAH	22,153,951	222	275,653			275,875		275,875
Consolidation of financial guaranty variable interest entities							778	778
Net income (loss)				(119,545)		(119,545)	(5,271)	(124,816)
Dividends ($0.135 per share)				(15,267)		(15,267)		(15,267)
Dividends on restricted stock units			99	(99)				
Net proceeds from issuance of common stock	44,275,000	443	447,642			448,085		448,085
Common stock repurchases	(1,010,050)	(10)	(3,666)			(3,676)		(3,676)
Shares cancelled to pay withholding taxes	(110,149)	(1)	(1,044)			(1,045)		(1,045)
Shares issued under Employees Stock Purchase Plan (ESPP)	21,349	0	205			205		205
Share-based compensation and other	318,765	2	7,500			7,502		7,502
Change in cash flow hedge, net of tax of $(169)					(314)	(314)		(314)
Change in cumulative translation adjustment					(1,438)	(1,438)	48	(1,390)
Net unrealized gains (losses) on fixed maturity securities, net of tax of $101,897					265,530	265,530		265,530
Balance, September 30, 2009	**156,604,569**	**$ 1,566**	**$ 2,010,759**	**$ 580,239**	**$ 209,013**	**$ 2,801,577**	**$ (4,445)**	**$ 2,797,132**

The accompanying notes are an integral part of these consolidated financial statements.

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ASSURED GUARANTY LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(in thousands)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Operating activities		
Net (loss) income	$ (124,816)	$ 312,667
Adjustments to reconcile net (loss) income to net cash flows provided by operating activities:		
Non-cash interest and operating expenses	11,756	13,647
Net amortization of premium on fixed maturity securities	9,212	2,400
Accretion of discount on premium receivable	(22,428)	
(Benefit) provision for deferred income taxes	(153,310)	105,275
Net realized investment losses (gains)	28,095	17,951
Unrealized losses (gains) on credit derivatives	432,638	(332,634)
Fair value loss (gain) on committed capital securities	93,961	(24,319)
Goodwill and settlements of pre-existing relationship	23,341	
Other income	(26,881)	
Change in deferred acquisition costs	29,998	(32,823)
Change in premiums receivable	56,087	(24,064)
Change in ceded unearned premium reserves	89,534	(6,404)
Change in unearned premium reserves	(298,594)	344,671
Change in reserves for losses and loss adjustment expenses, net	(23,868)	20,287
Change in funds held by Company under reinsurance contracts	(505)	4,136
Change in current income taxes	58,253	(19,916)
Other	111,106	(10,953)

Net cash flows provided by (used by) operating activities		**293,579**		**369,921**
Investing activities				
Fixed maturity securities:				
Purchases		(1,301,684)		(1,196,917)
Sales		1,258,372		401,854
Maturities		80,773		6,350
(Purchases) sales of short-term investments, net		(220,825)		185,690
Cash paid to acquire FSAH, net of cash acquired		(458,998)		
Paydowns and proceeds from sales of assets acquired in refinancing transactions		8,735		
Other		(718)		
Net cash flows provided by (used for) investing activities		**(634,345)**		**(603,023)**
Financing activities				
Net proceeds from issuance of common stock		448,340		248,971
Net proceeds from issuance of equity units		167,972		
Dividends paid		(15,267)		(11,892)
Repurchases of common stock		(3,676)		
Share activity under option and incentive plans		(840)		(3,664)
Tax benefit for stock options exercised				16
Repayment of note payable		(8,331)		
Net cash flows provided by (used for) financing activities		**588,198**		**233,431**
Effect of exchange rate changes		747		(513)
Increase (decrease) in cash		248,179		(184)
Cash at beginning of period		12,305		8,048
Cash at end of period	**$**	**260,484**	**$**	**7,864**
Supplementary cash flow information				

Cash paid during the period for:		
Income taxes	$ 6,603	$ 20,700
Interest	$ 22,980	$ 11,800

The accompanying notes are an integral part of these consolidated financial statements.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

SEPTEMBER 30, 2009

1. BUSINESS AND ORGANIZATION

Assured Guaranty Ltd. ("AGL") is a Bermuda-based holding company which provides, through its operating subsidiaries, credit and credit enhancement products to the public finance, structured finance and mortgage markets. References to "Assured Guaranty" or the "Company" are to AGL together with its subsidiaries. Credit and credit enhancement products are financial guaranties or other types of financial credit support, including credit derivatives that improve the credit of underlying debt obligations. The Company issues credit and credit enhancement policies in both insurance and credit derivative form.

The insurance subsidiaries of AGL are Assured Guaranty Corp. ("AGC"), Assured Guaranty Re Ltd. ("AG Re"), Assured Guaranty Re Overseas Ltd. ("AGRO"), Assured Guaranty Mortgage Insurance Company ("AGMIC"), Assured Guaranty (UK) Ltd. ("AGUK") and, as of July 1, 2009, Assured Guaranty Municipal Corp., formerly known as Financial Security Assurance Inc. ("AGM"), FSA Insurance Company, Financial Security Assurance International Ltd., and Financial Security Assurance (U.K.) Ltd.

The Financial Security Assurance Inc. name change to Assured Guaranty Municipal Corp. became effective November 9, 2009.

On July 1, 2009 (the "Acquisition Date"), the Company acquired Financial Security Assurance Holdings Ltd. (together with its subsidiaries, "FSAH") and most of its subsidiaries, including AGM, from Dexia Holdings Inc. ("Dexia Holdings") (the "FSAH Acquisition"). The FSAH Acquisition excluded FSAH's subsidiaries that made up FSAH's financial products segment (the "Financial Products Companies"). The Financial Products Companies were sold to an affiliate of Dexia Holdings prior to the FSAH Acquisition. AGM is a New York domiciled financial guaranty insurance company and the principal operating subsidiary of FSAH. FSAH's financial guaranty insurance subsidiaries participated in the same markets and issued financial guaranty contracts similar to those of the Company.

Segments

The Company's financial results include four principal business segments: financial guaranty direct, financial guaranty reinsurance, mortgage guaranty and other. The financial guaranty segments include policies in both insurance and credit derivative form. These segments are further discussed in Note 17.

Financial Guaranty Direct and Reinsurance

Financial guaranty insurance provides an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest when due. Upon an issuer's default, the Company is required under the financial guaranty contract to pay the principal and interest when due in accordance with the underlying contract. Financial guaranty insurance may be issued to the holders of the insured obligations at the time of issuance of those obligations, or may be issued in the secondary market to holders of public bonds and structured securities. Under a reinsurance agreement, the reinsurer receives a premium and, in exchange, agrees to indemnify another insurer, called the ceding company, for part or all of the liability of the ceding company under one or more financial guaranty insurance policies that the ceding company has issued. A credit derivative is a financial instrument whose characteristics and value depend upon the characteristics and value of an

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

1. BUSINESS AND ORGANIZATION (Continued)

underlying security. The Company markets its products directly to and through financial institutions, serving the U.S. and international markets.

Prior to the FSAH Acquisition, AG Re assumed business from FSAH and it continues to do so. For periods prior to the FSAH Acquisition, the Company reported the business assumed from FSAH in the financial guaranty reinsurance segment, reflecting the separate organizational structures as of those reporting dates. As a result, prior period segment results are consistent with the amounts previously reported by segment. For periods subsequent to the FSAH Acquisition, the Company included all financial guaranty business written by FSAH in the financial guaranty direct segment and the FSAH business assumed by AG Re is eliminated from the financial guaranty reinsurance segment as an intercompany transaction.

Mortgage Guaranty

Mortgage guaranty insurance is a specialized class of credit insurance that provides protection to mortgage lending institutions against the default by borrowers on mortgage loans that, at the time of the advance, had a loan to value ratio in excess of a specified ratio. Reinsurance in the mortgage guaranty insurance industry is used to increase the insurance capacity of the ceding company, to assist the ceding company in meeting applicable regulatory and rating agency requirements, to augment the financial strength of the ceding company, and to manage the ceding company's risk profile. The Company provides mortgage guaranty protection on an excess of loss basis.

Other

The Company has participated in several lines of business that are reflected in its historical financial statements but that the Company exited in connection with its 2004 initial public offering ("IPO"). The results from these lines of business make up the Company's "other" segment, discussed in Note 17.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

1. BUSINESS AND ORGANIZATION (Continued)

Current Status of Ratings

The Company's subsidiaries have been assigned the following insurance financial strength ratings as of November 16, 2009. These ratings are subject to continuous review:

Rating Agency Ratings and Outlooks

	S&P	Fitch	Moody's
Assured Guaranty Corp.	AAA/Negative Outlook	AA-/Negative Outlook	Aa3/Review for Downgrade
Assured Guaranty Re Ltd.	AA/Stable	AA-/Negative Outlook	A1/Review for Downgrade
Assured Guaranty Re Overseas Ltd.	AA/Stable	AA-/Negative Outlook	A1/Review for Downgrade
Assured Guaranty Mortgage Insurance Company	AA/Stable	AA-/Negative Outlook	A1/Review for Downgrade
Assured Guaranty (UK) Ltd.	AAA/Negative Outlook	AA-/Negative Outlook	Aa3/Review for Downgrade
Assured Guaranty Municipal Corp. (formerly Financial Security Assurance Inc.)	AAA/Negative Outlook	AA/Negative Outlook	Aa3/Negative Outlook
FSA Insurance Company	AAA/Negative Outlook	AA/Negative Outlook	Aa3/Negative Outlook
Financial Security Assurance International Ltd.	AAA/Negative Outlook	AA/Negative Outlook	Aa3/Negative Outlook
Financial Security Assurance (U.K.) Ltd	AAA/Negative Outlook	AA/Negative Outlook	Aa3/Negative Outlook

On November 12, 2009, Moody's Investors Service, Inc. ("Moody's") downgraded the insurance financial strength, debt and issuer ratings of AGL and certain of its subsidiaries. AGC and AGUK's insurance financial strength ratings were downgraded to Aa3 from Aa2 and AG Re, AGRO and AGMIC's insurance financial strength ratings were downgraded to A1 from Aa3. All of such ratings are on review for possible downgrade. Moody's stated that if the Company fully implemented certain capital strengthening initiatives, Moody's could conclude the rating review with a confirmation of the ratings of AGC and AGUK at the Aa3 level, with a negative outlook. Moody's further stated, however, that absent such initiatives, Moody's expected to lower such rating into the single-A range. Moody's stated that a key focus of its capital adequacy analysis was the evaluation of Assured Guaranty's exposure to mortgage-related losses. At the same time, Moody's affirmed the Aa3 insurance financial strength ratings of AGM and its affiliated insurance operating companies; all of such ratings have been assigned a negative outlook. There can be no assurance that Moody's will not take further action on the ratings of AGM and its affiliated insurance operating companies, or as to the ultimate conclusion of Moody's rating review of AGC, AGUK, or AG Re and its subsidiaries.

In response to Moody's rating action, the Company currently intends to implement a capital relief plan involving the cession of a portfolio of transactions to a third party reinsurer, intercompany capital support and approximately $300 million of additional capital. The Company may not be able to implement the capital strengthening initiatives fully or at all, and its ratings may be downgraded by one or more of the rating agencies as a result. Even if such capital strengthening initiatives were available, the cost of the capital relief may be high and therefore result in increased expense to the Company or dilution to AGL's shareholders.

On October 12, 2009, Fitch Ratings, Inc. ("Fitch") downgraded the debt and insurer financial strength ratings of Assured Guaranty and its subsidiaries, as applicable, stating that its downgrade was based on its expectations of credit losses arising from the Company's residential mortgage securitization

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

1. BUSINESS AND ORGANIZATION (Continued)

exposures, as well as other areas of concern in the insured portfolio of AGC and AG Re, particularly their exposure to trust preferred CDOs. Fitch downgraded the insurer financial strength ratings of AGC and Assured Guaranty (UK) Ltd. ("AGUK") to "AA-" from "AA" and the insurer financial strength ratings of AGM, FSA Insurance Company, Financial Security Assurance International Ltd. and Financial Security Assurance (U.K.) Ltd to "AA" from "AA+." It also downgraded the debt ratings of AGUS to "A-" from "A," the senior debt ratings of FSAH to "A-" from "A+" and its subordinated debt ratings to "BBB+" from "A." It affirmed the insurer financial strength ratings of AG Re, AGRO and AGMIC at "AA-." All of the above ratings have been assigned a negative outlook. There is no assurance that Fitch will not take further action regarding the Company's ratings.

On July 1, 2009, Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("S&P") published a Research Update in which it affirmed its "AAA" counterparty credit and financial strength ratings on AGC and AGM. At the same time, S&P revised its outlook on AGC and AGUK to negative from stable and continued its negative outlook on AGM. S&P cited as a rationale for its actions the large single risk concentration exposure that the Company and AGM retain to Belgium and France related to the residual exposure to FSAH's financial products segment prior to the posting of collateral by Dexia S.A. ("Dexia"), a Belgian corporation, in October 2011, all in connection with the FSAH Acquisition. In addition, the outlook also reflected S&P's view that the change in the competitive dynamics of the industry with the potential entrance of new competitors, alternative forms of credit enhancement and limited insurance penetration in the U.S. public finance market could hurt the companies' business prospects. There can be no assurance that S&P will not take further action on the Company's ratings.

See Note 6 and Note 9 for more information regarding the impact of rating agency actions upon the credit derivative business and the reinsurance business of the Company.

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD.

On the Acquisition Date, the Company, through its wholly-owned subsidiary AGUS, purchased FSAH and, indirectly, its subsidiaries (excluding those involved in FSAH's financial products business) from Dexia Holdings, an indirect subsidiary of Dexia. The acquired companies are collectively referred to as the "Acquired Companies." The Financial Products Companies were sold to an affiliate of Dexia Holdings prior to the FSAH Acquisition. FSAH's former financial products segment had been in the business of borrowing funds through the issuance of guaranteed investment contracts ("GICs") and medium term notes ("MTNs") and reinvesting the proceeds in investments that met FSAH's investment criteria. The financial products business also included portions of FSAH's leveraged lease business. In connection with the FSAH Acquisition, Dexia Holdings agreed to assume the risks in respect of the GICs and MTNs, and the risks relating to the equity payment undertaking agreement in the leveraged lease business; AGM agreed to retain the risks relating to the debt and strip policy portions of such business. See Note 12.

The Company is indemnified against exposure to FSAH's former financial products segment through guarantees issued by Dexia and certain of its affiliates. In addition, the Company is protected from exposure to the GIC business of FSAH's former financial products segment through guaranties issued by the French and Belgian governments.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)

FSAH is now a wholly owned subsidiary of AGUS and the Company's financial statements subsequent to the Acquisition Date include the activities of FSAH.

The purchase price paid by the Company was $546.0 million in cash and 22.3 million common shares of AGL with an Acquisition Date fair value of $275.9 million, for a total purchase price of $821.9 million.

At the closing of the FSAH Acquisition, Dexia Holdings, a Delaware corporation, owned approximately 14.0% of AGL's issued common shares. Dexia Holdings agreed that the voting rights with respect to all AGL's common shares issued pursuant to the purchase agreement providing for the sale of the FSAH shares owned by Dexia Holdings to Assured Guaranty will constitute less than 9.5% of the voting power of all issued and outstanding AGL common shares. Dexia Holdings transferred its common shares of AGL to Dexia, acting through its French branch, effective August 13, 2009.

The FSAH Acquisition was accounted for under the purchase method of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Accordingly, the purchase price was allocated to assets acquired and liabilities assumed based on their estimated fair value at the Acquisition Date. In many cases, determining the fair value of acquired assets and assumed liabilities required the Company to exercise significant judgment. The most significant of these determinations related to the valuation of the acquired financial guaranty direct and ceded contracts.

The fair value of the deferred premium revenue (which is a component of unearned premium reserve, as described below) is the estimated premium that a similarly rated hypothetical financial guarantor would demand to assume each policy. The methodology for determining such value takes into account the rating of the insured obligation expectation of loss and sector. As the fair value of the deferred premium revenue exceeded the Company's estimate of expected loss for each contract, no loss reserves were recorded at July 1, 2009.

Based on the Company's assumptions, the fair value of the Acquired Companies' deferred premium revenue on its insurance contracts at July 1, 2009 was $7.3 billion, an amount approximately $1.7 billion greater than the Acquired Companies' gross stand ready obligations at June 30, 2009. The stand-ready obligation as June 30, 2009 was comprised of $3.8 billion in deferred premium revenue and $1.8 billion of loss reserves. This indicates that the amounts of the Acquired Companies' contractual premiums were less than the premiums a market participant of similar credit quality would demand to assume those contracts at the Acquisition Date. The fair value of the Acquired Companies' deferred premium revenue on its ceded contracts at July 1, 2009 was an asset of $1.7 billion. The fair value of the ceded contracts is in part derived from the fair value of the related insurance contracts with an adjustment for the credit quality of each reinsurer applied.

