

ASSURED GUARANTY LTD
Form 10-Q
November 09, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended September 30, 2012
or
 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
(State or other jurisdiction
of incorporation)

98-0429991
(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 No

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 No

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

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

The number of registrant's Common Shares (\$0.01 par value) outstanding as of November 1, 2012 was 194,076,724 (includes 88,549 unvested restricted shares).

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PART I. Financial Information

ITEM 1. Financial Statements

Assured Guaranty Ltd.

Consolidated Balance Sheets (unaudited)

(dollars in millions except per share and share amounts)

	As of September 30, 2012	As of December 31, 2011
Assets		
Investment portfolio:		
Fixed maturity securities, available-for-sale, at fair value (amortized cost of \$9,589 and \$9,638)	\$10,318	\$10,142
Short term investments, at fair value	564	734
Other invested assets	205	223
Total investment portfolio	11,087	11,099
Cash	133	215
Premiums receivable, net of ceding commissions payable	944	1,003
Ceded unearned premium reserve	550	709
Deferred acquisition costs	127	132
Reinsurance recoverable on unpaid losses	56	69
Salvage and subrogation recoverable	430	368
Credit derivative assets	450	469
Deferred tax asset, net	729	804
Current income tax receivable	78	76
Financial guaranty variable interest entities' assets, at fair value	2,693	2,819
Other assets	286	262
Total assets	\$17,563	\$18,025
Liabilities and shareholders' equity		
Unearned premium reserve	\$5,332	\$5,963
Loss and loss adjustment expense reserve	594	679
Reinsurance balances payable, net	185	171
Long-term debt	840	1,038
Credit derivative liabilities	2,151	1,773
Financial guaranty variable interest entities' liabilities with recourse, at fair value	2,169	2,397
Financial guaranty variable interest entities' liabilities without recourse, at fair value	1,018	1,061
Other liabilities	322	291
Total liabilities	12,611	13,373
Commitments and contingencies (See Note 12)		
Common stock (\$0.01 par value, 500,000,000 shares authorized; 193,988,878 and 182,235,798 shares issued and outstanding in 2012 and 2011)	2	2
Additional paid-in capital	2,722	2,570
Retained earnings	1,693	1,708
Accumulated other comprehensive income, net of tax of \$200 and \$135	531	368
Deferred equity compensation (320,193 shares in 2012 and 2011)	4	4
Total shareholders' equity	4,952	4,652

Total liabilities and shareholders' equity	\$17,563	\$18,025
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The accompanying notes are an integral part of these consolidated financial statements.

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Assured Guaranty Ltd.

Consolidated Statements of Operations (unaudited)

(dollars in millions except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues				
Net earned premiums	\$222	\$211	\$635	\$695
Net investment income	102	95	301	295
Net realized investment gains (losses):				
Other-than-temporary impairment losses	(4	) (33	) (41	) (67
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	0	(17	) (30	) (35
Other net realized investment gains (losses)	6	5	11	19
Net realized investment gains (losses)	2	(11	) 0	(13
Net change in fair value of credit derivatives:				
Realized gains (losses) and other settlements	2	0	(78	) 25
Net unrealized gains (losses)	(38	) 1,156	(388	) 830
Net change in fair value of credit derivatives	(36	) 1,156	(466	) 855
Fair value gain (loss) on committed capital securities	(2	) 2	(12	) 3
Fair value gains (losses) on financial guaranty variable interest entities	38	(99	) 174	(154
Other income	16	(9	) 112	59
Total revenues	342	1,345	744	1,740
Expenses				
Loss and loss adjustment expenses	90	215	459	313
Amortization of deferred acquisition costs	4	4	14	13
Interest expense	21	25	71	74
Other operating expenses	48	46	163	163
Total expenses	163	290	707	563
Income (loss) before income taxes	179	1,055	37	1,177
Provision (benefit) for income taxes				
Current	(9	) (13	) (9	) (200
Deferred	46	307	10	520
Total provision (benefit) for income taxes	37	294	1	320
Net income (loss)	\$142	\$761	\$36	\$857
Earnings per share:				
Basic	\$0.73	\$4.15	\$0.19	\$4.66
Diluted	\$0.73	\$4.13	\$0.19	\$4.60
Dividends per share	\$0.09	\$0.045	\$0.27	\$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 millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income (loss)	\$142	\$761	\$36	\$857
Unrealized holding gains (losses) arising during the period on:				
Investments with no other-than-temporary impairment, net of tax provision (benefit) of \$34, \$52, \$61 and \$94	95	129	169	210
Investments with other-than-temporary impairment, net of tax provision (benefit) of \$4, \$(7), \$(4) and \$(3)	5	(14	) (13	) (6
Unrealized holding gains (losses) arising during the period, net of tax	100	115	156	204
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of \$(1), \$(4), \$(6), and \$(5)	—	(9	) (5	) (12
Change in net unrealized gains on investments	100	124	161	216
Other, net of tax provision	1	(3	) 2	(1
Other comprehensive income (loss)	\$101	\$121	\$163	\$215
Comprehensive income (loss)	\$243	\$882	\$199	\$1,072

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

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Assured Guaranty Ltd.

Consolidated Statement of Shareholders' Equity (unaudited)

For the Nine Months Ended September 30, 2012

(dollars in millions, except share data)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Deferred Equity Compensation	Total Shareholders' Equity
	Shares	Amount					
Balance at December 31, 2011	182,235,798	\$2	\$2,570	\$1,708	\$ 368	\$ 4	\$4,652
Net income	—	—	—	36	—	—	36
Dividends (\$0.27 per share)	—	—	—	(51)	—	—	(51)
Dividends on restricted stock units	—	—	0	0	—	—	—
Common stock issuance, net	13,428,770	0	173	—	—	—	173
Common stock repurchases	(2,066,759)	0	(24)	—	—	—	(24)
Share-based compensation and other	391,069	0	3	—	—	—	3
Other comprehensive income	—	—	—	—	163	—	163
Balance at September 30, 2012	193,988,878	\$2	\$2,722	\$1,693	\$ 531	\$ 4	\$4,952

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 millions)

	Nine Months Ended September	
	30,	
	2012	2011
Net cash flows provided by (used in) operating activities	\$(223	) \$601
Investing activities		
Fixed maturity securities:		
Purchases	(1,322	) (1,788
Sales	683	849
Maturities	758	503
Net sales (purchases) of short-term investments	282	182
Net proceeds from paydowns on financial guaranty variable interest entities' assets	407	598
Acquisition of MIAC, net of cash acquired	(91) —
Other	85	14
Net cash flows provided by (used in) investing activities	802	358
Financing activities		
Proceeds from issuances of common stock	173	—
Dividends paid	(51	) (25
Repurchases of common stock	(24	) (23
Share activity under option and incentive plans	(3	) (3
Net paydowns of financial guaranty variable interest entities' liabilities	(553	) (830
Repayment of long-term debt	(204	) (17
Net cash flows provided by (used in) financing activities	(662	) (898
Effect of exchange rate changes	1	4
Increase (decrease) in cash	(82	) 65
Cash at beginning of period	215	108
Cash at end of period	\$133	\$173
Supplemental cash flow information		
Cash paid (received) during the period for:		
Income taxes	\$(11	) \$89
Interest	\$56	\$58

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

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (unaudited)

September 30, 2012

1. Business and Basis of Presentation

Business

Assured Guaranty Ltd. (“AGL” and, together with its subsidiaries, “Assured Guaranty” or the “Company”) is a Bermuda-based holding company that provides, through its operating subsidiaries, credit protection products to the United States (“U.S.”) and international public finance (including infrastructure) and structured finance markets. The Company has applied its credit underwriting judgment, risk management skills and capital markets experience to offer insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments, including scheduled interest and principal payments. The Company markets its credit protection products directly to issuers and underwriters of public finance and structured finance securities as well as to investors in such obligations. The Company guarantees obligations issued in many countries, although its principal focus is on the U.S., Europe and Australia.

Financial guaranty insurance policies provide an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest (“Debt Service”) when due. Upon an obligor’s default on scheduled principal or interest payments due on the obligation, the Company is required under the financial guaranty policy to pay the principal or interest shortfall. The Company has issued financial guaranty insurance policies on public finance obligations and structured finance obligations. Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the taxing powers of U.S. state or municipal governmental authorities, as well as tax-supported bonds, revenue bonds and other obligations supported by covenants from state or municipal governmental authorities or other municipal obligors to impose and collect fees and charges for public services or specific infrastructure projects. The Company also includes within public finance obligations those obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including utilities, toll roads, health care facilities and government office buildings. Structured finance obligations insured by the Company are generally issued by special purpose entities and backed by pools of assets such as residential or commercial mortgage loans, consumer or trade receivables, securities or other assets having an ascertainable cash flow or market value. The Company also includes within structured finance obligations other specialized financial obligations.

In the past, the Company had sold credit protection by issuing policies that guaranteed payment obligations under credit derivatives. Financial guaranty contracts accounted for as credit derivatives are generally structured such that the circumstances giving rise to the Company’s obligation to make loss payments are similar to those for financial guaranty insurance contracts and only occurs upon one or more defined credit events such as failure to pay or bankruptcy, in each case, as defined within the transaction documents, with respect to one or more third party referenced securities or loans. Financial guaranty contracts accounted for as credit derivatives are primarily comprised of credit default swaps (“CDS”). The Company’s credit derivative transactions are governed by International Swaps and Derivative Association, Inc. (“ISDA”) documentation.

The Company has not entered into any new CDS in order to sell credit protection since the beginning of 2009, when regulatory guidelines were issued that limited the terms under which such protection could be sold. The capital and margin requirements applicable under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) also contributed to the decision of the Company not to enter into such new CDS in the foreseeable

future. The Company actively pursues opportunities to terminate existing CDS and, in certain cases, has converted existing CDS exposure into a financial guaranty insurance contract. These actions have the effect of reducing future fair value volatility in income and/or reducing rating agency capital charges.

The Company has historically entered into ceded reinsurance contracts in order to obtain greater business diversification and reduce the net potential loss from large risks. In January 2012, two of AGL's operating subsidiaries, Assured Guaranty Municipal Corp. ("AGM") and Assured Guaranty Corp. ("AGC"), entered into a \$435 million excess of loss reinsurance facility with third-party reinsurers, which reduced rating agency capital charges. The Company also has been reassuming previously ceded business from reinsurers. In the three-month period ended March 31, 2012 ("First Quarter 2012"), the Company reassumed a total of \$19.1 billion in par from two reinsurers and in the three-month period ended September 30, 2012, the Company reassumed \$9 million in par from one reinsurer. See Note 11, Reinsurance and Other Monoline Exposures.

When a rating agency assigns a public rating to a financial obligation guaranteed by one of AGL's insurance company

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subsidiaries, it generally awards that obligation the same rating it has assigned to the financial strength of the AGL subsidiary that provides the guaranty. Investors in products insured by AGL's insurance company subsidiaries frequently rely on ratings published by nationally recognized statistical rating organizations ("NRSROs") because such ratings influence the trading value of securities and form the basis for many institutions' investment guidelines as well as individuals' bond purchase decisions. Therefore, the Company manages its business with the goal of achieving high financial strength ratings. However, the models used by NRSROs differ, presenting conflicting goals that may make it inefficient or impractical to reach the highest rating level. The models are not fully transparent, contain subjective data (such as assumptions about future market demand for the Company's products) and change frequently. Ratings reflect only the views of the respective NRSROs and are subject to continuous review and revision or withdrawal at any time.

Unless otherwise noted, ratings disclosed herein on Assured Guaranty's insured portfolio reflect Assured Guaranty's internal ratings. Assured Guaranty's ratings scale is similar to that used by the NRSROs; however, the ratings in these financial statements may not be the same as those assigned by any such rating agency. For example, the super senior category, which is not generally used by rating agencies, is used by Assured Guaranty in instances where Assured Guaranty's AAA-rated exposure on its internal rating scale (which does not take into account Assured Guaranty's financial guaranty) has additional credit enhancement due to either (1) the existence of another security rated AAA that is subordinated to Assured Guaranty's exposure or (2) Assured Guaranty's exposure benefiting 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 Assured Guaranty's attachment point to be materially above the AAA attachment point.

Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and, in the opinion of management, reflect all adjustments that are of a normal recurring nature, necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated financial guaranty variable interest entities ("FG VIEs") 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 are as of September 30, 2012 and cover the three-month period ended September 30, 2012 ("Third Quarter 2012"), the three-month period ended September 30, 2011 ("Third Quarter 2011"), the nine-month period ended September 30, 2012 ("Nine Months 2012") and the nine-month period ended September 30, 2011 ("Nine Months 2011"). The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

The unaudited interim consolidated financial statements include the accounts of AGL and its direct and indirect subsidiaries (collectively, the "Subsidiaries") and its consolidated FG VIEs. Intercompany accounts and transactions between and among all consolidated entities have been eliminated. Certain prior year balances have been reclassified to conform to the current year's presentation.

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements included in AGL's Annual Report on Form 10-K for the year ended December 31, 2011, filed with the U.S. Securities and Exchange Commission (the "SEC").

AGL's principal insurance company subsidiaries are AGC, domiciled in Maryland; AGM, domiciled in New York; and Assured Guaranty Re Ltd. ("AG Re"), domiciled in Bermuda. In addition, the Company has another U.S. and another Bermuda insurance company subsidiary that participate in a pooling agreement with AGM, two insurance subsidiaries

organized in the United Kingdom, and a mortgage insurance company domiciled in New York. On May 31, 2012, the Company also completed the purchase of Municipal and Infrastructure Assurance Corporation ("MIAC"), which is domiciled in New York. See Note 2, Business Changes, Risks, Uncertainties and Accounting Developments. The Company's organizational structure includes various holdings companies, two of which—Assured Guaranty US Holdings Inc. ("AGUS") and Assured Guaranty Municipal Holdings Inc. ("AGMH")—have public debt outstanding. See Note 13, Long Term Debt and Credit Facilities.

2. Business Changes, Risks, Uncertainties and Accounting Developments

Summarized below are updates of the most significant recent events that have had, or may have in the future, a material effect on the financial position, results of operations or business prospects of the Company.

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Rating Actions

In the last several years, Standard and Poor's Ratings Services ("S&P") and Moody's Investors Service, Inc. ("Moody's") have downgraded the financial strength ratings of all the Company's insurance subsidiaries that they rate. On March 20, 2012, Moody's placed the ratings of AGL and its Subsidiaries, including the insurance financial strength rating of the Company's insurance subsidiaries, on review for possible downgrade. On October 30, 2012, Moody's indicated that it anticipates resolving its review during the first half of November 2012. There can be no assurance as to the actions that Moody's may take on the Company's ratings or that S&P will not take further action on the Company's ratings. For a discussion of the effect of rating actions by S&P or Moody's on the Company as of September 30, 2012, see the following:

• Note 4, Financial Guaranty Insurance Contracts

• Note 6, Financial Guaranty Contracts Accounted for as Credit Derivatives

• Note 11, Reinsurance and Other Monoline Exposures

• Note 13, Long Term Debt and Credit Facilities (regarding the impact on the Company's insured leveraged lease transactions)

Another situation in which the Company is exposed to downgrade risk is AGM may be required to pay claims in respect of AGMH's former financial products business if Dexia SA and its affiliates do not comply with their obligations following a downgrade of the financial strength rating of AGM. Most of the guaranteed investment contracts ("GICs") insured by AGM allow for the withdrawal of GIC funds in the event of a downgrade of AGM, unless the relevant GIC issuer posts collateral or otherwise enhances its credit. Most GICs insured by AGM allow for the termination of the GIC contract and a withdrawal of GIC funds at the option of the GIC holder in the event of a downgrade of AGM below a specified threshold, generally below A- by S&P or A3 by Moody's, with no right of the GIC issuer to avoid such withdrawal by posting collateral or otherwise enhancing its credit. Each GIC contract stipulates the thresholds below which the GIC issuer must post eligible collateral, along with the types of securities eligible for posting and the collateralization percentage applicable to each security type. These collateralization percentages range from 100% of the GIC balance for cash posted as collateral to, typically, 108% for asset-backed securities. At September 30, 2012, a downgrade of AGM to below AA- by S&P and Aa3 by Moody's would result in withdrawal of \$358 million of GIC funds and the need to post collateral on GICs with a balance of \$2.9 billion. In the event of such a downgrade, assuming an average margin of 105%, the market value as of September 30, 2012 that the GIC issuers would be required to post in order to avoid withdrawal of any GIC funds would be \$3.1 billion.

The insurance subsidiaries' financial strength ratings are an important competitive factor in the financial guaranty insurance and reinsurance markets. If the financial strength or financial enhancement ratings of the Company's insurance subsidiaries were reduced below current levels, the Company expects it could have adverse effects on its future business opportunities as well as the premiums it could charge for its insurance policies and consequently, a downgrade could harm the Company's new business production and results of operations in a material respect.

Accounting Changes

There has recently been significant GAAP rule making activity which has affected the accounting policies and presentation of the Company's financial information beginning on January 1, 2012, particularly:

• Adoption of new guidance that restricted the types and amounts of financial guaranty insurance acquisition costs that may be deferred. See Note 4, Financial Guaranty Insurance Contracts.

• Adoption of guidance that changed the presentation of other comprehensive income ("OCI"). See "Consolidated Statements of Comprehensive Income."

• Adoption of guidance requiring additional fair value disclosures. See Note 5, Fair Value Measurement.

In July 2012, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2012-02, "Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment" ("ASU 2012-02"). ASU 2012-02 amends prior indefinite-lived intangible asset impairment testing guidance. Under ASU 2012-02, the Company has the option to first assess qualitative factors to determine whether it is more likely than not (a likelihood of more than 50%) that an indefinite-lived intangible asset is impaired. If, after considering the totality of events and circumstances, an entity determines it is more likely than not that an indefinite-lived intangible asset is not impaired, then calculating the fair value of such asset is unnecessary. ASU 2012-02 is effective for interim and annual periods beginning after September 15, 2012 and the Company will adopt ASU 2012-02 at December 31, 2012. There will be no cumulative effect upon the adoption of ASU 2012-02 on the Company's consolidated financial position, results of operations or cash flows.

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Deutsche Bank Agreement

On May 8, 2012, Assured Guaranty reached a settlement with Deutsche Bank AG and certain of its affiliates (collectively, "Deutsche Bank"), resolving claims related to certain residential mortgage-backed securities ("RMBS") transactions issued, underwritten or sponsored by Deutsche Bank that were insured by Assured Guaranty under financial guaranty insurance policies and to certain RMBS exposures in re-securitization transactions as to which Assured Guaranty provides credit protection through CDS. As part of the settlement agreement (the "Deutsche Bank Agreement"), Assured Guaranty settled its litigation against Deutsche Bank on three RMBS transactions.

Assured Guaranty received a cash payment of \$166 million from Deutsche Bank upon signing of the Deutsche Bank Agreement, a portion of which partially reimbursed Assured Guaranty for past losses on certain transactions. Assured Guaranty and Deutsche Bank also entered into loss sharing arrangements covering future RMBS related losses, which are described below. Under the Deutsche Bank Agreement, Deutsche Bank AG placed eligible assets in trust in order to collateralize the obligations of a reinsurance affiliate under the loss-sharing arrangements. The Deutsche Bank reinsurance affiliate may be required to post additional collateral in the future to satisfy rating agency requirements. As of September 30, 2012 the balance of the assets held in trust of \$282 million was sufficient to fully collateralize Deutsche Bank's obligations, based on the Company's estimate of expected loss for the transactions covered under the agreement.

The settlement includes eight RMBS transactions ("Covered Transactions") that Assured Guaranty has insured through financial guaranty insurance policies. The Covered Transactions are backed by first lien and second lien mortgage loans. Under the Deutsche Bank Agreement, the Deutsche Bank reinsurance affiliate will reimburse 80% of Assured Guaranty's future losses on the Covered Transactions until Assured Guaranty's aggregate losses (including those to date that are partially reimbursed by the \$166 million cash payment) reach \$319 million. Assured Guaranty currently projects that in the base case the Covered Transactions will not generate aggregate losses in excess of \$319 million. In the event aggregate losses exceed \$389 million, the Deutsche Bank reinsurance affiliate is required to resume reimbursement at the rate of 85% of Assured Guaranty's losses in excess of \$389 million until such losses reach \$600 million. The Covered Transactions represented \$548 million of gross par outstanding (\$472 million on a net basis) as of September 30, 2012.

Certain uninsured tranches ("Uninsured Tranches") of three of the Covered Transactions are included as collateral in RMBS re-securitization transactions as to which Assured Guaranty provides credit protection through CDS. Under the Deutsche Bank Agreement, the Deutsche Bank reinsurance affiliate will reimburse losses on the CDS in an amount equal to 60% of losses in these Uninsured Tranches until the aggregate losses in the Uninsured Tranches reach \$141 million. In the event aggregate losses exceed \$161 million, reimbursement resumes at the rate of 60% until the aggregate losses reach \$185 million. The Deutsche Bank reinsurance affiliate is required to reimburse any losses in excess of \$185 million at the rate of 100% until the aggregate losses reach \$248 million. The Uninsured Tranches represent \$317 million of par outstanding as of September 30, 2012. As of September 30, 2012, lifetime losses in the base case are expected to exceed \$141 million (on a discounted basis).

Except for the Uninsured Tranches, the settlement does not include Assured Guaranty's CDS with Deutsche Bank. The parties have agreed to continue efforts to resolve CDS-related claims.

Reinsurance Agreements

As discussed in Note 11, Reinsurance and Other Monoline Exposures, the Company has entered into several agreements with reinsurers, including assumption and re-assumption agreements with Radian Asset Assurance Inc. ("Radian"), a re-assumption agreement with Tokio Marine & Nichido Fire Insurance Co., Ltd. ("Tokio") and a \$435 million excess of loss reinsurance facility.

MIAC Acquisition

On May 31, 2012, the Company purchased 100% of the outstanding common stock of MIAC from Radian for \$91 million in cash, resulting in \$16 million in indefinite-lived intangible assets which represents the value of MIAC's licenses. The other assets acquired consisted primarily of short-term investments. MIAC is licensed to provide financial guaranty insurance and reinsurance in 38 U.S. jurisdictions including the District of Columbia. The acquisition of MIAC enhances the Company's flexibility to respond to changes in the financial guaranty industry.

Remarketing of Senior Notes and Redemption of Equity Units

On June 1, 2012, the Company completed the remarketing of the \$173 million aggregate principal amount of 8.50%

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Senior Notes issued by AGUS in 2009 that were components of the Company's Equity Units. AGUS purchased all of the Senior Notes in the remarketing at a price of 100% of the aggregate principal amount thereof, and retired all of such notes on June 1, 2012. The proceeds from the remarketing were used to satisfy the obligations of the holders of the Equity Units to purchase AGL common shares pursuant to the forward purchase contracts that were also components of the Equity Units. Accordingly, on June 1, 2012, AGL issued 3.8924 common shares to holders of each \$50 Equity Unit, which represented a settlement rate of 3.8685 common shares plus certain anti-dilution adjustments, or an aggregate of 13,428,770 common shares. The Equity Units ceased to exist when the forward purchase contracts were settled on June 1, 2012.

3. Outstanding Exposure

The Company's financial guaranty contracts are written in different forms, but collectively are considered financial guaranty contracts. The Company seeks to limit its exposure to losses by underwriting obligations that are investment grade at inception, diversifying its insured portfolio and maintaining rigorous subordination or collateralization requirements on structured finance obligations. The Company also has utilized reinsurance by ceding business to third-party reinsurers. The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. Some of these VIEs are consolidated as described in Note 7, Consolidation of Variable Interest Entities. The outstanding par and Debt Service amounts presented below include outstanding exposures on VIEs whether or not they are consolidated.

Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011
	(in millions)			
Public finance	\$746,703	\$798,471	\$699,938	\$716,890
Structured finance	117,105	137,661	109,790	128,775
Total financial guaranty	\$863,808	\$936,132	\$809,728	\$845,665

In addition to the amounts shown in the table above, the Company's net mortgage guaranty insurance in force was approximately \$150 million as of September 30, 2012. The net mortgage guaranty insurance in force is assumed excess of loss business and comprises \$135 million covering loans originated in Ireland and \$15 million covering loans originated in the UK.

Financial Guaranty Portfolio by Internal Rating

Rating Category	As of September 30, 2012																	
	Public Finance U.S.				Public Finance Non-U.S.				Structured Finance U.S.				Structured Finance Non-U.S.				Total	
	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%		
	(dollars in millions)																	
Super senior	\$—	—	\$1,119	2.9	\$13,714	17.5	\$4,818	24.1	\$19,651	3.7								
AAA	4,575	1.2	1,392	3.6	30,745	39.2	8,504	42.5	45,216	8.4								
AA	131,488	32.9	950	2.4	9,996	12.7	725	3.6	143,159	26.7								
A	215,989	54.1	10,281	26.5	4,500	5.7	1,476	7.4	232,246	43.3								
BBB	42,353	10.6	22,712	58.7	4,093	5.2	2,594	13.0	71,752	13.4								
Below-investment-grade ("BIG")	4,771	1.2	2,266	5.9	15,456	19.7	1,876	9.4	24,369	4.5								

Total net par
outstanding

\$399,176 100.0% \$38,720 100.0% \$78,504 100.0% \$19,993 100.0% \$536,393 100.0%

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Rating Category	As of December 31, 2011														
	Public Finance U.S.			Public Finance Non-U.S.			Structured Finance U.S			Structured Finance Non-U.S			Total		
	Net Par Outstanding	%		Net Par Outstanding	%		Net Par Outstanding	%		Net Par Outstanding	%		Net Par Outstanding	%	
	(dollars in millions)														
Super senior	\$—	—	%	\$1,138	2.9	%	\$16,756	18.2	%	\$5,660	23.9	%	\$23,554	4.2	%
AAA	5,074	1.3		1,381	3.5		35,736	38.7		10,231	43.2		52,422	9.4	
AA	139,693	34.6		1,056	2.7		12,575	13.6		976	4.1		154,300	27.7	
A	213,164	52.9		11,744	30.1		4,115	4.5		1,518	6.4		230,541	41.3	
BBB	40,635	10.1		21,399	54.8		5,044	5.5		3,391	14.3		70,469	12.6	
BIG	4,507	1.1		2,328	6.0		18,008	19.5		1,919	8.1		26,762	4.8	
Total net par outstanding	\$403,073	100.0%		\$39,046	100.0%		\$92,234	100.0%		\$23,695	100.0%		\$558,048	100.0%	

Beginning in First Quarter 2012, the Company decided to classify those portions of risks benefiting from reimbursement obligations collateralized by eligible assets held in trust in acceptable reimbursement structures as the higher of 'AA' or their current internal rating. As of Third Quarter 2012, the Company applied this policy to the Bank of America Agreement and the Deutsche Bank Agreement (see Note 4, Financial Guaranty Insurance Contracts). The Bank of America Agreement was entered into in April 2011 and the reclassification in First Quarter 2012 resulted in a decrease in BIG net par outstanding as of December 31, 2011 of \$1,452 million from that previously reported.

In addition to amounts shown in the tables above, the Company had outstanding commitments to provide guaranties of \$1.7 billion for structured finance and \$0.9 billion for public finance obligations at September 30, 2012. The structured finance commitments include the unfunded component of pooled corporate and other transactions. Public finance commitments typically relate to primary and secondary public finance debt issuances. The expiration dates for the public finance commitments range between October 1, 2012 and February 25, 2017, with \$0.5 billion expiring prior to December 31, 2012. The commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty's request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.

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Economic Exposure to the Selected European Countries

Several European countries are experiencing significant economic, fiscal and/or political strains such that the likelihood of default on obligations with a nexus to those countries may be higher than the Company anticipated when such factors did not exist. The Company is closely monitoring its exposures in European countries where it believes heightened uncertainties exist, specifically, Greece, Hungary, Ireland, Italy, Portugal and Spain (the “Selected European Countries”). Published reports have identified countries that may be experiencing reduced demand for their sovereign debt in the current environment. The Company selected these European countries based on these reports and its view that their credit fundamentals are deteriorating. The Company’s economic exposure to the Selected European Countries (based on par for financial guaranty contracts and notional amount for financial guaranty contracts accounted for as derivatives) is shown in the following table net of ceded reinsurance.

Net Economic Exposure to Selected European Countries(1)
September 30, 2012

	Greece (in millions)	Hungary	Ireland	Italy	Portugal	Spain (2)	Total
Sovereign and sub-sovereign exposure:							
Public finance	\$—	\$—	\$—	\$992	\$108	\$260	\$1,360
Infrastructure finance	—	423	23	326	99	167	1,038
Sub-total	—	423	23	1,318	207	427	2,398
Non-sovereign exposure:							
Regulated utilities	—	—	—	228	—	9	237
RMBS	—	219	135	491	—	—	845
Commercial receivables	—	1	18	26	14	17	76
Pooled corporate	25	—	187	227	14	527	980
Sub-total	25	220	340	972	28	553	2,138
Total	\$25	\$643	\$363	\$2,290	\$235	\$980	\$4,536
Total BIG	\$—	\$511	\$8	\$242	\$125	\$410	\$1,296

(1) While the Company’s exposures are shown in U.S. dollars, the obligations the Company insures are in various currencies, including U.S. dollars, Euros and British pounds sterling. Included in the table above is \$135 million of reinsurance assumed on a 2004 - 2006 pool of Irish residential mortgages that is part of the Company’s remaining legacy mortgage reinsurance business. One of the residential mortgage-backed securities included in the table above includes residential mortgages in both Italy and Germany, and only the portion of the transaction equal to the portion of the original mortgage pool in Italian mortgages is shown in the table.

(2) See Note 4, Financial Guaranty Insurance Contracts.

The Company no longer guarantees any sovereign bonds of the Selected European Countries. The exposure shown in the “Public Finance Category” is from transactions backed by receivable payments from sub-sovereigns in Italy, Spain and Portugal. Sub-sovereign debt is debt issued by a governmental entity or government backed entity, or supported by such an entity, that is other than direct sovereign debt of the ultimate governing body of the country. The Company understands that Moody’s recently had undertaken a review of redenomination risk in selected countries in the Eurozone, including some of the Selected European Countries. No redenomination from the Euro to another currency has yet occurred and it may never occur. Therefore, it is not possible to be certain at this point how a redenomination of an issuer’s obligations might be implemented in the future and, in particular, whether any redenomination would extend to the Company’s obligations under a related financial guarantee. As of June 30, 2012, the Company had €218 million of net exposure to the sovereign debt of Greece. The Company accelerated claims under its guarantees during

the second quarter 2012, paying off in full its liabilities with respect to the Greek sovereign bonds it guaranteed. As of September 30, 2012, the Company no longer had any direct exposure to Greece.

Surveillance Categories

The Company segregates its insured portfolio into investment grade and BIG surveillance categories to facilitate the appropriate allocation of resources to monitoring and loss mitigation efforts and to aid in establishing the appropriate cycle for

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periodic review for each exposure. BIG exposures include all exposures with internal credit ratings below BBB-. The Company's internal credit ratings are based on internal assessments of the likelihood of default and loss severity in the event of default. 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. The Company refreshes its internal credit ratings on individual credits in quarterly, semi-annual or annual cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. The Company's insured credit ratings on assumed credits are based on the Company's reviews of low-rated credits or credits in volatile sectors, unless such information is not available, in which case, the ceding company's credit rating of the transactions are used. The Company models most assumed RMBS credits with par above \$1 million, as well as certain RMBS credits below that amount.

Credits identified as BIG are subjected to further review to determine the probability of a loss (see Note 4, Financial Guaranty Insurance Contracts). Surveillance personnel then assign each BIG transaction to the appropriate BIG surveillance category based upon whether a lifetime loss is expected and whether a claim has been paid. The Company expects "lifetime losses" on a transaction when the Company believes there is at least a 50% chance that, on a present value basis, it will pay more claims over the life of that transaction than it ultimately will have been reimbursed. For surveillance purposes, the Company calculates present value using a constant discount rate of 5%. (A risk-free rate is used for recording of reserves for financial statement purposes.)

