

ASSURED GUARANTY LTD  
Form 10-Q  
May 11, 2009  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

**For the Quarterly Period Ended March 31, 2009**

**OR**

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

**transition Period from                      to**

**Commission File No. 001-32141**

**ASSURED GUARANTY LTD.**

(Exact name of registrant as specified in its charter)

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**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 office)

**(441) 299-9375**

(Registrants 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 May 1, 2009 was 90,990,867.

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**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements**



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Assured Guaranty Ltd.  
Consolidated Balance Sheets  
(in thousands of U.S. dollars except per share and share amounts)

(Unaudited)

|  | March 31,<br>2009   | December 31,<br>2008 |
|--|---------------------|----------------------|
| <b>Assets</b>  |                     |                      |
| Fixed maturity securities, at fair value (amortized cost: \$3,172,426 in 2009 and \$3,162,308 in 2008)                                   | \$ 3,176,178        | \$ 3,154,137         |
| Short-term investments, at cost which approximates fair value  | 616,834             | 477,197              |
| <b>Total investments</b>   | <b>3,793,012</b>    | <b>3,631,334</b>     |
| Cash and cash equivalents  | 19,328              | 12,305               |
| Accrued investment income  | 34,310              | 32,846               |
| Deferred acquisition costs   | 382,525             | 288,616              |
| Prepaid reinsurance premiums   | 23,655              | 18,856               |
| Reinsurance recoverable on ceded losses  | 7,763               | 6,528                |
| Premiums receivable  | 748,414             | 15,743               |
| Goodwill   | 85,417              | 85,417               |
| Credit derivative assets   | 149,798             | 146,959              |
| Deferred tax asset   | 117,560             | 129,118              |
| Current income taxes receivable  |                     | 21,427               |
| Salvage recoverable  | 120,515             | 80,207               |
| Committed capital securities, at fair value  | 70,728              | 51,062               |
| Other assets   | 35,303              | 35,289               |
| <b>Total assets</b>  | <b>\$ 5,588,328</b> | <b>\$ 4,555,707</b>  |
| <b>Liabilities and shareholders equity</b>   |                     |                      |
| <b>Liabilities</b>   |                     |                      |
| Unearned premium reserves  | \$ 2,153,312        | \$ 1,233,714         |
| Reserves for losses and loss adjustment expenses   | 222,555             | 196,798              |
| Profit commissions payable   | 7,751               | 8,584                |
| Reinsurance balances payable   | 22,673              | 17,957               |
| Current income taxes payable   | 4,578               |                      |
| Funds held by Company under reinsurance contracts  | 30,962              | 30,683               |
| Credit derivative liabilities  | 706,768             | 733,766              |
| Senior Notes   | 197,452             | 197,443              |
| Series A Enhanced Junior Subordinated Debentures   | 149,774             | 149,767              |
| Other liabilities  | 66,910              | 60,773               |
| <b>Total liabilities</b>   | <b>3,562,735</b>    | <b>2,629,485</b>     |
| Commitments and contingencies  |                     |                      |
| <b>Shareholders equity</b>   |                     |                      |
| Common stock (\$0.01 par value, 500,000,000 shares authorized; 90,122,385 and 90,955,703 shares issued and outstanding in 2009 and 2008) | 901                 | 910                  |
| Additional paid-in capital   | 1,284,093           | 1,284,370            |
| Retained earnings  | 738,831             | 638,055              |
| Accumulated other comprehensive income   | 1,768               | 2,887                |
| <b>Total shareholders equity</b>   | <b>2,025,593</b>    | <b>1,926,222</b>     |
| <b>Total liabilities and shareholders equity</b>   | <b>\$ 5,588,328</b> | <b>\$ 4,555,707</b>  |

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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 and Comprehensive Income**  
(in thousands of U.S. dollars except per share amounts)

(Unaudited)

|   | Three Months Ended<br>March 31, |                     |
|---|---------------------------------|---------------------|
|   | 2009                            | 2008                |
| <b>Revenues</b>   |                                 |                     |
| Net earned premiums   | \$ 148,446                      | \$ 46,833           |
| Net investment income   | 43,601                          | 36,574              |
| Net realized investment (losses) gains  | (17,110)                        | 627                 |
| Change in fair value of credit derivatives  |                                 |                     |
| Realized gains and other settlements on credit derivatives                            | 20,579                          | 27,617              |
| Unrealized gains (losses) on credit derivatives                                       | 26,982                          | (259,621)           |
| Net change in fair value of credit derivatives  | 47,561                          | (232,004)           |
| Other income  | 20,568                          | 8,536               |
| <b>Total revenues</b>   | <b>243,066</b>                  | <b>(139,434)</b>    |
| <b>Expenses</b>   |                                 |                     |
| Loss and loss adjustment expenses   | 79,754                          | 55,138              |
| Profit commission expense   | 255                             | 1,180               |
| Acquisition costs   | 23,421                          | 11,883              |
| Other operating expenses  | 32,318                          | 28,638              |
| Interest expense  | 5,821                           | 5,821               |
| Other expense   | 1,400                           | 735                 |
| <b>Total expenses</b>   | <b>142,969</b>                  | <b>103,395</b>      |
| <b>Income (loss) before provision (benefit) for income taxes</b>                      | <b>100,097</b>                  | <b>(242,829)</b>    |
| Provision (benefit) for income taxes  |                                 |                     |
| Current   | 11,575                          | 10,113              |
| Deferred  | 3,033                           | (83,733)            |
| <b>Total provision (benefit) for income taxes</b>                                     | <b>14,608</b>                   | <b>(73,620)</b>     |
| <b>Net income (loss)</b>  | <b>85,489</b>                   | <b>(169,209)</b>    |
| <b>Other comprehensive loss, net of taxes</b>   |                                 |                     |
| Unrealized holding losses on fixed maturity securities arising during the period      | (9,702)                         | (4,897)             |
| Reclassification adjustment for realized losses (gains) included in net income (loss) | 17,075                          | (394)               |
| Change in net unrealized gains on fixed maturity securities                           | 7,373                           | (5,291)             |
| Change in cumulative translation adjustment   | (8,387)                         | 357                 |
| Change in cash flow hedge   | (105)                           | (105)               |
| <b>Other comprehensive loss, net of taxes</b>   | <b>(1,119)</b>                  | <b>(5,039)</b>      |
| <b>Comprehensive income (loss)</b>  | <b>\$ 84,370</b>                | <b>\$ (174,248)</b> |
| <b>Earnings per share(1):</b>   |                                 |                     |
| Basic   | \$ 0.94                         | \$ (2.09)           |

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|                     |    |       |    |        |
|---------------------|----|-------|----|--------|
| Diluted             | \$ | 0.93  | \$ | (2.09) |
| Dividends per share | \$ | 0.045 | \$ | 0.045  |

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(1) Effective January 1, 2009, the Company adopted FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. See Note 12 for more information.

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

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**Assured Guaranty Ltd.**  
**Consolidated Statements of Shareholders' Equity**  
**For the Three Months Ended March 31, 2009**  
(in thousands of U.S. dollars except per share amounts)

(Unaudited)

|  | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Shareholders'<br>Equity |
|--|-----------------|----------------------------------|----------------------|---|----------------------------------|
| <b>Balance, December 31, 2008</b>  | \$ 910          | \$ 1,284,370                     | \$ 638,055           | \$ 2,887  | \$ 1,926,222                     |
| Cumulative effect of accounting change -<br>Adoption of FAS 163 effective January 1,<br>2009 |                 |                                  | 19,443               |   | 19,443                           |
| Net income   |                 |                                  | 85,489               |   | 85,489                           |
| Dividends (\$0.045 per share)  |                 |                                  | (4,122)              |   | (4,122)                          |
| Dividends on restricted stock units  |                 | 34                               | (34)                 |   |                                  |
| Common stock repurchases   | (10)            | (3,666)                          |                      |   | (3,676)                          |
| Shares cancelled to pay withholding taxes  | (1)             | (941)                            |                      |   | (942)                            |
| Share-based compensation and other   | 2               | 4,296                            |                      |   | 4,298                            |
| Change in cash flow hedge, net of tax of<br>\$(56)   |                 |                                  |                      | (105)   | (105)                            |
| Change in cumulative translation<br>adjustment   |                 |                                  |                      | (8,387)   | (8,387)                          |
| Unrealized gain on fixed maturity<br>securities, net of tax of \$4,550                       |                 |                                  |                      | 7,373   | 7,373                            |
| <b>Balance, March 31, 2009</b>   | \$ 901          | \$ 1,284,093                     | \$ 738,831           | \$ 1,768  | \$ 2,025,593                     |

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

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**Assured Guaranty Ltd.**  
**Consolidated Statements of Cash Flows**  
**(in thousands of U.S. dollars)**

(Unaudited)

|   | Three Months Ended<br>March 31, |                  |
|---|---------------------------------|------------------|
|   | 2009                            | 2008             |
| <b>Operating activities</b>   |                                 |                  |
| Net income (loss)   | \$ 85,489                       | \$ (169,209)     |
| Adjustments to reconcile net income to net cash flows provided by operating activities: |                                 |                  |
| Non-cash interest and operating expenses  | 4,795                           | 7,612            |
| Net amortization of (discount) premium on fixed maturity securities                     | (1,819)                         | 1,178            |
| Accretion of discount on premium receivable   | (5,287)                         |                  |
| Provision (benefit) for deferred income taxes   | 3,033                           | (83,733)         |
| Net realized investment losses (gains)  | 17,110                          | (627)            |
| Unrealized (gains) losses on credit derivatives   | (26,982)                        | 259,621          |
| Fair value gain on committed capital securities   | (19,666)                        | (8,512)          |
| Change in deferred acquisition costs  | 7,927                           | (13,376)         |
| Change in accrued investment income   | (1,464)                         | (2,383)          |
| Change in premiums receivable   | (5,946)                         | 3,912            |
| Change in prepaid reinsurance premiums  | 1,826                           | (4,003)          |
| Change in unearned premium reserves   | 91,945                          | 126,989          |
| Change in reserves for losses and loss adjustment expenses, net                         | 13,870                          | 32,108           |
| Change in profit commissions payable  | (833)                           | (10,963)         |
| Change in funds held by Company under reinsurance contracts                             | 279                             | 3,599            |
| Change in current income taxes receivable   | 26,005                          | 9,670            |
| Other changes in credit derivative assets and liabilities, net                          | (2,856)                         | 4,372            |
| Other   | (20,409)                        | (7,210)          |
| <b>Net cash flows provided by operating activities</b>                                  | <b>167,017</b>                  | <b>149,045</b>   |
| <b>Investing activities</b>   |                                 |                  |
| Fixed maturity securities:  |                                 |                  |
| Purchases   | (289,219)                       | (326,204)        |
| Sales   | 274,260                         | 118,392          |
| Maturities  | 3,500                           | 3,250            |
| (Purchases) sales of short-term investments, net  | (139,622)                       | 62,142           |
| <b>Net cash flows used in investing activities</b>                                      | <b>(151,081)</b>                | <b>(142,420)</b> |
| <b>Financing activities</b>   |                                 |                  |
| Dividends paid  | (4,122)                         | (3,647)          |
| Repurchases of common stock   | (3,676)                         |                  |
| Share activity under option and incentive plans   | (942)                           | (2,262)          |
| Equity offering costs   |                                 | (429)            |
| <b>Net cash flows used in financing activities</b>                                      | <b>(8,740)</b>                  | <b>(6,338)</b>   |
| Effect of exchange rate changes   | (173)                           | 43               |
| Increase in cash and cash equivalents   | 7,023                           | 330              |
| Cash and cash equivalents at beginning of period  | 12,305                          | 8,048            |

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|   |           |               |           |              |
|---|-----------|---------------|-----------|--------------|
| <b>Cash and cash equivalents at end of period</b> | <b>\$</b> | <b>19,328</b> | <b>\$</b> | <b>8,378</b> |
|---|-----------|---------------|-----------|--------------|

**Supplementary cash flow information**

Cash (received)/paid during the period for:

|              |    |          |    |     |
|--------------|----|----------|----|-----|
| Income taxes | \$ | (14,514) | \$ | 500 |
| Interest     | \$ |          | \$ |     |

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

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**Assured Guaranty Ltd.  
Notes to Consolidated Financial Statements**

**March 31, 2009**

**(Unaudited)**

**1. Business and Organization**

Assured Guaranty Ltd. (the Company) is a Bermuda-based holding company which provides, through its operating subsidiaries, credit enhancement products to the public finance, structured finance and mortgage markets. Credit enhancement products are financial guarantees or other types of support, including credit derivatives, that improve the credit of underlying debt obligations. The Company issues policies in both financial guaranty and credit derivative form. Assured Guaranty Ltd. applies its credit expertise, risk management skills and capital markets experience to develop insurance, reinsurance and derivative products that meet the credit enhancement needs of its customers. Under a reinsurance agreement, the reinsurer, in consideration of a premium paid to it, agrees to indemnify another insurer, called the ceding company, for part or all of the liability of the ceding company under one or more insurance policies that the ceding company has issued. A derivative is a financial instrument whose characteristics and value depend upon the characteristics and value of an underlying security. Assured Guaranty Ltd. markets its products directly to and through financial institutions, serving the U.S. and international markets. Assured Guaranty Ltd.'s financial results include four principal business segments: financial guaranty direct, financial guaranty reinsurance, mortgage guaranty and other. These segments are further discussed in Note 14.

Financial guaranty insurance provides an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest when due. Financial guaranty insurance may be issued to the holders of the insured obligations at the time of issuance of those obligations, or may be issued in the secondary market to holders of public bonds and structured securities. A loss event occurs upon existing or anticipated credit deterioration, while a payment under a policy occurs when the insured obligation defaults. This requires the Company to pay the required principal and interest when due in accordance with the underlying contract. The principal types of obligations covered by the Company's financial guaranty direct and financial guaranty assumed reinsurance businesses are structured finance obligations and public finance obligations. Because both businesses involve similar risks, the Company analyzes and monitors its financial guaranty direct portfolio and financial guaranty assumed reinsurance portfolio on a unified process and procedure basis.

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

The Company has participated in several lines of business that are reflected in its historical financial statements but that the Company exited in connection with its 2004 initial public offering (IPO). The results from these lines of business make up the Company's Other segment discussed in Note 14.

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The Company's subsidiaries have been assigned the following insurance financial strength ratings as of the date of this filing. These ratings are subject to continuous review.

|   | <b>Moody's</b> | <b>S&amp;P</b>        | <b>Fitch</b>     |
|---|----------------|-----------------------|------------------|
| Assured Guaranty Corp.                      | Aa2(Excellent) | AAA(Extremely Strong) | AA(Very Strong)  |
| Assured Guaranty Re Ltd.                    | Aa3(Excellent) | AA(Very Strong)       | AA-(Very Strong) |
| Assured Guaranty Re Overseas Ltd.           | Aa3(Excellent) | AA(Very Strong)       | AA-(Very Strong) |
| Assured Guaranty Mortgage Insurance Company | Aa3(Excellent) | AA(Very Strong)       | AA-(Very Strong) |
| Assured Guaranty (UK) Ltd                   | Aa2(Excellent) | AAA(Extremely Strong) | AA(Very Strong)  |

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On May 4, 2009, Fitch Ratings Inc. ( Fitch ) downgraded the debt and insurer financial strength ratings of Assured Guaranty Ltd. and its subsidiaries. Fitch's insurer financial strength ratings for Assured Guaranty Corp. and Assured Guaranty (UK) Ltd., the Company's principal financial guaranty direct subsidiaries, are now AA (rating watch evolving), down from AAA (stable) while the insurer financial strength ratings for Assured Guaranty Re Ltd. ( AG Re ), the Company's principal financial guaranty reinsurance company, are rated AA- (rating watch evolving), down from AA (stable). Fitch's ratings on Assured Guaranty Ltd.'s \$200 million of 7.0% senior notes due 2034 are now A, down from A+ and their ratings on Assured Guaranty Ltd.'s \$150 million series A enhanced junior subordinated debentures are now rated A-, down from A.

**Acquisition of Financial Security Assurance Holdings Ltd.**

On November 14, 2008, Assured Guaranty Ltd. announced that it had entered into a definitive agreement ( the Purchase Agreement ) with Dexia Holdings, Inc. ( Dexia ) to purchase Financial Security Assurance Holdings Ltd. ( FSAH ) and, indirectly, all of its subsidiaries, including the financial guaranty insurance company, Financial Security Assurance, Inc. The definitive agreement provides that the Company will be indemnified against exposure to FSAH's Financial Products segment, which includes its guaranteed investment contract business. Pursuant to the Purchase Agreement, the Company agreed to buy 33,296,733 issued and outstanding shares of common stock of FSAH, representing as of the date thereof approximately 99.8524% of the issued and outstanding shares of common stock of FSAH. The remaining shares of FSAH are currently held by current or former directors of FSAH. Assured expects that it will acquire the remaining shares of FSAH common stock concurrent with the closing of the acquisition of shares of FSAH common stock from Dexia or shortly thereafter at the same price paid to Dexia. The Company has received all required shareholder and regulatory approvals and expects to close the FSAH acquisition in the second quarter 2009 upon the completion of various closing conditions and if the rating agencies complete their transaction reviews, including their evaluation of the separation of FSA's Financial Products segment, which the Company is not acquiring.

The purchase price is \$722 million (based upon the closing price of the Company's common shares on the NYSE on November 13, 2008 of \$8.10), consisting of \$361 million in cash and up to 44,567,901 of the Company's common shares. If, prior to the closing date under the stock purchase agreement, the Company issues new common shares (other than pursuant to an employee benefit plan) or other securities that are convertible into or exchangeable for or otherwise linked to the Company's common shares at a purchase price per share of less than \$8.10, the Company has agreed to issue to Dexia on the closing date an additional number of the Company's common shares with an aggregate value as of the closing date (measured based on the average of the volume weighted average price per share for each day in the 20 NYSE trading day period ending three business days prior to the closing date) representing the amount of dilution as a result of such issuance. The amount of dilution is defined to mean (x) the number of the Company's common shares issued (or that upon conversion or exchange would be issuable) as a result of the dilutive issuance, multiplied by (y) the positive difference if any between \$8.10 and the purchase (or reference, implied, conversion, exchange or comparable) price per share received by the Company in the dilutive issuance, multiplied by (z) the percentage of the issued and outstanding share capital of the Company represented by the Company common shares to be received by Dexia under the stock purchase agreement (without taking into account any additional Assured Guaranty Ltd.'s common shares issued or issuable as a result of the anti-dilution provision).

Under the Purchase Agreement, the Company may elect to pay \$8.10 per share in cash in lieu of up to 22,283,951 of the Company's common shares that it would otherwise deliver as part of the purchase price.

The Company expects to finance the cash portion of the acquisition with the proceeds of a public equity offering. The Company has received a backstop commitment ( the WLR Backstop Commitment ) from the WLR Funds, a related party, to fund the cash portion of the purchase price with the purchase of newly issued common shares. The Company entered into the WLR Backstop Commitment on November 13, 2008 with the WLR Funds. The WLR Backstop Commitment amended the Investment Agreement between the Company and the WLR Funds and provided to the Company the option to cause the WLR Funds to purchase from Assured Guaranty Ltd. or Assured Guaranty US Holdings Inc. a number of the Company's common shares equal to the quotient of (i) the aggregate dollar amount not to exceed \$361 million specified by the Company



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divided by (ii) the volume weighted average price of the Company's common share on the NYSE for the 20 NYSE trading days ending with the last NYSE trading day immediately preceding the date of the closing under the stock purchase agreement, with a floor of \$6.00 and a cap of \$8.50.

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The WLR Funds have no obligation to purchase these common shares pursuant to the WLR Backstop Commitment until the closing under the stock purchase agreement occurs. The Company may use the proceeds from the sale of the Company's common shares pursuant to the WLR Backstop Commitment solely to pay a portion of the purchase price under the stock purchase agreement. The WLR Funds' obligations under the WLR Backstop Commitment have been secured by letters of credit issued for the benefit of the Company by Bank of America, N.A. and RBS Citizens Bank, N.A., each in the amount of \$180.5 million.

The Company has paid the WLR Funds a nonrefundable commitment fee of \$10,830,000 in connection with the option granted by the WLR Backstop Commitment and has agreed to pay the WLR Funds' expenses in connection with the transactions contemplated thereby. The Company reimbursed the WLR Funds for the \$4.1 million cost of obtaining the letters of credit referred to above.

**2. Significant Accounting Policies**

*Basis of Presentation*

The unaudited interim consolidated financial statements, which include the accounts of the Company, 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, which are of a normal recurring nature, necessary for a fair statement of the Company's financial condition, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim consolidated financial statements cover the three-month period ended March 31, 2009 ( First Quarter 2009 ) and the three-month period ended March 31, 2008 ( First Quarter 2008 ). Operating results for the three-month period ended March 31, 2009 are not necessarily indicative of the results that may be expected for a full year. Certain prior year items have been reclassified to conform to the current year presentation. These unaudited interim consolidated financial statements should be read in conjunction with the Company's consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission. All intercompany accounts and transactions have been eliminated.

Certain of the Company's subsidiaries are subject to U.S. and U.K. income tax. The provision for income taxes is calculated in accordance with Statement of Financial Accounting Standards ( FAS ) FAS No. 109, Accounting for Income Taxes . The Company's provision for income taxes for interim financial periods is not based on an estimated annual effective rate due to the variability in changes in fair value of its credit derivatives, which prevents the Company from projecting a reliable estimated annual effective tax rate and pre-tax income for the full year of 2009. A discrete calculation of the provision is calculated for each interim period.

The volatility and disruption in the global financial markets have reached unprecedented levels. The availability and cost of credit has been materially affected. These factors, combined with depressed home prices and increasing foreclosures, falling equity market values, rising unemployment, declining business and consumer confidence and the risk of increased inflation, have precipitated an economic slowdown and fears of a severe recession. The conditions may adversely affect the Company's future profitability, financial position, investment portfolio, cash flow, statutory capital, financial strength ratings and stock price. Additionally, future legislative, regulatory or judicial changes in the jurisdictions regulating the Company may adversely affect its ability to pursue its current mix of business, materially impacting its financial results.



Table of Contents**Adoption of FAS 163**

In May 2008, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( FAS ) No. 163, Accounting for Financial Guarantee Insurance Contracts ( FAS 163 ). FAS 163 requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. FAS 163 also clarifies the methodology to be used for financial guaranty premium revenue recognition and claim liability measurement, as well as requiring expanded disclosures about the insurance enterprise's risk management activities. The provisions of FAS 163 related to premium revenue recognition and claim liability measurement are effective for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those fiscal years. Earlier application of these provisions was not permitted. The expanded risk management activity disclosure provisions of FAS 163 were effective for the third quarter of 2008 and are included in Note 7 of these unaudited interim consolidated financial statements. FAS 163 will be applied to all existing and future financial guaranty insurance contracts written by the Company.

FAS 163 mandates the accounting changes prescribed by the statement be recognized by the Company as a cumulative effect adjustment to retained earnings as of January 1, 2009. The impact of adopting FAS 163 on the Company's balance sheet was as follows:

| (dollar in thousands)                            | December 31,<br>2008<br>As reported | Transition<br>Adjustment | January 1,<br>2009<br>Per FAS 163 |
|--|-------------------------------------|--------------------------|-----------------------------------|
| <b>ASSETS:</b>                                   |                                     |                          |                                   |
| Deferred acquisition costs                       | \$ 288,616                          | \$ 101,836               | \$ 390,452                        |
| Prepaid reinsurance premiums                     | 18,856                              | 6,625                    | 25,481                            |
| Reinsurance recoverable on ceded losses          | 6,528                               | (1,184)                  | 5,344                             |
| Premiums receivable                              | 15,743                              | 721,438                  | 737,181                           |
| Deferred tax asset                               | 129,118                             | (7,743)                  | 121,375                           |
| Salvage recoverable                              | 80,207                              | 6,917                    | 87,124                            |
| Total assets                                     | 4,555,707                           | 827,889                  | 5,383,596                         |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>     |                                     |                          |                                   |
| Unearned premium reserves                        | \$ 1,233,714                        | \$ 827,653               | \$ 2,061,367                      |
| Reserves for losses and loss adjustment expenses | 196,798                             | (25,379)                 | 171,419                           |
| Reinsurance balances payable                     | 17,957                              | 6,172                    | 24,129                            |
| Total liabilities                                | 2,629,485                           | 808,446                  | 3,437,931                         |
| Retained earnings                                | 638,055                             | 19,443                   | 657,498                           |
| Total shareholders' equity                       | 1,926,222                           | 19,443                   | 1,945,665                         |
| Total liabilities and shareholders' equity       | 4,555,707                           | 827,889                  | 5,383,596                         |

A summary of the effects of FAS 163 on the balance sheet amounts above is as follows:

- Deferred acquisition costs increased to reflect commissions on future installment premiums related to assumed reinsurance policies.
- Premium receivable increased to reflect the recording of the net present value of future installment premiums discounted at a risk-free rate. Reinsurance balances payable increased correspondingly for those amounts ceded to reinsurers.

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- Unearned premium reserves increased to reflect the recording of the net present value of future installment premiums discounted at a risk-free rate and the change in the premium earnings methodology to the effective yield method prescribed by FAS 163. Prepaid reinsurance premiums increased correspondingly for those amounts ceded to reinsurers.
- Reserves for losses and loss adjustment expenses decreased to reflect the release of the Company's portfolio reserves on fundamentally sound credits. This was partially offset by an increase in case reserves, which are now calculated based on probability weighted cash flows discounted at a risk free rate instead of based on a single case best estimate reserve discounted based on the after-tax investment yield of the Company's investment portfolio (6%). Reinsurance recoverable on ceded losses decreased correspondingly. Salvage recoverable increased to reflect the change in discount

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rates.

- Deferred tax asset decreased to reflect the deferred tax effect of the above items.
- Retained earnings as of January 1, 2009 increased to reflect the net effect of the above adjustments.

***Premium Revenue Recognition***

Premiums are received either upfront or in installments.

*Upon Adoption of FAS 163*

The Company recognizes a liability for the unearned premium revenue at the inception of a financial guarantee contract equal to the present value of the premiums due or expected to be collected over the period of the contract. If the premium is a single premium received at the inception of the financial guarantee contract, the Company measures the unearned premium revenue as the amount received. The period of the contract is the expected period of risk that generally equates to the contract period. However, in some instances, the expected period of risk is significantly shorter than the full contract period due to expected prepayments. In those instances where the financial guarantee contract insures a homogeneous pool of assets that are contractually prepayable and where those prepayments are probable and the timing and amount of prepayments can be reasonably estimated the Company uses the expected period of risk to recognize premium revenues. The Company adjusts prepayment assumptions when those assumptions change and recognizes a prospective change in premium revenues as a result. The adjustment to the unearned premium revenue is equal the adjustment to the premium receivable with no effect on earnings at the time of the adjustment.

The Company recognizes the premium from a financial guarantee insurance contract as revenue over the period of the contract in proportion to the amount of insurance protection provided. As premium revenue is recognized, a corresponding decrease in the unearned premium revenue occurs. The amount of insurance protection provided is a function of the insured principal amount outstanding. Therefore, the proportionate share of premium revenue to be recognized in a given reporting period is a constant rate calculated based on the relationship between the insured principal amount outstanding in a given reporting period compared with the sum of each of the insured principal amounts outstanding for all periods. When the issuer of an insured financial obligation retires the insured financial obligation before its maturity and replaces it with a new financial obligation, referred to as a refunding, the financial guarantee insurance contract on the retired financial obligation is extinguished. The Company immediately recognizes any nonrefundable unearned premium revenue related to that contract as premium revenue and any associated acquisition costs previously deferred as an expense.

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The following table provides information for financial guaranty insurance contracts where premiums are received on an installment basis as of and for the three months ended March 31, 2009 (dollars in thousands):

|   |    |         |
|---|----|---------|
| Premiums receivable, net of ceding commissions (end of period)(1) | \$ | 737,925 |
| Unearned premium reserves (end of period)(2)                      | \$ | 957,804 |
| Accretion of discount on premium receivable                       | \$ | 5,287   |
| Weighted-average risk-free rate to discount premiums              |    | 2.7%    |
| Weighted-average period of premiums receivable (in years)         |    | 10.4    |

(1) Includes \$96.5 million of ceding commissions due on future installment premium receivable.

(2) Includes unearned premium related to the upfront portion of premiums received on bi-furcated deals.

The premiums receivable expected to be collected are:

**(dollar in thousands)**

|  |    |         |
|--|----|---------|
| 2009 (April 1 - June 30)                             | \$ | 27,976  |
| 2009 (July 1 - September 30)                         |    | 16,119  |
| 2009 (October 1 - December 31)                       |    | 17,245  |
| 2010 (January 1 - March 31)                          |    | 17,409  |
| 2010 (April 1 - December 31)                         |    | 41,949  |
| 2011   |    | 49,497  |
| 2012   |    | 47,449  |
| 2013   |    | 40,688  |
| 2014 - 2018  |    | 161,884 |
| 2019 - 2023  |    | 116,868 |
| 2024 - 2028  |    | 91,444  |
| 2029 - 2033  |    | 71,454  |
| 2034 - 2038  |    | 31,790  |
| 2039 - 2043  |    | 12,297  |
| 2044 - 2048  |    | 3,870   |
| 2049 - 2053  |    | 446     |
| 2053 - 2056  |    | 29      |
| Total premiums receivable, net of ceding commissions | \$ | 748,414 |

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

**(dollar in thousands)**

|   |    |         |
|---|----|---------|
| Balance as of January 1, 2009                 | \$ | 737,181 |
| Add: premiums written - net                   |    | 234,796 |
| Add: accretion of premium receivable discount |    | 5,287   |
| Less: premium payments received               |    | 228,850 |
| Balance as of March 31, 2009                  | \$ | 748,414 |

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The accretion of premium receivable discount is included in earned premium in the Company's statement of operations. The above amounts are presented net of applicable ceding commissions.



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The future expected premium revenue that the Company expects to recognize are:

(dollar in thousands)

|                                       |    |           |
|---------------------------------------|----|-----------|
| 2009 (April 1 - June 30)              | \$ | 42,034    |
| 2009 (July 1 - September 30)          |    | 46,771    |
| 2009 (October 1 - December 31)        |    | 45,668    |
| 2010 (January 1 - March 31)           |    | 42,529    |
| 2010 (April 1 - December 31)          |    | 125,647   |
| 2011                                  |    | 154,946   |
| 2012                                  |    | 141,417   |
| 2013                                  |    | 127,868   |
| 2014 - 2018                           |    | 512,825   |
| 2019 - 2023                           |    | 358,559   |
| 2024 - 2028                           |    | 251,200   |
| After 2028                            |    | 303,848   |
| Total future expected premium revenue | \$ | 2,153,312 |

In the Company's reinsurance businesses, the Company estimates the ultimate written and earned premiums to be received from a ceding company at the end of each quarter and the end of each year because some of the Company's ceding companies report premium data anywhere from 30 to 90 days after the end of the relevant period. Written premiums reported in the Company's statement of operations are based upon reports received from ceding companies supplemented by the Company's own estimates of premium for which ceding company reports have not yet been received. Differences between such estimates and actual amounts are recorded in the period in which the actual amounts are determined.

Prior to Adoption of FAS 163

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

Deferred Acquisition Costs

Acquisition costs incurred, other than those associated with financial guarantees written in credit derivative form, that vary with and are directly related to the production of new business are deferred in proportion to written premium and amortized in relation to earned premiums. These costs include direct and indirect expenses such as ceding commissions, brokerage expenses and the cost of underwriting and marketing personnel. Management uses its judgment in determining what types of costs should be deferred, as well as what percentage of these costs

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should be deferred. The Company annually conducts a study to determine which operating costs vary with, and are directly related to, the acquisition of new business and qualify for deferral. Ceding commissions received on premiums the Company cedes to other reinsurers reduce acquisition costs. Anticipated losses, loss adjustment expenses and the remaining costs of servicing the insured or reinsured business are considered in determining the recoverability of acquisition costs. Acquisition costs associated with credit derivative products are expensed as incurred. When an insured issue is retired early, as discussed above in the Premium Revenue Recognition section, the remaining related deferred acquisition cost is expensed at that time. Ceding commissions, calculated at their contractually defined

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rate, associated with future installment premiums on assumed and ceded reinsurance business were recorded in deferred acquisition costs upon the adoption of FAS 163 with a corresponding offset to premium receivable.

*Reserves for Losses and Loss Adjustment Expenses*

The Company's financial guarantees written in credit derivative form have substantially the same terms and conditions as its financial guaranty contracts written in insurance form. Under GAAP, however, the former are subject to derivative accounting rules and the latter are subject to insurance accounting rules.

Financial Guaranty Contracts Upon Adoption of FAS 163

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

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

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

Financial Guaranty Contracts Prior to Adoption of FAS 163

Reserves for losses for non-derivative transactions in the Company's financial guaranty direct and financial guaranty assumed reinsurance included case reserves and portfolio reserves. Case reserves were established when there was significant credit deterioration on specific insured obligations and the obligations were in default or default was probable, not necessarily upon non-payment of principal or interest by an insured.

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Case reserves represented the present value of expected future loss payments and loss adjustment expenses, net of estimated recoveries, but before considering ceded reinsurance. This reserving method was different from case reserves established by traditional property and casualty insurance companies, which establish case reserves upon notification of a claim and establish incurred but not reported reserves for the difference between actuarially estimated ultimate losses and recorded case reserves. Financial guaranty insurance and assumed reinsurance case reserves and related salvage and subrogation, if any, were discounted at the taxable equivalent yield on the Company's investment portfolio, which was approximately 6%, during 2008.

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

Portfolio reserves were not established based on a specific event, rather they are calculated by aggregating the portfolio reserve calculated for each individual transaction. Individual transaction reserves were calculated on a

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quarterly basis by multiplying the par in-force by the product of the ultimate loss and earning factors without regard to discounting. The ultimate loss factor was defined as the frequency of loss multiplied by the severity of loss, where the frequency was defined as the probability of default for each individual issue. The earning factor was inception to date earned premium divided by the estimated ultimate written premium for each transaction. The probability of default was estimated from rating agency data and was based on the transaction's credit rating, industry sector and time until maturity. The severity was defined as the complement of recovery/salvage rates gathered by the rating agencies of defaulting issues and was based on the industry sector.

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

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

Mortgage Guaranty and Other Lines of Business

Mortgage guaranty and other lines of business are not in the scope of FAS 163. Reserves for losses and loss adjustment expenses in the Company's mortgage guaranty line of business include case reserves and portfolio reserves. Case reserves are established when there is significant credit deterioration on specific insured obligations and the obligations are in default or default is probable, not necessarily upon non-payment of principal or interest by an insured. Case reserves represent the present value of expected future loss payments and loss adjustment expenses (LAE), net of estimated recoveries, but before considering ceded reinsurance. This reserving method is different from case reserves established by traditional property and casualty insurance companies, which establish case reserves upon notification of a claim and establish incurred but not reported (IBNR) reserves for the difference between actuarially estimated ultimate losses and recorded case reserves.

The Company also records portfolio reserves for mortgage guaranty line of business in a manner consistent with its financial guaranty business prior to the adoption of FAS 163. While other mortgage guaranty insurance companies do not record portfolio reserves, rather just case and IBNR reserves, the Company records portfolio reserves because the Company writes business on an excess of loss basis, while other industry participants write quota share or first layer loss business. The Company manages and underwrites this business in the same manner as its financial guaranty insurance and reinsurance business because they have similar characteristics as insured obligations of mortgage backed securities.

The Company also records IBNR reserves for its other line of business. IBNR is an estimate of losses for which the insured event has occurred but the claim has not yet been reported to the Company. In establishing IBNR, the Company uses traditional actuarial methods to estimate the reporting lag of such claims based on historical experience, claim reviews and information reported by ceding companies. The Company records IBNR for trade credit reinsurance within its other segment, which is 100% reinsured. The other segment represents lines of business that the Company exited or sold as part of the Company's IPO.

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Due to the inherent uncertainties of estimating loss and LAE reserves, actual experience may differ from the estimates reflected in the Company's consolidated financial statements, and the differences may be material.

### *Reinsurance*

In the ordinary course of business, the Company's insurance subsidiaries assume and retrocede business with other insurance and reinsurance companies. These agreements provide greater diversification of business and may minimize the net potential loss from large risks. Retrocessional contracts do not relieve the Company of its

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obligation to the reinsured. Reinsurance recoverable on ceded losses includes balances due from reinsurance companies for paid and unpaid losses and LAE that will be recovered from reinsurers, based on contracts in force, and is presented net of any provision for estimated uncollectible reinsurance. Any change in the provision for uncollectible reinsurance is included in loss and loss adjustment expenses. Prepaid reinsurance premiums represent the portion of premiums ceded to reinsurers relating to the unexpired terms of the reinsurance contracts in force.

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

***Salvage Recoverable***

When the Company becomes entitled to the underlying collateral (generally a future stream of cash flows or pool assets) of an insured credit under salvage and subrogation rights as a result of a claim payment or estimates recoveries from disputed claim payments on contractual grounds, it reduces the corresponding loss reserve for a particular financial guaranty insurance policy for the estimated salvage and subrogation, in accordance with FAS No. 60, *Accounting and Reporting by Insurance Enterprises*. If the expected salvage and subrogation exceeds the estimated loss reserve for a policy, such amounts are recorded as a salvage recoverable asset in the Company's balance sheets.

**3. Recent Accounting Pronouncements**

In December 2007, the FASB issued FAS No. 141 (revised), *Business Combinations* (FAS 141R). FAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. FAS 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. FAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim statements within those fiscal years. Early adoption is not permitted. Since FAS 141R applies prospectively to business combinations whose acquisition date is subsequent to the statement's adoption. The Company is applying the provisions of FAS 141R to account for its pending acquisition of FSAH. As of March 31, 2009, the Company had paid \$4.6 million related to the Company's pending acquisition of FSAH that the Company expensed in the first quarter 2009 in operating expenses.

In October 2008, the FASB issued FASB Staff Position (FSP) No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP 157-3). FSP 157-3 clarified the application of FAS 157, *Fair Value Measurements* (FAS 157), in a market that is not active. FSP 157-3 was effective when issued. It did not have an impact on the Company's current results of operations or financial position.

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The FASB adopted FSP FAS 133-1 and FIN 45-4, Disclosures About Credit Derivatives and Certain Guarantees ( FSAP 133-1 ) and FAS 161, Disclosures about Derivative Instruments and Hedging Activities ( FAS 161 ) to address concerns that current derivative disclosure requirements did not adequately address the potential adverse effects that these instruments can have on the financial performance and operations of an entity. Companies will be required to provide enhanced disclosures about their derivative activities to enable users to better understand: (1) how and why a company uses derivatives, (2) how it accounts for derivatives and related hedged items, and (3) how derivatives affect its financial statements. These should include the terms of the derivatives, collateral posting requirements and triggers, and other significant provisions that could be detrimental to earnings or liquidity. Management believes that the Company's current derivatives disclosures are in compliance with the requirements of FSP 133-1 and FAS 161.



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In April 2009, the FASB issued FSP FAS No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ( FSP 157-4 ). FSP 157-4 amends FAS 157 to provide additional guidance on estimating fair value when the volume and level of activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability. FSP 157-4 also provides additional guidance on circumstances that may indicate that a transaction is not orderly. FSP 157-4 supersedes FSP 157-3. FSP 157-4 amends FAS 157 to require additional disclosures about fair value measurements in annual and interim reporting periods. FSP 157-4 is effective for interim and annual reporting periods ending after June 15, 2009. Early adoption is permitted, but only for periods ending after March 15, 2009. FSP 157-4 must be applied prospectively and does not require disclosures for earlier periods presented for comparative purposes at initial adoption. The Company will adopt FSP 157-4 in its Form 10-Q for the period ended June 30, 2009. The Company is currently evaluating the impact, if any, FSP 157-4 will have on its financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* ( FSP 107-1 ). FSP 107-1 extends the disclosure requirements of FAS No. 107, *Disclosures about Fair Value of Financial Instruments*, to interim financial statements of publicly traded companies. FSP 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP 107-1 does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, FSP 107-1 requires comparative disclosures only for periods ending after initial adoption. The Company will adopt FSP 107-1 in its Form 10-Q for the period ended June 30, 2009. The Company is currently evaluating the impact, if any, FSP 107-1 will have on its financial statements disclosures.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* ( FSP 115-2 ). FSP 115-2 provides new guidance on the recognition and presentation of an other than temporary impairment ( OTTI ) for debt securities classified as available-for-sale and held-to-maturity and provides some new disclosure requirements for both debt and equity securities. FSP 115-2 mandates new disclosure requirements affect both debt and equity securities and extend the disclosure requirements (both new and existing) to interim periods. FSP 115-2 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP 115-2 is to be applied to existing and new investments held by an entity as of the beginning of the period in which it is adopted. The Company will adopt FSP 115-2 in its Form 10-Q for the period ended June 30, 2009. The Company is currently evaluating the impact, if any, FSP 115-2 will have on its financial statements.