For FSAH's long-term debt, the fair value was based upon quoted market prices available from third-party brokers as of the Acquisition Date. The fair value of this debt was approximately $0.3 billion lower than its carrying value immediately prior to the acquisition. This discount will be amortized into interest expense over the estimated remaining life of the debt.

Additionally, in accordance with GAAP, other purchase accounting adjustments included (1) the write off of the Acquired Companies' deferred acquisition cost and (2) the consolidation of certain

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)

financial guaranty variable interest entities ("VIEs") in which the combined variable interest of the Acquired Companies and AG Re was determined to be the primary beneficiary.

The following table represents the allocation of the purchase price to the net assets of the Acquired Companies. The bargain purchase gain results from the difference between the purchase price and the net assets fair value estimates.

	July 1, 2009 (in thousands)
Purchase price:	
Cash	$ 545,997
Fair value of common stock issued (based upon June 30, 2009 closing price of AGO common stock)	275,875
Total purchase price	821,872
Identifiable assets acquired:	
Investments	5,950,061
Cash	86,999
Premiums receivable, net	854,140
Ceded unearned premium reserve	1,727,673
Deferred tax asset, net	888,117
Financial guaranty variable interest entities assets	1,879,446
Other assets	662,496
Total assets	12,048,932
Liabilities assumed:	
Unearned premium reserves	7,286,393
Long-term debt	396,160
Note payable to related party	164,443
Credit derivative liabilities	920,018
Financial guaranty variable interest entities liabilities	1,878,586
Other liabilities	348,906
Total liabilities	10,994,506
Net assets resulting from acquisition	1,054,426
Bargain purchase gain resulting from the FSAH Acquisition	$ 232,554

The bargain purchase gain was recorded within "Goodwill and settlement of pre-existing relationship" in the Company's consolidated statements of operations in the three-month period ended September 30, 2009 ("Third Quarter 2009"). The bargain purchase results from the unprecedented credit crisis, which resulted in a significant decline in FSAH's franchise value due to material insured losses, ratings downgrades and significant losses at FSAH's parent company, which resulted in government intervention in its affairs and resulting motivation to sell FSAH, and the absence of potential purchasers of FSAH due to the financial crisis. The initial difference between the purchase price of $822 million and FSAH's recorded net assets of $2.1 billion was reduced significantly by the

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)

recognition of additional liabilities related to FSAH's insured portfolio on a fair value basis as required by purchase accounting. The Company and FSAH had a pre-existing reinsurance relationship before the acquisition. Under GAAP, this pre-existing relationship must be effectively settled at fair value. The loss relating to this pre-existing relationship results from the effective settlement of reinsurance contracts at fair value and the write-off of previously recorded assets and liabilities relating to this relationship recorded in the Company's historical accounts. The loss related to the contract settlement results from contractual premiums that were less than the Company's estimate of what a market participant would demand currently, estimated in a manner similar to how the value of the Acquired Companies insurance policies were valued, as described above.

A summary of goodwill and settlements of pre-existing relationship included in the consolidated statement of operations follows:

	Nine months ended September 30, 2009 (in thousands)
Goodwill impairment associated with reinsurance assumed line of business	$ 85,417
Gain on bargain purchase of FSAH	(232,554)
Settlement of pre-existing relationship in conjunction with the FSAH Acquisition	170,478
Goodwill and settlement of pre-existing relationship	$ 23,341

Application of Financial Guaranty Insurance Accounting (ASC 944-20) to the FSAH Acquisition

Under GAAP, acquisition accounting requires that the fair value of each of the financial guaranty contracts in FSAH's insured portfolio be recorded on the Company's balance sheet. The fair value of FSAH's direct contracts was recorded on the line items "premium receivable" and "unearned premium reserve" and the fair value of its ceded contracts was recorded within "other liabilities" and "ceded unearned premium reserves" on the balance sheet. In accordance with Accounting Standards Codification ("ASC") 805-10, "Business Combinations" (Statement of Financial Accounting Standards ("FAS") No. 141 (revised), "Business Combinations") and ASC 944-20, "Financial Services-Insurance"

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)

(FAS No. 163, "Accounting for Financial Guaranty Insurance Contracts"), management recorded the FSAH financial guaranty insurance and reinsurance contracts as follows:

Financial Guaranty Contracts Acquired in FSAH Acquisition

	FSAH Carrying Value As of June 30, 2009	Acquisition Accounting Adjustment(1)	Assured Guaranty Carrying Value As of July 1, 2009(2)
		(in thousands)	
Premiums receivable, net	$ 854,140	$	$ 854,140
Ceded unearned premium reserve	1,299,224	418,449	1,727,673
Reinsurance recoverable on paid and unpaid losses	279,915	(279,915)	
Reinsurance balances payable, net of commissions	249,564		249,564
Unearned premium reserve	3,778,676	3,507,717	7,286,393
Loss and loss adjustment expense reserves	1,821,309	(1,821,309)	
Deferred acquisition costs	289,290	(289,290)	

(1) Represents the adjustments required to record the Acquired Companies' balances at fair value. The fair value adjustment to unearned premium reserve takes into account ratings, estimated economic losses and current pricing.

(2) Represents the carrying value of the Acquired Companies' financial guaranty contracts, before intercompany eliminations primarily between AG Re and the Acquired Companies.

On July 1, 2009, premiums receivable and reinsurance balances payable were recorded at FSAH historical value (i.e. the carrying amount on the FSAH balance sheet at June 30, 2009, the date prior to the FSAH Acquisition) in the Company's consolidated balance sheet. Gross and ceded unearned premium reserve represents the stand ready obligation under ASC 944-20. The carrying value recorded on July 1, 2009 takes into account the total fair value of each financial guaranty contract, including expected losses, on a contract by contract basis, less premiums receivable or premiums payable.

Incurred losses are recognized in the consolidated statements of operations line item "loss and loss adjustment expenses" at the time that they exceed deferred premium revenue on a contract by contract basis. When a claim payment is made, it is recorded as a contra deferred premium revenue liability and becomes recognized in the income statement only when the sum of such claim payments and the present value of future expected losses exceeds deferred premium revenue. The new carrying value of gross and ceded unearned premium reserves therefore includes expected losses previously recognized in FSAH's financial statements prior to its acquisition by the Company. Such unearned premium reserves amounts will be earned through the "net earned premiums" line item on the consolidated statements of operations.

In accordance with GAAP, losses are recognized when they exceed deferred premium revenue on a contract by contract basis. Deferred premium revenue for the Acquired Companies includes fair value adjustments as noted in the table above, which incorporate, among other factors, estimates of expected loss at the Acquisition Date. As a result of the significant fair value adjustments, deferred premium revenue of the Acquired Companies exceeded its expected losses as of the Acquisition Date. Accordingly, no loss reserves were recorded on the Acquisition Date.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)

The unearned premium reserve related to AGM is comprised of the following components:

	Unearned Premium Reserve	
	July 1, 2009	September 30, 2009
	(in thousands)	
Deferred premium revenue	$ 5,654,020	$ 5,391,707
Claim payments		(250,539)
Unearned premium reserve	$ 5,654,020	$ 5,141,168

Claim payments relate to claims paid on policies for which the Company has a continuing obligation to provide insurance and for which there is no loss reserve because deferred premium revenue exceeds expected losses.

Goodwill Impairment Analysis

In accordance with GAAP, the Company does not amortize goodwill, but instead is required to perform an impairment test annually or more frequently should circumstances warrant. The impairment test evaluates goodwill for recoverability by comparing the fair value of the Company's direct and reinsurance lines of business to their carrying value. If fair value is greater than carrying value then goodwill is deemed to be recoverable and there is no impairment. If fair value is less than carrying value then goodwill is deemed to be impaired and written down to an amount such that the fair value of the reporting unit is equal to the carrying value, but not less than $0. As part of the impairment test of goodwill, there are inherent assumptions and estimates used by management in developing discounted future cash flows related to the Company's direct and reinsurance lines of business that are subject to change based on future events.

The Company reassessed the recoverability of goodwill in the Third Quarter 2009 subsequent to the FSAH Acquisition, which provided the Company's largest assumed book of business prior to the acquisition. As a result of the FSAH Acquisition, which significantly diminished the Company's potential near future market for assuming reinsurance, combined with the continued credit crisis, which has adversely affected the fair value of the Company's in-force policies, management determined that the full carrying value of $85.4 million of goodwill on its books prior to the FSAH Acquisition should be written off in the Third Quarter 2009. This charge does not have any adverse effect on the Company's debt agreements or its overall compliance with the covenants of its debt agreements.

Pro Forma Condensed Combined Statement of Operations

The following unaudited pro forma information presents the combined results of operations of Assured Guaranty and the Acquired Companies for the nine months ended September 30, 2009 ("Nine Months 2009") as if the FSAH Acquisition had been completed on January 1, 2009. The pro forma information is presented for illustrative purposes and are not intended to represent or be indicative of the actual results of operations of the combined company that would have been achieved had the FSAH Acquisition occurred at the beginning of each period presented, nor are they intended to represent or be indicative of future results of operations. The pro forma results of operations shown

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)

below are not comparable due to new accounting requirements for financial guaranty contracts effective January 1, 2009.

Pro Forma Unaudited Results of Operations

	Nine Months 2009			Nine Months 2008		
	Assured Guaranty As Reported	Pro Forma Adjustments for Acquisition	Pro Forma Combined	Assured Guaranty As Reported	Pro Forma Adjustments for Acquisition	Pro Forma Combined
	(in thousands)					
REVENUES						
Net earned premiums	$ 557,050	$ 574,445	$ 1,131,495	$ 184,034	$ 436,738	$ 620,772
Net investment income	171,643	96,831	268,474	120,247	160,093	280,340
Net realized investment gains (losses):	(28,096)	(9,687)	(37,783)	(17,951)	(1,727)	(19,678)
Net change in fair value of credit derivatives						
Realized gains and other settlements	120,086	59,963	180,049	89,370	98,764	188,134
Net unrealized gains (losses)	(432,637)	626,935	194,298	332,634	(467,904)	(135,270)
Net change in fair value of credit derivatives	(312,551)	686,898	374,347	422,004	(369,140)	52,864
Financial guaranty variable interest entities revenues	4,881		4,881			
Fair value gain (loss) on committed capital securities	(93,961)	6,655	(87,306)		70,704	70,704
Income from assets acquired in financing transactions	1,619	3,833	5,452		8,385	8,385
Other income	58,533	59,045	117,578	24,756	6,406	31,162
TOTAL REVENUES	**359,118**	**1,418,020**	**1,777,138**	**733,090**	**311,459**	**1,044,549**
EXPENSES						
Loss and loss adjustment expenses	251,109	44,272	295,381	175,805	1,482,367	1,658,172
Amortization of deferred acquisition costs	41,277	(10,339)	30,938	43,004	53,119	96,123
Other operating expenses	122,325	60,147	182,472	73,886	44,874	118,760
FSAH acquisition-related expenses	80,179	(80,179)				
Interest expense	37,495	31,886	69,381	17,462	49,242	66,704
Goodwill and settlement of pre-existing relationship	23,341	62,076	85,417			
Financial guaranty variable interest entities expenses	10,152		10,152			
Profit commission expense	2,549	(1,289)	1,260	758	(90)	668
Other expenses						
TOTAL EXPENSES	**568,427**	**106,574**	**675,001**	**310,915**	**1,629,512**	**1,940,427**

INCOME (LOSS) BEFORE INCOME TAXES	(209,309)	1,311,446	1,102,137	422,175	(1,318,053)	(895,878)
(Benefit) provision for income taxes	(84,493)	533,415	448,922	109,508	(517,275)	(407,767)
NET INCOME (LOSS)	**(124,816)**	**778,031**	**653,215**	**312,667**	**(800,778)**	**(488,111)**
Less: Noncontrolling interest of variable interest entities	(5,271)		(5,271)			
NET INCOME (LOSS) ATTRIBUTABLE TO ASSURED GUARANTY LTD.	**$ (119,545)**	**$ 778,031**	**$ 658,486**	**$ 312,667**	**$ (800,778)**	**$ (488,111)**
Net (loss) earnings per basic share			4.20			(3.59)

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)

Common Share and Equity Units Offerings

On June 24, 2009, AGL completed the sale of 44,275,000 of its common shares (including 5,775,000 common shares allocable to the underwriters pursuant to the overallotment option) at a price of $11.00 per share. Concurrent with the common share offering, AGL along with AGUS sold 3,450,000 equity units (including 450,000 equity units allocable to the underwriters) at a stated amount of $50 per unit. The equity units initially consist of a forward purchase contract and a 5% undivided beneficial ownership interest in $1,000 principal amount 8.50% senior notes due 2014 issued by AGUS ("8.50% Senior Notes"). Under the purchase contract, holders are required to purchase AGL's common shares no later than June 1, 2012. The threshold appreciation price of the equity units is $12.93, which represents a premium of 17.5% over the public offering price in the common share offering. The 8.50% Senior Notes are fully and unconditionally guaranteed by AGL. The net proceeds after underwriting expenses and offering costs for these two offerings totaled approximately $616.5 million. Of that amount, $170.8 million related to the equity unit offering, $168.0 million of which was recognized as long-term debt and $2.8 million as additional paid-in-capital in shareholders' equity in the consolidated balance sheets. Offering costs totaled approximately $43.5 million and were recorded within "Additional paid-in capital" in the consolidated balance sheets. For a description of the 8.50% Senior Notes, see Note 12.

In conjunction with the FSAH Acquisition, on November 13, 2008, the Company entered into an amendment (the "Amendment") to the investment agreement dated as of February 28, 2008 (the "Investment Agreement") between AGL and investment funds affiliated with WL Ross Group, L.P. ("WLR Funds"). The Amendment provided a back up funding commitment to finance the FSAH Acquisition. Pursuant to pre-emptive rights set forth in the Investment Agreement, WLR Funds purchased 3,850,000 common shares of the Company in the Company's June 2009 public common share offering at $11.00 per common share, the public offering price in the public offering. The WLR Funds own approximately 10.2% of the outstanding common stock of AGL as of the date of this filing. WLR Funds is an affiliate of Wilbur L. Ross, Jr., who is one of AGL's directors.

FSAH Acquisition-Related Expenses

Expenses related to the FSAH Acquisition are summarized below.

	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2009
	(in thousands)	
Severance costs	$ 37,147	$ 37,147
Professional services	13,624	27,739
Office consolidation	562	15,293
Total	$ 51,333	$ 80,179

The Company expects to incur additional FSAH Acquisition-related expenses, although such costs are expected to be less than the amount incurred during the first nine months of 2009. As of September 30, 2009, FSAH Acquisition-related expenses included $13.7 million in accrued expenses, not yet paid.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

3. BASIS OF PRESENTATION

The unaudited interim consolidated financial statements have been prepared in conformity with GAAP and, in the opinion of management, reflect all adjustments which are of a normal recurring nature, in addition to adjustments required by acquisition accounting, necessary for a fair statement of the Company's financial condition, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim consolidated financial statements cover Third Quarter 2009, the three-month period ended September 30, 2008 ("Third Quarter 2008"), Nine Months 2009 and the nine-month period ended September 30, 2008 ("Nine Months 2008"). Operating results for the three- and nine-month periods ended September 30, 2009 and 2008 are not necessarily indicative of the results that may be expected for a full year. The 2009 financial statements include the effects of the Company's common share and equity units offering that took place on June 24, 2009 and the effects of the FSAH Acquisition, which was effective July 1, 2009.

Certain prior year items have been reclassified to conform to the current year presentation. These unaudited interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission. All intercompany accounts and transactions have been eliminated.

Certain of the Company's subsidiaries are subject to U.S. and U.K. income tax. The Company's provision for income taxes for interim financial periods is not based on an estimated annual effective rate due to the variability in changes in fair value of its credit derivatives, which prevents the Company from projecting a reliable estimated annual effective tax rate and pre-tax income for the full year of 2009. A discrete calculation of the provision is calculated for each interim period.