Intense monitoring and intervention is employed for all BIG surveillance categories, with internal credit ratings reviewed quarterly. The three BIG categories are:

BIG Category 1: Below-investment-grade transactions showing sufficient deterioration to make lifetime losses possible, but for which none are currently expected. Transactions on which claims have been paid but are expected to be fully reimbursed (other than investment grade transactions on which only liquidity claims have been paid) are in this category.

BIG Category 2: Below-investment-grade transactions for which lifetime losses are expected but for which no claims (other than liquidity claims which is a claim that the Company expects to be reimbursed within one year) have yet been paid.

BIG Category 3: Below-investment-grade transactions for which lifetime losses are expected and on which claims (other than liquidity claims) have been paid. Transactions remain in this category when claims have been paid and only a recoverable remains.

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Financial Guaranty Exposures

(Insurance and Credit Derivative Form)

As of September 30, 2012

	BIG Net Par Outstanding				Net Par Outstanding	BIG Net Par as a % of Net Par Outstanding	
	BIG 1	BIG 2	BIG 3 (in millions)	Total BIG			
First lien U.S. RMBS:							
Prime first lien	\$27	\$461	\$3	\$491	\$663	0.1	%
Alt-A first lien	120	2,146	1,442	3,708	4,760	0.7	
Option ARM	60	425	734	1,219	1,753	0.2	
Subprime	116	1,350	854	2,320	7,541	0.4	
Second lien U.S. RMBS:							
Closed end second lien	—	451	412	863	985	0.2	
Home equity lines of credit ("HELOCs")	96	—	2,755	2,851	3,358	0.5	
Total U.S. RMBS	419	4,833	6,200	11,452	19,060	2.1	
Trust preferred securities ("TruPS")	2,026	—	951	2,977	5,863	0.6	
Other structured finance	1,156	377	1,370	2,903	73,574	0.5	
U.S. public finance	3,288	665	818	4,771	399,176	0.9	
Non-U.S. public finance	2,266	—	—	2,266	38,720	0.4	
Total	\$9,155	\$5,875	\$9,339	\$24,369	\$536,393	4.5	%

As of December 31, 2011

	BIG Net Par Outstanding				Net Par Outstanding	BIG Net Par as a % of Net Par Outstanding	
	BIG 1	BIG 2	BIG 3 (in millions)	Total BIG			
First lien U.S. RMBS:							
Prime first lien	\$77	\$465	\$—	\$542	\$739	0.1	%
Alt-A first lien	1,695	1,028	1,540	4,263	5,329	0.8	
Option ARM	25	689	882	1,596	2,433	0.3	
Subprime (including net interest margin securities)	795	1,200	513	2,508	8,136	0.4	
Second lien U.S. RMBS:							
Closed end second lien	—	495	520	1,015	1,040	0.2	
HELOCs	421	—	2,858	3,279	3,890	0.6	
Total U.S. RMBS	3,013	3,877	6,313	13,203	21,567	2.4	
TruPS	2,501	—	951	3,452	6,334	0.6	
Other structured finance	1,295	548	1,429	3,272	88,028	0.6	
U.S. public finance	3,395	274	838	4,507	403,073	0.8	
Non-U.S. public finance (1)	2,046	282	—	2,328	39,046	0.4	
Total	\$12,250	\$4,981	\$9,531	\$26,762	\$558,048	4.8	%

(1) Includes \$282 million in net par as of December 31, 2011, for bonds of the Hellenic Republic of Greece. See Note 4, Financial Guaranty Insurance Contracts.

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Below-Investment-Grade Credits

By Category

Description	As of September 30, 2012			Number of Risks(2)		
	Net Par Outstanding					
	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	\$6,943	\$2,212	\$9,155	148	31	179
Category 2	3,233	2,642	5,875	90	30	120
Category 3	7,299	2,040	9,339	136	31	167
Total BIG	\$17,475	\$6,894	\$24,369	374	92	466

Description	As of December 31, 2011			Number of Risks(2)		
	Net Par Outstanding					
	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	\$8,297	\$3,953	\$12,250	171	40	211
Category 2	3,458	1,523	4,981	71	33	104
Category 3	7,204	2,327	9,531	126	26	152
Total BIG	\$18,959	\$7,803	\$26,762	368	99	467

(1) Includes net par outstanding for FG VIEs.

(2) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making Debt Service payments.

Hurricane Sandy

On October 29, 2012, Hurricane Sandy made landfall in New Jersey and caused significant loss of life and property damage in New Jersey, New York and Connecticut. While the Company is continuing to evaluate the effects of Hurricane Sandy on its insured portfolio, it does not expect any significant losses as a result of the hurricane at this time.

4. Financial Guaranty Insurance Contracts

Change in accounting for deferred acquisition costs

In October 2010, the FASB adopted Accounting Standards Update (“Update”) No. 2010-26. The Company adopted this guidance January 1, 2012, with retrospective application. The Update specifies that certain costs incurred in the successful acquisition of new and renewal insurance contracts should be capitalized. These costs include direct costs of contract acquisition that result directly from and are essential to the contract transaction. These costs include expenses such as ceding commissions and the cost of underwriting personnel. Management uses its judgment in determining the type and amount of cost to be deferred. The Company conducts an annual study to determine which operating costs qualify for deferral. Ceding commission income on business ceded to third party reinsurers reduces

policy acquisition costs and is deferred. Costs incurred by the insurer for soliciting potential customers, market research, training, administration, unsuccessful acquisition efforts, and product development as well as all overhead type costs are charged to expense as incurred.

Expected losses, which include loss adjustment expenses (“LAE”), investment income, and the remaining costs of servicing the insured or reinsured business are considered in determining the recoverability of deferred acquisition costs. When an insured issue is retired early, the remaining related deferred acquisition cost is expensed at that time. Ceding commission expense and income associated with future installment premiums on assumed and ceded business, respectively,

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are calculated at their contractually defined rates and recorded in deferred acquisition costs on the consolidated balance sheets with a corresponding offset to net premium receivable or reinsurance balances payable.

As of January 1, 2011, the effect of retrospective application of the new guidance was a reduction to deferred acquisition costs of \$94 million and a reduction to retained earnings of \$64 million.

Effect of Retrospective Application of New Deferred Acquisition Cost Guidance
On Consolidated Statements of Operations

	As Reported Third Quarter 2011	Retroactive Application Adjustment	As Revised Third Quarter 2011
	(in millions except per share amounts)		
Amortization of deferred acquisition costs	\$7	\$(3)	\$4
Other operating expenses	42	4	46
Net income (loss)	761	0	761
Earnings per share:			
Basic	\$4.15	\$—	\$4.15
Diluted	4.13	—	4.13

	As Reported Nine Months 2011	Retroactive Application Adjustment	As Revised Nine Months 2011
	(in millions except per share amounts)		
Amortization of deferred acquisition costs	\$24	\$(11)	\$13
Other operating expenses	147	16	163
Net income (loss)	859	(2)	857
Earnings per share:			
Basic	4.67	(0.01)	4.66
Diluted	4.61	(0.01)	4.60

The portfolio of outstanding exposures discussed in Note 3, Outstanding Exposure, includes financial guaranty contracts that meet the definition of insurance contracts as well as those that meet the definition of derivative contracts. Amounts presented in this note relate only to financial guaranty insurance contracts. See Note 6, Financial Guaranty Contracts Accounted for as Credit Derivatives. Tables presented herein also present reconciliations to financial statement line items for other less significant types of insurance.

Net Earned Premiums

	Third Quarter 2012	2011	Nine Months 2012	2011
	(in millions)			
Scheduled net earned premiums	\$144	\$178	\$441	\$596
Acceleration of premium earnings	73	27	178	77
Accretion of discount on net premiums receivable	4	6	15	21
Total financial guaranty	221	211	634	694
Other	1	0	1	1
Total net earned premiums(1)	\$222	\$211	\$635	\$695

(1) Excludes \$17 million and \$20 million in Third Quarter 2012 and 2011, respectively, and \$50 million and \$57 million for Nine Months 2012 and 2011, respectively, related to consolidated FG VIEs.

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Gross Premium Receivable, Net of Ceding Commissions Roll Forward

	Nine Months	
	2012	2011
	(in millions)	
Balance beginning of period	\$1,003	\$1,168
Premium written, net	134	153
Premium payments received, net	(225	) (228
Adjustments to the premium receivable:		
Changes in the expected term of financial guaranty insurance contracts	12	(117
Accretion of discount	19	23
Foreign exchange translation	10	(3
Consolidation of FG VIEs	(5	) (10
Other adjustments	(4	) 1
Balance, end of period (1)	\$944	\$987

(1) Excludes \$30 million and \$29 million as of September 30, 2012 and 2011, respectively, related to consolidated FG VIEs.

Gains or losses due to foreign exchange rate changes relate to installment premium receivables denominated in currencies other than the U.S. dollar. Approximately 50%, 47% and 49% of installment premiums at September 30, 2012, December 31, 2011 and September 30, 2011, respectively, are denominated in currencies other than the U.S. dollar, primarily in Euro and British Pound Sterling.

Actual collections may differ from expected collections in the tables below due to factors such as foreign exchange rate fluctuations, counterparty collectability issues, accelerations, commutations and changes in expected lives.

Expected Collections of Gross Premiums Receivable,
Net of Ceding Commissions (Undiscounted)

	September 30, 2012
	(in millions)
2012 (October 1 – December 31)	\$65
2013	112
2014	93
2015	83
2016	77
2017-2021	305
2022-2026	206
2027-2031	152
After 2031	190
Total(1)	\$1,283

(1) Excludes expected cash collections on FG VIEs of \$35 million.

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Components of Unearned Premium Reserve

	As of September 30, 2012			As of December 31, 2011			
	Gross (in millions)	Ceded	Net(1)	Gross	Ceded	Net(1)	
Deferred premium revenue	\$5,476	\$576	\$4,900	\$6,046	\$728	\$5,318	
Contra-paid	(152) (26) (126) (92) (19) (73)
Total financial guaranty	5,324	550	4,774	5,954	709	5,245	
Other	8	0	8	9	0	9	
Total	\$5,332	\$550	\$4,782	\$5,963	\$709	\$5,254	

(1) Total net unearned premium reserve excludes \$226 million and \$274 million related to FG VIEs as of September 30, 2012 and December 31, 2011, respectively.

The following table provides a schedule of the expected timing of the income statement recognition of pre-tax financial guaranty insurance net deferred premium revenue and the present value of net expected losses to be expensed. The amount and timing of actual premium earnings and loss and LAE may differ from the estimates shown below due to factors such as refundings, accelerations, commutations, changes in expected lives and updates to loss estimates. A loss and LAE reserve is only recorded for the amount by which net expected loss to be expensed exceeds deferred premium revenue determined on a contract-by-contract basis. This table excludes amounts related to consolidated FG VIEs.

Expected Timing of Premium and Loss Recognition

	As of September 30, 2012		
	Scheduled Net Earned Premium (in millions)	Net Expected Loss to be Expensed	Net
2012 (October 1–December 31)	\$141	\$25	\$116
Subtotal 2012	141	25	116
2013	490	75	415
2014	433	49	384
2015	379	38	341
2016	343	35	308
2017 - 2021	1,294	124	1,170
2022 - 2026	814	66	748
2027 - 2031	498	34	464
After 2031	508	30	478
Total present value basis(1)(2)	4,900	476	4,424
Discount	270	235	35
Total future value	\$5,170	\$711	\$4,459

(1) Balances represent discounted amounts.

(2) Consolidation of FG VIEs resulted in reductions of \$364 million in future scheduled net earned premium and \$195 million in net expected loss to be expensed.

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Selected Information for Policies Paid in Installments

	As of September 30, 2012	As of December 31, 2011		
	(dollars in millions)			
Premiums receivable, net of ceding commission payable	\$944	\$1,003		
Gross deferred premium revenue	1,920	2,193		
Weighted-average risk-free rate used to discount premiums	3.6	%	3.4	%
Weighted-average period of premiums receivable (in years)	9.9		9.8	

Loss Estimation Process

The Company's loss reserve committees estimate expected loss to be paid (including any loss adjustment expenses). Surveillance personnel present analyses related to potential losses to the Company's loss reserve committees for consideration in estimating the expected loss to be paid. Such analyses include the consideration of various scenarios with potential probabilities assigned to them. Depending upon the nature of the risk, the Company's view of the potential size of any loss and the information available to the Company, that analysis may be based upon individually developed cash flow models, internal credit rating assessments and sector-driven loss severity assumptions or judgmental assessments. In the case of its assumed business, the Company may conduct its own analysis as just described or, depending on the Company's view of the potential size of any loss and the information available to the Company, the Company may use loss estimates provided by ceding insurers. The Company's loss reserve committees review and refresh the estimate of expected loss to be paid each quarter. The Company's estimate of ultimate loss on a policy is subject to significant uncertainty over the life of the insured transaction due to the potential for significant variability in credit performance as a result of economic, fiscal and financial market variability over the long duration of most contracts. The determination of expected loss to be paid is an inherently subjective process involving numerous estimates, assumptions and judgments by management.

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The following table presents a roll forward of the present value of net expected loss to be paid for financial guaranty insurance contracts by sector. Net expected loss to be paid is the estimate of the present value of future claim payments, net of reinsurance and net of salvage and subrogation, which includes the present value benefit of estimated recoveries for breaches of representations and warranties (“R&W”). The Company used weighted average risk-free rates for U.S. dollar denominated obligations, which ranged from 0.0% to 3.19% as of September 30, 2012 and 0.0% to 3.27% as of December 31, 2011.

Present Value of Net Expected Loss to be Paid
Roll Forward by Sector(1)

	Net Expected Loss to be Paid as of June 30, 2012 (in millions)	Economic Loss Development(2)	(Paid) Recovered Losses(3)	Net Expected Loss to be Paid as of September 30, 2012(4)
U.S. RMBS:				
First lien:				
Prime first lien	\$3	\$1	\$—	\$4
Alt-A first lien	192	4	(8	) 188
Option ARM	(36	) 7	(88	) (117
Subprime	159	11	(5	) 165
Total first lien	318	23	(101	) 240
Second lien:				
Closed-end second lien	(17	) (1	) (3	) (21
HELOCs	(63	) (14	) (30	) (107
Total second lien	(80	) (15	) (33	) (128
Total U.S. RMBS	238	8	(134	) 112
TruPS	7	3	(1	) 9
Other structured finance	221	1	(1	) 221
U.S. public finance	58	8	(56	) 10
Non-U.S. public finance	302	33	(289) 46
Total financial guaranty	826	53	(481) 398
Other	(4) —	—	(4
Total	\$822	\$53	\$(481) \$394

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	Net Expected Loss to be Paid as of June 30, 2011 (in millions)	Economic Loss Development(2)	(Paid) Recovered Losses(3)	Net Expected Loss to be Paid as of September 30, 2011
U.S. RMBS:				
First lien:				
Prime first lien	\$3	\$ (1	) \$—	\$ 2
Alt-A first lien	167	(3	) (16	) 148
Option ARM	267	51	(75	) 243
Subprime	162	36	(1	) 197
Total first lien	599	83	(92	) 590
Second lien:				
Closed-end second lien	(95	) 47	(1	) (49
HELOCs	(38	) (8	) (24	) (70
Total second lien	(133	) 39	(25	) (119
Total U.S. RMBS	466	122	(117	) 471
TruPS	4	8	1	13
Other structured finance	177	75	(6	) 246
U.S. public finance	60	1	(30	) 31
Non-U.S. public finance	6	6	—	12
Total financial guaranty	713	212	(152	) 773
Other	2	—	—	2
Total	\$715	\$212	\$(152	) \$ 775

	Net Expected Loss to be Paid as of December 31, 2011(4) (in millions)	Economic Loss Development(2)	(Paid) Recovered Losses(3)	Net Expected Loss to be Paid as of September 30, 2012(4)
U.S. RMBS:				
First lien:				
Prime first lien	\$2	\$2	\$—	\$ 4
Alt-A first lien	135	18	35	188
Option ARM	153	6	(276	) (117
Subprime	140	33	(8	) 165
Total first lien	430	59	(249	) 240
Second lien:				
Closed-end second lien	(80	) (5	) 64	(21
HELOCs	(31	) 9	(85	) (107
Total second lien	(111	) 4	(21	) (128
Total U.S. RMBS	319	63	(270	) 112
TruPS	13	(3	) (1	) 9
Other structured finance	240	12	(31	) 221
U.S. public finance	16	66	(72	) 10
Non-U.S. public finance	50	216	(220) 46
Total financial guaranty	638	354	(594) 398
Other	2	(6) —	(4

Total	\$640	\$348	\$(594) \$ 394
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	Net Expected Loss to be Paid as of December 31, 2010 (in millions)	Economic Loss Development(2)	(Paid) Recovered Losses(3)	Expected Loss to be Paid as of September 30, 2011
U.S. RMBS:				
First lien:				
Prime first lien	\$ 1	\$ 1	\$—	\$ 2
Alt-A first lien	184	19	(55	) 148
Option ARM	524	(38	) (243	) 243
Subprime	201	13	(17	) 197
Total first lien	910	(5	) (315	) 590
Second lien:				
Closed-end second lien	57	(63	) (43	) (49
HELOCs	(806	) 97	639	(70
Total second lien	(749	) 34	596	(119
Total U.S. RMBS	161	29	281	471
TruPS	(1	) 15	(1	) 13
Other structured finance	160	93	(7	) 246
U.S. public finance	82	(12	) (39	) 31
Non-U.S public finance	7	5	—	12
Total financial guaranty	409	130	234	773
Other	2	—	—	2
Total	\$411	\$130	\$234	\$ 775

(1) Amounts include all expected payments whether or not the insured VIE is consolidated.

(2) Economic loss development includes the effects of changes in assumptions based on observed market trends, changes in discount rates, accretion of discount and the economic effects of loss mitigation efforts.

Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are (3) typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance recoverable on paid losses included in other assets.

(4) Includes expected LAE to be paid for mitigating claim liabilities of \$26 million as of September 30, 2012 and \$36 million as of December 31, 2011.

The table below provides a reconciliation of expected loss to be paid to expected loss to be expensed. Expected loss to be paid differs from expected loss to be expensed due to: (1) the contra-paid which represent the payments that have been made but have not yet been expensed, (2) for transactions with a net expected recovery, the addition of claim payments that have been made (and therefore are not included in expected loss to be paid) that are expected to be recovered in the future (and therefore have also reduced expected loss to be paid), and (3) loss reserves that have already been established (and therefore expensed but not yet paid).

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Reconciliation of Financial Guaranty Insurance Present Value of Net Expected Loss to be Paid and Net Present Value of Net Expected Loss to be Expensed

	As of September 30, 2012 (in millions)
Net expected loss to be paid	\$398
Less: net expected loss to be paid for FG VIEs	(81)
Total	479
Contra-paid, net	126
Other recoveries (1)	30
Salvage and subrogation recoverable	424
Ceded salvage and subrogation recoverable(2)	(47)
Loss and LAE reserve	(591)
Reinsurance recoverable on unpaid losses	55
Net expected loss to be expensed(3)	\$476

(1) R&W recoveries recorded in other assets on the consolidated balance sheet.

(2) Recorded in reinsurance balances payable on the consolidated balance sheet.

(3) Excludes \$195 million related to consolidated FG VIEs.

The Company's Approach to Projecting Losses in U.S. RMBS

The Company projects losses on its insured U.S. RMBS on a transaction-by-transaction basis by projecting the performance of the underlying pool of mortgages over time and then applying the structural features (i.e., payment priorities and tranching) of the RMBS to the projected performance of the collateral over time. The resulting projected claim payments or reimbursements are then discounted using risk-free rates. For transactions where the Company projects it will receive recoveries from providers of R&W, it projects the amount of recoveries and either establishes a recovery for claims already paid or reduces its projected claim payments accordingly.

The further behind a mortgage borrower falls in making payments, the more likely it is that he or she will default. The rate at which borrowers from a particular delinquency category (number of monthly payments behind) eventually default is referred to as the "liquidation rate." Liquidation rates may be derived from observed roll rates, which are the rates at which loans progress from one delinquency category to the next and eventually to default and liquidation. The Company applies liquidation rates to the mortgage loan collateral in each delinquency category and makes certain timing assumptions to project near-term mortgage collateral defaults from loans that are currently delinquent.

Mortgage borrowers that are not more than one payment behind (generally considered performing borrowers) have demonstrated an ability and willingness to pay throughout the recession and mortgage crisis, and as a result are viewed as less likely to default than delinquent borrowers. Performing borrowers that eventually default will also need to progress through delinquency categories before any defaults occur. The Company projects how many of the currently performing loans will default and when they will default, by first converting the projected near term defaults of delinquent borrowers derived from liquidation rates into a vector of conditional default rates ("CDR"), then projecting how the conditional default rates will develop over time. Loans that are defaulted pursuant to the conditional default rate after the liquidation of currently delinquent loans represent defaults of currently performing loans. A conditional default rate is the outstanding principal amount of defaulted loans liquidated in the current month

divided by the remaining outstanding amount of the whole pool of loans (or “collateral pool balance”). The collateral pool balance decreases over time as a result of scheduled principal payments, partial and whole principal prepayments, and defaults.

In order to derive collateral pool losses from the collateral pool defaults it has projected, the Company applies a loss severity. The loss severity is the amount of loss the transaction experiences on a defaulted loan after the application of net proceeds from the disposal of the underlying property. The Company projects loss severities by sector based on its experience to date. Further detail regarding the assumptions and variables the Company used to project collateral losses in its U.S. RMBS portfolio may be found below in the sections “U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second

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Lien” and “U.S. First Lien RMBS Loss Projections: Alt-A First Lien, Option ARM, Subprime and Prime.”

The Company is in the process of enforcing claims for breaches of R&W regarding the characteristics of the loans included in the collateral pools. The Company calculates a credit from the RMBS issuer for such recoveries where the R&W were provided by an entity the Company believes to be financially viable and where the Company already has access or

believes it will attain access to the underlying mortgage loan files. Where the Company has an agreement with an R&W provider (e.g., the the Bank of America Agreement or the Deutsche Bank Agreement) or where it is in advanced discussions on a potential agreement, that credit is based on the agreement or potential agreement. In second lien RMBS transactions where there is no agreement or advanced discussions, this credit is based on a percentage of actual repurchase rates achieved across those transactions where material repurchases have been made. In first lien RMBS transactions where there is no agreement or advanced discussions, this credit is estimated by reducing collateral losses projected by the Company to reflect a percentage of the recoveries the Company believes it will achieve, based on a percentage of actual repurchase rates achieved or based on the amounts the Company was able to negotiate under the Bank of America Agreement and Deutsche Bank Agreement. The first lien approach is different from the second lien approach because the Company’s first lien transactions have multiple tranches and a more complicated method is required to correctly allocate credit to each tranche. In each case, the credit is a function of the projected lifetime collateral losses in the collateral pool, so an increase in projected collateral losses generally increases the R&W credit calculated by the Company for the RMBS issuer. Further detail regarding how the Company calculates these credits may be found under “Breaches of Representations and Warranties” below.

The Company projects the overall future cash flow from a collateral pool by adjusting the payment stream from the principal and interest contractually due on the underlying mortgages for (a) the collateral losses it projects as described above, (b) assumed voluntary prepayments and (c) recoveries for breaches of R&W as described above. The Company then applies an individual model of the structure of the transaction to the projected future cash flow from that transaction’s collateral pool to project the Company’s future claims and claim reimbursements for that individual transaction. Finally, the projected claims and reimbursements are discounted using risk-free rates. As noted above, the Company runs several sets of assumptions regarding mortgage collateral performance, or scenarios, and probability weights them.

Third Quarter-End 2012 U.S. RMBS Loss Projections

The Company's RMBS loss projection methodology assumes that the housing and mortgage markets will eventually improve. Each quarter the Company makes a judgment as to whether to change its assumptions used to make RMBS loss projections based on its observation during the quarter of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and, for first liens, loss severity) as well as the residential property market and economy in general, and, to the extent it observes changes, it makes a judgment as whether those changes are normal fluctuations or part of a trend. Based on such observations, the Company chose to use essentially the same methodology and scenarios to project RMBS loss as of September 30, 2012 as it used as of June 30, 2012. The methodology and scenarios used as of September 30, 2012 were also essentially the same as those it used as of December 31, 2011, except that as compared to December 31, 2011 (i) in its most optimistic scenario, it reduced by three months the period it assumed it would take the mortgage market to recover and (ii) in its most pessimistic scenario, it increased by three months the period it assumed it would take the mortgage market to recover. The methodology the Company uses to project RMBS losses and the scenarios it employs are described in more detail below under "-- U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second Lien" and "-- U.S. First Lien RMBS Loss Projections: Alt A First Lien, Option ARM, Subprime and Prime".

U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second Lien

The Company insures two types of second lien RMBS: those secured by HELOCs and those secured by closed end second lien mortgages. 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 closed end second lien. Second lien RMBS sometimes include a portion of loan collateral with a different priority than the majority of the collateral. 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, a subsidiary of Bank of America. See “—Breaches of Representations and Warranties.”

The delinquency performance of HELOC and closed end second lien exposures included in transactions insured by the Company began to deteriorate in 2007, and such transactions, continue to perform below the Company's original underwriting expectations. While insured securities benefit from structural protections within the transactions designed to absorb collateral losses in excess of previous historically high levels, in many second lien RMBS projected losses now exceed those structural protections.

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The Company believes the primary variables affecting its expected losses in second lien RMBS transactions are the amount and timing of future losses in the collateral pool supporting the transactions and the amount of loans repurchased for breaches of R&W (or agreements with R&W providers related to such obligations). Expected losses are also a function of the structure of the transaction; the voluntary prepayment rate (typically also referred to as conditional prepayment rate ("CPR") of the collateral); the interest rate environment; and assumptions about the draw rate and loss severity. These variables are interrelated, difficult to predict and subject to considerable volatility. If actual experience differs from 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.

The following table shows the range of key assumptions for the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 second lien U.S. RMBS.

Key Assumptions in Base Case Expected Loss Estimates
Second Lien RMBS(1)

HELOC key assumptions	As of September 30, 2012		As of June 30, 2012		As of December 31, 2011	
Plateau CDR	2.2	%– 12.9%	2.9	%– 20.9%	4.0	%– 27.4%
Final CDR trended down to	0.4	%– 3.2%	0.4	%– 3.2%	0.4	%– 3.2%
Expected period until final CDR	36 months		36 months		36 months	
Initial CPR	3.7	%– 17.5%	2.7	%– 16.4%	1.4	%– 25.8%
Final CPR	10%		10%		10%	
Loss severity	98%		98%		98%	
Initial draw rate	0.0	%– 3.5%	0.0	%– 4.1%	0.0	%– 15.3%
Closed-end second lien key assumptions	As of September 30, 2012		As of June 30, 2012		As of December 31, 2011	
Plateau CDR	6.2	%– 19.0%	4.3	%– 20.7%	6.9	%– 24.8%
Final CDR trended down to	3.3	%– 9.1%	3.3	%– 9.1%	3.5	%– 9.2%
Expected period until final CDR	36 months		36 months		36 months	
Initial CPR	1.8	%– 10.1%	1.1	%– 11.0%	0.9	%– 14.7%
Final CPR	10%		10%		10%	
Loss severity	98%		98%		98%	

(1) Represents variables for most heavily weighted scenario (the "base case").

In second lien transactions the projection of near-term defaults from currently delinquent loans is relatively straightforward because loans in second lien transactions are generally "charged off" (treated as defaulted) by the securitization's servicer once the loan is 180 days past due. Most second lien transactions report the amount of loans in five monthly delinquency categories (i.e., 30-59 days past due, 60-89 days past due, 90-119 days past due, 120-149 days past due and 150-179 days past due). The Company estimates the amount of loans that will default over the next five months by calculating current representative liquidation rates (the percent of loans in a given delinquency status that are assumed to ultimately default) from selected representative transactions and then applying an average of the preceding twelve months' liquidation rates to the amount of loans in the delinquency categories. The amount of loans projected to default in the first through fifth months is expressed as a CDR. The first four months' CDR is

calculated by applying the liquidation rates to the current period past due balances (i.e., the 150-179 day balance is liquidated in the first projected month, the 120-149 day balance is liquidated in the second projected month, the 90-119 day balance is liquidated in the third projected month and the 60-89 day balance is liquidated in the fourth projected month). For the fifth month the CDR is calculated using the average 30-59 day past due balances for the prior three months. An average of the third, fourth and fifth month CDR is then used as the basis for the plateau period that follows the embedded five months of losses.

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As of September 30, 2012, for the base case scenario, the CDR (the “plateau CDR”) was held constant for one month. Once the plateau period has ended, the CDR is assumed to gradually trend down in uniform increments to its final long-term steady state CDR. In the base case scenario, the time over which the CDR trends down to its final CDR is 30 months. Therefore, the total stress period for second lien transactions is 36 months, comprising five months of delinquent data, a one month plateau period and 30 months of decrease to the steady state CDR. This is the same as June 30, 2012 and December 31, 2011. The long-term steady state CDR is calculated as the constant CDR that would have yielded the amount of losses originally expected at underwriting. When a second lien loan defaults, there is generally a very low recovery. Based on current expectations of future performance, the Company assumes that it will only recover 2% of the collateral, the same as June 30, 2012 and December 31, 2011.

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected (which is a function of the CDR and the loan balance over time) as well as the amount of excess spread (which is the excess of the interest paid by the borrowers on the underlying loan over the amount of interest and expenses owed on the insured obligations). In the base case, the current CPR (based on an average of the most recent three months) is assumed to continue until the end of the plateau before gradually increasing to the final CPR over the same period the CDR decreases. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. The final CPR is assumed to be 10% for both HELOC and closed-end second lien transactions. This level is much higher than current rates for most transactions, but lower than the historical average, which reflects the Company’s continued uncertainty about the projected performance of the borrowers in these transactions. This pattern is consistent with how the Company modeled the CPR at June 30, 2012 and December 31, 2011. To the extent that prepayments differ from projected levels it could materially change the Company’s projected excess spread and losses.

The Company uses a number of other variables in its second lien loss projections, including the spread between relevant interest rate indices, and HELOC draw rates (the amount of new advances provided on existing HELOCs expressed as a percentage of current outstanding advances). For HELOC transactions, the draw rate is assumed to decline from the current level to a final draw rate over a period of three months. The final draw rates were assumed to range from 0.0% to 1.8%.

In estimating expected losses, the Company modeled and probability weighted three possible CDR curves applicable to the period preceding the return to the long-term steady state CDR. 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 the assumptions affecting its modeling results.

As of September 30, 2012, the Company’s base case assumed a one month CDR plateau and a 30 month ramp-down (for a total stress period of 36 months), the same as June 30, 2012 and December 31, 2011. The Company also modeled a scenario with a longer period of elevated defaults and another with a shorter period of elevated defaults and weighted them the same as of June 30, 2012 and December 31, 2011. The length of the ramp-downs the Company used as of September 30, 2012 and June 30, 2012 were three months shorter in the optimistic cases and three months longer in the pessimistic cases than the Company used as of December 31, 2011 reflecting both positive and negative developments observed by the Company in the market. Increasing the CDR plateau to four months and increasing the ramp-down by three months to 33-months (rather than 30 months as of December 31, 2011, for a total stress period of 42 months rather than 39 months as of December 31, 2011) would increase the expected loss by approximately \$53 million for HELOC transactions and \$4 million for closed-end second lien transactions. On the other hand, keeping the CDR plateau at one month but decreasing the length of the CDR ramp-down to a 21 months (rather than 24 months as of December 31, 2011, for a total stress period of 27 months rather than 30 months as of December 31, 2011) would decrease the expected loss by approximately \$52 million for HELOC transactions and \$3 million for closed-end second lien transactions.

U.S. First Lien RMBS Loss Projections: Alt-A First Lien, Option ARM, Subprime 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 consists 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 first lien.” The collateral supporting such transactions consists of first-lien residential mortgage loans made to “prime” quality borrowers who 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 amortize the loan negatively (i.e., increase the amount of principal owed), the transaction is referred to as an “Option ARM.” Finally, transactions may be composed primarily of loans made to prime borrowers. First lien RMBS sometimes include a portion of

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loan collateral that differs in priority from the majority of the collateral.