#### **4. Credit Derivatives**

Financial guarantees written in credit derivative form issued by the Company, principally in the form of insured credit default swap ( CDS ) contracts, have been deemed to meet the definition of a derivative under FAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( FAS 133 ), FAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* ( FAS 149 ) and FAS No. 155, *Accounting for Certain Hybrid Financial Instruments* ( FAS 155 ). FAS 133 and FAS 149 require that an entity recognize all derivatives as either assets or liabilities in the consolidated balance sheets and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as a fair value, cash flow or foreign currency hedge. FAS 155 requires companies to recognize freestanding or embedded derivatives relating to beneficial interests in securitized financial instruments. This recognition was not required prior to January 1, 2007. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

Realized gains and other settlements on credit derivatives include credit derivative premiums received and receivable for credit protection the Company has sold under its insured CDS contracts as well as any contractual claim losses paid and payable related to insured credit events under these contracts, ceding commissions (expense) income and realized gains or losses related to their early termination. The Company almost always holds credit derivative contracts to maturity. However, in certain circumstances such as for the downgrade of AGC or AGRe, the CDS

counterparty may decide to terminate a credit derivative contract prior to maturity.

The following table disaggregates realized gains and other settlements on credit derivatives into its component

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parts for the periods ended March 31, 2009 and 2008 (dollars in thousands):

|   | <b>Three Months Ended<br/>March 31,</b> |             |
|---|---|-------------|
|   | <b>2009</b>                             | <b>2008</b> |
| <b>Realized gains and other settlements on credit derivatives</b>         |   |             |
| Net credit derivative premiums received and receivable                    | \$ 29,515                               | \$ 27,822   |
| Net credit derivative losses (paid and payable) recovered and recoverable | (9,058)                                 | 14          |
| Ceding commissions received/receivable (paid/payable), net                | 122                                     | (219)       |
| Total realized gains and other settlements on credit derivatives          | \$ 20,579                               | \$ 27,617   |

Unrealized gains (losses) on credit derivatives represent the adjustments for changes in fair value that are recorded in each reporting period, under FAS 133. Changes in unrealized gains and losses on credit derivatives are reflected in the consolidated statements of operations and comprehensive income in unrealized gains (losses) on credit derivatives. Cumulative unrealized losses, determined on a contract by contract basis, are reflected as either net assets or net liabilities in the Company's balance sheets. Unrealized gains and losses resulting from changes in the fair value of credit derivatives occur because of changes in interest rates, credit spreads, the credit ratings of the referenced entities and the issuing Company's own credit rating and other market factors. The unrealized gains and losses on credit derivatives will reduce to zero as the exposure approaches its maturity date, unless there is a payment default on the exposure or early termination. Changes in the fair value of the Company's credit derivative contracts do not generally reflect actual claims or credit losses, and have no impact on the Company's claims paying resources, rating agency capital or regulatory capital positions.

The Company determines fair value of its credit derivative contracts primarily through modeling that uses various inputs such as credit spreads, based on observable market indices and on recent pricing for similar contracts, and expected contractual life to derive an estimate of the value of our contracts in our principal market (see Note 5). Credit spreads capture the impact of recovery rates and performance of underlying assets, among other factors, on these contracts. The Company's pricing model takes into account not only how credit spreads on risks that it assumes affects pricing, but how the Company's own credit spread affects the pricing of its deals. If credit spreads of the underlying obligations change, the fair value of the related credit derivative changes. Market liquidity could also impact valuations of the underlying obligations.

The impact of changes in credit spreads will vary based upon the volume, tenor, interest rates, and other market conditions at the time these fair values are determined. In addition, since each transaction has unique collateral and structure terms, the underlying change in fair value of each transaction may vary considerably. The fair value of credit derivative contracts also reflects the change in the Company's own credit cost based on the price to purchase credit protection on AGC. During First Quarter 2009, the Company incurred net pre-tax unrealized gains on credit derivative contracts of \$27.0 million. Of this amount, \$2,291.5 million was due to the widening of AGC's own credit spread from 1,775 basis points at December 31, 2008 to 3,847 basis points at March 31, 2009. As of March 31, 2009 the net credit liability includes a reduction in the liability of \$6,439.1 million associated with the widening of AGC's credit spread to 3,847 basis points. Management believes that the widening of AGC's credit spread is due to the correlation between AGC's risk profile and that experienced currently by the broader financial markets and increased demand for credit protection against AGC as the result of its direct segment financial guarantee volume as well as the overall lack of liquidity in the CDS market. Offsetting the gain attributable to the significant increase in AGC's credit spread were declines in fixed income security market prices primarily attributable to widening spreads in certain markets as a result of the continued deterioration in credit markets and some credit rating downgrades, rather than from delinquencies or defaults on securities guaranteed by the Company. The higher credit spreads in the fixed income security market are due to the recent lack of liquidity in the high yield collateralized debt obligation and collateralized loan obligation markets as well as continuing market concerns over the most recent vintages of subprime residential mortgage backed securities and commercial mortgage backed securities.

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During First Quarter 2008, the Company incurred net mark-to-market losses on credit derivative contracts of \$(259.6) million, pre-tax, related to high yield and investment grade corporate collateralized loan obligations ( CLOs ), as well as residential and commercial mortgage backed securities exposures. The unrealized loss on credit derivatives

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resulted largely from the decline in fixed income security market prices resulting from higher credit spreads, due to the lack of liquidity in the High Yield CDO and CLO market as well as market concerns over continued recent vintages of subprime residential mortgage backed securities, rather than from credit rating downgrades, delinquencies or defaults on securities guaranteed by the Company.

The total notional amount of credit derivative exposure outstanding as of March 31, 2009 and December 31, 2008 and included in the Company's financial guaranty exposure was \$73.3 billion and \$75.1 billion, respectively.

The components of the Company's unrealized gain (loss) on credit derivatives for the three months ended March 31, 2009 is:

| Asset Type                                 | As of March 31, 2009                    |             | Weighted<br>Average Credit<br>Rating(1) | First Quarter 2009                         |               |
|--|---|-------------|---|--|---------------|
|  | Net Par<br>Outstanding<br>(in billions) |             |   | Unrealized Gain<br>(Loss)<br>(in millions) |               |
| Corporate collateralized loan obligations  | \$                                      | 26.0        | AAA                                     | \$   | (78.9)        |
| Market value CDOs of corporate obligations |   | 3.4         | AAA                                     |  | (7.0)         |
| Trust preferred securities                 |   | 6.0         | A-                                      |  | 75.3          |
| <b>Total pooled corporate obligations</b>  |   | <b>35.4</b> | <b>AA+</b>                              |  | <b>(10.5)</b> |
| Commercial mortgage-backed securities      |   | 5.8         | AAA                                     |  | (31.2)        |
| Residential mortgage-backed securities     |   | 19.6        | AA-                                     |  | (89.8)        |
| Other                                      |   | 9.3         | AA-                                     |  | 142.3         |
| <b>Total</b>                               |   | <b>70.0</b> | <b>AA</b>                               |  | <b>10.8</b>   |
| Reinsurance exposures written in CDS form  |   | 3.3         | AA+                                     |  | 16.2          |
| <b>Grand Total</b>                         | <b>\$</b>                               | <b>73.3</b> | <b>AA</b>                               | <b>\$</b>                                  | <b>27.0</b>   |

(1) Based on the Company's internal rating, which is on a comparable scale to that of the nationally recognized rating agencies.

Corporate collateralized loan obligations, market value CDOs, and trust preferred securities, which comprise the Company's pooled corporate exposures, include all U.S. structured finance pooled corporate obligations and international pooled corporate obligations. Commercial mortgage backed securities are comprised of commercial U.S. structured finance and commercial international mortgage backed securities. Residential mortgage backed securities are comprised of prime and subprime U.S. mortgage backed and home equity securities, international residential mortgage backed and international home equity securities. Other includes all other U.S. and international asset classes, such as commercial receivables, and international infrastructure and pooled infrastructure securities.

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

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The Company's \$9.3 billion exposure to Other CDS contracts is also highly diversified. It includes \$3.7 billion of exposure to four pooled infrastructure transactions comprised of diversified pools of international infrastructure project transactions and loans to regulated utilities. These pools were all structured with underlying credit enhancement sufficient for the Company to attach at super senior AAA levels. The remaining \$5.6 billion of exposure in Other CDS contracts is comprised of numerous deals typically structured with significant underlying credit enhancement and spread across various asset classes, such as commercial receivables, infrastructure, regulated utilities and consumer receivables. Substantially all of this \$9.3 billion of exposure is rated investment grade and the weighted average credit rating is AA-.

The unrealized gain of \$142.3 million on Other CDS contracts for the three months ended March 31, 2009 is primarily attributable to the aforementioned change in AGC's credit spread. This increased hedge cost caused the

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implied spreads of several UK public finance infrastructure transactions and a film securitization transaction to narrow during the quarter as on offset.

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

The Company's exposure to the mortgage industry is discussed in Note 7.

The following table presents additional details about the Company's unrealized loss on pooled corporate obligation credit derivatives, which includes collateralized loan obligations, market value CDOs and trust preferred securities, by asset type as of March 31, 2009:

| Asset Type                                 | Original Subordination(2) | Current Subordination(2) | Net Par Outstanding (in billions) | Weighted Average Credit Rating(1) | First Quarter 2009 Unrealized Gain (Loss) (in millions) |
|--|---------------------------|--------------------------|-----------------------------------|-----------------------------------|---|
| High yield corporate obligations           | 35.9%                     | 29.6%                    | \$ 22.8                           | AAA                               | \$ (77.4)   |
| Trust preferred                            | 46.7%                     | 41.7%                    | 6.0                               | A-                                | 75.3  |
| Market value CDOs of corporate obligations | 38.4%                     | 27.3%                    | 3.4                               | AAA                               | (7.0)   |
| Investment grade corporate obligations     | 28.7%                     | 29.9%                    | 2.3                               | AAA                               | 1.6   |
| Commercial real estate                     | 49.1%                     | 47.9%                    | 0.8                               | AAA                               | (2.2)   |
| CDO of CDOs (corporate obligations)        | 1.7%                      | 5.4%                     | 0.1                               | AAA                               | (0.9)   |
| <b>Total</b>                               | <b>37.7%</b>              | <b>31.8%</b>             | <b>\$ 35.4</b>                    | <b>AA+</b>                        | <b>\$ (10.5)</b>  |

(1) Based on the Company's internal rating, which is on a comparable scale to that of the nationally recognized rating agencies.

(2) 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

The following table presents additional details about the Company's unrealized loss on credit derivatives associated with commercial mortgage-backed securities by vintage as of March 31, 2009:

| Vintage        | Original Subordination(2) | Current Subordination(2) | Net Par Outstanding (in billions) | Weighted Average Credit Rating(1) | First Quarter 2009 Unrealized Gain (Loss) (in millions) |
|----------------|---------------------------|--------------------------|-----------------------------------|-----------------------------------|---|
| 2004 and Prior | 19.8%                     | 21.5%                    | \$ 0.3                            | AAA                               | \$ (0.6)  |
| 2005           | 27.8%                     | 28.9%                    | 3.4                               | AAA                               | (19.7)  |
| 2006           | 27.7%                     | 28.5%                    | 1.8                               | AAA                               | (9.6)   |

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|              |              |                 |            |            |                  |
|--------------|--------------|-----------------|------------|------------|------------------|
| 2007         | 35.8%        | 35.9%           | 0.2        | AAA        | (1.4)            |
| 2008         |              |                 |            |            |                  |
| 2009         |              |                 |            |            |                  |
| <b>Total</b> | <b>27.7%</b> | <b>28.7% \$</b> | <b>5.8</b> | <b>AAA</b> | <b>\$ (31.2)</b> |



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The following tables present additional details about the Company's unrealized loss on credit derivatives associated with residential mortgage-backed securities by vintage and asset type as of March 31, 2009:

| Vintage        | Original<br>Subordination(2) | Current<br>Subordination(2) | Net Par<br>Outstanding<br>(in billions) | Weighted<br>Average<br>Credit<br>Rating(1) | First Quarter<br>2009<br>Unrealized<br>Gain (Loss)<br>(in millions) |
|----------------|------------------------------|-----------------------------|---|--|---|
| 2004 and Prior | 5.2%                         | 13.0%                       | \$ 0.4                                  | A  | \$ 4.6  |
| 2005           | 24.5%                        | 51.6%                       | 4.8                                     | AA   | 1.3   |
| 2006           | 16.6%                        | 23.5%                       | 5.7                                     | AA   | 1.2   |
| 2007           | 16.5%                        | 18.7%                       | 8.7                                     | A  | (96.9)  |
| 2008           |                              |                             |   |  |   |
| 2009           |                              |                             |   |  |   |
| <b>Total</b>   | <b>18.2%</b>                 | <b>28.1%</b>                | <b>\$ 19.6</b>                          | <b>AA-</b>                                 | <b>\$ (89.8)</b>  |

| Asset Type       | Original<br>Subordination(2) | Current<br>Subordination(2) | Net Par<br>Outstanding<br>(in billions) | Weighted<br>Average<br>Credit<br>Rating(1) | First Quarter<br>2009<br>Unrealized<br>Gain (Loss)<br>(in millions) |
|------------------|------------------------------|-----------------------------|---|--|---|
| Alt-A loans      | 20.3%                        | 23.1%                       | \$ 6.3                                  | A-   | \$ (44.1)   |
| Prime first lien | 10.3%                        | 12.6%                       | 7.8                                     | AA+  | (48.7)  |
| Subprime lien    | 26.9%                        | 55.0%                       | 5.6                                     | AA-  | 3.0   |
| <b>Total</b>     | <b>18.2%</b>                 | <b>28.1%</b>                | <b>\$ 19.6</b>                          | <b>AA-</b>                                 | <b>\$ (89.8)</b>  |

In general, the Company structures credit derivative transactions such that the circumstances giving rise to our obligation to make payments is similar to that for financial guaranty policies and generally occurs as losses are realized on the underlying reference obligation. Nonetheless, credit derivative transactions are governed by International Swaps and Derivatives Association, Inc. ( ISDA ) documentation and operate differently from financial guaranty insurance policies. For example, our 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 policy on a direct primary basis. In addition, while the Company's exposure under credit derivatives, like the Company's exposure under financial guaranty insurance policies, is generally for as long as the reference obligation remains outstanding, unlike financial guaranty insurance policies, a credit derivative may be terminated due to the occurrence of an event of default set forth in the ISDA documentation or other specific termination events. In some older credit derivative transactions, one such specified termination event is the failure of AGC to maintain specified financial strength ratings ranging from A or A2 to BBB- or Baa3. If a credit derivative is terminated the Company could be required to make a mark-to-market payment as determined under the ISDA documentation. For example, if AGC's ratings were downgraded to A- or A3, the CDS counterparties could terminate CDS covering \$847.8 million par insured. If AGC's ratings are downgraded to levels between BBB+ or Baa1 and BB+ or Ba1, the CDS counterparties could terminate the CDS covering \$10.9 billion par insured. Given current market conditions, the Company does not believe that it can accurately estimate the payments it would be required to make if AGC or AGRe were downgraded and the CDS counterparties terminated the CDS. These payments could have a material adverse effect on the Company's liquidity and financial condition. During May 2009 the Company entered into an agreement with a CDS counterparty, which had the right to terminate four CDS contracts if AGC was downgraded below AA- or Aa3. Under the agreement, the CDS counterparty's right to terminate the CDS contracts based on AGC's ratings was eliminated. In return, the Company agreed to post up to \$250 million in collateral to secure its payment obligations under the CDS contracts covering \$5.9 billion of par insured. The collateral posting would increase to up to \$300 million if AGC were downgraded to below AA- or A2. The posting of this collateral has no impact on the Company's net income or shareholders' equity under U.S. GAAP nor does it impact AGC's statutory surplus or net income.

Under a limited number of credit derivative contracts, the Company is required to post eligible securities as collateral, generally cash or U.S. government or agency securities. The need to post collateral under these transactions is generally based on mark-to-market valuation in excess of contractual thresholds. The particular thresholds decline if the Company's ratings decline. As of March 31, 2009 the Company had pre-IPO

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transactions with approximately \$1.8 billion of par subject to collateral posting due to changes in market value. Of this amount, as of March 31, 2009, the Company posted collateral totaling approximately \$177.9 million (including \$156.2 million for AGC) based on the unrealized mark-to-market loss position for transactions with two of its counterparties. Any amounts required to be posted as collateral in the future will depend on changes in the market values of these transactions. Additionally, in the event AGC were downgraded below A-, contractual thresholds would be eliminated and the amount of par that could be subject to collateral posting requirements would be \$2.3 billion. Based on market values as of March 31, 2009, the Company estimates that such a downgrade would have resulted in AGC posting an additional \$113.7 million of collateral. The actual amounts posted would be based on market conditions at the time of the posting and would be based on the CDS contract's ISDA documentation. The actual amounts that would be required to be posted could be materially larger than the Company's estimate. As described above, in May 2009 AGC posted an additional \$250 million of collateral.

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As of March 31, 2009 and December 31, 2008, the Company considered the impact of its own credit risk, in combination with credit spreads on risk that it assumes through CDS contracts, in determining the fair value of its credit derivatives. The Company determines its own credit risk based on quoted CDS prices traded on the Company at each balance sheet date. The quoted price of CDS contracts traded on AGC at March 31, 2009 and December 31, 2008 was 3,847 basis points and 1,775 basis points, respectively. Historically, the price of CDS traded on AGC moves directionally the same as general market spreads. Generally, a widening of the CDS prices traded on AGC 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 has an effect of offsetting unrealized gains that result from narrowing general market credit spreads. An overall narrowing of spreads generally results in an unrealized gain on credit derivatives for the Company and an overall widening of spreads generally results in an unrealized loss for the Company. At March 31, 2009, the values of our CDS contracts before and after considering implications of our credit spreads were \$(6,959.5) million and \$(520.4) million, respectively. At December 31, 2008, the values of our CDS contracts before and after considering implications of our credit spreads were \$(4,686.8) million and \$(539.2) million, respectively. As noted above, our own credit spread widened from 180 basis points at December 31, 2007 to 1,775 basis points at December 31, 2008.

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 on the risks that it assumes at March 31, 2009:

(Dollars in millions)

| Credit Spreads(1)      |                      | Estimated Net<br>Fair Value (Pre-Tax) | Estimated Pre-Tax<br>Change in Gain / (Loss) |
|------------------------|----------------------|---------------------------------------|--|
| <b>March 31, 2009:</b> |                      |                                       |  |
| 100%                   | widening in spreads  | \$ (1,603.8)                          | \$ (1,083.4)                                 |
| 50%                    | widening in spreads  | (1,075.6)                             | (555.2)                                      |
| 25%                    | widening in spreads  | (792.5)                               | (272.1)                                      |
| 10%                    | widening in spreads  | (632.7)                               | (112.3)                                      |
|                        | Base Scenario        | (520.4)                               |  |
| 10%                    | narrowing in spreads | (457.2)                               | 63.2   |
| 25%                    | narrowing in spreads | (366.0)                               | 154.4  |
| 50%                    | narrowing in spreads | (233.0)                               | 287.4  |

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

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

## 5. Fair Value of Financial Instruments

### Background

Effective January 1, 2008, the Company adopted FAS No. 157, Fair Value Measurements ( FAS 157 ). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 applies to other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements.

FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. The price shall represent that available in the principal market for the asset or liability. If there is no principal market, then the price is based on the market that maximizes the value received for an asset or minimizes the amount paid for a liability (i.e. the most advantageous market).

FAS 157 specifies a fair value hierarchy based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Company estimates of market assumptions. In accordance with FAS 157, the fair value hierarchy prioritizes model inputs into three broad levels as follows:

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- Level 1 Quoted prices for identical instruments in active markets.
- Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and observable inputs other than quoted prices, such as interest rates or yield curves and other inputs derived from or corroborated by observable market inputs.
- Level 3 Model derived valuations in which one or more significant inputs or significant value drivers are unobservable. This hierarchy requires the use of observable market data when available.

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

*Effect on the Company's financial statements*

FAS 157 applies to both amounts recorded in the Company's financial statements and to disclosures. Amounts recorded at fair value in the Company's financial statements on a recurring basis are fixed maturity securities available for sale, short-term investments, credit derivative assets and liabilities relating to the Company's CDS contracts and CCS Securities. The fair value of these items as of March 31, 2009 is summarized in the following table.

| (Dollars in millions)         | Fair Value        | Fair Value Measurements Using                                  |   |   |
|-------------------------------|-------------------|--|---|---|
|                               |                   | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets</b>                 |                   |  |   |   |
| Fixed maturity securities     | \$ 3,176.2        | \$   | \$ 3,176.2                                    | \$  |
| Short-term investments        | 616.8             | 67.3   | 549.5   |   |
| Credit derivative assets      | 149.8             |  |   | 149.8                                     |
| CCS Securities                | 70.7              |  | 70.7  |   |
| <b>Total assets</b>           | <b>\$ 4,013.5</b> | <b>\$ 67.3</b>   | <b>\$ 3,796.4</b>                             | <b>\$ 149.8</b>                           |
| <b>Liabilities</b>            |                   |  |   |   |
| Credit derivative liabilities | \$ 706.8          | \$   | \$  | \$ 706.8                                  |
| <b>Total liabilities</b>      | <b>\$ 706.8</b>   | <b>\$</b>  | <b>\$</b>                                     | <b>\$ 706.8</b>                           |

The fair value of these items as of December 31, 2008 is summarized in the following table.

| (Dollars in millions)     | Fair Value | Fair Value Measurements Using                                  |   |   |
|---------------------------|------------|--|---|---|
|                           |            | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets</b>             |            |  |   |   |
| Fixed maturity securities | \$ 3,154.1 | \$   | \$ 3,154.1                                    | \$  |

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|                               |            |    |      |    |         |    |       |
|-------------------------------|------------|----|------|----|---------|----|-------|
| Short-term investments        | 477.2      |    | 47.8 |    | 429.4   |    |       |
| Credit derivative assets      | 147.0      |    |      |    |         |    | 147.0 |
| CCS Securities                | 51.1       |    |      |    | 51.1    |    |       |
| <b>Total assets</b>           | \$ 3,829.4 | \$ | 47.8 | \$ | 3,634.6 | \$ | 147.0 |
| <b>Liabilities</b>            |            |    |      |    |         |    |       |
| Credit derivative liabilities | \$ 733.8   | \$ |      | \$ |         | \$ | 733.8 |
| <b>Total liabilities</b>      | \$ 733.8   | \$ |      | \$ |         | \$ | 733.8 |

*Fixed Maturity Securities and Short-term Investments*

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

Typical inputs used by these three pricing methods include, but are not limited to, reported trades, benchmark yields, issuer spreads, bids, offers, and/or estimated cash flows and prepayments speeds. Based on the typical trading volumes and the lack of quoted market prices for fixed maturities, third party pricing services will normally derive the security prices through recent reported trades for identical or similar securities making adjustments through the reporting date based upon available market observable information as outlined above. If there are no recent reported trades, the third party pricing services and brokers may use matrix or model processes to develop a security price where future cash flow expectations are developed based upon collateral performance and discounted at an estimated market rate. Included in the pricing of asset backed securities are estimates of the rate of future prepayments of principal over the remaining life of the securities. Such estimates are derived based on the characteristics of the underlying structure and prepayment speeds previously experienced at the interest rate levels projected for the underlying collateral. The Company does not make any internal adjustments to prices provided by its third party pricing service.

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The Company has analyzed the third party pricing services' valuation methodologies and related inputs, and has also evaluated the various types of securities in its investment portfolio to determine an appropriate FAS 157 fair value hierarchy level based upon trading activity and observability of market inputs. Based on this evaluation, each price was classified as Level 1, 2 or 3. Prices provided by third party pricing services with market observable inputs are classified as Level 2. Prices on the money fund portion of short-term investments are classified as Level 1. No investments were classified as Level 3 as of or for the three months ended March 31, 2009.

***Committed Capital Securities ( CCS Securities )***

The fair value of CCS Securities represents the present value of remaining expected put option premium payments under the CCS Securities agreements and the value of such estimated payments based upon the quoted price for such premium payments as of March 31, 2009 (see Note 10). The \$70.7 million fair value asset for CCS Securities is included in the consolidated balance sheet. Changes in fair value of this asset are included in other income in the consolidated statement of operations and comprehensive income. The significant market inputs used are observable, therefore, the Company classified this fair value measurement as Level 2.

***Level 3 Valuation Techniques***

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. A brief description of the valuation techniques used for Level 3 assets and liabilities is provided below.

***Credit Derivatives***

The Company's credit derivatives consist of insured CDS contracts (see Note 4). As discussed in Note 4, the Company does not typically exit its credit derivative contracts, and there are no quoted prices for its instruments or for similar instruments. Observable inputs other than quoted market prices exist, however, these inputs reflect contracts that do not contain terms and conditions similar to the credit derivative contracts issued by the Company. Therefore, the valuation of credit derivative contracts requires the use of models that contain significant, unobservable inputs. Thus, we believe the credit derivative valuations are in Level 3 in the fair value hierarchy discussed above.

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining expected premiums the Company receives for the credit protection and the estimated present value of premiums that a comparable financial guarantor would hypothetically charge the Company for the same protection at the balance sheet date. The fair value of the Company's credit 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. Contractual cash flows, which are included in the Realized gains and other settlements on credit derivatives' fair value component of credit derivatives, are the most readily observable variables of the fair value of credit derivative contracts since they are based on contractual terms. These variables include (i) net premiums received and receivable on written credit derivative contracts, (ii) net premiums paid and payable on purchased contracts, (iii) losses paid and payable to credit derivative contract counterparties and (iv) losses recovered and recoverable on purchased contracts. The remaining key variables described above impact Unrealized gains (losses) on credit derivatives.

Market conditions at March 31, 2009 were such that market prices of the Company's CDS contracts were not generally available. Where market prices were not available, the Company used a combination of observable market data and valuation models, using various market indices, credit spreads, the Company's own credit risk, and estimated contractual payments to estimate the Unrealized gains (losses) on credit derivatives portion of the fair value of its credit derivatives. These models are primarily developed internally based on market conventions for similar transactions.

Management considers the non-standard terms of its credit derivative contracts in determining the fair value of these contracts. These terms differ from credit derivatives sold by companies outside the financial guaranty industry. The non-standard terms include the absence of collateral support agreements or immediate settlement provisions, relatively high attachment points and the fact that the Company does not exit derivatives it sells for



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credit protection purposes, except under specific circumstances such as exiting a line of business. Because of these terms and conditions, the fair value of the Company's credit derivatives may not reflect the same prices observed in an actively traded market of credit derivatives that do not contain terms and conditions similar to those observed in the financial guaranty market. These models and the related assumptions are continuously reevaluated by management and enhanced, as appropriate, based upon improvements in modeling techniques and availability of more timely market information.

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

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

*Assumptions*

The key assumptions of our internally developed model include:

- 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 LIBOR. Such pricing is well established by historical financial guarantee fees relative to capital market spreads as observed and executed in competitive markets, including in financial guarantee reinsurance and secondary market transactions.
- Gross spread on a financial guarantee written in CDS form is allocated among 1) profit the originator, usually an investment bank, realizes for putting the deal together and funding the transaction, 2) premiums paid to us for our credit protection provided and 3) the cost of CDS protection purchased on us by the originator to hedge their counterparty credit risk exposure to the Company. The premium the Company receives is referred to as the net spread. The Company's own credit risk is factored into the determination of net spread based on the impact of changes in the quoted market price for credit protection bought on the Company, as reflected by quoted market prices on CDS sold on Assured Guaranty Corp. The cost to acquire CDS protection sold on AGC affects the amount of spread on CDS deals that the Company captures and, hence, their fair value. As the cost to acquire CDS protection sold on AGC increases the amount of premium we capture on a deal generally decreases. As the cost to acquire CDS protection sold on AGC decreases the amount of premium we capture on a deal generally increases. In our model, the premium we capture is not permitted to go below the minimum rate that we would currently charge to assume similar risks. This has the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts.
- The Company determines the fair value of its CDS contracts by applying the net spread for the remaining duration of each contract to the notional value of its CDS contracts.
- Actual transactions are used to validate the model results and to explain the correlation between various market indices and indicative CDS market prices.

*Inputs*

The specific model inputs are listed below, including how we derive inputs for market credit spreads on the underlying transaction collateral.

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

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This is an observable input that the Company obtains for deals it has closed or bid on in the market place.

- **Credit spreads on risks assumed** These are obtained from market data sources published by third parties (e.g. dealer spread tables for the collateral similar to assets within our transactions) as well as collateral-specific spreads provided by trustees or obtained from market sources. If observable market credit spreads are not available or reliable for the underlying reference obligations, then market indices are used that most closely resembles the underlying reference obligations, considering asset class, credit quality rating and maturity of the underlying reference obligations. As discussed previously, these indices are adjusted to reflect the non-standard terms of the Company's CDS contracts. As of March 31, 2009, the Company obtained approximately 20% of its credit spread data, based on notional par outstanding, from sources published by third parties, while 80% was obtained from market sources or similar market indices. Market sources determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. Management validates these quotes by cross-referencing quotes received from one market source against quotes received from another market source to ensure reasonableness. In addition, we compare the relative change in price quotes received from one quarter to another, with the relative change experienced by published market indices for a specific asset class. Collateral specific spreads obtained from third-party, independent market sources are un-published spread quotes from market participants and or market traders whom are not trustees. Management obtains this information as the result of direct communication with these sources as part of the valuation process.
- **Credit spreads on the Company's name** The Company obtains the quoted price of CDS contracts traded on AGC from market data sources published by third parties.

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

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

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

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

In this example, the contractual cash flows (the AGC premium above) exceed the amount a market participant would require AGC to pay in today's market to accept its obligations under the credit default swap contract, thus resulting in an asset. This credit derivative asset is equal to the difference in premium rate discounted at a risk adjusted rate over the weighted average remaining life of the contract. The expected future cash flows for the Company's credit derivatives were discounted at rates ranging from 1.0% to 23.0% over LIBOR at March 31, 2009, with over 95% of the transactions ranging from 1.0% to 6.0% over LIBOR.

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

The amount of premium a financial guaranty insurance market participant can demand is inversely related to the cost of credit protection on the insurance company as measured by market credit spreads. This is because the buyers of credit protection typically hedge a portion of their risk to the financial guarantor, due to the fact that

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contractual terms of financial guaranty insurance contracts typically do not require the posting of collateral by the guarantor. The widening of a financial guarantor's own credit spread increases the cost to buy credit protection on the guarantor, thereby, reducing the amount of premium the guarantor can capture out of the gross spread on the deal. The extent of the hedge depends on the types of instruments insured and the current market conditions.

A credit derivative asset under FAS 157 is the result of contractual cash flows on in-force deals in excess of what a hypothetical financial guarantor could receive if it sold protection on the same risk as of the current reporting date. If the Company were able to freely exchange these contracts (i.e., assuming its contracts did not contain proscriptions on transfer and there was a viable exchange market), it would be able to realize an asset representing the difference between the higher contractual premiums to which it is entitled and the current market premiums for a similar contract.

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

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

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

Over time the data inputs can change as new sources become available or existing sources are discontinued or are no longer considered to be the most appropriate. It is the Company's objective to move to higher levels on the hierarchy whenever possible, but it is sometimes necessary to move to lower priority inputs because of discontinued data sources or assessments that the higher priority inputs are no longer considered to be representative of market spreads for a given type of collateral. This can happen, for example, if transaction volume changes such that a previously used spread index is no longer viewed as being reflective of current market levels.

As of March 31, 2009, the Company obtained approximately 8% of its credit spread information, based on notional par outstanding, from actual collateral specific credit spreads, while 80% was based on market indices and 12% was based on spreads provided by the CDS counterparty. The Company interpolates a curve based on the historical relationship between premium the Company receives when a financial guarantee written in CDS form closes to the daily closing price of the market index related to the specific asset class and rating of the deal. This curve indicates expected credit spreads at each indicative level on the related market index. For specific transactions where no price quotes are available and

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credit spreads need to be extrapolated, an alternative transaction for which the Company has received a spread quote from one of the first three sources within the Company's spread hierarchy is chosen. This alternative transaction will be within the same asset class, have similar underlying assets, similar credit ratings, and similar time to maturity. The Company then calculates the percentage of relative spread change quarter over quarter for the alternative transaction. This percentage change is then applied to the historical credit spread of the transaction for which no price quote was received in order to calculate the transactions current spread. Counterparties determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. These quotes are validated by cross-referencing quotes received from one market source with those quotes received from another market source to ensure reasonableness. In addition, management compares the relative change experienced on published market indices for a specific asset class for reasonableness and accuracy.

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

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

- The model takes account of transaction structure and the key drivers of market value. The transaction structure includes par insured, weighted average life, level of subordination and composition of collateral.
- The model maximizes the use of market-driven inputs whenever they are available. The key inputs to the model are market-based spreads for the collateral, and the credit rating of referenced entities. These are viewed by us to be the key parameters that affect fair value of the transaction.
- The Company is able to use actual transactions to validate its model results and to explain the correlation between various market indices and indicative CDS market prices.
- The model is a well-documented, consistent approach to valuing positions that minimizes subjectivity. The Company has developed a hierarchy for market-based spread inputs that helps mitigate the degree of subjectivity during periods of high illiquidity.

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

- There is no exit market or actual exit transactions. Thus our exit market is a hypothetical one based on our entry market.
- There is a very limited market in which to verify the fair values developed by the Company's model.
- At March 31, 2009, the markets for the inputs to the model were highly illiquid, which impacts their reliability. However, the Company employs various procedures to corroborate the reasonableness of quotes received and calculated by our internal valuation model, including comparing to other quotes received on similarly structured transactions, observed spreads on structured products with comparable underlying assets and, on a selective basis when possible, through second independent quotes on the same reference obligation.
- Due to the non-standard terms under which the Company enters into derivative contracts, the fair value of its credit derivatives may not reflect the same prices observed in an actively traded market of credit derivatives that do not contain terms and conditions similar to those observed in the financial guaranty market.

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

The net par outstanding of the Company's credit derivative contracts was \$73.3 billion and \$75.1 billion at March 31, 2009 and December 31, 2008, respectively. The estimated remaining average life of these contracts at March 31, 2009 was 7.9 years.

As required by FAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. As of March 31, 2009, these contracts are classified as Level 3 in the FAS 157 hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation model, most significantly the Company's estimate of the value of the non-standard terms and conditions of its credit derivative contracts and of the Company's current credit standing.

The table below presents a reconciliation of the Company's credit derivatives whose fair value included significant unobservable inputs (Level 3) during the three months ended March 31, 2009 and 2008.



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| (Dollars in millions)  | Fair Value Measurements Using<br>Significant Unobservable Inputs<br>(Level 3) |   |
|--|---|---|
|  | First Quarter 2009<br>Credit Derivative<br>Liability (Asset), net             | First Quarter 2008<br>Credit Derivative<br>Liability (Asset), net |
| Beginning Balance  | \$ 586,807  | \$ 617,644  |
| Total gains or losses realized and unrealized  |   |   |
| Unrealized (gains) losses on credit derivatives  | (26,982)  | 259,621   |
| Realized gains and other settlements on credit derivatives   | (20,579)  | (27,617)  |
| Current period net effect of purchases, settlements and other activity included in unrealized portion of beginning balance | 17,724  | 31,989  |
| Transfers in and/or out of Level 3   |   |   |
| Ending Balance   | \$ 556,970  | \$ 881,637  |
| Gains and losses (realized and unrealized) included in earnings for the period are reported as follows:                    |   |   |
| Total realized and unrealized (gains) losses included in earnings for the period   | \$ (47,561)   | \$ 232,004  |
| Change in unrealized (gains) losses on credit derivatives still held at the reporting date                                 | \$ (27,182)   | \$ 262,462  |

**6. Investments**

The following table summarizes the Company's aggregate investment portfolio as of March 31, 2009:

|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains<br>(in thousands of U.S. dollars) | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
|---|-------------------|--|-------------------------------|-------------------------|
| <i>Fixed maturity securities</i>                |                   |  |                               |                         |
| U.S. government and agencies                    | \$ 426,058        | \$ 36,575  | \$ (23)                       | \$ 462,610              |
| Obligations of state and political subdivisions | 1,245,811         | 34,310   | (32,102)                      | 1,248,019               |
| Corporate securities                            | 278,772           | 3,984  | (20,522)                      | 262,234                 |
| Mortgage-backed securities                      | 1,089,288         | 28,968   | (50,109)                      | 1,068,147               |
| Asset-backed securities                         | 70,880            | 249  | (2,006)                       | 69,123                  |
| Foreign government securities                   | 61,617            | 4,428  |                               | 66,045                  |
| Preferred stock                                 |                   |  |                               |                         |
| Total fixed maturity securities                 | 3,172,426         | 108,514  | (104,762)                     | 3,176,178               |
| Short-term investments                          | 616,834           |  |                               | 616,834                 |
| Total investments                               | \$ 3,789,260      | \$ 108,514   | \$ (104,762)                  | \$ 3,793,012            |

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The following table summarizes the Company's aggregate investment portfolio as of December 31, 2008:

|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains<br>(in thousands of U.S. dollars) | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
|---|-------------------|--|-------------------------------|-------------------------|
| <i>Fixed maturity securities</i>                |                   |  |                               |                         |
| U.S. government and agencies                    | \$ 426,592        | \$ 49,370  | \$ (36)                       | \$ 475,926              |
| Obligations of state and political subdivisions | 1,235,942         | 33,196   | (51,427)                      | 1,217,711               |
| Corporate securities                            | 274,237           | 5,793  | (11,793)                      | 268,237                 |
| Mortgage-backed securities                      | 1,081,879         | 21,772   | (51,817)                      | 1,051,834               |
| Asset-backed securities                         | 80,710            |  | (7,144)                       | 73,566                  |
| Foreign government securities                   | 50,323            | 4,173  |                               | 54,496                  |
| Preferred stock                                 | 12,625            |  | (258)                         | 12,367                  |
| Total fixed maturity securities                 | 3,162,308         | 114,304  | (122,475)                     | 3,154,137               |
| Short-term investments                          | 477,197           |  |                               | 477,197                 |
| Total investments                               | \$ 3,639,505      | \$ 114,304   | \$ (122,475)                  | \$ 3,631,334            |

Approximately 28% and 29% of the Company's total investment portfolio as of March 31, 2009 and December 31, 2008, respectively, was composed of mortgage backed securities, including collateralized mortgage obligations and commercial mortgage backed securities. As of March 31, 2009 and December 31, 2008, respectively, approximately 70% and 69% of the Company's total mortgage backed securities were government agency obligations. As of both March 31, 2009 and December 31, 2008, the weighted average credit quality of the Company's entire investment portfolio was AA+. The Company's portfolio is comprised primarily of high-quality, liquid instruments. The Company continues to receive sufficient information to value its investments and has not had to modify its approach due to the current market conditions.

Under agreements with its cedants and in accordance with statutory requirements, the Company maintains fixed maturity securities in trust accounts of \$1,269.2 million and \$1,233.4 million as of March 31, 2009 and December 31, 2008, respectively, for the benefit of reinsured companies and for the protection of policyholders, generally in states in which the Company or its subsidiaries, as applicable, are not licensed or accredited.

Under certain derivative contracts, the Company is required to post eligible securities as collateral, generally cash or U.S. government or agency securities. The need to post collateral under these transactions is generally based on mark-to-market valuation in excess of contractual thresholds. The fair market value of the Company's pledged securities totaled \$177.9 million and \$157.7 million as of March 31, 2009 and December 31, 2008, respectively.

The Company has a formal review process for all securities in its investment portfolio, including a review for impairment losses. Factors considered when assessing impairment include:

- a decline in the market value of a security by 20% or more below amortized cost for a continuous period of at least six months;
- a decline in the market value of a security for a continuous period of 12 months;

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- recent credit downgrades of the applicable security or the issuer by rating agencies;
- the financial condition of the applicable issuer;
- whether loss of investment principal is anticipated;
- whether scheduled interest payments are past due; and
- whether the Company has the ability and intent to hold the security for a sufficient period of time to allow for anticipated recoveries in fair value.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss on the balance sheet in accumulated other comprehensive income in shareholders' equity. If the Company believes the decline is other than temporary, the Company will write down the carrying value of the investment and record a realized loss in its consolidated statements of operations and comprehensive income. In periods subsequent to the recognition of an other-than-temporary impairment, the impaired security is accounted for as if it had been purchased on the measurement date of the impairment. Accordingly, the discount (or reduced premium) based on the new cost basis is accreted into net investment income in future periods based upon

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the amount and timing of expected future cash flows of the security, if the recoverable value of the investment based upon those cash flows is greater than the carrying value of the investment after the impairment.

The Company's assessment of a decline in value includes management's current assessment of the factors noted above. The Company also seeks advice from its outside investment managers. If that assessment changes in the future, the Company may ultimately record a loss after having originally concluded that the decline in value was temporary.