Volatility and disruption in the global financial markets including depressed home prices and increasing foreclosures, falling equity market values, rising unemployment, declining business and consumer confidence and the risk of increased inflation, have precipitated an economic slowdown. The conditions may adversely affect the Company's future profitability, financial position, investment portfolio, cash flow, statutory capital, financial strength ratings and stock price. Additionally, future legislative, regulatory or judicial changes in the jurisdictions regulating the Company may adversely affect its ability to pursue its current mix of business, materially impacting its financial results.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

3. BASIS OF PRESENTATION (Continued)

Subsequent Events

The Company has performed an evaluation of events that have occurred subsequent to September 30, 2009 and through November 16, 2009 (the date of filing of this quarterly report on Form 10-Q). There have been no material subsequent events that occurred during such period that would require disclosure in the consolidated financial statements as of or for the three and nine months ending September 30, 2009.

Update for Significant Accounting Policies

Adoption of ASC 944-20

Effective January 1, 2009, the Company adopted ASC 944-20. ASC 944-20 changed the premium revenue recognition and loss reserving methodology for non-derivative financial guaranty contracts. See Note 5 for a detailed description of, and the disclosures required by, ASC 944-20 for premiums and losses on financial guaranty insurance contracts.

Update for Significant Accounting Policies as a Result of FSAH Acquisition

Foreign Currency Translation

Assets, liabilities, revenues and expenses denominated in non-U.S. currencies are translated into U.S. dollars using applicable exchange rates. Gains and losses relating to translating functional currency financial statements for U.S. reporting are included in "other comprehensive income" within shareholders' equity. Gains and losses relating to nonfunctional currency transactions, including non-U.S. operations where the functional currency is the U.S. dollar, are reported in "other income" in the consolidated statement of operations, except for unrealized gains and losses on available-for-sale securities which are recorded in "accumulated other comprehensive income" unless the unrealized loss on a security is deemed to be an other than temporary impairment ("OTTI").

Financial Guaranty Variable Interest Entities and Noncontrolling Interest

The Company consolidates VIEs for which it determines that it is the primary beneficiary. In determining whether the Company is the primary beneficiary, a number of factors are considered, including the structure of the entity and the risks it was created to pass along to variable interest holders, the extent of credit risk absorbed by the Company through its insurance contract, the extent to which credit protection provided by other variable interest holders reduces this exposure and the exposure that the Company cedes to third party reinsurers. See Note 13 for more information regarding the Company's consolidated VIEs.

The Company adopted ASC 810-10, "Consolidation" (FAS No. 160, "Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51") and presented noncontrolling interest in the consolidated financial statements.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

3. BASIS OF PRESENTATION (Continued)

Long-Term Debt and Notes Payable to Related Party

In accordance with acquisition accounting, long-term debt and notes payable to a related party were recorded at fair value on July 1, 2009. The fair-value adjustment is accreted through income over the term of the debt outstanding.

Cash and Short-Term Investments

Cash includes demand deposits.

Short-term investments, which are those investments with a maturity of less than one year at time of purchase, are carried at fair value. Amounts deposited in money market funds and investments with a maturity at time of purchase of three months or less are included in short-term investments.

4. RECENT ACCOUNTING PRONOUNCEMENTS

In August 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update No. 2009-05, "Fair Value Measurements and Disclosures Measuring Liabilities at Fair Value" ("ASU 2009-05"). The update provides clarification for circumstances in which a quoted price in an active market for an identical liability is not available. ASU 2009- 05 is effective for the first reporting period beginning after August 2009. The adoption of ASU 2009-05 did not have a material impact on the Company's financial statements.

In June 2009, the FASB issued ASC 105, "Generally Accepted Accounting Principles" (FAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162"). This statement modifies the GAAP hierarchy by establishing only two levels of GAAP, authoritative and non-authoritative accounting literature. Effective July 2009, the FASB Accounting Standards Codification, also known collectively as the "Codification," is considered the single source of authoritative U.S. accounting and reporting standards, except for additional authoritative rules and interpretive releases issued by the Securities and Exchange Commission ("SEC"). Non-authoritative guidance and literature would include, among other things, FASB Concepts Statements, American Institute of Certified Public Accountants Issue Papers and Technical Practice Aids and accounting textbooks. The Codification was developed to organize GAAP pronouncements by topic so that users can more easily access authoritative accounting guidance. It is organized by topic, subtopic, section, and paragraph, each of which is identified by a numerical designation. Technical references to GAAP included in these Notes to Consolidated Financial Statements are provided under the new FASB ASC structure with the prior terminology included parenthetically when first used.

In June 2009, the FASB issued FAS No. 167, "Amendments to FASB Interpretation No. 46(R) ("FAS 167"). FAS 167 changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. FAS 167 will require a company to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to that involvement. FAS 167 will become effective for the Company's fiscal year beginning January 1, 2010. The Company is currently evaluating the effect, if any, the adoption of FAS 167 will have on its consolidated financial statements.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

4. RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

In September 2008, the FASB issued ASC 815-10-65-2, "Derivatives and Hedging" (Staff Position ("FSP") FAS 133-1 and FASB Interpretation No. ("FIN") 45-4, "Disclosures About Credit Derivatives and Certain Guarantees") and ASC 815-10, "Derivatives and Hedging" (FAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities") to address concerns that current derivative disclosure requirements did not adequately address the potential adverse effects that these instruments can have on the financial performance and operations of an entity. Companies are required to provide enhanced disclosures about their derivative activities to enable users to better understand: (1) how and why a company uses derivatives, (2) how it accounts for derivatives and related hedged items, and (3) how derivatives affect its financial statements. These should include the terms of the derivatives, collateral posting requirements, triggers, and other significant provisions that could be detrimental to earnings or liquidity. Management believes that the Company's current derivatives disclosures are in compliance with the requirements of ASC 815-10-65-2 and ASC 815-10.

In December 2007, the FASB issued ASC 805-10. ASC 805-10 establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. ASC 805-10 also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. The Company applied the provisions of ASC 805-10 to account for the FSAH Acquisition. See Note 2.

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS

Effective January 1, 2009, the Company adopted ASC 944-20. ASC 944-20 clarifies the methodology to be used for financial guaranty premium revenue recognition and claim liability measurement, and expands the disclosures about the insurance enterprise's risk management activities. ASC 944-20 has been applied to all existing financial guaranty insurance and reinsurance contracts written by the Company except for financial guaranty contracts considered derivatives under ASC 815-10-65-2. The accounting changes prescribed by the statement were recognized by the Company as a cumulative effect adjustment to retained earnings as of January 1, 2009. As a result of the adoption of ASC 944-20 as well as the FSAH Acquisition, premium earnings and loss and loss adjustment expenses are not comparable between 2008 and 2009.

Premium Revenue Recognition

Upon Adoption of ASC 944-20

The Company recognizes a liability for unearned premium reserve at the inception of a financial guaranty contract equal to the present value of the premiums due or expected to be collected over the period of the contract or, for those contracts acquired under a business combination, at management's estimate of the contract fair value as of the date of the acquisition.

If the premium is a single premium received at the inception of the financial guaranty contract, the Company measures the unearned premium reserve as the amount received.

For premiums received in installments, the Company measures the unearned premium reserve as the present value of premiums due or expected to be collected over the life of the contracts. The term

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

of the financial guaranty contract that is used as the basis for the calculation of the present value of premiums due or expected to be collected is either (a) the contractual term or (b) the expected term. The contractual term is used unless the obligations underlying the financial guaranty contract represent homogeneous pools of assets for which prepayments are contractually prepayable, the amount of prepayments are probable, and the timing and amount of prepayments can be reasonably estimated. The Company adjusts prepayment assumptions when those assumptions change and recognizes a prospective change in premium revenues as a result. The adjustment to the unearned premium reserve is equal to the adjustment to the premium receivable with no effect on earnings at the time of the adjustment.

The Company recognizes the premium from a financial guaranty insurance contract as revenue over the contractual period or expected period of the contract in proportion to the amount of insurance protection provided. As premium revenue is recognized, a corresponding decrease in the unearned premium reserve occurs. The amount of insurance protection provided is a function of the insured principal amount outstanding. Accordingly, the proportionate share of premium revenue recognized in a given reporting period is a constant rate calculated based on the relationship between the insured principal amount outstanding in the reporting period compared with the sum of each of the insured principal amounts outstanding for all periods. When the issuer of an insured financial obligation retires the insured financial obligation before its maturity, the financial guaranty insurance contract on the retired financial obligation is extinguished. The Company immediately recognizes any nonrefundable unearned premium reserve related to that contract as premium revenue and any associated acquisition costs previously deferred as an expense. Upon the FSAH Acquisition, the Company revised its assumptions used in calculating premium earnings to conform all entities within the consolidated group.

Premium revenue and the related amortization of deferred acquisition costs are accelerated when the Company is legally released from its financial guaranty insurance contract.

Prior to Adoption of ASC 944-20

Prior to January 1, 2009, upfront premiums were earned in proportion to the expiration of the amount at risk. Each installment premium was earned ratably over its installment period, generally one year or less. Premium earnings under both the upfront and installment revenue recognition methods were based upon and were in proportion to the principal amount guaranteed and therefore resulted in higher premium earnings during periods where guaranteed principal was higher. For insured bonds for which the par value outstanding was declining during the insurance period, upfront premium earnings were greater in the earlier periods, thereby matching revenue recognition with the underlying risk. The premiums were allocated in accordance with the principal amortization schedule of the related bond issuance and were earned ratably over the amortization period. When an insured issuance was retired early, was called by the issuer, or was in substance paid in advance through a refunding accomplished by placing U.S. Government securities in escrow, the remaining unearned premium reserves were earned at that time. Unearned premium reserves represented the portion of premiums written that were applicable to the unexpired amount at risk of insured bonds. On contracts where premiums were paid in installments, only the currently due installment was recorded in the financial statements.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

Summary of Consolidated Financial Guaranty Contracts

The following tables provide information for financial guaranty insurance contracts where premiums are received on an installment basis as of and for the nine months ended September 30, 2009:

Selected Information for Policies Paid in Installments

	September 30, 2009
	(dollars in thousands)
Premiums receivable, net (end of period)	$ 1,493,178
Deferred premium revenue (end of period)	$ 4,606,623
Accretion of discount on premium receivable	$ 24,350
Weighted-average risk-free rate to discount premiums	3.2%
Weighted-average period of premiums receivable (in years)	10.3

Expected Collections of Premiums

(dollars in thousands)	
2009 (October 1 December 31)	$ 98,732
2010 (January 1 March 31)	42,816
2010 (April 1 June 30)	41,598
2010 (July 1 September 30)	38,164
2010 (October 1 December 31)	36,454
2011	137,556
2012	124,896
2013	113,735
2014 2018	457,260
2019 2023	326,793
2024 2028	242,453
2029 2033	172,070
2034 2038	88,236
2039 2043	36,711
2044 2048	15,799
2049 2053	4,708
2054 2056	2,435
Total premiums receivable, net	$ 1,980,416

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

The following table provides a reconciliation of the beginning and ending balances of premium receivable:

Gross Premium Receivable Rollforward(1)

	(in thousands)
Premium receivable at January 1	$ 737,181
Premiums written, net	376,799
Accretion of premium receivable discount	10,812
Premium payments received	(371,900)
Premium receivable, net at June 30	752,892
Premiums receivable purchased in FSAH Acquisition on July 1, 2009 including intercompany eliminations	800,944
Premiums receivable, net as of July 1, 2009	1,553,836
Premium written, net	148,493
Premium payments received	(217,702)
Adjustments to the premium receivable:	
Changes in the expected term of financial guaranty insurance contracts	(21,093)
Accretion of the premium receivable discount	12,640
Foreign exchange rate changes	27,869
Premium receivable, net at September 30	$ 1,504,043

(1) The "accretion of premium receivable discount" is included in earned premium in the Company's consolidated statements of operations. The above amounts are presented net of applicable ceding commissions on assumed business.

The following table presents the components of net premiums earned.

Net Premiums Earned

	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2009
	(in thousands)	
Net earned premiums	$ 300,973	$ 406,912
Acceleration of premium earnings	17,374	127,710
Accretion of discount on premium receivable	11,623	22,428
Total net earned premiums and accretion	$ 329,970	$ 557,050

In the Company's assumed businesses, the Company estimates the ultimate written and earned premiums to be received from a ceding company at the end of each quarter and the end of each year. A portion of the premiums must be estimated because some of the Company's ceding companies report premium data between 30 and 90 days after the end of the reporting period. Earned premium reported

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

in the Company's statement of operations are based upon reports received from ceding companies supplemented by the Company's own estimates of premium for which ceding company reports have not yet been received. Differences between such estimates and actual amounts are recorded in the period in which the actual amounts are determined.

The following table provides a schedule of how the Company's premiums and losses are expected to run off in the consolidated statement of operations.

Runoff of Deferred Premium Revenue, Net

	Deferred Premium Revenue	Expected Losses	Deferred Premium Revenue in Excess of Expected Losses
		(in thousands)	
2009 (October 1 December 31)	$ 304,034	$ 16,573	$ 287,461
2010 (January 1 March 31)	284,117	26,572	257,545
2010 (April 1 June 30)	272,488	45,558	226,930
2010 (July 1 September 30)	256,776	44,581	212,195
2010 (October 1 December 31)	240,575	41,713	198,862
2011	809,059	116,795	692,264
2012	670,813	120,265	550,548
2013	570,663	119,163	451,500
2014 2018	1,894,073	354,485	1,539,588
2019 2023	1,019,119	86,082	933,037
2024 2028	642,081	40,791	601,290
After 2028	742,838	53,082	689,756
Total	$ 7,706,636	$ 1,065,660	$ 6,640,976

Deferred Acquisition Costs

Acquisition costs incurred on financial guaranty insurance contracts that vary with and are directly related to the production of new business are deferred and then amortized in relation to earned premiums. These costs include direct and indirect expenses such as ceding commissions, brokerage expenses and the cost of underwriting and marketing personnel. Management uses its judgment in determining what types of costs should be deferred, as well as what percentage of these costs should be deferred. The Company annually conducts a study to determine which operating costs vary with, and are directly related to, the acquisition of new business and qualify for deferral. Ceding commissions received on premiums the Company cedes to other reinsurers reduce acquisition costs. Expected losses, loss adjustment expenses and the remaining costs of servicing the insured or reinsured business are considered in determining the recoverability of acquisition costs. Acquisition costs associated with financial guaranty contracts accounted for as credit derivatives are expensed as incurred. When an insured issue is retired early, the remaining related deferred acquisition cost is expensed at that time. Ceding commissions associated with future installment premiums on assumed and ceded business are calculated at their contractually defined rate and recorded in deferred acquisition costs consistent with

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

the adoption of ASC 944-20. There is a corresponding offset to premium receivable. No deferred acquisition costs are recorded in connection with policies acquired as part of a business combination.

Reserves for Losses and Loss Adjustment Expenses

Financial Guaranty Contracts Upon Adoption of ASC 944-20

The Company recognizes a reserve for losses and loss adjustment expenses on a financial guaranty insurance contract when expected loss exceeds the deferred premium revenue for that contract based on the present value of expected net cash outflows to be paid under the insurance contract. The unearned premium reserve represents the insurance enterprise's stand-ready obligation under a financial guaranty insurance contract at initial recognition. Subsequently, if the likelihood of a default (insured event) increases so that the present value of the expected net cash outflows expected to be paid under the insurance contract exceeds the unearned premium reserve, the Company recognizes a reserve for losses and loss adjustment expenses for the amount of expected loss in excess of unearned premium reserve.

The expected loss is equal to the present value of expected net cash outflows to be paid under the insurance contract discounted using a current risk-free rate. That current risk-free rate is based on the remaining period (the contract or expected period, as applicable) of the insurance contract. Expected net cash outflows (cash outflows, net of potential recoveries, expected to be paid to the holder of the insured financial obligation, excluding reinsurance) are probability-weighted cash flows that reflect the likelihood of possible outcomes. The Company estimates the expected net cash outflows using management's assumptions about the likelihood of possible outcomes based on all information available to it. Those assumptions consider the relevant facts and circumstances and are consistent with the information tracked and monitored through the Company's risk-management activities.

The Company updates the discount rate each reporting period and revises expected net cash outflows when increases (or decreases) in the likelihood of a default (insured event) and potential recoveries occur. Revisions to a reserve for loss and loss adjustment expenses, in periods after initial recognition, are recognized as incurred loss and loss adjustment expenses (recoveries) in the period of the change.

When a claim payment is made on a contract it reduces loss reserves or, to the extent loss reserve are not recorded, it reduces unearned premium reserve.