The performance of the Company's first lien RMBS exposures began to deteriorate in 2007 and such transactions, continue to perform below the Company's original underwriting expectations. The Company currently projects first lien collateral losses many times those expected at the time of underwriting. While insured securities benefited from structural protections within the transactions designed to absorb some of the collateral losses, in many first lien RMBS transactions, projected losses exceed those structural protections.

The majority of projected losses in first lien RMBS transactions are expected to come from non-performing mortgage loans (those that are delinquent or in foreclosure or where the loan has been foreclosed and the RMBS issuer owns the underlying real estate). Changes in the amount of non-performing loans from the amount projected in the previous period are one of the primary drivers of loss development in this portfolio. In order to determine the number of defaults resulting from these delinquent and foreclosed loans, the Company applies a liquidation rate assumption to loans in each of various delinquency categories. The Company arrived at its liquidation rates based on data purchased from a third party, and assumptions about how delays in the foreclosure process may ultimately affect the rate at which loans are liquidated. The liquidation rate is a standard industry measure that is used to estimate the number of loans in a given aging category that will default within a specified time period. The Company projects these liquidations to occur over two years. The Company used the same liquidation rates for September 30, 2012 as it did for June 30, 2012 and December 31, 2011. The following table shows liquidation assumptions for various delinquency categories.

First Lien Liquidation Rates
as of September 30, 2012

30 – 59 Days Delinquent	
Alt A and Prime	35%
Option ARM	50
Subprime	30
60 – 89 Days Delinquent	
Alt A and Prime	55
Option ARM	65
Subprime	45
90+ Days Delinquent	
Alt A and Prime	65
Option ARM	75
Subprime	60
Bankruptcy	
Alt A and Prime	55
Option ARM	70
Subprime	50
Foreclosure	
Alt A and Prime	85
Option ARM	85
Subprime	80
Real Estate Owned ("REO")	
All	100

While the Company uses liquidation rates as described above to project defaults of non-performing loans, it projects defaults on presently current loans by applying a CDR trend. The start of that CDR trend is based on the defaults the

Company projects will emerge from currently nonperforming loans. The total amount of expected defaults from the non-performing loans is translated into a constant CDR (i.e., the CDR plateau), which, if applied for each of the next 24 months, would be sufficient to produce approximately the amount of defaults that were calculated to emerge from the various delinquency categories. The CDR thus calculated individually on the delinquent collateral pool for each RMBS is then used as the starting point for the CDR curve used to project defaults of the presently performing loans.

In the base case, after the initial 24-month CDR plateau period, each transaction's CDR is projected to improve over

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12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for 36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. Under the Company's methodology, defaults projected to occur in the first 24 months represent defaults that can be attributed to loans that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected CDR trend after the first 24 month period represent defaults attributable to borrowers that are currently performing.

Another important driver of loss projections is loss severity, which is 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 historic high levels, and the Company is assuming that these high levels generally will continue for another year (in the case of subprime loans, the Company assumes the unprecedented 90% loss severity rate will continue for six months then drop to 80% for six months before following the ramp described below). The Company determines its initial loss severity based on actual recent experience. The Company's loss severity assumptions for September 30, 2012 were the same as it used for June 30, 2012 and December 31, 2011. The Company then assumes that loss severities begin returning to levels consistent with underwriting assumptions beginning in June 2013, and in the base case scenario, decline over two years to 40%.

The following table shows the range of key assumptions used in the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 first lien U.S. RMBS.

Key Assumptions in Base Case Expected Loss Estimates
First Lien RMBS(1)

	As of September 30, 2012			As of June 30, 2012			As of December 31, 2011		
Alt-A First Lien									
Plateau CDR	3.5	%-	23.5%	3.3	%-	23.0%	2.8	%-	41.3%
Intermediate CDR	0.7	%-	4.7%	0.7	%-	4.6%	0.6	%-	8.3%
Final CDR	0.2	%-	1.2%	0.2	%-	1.2%	0.1	%-	2.1%
Initial loss severity	65%			65%			65%		
Initial CPR	0.0	%-	31.9%	0.0	%-	27.1%	0.0	%-	24.4%
Final CPR	15%			15%			15%		
Option ARM									
Plateau CDR	7.6	%-	27.7%	9.3	%-	30.2%	11.7	%-	31.5%
Intermediate CDR	1.5	%-	5.5%	1.9	%-	6.0%	2.3	%-	6.3%
Final CDR	0.4	%-	1.4%	0.5	%-	1.5%	0.6	%-	1.6%
Initial loss severity	65%			65%			65%		
Initial CPR	0.0	%-	4.0%	0.6	%-	4.9%	0.3	%-	10.8%
Final CPR	15%			15%			15%		
Subprime									
Plateau CDR	7.5	%-	28.4%	7.2	%-	29.2%	8.6	%-	29.9%
Intermediate CDR	1.5	%-	5.7%	1.4	%-	5.8%	1.7	%-	6.0%
Final CDR	0.4	%-	1.4%	0.4	%-	1.5%	0.4	%-	1.5%
Initial loss severity	90%			90%			90%		
Initial CPR	0.0	%-	7.4%	0.0	%-	8.8%	0.0	%-	16.3%
Final CPR	15%			15%			15%		

(1) Represents variables for most heavily weighted scenario (the "base case").

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected (since that amount is a function of the conditional default rate, the loss severity and the loan balance over time) as well as the amount of excess spread (the amount by which the interest paid by the borrowers on the underlying loan exceeds the amount of interest owed on the insured obligations). The assumption for the CPR follows a similar pattern to that of the conditional default rate.

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The current level of voluntary prepayments is assumed to continue for the plateau 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. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant.

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 loss projections for those transactions based on actual performance and management's estimates of future performance.

In estimating expected losses, the Company modeled and probability weighted sensitivities for first lien transactions by varying its assumptions of how fast a recovery is expected to occur. One of the variables used to model sensitivities was how quickly the conditional default rate returned to its modeled equilibrium, which was defined as 5% of the current conditional default rate. The Company also stressed CPR and the speed of recovery of loss severity rates. The Company probability weighted a total of five scenarios (including its base case) as of September 30, 2012, the same number of scenarios as June 30, 2012 and December 31, 2011. For September 30, 2012 the Company used the same scenarios and weightings as it has for June 30, 2012, which were also the same as it used for December 31, 2011 except that for September 30, 2012 and June 30, 2012 it assumed in the most stressful scenario that the recovery would occur three months more slowly and in the most optimistic scenario that it would occur three months more quickly than it had for December 31, 2011. In a somewhat more stressful environment than that of the base case, where the conditional default rate plateau was extended three months (to be 27 months long) before the same more gradual conditional default rate recovery and loss severities were assumed to recover over four rather than two years (and subprime loss severities were assumed to recover only to 60%), expected loss to be paid would increase from current projections by approximately \$25 million for Alt-A first liens, \$23 million for Option ARM, \$108 million for subprime and \$1 million for prime transactions. In an even more stressful scenario where loss severities were assumed to rise and then recover over eight years and the initial ramp-down of the conditional default rate was assumed to occur over 15 months (rather than 12 months as of December 31, 2011) and other assumptions were the same as the other stress scenario, expected loss to be paid would increase from current projections by approximately \$71 million for Alt-A first liens, \$56 million for Option ARM, \$167 million for subprime and \$4 million for prime transactions. The Company also considered two scenarios where the recovery was faster than in its base case. In a scenario with a somewhat less stressful environment than the base case, where conditional default rate recovery was somewhat less gradual and the initial subprime loss severity rate was assumed to be 80% for 12 months and was assumed to recover to 40% over two years, expected loss to be paid would decrease from current projections by approximately \$4 million for Alt-A first lien, \$30 million for Option ARM, \$29 million for subprime and \$0 million for prime transactions. In an even less stressful scenario where the conditional default rate plateau was three months shorter (21 months, effectively assuming that liquidation rates would improve) and the conditional default rate recovery was more pronounced, (including an initial ramp-down of the conditional default rate over nine months rather than 12 months as at December 31, 2011), expected loss to be paid would decrease from current projections by approximately \$28 million for Alt-A first lien, \$68 million for Option ARM, \$56 million for subprime and \$1 million for prime transactions.

Breaches of Representations and Warranties

The Company is pursuing reimbursements for breaches of R&W regarding loan characteristics. Performance of the collateral underlying certain first and second lien securitizations has substantially differed from the Company's original expectations. The Company has employed several loan file diligence firms and law firms as well as devoted internal resources to review the mortgage files surrounding many of the defaulted loans. The Company's success in these efforts has resulted in three negotiated agreements in respect of the Company's R&W claims, including one on April 14, 2011 with Bank of America and one on May 8, 2012 with Deutsche Bank AG as described under "Deutsche

Bank Agreement” in Note 2, Business Changes, Risks, Uncertainties and Accounting Developments.

The Company has included in its net expected loss estimates as of September 30, 2012 an estimated benefit from loan repurchases related to breaches of R&W of \$1.1 billion, which includes \$471 million from Bank of America and Deutsche Bank under their respective agreements and \$660 million in transactions where the Company does not yet have such an agreement. Proceeds projected to be reimbursed to the Company on transactions where the Company has already paid claims are viewed as a recovery on paid losses. For transactions where the Company has not already paid claims, projected recoveries reduce projected loss estimates. In either case, projected recoveries have no effect on the amount of the Company's exposure. These amounts reflect payments made pursuant to the negotiated transaction agreements and not payments made pursuant to legal settlements. See “Recovery Litigation” below for a description of the related legal proceedings the Company has commenced.

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The Company's success in pursuing breaches of R&W is based upon a detailed review of loan files. The Company reviewed approximately 34,200 second lien and 6,800 first lien loan files (representing approximately \$2,593 million and \$2,357 million, respectively, of loans) in financial guaranty transactions as to which it eventually reached agreements, including the agreements with Bank of America and Deutsche Bank. For the RMBS transactions as to which the Company had not settled its claims for breaches of R&W as of September 30, 2012, the Company had performed a detailed review of approximately 11,000 second lien and 23,200 first lien loan files, representing approximately \$812 million in second lien and \$7,187 million in first lien outstanding par of loans underlying insured transactions. In the majority of its loan file reviews, the Company identified breaches of one or more R&W regarding the characteristics of the loans, such as misrepresentation of income or employment of the borrower, occupancy, undisclosed debt and non-compliance with underwriting guidelines at loan origination.

Through September 30, 2012 the Company has caused entities providing R&Ws to pay or agree to pay approximately \$2.7 billion (gross of reinsurance) in respect of their R&W liabilities for transactions in which the Company has provided a financial guaranty. Of this, \$2.1 billion are payments made or to be made directly to the Company pursuant to agreements with R&W providers (e.g. the Bank of America Agreement and Deutsche Bank Agreement) and approximately \$607 million are amounts paid (or committed to be paid) into the relevant RMBS financial guaranty transactions pursuant to the transaction documents.

The \$2.1 billion of payments made or to be made directly to the Company by R&W providers under agreements with the Company includes \$1,571 million that has already been received by the Company, as well as \$489 million the Company projects receiving in the future pursuant to such currently existing agreements. Because most of that \$489 million is projected to be received through loss-sharing arrangements, the exact amount the Company will receive will depend on actual losses experienced by the covered transactions. This amount is included in the Company's calculated credit for R&W recoveries, described below.

The \$607 million paid, or committed to be paid, by R&W providers are paid into the relevant RMBS transactions in accordance with the priority of payments set out in the relevant transaction documents. Because the Company may insure only a portion of the capital structure of a transaction, such payments will not necessarily directly benefit the Company dollar-for-dollar, especially in first lien transactions. However, such payments do reduce collateral pool losses and so usually reduce the Company's expected losses.

The Company did not incorporate any gain contingencies or damages paid from potential litigation in its estimated repurchases. The amount the Company will ultimately recover related to contractual R&W is uncertain and subject to a number of factors including the counterparty's ability to pay, the number and loss amount of loans determined to have breached R&W and, potentially, negotiated settlements or litigation recoveries. As such, the Company's estimate of recoveries is uncertain and actual amounts realized may differ significantly from these estimates. In arriving at the expected recovery from breaches of R&W, the Company considered the creditworthiness of the provider of the R&W, the number of breaches found on defaulted loans, the success rate in resolving these breaches across those transactions where material repurchases have been made and the potential amount of time until the recovery is realized.

The calculation of expected recovery from breaches of R&W involved a variety of scenarios which ranged from the Company recovering substantially all of the losses it incurred due to violations of R&W to the Company realizing limited recoveries. These scenarios were probability weighted in order to determine the recovery incorporated into the Company's estimate of expected losses. This approach was used for both loans that had already defaulted and those assumed to default in the future.

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Balance Sheet Classification of R&W Benefit, Net of Reinsurance

	As of September 30, 2012			As of December 31, 2011		
	For all Financial Guaranty Insurance Contracts (in millions)	Effect of Consolidating FG VIEs	Reported on Balance Sheet(1)	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet(1)
Salvage and subrogation recoverable	\$363	\$(130)	\$ 233	\$402	\$(197)	\$ 205
Loss and LAE reserve	630	(35)	595	858	(75)	783

(1) The remaining benefit for R&W is not recorded on the balance sheet until the expected loss, net of R&W, exceeds unearned premium reserve.

The following table represents the Company's total estimated R&W recoveries netted in expected loss to be paid, from defective mortgage loans included in certain first and second lien U.S. RMBS loan securitizations that it insures.

Roll Forward of Estimated Benefit from Recoveries from Representation and Warranty Breaches, Net of Reinsurance

	Future Net R&W Benefit as of December 31, 2011	R&W Development and Accretion of Discount During Nine Months 2012	R&W Recovered During Nine Months 2012(1)	Future Net R&W Benefit as of September 30, 2012
	(in millions)			
Prime first lien	\$3	\$ 1	\$—	\$ 4
Alt-A first lien	203	23	(67)	159
Option ARM	714	50	(157)	607
Subprime	101	3	—	104
Closed end second lien	224	—	(88)	136
HELOC	190	6	(76)	120
Total	\$1,435	\$ 83	\$(388)	\$ 1,130

	Future Net R&W Benefit as of December 31, 2011	R&W Development and Accretion of Discount During Nine Months 2011	R&W Recovered During Nine Months 2011(1)	Future Net R&W Benefit as of September 30, 2011
	(in millions)			
Prime first lien	\$1	\$ 2	\$—	\$ 3
Alt-A first lien	81	112	—	193
Option ARM	309	531	(68)	772
Subprime	27	81	—	108
Closed end second lien	179	37	(9)	207
HELOC	1,004	167	(903)	268
Total	\$1,601	\$ 930	\$(980)	\$ 1,551

(1) Gross amounts recovered were \$411 million and \$1,108 million in Nine Months 2012 and 2011, respectively.

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Financial Guaranty Insurance U.S. RMBS Risks with R&W Benefit

	Number of Risks (1) as of		Debt Service as of	
	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011
	(dollars in millions)			
Prime first lien	1	1	\$36	\$42
Alt-A first lien	19	22	1,414	1,733
Option ARM	9	12	912	1,460
Subprime	5	5	813	906
Closed-end second lien	4	4	237	361
HELOC (2)	4	15	174	2,978
Total	42	59	\$3,586	\$7,480

(1) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making debt service payments.

(2) The decline in number of HELOC risks and debt service relates to the final payment from Bank of America for covered HELOC transactions and due to fundings from an R&W provider.

The following table provides a breakdown of the development and accretion amount in the roll forward of estimated recoveries associated with alleged breaches of R&W.

	Third Quarter		Nine Months	
	2012	2011	2012	2011
	(in millions)			
Inclusion or removal of deals with breaches of R&W during period	\$—	\$1	\$(5)	\$108
Change in recovery assumptions as the result of additional file review and recovery success	—	43	70	242
Estimated increase (decrease) in defaults that will result in additional (lower) breaches	10	(23)	10	11
Results of settlements	—	130	—	560
Accretion of discount on balance	2	8	8	9
Total	\$12	\$159	\$83	\$930

The Company assumes that recoveries on transactions backed by HELOC and closed-end second lien loans that were not subject to the Bank of America Agreement or Deutsche Bank Agreement will occur in two to four years from the balance sheet date depending on the scenarios, and that recoveries on transactions backed by Alt-A first lien, Option ARM and Subprime loans will occur as claims are paid over the life of the transactions. Recoveries on second lien transactions subject to the Bank of America Agreement were paid in full by March 31, 2012.

As of September 30, 2012, cumulative collateral losses on the first lien RMBS transactions subject to a comprehensive agreement with Bank of America Corporation and its subsidiaries, including Countrywide Financial Corporation and its subsidiaries (collectively, "Bank of America"), 20 of which were transactions as to which the Company issued financial guaranty insurance contracts and one of which was a transaction on which the Company sold protection through a CDS (the "Bank of America Agreement"), were approximately \$2.8 billion and \$0.1 billion, respectively. The Company estimates that cumulative projected collateral losses for the 20 financial guaranty insurance transactions and one CDS transaction will be \$4.9 billion and \$0.2 billion, respectively. The Bank of America Agreement covers cumulative collateral losses up to \$6.6 billion for all these transactions. Bank of America had placed approximately

\$1.0 billion of eligible assets in trust in order to collateralize the reimbursement obligation relating to these and one covered first lien CDS transaction. The amount of assets required to be posted may increase or decrease from time to time as determined by rating agency requirements.

On May 8, 2012, Assured Guaranty reached a settlement with Deutsche Bank AG and certain of its affiliates (collectively, "Deutsche Bank"), resolving claims related to certain RMBS transactions issued, underwritten or sponsored by Deutsche Bank that were insured by Assured Guaranty under financial guaranty insurance policies and to certain RMBS

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exposures in re-securitization transactions as to which Assured Guaranty provides credit protection through CDS. See Note 2, Business Changes, Risks, Uncertainties and Accounting Developments, for more information.

Student Loan Transactions

The Company has insured or reinsured \$2.6 billion net par of student loan securitizations, of which \$1.3 billion was issued by private issuers and classified as asset-backed and \$1.3 billion was issued by public authorities and classified as public finance. Of these amounts, \$150 million and \$445 million, respectively, are rated BIG. The Company is projecting approximately \$56 million of net expected loss to be paid in these portfolios. In general, the losses are due to: (i) the poor credit performance of private student loan collateral and high loss severities; (ii) high interest rates on auction rate securities with respect to which the auctions have failed or (iii) lower risk-free rates used for discounting, which result in higher present value losses on transactions where losses are payable at final maturity. The largest of these losses was approximately \$25 million and related to a transaction backed by a pool of private student loans ceded to AG Re by another monoline insurer. The guaranteed bonds were issued as auction rate securities that now bear a high rate of interest due to the downgrade of the primary insurer's financial strength rating. Further, the underlying loan collateral has performed below expectations. The overall decrease of approximately \$7 million in net expected loss during Third Quarter 2012 is primarily due to developments in loss mitigation efforts and the increase in risk-free rates used to discount losses.

Trust Preferred Securities Collateralized Debt Obligations

The Company has insured or reinsured \$1.6 billion of net par of collateralized debt obligations ("CDOs") backed by TruPS and similar debt instruments, or "TruPS CDOs." Of that amount, \$725 million is rated BIG. The underlying collateral in the TruPS CDOs consists of subordinated debt instruments such as TruPS issued by bank holding companies and similar instruments issued by insurance companies, real estate investment trusts ("REITs") and other real estate related issuers.

The Company projects losses for TruPS CDOs by projecting the performance of the asset pools across several scenarios (which it weights) and applying the CDO structures to the resulting cash flows. At September 30, 2012, the Company has projected expected losses to be paid for TruPS CDOs that are accounted for as financial guaranty insurance of \$9 million. The increase of approximately \$2 million in net expected loss during Third Quarter 2012 was driven primarily by changes in London Interbank Offered Rate ("LIBOR").

"XXX" Life Insurance Transactions

The Company's \$2.3 billion net par of XXX life insurance transactions as of September 30, 2012 include \$883 million rated BIG. The BIG "XXX" life insurance reserve securitizations are based on discrete blocks of individual life insurance business. In each such transaction the monies raised by the sale of the bonds insured by the Company were 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.

The BIG "XXX" life insurance transactions consist of two transactions: Ballantyne Re p.l.c and Orkney Re II p.l.c. These transactions had material amounts of their assets invested in U.S. RMBS transactions. Based on its analysis of the information currently available, including estimates of future investment performance, and projected credit impairments on the invested assets and performance of the blocks of life insurance business at September 30, 2012, the Company's projected net expected loss to be paid is \$134 million.

U.S. Public Finance Transactions

U.S. municipalities and related entities have been under increasing pressure over the last few quarters, and a few have filed for protection under the U.S. Bankruptcy Code, entered into state processes designed to help municipalities in fiscal distress or otherwise indicated they may consider not meeting their obligations to make timely payments on their debts. The Company expects that bondholder rights will be enforced. However, due to the early stage of these developments, and the circumstances surrounding each instance, the ultimate outcome cannot be certain. The Company will continue to analyze developments in each of these matters closely. The municipalities whose obligations the Company has insured that have filed for protection under Chapter 9 of the U.S Bankruptcy Code are: Jefferson County, Alabama and Stockton, California. The City Council of Harrisburg, Pennsylvania had also filed a purported bankruptcy petition, which was later dismissed by the bankruptcy court; a receiver for the City of Harrisburg was appointed by the Commonwealth Court of Pennsylvania on December 2, 2011.

The Company has net exposure to Jefferson County, Alabama of \$708 million as of September 30, 2012. On

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November 9, 2011, Jefferson County filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. Most of the Company's net Jefferson County exposure relates to \$479 million in sewer revenue exposure, of which \$206 million is direct and \$273 million is assumed reinsurance exposure. The sewer revenue warrants are secured by a pledge of the net revenues of the sewer system. The bankruptcy court has affirmed that the net revenues constitute a "special revenue" under Chapter 9. Therefore, the lien on net revenues of the sewer system survives the bankruptcy filing and such net revenues are not subject to the automatic stay during the pendency of Jefferson County's bankruptcy case. BNY Mellon, as trustee, had brought a lawsuit regarding the amount of net revenues to which it is entitled. Since its bankruptcy filing, Jefferson County had been withholding estimated bankruptcy-related legal expenses and an amount representing a monthly reserve for future expenditures and depreciation and amortization from the monthly payments it had been making to the trustee from sewer revenues for debt service. On June 29, 2012, the Bankruptcy Court ruled that "Operating Expenses" as determined under the bond indenture do not include (1) a reserve for depreciation, amortization, or future expenditures, or (2) an estimate for professional fees and expenses, such that, after payment of Operating Expenses (as defined in the indenture), monies remaining in the Revenue Account created under the bond indenture must be distributed in accordance with the waterfall set forth in the indenture without withholding any monies for depreciation, amortization, reserves, or estimated expenditures that are the subject of this litigation. Whether sufficient net revenues will be available for the payment of regularly scheduled debt service ultimately depends on the bankruptcy court's valuation of the sewer revenue stream. The Company also has assumed exposure of \$32 million to warrants that are payable from Jefferson County's general fund on a "subject to appropriation" basis. During the past quarter Jefferson County chose not to make payment under its General Obligation bonds, so the Company has established a projected loss for these warrants as well. The Company's remaining net exposure of \$197 million to Jefferson County relates to obligations that are secured by, or payable from, certain taxes that may have the benefit of a statutory lien or a lien on "special revenues" or other collateral.

On June 28, 2012, the City of Stockton, California filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. The Company's net exposure to Stockton's general fund is \$160 million, consisting of pension obligation and lease revenue bonds. As of September 30, 2012, the Company had paid \$8 million in net claims.

The Company has \$156 million of net par exposure to The City of Harrisburg, Pennsylvania, of which \$95 million is BIG. The Company has paid \$10 million in net claims as of September 30, 2012, and expects a full recovery.

The Company has \$336 million of net par exposure to the Louisville Arena Authority. The bond proceeds were used to construct the KFC Yum Center, home to the University of Louisville men's and women's basketball teams. Actual revenues available for debt service are well below original projections, and under the Company's internal rating scale, the transaction is below investment grade.

The Company has \$26 million remaining in net par exposure to bonds secured by the excess free cash flow of the Foxwoods Casino, run by the Mashantucket Pequot Tribe. The Company had paid \$86 million in net claims as of September 30, 2012, and expects full recovery of such amount.

The Company projects that its total expected net loss from troubled U.S. public finance credits will be \$10 million as of September 30, 2012, down from \$58 million as of June 30, 2012. This decrease was due primarily to the increase in expected recoveries on Foxwoods Casino.

Other Notable Transactions

At June 30, 2012, the Company had €314 million (€218 million on a net basis) of exposure to the sovereign debt of Greece. The Company accelerated claims under its financial guaranties during the quarter, paying off in full its liabilities with respect to the Greek sovereign bonds it guaranteed. At September 30, 2012, the Company had paid \$289 million in net claims and no longer had any direct financial guaranty exposure to Greece.

The Company projects losses on, or is monitoring particularly closely, a number of other transactions, the most significant of which are described in the following paragraphs.

The Company insures and reinsures credits with sub-sovereign exposure to various Spanish regions where a Spanish sovereign default causes the regions also to default. The Company's gross exposure to these credits is €444 million and its exposure net of reinsurance is €319 million. During Third Quarter 2012, the Company downgraded these exposures to the BB category due to concerns that these regions would not pay under their contractual obligations. As a result the Company increased its net expected loss to \$34 million, which represents a \$31 million increase from last quarter.

The Company insures or reinsures a total of \$306 million net par of securities backed by manufactured housing

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loans, a total of \$210 million rated BIG. The Company has expected loss to be paid of \$31 million as of September 30, 2012 compared to \$26 million as of June 30, 2012.

The Company also has outstanding exposures to certain infrastructure transactions in its insured portfolio that may expose it to refinancing risk. These transactions generally involve long-term infrastructure projects that are financed by bonds that mature prior to the expiration of the project concession. While the cash flows from these projects were expected to be sufficient to repay all of the debt over the life of the project concession, in order to pay the principal on the early maturing debt, the Company expected it to be refinanced in the market at or prior to its maturity. Due to market dislocation and increased credit spreads, the Company may have to pay a claim at the maturity of the securities, and then recover its payment from cash flows produced by the project in the future. The Company generally projects that in most scenarios it will be fully reimbursed for such payments. The projected inflows and outflows are included in the Company's "Financial Guaranty Insurance BIG Transaction Loss Summary" table in this Note.

Recovery Litigation

RMBS Transactions

As of the date of this filing, AGM and AGC have lawsuits pending against a number of providers of representations and warranties in U.S. RMBS transactions insured by them, seeking damages, including indemnity or reimbursement for losses. In the lawsuits, AGM and AGC have alleged breaches of R&W both in respect of the underlying loans in the transactions and the accuracy of the information provided to AGM and AGC, and failure to cure or repurchase defective loans identified by AGM and AGC to such persons:

Flagstar: AGM has sued Flagstar Bank, FSB, Flagstar Capital Markets Corporation and Flagstar ABS, LLC on the Flagstar Home Equity Loan Trust, Series 2005-1 and Series 2006-2 second lien transactions. The trial in the United States District Court for the Southern District of New York began in October 2012.

Deutsche Bank: AGM has sued Deutsche Bank AG affiliates DB Structured Products, Inc. and ACE Securities Corp. on the ACE Securities Corp. Home Equity Loan Trust, Series 2006-GP1 second lien transaction.

J.P. Morgan: AGC has sued JPMorgan Chase & Co.'s affiliate EMC Mortgage LLC, J.P. Morgan Securities Inc. (formerly known as Bear, Stearns & Co. Inc.) and JPMorgan Chase Bank, N.A. on the SACO I Trust 2005-GP1 second lien transaction and EMC Mortgage LLC on the Bear Stearns Asset Backed Securities I Trust 2005-AC5 and Bear Stearns Asset Backed Securities I Trust 2005-AC6 first lien transactions.

ResCap: AGM has sued GMAC Mortgage, LLC (formerly GMAC Mortgage Corporation; Residential Asset Mortgage Products, Inc.; Ally Bank (formerly GMAC Bank); Residential Funding Company, LLC (formerly Residential Funding Corporation); Residential Capital, LLC (formerly Residential Capital Corporation, "ResCap"); Ally Financial (formerly GMAC, LLC); and Residential Funding Mortgage Securities II, Inc. on the GMAC RFC Home Equity Loan-Backed Notes, Series 2006-HSA3 and GMAC Home Equity Loan-Backed Notes, Series 2004-HE3 second lien transactions. On May 14, 2012, ResCap and several of its affiliates (the "Debtors") filed for Chapter 11 protection with the U.S. Bankruptcy Court. The automatic stay of Bankruptcy Code Section 362 (a) stays lawsuits (such as the suit brought by AGM) against the Debtors and AGM, the Debtors and the non-Debtor affiliates have filed a stipulation with the court agreeing to extend the stay to the non-Debtor affiliates until January 31, 2013.

In addition, AGM and AGC have brought actions against providers of R&W in U.S. RMBS transactions insured by them, alleging breaches of R&W in respect of the underlying loans in the transactions, breaches of contract in procuring falsely inflated shadow ratings (a condition to the issuance by AGM and AGC of its policies) by providing

false and misleading information to the rating agencies, and failure to cure or repurchase defective loans identified by AGM and AGC:

Credit Suisse: AGM and AGC have sued DLJ Mortgage Capital, Inc. (“DLJ”) and Credit Suisse Securities (USA) LLC (“Credit Suisse”) on first lien U.S. RMBS transactions insured by them. The ones insured by AGM are: CSAB Mortgage-Backed Pass Through Certificates, Series 2006-2; CSAB Mortgage-Backed Pass Through Certificates, Series 2006-3; CSAB Mortgage-Backed Pass Through Certificates, Series 2006-4; and CMSC Mortgage-Backed Pass Through Certificates, Series 2007-3. The ones insured by AGC are: CSAB Mortgage-Backed Pass Through Certificates, Series 2007-1 and TBW Mortgage-Backed Pass Through Certificates, Series 2007-2. On December 6, 2011, DLJ and Credit Suisse filed a motion to dismiss the cause

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of action asserting breach of the document containing the condition precedent regarding the rating of the securities and claims for rescissionary damages and other relief in the complaint, and on October 11, 2012, the Supreme Court of the State of New York granted the motion to dismiss. AGM and AGC intend to appeal the dismissal of certain of its claims. The causes of action against DLJ for breach of R&W and breach of its repurchase obligations remain.

UBS: AGM has sued UBS Real Estate Securities Inc. on the MASTR Adjustable Rate Mortgages Trust 2006-OA2, MASTR Adjustable Rate Mortgages Trust 2007-1 and MASTR Adjustable Rate Mortgages Trust 2007-3 first lien transactions. In April 2012, UBS filed a motion to dismiss the complaint and on August 15, 2012, the United States District Court for the Southern District of New York rejected the motion to dismiss as to AGM's claims of breach of R&W and for rescissionary damages. It also upheld AGM's breach of warranty claim related to the shadow ratings issued with respect to the transactions. The motion to dismiss was granted against AGM's claims for breach of the repurchase obligation, which the court held could only be enforced by the trustee of the applicable trusts, and for declaratory judgments that UBS failed to cure breaches and for reimbursement of all insurance payments made to UBS. On September 28, 2012, at the direction of AGM, the trustee of the trusts filed a breach of contract complaint against UBS on behalf of the applicable trusts.

AGM also has a lawsuit pending against UBS Securities LLC, as underwriter, as well as several named and unnamed control persons of IndyMac Bank, FSB and related IndyMac entities, that it filed in September 2010 on the IndyMac IMSC Mortgage Loan Trust, Series 2007-HOA-1a first lien transaction (the "HOA1 Transaction"), seeking damages for alleged violations of state securities laws and breach of contract, among other claims. In addition, on August 9, 2012, AGM filed a complaint against OneWest Bank, FSB, the servicer of the mortgage loans underlying the HOA1 Transaction and the IndyMac Home Equity Mortgage Loan Asset-Backed Trust, Series 2007-H1 HELOC transaction seeking damages, specific performance and declaratory relief in connection with OneWest failing to properly service the mortgage loans.