As part of its other than temporary impairment review process, management considers the nature of the investment, the cause for the impairment (interest or credit related), the severity (both as a percentage of book value and absolute dollars) and duration of the impairment, the severity of the impairment regardless of duration, and any other available evidence, such as discussions with investment advisors, volatility of the securities fair value and recent news reports when performing its assessment.

As of March 31, 2009, the Company's gross unrealized loss position stood at \$104.8 million compared to \$122.5 million at December 31, 2008. The \$17.7 million decrease in gross unrealized losses was primarily attributable to municipal securities, \$19.3 million, mortgage and asset backed securities, \$6.9 million, and partially offset by an increase in gross unrealized losses in corporate securities, \$8.8 million. The decrease in gross unrealized losses during the three months ended March 31, 2009 was related to the recovery of liquidity in the financial markets.

As of March 31, 2009, the Company had 85 securities in an unrealized loss position for greater than 12 months, representing a gross unrealized loss of \$55.8 million. Of these securities, 28 securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of March 31, 2009 was \$39.0 million. This unrealized loss is primarily attributable to the market illiquidity and volatility in the U.S. economy mentioned above and not specific to individual issuer credit. Except as noted below, the Company has recognized no other than temporary impairment losses and has the ability and intent to hold these securities until a recovery in value.

The Company recognized \$18.5 million of other than temporary impairment losses substantially related to mortgage backed and corporate securities for the three months ended March 31, 2009 primarily due to the fact that it does not have the intent to hold these securities until there is a recovery in their value. The Company continues to monitor the value of these investments. Future events may result in further impairment of the Company's investments. The Company had no write downs of investments for other than temporary impairment losses for the three months ended March 31, 2008.

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The following table summarizes the unrealized losses in our investment portfolio by type of security and the length of time such securities have been in a continuous unrealized loss position as of the dates indicated:

| Length of Time in Continuous Unrealized Loss Position | As of March 31, 2009 |                         | As of December 31, 2008 |                         |
|---|----------------------|-------------------------|-------------------------|-------------------------|
|   | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value    | Gross Unrealized Losses |
|   | (\$ in millions)     |                         |                         |                         |
| <b>Municipal securities</b>                           |                      |                         |                         |                         |
| 0-6 months  | \$ 148.1             | \$ (2.6)                | \$ 168.8                | \$ (5.8)                |
| 7-12 months   | 174.8                | (5.8)                   | 310.6                   | (22.9)                  |
| Greater than 12 months                                | 295.8                | (23.7)                  | 137.9                   | (22.7)                  |
|   | 618.7                | (32.1)                  | 617.3                   | (51.4)                  |
| <b>Corporate securities</b>                           |                      |                         |                         |                         |
| 0-6 months  | 66.9                 | (7.6)                   | 23.7                    | (1.7)                   |
| 7-12 months   | 71.8                 | (9.0)                   | 81.9                    | (8.5)                   |
| Greater than 12 months                                | 20.1                 | (4.0)                   | 14.2                    | (1.6)                   |
|   | 158.8                | (20.6)                  | 119.8                   | (11.8)                  |
| <b>U.S. Government obligations</b>                    |                      |                         |                         |                         |
| 0-6 months  | 8.0                  |                         |                         |                         |
| 7-12 months   |                      |                         | 8.0                     |                         |
| Greater than 12 months                                |                      |                         |                         |                         |
|   | 8.0                  |                         | 8.0                     |                         |
| <b>Mortgage and asset-backed securities</b>           |                      |                         |                         |                         |
| 0-6 months  | 68.8                 | (12.0)                  | 143.6                   | (15.5)                  |
| 7-12 months   | 126.4                | (12.0)                  | 111.0                   | (36.2)                  |
| Greater than 12 months                                | 113.1                | (28.1)                  | 74.4                    | (7.3)                   |
|   | 308.3                | (52.1)                  | 329.0                   | (59.0)                  |
| <b>Preferred stocks</b>                               |                      |                         |                         |                         |
| 0-6 months  |                      |                         | 12.4                    | (0.3)                   |
| 7-12 months   |                      |                         |                         |                         |
| Greater than 12 months                                |                      |                         |                         |                         |
|   |                      |                         | 12.4                    | (0.3)                   |
| <b>Total</b>  | <b>\$ 1,093.8</b>    | <b>\$ (104.8)</b>       | <b>\$ 1,086.5</b>       | <b>\$ (122.5)</b>       |

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The following table summarizes the unrealized losses in our investment portfolio by type of security and remaining time to maturity as of the dates indicated:

| Remaining Time to Maturity                  | As of March 31, 2009 |                         | As of December 31, 2008 |                         |
|---|----------------------|-------------------------|-------------------------|-------------------------|
|   | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value    | Gross Unrealized Losses |
|   | (\$ in millions)     |                         |                         |                         |
| <b>Municipal securities</b>                 |                      |                         |                         |                         |
| Due in one year or less                     | \$                   | \$                      | \$                      | \$                      |
| Due after one year through five years       |                      |                         | 5.4                     |                         |
| Due after five years through ten years      | 43.0                 | (1.6)                   | 42.4                    | (2.6)                   |
| Due after ten years                         | 575.7                | (30.5)                  | 569.5                   | (48.8)                  |
|   | 618.7                | (32.1)                  | 617.3                   | (51.4)                  |
| <b>Corporate securities</b>                 |                      |                         |                         |                         |
| Due in one year or less                     | 4.5                  |                         | 0.8                     |                         |
| Due after one year through five years       | 28.9                 | (2.8)                   | 23.9                    | (1.2)                   |
| Due after five years through ten years      | 104.6                | (11.5)                  | 72.6                    | (6.6)                   |
| Due after ten years                         | 20.8                 | (6.3)                   | 22.5                    | (4.0)                   |
|   | 158.8                | (20.6)                  | 119.8                   | (11.8)                  |
| <b>U.S. Government obligations</b>          |                      |                         |                         |                         |
| Due in one year or less                     | 8.0                  |                         | 8.0                     |                         |
| Due after one year through five years       |                      |                         |                         |                         |
| Due after five years through ten years      |                      |                         |                         |                         |
| Due after ten years                         | 8.0                  |                         | 8.0                     |                         |
|   |                      |                         |                         |                         |
| <b>Mortgage and asset-backed securities</b> | 308.3                | (52.1)                  | 329.0                   | (59.0)                  |
| <b>Preferred stocks</b>                     |                      |                         | 12.4                    | (0.3)                   |
| <b>Total</b>                                | \$ 1,093.8           | \$ (104.8)              | \$ 1,086.5              | \$ (122.5)              |

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The following table summarizes, for all securities sold at a loss through March 31, 2009 and 2008, the fair value and realized loss by length of time such securities were in a continuous unrealized loss position prior to the date of sale:

| Length of Time in Continuous Unrealized Loss<br>Prior to Sale | Three Months Ended<br>March 31, |                             |                            |                             |          |
|---|---------------------------------|-----------------------------|----------------------------|-----------------------------|----------|
|   | 2009                            | 2008                        |                            |                             |          |
|   | Estimated<br>Fair<br>Value      | Gross<br>Realized<br>Losses | Estimated<br>Fair<br>Value | Gross<br>Realized<br>Losses |          |
|   | (\$ in millions)                |                             |                            |                             |          |
| <b>Municipal securities</b>                                   |                                 |                             |                            |                             |          |
| 0-6 months  | \$                              | \$                          | \$                         | 2.5                         | \$ (0.3) |
| 7-12 months   |                                 |                             |                            |                             |          |
| Greater than 12 months  | 3.7                             | (1.7)                       |                            |                             |          |
|   | 3.7                             | (1.7)                       | 2.5                        |                             | (0.3)    |
| <b>Corporate securities</b>                                   |                                 |                             |                            |                             |          |
| 0-6 months  | 1.1                             | (0.4)                       | 0.4                        |                             |          |
| 7-12 months   | 7.3                             | (6.9)                       | 2.1                        |                             |          |
| Greater than 12 months  | 0.8                             | (0.2)                       |                            |                             |          |
|   | 9.2                             | (7.5)                       | 2.5                        |                             |          |
| <b>U.S. Government securities</b>                             |                                 |                             |                            |                             |          |
| 0-6 months  |                                 |                             |                            |                             |          |
| 7-12 months   |                                 |                             |                            |                             |          |
| Greater than 12 months  |                                 |                             |                            |                             |          |
| <b>Mortgage and asset-backed securities</b>                   |                                 |                             |                            |                             |          |
| 0-6 months  | 0.1                             | (0.1)                       | 4.9                        |                             | (0.1)    |
| 7-12 months   | 7.6                             | (3.4)                       | 1.2                        |                             |          |
| Greater than 12 months  | 23.3                            | (12.2)                      | 1.2                        |                             |          |
|   | 31.0                            | (15.7)                      | 7.3                        |                             | (0.1)    |
| <b>Preferred stock</b>  |                                 |                             |                            |                             |          |
| 0-6 months  | 11.2                            | (1.5)                       |                            |                             |          |
| 7-12 months   |                                 |                             |                            |                             |          |
| Greater than 12 months  |                                 |                             |                            |                             |          |
|   | 11.2                            | (1.5)                       |                            |                             |          |
| Total   | \$ 55.1                         | \$ (26.4)                   | \$ 12.3                    | \$                          | (0.4)    |

**7. Significant Risk Management Activities**

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

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Risk Management and Surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio, including exposures in both the Direct and Reinsurance segments. The primary objective of the surveillance process is to monitor trends and changes in transaction credit quality, detect any deterioration in credit quality, and recommend to management such remedial actions as may be necessary or appropriate. All transactions in the insured portfolio are risk rated, and surveillance personnel are responsible for



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adjusting those ratings to reflect changes in transaction credit quality. Surveillance personnel are also responsible for managing work-out and loss situations when necessary. For transactions where a loss is considered probable, surveillance personnel present analysis related to potential loss situations to a Reserve Committee. The Reserve Committee is made up of the Chief Executive Officer, Chief Financial Officer, Chief Actuary, General Counsel and Chief Accounting Officer. The Reserve Committee considers the information provided by surveillance personnel when setting reserves.

***Direct Businesses***

We conduct surveillance procedures to track risk aggregations and monitor performance of each risk. The review cycle and scope vary based upon transaction type and credit quality. In general, the review process includes the collection and analysis of information from various sources, including trustee and servicer reports, financial statements and reports, general industry or sector news and analyses, and rating agency reports. For Public Finance risks, the surveillance process includes monitoring general economic trends, developments with respect to state and municipal finances, and the financial situation of the issuers. For Structured Finance transactions, the surveillance process can include monitoring transaction performance data and cash flows, compliance with transaction terms and conditions, and evaluation of servicer or collateral manager performance and financial condition. Additionally, the Company uses various quantitative tools and models to assess transaction performance and identify situations where there may have been a change in credit quality. For all transactions, surveillance activities may include discussions with or site visits to issuers, servicers or other parties to a transaction.

***Reinsurance Businesses***

For transactions in the Company's Reinsurance segment, the primary insurers are responsible for conducting ongoing surveillance, and our surveillance personnel monitor the activities of the primary insurers through a variety of means, such as review of surveillance reports provided by the primary insurers, and meetings and discussions with their analysts. Our surveillance personnel take steps to ensure that the primary insurer is managing risk pursuant to the terms of the applicable reinsurance agreement. To this end, we conduct periodic reviews of ceding companies' surveillance activities and capabilities. That process may include the review of the primary insurer's underwriting, surveillance, and claim files for certain transactions. In the event of credit deterioration of a particular exposure, more frequent reviews of the ceding company's risk mitigation activities are conducted. Our surveillance personnel also monitor general news and information, industry trends, and rating agency reports to help focus surveillance activities on sectors or credits of particular concern. For certain exposures, we also will undertake an independent analysis and remodeling of the transaction.

***Below Investment Grade Credits***

The Company's surveillance department is responsible for monitoring our portfolio of credits and maintains a list of below investment grade (BIG) credits. The BIG credits are divided into three categories:

- Category 1 (below investment grade credit with no expected losses);
- Category 2 (below investment grade credit with a loss reserve established prior to an event of default);

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- Category 3 (below investment grade credit with a loss reserve established and where an event of default has occurred or is imminent).

The BIG credit list includes all credits rated lower than BBB- where there is a material amount of exposure (generally greater than \$10.0 million) or a material risk of the Company incurring a loss greater than \$0.5 million. Credit ratings are based on the Company's internal assessment of the likelihood of default. The Company's internal credit ratings are generally in line or lower than those of the ratings agencies.

As part of our surveillance process, we continually monitor all of our investment grade credits to determine whether they have suffered any credit impairments. Our quarterly procedures included qualitative and quantitative analysis on all of our insured credits to ensure that all potential BIG credits have been identified. Credits we identified through this process as having future credit impairments are subjected to further review by surveillance personnel to ensure that they have an appropriate ratings assigned to them.

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The following table provides financial guaranty net par outstanding by BIG category as of March 31, 2009 (dollars in millions):

|  | BIG Credits |            |            |            |
|--|-------------|------------|------------|------------|
|  | Category 1  | Category 2 | Category 3 | Total      |
| Number of policies   | 82          | 175        | 120        | 377        |
| Remaining weighted-average contract period (in years)                            | 16.9        | 12.1       | 7.4        | 11.5       |
| Insured contractual payments outstanding:  |             |            |            |            |
| Principal  | \$ 1,641.8  | \$ 1,226.4 | \$ 2,287.8 | \$ 5,155.9 |
| Interest   | 1,139.7     | 629.0      | 684.5      | 2,453.2    |
| Total  | \$ 2,781.5  | \$ 1,855.4 | \$ 2,972.3 | \$ 7,609.1 |
| Gross reserves for loss and loss adjustment expenses                             |             |            |            |            |
|  | \$ 2.8      | \$ 99.4    | \$ 192.9   | \$ 295.1   |
| Less:  |             |            |            |            |
| Gross potential recoveries   |             |            | 120.5      | 120.5      |
| Discount, net  | 1.0         | 44.1       | 40.0       | 85.1       |
| Net reserves for loss and loss adjustment expenses                               | \$ 1.8      | \$ 55.3    | \$ 32.4    | \$ 89.5    |
| Unearned premium reserves  | \$ 1.8      | \$ 9.9     | \$ 14.5    | \$ 26.2    |
| Net reserves for loss and loss adjustment expenses reported in the balance sheet |             |            |            |            |
|  | \$          | \$ 45.4    | \$ 17.9    | \$ 63.2    |
| Reinsurance recoverable  | \$          | \$         | \$ (3.9)   | \$ (3.9)   |

The Company's loss adjustment expense reserves for mitigating claim liabilities were \$1.7 million as of March 31, 2009.

In accordance with FAS 163, the above table includes financial guaranty contracts written in insurance form. It does not include financial guaranty contracts written in CDS form, mortgage guaranty insurance or the Company's other lines of insurance.

The Company used weighted-average risk free discount rate of 2.4% to discount reserves for loss and loss adjustment expenses.

***Overview of Significant Risk Management Activities***

The Company insures various types of residential mortgage backed securitizations ( RMBS ). Such transactions may include obligations backed by closed-end first mortgage loans and closed and open-end second mortgage loans or home equity loans on one-to-four family residential

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properties, including condominiums and cooperative apartments. An RMBS transaction where the underlying collateral is comprised of revolving home equity lines of credit is generally referred to as a HELOC transaction. In general, the collateral supporting HELOC securitizations are second lien loans made to prime borrowers. As of March 31, 2009, the Company had net par outstanding of \$1.6 billion related to HELOC securitizations, of which \$1.2 billion were written in the Company's financial guaranty direct segment. As of March 31, 2009, the Company had net par outstanding of \$1.4 billion for transactions with Countrywide, of which \$1.1 billion were written in the Company's financial guaranty direct segment ( direct Countrywide transactions or Countrywide 2005-J and Countrywide 2007-D ). As of December 31, 2008, the Company had net par outstanding of \$1.7 billion related to HELOC securitizations, of which \$1.5 billion were transactions with Countrywide.

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The performance of our HELOC exposures deteriorated during 2007 and 2008 and the first three months of 2009 and transactions, particularly those originated in the period from 2005 through 2007, continue to perform below our original underwriting expectations. In accordance with its standard practice, during the three months ended March 31, 2009, we evaluated the most currently available information, including trends in delinquencies and charge-offs on the underlying loans, draw rates on the lines of credit, and the servicer's ability to fulfill its contractual obligations including its obligation to fund additional draws. The key assumptions used in our analysis of potential case loss reserves on the direct Countrywide transactions are presented in the following table:

**Key Variables**

|  |  |
|--|--|
| Constant payment rate (CPR)                    | 3-month average, 5.63% as of March 31, 2009  |
| Constant default rate (CDR)                    | 6-month average CDR of approximately 18.19% used for our initial default projections, ramping down to a steady state CDR of 1.0% |
| Draw rate                                      | 3-month average, 1.2% as of March 31, 2009   |
| Excess spread                                  | 250 bps per annum  |
| Repurchases of Ineligible loans by Countrywide | \$79.0 million; or approximately 3.3% of original pool balance of \$2.4 billion  |
| Loss Severity                                  | 100%   |

In recent periods, CDR, CPR, Draw Rates and delinquency percentages have fluctuated within ranges that we believe make it appropriate to use rolling averages to project future performance. Accordingly, the Company is using modeling assumptions that are based upon or which approximate recent actual historical performance to project future performance and potential losses. In the first quarter 2009, consistent with FAS 163, the Company modeled and probability weighted a variety of potential time periods over which an elevated CDR may potentially occur. Further, the Company also incorporated in its loss reserve estimates the possibility that in some of those scenarios the prepayment rates increase after the stressed CDR period, leading to lower recoveries through excess spread. The Company continues to model sensitivities around the results booked using a variety of CDR rates and stress periods as well as other modeling approaches including roll rates and hybrid roll rate/CDR methods.

As a result of this modeling and analysis, the Company incurred loss and loss adjustment expenses of \$(4.9) million for its direct Countrywide transactions during First Quarter 2009. The Company's cumulative incurred loss and loss adjustment expenses on the direct Countrywide transactions as of March 31, 2009 were \$93.3 million (\$73.0 million after-tax). During First Quarter 2009, the Company paid losses and loss adjustment expenses for its direct Countrywide transactions of \$35.5 million compared to \$22.6 million paid during First Quarter 2008. The Company's cumulative paid losses and loss adjustment expenses for its direct Countrywide transactions are \$205.5 million as of March 31, 2009. The Company expects to recover a significant amount of these paid losses through excess spread from future cash flows as well as funding of future draws and recoverables from breaches of representations and warranties with respect to the underlying collateral. The recoverable that reduces these losses in the amount of \$112.2 million is included in salvage recoverable on the balance sheet as of March 31, 2009.

For the three months ended March 31, 2009, the Company incurred loss and loss adjustment expenses of \$18.7 million for its HELOC exposures. Of this amount, \$(0.1) million related to the Company's financial guaranty direct segment, including \$(4.9) million of incurred loss and loss adjustment expenses for the direct Countrywide transactions. The remaining \$18.7 million of incurred loss and loss adjustment expenses related to the Company's assumed HELOC exposures in its financial guaranty reinsurance segment.

The ultimate performance of the Company's HELOC transactions will depend on many factors, such as the level and timing of loan defaults, interest proceeds generated by the securitized loans, repayment speeds and changes in home prices, as well as the levels of credit support built into each transaction. Other factors also may have a material impact upon the ultimate performance of each transaction, including the ability of the seller and servicer to fulfill all of their contractual obligations including its obligation to fund future draws on lines of credit as well as the amount of benefit received from put-backs of ineligible loans to Countrywide. The variables affecting transaction performance are interrelated,

difficult to predict and subject to considerable volatility. If actual results differ materially from any of our

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assumptions, the losses incurred could be materially different from our estimate. We continue to update our evaluation of these exposures as new information becomes available.

A summary of the Company's exposure to these two transactions and their actual performance statistics through March 31, 2009 are as follows:

(\$ in millions)

|  | Countrywide 2005J |         | Countrywide 2007D |         |
|--|-------------------|---------|-------------------|---------|
| Original principal balance                             | \$                | 1,500   | \$                | 900     |
| Remaining principal balance                            | \$                | 492.5   | \$                | 580.9   |
| Cumulative losses (% of original principal balance)(1) |                   | 12.1%   |                   | 17.2%   |
| Total delinquencies (% of current balance)(2)          |                   | 19.4%   |                   | 17.3%   |
| Average initial FICO score of borrowers(3)             |                   | 709     |                   | 712     |
| Interest margin over prime(4)                          |                   | 2.0%    |                   | 1.8%    |
| Revolving period(5)                                    |                   | 10      |                   | 10      |
| Repayment period(6)                                    |                   | 15      |                   | 15      |
| Average draw rate(7)                                   |                   | 1.1%    |                   | 1.5%    |
| Average constant payment rate(8)                       |                   | 5.0%    |                   | 6.3%    |
| Excess spread(9)                                       |                   | 321 bps |                   | 292 bps |
| Expected collateral loss(10)                           |                   | 20.2%   |                   | 34.1%   |

- 
- (1) Cumulative collateral losses expressed as a percentage of the original deal balance.
- (2) Total delinquencies (includes bankruptcies, foreclosures and real estate owned by Countrywide) as a percentage of the current deal balance.
- (3) Fair Isaacs and Company score is a measurement designed to indicate the credit quality of a borrower.
- (4) Floating rate charged to borrowers above the prime rate.
- (5) Time period (usually 5-10 years) in which the borrower may draw funds from their HELOC.
- (6) Time period (usually 10-20years) in which the borrower must repay the funds withdrawn from the HELOC.
- (7) Represents the three-month average draw rate as of March 2009.
- (8) Represents the three-month average constant payment rate as of March 2009.
- (9) Excess spread during March 2009.
- (10) Calculated using a weighted average basis.

Another type of RMBS transaction is generally referred to as Subprime RMBS. The collateral supporting such transactions is comprised of first-lien residential mortgage loans made to subprime borrowers. A subprime borrower is one considered to be a higher risk credit based on credit scores or other risk characteristics. As of March 31, 2009, we had net par outstanding of \$6.5 billion related to Subprime RMBS securitizations, of which \$612 million is classified by us as Below Investment Grade risk. Of the total U.S. Subprime RMBS exposure of \$6.5 billion, \$6.0 billion is from transactions issued in the period from 2005 through 2007 and written in our direct financial guaranty segment. As of March 31, 2009, we had case reserves of \$10.0 million related to our \$6.5 billion U.S. Subprime RMBS exposure, of which \$1.8 million were related to our \$6.0 billion exposure in the direct financial guaranty segment for transactions issued from 2005 through 2007.

The problems affecting the subprime mortgage market have been widely reported, with rising delinquencies, defaults and foreclosures negatively impacting the performance of Subprime RMBS transactions. Those concerns relate primarily to Subprime RMBS issued in the period from 2005 through 2007. The \$6.0 billion exposure that we have to such transactions in our direct financial guaranty segment benefits from various structural protections, including credit enhancement that on average currently equals approximately 54.6% of the remaining principal balance of the transactions.

We also have exposure of \$415 million to Closed-End Second ( CES ) RMBS transactions, of which \$405 million is in the direct segment. As with other types of RMBS, we have seen significant deterioration in the performance of our CES transactions. On two transactions, which had exposure of \$304 million, as of March 31, 2009 we have seen a significant increase in delinquencies and collateral losses, which resulted in erosion of the Company's credit enhancement and the payment of claims totaling \$26.4 million. Based on the Company's analysis of these transaction and their projected collateral losses, the Company had case reserves of \$38.1 million as of March 31, 2009.

Another type of RMBS transaction is generally referred to as Alt-A RMBS. The collateral supporting such transactions is comprised of first-lien residential mortgage loans made to prime quality borrowers that lack certain



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ancillary characteristics that would make them prime. Included in this category is Alt-A Option ARMs, which include transactions where 66% or more of the collateral is comprised of mortgage loans that have the potential to negatively amortize. As of March 31, 2009, the Company had net par outstanding of \$7.7 billion related to Alt-A RMBS securitizations. Of that amount, \$7.4 billion is from transactions issued in the period from 2005 through 2007 and written in the Company's financial guaranty direct segment. As of March 31, 2009, the Company had case reserves of \$12.5 million for ALT-A and \$11.4 million for Option-ARM related to its \$7.7 billion Alt-A/Option ARM RMBS exposure, in the financial guaranty direct and reinsurance segments, respectively.

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

The Company has exposure on two life insurance reserve securitization transactions based on two discrete blocks of individual life insurance business reinsured by Scottish Re (U.S.) Inc. ( Scottish Re ). The two transactions relate to Ballantyne Re p.l.c. ( Ballantyne ) (gross exposure of \$500 million) and Orkney Re II, p.l.c. ( Orkney II ) (gross exposure of \$423 million). Under both transactions, monies raised through the issuance of the insured notes support present and future U.S. statutory life insurance reserve requirements. The monies were invested at inception of each transaction in accounts managed by a large, well-known investment manager. However, those investment accounts have incurred substantial mark-to-market losses since mid-year 2007, principally as a result of their exposure to subprime and Alt-A RMBS transactions. Largely as a result of these mark-to-market losses both we and the rating agencies have downgraded our exposure to both Ballantyne and Orkney II to below investment grade. As regards the Ballantyne transaction, the Company is working with the directing guarantor, who has insured exposure of \$900 million, to remediate the risk. On the Orkney Re II transaction, the Company, as directing financial guarantor, is taking remedial action.

Some credit losses have been realized on the securities in the Ballantyne and Orkney Re II portfolios and significant additional credit losses are expected to occur. Performance of the underlying blocks of life insurance business thus far generally has been in accordance with expectations. The combination of cash flows from the investment accounts and the treaty settlements currently is sufficient to cover interest payments due on the notes that we insure. Adverse treaty performance and/or a rise in credit losses on the invested assets are expected to lead to interest shortfalls. Additionally, the transactions also contain features linked to the market values of the invested assets, reserve funding requirements on the underlying blocks of life insurance business, and minimum capital requirements for the transactions themselves that may trigger a shut off of interest payments to the insured notes and thereby result in claim payments by the Company.

Another key risk is that the occurrence of certain events may result in a situation where either Ballantyne and/or Orkney Re II are required to sell assets and potentially realize substantial investment losses and for Assured Guaranty Ltd. to incur corresponding insured losses ahead of the scheduled final maturity date. For example, cedants to Scottish Re may have the right to recapture blocks of life insurance business which Scottish Re has ceded to Orkney Re II. Such recaptures could require Orkney Re II to sell assets and realize investment losses. In the Ballantyne transaction, further declines in the market value of the invested assets and/or an increase in the reserve funding requirements could lead to a similar mandatory realization of investment losses and for Assured Guaranty Ltd. to incur corresponding insured losses ahead of the scheduled final maturity date.

In order for the Company to incur an ultimate net loss on these transactions, adverse experience on the underlying block of life insurance policies and/or credit losses in the investment portfolio would need to exceed the level of credit enhancement built into the transaction structures. Based on its analysis of the information currently available, including estimates of future investment performance, projected credit impairments on the invested assets and performance of the blocks of life insurance business, at March 31, 2009, the Company's case reserve is now \$43.0 million for the Ballantyne transaction. The Company has not established a case loss reserve for the Orkney Re II transaction.

On December 19, 2008, the Company sued J.P. Morgan Investment Management Inc. ( JPMIM ), the

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investment manager in the Orkney II transaction, in New York Supreme Court alleging that JPMIM engaged in breaches of fiduciary duty, gross negligence and breaches of contract based upon its handling of the investments of Orkney Re II. JPMIM has filed a motion to dismiss Assured's complaint, which has been opposed by Assured. The Court has not yet acted on the motion to dismiss.

The Company has exposure to a public finance transaction for sewer service in Jefferson County, Alabama through several reinsurance treaties. The Company's total exposure to this transaction is approximately \$455 million as of March 31, 2009. The Company has made debt service payments during the year and expects to make additional payments in the near term. Through our cedants, the Company is currently in discussions with the bond issuer to structure a solution, which may result in some or all of these payments being recoverable. The Company incurred cumulative loss and loss adjustment expenses of \$19.3 million as of March 31, 2009.

**8. Analysis Of Premiums Written, Premiums Earned And Loss And Loss Adjustment Expenses**

The Company enters into reinsurance agreements with non-affiliated companies to limit its exposure to risk on an on-going basis. In the event that any or all of the reinsurers are unable to meet their obligations, the Company would be liable for such defaulted amounts. Direct, assumed, and ceded premium and loss and loss adjustment expense amounts for three months ended March 31, 2009 and 2008 were as follows:

|  | <b>Three Months Ended</b>             |                   |
|--|---------------------------------------|-------------------|
|  | <b>March 31,</b>                      |                   |
|  | <b>2009</b>                           | <b>2008</b>       |
|  | <b>(in thousands of U.S. dollars)</b> |                   |
| <b>Premiums Written</b>                  |                                       |                   |
| Direct                                   | \$ 140,080                            | \$ 146,409        |
| Assumed                                  | 94,678                                | 29,393            |
| Ceded                                    | 38                                    | (6,110)           |
| <b>Net</b>                               | <b>\$ 234,796</b>                     | <b>\$ 169,692</b> |
| <b>Premiums Earned</b>                   |                                       |                   |
| Direct                                   | \$ 106,463                            | \$ 17,967         |
| Assumed                                  | 46,928                                | 30,927            |
| Ceded                                    | (4,945)                               | (2,061)           |
| <b>Net</b>                               | <b>\$ 148,446</b>                     | <b>\$ 46,833</b>  |
| <b>Loss and Loss Adjustment Expenses</b> |                                       |                   |
| Direct                                   | \$ 15,066                             | \$ 35,915         |
| Assumed                                  | 67,228                                | 19,028            |
| Ceded                                    | (2,540)                               | 195               |
| <b>Net</b>                               | <b>\$ 79,754</b>                      | <b>\$ 55,138</b>  |

Net premiums written for First Quarter 2009 were \$234.8 million compared with \$169.7 million for First Quarter 2008. The \$65.1 million increase is mainly attributable to the Company's direct premiums written resulting from the expansion of the Company's financial guaranty direct segment, particularly in the U.S. public finance market. First Quarter 2009 included upfront direct premiums written of \$112.9 million from the

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Company's U.S. public finance business compared with \$121.6 million in First Quarter 2008.

Net premiums earned for First Quarter 2009 were \$148.4 million compared with \$46.8 million for First Quarter 2008. The \$101.6 million increase is partially attributable to the Company's direct earned premiums which increased \$88.5 million in First Quarter 2009, compared with First Quarter 2008. This increase is principally attributable to accelerated premiums earned of \$73.6 million resulting from early contract terminations in the financial guaranty direct segment and to the continued growth of the Company's in-force book of business. First Quarter 2009 earned premiums include \$5.3 million related to the accretion of discount on future financial guaranty installment premiums as the result of the implementation of FAS 163 effective January 1, 2009. The First Quarter 2009 and First Quarter 2008 did not have any earned premiums from public finance refundings in the financial guaranty direct segment but did have \$16.7 million and \$2.4 million in the financial guaranty reinsurance segment

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for these periods. Public finance refundings reflect the unscheduled pre-payment or refundings of underlying municipal bonds. Also contributing to the Company's increase in net premiums earned was the financial guaranty reinsurance segment, which increased \$18.4 million compared to the same period last year. This increase was mainly due to the portfolio assumed from Ambac Assurance Corp. ( Ambac ) during December 2007. Offsetting these increases was a decrease of \$1.1 million in net premiums earned in the mortgage segment due to run-off.

Loss and loss adjustment expenses ( LAE ) were \$79.8 million and \$55.1 million for First Quarter 2009 and First Quarter 2008, respectively. First Quarter 2009 included a decrease in loss and loss adjustment expenses in the financial guaranty direct segment of \$24.2 million offset by an increase of \$17.6 million in the financial guaranty reinsurance segment and \$31.2 million in the mortgage segment, as a result of a loss reserve estimate related to a contract under dispute.

To limit its exposure on assumed risks, the Company entered into certain proportional and non-proportional retrocessional agreements with other insurance companies, primarily subsidiaries of ACE Limited ( ACE ), the Company's former parent, to cede a portion of the risk underwritten by the Company, prior to the IPO. In addition, the Company enters into reinsurance agreements with non-affiliated companies to limit its exposure to risk on an on-going basis.

Reinsurance recoverable on ceded losses and LAE as of March 31, 2009 and December 31, 2008 were \$7.8 million and \$6.5 million, respectively and are mainly related to the Company's other segment. In the event that any or all of the reinsurers are unable to meet their obligations, the Company would be liable for such defaulted amounts.

*Agreement with CIFG Assurance North America, Inc.*

AGC entered into an agreement with CIFG Assurance North America, Inc. ( CIFG ) to assume a diversified portfolio of financial guaranty contracts totaling approximately \$13.3 billion of net par outstanding. The Company closed the transaction in January 2009 and received \$75.6 million (\$85.7 million of upfront premiums net of ceding commissions) and will receive approximately \$12.2 million of future installments premiums.

**9. Commitments and Contingencies**

*Litigation*

Effective January 1, 2004, Assured Guaranty Mortgage Insurance Company ( AGMIC ) reinsured a private mortgage insurer (the Reinsured ) under a Mortgage Insurance Stop Loss Excess of Loss Reinsurance Agreement (the Agreement ). Under the Agreement, AGMIC agreed to cover the Reinsured's aggregate mortgage guaranty insurance losses in excess of a \$25 million retention and subject to a \$95 million limit.

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Coverage under the Agreement was triggered only when the Reinsured's: (1) combined loss ratio exceeded 100%; and (2) risk to capital ratio exceeded 25 to 1, according to insurance statutory accounting. In April 2008, AGMIC notified the Reinsured it was terminating the Agreement because of the Reinsured's breach of the terms of the Agreement. The Reinsured notified AGMIC that it considers the Agreement to remain in effect and that the two coverage triggers under the Agreement apply as of April 1, 2008. By letter dated May 5, 2008, the Reinsured demanded arbitration against AGMIC seeking a declaration that the Agreement remains in effect and alleged compensatory and other damages. The arbitration hearing took place before a three person panel in December 2008 and January 2009. Post hearing briefing and oral arguments was completed on February 26, 2009, and the arbitration panel could render its decision at any time.

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 could have a material adverse effect on the Company's results of operations in a particular quarter or fiscal year.

### *Real Estate Leases*

The Company and its subsidiaries are party to various lease agreements. In June 2008, the Company's subsidiary, Assured Guaranty Corp., entered into a new five-year lease agreement for New York office space. Future

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minimum annual payments of \$5.3 million for the first twelve month period and \$5.7 million for subsequent twelve month periods commenced October 1, 2008 and are subject to escalation in building operating costs and real estate taxes.

***Reinsurance***

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. The amounts, if any, the Company will recover in these proceedings are uncertain, although recoveries in any one or more of these proceedings during any quarter or fiscal year could be material to the Company's results of operations in that particular quarter or fiscal year.

The Company is party to reinsurance agreements with most of the major monoline primary financial guaranty insurance companies. The Company's facultative and treaty agreements are generally subject to termination (i) upon written notice (ranging from 90 to 120 days) prior to the specified deadline for renewal, (ii) at the option of the primary insurer if the Company fails to maintain certain financial, regulatory and rating agency criteria which 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 (iii) upon certain changes of control of the Company. Upon termination under the conditions set forth in (ii) and (iii) above, the Company may be required (under some of its reinsurance agreements) to return to the primary insurer all statutory unearned premiums, less ceding commissions, attributable to reinsurance ceded pursuant to such agreements after which the Company would be released from liability with respect to the ceded business. Upon the occurrence of the conditions set forth in (ii) 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.

**10. Long-Term Debt and Credit Facilities**

The Company's unaudited interim consolidated financial statements include long-term debt used to fund the Company's insurance operations, and related interest expense, as described below.

***Senior Notes***

On May 18, 2004, Assured Guaranty US Holdings Inc. ( AGUS ), a subsidiary of the Company, issued \$200.0 million of 7.0% Senior Notes due 2034 for net proceeds of \$197.3 million. The proceeds of the offering were used to repay substantially all of a \$200.0 million promissory note issued to a subsidiary of ACE in April 2004 as part of the IPO related formation transactions. The coupon on the Senior Notes is 7.0%, however, the effective rate is approximately 6.4%, taking into account the effect of a cash flow hedge executed by the Company in March 2004, the term of which matches that of the Senior Notes. The Company recorded interest expense of \$3.3 million, including \$0.2 million of amortized gain on the cash flow hedge, for both First Quarter 2009 and First Quarter 2008. These Senior Notes are fully and unconditionally guaranteed by Assured Guaranty Ltd.

*Series A Enhanced Junior Subordinated Debentures*

On December 20, 2006, AGUS issued \$150.0 million of Series A Enhanced Junior Subordinated Debentures (the "Debentures") due 2066 for net proceeds of \$149.7 million. The proceeds of the offering were used to repurchase 5,692,599 of Assured Guaranty Ltd.'s common shares from ACE Bermuda Insurance Ltd., a subsidiary of ACE. The Debentures pay a fixed 6.40% rate of interest until December 15, 2016, and thereafter pay a floating rate of interest, reset quarterly, at a rate equal to 3 month LIBOR plus a margin equal to 2.38%. AGUS may elect at one or more times to defer payment of interest for one or more consecutive periods for up to ten years. Any unpaid interest bears interest at the then applicable rate. AGUS may not defer interest past the maturity date. The Company recorded interest expense of \$2.5 million in both First Quarter 2009 and First Quarter 2008. These Debentures are guaranteed on a junior subordinated basis by Assured Guaranty Ltd.



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*Credit Facilities*

**2006 Credit Facility**

On November 6, 2006, Assured Guaranty Ltd. and certain of its subsidiaries entered into a \$300.0 million five-year unsecured revolving credit facility (the 2006 credit facility) with a syndicate of banks. Under the \$300.0 million credit facility, each of Assured Guaranty Corp. ( AGC ), Assured Guaranty (UK) Ltd. ( AG (UK) ), Assured Guaranty Re Ltd. ( AG Re ), Assured Guaranty Re Overseas Ltd. ( AGRO ) and Assured Guaranty Ltd. are entitled to request the banks to make loans to such borrower or to request that letters of credit be issued for the account of such borrower.

Of the \$300.0 million available to be borrowed, no more than \$100.0 million may be borrowed by Assured Guaranty Ltd., AG Re or AGRO, individually or in the aggregate, and no more than \$20.0 million may be borrowed by AG (UK). The stated amount of all outstanding letters of credit and the amount of all unpaid drawings in respect of all letters of credit cannot, in the aggregate, exceed \$100.0 million.

The 2006 credit facility also provides that Assured Guaranty Ltd. may request that the commitment of the banks be increased an additional \$100.0 million up to a maximum aggregate amount of \$400.0 million. Any such incremental commitment increase is subject to certain conditions provided in the agreement and must be for at least \$25.0 million.

The proceeds of the loans and letters of credit are to be used for the working capital and other general corporate purposes of the borrowers and to support reinsurance transactions.

At the closing of the 2006 credit facility, (i) AGC guaranteed the obligations of AG (UK) under such facility, (ii) Assured Guaranty Ltd. guaranteed the obligations of AG Re and AGRO under such facility and agreed that, if the Company Consolidated Assets (as defined in the related credit agreement) of AGC and its subsidiaries were to fall below \$1.2 billion, it would, within 15 days, guarantee the obligations of AGC and AG (UK) under such facility, (iii) Assured Guaranty Overseas US Holdings Inc., guaranteed the obligations of Assured Guaranty Ltd., AG Re and AGRO under such facility and (iv) each of AG Re and AGRO guarantees the other as well as Assured Guaranty Ltd.

The 2006 credit facility's financial covenants require that Assured Guaranty Ltd. (a) maintain a minimum net worth of seventy-five percent (75%) of the Consolidated Net Worth of Assured Guaranty Ltd. as of the most recent fiscal quarter of Assured Guaranty Ltd. prior to November 6, 2006 and (b) maintain a maximum debt-to-capital ratio of 30%. In addition, the 2006 credit facility requires that AGC maintain qualified statutory capital of at least 75% of its statutory capital as of the fiscal quarter prior to November 6, 2006. Furthermore, the 2006 credit facility contains restrictions on Assured Guaranty Ltd. and its subsidiaries, including, among other things, in respect of their ability to incur debt, permit liens, become liable in respect of guaranties, make loans or investments, pay dividends or make distributions, dissolve or become party to a merger, consolidation or acquisition, dispose of assets or enter into affiliate transactions. Most of these restrictions are subject to certain minimum thresholds and exceptions. The 2006 credit facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representation or warranty, bankruptcy or insolvency proceedings, change of control and cross-default to other debt agreements. A default by one borrower will give rise to a right of the lenders to terminate the facility and accelerate all amounts then outstanding. As of March 31, 2009 and December 31, 2008, Assured Guaranty was in compliance with all of those financial covenants.

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As of March 31, 2009 and December 31, 2008, no amounts were outstanding under this facility nor have there been any borrowings under this facility.

Letters of credit totaling approximately \$2.9 million remained outstanding as of March 31, 2009 and December 31, 2008, respectively, discussed in Note 9.