The deferred premium revenue represents the amount that will be recorded through earned premiums in the consolidated statements of operations over the terms of the relevant financial guaranty contracts. Accumulated claim payments do not reduce the amount of earned premium to be recognized over the life of a given contract; instead, such losses are recorded in "loss and loss adjustment expenses" on the consolidated statements of operations beginning in the reporting period that "total losses" (i.e. the sum of cumulative claim payments, plus estimated expected future losses), exceeds deferred premium revenue. The amount recorded in "loss and loss adjustment expense" in a given reporting period is the excess of total losses over deferred premium revenue on a contract by contract basis.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

Financial Guaranty Contracts Prior to Adoption of ASC 944-20

Prior to January 1, 2009, reserves for losses for non-derivative transactions in the Company's financial guaranty contracts included case reserves and portfolio reserves. Case reserves were established when there was significant credit deterioration on specific insured obligations and the obligations were in default or default was probable, not necessarily upon non-payment of principal or interest by an insured. Case reserves represented the present value of expected future loss payments and loss adjustment expenses, net of estimated recoveries, but before considering ceded reinsurance. This reserving method was different from case reserves established by traditional property and casualty insurance companies, which establish case reserves upon notification of a claim and establish incurred but not reported reserves for the difference between actuarially estimated ultimate losses and recorded case reserves. Financial guaranty insurance and assumed case reserves and related salvage and subrogation, if any, were discounted at the taxable equivalent yield on the Company's investment portfolio, which was approximately 6%, during 2008.

The Company recorded portfolio reserves in its financial guaranty business. Portfolio reserves were established with respect to the portion of the Company's business for which case reserves were not established.

Portfolio reserves were not established based on a specific event. Instead, they were calculated by aggregating the portfolio reserve calculated for each individual transaction. Individual transaction reserves were calculated on a quarterly basis by multiplying the par in-force by the product of the ultimate loss and earning factors without regard to discounting. The ultimate loss factor was defined as the frequency of loss multiplied by the severity of loss, where the frequency was defined as the probability of default for each individual issue. The earning factor was inception to date earned premium divided by the estimated ultimate written premium for each transaction. The probability of default was estimated from rating agency data and was based on the transaction's credit rating, industry sector and time until maturity. The severity was defined as the complement of recovery/salvage rates gathered by the rating agencies of defaulting issues and was based on the industry sector.

Portfolio reserves were recorded gross of reinsurance. The Company did not cede any amounts under these reinsurance contracts, as the Company's recorded portfolio reserves did not exceed the Company's contractual retentions, required by said contracts.

The Company recorded an incurred loss that was reflected in the statement of operations upon the establishment of portfolio reserves. When the Company initially recorded a case reserve, the Company reclassified the corresponding portfolio reserve already recorded for that credit within the balance sheet. The difference between the initially recorded case reserve and the reclassified portfolio reserve was recorded as a charge in the Company's statement of operations. Any subsequent change in portfolio reserves or the initial case reserves was recorded quarterly as a charge or credit in the Company's statement of operations in the period such estimates changed.

Reinsurance

In the ordinary course of business, the Company's insurance subsidiaries assume and cede business with other insurance and reinsurance companies. These agreements provide greater diversification of

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business and may reduce the net potential loss from large risks. Ceded contracts do not relieve the Company of its obligations. Reinsurance recoverable on ceded losses include balances due from reinsurance companies for paid and unpaid losses and loss adjustment expenses that will be recovered from reinsurers, based on contracts in force, and is presented net of any provision for estimated uncollectible reinsurance. However, the reinsurance receivable on ceded losses that were acquired in the FSAH Acquisition is recorded at fair value as a component of ceded unearned premium reserve at July 1, 2009. Any change in the provision for uncollectible reinsurance is included in loss and loss adjustment expenses. Ceded reinsurance premiums represent the portion of premiums ceded to reinsurers.

Certain of the Company's assumed and ceded reinsurance contracts are funds held arrangements. In a "funds held" arrangement, the ceding company retains the premiums instead of paying them to the reinsurer and losses are offset against these funds in an experience account. Because the reinsurer is not in receipt of the funds, the reinsurer earns interest on the experience account balance at a predetermined credited rate of interest. The Company generally earns interest at fixed rates of between 4% and 6% on its assumed funds held arrangements and generally pays interest at fixed rates of between 4% and 6% on its ceded funds held arrangements. The interest earned or credited on funds held arrangements is included in net investment income. In addition, interest on funds held arrangements will continue to be earned or credited until the experience account is fully depleted, which can extend many years beyond the expiration of the coverage period.

Salvage Recoverable

When the Company becomes entitled to the underlying collateral (generally a future stream of cash flows or pool assets) of an insured credit under salvage and subrogation rights as a result of a claim payment or estimates recoveries from disputed claim payments on contractual grounds, it reduces the corresponding loss reserve for a particular financial guaranty insurance policy for the estimated salvage and subrogation. If the expected salvage and subrogation exceeds the estimated loss reserve for a policy, such amounts are recorded as a salvage recoverable asset in the Company's balances sheets.

Significant Risk Management Activities

The Risk Oversight and Audit Committees of the Board of Directors of AGL oversee the Company's risk management policies and procedures. Within the limits established by the board committees, specific risk policies and limits are set by the Portfolio Risk Management Committee, which includes members of senior management and senior Credit and Surveillance officers. As part of its risk management strategy, the Company may seek to obtain third party reinsurance or retrocessions and may also periodically enter into other arrangements to alleviate all or a portion of certain risks.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

Risk Management and Surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio, including exposures in both the financial guaranty direct and financial guaranty reinsurance segments. The primary objective of the surveillance process is to monitor trends and changes in transaction credit quality, detect any deterioration in credit quality, and recommend to management such remedial actions as may be necessary or appropriate. All transactions in the insured portfolio are assigned internal credit ratings, and surveillance personnel are responsible for recommending adjustments to those ratings to reflect changes in transaction credit quality. Surveillance personnel are also responsible for managing work-out and loss situations when necessary.

The Company segregates its insured portfolio of investment grade and below investment grade ("BIG") risks into surveillance categories to facilitate the appropriate allocation of resources to monitoring and loss mitigation efforts and to aid in establishing the appropriate cycle for periodic review for each exposure. BIG credits include all credits internally rated lower than BBB-. The Company's internal credit ratings are based on the Company's internal assessment of the likelihood of default. The Company's internal credit ratings are expressed on a ratings scale similar to that used by the rating agencies and are generally reflective of an approach similar to that employed by the rating agencies.

The Company monitors its investment grade credits to determine whether any new credits need to be internally downgraded to BIG. Quarterly procedures include qualitative and quantitative analysis on the Company's insured portfolio to identify potential new BIG credits. The Company refreshes its internal credit ratings on individual credit in cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits and in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. Credits identified through this process as BIG are subjected to further review by surveillance personnel to determine whether a loss is probable. For transactions where a loss is considered probable, surveillance personnel present analysis related to potential loss situations to a reserve committee. There is a reserve committee for AGC and AGM made up of the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, General Counsel, Chief Accounting Officer, Chief Surveillance Officer and Chief Actuary which establishes reserves for those entities. There is also a reserve committee of AGL made up of the Chief Executive Officer, Chief Financial Officer, General Counsel and Chief Accounting Officer of that company, as well as the Chief Actuary of AGC and AGM, which establishes reserves for the Company. The reserve committees consider the information provided by surveillance personnel when setting reserves.

Below Investment Grade Surveillance Categories

Within the BIG category, the Company assigns each credit to one of three surveillance categories:

BIG Category 1: BIG transactions showing sufficient deterioration to make material losses possible, but for which no losses have been incurred. Non-investment grade transactions on which liquidity claims have been paid are in this category. Intense monitoring and intervention is employed, with internal credit ratings reviewed quarterly.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

BIG Category 2: BIG transactions for which expected losses have been established but for which no unreimbursed claims have yet been paid. Intense monitoring and intervention is employed, with internal credit ratings reviewed quarterly.

BIG Category 3: BIG transactions for which expected losses have been established and on which unreimbursed claims have been paid. Transactions remain in this category when claims have been paid and only a recoverable remains. Intense monitoring and intervention is employed, with internal credit ratings reviewed quarterly.

The following table provides information on financial guaranty insurance and reinsurance contracts categorized BIG as of September 30, 2009:

	BIG Categories			
	BIG 1	BIG 2	BIG 3	Total
	(dollars in millions)			
Number of policies	231	189	121	541
Remaining weighted-average contract period (in years)	8.6	9.6	6.7	8.6
Insured contractual payments outstanding:				
Principal	$ 6,313.7	$ 7,266.1	$ 3,967.8	$ 17,547.6
Interest	1,865.3	2,832.4	1,034.0	5,731.7
Total	$ 8,179.0	$ 10,098.5	$ 5,001.8	$ 23,279.3
Gross expected cash outflows for loss and loss adjustment expenses	18.4	2,229.8	588.9	$ 2,837.1
Less:				
Gross potential recoveries	18.2	588.5	601.4	1,208.1
Discount, net	0.0	638.9	(59.1)	579.8
Present value of expected cash flows for loss and loss adjustment expenses	0.2	1,002.4	46.6	1,049.2
Unearned premium reserves	$ 104.3	$ 1,608.6	605.4	2,318.3
Gross reserves (salvage) for loss and loss adjustment	$	$ 141.3	$ (112.3)	$ 29.0

expenses reported in the balance sheet						
Reinsurance recoverable (payable)	$	1.2	$	(4.4)	$	(3.2)

The Company's loss adjustment expense reserves for mitigating claim liabilities were $1.6 million as of September 30, 2009.

The Company used a weighted-average risk free discount rate of approximately 2.3% to discount reserves for loss and loss adjustment expenses.

Overview of Significant Risk Management Activities

Since the onset of the credit crisis in the fall of 2007 and the ensuing sharp recession, the Company has been intensely involved in risk management activities. Its most significant activities have

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

centered on the residential mortgage sector, where the crisis began, but it is also active in other areas experiencing stress. Residential mortgage loans are loans secured by mortgages on one to four family homes. RMBS may be broadly divided into two categories: (1) first lien transactions, which are generally comprised of loans with mortgages that are senior to any other mortgages on the same property, and (2) second lien transactions, which are comprised of loans with mortgages that are often not senior to other mortgages, but rather are second in priority. Both first lien RMBS and second lien RMBS sometimes include a portion of loan collateral with a different priority than the majority of the collateral.

Second Lien RMBS: HELOCs and CES

The Company insures two types of second lien RMBS, those secured by home equity lines of credit ("HELOCs") and those secured by closed-end second mortgages ("CES"). HELOCs are revolving lines of credit generally secured by a second lien on a one to four family home. A mortgage for a fixed amount secured by a second lien on a one-to-four family home is generally referred to as a CES. The Company has material exposure to second lien mortgage loans originated and serviced by a number of parties, but the Company's most significant second lien exposure is to HELOCs originated and serviced by Countrywide.

As of September 30, 2009, the Company had insured $6.3 billion in net par of HELOC transactions, of which $6.1 billion was in the financial guaranty direct segment. Of the total, $4.8 billion was rated BIG by the Company as of September 30, 2009, with $4.5 billion in net par rated BIG 2 or BIG 3. As of September 30, 2009 the Company had a gross salvage asset related to HELOC policies of $148.5 million, prior to reinsurance or netting of unearned premium as required by GAAP, and a net salvage asset of $145.2 million.

As of September 30, 2009, the Company had insured $1.3 billion in net par of CES transactions, of which $1.2 billion was in the financial guaranty direct segment. Of the $1.3 billion, $1.2 billion was rated either BIG 2 or BIG 3 by the Company as of September 30, 2009. As of September 30, 2009 the Company had gross expected loss, prior to reinsurance or netting of unearned premium, in this sector of $254.3 million, and gross reserves of $30.5 million.

The performance of the Company's HELOC and CES exposures deteriorated during 2007 and 2008 and the first nine months of 2009 and transactions, particularly those originated in the period from 2005 through 2007, continue to perform below the Company's original underwriting expectations. In accordance with the Company's standard practices, during Third Quarter 2009 and Nine Months 2009, the Company evaluated the most current available information as part of its loss reserving process, including trends in delinquencies and charge-offs on the underlying loans and its success in requiring providers of representations and warranties to purchase ineligible loans out of these transactions.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

The following table shows the Company's key assumptions used in its loss reserves for these types of policies as of September 30, 2009 and December 31, 2008:

HELOC Key Variables	September 30, 2009	December 31, 2008
Plateau Conditional Default Rate (CDR)	10.6% 39.7%	19 21%
Final CDR	0.5% 3.2%	1%
Expected Period until Final CDR	21 months	15 months
Initial Conditional Prepayment Rate (CPR)	0.4% 16.0%	7.0% 8.0%
Final CPR	10%	7.0% 8.0%
Loss Severity	95%	100%
Future Repurchase of Ineligible Loans	$724.8 million	$49 million
Initial Draw Rate	0.3% 4.0%	1.0% 2.0%

Closed-End Second Liens Key Variables	September 30, 2009	December 31, 2008
Plateau CDR	21.3% 42.6%	34.0% 36.0%
Final CDR	3.3% 8.1%	3.4% 3.6%
Expected Period until Final CDR achieved	21 months	24 months
Initial CPR	0.6% 4.9%	7%
Final CPR	10%	7%
Loss Severity	95%	100%
Future Repurchase of Ineligible Loans	$79.5 million	

The primary driver of the adverse development the Company has experienced related to its HELOC and CES exposure is the result of much higher total pool delinquencies than had been experienced historically. In order to project future defaults in each pool, a conditional default rate ("CDR") is applied each reporting period to various delinquency categories to calculate the projected losses to the pool. During the Third Quarter 2009, the Company modified its calculation methodology for HELOC transactions from an approach that used an average of the prior six months' CDR to an approach that projects future CDR based on currently delinquent loans. This change was made due to the continued volatility in mortgage backed transactions. Management believes that this refinement in approach should prove to be more responsive to changes in CDR rates than the prior methodology. Under this methodology, current representative roll rates are used to estimate losses in the first five months from loans that are currently delinquent and then the CDR of the fifth month is held constant for a period of time. Taken together, the first five months of losses plus the period of time for which the CDR is held constant represent the stress period. Once the stress period has elapsed, the CDR is assumed to gradually trend down to its final CDR. In the base case as of September 30, 2009, the total time between the current period's CDR and the long-term assumed CDR used to project losses was 21 months. At the end of this period, the long-term steady CDRs modeled were between 0.5% and 3.2% for HELOC transactions and between 3.3% and 8.1% for CES transactions. The Company continued to assume an extended stress period based on transaction performance and the continued weakened overall economic environment.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

The assumption for the Conditional Prepayment Rate ("CPR"), which represents voluntary prepayments, follows a similar pattern to that of the CDR. The current CPR is assumed to continue for the stress period before gradually increasing to the final CPR, which is assumed to be 10% for both HELOC and CES transactions. This level is much higher than current rates but lower than the historical average, which reflects the Company's continued uncertainty about performance of the borrowers in these transactions. For HELOC transactions, the draw rate is assumed to decline from the current level to the final draw rate over a period of 4 months. The final draw rates were assumed to be between 0.2% and 2.0%.

In the Third Quarter 2009 and Nine Months 2009, the Company modeled and probability weighted three potential time periods over which an elevated CDR may potentially occur, one of which assumed a three month shorter period of elevated CDR and another of which assumed a three month longer period of elevated CDR than the most heavily weighted scenario described in the table above. Given that draw rates have been reduced to levels below the historical average and that loss severities in these products have been higher than anticipated at inception, the Company believes that the level of the elevated CDR and the length of time it will persist is the primary driver behind the likely amount of losses the collateral will suffer (before considering the effects of repurchases of ineligible loans). The Company continues to evaluate all of the assumptions informing its modeling results.

Performance of the collateral underlying certain securitizations has substantially differed from the Company's original expectations. Employing several loan file diligence firms and law firms as well as internal resources, as of September 30, 2009 the Company had performed a detailed review of over 18,500 files, representing nearly $1.5 billion in outstanding par of defaulted second lien loans underlying insured transactions, and identified a material number of defaulted loans that breach representations and warranties regarding the characteristics of the loans. The Company continues to review new files as new loans default and as new loan files are made available to it. Following negotiation with the sellers and originators of the breaching loans, as of mid-October 2009 the Company had reached agreement to have $128.9 million of the second lien loans repurchased. The Company has included in its loss estimates for second liens as of September 30, 2009 an estimated benefit from repurchases of $804.3 million, of which $380.8 million is either netted from the Company's GAAP loss reserves or included in salvage recoverable, with the balance pertaining to policies whose calculated loss reserve is less than its unearned premium reserve, principally as a result of the effects of purchase accounting on AGM's financial guaranty policies. The Company recognized a benefit related from repurchases of $189.2 million in the Third Quarter 2009. The amount the Company ultimately recovers related to contractual representations and warranties is uncertain and subject to a number of factors including the counterparty's ability to pay, the number and amount of loans determined to have breached representations and warranties and, potentially, negotiated settlements or litigation. As such, the Company's estimate of recoveries is uncertain and actual amounts realized may differ significantly from these estimates.