“XXX” Life Insurance Transactions

In December 2008, Assured Guaranty (UK) Ltd. (“AGUK”) filed an action against J.P. Morgan Investment Management Inc. (“JPMIM”), the investment manager in the Orkney Re II transaction, in the Supreme Court of the State of New York 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. After AGUK’s claims were dismissed with prejudice in January 2010, AGUK was successful in its subsequent motions and appeals and, as of December 2011, all of AGUK’s claims for breaches of fiduciary duty, gross negligence and contract were reinstated in full. Separately, at the trial court level, discovery is ongoing.

Public Finance Transactions

In June 2010, AGM sued JPMorgan Chase Bank, N.A. and JPMorgan Securities, Inc. (together, “JPMorgan”), the underwriter of debt issued by Jefferson County, in the Supreme Court of the State of New York alleging that JPMorgan induced AGM to issue its insurance policies in respect of such debt through material and fraudulent misrepresentations and omissions, including concealing that it had secured its position as underwriter and swap provider through bribes to Jefferson County commissioners and others. In December 2010, the court denied JPMorgan’s motion to dismiss. AGM has filed a motion with the Jefferson County bankruptcy court to confirm that continued prosecution of the lawsuit against JPMorgan will not violate the automatic stay applicable to Jefferson County notwithstanding JPMorgan’s interpleading of Jefferson County into the lawsuit. AGM is continuing its risk remediation efforts for this exposure.

In September 2010, AGM, together with TD Bank, National Association and Manufacturers and Traders Trust Company, as trustees, filed a complaint in the Court of Common Pleas of Dauphin County, Pennsylvania against The

Harrisburg Authority, The City of Harrisburg, Pennsylvania, and the Treasurer of the City in connection with certain Resource Recovery Facility bonds and notes issued by The Harrisburg Authority, alleging, among other claims, breach of contract by both The Harrisburg Authority and The City of Harrisburg, and seeking remedies including an order of mandamus compelling the City to satisfy its obligations on the defaulted bonds and notes and the appointment of a receiver for The Harrisburg Authority. Acting on its own, the City Council of Harrisburg filed a purported bankruptcy petition for the City in October 2011, which petition and a subsequent appeal were dismissed by the bankruptcy court in November 2011. The City Council appealed the dismissal of the appeal and such appeal was dismissed as untimely both by the District Court and the Third Circuit Court of Appeals. As a result of the dismissal, the actions brought by AGM and the trustees against The City of Harrisburg and The Harrisburg Authority are no longer stayed. A receiver for The City of Harrisburg (the "City Receiver") was appointed by the Commonwealth Court of Pennsylvania in December 2011. The City Receiver filed a motion to intervene in the mandamus action and action for the appointment of a receiver for the resource recovery facility. In March 2012, the Court of Common Pleas of Dauphin County, Pennsylvania issued an order granting the motion for the appointment of a

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receiver for the resource recovery facility, which order has been appealed by The Harrisburg Authority.

Net Loss Summary

The following table provides information on loss and LAE reserves net of reinsurance and salvage and subrogation recoverable on the consolidated balance sheets.

Loss and LAE Reserve (Recovery)

Net of Reinsurance and Salvage and Subrogation Recoverable

	As of September 30, 2012			As of December 31, 2011		
	Loss and LAE Reserve (in millions)	Salvage and Subrogation Recoverable	Net	Loss and LAE Reserve	Salvage and Subrogation Recoverable	Net
U.S. RMBS:						
First lien:						
Prime first lien	\$3	\$—	\$3	\$1	\$—	\$1
Alt-A first lien	86	—	86	70	55	15
Option ARM	71	212	(141)	142	141	1
Subprime	79	—	79	51	0	51
Total first lien	239	212	27	264	196	68
Second lien:						
Closed-end second lien	11	67	(56)	11	136	(125)
HELOC	41	194	(153)	61	177	(116)
Total second lien	52	261	(209)	72	313	(241)
Total U.S. RMBS	291	473	(182)	336	509	(173)
TruPS	7	—	7	11	—	11
Other structured finance	194	5	189	223	6	217
U.S. public finance	80	103	(23)	62	70	(8)
Non-U.S. public finance	29	—	29	38	—	38
Total financial guaranty	601	581	20	670	585	85
Other	2	6	(4)	2	—	2
Subtotal	603	587	16	672	585	87
Effect of consolidating FG VIEs	(65)	(204)	139	(62)	(258)	196
Total (1)	\$538	\$383	\$155	\$610	\$327	\$283

(1) See “Components of Net Reserves (Salvage)” table for loss and LAE reserve and salvage and subrogation recoverable components.

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The following table reconciles the loss and LAE reserve and salvage and subrogation components on the consolidated balance sheet to the financial guaranty net reserves (salvage) in the financial guaranty BIG transaction loss summary tables.

Components of Net Reserves (Salvage)

	As of September 30, 2012 (in millions)	As of December 31, 2011
Loss and LAE reserve	\$594	\$679
Reinsurance recoverable on unpaid losses	(56	) (69
Subtotal	538	610
Salvage and subrogation recoverable	(430	) (368
Salvage and subrogation payable(1)	47	41
Other recoveries(2)	(30) —
Subtotal	(413	) (327
Total	125	283
Less: other	(4	) 2
Financial guaranty net reserves (salvage)	\$129	\$281

(1) Recorded as a component of reinsurance balances payable.

(2) R&W recoveries recorded in other assets on the consolidated balance sheet.

The following table presents the loss and LAE recorded in the consolidated statements of operations by sector for financial guaranty insurance contracts. Amounts presented are net of reinsurance and net of the benefit for recoveries from breaches of R&W.

Table of ContentsLoss and LAE Reported
on the Consolidated Statements of Operations

	Third Quarter		Nine Months		
	2012	2011	2012	2011	
	(in millions)				
Financial Guaranty:					
U.S. RMBS:					
First lien:					
Prime first lien	\$1	\$0	\$2	\$1	
Alt-A first lien	9	25	37	52	
Option ARM	25	92	94	134	
Subprime	9	16	33	11	
Total first lien	44	133	166	198	
Second lien:					
Closed end second lien	(1	) 22	1	7
HELOC	2	19	21	116	
Total second lien	1	41	22	123	
Total U.S. RMBS	45	174	188	321	
TruPS	2	7	(4	) 11
Other structured finance	1	77	2	104	
U.S. public finance	2	(5) 47	(18)
Non-U.S. public finance	38	—	233	1	
Total financial guaranty	88	253	466	419	
Other	—	—	(6) —	
Subtotal	88	253	460	419	
Effect of consolidating FG VIEs	2	(38) (1) (106)
Total loss and LAE	\$90	\$215	\$459	\$313	

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The following table provides information on financial guaranty contracts categorized as BIG.

Financial Guaranty Insurance BIG Transaction Loss Summary
September 30, 2012

	BIG Categories						Total BIG, Net	Effect of Consolidating FG VIEs	Total
	BIG 1		BIG 2		BIG 3				
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	148	56	90	24	136	51	374	—	374
Remaining weighted-average contract period (in years)	11.1	9.3	12.0	15.6	8.9	6.0	10.6	—	10.6
Outstanding exposure:									
Principal	\$8,410	\$(1,467)	\$3,390	\$(157)	\$7,854	\$(555)	\$17,475	\$—	\$17,475
Interest	4,281	(560)	2,308	(157)	2,531	(144)	8,259	—	8,259
Total(2)	\$12,691	\$(2,027)	\$5,698	\$(314)	\$10,385	\$(699)	\$25,734	\$—	\$25,734
Expected cash outflows (inflows)	\$1,661	\$(563)	\$1,041	\$(97)	\$3,052	\$(136)	\$4,958	\$(736)	\$4,222
Potential recoveries(3)	(1,798)	576	(638)	19	(2,541)	133	(4,249)	741	(3,508)
Subtotal	(137)	13	403	(78)	511	(3)	709	5	714
Discount	61	(3)	(75)	29	(320)	(3)	(311)	76	(235)
Present value of expected cash flows	\$(76)	\$10	\$328	\$(49)	\$191	\$(6)	\$398	\$81	\$479
Deferred premium revenue	\$88	\$(13)	\$265	\$(26)	\$848	\$(97)	\$1,065	\$(315)	\$750
Reserves (salvage)(4)	\$(115)	\$15	\$155	\$(37)	\$(42)	\$14	\$(10)	\$139	\$129

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December 31, 2011

	BIG Categories						Total BIG, Net	Effect of Consolidating FG VIEs	Total
	BIG 1		BIG 2		BIG 3				
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	171	(68)	71	(26)	126	(48)	368	—	368
Remaining weighted-average contract period (in years)	10.0	9.2	13.7	20.5	9.2	6.4	10.4	—	10.4
Outstanding exposure:									
Principal	\$9,675	\$(1,378)	\$3,732	\$(274)	\$7,831	\$(627)	\$18,959	\$—	\$18,959
Interest	4,309	(486)	2,889	(405)	2,486	(170)	8,623	—	8,623
Total(2)	\$13,984	\$(1,864)	\$6,621	\$(679)	\$10,317	\$(797)	\$27,582	\$—	\$27,582
Expected cash outflows (inflows)	\$1,731	\$(659)	\$1,833	\$(121)	\$2,423	\$(133)	\$5,074	\$(998)	\$4,076
Potential recoveries(3)	(1,798)	664	(1,079)	39	(2,041)	100	(4,115)	1,060	(3,055)
Subtotal	(67)	5	754	(82)	382	(33)	959	62	1,021
Discount	16	(5)	(241)	32	(125)	2	(321)	45	(276)
Present value of expected cash flows	\$(51)	\$0	\$513	\$(50)	\$257	\$(31)	\$638	\$107	\$745
Deferred premium revenue	\$261	\$(69)	\$281	\$(12)	\$992	\$(127)	\$1,326	\$(391)	\$935
Reserves (salvage)(4)	\$(97)	\$7	\$320	\$(42)	\$(110)	\$7	\$85	\$196	\$281

A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of (1) making debt service payments. The ceded number of risks represents the number of risks for which the Company ceded a portion of its exposure.

(2) Includes BIG amounts related to FG VIEs which are not eliminated.

(3) Includes estimated future recoveries for breaches of R&W as well as excess spread, and draws on HELOCs.

(4) See table "Components of net reserves (salvage)."

Ratings Impact on Financial Guaranty Business

A downgrade of one of the Company's insurance subsidiaries may result in increased claims under financial guaranties issued by the Company, if the insured obligors were unable to pay.

For example, AGM has issued financial guaranty insurance policies in respect of the obligations of municipal obligors under interest rate swaps. Under the swaps, AGM insures periodic payments owed by the municipal obligors to the

bank counterparties. Under certain of the swaps, AGM also insures termination payments that may be owed by the municipal obligors to the bank counterparties. If (i) AGM has been downgraded below the rating trigger set forth in a swap under which it has insured the termination payment, which rating trigger varies on a transaction by transaction basis; (ii) the municipal obligor has the right to cure by, but has failed in, posting collateral, replacing AGM or otherwise curing the downgrade of AGM; (iii) the transaction documents include as a condition that an event of default or termination event with respect to the municipal obligor has occurred, such as the rating of the municipal obligor being downgraded past a specified level, and such condition has been met; (iv) the bank counterparty has elected to terminate the swap; (v) a termination payment is payable by the municipal obligor; and (vi) the municipal obligor has failed to make the termination payment payable by it, then AGM would be required to pay the termination payment due by the municipal obligor, in an amount not to exceed the policy limit set forth in the financial guaranty insurance policy. The claim payments would be subject to recovery from the municipal obligor. As of September 30, 2012, taking into consideration whether the rating of the municipal obligor was below any applicable specified trigger as of such date, if the financial strength rating of AGM were downgraded below "A" by S&P or below "A2" by Moody's, and the conditions giving rise to the obligation of AGM to make a payment under the swap policies

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were all satisfied, then AGM could pay claims in an amount not exceeding \$370 million in respect of such termination payments.

As another example, with respect to variable rate demand obligations ("VRDOs") for which a bank has agreed to provide a liquidity facility, a downgrade of AGM or AGC may provide the bank with the right to give notice to bondholders that the bank will terminate the liquidity facility, causing the bondholders to tender their bonds to the bank. Bonds held by the bank accrue interest at a "bank bond rate" that is higher than the rate otherwise borne by the bond (typically the prime rate plus 2.00% — 3.00%, and capped at the lesser of 25% and the maximum legal limit). In the event the bank holds such bonds for longer than a specified period of time, usually 90-180 days, the bank has the right to demand accelerated repayment of bond principal, usually through payment of equal installments over a period of not less than five years. In the event that a municipal obligor is unable to pay interest accruing at the bank bond rate or to pay principal during the shortened amortization period, a claim could be submitted to AGM or AGC under its financial guaranty policy. As of September 30, 2012, AGM and AGC have insured approximately \$0.8 billion of par of VRDOs issued by municipal obligors rated BBB- or lower pursuant to the Company's internal rating. For a number of such obligations, a downgrade of AGM or AGC below "A+" by S&P or below "A1" by Moody's triggers the ability of the bank to notify bondholders of the termination of the liquidity facility and to demand accelerated repayment of bond principal over a period of 5 to 10 years. The specific terms relating to the rating levels that trigger the bank's termination right, and whether it is triggered by a downgrade by one rating agency or a downgrade by all rating agencies then rating the insurer, vary depending on the transaction.

5. Fair Value Measurement

The Company carries a significant portion of its assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e., exit price). 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 a hypothetical market that maximizes the value received for an asset or minimizes the amount paid for a liability (i.e., the most advantageous market).

Fair value is based on quoted market prices, where available. If listed prices or quotes are not available, fair value is based on either internally developed models that primarily use, as inputs, market-based or independently sourced market parameters, including but not limited to yield curves, interest rates and debt prices or with the assistance of an independent third-party using a discounted cash flow approach and the third party's proprietary pricing models. In addition to market information, models also incorporate transaction details, such as maturity of the instrument and contractual features designed to reduce the Company's credit exposure, such as collateral rights as applicable.

Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, the Company's creditworthiness and constraints on liquidity. As markets and products develop and the pricing for certain products becomes more or less transparent, the Company may refine its methodologies and assumptions. During 2012, no changes were made to the Company's valuation models that had or are expected to have, a material impact on the Company's consolidated balance sheets or statements of operations and comprehensive income.

The Company's methods for calculating fair value produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. The use of different methodologies or assumptions to determine fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The fair value hierarchy is determined based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Company estimates of market assumptions. The fair value hierarchy prioritizes model inputs into three broad levels as follows, with Level 1 being the highest and Level 3 the lowest. An asset or liability's categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation.

Level 1—Quoted prices for identical instruments in active markets. The Company generally defines an active market as a market in which trading occurs at significant volumes. Active markets generally are more liquid and have a lower bid-ask spread than an inactive market.

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.

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Level 3—Model derived valuations in which one or more significant inputs or significant value drivers are unobservable. 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.

Transfers between Levels 1, 2 and 3 are recognized at the beginning of the period when the transfer occurs. The Company reviews the classification between Levels 1, 2 and 3 quarterly to determine whether a transfer is necessary. During the periods presented, there were no transfers between Level 1 and Level 2. The committed capital securities ("CCS") were transferred to Level 3 in the fair value hierarchy in Third Quarter 2011 because the Company was no longer able to obtain the same level of pricing information as in past quarters. There were no transfers in or out Level 3 during Third Quarter or Nine Months 2012.

Measured and Carried at Fair Value

Fixed Maturity Securities and Short-term Investments

The fair value of bonds in the investment portfolio is generally based on prices received from third party pricing services or alternative pricing sources with reasonable levels of price transparency. The pricing services prepare estimates of fair value measurements using their pricing applications, which include available relevant market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. Additional valuation factors that can be taken into account are nominal spreads and liquidity adjustments. The pricing services evaluate each asset class based on relevant market and credit information, perceived market movements, and sector news. The market inputs used in the pricing evaluation, listed in the approximate order of priority include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data and industry and economic events. Benchmark yields have in many cases taken priority over reported trades for securities that trade less frequently. The extent of the use of each input is dependent on the asset class and the market conditions. Given the asset class, the priority of the use of inputs may change or some market inputs may not be relevant. Additionally, the valuation of fixed maturity investments is more subjective when markets are less liquid due to the lack of market based inputs, which may increase the potential that the estimated fair value of an investment is not reflective of the price at which an actual transaction would occur. The vast majority of fixed maturities are classified as Level 2.

Short-term investments, that are traded in active markets, are classified within Level 1 in the fair value hierarchy and are based on quoted market prices. Securities such as discount notes are classified within Level 2 because these securities are typically not actively traded due to their approaching maturity and, as such, their cost approximates fair value.

Prices determined based upon model processes where at least one significant model assumption or input is unobservable, are considered to be Level 3 in the fair value hierarchy. At September 30, 2012, the Company used model processes to price 33 fixed maturity securities, which was 5% or \$519 million of the Company's fixed maturity securities and short-term investments at fair value. Level 3 securities were priced with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach using the third-party's proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); house price depreciation/appreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the bond including collateral type,

weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could materially change the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

Other Invested Assets

Other invested assets includes certain investments that are carried and measured at fair value on a recurring basis and non-recurring basis, as well as assets not carried at fair value. Within other invested assets, \$95 million are carried at fair value on a recurring basis as of September 30, 2012. These assets primarily comprise certain short-term investments and fixed maturity securities classified as trading and are Level 2 in the fair value hierarchy. Also carried at fair value on a recurring basis are \$1 million in notes classified as Level 3 in the fair value hierarchy. The fair value of these notes is determined by calculating the present value of the expected cash flows. The unobservable inputs used in the fair value measurement of the notes are discount rate, prepayment speed and default rate.

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Within other invested assets, \$7 million are carried at fair value on a non-recurring basis as of September 30, 2012. These assets are comprised of mortgage loans which are classified as Level 3 in the fair value hierarchy as there are significant unobservable inputs used in the valuation of such loans. The non-performing portion of these mortgage loans is valued using an average recovery rate. The performing loans are valued using management's determination of future cash flows arising from these loans, discounted at the rate of return that would be required by a market participant. The unobservable inputs used in the fair value measurement of the mortgage loans are discount rate, recovery on delinquent loans, loss severity, prepayment speed and default rate.

Other Assets

Committed Capital Securities

The fair value of CCS, which is recorded in "other assets" on the consolidated balance sheets, represents the difference between the present value of remaining expected put option premium payments under AGC's CCS (the "AGC CCS Securities") and AGM's Committed Preferred Trust Securities (the "AGM CPS Securities") agreements, and the estimated present value that the Company would hypothetically have to pay currently for a comparable security (see Note 13, Long Term Debt and Credit Facilities). The estimated current cost of the Company's CCS depends on several factors, including broker-dealer quotes for the outstanding securities, the U.S. dollar forward swap curve, LIBOR curve projections and the term the securities are estimated to remain outstanding.

In Third Quarter 2011, these securities were transferred to Level 3 in the fair value hierarchy because there is a reliance on significant unobservable inputs to the valuation model, including a broker-dealer quote and the Company's estimate of the term the securities will be outstanding. Prior to Third Quarter 2011, the significant market inputs used were observable; therefore, the Company classified this fair value measurement as Level 2. The Company is no longer able to obtain the same level of pricing information as in past quarters.

Supplemental Executive Retirement Plans

The Company classifies the fair value measurement of the assets of the Company's various supplemental executive retirement plans as either Level 1 or Level 2. The fair value of these assets is valued based on the observable published daily values of the underlying mutual fund included in the aforementioned plans (Level 1) or based upon the net asset value of the funds if a published daily value is not available (Level 2).

Financial Guaranty Contracts Accounted for as Credit Derivatives

The Company's credit derivatives consist primarily of insured CDS contracts, and also include interest rate swaps that fall under derivative accounting standards requiring fair value accounting through the statement of operations. The Company does not enter into CDS with the intent to trade these contracts and the Company may not unilaterally terminate a CDS contract absent an event of default or termination event that entitles the Company to terminate; however, the Company has mutually agreed with various counterparties to terminate certain CDS transactions. Such terminations generally are completed for an amount that approximates the present value of future premiums, not at fair value.

The terms of the Company's CDS contracts differ from more standardized credit derivative contracts sold by companies outside the financial guaranty industry. Management considers the non-standard terms of its credit derivative contracts in determining the fair value of these contracts. The non-standard terms include the absence of collateral support agreements or immediate settlement provisions. In addition, the Company employs relatively high attachment points and does not exit derivatives it sells or purchases for credit protection purposes, except under specific circumstances such as mutual agreements with counterparties to terminate certain CDS contracts.

Due to the lack of quoted prices for its instruments or for similar instruments, the Company determines the fair value of its credit derivative contracts primarily through modeling that uses various inputs to derive an estimate of the fair value of the Company's contracts in principal markets. 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. 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. These contracts are classified as Level 3 in the fair value hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation

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model, most importantly 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.

The Company's 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 and relevant market information.

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining net premiums the Company expects to receive or pay for the credit protection under the contract and the estimated present value of premiums that a financial guarantor of comparable credit-worthiness would hypothetically charge or pay the Company for the same protection. The fair value of the Company's credit 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. The expected remaining contractual cash flows are the most readily observable inputs since they are based on the CDS contractual terms. These cash flows include premiums to be received or paid under the terms of the contract. Credit spreads capture the effect of recovery rates and performance of underlying assets of these contracts, among other factors. If credit spreads of the underlying obligations change, the fair value of the related credit derivative changes. Market liquidity also affects valuations of the underlying obligations. Market conditions at September 30, 2012 were such that market prices of the Company's CDS contracts were not available. Since market prices were not available, the Company used proprietary valuation models that used both unobservable and observable market data inputs as described under "Assumptions and Inputs" below. These models are primarily developed internally based on market conventions for similar transactions.

Valuation models include management estimates and current market information. Management is also required to make assumptions of 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, when available, performance of underlying assets, life of the instrument, and the nature and extent of activity in the financial guaranty credit derivative marketplace. The assumptions that management uses to determine the 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.

· How gross spread is calculated: 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 LIBOR. Such pricing is well established by historical financial guaranty fees relative to the credit spread on risks assumed as observed and executed in competitive markets, including in financial guaranty reinsurance and secondary market transactions.

· How gross spread is allocated: Gross spread on a financial guaranty contract accounted for as CDS is allocated among:

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

2. premiums paid to the Company for the Company's credit protection provided ("net spread");
and

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

- The weighted average life which is based on expected remaining contractual cash flows and debt service schedules, which are readily observable inputs since they are based on the CDS contractual terms.

- The rates used to discount future expected losses.

The expected future premium cash flows for the Company's credit derivatives were discounted at rates ranging from 0.15% to 2.61% at September 30, 2012 and 0.30% to 2.70% at December 31, 2011.

Gross spread is used to ultimately determine the net spread a comparable financial guarantor would charge the Company

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to transfer its risk at the reporting date. The Company obtains gross 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 resemble the underlying reference obligations, considering asset class, credit quality rating and maturity of the underlying reference obligations. These indices are adjusted to reflect the non-standard terms of the Company's CDS contracts. 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 or market traders who are not trustees. Management obtains this information as the result of direct communication with these sources as part of the valuation process.

With respect to CDS transactions for which there is an expected claim payment within the next twelve months, the allocation of gross spreads reflects a higher allocation to the cost of credit rather than the bank profit component. In the current market, it is assumed that a bank would be willing to accept a lower profit on distressed transactions in order to remove these transactions from its financial statements.

The following spread hierarchy is utilized in determining which source of gross 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).
- Deals priced or closed during a specific quarter within a specific asset class and specific rating.
- Credit spreads interpolated based upon market indices.
- Credit spreads provided by the counterparty of the CDS.
- Credit spreads extrapolated based upon transactions of similar asset classes, similar ratings, and similar time to maturity.

Information by Credit Spread Type

	As of September 30, 2012	As of December 31, 2011	
Based on actual collateral specific spreads	5	% 5	%
Based on market indices	89	% 90	%
Provided by the CDS counterparty	6	% 5	%
Total	100	% 100	%

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 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.

The Company interpolates a curve based on the historical relationship between the premium the Company receives when a credit derivative is closed 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 transactions with unique terms or characteristics where no price quotes are available, management extrapolates credit spreads based on 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. 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

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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.

The premium the Company receives is referred to as the "net spread." 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. 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 referencing AGC or AGM. 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. The cost to acquire CDS protection referencing AGC or AGM affects the amount of spread on CDS deals that the Company retains and, hence, their fair value. As the cost to acquire CDS protection referencing AGC or AGM increases, the amount of premium the Company retains on a deal generally decreases. As the cost to acquire CDS protection referencing AGC or AGM decreases, the amount of premium the Company retains on a deal generally increases. In the Company's valuation 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 assumption can have the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts. Given the current market conditions and the Company's own credit spreads, approximately 73%, as of September 30, 2012 and approximately 78% as of December 31, 2011 of our CDS contracts are fair valued using this minimum premium. The Company corroborates the assumptions in its fair value model, including the portion of exposure to AGC and AGM hedged by its counterparties, with independent third parties each reporting period. The current level of AGC's and AGM's own credit spread has resulted in the bank or deal originator hedging a significant portion of its exposure to AGC and AGM. This reduces the amount of contractual cash flows AGC and AGM can capture as premium 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 assuming all other assumptions remain constant. This is because the buyers of credit protection typically hedge a portion of their risk to the financial guarantor, due to the fact that the Company's contracts' contractual terms 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 fair value resulting in a credit derivative asset on protection sold is the result of contractual cash inflows 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 a gain representing the difference between the higher contractual premiums to which it is entitled and the current market premiums for a similar contract. The Company determines the fair value of its CDS contracts by applying the difference between the current net spread and the contractual net spread for the remaining duration of each contract to the notional value of its CDS contracts.

Example

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. The assumptions used in these examples are hypothetical amounts. 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	%
The Company 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)

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× 10% = 30 basis points). Under this scenario the Company 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 the Company would receive premium of 10 basis points, or 2% of the gross spread. Due to the increased cost to hedge AGC's name, the amount of profit the bank would expect to receive, and the premium the Company would expect to receive decline significantly.

In this example, the contractual cash flows (the Company premium received per annum above) exceed the amount a market participant would require the Company 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 rates discounted at the corresponding LIBOR over the weighted average remaining life of the contract.

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

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 validate the reasonableness of the fair values developed by the Company's model.
- At September 30, 2012 and December 31, 2011, the markets for the inputs to the model were highly illiquid, which impacts their reliability.
- 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.

Fair Value Option on FG VIEs' Assets and Liabilities

The Company elected the fair value option for all the FG VIEs' assets and liabilities. See Note 7, Consolidation of Variable Interest Entities.

The FG VIEs that are consolidated by the Company issued securities collateralized by HELOCs, first lien and second lien RMBS, subprime automobile loans, and other loans and receivables. The lowest level input that is significant to the fair value measurement of these assets and liabilities in its entirety was a Level 3 input (i.e. unobservable), therefore management classified them as Level 3 in the fair value hierarchy. Prices were generally determined with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach and the third-party's proprietary pricing models. The models to price the FG VIEs' liabilities used, where appropriate, inputs such as estimated prepayment speeds; market values of the assets that collateralize the securities; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; house price depreciation/appreciation rates based on macroeconomic forecasts and, for those liabilities insured by the Company, the benefit from the Company's insurance policy guaranteeing the timely

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payment of principal and interest for the FG VIE tranches insured by the Company, taking into account the timing of the potential default and the Company's own credit rating. These inputs are utilized to project the future cash flows of the security and to evaluate the overall bond profile. The third-party also utilizes an internal model to determine an appropriate yield at which to discount the cash flows of the security, by factoring in collateral types, weighted-average lives, and other structural attributes specific to the security being priced. The expected yield is further calibrated by utilizing algorithm's designed to aggregate market color, received by the third-party, on comparable bonds.

Changes in fair value of the FG VIEs' assets and liabilities are included in fair value gains (losses) on FG VIEs within the consolidated statement of operations. Except for net credit impairment that triggers a claim on the financial guaranty contract, the unrealized fair value adjustments related to the consolidated FG VIEs will reverse to zero over the terms of these financial instruments.

The fair value of the Company's FG VIE assets is sensitive to changes relating to estimated prepayment speeds; estimated default rates (determined on the basis of an analysis of collateral attributes such as: historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; and house price depreciation/appreciation rates based on macroeconomic forecasts. Significant changes to some of these inputs could materially change the market value of the FG VIE's assets and the implied collateral losses within the transaction. In general, the fair value of the FG VIE asset is most sensitive to changes in the projected collateral losses, where an increase in collateral losses typically leads to a decrease in the fair value of FG VIE assets, while a decrease in collateral losses typically leads to an increase in the fair value of FG VIE assets. These factors also directly impact the fair value of the Company's uninsured VIE liabilities.

The fair value of the Company's insured FG VIE liabilities is also sensitive to changes relating to estimated prepayment speeds; market values of the assets that collateralize the securities; estimated default rates (determined on the basis of an analysis of collateral attributes such as: historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; and house price depreciation/appreciation rates based on macroeconomic forecasts. In addition, the Company's insured FG VIE liabilities are also sensitive to changes in the Company's implied credit worthiness. Significant changes to any of these inputs could materially change the timing of expected losses within the insured transaction which is a significant factor in determining the implied benefit from the Company's insurance policy guaranteeing the timely payment of principal and interest for the tranches of debt issued by the FG VIE that is insured by the Company. In general, extending the timing of expected loss payments by the Company into the future typically leads to a decrease in the value of the Company's insurance and a decrease in the fair value of the Company's insured FG VIE liabilities, while a shortening of the timing of expected loss payments by the Company typically leads to an increase in the value of the Company's insurance and an increase in the fair value of the Company's insured FG VIE liabilities.

Not Carried at Fair Value

Financial Guaranty Contracts in Insurance Form

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

Long-Term Debt

The Company's long-term debt, excluding notes payable, is valued by broker-dealers using third party independent pricing sources and standard market conventions. The market conventions utilize market quotations, market transactions for the Company's comparable instruments, and to a lesser extent, similar instruments in the broader insurance industry. The fair value measurement was classified as Level 2 in the fair value hierarchy.

The fair value of the notes payable that are recorded within long-term debt was determined by calculating the present value of the expected cash flows. The Company determines discounted future cash flows using market driven discount rates and a variety of assumptions, including LIBOR curve projections, prepayment and default assumptions, and AGM CDS spreads. The fair value measurement was classified as Level 3 in the fair value hierarchy because there is a reliance on significant unobservable inputs to the valuation model, including the discount rates, prepayment and default assumptions, loss severity and recovery on delinquent loans.

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Other Invested Assets

Assets Acquired in Refinancing Transactions

The fair value of the other invested assets was determined by calculating the present value of the expected cash flows. The Company uses a market approach to determine discounted future cash flows using market driven discount rates and a variety of assumptions, including LIBOR curve projections and prepayment and default assumptions. The fair value measurement was classified as Level 3 in the fair value hierarchy because there is a reliance on significant unobservable inputs to the valuation model, including the discount rates, prepayment and default assumptions, loss severity and recovery on delinquent loans.

Other Assets and Other Liabilities

The Company's other assets and other liabilities consist predominantly of accrued interest, receivables for securities sold and payables for securities purchased, the carrying values of which approximate fair value.

Financial Instruments Carried at Fair Value

Amounts recorded at fair value in the Company's financial statements are included in the tables below.