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**Non-Recourse Credit Facilities**

*AG Re Credit Facility*

On July 31, 2007 AG Re entered into a non-recourse credit facility ( AG Re Credit Facility ) with a syndicate of banks which provides up to \$200.0 million to satisfy certain reinsurance agreements and obligations. The AG Re Credit Facility expires in July 2014.

The AG Re Credit Facility does not contain any financial covenants. The AG Re Credit Facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representation or warranty, bankruptcy or insolvency proceedings, change of control and cross default to other debt agreements. If any such event of default were triggered, AG Re could be required to repay potential outstanding borrowings in an accelerated manner.

AG Re's obligations to make payments of principal and interest on loans under the AG Re Credit Facility, whether at maturity, upon acceleration or otherwise, are limited recourse obligations of AG Re and are payable solely from the collateral securing the AG Re Credit Facility, including recoveries with respect to certain insured obligations in a designated portfolio, premiums with respect to defaulted insured obligations in that portfolio, certain designated reserves and other designated collateral.

As of March 31, 2009 and December 31, 2008, no amounts were outstanding under this facility nor have there been any borrowings under the life of this facility.

**Committed Capital Securities**



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On April 8, 2005, AGC entered into four separate agreements with four different unaffiliated custodial trusts pursuant to which AGC may, at its option, cause each of the custodial trusts to purchase up to \$50.0 million of perpetual preferred stock of AGC. 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 \$200.0 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 were not exercised during 2009 or 2008. Initially, all of committed capital securities of the custodial trusts (the CCS Securities) were issued to a special purpose pass-through trust (the Pass-Through Trust). The Pass-Through Trust was dissolved in April 2008 and the committed capital securities were distributed to the holders of the Pass-Through Trust's securities. Neither the Pass-Through Trust nor the Custodial Trusts are consolidated in Assured Guaranty Ltd.'s financial statements.

Income distributions on the Pass-Through Trust Securities and CCS Securities 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 CCS Securities are determined pursuant to an auction process. On April 7, 2008 this auction process failed, thereby increasing the annualized rate on the CCS Securities to One-Month LIBOR plus 250 basis points. Distributions on the AGC Preferred Stock will be determined pursuant to the same process.

During First Quarter 2009 and First Quarter 2008, AGC incurred \$1.4 million and \$0.7 million, respectively, of put option premiums which are an on-going expense. The increase in First Quarter 2009 compared with First Quarter 2008 was due to the increase in annualized rates from One-Month LIBOR plus 110 basis points to One-Month LIBOR plus 250 basis points as a result of the failed auction process in April 2008. These expenses are presented in the Company's unaudited interim consolidated statements of operations and comprehensive income under other expense.

The CCS securities had a fair value of \$70.7 million (see Note 5) and \$51.1 million as of March 31, 2009 and December 31, 2008, respectively, and a change in fair value during First Quarter 2009 and First Quarter 2008 of \$19.7 million and \$8.5 million, respectively, which are recorded in the unaudited interim consolidated statements of operations and comprehensive income in other income.

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**11. Employee Benefit Plans**

*Share-Based Compensation*

Share-based compensation expense in First Quarter 2009 and First Quarter 2008 was \$3.8 million (\$3.1 million after tax) and \$6.4 million (\$5.4 million after tax), respectively. The effect on basic and diluted earnings per share for First Quarter 2009 and First Quarter 2008 was \$0.03 and \$0.07, respectively. First Quarter 2009 and First Quarter 2008 expense included \$2.0 million (\$1.8 million after tax) and \$3.9 million (\$3.5 million after tax), respectively, related to accelerated vesting for stock award grants to retirement-eligible employees.

*Performance Retention Plan*

The Company recognized approximately \$5.2 million (\$4.4 million after-tax) and \$5.5 million (\$4.6 million after-tax) of expense for performance retention awards in First Quarter 2009 and First Quarter 2008, respectively. Included in First Quarter 2009 and First Quarter 2008 amounts were \$4.3 million and \$4.6 million, respectively, of accelerated expense related to retirement eligible employees.

**12. Earnings Per Share**

Effective January 1, 2009, the Company adopted FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* ( FSP ). The FSP clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends or dividend equivalents before vesting should be considered participating securities. Restricted stock awards granted prior to February 2008 are considered participating securities as they received non-forfeitable rights to dividends at the same rate as common stock. As participating securities, the Company is required to include these instruments in the calculation of basic earnings per share ( EPS ), and needs to calculate basic EPS using the two-class method described in FAS No. 128, *Earnings per Share*.

Prior to adoption of the FSP, restricted stock was included in our dilutive EPS calculation using the treasury stock method. The two-class method of computing EPS is an earnings allocation formula that determines EPS for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Basic EPS is then calculated by dividing net (loss) income available to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted EPS adjusts basic (loss) earnings per share for the effects of restricted stock, stock options and other potentially dilutive financial instruments ( dilutive securities ), only in the periods in which such effect is dilutive. The dilutive effect of the dilutive securities is reflected in diluted EPS by application of the more dilutive of (1) the treasury stock method or (2) the two-class method assuming nonvested shares are not converted into common shares. The FSP requires the presentation of basic and diluted EPS for each class of common stock. The Company has a single class of common stock. Therefore, the following EPS amounts only pertain to common stock. Pursuant to the FSP, all prior period EPS data were adjusted retrospectively. The impact of adopting the FSP increased previously reported basic EPS by \$0.02 and previously reported diluted EPS by \$0.02 for the three months ended March 31, 2008.



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The following table sets forth the computation of basic and diluted earnings per share:

|   | <b>Three Months Ended March 31,</b>                                |              |
|---|--|--------------|
|   | <b>2009</b>  | <b>2008</b>  |
|   | <b>(in thousands of U.S. dollars<br/>except per share amounts)</b> |              |
| Net income (loss)   | \$ 85,489  | \$ (169,209) |
| Less: Distributed and undistributed income (loss) available to nonvested shareholders | 501  | (2,131)      |
| Distributed and undistributed income (loss) available to common shareholders          | \$ 84,988  | \$ (167,078) |
| Basic shares  | 90,811   | 80,044       |
| Effect of dilutive securities:  |  |              |
| Options and restricted stock awards   | 364  |              |
| Diluted shares  | 91,175   | 80,044       |
| Basic EPS   | \$ 0.94  | \$ (2.09)    |
| Diluted EPS   | \$ 0.93  | \$ (2.09)    |

Potentially dilutive securities representing approximately 4.8 million and 5.4 million shares of common stock for the three months ended March 31, 2009 and 2008, respectively, were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive.

**13. Income Taxes**

As of both March 31, 2009 and December 31, 2008, Assured Guaranty Re Overseas Ltd. ( AGRO ) had a stand alone NOL of \$47.9 million, which is available to offset its future U.S. taxable income. The Company has \$27.2 million of this NOL available through 2017 and \$20.7 million available through 2023. AGRO's stand alone NOL is not permitted to offset the income of any other members of AGRO's consolidated group due to certain tax regulations. Assured Guaranty Mortgage Insurance Company ( AGMIC ) is a member of the same consolidated tax group as AGRO. In First Quarter 2009 AGMIC had a projected NOL of \$9.6 million which would be available through 2020.

Under applicable accounting rules, the Company is required to establish a valuation allowance for NOLs that are more likely than not to expire before being utilized. Management has assessed the likelihood of realization of all of its deferred tax assets. Based on this analysis, management believes it is more likely than not that \$20.0 million of AGRO's \$47.9 million NOL will not be utilized before it expires and has established a \$7.0 million valuation allowance related to the NOL deferred tax asset. In addition, management believes it is more likely than not that AGMIC's NOL will not be utilized before it expires and has established a \$3.4 million valuation allowance related to the NOL deferred tax asset. Management believes that all other deferred income taxes are more-likely-than-not to be realized. The valuation allowance is subject to considerable judgment, is reviewed quarterly and will be adjusted to the extent actual taxable income differs from estimates of future taxable income that may be used to realize NOLs or capital losses.

***Liability For Tax Basis Step-Up Adjustment***



In connection with the IPO, the Company and ACE Financial Services Inc. ( AFS ), a subsidiary of ACE, entered into a tax allocation agreement, whereby the Company and AFS made a Section 338 (h)(10) election that has the effect of increasing the tax basis of certain affected subsidiaries tangible and intangible assets to fair value. Future tax benefits that the Company derives from the election will be payable to AFS when realized by the Company.

As a result of the election, the Company has adjusted its net deferred tax liability to reflect the new tax basis of the Company s affected assets. The additional basis is expected to result in increased future income tax deductions and, accordingly, may reduce income taxes otherwise payable by the Company. Any tax benefit realized by the Company will be paid to AFS. Such tax benefits will generally be calculated by comparing the Company s

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affected subsidiaries' actual taxes to the taxes that would have been owed by those subsidiaries had the increase in basis not occurred. After a 15 year period, to the extent there remains an unrealized tax benefit, the Company and AFS will negotiate a settlement of the unrealized benefit based on the expected realization at that time.

The Company initially recorded a \$49.0 million reduction of its existing deferred tax liability, based on an estimate of the ultimate resolution of the Section 338(h)(10) election. Under the tax allocation agreement, the Company estimated that, as of the IPO date, it was obligated to pay \$20.9 million to AFS and accordingly established this amount as a liability. The initial difference, which is attributable to the change in the tax basis of certain liabilities for which there is no associated step-up in the tax basis of its assets and no amounts due to AFS, resulted in an increase to additional paid-in capital of \$28.1 million. As of March 31, 2009 and December 31, 2008, the liability for tax basis step-up adjustment, which is included in the Company's balance sheets in "Other liabilities," was \$9.0 million and \$9.1 million, respectively. The Company has paid ACE and correspondingly reduced its liability by \$0.2 million and \$0.2 million in First Quarter 2009 and First Quarter 2008, respectively.

*Tax Treatment of CDS*

The Company treats the guaranty it provides on CDS as insurance contracts for tax purposes and as such a taxable loss does not occur until the Company expects to make a loss payment to the buyer of credit protection based upon the occurrence of one or more specified credit events with respect to the contractually referenced obligation or entity. The Company holds its CDS to maturity, at which time any unrealized mark to market loss would revert to zero absent any credit related losses. As of March 31, 2009, the Company did not anticipate any significant credit related losses on its credit default swaps and, therefore, no resultant tax deductions.

The tax treatment of CDS is an unsettled area of the law. The uncertainty relates to the IRS's determination of the income or potential loss associated with CDS as either subject to capital gain (loss) or ordinary income (loss) treatment. In treating CDS as insurance contracts the Company treats both the receipt of premium and payment of losses as ordinary income and believes it is more likely than not that any CDS credit related losses will be treated as ordinary by the IRS. To the extent the IRS takes the view that the losses are capital losses in the future and the Company incurred actual losses associated with the CDS the Company would need sufficient taxable income of the same character within the carryback and carryforward period available under the tax law.

As of March 31, 2009 and December 31, 2008 the deferred tax assets associated with CDS were \$124.0 million and \$116.5 million, respectively. The Company came to the conclusion that it is more likely than not that its deferred tax asset related to CDS will be fully realized after weighing all positive and negative evidence available as required under FAS 109. The evidence that was considered included the following:

Negative Evidence

- Although the Company believes that income or losses for these credit default swaps are properly characterized for tax purposes as ordinary, the federal tax treatment is an unsettled area of tax law as described above.
- Changes in the fair value of CDS have resulted in significant swings in the Company's net income in recent periods. Changes in the fair value of CDS in future periods could result in the U.S. consolidated tax group having a pre-tax loss under GAAP. Although not recognized for tax, this loss could result in a cumulative three year pre-tax loss, which is considered significant negative evidence for the recoverability of a

deferred tax asset under FAS 109.

- For the three year period ended March 31, 2009 the US consolidated tax group had a pre-tax loss under GAAP of \$103.9 million.

Positive Evidence

- The mark to market loss on CDS is not considered a tax event, and therefore no taxable loss has occurred.
- The Company is in a cumulative net gain position related to the taxable activity on CDS contracts.
- The Company has no significant anticipated loss payments under its existing CDS contracts.
- After analysis of the current tax law on CDS the Company believes it is more likely than not that the CDS will be treated as ordinary income or loss for tax purposes.
- Assuming a hypothetical loss were triggered for the amount of deferred tax asset ( DTA ), there would be enough taxable income through carryback and future income to offset it as follows:

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- The amortization of the tax-basis unearned premium reserve of \$599.6 million as of March 31, 2009 as well as the collection of future installment premiums of contracts already written we believe will result in significant taxable income in the future.
- The Company has the ability to carryback losses two years which would offset over \$22.8 million of losses as of March 31, 2009.
- Although the Company has a significant tax exempt portfolio, this can be converted to taxable securities as permitted as a tax planning strategy under FAS 109.
- The mark-to-market loss is reflective of market valuations and will change from quarter to quarter. It is not indicative of the Company's ability to enter new business. The Company writes and continues to write new business which will increase the amortization of unearned premium and investment portfolio resulting in expected taxable income in future periods.

After examining all of the available positive and negative evidence, the Company believes that no valuation allowance is necessary in connection with the deferred tax asset. The Company will continue to analyze the need for a valuation allowance on a quarter to quarter basis.

**14. Segment Reporting**

The Company has four principal business segments: (1) financial guaranty direct, which includes transactions whereby the Company provides an unconditional and irrevocable guaranty that indemnifies the holder of a financial obligation against non-payment of principal and interest when due, and could take the form of a credit derivative; (2) financial guaranty reinsurance, which includes agreements whereby the Company is a reinsurer and agrees to indemnify a primary insurance company against part or all of the loss which the latter may sustain under a policy it has issued; (3) mortgage guaranty, which includes mortgage guaranty insurance and reinsurance whereby the Company provides protection against the default of borrowers on mortgage loans; and (4) other, which includes lines of business in which the Company is no longer active.

The Company does not segregate assets and liabilities at a segment level since management reviews and controls these assets and liabilities on a consolidated basis. The Company allocates operating expenses to each segment based on a comprehensive cost study and is based on departmental time estimates and headcount.

Management uses underwriting gains and losses as the primary measure of each segment's financial performance. Underwriting gain is calculated as net earned premiums plus realized gains and other settlements on credit derivatives, less the sum of loss and loss adjustment expenses (recoveries) including incurred losses on credit derivatives, profit commission expense, acquisition costs and other operating expenses that are directly related to the operations of the Company's insurance businesses. This measure excludes certain revenue and expense items, such as net investment income, realized investment gains and losses, unrealized losses on credit derivatives, other income, and interest and other expenses, that are not directly related to the underwriting performance of the Company's insurance operations, but are included in net income.

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The following tables summarize the components of underwriting gain (loss) for each reporting segment:

|   | Three Months Ended March 31, 2009 |                                      |                      |       | Total    |
|---|-----------------------------------|--------------------------------------|----------------------|-------|----------|
|   | Financial<br>Guaranty<br>Direct   | Financial<br>Guaranty<br>Reinsurance | Mortgage<br>Guaranty | Other |          |
|   | (in millions of U.S. dollars)     |                                      |                      |       |          |
| Net earned premiums                                       | \$ 101.5                          | \$ 46.2                              | \$ 0.8               | \$    | \$ 148.4 |
| Realized gain and other settlements on credit derivatives | 20.0                              | 0.6                                  |                      |       | 20.6     |
| Loss and loss adjustment expenses                         | 11.7                              | 36.8                                 | 31.2                 |       | 79.8     |
| Incurred losses (gains) on credit derivatives             | (7.3)                             | (0.7)                                |                      |       | (8.1)    |
| Total loss and loss adjustment expenses                   | 4.4                               | 36.1                                 | 31.2                 |       | 71.7     |
| Profit commission expense                                 |                                   | 0.2                                  | 0.1                  |       | 0.3      |
| Acquisition costs   | 6.2                               | 17.1                                 | 0.1                  |       | 23.4     |
| Other operating expenses                                  | 24.0                              | 7.6                                  | 0.7                  |       | 32.3     |
| Underwriting gain (loss)                                  | \$ 87.0                           | \$ (14.2)                            | \$ (31.3)            | \$    | \$ 41.5  |

|   | Three Months Ended March 31, 2008 |                                      |                      |       | Total     |
|---|-----------------------------------|--------------------------------------|----------------------|-------|-----------|
|   | Financial<br>Guaranty<br>Direct   | Financial<br>Guaranty<br>Reinsurance | Mortgage<br>Guaranty | Other |           |
|   | (in millions of U.S. dollars)     |                                      |                      |       |           |
| Net earned premiums                                       | \$ 17.3                           | \$ 27.8                              | \$ 1.9               | \$    | \$ 46.8   |
| Realized gain and other settlements on credit derivatives | 27.3                              | 0.3                                  |                      |       | 27.6      |
| Loss and loss adjustment expenses (recoveries)            | 35.9                              | 19.2                                 |                      |       | 55.1      |
| Incurred losses on credit derivatives                     | 3.2                               |                                      |                      |       | 3.2       |
| Total loss and loss adjustment expenses (recoveries)      | 39.1                              | 19.2                                 |                      |       | 58.3      |
| Profit commission expense                                 |                                   | 1.1                                  | 0.1                  |       | 1.2       |
| Acquisition costs   | 3.0                               | 8.8                                  | 0.1                  |       | 11.9      |
| Other operating expenses                                  | 21.3                              | 6.4                                  | 0.9                  |       | 28.6      |
| Underwriting (loss) gain                                  | \$ (18.9)                         | \$ (7.3)                             | \$ 0.8               | \$    | \$ (25.4) |

The following is a reconciliation of total underwriting (loss) gain to (loss) income before provision for income taxes for the periods ended:

|                                | Three Months Ended<br>March 31, |           |
|--------------------------------|---------------------------------|-----------|
|                                | 2009                            | 2008      |
|                                | (in millions of U.S. dollars)   |           |
| Total underwriting gain (loss) | \$ 41.5                         | \$ (25.4) |
| Net investment income          | 43.6                            | 36.6      |

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|  |          |            |
|--|----------|------------|
| Net realized investment (losses) gains   | (17.1)   | 0.6        |
| Unrealized gains (losses) on credit derivatives, excluding incurred losses on credit derivatives | 18.8     | (256.4)    |
| Other income   | 20.6     | 8.5        |
| Interest expense   | (5.8)    | (5.8)      |
| Other expense  | (1.4)    | (0.7)      |
| Income (loss) before provision for income taxes  | \$ 100.1 | \$ (242.8) |

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The following table provides the lines of businesses from which each of the Company's segments derive their net earned premiums:

|   | <b>Three Months Ended</b>            |                |
|---|--------------------------------------|----------------|
|   | <b>March 31,</b>                     |                |
|   | <b>2009</b>                          | <b>2008</b>    |
|   | <b>(in millions of U.S. dollars)</b> |                |
| <b>Financial guaranty direct:</b>   |                                      |                |
| Public finance  | \$ 85.5                              | \$ 4.1         |
| Structured finance  | 16.0                                 | 13.2           |
| <b>Total</b>  | <b>101.5</b>                         | <b>17.3</b>    |
| <b>Financial guaranty reinsurance:</b>  |                                      |                |
| Public finance  | 34.8                                 | 18.6           |
| Structured finance  | 11.4                                 | 9.2            |
| <b>Total</b>  | <b>46.2</b>                          | <b>27.8</b>    |
| <b>Mortgage guaranty:</b>   |                                      |                |
| Mortgage guaranty   | 0.8                                  | 1.9            |
| <b>Total net earned premiums</b>  | <b>148.4</b>                         | <b>46.8</b>    |
| <b>Net credit derivative premiums received and receivable</b>                           | <b>29.5</b>                          | <b>27.8</b>    |
| <b>Total net earned premiums and credit derivative premiums received and receivable</b> | <b>\$ 178.0</b>                      | <b>\$ 74.7</b> |

The other segment had an underwriting gain of \$0 million for both First Quarter 2009 and First Quarter 2008.

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The following tables present the unaudited condensed consolidated financial information for Assured Guaranty Ltd., Assured Guaranty US Holdings Inc., of which AGC is a subsidiary and other subsidiaries of Assured Guaranty Ltd. as of March 31, 2009 and December 31, 2008 and for the three months ended March 31, 2009 and 2008.

## CONDENSED CONSOLIDATING BALANCE SHEET

AS OF MARCH 31, 2009

(in thousands of U. S. dollars)

|  | Assured<br>Guaranty Ltd.<br>(Parent<br>Company) | Assured<br>Guaranty US<br>Holdings Inc. | AG Re and<br>Other<br>Subsidiaries | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|--|---|---|------------------------------------|------------------------------|--|
| <b>Assets</b>  |   |   |                                    |                              |  |
| Total investments and cash                           | \$ 4,419  | \$ 1,799,467                            | \$ 2,008,454                       | \$                           | \$ 3,812,340                               |
| Investment in subsidiaries                           | 2,003,499                                       |   |                                    | (2,003,499)                  |  |
| Deferred acquisition costs                           |   | 55,804                                  | 326,721                            |                              | 382,525                                    |
| Reinsurance recoverable                              |   | 21,407                                  | 2,472                              | (16,116)                     | 7,763                                      |
| Goodwill   |   | 85,417                                  |                                    |                              | 85,417                                     |
| Credit derivative assets                             |   | 121,321                                 | 28,477                             |                              | 149,798                                    |
| Premiums receivable                                  |   | 419,250                                 | 475,303                            | (146,139)                    | 748,414                                    |
| Deferred tax asset                                   |   | 101,595                                 | 15,965                             |                              | 117,560                                    |
| Other  | 22,598  | 584,873                                 | 62,075                             | (385,035)                    | 284,511                                    |
| <b>Total assets</b>                                  | <b>\$ 2,030,516</b>                             | <b>\$ 3,189,134</b>                     | <b>\$ 2,919,467</b>                | <b>\$ (2,550,789)</b>        | <b>\$ 5,588,328</b>                        |
| <b>Liabilities and shareholders equity</b>           |   |   |                                    |                              |  |
| <b>Liabilities</b>                                   |   |   |                                    |                              |  |
| Unearned premium reserves                            | \$  | \$ 1,202,038                            | \$ 1,291,100                       | \$ (339,826)                 | \$ 2,153,312                               |
| Reserves for losses and loss<br>adjustment expenses  |   | 143,633                                 | 122,799                            | (43,877)                     | 222,555                                    |
| Profit commissions payable                           |   | 3,971                                   | 3,780                              |                              | 7,751                                      |
| Credit derivative liabilities                        |   | 497,401                                 | 209,367                            |                              | 706,768                                    |
| Senior Notes   |   | 197,452                                 |                                    |                              | 197,452                                    |
| Series A Enhanced Junior<br>Subordinated Debentures  |   | 149,774                                 |                                    |                              | 149,774                                    |
| Other  | 4,923   | 234,145                                 | 49,642                             | (163,587)                    | 125,123                                    |
| <b>Total liabilities</b>                             | <b>4,923</b>                                    | <b>2,428,414</b>                        | <b>1,676,688</b>                   | <b>(547,290)</b>             | <b>3,562,735</b>                           |
| <b>Total shareholders equity</b>                     | <b>2,025,593</b>                                | <b>760,720</b>                          | <b>1,242,779</b>                   | <b>(2,003,499)</b>           | <b>2,025,593</b>                           |
| <b>Total liabilities and shareholders<br/>equity</b> | <b>\$ 2,030,516</b>                             | <b>\$ 3,189,134</b>                     | <b>\$ 2,919,467</b>                | <b>\$ (2,550,789)</b>        | <b>\$ 5,588,328</b>                        |





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CONDENSED CONSOLIDATING BALANCE SHEET

AS OF DECEMBER 31, 2008

(in thousands of U. S. dollars)

|  | Assured<br>Guaranty Ltd.<br>(Parent<br>Company) | Assured<br>Guaranty US<br>Holdings Inc. | AG Re and<br>Other<br>Subsidiaries | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|--|---|---|------------------------------------|------------------------------|--|
| <b>Assets</b>  |   |   |                                    |                              |  |
| Total investments and cash                           | \$ 188  | \$ 1,651,761                            | \$ 1,991,690                       | \$                           | \$ 3,643,639                               |
| Investment in subsidiaries                           | 1,901,108                                       |   |                                    | (1,901,108)                  |  |
| Deferred acquisition costs                           |   | 78,987                                  | 209,629                            |                              | 288,616                                    |
| Reinsurance recoverable                              |   | 22,014                                  | 3,474                              | (18,960)                     | 6,528                                      |
| Goodwill   |   | 85,417                                  |                                    |                              | 85,417                                     |
| Credit derivative assets                             |   | 125,082                                 | 21,877                             |                              | 146,959                                    |
| Premiums receivable                                  |   | 6,659                                   | 23,559                             | (14,475)                     | 15,743                                     |
| Deferred tax asset                                   |   | 109,565                                 | 19,553                             |                              | 129,118                                    |
| Other  | 29,427  | 383,272                                 | 49,502                             | (222,514)                    | 239,687                                    |
| <b>Total assets</b>                                  | <b>\$ 1,930,723</b>                             | <b>\$ 2,462,757</b>                     | <b>\$ 2,319,284</b>                | <b>\$ (2,157,057)</b>        | <b>\$ 4,555,707</b>                        |
| <b>Liabilities and shareholders equity</b>           |   |   |                                    |                              |  |
| <b>Liabilities</b>                                   |   |   |                                    |                              |  |
| Unearned premium reserves                            | \$  | \$ 707,957                              | \$ 713,948                         | \$ (188,191)                 | \$ 1,233,714                               |
| Reserves for losses and loss<br>adjustment expenses  |   | 133,710                                 | 90,752                             | (27,664)                     | 196,798                                    |
| Profit commissions payable                           |   | 3,971                                   | 4,613                              |                              | 8,584                                      |
| Credit derivative liabilities                        |   | 481,253                                 | 252,513                            |                              | 733,766                                    |
| Senior Notes   |   | 197,443                                 |                                    |                              | 197,443                                    |
| Series A Enhanced Junior<br>Subordinated Debentures  |   | 149,767                                 |                                    |                              | 149,767                                    |
| Other  | 4,501   | 82,024                                  | 62,982                             | (40,094)                     | 109,413                                    |
| <b>Total liabilities</b>                             | <b>4,501</b>                                    | <b>1,756,125</b>                        | <b>1,124,808</b>                   | <b>(255,949)</b>             | <b>2,629,485</b>                           |
| <b>Total shareholders equity</b>                     | <b>1,926,222</b>                                | <b>706,632</b>                          | <b>1,194,476</b>                   | <b>(1,901,108)</b>           | <b>1,926,222</b>                           |
| <b>Total liabilities and shareholders<br/>equity</b> | <b>\$ 1,930,723</b>                             | <b>\$ 2,462,757</b>                     | <b>\$ 2,319,284</b>                | <b>\$ (2,157,057)</b>        | <b>\$ 4,555,707</b>                        |

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CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

FOR THE THREE MONTHS ENDED MARCH 31, 2009

(in thousands of U. S. dollars)

|   | Assured<br>Guaranty Ltd.<br>(Parent<br>Company) | Assured<br>Guaranty US<br>Holdings Inc. | AG Re and<br>Other<br>Subsidiaries | Consolidating<br>Adjustments* | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|---|---|---|------------------------------------|-------------------------------|--|
| <b>Revenues</b>   |   |   |                                    |                               |  |
| Net earned premiums                                       | \$  | \$ 67,725                               | \$ 80,721                          | \$                            | \$ 148,446                                 |
| Net investment income                                     | 1   | 19,313                                  | 24,367                             | (80)                          | 43,601                                     |
| Net realized investment gains (losses)                    |   | 238                                     | (17,348)                           |                               | (17,110)                                   |
| Change in fair value of credit derivatives                |   |   |                                    |                               |  |
| Realized gain and other settlements on credit derivatives |   | 24,363                                  | (3,763)                            | (21)                          | 20,579                                     |
| Unrealized losses on credit derivatives                   |   | (23,147)                                | 50,108                             | 21                            | 26,982                                     |
| Net change in fair value of credit derivatives            |   | 1,216                                   | 46,345                             |                               | 47,561                                     |
| Equity in earnings of subsidiaries                        | 96,726  |   |                                    | (96,726)                      |  |
| Other income  |   | 20,809                                  |                                    | (241)                         | 20,568                                     |
| <b>Total revenues</b>                                     | <b>96,727</b>                                   | <b>109,301</b>                          | <b>134,085</b>                     | <b>(97,047)</b>               | <b>243,066</b>                             |
| <b>Expenses</b>   |   |   |                                    |                               |  |
| Loss and loss adjustment expenses                         |   | 21,382                                  | 58,372                             |                               | 79,754                                     |
| Acquisition costs and other operating expenses            | 11,238  | 16,238                                  | 28,518                             |                               | 55,994                                     |
| Other   |   | 7,221                                   |                                    |                               | 7,221                                      |
| <b>Total expenses</b>                                     | <b>11,238</b>                                   | <b>44,841</b>                           | <b>86,890</b>                      |                               | <b>142,969</b>                             |
| (Loss) income before (benefit) provision for income taxes | 85,489  | 64,460                                  | 47,195                             | (97,047)                      | 100,097                                    |
| Total (benefit) provision for income taxes                |   | 18,781                                  | (4,173)                            |                               | 14,608                                     |
| <b>Net (loss) income</b>                                  | <b>\$ 85,489</b>                                | <b>\$ 45,679</b>                        | <b>\$ 51,368</b>                   | <b>\$ (97,047)</b>            | <b>\$ 85,489</b>                           |

\* Due to the accounting for subsidiaries under common control, net income in the consolidating adjustment column does not equal parent company equity in earnings of subsidiaries, due to 1) recognition of income by Assured Guaranty US Holdings Inc. for dividends received from Assured Guaranty Ltd. and 2) the residual effects of the FSA agreement.



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## CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

FOR THE THREE MONTHS ENDED MARCH 31, 2008

(in thousands of U. S. dollars)

|  | Assured<br>Guaranty Ltd.<br>(Parent<br>Company) | Assured<br>Guaranty US<br>Holdings Inc. | AG Re and<br>Other<br>Subsidiaries | Consolidating<br>Adjustments* | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|--|---|---|------------------------------------|-------------------------------|--|
| <b>Revenues</b>  |   |   |                                    |                               |  |
| Net earned premiums  | \$  | \$ 16,034                               | \$ 30,799                          | \$                            | \$ 46,833                                  |
| Net investment income  | 7   | 16,250                                  | 20,313                             | 4                             | 36,574                                     |
| Net realized investment gains<br>(losses)                    |   | 667                                     | (40)                               |                               | 627  |
| Change in fair value of credit<br>derivatives                |   |   |                                    |                               |  |
| Realized gain and other settlements<br>on credit derivatives |   | 21,881                                  | 5,736                              |                               | 27,617                                     |
| Unrealized losses on credit<br>derivatives                   |   | (216,387)                               | (43,234)                           |                               | (259,621)                                  |
| Net change in fair value of credit<br>derivatives            |   | (194,506)                               | (37,498)                           |                               | (232,004)                                  |
| Equity in earnings of subsidiaries                           | (160,678)                                       |   |                                    | 160,678                       |  |
| Other income   |   | 8,777                                   |                                    | (241)                         | 8,536                                      |
| Total revenues   | (160,671)                                       | (152,778)                               | 13,574                             | 160,441                       | (139,434)                                  |
| <b>Expenses</b>  |   |   |                                    |                               |  |
| Loss and loss adjustment expenses                            |   | 23,525                                  | 31,613                             |                               | 55,138                                     |
| Acquisition costs and other operating<br>expenses            | 8,538   | 19,782                                  | 13,381                             |                               | 41,701                                     |
| Other  |   | 6,556                                   |                                    |                               | 6,556                                      |
| Total expenses   | 8,538   | 49,863                                  | 44,994                             |                               | 103,395                                    |
| (Loss) income before (benefit)<br>provision for income taxes | (169,209)                                       | (202,641)                               | (31,420)                           | 160,441                       | (242,829)                                  |
| Total (benefit) provision for income<br>taxes                |   | (74,340)                                | 720                                |                               | (73,620)                                   |
| Net (loss) income  | \$ (169,209)                                    | \$ (128,301)                            | \$ (32,140)                        | \$ 160,441                    | \$ (169,209)                               |

\* Due to the accounting for subsidiaries under common control, net income in the consolidating adjustment column does not equal parent company equity in earnings of subsidiaries, due to 1) recognition of income by Assured Guaranty US Holdings Inc. for dividends received from Assured Guaranty Ltd. and 2) the residual effects of the FSA agreement.



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## CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2009

(in thousands of U. S. dollars)

|  | Assured<br>Guaranty Ltd.<br>(Parent<br>Company) | Assured<br>Guaranty US<br>Holdings Inc. | AG Re and<br>Other<br>Subsidiaries | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|--|---|---|------------------------------------|------------------------------|--|
| Dividends received   | \$ 16,576                                       | \$ 241                                  | \$                                 | \$ (16,817)                  | \$   |
| Other operating activities                                       | (3,364)   | 123,162                                 | 47,219                             |                              | 167,017                                    |
| <b>Net cash flows provided by (used in) operating activities</b> | <b>13,212</b>                                   | <b>123,403</b>                          | <b>47,219</b>                      | <b>(16,817)</b>              | <b>167,017</b>                             |
| <b>Cash flows from investing activities</b>                      |   |   |                                    |                              |  |
| Fixed maturity securities:                                       |   |   |                                    |                              |  |
| Purchases  |   | (140,300)                               | (148,919)                          |                              | (289,219)                                  |
| Sales  |   | 135,380                                 | 138,880                            |                              | 274,260                                    |
| Maturities   |   |   | 3,500                              |                              | 3,500                                      |
| Purchases of short-term investments, net                         | (4,231)   | (111,330)                               | (24,061)                           |                              | (139,622)                                  |
| <b>Net cash flows used in investing activities</b>               | <b>(4,231)</b>                                  | <b>(116,250)</b>                        | <b>(30,600)</b>                    |                              | <b>(151,081)</b>                           |
| <b>Cash flows from financing activities</b>                      |   |   |                                    |                              |  |
| Dividends paid   | (4,363)   |   | (16,576)                           | 16,817                       | (4,122)                                    |
| Repurchases of common stock                                      | (3,676)   |   |                                    |                              | (3,676)                                    |
| Share activity under option and incentive plans                  | (942)   |   |                                    |                              | (942)                                      |
| <b>Net cash flows used in financing activities</b>               | <b>(8,981)</b>                                  |   | <b>(16,576)</b>                    | <b>16,817</b>                | <b>(8,740)</b>                             |
| Effect of exchange rate changes                                  |   | (142)                                   | (31)                               |                              | (173)                                      |
| Increase in cash and cash equivalents                            |   | 7,011                                   | 12                                 |                              | 7,023                                      |
| Cash and cash equivalents at beginning of period                 |   | 10,226                                  | 2,079                              |                              | 12,305                                     |
| <b>Cash and cash equivalents at end of period</b>                | <b>\$</b>                                       | <b>\$ 17,237</b>                        | <b>\$ 2,091</b>                    | <b>\$</b>                    | <b>\$ 19,328</b>                           |

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## CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2008

(in thousands of U. S. dollars)

|  | Assured<br>Guaranty Ltd.<br>(Parent<br>Company) | Assured<br>Guaranty US<br>Holdings Inc. | AG Re and<br>Other<br>Subsidiaries | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|--|---|---|------------------------------------|------------------------------|--|
| Dividends received   | \$  | \$ 241                                  | \$                                 | \$ (241)                     | \$   |
| Other operating activities                                       | 10,272  | 114,214                                 | 24,559                             |                              | 149,045                                    |
| <b>Net cash flows provided by (used in) operating activities</b> | <b>10,272</b>                                   | <b>114,455</b>                          | <b>24,559</b>                      | <b>(241)</b>                 | <b>149,045</b>                             |
| <b>Cash flows from investing activities</b>                      |   |   |                                    |                              |  |
| Fixed maturity securities:                                       |   |   |                                    |                              |  |
| Purchases  |   | (77,831)                                | (248,373)                          |                              | (326,204)                                  |
| Sales  |   | 59,039                                  | 59,353                             |                              | 118,392                                    |
| Maturities   |   |   | 3,250                              |                              | 3,250                                      |
| (Purchases) sales of short-term investments, net                 | (3,693)   | (95,814)                                | 161,649                            |                              | 62,142                                     |
| <b>Net cash flows used in investing activities</b>               | <b>(3,693)</b>                                  | <b>(114,606)</b>                        | <b>(24,121)</b>                    |                              | <b>(142,420)</b>                           |
| <b>Cash flows from financing activities</b>                      |   |   |                                    |                              |  |
| Dividends paid   | (3,888)   |   |                                    | 241                          | (3,647)                                    |
| Share activity under option and incentive plans                  | (2,262)   |   |                                    |                              | (2,262)                                    |
| Offering costs   | (429)   |   |                                    |                              | (429)                                      |
| <b>Net cash flows used in financing activities</b>               | <b>(6,579)</b>                                  |   |                                    | <b>241</b>                   | <b>(6,338)</b>                             |
| Effect of exchange rate changes                                  |   | 29                                      | 14                                 |                              | 43   |
| (Decrease) increase in cash and cash equivalents                 |   | (122)                                   | 452                                |                              | 330  |
| Cash and cash equivalents at beginning of period                 |   | 5,688                                   | 2,360                              |                              | 8,048                                      |
| <b>Cash and cash equivalents at end of period</b>                | <b>\$</b>                                       | <b>\$ 5,566</b>                         | <b>\$ 2,812</b>                    | <b>\$</b>                    | <b>\$ 8,378</b>                            |



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**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 Assured Guaranty Ltd. (hereafter Assured Guaranty, we, our or the Company) expectations or forecasts of future events. You can identify these statements 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 may turn out to be wrong and are based on current expectations and the current economic environment. Assured Guaranty's actual results may vary materially. Among factors that could cause actual results to differ materially are: (1) downgrades of the financial strength ratings assigned by the major rating agencies to any of our insurance subsidiaries at any time, which has occurred in the past; (2) downgrades of the transactions we insure; (3) our inability to execute our business strategy; (4) reduction in the amount of reinsurance facultative cessions or portfolio opportunities available to us; (5) contract cancellations; (6) developments in the world's financial and capital markets that adversely affect our loss experience, the demand for our products, our access to capital, our unrealized (losses) gains on derivative financial instruments or our investment returns; (7) more severe or frequent losses associated with our insurance products, or changes in our assumptions used to estimate loss reserves and unrealized (losses) gains on derivative financial instruments; (8) changes in regulation or tax laws applicable to us, our subsidiaries or customers; (9) governmental actions; (10) natural or man-made catastrophes; (11) dependence on customers; (12) decreased demand for our insurance or reinsurance products or increased competition in our markets; (13) loss of key personnel; (14) technological developments; (15) the effects of mergers, acquisitions and divestitures; (16) changes in accounting policies or practices; (17) changes in the credit markets, segments thereof or general economic conditions, including the overall level of activity in the economy or particular sectors, interest rates, credit spreads and other factors; (18) other risks and uncertainties that have not been identified at this time; and (19) management's response to these factors. Assured Guaranty is not obligated to publicly correct or update any forward-looking statement if we later become aware that it is not likely to be achieved, except as required by law. You are advised, however, to consult any further disclosures we make on related subjects in our periodic reports filed with the Securities and Exchange Commission.

**Executive Summary**

Assured Guaranty Ltd. is a Bermuda based holding company which provides, through its operating subsidiaries, credit enhancement products to the public finance, structured finance and mortgage markets. We apply our credit expertise, risk management skills and capital markets experience to develop insurance, reinsurance and credit derivative products that meet the credit enhancement needs of our customers. We market our products directly and through financial institutions. We serve the U.S. and international markets.

Our insurance company subsidiaries have been assigned the following insurance financial strength ratings as of the date of this filing. These ratings are subject to continuous review.

|                                   | <b>Moody's</b> | <b>S&amp;P</b>        | <b>Fitch</b>     |
|-----------------------------------|----------------|-----------------------|------------------|
| Assured Guaranty Corp.            | Aa2(Excellent) | AAA(Extremely Strong) | AA(Very Strong)  |
| Assured Guaranty Re Ltd.          | Aa3(Excellent) | AA(Very Strong)       | AA-(Very Strong) |
| Assured Guaranty Re Overseas Ltd. | Aa3(Excellent) | AA(Very Strong)       | AA-(Very Strong) |
| Assured Guaranty Mortgage         | Aa3(Excellent) | AA(Very Strong)       | AA-(Very Strong) |
| Assured Guaranty (UK) Ltd         | Aa2(Excellent) | AAA(Extremely Strong) | AA(Very Strong)  |

Aaa (Exceptional) is the highest ranking, which Assured Guaranty Corp. (AGC) and Assured Guaranty (UK) Ltd. achieved in July 2007, and Aa2 (Excellent) is the third highest ranking of 21 ratings categories used by Moody's Investors Service (Moody's). A AAA (Extremely Strong) rating is the highest ranking and AA (Very Strong) is the third highest ranking of the 21 ratings categories used by Standard & Poor's Inc. (S&P). AAA (Extremely Strong) is the highest ranking and AA (Very Strong) is the third highest ranking of the 24 ratings categories used by Fitch

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Ratings ( Fitch ). An insurance financial strength rating is an opinion with respect to an insurer 's ability to pay under its insurance policies and contracts in accordance with their terms. The opinion is not specific to any particular policy or contract. Insurance financial strength ratings do not refer to an insurer 's

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ability to meet non insurance obligations and are not a recommendation to purchase or discontinue any policy or contract issued by an insurer or to buy, hold, or sell any security issued by an insurer, including our common shares.