The ultimate performance of the Company's HELOC and CES transactions will depend on many factors, such as the level and timing of loan defaults, interest proceeds generated by the securitized loans, prepayment speeds and changes in home prices, as well as the levels of credit support built into each transaction. The ability and willingness of providers of representations and warranties to repurchase ineligible loans from the transactions will also have a material effect on the Company's

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

ultimate loss on these transactions. Finally, other factors also may have a material impact upon the ultimate performance of each transaction, including the ability of the seller and servicer to fulfill all of their contractual obligations including any obligation to fund future draws on lines of credit. The variables affecting transaction performance are interrelated, difficult to predict and subject to considerable volatility. If actual results differ materially from any of the Company's assumptions, the losses incurred could be materially different from the estimate. The Company continues to update its evaluation of these exposures as new information becomes available.

First Lien RMBS: Subprime, Alt-A, Option ARM and Prime

First lien RMBS are generally categorized in accordance with the characteristics of the first lien mortgage loans on one to four family homes supporting the transactions. The collateral supporting "Subprime RMBS" transactions is comprised of first-lien residential mortgage loans made to subprime borrowers. A "subprime borrower" is one considered to be a higher risk credit based on credit scores or other risk characteristics. Another type of RMBS transaction is generally referred to as "Alt-A RMBS." The collateral supporting such transactions is comprised of first-lien residential mortgage loans made to "prime" quality borrowers that lack certain ancillary characteristics that would make them prime. When more than 66% of the loans originally included in the pool are mortgage loans with an option to make a minimum payment that has the potential to negatively amortize the loan (*i.e*., increase the amount of principal owed), the transaction is referred to as an "Option ARMs." Finally, transactions may include loans made to prime borrowers.

The problems affecting the subprime mortgage market have been widely reported, with rising delinquencies, defaults and foreclosures negatively impacting the performance of Subprime RMBS transactions. Those concerns relate primarily to Subprime RMBS issued in the period from 2005 through 2007. As of September 30, 2009, the Company had insured $5.0 billion in net par of Subprime RMBS transactions, of which $4.9 billion was in the financial guaranty direct segment. These transactions benefit from various structural protections, including credit enhancement that in the direct portfolio for the vintages 2005 through 2008 currently averages approximately 32.1% of the remaining insured balance. Of the total Subprime RMBS, $1.9 billion was rated BIG by the Company as of September 30, 2009, with $0.7 billion in net par rated BIG 2 or BIG 3. As of September 30, 2009 the Company had gross reserves, prior to reinsurance or netting of unearned premium, in this sector of $52.7 million, and net reserves of $20.9 million.

As has been reported, the problems affecting the subprime mortgage market are affecting Option ARM RMBS transactions, with rising delinquencies, defaults and foreclosures negatively impacting their performance. Those concerns relate primarily to Option ARM RMBS issued in the period from 2005 through 2007. As of September 30, 2009, the Company had insured $2.9 billion in net par of Option ARM RMBS transactions, all of which was in the financial guaranty direct segment. These transactions benefit from various structural protections, including credit enhancement that in the direct portfolio for the vintages 2005 through 2007 currently averages approximately 9.8% of the remaining insured balance. Of the Company's $2.9 billion total Option ARM RMBS net insured par, $2.8 billion was rated BIG by the Company as of September 30, 2009, with $2.0 billion in net par rated BIG 2 or BIG 3. As of September 30, 2009 the Company had gross reserves, prior to reinsurance or netting of unearned premium, in this sector of $446.7 million, and net reserves of $19.1 million.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

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5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

As has also been reported, the problems affecting the subprime mortgage market are now affecting Alt-A RMBS transactions, with rising delinquencies, defaults and foreclosures negatively impacting their performance. Those concerns relate primarily to Alt-A RMBS issued in the period from 2005 through 2007. As of September 30, 2009, the Company had insured $2.5 billion in net par of Alt-A RMBS transactions, all of which was in the financial guaranty direct segment. These transactions benefit from various structural protections, including credit enhancement that in the direct portfolio for the vintages 2005 through 2007 currently averages approximately 7.6% of the remaining insured balance. Of the total Alt-A RMBS, $1.7 billion was rated BIG by the Company as of September 30, 2009, with $1.6 billion in net par rated BIG 2 or BIG 3. As of September 30, 2009 the Company had gross reserves, prior to reinsurance or netting of unearned premium, in this sector of $214.6 million, and net reserves of $20.4 million.

The performance of the Company's first lien RMBS exposures deteriorated during 2007 and 2008 and the first nine months of 2009 and transactions, particularly those originated in the period from 2005 through 2007, continue to perform below the Company's original underwriting expectations. Most of the projected losses in the First Lien RMBS transactions are expected to come from mortgage loans that are currently delinquent, so an increase in delinquent loans beyond those expected last quarter is one of the primary drivers of loss development in this portfolio. Like many market participants, the Company applies a liquidation rate assumption to loans in various delinquency categories to determine what proportion of loans in those categories will eventually default.

The following table shows the Company's liquidation assumptions for various delinquency categories as of September 30, 2009 and December 31, 2008:

	September 30, 2009	December 31, 2008
30 59 Days Delinquent		
Subprime	45%	48%
Option ARM	50	47
Alt-A	50	42
60 89 Days Delinquent		
Subprime	65	70
Option ARM	65	71
Alt-A	65	66
90 BK		
Subprime	70	90
Option ARM	75	91
Alt-A	75	84
Foreclosure		
Subprime	85	100
Option ARM	85	100
Alt-A	85	100
REO		
Subprime	100	100
Option ARM	100	100
Alt-A	100	100

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5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

Another important driver of loss projections in this area is loss severities, i.e. the amount of loss the transaction incurs on a loan after the application of net proceeds from the disposal of the underlying property. Loss severities experienced in first lien transactions have reached historical highs, and the Company has been revising its assumptions to match experience. The Company is assuming that loss severities begin returning to more normal levels beginning in October 2010, reducing over two or four years to either 40% or 20 points (i.e. from 60% to 40%) below their initial levels, depending on the scenario.

The following table shows the Company's initial loss severity assumptions as of September 30, 2009 and December 31, 2008:

	September 30, 2009	December 31, 2008
Subprime	70%	70%
Option ARM	60	54
Alt-A	65	54

The primary driver of the adverse development related to first lien exposure, as was the case with the Company's second lien transactions, is the result of the continued increase in delinquent mortgages. During the Third Quarter 2009, the Company modified its method of predicting losses from one where losses for both current and delinquent loans were projected using liquidation rates to a method where only the loss related to delinquent loans is calculated using liquidation rates, while losses from current loans are determined by applying a CDR trend. The Company made this change so that its methodology would be more responsive in reacting to the volatility in delinquency data. For delinquent loans, a liquidation rate is applied to loans in various stages of delinquency to determine the portion of loans in each delinquency category that will eventually default. Then, for each transaction, management calculates the constant CDR that, over the next 24 months, would be sufficient to produce the amount of losses that were calculated to emerge from the various delinquency categories. That CDR plateau is extended another three months, for a total of 27 months, in some scenarios. Each transaction's CDR is calculated to improve over 12 months to an intermediate CDR based upon its CDR plateau, then trail off to its final CDR. The intermediate CDRs modeled were between 0.5% and 7.6% for Alt-A first lien transactions, between 3.2% to 6.3% for Option ARM transactions and between 3.1% and 7.6% for Subprime transactions. The defaults resulting from the CDR after the 24 month represent the defaults that can be attributed to borrowers that are currently performing.

The assumption for the CPR follows a similar pattern to that of the CDR. The current level of voluntary prepayments is assumed to continue for the stress period before gradually increasing over 12 months to the final CPR, which is assumed to be either 10% or 15% depending on the scenario run. In the Third Quarter 2009 and Nine Months 2009, consistent with ASC 944-20, the Company modeled and probability weighted four different scenarios with differing CDR curve shapes, loss severity development assumptions and voluntary prepayment assumptions.

The performance of the collateral underlying certain of these securitizations has substantially differed from the Company's original expectations. As with the second lien policies, as of September 30, 2009 the Company had performed a detailed review of over 2,500 files representing over $1.1 billion in outstanding par of defaulted first lien loans underlying insured transactions, and a material number of defaulted loans that breach representations and warranties regarding the

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5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

characteristics of the loans. The Company continues to review new files as new loans default and as new loan files are made available to it. Following negotiation with the sellers and originators of the breaching loans, as of mid-October 2009 the Company had reached agreement to have $17.2 million of first lien loans repurchased. The Company has included in its loss estimates for first lien an estimated benefit from repurchases of $310.7 million, of which $66.2 million is netted from the Company's GAAP loss reserves, with the balance pertaining to policies whose calculated loss reserve is less than its deferred premium revenue, principally as a result of the effects of purchase accounting on AGM's financial guaranty policies. The amount the Company ultimately recovers related to contractual representations and warranties is uncertain and subject to a number of factors including the counterparty's ability to pay, the number and amount of loans determined to have breached representations and warranties and, potentially, negotiated settlements or litigation. As such, the Company's estimate of recoveries is uncertain and actual amounts realized may differ significantly from these estimates.

The Company also insures one direct nominally prime RMBS transaction rated BIG with a net outstanding par at September 30, 2009 of $52 million, which it models as an Alt-A transaction and on which it has established case reserves of $2.3 million. Finally, the Company insures Net Interest Margin ("NIM") securities with a net par outstanding as of September 30, 2009 of $103 million. While these securities are backed by First Lien RMBS, the Company no longer expects to receive any cash flow on the underlying First Lien RMBS and has, therefore, fully reserved for these transactions, with the exception of expected payments of $119.3 million from third parties to cover principal and interest on the NIMs.

The ultimate performance of the Company's First Lien RMBS transactions remains highly uncertain and may be subject to considerable volatility due to the influence of many factors, including the level and timing of loan defaults, changes in housing prices and other variables. The Company will continue to monitor the performance of its RMBS exposures and will adjust the risk ratings of those transactions based on actual performance and management's estimates of future performance.

"XXX" Life Insurance Transactions

The Company has insured $2.2 billion of net par in "XXX" life insurance reserve securitization transactions based on discrete blocks of individual life insurance business. In these transactions the monies raised by the sale of the bonds insured by the Company are used to capitalize a special purpose vehicle that provides reinsurance to a life insurer or reinsurer. The monies are invested at inception in accounts managed by third-party investment managers. In order for the Company to incur an ultimate net loss on these transactions, adverse experience on the underlying block of life insurance policies and/or credit losses in the investment portfolio would need to exceed the level of credit enhancement built into the transaction structures.

The Company's $2.2 billion in net par of XXX Life Insurance transactions includes $1.8 billion in the financial guaranty direct segment. Of the total, $882.5 million was rated BIG by the Company as of September 30, 2009, and corresponded to two transactions, classified as BIG 2 and BIG 3. These two XXX transactions had material amounts of their assets invested in US RMBS transactions.

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5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

Based on its analysis of the information currently available, including estimates of future investment performance provided by the current investment manager, projected credit impairments on the invested assets and performance of the blocks of life insurance business at September 30, 2009, the Company's gross reserve, prior to reinsurance or netting of unearned premium, for its two BIG XXX insurance transactions was $60.6 million and its net reserve was $43.2 million.

On December 19, 2008, the Company sued J.P. Morgan Investment Management Inc. ("JPMIM"), the investment manager in one of the transactions, which relates to Orkney Re II, p.l.c. ("Orkney Re II"), in New York Supreme Court alleging that JPMIM engaged in breaches of fiduciary duty, gross negligence and breaches of contract based upon its handling of the investments of Orkney Re II. On May 13, 2009, the Company filed a First Amended Complaint, additionally asserting the same claims in the name of Orkney Re II. JPMIM has filed a motion to dismiss the First Amended Complaint. The court has not yet acted upon the motion.

Public Finance Transactions

The Company has exposure to a public finance transaction for sewer service in Jefferson County, Alabama. The Company's total exposure to this transaction is approximately $597.8 million of net par, of which $238.9 million is in the financial guaranty direct segment. The Company has made debt service payments during the year and expects to make additional payments in the near term. The Company is continuing its risk remediation efforts for this exposure.

Other Sectors and Transactions

The Company continues to closely monitor other sectors and individual transactions it feels warrant the additional attention, including, as of September 30, 2009, its commercial mortgage exposure of $0.7 billion of net par, of which $0.3 billion was in the financial guaranty direct segment; its Trust Preferred Securities Collateralized Debt Obligations exposure of $1.2 billion, all of which was in the financial guaranty direct segment; and its U.S. health care exposure of $22.1 billion of net par, of which $19.6 billion was in the financial guaranty direct segment.

6. CREDIT DERIVATIVES

Certain financial guaranties written in credit derivative form, principally in the form of insured credit default swap ("CDS") contracts, have been deemed to meet the definition of a derivative under GAAP, which requires that an entity recognize all derivatives as either assets or liabilities in the consolidated balance sheet and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as a fair value, cash flow or foreign currency hedge. GAAP requires companies to recognize freestanding or embedded derivatives relating to beneficial interests in securitized financial instruments. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

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6. CREDIT DERIVATIVES (Continued)

In general, the Company structures credit derivative transactions such that the circumstances giving rise to the Company's obligation to make loss payments is similar to that for financial guaranty insurance policies and only occurs as losses are realized on the underlying reference obligation. Nonetheless, credit derivative transactions are governed by International Swaps and Derivatives Association, Inc. ("ISDA") documentation and operate differently from financial guaranty insurance policies. For example, the Company's control rights with respect to a reference obligation under a credit derivative may be more limited than when the Company issues a financial guaranty policy on a direct primary basis. In addition, while the Company's exposure under credit derivatives, like the Company's exposure under financial guaranty policies, has been generally for as long as the reference obligation remains outstanding, unlike financial guaranty insurance policies, a credit derivative may be terminated for a breach of the ISDA documentation or other specific events. If events of default or termination events specified in the credit derivative documentation were to occur, the non-defaulting or the non-affected party, which may be either the Company or the counterparty, depending upon the circumstances, may decide to terminate a credit derivative prior to maturity. The Company may be required to make a termination payment to its swap counterparty upon such termination.

Some of the Company's CDS have rating triggers that allow certain CDS counterparties to terminate in the case of downgrades. If certain of its credit derivative contracts were terminated the Company could be required to make a termination payment as determined under the relevant documentation, although under certain documents, the Company may have the right to cure the termination event by posting collateral, assigning its rights and obligations in respect of the transactions to a third party or seeking a third party guaranty of the obligations of the Company. As of September 30, 2009, if AGC's ratings were downgraded to levels between BBB or Baa2 and BB+ or Ba1, certain CDS counterparties could terminate certain CDS contracts covering approximately $7.3 billion par insured, compared to approximately $7.7 billion as of June 30, 2009. As of September 30, 2009, if AGRO's ratings were downgraded to BBB- or Baa3, certain CDS counterparties could terminate certain CDS contracts covering approximately $3.1 million par insured. As of September 30, 2009, AG Re had no CDS exposure subject to termination based on its rating. The Company does not believe that it can accurately estimate the termination payments it could be required to make if, as a result of any such downgrade, a CDS counterparty terminated its CDS contracts with the Company. These payments could have a material adverse effect on the Company's liquidity and financial condition.

Under a limited number of other CDS contracts, the Company may be required to post eligible securities as collateral generally cash or U.S. government or agency securities. This requirement is based generally on a mark-to-market valuation in excess of contractual thresholds that decline if the Company's ratings decline. As of September 30, 2009, the Company had posted approximately $570.6 million of collateral in respect of approximately $19.8 billion of par insured. Upon the downgrade of AGC by Moody's on November 12, 2009, certain of the thresholds set out in the CDS contracts were eliminated, and as of November 16, 2009, the amount of par that the Company has subject to collateral posting requirements is approximately $20.38 billion. Accordingly, the Company may be required to post incremental collateral in addition to the $570.6 million already being posted. Amounts required to be posted as collateral in the future will depend the market values of the transactions subject to the collateral posting, which market values change from time to time.