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of September 30, 2012

	Fair Value (in millions)	Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Assets:				
Investment portfolio, available-for-sale:				
Fixed maturity securities				
U.S. government and agencies	\$810	\$—	\$810	\$—
Obligations of state and political subdivisions	5,714	—	5,703	11
Corporate securities	1,030	—	1,030	—
Mortgage-backed securities:				
RMBS	1,384	—	1,175	209
Commercial mortgage-backed securities ("CMBS")	513	—	513	—
Asset-backed securities	561	—	262	299
Foreign government securities	306	—	306	—
Total fixed maturity securities	10,318	—	9,799	519
Short-term investments	564	268	296	—
Other invested assets(1)	103	—	95	8
Credit derivative assets	450	—	—	450
FG VIEs' assets, at fair value	2,693	—	—	2,693
Other assets(2)	71	24	5	42
Total assets carried at fair value	\$14,199	\$292	\$10,195	\$3,712
Liabilities:				
Credit derivative liabilities	\$2,151	\$—	\$—	\$2,151
FG VIEs' liabilities with recourse, at fair value	2,169	—	—	2,169
FG VIEs' liabilities without recourse, at fair value	1,018	—	—	1,018

Total liabilities carried at fair value	\$5,338	\$—	\$—	\$5,338
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As of December 31, 2011

	Fair Value (in millions)	Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Assets:				
Investment portfolio, available-for-sale:				
Fixed maturity securities				
U.S. government and agencies	\$922	\$—	\$922	\$—
Obligations of state and political subdivisions	5,456	—	5,446	10
Corporate securities	1,038	—	1,038	—
Mortgage-backed securities:				
RMBS	1,428	—	1,294	134
CMBS	500	—	500	—
Asset-backed securities	458	—	223	235
Foreign government securities	340	—	340	—
Total fixed maturity securities	10,142	—	9,763	379
Short-term investments	734	210	524	—
Other invested assets(1)	43	—	32	11
Credit derivative assets	469	—	—	469
FG VIEs' assets, at fair value	2,819	—	—	2,819
Other assets(2)	80	26	—	54
Total assets carried at fair value	\$14,287	\$236	\$10,319	\$3,732
Liabilities:				
Credit derivative liabilities	\$1,773	\$—	\$—	\$1,773
FG VIEs' liabilities with recourse, at fair value	2,397	—	—	2,397
FG VIEs' liabilities without recourse, at fair value	1,061	—	—	1,061
Total liabilities carried at fair value	\$5,231	\$—	\$—	\$5,231

(1) Includes mortgage loans that are recorded at fair value on a non-recurring basis. At September 30, 2012 and December 31, 2011, such investments were carried at their market value of \$7 million and \$9 million, respectively.

(2) Includes fair value of CCS and supplemental executive retirement plan assets.

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Changes in Level 3 Fair Value Measurements

The table below presents a roll forward of the Company's Level 3 financial instruments carried at fair value on a recurring basis during Third Quarter and Nine Months 2012 and 2011.

Fair Value Level 3 Rollforward
Recurring Basis

	Third Quarter 2012 Fixed Maturity Securities								
	Obligations of State and Political Subdivisions	RMBS	Asset- Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIE's Liabilities with Recourse, at Fair Value	FG VIE's Liabilities without Recourse, at Fair Value
	(in millions)								
Fair value as of June 30, 2012	\$10	\$167	\$274	\$1	\$2,726	\$44	\$(1,666)	\$(2,239)	\$(1,042)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	0	(2)4	(2)6	(2)—	91	(3)(2)	(4)(36)	(6)(76)	(3)(19)
Other comprehensive income (loss)	0	13	20	—	—	—	—	—	—
Purchases	1	42	1	—	—	—	—	—	—
Settlements	—	(17)	(2)	—	(124)	—	1	146	43
FG VIE consolidations	—	—	—	—	—	—	—	—	—
Fair value as of September 30, 2012	\$11	\$209	\$299	\$1	\$2,693	\$42	\$(1,701)	\$(2,169)	\$(1,018)
Change in unrealized gains/(losses) related to financial instruments held as of September 30, 2012	\$0	\$10	\$20	\$—	\$165	\$(2)	\$(39)	\$(55)	\$(58)

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Fixed Maturity Securities

	RMBS	Asset- Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIE's Liabilities with Recourse, at Fair Value	FG VIE's Liabilities without Recourse, at Fair Value
(in millions)								
Fair value as of June 30, 2011	\$88	\$274	\$2	\$3,492	\$—	\$(2,188)	\$(2,849)	\$(1,283)
Total pretax realized and unrealized gains/(losses) recorded in:(1)								
Net income (loss) ⁶	(2)	(8)	(2)—	(313)	(3)2	(4)1,156	(6)97	(3)89 (3)
Other comprehensive income (loss)	(37)	(15)	0	—	—	—	—	—
Purchases	43	—	—	—	—	—	—	—
Sales	(8)	(1)	—	—	—	—	—	—
Settlements	—	—	—	(174)	—	4	176	61
FG VIE consolidations	—	—	—	—	—	—	—	—
Transfers into Level 3	—	—	—	—	20	—	—	—
Fair value as of September 30, 2011	\$92	\$250	\$2	\$3,005	\$22	\$(1,028)	\$(2,576)	\$(1,133)
Change in unrealized gains/(losses) related to financial instruments held as of September 30, 2011	\$(37)	\$(15)	\$0	\$(181)	\$2	\$1,159	\$98	\$60

Nine Months 2012
Fixed Maturity Securities

	Obligations of State and Political Subdivisions	RMBS	Asset- Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
(in millions)									
	\$10	\$134	\$235	\$2	\$2,819	\$54	\$(1,304)	\$(2,397)	\$(1,061)

Fair value as of December 31, 2011									
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	—	(2)9	(2)20	(2)—	269	(3)(12)	(4)(466)	(6)(212)	(3)(112)
Other comprehensive 1 income (loss)		6	8	(1)	—	—	—	—	—
Purchases	1	97	41	—	—	—	—	—	—
Settlements	(1)	(37)	(5)	—	(410)	—	69	461	155
FG VIE consolidations	—	—	—	—	15	—	—	(21)	—
Fair value as of September 30, \$11 2012		\$209	\$299	\$1	\$2,693	\$42	\$(1,701)	\$(2,169)	\$(1,018)
Change in unrealized gains/(losses) related to financial instruments held as of September 30, 2012	\$1	\$2	\$8	\$(1)	\$468	\$(12)	\$(391)	\$(180)	\$(213)

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Nine Months 2011 Fixed Maturity Securities															
	RMBS	Asset- Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value							
	(in millions)														
Fair value as of December 31, 2010	\$100	\$210	\$2	\$3,657	\$—	\$ (1,870)	\$ (3,031)	\$ (1,337)							
Total pretax realized and unrealized gains/(losses) recorded in:(1)															
Net income (loss)	(25)	(2)	(4)	(2)	—	(290)	(3)	2	(4)	855	(6)	101	(3)	40	(3)
Other comprehensive income (loss)	(85)	(2)	—	—	—	—	—	—	—	—	—	—	—	—	—
Purchases	195	47	—	—	—	—	—	—	—	—	—	—	—	—	—
Sales	(29)	(1)	—	—	—	—	—	—	—	—	—	—	—	—	—
Settlements	—	—	—	(644)	—	(13)	626	227	—	—	—	—	—	—	—
FG VIE consolidations	(64)	—	—	282	—	—	(272)	(63)	—	—	—	—	—	—	—
Transfers into Level 3	—	—	—	—	20	—	—	—	—	—	—	—	—	—	—
Fair value as of September 30, 2011	\$92	\$250	\$2	\$3,005	\$22	\$ (1,028)	\$ (2,576)	\$ (1,133)							
Change in unrealized gains/(losses) related to financial instruments held as of September 30, 2011	\$(85)	\$(2)	\$—	\$(158)	\$2	\$ 848	\$ 101	\$ 11							

Realized and unrealized gains (losses) from changes in values of Level 3 financial instruments represent gains (1)(losses) from changes in values of those financial instruments only for the periods in which the instruments were classified as Level 3.

(2)Included in net realized investment gains (losses) and net investment income.

(3)Included in fair value gains (losses) on FG VIEs.

(4) Recorded in fair value gain (loss) on committed capital securities.

(5) Represents net position of credit derivatives. The consolidated balance sheet presents gross assets and liabilities based on net counterparty exposure.

(6) Reported in net change in fair value of credit derivatives.

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Level 3 Fair Value Disclosures

Quantitative Information About Level 3 Fair Value Inputs

Financial Instrument Description	Fair Value at September 30, 2012 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Assets:				
Fixed maturity securities:				
Obligations of state and political subdivisions	\$ 11	Discounted cash flow	Rate of inflation Cash flow receipts Collateral recovery period	1.0 %- 3.0% 4.9 %- 29.1% 1 month - 10 years
RMBS	209	Discounted cash flow	CPR CDR Severity Yield	0.8 %- 7.5% 4.4 %- 28.6% 48.0 %- 102.8% 4.3 %- 14.8%
Asset-backed securities:				
Whole business securitization	54	Discounted cash flow	Annual gross revenue projections (in millions) Value of primary financial guaranty policy Liquidity discount	\$54 - \$96 43.8% 5.0 %- 20.0%
Investor owned utility	192	Discounted cash flow	Liquidation value (in millions) Years to liquidation Discount factor	\$174 - \$281 0 years - 2 years 14.5%
XXX life insurance transactions	53	Discounted cash flow	Yield	12.8%
Other invested assets	8	Discounted cash flow	Discount for lack of liquidity Recovery on delinquent loans Default rates Loss severity Prepayment speeds	10.0 %- 20.0% 20.0 %- 60.0% 1.0 %- 10.0% 40.0 %- 90.0% 6.0 %- 15.0%
FG VIEs' assets, at fair value	2,693	Discounted cash flow	CPR CDR Loss severity Yield	0.0 %- 11.8% 2.6 %- 37.6% 37.5 %- 103.8% 4.6 %- 20.0%

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Financial Instrument Description	Fair Value at September 30, 2012 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range	
Other assets	42	Discounted cash flow	Quotes from third party pricing Term (years)	\$39 3	- \$44
Liabilities:					
	(1,701)	Discounted cash flow	Year 1 loss estimates Hedge cost (in bps)	0.0 83.2	%- 60.0% - 780.0
Credit derivative liabilities, net			Bank profit (in bps) Internal floor (in bps) Internal credit rating	1.0 7.0 AAA	- 1,293.0 - 40.0 - BIG
FG VIEs' liabilities, at fair value	(3,187)	Discounted cash flow	CPR CDR Loss severity Yield	0.0 2.6 37.5 4.6	%- 11.8% %- 37.6% %- 103.8% %- 20.0%

The carrying amount and estimated fair value of the Company's financial instruments are presented in the following table.

Fair Value of Financial Instruments

	As of September 30, 2012		As of December 31, 2011	
	Carrying Amount (in millions)	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Fixed maturity securities	\$10,318	\$10,318	\$10,142	\$10,142
Short-term investments	564	564	734	734
Other invested assets	165	176	170	182
Credit derivative assets	450	450	469	469
FG VIEs' assets, at fair value	2,693	2,693	2,819	2,819
Other assets	183	183	186	186
Liabilities:				
Financial guaranty insurance contracts(1)	4,102	6,929	4,657	4,313
Long-term debt(2)	840	1,058	1,038	1,186
Credit derivative liabilities	2,151	2,151	1,773	1,773
FG VIEs' liabilities with recourse, at fair value	2,169	2,169	2,397	2,397
FG VIEs' liabilities without recourse, at fair value	1,018	1,018	1,061	1,061
Other liabilities	64	64	16	16

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

(2)
premium.

Carrying amount represented principal less accumulated discount or plus accumulated

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6. Financial Guaranty Contracts Accounted for as Credit Derivatives

The Company has a portfolio of financial guaranty contracts that meet the definition of a derivative in accordance with GAAP (primarily CDS). Until the Company ceased selling credit protection through credit derivative contracts in the beginning of 2009, following the issuance of regulatory guidelines that limited the terms under which the credit protection could be sold, management considered these agreements to be a normal part of its financial guaranty business. The potential capital or margin requirements that may apply under the Dodd-Frank Wall Street Reform and Consumer Protection Act contributed to the decision of the Company not to sell new credit protection through CDS in the foreseeable future.

Credit derivative transactions are governed by ISDA documentation and have different characteristics from financial guaranty insurance contracts. 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 insurance contract. In addition, while the Company's exposure under credit derivatives, like the Company's exposure under financial guaranty insurance contracts, has been generally for as long as the reference obligation remains outstanding, unlike financial guaranty contracts, a credit derivative may be terminated for a breach of the ISDA documentation or other specific events. A loss payment is made only upon the occurrence of one or more defined credit events with respect to the referenced securities or loans. A credit event may be a non-payment event such as a failure to pay, bankruptcy or restructuring, as negotiated by the parties to the credit derivative transactions. 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. The Company may not unilaterally terminate a CDS contract; however, the Company on occasion has mutually agreed with various counterparties to terminate certain CDS transactions.

Credit Derivative Net Par Outstanding by Sector

The estimated remaining weighted average life of credit derivatives was 3.8 years at September 30, 2012 and 4.3 years at December 31, 2011. The components of the Company's credit derivative net par outstanding are presented below.

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Credit Derivatives Net Par Outstanding

Asset Type	As of September 30, 2012				As of December 31, 2011			
	Net Par Outstanding	Original Subordination	Current Subordination	Weighted Average Credit Rating	Net Par Outstanding	Original Subordination	Current Subordination	Weighted Average Credit Rating
	(dollars in millions)							
Pooled corporate obligations:								
Collateralized loan obligation/collateral bond obligations	\$31,033	32.9 %	33.0 %	AAA	\$34,567	32.6 %	32.0 %	AAA
Synthetic investment grade pooled corporate obligations	9,601	21.6	19.8	AAA	12,393	20.4	18.7	AAA
Synthetic high yield pooled corporate obligations	3,655	35.1	30.1	AA+	5,049	35.7	30.3	AA+
TruPS CDOs	4,214	46.7	33.0	BB	4,518	46.6	31.9	BB
Market value CDOs of corporate obligations	3,941	33.0	28.3	AAA	4,546	30.6	28.9	AAA
Total pooled corporate obligations	52,444	32.1	30.1	AAA	61,073	31.2	28.9	AAA
U.S. RMBS:								
Option ARM and Alt-A first lien	3,543	20.1	10.8	B+	4,060	19.6	13.6	BB-
Subprime first lien	3,634	29.7	53.2	A+	4,012	30.1	53.9	A+
Prime first lien	348	10.9	6.1	B	398	10.9	8.4	B
Closed end second lien and HELOCs	51	—	—	B-	62	—	—	B
Total U.S. RMBS	7,576	24.2	30.8	BBB	8,532	24.1	32.2	BBB
CMBS	4,195	33.5	41.5	AAA	4,612	32.6	38.9	AAA
Other	10,469	—	—	A	10,830	—	—	A
Total	\$74,684			AA+	\$85,047			AA+

(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.

Except for TruPS CDOs, the Company's exposure to pooled corporate obligations is highly diversified in terms of obligors and 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 consists of collateralized loan obligation ("CLO") or synthetic pooled corporate obligations. Most of these CLOs have an average obligor size of less than 1% of the total transaction 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 TruPS CDO asset pools are generally less diversified by obligors and industries than the typical CLO asset pool. Also, the underlying collateral in TruPS CDOs consists primarily of subordinated debt instruments such as TruPS issued by bank holding companies and similar instruments issued by insurance companies, REITs and other

real estate related issuers while CLOs typically contain primarily senior secured obligations. However, to mitigate these risks TruPS CDOs were typically structured with higher levels of embedded credit enhancement than typical CLOs.

The Company's exposure to "Other" CDS contracts is also highly diversified. It includes \$3.2 billion of exposure to three pooled infrastructure transactions comprising 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 at origination. The remaining \$7.3 billion of exposure in "Other" CDS contracts comprises numerous deals across various asset classes, such as commercial receivables, international RMBS, infrastructure, regulated utilities and consumer receivables. Of the total net par outstanding in the "Other" sector, \$905 million is rated BIG.

The Company has exposure to U.S. RMBS in CDS form which is similar to its U.S. RMBS risks in financial guaranty

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insurance form described in Note 4, Financial Guaranty Insurance.

Distribution of Credit Derivative Net Par Outstanding by Internal Rating

Ratings	As of September 30, 2012		As of December 31, 2011		
	Net Par Outstanding (dollars in millions)	% of Total	Net Par Outstanding	% of Total	
Super Senior	\$18,984	25.4	% \$21,802	25.6	%
AAA	34,877	46.7	40,240	47.3	
AA	3,422	4.6	4,342	5.1	
A	5,786	7.8	5,830	6.9	
BBB	4,721	6.3	5,030	5.9	
BIG	6,894	9.2	7,803	9.2	
Total credit derivative net par outstanding	\$74,684	100.0	% \$85,047	100.0	%

Credit Derivative

U.S. Residential Mortgage-Backed Securities

Vintage	As of September 30, 2012				Net Change in Unrealized Gain (Loss)	
	Net Par Outstanding (in millions)	Original Subordination(1)	Current Subordination(1)	Weighted Average Credit Rating	Third Quarter 2012	Nine Months 2012
2004 and Prior	\$130	6.4	% 19.4	% BBB+	\$3	\$3
2005	2,175	30.9	66.3	AA	11	10
2006	1,589	29.4	34.7	A-	(24	) (38
2007	3,682	18.5	8.6	B	(68	) (432
Total	\$7,576	24.2	% 30.8	% BBB	\$(78	) \$(457

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

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Net Change in Fair Value of Credit Derivatives

Net Change in Fair Value of Credit Derivatives Gain (Loss)

	Third Quarter 2012	2011	Nine Months 2012	2011
	(in millions)			
Net credit derivative premiums received and receivable	\$ 33	\$ 40	\$ 96	\$ 148
Net ceding commissions (paid and payable) received and receivable	0	1	0	3
Realized gains on credit derivatives	33	41	96	151
Terminations	—	—	(1	) (23
Net credit derivative losses (paid and payable) recovered and recoverable	(31	) (41	) (173	) (103
Total realized gains (losses) and other settlements on credit derivatives	2	0	(78	) 25
Net unrealized gains (losses) on credit derivatives	(38	) 1,156	(388	) 830
Net change in fair value of credit derivatives	\$(36	) \$1,156	\$(466	) \$855

In Third Quarter 2012 and Nine Months 2012, CDS contracts totaling \$0.3 billion and \$1.1 billion in net par were terminated. In Third Quarter 2011 and Nine Months 2011, CDS contracts totaling \$1.8 billion and \$9.5 billion in net par were terminated. The increase in paid losses was due primarily to claims paid on an insured film securitization and higher losses on Alt-A transactions in 2012.

Changes in the fair value of credit derivatives occur primarily because of changes in interest rates, credit spreads, notional amounts, credit ratings of the referenced entities, expected terms, realized gains (losses) and other settlements, and the issuing company's own credit rating, credit spreads and other market factors. Except for net estimated credit impairments (i.e., net expected payments), the unrealized gains and losses on credit derivatives are expected to reduce to zero as the exposure approaches its maturity date. With considerable volatility continuing in the market, unrealized gains (losses) on credit derivatives may fluctuate significantly in future periods.

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Net Change in Unrealized Gains (Losses) on Credit Derivatives By Sector

Asset Type	Third Quarter		Nine Months		
	2012	2011	2012	2011	
	(in millions)				
Pooled corporate obligations:					
CLOs/Collateral bond obligations	\$ (2	) \$ 13	\$ 5	\$ 11
Synthetic investment grade pooled corporate	10	1	19	11	
Synthetic high yield pooled corporate	9	(2) 20	(1)
TruPS CDOs	15	82	18	46	
Market value CDOs of corporate obligations	—	6	—	0	
Total pooled corporate obligations	32	100	62	67	
U.S. RMBS:					
Option ARM and Alt-A first lien	(63	) 781	(406	) 541
Subprime first lien	(24	) 109	(11	) 18
Prime first lien	9	102	(42	) 90
Closed end second lien and HELOCs	—	8	2	9	
Total U.S. RMBS	(78	) 1,000	(457	) 658
CMBS	—	0	—	10	
Other	8	56	7	95	
Total	\$ (38	) \$ 1,156	\$ (388	) \$ 830

In Third Quarter 2012, U.S. RMBS unrealized fair value losses were generated primarily in the Alt-A, Option ARM and subprime RMBS sectors due to wider implied net spreads. The wider implied net spreads were primarily a result of the decreased cost to buy protection in AGC's name as the market cost of AGC's credit protection decreased. These transactions were pricing above their floor levels (or the minimum rate at which the Company would consider assuming these risks based on historical experience); therefore when the cost of purchasing CDS protection on AGC, which management refers to as the CDS spread on AGC, decreased the implied spreads that the Company would expect to receive on these transactions increased. The cost of AGM's credit protection also decreased during the quarter, but did not lead to significant fair value losses, as the majority of AGM policies continue to price at floor levels.

During Nine Months 2012, the cost to buy protection on AGC's name declined. This led to U.S. RMBS unrealized fair value losses which were generated primarily in the prime first lien, Alt-A and Option ARM RMBS sectors due to wider implied net spreads. The wider implied net spreads were primarily a result of the decreased cost to buy protection in AGC's name as the market cost of AGC's credit protection decreased. These transactions were pricing above their floor levels; therefore when the cost of purchasing CDS protection on AGC, decreased the implied spreads that the Company would expect to receive on these transactions increased. The cost of AGM's credit protection also decreased during Nine Months 2012, but did not lead to significant fair value losses, as the majority of AGM policies continue to price at floor levels.

In Third Quarter 2011, U.S. RMBS change in unrealized fair value were gains generated primarily in the prime first lien, Alt-A, Option ARM and subprime RMBS sectors due to tighter implied net spreads. The tighter implied net spreads were primarily the result of the increased cost to buy protection in AGC's name as the market cost of AGC's credit protection increased significantly. These transactions were pricing above their floor levels; therefore when the cost of purchasing CDS protection on AGC, which management refers to as the CDS spread on AGC, increased the implied spreads that the Company would expect to receive on these transactions decreased. The cost of AGM's credit

protection also increased during the quarter, but did not lead to significant fair value gains, as the majority of AGM policies continue to price at floor levels. Given the market conditions and the Company's own credit spreads existing in Third Quarter 2011, the majority of our CDS contracts are fair valued using this minimum premium.

The unrealized fair value gains for Nine Months 2011 were primarily driven by tighter implied net spreads in the Alt-A first lien and Option ARMs, and Subprime RMBS sectors. The tighter implied net spreads were a result of the increased cost to buy protection in AGC's name as the market cost of AGC's credit protection increased significantly during the period. As discussed above, these transactions were pricing above their floor levels which decreased the implied spreads that the Company

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would expect to receive on these transactions. The unrealized gains for Nine Months 2011 in the Option ARM and Alt-A first lien sectors also include an increase in R&W benefits on several credit derivative transactions within these sectors, as a result of a settlement with a CDS counterparty. The cost of AGM's credit protection also increased during Nine Months 2011, but did not lead to significant fair value gains, as the majority of AGM policies continue to price at floor levels.

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 structural 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. The Company determines its own credit risk based on quoted CDS prices traded on the Company at each balance sheet date. 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.

Five-Year CDS Spread on AGC and AGM

	As of September 30, 2012	As of June 30, 2012	As of March 31, 2012	As of December 31, 2011
Quoted price of CDS contract (in basis points):				
AGC	780	904	743	1,140
AGM	638	652	555	778

Components of Credit Derivative Assets (Liabilities)

	As of September 30, 2012 (in millions)	As of December 31, 2011
Credit derivative assets	\$450	\$469
Credit derivative liabilities	(2,151)	(1,773)
Net fair value of credit derivatives	\$(1,701)	\$(1,304)

	As of September 30, 2012 (in millions)	As of December 31, 2011
Fair value of credit derivatives before effect of AGC and AGM credit spreads	\$(4,955)	\$(5,596)
Plus: Effect of AGC and AGM credit spreads	3,254	4,292
Net fair value of credit derivatives	\$(1,701)	\$(1,304)

The fair value of CDS contracts at September 30, 2012, before considering the implications of AGC's and AGM's credit spreads, is a direct result of continued wide credit spreads in the fixed income security markets, and ratings downgrades. The asset classes that remain most affected are recent vintages of prime first lien, Alt-A, Option ARM, subprime RMBS deals as well as trust-preferred securities. When looking at September 30, 2012 compared with December 31, 2011, there was a narrowing of spreads primarily relating to the Company's Alt-A first lien and subprime RMBS transactions. This narrowing of spreads resulted in a gain of approximately \$641 million, before

taking into account AGC's or AGM's credit spreads.

Management believes that the trading level of AGC's and AGM's credit spreads are due to the correlation between AGC's and AGM's risk profile and the current risk profile of the broader financial markets and to increased demand for credit protection against AGC and AGM as the result of its financial guaranty 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 higher credit spreads in the fixed income security markets. The higher credit spreads in the fixed income security market are due to the lack of liquidity in the high yield CDO, Trust- Preferred CDO, and CLO markets as well as continuing market concerns over the most recent vintages of subprime RMBS.

The following table presents the fair value and the present value of expected claim payments or recoveries for contracts

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accounted for as derivatives.

Net Fair Value and Expected Losses of Credit Derivatives by Sector

Asset Type	Fair Value of Credit Derivative Asset (Liability), net		Present Value of Expected Claim (Payments) Recoveries(1)	
	As of September 30, 2012 (in millions)	As of December 31, 2011	As of September 30, 2012	As of December 31, 2011
Pooled corporate obligations:				
CLOs/ Collateralized bond obligations	\$3	\$(1) \$—	\$—
Synthetic investment grade pooled corporate	(6	) (24) —	—
Synthetic high-yield pooled corporate	4	(16	) —	(5
TruPS CDOs	6	(12	) (30	) (40
Market value CDOs of corporate obligations	2	3	—	—
Total pooled corporate obligations	9	(50	) (30	) (45
U.S. RMBS:				
Option ARM and Alt-A first lien	(1,026	) (596	) (118	) (191
Subprime first lien	(17	) (23	) (69	) (95
Prime first lien	(87	) (44) —	—
Closed-end second lien and HELOCs	(13	) (15	) 4	7
Total U.S. RMBS	(1,143	) (678	) (183	) (279
CMBS	(4	) (5) —	—
Other	(563	) (571	) (93	) (95
Total	\$(1,701	) \$(1,304	) \$(306	) \$(419

Represents amount in excess of the present value of future installment fees to be received of \$53 million as of (1) September 30, 2012 and \$47 million as of December 31, 2011. Includes R&W benefit of \$241 million as of September 30, 2012 and \$215 million as of December 31, 2011.

Ratings Sensitivities of Credit Derivative Contracts

Within the Company's insured CDS portfolio, the transaction documentation for \$2.2 billion in CDS par insured provides that a downgrade of the financial strength rating of AGC past a specified level (which level varies from transaction to transaction), would constitute a termination event that would allow the CDS counterparty to terminate the affected transactions. If the CDS counterparty elected to terminate the affected transactions, under some transaction documents the Company could be required to make a termination payment (or may be entitled to receive a termination payment from the CDS counterparty) and under other transaction documents the credit protection would be cancelled and no termination payment would be owing by either party. Under certain documents, the Company has 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. The Company currently has three ISDA master agreements under which the applicable counterparty could elect to terminate transactions upon a rating downgrade of AGC. If AGC's financial strength ratings were downgraded to BBB- or Baa3, \$89 million in par insured could be terminated by one counterparty; and if AGC's ratings were downgraded to BB+ or Ba1, an additional approximately \$2.1 billion in par insured could be terminated by the other two counterparties. 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 collateral to secure its obligation to make payments under such contracts. Eligible collateral is generally cash or U.S. government or agency securities; eligible collateral other than cash is valued at a discount to the face amount. For certain of such contracts, the CDS counterparty has agreed to have some exposure to the Company on an unsecured basis, but as the financial strength ratings of the Company's insurance subsidiaries decline, the amount of unsecured exposure to the Company allowed by the CDS counterparty decreases until, at a specified rating level (which level varies from transaction to transaction), the Company must collateralize all of the

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exposure. The amount of collateral required is based on a mark-to-market valuation of the exposure that must be secured. Under other contracts, the Company has negotiated caps such that the posting requirement cannot exceed a certain fixed amount, regardless of the financial strength ratings of the Company's insurance subsidiaries. As of September 30, 2012 the amount of insured par that is subject to collateral posting is approximately \$13.8 billion (which amount is not reduced by unsecured exposure to the Company allowed by CDS counterparties at current financial strength rating levels), for which the Company has agreed to post approximately \$687 million of collateral (which amount reflects some of the eligible collateral being valued at a discount to the face amount). The Company may be required to post additional collateral from time to time, depending on its financial strength ratings and on the market values of the transactions subject to the collateral posting. For approximately \$13.4 billion of that \$13.8 billion, at the Company's current ratings, the Company need not post on a cash basis more than \$625 million, regardless of any change in the market value of the transactions, due to caps negotiated with counterparties. For the avoidance of doubt, the \$625 million is already included in the \$687 million that the Company has agreed to post. In the event AGC's ratings are downgraded to A+ or A3, the maximum amount to be posted against the \$13.4 billion increases by \$50 million to \$675 million.

Sensitivity to Changes in Credit Spread

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.

Effect of Changes in Credit Spread

Credit Spreads(1)	As of September 30, 2012	
	Estimated Net Fair Value (Pre-Tax) (in millions)	Estimated Change in Gain/(Loss) (Pre-Tax)
100% widening in spreads	\$(3,506)	) \$(1,805)
50% widening in spreads	(2,603)	) (902)
25% widening in spreads	(2,152)	) (451)
10% widening in spreads	(1,881)	) (180)
Base Scenario	(1,701)) —
10% narrowing in spreads	(1,553)	) 148
25% narrowing in spreads	(1,337)	) 364
50% narrowing in spreads	(982)	) 719

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

7. Consolidation of Variable Interest Entities

The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. AGC and AGM do not sponsor any VIEs when underwriting third party financial guaranty insurance or credit derivative transactions, nor has either of them acted as the servicer or collateral manager for any VIE obligations that it insures. The transaction structure generally provides certain financial protections to the Company. This financial protection can take several forms, the most common of which are overcollateralization, first loss protection (or subordination) and excess spread. In the case of overcollateralization (i.e., the principal amount of the securitized assets exceeds the principal amount of the structured finance obligations guaranteed by the Company), the structure

allows defaults of the securitized assets before a default is experienced on the structured finance obligation guaranteed by the Company. In the case of first loss, the financial guaranty insurance policy only covers a senior layer of losses experienced by multiple obligations issued by special purpose entities, including VIEs. The first loss exposure with respect to the assets is either retained by the seller or sold off in the form of equity or mezzanine debt to other investors. In the case of excess spread, the financial assets contributed to special purpose entities, including VIEs, generate cash flows that are in excess of the interest payments on the debt issued by the special purpose entity. Such excess spread is typically distributed through the transaction's cash flow waterfall and may be used to create additional credit enhancement, applied to redeem debt issued by the special purpose entities, including VIEs (thereby, creating additional overcollateralization), or distributed to equity or other investors in the transaction.

As a condition to issuing a financial guaranty contract in respect of certain of a VIE's debt obligations, the Company

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obtains certain protective rights with respect to the VIE that are triggered by the occurrence of certain events, such as failure to be in compliance with a covenant due to poor transaction performance or a deterioration in a servicer or collateral manager's financial condition. At the inception of a transaction, the Company typically is not deemed to control a VIE; however, once a trigger event occurs, the Company's control of the VIE typically increases. The Company continuously evaluates its power to direct the activities that most significantly impact the economic performance of VIEs that have debt obligations insured by the Company, such as its ability to unilaterally terminate and replace the servicer upon the occurrence of certain triggering events and, accordingly, where the Company is obligated to absorb VIE losses that could potentially be significant to the VIE. The protective rights that the Company obtains under its insurance contract for a particular transaction give the Company additional controls over a VIE if there is either deterioration in the performance of the transaction or in the financial health of the servicer or collateral manager. The Company is deemed to be the control party for financial reporting purposes, typically when its protective rights give it the power to both terminate and replace the servicer or collateral manager, which are rights typically given to a financial guaranty insurer. If the Company's protective rights that could make it the control party have not been triggered, then it does not consolidate the VIE. As of September 30, 2012, the Company had issued financial guaranty contracts for approximately 1,200 VIEs that it did not consolidate.