On November 21, 2008, Moody's downgraded the insurance financial strength ratings of Assured Guaranty Corp. ( AGC ) and its wholly owned subsidiary, Assured Guaranty (UK) Ltd., to Aa2 from Aaa and also downgraded the insurance financial strength ratings of Assured Guaranty Re Ltd. ( AG Re ) and its affiliated insurance operating companies to Aa3 from Aa2. In the same rating action, Moody's downgraded the senior unsecured rating of Assured Guaranty US Holdings Inc. and the issuer rating of the ultimate holding company, Assured Guaranty Ltd. to A2 from Aa3.

On May 4, 2009, Fitch Ratings Inc. ( Fitch ) downgraded the debt and insurer financial strength ratings of Assured Guaranty Ltd. and its subsidiaries. Fitch's insurer financial strength ratings for Assured Guaranty Corp. and Assured Guaranty (UK) Ltd., the Company's principal financial guaranty direct subsidiaries, are now AA (rating watch evolving), down from AAA (stable) while the insurer financial strength ratings for Assured Guaranty Re Ltd. ( AG Re ), the Company's principal financial guaranty reinsurance company, are rated AA- (rating watch evolving), down from AA (stable). Fitch's ratings on Assured Guaranty Ltd.'s \$200 million of 7.0% senior notes due 2034 are now A, down from A+ and their ratings on Assured Guaranty Ltd.'s \$150 million series A enhanced junior subordinated debentures are now rated A-, down from A.

If the ratings of any of our insurance subsidiaries were reduced below current levels, we expect it would have an adverse effect on our subsidiary's competitive position and its prospects for future business opportunities. A downgrade may also reduce the value of the reinsurance we offer, which may no longer be of sufficient economic value for our customers to continue to cede to our subsidiaries at economically viable rates.

With respect to a significant portion of our in-force financial guaranty reinsurance business, in the event that AG Re were downgraded from Aa3 to A1, subject to the terms of each reinsurance agreement, the ceding company may have the right to recapture business ceded to AG Re and assets representing substantially all of the statutory unearned premium and loss reserves (if any) associated with that business. As of March 31, 2009, the statutory unearned premium, which represents deferred revenue to the Company, subject to recapture is approximately \$170 million. If this entire amount was recaptured, it would result in a corresponding one-time reduction to net income of approximately \$15 million. With respect to one of AG Re's ceding companies, the right to recapture business can only be exercised if AG Re were downgraded to the A category by more than one rating agency, or below A2 or A by any one rating agency. As of March 31, 2009, the statutory unearned premium subject to recapture by this ceding company is approximately \$358 million. If this entire amount were recaptured, it would result in a corresponding one-time reduction to net income of approximately \$42 million. Alternatively, the ceding company can increase the commissions it charges AG Re for cessions. Any such increase may be retroactive to the date of the cession. As of March 31, 2009, the potential increase in ceding commissions would result in a one-time reduction to net income of approximately \$40 million. The effect on net income under these scenarios is exclusive of any capital gains or losses that may be realized.

If a credit derivative is terminated, the Company could be required to make a mark-to-market payment as determined under the ISDA documentation. In some older credit derivative transactions, one such specified event is the failure of AGC to maintain specified financial strength ratings ranging from A or A2 to BBB- or Baa3. If a credit derivative is terminated the Company could be required to make a mark-to-market payment as determined under the ISDA documentation. For example, if AGC's ratings were downgraded to A- or A3, the CDS counterparties could terminate CDS covering \$847.8 million par insured. If AGC's ratings are downgraded to levels between BBB+ or Baa1 and BB+ or Ba1, the CDS counterparties could terminate the CDS covering \$10.9 billion par insured. Given current market conditions, the Company does not believe that it can accurately estimate the payments it would be required to make if AGC or AGRe were downgraded and the CDS counterparties terminated the CDS. These payments could have a material adverse effect on the Company's liquidity and financial condition. During May 2009 the Company entered into an agreement with a CDS counterparty, which had the right to terminate four CDS contracts if AGC was downgraded below AA- or Aa3. Under the agreement, the CDS counterparty's right to terminate the CDS contracts based

on AGC's ratings was eliminated. In return, the Company agreed to post up to \$250 million in collateral to secure its payment obligations under the CDS contracts covering \$5.9 billion of par insured. The collateral posting would increase to up to \$300 million if AGC were downgraded to below AA- or A2. The posting of this collateral has no impact on the Company's net income or shareholders' equity under U.S. GAAP nor does it impact AGC's statutory surplus or net income.

Under a limited number of credit derivative contracts, the Company is required to post eligible securities as collateral, generally cash or U.S. government or agency securities. The need to post collateral under these transactions is generally based on mark-to-market valuation in excess of contractual thresholds. The particular thresholds decline if the Company's ratings decline. As of March 31, 2009 the Company had pre-IPO transactions with approximately \$1.8 billion of par subject to collateral posting due to changes in market value. Of this amount, as of March 31, 2009, the Company posted collateral totaling approximately \$177.9 million (including \$156.2 million for AGC) based on the unrealized mark-to-market loss position for transactions with two of its counterparties. Any amounts required to be posted as collateral in the future will depend on changes in the market.

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values of these transactions. Additionally, in the event AGC were downgraded below A-, contractual thresholds would be eliminated and the amount of par that could be subject to collateral posting requirements would be \$2.3 billion. Based on market values as of March 31, 2009, the Company estimates that such a downgrade would have resulted in AGC posting an additional \$113.7 million of collateral. The actual amounts posted would be based on market conditions at the time of the posting and would be based on the CDS contract's ISDA documentation. The actual amounts that would be required to be posted could be materially larger than the Company's estimate. As described above, in May 2009 AGC posted an additional \$250 million of collateral.

The Company's financial strength ratings assigned by S&P were affirmed on June 18, 2008. Management is uncertain what, if any, impact Fitch and Moody's ratings actions will have on the Company's financial strength ratings from S&P.

On April 8, 2008, investment funds managed by WL Ross & Co. LLC (WL Ross) purchased 10,651,896 shares of the Company's common equity at a price of \$23.47 per share, resulting in proceeds to the Company of \$250.0 million. The Company contributed \$150.0 million of these proceeds to its subsidiary, Assured Guaranty Re Ltd. In addition, the Company contributed \$100.0 million of these proceeds to its subsidiary, Assured Guaranty US Holdings Inc., which in turn contributed the same amount to its subsidiary, AGC. The commitment to purchase these shares was previously announced on February 29, 2008. In addition, Wilbur L. Ross, Jr., President and Chief Executive Officer of WL Ross, has been elected as a Director of the Company with a term expiring at the Company's 2012 annual general meeting of shareholders.

On November 14, 2008, Assured Guaranty Ltd. announced that it had entered into a definitive agreement (the Purchase Agreement) with Dexia Holdings, Inc. (Dexia) to purchase Financial Security Assurance Holdings Ltd. (FSAH) and, indirectly, all of its subsidiaries, including the financial guaranty insurance company, Financial Security Assurance, Inc. The definitive agreement provides that the Company will be indemnified against exposure to FSAH's Financial Products segment, which includes its guaranteed investment contract business. Pursuant to the Purchase Agreement, the Company agreed to buy 33,296,733 issued and outstanding shares of common stock of FSAH, representing as of the date thereof approximately 99.8524% of the issued and outstanding shares of common stock of FSAH. The remaining shares of FSAH are currently held by current or former directors of FSAH. Assured expects that it will acquire the remaining shares of FSAH common stock concurrent with the closing of the acquisition of shares of FSAH common stock from Dexia or shortly thereafter at the same price paid to Dexia. The Company has received all required shareholder and regulatory approvals and expect to close the FSAH acquisition at the end of second quarter 2009 if the rating agencies complete their transaction reviews on a timely basis, including their evaluation of the separation of FSA's Financial Products segment, which the Company is not acquiring.

The purchase price is \$722 million (based upon the closing price of the Company's common shares on the NYSE on November 13, 2008 of \$8.10), consisting of \$361 million in cash and up to 44,567,901 of the Company's common shares. If, prior to the closing date under the stock purchase agreement, the Company issues new common shares (other than pursuant to an employee benefit plan) or other securities that are convertible into or exchangeable for or otherwise linked to the Company's common shares at a purchase price per share of less than \$8.10, the Company has agreed to issue to Dexia on the closing date an additional number of the Company's common shares with an aggregate value as of the closing date (measured based on the average of the volume weighted average price per share for each day in the 20 NYSE trading day period ending three business days prior to the closing date) representing the amount of dilution as a result of such issuance. The amount of dilution is defined to mean (x) the number of the Company's common shares issued (or that upon conversion or exchange would be issuable) as a result of the dilutive issuance, multiplied by (y) the positive difference if any between \$8.10 and the purchase (or reference, implied, conversion, exchange or comparable) price per share received by the Company in the dilutive issuance, multiplied by (z) the percentage of the issued and outstanding share capital of the Company represented by the Company common shares to be received by Dexia under the stock purchase agreement (without taking into account any additional Assured Guaranty Ltd.'s common shares issued or issuable as a result of the anti-dilution provision).

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Under the Purchase Agreement, the Company may elect to pay \$8.10 per share in cash in lieu of up to 22,283,951 of the Company's common shares that it would otherwise deliver as part of the purchase price.

The Company expects to finance the cash portion of the acquisition with the proceeds of a public equity offering. The Company has received a backstop commitment ( the WLR Backstop Commitment ) from the WLR Funds, a related party, to fund the cash portion of the purchase price with the purchase of newly issued common shares. The Company entered into the WLR Backstop Commitment on November 13, 2008 with the WLR Funds. The WLR Backstop Commitment amended the Investment Agreement between the Company and the WLR Funds



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and provided to the Company the option to cause the WLR Funds to purchase from Assured Guaranty Ltd. or Assured Guaranty US Holdings Inc. a number of the Company's common shares equal to the quotient of (i) the aggregate dollar amount not to exceed \$361 million specified by the Company divided by (ii) the volume weighted average price of the Company's common share on the NYSE for the 20 NYSE trading days ending with the last NYSE trading day immediately preceding the date of the closing under the stock purchase agreement, with a floor of \$6.00 and a cap of \$8.50.

The WLR Funds have no obligation to purchase these common shares pursuant to the WLR Backstop Commitment until the closing under the stock purchase agreement occurs. The Company may use the proceeds from the sale of the Company's common shares pursuant to the WLR Backstop Commitment solely to pay a portion of the purchase price under the stock purchase agreement. The WLR Funds' obligations under the WLR Backstop Commitment have been secured by letters of credit issued for the benefit of the Company by Bank of America, N.A. and RBS Citizens Bank, N.A., each in the amount of \$180.5 million.

The Company has paid the WLR Funds a nonrefundable commitment fee of \$10,830,000 in connection with the option granted by the WLR Backstop Commitment and has agreed to pay the WLR Funds' expenses in connection with the transactions contemplated thereby. The Company has reimbursed the WLR Funds for the \$4.1 million cost of obtaining the letters of credit referred to above.

In January 2009, AGC finalized an agreement with CIFG Assurance North America, Inc. ( CIFG ) to assume a diversified portfolio of financial guaranty contracts totaling approximately \$13.3 billion of net par outstanding. AGC received \$75.6 million, which included \$85.7 million of upfront premiums net of ceding commissions and approximately \$12.2 million of future installments related to this transaction.

We regularly evaluate potential acquisitions of other companies, lines of business and portfolios of risks and hold discussions with potential third parties regarding such transactions. As a general rule, we publicly announce such transactions only after a definitive agreement has been reached.

The financial guaranty industry, along with many other financial institutions, continues to be threatened by deterioration of the credit performance of securities collateralized by U.S. residential mortgages. There is significant uncertainty surrounding general economic factors, including interest rates and housing prices, which may adversely affect our loss experience on these securities. The Company continues to monitor these exposures and update our loss estimates as new information is received. Additionally, scrutiny from state and federal regulatory agencies could result in changes that limit our business.

Our financial results include four principal business segments: financial guaranty direct, financial guaranty reinsurance, mortgage guaranty and other. The other segment represents lines of business that we exited or sold as part of our 2004 initial public offering ( IPO ).

We derive our revenues principally from premiums from our insurance and reinsurance businesses, unrealized gains and losses and realized gains and other settlements on credit derivatives, net investment income, and net realized gains and losses from our investment portfolio. Our premiums and realized gains and other settlement on credit derivatives are a function of the amount and type of contracts we write as well as prevailing market prices. We receive payments on an upfront basis when the policy is issued or the contract is executed and/or on an installment basis over the life of the applicable transaction.

Investment income is a function of invested assets and the yield that we earn on those assets. 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 our invested assets. In addition, we could realize capital losses on securities in our investment portfolio from other than temporary declines in market value as a result of changing market conditions, including changes in market interest rates, and changes in the credit quality of our invested assets.

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Realized gains and other settlements on credit derivatives include credit derivative premiums received and receivable for credit protection the Company has sold under its credit default swaps ( CDS ), any contractual claim losses paid and payable related to insured credit events under these contracts, realized gains or losses related to their early termination and ceding commissions (expense) income. The Company generally holds credit derivative contracts to maturity. However, in certain circumstances such as for risk management purposes or as a result of a decision to exit a line of business, the Company may decide to terminate a derivative contract prior to maturity.

Unrealized gains (losses) on credit derivatives represent the adjustments for changes in fair value that are recorded in each reporting period under Statement of Financial Accounting Standards ( FAS ) No. 133, Accounting for Derivative Instruments and Hedging Activities ( FAS 133 ). Changes in unrealized gains and losses on credit derivatives are reflected in the consolidated statements of operations and comprehensive income in unrealized gains (losses) on credit derivatives. Cumulative unrealized gains (losses), determined on a contract by contract basis, are reflected as either net assets or net liabilities in the Company s balance sheets. Unrealized gains and losses resulting from changes in the fair value of credit derivatives occur because of changes in interest rates, credit spreads, the credit ratings of the referenced entities, the Company s credit rating and other market factors. The unrealized gains (losses) on credit derivatives will reduce to zero as the exposure approaches its maturity date, unless there is a payment default on the exposure. Changes in the fair value of the Company s credit derivatives do not reflect actual claims or credit losses, and have no impact on the Company s claims paying resources, rating agency capital or regulatory capital positions.

In the three months ended March 31, 2009 and 2008 the Company also recorded a fair value gain of \$19.7 million and \$8.5 million, pre-tax, respectively, related to Assured Guaranty Corp. s committed capital securities.

Our expenses consist primarily of losses and loss adjustment expenses ( LAE ), profit commission expense, acquisition costs, operating expenses, interest expense, put-option premium expense associated with our committed capital securities (the CCS Securities ) and income taxes. Losses and LAE are a function of the amount and types of business we write. Losses and LAE are based upon estimates of the ultimate aggregate losses inherent in the portfolio. The risks we take have a low expected frequency of loss and are investment grade at the time we accept the risk. Profit commission expense represents payments made to ceding companies generally based on the profitability of the business reinsured by us. Acquisition costs are related to the production of new business. Certain acquisition costs that vary with and are directly attributable to the production of new business are deferred and recognized over the period in which the related premiums are earned. Operating expenses consist primarily of salaries and other employee related costs, including share based compensation, various outside service providers, rent and related costs and other expenses related to maintaining a holding company structure. These costs do not vary with the amount of premiums written. Interest expense is a function of outstanding debt and the contractual interest rate related to that debt. Put-option premium expense, which is included in other expenses on the Consolidated Statements of Operations and Comprehensive Income, is a function of the outstanding amount of the CCS Securities and the applicable distribution rate. Income taxes are a function of our profitability and the applicable tax rate in the various jurisdictions in which we do business.

**Critical Accounting Estimates**

Our unaudited interim consolidated financial statements include amounts that, either by their nature or due to requirements of accounting principles generally accepted in the United States of America ( GAAP ), are determined using estimates and assumptions. The actual amounts realized could ultimately be materially different from the amounts currently provided for in our unaudited interim consolidated financial statements. We believe the items requiring the most inherently subjective and complex estimates to be reserves for losses and LAE, fair value of credit derivatives, fair value of committed capital securities, valuation of investments, other than temporary impairments of investments, premium revenue recognition, deferred acquisition costs, deferred income taxes and accounting for share based compensation. An understanding of our accounting policies for these items is of critical importance to understanding our unaudited interim consolidated financial statements. The following discussion provides more information regarding the estimates and assumptions used for these items and should be read in conjunction

with the notes to our unaudited interim consolidated financial statements.

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***Reserves for Losses and Loss Adjustment Expenses***

The Company's financial guarantees written in credit derivative form have substantially the same terms and conditions as its financial guaranty contracts written in insurance form. Under GAAP, however, the former are subject to derivative accounting rules and the latter are subject to insurance accounting rules.

*Financial Guaranty Contracts Upon Adoption of FAS 163*

The Company, subsequent to the adoption of FAS No. 163, Accounting for Financial Guarantee Insurance Contracts ( FAS 163 ) on January 1, 2009, recognizes a reserve for losses and loss adjustment expenses on a financial guarantee insurance contract when the Company expects that a claim loss will exceed the unearned premium revenue for that contract based on the present value of expected net cash outflows to be paid under the insurance contract. The unearned premium revenue represents the insurance enterprise's stand-ready obligation under a financial guarantee insurance contract at initial recognition. Subsequently, if the likelihood of a default (insured event) increases so that the present value of the expected net cash outflows expected to be paid under the insurance contract exceeds the unearned premium revenue, the Company recognizes a reserve for losses and loss adjustment expenses in addition to the unearned premium revenue.

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

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

It is possible that our estimated loss and loss adjustment expense reserves recorded in our March 31, 2009 financial statements could experience significant adverse development which could lead to material amounts of incurred loss and loss adjustment expenses in future reporting periods as a result of continued deterioration in housing prices; the effects of a weakened economy marked by growing unemployment and wage pressures and/or continued illiquidity of the mortgage market. The company believes that the maximum probable development on its loss reserve for structured finance credits is \$306 million. This amount reflects stressed loss assumptions that the Company used in modeling all of its material below investment grade credits. These scenarios were modeled by increasing defaults probabilities, default severities and expected recoveries to reflect the company's view of the maximum probable deterioration likely to occur on these transactions.

*Financial Guaranty Contracts Prior to Adoption of FAS 163*

Reserves for losses and loss adjustment expenses for non-derivative transactions in our financial guaranty direct and financial guaranty assumed reinsurance included case reserves and portfolio reserves. See the Fair Value of Credit Derivatives of the Critical Accounting Estimates section for more information on our derivative transactions. Case reserves were established when there was significant credit deterioration on specific insured obligations and the obligations were in default or default was probable, not necessarily upon non-payment of principal or interest by an insured. Case reserves represented the present value of expected future loss payments and LAE, net of estimated recoveries, but before considering ceded reinsurance. This reserving method was different from case reserves established by traditional property and casualty insurance companies, which establish case reserves upon notification of a claim and establish incurred but not reported ( IBNR ) reserves for the difference between actuarially estimated ultimate losses and recorded case reserves. Financial guaranty insurance and assumed reinsurance case reserves and related salvage and subrogation, if any, were discounted at the taxable equivalent yield on our investment portfolio, which was approximately 6%, during 2008.

We recorded portfolio reserves in our financial guaranty direct and financial guaranty assumed reinsurance business. Portfolio reserves were established with respect to the portion of our business for which case reserves were not established.

Portfolio reserves were not established based on a specific event, rather they are calculated by aggregating the portfolio reserve calculated for each individual transaction. Individual transaction reserves were calculated on a quarterly basis by multiplying the par in-force by the product of the ultimate loss and earning factors without regard to discounting. The ultimate loss factor was defined as the frequency of loss multiplied by the severity of loss, where the frequency was defined as the probability of default for each individual issue. The earning factor was inception to

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date earned premium divided by the estimated ultimate written premium for each transaction. The probability of default was estimated from rating agency data and was based on the transaction's credit rating, industry sector and time until maturity. The severity was defined as the complement of recovery/salvage rates gathered by the rating agencies of defaulting issues and was based on the industry sector.

Portfolio reserves were recorded gross of reinsurance. We did not cede any amounts under these reinsurance contracts, as our recorded portfolio reserves did not exceed our contractual retentions, required by said contracts.

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

The weighted average default frequencies and severities of the Company's portfolio reserves as of December 31, 2008 were as follows (Effective January 1, 2009, upon the adoption of FAS 163, the Company no longer maintains portfolio reserves.):

|                   | <b>Average<br/>Default<br/>Frequency</b> | <b>Average<br/>Default<br/>Severity</b> |
|-------------------|--|---|
| December 31, 2008 | 1.08%                                    | 23.87%                                  |

The Company incorporates default frequency and severity by asset class into its portfolio loss reserve models. Average default frequency and severity are based on information published by rating agencies. The increase in average default frequency shown in 2008 is reflective of downgrades within the Company's direct insured portfolio, including HELOC exposures. Rating agencies update default frequency and severity information on a periodic basis, as warranted by changes in observable data.

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*Mortgage Guaranty and Other Lines of Business*

Reserves for losses and loss adjustment expenses in our mortgage guaranty line of business include case reserves and portfolio reserves. Case reserves are established when there is significant credit deterioration on specific insured obligations and the obligations are in default or default is probable, not necessarily upon non-payment of principal or interest by an insured. Case reserves represent the present value of expected future loss payments and loss adjustment expenses ( LAE ), net of estimated recoveries, but before considering ceded reinsurance. This reserving method is different from case reserves established by traditional property and casualty insurance companies, which establish case reserves upon notification of a claim and establish incurred but not reported ( IBNR ) reserves for the difference between actuarially estimated ultimate losses and recorded case reserves.

We also record portfolio reserves for our mortgage guaranty line of business in a manner consistent with our financial guaranty business prior to the adoption of FAS 163. While other mortgage guaranty insurance companies do not record portfolio reserves, rather just case reserves and IBNR reserves, we record portfolio reserves because we write business on an excess of loss basis, while other industry participants write quota share or first layer loss business. We manage and underwrite this business in the same manner as our financial guaranty insurance and reinsurance business because they have similar characteristics as insured obligations of mortgage backed securities.

We also record IBNR reserves for our other lines of business. IBNR is an estimate of losses for which the insured event has occurred but the claim has not yet been reported to us. In establishing IBNR, we use traditional actuarial methods to estimate the reporting lag of such claims based on historical experience, claim reviews and information reported by ceding companies. We record IBNR for trade credit reinsurance within our other segment, which is 100% reinsured. The other segment represents lines of business that we exited or sold as part of the Company's IPO.

Due to the inherent uncertainties of estimating loss and LAE reserves, actual experience may differ from the estimates reflected in our consolidated financial statements and the differences may be material.

*Home Equity Line of Credit (HELOC) Transactions*

Specifically with respect to reserves related to our U.S. home equity line of credit ( HELOC ) and other U.S. residential mortgage exposures, there exists significant uncertainty as to the ultimate performance of these transactions. As of March 31, 2009, the Company had net par outstanding of \$1.6 billion related to HELOC securitizations, of which \$1.4 billion are transactions with Countrywide and \$1.1 billion were written in the Company's financial guaranty direct segment ( direct Countrywide transactions or Countrywide 2005 J and Countrywide 2007 D ).

The performance of our HELOC exposures deteriorated during 2007 and 2008 and the first three months of 2009 and transactions, particularly those originated in the period from 2005 through 2007, continue to perform below our original underwriting expectations. In accordance with our standard practice, during the three months ended March 31, 2009, we evaluated the most currently available information, including trends in delinquencies and charge-offs on the underlying loans, draw rates on the lines of credit, and the servicer's ability to fulfill its contractual obligations including its obligation to fund additional draws. In recent periods, Constant Default Rate (CDR), Constant Payment Rate (CPR), Draw Rates and delinquency percentages have fluctuated within ranges that we believe make it appropriate to use rolling averages to project future performance. Accordingly, the Company is using modeling assumptions that are based upon or which approximate recent actual historical



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performance to project future performance and potential losses. In the first quarter 2009, consistent with FAS 163, the Company modeled and probability weighted a variety of potential time periods over which an elevated CDR may potentially occur. Further, the Company also incorporated in its loss reserve estimates the possibility that in some of those scenarios the prepayment rates increase after the stressed CDR period, leading to lower recoveries through excess spread. The Company continues to model sensitivities around the results booked using a variety of CDR rates and stress periods as well as other modeling

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approaches including roll rates and hybrid roll rate/CDR methods. As a result of this modeling and analysis, the Company incurred loss and loss adjustment expenses of \$(4.9) million for its direct Countrywide transactions during the three months ended March 31, 2009. The Company's cumulative incurred loss and loss adjustment expenses on the direct Countrywide transactions as of March 31, 2009 was \$93.3 million (\$73.0 million after-tax). During 2009, the Company paid losses and loss adjustment expenses for its direct Countrywide transactions of \$35.5 million. The Company's cumulative paid losses and loss adjustment expenses for its direct Countrywide transactions are \$205.5 million as of March 31, 2009, of which we expect to recover \$112.2 million from the receipt of excess spread from future cash flows as well as funding of future draws and recoverables from breaches of representations and warranties with respect to the underlying collateral. This amount of \$112.2 million is included in salvage recoverable on the balance sheet as of March 31, 2009.

Credit support for HELOC transactions comes primarily from two sources. In the first instance, excess spread is used to build a certain amount of credit enhancement and absorb losses. Over the past 12 months, excess spread (the difference between the interest collections on the collateral and the interest paid on the insured notes) has averaged approximately 270 basis points per annum. Additionally, for the transactions serviced by Countrywide, the servicer is required to fund additional draws on the HELOC loans following the occurrence of a Rapid Amortization Event. Among other things, such an event is triggered when claim payments by us exceed a certain threshold. Prior to the occurrence of a Rapid Amortization Event, during the transactions' revolving period, new draws on the HELOC loans are funded first from principal collections. As such, during the revolving period no additional credit enhancement is created by the additional draws, and the speed at which our exposure amortizes is reduced to the extent of such additional draws, since principal collections are used to fund those draws rather than pay down the insured notes. Subsequent to the occurrence of a Rapid Amortization Event, new draws are funded by Countrywide and all principal collections are used to pay down the insured notes. Any draws funded by Countrywide are subordinate to us in the cash flow waterfall and hence represent additional credit enhancement available to absorb losses before we have to make a claim payment. Additionally, since all principal collections are used to pay down the insured notes, rather than fund additional draws, our exposure begins to amortize more quickly. A Rapid Amortization Event occurred for Countrywide 2007 D in April 2008 and for Countrywide 2005 J in May 2008.

We have modeled our HELOC exposures under a number of different scenarios, taking into account the multiple variables and structural features that materially affect transaction performance and potential losses to us. The key variables include the speed or rate at which borrowers make payments on their loans, as measured by the CPR(1), the default rate, as measured by the CDR(2), excess spread, and the amount of loans that are already delinquent more than 30 days. We also take into account the pool factor (the percentage of the original principal balance that remains outstanding), and the timing of the remaining cash flows. Additionally, it should be noted that our contractual rights allow us to retroactively claim that loans included in the insured pool were inappropriately included in the pool by the seller, and to put these loans back to the seller such that we would not be responsible for losses related to these loans. Such actions would benefit us by reducing potential losses. We have included in our loss model an estimated benefit for loans we expect Countrywide will repurchase.

The ultimate performance of the Company's HELOC transactions will depend on many factors, such as the level and timing of loan defaults, interest proceeds generated by the securitized loans, repayment speeds and changes in home prices, as well as the levels of credit support built into each transaction. Other factors also may have a material impact upon the ultimate performance of each transaction, including the ability of the seller and servicer to fulfill all of their contractual obligations including its obligation to fund future draws on lines of credit, as well as the amount of benefit received from repurchases of ineligible loans by Countrywide. The variables affecting transaction performance are interrelated, difficult to predict and subject to considerable volatility. Consequently, the range of potential outcomes is wide and subject to significant uncertainty. We continue to update our evaluation of these exposures as new information becomes available.

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(1) The CPR is the annualized rate at which the portfolio amortizes, so that a 15% CPR implies that 15% of the collateral will be retired over a one-year period.

(2) The CDR is the annualized default rate, so that a 1.0% CDR implies that 1.0% of the remaining collateral will default each year.



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The key assumptions used in our analysis of potential case loss reserves on the direct Countrywide transactions are presented in the following table:

| <b>Key Variables</b>                           |  |
|--|--|
| Constant payment rate (CPR)                    | 3-month average, 5 6.3% as of March 31, 2009   |
| Constant default rate (CDR)                    | 6-month average CDR of approximately 18 19% used for our initial default projections, ramping down to a steady state CDR of 1.0% |
| Draw rate                                      | 3-month average, 1 2% as of March 31, 2009   |
| Excess spread                                  | 250 bps per annum  |
| Repurchases of Ineligible loans by Countrywide | \$79.0 million; or approximately 3.3% of original pool balance of \$2.4 billion  |
| Loss Severity                                  | 100%   |

*Subprime, Alt-A and Closed End Second RMBS Transactions*

Another type of RMBS transaction is generally referred to as Subprime RMBS. The collateral supporting such transactions is comprised of first-lien residential mortgage loans made to subprime borrowers. A subprime borrower is one considered to be a higher risk credit based on credit scores or other risk characteristics. As of March 31, 2009, we had net par outstanding of \$6.5 billion related to Subprime RMBS securitizations, of which \$612 million is classified by us as Below Investment Grade risk. Of the total U.S. Subprime RMBS exposure of \$6.5 billion, \$6.0 billion is from transactions issued in the period from 2005 through 2007 and written in our direct financial guaranty segment. As of March 31, 2009, we had case reserves of \$10.0 million related to our \$6.5 billion U.S. Subprime RMBS exposure, of which \$1.8 million were portfolio reserves related to our \$6.0 billion exposure in the direct financial guaranty segment for transactions issued from 2005 through 2007.

The problems affecting the subprime mortgage market have been widely reported, with rising delinquencies, defaults and foreclosures negatively impacting the performance of Subprime RMBS transactions. Those concerns relate primarily to Subprime RMBS issued in the period from 2005 through 2007. The \$6.0 billion exposure that we have to such transactions in our direct financial guaranty segment benefits from various structural protections, including credit enhancement that on average currently equals approximately 54.6% of the remaining principal balance of the transactions.

We also have exposure of \$415 million to Closed-End Second (CES) RMBS transactions, of which \$405 million is in the direct segment. As with other types of RMBS, we have seen significant deterioration in the performance of our CES transactions. On two transactions, which had exposure of \$304 million, as of March 31, 2009 we have seen a significant increase in delinquencies and collateral losses, which resulted in erosion of the Company's credit enhancement and the payment of claims totaling \$26.4 million. Based on the Company's analysis of these transaction and their projected collateral losses, the Company had case reserves of \$38.1 million as of March 31, 2009 in its direct segment.

Another type of RMBS transaction is generally referred to as Alt-A RMBS. The collateral supporting such transactions is comprised of first-lien residential mortgage loans made to prime quality borrowers that lack certain ancillary characteristics that would make them prime. Included in this category is Alt-A Option ARMs, which include transactions where 66% or more of the collateral is comprised of mortgage loans that have the potential to negatively amortize. As of March 31, 2009, the Company had net par outstanding of \$7.7 billion related to Alt-A RMBS securitizations. Of that amount, \$7.4 billion is from transactions issued in the period from 2005 through 2007 and written in the Company's financial guaranty direct segment. As of March 31, 2008, the Company had case reserves of \$12.5 million for Alt-A and \$11.4 million for the Option-ARM related to its \$7.7 billion Alt-A/Option-ARM RMBS exposure, in the financial guaranty direct and reinsurance segments,

respectively.

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

*Life Insurance Securitizations*

The Company has exposure on two life insurance reserve securitization transactions based on two discrete blocks of individual life insurance business reinsured by Scottish Re (U.S.) Inc. ( Scottish Re ). The two transactions relate to Ballantyne Re p.l.c. ( Ballantyne ) (gross exposure of \$500 million) and Orkney Re II, p.l.c. ( Orkney II ) (gross exposure of \$423 million). Under both transactions, monies raised through the issuance of the insured notes support present and future U.S. statutory life insurance reserve requirements. The monies were invested at inception of each transaction in accounts managed by a large, well-known investment manager. However, those investment accounts have incurred substantial mark-to-market losses since mid-year 2007, principally as a result of their exposure to subprime and Alt-A RMBS transactions. Largely as a result of these mark-to-market losses both we and the rating agencies have downgraded our exposure to both Ballantyne and Orkney II to below investment grade. As regards the Ballantyne transaction, the Company is working with the directing guarantor, who has insured exposure of \$900 million, to remediate the risk. On the Orkney Re II transaction, the Company, as directing financial guarantor, is taking remedial action.

Some credit losses have been realized on the securities in the Ballantyne and Orkney Re II portfolios and significant additional credit losses are expected to occur. Performance of the underlying blocks of life insurance business thus far generally has been in accordance with expectations. The combination of cash flows from the investment accounts and the treaty settlements currently is sufficient to cover interest payments due on the notes that we insure. Adverse treaty performance and/or a rise in credit losses on the invested assets are expected to lead to interest shortfalls. Additionally, the transactions also contain features linked to the market values of the invested assets, reserve funding requirements on the underlying blocks of life insurance business, and minimum capital requirements for the transactions themselves that may trigger a shut off of interest payments to the insured notes and thereby result in claim payments by the Company.

Another key risk is that the occurrence of certain events may result in a situation where either Ballantyne and/or Orkney Re II are required to sell assets and potentially realize substantial investment losses and for Assured Guaranty Ltd. to incur corresponding insured losses ahead of the scheduled final maturity date. For example, cedants to Scottish Re may have the right to recapture blocks of life insurance business which Scottish Re has ceded to Orkney Re II. Such recaptures could require Orkney Re II to sell assets and realize investment losses. In the Ballantyne transaction, further declines in the market value of the invested assets and/or an increase in the reserve funding requirements could lead to a similar mandatory realization of investment losses and for Assured Guaranty Ltd. to incur corresponding insured losses ahead of the scheduled final maturity date.

In order for the Company to incur an ultimate net loss on these transactions, adverse experience on the underlying block of life insurance policies and/or credit losses in the investment portfolio would need to exceed the level of credit enhancement built into the transaction structures. Based on its analysis of the information currently available, including estimates of future investment performance, projected credit impairments on the invested assets and performance of the blocks of life insurance business, at March 31, 2009, the Company's case reserve is \$43.0 million for the Ballantyne transaction. This case reserve reflects expected losses resulting primarily from the deterioration in the investment portfolio as discussed above. At this time we do not expect the shut off triggers or recaptures by cedants discussed above to occur. Should these events occur our losses could be significantly greater than our case reserve. The Company has not established a case loss reserve for the Orkney Re II transaction.

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On December 19, 2008, the Company sued J.P. Morgan Investment Management Inc. ( JPMIM ), the investment manager in the Orkney II transaction, in New York Supreme Court alleging that JPMIM engaged in breaches of fiduciary duty, gross negligence and breaches of contract based upon its handling of the investments of Orkney Re II. JPMIM requested and was given an extension of time to answer until the end of February.

The Company has exposure to a public finance transaction for sewer service in Jefferson County, Alabama through several reinsurance treaties. The Company's total exposure to this transaction is approximately \$455 million as of March 31, 2009. The Company has made debt service payments during the year and expects to make additional

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payments in the near term. Through our cedants, the Company is currently in discussions with the bond issuer to structure a solution, which may result in some or all of these payments being recoverable. The Company incurred cumulative loss and loss adjustment expenses of \$19.3 million as of March 31, 2009.

A sensitivity analysis is not appropriate for our other segment reserves, since the amounts are 100% reinsured.

The following tables summarize our reserves for losses and LAE by segment and type of reserve as of the dates presented. For an explanation of changes in these reserves see Consolidated Results of Operations.

|  | As of March 31, 2009            |                                      |                      |        |    | Total |
|--|---------------------------------|--------------------------------------|----------------------|--------|----|-------|
|  | Financial<br>Guaranty<br>Direct | Financial<br>Guaranty<br>Reinsurance | Mortgage<br>Guaranty | Other  |    |       |
|  | (in millions of U.S. dollars)   |                                      |                      |        |    |       |
| <i>Financial Guaranty Insurance Reserves by segment and type(1):</i> |                                 |                                      |                      |        |    |       |
| Case   | \$ 110.3                        | \$ 73.4                              | \$ 30.1              | \$ 1.2 | \$ | 215.0 |
| IBNR and portfolio   | N/A                             | N/A                                  | 1.9                  | 5.6    |    | 7.5   |
| Total financial guaranty insurance loss and LAE reserves             | 110.3                           | 73.4                                 | 32.0                 | 6.8    |    | 222.6 |
| <i>Credit Derivative Reserves by segment and type(2):</i>            |                                 |                                      |                      |        |    |       |
| Case   | 40.8                            | 4.8                                  |                      |        |    | 45.6  |
| Total credit derivative loss and LAE reserves                        | 40.8                            | 4.8                                  |                      |        |    | 45.6  |
| Total loss and LAE reserves, including credit derivatives(3)         | \$ 151.1                        | \$ 78.2                              | \$ 32.0              | \$ 6.8 | \$ | 268.2 |



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|  | As of December 31, 2008   |                                |                   |        |                               | Total |
|--|---------------------------|--------------------------------|-------------------|--------|-------------------------------|-------|
|  | Financial Guaranty Direct | Financial Guaranty Reinsurance | Mortgage Guaranty | Other  | (in millions of U.S. dollars) |       |
| <i>Financial Guaranty Insurance Reserves by segment and type(1):</i>             |                           |                                |                   |        |                               |       |
| Case   | \$ 64.2                   | \$ 55.7                        | \$ 0.1            | \$ 1.5 | \$                            | 121.5 |
| IBNR   |                           |                                |                   | 3.0    |                               | 3.0   |
| Portfolio reserves associated with fundamentally sound credits                   | 11.8                      | 35.5                           | 2.5               |        |                               | 49.8  |
| Portfolio reserves associated with CMC credits                                   | 15.8                      | 6.7                            |                   |        |                               | 22.5  |
| Total financial guaranty insurance loss and LAE reserves                         | 91.8                      | 97.9                           | 2.6               | 4.5    |                               | 196.8 |
| <i>Credit Derivative Reserves by segment and type(2):</i>                        |                           |                                |                   |        |                               |       |
| Case   | 7.2                       | 5.5                            |                   |        |                               | 12.7  |
| Credit derivative portfolio reserves associated with fundamentally sound credits | 15.7                      |                                |                   |        |                               | 15.7  |
| Credit derivative portfolio reserves associated with CMC credits                 | 23.4                      |                                |                   |        |                               | 23.4  |
| Total credit derivative loss and LAE reserves                                    | 46.3                      | 5.5                            |                   |        |                               | 51.8  |
| Total loss and LAE reserves, including credit derivatives(3)                     | \$ 138.1                  | \$ 103.4                       | \$ 2.6            | \$ 4.5 | \$                            | 248.6 |

(1) Included in Reserves for losses and loss adjustment expenses on the Balance Sheet.

(2) Included in Credit derivative liabilities/assets on the Balance Sheet.

(3) Total does not add due to rounding.

N/A = Not applicable

The following table sets forth the financial guaranty insurance policy and CDS contract in-force portfolio by underlying rating:

| Ratings(1)   | As of March 31, 2009 |                          | As of December 31, 2008 |                          |
|--------------|----------------------|--------------------------|-------------------------|--------------------------|
|              | Net par outstanding  | % of Net par outstanding | Net par outstanding     | % of Net par outstanding |
| Super senior | \$ 29.6              | 12.5%                    | \$ 32.4                 | 14.5%                    |
| AAA          | 33.1                 | 13.9%                    | 40.7                    | 18.3%                    |

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|                        |    |       |        |          |        |
|------------------------|----|-------|--------|----------|--------|
| AA                     |    | 50.5  | 21.3%  | 47.7     | 21.4%  |
| A                      |    | 80.2  | 33.8%  | 66.0     | 29.6%  |
| BBB                    |    | 34.4  | 14.5%  | 29.4     | 13.2%  |
| Below investment grade |    | 9.4   | 4.0%   | 6.6      | 3.0%   |
| Total exposures(2)     | \$ | 237.2 | 100.0% | \$ 222.7 | 100.0% |

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

(2) Total does not add due to rounding.

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The change in ratings above is mainly related to the Company's U.S. RMBS exposures.

Our surveillance department is responsible for monitoring our portfolio of credits and maintains a list of below investment grade (BIG) credits. This list includes credits written in both financial guarantee insurance policy and CDS contract form. The BIG credits are divided into three categories: Category 1 (below investment grade credit with no expected losses); Category 2 (below investment grade credit with a loss reserve established prior to an event of default); Category 3 (below investment grade credit with a loss reserve established and where an event of default has occurred or is imminent).