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SEPTEMBER 30, 2009

6. CREDIT DERIVATIVES (Continued)

As of November 16, 2009, if AGC were further downgraded, additional contractual thresholds would be eliminated and the amount of par that the Company would have subject to collateral posting requirements would increase to approximately $20.41 billion in the case of a downgrade below AA- or Aa3 to A+ or A1, and approximately $20.49 billion in the case of a downgrade below A- or A3 to BBB+ or Baa1 or below. In each case, the actual amounts required to be posted would be based on market conditions at the time of the posting and the applicable CDS contracts. Any such amounts posted could have a material adverse effect on the Company's liquidity.

As of September 30, 2009, AGM had no CDS exposure subject to termination based on its rating, or subject to collateral posting.

"Realized gains and other settlements" on credit derivatives include credit derivative premiums received and receivable for credit protection the Company has sold under its insured CDS contracts, premiums paid and payable for credit protection the Company has purchased as well as any contractual claim losses paid and payable and received and receivable related to insured credit events under these contracts, ceding commissions (expense) income and realized gains or losses related to their early termination.

The following table disaggregates realized gains and other settlements on credit derivatives into its component parts for the Third Quarter and Nine Months 2009 and 2008:

Realized Gains and Other Settlements on Credit Derivatives

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in thousands)			
Realized gains and other settlements on credit derivatives				
Net credit derivative premiums received and receivable	$ 57,447	$ 30,545	$ 114,915	$ 89,853
Net credit derivative losses (paid and payable) recovered and recoverable	14,270	30	5,227	410
Ceding commissions received/receivable (paid/payable), net	(26)	(615)	(56)	(893)
Total realized gains and other settlements on credit derivatives	$ 71,691	$ 29,960	$ 120,086	$ 89,370

"Net unrealized gains (losses)" on credit derivatives represent the adjustments for changes in fair value that are recorded in each reporting period, under ASC 815-10. Changes in unrealized gains and losses on credit derivatives are reflected in the consolidated statements of operations in "net unrealized gains (losses)" on credit derivatives. Cumulative unrealized losses, determined on a contract by contract basis, are reflected as either net assets or net liabilities in the Company's balance sheets. Unrealized gains and losses resulting from changes in the fair value of credit derivatives occur because of changes in interest rates, credit spreads, the credit ratings of the referenced entities and the issuing company's own credit rating and other market factors. The unrealized gains and losses on credit derivatives will reduce to zero as the exposure approaches its maturity date, unless there is a payment default on the exposure or early termination. If unrealized losses on credit derivatives reduce the Company's

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6. CREDIT DERIVATIVES (Continued)

consolidated net worth to less than 75% of the consolidated net worth of the Company as of the quarter ended June 30, 2009, the Company would be in violation of its financial covenants in its 2006 credit facility. See Note 12.

The Company determines the fair value of its credit derivative contracts primarily through modeling that uses various inputs to derive an estimate of the value of the Company's contracts in principal markets. See Note 7. Inputs include expected contractual life and credit spreads, based on observable market indices and on recent pricing for similar contracts. Credit spreads capture the impact of recovery rates and performance of underlying assets, among other factors, on these contracts. The Company's pricing model takes into account not only how credit spreads on risks that it assumes affect pricing, but also how the Company's own credit spread affects the pricing of its deals. If credit spreads of the underlying obligations change, the fair value of the related credit derivative changes. Market liquidity could also impact valuations of the underlying obligations.

The impact of changes in credit spreads will vary based upon the volume, tenor, interest rates, and other market conditions at the time these fair values are determined. In addition, since each transaction has unique collateral and structure terms, the underlying change in fair value of each transaction may vary considerably. The fair value of credit derivative contracts also reflects the change in the Company's own credit cost, based on the price to purchase credit protection on AGC and AGM. During Third Quarter 2009 and Nine Months 2009, the Company incurred net pre-tax unrealized losses on credit derivatives of $205.3 million and $432.6 million, respectively. As of September 30, 2009 the net credit liability included a reduction in the liability of $6,716.1 million representing AGC's and AGM's credit value adjustment, which was based on the market cost of AGC's and AGM's credit protection of 825 and 660 basis points, respectively. Management believes that the trading level of AGC's and AGM's credit spread was due to the correlation between AGC's and AGM's risk profile and that experienced currently by the broader financial markets and increased demand for credit protection against AGC and AGM as the result of its financial guaranty direct segment financial guarantee volume, as well as the overall lack of liquidity in the CDS market. Offsetting the benefit attributable to AGC's and AGM's credit spread were declines in fixed income security market prices primarily attributable to widening spreads in certain markets as a result of the continued deterioration in credit markets and some credit rating downgrades. The higher credit spreads in the fixed income security market were primarily due to continuing market concerns over the most recent vintages of Subprime RMBS and trust-preferred securities.

During Third Quarter and Nine Months 2008, the Company incurred net pre-tax unrealized losses of $116.2 million and unrealized gains of $332.6 million on credit derivatives, respectively. The Third Quarter 2008 loss included a gain of $668.0 million associated with the change in AGC's credit spread, which widened substantially from 900 basis points at June 30, 2008 to 1,255 basis points at September 30, 2008.

The total notional amount of credit derivative exposure outstanding as of September 30, 2009 and December 31, 2008 and included in the Company's financial guaranty exposure was $123.4 billion and $75.1 billion, respectively.

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6. CREDIT DERIVATIVES (Continued)

The components of the Company's unrealized gain (loss) on credit derivatives as of and for the three and nine months ended September 30, 2009 are:

Asset Type	As of September 30, 2009 Net Par Outstanding	Weighted Average Credit Rating(1)	Third Quarter 2009 Unrealized Gain (Loss)	Nine Months 2009 Unrealized Gain (Loss)
	(in billions)		(in millions)	
Financial Guaranty Direct:				
Pooled corporate obligations:				
High yield corporates	$ 60.7	AAA	$ 47.9	$ (28.0)
Trust preferred securities	6.1	BBB-	(32.3)	(32.6)
Market value CDOs of corporate obligations	5.5	AAA	(0.8)	(8.1)
Investment grade corporates	14.8	AAA*(2)	(21.6)	(18.7)
CDO of CDOs (corporate)			6.6	6.3
Total pooled corporate obligations	87.1	AAA	(0.2)	(81.1)
U.S. RMBS:				
Prime first lien	3.1	A+	(31.3)	(70.0)
Alt-A first lien	6.2	BB+	(41.8)	(287.6)
Subprime lien	5.5	A+	(1.5)	2.2
Total U.S. RMBS	14.8	A-	(74.6)	(355.4)
Commercial mortgage-backed securities	7.3	AAA	0.1	(31.9)
Other	12.6	AA-	(102.2)	52.3
Total Financial Guaranty Direct	121.8	AA+	(176.9)	(416.1)
Financial Guaranty Reinsurance	1.6	AA+	(28.4)	(16.5)
Total	**$ 123.4**	**AA+**	**$ (205.3)**	**$ (432.6)**

(1) Based on the Company's internal rating, which is on a ratings scale similar to that used by the nationally recognized rating agencies.

(2) The "super senior category," which is not a category generally used by rating agencies, is used by the Company in instances where the Company's triple-A rated exposure has additional credit enhancement due to either (1) the existence of another security rated triple-A that is subordinated to the Company's exposure or (2) the Company's exposure benefits from a different from of credit enhancement that would pay any claims first in the event that any of the exposures incurs a loss, and such credit enhancement, in management's opinion, causes the Company's attachment point to be materially above the triple-A attachment point.

Corporate collateralized loan obligations ("CLOs"), synthetic pooled corporate obligations, market value CDOs, and trust preferred securities ("TRUPS"), which comprise the Company's pooled corporate exposures, include all U.S. structured finance pooled corporate obligations and international pooled corporate obligations. RMBS are comprised of prime and Subprime U.S. mortgage-backed and home equity securities, international RMBS and international home equity securities. Commercial

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

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6. CREDIT DERIVATIVES (Continued)

mortgage-backed securities are comprised of commercial U.S. structured finance and commercial international mortgage backed securities. "Other" includes all other U.S. and international asset classes, such as commercial receivables, and international infrastructure and pooled infrastructure securities.

The Company's exposure to pooled corporate obligations is highly diversified in terms of obligors and, except in the case of TRUPS, industries. Most pooled corporate transactions are structured to limit exposure to any given obligor and industry. The majority of the Company's pooled corporate exposure in the financial guaranty direct segment consists of CLOs or synthetic pooled corporate obligations. Most of these direct CLOs have an average obligor size of less than 1% and typically restrict the maximum exposure to any one industry to approximately 10%. The Company's exposure also benefits from embedded credit enhancement in the transactions which allows a transaction to sustain a certain level of losses in the underlying collateral, further insulating the Company from industry specific concentrations of credit risk on these deals.

The Company's $12.6 billion exposure to "Other" CDS contracts is also highly diversified. It includes $4.3 billion of exposure to four pooled infrastructure transactions comprised of diversified pools of international infrastructure project transactions and loans to regulated utilities. These pools were all structured with underlying credit enhancement sufficient for the Company to attach at super senior AAA levels. The remaining $8.3 billion of exposure in "Other" CDS contracts is comprised of numerous deals typically structured with significant underlying credit enhancement and spread across various asset classes, such as commercial receivables, infrastructure, regulated utilities and consumer receivables. Substantially all of this $12.6 billion of exposure is rated investment grade and the weighted average credit rating is AA-.

The unrealized loss of $102.2 million in Third Quarter 2009 and unrealized gain of $52.3 million in Nine Months 2009 on "Other" CDS contracts is primarily attributable to implied spread widening during Third Quarter 2009 on a U.S. infrastructure transaction, a XXX life insurance securitization and a film securitization transaction.

With considerable volatility continuing in the market, unrealized gains (losses) on credit derivatives may fluctuate significantly in future periods.

The Company's exposure to the mortgage industry is discussed in Note 5.

As of September 30, 2009 and December 31, 2008, the Company considered the impact of its own credit risk, in combination with credit spreads on risk that it assumes through CDS contracts, in determining the fair value of its credit derivatives. The Company determines its own credit risk based on quoted CDS prices traded on the Company at each balance sheet date. The quoted price of CDS contracts traded on AGC at September 30, 2009 and December 31, 2008 was 825 basis points and 1,775 basis points, respectively. The quoted price of CDS contracts traded on AGM at September 30, 2009 and December 31, 2008 was 660 basis points and 1,420 basis points, respectively. Historically, the price of CDS traded on AGC and AGM moves directionally the same as general market spreads. Generally, a widening of the CDS prices traded on AGC and AGM has an effect of offsetting unrealized losses that result from widening general market credit spreads, while a narrowing of the CDS prices traded on AGC and AGM has an effect of offsetting unrealized gains that result from narrowing general market credit spreads. An overall narrowing of spreads generally results in an unrealized gain on credit derivatives for the Company and an overall widening of spreads generally results in an unrealized loss

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6. CREDIT DERIVATIVES (Continued)

for the Company. At September 30, 2009, the values of the Company's CDS contracts before and after considering implications of the Company's credit spreads were negative $7,991.9 million and negative $1,275.8 million, respectively. At December 31, 2008, the values of the Company's CDS contracts before and after considering implications of the Company's credit spreads were negative $4,686.8 million and negative $539.2 million, respectively.

The following table presents additional details about the Company's unrealized loss on pooled corporate obligation credit derivatives by asset type, as of September 30, 2009:

Asset Type	Original Subordination(1)	Current Subordination(1)	Net Par Outstanding (in billions)	Weighted Average Credit Rating(2)	Third Quarter 2009 Unrealized Gain (Loss) (in millions)	Nine Months 2009 Unrealized Gain (Loss) (in millions)
High yield corporate obligations	32.5%	28.0%	$ 60.7	AAA	$ 47.9	$ (28.0)
Trust preferred securities	46.6	38.0	6.1	BBB-	(32.3)	(32.6)
Market value CDOs of corporate obligations	32.1	39.3	5.5	AAA	(0.8)	(8.1)
Investment grade corporate obligations	19.2	17.8	14.8	AAA*(3)	(21.6)	(18.7)
CDO of CDOs (corporate obligations)					6.6	6.3
Total	**31.2%**	**27.7%**	**$ 87.1**	**AAA**	**$ (0.2)**	**$ (81.1)**

(1) Represents the sum of subordinate tranches and over-collateralization and does not include any benefit from excess interest collections that may be used to absorb losses.

(2) Based on the Company's internal rating, which is on a ratings scale similar to that used by the nationally recognized rating agencies.

(3) The "super senior category," which is a category not generally used by rating agencies, is used by the Company in instances where the Company's triple A-rated exposure has additional credit enhancement due to either (1) the existence of another security rated triple A that is subordinated to the Company's exposure or (2) the Company's exposure benefits from a different form of credit enhancement that would pay any claims first in the event that any of the exposures incurs a loss, and such credit enhancement, in management's opinion, causes the Company's attachment point to be materially above the triple A attachment point.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

6. CREDIT DERIVATIVES (Continued)

The following table presents additional details about the Company's unrealized gain (loss) on credit derivatives associated with commercial mortgage-backed securities by vintage as of September 30, 2009:

Vintage	Original Subordination(1)	Current Subordination(1)	Net Par Outstanding (in billions)	Weighted Average Credit Rating(2)	Third Quarter 2009 Unrealized Gain (Loss) (in millions)	Nine Months 2009 Unrealized Gain (Loss) (in millions)
2004 and Prior	26.1%	37.7%	$ 0.9	AAA	$ (0.3)	$ (0.6)
2005	27.2	25.8	3.7	AAA	0.2	(18.6)
2006	29.7	28.7	2.0	AAA	0.2	(10.1)
2007	46.6	44.8	0.7	AAA	(0.0)	(2.6)
2008						
2009						
Total	**29.6%**	**29.9%**	**$ 7.3**	**AAA**	**$ 0.1**	**$ (31.9)**

(1) Represents the sum of subordinate tranches and over-collateralization and does not include any benefit from excess interest collections that may be used to absorb losses.

(2) Based on the Company's internal rating, which is on a ratings scale similar to that used by the nationally recognized rating agencies.

The following tables present additional details about the Company's unrealized loss on credit derivatives associated with RMBS by vintage and asset type as of September 30, 2009:

Vintage	Original Subordination(1)	Current Subordination(1)	Net Par Outstanding (in billions)	Weighted Average Credit Rating(2)	Third Quarter 2009 Unrealized Gain (Loss) (in millions)	Nine Months 2009 Unrealized Gain (Loss) (in millions)
2004 and Prior	5.6%	16.0%	$ 0.8	AA+	$ (0.1)	$ 32.9
2005	26.4	56.1	3.8	AA-	(1.4)	(1.3)
2006	18.4	25.2	3.6	A+	(19.0)	(19.6)
2007	18.5	19.5	6.6	BB+	(54.1)	(367.4)
2008						
2009						
Total	**20.3%**	**30.8%**	**$ 14.8**	**A-**	**$ (74.6)**	**$ (355.4)**

(1) Represents the sum of subordinate tranches and over-collateralization and does not include any benefit from excess interest collections that may be used to absorb losses.

(2) Based on the Company's internal rating, which is on a ratings scale similar to that used by the nationally recognized rating agencies.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

6. CREDIT DERIVATIVES (Continued)

Asset Type	Original Subordination(1)	Current Subordination(1)	Net Par Outstanding (in billions)	Weighted Average Credit Rating(2)	Third Quarter 2009 Unrealized Gain (Loss) (in millions)	Nine Months 2009 Unrealized Gain (Loss) (in millions)
Alt-A loans	20.3%	22.1%	$ 6.2	BB+	$ (41.8)	$ (287.6)
Prime first lien	9.1	12.2	3.1	A+	(31.3)	(70.0)
Subprime lien	27.5	53.0	5.5	A+	(1.5)	2.2
Total	**20.3%**	**30.8%**	**$ 14.8**	**A-**	**$ (74.6)**	**$ (355.4)**

(1) Represents the sum of subordinate tranches and over-collateralization and does not include any benefit from excess interest collections that may be used to absorb losses.

(2) Based on the Company's internal rating, which is on a ratings scale similar to that used by the nationally recognized rating agencies.

The following table summarizes the estimated change in fair values on the net balance of the Company's credit derivative positions assuming immediate parallel shifts in credit spreads on AGC and AGM and on the risks that they both assume at September 30, 2009:

Credit Spreads(1)	Estimated Net Fair Value (Pre-Tax)	Estimated Pre-Tax Change in Gain/(Loss)
	(in millions)	
September 30, 2009:		
100% widening in spreads	$ (3,734.5)	$ (2,458.7)
50% widening in spreads	(2,506.1)	(1,230.3)
25% widening in spreads	(1,891.9)	(616.1)
10% widening in spreads	(1,524.2)	(248.4)
Base Scenario	(1,275.8)	
10% narrowing in spreads	(1,095.8)	180.0
25% narrowing in spreads	(826.2)	449.6
50% narrowing in spreads	(380.6)	895.2

(1) Includes the effects of spreads on both the underlying asset classes and the Company's own credit spread.