AGC and AGM are not primarily liable for the debt obligations issued by the VIEs they insure and would only be required to make payments on these debt obligations in the event that the issuer of such debt obligations defaults on any principal or interest due. AGL's and its Subsidiaries' creditors do not have any rights with regard to the assets of the VIEs. Proceeds from sales, maturities, prepayments and interest from VIE assets may only be used to pay debt service on VIE liabilities. Net fair value gains and losses on FG VIEs are expected to reverse to zero at maturity of the VIE debt, except for net premiums received and claims paid by AGC or AGM under the financial guaranty insurance contract. The Company's estimate of expected loss to be paid for FG VIEs is included in Note 4, Financial Guaranty Insurance Contracts.

Consolidated FG VIEs

During Third Quarter 2012, the Company determined that, based on the assessment of its control rights over servicer or collateral manager replacement, given that servicing/managing collateral were deemed to be the FG VIEs' most significant activities, no additional VIEs required consolidation. There were a total of 34 consolidated FG VIEs at September 30, 2012, compared to 33 FG VIEs at December 31, 2011.

The total unpaid principal balance for the FG VIEs' assets that were over 90 days or more past due was approximately \$955 million. The aggregate unpaid principal of the FG VIEs' assets was approximately \$2,846 million greater than the aggregate fair value at September 30, 2012. The change in the instrument-specific credit risk of the FG VIEs' assets for Third Quarter 2012 and Nine Months 2012 were gains of \$65 million and \$235 million, respectively. The change in the instrument-specific credit risk of the FG VIEs' assets for the Third Quarter 2011 and Nine Months 2011 were losses of \$178 million and \$657 million, respectively.

The aggregate unpaid principal balance was approximately \$2,321 million greater than the aggregate fair value of the FG VIEs' liabilities as of September 30, 2012.

The Company has limited contractual rights to obtain the financial records of its consolidated FG VIEs. The FG VIEs do not prepare separate GAAP financial statements; therefore, the Company compiles GAAP financial information for them based on trustee reports prepared by and received from third parties. Such trustee reports are not available to the Company until approximately 30 days after the end of any given period. The time required to perform adequate reconciliations and analyses of the information in these trustee reports results in a one quarter lag in reporting the FG VIEs' activities. The Company records the fair value of FG VIE assets and liabilities based on modeled prices. The Company updates the model assumptions each reporting period for the most recent available information, which

incorporates the impact of material events that may have occurred since the quarter lag date. Interest income and interest expense are derived from the trustee reports and included in “fair value gains (losses) on FG VIEs” in the consolidated statement of operations. The Company has elected the fair value option for assets and liabilities classified as FG VIEs’ assets and liabilities because the carrying amount transition method was not practical.

The table below shows the carrying value of the consolidated FG VIEs’ assets and liabilities in the consolidated financial statements, segregated by the types of assets that collateralize their respective debt obligations.

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Consolidated FG VIEs

By Type of Collateral

	As of September 30, 2012			As of December 31, 2011		
	Number of FG VIEs	Assets	Liabilities	Number of FG VIEs	Assets	Liabilities
	(dollars in millions)					
With recourse:						
HELOCs	8	\$541	\$822	8	\$573	\$908
First liens:						
Alt-A first lien	3	115	94	3	118	106
Option ARM	2	38	181	2	50	245
Subprime	7	395	495	5	387	473
Closed-end second lien	10	207	198	10	184	219
Automobile loans	3	70	70	4	156	156
Life insurance	1	309	309	1	290	290
Total with recourse	34	1,675	2,169	33	1,758	2,397
Without recourse	—	1,018	1,018	—	1,061	1,061
Total	34	\$2,693	\$3,187	33	\$2,819	\$3,458

Gross Unpaid Principal for FG VIEs' Liabilities
with Recourse

	As of September 30, 2012 (in millions)	As of December 31, 2011
Gross unpaid principal for FG VIEs' liabilities with recourse	\$3,395	\$3,796

Contractual Maturity Schedule of FG VIE Liabilities with Recourse

Contractual Maturity	As of September 30, 2012 (in millions)
2012	\$—
2013	—
2014	69
2015	—
2016	—
Thereafter	3,326
Total	\$3,395

The consolidation of FG VIEs has a significant effect on net income and shareholder's equity due to (1) changes in fair value gains (losses) on FG VIE assets and liabilities, (2) the elimination of premiums and losses related to the AGC and AGM insured FG VIE liabilities and (3) the elimination of investment balances related to the Company's purchase of AGC and AGM insured FG VIE debt. Upon consolidation of a FG VIE, the related insurance and, if applicable, the related investment balances, are considered intercompany transactions and therefore eliminated. Such eliminations are included in the table below to present the full effect of consolidating FG VIEs.

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Effect of Consolidating FG VIEs on Net Income and Shareholders' Equity(1)

	Third Quarter		Nine Months	
	2012	2011	2012	2011
	(in millions)			
Net earned premiums	\$ (17	) \$ (20	) \$ (50	) \$ (57
Net investment income	(3	) (4	) (9	) (5
Net realized investment gains (losses)	0	7	4	7
Fair value gains (losses) on FG VIEs	38	(99	) 174	(154
Loss and LAE	(2	) 38	1	106
Total pretax effect on net income	16	(78	) 120	(103
Less: tax provision (benefit)	5	(27	) 42	(36
Total effect on net income (loss)	\$ 11	\$ (51	) \$ 78	\$ (67
			As of	As of
			September 30,	December 31,
			2012	2011
			(in millions)	
Total (decrease) increase on shareholders' equity			\$ (335	) \$ (405

(1) Includes the effect of eliminating insurance balances related to the financial guaranty insurance contracts.

Fair value gains (losses) on FG VIEs represent the net change in fair value on the consolidated FG VIEs' assets and liabilities. During Third Quarter 2012, the Company recorded a pre-tax net fair value gain of consolidated FG VIEs of \$38 million. While prices appreciated slightly during the period on the Company's FG VIE assets and liabilities, the gain for Third Quarter 2012 was primarily driven by large principal paydowns made on the Company's FG VIE assets. For Nine Months 2012, the Company recorded a pre-tax net fair value gain on consolidated FG VIEs of \$174 million. The majority of this gain, \$163 million, is a result of a R&W settlement with Deutsche Bank that closed during second quarter 2012.

A pre-tax fair value loss of approximately \$99 million was recorded on the consolidated FG VIEs during Third Quarter 2011 and was primarily driven by deterioration on several HELOC transactions. During the period, long term conditional default rates increased on these transactions, which caused the prices for these HELOCs to decline. The prices for the corresponding liability for these transactions remained relatively consistent with the prior quarter. This was also the primary driver of the \$154 million pre-tax net unrealized loss in the fair value of consolidated FG VIEs during Nine Months 2011. Nine Months 2011 amount was also driven by the unrealized loss on consolidation of eight new VIEs, as well as two existing transactions in which the fair value of the underlying collateral depreciated, while the price of the wrapped senior bonds was largely unchanged from the prior quarter.

Non-Consolidated VIEs

To date, the Company's analyses have indicated that it does not have a controlling financial interest in any other VIEs and, as a result, they are not consolidated in the consolidated financial statements. The Company's exposure provided through its financial guaranties with respect to debt obligations of special purpose entities is included within net par outstanding in Note 3, Outstanding Exposure.

8. Investments

Investment Portfolio

Net investment income is a function of the yield that the Company earns on invested assets and the size of the portfolio. The investment yield is a function of market interest rates at the time of investment as well as the type, credit quality and maturity of the invested assets. Net investment income increased primarily due to higher income earned on loss mitigation bonds. Income earned on the general portfolio excluding loss mitigation bonds declined slightly due to lower reinvestment rates. Accrued investment income on fixed maturity, short-term investments and assets acquired in refinancing transactions was \$100 million and \$101 million as of September 30, 2012 and December 31, 2011, respectively.

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Net Investment Income

	Third Quarter		Nine Months	
	2012	2011	2012	2011
	(in millions)			
Income from fixed maturity securities	\$101	\$96	\$303	\$298
Income from short-term investments	1	1	1	1
Income from assets acquired in refinancing transactions	2	1	4	4
Gross investment income	104	98	308	303
Investment expenses	(2)	(3)	(7)	(8)
Net investment income	\$102	\$95	\$301	\$295

Net Realized Investment Gains (Losses)

	Third Quarter		Nine Months	
	2012	2011	2012	2011
	(in millions)			
Realized gains on investment portfolio	\$8	\$5	\$34	\$26
Realized losses on investment portfolio	(2)	0	(23)	(7)
Other-than-temporary impairment ("OTTI")				
Intent to sell	0	(1)	0	(5)
Credit component of OTTI securities	(4)	(15)	(11)	(27)
OTTI	(4)	(16)	(11)	(32)
Net realized investment gains (losses)	\$2	\$(11)	\$0	\$(13)

The following table presents the roll-forward of the credit losses of fixed maturity securities for which the Company has recognized OTTI and where the portion of the fair value adjustment related to other factors was recognized in OCI.

Roll Forward of Credit Losses in the Investment Portfolio

	Third Quarter		Nine Months	
	2012	2011	2012	2011
	(in millions)			
Balance, beginning of period	\$53	\$22	\$47	\$27
Additions for credit losses on securities for which an OTTI was not previously recognized	1	14	8	25
Eliminations of securities issued by FG VIEs	0	—	0	(13)
Reductions for securities sold during the period	(3)	—	(4)	(5)
Additions for credit losses on securities for which an OTTI was previously recognized	3	1	3	3
Balance, end of period	\$54	\$37	\$54	\$37

Table of ContentsFixed Maturity Securities and Short Term Investments
by Security Type

As of September 30, 2012

Investment Category	Percent of Total(1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI(2) Gain (Loss) on Securities with OTTI	Weighted Average Credit Quality (3)
(dollars in millions)							
Fixed maturity securities:							
U.S. government and agencies	6	% \$743	\$66	\$—	\$809	\$—	AA+
Obligations of state and political subdivisions	45	5,213	501	0	5,714	9	AA
Corporate securities	13	947	83	0	1,030	0	A+
Mortgage-backed securities(4):	—						
RMBS	22	1,393	76	(85	) 1,384	(50	) AA-
CMBS	4	475	39	0	514	—	AAA
Asset-backed securities	2	532	42	(13	) 561	26	BIG
Foreign government securities	2	286	20	0	306	0	AAA
Total fixed maturity securities	94	9,589	827	(98	) 10,318	(15	) AA-
Short-term investments	6	564	0	0	564	—	AAA
Total investment portfolio	100	% \$10,153	\$827	\$(98	) \$10,882	\$(15	) AA

As of December 31, 2011

Investment Category	Percent of Total(1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI Gain (Loss) on Securities with OTTI	Weighted Average Credit Quality (3)
(dollars in millions)							
Fixed maturity securities:							
U.S. government and agencies	8	% \$850	\$72	\$0	\$922	\$—	AA+
Obligations of state and political subdivisions	49	5,097	359	(1	) 5,455	6	AA
Corporate securities	10	989	52	(2	) 1,039	0	A+
Mortgage-backed securities(4):							
RMBS	14	1,454	64	(90	) 1,428	(35	) AA
CMBS	5	476	24	0	500	2	AAA
Asset-backed securities	4	439	38	(19) 458	29	BBB-
Foreign government securities	3	333	13	(6) 340	—	AAA

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Total fixed maturity securities	93	9,638	622	(118)	10,142	2	AA
Short-term investments	7	734	—	—	734	—	AAA
Total investment portfolio	100	% \$10,372	\$622	\$(118)	\$10,876	\$2	AA

(1) Based on amortized cost.

(2) Accumulated Other Comprehensive Income ("AOCI").

Ratings in the tables above represent the lower of the Moody's and S&P classifications except for bonds purchased (3) for loss mitigation or risk management strategies, which use internal ratings classifications. The Company's portfolio consists primarily of high-quality, liquid instruments.

(4) Government-agency obligations were approximately 62% of mortgage backed securities as of September 30, 2012 and 66% as of December 31, 2011 based on fair value.

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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. As of September 30, 2012, amounts, net of tax, in AOCI included a net unrealized loss of \$10 million for securities for which the Company had recognized OTTI and a net unrealized gain of \$539 million for securities for which the Company had not recognized OTTI. As of December 31, 2011, amounts, net of tax, in AOCI included a net unrealized gain of \$3 million for securities for which the Company had recognized OTTI and a net unrealized gain of \$364 million for securities for which the Company had not recognized OTTI.

The Company's investment portfolio in tax-exempt and taxable municipal securities includes issuances by a wide number of municipal authorities across the U.S. and its territories. This is a high quality portfolio of municipal securities with an average rating of AA as of September 30, 2012 and AA as of December 31, 2011. Securities rated lower than A-/A3 by S&P or Moody's are not eligible to be purchased for the Company's portfolio unless acquired for loss mitigation or risk management strategies.

The following tables present the fair value of the Company's available-for-sale municipal bond portfolio as of September 30, 2012 and December 31, 2011 by state, excluding \$559 million and \$403 million of pre-refunded bonds, respectively. The credit ratings are based on the underlying ratings and do not include any benefit from bond insurance.

Fair Value of Available-for-Sale Municipal Bond Portfolio by State

State	As of September 30, 2012		Revenue	Fair Value	Amortized Cost	Average Credit Rating
	State General Obligation (in millions)	Local General Obligation				
Texas	\$89	\$353	\$357	\$799	\$728	AA
New York	13	67	607	687	631	AA
California	23	71	325	419	374	AA-
Florida	98	—	259	357	320	AA-
Illinois	14	83	193	290	265	A+
Washington	34	40	153	227	207	AA
Massachusetts	42	10	173	225	200	AA
Arizona	—	8	171	179	164	AA+
Georgia	14	20	110	144	133	A+
Michigan	—	29	114	143	131	AA-
All others	312	253	1,120	1,685	1,544	AA-
Total	\$639	\$934	\$3,582	\$5,155	\$4,697	AA

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State	As of December 31, 2011		Revenue	Fair Value	Amortized Cost	Average Credit Rating
	State General Obligation (in millions)	Local General Obligation				
Texas	\$86	\$342	\$346	\$774	\$724	AA
New York	12	60	623	695	654	AA
California	19	51	297	367	336	AA
Florida	34	62	247	343	317	AA
Illinois	16	87	197	300	281	AA
Massachusetts	43	9	164	216	199	AA
Washington	38	53	123	214	200	AA
Arizona	—	8	164	172	163	AA
Ohio	—	53	86	139	129	AA
Michigan	—	37	99	136	129	AA
All others	311	271	1,114	1,696	1,588	AA
Total	\$559	\$1,033	\$3,460	\$5,052	\$4,720	AA

The revenue bond portfolio is comprised primarily of essential service revenue bonds issued by water and sewer authorities and other utilities, transportation authorities, universities and healthcare providers.

Revenue Sources

Type	As of September 30, 2012		As of December 31, 2011	
	Fair Value (in millions)	Amortized Cost	Fair Value	Amortized Cost
Tax backed	\$746	\$679	\$717	\$670
Transportation	730	660	800	749
Water and sewer	570	522	530	501
Municipal utilities	565	516	529	494
Higher education	422	381	332	307
Healthcare	313	287	273	258
All others	236	221	279	264
Total	\$3,582	\$3,266	\$3,460	\$3,243

The Company's investment portfolio is managed by four outside managers. As municipal investments are a material portion of the Company's overall investment portfolio, the Company has established detailed guidelines regarding credit quality, exposure to a particular sector and exposure to a particular obligor within a sector. Each of the portfolio managers perform independent analysis on every municipal security they purchase for the Company's portfolio. The Company meets with each of its portfolio managers quarterly and reviews all investments with a change in credit rating as well as any investments on the manager's watch list of securities with the potential for downgrade.

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The following tables summarize, for all securities in an unrealized loss position, the aggregate fair value and gross unrealized loss by length of time the amounts have continuously been in an unrealized loss position.

Fixed Maturity Securities

Gross Unrealized Loss by Length of Time

	As of September 30, 2012				Total Fair value	Unrealized loss	
	Less than 12 months Fair value (dollars in millions)	Unrealized loss	12 months or more Fair value	Unrealized loss			
U.S. government and agencies	\$—	\$—	\$—	\$—	\$—	\$—	
Obligations of state and political subdivisions	22	0	—	—	22	0	
Corporate securities	16	0	—	—	16	0	
Mortgage-backed securities:							
RMBS	156	(47) 95	(38) 251	(85)
CMBS	2	0	—	—	2	0	
Asset-backed securities	20	(2) 33	(11) 53	(13)
Foreign government securities	2	0	—	—	2	0	
Total	\$218	\$(49) \$128	\$(49) \$346	\$(98)
Number of securities		39		16		55	
Number of securities with OTTI		6		6		12	

	As of December 31, 2011				Total Fair value	Unrealized loss	
	Less than 12 months Fair value (dollars in millions)	Unrealized loss	12 months or more Fair value	Unrealized loss			
U.S. government and agencies	\$4	\$0	\$—	\$—	\$4	\$0	
Obligations of state and political subdivisions	17	0	21	(1	) 38	(1)
Corporate securities	80	(2	) 3	—	83	(2)
Mortgage-backed securities:							
RMBS	187	(68	) 36	(22	) 223	(90)
CMBS	3	0	—	—	3	0	
Asset-backed securities	—	—	26	(19	) 26	(19)
Foreign government securities	141	(6	) —	—	141	(6)
Total	\$432	\$(76	) \$86	\$(42	) \$518	\$(118)
Number of securities		56		20		76	
Number of securities with OTTI		6		4		10	

Of the securities in an unrealized loss position for 12 months or more as of September 30, 2012, nine securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of September 30, 2012 was \$49 million. The Company has determined that the unrealized losses recorded as of September 30, 2012 are yield related and not the result of other-than-temporary impairments.

The amortized cost and estimated fair value of available-for-sale fixed maturity securities by contractual maturity as of September 30, 2012 are shown below. 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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by Contractual Maturity

	As of September 30, 2012	
	Amortized Cost	Estimated Fair Value
	(in millions)	
Due within one year	\$379	\$382
Due after one year through five years	1,442	1,525
Due after five years through 10 years	2,305	2,550
Due after 10 years	3,595	3,963
Mortgage-backed securities:		
RMBS	1,393	1,384
CMBS	475	514
Total	\$9,589	\$10,318

Under agreements with its cedants and in accordance with statutory requirements, the Company maintains fixed maturity securities in trust accounts for the benefit of reinsured companies, which amounted to \$412 million and \$380 million as of September 30, 2012 and December 31, 2011, respectively. In addition, to fulfill state licensing requirements the Company has placed on deposit eligible securities of \$27 million and \$24 million as of September 30, 2012 and December 31, 2011, respectively. To provide collateral for a letter of credit, the Company holds a fixed maturity investment in a segregated account which amounted to \$4 million and \$4 million as of September 30, 2012 and December 31, 2011, respectively. In connection with an excess of loss reinsurance facility \$22 million in short term securities have been deposited into a trust for the benefit of the reinsurers.

Under certain derivative contracts, the Company is required to post eligible securities as collateral. The need to post collateral under these transactions is generally based on fair value assessments in excess of contractual thresholds. The fair value of the Company's pledged securities totaled \$687 million and \$780 million as of September 30, 2012 and December 31, 2011, respectively.

No material investments of the Company were non-income producing for Nine Months 2012 and 2011, respectively.

The Company purchased securities that it has insured, and for which it has expected losses to be paid, in order to mitigate the economic effect of insured losses ("loss mitigation bonds"). These securities were purchased at a discount and are accounted for excluding the effects of the Company's insurance on the securities. As of September 30, 2012, securities purchased for loss mitigation purposes included in the fixed maturity portfolio on the consolidated balance sheet had a fair value of \$314 million representing \$863 million of par.

Under the terms of certain credit derivative contracts, the Company has obtained the obligations referenced in the transactions and recorded such assets in fixed maturity securities in the consolidated balance sheets. Such fair value amounts totaled \$194 million, representing \$220 million in par.

9. Insurance Company Regulatory Requirements

Dividend Restrictions and Capital Requirements

AGC is a Maryland domiciled insurance company. As of September 30, 2012, the amount available for distribution from AGC during 2012 with notice to, but without prior approval of, the Maryland Commissioner of Insurance under

the Maryland insurance law is approximately \$92 million. During Nine Months 2012 and 2011, AGC declared and paid \$55 million and \$20 million, respectively, in dividends to AGUS.

AGM is a New York domiciled insurance company. Based on AGM's statutory statements to be filed for Third Quarter 2012, the maximum amount available for payment of dividends by AGM without regulatory approval over the 12 months following September 30, 2012, was approximately \$178 million. Also in connection with the acquisition of AGMH on July 1, 2009 ("AGMH Acquisition"), the Company committed to the New York Department of Financial Services that AGM would not pay any dividends for a period of two years from the Acquisition Date without written approval of the New York Department of

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Financial Services. AGM did not pay any dividends in 2011. During Nine Months 2012, AGM declared and paid dividends of \$30 million to its parent, AGMH.

AG Re is a Bermuda domiciled insurance company and its dividend distribution is governed by Bermuda law. The amount available at AG Re to pay dividends in 2012 in compliance with Bermuda law is approximately \$231 million. However, any distribution that results in a reduction of 15% (\$192 million as of December 31, 2011) or more of AG Re's total statutory capital, as set out in its previous year's financial statements, would require the prior approval of the Bermuda Monetary Authority. Dividends are limited by requirements that the subject company must at all times (i) maintain the minimum solvency margin required under the Insurance Act of 1978 and (ii) have relevant assets in an amount at least equal to 75% of relevant liabilities, both as defined under the Insurance Act of 1978. AG Re, as a Class 3B insurer, is prohibited from declaring or paying in any financial year dividends of more than 25% of its total statutory capital and surplus (as shown on its previous financial year's statutory balance sheet) unless it files (at least 7 days before payment of such dividends) with the Authority an affidavit stating that it will continue to meet the required margins. During Nine Months 2012, AG Re declared \$110 million and paid \$111 million, which included \$1 million declared in the prior years, and in the same period of 2011 declared and paid \$54 million, to its parent, AGL, respectively. As of September 30, 2012, AG Re had unencumbered assets of \$197 million, representing assets not held in trust for the benefit of cedants.

10. Income Taxes

Provision for Income Taxes

AGL and its Bermuda Subsidiaries, which include AG Re, Assured Guaranty Re Overseas Ltd. ("AGRO"), Assured Guaranty (Bermuda) Ltd. and Cedar Personnel Ltd., are not subject to any income, withholding or capital gains taxes under current Bermuda law. The Company has received an assurance from the Minister of Finance in Bermuda that, in the event of any taxes being imposed, AGL and its Bermuda Subsidiaries will be exempt from taxation in Bermuda until March 31, 2035. The Company's U.S. and United Kingdom ("U.K.") subsidiaries are subject to income taxes imposed by U.S. and U.K. authorities, respectively, and file applicable tax returns. In addition, AGRO, a Bermuda domiciled company and Assured Guaranty (Europe) Ltd., a U.K. domiciled company, have elected under Section 953(d) of the U.S. Internal Revenue Code to be taxed as a U.S. domestic corporation.

In conjunction with AGMH Acquisition, AGMH has joined the consolidated federal tax group of AGUS, AGC, and AG Financial Products Inc. ("AGFP"). In conjunction with the acquisition of MIAC on May 31, 2012, ("MIAC Acquisition"), MIAC has joined the consolidated federal tax group. For the periods beginning on July 1, 2009 and forward, AGMH files a consolidated federal income tax return with AGUS, AGC, AGFP and AG Analytics Inc. ("AGUS consolidated tax group"). In addition, a new tax sharing agreement was entered into effective July 1, 2009 whereby each company in the AGUS consolidated tax group will pay or receive its proportionate share of taxable expense or benefit as if it filed on a separate return basis with current period credit for net losses to the extent used in consolidation. Assured Guaranty Overseas US Holdings Inc. and its subsidiaries AGRO, Assured Guaranty Mortgage Insurance Company and AG Intermediary Inc., have historically filed their own consolidated federal income tax return. Each company, as a member of its respective consolidated tax return group, pays its proportionate share of the consolidated federal tax burden for its group as if each company filed on a separate return basis with current period credit for net losses to the extent used in consolidation.

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 fair value of its credit derivatives, which prevents the Company from projecting a reliable estimated annual effective tax rate and pretax income for the full year 2012. A discrete calculation of the provision is calculated for each interim period.

The effective tax rates reflect the proportion of income recognized by each of the Company's operating subsidiaries, with U.S. subsidiaries taxed at the U.S. marginal corporate income tax rate of 35%, U.K. subsidiaries taxed at the U.K. blended marginal corporate tax rate of 24.5% unless subject to U.S. tax by election or as a U.S. controlled foreign corporation, and no taxes for the Company's Bermuda holding company and Bermuda subsidiaries unless subject to U.S. tax by election or as a U.S. controlled foreign corporation. For periods subsequent to April 1, 2012, the U.K. corporation tax rate has been reduced to 24%, for the period April 1, 2011 to April 1, 2012 the U.K. corporation tax rate was 26% resulting in a blended tax rate of 24.5% in 2012 and prior to April 1, 2011, the U.K. corporation tax rate was 28% resulting in a blended tax rate of 26.5% in 2011. The Company's overall corporate effective tax rate fluctuates based on the distribution of income across jurisdictions.

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A reconciliation of the difference between the provision for income taxes and the expected tax provision at statutory rates in taxable jurisdictions is presented below.

Effective Tax Rate Reconciliation

	Third Quarter		Nine Months		
	2012	2011	2012	2011	
	(in millions)				
Expected tax provision (benefit) at statutory rates in taxable jurisdictions	\$51	\$309	\$43	\$364	
Tax-exempt interest	(15)	(14)	(46)	(46)	
True-up from tax return filings	—	(3)	—	(3)	
Change in liability for uncertain tax positions	0	0	1	1	
Other	1	2	3	4	
Total provision (benefit) for income taxes	\$37	\$294	\$1	\$320	
Effective tax rate	20.6	% 27.9	% 3.7	% 27.2	%

The expected tax provision at statutory rates in taxable jurisdictions is calculated as the sum of pretax income in each jurisdiction multiplied by the statutory tax rate of the jurisdiction by which it will be taxed. Pretax income of the Company's subsidiaries which are not U.S. domiciled but are subject to U.S. tax by election or as controlled foreign corporations are included at the U.S. statutory tax rate. Where there is a pretax loss in one jurisdiction and pretax income in another, the total combined expected tax rate may be higher or lower than any of the individual statutory rates.

The following table presents pretax income and revenue by jurisdiction.

Pretax Income (Loss) by Tax Jurisdiction

	Third Quarter		Nine Months	
	2012	2011	2012	2011
	(in millions)			
United States	\$145	\$884	\$123	\$1,039
Bermuda	34	171	(86)	138
UK	0	0	0	0
Total	\$179	\$1,055	\$37	\$1,177

Revenue by Tax Jurisdiction

	Third Quarter		Nine Months	
	2012	2011	2012	2011
	(in millions)			
United States	\$288	\$1,084	\$688	\$1,453
Bermuda	54	261	56	287
UK	0	0	0	0
Total	\$342	\$1,345	\$744	\$1,740

Pretax income by jurisdiction may be disproportionate to revenue by jurisdiction to the extent that insurance losses incurred are disproportionate.

Valuation Allowance

The Company came to the conclusion that it is more likely than not that its net deferred tax asset will be fully realized after weighing all positive and negative evidence available as required under GAAP. The positive evidence that was considered included the cumulative operating income the Company has earned over the last three years, and the significant unearned premium income to be included in taxable income. The positive evidence outweighs any negative evidence that exists. As such, the Company believes that no valuation allowance is necessary in connection with this deferred tax asset. The Company will

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continue to analyze the need for a valuation allowance on a quarterly basis.

Uncertain Tax Positions

It is reasonably possible that a change in the balance of unrecognized tax benefits may occur within the next twelve months due to the closing of IRS audits or the lapse of statute of limitations. Based on the information currently available, the Company does not expect any changes to be material to the consolidated financial condition or results of operations.

11. Reinsurance and Other Monoline Exposures

The Company assumes exposure on insured obligations (“Assumed Business”) and cedes portions of its exposure on obligations it has insured (“Ceded Business”) in exchange for premiums, net of ceding commissions.

Assumed and Ceded Business

The Company is party to reinsurance agreements as a reinsurer to other monoline financial guaranty insurance companies. Under these relationships, the Company assumes a portion of the ceding company’s insured risk in exchange for a premium. The Company may be exposed to risk in this portfolio in that the Company may be required to pay losses without a corresponding premium in circumstances where the ceding company is experiencing financial distress and is unable to pay premiums. The Company’s facultative and treaty agreements are generally subject to termination:

- (a) at the option of the primary insurer if the Company fails to maintain certain financial, regulatory and rating agency criteria that are equivalent to or more stringent than those the Company is otherwise required to maintain for its own compliance with state mandated insurance laws and to maintain a specified financial strength rating for the particular insurance subsidiary, or
- (b) upon certain changes of control of the Company.

Upon termination under these conditions, the Company may be required (under some of its reinsurance agreements) to return to the primary insurer all unearned premiums, less ceding commissions, and loss reserves calculated on a statutory basis of accounting, attributable to reinsurance ceded pursuant to such agreements after which the Company would be released from liability with respect to the Assumed Business. Upon the occurrence of the conditions set forth in (a) above, whether or not an agreement is terminated, the Company may be required to obtain a letter of credit or alternative form of security to collateralize its obligation to perform under such agreement or it may be obligated to increase the level of ceding commission paid.

With respect to a significant portion of the Company’s in-force financial guaranty Assumed Business, due to the downgrade of AG Re to A1, subject to the terms of each policy, the ceding company may have the right to recapture Assumed Business ceded to AG Re and assets representing substantially all of the statutory unearned premium (net of ceding commissions) and loss reserves (if any) associated with that business. As of September 30, 2012, if all of AG Re’s Assumed Business was recaptured, it would result in a corresponding one-time reduction to net income of approximately \$5 million. In the case of AGC, some of its in force financial guaranty Assumed Business is subject to recapture at AGC’s current ratings. Subject to the terms of each reinsurance agreement, upon recapture the ceding company typically is owed assets representing substantially all of the statutory unearned premium (net of ceding commissions) and loss reserves (if any) associated with that business. As of September 30, 2012, if all of AGC’s Assumed Business was recaptured, it would result in a corresponding one-time reduction to net income of approximately \$11 million.

The Company has Ceded Business to non-affiliated companies to limit its exposure to risk. Under these relationships, the Company cedes a portion of its insured risk in exchange for a premium paid to the reinsurer. The Company remains primarily liable for all risks it directly underwrites and is required to pay all gross claims. It then seeks reimbursement from the reinsurer for its proportionate share of claims. The Company may be exposed to risk for this exposure if it were required to pay the gross claims and not be able to collect ceded claims from an assuming company experiencing financial distress. A number of the financial guaranty insurers to which the Company has ceded par have experienced financial distress and been downgraded by the rating agencies as a result. In addition, state insurance regulators have intervened with respect to some of these insurers. The Company's ceded contracts generally allow the Company to recapture Ceded Business after certain triggering events, such as reinsurer downgrades.

Over the past several years, the Company has entered into several commutations in order to reassume previously ceded books of business from BIG financial guaranty companies and its other reinsurers. The Company has also cancelled assumed reinsurance contracts. The Company reassumed business from one reinsurer in Third Quarter 2012 and there were no

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commutations in Third Quarter 2011. These commutations of ceded and cancellations of assumed business resulted in gains of \$1 million, \$84 million and \$32 million for Third Quarter 2012 and Nine Months 2012 and 2011, respectively, which were recorded in other income. While certain Ceded Business has been reassumed, the Company still has significant Ceded Business with third parties.