The BIG credit list includes all credits rated lower than BBB- where there is a material amount of exposure (generally greater than \$10.0 million) or a material risk of the Company incurring a loss greater than \$0.5 million. Credit ratings are based on the Company's internal assessment of the likelihood of default. The Company's internal credit ratings are generally in line or lower than those of the ratings agencies.

As part of our surveillance process, we continually monitor all of our investment grade credits to determine whether they have suffered any credit impairments. Our quarterly procedures included qualitative and quantitative analysis on all of our insured credits to ensure that all potential BIG credits have been identified. Credits we identified through this process as having future credit impairments are subjected to further review by surveillance personnel to ensure that they have an appropriate ratings assigned to them.

The following table provides financial guaranty insurance policy and CDS contract net par outstanding by credit monitoring category as of March 31, 2009:

| Description:        | Net Par<br>Outstanding | As of March 31, 2009                            |                              | Case<br>Reserves(2) |
|---------------------|------------------------|---|------------------------------|---------------------|
|                     |                        | % of Net Par<br>Outstanding<br>(\$ in millions) | # of Policies<br>in Category |                     |
| Category 1          | \$ 3,733               | 39.8%   | 117                          | \$                  |
| Category 2          | 3,363                  | 35.8%   | 222                          | 83.9                |
| Category 3          | 2,295                  | 24.4%   | 125                          | 145.5               |
| <b>BIG total(1)</b> | <b>\$ 9,391</b>        | <b>100.0%</b>                                   | <b>464</b>                   | <b>\$ 229.3</b>     |

(1) Total does not add due to rounding.

(2) Includes case reserves on credit derivatives of \$45.6 million at March 31, 2009, which balances are included in credit derivative liabilities in the Company's consolidated balance sheets.

During the first quarter 2009, we added net par of approximately \$1.7 billion related to U.S. RMBS, \$0.8 billion related trust preferred collateralized debt obligations and \$0.4 billion related to U.S. municipal obligations to our BIG list.

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Prior to 2009, our surveillance department maintained a list of closely monitored credits ( CMC ). The closely monitored credits were divided into four categories: Category 1 (low priority; fundamentally sound, greater than normal risk); Category 2 (medium priority; weakening credit profile, may result in loss); Category 3 (high priority; claim/default probable, case reserve established); Category 4 (claim paid, case reserve established for future payments). The closely monitored credits included all below investment grade ( BIG ) exposures where there was a material amount of exposure (generally greater than \$10.0 million) or a material risk of the Company incurring a loss greater than \$0.5 million. The closely monitored credits also included investment grade ( IG ) risks where credit quality was deteriorating and where, in the view of the Company, there was significant potential that the risk quality would fall below investment grade. As of December 31, 2008, the closely monitored credits included approximately 99% of our BIG exposure, and the remaining BIG exposure of \$92.3 million was distributed across 89 different credits. Other than those excluded BIG credits, credits that were not included in the closely monitored credit list were categorized as fundamentally sound risks.

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The following table provides financial guaranty insurance policy and CDS contract net par outstanding by credit monitoring category as of December 31, 2008:

| Description:                         | Net Par<br>Outstanding | As of December 31, 2008                         |                             | Case<br>Reserves(2) |
|--------------------------------------|------------------------|---|-----------------------------|---------------------|
|                                      |                        | % of Net Par<br>Outstanding<br>(\$ in millions) | # of Credits<br>in Category |                     |
| Fundamentally sound risk             | \$ 215,987             | 97.0%   |                             |                     |
| Closely monitored:                   |                        |   |                             |                     |
| Category 1                           | 2,967                  | 1.3%  | 51                          | \$ 1                |
| Category 2                           | 767                    | 0.3%  | 21                          |                     |
| Category 3                           | 2,889                  | 1.3%  | 54                          | 111                 |
| Category 4                           | 20                     |   | 14                          | 20                  |
| CMC total(1)                         | 6,643                  | 3.0%  | 140                         | 133                 |
| Other below investment grade<br>risk | 92                     |   | 89                          |                     |
| Total(1)                             | \$ 222,722             | 100.0%  |                             | \$ 133              |

(1) Total does not add due to rounding.

(2) Includes case reserves on credit derivatives of \$12.7 million at December 31, 2008, which balances are included in credit derivative liabilities in the Company's consolidated balance sheets.

**Salvage Recoverable**

When we become entitled to the underlying collateral of an insured credit under salvage and subrogation rights as a result of a claim payment, it reduces the corresponding loss reserve for a particular financial guaranty insurance policy for the estimated salvage and subrogation, in accordance with FAS No. 60, Accounting and Reporting by Insurance Enterprises. If the expected salvage and subrogation exceeds the estimated loss reserve for a policy, such amounts are recorded as a salvage recoverable asset in our balance sheets.

**Fair Value of Credit Derivatives**

The Company follows FAS 133, FAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities (FAS 149) and FAS No. 155, Accounting for Certain Hybrid Financial Instruments (FAS 155), which establishes accounting and reporting standards for derivative instruments and FAS No. 157, Fair Value Measurements, which establishes a comprehensive framework for measuring fair value. FAS 133 and FAS 149 require recognition of all derivatives on the balance sheet at fair value. FAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FAS 157 also requires an entity maximize the use of

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observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value. The price shall represent that available in the principal market for the asset or liability. If there is no principal market, then the price is based on the market that maximizes the value received for an asset or minimizes the amount paid for a liability (i.e. the most advantageous market).

FAS 157 specifies a fair value hierarchy based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Company-based market assumptions. In accordance with FAS 157, the fair value hierarchy prioritizes model inputs into three broad levels as follows:

- Level 1 Quoted prices for identical instruments in active markets.
- Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and observable inputs other than quoted prices, such as interest rates or yield curves and other inputs derived from or corroborated by observable market inputs.

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- Level 3 Model derived valuations in which one or more significant inputs or significant value drivers are unobservable. This hierarchy requires the use of observable market data when available.

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

We issue credit derivatives that we view as an extension of our financial guaranty business but that do not qualify for the financial guaranty insurance scope exception under FAS 133 and FAS 149 and therefore are reported at fair value, with changes in fair value included in our earnings.

Our realized gains and other settlements on credit derivatives include credit derivative premiums received and receivable, credit derivative losses paid and payable and realized gains or losses due to early terminations and ceding commissions (expense) income. Credit derivative premiums and ceding commissions (expense) income are earned over the life of the transaction. Claim payments or recoveries are related to credit events requiring payment by or to us under the credit derivative contract. Realized gains or losses are recorded related to the early termination of credit derivative contracts.

Our unrealized gains and losses on credit derivatives represent changes in fair value of these instruments that are required to be recorded under FAS 133. The unrealized gains and losses on credit derivatives will reduce to zero as the exposure approaches its maturity date, unless there is a payment default on the exposure. However, in the event that we terminate a credit derivative contract prior to maturity the unrealized gain or loss will be realized through realized gains or losses and other settlements on credit derivatives. Changes in the fair value of our derivative contracts do not reflect actual claims or credit losses, and have no impact on the Company's claims paying resources, rating agency capital or regulatory capital positions or debt covenants.

We do not typically exit our credit derivative contracts and there are not quoted prices for our instruments or similar instruments. Observable inputs other than quoted market prices exist, however, these inputs reflect contracts that do not contain terms and conditions similar to the credit derivatives issued by us. Therefore, the valuation of our credit derivative contracts requires the use of models that contain significant, unobservable inputs. Thus, we believe that our credit derivative contract valuations are in Level 3 in the fair value hierarchy of FAS 157.

The fair value of these instruments represents the difference between the present value of remaining contractual premiums charged for the credit protection and the estimated present value of premiums that a comparable financial guarantor would hypothetically charge for the same protection at the balance sheet date. The fair value of these contracts depends on a number of factors including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of the referenced entities, the our own credit risk and remaining contractual flows.

Remaining contractual cash flows, which are included in the realized gains and other settlements on credit derivatives component of credit derivatives, are the most readily observable variables since they are based on the CDS contractual terms. These variables include i) net premiums received and receivable on written credit derivative contracts, ii) net premiums paid and payable on purchased contracts, iii) losses paid and payable to credit derivative contract counterparties and iv) losses recovered and recoverable on purchased contracts. The remaining key variables described above impact unrealized gains (losses) on credit derivatives.

Market conditions at March 31, 2009 were such that market prices for our CDS contracts were generally not available. Where market prices were not available, we used a combination of observable market data and valuation models, including various market indices, credit spreads, our own credit risk and estimated contractual payments to estimate the fair value of the Company's credit derivatives. These models are primarily developed internally based on market conventions for similar transactions. Management considers the non-standard terms of its credit derivative contracts in determining the fair value of these contracts. These terms differ from credit derivatives sold by companies outside of the financial guaranty industry. The non-standard terms include the absence of collateral support agreements or immediate settlement provisions, relatively high attachment points and the fact that the Company does not exit derivatives it sells for credit protection purposes, except under specific circumstances such as exiting a line of business. Because of these terms and conditions, the fair value of the Company's credit derivatives may not reflect the same prices observed in an actively traded market of credit default swaps that do not contain terms and conditions similar to those observed in the financial guaranty market. These models and the



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related assumptions are continuously reevaluated by management and enhanced, as appropriate, based upon improvements in modeling techniques and availability of more timely market information.

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

The fair value adjustment excluding incurred losses on credit derivatives recognized in our statement of operations for the three months ended March 31, 2009 ( First Quarter 2009 ) was a \$27.0 million gain compared with a \$259.6 million loss for the three months ended March 31, 2008 ( First Quarter 2008 ). The change in fair value for First Quarter 2009 was attributable to spreads widening and includes no credit losses, partially offset by the higher credit risk of the Company as indicated by the cost of credit protection on us, which increased from 1,775 basis points at December 31, 2008 to 3,847 basis points at March 31, 2009. The change in fair value for First Quarter 2008 is mainly due to credit spreads widening, primarily related to the deterioration of the sub-prime mortgage market, partially offset by the higher credit risk of the Company as indicated by the cost of credit protection on us, which increased from 180 basis points at December 31, 2007 to 540 basis points at March 31, 2008. For First Quarter 2008, approximately 41% of the Company's unrealized loss on credit derivatives is due to a decline in the market value of high yield and investment grade corporate collateralized loan obligation transactions, with the balance generated by lower market values principally in the residential and commercial mortgage backed securities markets. With considerable volatility continuing in the market, the fair value adjustment amount will fluctuate significantly in future periods.

*Fair Value of Committed Capital Securities ( CCS )*

The fair value of CCS Securities represents the present value of remaining expected put option premium payments under the CCS Securities agreements and the value of such estimated payments based upon the quoted price for such premium payments as of March 31, 2009 and December 31, 2008. The \$70.7 million and \$51.1 million fair value asset for CCS Securities as of March 31, 2009 and December 31, 2008, respectively, is included in the consolidated balance sheets. Changes in fair value of this asset are included in other income in the consolidated statements of operations and comprehensive income. In First Quarter 2009 and First Quarter 2008 the Company recorded a fair value gain of \$19.7 million and \$8.5 million, pre-tax, related to Assured Guaranty Corp.'s CCS Securities.

*Valuation of Investments*

As of March 31, 2009 and December 31, 2008, we had total investments of \$3.8 billion and \$3.6 billion, respectively. The fair values of all of our investments are calculated from independent market valuations. The fair values of the Company's U.S. Treasury securities are primarily determined based upon broker dealer quotes obtained from several independent active market makers. The fair values of the Company's portfolio other than U.S. Treasury securities are determined primarily using matrix pricing models. The matrix pricing models incorporate factors such as tranche type, collateral coupons, average life, payment speeds, and spreads, in order to calculate the fair values of specific securities owned by the Company. As of March 31, 2009, under FAS 157, all of our fixed maturity securities were classified as Level 2 and our short-term investments were classified as either Level 1 or Level 2.

As of March 31, 2009, approximately 84% of our investments were long-term fixed maturity securities, and our portfolio had an average duration of 3.8 years, compared with 87% and 4.1 years as of December 31, 2008. Changes in interest rates affect the value of our fixed maturity portfolio. As interest rates fall, the fair value of fixed maturity securities increases and as interest rates rise, the fair value of fixed maturity securities decreases. The

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Company's portfolio is comprised primarily of high-quality, liquid instruments. We continue to receive sufficient information to value our investments and have not had to modify our approach due to the current market conditions.

***Other Than Temporary Impairments***

We have a formal review process for all securities in our investment portfolio, including a review for impairment losses. Factors considered when assessing impairment include:

- a decline in the market value of a security by 20% or more below amortized cost for a continuous period of at least six months;
- a decline in the market value of a security for a continuous period of 12 months;
- recent credit downgrades of the applicable security or the issuer by rating agencies;
- the financial condition of the applicable issuer;
- whether loss of investment principal is anticipated;
- whether scheduled interest payments are past due; and
- whether we have the ability and intent to hold the security for a sufficient period of time to allow for anticipated recoveries in fair value.

If we believe a decline in the value of a particular investment is temporary, we record the decline as an unrealized loss on our balance sheet in accumulated other comprehensive income in shareholders' equity. If we believe the decline is other than temporary, we write down the carrying value of the investment and record a realized loss in our statement of operations. In periods subsequent to the recognition of an other-than-temporary impairment, the impaired security is accounted for as if it had been purchased on the measurement date of the impairment. Accordingly, the discount (or reduced premium) based on the new cost basis is accreted into net investment income in future periods based upon the amount and timing of expected future cash flows of the security, if the recoverable value of the investment based upon those cash flows is greater than the carrying value of the investment after the impairment.

Our assessment of a decline in value includes management's current assessment of the factors noted above. If that assessment changes in the future, we may ultimately record a loss after having originally concluded that the decline in value was temporary.

As part of our other than temporary impairment review process, we consider the nature of the investment, the cause for the impairment (interest or credit related), the severity (both as a percentage of book value and absolute dollars) and duration of the impairment and any other available evidence, such as discussions with investment advisors, volatility of the securities fair value, recent news reports, etc., when performing our assessment.

The Company recognized \$18.5 million of other than temporary impairment losses substantially related to mortgage backed and corporate securities for the three months ended March 31, 2009 primarily due to the fact that it does not have the intent to hold these securities until there is a recovery in their value. The Company continues to monitor the value of these investments. Future events may result in further impairment of the Company's investments. The Company had no write downs of investments for other than temporary impairment losses for the three months ended March 31, 2008.

As of March 31, 2009, excluding the securities described above, the Company's gross unrealized loss position stood at \$104.8 million compared to \$122.5 million at December 31, 2008. The \$17.7 million decrease in gross unrealized losses was primarily attributable to municipal securities, \$19.3 million, mortgage and asset backed securities, \$6.9 million, and partially offset by an increase in gross unrealized losses in corporate securities, \$8.8 million. The decrease in gross unrealized losses during the three months ended March 31, 2009 was related to the recovery of liquidity in the financial markets.

As of March 31, 2009, the Company had 85 securities in an unrealized loss position for greater than 12 months, representing a gross unrealized loss of \$55.8 million. Of these securities, 28 securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of March 31, 2009 was \$39.0 million. This unrealized loss is primarily attributable to the market illiquidity and volatility in the U.S. economy

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mentioned above and not specific to individual issuer credit. Except as noted below, the Company has recognized no other than temporary impairment losses and has the ability and intent to hold these securities until a recovery in value.

The following table summarizes the unrealized losses in our investment portfolio by type of security and the length of time such securities have been in a continuous unrealized loss position as of the dates indicated:

| Length of Time in Continuous Unrealized Loss Position | As of March 31, 2009 |                         | As of December 31, 2008 |                         |
|---|----------------------|-------------------------|-------------------------|-------------------------|
|   | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value    | Gross Unrealized Losses |
|   | (\$ in millions)     |                         |                         |                         |
| <b>Municipal securities</b>                           |                      |                         |                         |                         |
| 0-6 months  | \$ 148.1             | \$ (2.6)                | \$ 168.8                | \$ (5.8)                |
| 7-12 months   | 174.8                | (5.8)                   | 310.6                   | (22.9)                  |
| Greater than 12 months                                | 295.8                | (23.7)                  | 137.9                   | (22.7)                  |
|   | 618.7                | (32.1)                  | 617.3                   | (51.4)                  |
| <b>Corporate securities</b>                           |                      |                         |                         |                         |
| 0-6 months  | 66.9                 | (7.6)                   | 23.7                    | (1.7)                   |
| 7-12 months   | 71.8                 | (9.0)                   | 81.9                    | (8.5)                   |
| Greater than 12 months                                | 20.1                 | (4.0)                   | 14.2                    | (1.6)                   |
|   | 158.8                | (20.6)                  | 119.8                   | (11.8)                  |
| <b>U.S. Government obligations</b>                    |                      |                         |                         |                         |
| 0-6 months  | 8.0                  |                         |                         |                         |
| 7-12 months   |                      |                         | 8.0                     |                         |
| Greater than 12 months                                |                      |                         |                         |                         |
|   | 8.0                  |                         | 8.0                     |                         |
| <b>Mortgage and asset-backed securities</b>           |                      |                         |                         |                         |
| 0-6 months  | 68.8                 | (12.0)                  | 143.6                   | (15.5)                  |
| 7-12 months   | 126.4                | (12.0)                  | 111.0                   | (36.2)                  |
| Greater than 12 months                                | 113.1                | (28.1)                  | 74.4                    | (7.3)                   |
|   | 308.3                | (52.1)                  | 329.0                   | (59.0)                  |
| <b>Preferred stocks</b>                               |                      |                         |                         |                         |
| 0-6 months  |                      |                         | 12.4                    | (0.3)                   |
| 7-12 months   |                      |                         |                         |                         |
| Greater than 12 months                                |                      |                         |                         |                         |
|   |                      |                         | 12.4                    | (0.3)                   |
| Total   | \$ 1,093.8           | \$ (104.8)              | \$ 1,086.5              | \$ (122.5)              |

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The following table summarizes the unrealized losses in our investment portfolio by type of security and remaining time to maturity as of the dates indicated:

| Remaining Time to Maturity                  | As of March 31, 2009 |                         | As of December 31, 2008 |                         |
|---|----------------------|-------------------------|-------------------------|-------------------------|
|   | Estimated Fair Value | Gross Unrealized Losses | Estimated Fair Value    | Gross Unrealized Losses |
|   | (\$ in millions)     |                         |                         |                         |
| <b>Municipal securities</b>                 |                      |                         |                         |                         |
| Due in one year or less                     | \$                   | \$                      | \$                      | \$                      |
| Due after one year through five years       |                      |                         | 5.4                     |                         |
| Due after five years through ten years      | 43.0                 | (1.6)                   | 42.4                    | (2.6)                   |
| Due after ten years                         | 575.7                | (30.5)                  | 569.5                   | (48.8)                  |
|   | 618.7                | (32.1)                  | 617.3                   | (51.4)                  |
| <b>Corporate securities</b>                 |                      |                         |                         |                         |
| Due in one year or less                     | 4.5                  |                         | 0.8                     |                         |
| Due after one year through five years       | 28.9                 | (2.8)                   | 23.9                    | (1.2)                   |
| Due after five years through ten years      | 104.6                | (11.5)                  | 72.6                    | (6.6)                   |
| Due after ten years                         | 20.8                 | (6.3)                   | 22.5                    | (4.0)                   |
|   | 158.8                | (20.6)                  | 119.8                   | (11.8)                  |
| <b>U.S. Government obligations</b>          |                      |                         |                         |                         |
| Due in one year or less                     | 8.0                  |                         | 8.0                     |                         |
| Due after one year through five years       |                      |                         |                         |                         |
| Due after five years through ten years      |                      |                         |                         |                         |
| Due after ten years                         | 8.0                  |                         | 8.0                     |                         |
|   |                      |                         |                         |                         |
| <b>Mortgage and asset-backed securities</b> | 308.3                | (52.1)                  | 329.0                   | (59.0)                  |
| <b>Preferred stocks</b>                     |                      |                         | 12.4                    | (0.3)                   |
| Total                                       | \$ 1,093.8           | \$ (104.8)              | \$ 1,086.5              | \$ (122.5)              |

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The following table summarizes, for all securities sold at a loss through March 31, 2009 and 2008, the fair value and realized loss by length of time such securities were in a continuous unrealized loss position prior to the date of sale:

| Length of Time in Continuous Unrealized Loss Prior to Sale | 2009                 |                       | Three Months Ended March 31, 2008 |                       | Gross Realized Losses |
|--|----------------------|-----------------------|-----------------------------------|-----------------------|-----------------------|
|  | Estimated Fair Value | Gross Realized Losses | Estimated Fair Value              | Gross Realized Losses |                       |
| (\$ in millions)   |                      |                       |                                   |                       |                       |
| <b>Municipal securities</b>                                |                      |                       |                                   |                       |                       |
| 0-6 months   | \$                   | \$                    | \$                                | 2.5                   | \$ (0.3)              |
| 7-12 months  |                      |                       |                                   |                       |                       |
| Greater than 12 months                                     | 3.7                  | (1.7)                 |                                   |                       |                       |
|  | 3.7                  | (1.7)                 | 2.5                               |                       | (0.3)                 |
| <b>Corporate securities</b>                                |                      |                       |                                   |                       |                       |
| 0-6 months   | 1.1                  | (0.4)                 | 0.4                               |                       |                       |
| 7-12 months  | 7.3                  | (6.9)                 | 2.1                               |                       |                       |
| Greater than 12 months                                     | 0.8                  | (0.2)                 |                                   |                       |                       |
|  | 9.2                  | (7.5)                 | 2.5                               |                       |                       |
| <b>U.S. Government securities</b>                          |                      |                       |                                   |                       |                       |
| 0-6 months   |                      |                       |                                   |                       |                       |
| 7-12 months  |                      |                       |                                   |                       |                       |
| Greater than 12 months                                     |                      |                       |                                   |                       |                       |
| <b>Mortgage and asset-backed securities</b>                |                      |                       |                                   |                       |                       |
| 0-6 months   | 0.1                  | (0.1)                 | 4.9                               |                       | (0.1)                 |
| 7-12 months  | 7.6                  | (3.4)                 | 1.2                               |                       |                       |
| Greater than 12 months                                     | 23.3                 | (12.2)                | 1.2                               |                       |                       |
|  | 31.0                 | (15.7)                | 7.3                               |                       | (0.1)                 |
| <b>Preferred stock</b>                                     |                      |                       |                                   |                       |                       |
| 0-6 months   | 11.2                 | (1.5)                 |                                   |                       |                       |
| 7-12 months  |                      |                       |                                   |                       |                       |
| Greater than 12 months                                     |                      |                       |                                   |                       |                       |
|  | 11.2                 | (1.5)                 |                                   |                       |                       |
| Total  | \$ 55.1              | \$ (26.4)             | \$ 12.3                           | \$                    | (0.4)                 |

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***Premium Revenue Recognition***

Premiums are received either upfront or in installments.

Upon Adoption of FAS 163

The Company recognizes a liability for the unearned premium revenue at the inception of a financial guarantee contract equal to the present value of the premiums due or expected to be collected over the period of the contract. If the premium is a single premium received at the inception of the financial guarantee contract, the Company measures the unearned premium revenue as the amount received. The period of the contract is the expected period of risk that generally equates to the contract period. However, in some instances, the expected period of risk is significantly shorter than the full contract period due to expected prepayments. In those instances where the financial guarantee contract insures a homogeneous pool of assets that are contractually prepayable and where those prepayments are probable and the timing and amount of prepayments can be reasonably estimated the Company uses the expected period of risk to recognize premium revenues. The Company adjusts prepayment assumptions when those assumptions change and recognizes a prospective change in premium revenues as a result. The adjustment to the unearned premium revenue is equal the adjustment to the premium receivable with no effect on earnings at the time of the adjustment.

The Company recognizes the premium from a financial guarantee insurance contract as revenue over the period of the contract in proportion to the amount of insurance protection provided. As premium revenue is recognized, a corresponding decrease in the unearned premium revenue occurs. The amount of insurance protection provided is a function of the insured principal amount outstanding. Therefore, the proportionate share of premium revenue to be recognized in a given reporting period is a constant rate calculated based on the relationship between the insured principal amount outstanding in a given reporting period compared with the sum of each of the insured principal amounts outstanding for all periods. When the issuer of an insured financial obligation retires the insured financial obligation before its maturity and replaces it with a new financial obligation, referred to as a refunding, the financial guarantee insurance contract on the retired financial obligation is extinguished. The Company immediately recognizes any nonrefundable unearned premium revenue related to that contract as premium revenue and any associated acquisition costs previously deferred as an expense.

In our reinsurance businesses, we estimate the ultimate written and earned premiums to be received from a ceding company at the end of each quarter and the end of each year because some of our ceding companies report premium data anywhere from 30 to 90 days after the end of the relevant period. Written premiums reported in our statement of operations are based upon reports received from ceding companies supplemented by our own estimates of premium for which ceding company reports have not yet been received. As of March 31, 2009 and December 31, 2008, the assumed premium estimate and related ceding commissions included in our unaudited interim consolidated financial statements were \$0.4 million and \$0.2 million and \$5.4 million and \$1.0 million, respectively. Key assumptions used to arrive at management's best estimate of assumed premiums are premium amounts reported historically and informal communications with ceding companies. Differences between such estimates and actual amounts are recorded in the period in which the actual amounts are determined. Historically, the differences have not been material. We do not record a provision for doubtful accounts related to our assumed



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premium estimate. Historically there have not been any material issues related to the collectibility of assumed premium. No provision for doubtful accounts related to our premium receivable was recorded for March 31, 2009 or December 31, 2008.

Prior to Adoption of FAS 163

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

*Deferred Acquisition Costs*

Acquisition costs incurred, other than those associated with credit derivative products, that vary with and are directly related to the production of new business are deferred in proportion to written premium and amortized in relation to earned premiums. These costs include direct and indirect expenses such as ceding commissions, brokerage expenses and the cost of underwriting and marketing personnel. As of March 31, 2009 and December 31, 2008, we had deferred acquisition costs of \$382.5 million and \$288.6 million, respectively. Ceding commissions paid to primary insurers are the largest component of deferred acquisition costs, constituting 69% and 59% of total deferred acquisition costs as of March 31, 2009 and December 31, 2008, respectively. Management uses its judgment in determining what types of costs should be deferred, as well as what percentage of these costs should be deferred. We annually conduct a study to determine which operating costs vary with, and are directly related to, the acquisition of new business and qualify for deferral. Ceding commissions received on premiums we cede to other reinsurers reduce acquisition costs. Anticipated losses, LAE and the remaining costs of servicing the insured or reinsured business are considered in determining the recoverability of acquisition costs. Acquisition costs associated with credit derivative products are expensed as incurred. When an insured issue is retired early, as discussed above in the Premium Revenue Recognition section of these Critical Accounting Estimates, the remaining related deferred acquisition cost is expensed at that time. Ceding commissions, calculated at their contractually defined rate, associated future installment premiums on assumed and ceded reinsurance business were recorded in deferred acquisition costs upon the adoption of FAS 163.

*Taxation of Subsidiaries*

The Company's Bermuda subsidiaries are not subject to any income, withholding or capital gains taxes under current Bermuda law. The Company's U.S. and U.K. subsidiaries are subject to income taxes imposed by U.S. and U.K. authorities and file applicable tax returns. In addition, AGRO, a Bermuda domiciled company, has elected under Section 953(d) of the U.S. Internal Revenue Code to be taxed as a U.S. domestic corporation.

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The U.S. Internal Revenue Service ( IRS ) has completed audits of all of the Company 's U.S. subsidiaries ' federal income tax returns for taxable years through 2001. In September 2007, the IRS completed its audit of tax years 2002 through 2004 for Assured Guaranty Overseas US Holdings Inc. and subsidiaries, which includes Assured Guaranty Overseas US Holdings Inc., AGRO, Assured Guaranty Mortgage Insurance Company and AG Intermediary Inc. As a result of the audit there were no significant findings and no cash settlements with the IRS. In addition, the IRS is reviewing Assured Guaranty US Holdings Inc. and subsidiaries ( AGUS ) for tax years 2002 through the date of the IPO. AGUS includes Assured Guaranty US Holdings Inc., AGC and AG Financial Products and were part of the consolidated tax return of a subsidiary of ACE Limited ( ACE ), our former Parent, for years prior to the IPO. The Company is indemnified by ACE for any potential tax liability associated with the tax examination of AGUS as it relates to years prior to the IPO. In addition, tax years 2005 and subsequent remain open.

### *Deferred Income Taxes*

As of March 31, 2009 and December 31, 2008, we had a net deferred income tax asset of \$117.6 million and a net deferred income tax asset of \$129.1 million, respectively. Certain of our subsidiaries are subject to U.S. income tax. Deferred income tax assets and liabilities are established for the temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities using enacted rates in effect for the year in which the differences are expected to reverse. Such temporary differences relate principally to unrealized gains and losses on investments and credit derivatives , deferred acquisition costs, reserves for losses and LAE, unearned premium reserves, net operating loss carryforwards ( NOLs ) and statutory contingency reserves. A valuation allowance is recorded to reduce a deferred tax asset to the amount that in management 's opinion is more likely than not to be realized.

As of both March 31, 2009 and December 31, 2008, Assured Guaranty Re Overseas Ltd. ( AGRO ) had a stand alone NOL of \$47.9 million, which is available to offset its future U.S. taxable income. The Company has \$27.2 million of this NOL available through 2017 and \$20.7 million available through 2023. AGRO 's stand alone

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NOL is not permitted to offset the income of any other members of AGRO's consolidated group due to certain tax regulations. Assured Guaranty Mortgage Insurance Company (AGMIC) is a member of the same consolidated tax group as AGRO. In First Quarter 2009 AGMIC had a projected NOL of \$9.6 million which would be available through 2020.

Under applicable accounting rules, we are required to establish a valuation allowance for NOLs that we believe are more likely than not to expire before being utilized. Management has assessed the likelihood of realization of all of its deferred tax assets. Based on this analysis, management believes it is more likely than not that \$20.0 million of AGRO's \$47.9 million NOL will not be utilized before it expires and has established a \$7.0 million valuation allowance related to the NOL deferred tax asset. In addition, management believes it is more likely than not that AGMIC's NOL will not be utilized before it expires and has established a \$3.4 million valuation allowance related to the NOL deferred tax asset. Management believes that all other deferred income taxes are more-likely-than-not to be realized. The valuation allowance is subject to considerable judgment, is reviewed quarterly and will be adjusted to the extent actual taxable income differs from estimates of future taxable income that may be used to realize NOLs or capital losses.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 (FIN 48), on January 1, 2007. The total liability for unrecognized tax benefits as of both March 31, 2009 and December 31, 2008 was \$5.1 million and is included in other liabilities on the balance sheet. The Company does not believe it is reasonably possible that this amount will change significantly in the next twelve months. The Company's policy is to recognize interest and penalties related to uncertain tax positions in income tax expense.

***Liability For Tax Basis Step-Up Adjustment***

In connection with the IPO, the Company and ACE Financial Services Inc. (AFS), a subsidiary of ACE, entered into a tax allocation agreement, whereby the Company and AFS made a Section 338 (h)(10) election that has the effect of increasing the tax basis of certain affected subsidiaries tangible and intangible assets to fair value. Future tax benefits that the Company derives from the election will be payable to AFS when realized by the Company.

As a result of the election, the Company has adjusted its net deferred tax liability to reflect the new tax basis of the Company's affected assets. The additional basis is expected to result in increased future income tax deductions and, accordingly, may reduce income taxes otherwise payable by the Company. Any tax benefit realized by the Company will be paid to AFS. Such tax benefits will generally be calculated by comparing the Company's affected subsidiaries' actual taxes to the taxes that would have been owed by those subsidiaries had the increase in basis not occurred. After a 15 year period, to the extent there remains an unrealized tax benefit, the Company and AFS will negotiate a settlement of the unrealized benefit based on the expected realization at that time.

The Company initially recorded a \$49.0 million reduction of its existing deferred tax liability, based on an estimate of the ultimate resolution of the Section 338(h)(10) election. Under the tax allocation agreement, the Company estimated that, as of the IPO date, it was obligated to pay \$20.9 million to AFS and accordingly established this amount as a liability. The initial difference, which is attributable to the change in the tax basis of certain liabilities for which there is no associated step-up in the tax basis of its assets and no amounts due to AFS, resulted in an increase to additional paid-in capital of \$28.1 million. As of March 31, 2009 and December 31, 2008, the liability for tax basis step-up adjustment, which is included in the Company's balance sheets in Other liabilities, was \$9.0 million and \$9.1 million, respectively. The Company has paid ACE and correspondingly reduced its liability by \$0.2 million and \$0.2 million in First Quarter 2009 and First Quarter 2008, respectively.

*Accounting for Share-Based Compensation*

Effective January 1, 2006, we adopted the fair value recognition provisions of FAS No. 123 (revised), Share-Based Payment ( FAS 123R ) using the modified prospective transition method. Share-based compensation expense in First Quarter 2009 and First Quarter 2008 was \$3.8 million (\$3.1 million after tax) and \$6.4 million (\$5.4 million after tax), respectively. The effect on basic and diluted earnings per share for First Quarter 2009 and First Quarter 2008 was \$0.03 and \$0.07, respectively. First Quarter 2009 and First Quarter 2008 expense included \$2.0 million (\$1.8 million after tax) and \$3.9 million (\$3.5 million after tax), respectively, related to accelerated vesting for stock award grants to retirement-eligible employees.

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*Accounting for Cash-Based Compensation*

The Company's compensation expense for First Quarter 2009 and First Quarter 2008 was in the form of performance retention awards. The Company recognized approximately \$5.2 million (\$4.4 million after-tax) and \$5.5 million (\$4.6 million after-tax) of expense for performance retention awards in First Quarter 2009 and First Quarter 2008, respectively. Included in First Quarter 2009 and First Quarter 2008 amounts were \$4.3 million and \$4.6 million, respectively, of accelerated expense related to retirement eligible employees.

**Information on Residential Mortgage Backed Securities ( RMBS ), Subprime RMBS, Collateralized Debt Obligations of Asset Backed Securities ( CDOs of ABS ) and Prime RMBS Exposures**

**Our Risk Management and Surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio. The primary objective of the surveillance process is to monitor trends and changes in transaction credit quality, detect any deterioration in credit quality and take such remedial actions as may be necessary or appropriate. All transactions in the insured portfolio are risk rated, and surveillance personnel are responsible for adjusting these ratings to reflect changes in transaction credit quality. In assessing the credit quality of our insured portfolio, we take into consideration a variety of factors. For RMBS exposures such factors include the amount of credit support or subordination benefiting our exposure, delinquency and loss trends on the underlying collateral, the extent to which the exposure has amortized and the year in which it was insured.**



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The tables below provide information on the risk ratings and certain other risk characteristics of the Company's RMBS, subprime RMBS, CDOs of ABS and Prime exposures as of March 31, 2009 (dollars in millions):





Table of Contents**Distribution of U.S. RMBS by Rating(1) and by Segment as of March 31, 2009**

| Ratings(1):               | Direct<br>Net Par<br>Outstanding | %      | Reinsurance<br>Net Par<br>Outstanding | %      | Total<br>Net Par<br>Outstanding | %      |
|---------------------------|----------------------------------|--------|---------------------------------------|--------|---------------------------------|--------|
| Super senior              | \$ 4,430                         | 26.3%  | \$                                    |        | \$ 4,430                        | 24.8%  |
| AAA                       | 932                              | 5.5%   | 151                                   | 15.5%  | 1,083                           | 6.1%   |
| AA                        | 991                              | 5.9%   | 100                                   | 10.2%  | 1,091                           | 6.1%   |
| A                         | 2,325                            | 13.8%  | 111                                   | 11.4%  | 2,437                           | 13.7%  |
| BBB                       | 2,601                            | 15.4%  | 127                                   | 13.0%  | 2,728                           | 15.3%  |
| Below investment<br>grade | 5,591                            | 33.1%  | 488                                   | 49.9%  | 6,079                           | 34.1%  |
|                           | \$ 16,871                        | 100.0% | \$ 977                                | 100.0% | \$ 17,847                       | 100.0% |

**Distribution of U.S. RMBS by rating, December 31, 2006 to March 31, 2009**

| Ratings(1):               | 12/31/2006 | 12/31/2007 | 12/31/2008 | 3/31/2009 |
|---------------------------|------------|------------|------------|-----------|
| Super senior              | 41.4%      | 35.4%      | 34.7%      | 24.8%     |
| AAA                       | 23.1%      | 33.9%      | 9.1%       | 6.1%      |
| AA                        | 0.3%       | 5.0%       | 8.5%       | 6.1%      |
| A                         | 9.2%       | 6.4%       | 13.4%      | 13.7%     |
| BBB                       | 25.1%      | 9.1%       | 10.4%      | 15.3%     |
| Below investment<br>grade | 0.9%       | 10.1%      | 24.0%      | 34.1%     |
|                           | 100.0%     | 100.0%     | 100.0%     | 100.0%    |

**Distribution of U.S. RMBS by Rating(1) and Type of Exposure as of March 31, 2009**

| Ratings(1):               | Prime First<br>Lien | Prime<br>Closed<br>End<br>Seconds | Prime<br>HELOC | Alt-A First<br>Lien | Alt-A<br>Option<br>ARMs | Subprime<br>First Lien | Total Net Par<br>Outstanding |
|---------------------------|---------------------|-----------------------------------|----------------|---------------------|-------------------------|------------------------|------------------------------|
| Super senior              | \$                  | \$ 46                             | \$             | \$ 1,493            | \$                      | \$ 2,890               | \$ 4,430                     |
| AAA                       | 12                  | 57                                | 10             | 710                 | 9                       | 286                    | 1,083                        |
| AA                        | 74                  |                                   | 12             | 726                 | 9                       | 269                    | 1,091                        |
| A                         | 107                 | 3                                 | 8              | 883                 | 202                     | 1,234                  | 2,437                        |
| BBB                       | 717                 |                                   | 109            | 564                 | 85                      | 1,253                  | 2,728                        |
| Below investment<br>grade | 655                 | 309                               | 1,496          | 1,756               | 1,250                   | 612                    | 6,079                        |
| Total exposures           | \$ 1,566            | \$ 415                            | \$ 1,636       | \$ 6,132            | \$ 1,554                | \$ 6,543               | \$ 17,847                    |

**Distribution of U.S. RMBS by Year Insured and Type of Exposure as of March 31, 2009**

| Year Insured:   | Prime First<br>Lien | Prime<br>Closed<br>End<br>Seconds | Prime<br>HELOC | Alt-A First<br>Lien | Alt-A<br>Option<br>ARMs | Subprime<br>First Lien | Total Net Par<br>Outstanding |
|-----------------|---------------------|-----------------------------------|----------------|---------------------|-------------------------|------------------------|------------------------------|
| 2004 and prior  | \$ 117              | \$ 3                              | \$ 147         | \$ 83               | \$ 69                   | \$ 492                 | \$ 911                       |
| 2005            | 196                 |                                   | 696            | 382                 | 51                      | 83                     | 1,408                        |
| 2006            | 337                 | 5                                 | 130            | 58                  | 76                      | 4,423                  | 5,030                        |
| 2007            | 916                 | 408                               | 664            | 3,151               | 1,210                   | 1,517                  | 7,864                        |
| 2008            |                     |                                   |                | 2,459               | 148                     | 27                     | 2,634                        |
| 2009            |                     |                                   |                |                     |                         |                        |                              |
| Total exposures | \$ 1,566            | \$ 415                            | \$ 1,636       | \$ 6,132            | \$ 1,554                | \$ 6,543               | \$ 17,847                    |

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

Table of Contents**Distribution of U.S. RMBS by Rating(1) and Year Insured as of March 31, 2009**

| Year insured:  | Super Senior | AAA Rated | AA Rated | A Rated  | BBB Rated | BIG Rated | Total     |
|----------------|--------------|-----------|----------|----------|-----------|-----------|-----------|
| 2004 and prior | \$           | \$ 187    | \$ 136   | \$ 182   | \$ 153    | \$ 252    | \$ 911    |
| 2005           |              | 55        | 155      | 181      | 171       | 845       | 1,408     |
| 2006           | 2,890        | 178       | 233      | 531      | 893       | 305       | 5,030     |
| 2007           | 46           | 67        | 566      | 1,010    | 1,511     | 4,664     | 7,864     |
| 2008           | 1,493        | 597       |          | 531      |           | 13        | 2,634     |
| 2009           |              |           |          |          |           |           |           |
|                | \$ 4,430     | \$ 1,083  | \$ 1,091 | \$ 2,437 | \$ 2,728  | \$ 6,079  | \$ 17,847 |
| % of total     | 24.8%        | 6.1%      | 6.1%     | 13.7%    | 15.3%     | 34.1%     | 100.0%    |