The Company had no derivatives designated as hedges during 2009 and 2008.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount and estimated fair value of financial instruments are presented in the following table:

	As of September 30, 2009		As of December 31, 2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in thousands)			
Assets:				
Fixed maturity securities	$ 8,448,099	$ 8,448,099	$ 3,154,137	$ 3,154,137
Cash and short-term investments	1,753,375	1,753,375	489,502	489,502
Credit derivative assets	462,298	462,298	146,959	146,959
Assets acquired in refinancing transactions	159,180	163,824		
Committed capital securities, at fair value	38,516	38,516		
Financial guaranty variable interest entities assets	706,611	706,611		
Other assets	19,536	19,536		
Liabilities:				
Financial guaranty insurance contracts(1)	7,677,316	8,715,390	1,233,714	1,785,769
Long-term debt:				
7.0% Senior Notes	197,471	129,780	197,443	105,560
8.50% Senior Notes	169,923	142,313		
Series A Enhanced Junior Subordinated Debentures	149,789	93,750	149,767	37,500
6$^7/_8$% QUIBS	66,571	66,400		
6.25% Notes	133,658	138,000		
5.60% Notes	52,407	54,000		
Junior Subordinated Debentures	145,418	181,500		
Note payable to related party	155,827	157,657		
Credit derivative liabilities	2,100,465	2,100,465	733,766	733,766
Financial guaranty variable interest entities liabilities	841,719	841,719		
Off-Balance Sheet Instruments:				
Financial guaranty contracts future installment premiums				463,407

(1) Includes the balance sheet amounts related to financial guaranty insurance contract premiums and losses, net of reinsurance.

Background

Effective January 1, 2008, the Company adopted ASC 820-10. ASC 820-10 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. ASC 820-10 applies to other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements.

ASC 820-10 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. The price represents the price available in the principal market for the asset or liability. If there is no principal market, then the price is based on the market that maximizes the value received for an asset or minimizes the amount paid for a liability (i.e. the most advantageous market).

ASC 820-10 specifies a fair value hierarchy based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

obtained from independent sources, while unobservable inputs reflect Company estimates of market assumptions. In accordance with ASC 820-10, the fair value hierarchy prioritizes model inputs into three broad levels as follows:

Level 1 Quoted prices for identical instruments in active markets.

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and observable inputs other than quoted prices, such as interest rates or yield curves and other inputs derived from or corroborated by observable market inputs.

Level 3 Model derived valuations in which one or more significant inputs or significant value drivers are unobservable. This hierarchy requires the use of observable market data when available. Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation.

An asset or liability's categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation.

Financial Instruments Carried at Fair Value on a Recurring Basis

The measurement provision of ASC 820-10 applies to both amounts recorded in the Company's financial statements and to disclosures. Amounts recorded at fair value in the Company's financial statements on a recurring basis are included in the tables below. The fair value of these items as of September 30, 2009 is summarized in the following table.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Fair Value Hierarchy of Financial Instruments
Recurring Basis
As of September 30, 2009

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in millions)		
Assets				
Investment portfolio, available-for-sale:				
Fixed maturity securities:				
U.S. government and agencies	$ 988.9	$	$ 988.9	$
Obligations of state and political subdivisions	5,239.6		5,239.6	
Corporate securities	370.3		370.3	
Mortgage-backed securities:				
Residential mortgage-backed securities	1,196.3		1,196.3	
Commercial mortgage-backed securities	246.9		246.9	
Asset-backed securities	54.8		54.8	
Foreign government securities	351.3		351.3	
Short-term investments	1,492.9	471.1	1,018.8	
Cash	260.5	260.5		
Credit derivative assets	462.3			462.3
Committed capital securities, at fair value	38.5		38.5	
Other assets:				
Equity securities	2.5	2.5		
DCP and SERP(1)	17.1	17.1		
Total assets	$ 10,754.8	$ 754.2	$ 9,505.4	$ 495.2
Liabilities				
Credit derivative liabilities	$ 2,100.5	$	$	$ 2,100.5
Total liabilities	$ 2,100.5	$	$	$ 2,100.5

(1) Represents assets that economically defease the Company's liability for deferred compensation plans ("DCP") and supplemental executive retirement plans ("SERP").

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Fair Value Hierarchy of Financial Instruments
Recurring Basis
As of December 31, 2008(1)

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in millions)		
Investment portfolio, available-for-sale:				
Fixed maturity securities:				
U.S. government and agencies	$ 475.9	$	$ 475.9	$
Obligations of state and political subdivisions	1,217.7		1,217.7	
Corporate securities	268.2		268.2	
Mortgage-backed securities:				
Residential mortgage-backed securities	830.3		830.3	
Commercial mortgage-backed securities	221.5		221.5	
Asset-backed securities	73.6		73.6	
Foreign government securities	54.5		54.5	
Preferred stock	12.4		12.4	
Short-term investments	477.2	47.8	429.4	
Cash	12.3	12.3		
Credit derivative assets	147.0			147.0
Committed capital securities, at fair value	51.1		51.1	
Total assets	$ 3,841.7	$ 60.1	$ 3,634.6	$ 147.0
Liabilities				
Credit derivative liabilities	$ 733.8	$	$	$ 733.8
Total liabilities	$ 733.8	$	$	$ 733.8

(1) Reclassified to conform to the current period's presentation.

Fixed Maturity Securities and Short-term Investments

The fair value of fixed maturity securities and short-term investments is determined using one of three different pricing services: pricing vendors, index providers or broker-dealer quotations. Pricing services for each sector of the market are determined based upon the provider's expertise.

The Company's third-party investment manager obtains prices from pricing services, index providers or broker-dealers. From time to time a pricing source may be updated to improve consistency of coverage and/or accuracy of prices.

Generally one price is obtained for each security. Where multiple prices are obtained, the investment manager maintains a hierarchy by asset class to prioritize the pricing source to be used. The investment manager performs daily and monthly controls to ensure completeness and accuracy of security prices, such as reviewing missing price or stale price data and day-over-day variance reports by asset class. The investment manager maintains a valuation oversight committee that is required to approve all changes in pricing practices and policies.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Fixed maturity securities are valued by broker-dealers, pricing services or index providers using standard market conventions. The market conventions utilize market quotations, market transactions in comparable instruments, and various relationships between instruments such as yield to maturity, dollar prices and spread prices in determining value. Generally, all of the Company's fixed maturity securities are priced using matrix pricing. The Company used no model processes to price its fixed maturity securities as of September 30, 2009.

Broker-dealer quotations obtained to price securities are generally considered to be indicative and are nonactionable (i.e. non-binding).

The Company is provided with a pricing chart, which for each asset class provides the pricing source, pricing methodology and recommended ASC 820-10 fair value level. The Company reviews the pricing source of each security each reporting period to determine the method of pricing and appropriateness of ASC 820-10 fair value level. The Company considers securities prices from pricing services, index providers or broker-dealers to be Level 2 in the ASC 820-10 fair value hierarchy. Prices determined based upon model processes are considered to be Level 3 in the ASC 820-10 fair value hierarchy. No investments were classified as Level 3 as of or for the three- and nine-month periods ended September 30, 2009.

The Company did not make any internal adjustments to prices provided by its third party pricing service.

Committed Capital Securities

The fair value of committed capital securities ("CCS Securities") represents the present value of remaining expected put option premium payments under the CCS Securities agreements and the value of such estimated payments based upon the quoted price for such premium payments as of September 30, 2009 (see Note 12). The $38.5 million fair value asset for CCS Securities is included in the consolidated balance sheet. Changes in fair value of this asset are included in the consolidated statement of operations. The significant market inputs used are observable, therefore, the Company classified this fair value measurement as Level 2.

Credit Derivatives

The Company's credit derivatives consist primarily of insured CDS contracts, as well as NIM securitization and interest rate swaps (see Note 6). The Company does not typically exit its credit derivative contracts, and there are no quoted prices for its instruments or for similar instruments. Observable inputs other than quoted market prices exist; however, these inputs reflect contracts that do not contain terms and conditions similar to the credit derivative contracts issued by the Company. Therefore, the valuation of credit derivative contracts requires the use of models that contain significant, unobservable inputs. The Company accordingly believes the credit derivative valuations are in Level 3 in the fair value hierarchy discussed above.

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining expected premiums the Company receives for the credit protection and the estimated present value of premiums that a comparable financial guarantor would hypothetically charge the Company for the same protection at the balance sheet date. The fair value of the Company's credit

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

derivatives depends on a number of factors, including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of referenced entities, the Company's own credit risk and remaining contractual cash flows.

Market conditions at September 30, 2009 were such that market prices of the Company's CDS contracts were not generally available. Where market prices were not available, the Company used a combination of observable market data and valuation models, using various market indices, credit spreads, the Company's own credit risk, and estimated contractual payments to estimate the "Unrealized gains (losses) on credit derivatives" portion of the fair value of its credit derivatives. These models are primarily developed internally based on market conventions for similar transactions.

Management considers the non-standard terms of its credit derivative contracts in determining the fair value of these contracts. These terms differ from credit derivatives sold by companies outside the financial guaranty industry. The non-standard terms include the absence of collateral support agreements or immediate settlement provisions, relatively high attachment points and the fact that the Company does not exit derivatives it sells for credit protection purposes, except under specific circumstances such as novations upon exiting a line of business. Because of these terms and conditions, the fair value of the Company's credit derivatives may not reflect the same prices observed in an actively traded market of credit derivatives that do not contain terms and conditions similar to those observed in the financial guaranty market. These models and the related assumptions are continuously reevaluated by management and enhanced, as appropriate, based upon improvements in modeling techniques and availability of more timely market information.

Valuation models include the use of management estimates and current market information. Management is also required to make assumptions on how the fair value of credit derivative instruments is affected by current market conditions. Management considers factors such as current prices charged for similar agreements, performance of underlying assets, life of the instrument, and the extent of credit derivative exposure the Company ceded under reinsurance agreements, and the nature and extent of activity in the financial guaranty credit derivative marketplace. The assumptions that management uses to determine its fair value may change in the future due to market conditions. Due to the inherent uncertainties of the assumptions used in the valuation models to determine the fair value of these credit derivative products, actual experience may differ from the estimates reflected in the Company's consolidated financial statements and the differences may be material.

Assumptions and Inputs

Listed below are various inputs and assumptions that are key to the establishment of the Company's fair value for CDS contracts.

The key assumptions of the Company's internally developed model include the following:

> Gross spread is the difference between the yield of a security paid by an issuer on an insured versus uninsured basis or, in the case of a CDS transaction, the difference between the yield and an index such as the London Interbank Offered Rate ("LIBOR"). Such pricing is well established by historical financial guaranty fees relative to capital market spreads as observed and executed in competitive markets, including in financial guaranty reinsurance and secondary market transactions.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Gross spread on a financial guaranty written in CDS form is allocated among:

1. the profit the originator, usually an investment bank, realizes for putting the deal together and funding the transaction;

2. premiums paid to the Company for the Company's credit protection provided; and

3. the cost of CDS protection purchased on the Company by the originator to hedge their counterparty credit risk exposure to the Company.

The premium the Company receives is referred to as the "net spread." The Company's own credit risk is factored into the determination of net spread based on the impact of changes in the quoted market price for credit protection bought on the Company, as reflected by quoted market prices on CDS sold on AGC. The cost to acquire CDS protection sold on AGC affects the amount of spread on CDS deals that the Company captures and, hence, their fair value. As the cost to acquire CDS protection sold on AGC increases, the amount of premium the Company captures on a deal generally decreases. As the cost to acquire CDS protection sold on AGC decreases, the amount of premium the Company captures on a deal generally increases. In the Company's model, the premium the Company captures is not permitted to go below the minimum rate that the Company would currently charge to assume similar risks. This has the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts.

The Company determines the fair value of its CDS contracts by applying the net spread for the remaining duration of each contract to the notional value of its CDS contracts.

Actual transactions are used to validate the model results and to explain the correlation between various market indices and indicative CDS market prices.

The Company's specific model inputs are gross spread, credit spreads on risks assumed and credit spreads on the Company's name.

Gross spread is an input into the Company's fair value model that is used to ultimately determine the net spread a comparable financial guarantor would charge the Company to transfer risk at the reporting date. The Company's estimate of fair value represents the difference between the estimated present value of premiums that a comparable financial guarantor would accept to assume the risk from the Company on the current reporting date, on terms identical to the original contracts written by the Company and at the contractual premium for each individual credit derivative contract. This is an observable input that the Company obtains for deals it has closed or bid on in the market place.

The Company obtains credit spreads on risks assumed from market data sources published by third parties (e.g. dealer spread tables for the collateral similar to assets within the Company's transactions) as well as collateral-specific spreads provided by trustees or obtained from market sources. If observable market credit spreads are not available or reliable for the underlying reference obligations, then market indices are used that most closely resembles the underlying reference obligations, considering asset class, credit quality rating and maturity of the underlying reference obligations. As discussed previously, these indices are adjusted to reflect the non-standard terms of the Company's CDS contracts. As of September 30, 2009, the Company obtained approximately 9% of its credit spread

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

data, based on notional par outstanding, from sources published by third parties, while 91% was obtained from market sources or similar market indices. Market sources determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. Management validates these quotes by cross-referencing quotes received from one market source against quotes received from another market source to ensure reasonableness. In addition, the Company compares the relative change in price quotes received from one quarter to another, with the relative change experienced by published market indices for a specific asset class. Collateral specific spreads obtained from third-party, independent market sources are un-published spread quotes from market participants and or market traders whom are not trustees. Management obtains this information as the result of direct communication with these sources as part of the valuation process.

For credit spreads on the Company's name the Company obtains the quoted price of CDS contracts traded on AGC and AGM from market data sources published by third parties.

Example

The following is an example of how changes in gross spreads, the Company's own credit spread and the cost to buy protection on the Company affect the amount of premium the Company can demand for its credit protection. Scenario 1 represents the market conditions in effect on the transaction date and Scenario 2 represents market conditions at a subsequent reporting date.

	Scenario 1		**Scenario 2**	
	bps	**% of Total**	**bps**	**% of Total**
Original Gross Spread/Cash Bond Price (in Bps)	185		500	
Bank Profit (in Bps)	115	62%	50	10%
Hedge Cost (in Bps)	30	16	440	88
AGC Premium Received Per Annum (in Bps)	40	22	10	2

In Scenario 1, the gross spread is 185 basis points. The bank or deal originator captures 115 basis points of the original gross spread and hedges 10% of its exposure to AGC, when the CDS spread on AGC was 300 basis points (300 basis points × 10% = 30 basis points). Under this scenario AGC received premium of 40 basis points, or 22% of the gross spread.

In Scenario 2, the gross spread is 500 basis points. The bank or deal originator captures 50 basis points of the original gross spread and hedges 25% of its exposure to AGC, when the CDS spread on AGC was 1,760 basis points (1,760 basis points × 25% = 440 basis points). Under this scenario AGC would receive premium of 10 basis points, or 2% of the gross spread.

In this example, the contractual cash flows (the AGC premium above) exceed the amount a market participant would require AGC to pay in today's market to accept its obligations under the CDS contract, thus resulting in an asset. This credit derivative asset is equal to the difference in premium rate discounted at the corresponding London Inter-Bank Offer Rate ("LIBOR") over the weighted average remaining life of the contract. The expected future cash flows for the Company's credit derivatives were discounted at rates ranging from 0.5% to 4% at September 30, 2009.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The Company corroborates the assumptions in its fair value model, including the amount of exposure to AGC hedged by its counterparties, with independent third parties each reporting period. Recent increases in the CDS spread on AGC have resulted in the bank or deal originator hedging a greater portion of its exposure to AGC. This has the effect of reducing the amount of contractual cash flows AGC can capture for selling its protection.

The amount of premium a financial guaranty insurance market participant can demand is inversely related to the cost of credit protection on the insurance company as measured by market credit spreads. This is because the buyers of credit protection typically hedge a portion of their risk to the financial guarantor, due to the fact that contractual terms of financial guaranty insurance contracts typically do not require the posting of collateral by the guarantor. The widening of a financial guarantor's own credit spread increases the cost to buy credit protection on the guarantor, thereby reducing the amount of premium the guarantor can capture out of the gross spread on the deal. The extent of the hedge depends on the types of instruments insured and the current market conditions.