Net Effect of Commutations of Ceded
Reinsurance Contracts

	Third Quarter		Nine Months	
	2012	2011	2012	2011
	(in millions)			
Increase (decrease) in net unearned premium reserve	\$2	\$—	\$108	\$(20)
Increase (decrease) in net par outstanding	9	—	19,082	(780)

Effect of Reinsurance on Statement of Operations

	Third Quarter		Nine Months	
	2012	2011	2012	2011
	(in millions)			
Premiums Written:				
Direct	\$24	\$37	\$131	\$94
Assumed(1)	0	(15)	13	(67)
Ceded(2)	1	1	88	6
Net	\$25	\$23	\$232	\$33
Premiums Earned:				
Direct	\$242	\$227	\$694	\$742
Assumed	13	4	39	35
Ceded	(33)	(20)	(98)	(82)
Net	\$222	\$211	\$635	\$695
Loss and LAE:				
Direct	\$112	\$244	\$558	\$380
Assumed	(4)	(2)	13	(7)
Ceded	(18)	(27)	(112)	(60)
Net	\$90	\$215	\$459	\$313

(1) Negative assumed premiums written were due to commutations and changes in expected debt service schedules.

(2) Positive ceded premiums written were due to commutations and changes in expected debt service schedules.

Reinsurer Exposure

In addition to assumed and ceded reinsurance arrangements, the Company may also have exposure to some financial guaranty reinsurers (i.e., monolines) in other areas. Second-to-pay insured par outstanding represents transactions the Company has insured that were previously insured by other monolines. The Company underwrites such transactions based on the underlying insured obligation without regard to the primary insurer. Another area of exposure is in the investment portfolio where the Company holds fixed maturity securities that are wrapped by monolines and whose value may decline based on the rating of the monoline. At September 30, 2012, based on fair value, the Company had \$664 million of fixed maturity securities in its investment portfolio wrapped by National Public Finance Guarantee Corporation, \$537 million by Ambac Assurance Corporation ("Ambac") and \$36 million by other guarantors.

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Exposure by Reinsurer

Reinsurer	Ratings at November 7, 2012		Par Outstanding As of September 30, 2012		Assumed Par Outstanding
	Moody's Reinsurer Rating	S&P Reinsurer Rating	Ceded Par Outstanding(1)	Second-to-Pay Insured Par Outstanding	
	(dollars in millions)				
American Overseas Reinsurance Company Limited(2)	WR(3)	WR	\$10,309	\$—	\$24
Tokio	Aa3(4)	AA-(4)	8,748	—	937
Radian	Ba1	B+	5,364	44	1,474
Syncora Guarantee Inc.	Ca	WR	4,092	2,043	165
Mitsui Sumitomo Insurance Co. Ltd.	A1	A+	2,256	—	—
ACA Financial Guaranty Corp.	NR	WR	829	6	1
Swiss Reinsurance Co.	A1	AA-	434	—	—
Ambac	WR	WR	85	7,151	21,231
CIFG Assurance North America Inc.	WR	WR	65	255	5,583
MBIA Inc.	(5)	(5)	—	11,497	8,798
Financial Guaranty Insurance Co.	WR	WR	—	3,336	2,020
Other	Various	Various	1,008	2,064	96
Total			\$33,190	\$26,396	\$40,329

(1) Includes \$4,198 million in ceded par outstanding related to insured credit derivatives.

(2) Formerly RAM Reinsurance Company Ltd.

(3) Represents "Withdrawn Rating."

(4) The Company has structural collateral agreements satisfying the triple-A credit requirement of S&P and/or Moody's.

(5) MBIA Inc. includes various subsidiaries which are rated BBB by S&P and Baa2, B3, WR and NR by Moody's.

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Amounts Due (To) From Reinsurers

	As of September 30, 2012			
	Assumed Premium, net of Commissions	Ceded Premium, net of Commissions	Assumed Expected Loss and LAE	Ceded Expected Loss and LAE
	(in millions)			
American Overseas Reinsurance Company Limited	\$—	\$(12	) \$—	\$12
Tokio	—	(23	) —	35
Radian	—	(18	) —	(4
Syncora Guarantee Inc.	—	(37	) 1	—
Mitsui Sumitomo Insurance Co. Ltd.	—	(5	) —	8
Swiss Reinsurance Co.	—	(3	) —	1
Ambac	81	—	(85) —
CIFG Assurance North America Inc.	—	—	—	2
MBIA Inc.	—	—	(22) —
Financial Guaranty Insurance Co.	9	—	(30) —
Other	—	(40) —	—
Total	\$90	\$(138	) \$(136	) \$54

Excess of Loss Reinsurance Facility

On January 22, 2012, AGC and AGM entered into an aggregate excess of loss reinsurance facility, effective as of January 1, 2012. At AGC's and AGM's option, the facility will cover losses occurring from January 1, 2012 through December 31, 2019 or from January 1, 2013 through December 31, 2020. The contract terminates, unless AGC and AGM choose to extend it, on January 1, 2014. The facility covers U.S. public finance credits insured or reinsured by AGC and AGM as of September 30, 2011, excluding credits that were rated non-investment grade as of December 31, 2011 by Moody's or S&P or internally by AGC or AGM and subject to certain per credit limits. The facility attaches when AGC's or AGM's net losses (net of AGC's and AGM other reinsurance, other than pooling reinsurance provided to AGM by AGM's subsidiaries and net of recoveries) exceed in the aggregate \$2 billion and covers a portion of the next \$600 million of losses, with the reinsurers assuming pro rata in the aggregate \$435 million of the \$600 million of losses and AGC and AGM jointly retaining the remaining \$165 million of losses. The reinsurers are required to be rated at least AA-(Stable Outlook) through December 31, 2014 or to post collateral sufficient to provide AGM and AGC with the same reinsurance credit as reinsurers rated AA-. AGM and AGC are obligated to pay the reinsurers their share of recoveries relating to losses during the coverage period in the covered portfolio. This obligation is secured by a pledge of the recoveries, which will be deposited into a trust for the benefit of the reinsurers. The Company has paid approximately \$22 million of premiums during Nine Months 2012. The remaining \$22 million of premiums, which are due in January 2013, have been deposited into a trust for the benefit of the reinsurers as of September 30, 2012.

Re-Assumption and Reinsurance Agreements with Radian Asset Assurance Inc.

On January 24, 2012, AGM reassumed \$12.9 billion of par it had previously ceded to Radian and AGC reinsured approximately \$1.8 billion of U.S. public finance par from Radian. The Company received a payment of \$86 million from Radian for the re-assumption, which consisted 96% of public finance exposure and 4% of structured finance credits; additionally, the Company projects it will receive an incremental \$2 million present value from future installment premiums. In connection with the reinsurance assumption, the Company received a payment of \$22 million. Both the reassumed and reinsured portfolios were composed entirely of selected credits that met the

Company's underwriting standards.

Tokio Marine & Nichido Fire Insurance Co., Ltd. Agreement

Effective as of March 1, 2012, AGM and Tokio entered into a Commutation, Reassumption and Release Agreement for a portfolio consisting of approximately \$6.2 billion in par of U.S. public finance exposures outstanding as of February 29, 2012. Tokio paid AGM the statutory unearned premium outstanding as of February 29, 2012 plus a commutation premium.

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12. Commitments and Contingencies

Legal Proceedings

Litigation

Lawsuits arise in the ordinary course of the Company's business. It is the opinion of the Company's management, based upon the information available, that the expected outcome of litigation against the Company, individually or in the aggregate, will not have a material adverse effect on the Company's financial position or liquidity, although an adverse resolution of litigation against the Company in a fiscal quarter or year could have a material adverse effect on the Company's results of operations in a particular quarter or year. In addition, in the ordinary course of their respective businesses, certain of the Company's subsidiaries assert claims in legal proceedings against third parties to recover losses paid in prior periods. For example, as described in Note 4 (Financial Guaranty Insurance Contracts—Recovery Litigation), as of the date of this filing, AGC and AGM have filed complaints against certain sponsors and underwriters of RMBS securities that AGC or AGM had insured, alleging, among other claims, that such persons had breached R&W in the transaction documents, failed to cure or repurchase defective loans and/or violated state securities laws. The amounts, if any, the Company will recover in proceedings to recover losses are uncertain, and recoveries, or failure to obtain recoveries, in any one or more of these proceedings during any quarter or year could be material to the Company's results of operations in that particular quarter or year.

Proceedings Relating to the Company's Financial Guaranty Business

The Company receives subpoenas duces tecum and interrogatories from regulators from time to time.

In August 2008, a number of financial institutions and other parties, including AGM and other bond insurers, were named as defendants in a civil action brought in the circuit court of Jefferson County, Alabama relating to the County's problems meeting its sewer debt obligations: Charles E. Wilson vs. JPMorgan Chase & Co et al (filed the Circuit Court of Jefferson County, Alabama), Case No. 01-CV-2008-901907.00, a putative class action. The action was brought on behalf of rate payers, tax payers and citizens residing in Jefferson County, and alleges conspiracy and fraud in connection with the issuance of the County's debt. The complaint in this lawsuit seeks equitable relief, unspecified monetary damages, interest, attorneys' fees and other costs. On January, 13, 2011, the circuit court issued an order denying a motion by the bond insurers and other defendants to dismiss the action. Defendants, including the bond insurers, have petitioned the Alabama Supreme Court for a writ of mandamus to the circuit court vacating such order and directing the dismissal with prejudice of plaintiffs' claims for lack of standing. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from this lawsuit.

Beginning in July 2008, AGM and various other financial guarantors were named in complaints filed in the Superior Court for the State of California, City and County of San Francisco. Since that time, plaintiffs' counsel has filed amended complaints against AGM and AGC and added additional plaintiffs. As of the date of this filing, the plaintiffs with complaints against AGM and AGC, among other financial guaranty insurers, are: (a) City of Los Angeles, acting by and through the Department of Water and Power; (b) City of Sacramento; (c) City of Los Angeles; (d) City of Oakland; (e) City of Riverside; (f) City of Stockton; (g) County of Alameda; (h) County of Contra Costa; (i) County of San Mateo; (j) Los Angeles World Airports; (k) City of Richmond; (l) Redwood City; (m) East Bay Municipal Utility District; (n) Sacramento Suburban Water District; (o) City of San Jose; (p) County of Tulare; (q) The Regents of the University of California; (r) The Redevelopment Agency of the City of Riverside; (s) The Public Financing Authority of the City of Riverside; (t) The Jewish Community Center of San Francisco; (u) The San Jose Redevelopment Agency; (v) The Redevelopment Agency of the City of Stockton; (w) The Public Financing Authority of the City of Stockton; and (x) The Olympic Club. Complaints filed by the City and County of San Francisco and the Sacramento Municipal Utility District were subsequently dismissed against AGM and AGC. These complaints allege

that the financial guaranty insurer defendants (i) participated in a conspiracy in violation of California's antitrust laws to maintain a dual credit rating scale that misstated the credit default risk of municipal bond issuers and created market demand for municipal bond insurance, (ii) participated in risky financial transactions in other lines of business that damaged each insurer's financial condition (thereby undermining the value of each of their guaranties), and (iii) failed to adequately disclose the impact of those transactions on their financial condition. In addition to their antitrust claims, various plaintiffs in these actions assert claims for breach of the covenant of good faith and fair dealing, fraud, unjust enrichment, negligence, and negligent misrepresentation. At hearings held in July and October 2011 relating to AGM, AGC and the other defendants' demurrer, the court overruled the demurrer on the following claims: breach of contract, violation of California's antitrust statute and of its unfair business practices law, and fraud. The remaining claims were dismissed. On December 2, 2011, AGM, AGC and the other bond insurer defendants filed an anti-SLAPP ("Strategic Lawsuit Against Public Participation") motion to strike the complaints under California's Code of Civil Procedure. On May 1, 2012, the court ruled in favor of the bond insurer defendants on the first stage of the anti-SLAPP motion as to the causes of action arising from the

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alleged conspiracy, but denied the motion as to those causes of action based on transaction specific representations and omissions about the bond insurer defendants' credit ratings and financial health. The court has scheduled a hearing on the second stage of the anti-SLAPP motion for March 6, 2013. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from these lawsuits.

In September 2010, AGM, among others, was named as a defendant in an interpleader complaint filed by Wells Fargo Bank, N.A., as trust administrator, in the United States District Court, Southern District of New York. The interpleader complaint relates to the MASTR Adjustable Rate Mortgages Trust 2006-OA2, Mortgage Pass-Through Certificates, Series 2006-OA2 RMBS transaction, in which AGM had insured certain classes of certificates. Certain holders of uninsured certificates have disputed payments made by the trust administrator to reimburse AGM for claims it had paid under its financial guaranty policy, and the trust administrator sought adjudication of the priority of AGM's reimbursements. On March 29, 2011, the court granted a motion for judgment on the pleadings and ruled that, pursuant to the waterfall, AGM is only entitled to receive funds that would otherwise have been distributed to the holders of the classes that AGM insures, and that AGM receive such funds at the respective steps in the waterfall that immediately follow the steps at which such certificate holders would otherwise have received such funds. The court further ordered AGM to repay to the MARM 2006-OA2 trust the approximately \$7 million that had been credited to it by Wells Fargo. On December 13, 2011, the court entered judgment substantially in conformance with its March 29, 2011 decision. AGM appealed the judgment and in July 2012, the judge granted AGM's motion that the judgment be stayed pending the appeal. AGM has paid approximately \$146 million in claims on this transaction and estimates that, as a result of this adverse decision, if and to the extent it is not modified, such amount will not be reimbursed. Such amount does not include the repayment of the \$7 million credit.

On April 8, 2011, AG Re and AGC filed a Petition to Compel Arbitration with the Supreme Court of the State of New York, requesting an order compelling Ambac to arbitrate Ambac's disputes with AG Re and AGC concerning their obligations under reinsurance agreements with Ambac. In March 2010, Ambac placed a number of insurance policies that it had issued, including policies reinsured by AG Re and AGC pursuant to the reinsurance agreements, into a segregated account. The Wisconsin state court has approved a rehabilitation plan whereby permitted claims under the policies in the segregated account will be paid 25% in cash and 75% in surplus notes issued by the segregated account. Ambac has advised AG Re and AGC that it has and intends to continue to enter into commutation agreements with holders of policies issued by Ambac, and reinsured by AG Re and AGC, pursuant to which Ambac will pay a combination of cash and surplus notes to the policyholder. AG Re and AGC have informed Ambac that they believe their only current payment obligation with respect to the commutations arises from the cash payment, and that there is no obligation to pay any amounts in respect of the surplus notes until payments of principal or interest are made on such notes. Ambac has disputed this position on one commutation and may take a similar position on subsequent commutations. On April 15, 2011, attorneys for the Wisconsin Insurance Commissioner, as Rehabilitator of Ambac's segregated account, and for Ambac filed a motion with Lafayette County, Wis., Circuit Court Judge William Johnston, asking him to find AG Re and AGC to be in violation of an injunction protecting the interests of the segregated account by their seeking to compel arbitration on this matter and failing to pay in full all amounts with respect to Ambac's payments in the form of surplus notes. On June 14, 2011, Judge Johnston issued an order granting the Rehabilitator's and Ambac's motion to enforce the injunction against AGC and AG Re and the parties filed a stipulation dismissing the Petition to Compel Arbitration without prejudice. AGC and AG Re have appealed Judge Johnston's order to the Wisconsin Court of Appeals.

On November 28, 2011, Lehman Brothers International (Europe) (in administration) ("LBIE") sued AG Financial Products Inc. ("AG Financial Products"), an affiliate of AGC which in the past had provided credit protection to counterparties under credit default swaps. AGC acts as the credit support provider of AG Financial Products under these credit default swaps. LBIE's complaint, which was filed in the Supreme Court of the State of New York, alleged that AG Financial Products improperly terminated nine credit derivative transactions between LBIE and AG Financial

Products and improperly calculated the termination payment in connection with the termination of 28 other credit derivative transactions between LBIE and AG Financial Products. With respect to the 28 credit derivative transactions, AG Financial Products calculated that LBIE owes AG Financial Products approximately \$25 million, whereas LBIE asserted in the complaint that AG Financial Products owes LBIE a termination payment of approximately \$1.4 billion. LBIE is seeking unspecified damages. On February 3, 2012, AG Financial Products filed a motion to dismiss certain of the counts in the complaint. Oral arguments on such motion to dismiss took place in September 2012. The Company cannot reasonably estimate the possible loss, if any, that may arise from this lawsuit.

Proceedings Related to AGMH's Former Financial Products Business

The following is a description of legal proceedings involving AGMH's former Financial Products Business. Although the Company did not acquire AGMH's former Financial Products Business, which included AGMH's former GIC business,

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medium term notes business and portions of the leveraged lease businesses, certain legal proceedings relating to those businesses are against entities that the Company did acquire. While Dexia SA and Dexia Cr dit Local S.A. (“DCL”), jointly and severally, have agreed to indemnify the Company against liability arising out of the proceedings described below in the “—Proceedings Related to AGMH’s Former Financial Products Business” section, such indemnification might not be sufficient to fully hold the Company harmless against any injunctive relief or civil or criminal sanction that is imposed against AGMH or its subsidiaries.

Governmental Investigations into Former Financial Products Business

AGMH and/or AGM have received subpoenas duces tecum and interrogatories or civil investigative demands from the Attorney General of the States of Connecticut, Florida, Illinois, Massachusetts, Missouri, New York, Texas and West Virginia relating to their investigations of alleged bid rigging of municipal GICs. AGMH is responding to such requests. AGMH may receive additional inquiries from these or other regulators and expects to provide additional information to such regulators regarding their inquiries in the future. In addition,

AGMH received a subpoena from the Antitrust Division of the Department of Justice in November 2006 issued in connection with an ongoing criminal investigation of bid rigging of awards of municipal GICs and other municipal derivatives;

AGM received a subpoena from the SEC in November 2006 related to an ongoing industry-wide investigation concerning the bidding of municipal GICs and other municipal derivatives; and

AGMH received a “Wells Notice” from the staff of the Philadelphia Regional Office of the SEC in February 2008 relating to the investigation concerning the bidding of municipal GICs and other municipal derivatives. The Wells Notice indicates that the SEC staff is considering recommending that the SEC authorize the staff to bring a civil injunctive action and/or institute administrative proceedings against AGMH, alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act.

Pursuant to the subpoenas, AGMH has furnished to the Department of Justice and SEC records and other information with respect to AGMH’s municipal GIC business. The ultimate loss that may arise from these investigations remains uncertain.

In July 2010, a former employee of AGM who had been involved in AGMH’s former Financial Products Business was indicted along with two other persons with whom he had worked at Financial Guaranty Insurance Company. Such former employee and the other two persons were convicted of wire fraud and conspiracy to commit fraud.

Lawsuits Relating to Former Financial Products Business

During 2008, nine putative class action lawsuits were filed in federal court alleging federal antitrust violations in the municipal derivatives industry, seeking damages and alleging, among other things, a conspiracy to fix the pricing of, and manipulate bids for, municipal derivatives, including GICs. These cases have been coordinated and consolidated for pretrial proceedings in the U.S. District Court for the Southern District of New York as MDL 1950, In re Municipal Derivatives Antitrust Litigation, Case No. 1:08-cv-2516 (“MDL 1950”).

Five of these cases named both AGMH and AGM: (a) Hinds County, Mississippi v. Wachovia Bank, N.A.; (b) Fairfax County, Virginia v. Wachovia Bank, N.A.; (c) Central Bucks School District, Pennsylvania v. Wachovia Bank, N.A.; (d) Mayor and City Council of Baltimore, Maryland v. Wachovia Bank, N.A.; and (e) Washington County, Tennessee v. Wachovia Bank, N.A. In April 2009, the MDL 1950 court granted the defendants’ motion to dismiss on the federal claims, but granted leave for the plaintiffs to file a second amended complaint. In June 2009, interim lead plaintiffs’

counsel filed a Second Consolidated Amended Class Action Complaint; although the Second Consolidated Amended Class Action Complaint currently describes some of AGMH's and AGM's activities, it does not name those entities as defendants. In March 2010, the MDL 1950 court denied the named defendants' motions to dismiss the Second Consolidated Amended Class Action Complaint. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees and other costs. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from these lawsuits.

Four of the cases named AGMH (but not AGM) and also alleged that the defendants violated California state antitrust law and common law by engaging in illegal bid-rigging and market allocation, thereby depriving the cities or municipalities of competition in the awarding of GICs and ultimately resulting in the cities paying higher fees for these products: (f) City of Oakland, California v. AIG Financial Products Corp.; (g) County of Alameda, California v. AIG Financial Products Corp.; (h) City of Fresno, California v. AIG Financial Products Corp.; and (i) Fresno County Financing Authority v. AIG Financial

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Products Corp. When the four plaintiffs filed a consolidated complaint in September 2009, the plaintiffs did not name AGMH as a defendant. However, the complaint does describe some of AGMH's and AGM's activities. The consolidated complaint generally seeks unspecified monetary damages, interest, attorneys' fees and other costs. In April 2010, the MDL 1950 court granted in part and denied in part the named defendants' motions to dismiss this consolidated complaint.

In 2008, AGMH and AGM also were named in five non-class action lawsuits originally filed in the California Superior Courts alleging violations of California law related to the municipal derivatives industry: (a) City of Los Angeles, California v. Bank of America, N.A.; (b) City of Stockton, California v. Bank of America, N.A.; (c) County of San Diego, California v. Bank of America, N.A.; (d) County of San Mateo, California v. Bank of America, N.A.; and (e) County of Contra Costa, California v. Bank of America, N.A. Amended complaints in these actions were filed in September 2009, adding a federal antitrust claim and naming AGM (but not AGMH) and AGUS, among other defendants. These cases have been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings.

In late 2009, AGM and AGUS, among other defendants, were named in six additional non-class action cases filed in federal court, which also have been coordinated and consolidated for pretrial proceedings with MDL 1950: (f) City of Riverside, California v. Bank of America, N.A.; (g) Sacramento Municipal Utility District v. Bank of America, N.A.; (h) Los Angeles World Airports v. Bank of America, N.A.; (i) Redevelopment Agency of the City of Stockton v. Bank of America, N.A.; (j) Sacramento Suburban Water District v. Bank of America, N.A.; and (k) County of Tulare, California v. Bank of America, N.A.

The MDL 1950 court denied AGM and AGUS's motions to dismiss these eleven complaints in April 2010. Amended complaints were filed in May 2010. On October 29, 2010, AGM and AGUS were voluntarily dismissed with prejudice from the Sacramento Municipal Utility District case only. The complaints in these lawsuits generally seek or sought unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from the remaining lawsuits.

In May 2010, AGM and AGUS, among other defendants, were named in five additional non-class action cases filed in federal court in California: (a) City of Richmond, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); (b) City of Redwood City, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); (c) Redevelopment Agency of the City and County of San Francisco, California v. Bank of America, N.A. (filed on May 21, 2010, N.D. California); (d) East Bay Municipal Utility District, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); and (e) City of San Jose and the San Jose Redevelopment Agency, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California). These cases have also been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings. In September 2010, AGM and AGUS, among other defendants, were named in a sixth additional non-class action filed in federal court in New York, but which alleges violation of New York's Donnelly Act in addition to federal antitrust law: Active Retirement Community, Inc. d/b/a Jefferson's Ferry v. Bank of America, N.A. (filed on September 21, 2010, E.D. New York), which has also been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings. In December 2010, AGM and AGUS, among other defendants, were named in a seventh additional non-class action filed in federal court in the Central District of California, Los Angeles Unified School District v. Bank of America, N.A., and in an eighth additional non-class action filed in federal court in the Southern District of New York, Kendal on Hudson, Inc. v. Bank of America, N.A. These cases also have been consolidated with MDL 1950 for pretrial proceedings. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from these lawsuits.

In January 2011, AGM and AGUS, among other defendants, were named in an additional non-class action case filed in federal court in New York, which alleges violation of New York's Donnelly Act in addition to federal antitrust law: Peconic Landing at Southold, Inc. v. Bank of America, N.A. This case has been consolidated with MDL 1950 for pretrial proceedings. The complaint in this lawsuit generally seeks unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from this lawsuit.

In September 2009, the Attorney General of the State of West Virginia filed a lawsuit (Circuit Ct. Mason County, W. Va.) against Bank of America, N.A. alleging West Virginia state antitrust violations in the municipal derivatives industry, seeking damages and alleging, among other things, a conspiracy to fix the pricing of, and manipulate bids for, municipal derivatives, including GICs. An amended complaint in this action was filed in June 2010, adding a federal antitrust claim and naming AGM (but not AGMH) and AGUS, among other defendants. This case has been removed to federal court as well as transferred to the S.D.N.Y. and consolidated with MDL 1950 for pretrial proceedings. The complaint in this lawsuit generally seeks civil penalties, unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from this lawsuit.

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13. Long-Term Debt and Credit Facilities

Long-Term Debt Obligations

The principal and carrying values of the Company's long-term debt are presented in the table below.

Principal and Carrying Amounts of Debt

	As of September 30, 2012		As of December 31, 2011	
	Principal	Carrying Value	Principal	Carrying Value
	(in millions)			
AGUS:				
7.0% Senior Notes	\$200	\$197	\$200	\$197
8.50% Senior Notes(1)	—	—	173	172
Series A Enhanced Junior Subordinated Debentures	150	150	150	150
Total AGUS	350	347	523	519
AGMH:				
67/8% QUIBS	100	68	100	67
6.25% Notes	230	137	230	136
5.60% Notes	100	54	100	54
Junior Subordinated Debentures	300	162	300	158
Total AGMH	730	421	730	415
AGM:				
Notes Payable	66	72	97	104
Total AGM	66	72	97	104
Total	\$1,146	\$840	\$1,350	\$1,038

(1) On June 1, 2012, AGUS retired all of the Senior Notes that it purchased in the remarketing. See Note 2, Business Changes, Risks, Uncertainties and Accounting Developments.

Recourse Credit Facilities

2009 Strip Coverage Facility

In connection with the AGMH Acquisition, AGM agreed to retain the risks relating to the debt and strip policy portions of the leveraged lease business. The liquidity risk to AGM related to the strip policy portion of the leveraged lease business is mitigated by the strip coverage facility described below.

In a leveraged lease transaction, a tax-exempt entity (such as a transit agency) transfers tax benefits to a tax-paying entity by transferring ownership of a depreciable asset, such as subway cars. The tax-exempt entity then leases the asset back from its new owner.

If the lease is terminated early, the tax-exempt entity must make an early termination payment to the lessor. A portion of this early termination payment is funded from monies that were pre-funded and invested at the closing of the leveraged lease transaction (along with earnings on those invested funds). The tax-exempt entity is obligated to pay the remaining, unfunded portion of this early termination payment (known as the "strip coverage") from its own sources. AGM issued financial guaranty insurance policies (known as "strip policies") that guaranteed the payment of these unfunded strip coverage amounts to the lessor, in the event that a tax-exempt entity defaulted on its obligation to pay this portion of its early termination payment. AGM can then seek reimbursement of its strip policy payments from the

tax-exempt entity, and can also sell the transferred depreciable asset and reimburse itself from the sale proceeds.

One event that may lead to an early termination of a lease is the downgrade of AGM, as the strip coverage provider, or the downgrade of the equity payment undertaker within the transaction, in each case, generally to a financial strength rating below double-A. Upon such downgrade, the tax exempt entity is generally obligated to find a replacement credit enhancer within a specified period of time; failure to find a replacement could result in a lease default, and failure to cure the default within a specified period of time could lead to an early termination of the lease and a demand by the lessor for a termination

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payment from the tax exempt entity. However, even in the event of an early termination of the lease, there would not necessarily be an automatic draw on AGM's policy, as this would only occur to the extent the tax-exempt entity does not make the required termination payment.

AIG International Group, Inc. is one entity that has acted as equity payment undertaker in a number of transactions in which AGM acted as strip coverage provider. AIG was downgraded in the third quarter of 2008 and AGM was downgraded by Moody's in the fourth quarter of 2008. As a result of those downgrades, as of September 30, 2012, 45 leveraged lease transactions in which AGM acts as strip coverage provider were breaching either a ratings trigger related to AIG or a ratings trigger related to AGM. For such 45 leveraged lease transactions, if early termination of the leases were to occur and the tax-exempt entities do not make the required early termination payments, then AGM would be exposed to possible liquidity claims on gross exposure of approximately \$981 million as of September 30, 2012. S&P's downgrade of AGM to AA- in November 2011 did not have an additional impact on the transactions. However, if AGM were downgraded to A+ by S&P or A1 by Moody's, as of September 30, 2012, another 26 leveraged lease transactions in which AGM acts as strip coverage provider would be affected. For such 26 leveraged lease transactions, if early termination of the leases were to occur and the tax-exempt entities do not make the required early termination payments, then AGM would be exposed to possible liquidity claims on gross exposure of an additional approximately \$992 million as of September 30, 2012. To date, none of the leveraged lease transactions that involve AGM has experienced an early termination due to a lease default and a claim on the AGM guaranty. It is difficult to determine the probability that the Company will have to pay strip provider claims or the likely aggregate amount of such claims. At September 30, 2012, approximately \$607 million of cumulative strip par exposure had been terminated on a consensual basis. The consensual terminations have resulted in no claims on AGM.

On July 1, 2009, AGM and DCL, acting through its New York Branch ("Dexia Crédit Local (NY)"), entered into a credit facility (the "Strip Coverage Facility"). Under the Strip Coverage Facility, Dexia Crédit Local (NY) agreed to make loans to AGM to finance all draws made by lessors on AGM strip policies that were outstanding as of November 13, 2008, up to the commitment amount. The commitment amount of the Strip Coverage Facility was \$1 billion at closing of the AGMH Acquisition but is scheduled to amortize over time. As of September 30, 2012, the maximum commitment amount of the Strip Coverage Facility has amortized to \$969 million. It may also be reduced in 2014 to \$750 million, if AGM does not have a specified consolidated net worth at that time.

Fundings under this facility are subject to certain conditions precedent, and their repayment is collateralized by a security interest that AGM granted to Dexia Crédit Local (NY) in amounts that AGM recovers—from the tax-exempt entity, or from asset sale proceeds—following its payment of strip policy claims. The Strip Coverage Facility will terminate upon the earliest to occur of an AGM change of control, the reduction of the commitment amount to \$0, and January 31, 2042.

The Strip Coverage Facility's financial covenants require that AGM and its subsidiaries maintain a maximum debt-to-capital ratio of 30% and maintain a minimum net worth of 75% of consolidated net worth as of July 1, 2009, plus, starting July 1, 2014, 25% of the aggregate consolidated net income (or loss) for the period beginning July 1, 2009 and ending on June 30, 2014 or, if the commitment amount has been reduced to \$750 million as described above, zero. The Company is in compliance with all financial covenants as of the date of this filing.

The Strip Coverage Facility contains restrictions on AGM, including, among other things, in respect of its ability to incur debt, permit liens, pay dividends or make distributions, dissolve or become party to a merger or consolidation. Most of these restrictions are subject to exceptions. The Strip Coverage Facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, bankruptcy or insolvency proceedings and cross-default to other debt agreements.

As of September 30, 2012 and December 31, 2011, no amounts were outstanding under this facility, nor have there been any borrowings during the life of this facility.

Limited Recourse Credit Facilities

AG Re Credit Facility

On July 31, 2007, AG Re entered into a limited recourse credit facility (“AG Re Credit Facility”) with a syndicate of banks which provides up to \$200 million for the payment of losses in respect of the covered portfolio. The AG Re Credit Facility expires in June 2014. The facility can be utilized after AG Re has incurred, during the term of the facility, cumulative municipal losses (net of any recoveries) in excess of the greater of \$260 million or the average annual debt service of the covered portfolio multiplied by 4.5%. The obligation to repay loans under this agreement is a limited recourse obligation payable solely from, and collateralized by, a pledge of recoveries realized on defaulted insured obligations in the covered

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portfolio, including certain installment premiums and other collateral.

As of September 30, 2012 and December 31, 2011 no amounts were outstanding under this facility nor have there been any borrowings during the life of this facility.

Letters of Credit

AGC entered into a letter of credit agreement in December 2011 with Bank of New York Mellon totaling approximately \$3 million in connection with a 2008 lease for office space, which space was subsequently sublet. As of September 30, 2012, \$3 million was outstanding under this letter of credit.