**Distribution of U.S. Prime HELOC RMBS by Rating(1) and Year Insured as of March 31, 2009**

| Year insured:  | Super Senior | AAA Rated | AA Rated | A Rated | BBB Rated | BIG Rated | Total    |
|----------------|--------------|-----------|----------|---------|-----------|-----------|----------|
| 2004 and prior | \$           | \$ 0      | \$ 11    | \$ 5    | \$ 91     | \$ 39     | \$ 147   |
| 2005           |              |           |          | 2       | 14        | 680       | 696      |
| 2006           |              |           |          |         | 3         | 127       | 130      |
| 2007           |              | 10        | 1        | 1       | 1         | 651       | 664      |
| 2008           |              |           |          |         |           |           |          |
| 2009           |              |           |          |         |           |           |          |
|                | \$           | \$ 10     | \$ 12    | \$ 8    | \$ 109    | \$ 1,496  | \$ 1,636 |
| % of total     | 0.0%         | 0.6%      | 0.7%     | 0.5%    | 6.7%      | 91.5%     | 100.0%   |

**Distribution of U.S. Closed End Seconds RMBS by Rating(1) and Year Insured as of March 31, 2009**

| Year insured:  | Super Senior | AAA Rated | AA Rated | A Rated | BBB Rated | BIG Rated | Total  |
|----------------|--------------|-----------|----------|---------|-----------|-----------|--------|
| 2004 and prior | \$           | \$ 0      | \$       | \$ 2    | \$        | \$        | \$ 3   |
| 2005           |              |           |          |         |           |           |        |
| 2006           |              |           |          |         |           | 5         | 5      |
| 2007           | 46           | 57        |          | 1       |           | 304       | 408    |
| 2008           |              |           |          |         |           |           |        |
| 2009           |              |           |          |         |           |           |        |
|                | \$ 46        | \$ 57     | \$       | \$ 3    | \$        | \$ 309    | \$ 415 |
| % of total     | 11.2%        | 13.8%     | 0.0%     | 0.7%    | 0.0%      | 74.3%     | 100.0% |

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

Table of Contents**Distribution of U.S. Alt-A RMBS by Rating(1) and Year Insured as of March 31, 2009**

| Year insured:  | Super Senior | AAA Rated | AA Rated | A Rated | BBB Rated | BIG Rated | Total    |
|----------------|--------------|-----------|----------|---------|-----------|-----------|----------|
| 2004 and prior | \$           | \$ 14     | \$ 7     | \$ 41   | \$ 21     | \$        | \$ 83    |
| 2005           |              | 46        | 155      | 26      | 39        | 115       | 382      |
| 2006           |              | 52        |          |         |           | 6         | 58       |
| 2007           |              |           | 565      | 446     | 504       | 1,635     | 3,151    |
| 2008           | 1,493        | 597       |          | 369     |           |           | 2,459    |
| 2009           |              |           |          |         |           |           |          |
|                | \$ 1,493     | \$ 710    | \$ 726   | \$ 883  | \$ 564    | \$ 1,756  | \$ 6,132 |
| % of total     | 24.4%        | 11.6%     | 11.8%    | 14.4%   | 9.2%      | 28.6%     | 100.0%   |

**Distribution of U.S. Alt-A Option ARM RMBS by Rating(1) and Year Insured as of March 31, 2009**

| Year insured:  | Super Senior | AAA Rated | AA Rated | A Rated | BBB Rated | BIG Rated | Total    |
|----------------|--------------|-----------|----------|---------|-----------|-----------|----------|
| 2004 and prior | \$           | \$        | \$       | \$ 52   | \$ 17     | \$        | \$ 69    |
| 2005           |              | 8         |          |         | 1         | 42        | 51       |
| 2006           |              | 1         | 9        |         |           | 66        | 76       |
| 2007           |              |           |          | 2       | 67        | 1,141     | 1,210    |
| 2008           |              |           |          | 148     |           |           | 148      |
| 2009           |              |           |          |         |           |           |          |
|                | \$           | \$ 9      | \$ 9     | \$ 202  | \$ 85     | \$ 1,250  | \$ 1,554 |
| % of total     | 0.0%         | 0.6%      | 0.6%     | 13.0%   | 5.4%      | 80.4%     | 100.0%   |

**Distribution of U.S. Subprime RMBS by Rating(1) and Year Insured as of March 31, 2009**

| Year insured:  | Super Senior | AAA Rated | AA Rated | A Rated  | BBB Rated | BIG Rated | Total    |
|----------------|--------------|-----------|----------|----------|-----------|-----------|----------|
| 2004 and prior | \$           | \$ 160    | \$ 44    | \$ 50    | \$ 24     | \$ 214    | \$ 492   |
| 2005           |              | 1         |          | 77       | 3         | 2         | 83       |
| 2006           | 2,890        | 124       | 224      | 531      | 554       | 100       | 4,423    |
| 2007           |              |           | 1        | 561      | 672       | 284       | 1,517    |
| 2008           |              |           |          | 14       |           | 13        | 27       |
| 2009           |              |           |          |          |           |           |          |
|                | \$ 2,890     | \$ 286    | \$ 269   | \$ 1,234 | \$ 1,253  | \$ 612    | \$ 6,543 |
| % of total     | 44.2%        | 4.4%      | 4.1%     | 18.9%    | 19.1%     | 9.4%      | 100.0%   |

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

Table of Contents**Distribution of Financial Guaranty Direct U.S. RMBS by Rating(1) and Type of Exposure as of March 31, 2009**

| Ratings(1):            | Prime First Lien | Prime Closed End Seconds | Prime HELOC | Alt-A First Lien | Alt-A Option ARMs | Subprime First Lien | Total Net Par Outstanding |
|------------------------|------------------|--------------------------|-------------|------------------|-------------------|---------------------|---------------------------|
| Super senior           | \$               | \$ 46                    | \$          | \$ 1,493         | \$                | \$ 2,890            | \$ 4,430                  |
| AAA                    |                  | 55                       |             | 654              |                   | 224                 | 932                       |
| AA                     |                  |                          | 6           | 724              |                   | 261                 | 991                       |
| A                      | 75               |                          |             | 856              | 201               | 1,194               | 2,325                     |
| BBB                    | 716              |                          | 15          | 563              | 84                | 1,222               | 2,601                     |
| Below investment grade | 649              | 304                      | 1,146       | 1,728            | 1,233             | 531                 | 5,591                     |
| Total exposures        | \$ 1,441         | \$ 405                   | \$ 1,168    | \$ 6,018         | \$ 1,518          | \$ 6,322            | \$ 16,871                 |

**Distribution of Financial Guaranty Direct U.S. RMBS by Year Insured as of March 31, 2009**

| Year insured:  | Prime First Lien | Prime Closed End Seconds | Prime HELOC | Alt-A First Lien | Alt-A Option ARMs | Subprime First Lien | Total Net Par Outstanding |
|----------------|------------------|--------------------------|-------------|------------------|-------------------|---------------------|---------------------------|
| 2004 and prior | \$               | \$                       | \$ 21       | \$ 49            | \$ 68             | \$ 344              | \$ 483                    |
| 2005           | 189              |                          | 572         | 376              | 40                | 77                  | 1,254                     |
| 2006           | 336              |                          |             |                  | 56                | 4,403               | 4,794                     |
| 2007           | 916              | 405                      | 575         | 3,134            | 1,206             | 1,498               | 7,732                     |
| 2008           |                  |                          |             | 2,459            | 148               |                     | 2,607                     |
| 2009           | \$ 1,441         | \$ 405                   | \$ 1,168    | \$ 6,018         | \$ 1,518          | \$ 6,322            | \$ 16,871                 |

**Distribution of Financial Guaranty Direct U.S. RMBS by Year Issued as of March 31, 2009**

| Year issued:   | Prime First Lien | Prime Closed End Seconds | Prime HELOC | Alt-A First Lien | Alt-A Option ARMs | Subprime First Lien | Total Net Par Outstanding |
|----------------|------------------|--------------------------|-------------|------------------|-------------------|---------------------|---------------------------|
| 2004 and prior | \$               | \$                       | \$ 21       | \$ 49            | \$ 68             | \$ 344              | \$ 483                    |
| 2005           | 189              |                          | 572         | 376              | 40                | 3,580               | 4,757                     |
| 2006           | 336              |                          |             | 360              | 56                | 1,900               | 2,651                     |
| 2007           | 916              | 405                      | 575         | 5,233            | 1,354             | 498                 | 8,980                     |
| 2008           |                  |                          |             |                  |                   |                     |                           |
| 2009           | \$ 1,441         | \$ 405                   | \$ 1,168    | \$ 6,018         | \$ 1,518          | \$ 6,322            | \$ 16,871                 |

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

Table of Contents**Distribution of Financial Guaranty Direct U.S. RMBS Net Par Outstanding by Rating(1) and Year Issued as of March 31, 2009**

| Year issued:   | Super Senior | AAA Rated | AA Rated | A Rated  | BBB Rated | BIG Rated | Total     |
|----------------|--------------|-----------|----------|----------|-----------|-----------|-----------|
| 2004 and prior | \$           | \$ 111    | \$ 48    | \$ 96    | \$ 52     | \$ 176    | \$ 483    |
| 2005           | 1,990        | 170       | 379      | 710      | 706       | 801       | 4,757     |
| 2006           | 1,174        |           |          | 100      | 961       | 417       | 2,651     |
| 2007           | 1,266        | 651       | 565      | 1,419    | 882       | 4,197     | 8,980     |
| 2008           |              |           |          |          |           |           |           |
| 2009           |              |           |          |          |           |           |           |
|                | \$ 4,430     | \$ 932    | \$ 991   | \$ 2,325 | \$ 2,601  | \$ 5,591  | \$ 16,871 |
| % of total     | 26.3%        | 5.5%      | 5.9%     | 13.8%    | 15.4%     | 33.1%     | 100.0%    |

**Distribution of Financial Guaranty Direct U.S. RMBS Net Par Outstanding by Rating(1) and Year Insured as of March 31, 2009**

| Year issued:   | Super Senior | AAA Rated | AA Rated | A Rated  | BBB Rated | BIG Rated | Total     |
|----------------|--------------|-----------|----------|----------|-----------|-----------|-----------|
| 2004 and prior | \$           | \$ 111    | \$ 48    | \$ 96    | \$ 52     | \$ 176    | \$ 483    |
| 2005           |              | 46        | 155      | 179      | 153       | 721       | 1,254     |
| 2006           | 2,890        | 124       | 224      | 531      | 889       | 136       | 4,794     |
| 2007           | 46           | 55        | 565      | 1,002    | 1,507     | 4,558     | 7,732     |
| 2008           | 1,493        | 597       |          | 517      |           |           | 2,607     |
| 2009           |              |           |          |          |           |           |           |
|                | \$ 4,430     | \$ 932    | \$ 991   | \$ 2,325 | \$ 2,601  | \$ 5,591  | \$ 16,871 |
| % of total     | 26.3%        | 5.5%      | 5.9%     | 13.8%    | 15.4%     | 33.1%     | 100.0%    |

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

Table of Contents**Distribution of Financial Guaranty Direct U.S. Mortgage-Backed Securities Issued January 1, 2005 or Later by Exposure Type, Average Pool Factor, Subordination, Cumulative Losses and 60+ Day Delinquencies as of March 31, 2009 (1)****U.S. Prime First Lien**

| Year issued: | Net Par Outstanding | Pool Factor(2) | Subordination (3) | Cumulative Losses (4) | 60+ Day Delinquencies (5) | Number of transactions |
|--------------|---------------------|----------------|-------------------|-----------------------|---------------------------|------------------------|
| 2005         | \$ 189              | 73.2%          | 5.3%              | 0.1%                  | 4.0%                      | 6                      |
| 2006         | 336                 | 68.2%          | 5.9%              | 0.1%                  | 3.0%                      | 2                      |
| 2007         | 916                 | 83.8%          | 10.3%             | 0.3%                  | 4.2%                      | 2                      |
| 2008         | N/A                 | N/A            | N/A               | N/A                   | N/A                       | N/A                    |
| 2009         | N/A                 | N/A            | N/A               | N/A                   | N/A                       | N/A                    |
|              | \$ 1,441            | 78.8%          | 8.6%              | 0.2%                  | 3.9%                      | 10                     |

**U.S. Prime CES**

| Year issued: | Net Par Outstanding | Pool Factor(2) | Subordination (3) | Cumulative Losses (4) | 60+ Day Delinquencies (5) | Number of transactions |
|--------------|---------------------|----------------|-------------------|-----------------------|---------------------------|------------------------|
| 2005         | N/A                 | N/A            | N/A               | N/A                   | N/A                       | N/A                    |
| 2006         | N/A                 | N/A            | N/A               | N/A                   | N/A                       | N/A                    |
| 2007         | 405                 | 61.2%          | 21.5%             | 30.5%                 | 21.1%                     | 5                      |
| 2008         | N/A                 | N/A            | N/A               | N/A                   | N/A                       | N/A                    |
| 2009         | N/A                 | N/A            | N/A               | N/A                   | N/A                       | N/A                    |
|              | \$ 405              | 61.2%          | 21.5%             | 30.5%                 | 21.1%                     | 5                      |

**U.S. Prime HELOC**

| Year issued: | Net Par Outstanding | Pool Factor(2) | Subordination (3) | Cumulative Losses (4) | 60+ Day Delinquencies (5) | Number of transactions |
|--------------|---------------------|----------------|-------------------|-----------------------|---------------------------|------------------------|
| 2005         | \$ 572              | 31.7%          | 0.0%              | 11.9%                 | 15.0%                     | 2                      |
| 2006         | N/A                 | N/A            | N/A               | N/A                   | N/A                       | N/A                    |
| 2007         | 575                 | 64.3%          | 0.0%              | 16.9%                 | 12.8%                     | 2                      |
| 2008         | N/A                 | N/A            | N/A               | N.A.                  | N/A                       | N/A                    |
| 2009         | N/A                 | N/A            | N/A               | N.A.                  | N/A                       | N/A                    |
|              | \$ 1,146            | 48.0%          | 0.0%              | 14.4%                 | 13.9%                     | 4                      |

**U.S. Alt-A First Lien**

| Year issued: | Net Par Outstanding | Pool Factor(2) | Subordination (3) | Cumulative Losses (4) | 60+ Day Delinquencies (5) | Number of transactions |
|--------------|---------------------|----------------|-------------------|-----------------------|---------------------------|------------------------|
| 2005         | \$ 376              | 59.8%          | 11.7%             | 1.0%                  | 10.6%                     | 13                     |
| 2006         | 360                 | 73.3%          | 39.4%             | 3.3%                  | 30.3%                     | 2                      |
| 2007         | 5,233               | 77.8%          | 20.5%             | 1.6%                  | 24.0%                     | 11                     |
| 2008         | N/A                 | N/A            | N/A               | N/A                   | N/A                       | N/A                    |
| 2009         | N/A                 | N/A            | N/A               | N/A                   | N/A                       | N/A                    |
|              | \$ 5,969            | 76.4%          | 21.1%             | 1.7%                  | 23.5%                     | 26                     |

(1) Net par outstanding is based on values as of March 2009. All performance information such as pool factor, subordination, cumulative losses and delinquency is based on March 2009 information obtained from Intex, Bloomberg, and/or provided by the trustee and may be subject to restatement or correction.



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- (2) Pool factor is the percentage of net par outstanding divided by the original net par outstanding of the transactions at inception.
- (3) Represents the sum of subordinate tranches and over-collateralization, expressed as a percentage of total transaction size and does not include any benefit from excess interest collections that may be used to absorb losses.
- (4) Cumulative losses are defined as net charge-offs on the underlying loan collateral divided by the original pool balance.
- (5) 60+ day delinquencies are defined as loans that are greater than 60 days delinquent and all loans that are in foreclosure, bankruptcy or REO divided by net par outstanding.

Table of Contents**Distribution of Financial Guaranty Direct U.S. Mortgage-Backed Securities Issued January 1, 2005 or Later by Exposure Type, Average Pool Factor, Subordination, Cumulative Losses and 60+ Day Delinquencies as of March 31, 2009 (1)****U.S. Alt-A Option ARMs**

| Year issued: | Net Par Outstanding | Pool Factor(2) | Subordination (3) | Cumulative Losses (4) | 60+ Day Delinquencies(5) | Number of transactions |
|--------------|---------------------|----------------|-------------------|-----------------------|--------------------------|------------------------|
| 2005         | \$ 40               | 32.3%          | 27.6%             | 1.0%                  | 22.4%                    | 1                      |
| 2006         | 56                  | 55.1%          | 19.1%             | 1.2%                  | 30.6%                    | 1                      |
| 2007         | 1,354               | 79.6%          | 20.7%             | 1.3%                  | 25.3%                    | 7                      |
| 2008         | N/A                 | N/A            | N/A               | N/A                   | N/A                      | N/A                    |
| 2009         | N/A                 | N/A            | N/A               | N/A                   | N/A                      | N/A                    |
|              | \$ 1,450            | 77.4%          | 20.8%             | 1.3%                  | 25.5%                    | 9                      |

**U.S. Subprime First Lien**

| Year issued: | Net Par Outstanding | Pool Factor(2) | Subordination (3) | Cumulative Losses (4) | 60+ Day Delinquencies(5) | Number of transactions |
|--------------|---------------------|----------------|-------------------|-----------------------|--------------------------|------------------------|
| 2005         | \$ 3,580            | 31.5%          | 63.6%             | 7.1%                  | 41.9%                    | 42                     |
| 2006         | 1,900               | 46.4%          | 41.3%             | 8.9%                  | 42.8%                    | 49                     |
| 2007         | 498                 | 48.0%          | 40.5%             | 9.3%                  | 45.6%                    | 2                      |
| 2008         | N/A                 | N/A            | N/A               | N/A                   | N/A                      | N/A                    |
| 2009         | N/A                 | N/A            | N/A               | N/A                   | N/A                      | N/A                    |
|              | \$ 5,977            | 37.6%          | 54.6%             | 7.9%                  | 42.5%                    | 93                     |

**U.S. CMBS**

| Year issued: | Net Par Outstanding | Pool Factor(2) | Subordination (3) | Cumulative Losses (4) | 60+ Day Delinquencies(5) | Number of transactions |
|--------------|---------------------|----------------|-------------------|-----------------------|--------------------------|------------------------|
| 2005         | \$ 3,429            | 96.5%          | 28.9%             | 0.0%                  | 0.2%                     | 158                    |
| 2006         | 1,418               | 98.2%          | 30.6%             | 0.0%                  | 0.3%                     | 57                     |
| 2007         | 524                 | 89.2%          | 20.6%             | 0.0%                  | 2.1%                     | 13                     |
| 2008         | N/A                 | N/A            | N/A               | N/A                   | N/A                      | N/A                    |
| 2009         | N/A                 | N/A            | N/A               | N/A                   | N/A                      | N/A                    |
|              | \$ 5,371            | 96.2%          | 28.5%             | 0.0%                  | 0.4%                     | 228                    |

(1) Net par outstanding is based on values as of March 2009. All performance information such as pool factor, subordination, cumulative losses and delinquency is based on March 2009 information obtained from Intex, Bloomberg, and/or provided by the trustee and may be subject to restatement or correction.

(2) Pool factor is the percentage of net par outstanding divided by the original net par outstanding of the transactions at inception.

(3) Represents the sum of subordinate tranches and over-collateralization, expressed as a percentage of total transaction size and does not include any benefit from excess interest collections that may be used to absorb losses.

(4) Cumulative losses are defined as net charge-offs on the underlying loan collateral divided by the original pool balance.

(5) 60+ day delinquencies are defined as loans that are greater than 60 days delinquent and all loans that are in foreclosure, bankruptcy or REO divided by net par outstanding.

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**Consolidated Results of Operations (1)**



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The following table presents summary consolidated results of operations data for the three months ended March 31, 2009 and 2008.

|  | Three Months Ended<br>March 31, |                   |
|--|---------------------------------|-------------------|
|  | 2009 <sup>(2)</sup>             | 2008              |
|  | (\$ in millions)                |                   |
| <b>Revenues:</b>   |                                 |                   |
| Net earned premiums  | \$ 148.4                        | \$ 46.8           |
| Net investment income                                      | 43.6                            | 36.6              |
| Net realized investment (losses) gains                     | (17.1)                          | 0.6               |
| Change in fair value of credit derivatives                 |                                 |                   |
| Realized gains and other settlements on credit derivatives | 20.6                            | 27.6              |
| Unrealized gains (losses) on credit derivatives            | 27.0                            | (259.6)           |
| Net change in fair value of credit derivatives             | 47.6                            | (232.0)           |
| Other income   | 20.6                            | 8.5               |
| <b>Total revenues</b>                                      | <b>243.1</b>                    | <b>(139.4)</b>    |
| <b>Expenses:</b>   |                                 |                   |
| Loss and loss adjustment expenses                          | 79.8                            | 55.1              |
| Profit commission expense                                  | 0.3                             | 1.2               |
| Acquisition costs  | 23.4                            | 11.9              |
| Operating expenses   | 32.3                            | 28.6              |
| Interest expense   | 5.8                             | 5.8               |
| Other expenses   | 1.4                             | 0.7               |
| <b>Total expenses</b>                                      | <b>143.0</b>                    | <b>103.4</b>      |
| Income (loss) before provision (benefit) for income taxes  | 100.1                           | (242.8)           |
| Provision (benefit) for income taxes                       | 14.6                            | (73.6)            |
| <b>Net income (loss)</b>                                   | <b>\$ 85.5</b>                  | <b>\$ (169.2)</b> |
| <b>Underwriting gain (loss) by segment:</b>                |                                 |                   |
| Financial guaranty direct                                  | \$ 87.0                         | \$ (18.9)         |
| Financial guaranty reinsurance                             | (14.2)                          | (7.3)             |
| Mortgage guaranty  | (31.3)                          | 0.8               |
| Other  |                                 |                   |
| <b>Total</b>   | <b>\$ 41.5</b>                  | <b>\$ (25.4)</b>  |

(1) Some amounts may not add due to rounding.

(2) Effective January 1, 2009, the Company adopted FAS 163. Please see [Critical Accounting Estimates](#) for additional information.

We organize our business around four principal business segments: financial guaranty direct, financial guaranty reinsurance, mortgage guaranty and other. There are a number of lines of business that we have exited as part of our IPO in April 2004, which are included in the other segment. However, the results of these businesses are reflected in the above numbers. These unaudited interim consolidated financial statements cover the First Quarter 2009 and the First Quarter 2008.

*Net Income (Loss)*



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Net income (loss) was \$85.5 million and \$(169.2) million for First Quarter 2009 and First Quarter 2008, respectively. The increase of \$254.7 million in 2009 compared with 2008 is primarily due to the following factors:



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- a \$27.0 million unrealized gain on credit derivatives in First Quarter 2009 compared with a \$(259.6) million unrealized loss on credit derivatives in First Quarter 2008, mainly attributable to the Company's own credit spread widening. The unrealized gain (loss) on credit derivatives, net of related income taxes, was \$33.2 million and \$(183.5) million for First Quarter 2009 and First Quarter 2008, respectively. With considerable volatility continuing in the market, this amount will fluctuate significantly in future periods,
- an increase of \$66.9 million in underwriting gain to \$41.5 million in 2009, compared with a \$(25.4) million underwriting loss in 2008, primarily due to an increase in net earned premiums of \$101.6 million, of which \$73.6 million related to the cancellation of certain financial guaranty contracts and \$14.3 million related to an increase in refundings
- an increase of \$7.0 million in net investment income to \$43.6 million in First Quarter 2009 from \$36.6 million in First Quarter 2008 which is attributable to increased invested assets from positive operating cash flows, and
- an increase of \$12.1 million in other income, which included a fair value gain of \$19.7 million pre-tax, \$12.8 million after-tax, related to Assured Guaranty Corp.'s committed capital securities.

Partially offsetting these positive factors were:

- an increase in net realized investment (losses) of \$(17.7) million primarily related to the \$(18.5) million write down of securities due to other than temporary impairment,
- an increase of \$3.7 million in operating expenses to \$32.3 million in 2009 from \$28.6 million in 2008, mainly as a result of legal, accounting and advisory costs related to our pending acquisition of FSA, and
- a \$88.2 million increase in our provision (benefit) for income tax to \$14.6 million in First Quarter 2009, compared with \$(73.6) million in First Quarter 2008. The provision in First Quarter 2009 was mainly related to the unrealized gain on credit derivatives recognized in First Quarter 2009.

*Net Earned Premiums*

|                            | <b>Three Months Ended</b> |             |
|----------------------------|---------------------------|-------------|
|                            | <b>March 31,</b>          |             |
| <b>Net Earned Premiums</b> | <b>2009</b>               | <b>2008</b> |
|                            | (\$ in millions)          |             |

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|  |    |       |    |      |
|--|----|-------|----|------|
| Financial guaranty direct                    | \$ | 101.5 | \$ | 17.3 |
| Financial guaranty reinsurance               |    | 46.2  |    | 27.8 |
| Mortgage guaranty                            |    | 0.8   |    | 1.9  |
| Total financial guaranty net earned premiums |    | 148.4 |    | 46.8 |
| Other  |    |       |    |      |
| Total net earned premiums                    | \$ | 148.4 | \$ | 46.8 |

Net earned premiums for First Quarter 2009 were \$148.4 million compared with \$46.8 million for First Quarter 2008. First Quarter 2009 earned premiums include \$5.3 million related to the accretion of discount on future financial guaranty installment premiums as the result of the implementation of FAS 163 effective January 1, 2009. Financial guaranty direct net earned premiums increased \$84.2 million in First Quarter 2009, compared with First Quarter 2008. This increase is attributable to cancellation of certain international infrastructure transactions which resulted in \$73.6 million of net earned premiums, as well as the continued growth of our in-force book of business. The First Quarter 2009 and First Quarter 2008 had no earned premiums from public finance refundings in the financial guaranty direct segment. Public finance refunding premiums reflect the unscheduled pre-payment or refundings of underlying municipal bonds. Our financial guaranty reinsurance segment increased \$18.4 million in

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2009 compared with 2008 due mainly to an increase in refundings of \$14.3 million, as well as the CIFG portfolio assumed in the First Quarter of 2009 which contributed \$4.4 million to net earned premiums. The \$1.1 million decrease in net earned premiums in our mortgage guaranty segment in 2009 compared with 2008 reflects the run-off of this business.

***Net Investment Income***

Net investment income was \$43.6 million for First Quarter 2009, compared with \$36.6 million for First Quarter 2008. The \$7.0 million increase is attributable to increased invested assets due to positive operating cash flows.

***Net Realized Investment (Losses) Gains***

Net realized investment (losses) gains, principally from the sale of fixed maturity securities, were \$(17.1) million and \$0.6 million for First Quarter 2009 and First Quarter 2008, respectively. The Company recognized \$18.5 million of other than temporary impairment losses substantially related to mortgage backed and corporate securities for the three months ended March 31, 2009 primarily due to the fact that it does not have the intent to hold these securities until there is a recovery in their value. The Company had no write downs of investments for other than temporary impairment losses for both the three months ended March 31, 2008. Net realized investment (losses) gains, net of related income taxes, were \$(17.1) million and \$0.4 million for First Quarter 2009 and First Quarter 2008, respectively.

***Realized Gains and Other Settlements on Credit Derivatives***

| Realized gains and other settlements on credit derivatives                | Three Months Ended |                |
|---|--------------------|----------------|
|   | 2009               | March 31, 2008 |
|   | (\$ in millions)   |                |
| Net credit derivative premiums received and receivable:                   |                    |                |
| Direct segment  | \$ 28.4            | \$ 27.3        |
| Reinsurance segment   | 1.2                | 0.5            |
| Total net credit derivative premiums received and receivable              | 29.5               | 27.8           |
| Net credit derivative losses (paid and payable) recovered and recoverable | (9.1)              |                |
| Ceding commissions received/receivable (paid/payable), net                | 0.1                | (0.2)          |
| Total realized gains and other settlements on credit derivatives          | \$ 20.6            | \$ 27.6        |

Realized gains and other settlements on credit derivatives, were \$20.6 million and \$27.6 million for First Quarter 2009 and First Quarter 2008, respectively. Total net credit derivative premiums received and receivable, which represents premium income recognized attributable to CDS contracts, was \$29.5 million and \$27.8 million for the First Quarter 2009 and First Quarter 2008, respectively. This increase is attributable to growth in our direct business written in CDS form. Net credit derivative losses (paid and payable) recovered and recoverable, which represents contractual claim losses paid and payable related to insured credit events under these contracts, were \$(9.1) million and \$0 million for the First Quarter 2009 and First Quarter 2008, respectively. We did not have any losses paid or payable under these contracts in First Quarter 2008.



Table of Contents*Unrealized Gains (Losses) on Credit Derivatives*

| Unrealized gains (losses) on credit derivatives  | Three Months Ended<br>March 31, |                   |
|--|---------------------------------|-------------------|
|  | 2009                            | 2008              |
|  | (\$ in millions)                |                   |
| <b>Pre-tax:</b>  |                                 |                   |
| Unrealized gains (losses) on credit derivatives, excluding incurred losses on credit derivatives | \$ 18.8                         | \$ (256.4)        |
| Incurred gains (losses) on credit derivatives  | 8.1                             | (3.2)             |
| <b>Total unrealized losses on credit derivatives</b>   | <b>\$ 26.9</b>                  | <b>\$ (259.6)</b> |
| <b>After-tax:</b>  |                                 |                   |
| Unrealized gains (losses) on credit derivatives, excluding incurred losses on credit derivatives | \$ 26.3                         | \$ (181.4)        |
| Incurred gains (losses) on credit derivatives  | 6.9                             | (2.2)             |
| <b>Total unrealized gains (losses) on credit derivatives</b>                                     | <b>\$ 33.2</b>                  | <b>\$ (183.6)</b> |

Credit derivatives are recorded at fair value as required by FAS 133, FAS 149 and FAS 155. The fair value adjustment for First Quarter 2009 and First Quarter 2008 was a \$27.0 million gain and a \$259.6 million loss, respectively. The change in fair value for First Quarter 2009 was attributable to spreads widening and includes no credit losses, partially offset by the higher credit risk of the Company as indicated by the cost of credit protection on us, which increased from 1,775 basis points at December 31, 2008 to 3,847 basis points at March 31, 2009. The change in fair value for First Quarter 2008 was attributable to spreads widening and includes no credit losses, partially offset by the higher credit risk of the Company as indicated by the cost of credit protection on us, which increased from 180 basis points at December 31, 2007 to 540 basis points at March 31, 2008. For the three months ended March 31, 2008, approximately 41% of our unrealized loss on derivative financial instruments was due to a decline in the market value of high yield and investment grade corporate collateralized loan obligation transactions, with the balance generated by lower market values principally in the residential and commercial mortgage backed securities markets. Changes in the fair value of our derivative contracts do not reflect actual claims or credit losses, and have no impact on the Company's claims paying resources, rating agency capital or regulatory capital positions. With considerable volatility continuing in the market, the fair value adjustment amount will fluctuate significantly in future periods. Unrealized gains (losses) on credit derivatives, excluding incurred losses on credit derivatives, net of related income taxes, were \$26.3 million and \$(181.4) million for First Quarter 2009 and First Quarter 2008, respectively.

The gain or loss created by the estimated fair value adjustment will rise or fall based on estimated market pricing and may not be an indication of ultimate claims. Fair value is defined as the amount at which an asset or liability could be bought or sold in a current transaction between willing parties. We enter into credit derivative contracts which require us to make payments upon the occurrence of certain defined credit events relating to an underlying obligation (generally a fixed income obligation). The Company's credit derivative exposures are substantially similar to its financial guaranty insurance contracts and provide for credit protection against payment default. They are contracts that are generally held to maturity. The unrealized gains and losses on credit derivatives will reduce to zero as the exposure approaches its maturity date, unless there is a payment default on the exposure.

Management also calculates loss reserve expenses on our credit derivative contracts in the same manner as we do for our financial guaranty insurance contracts. Prior to the First Quarter 2008, incurred losses on credit derivatives were apportioned in our financial statements from unrealized gains (losses) on credit derivatives and included in loss and loss adjustment expenses. As a result of reclassifying our accounting activity related to credit derivative contracts commencing with the First Quarter 2008, we no longer make this apportionment in our financial statements, but believe it is an important metric in evaluating the credit quality of our credit derivative contracts. The incurred gains (losses) on credit derivatives were \$8.1 million (\$6.9 million after-tax) and \$(3.2) million (\$(2.2) million after-tax) for the First Quarter of 2009 and First

Quarter of 2008, respectively. The decrease for 2009 as compared with 2008 is primarily due to losses paid and the concurrent release of related reserves, as well as change in our reserving

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methodology for CDS credits in order to be consistent with the change in reserving methodology for our financial guaranty credits, as prescribed by FAS 163.

***Other Income***

The First Quarter 2009 and First Quarter 2008 amount included a fair value gain of \$19.7 million and \$8.5 million, pre-tax, related to Assured Guaranty Corp.'s committed capital securities. The increase was due to the widening of the Company's credit spreads.

***Loss and Loss Adjustment Expenses***

| Loss and Loss Adjustment Expenses                          | Three Months Ended<br>March 31, |         |
|--|---------------------------------|---------|
|  | 2009                            | 2008    |
|  | (\$ in millions)                |         |
| Financial guaranty direct                                  | \$ 11.7                         | \$ 35.9 |
| Financial guaranty reinsurance                             | 36.8                            | 19.2    |
| Mortgage guaranty  | 31.2                            |         |
| Total financial guaranty loss and loss adjustment expenses | 79.8                            | 55.1    |
| Other  |                                 |         |
| Total loss and loss adjustment expenses                    | \$ 79.8                         | \$ 55.1 |

Loss and loss adjustment expenses for First Quarter 2009 and First Quarter 2008 were \$79.8 million and \$55.1 million, respectively. Loss and loss adjustment expenses for the financial guaranty direct segment decreased \$24.2 million to \$11.7 million in First Quarter 2009 from \$35.9 million in First Quarter 2008. This decrease is mainly due to First Quarter 2008 including an increase in portfolio reserves of \$35.7 million related mainly to our HELOC and other RMBS exposures driven by internal ratings downgrades. The financial guaranty reinsurance segment loss and loss adjustment expenses were \$36.8 million in First Quarter 2009, compared with \$19.2 million in First Quarter 2008. First Quarter 2009 included loss and loss adjustment expenses of \$22.1 million related to our HELOC and RMBS exposures, and \$8.1 million related to the Jefferson County public finance transaction. First Quarter 2008 included increases in case and portfolio reserves of \$9.3 million and \$7.4 million, respectively, related primarily to our HELOC and U.S. Subprime RMBS exposures. Loss and loss adjustment expenses in our Mortgage guaranty segment increased \$31.2 million primarily due to a loss reserve estimate related to an arbitration proceeding.

*Profit Commission Expense*





Profit commissions, which are primarily related to our mortgage guaranty segment, allow the ceding company to share favorable experience on a reinsurance contract due to lower than expected losses. Expected or favorable loss development generates profit commission expense, while the inverse occurs on unfavorable loss development. Portfolio reserves are not a component of these profit commission calculations. Profit commissions for First Quarter 2009 and First Quarter 2008 were \$0.3 million and \$1.2 million, respectively. The decrease is primarily related to an increase in loss and loss adjustment expenses for certain assumed business subject to profit commission.

*Acquisition Costs*

Acquisition costs primarily consist of ceding commissions, brokerage fees and operating expenses that are related to the acquisition of new business. Acquisition costs that vary with and are directly related to the acquisition of new business are deferred and amortized in relation to earned premium. For First Quarter 2009 and First Quarter 2008, acquisition costs incurred were \$23.4 million and \$11.9 million, respectively. These amounts are consistent with changes in net earned premium from non-derivative transactions.

*Operating Expenses*

For First Quarter 2009 and First Quarter 2008, operating expenses were \$32.3 million and \$28.6 million, respectively. The \$3.7 million increase in 2009 compared with 2008 is mainly due to legal, accounting and advisory

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expenses related to our pending acquisition of FSA. Additionally, there was a decrease in the amount of operating expenses deferred as acquisition costs as a result of changes in market conditions.

***Interest Expense***

For First Quarter 2009 and First Quarter 2008, interest expense was \$5.8 million and \$5.8 million, respectively. Interest expense related to the issuance of our 7% Senior Notes ( Senior Notes ) in May 2004 was \$3.3 million, respectively, in both First Quarter 2009 and First Quarter 2008. Interest expense related to the issuance of our 6.40% Series A Enhanced Junior Subordinated Debentures in December 2006 was \$2.5 million in both First Quarter 2009 and First Quarter 2008. The coupon on the Senior Notes is 7.0%, however, the effective rate is approximately 6.4%, which reflects the effect of a cash flow hedge executed by the Company in March 2004, the term of which matches that of the Senior Notes.

***Other Expenses***

For First Quarter 2009 and First Quarter 2008, other expenses were \$1.4 million and \$0.7 million, respectively. These amounts reflect the put option premiums associated with AGC's \$200.0 million committed capital securities. The increase in 2009 compared to 2008 was due to the increase in annualized rates from One-Month LIBOR plus 110 basis points to One-Month LIBOR plus 250 basis points as a result of the failed auction process in April 2008.

***Income Tax***

For First Quarter 2009 and First Quarter 2008, income tax expense (benefit) was \$14.6 million and \$(73.6) million and our effective tax rate was 14.6% and 30.3%, respectively. Our effective tax rates reflect the proportion of income recognized by each of our operating subsidiaries, with U.S. subsidiaries taxed at the U.S. marginal corporate income tax rate of 35%, UK subsidiaries taxed at the UK marginal corporate tax rate of 30%, and no taxes for our Bermuda holding company and subsidiaries. Accordingly, our overall corporate effective tax rate fluctuates based on the distribution of taxable income across these jurisdictions. First Quarter 2009 included \$27.0 million of unrealized gains on credit derivatives, the majority of which is associated with subsidiaries taxed in the U.S., and is the primary reason for the 14.6% effective tax rate. First Quarter 2008 included \$259.6 million of unrealized losses on credit derivatives, the majority of which is associated with subsidiaries taxed in the U.S., and is the primary reason for the 30.3% effective tax rate.

**Segment Results of Operations**

Our financial results include four principal business segments: financial guaranty direct, financial guaranty reinsurance, mortgage guaranty and other. Management uses underwriting gains and losses as the primary measure of each segment's financial performance. Underwriting gain is calculated as net earned premiums plus realized gains and other settlements on credit derivatives less the sum of loss and loss adjustment expenses including incurred losses on credit derivatives, profit commission expense, acquisition costs and other operating expenses that are directly related to the operations of our insurance businesses. This measure excludes certain revenue and expense items, such as net investment income, realized investment gains and losses, unrealized gains and losses on credit derivatives, excluding loss reserves allocation, other income,

and interest and other expenses, that are not directly related to the underwriting performance of our insurance operations, but are included in net income.

Loss and loss adjustment expense ratio, which is a non-GAAP financial measure, is defined as loss and loss adjustment expenses (recoveries) plus the Company's net estimate of credit derivative incurred case and portfolio loss and loss adjustment expense reserves, which is included in unrealized gains (losses) on credit derivatives, plus net credit derivative losses (recoveries), which is included in realized gains and other settlements on credit derivatives, divided by net earned premiums plus net credit derivative premiums received and receivable, which is included in realized gains and other settlements on credit derivatives. Expense ratio is calculated by dividing the sum of ceding commissions expense (income), profit commission expense, acquisition costs and operating expenses by net earned premiums plus net credit derivative premiums received and receivable, which is included in realized

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gains and other settlements on credit derivatives. Combined ratio, which is a non-GAAP financial measure, is the sum of the loss and loss adjustment expense ratio and the expense ratio.

***Financial Guaranty Direct Segment***

The financial guaranty direct segment consists of our primary financial guaranty insurance business and our credit derivative business. Financial guaranty insurance provides an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest when due. Financial guaranty insurance may be issued to the holders of the insured obligations at the time of issuance of those obligations, or may be issued in the secondary market to holders of public bonds and structured securities. As an alternative to traditional financial guaranty insurance, credit protection on a particular security or issuer can also be provided through a credit derivative, such as a credit default swap. Under a credit default swap, the seller of protection makes a specified payment to the buyer of protection upon the occurrence of one or more specified credit events with respect to a reference obligation or a particular reference entity. Credit derivatives typically provide protection to a buyer rather than credit enhancement of an issue as in traditional financial guaranty insurance.