A credit derivative asset under ASC 820-10 is the result of contractual cash flows on in-force deals in excess of what a hypothetical financial guarantor could receive if it sold protection on the same risk as of the current reporting date. If the Company were able to freely exchange these contracts (i.e., assuming its contracts did not contain proscriptions on transfer and there was a viable exchange market), it would be able to realize an asset representing the difference between the higher contractual premiums to which it is entitled and the current market premiums for a similar contract.

To clarify, management does not believe there is an established market where financial guaranty insured credit derivatives are actively traded. The terms of the protection under an insured financial guaranty credit derivative do not, except for certain rare circumstances, allow the Company to exit its contracts. Management has determined that the exit market for the Company's credit derivatives is a hypothetical one based on its entry market. Management has tracked the historical pricing of the Company's deals to establish historical price points in the hypothetical market that are used in the fair value calculation.

The following spread hierarchy is utilized in determining which source of spread to use, with the rule being to use CDS spreads where available. If not available, the Company either interpolates or extrapolates CDS spreads based on similar transactions or market indices.

- Actual collateral specific credit spreads (if up-to-date and reliable market-based spreads are available, they are used).
- Credit spreads are interpolated based upon market indices or deals priced or closed during a specific quarter within a specific asset class and specific rating.
- Credit spreads provided by the counterparty of the CDS.
- Credit spreads are extrapolated based upon transactions of similar asset classes, similar ratings, and similar time to maturity.

Over time the data inputs can change as new sources become available or existing sources are discontinued or are no longer considered to be the most appropriate. It is the Company's objective to move to higher levels on the hierarchy whenever possible, but it is sometimes necessary to move to

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

lower priority inputs because of discontinued data sources or management's assessment that the higher priority inputs are no longer considered to be representative of market spreads for a given type of collateral. This can happen, for example, if transaction volume changes such that a previously used spread index is no longer viewed as being reflective of current market levels.

As of September 30, 2009, the Company obtained approximately 5% of its credit spread information, based on notional par outstanding, from actual collateral specific credit spreads, while 91% was based on market indices and 4% was based on spreads provided by the CDS counterparty. The Company interpolates a curve based on the historical relationship between premium the Company receives when a financial guaranty written in CDS form closes to the daily closing price of the market index related to the specific asset class and rating of the deal. This curve indicates expected credit spreads at each indicative level on the related market index. For specific transactions where no price quotes are available and credit spreads need to be extrapolated, an alternative transaction for which the Company has received a spread quote from one of the first three sources within the Company's spread hierarchy is chosen. This alternative transaction will be within the same asset class, have similar underlying assets, similar credit ratings, and similar time to maturity. The Company then calculates the percentage of relative spread change quarter over quarter for the alternative transaction. This percentage change is then applied to the historical credit spread of the transaction for which no price quote was received in order to calculate the transactions current spread. Counterparties determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. These quotes are validated by cross-referencing quotes received from one market source with those quotes received from another market source to ensure reasonableness. In addition, management compares the relative change experienced on published market indices for a specific asset class for reasonableness and accuracy.

Strengths and Weaknesses of Model

The Company's credit derivative valuation model, like any financial model, has certain strengths and weaknesses.

The primary strengths of the Company's CDS modeling techniques are:

- The model takes account of transaction structure and the key drivers of market value. The transaction structure includes par insured, weighted average life, level of subordination and composition of collateral.

- The model maximizes the use of market-driven inputs whenever they are available. The key inputs to the model are market-based spreads for the collateral, and the credit rating of referenced entities. These are viewed by the Company to be the key parameters that affect fair value of the transaction.

- The Company is able to use actual transactions to validate its model results and to explain the correlation between various market indices and indicative CDS market prices.

- The model is a well-documented, consistent approach to valuing positions that minimizes subjectivity. The Company has developed a hierarchy for market-based spread inputs that helps mitigate the degree of subjectivity during periods of high illiquidity.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The primary weaknesses of the Company's CDS modeling techniques are:

- There is no exit market or actual exit transactions. Therefore the Company's exit market is a hypothetical one based on the Company's entry market.

- There is a very limited market in which to verify the fair values developed by the Company's model.

- At September 30, 2009, the markets for the inputs to the model were highly illiquid, which impacts their reliability. However, the Company employs various procedures to corroborate the reasonableness of quotes received and calculated by the Company's internal valuation model, including comparing to other quotes received on similarly structured transactions, observed spreads on structured products with comparable underlying assets and, on a selective basis when possible, through second independent quotes on the same reference obligation.

- Due to the non-standard terms under which the Company enters into derivative contracts, the fair value of its credit derivatives may not reflect the same prices observed in an actively traded market of credit derivatives that do not contain terms and conditions similar to those observed in the financial guaranty market.

Limitations on Model

As discussed above, the Company does not trade or exit its credit derivative contracts in the normal course of business. As such, the ability to test modeled results is limited by the absence of actual exit transactions. However, management does compare modeled results to actual data that is available. Management first attempts to compare modeled values to premiums on deals the Company received on new deals written within the reporting period. If no new transactions were written for a particular asset type in the period or if the number of transactions is not reflective of a representative sample, management compares modeled results to premium bids offered by the Company to provide credit protection on new transactions within the reporting period, the premium the Company has received on historical transactions to provide credit protection in net tight and wide credit environments and/or the premium on transactions closed by other financial guaranty insurance companies during the reporting period.

The net par outstanding of the Company's credit derivative contracts was $123.4 billion and $75.1 billion at September 30, 2009 and December 31, 2008, respectively. The estimated remaining average life of these contracts at September 30, 2009 was 6.1 years.

As required by ASC 820-10, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. As of September 30, 2009, these contracts are classified as Level 3 in the ASC 820-10 hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation model, most significantly the Company's estimate of the value of the non-standard terms and conditions of its credit derivative contracts and of the Company's current credit standing.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Financial Instruments Carried at Fair Value on a Non-recurring Basis

Assets Acquired in Refinancing Transactions

Mortgage loans included in assets acquired in refinancing transactions are accounted for at fair value when lower than cost.

Level 3 Instruments

The table below presents a reconciliation of the Company's financial instruments whose fair value included significant unobservable inputs (Level 3) during the Third Quarter 2009.

Fair Value Level 3 Rollforward

	Three Months Ended September 30, 2009		
	Assets Acquired in Refinancing Transactions	Credit Derivative Asset (Liability), Net	Total Net Assets (Liabilities)
		(in thousands)	
Beginning Balance, June 30, 2009	$	$ (811,402)	$ (811,402)
FSAH Acquisition	33,810	(622,828)	(589,018)
Adjusted beginning balance	33,810	(1,434,230)	(1,400,420)
Total gains or losses realized and unrealized:			
Unrealized gains (losses) on credit derivatives		(205,336)	(205,336)
Realized gains and other settlements on credit derivatives		71,691	71,691
Other income	(637)		(637)
Current period net effect of purchases, settlements and other activity included in unrealized portion of beginning balance	(230)	(70,292)	(70,522)
Transfers in and/or out of Level 3			
Ending Balance, September 30, 2009	$ 32,943	$ (1,638,167)	$ (1,605,224)
Gains and losses (realized and unrealized) included in earnings for the period are reported as follows:			
Total realized and unrealized gains (losses) included in earnings for the period		$ (133,645)	$ (133,645)
Change in unrealized gains (losses) on credit derivatives still held at the reporting date		$ (184,190)	$ (184,190)

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The table below presents a reconciliation of the Company's financial instruments whose fair value included significant unobservable inputs (Level 3) during the Nine Months 2009.

	Nine Months Ended September 30, 2009		
	Assets Acquired in Refinancing Transactions	Credit Derivative Asset (Liability), Net	Total Net Assets (Liabilities)
		(in thousands)	
Beginning Balance	$	$ (586,807)	$ (586,807)
FSAH Acquisition	33,810	(622,828)	(589,018)
Adjusted beginning balance	33,810	(1,209,635)	(1,175,825)
Total gains or losses realized and unrealized:			
Unrealized gains (losses) on credit derivatives		(432,638)	(432,638)
Realized gains and other settlements on credit derivatives		120,086	120,086
Other income	(637)		(637)
Current period net effect of purchases, settlements and other activity included in unrealized portion of beginning balance	(230)	(115,980)	(116,210)
Transfers in and/or out of Level 3			
Ending Balance, September 30, 2009	$ 32,943	$ (1,638,167)	$ (1,605,224)
Gains and losses (realized and unrealized) included in earnings for the period are reported as follows:			
Total realized and unrealized gains (losses) included in earnings for the period		$ (312,552)	$ (312,552)
Change in unrealized gains (losses) on credit derivatives still held at the reporting date		$ (439,735)	$ (439,735)

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The table below presents a reconciliation of the Company's credit derivatives whose fair value included significant unobservable inputs (Level 3) during Third Quarter and Nine Months 2008.

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	Three Months Ended September 30, 2008 Credit Derivative (Liability) Asset, Net	Nine Months Ended September 30, 2008 Credit Derivative (Liability) Asset, Net
	(in thousands)	
Beginning Balance	$ (165,943)	$ (617,644)
Total gains or losses realized and unrealized		
Unrealized gains (losses) on credit derivatives	(116,247)	332,634
Realized gains and other settlements on credit derivatives	29,960	89,370
Current period net effect of purchases, settlements and other activity included in unrealized portion of beginning balance	(33,733)	(90,323)
Transfers in and/or out of Level 3		
Ending Balance	$ (285,963)	$ (285,963)
Gains and losses (realized and unrealized) included in earnings for the period are reported as follows:		
Total realized and unrealized gains (losses) included in earnings for the period	$ 86,287	$ (422,004)
Change in unrealized gains (losses) on credit derivatives still held at the reporting date	$ 116,838	$ (325,729)

Unearned Premium Reserves

The fair value of the Company's unearned premium reserves was based on the management's estimate of what a similarly rated financial guaranty insurance company would demand to assume the Company's in-force book of financial guaranty insurance business. This amount was based on the pricing assumptions management has observed in recent portfolio transfers that have occurred in the financial guaranty market and included adjustments to the carrying value of unearned premium reserves for stressed losses and ceding commissions. The significant inputs for stressed losses and ceding commissions were not readily observable inputs. The Company accordingly classified this fair value measurement as Level 3.

Long Term Debt and Notes Payable to Related Party

The Company's long term debt is valued by broker-dealers using third party independent pricing sources and standard market conventions. The market conventions utilize market quotations, market transactions in comparable instruments, and various relationships between instruments, such as yield to maturity. The Company classified this fair value measurement as Level 3.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

For a description of the Company's long term debt, see Note 12.

The fair value of the note payable to related party was determined by calculating the present value of the expected cash flows. The Company classified this fair value measurement as Level 3.

Financial Guaranty Variable Interest Entities Assets and Liabilities

The fair values of VIE assets and VIE liabilities are determined using prices provided by broker-dealers or valuation models that use market-based inputs, including contractual terms and yield curves. These fair values do not consider the Company's own credit risk, as this risk is borne by the underlying VIE assets that serve to collateralize the VIE liabilities. The most significant market inputs used are unobservable and, therefore, the Company classified these fair value measurements as Level 3.

Future Installment Premiums

As described in Note 5, with the adoption of ASC 944-20 effective January 1, 2009, future installment premiums are included in the unearned premium reserves for contracts written in financial guaranty form. See "Unearned Premium Reserves" section above for additional information.

Prior to adoption of ASC 944-20, future installment premiums were not recorded in the Company's financial statements. The fair value of the Company's installment premiums was derived by calculating the present value of the estimated future cash flow stream for financial guaranty installment premiums discounted at 6.0%. The significant inputs used to fair value this item were observable. The Company accordingly classified this fair value measurement as Level 2.

8. INVESTMENT PORTFOLIO

As of the Acquisition Date, the investment portfolio includes assets acquired in the FSAH Acquisition with a fair value of $5.8 billion, which is the Company's cost basis. The difference between fair value at the Acquisition Date and par value will be amortized through net investment income over the estimated lives of each security. The weighted average life of these securities is 4.8 years. In Third Quarter 2009 net investment income included approximately $13.8 million in amortization of premium

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

8. INVESTMENT PORTFOLIO (Continued)

on the assets acquired as part of the FSAH Acquisition. The following tables summarize the Company's aggregate investment portfolio:

Investment Portfolio by Security Type

Investments Category	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	OTTI in OCI
	As of September 30, 2009 (in thousands)				
Fixed maturity securities					
U.S. government and agencies	$ 950,113	$ 39,083	$ (349)	$ 988,847	$
Obligations of state and political subdivisions	4,984,165	256,667	(1,283)	5,239,549	
Corporate securities	356,516	15,376	(1,512)	370,380	
Mortgage-backed securities:					
Residential mortgage-backed securities	1,184,107	34,812	(22,619)	1,196,300	72,953
Commercial mortgage-backed securities	255,680	3,008	(11,820)	246,868	9,209
Asset-backed securities	69,600	1,690	(16,480)	54,810	
Foreign government securities	350,877	4,672	(4,204)	351,345	
Preferred stock					
Total fixed maturity securities	8,151,058	355,308	(58,267)	8,448,099	82,162
Short-term investments	1,492,479	412		1,492,891	
Total investments	$ 9,643,537	$ 355,720	$ (58,267)	$ 9,940,990	$ 82,162

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

8. INVESTMENT PORTFOLIO (Continued)

	As of December 31, 2008(1)			
Investments Category	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
	(in thousands)			
Fixed maturity securities				
U.S. government and agencies	$ 426,592	$ 49,370	$ (36)	$ 475,926
Obligations of state and political subdivisions	1,235,942	33,196	(51,427)	1,217,711
Corporate securities	274,237	5,793	(11,793)	268,237
Mortgage-backed securities:				
Residential mortgage-backed securities	829,091	21,717	(20,470)	830,338
Commercial mortgage-backed securities	252,788	55	(31,347)	221,496
Asset-backed securities	80,710		(7,144)	73,566
Foreign government securities	50,323	4,173		54,496
Preferred stock	12,625		(258)	12,367
Total fixed maturity securities	3,162,308	114,304	(122,475)	3,154,137
Short-term investments	477,197			477,197
Total investments	$ 3,639,505	$ 114,304	$ (122,475)	$ 3,631,334

(1) Reclassified to conform to the current period's presentation.

Approximately 15% and 29% of the Company's total investment portfolio as of September 30, 2009 and December 31, 2008, respectively, was composed of mortgage backed securities, including collateralized mortgage obligations and commercial mortgage backed securities. As of September 30, 2009 and December 31, 2008, respectively, approximately 82% and 69% of the Company's total mortgage backed securities were government agency obligations. As of September 30, 2009 and December 31, 2008, respectively, the weighted average credit quality of the Company's entire investment portfolio was AA and AA+. These ratings are represented by the lower of the Moody's and S&P classifications. The Company's portfolio is comprised primarily of high-quality, liquid instruments. The Company continues to receive sufficient information to value its investments and has not had to modify its valuation approach due to the current market conditions.

The amortized cost and estimated fair value of available-for-sale fixed maturity securities as of September 30, 2009 are shown below, by contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

8. INVESTMENT PORTFOLIO (Continued)

Distribution of Fixed-Income Securities in Investment Portfolio by Contractual Maturity

	Amortized Cost	Estimated Fair Value
	(in thousands)	
Due within one year	$ 256,575	$ 257,894
Due after one year through five years	1,507,759	1,535,386
Due after five years through ten years	1,365,797	1,425,988
Due after ten years	3,581,140	3,785,663
Mortgage-backed securities:		
Residential mortgage-backed securities	1,184,107	1,196,300
Commercial mortgage-backed securities	255,680	246,868
Total	$ 8,151,058	$ 8,448,099

Proceeds from the sale of available-for-sale fixed maturity securities were $1,258.4 million and $401.9 million for the Nine Months 2009 and 2008, respectively.

Net Realized Investment Gains (Losses)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in thousands)			
Gains on investment portfolio	$ 5,752	$ 1,365	$ 25,340	$ 4,639
Losses on investment portfolio	(4,033)	(3,123)	(12,340)	(4,054)
Assets acquired in refinancing transactions	218		218	
Other than temporary impairments	(8,034)	(18,273)	(41,313)	(18,536)
Net realized investment (losses) gains	$ (6,097)	$ (20,031)	$ (28,095)	$ (17,951)

Net Investment Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(in thousands)			
Income from fixed maturity securities	$ 88,162	$ 42,022	$ 175,468	$ 111,949
Income from short-term investments	(1,506)	2,201	6	10,431
Gross investment income	86,656	44,223	175,474	122,380
Less: investment expenses	1,914	782	3,831	2,133

Net investment income	$	84,742	$	43,441	$	171,643	$