Committed Capital Securities

On April 8, 2005, AGC entered into separate agreements (the "Put Agreements") with four custodial trusts (each, a "Custodial Trust") pursuant to which AGC may, at its option, cause each of the Custodial Trusts to purchase up to \$50 million of perpetual preferred stock of AGC (the "AGC Preferred Stock"). The custodial trusts were created as a vehicle for providing capital support to AGC by allowing AGC to obtain immediate access to new capital at its sole discretion at any time through the exercise of the put option. If the put options were exercised, AGC would receive \$200 million in return for the issuance of its own perpetual preferred stock, the proceeds of which may be used for any purpose, including the payment of claims. The put options have not been exercised through the date of this filing. Initially, all of AGC CCS were issued to a special purpose pass-through trust (the "Pass-Through Trust"). The Pass-Through Trust was dissolved in April 2008 and the AGC CCS were distributed to the holders of the Pass-Through Trust's securities. Neither the Pass-Through Trust nor the custodial trusts are consolidated in the Company's financial statements.

Income distributions on the Pass-Through Trust Securities and AGC CCS were equal to an annualized rate of one-month LIBOR plus 110 basis points for all periods ending on or prior to April 8, 2008. Following dissolution of the Pass-Through Trust, distributions on the AGC CCS Securities are determined pursuant to an auction process. On April 7, 2008 this auction process failed, thereby increasing the annualized rate on the AGC CCS to one-month LIBOR plus 250 basis points. Distributions on the AGC preferred stock will be determined pursuant to the same process.

In June 2003, \$200 million of "AGM CPS Securities", money market preferred trust securities, were issued by trusts created for the primary purpose of issuing the AGM CPS Securities, investing the proceeds in high-quality commercial paper and selling put options to AGM, allowing AGM to issue the trusts non-cumulative redeemable perpetual preferred stock (the "AGM Preferred Stock") of AGM in exchange for cash. There are four trusts, each with an initial aggregate face amount of \$50 million. These trusts hold auctions every 28 days, at which time investors submit bid orders to purchase AGM CPS Securities. If AGM were to exercise a put option, the applicable trust would transfer the portion of the proceeds attributable to principal received upon maturity of its assets, net of expenses, to AGM in exchange for AGM Preferred Stock. AGM pays a floating put premium to the trusts, which represents the difference between the commercial paper yield and the winning auction rate (plus all fees and expenses of the trust). If an auction does not attract sufficient clearing bids, however, the auction rate is subject to a maximum rate of one-month LIBOR plus 200 basis points for the next succeeding distribution period. Beginning in August 2007, the AGM CPS Securities required the maximum rate for each of the relevant trusts. AGM continues to have the ability to exercise its put option and cause the related trusts to purchase AGM Preferred Stock. The trusts provide AGM access to new capital at its sole discretion through the exercise of the put options. The Company does not consider itself to be the primary beneficiary of the trusts. See Note 5 "Fair Value Measurement—Other Assets—Committed Capital Securities" for a fair value measurement discussion.

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14. Earnings Per Share

Computation of Earnings Per Share

	Third Quarter		Nine Months	
	2012	2011	2012	2011
	(in millions, except per share amounts)			
Basic earnings per share ("EPS"):				
Net income (loss) attributable to AGL	\$ 142	\$ 761	\$ 36	\$ 857
Less: Distributed and undistributed income (loss) available to nonvested shareholders	—	1	1	1
Distributed and undistributed income (loss) available to common shareholders of AGL and subsidiaries	\$ 142	\$ 760	\$ 35	\$ 856
Basic shares	194.0	183.2	187.6	183.7
Basic EPS	\$0.73	\$4.15	\$0.19	\$4.66
Diluted EPS:				
Distributed and undistributed income (loss) available to common shareholders of AGL and subsidiaries	\$ 142	\$ 760	\$ 35	\$ 856
Plus: Re-allocation of undistributed income (loss) available to nonvested shareholders of AGL and subsidiaries	—	—	—	—
Distributed and undistributed income (loss) available to common shareholders of AGL and subsidiaries	\$ 142	\$ 760	\$ 35	\$ 856
Basic shares	194.0	183.2	187.6	183.7
Effect of dilutive securities:				
Options and restricted stock awards	0.7	0.8	0.7	0.9
Equity units	—	—	1.0	1.7
Diluted shares	194.7	184.0	189.3	186.3
Diluted EPS	\$0.73	\$4.13	\$0.19	\$4.60
Potentially dilutive securities excluded from computation of EPS because of antidilutive effect	3.9	13.3	11.9	6.7

15. Shareholders' Equity

On November 14, 2011, the Company's Board of Directors approved a new share repurchase program, for up to 5.0 million common shares, to replace the prior program. Share repurchases will take place at management's discretion depending on market conditions. In Nine Months 2012, the Company paid \$24 million to repurchase 2,066,759 common shares.

On August 4, 2010, the Company's Board of Directors approved a new share repurchase program for up to 2.0 million common shares. In August 2011, the Company paid \$23 million to repurchase 2,000,000 common shares.

In August 2011, the Chief Executive Officer and the General Counsel of the Company elected to invest a portion of their accounts under the Company's supplemental employee retirement plan ("SERP") in 138,375 units in the employer stock fund in the SERP. Each unit in the employer stock fund represents the right to receive one AGL common share upon a distribution from the SERP. The 138,375 units equals the number of AGL common shares which could have been purchased with the value of the account deemed invested in the employer stock fund as of the date of such election. The election to invest in the employer stock fund is irrevocable (i.e., any portion of a SERP account allocated to the employer stock fund and invested in units shall remain allocated to the employer stock fund until the participant

receives a distribution from SERP). At the same time such investment elections were made, in August 2011, the Company purchased 138,375 AGL common shares and placed such shares in trust to be distributed to the Chief Executive Officer and the General Counsel upon a distribution from the SERP in settlement of their units invested in the employer stock fund. The Company recorded the purchase of such shares in “deferred equity compensation” in the consolidated balance sheet.

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16. Other Comprehensive Income

The following tables present the changes in the balances of each component of accumulated other comprehensive income.

Three Months Ended September 30, 2012

	Net Unrealized Gains (Losses) on Investments	Cumulative Translation Adjustment	Cash Flow Hedge	Total Accumulated Other Comprehensive Income
	(in millions)			
Balance, June 30, 2012	\$428	\$(7	) \$9	\$430
Other comprehensive income (loss)	100	1	0	101
Balance, September 30, 2012	\$528	\$(6	) \$9	\$531

Three Months Ended September 30, 2011

	Net Unrealized Gains (Losses) on Investments	Cumulative Translation Adjustment	Cash Flow Hedge	Total Accumulated Other Comprehensive Income
	(in millions)			
Balance, June 30, 2011	\$202	\$(6	) \$10	\$206
Other comprehensive income (loss)	124	(3	) 0	121
Balance, September 30, 2011	\$326	\$(9	) \$10	\$327

Nine Months Ended September 30, 2012

	Net Unrealized Gains (Losses) on Investments	Cumulative Translation Adjustment	Cash Flow Hedge	Total Accumulated Other Comprehensive Income
	(in millions)			
Balance, December 31, 2011	\$367	\$(8	) \$9	\$368
Other comprehensive income (loss)	161	2	0	163
Balance, September 30, 2012	\$528	\$(6	) \$9	\$531

Nine Months Ended September 30, 2011

	Net Unrealized Gains (Losses) on Investments	Cumulative Translation Adjustment	Cash Flow Hedge	Total Accumulated Other Comprehensive Income
	(in millions)			
Balance, December 31, 2010	\$110	\$(8	) \$10	\$112
Other comprehensive income (loss)	216	(1) 0	215
Balance, September 30, 2011	\$326	\$(9) \$10	\$327

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17. Subsidiary Information

The following tables present the condensed consolidating financial information for AGMH and AGUS (which are wholly-owned subsidiaries of AGL), which have issued publicly traded debt securities that are fully and unconditionally guaranteed by AGL as of September 30, 2012 and December 31, 2011 and for the three and nine months ended September 30, 2012 and 2011. The information for AGMH and AGUS presents its subsidiaries on the equity method of accounting.

CONDENSED CONSOLIDATING BALANCE SHEET
AS OF SEPTEMBER 30, 2012
(in millions)

	Assured Guaranty Ltd. (Parent)	AGUS (Issuer)	AGMH (Issuer)	Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)
ASSETS						
Total investment portfolio and cash	\$ 225	\$32	\$47	\$10,916	\$ —	\$ 11,220
Investment in subsidiaries	4,711	3,917	3,113	3,470	(15,211)	—
Premiums receivable, net of ceding commissions payable	—	—	—	1,073	(129)	944
Ceded unearned premium reserve	—	—	—	1,534	(984)	550
Deferred acquisition costs	—	—	—	207	(80)	127
Reinsurance recoverable on unpaid losses	—	—	—	214	(158)	56
Credit derivative assets	—	—	—	520	(70)	450
Deferred tax asset, net	—	22	(77)	799	(15)	729
Intercompany receivable	—	—	—	473	(473)	—
Financial guaranty variable interest entities' assets, at fair value	—	—	—	2,693	—	2,693
Other	24	29	24	858	(141)	794
TOTAL ASSETS	\$ 4,960	\$4,000	\$3,107	\$22,757	\$ (17,261)	\$ 17,563
LIABILITIES AND SHAREHOLDERS' EQUITY						
Unearned premium reserves	\$ —	\$ —	\$ —	\$6,285	\$ (953)	\$ 5,332
Loss and LAE reserve	—	—	—	761	(167)	594
Long-term debt	—	347	421	72	—	840
Intercompany payable	—	173	—	300	(473)	—
Credit derivative liabilities	—	—	—	2,221	(70)	2,151
Financial guaranty variable interest entities' liabilities, at fair value	—	—	—	3,187	—	3,187
Other	8	10	21	726	(258)	507
TOTAL LIABILITIES	8	530	442	13,552	(1,921)	12,611
TOTAL SHAREHOLDERS' EQUITY	4,952	3,470	2,665	9,205	(15,340)	4,952
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 4,960	\$4,000	\$3,107	\$22,757	\$ (17,261)	\$ 17,563

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CONDENSED CONSOLIDATING BALANCE SHEET
AS OF DECEMBER 31, 2011
(in millions)

	Assured Guaranty Ltd. (Parent)	AGUS (Issuer)	AGMH (Issuer)	Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)
ASSETS						
Total investment portfolio and cash	\$ 33	\$99	\$61	\$11,121	\$—	\$ 11,314
Investment in subsidiaries	4,607	3,730	2,802	3,258	(14,397)	—
Premiums receivable, net of ceding commissions payable	—	—	—	1,150	(147)	1,003
Ceded unearned premium reserve	—	—	—	1,739	(1,030)	709
Deferred acquisition costs	—	—	—	223	(91)	132
Reinsurance recoverable on unpaid losses	—	—	—	212	(143)	69
Credit derivative assets	—	—	—	503	(34)	469
Deferred tax asset, net	—	22	(77)	867	(8)	804
Intercompany receivable	—	—	—	300	(300)	—
Financial guaranty variable interest entities' assets, at fair value	—	—	—	2,819	—	2,819
Other	23	(71)	27	836	(109)	706
TOTAL ASSETS	\$ 4,663	\$3,780	\$2,813	\$23,028	\$(16,259)	\$ 18,025
LIABILITIES AND SHAREHOLDERS' EQUITY						
Unearned premium reserves	\$—	\$—	\$—	\$6,950	\$(987)	\$ 5,963
Loss and LAE reserve	—	—	—	834	(155)	679
Long-term debt	—	519	415	104	—	1,038
Intercompany payable	—	—	—	300	(300)	—
Credit derivative liabilities	—	0	—	1,807	(34)	1,773
Financial guaranty variable interest entities' liabilities, at fair value	—	—	—	3,458	—	3,458
Other	11	3	16	675	(243)	462
TOTAL LIABILITIES	11	522	431	14,128	(1,719)	13,373
TOTAL SHAREHOLDERS' EQUITY	4,652	3,258	2,382	8,900	(14,540)	4,652
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 4,663	\$3,780	\$2,813	\$23,028	\$(16,259)	\$ 18,025

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CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
AND COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2012
(in millions)

	Assured Guaranty Ltd. (Parent)	AGUS (Issuer)	AGMH (Issuer)	Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)
REVENUES						
Net earned premiums	\$ —	\$ —	\$ —	\$ 219	\$ 3	\$ 222
Net investment income	—	—	0	107	(5)	102
Net realized investment gains (losses)	—	—	—	2	—	2
Net change in fair value of credit derivatives:						
Realized gains (losses) and other settlements	—	—	—	2	—	2
Net unrealized gains (losses)	—	—	—	(38)	—	(38)
Net change in fair value of credit derivatives	—	—	—	(36)	—	(36)
Equity in earnings of subsidiaries	146	105	157	100	(508)	—
Other	—	—	—	53	(1)	52
TOTAL REVENUES	146	105	157	445	(511)	342
EXPENSES						
Loss and LAE	—	—	—	90	—	90
Amortization of deferred acquisition costs	—	—	—	6	(2)	4
Interest expense	—	7	13	6	(5)	21
Other operating expenses	4	0	1	44	(1)	48
TOTAL EXPENSES	4	7	14	146	(8)	163
INCOME (LOSS) BEFORE INCOME TAXES	142	98	143	299	(503)	179
Total provision (benefit) for income taxes	—	(3)	(5)	42	3	37
NET INCOME (LOSS)	\$ 142	\$ 101	\$ 148	\$ 257	\$ (506)	\$ 142
COMPREHENSIVE INCOME (LOSS)	\$ 243	\$ 175	\$ 190	\$ 432	\$ (797)	\$ 243

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CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
AND COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2011
(in millions)

	Assured Guaranty Ltd. (Parent)	AGUS (Issuer)	AGMH (Issuer)	Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)	
REVENUES							
Net earned premiums	\$ —	\$ —	\$ —	\$ 208	\$ 3	\$ 211	
Net investment income	—	—	0	99	(4	) 95
Net realized investment gains (losses)	—	—	—	(11) —	(11)
Net change in fair value of credit derivatives:							
Realized gains (losses) and other settlements	—	—	—	0	—	0	
Net unrealized gains (losses)	—	—	—	1,156	—	1,156	
Net change in fair value of credit derivatives	—	—	—	1,156	—	1,156	
Equity in earnings of subsidiaries	766	586	15	579	(1,946) —	
Other	—	—	—	(106) —	(106)
TOTAL REVENUES	766	586	15	1,925	(1,947	) 1,345
EXPENSES							
Loss and LAE	—	—	—	219	(4	) 215
Amortization of deferred acquisition costs	—	—	—	7	(3	) 4
Interest expense	—	10	13	6	(4	) 25
Other operating expenses	5	1	0	43	(3	) 46
TOTAL EXPENSES	5	11	13	275	(14	) 290
INCOME (LOSS) BEFORE INCOME TAXES	761	575	2	1,650	(1,933	) 1,055
Total provision (benefit) for income taxes	—	(4	) (5	) 296	7	294
NET INCOME (LOSS)	\$ 761	\$ 579	\$ 7	\$ 1,354	\$ (1,940) \$ 761	
COMPREHENSIVE INCOME (LOSS)	\$ 882	\$ 664	\$ 55	\$ 1,560	\$ (2,279) \$ 882	

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CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
AND COMPREHENSIVE INCOME
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012
(in millions)

	Assured Guaranty Ltd. (Parent)	AGUS (Issuer)	AGMH (Issuer)	Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)	
REVENUES							
Net earned premiums	\$ —	\$ —	\$ —	\$ 625	\$ 10	\$ 635	
Net investment income	0	—	1	313	(13	) 301
Net realized investment gains (losses)	0	—	0	0	—	0	
Net change in fair value of credit derivatives:							
Realized gains (losses) and other settlements	—	—	—	(78) —	(78)
Net unrealized gains (losses)	—	—	—	(388) —	(388)
Net change in fair value of credit derivatives	—	—	—	(466) —	(466)
Equity in earnings of subsidiaries	52	112	319	94	(577) —	
Other	—	—	—	276	(2	) 274
TOTAL REVENUES	52	112	320	842	(582	) 744
EXPENSES							
Loss and LAE	—	—	—	461	(2	) 459
Amortization of deferred acquisition costs	—	—	—	24	(10	) 14
Interest expense	—	27	40	17	(13	) 71
Other operating expenses	16	1	1	149	(4	) 163
TOTAL EXPENSES	16	28	41	651	(29	) 707
INCOME (LOSS) BEFORE INCOME TAXES	36	84	279	191	(553	) 37
Total provision (benefit) for income taxes	—	(10	) (14	) 17	8	1
NET INCOME (LOSS)	\$ 36	\$ 94	\$ 293	\$ 174	\$ (561) \$ 36	
COMPREHENSIVE INCOME (LOSS)	\$ 199	\$ 212	\$ 364	\$ 455	\$ (1,031) \$ 199	

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CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
AND COMPREHENSIVE INCOME
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011
(in millions)

	Assured Guaranty Ltd. (Parent)	AGUS (Issuer)	AGMH (Issuer)	Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)	
REVENUES							
Net earned premiums	\$ —	\$ —	\$ —	\$ 687	\$ 8	\$ 695	
Net investment income	—	—	0	306	(11	) 295
Net realized investment gains (losses)	—	—	—	(13) —	(13)
Net change in fair value of credit derivatives:							
Realized gains (losses) and other settlements	—	—	—	25	—	25	
Net unrealized gains (losses)	—	—	—	830	—	830	
Net change in fair value of credit derivatives	—	—	—	855	—	855	
Equity in earnings of subsidiaries	876	715	352	695	(2,638) —	
Other	—	—	—	(90) (2) (92)
TOTAL REVENUES	876	715	352	2,440	(2,643	) 1,740
EXPENSES							
Loss and LAE	—	—	—	314	(1	) 313
Amortization of deferred acquisition costs	—	—	—	28	(15	) 13
Interest expense	—	30	40	15	(11	) 74
Other operating expenses	19	1	1	147	(5	) 163
TOTAL EXPENSES	19	31	41	504	(32	) 563
INCOME (LOSS) BEFORE INCOME TAXES	857	684	311	1,936	(2,611	) 1,177
Total provision (benefit) for income taxes	—	(11	) (14	) 335	10	320
NET INCOME (LOSS)	\$ 857	\$ 695	\$ 325	\$ 1,601	\$ (2,621) \$ 857	
COMPREHENSIVE INCOME (LOSS)	\$ 1,072	\$ 867	\$ 426	\$ 1,988	\$ (3,281) \$ 1,072	

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CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
 FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012
 (in millions)

	Assured Guaranty Ltd. (Parent)	AGUS (Issuer)	AGMH (Issuer)	Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)
Net cash flows provided by (used in) operating activities	\$ 98	\$ 23	\$ 14	\$(82)	\$(276)	\$(223)
Cash flows from investing activities						
Fixed maturity securities:						
Purchases	(160)	(1)	(11)	(1,150)	—	(1,322)
Sales	—	—	1	682	—	683
Maturities	1	—	3	754	—	758
Sales (purchases) of short-term investments, net	(34)	27	23	266	—	282
Net proceeds from financial guaranty variable entities' assets	—	—	—	407	—	407
Acquisition of MIAC	—	(91)	—	—	—	(91)
Intercompany debt	—	—	—	(173)	173	—
Investment in subsidiary	—	—	50	—	(50)	—
Other	—	—	—	85	—	85
Net cash flows used in investing activities	(193)	(65)	66	871	123	802
Cash flows from financing activities						
Issuance of common stock	173	—	—	—	—	173
Return of capital	—	—	—	(50)	50	—
Dividends paid	(51)	—	(80)	(196)	276	(51)
Repurchases of common stock	(24)	—	—	—	—	(24)
Share activity under option and incentive plans	(3)	—	—	—	—	(3)
Net paydowns of financial guaranty variable entities' liabilities	—	—	—	(553)	—	(553)
Payment of long-term debt	—	(173)	—	(31)	—	(204)
Intercompany debt	—	173	—	—	(173)	—
Net cash flows provided by (used in) financing activities	95	—	(80)	(830)	153	(662)
Effect of exchange rate changes	—	—	—	1	—	1
Increase (decrease) in cash	—	(42)	—	(40)	—	(82)
Cash at beginning of period	—	72	0	143	—	215
Cash at end of period	\$ —	\$ 30	\$ 0	\$ 103	\$ —	\$ 133

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CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
 FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011
 (in millions)

	Assured Guaranty Ltd. (Parent)	AGUS (Issuer)	AGMH (Issuer)	Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)	
Net cash flows provided by (used in) operating activities	\$ 41	\$ 13	\$(20	) \$641	\$ (74	) \$ 601	
Cash flows from investing activities							
Fixed maturity securities:							
Purchases	—	—	(3	) (1,785	) —	(1,788)
Sales	—	—	—	849	—	849	
Maturities	—	—	1	502	—	503	
Sales (purchases) of short-term investments, net	10	(24	) (3	) 199	—	182	
Net proceeds from financial guaranty variable entities' assets	—	—	—	598	—	598	
Investment in subsidiary	—	—	25	—	(25) —	
Other	—	—	—	14	—	14	
Net cash flows used in investing activities	10	(24	) 20	377	(25	) 358	
Cash flows from financing activities							
Return of capital	—	—	—	(25	) 25	—	
Dividends paid	(25	) —	—	(74	) 74	(25)
Repurchases of common stock	(23	) —	—	—	—	(23)
Share activity under option and incentive plans	(3	) —	—	—	—	(3)
Net paydowns of financial guaranty variable entities' liabilities	—	—	—	(830	) —	(830)
Payment of long-term debt	—	—	—	(17	) —	(17)
Net cash flows provided by (used in) financing activities	(51	) —	—	(946	) 99	(898)
Effect of exchange rate changes	—	—	—	4	—	4	
Increase (decrease) in cash	—	(11	) —	76	—	65	
Cash at beginning of period	—	13	—	95	—	108	
Cash at end of period	\$ 0	\$ 2	\$ —	\$ 171	\$ —	\$ 173	

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

This Form 10-Q contains information that includes or is based upon forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward looking statements give the expectations or forecasts of future events of Assured Guaranty Ltd. ("AGL" and, together with its subsidiaries, "Assured Guaranty" or the "Company"). These statements can be identified by the fact that they do not relate strictly to historical or current facts and relate to

future operating or financial performance.

Any or all of Assured Guaranty's forward looking statements herein are based on current expectations and the current economic environment and may turn out to be incorrect. Assured Guaranty's actual results may vary materially. Among factors that could cause actual results to differ materially are:

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- rating agency action, including a ratings downgrade, a change in outlook, the placement of ratings on watch for downgrade, or a change in rating criteria, at any time, of Assured Guaranty or any of its subsidiaries and/or of transactions that Assured Guaranty's subsidiaries have insured, all of which have occurred in the past;
- developments in the world's financial and capital markets that adversely affect issuers' payment rates, Assured Guaranty's loss experience, its access to capital, its unrealized (losses) gains on derivative financial instruments or its investment returns;
- changes in the world's credit markets, segments thereof or general economic conditions;
- the impact of rating agency action with respect to sovereign debt and the resulting effect on the value of securities in the Company's investment portfolio and collateral posted by and to the Company;
- more severe or frequent losses impacting the adequacy of Assured Guaranty's expected loss estimates;
- the impact of market volatility on the mark-to-market of Assured Guaranty's contracts written in credit default swap form;
- reduction in the amount of insurance opportunities available to Assured Guaranty;
- deterioration in the financial condition of Assured Guaranty's reinsurers, the amount and timing of reinsurance recoverables actually received and the risk that reinsurers may dispute amounts owed to Assured Guaranty under its reinsurance agreements;
- the possibility that Assured Guaranty will not realize insurance loss recoveries or damages expected from originators, sellers, sponsors, underwriters or servicers of residential mortgage-backed securities transactions;
- the possibility that budget shortfalls or other factors will result in credit losses or impairments on obligations of state and local governments that the Company insures or reinsures;
- increased competition, including from new entrants into the financial guaranty industry;
- changes in applicable accounting policies or practices;
- changes in applicable laws or regulations, including insurance and tax laws;
- other governmental actions;
- difficulties with the execution of Assured Guaranty's business strategy;
- contract cancellations;
- Assured Guaranty's dependence on customers;
- loss of key personnel;
- adverse technological developments;
- the effects of mergers, acquisitions and divestitures;

- natural or man-made catastrophes;
- other risks and uncertainties that have not been identified at this time;
- management's response to these factors; and
- other risk factors identified in Assured Guaranty's filings with the U.S. Securities and Exchange Commission (the "SEC").

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The foregoing review of important factors should not be construed as exhaustive, and should be read in conjunction with the other cautionary statements that are included in this Quarterly Report. The Company undertakes no obligation to update publicly or review any forward looking statement, whether as a result of new information, future developments or otherwise, except as required by law. Investors are advised, however, to consult any further disclosures the Company makes on related subjects in the Company's reports filed with the SEC.

If one or more of these or other risks or uncertainties materialize, or if the Company's underlying assumptions prove to be incorrect, actual results may vary materially from what the Company projected. Any forward looking statements in this Form 10-Q reflect the Company's current views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to its operations, results of operations, growth strategy and liquidity.

For these statements, the Company claims the protection of the safe harbor for forward looking statements contained in Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act").

Convention

Unless otherwise noted, ratings disclosed herein on Assured Guaranty's insured portfolio reflect its internal rating. Although Assured Guaranty's rating scale is similar to that used by the nationally recognized statistical rating organizations, the ratings may not be the same as ratings assigned by any such rating agency. For example the super senior category, which is not generally used by rating agencies, is used by Assured Guaranty in instances where its AAA-rated exposure has additional credit enhancement due to either (1) the existence of another security rated AAA that is subordinated to Assured Guaranty's exposure or (2) Assured Guaranty's exposure benefiting 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 Assured Guaranty's attachment point to be materially above the AAA attachment point.

Introduction

AGL provides, through its operating subsidiaries, credit protection products in the United States ("U.S.") and international public finance (including infrastructure) and structured finance markets. The Company has applied its credit underwriting judgment, risk management skills and capital markets experience to offer insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments, including scheduled interest and principal payments. The Company markets its credit protection products directly to issuers and underwriters of public finance and structured finance securities as well as to investors in such obligations. The Company guarantees obligations issued in many countries, although its principal focus is on the U.S., Europe and Australia.

Financial guaranty contracts provide an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest when due. The Company has issued financial guaranty insurance policies on both public finance obligations and structured finance obligations. Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the taxing powers of U.S. state or municipal governmental authorities, as well as tax-supported bonds, revenue bonds and other obligations supported by covenants from state or municipal governmental authorities or other municipal obligors to impose and collect fees and charges for public services or specific infrastructure projects. Public finance obligations include obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including government office buildings, toll roads, health care facilities and utilities. Structured finance obligations insured or assumed through reinsurance by the Company are backed by pools of assets such as residential mortgage loans, consumer or trade receivables, securities or other assets having an ascertainable cash flow or market value and generally issued by

special purpose entities.

Debt obligations guaranteed by the Company's insurance subsidiaries are generally awarded ratings that are the same rating as the financial strength rating of the insurance subsidiary that has guaranteed that obligation. Investors in products insured by Assured Guaranty Municipal Corp. ("AGM") or Assured Guaranty Corp. ("AGC") frequently rely on rating agency ratings. Therefore, low financial strength ratings or uncertainty over AGM's or AGC's abilities to maintain their financial strength ratings would have a negative impact on the demand for their insurance product.

A downgrade by Moody's Investors Service, Inc. ("Moody's") or Standard and Poor's Ratings Services ("S&P") of the financial strength ratings of the Company's insurance subsidiaries may have a negative impact on the Company's liquidity. A downgrade may trigger (1) increased claims on some of the Company's insurance policies, in certain cases, on a more accelerated basis than when the original transaction closed; or (2) termination payments or collateral posting under credit default swap ("CDS") contracts. A downgrade in the financial strength ratings may also enable beneficiaries of the Company's

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policies to cancel the credit protection offered by the Company and cease paying premium. A downgrade may also enable primary insurance companies that had ceded business to the Company to recapture a significant portion of its in-force financial guaranty reinsurance business. On March 20, 2012, Moody's placed the ratings of AGL and of those subsidiaries that it rates, including the financial strength ratings of the insurance subsidiaries, on review for possible downgrade. On October 30, 2012, Moody's indicated that it anticipates resolving its review during the first half of November 2012. There can be no assurance as to the actions that Moody's may take on the Company's ratings.

Available Information

The Company maintains an Internet web site at www.assuredguaranty.com. The Company makes available, free of charge, on its web site (at www.assuredguaranty.com/investor-information/by-company/assured-guaranty-ltd/sec-filings) the Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13 (a) or 15 (d) of the Exchange Act as soon as reasonably practicable after the Company files such material with, or furnishes it to, the SEC. The Company also makes available, free of charge, through its web site (at www.assuredguaranty.com/governance) links to the Company's Corporate Governance Guidelines, its Code of Conduct and the charters for its Board Committees.

The Company routinely posts important information for investors on its web site (at www.assuredguaranty.com/about-us/company-statements). The Company uses this web site as a means of disclosing material, non-public information and for complying with its disclosure obligations under SEC Regulation FD. Accordingly, investors should monitor the Investor Information portion of the Company's web site, in addition to following the Company's press releases, SEC filings, public conference calls, presentations and webcasts.

The information contained on, or that may be accessed through, the Company's web site is not incorporated by reference into, and is not a part of, this report.

Executive Summary

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the Company's consolidated financial statements and accompanying notes which appear elsewhere in this Form 10-Q. It contains forward looking statements that involve risks and uncertainties. Please see "Forward Looking Statements" for more information.

This executive summary of management's discussion and analysis highlights selected information and may not contain all of the information that is important to readers of this Quarterly Report. For a complete description of events, trends and uncertainties, as well as the capital, liquidity, credit, operational and market risks and the critical accounting policies and estimates affecting the Company, this Quarterly Report should be read in its entirety and in addition to Assured Guaranty's Annual Report on Form 10-K.

Economic Environment

The Company continued to be the most active provider of financial guaranty insurance for the three months ended September 30, 2012 ("Third Quarter 2012") and nine months ended September 30, 2012 ("Nine Months 2012") as a result of its financial strength and its ability to maintain financial strength ratings in the double-A ratings category throughout the financial crisis. All of the Company's former financial guaranty competitors, except AGM, which the Company acquired in 2009, have had their financial strength ratings downgraded by rating agencies to below investment grade levels or are no longer rated, severely impacting their ability to underwrite new business. Only two other industry participants have investment grade financial strength ratings today, but they are not underwriting

material new business. National Public Finance Guarantee Corporation has been involved in litigation challenging its separation from MBIA Insurance Corp. and appears not to have financial strength ratings adequate to issue new financial guaranty policies on public finance obligations. Build America Mutual Assurance Company is a new entrant to the industry that commenced operations during Third Quarter 2012. Business conditions have been difficult for the entire financial guaranty insurance industry since mid-2007, and the Company continues to face challenges in maintaining its market penetration today. The Company expects Build American Mutual will compete against the Company for smaller transactions. However, the presence of a new financial guaranty insurer may lead to higher overall insurance penetration of the U.S. municipal bond market.

The overall economic environment in the U.S. in Third Quarter 2012 was stronger than in the three months ended September 30, 2011 (“Third Quarter 2011”), and indicators such as lower delinquency rates and more stable housing prices point toward recovery in the housing market. However, unemployment rates remain too high for a robust general economic

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recovery to have taken hold.

Municipal credits have experienced budgetary stress since the recent credit crisis and the ensuing recession, compounded in many cases by significant unfunded pension and retiree health care liabilities. While revenues at the state level have been rebounding in general, many local governments have continued to face structural deficits as a result of the decline in property taxes. Although the vast majority of municipalities have been taking steps to address their fiscal challenges, a small number have sought bankruptcy protection. The Company is closely monitoring legal proceedings in municipal bankruptcy cases in various states as this is an area of law that has not been tested due to the relative