The table below summarizes the financial results of our financial guaranty direct segment for the periods presented:

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|  | Three Months Ended |           |
|--|--------------------|-----------|
|  | 2009               | 2008      |
|  | March 31,          |           |
|  | (\$ in millions)   |           |
| Net earned premiums  | \$ 101.5           | \$ 17.3   |
| Realized gains and other settlements on credit derivatives:      |                    |           |
| Net credit derivative premiums received and receivable           | 28.4               | 27.3      |
| Net credit derivative losses paid and payable                    | (8.8)              |           |
| Ceding commissions received/receivable (paid/payable), net       | 0.4                | (0.1)     |
| Total realized gains and other settlements on credit derivatives | 20.0               | 27.3      |
| Loss and loss adjustment expenses                                | 11.7               | 35.9      |
| Incurred (gains) losses on credit derivatives                    | (7.3)              | 3.2       |
| Total loss and loss adjustment expenses                          | 4.4                | 39.1      |
| Profit commission expense  |                    |           |
| Acquisition costs  | 6.2                | 3.0       |
| Operating expenses   | 24.0               | 21.3      |
| Underwriting gain (loss)   | \$ 87.0            | \$ (18.9) |
| Loss and loss adjustment expense ratio                           | 10.1%              | 87.7%     |
| Expense ratio  | 22.9%              | 54.6%     |
| Combined ratio   | 33.0%              | 142.3%    |

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| Net Earned Premiums   | Three Months Ended<br>March 31, |         |
|---|---------------------------------|---------|
|   | 2009                            | 2008    |
|   | (\$ in millions)                |         |
| Public finance  | \$ 85.5                         | \$ 4.1  |
| Structured finance  | 16.0                            | 13.2    |
| Total   | \$ 101.5                        | \$ 17.3 |
| Included in public finance direct net earned premiums are refundings of:                | \$                              | \$      |
| Included in public finance direct net earned premiums are transaction cancellations of: | \$ 73.6                         | \$      |

Net earned premiums for First Quarter 2009 were \$101.5 million compared with \$17.3 million for First Quarter 2008. The increase in net earned premiums is mainly due to the cancellation of certain international infrastructure transactions, which resulted in \$73.6 million of net earned premiums, as well as an increase in our U.S. Public Finance market penetration, which has generated additional net earned premiums and in-force business. First Quarter 2009 and First Quarter 2008 had no public finance refundings, which reflect the unscheduled pre-payment or refundings of underlying municipal bonds and are sensitive to market interest rates. We evaluate our net earned premiums both including and excluding these refundings.

| Realized gains and other settlements on credit derivatives       | Three Months Ended<br>March 31, |         |
|--|---------------------------------|---------|
|  | 2009                            | 2008    |
|  | (\$ in millions)                |         |
| Net credit derivative premiums received and receivable           | \$ 28.4                         | \$ 27.3 |
| Net credit derivative losses paid or payable                     | (8.8)                           |         |
| Ceding commissions received/receivable (paid/payable), net       | 0.4                             | (0.1)   |
| Total realized gains and other settlements on credit derivatives | \$ 20.0                         | \$ 27.3 |

Realized gains and other settlements on credit derivatives, were \$20.0 million and \$27.3 million for First Quarter 2009 and First Quarter 2008, respectively. This decrease is attributable to the \$8.8 million of losses paid or payable under these contracts in the First Quarter 2009. We did not have any losses paid or payable under these contracts in First Quarter 2008.

Loss and LAE were \$11.7 million and \$35.9 million for First Quarter 2009 and First Quarter 2008, respectively. First Quarter 2009 loss and LAE is mainly related to our HELOC and other RMBS exposures. First Quarter 2008 included an increase in portfolio reserves of \$35.7 million mainly attributable to our HELOC and other RMBS exposures driven by internal ratings downgrades.

Incurred (gains) losses on credit derivatives were \$(7.3) million for First Quarter 2009 compared with \$3.2 million for First Quarter 2008. The decrease is primarily due to the losses paid mentioned above which resulted in a release of \$3.8 million in reserves, as well as positive development for some credits within our CDS portfolio.

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For First Quarter 2009 and First Quarter 2008, acquisition costs incurred were \$6.2 million and \$3.0 million, respectively. The changes in acquisition costs incurred over the periods are directly related to changes in net earned premiums from non-derivative transactions.

Operating expenses for First Quarter 2009 and First Quarter 2008 were \$24.0 million and \$21.3 million, respectively. The increase in operating expenses for First Quarter 2009, compared with First Quarter 2008 is mainly due to legal, accounting and advisory expenses related to our pending acquisition of FSA. Additionally, there was a decrease in the amount of operating expenses deferred as acquisition costs as a result of changes in market conditions.



Table of Contents**Financial Guaranty Reinsurance Segment**

In our financial guaranty reinsurance business, we assume all or a portion of risk undertaken by other insurance companies that provide financial guaranty protection. The financial guaranty reinsurance business consists of public finance and structured finance reinsurance lines. Premiums on public finance are typically written upfront and earned over the life of the policy, and premiums on structured finance are typically written on an installment basis and earned ratably over the installment period.

The table below summarizes the financial results of our financial guaranty reinsurance segment for the periods presented:

|  | <b>Three Months Ended<br/>March 31,</b> |             |
|--|---|-------------|
|  | <b>2009</b>                             | <b>2008</b> |
|  | (\$ in millions)                        |             |
| Net earned premiums  | \$ 46.2                                 | \$ 27.8     |
| Realized gains and other settlements on credit derivatives:      |   |             |
| Net credit derivative premiums received and receivable           | 1.2                                     | 0.5         |
| Net credit derivative losses paid and payable                    | (0.3)                                   |             |
| Ceding commissions paid/payable, net                             | (0.3)                                   | (0.2)       |
| Total realized gains and other settlements on credit derivatives | 0.6                                     | 0.3         |
| Loss and loss adjustment expenses                                | 36.8                                    | 19.2        |
| Incurred (gains) losses on credit derivatives                    | (0.7)                                   |             |
| Total loss and loss adjustment expenses                          | 36.1                                    | 19.2        |
| Profit commission expense  | 0.2                                     | 1.1         |
| Acquisition costs  | 17.1                                    | 8.8         |
| Operating expenses   | 7.6                                     | 6.4         |
| Underwriting loss  | \$ (14.2)                               | \$ (7.3)    |
| Loss and loss adjustment expense ratio                           | 76.9%                                   | 67.8%       |
| Expense ratio  | 53.1%                                   | 58.1%       |
| Combined ratio   | 130.0%                                  | 125.9%      |

| <b>Net Earned Premiums</b>  | <b>Three Months Ended<br/>March 31,</b> |             |
|---|---|-------------|
|   | <b>2009</b>                             | <b>2008</b> |
|   | (\$ in millions)                        |             |
| Public finance  | \$ 34.8                                 | \$ 18.6     |
| Structured finance  | 11.4                                    | 9.2         |
| Total   | \$ 46.2                                 | \$ 27.8     |
| Included in public finance reinsurance net earned premiums are refundings of: | \$ 16.7                                 | \$ 2.4      |



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Net earned premiums for First Quarter 2009 were \$46.2 million compared with \$27.8 million for First Quarter 2008. Net earned premiums increased \$18.4 million, in 2009 compared with 2008, due mainly to an increase in refundings of \$14.3 million, as well as the CFIG portfolio assumed during the First Quarter 2009 which contributed \$4.4 million to net earned premiums. Public finance net earned premiums also include refundings, which reflect the unscheduled pre-payment or refundings of underlying municipal bonds. These unscheduled refundings, which were \$16.7 million for First Quarter 2009, compared with \$2.4 million for First Quarter 2008, are sensitive to market interest rates. We evaluate our net earned premiums both including and excluding these refundings.

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| Realized gains and other settlements on credit derivatives       | Three Months Ended<br>March 31, |        |
|--|---------------------------------|--------|
|  | 2009                            | 2008   |
|  | (\$ in millions)                |        |
| Net credit derivative premiums received and receivable           | \$ 1.2                          | \$ 0.5 |
| Net credit derivative losses paid or payable                     | (0.3)                           |        |
| Ceding commissions paid/payable, net                             | (0.3)                           | (0.2)  |
| Total realized gains and other settlements on credit derivatives | \$ 0.6                          | \$ 0.3 |

Realized gains and other settlements on credit derivatives, were \$0.6 million and \$0.3 million for First Quarter 2009 and First Quarter 2008, respectively. Net credit derivative premiums received and receivable, which represents premium income recognized attributable to CDS contracts, and related ceding commission expense, increased based on amounts reported to us by our cedants. We had \$0.3 million of losses paid or payable under these contracts in the First Quarter 2009. We did not have any losses paid or payable under these contracts in the First Quarter 2008.

Losses and LAE were \$36.8 million and \$19.2 million for First Quarter 2009 and First Quarter 2008, respectively. First Quarter 2009 loss and LAE included \$22.1 million related to our assumed HELOC and RMBS exposures, as well as \$8.1 million related to the Jefferson County public finance transaction. First Quarter 2008 included increases to case and portfolio reserves of \$9.3 million and \$7.4 million, respectively, mainly related to our U.S. Subprime RMBS and HELOC exposures.

Profit commission expense was \$0.2 million and \$1.1 million in First Quarter 2009 and First Quarter 2008, respectively. The decrease is primarily related to amounts reported by our ceding companies.

For First Quarter 2009 and First Quarter 2008, acquisition costs incurred were \$17.1 million and \$8.8 million, respectively. The changes in acquisition costs incurred over the periods are directly related to changes in net earned premiums from non-derivative transactions.

Operating expenses for First Quarter 2009 and First Quarter 2008, were \$7.6 million and \$6.4 million, respectively. The increase in operating expenses for First Quarter 2009, compared with First Quarter 2008 is mainly due to legal, accounting and advisory expenses related to our pending acquisition of FSA. Additionally, there was a decrease in the amount of operating expenses deferred as acquisition costs as a result of changes in market conditions.

***Mortgage Guaranty Segment***

Mortgage guaranty insurance provides protection to mortgage lending institutions against the default of borrowers on mortgage loans that, at the time of the advance, had a loan-to-value ratio in excess of a specified ratio. We primarily function as a reinsurer in this industry and assume all or a portion of the risks undertaken by primary mortgage insurers.



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The table below summarizes the financial results of our mortgage guaranty segment for the periods presented:

|  | <b>Three Months Ended<br/>March 31,</b> |             |
|--|---|-------------|
|  | <b>2009</b>                             | <b>2008</b> |
|  | (\$ in millions)                        |             |
| Net earned premiums                    | \$ 0.8                                  | \$ 1.9      |
| Loss and loss adjustment expenses      | 31.2                                    |             |
| Profit commission expense              | 0.1                                     | 0.1         |
| Acquisition costs                      | 0.1                                     | 0.1         |
| Operating expenses                     | 0.7                                     | 0.9         |
| <br>                                   |   |             |
| Underwriting (loss) gain               | \$ (31.3)                               | \$ 0.8      |
| <br>                                   |   |             |
| Loss and loss adjustment expense ratio | 3,900.0%                                | 0.0%        |
| Expense ratio                          | 112.5%                                  | 57.9%       |
| <br>                                   |   |             |
| Combined ratio                         | 4,012.5%                                | 57.9%       |

For First Quarter 2009 and First Quarter 2008, net earned premiums were \$0.8 million and \$1.9 million, respectively. The decrease in net earned premiums reflects the run-off of our book of business.

Loss and LAE were \$31.2 million and \$0 million for First Quarter 2009 and First Quarter 2008, respectively. The increase in loss and LAE is mainly a result of a loss reserve estimate related to a contract under dispute.

Profit commission expense for both First Quarter 2009 and First Quarter 2008 was \$0.1 million.

Acquisition costs incurred for both First Quarter 2009 and First Quarter 2008 were \$0.1 million. The acquisition costs incurred in 2009 and 2008 are directly related to net earned premiums.

Operating expenses for First Quarter 2009 and First Quarter 2008, were \$0.7 million and \$0.9 million, respectively. The decrease in operating expenses for First Quarter 2009, compared with First Quarter 2008 is mainly due to a decrease in the amount of operating expenses allocated to this segment as a result of run-off of this book of business.

***Other Segment***

The other segment represents lines of business that we exited or sold as part of our 2004 IPO.

The other segment had \$0 underwriting gain during both First Quarter 2009 or First Quarter 2008.

### **Liquidity and Capital Resources**

Our liquidity, both on a short-term basis (for the next twelve months) and a long-term basis (beyond the next twelve months), is largely dependent upon: (1) the ability of our operating subsidiaries to pay dividends or make other payments to us, (2) external financings and (3) net investment income from our invested assets. Our liquidity requirements include the payment of our operating expenses, interest on our debt, and dividends on our common shares. We may also require liquidity to make periodic capital investments in our operating subsidiaries. In the ordinary course of our business, we evaluate our liquidity needs and capital resources in light of holding

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company expenses, debt-related expenses and our dividend policy, as well as rating agency considerations. Based on the amount of dividends we expect to receive from our subsidiaries and the income we expect to receive from our invested assets, management believes that we will have sufficient liquidity to satisfy our needs over the next twelve months, including the ability to pay dividends on our common shares. Total cash paid in First Quarter 2009 and First Quarter 2008 for dividends to shareholders was \$4.1 million, or \$0.045 per common share, and \$3.6 million, or \$0.045 per common share, respectively. Beyond the next twelve months, the ability of our operating subsidiaries to declare and pay dividends may be influenced by a variety of factors including market conditions, insurance and rating agencies regulations and general economic conditions. Consequently, although management believes that we will continue to have sufficient liquidity to meet our debt service and other obligations over the long term, it remains possible that we may be required to seek external debt or equity financing in order to meet our operating expenses, debt service obligations or pay dividends on our common shares. These external sources of financing may or may not be available to us, and if available, the costs of such financing may be higher than our current levels.

We anticipate that a major source of our liquidity, for the next twelve months and for the longer term, will be amounts paid by our operating subsidiaries as dividends. Certain of our operating subsidiaries are subject to restrictions on their ability to pay dividends. See

**Business Regulation.** The amount available at AGC to pay dividends in 2009 with notice to, but without the prior approval of, the Maryland Insurance Commissioner is approximately \$37.8 million. Dividends paid by a U.S. company to a Bermuda holding company presently are subject to a 30% withholding tax. The amount available at AG Re to pay dividends or make a distribution of contributed surplus in 2009 in compliance with Bermuda law is \$1,125.0 million. However, any distribution which results in a reduction of 15% 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.

Liquidity at our operating subsidiaries is used to pay operating expenses, claims, payment obligations with respect to credit derivatives, including collateral postings, reinsurance premiums and dividends to Assured Guaranty US Holdings Inc. ( AGUS ) for debt service and dividends to us, as well as, where appropriate, to make capital investments in their own subsidiaries. In addition, certain of our operating companies may be required to post additional collateral in connection with credit derivatives and reinsurance transactions. Management believes that these subsidiaries' operating needs generally can be met from operating cash flow, including gross written premium and investment income from their respective investment portfolios.

Net cash flows provided by operating activities were \$167.0 million and \$149.0 million during First Quarter 2009 and First Quarter 2008, respectively. The increase in First Quarter 2009 cash flows provided by operating activities compared with First Quarter 2008 was due to the large proportion of upfront premiums received in our financial guaranty direct segment due to growth in our U.S. public finance business and the assumption of a portfolio from CIFG Assurance North America, Inc.

Net cash flows used in investing activities were \$151.1 million and \$142.4 million during First Quarter 2009 and First Quarter 2008, respectively. These investing activities consist of net purchases and sales of fixed maturity securities and short-term investments. The increase in 2009 was due to purchases of fixed maturity securities with the cash generated from positive cash flows from operating activities.

Net cash flows used in financing activities were \$8.7 million and \$6.3 million during First Quarter 2009 and First Quarter 2008. During First Quarter 2009 we paid \$4.1 million in dividends, \$0.9 million, net, under our option and incentive plans and \$3.7 million for share repurchases as described below. During First Quarter 2008 we paid \$3.6 million in dividends, \$2.3 million, net, under our option and incentive plans and \$0.4 million for offering costs incurred in connection with the December 2007 equity offering.



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On November 8, 2007, the Company's Board of Directors approved a new share repurchase program for up to 2.0 million common shares. Share repurchases will take place at management's discretion depending on market conditions. Through December 31, 2008 we repurchased 0.3 million shares of our Common Stock. During First Quarter 2009 we paid \$3.7 million to repurchase 1.0 million shares of our Common Stock.

The Company expects to close its acquisition of FSAH in the second quarter of 2009. The Company expects to fund the cash portion of the acquisition, \$361 million, with the proceeds of a public equity offering.

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The Company has received the WLR Backstop Commitment to fund the cash portion of the purchase price with the purchase of newly issued common shares. The Company entered into the WLR Backstop Commitment on November 13, 2008 with the WLR Funds. The WLR Backstop Commitment amended the Investment Agreement between the Company and the WLR Funds and provided to the Company the option to cause the WLR Funds to purchase from Assured Guaranty Ltd. or Assured Guaranty US Holdings Inc. a number of the Company's common shares equal to the quotient of (i) the aggregate dollar amount not to exceed \$361 million specified by the Company divided by (ii) the volume weighted average price of the Company's common share on the NYSE for the 20 NYSE trading days ending with the last NYSE trading day immediately preceding the date of the closing under the stock purchase agreement, with a floor of \$6.00 and a cap of \$8.50.

The WLR Funds have no obligation to purchase these common shares pursuant to the WLR Backstop Commitment until the closing under the stock purchase agreement occurs. The Company may use the proceeds from the sale of the Company's common shares pursuant to the WLR Backstop Commitment solely to pay a portion of the purchase price under the stock purchase agreement. The WLR Funds' obligations under the WLR Backstop Commitment have been secured by letters of credit issued for the benefit of the Company by Bank of America, N.A. and RBS Citizens Bank, N.A., each in the amount of \$180.5 million.

The Company has paid the WLR Funds a nonrefundable commitment fee of \$10,830,000 in connection with the option granted by the WLR Backstop Commitment and has agreed to pay the WLR Funds' expenses in connection with the transactions contemplated thereby. The Company has reimbursed the WLR Funds for the \$4.1 million cost of obtaining the letters of credit referred to above.

As of March 31, 2009 our future cash payments associated with contractual obligations pursuant to our operating leases for office space and have not materially changed since December 31, 2008.

*Credit Facilities*

**2006 Credit Facility**

On November 6, 2006, Assured Guaranty Ltd. and certain of its subsidiaries entered into a \$300.0 million five-year unsecured revolving credit facility (the 2006 credit facility) with a syndicate of banks, for which ABN AMRO Incorporated and Bank of America Securities LLC acted as lead arrangers. Under the 2006 credit facility, each of AGC, Assured Guaranty (UK) Ltd. (AG (UK)), AG Re, AGRO and Assured Guaranty Ltd. are entitled to request the banks to make loans to such borrower or to request that letters of credit be issued for the account of such borrower.

Of the \$300.0 million available to be borrowed, no more than \$100.0 million may be borrowed by Assured Guaranty Ltd., AG Re or AGRO, individually or in the aggregate, and no more than \$20.0 million may be borrowed by AG (UK). The stated amount of all outstanding letters of credit and the amount of all unpaid drawings in respect of all letters of credit cannot, in the aggregate, exceed \$100.0 million.

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The 2006 credit facility also provides that Assured Guaranty Ltd. may request that the commitment of the banks be increased an additional \$100.0 million up to a maximum aggregate amount of \$400.0 million. Any such incremental commitment increase is subject to certain conditions provided in the agreement and must be for at least \$25.0 million.

The proceeds of the loans and letters of credit are to be used for the working capital and other general corporate purposes of the borrowers and to support reinsurance transactions.

At the closing of the 2006 credit facility, (i) AGC guaranteed the obligations of AG (UK) under such facility, (ii) Assured Guaranty Ltd. guaranteed the obligations of AG Re and AGRO under such facility and agreed that, if the Company Consolidated Assets (as defined in the related credit agreement) of AGC and its subsidiaries were to fall below \$1.2 billion, it would, within 15 days, guarantee the obligations of AGC and AG (UK) under such facility, (iii) Assured Guaranty Overseas US Holdings Inc. guaranteed the obligations of Assured Guaranty Ltd., AG

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Re and AGRO under such facility and (iv) Each of AG Re and AGRO guarantees the other as well as Assured Guaranty Ltd.

The 2006 credit facility's financial covenants require that Assured Guaranty Ltd. (a) maintain a minimum net worth of seventy-five percent (75%) of the Consolidated Net Worth of Assured Guaranty Ltd. as of the most recent fiscal quarter of Assured Guaranty Ltd. prior to November 6, 2006 and (b) maintain a maximum debt-to-capital ratio of 30%. In addition, the 2006 credit facility requires that AGC maintain qualified statutory capital of at least 75% of its statutory capital as of the fiscal quarter prior to November 6, 2006. Furthermore, the 2006 credit facility contains restrictions on Assured Guaranty Ltd. and its subsidiaries, including, among other things, in respect of their ability to incur debt, permit liens, become liable in respect of guaranties, make loans or investments, pay dividends or make distributions, dissolve or become party to a merger, consolidation or acquisition, dispose of assets or enter into affiliate transactions. Most of these restrictions are subject to certain minimum thresholds and exceptions. The 2006 credit facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representation or warranty, bankruptcy or insolvency proceedings, change of control and cross default to other debt agreements. A default by one borrower will give rise to a right of the lenders to terminate the facility and accelerate all amounts then outstanding. As of March 31, 2009 and December 31, 2008, Assured Guaranty was in compliance with all of those financial covenants.

As of March 31, 2009 and December 31, 2008, no amounts were outstanding under this facility nor have there been any borrowings under this facility.

The 2006 credit facility replaced a \$300.0 million three-year credit facility. Letters of credit totaling approximately \$2.9 million remained outstanding as of March 31, 2009 and December 31, 2008, respectively, related to the Real Estate Lease agreement discussed above.

**Non-Recourse Credit Facilities**

***AG Re Credit Facility***

On July 31, 2007 AG Re entered into a non-recourse credit facility ( AG Re Credit Facility ) with a syndicate of banks which provides up to \$200.0 million to satisfy certain reinsurance agreements and obligations. The AG Re Credit Facility expires in July 2014.

The AG Re Credit Facility does not contain any financial covenants. The AG Re Credit Facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representation or warranty, bankruptcy or insolvency proceedings, change of control and cross default to other debt agreements. If any such event of default were triggered, AG Re could be required to repay potential outstanding borrowings in an accelerated manner.

AG Re's obligations to make payments of principal and interest on loans under the AG Re Credit Facility, whether at maturity, upon acceleration or otherwise, are limited recourse obligations of AG Re and are payable solely from the collateral securing the AG Re Credit Facility, including recoveries with respect to certain insured obligations in a designated portfolio, premiums with respect to defaulted insured obligations in that

portfolio, certain designated reserves and other designated collateral.

As of March 31, 2009 and December 31, 2008, no amounts were outstanding under this facility nor have there been any borrowings under the life of this facility.

**Committed Capital Securities**

On April 8, 2005, AGC entered into separate agreements (the Put Agreements ) with each of Woodbourne Capital Trust I, Woodbourne Capital Trust II, Woodbourne Capital Trust III and Woodbourne Capital Trust IV

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(each, a Custodial Trust ) pursuant to which AGC may, at its option, cause each of the Custodial Trusts to purchase up to \$50,000,000 of perpetual preferred stock of AGC (the AGC Preferred Stock ).

**Structure**

Each of the Custodial Trusts is a newly organized Delaware statutory trust formed for the purpose of (i) issuing a series of flex committed capital securities (the CCS Securities ) representing undivided beneficial interests in the assets of such Custodial Trust; (ii) investing the proceeds from the issuance of the CCS Securities or any redemption in full of AGC Preferred Stock in a portfolio of high-grade commercial paper and (in limited cases) U.S. Treasury Securities (the Eligible Assets ), (iii) entering into the Put Agreement with AGC; and (iv) entering into related agreements.

Initially, all of the CCS Securities were issued to a special purpose pass-through trust (the Pass-Through Trust ). The Pass-Through Trust was dissolved in April 2008 and the committed capital securities were distributed to the holders of the Pass-Through Trust 's securities. Neither the Pass-Through Trust nor the Custodial Trusts are consolidated in Assured Guaranty 's financial statements.

Income distributions on the Pass-Through Trust Securities and CCS Securities 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 CCS Securities will be determined pursuant to an auction process. On April 7, 2008 this auction process failed, thereby increasing the annualized rate on the CCS Securities to One-Month LIBOR plus 250 basis points. Distributions on the AGC Preferred Stock will be determined pursuant to the same process or, if the Company so elects upon the dissolution of the Custodial Trusts at a fixed rate equal to One-Month LIBOR plus 250 basis points (based on the then current 30-year swap rate).

**Put Agreement**

Pursuant to the Put Agreement, AGC will pay a monthly put premium to each Custodial Trust except (1) during any period when the AGC Preferred Stock that has been put to a Custodial Trust is held by that Custodial Trust or (2) upon termination of the Put Agreement. The put premium will equal the product of (A) the applicable distribution rate on the CCS Securities for the respective distribution period less the excess of (i) the Custodial Trust 's stated return on the Eligible Assets for such distribution period (including any fees and expenses of the Pass-Through Trust) (expressed as an annual rate) over (ii) the expenses of the Custodial Trust for such distribution period (expressed as an annual rate), (B) the aggregate face amount of the CCS Securities of the Custodial Trust outstanding on the date the put premium is calculated, and (C) a fraction, the numerator of which will be the actual number of days in such distribution period and the denominator of which will be 360. In addition, and as a condition to exercising the put option under a Put Agreement, AGC is required to enter into a Custodial Trust Expense Reimbursement Agreement with the respective Custodial Trust pursuant to which AGC agrees it will pay the fees and expenses of the Custodial Trust (which includes the fees and expenses of the Pass-Through Trust) during the period when such Custodial Trust holds AGC Preferred Stock.

Upon exercise of the put option granted to AGC pursuant to the Put Agreement, a Custodial Trust will liquidate its portfolio of Eligible Assets and purchase the AGC Preferred Stock and will hold the AGC Preferred Stock until the earlier of (i) the redemption of such AGC Preferred

Stock and (ii) the liquidation or dissolution of the Custodial Trust.

Each Put Agreement has no scheduled termination date or maturity, however, it will terminate if (1) AGC fails to pay the put premium in accordance with the Put Agreement, and such failure continues for five business days, (2) AGC elects to have the AGC Preferred Stock bear a fixed rate dividend (a Fixed Rate Distribution Event ), (3) AGC fails to pay (i) dividends on the AGC Preferred Stock, or (ii) the fees and expenses of the Custodial Trust, for the related dividend period, and such failure continues for five business days, (4) AGC fails to pay the redemption price of the AGC Preferred Stock and such failure continues for five business days, (5) the face amount of a Custodial Trust's CCS Securities is less than \$20,000,000, (6) AGC elects to terminate the Put Agreement, or (7) a decree of judicial dissolution of the Custodial Trust is entered. If, as a result of AGC's failure to pay the put premium, the Custodial Trust is liquidated, AGC will be required to pay a termination payment which will be distributed to the holders of the Pass-Through Trust Securities. The termination payment will be at a rate equal to 1.10% per annum of the amount invested in Eligible Assets calculated from the date of the failure to pay the put premium through the end of the applicable period.

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As of March 31, 2009 and December 31, 2008, the put option had not been exercised.

*AGC Preferred Stock*

AGC Preferred Stock under the Put Agreement will be issued in one or more series, with each series in an aggregate liquidation preference amount equal to the aggregate face amount of a Custodial Trust's outstanding CCS Securities, net of fees and expenses, upon exercise of the put option. Unless redeemed by AGC, the AGC Preferred Stock will be perpetual.

For each distribution period, holders of the outstanding AGC Preferred Stock of any series, in preference to the holders of common stock and of any other class of shares ranking junior to the AGC Preferred Stock, will be entitled to receive out of any funds legally available therefore when, as and if declared by the Board of Directors of AGC or a duly authorized committee thereof, cash dividends at a rate per share equal to the dividends rate for such series of AGC Preferred Stock for the respective distribution period. Prior to a Fixed Rate Distribution Event, the dividend rate on the AGC Preferred Stock will be equal to the distribution rate on the CCS Securities. The Custodial Trust's expenses (including any expenses of the Pass-Through Trust) for the period will be paid separately by AGC pursuant to the Custodial Trust Expense Reimbursement Agreement.

Upon a Fixed Rate Distribution Event, the distribution rate on the AGC Preferred Stock will equal the fixed rate equivalent of one-month LIBOR plus 2.50%. A Fixed Rate Distribution Event will be deemed to have occurred when AGC Preferred Stock is outstanding, if: (1) AGC elects to have the AGC Preferred Stock bear dividends at a fixed rate, (2) AGC fails to pay dividends on the AGC Preferred Stock for the related distribution period and such failure continues for five business days or (3) AGC fails to pay the fees and expenses of the Custodial Trust for the related distribution period pursuant to the Custodial Trust Expense Reimbursement Agreement and such failure continues for five business days.

During the period in which AGC Preferred Stock is held by a Custodial Trust and unless a Fixed Rate Distribution Event has occurred, dividends will be paid every 49 days. Following a Fixed Rate Distribution Event, dividends will be paid every 90 days.

Following exercise of the put option during any Flexed Rate Period, AGC may redeem the AGC Preferred Stock held by a Custodial Trust in whole and not in part on any distribution payment date by paying a redemption price to such Custodial Trust in an amount equal to the liquidation preference amount of the AGC Preferred Stock (plus any accrued but unpaid dividends on the AGC Preferred Stock for the then current distribution period). If AGC redeems the AGC Preferred Stock held by a Custodial Trust, the Custodial Trust will reinvest the redemption proceeds in Eligible Assets and, in accordance with the Put Agreement, AGC will pay the put premium to the Custodial Trust. If the AGC Preferred Stock was distributed to holders of CCS Securities during any Flexed Rate Period then AGC may not redeem the AGC Preferred Stock until the end of such period.

Following exercise of the put option AGC Preferred Stock held by a Custodial Trust in whole or in part on any distribution payment date by paying a redemption price to the Custodial Trust in an amount equal to the liquidation preference amount of the AGC Preferred Stock to be redeemed (plus any accrued but unpaid dividends on such AGC Preferred Stock for the then current distribution period). If AGC partially redeems the AGC Preferred Stock held by a Custodial Trust, the redemption proceeds will be distributed pro rata to the holders of the CCS Securities (and a corresponding reduction in the aggregate face amount of CCS Securities); provided that AGC must redeem all of the AGC Preferred Stock if after giving effect to a partial redemption, the aggregate liquidation preference amount of the AGC Preferred Stock held by



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such Custodial Trust immediately following such redemption would be less than \$20,000,000. If a Fixed Rate Distribution Event occurs, AGC may not redeem the AGC Preferred Stock for a period of two years from the date of such Fixed Rate Distribution Event.

### *Investment Portfolio*



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Our investment portfolio consisted of \$3,176.2 million of fixed maturity securities, \$616.8 million of short-term investments and a duration of 3.8 years as of March 31, 2009, compared with \$3,154.1 million of fixed maturity securities, \$477.2 million of short-term investments and a duration of 4.1 years as of December 31, 2008.

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Our fixed maturity securities are designated as available-for-sale in accordance with FAS No. 115 Accounting for Certain Investments in Debt and Equity Securities ( FAS 115 ). Fixed maturity securities are reported at their fair value in accordance with FAS 115, and the change in fair value is reported as part of accumulated other comprehensive income. If we believe the decline in fair value is other than temporary, we write down the carrying value of the investment and record a realized loss in our statement of operations.

Fair value of the fixed maturity securities is based upon market prices provided by either independent pricing services or, when such prices are not available, by reference to broker or underwriter bid indications. Our investment portfolio does not include any non-publicly traded securities. For a detailed description of our valuation of investments see Critical Accounting Estimates.

We review our investment portfolio for possible impairment losses. For additional information, see Critical Accounting Estimates.

The following table summarizes the ratings distributions of our investment portfolio as of March 31, 2009 and December 31, 2008. Ratings are represented by the lower of the Moody's Investors Service and Standard & Poor's Inc., a division of The McGraw-Hill Companies, Inc., classifications.

|                           | As of March 31, 2009 | As of December 31, 2008 |
|---------------------------|----------------------|-------------------------|
| AAA or equivalent         | 55.6%                | 59.0%                   |
| AA                        | 27.8%                | 23.8%                   |
| A                         | 14.1%                | 15.5%                   |
| BBB                       | 1.4%                 | 1.7%                    |
| Below investment grade(1) | 1.1%                 |                         |
| Total                     | 100.0%               | 100.0%                  |

(1) Represents \$1.0 million, or less than 0.1%, of the investment portfolio at December 31, 2008.

As of March 31, 2009, our investment portfolio contained 12 securities that were not rated or rated below investment grade compared to three securities as of December 31, 2008. As of both March 31, 2009 and December 31, 2008, the weighted average credit quality of our entire investment portfolio was AA+.

As of March 31, 2009, \$618.7 million of the Company's \$3,176.2 million of fixed maturity securities were guaranteed by third parties. The following table presents the credit rating of these \$618.7 million of securities without the third-party guaranty:

| Rating | Amount (in millions) |
|--------|----------------------|
| AAA    | \$ 14.5              |
| AA     | 370.3                |

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|               |    |       |
|---------------|----|-------|
| A             |    | 205.0 |
| BBB           |    | 0.3   |
| Not Available |    | 28.6  |
| Total(1)      | \$ | 618.7 |

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(1) Excludes \$19.2 million of fixed maturity securities wrapped by Assured Guaranty Corp. and rated below investment grade.

As of March 31, 2009, the distribution by third-party guarantor of the \$618.7 million is presented in the following table:

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| Guarantor | Amount (in millions) |       |
|-----------|----------------------|-------|
| Ambac     | \$                   | 197.5 |
| MBIA      |                      | 195.9 |
| FSA       |                      | 152.6 |
| FGIC      |                      | 72.7  |
| Total(1)  | \$                   | 618.7 |

(1) Excludes \$19.2 million of fixed maturity securities wrapped by Assured Guaranty Corp. and rated below investment grade.

As of March 31, 2009 and to date, the Company has had no investments in or asset positions with any of these guarantors.

Short-term investments include securities with maturity dates equal to or less than one year from the original issue date. Our short-term investments are composed of money market funds, discounted notes and certain time deposits for foreign cash portfolios. Short-term investments are reported at cost, which approximates the fair value of these securities due to the short maturity of these investments.

Under agreements with our cedants and in accordance with statutory requirements, we maintain fixed maturity securities in trust accounts for the benefit of reinsured companies and for the protection of policyholders, generally in states where we or our subsidiaries, as applicable, are not licensed or accredited. The carrying value of such restricted balances as of March 31, 2009 and December 31, 2008 was \$1,269.2 million and \$1,233.4 million, respectively.

Under certain derivative contracts, the Company is required to post eligible securities as collateral, generally cash or U.S. government or agency securities. The need to post collateral under these transactions is generally based on mark-to-market valuation in excess of contractual thresholds. The fair market value of the Company's pledged securities totaled \$177.9 million and \$157.7 million as of March 31, 2009 and December 31, 2008, respectively.

**Credit Risk**

The recent credit crisis and related turmoil in the global financial system has had and may continue to have an impact on our business. On September 15, 2008, Lehman Brothers Holdings Inc. filed for protection under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court in the Southern District of New York. As of March 31, 2009, we had CDS contracts outstanding with Lehman Brothers International (Europe), a subsidiary of Lehman Brothers Holdings Inc., with future installment payments totaling \$29.4 million (\$24.7 million present value). We have not received payment since September 15, 2008, and are currently reviewing our rights under the CDS contracts.

As of March 31, 2009, the present value of future installments ( PVI ) of our CDS contracts with counterparties in the financial services industry is approximately \$539.0 million. The largest counterparties are:

| Counterparty     | PVI Amount (in millions) |              |
|------------------|--------------------------|--------------|
| Deutsche Bank AG | \$                       | 175.8        |
| RBS/ABN AMRO     |                          | 43.8         |
| Barclays Capital |                          | 36.9         |
| Dexia Bank       |                          | 30.0         |
| Others (1)       |                          | 252.5        |
| <b>Total</b>     | <b>\$</b>                | <b>539.0</b> |

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(1) Each counterparty within the Other category represents less than 5% of the total.

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**Recent Accounting Pronouncements**





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In December 2007, the FASB issued FAS No. 141 (revised), *Business Combinations* ( FAS 141R ). FAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. FAS 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. FAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim statements within those fiscal years. Early adoption is not permitted. Since FAS 141R applies prospectively to business combinations whose acquisition date is subsequent to the statement's adoption. The Company is applying the provisions of FAS 141R to account for its pending acquisition of FSAH. As of March 31, 2009, the Company had paid \$4.6 million related to the Company's pending acquisition of FSAH that the Company expensed in the first quarter 2009.

In October 2008, the FASB issued FASB Staff Position ( FSP ) No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* ( FSP 157-3 ). FSP 157-3 clarified the application of FAS 157, *Fair Value Measurements* ( FAS 157 ), in a market that is not active. FSP 157-3 was effective when issued. It did not have an impact on the Company's current results of operations or financial position.

The FASB adopted FSP FAS 133-1 and FIN 45-4, *Disclosures About Credit Derivatives and Certain Guarantees* and FAS 161, *Disclosures about Derivative Instruments and Hedging Activities* to address concerns that current derivative disclosure requirements did not adequately address the potential adverse effects that these instruments can have on the financial performance and operations of an entity. Companies will be required to provide enhanced disclosures about their derivative activities to enable users to better understand: (1) how and why a company uses derivatives, (2) how it accounts for derivatives and related hedged items, and (3) how derivatives affect its financial statements. These should include the terms of the derivatives, collateral posting requirements and triggers, and other significant provisions that could be detrimental to earnings or liquidity. Management believes that the Company's current derivatives disclosures are in compliance with the items required by FSP 133-1 and FAS 161.

In April 2009, the FASB issued FSP FAS No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ( FSP 157-4 ). FSP 157-4 amends FAS 157 to provide additional guidance on estimating fair value when the volume and level of activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability. FSP 157-4 also provides additional guidance on circumstances that may indicate that a transaction is not orderly. FSP 157-4 supersedes FSP 157-3. FSP 157-4 amends FAS 157 to require additional disclosures about fair value measurements in annual and interim reporting periods. FSP 157-4 is effective for interim and annual reporting periods ending after June 15, 2009. Early adoption is permitted, but only for periods ending after March 15, 2009. FSP 157-4 must be applied prospectively and does not require disclosures for earlier periods presented for comparative purposes at initial adoption. The Company will adopt FSP 157-4 in its Form 10-Q for the period ended June 30, 2009. The Company is currently evaluating the impact, if any, FSP 157-4 will have on its financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* ( FSP 107-1 ). FSP 107-1 extends the disclosure requirements of FAS No. 107, *Disclosures about Fair Value of Financial Instruments*, to interim financial statements of publicly traded companies. FSP 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP 107-1 does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, FSP 107-1 requires comparative disclosures only for periods ending after initial adoption. The Company will adopt FSP 107-1 in its Form 10-Q for the period ended June 30, 2009. The Company is currently evaluating the impact, if any, FSP 107-1 will have on its financial statements.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* ( FSP 115-2 ). FSP 115-2 provides new guidance on the recognition and



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presentation of an other than temporary impairment ( OTTI ) for debt securities classified as available-for-sale and held-to-maturity and provides some new disclosure requirements for both debt and equity securities. FSP 115-2 mandates new disclosure requirements affect both debt and equity securities and extend the disclosure requirements (both new and existing) to interim periods. FSP 115-2 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP 115-2 is to be applied to existing and new investments held by an entity as of the beginning of the period in which it is adopted. The Company will adopt FSP 115-2 in its Form 10-Q for the period ended June 30, 2009. The Company is currently evaluating the impact, if any, FSP 115-2 will have on its financial statements.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

**Market Risk**

Market risk represents the potential for losses that may result from changes in the value of a financial instrument as a result of changes in market conditions. The primary market risks that impact the value of our financial instruments are interest rate risk, basis risk, such as taxable interest rates relative to tax-exempt interest rates, and credit spread risk. Each of these risks and the specific types of financial instruments impacted are described below. Senior managers in our surveillance department are responsible for monitoring risk limits and applying risk measurement methodologies. The estimation of potential losses arising from adverse changes in market conditions is a key element in managing market risk. We use various systems, models and stress test scenarios to monitor and manage market risk. These models include estimates made by management that use current and historic market information. The valuation results from these models could differ materially from amounts that actually are realized in the market. See Critical Accounting Estimates Valuation of Investments.

Financial instruments that may be adversely affected by changes in interest rates consist primarily of investment securities. The primary objective in managing our investment portfolio is generation of an optimal level of after-tax investment income while preserving capital and maintaining adequate liquidity. Investment strategies are based on many factors, including our tax position, fluctuation in interest rates, regulatory and rating agency criteria and other market factors. As of January 1, 2005 we have retained BlackRock Financial Management, Inc. to manage our investment portfolio. These investment managers manage our fixed maturity investment portfolio in accordance with investment guidelines approved by our Board of Directors.

Financial instruments that may be adversely affected by changes in credit spreads consist primarily of Assured Guaranty's outstanding credit derivative contracts. We enter into credit derivative contracts which require us to make payments upon the occurrence of certain defined credit events relating to an underlying obligation (generally a fixed income obligation). The Company's credit derivative exposures are substantially similar to its financial guaranty insurance contracts and provide for credit protection against payment default, and are generally not subject to collateral calls due to changes in market value. In general, the Company structures credit derivative transactions such that the circumstances giving rise to our obligation to make loss payments is similar to that for financial guaranty insurance policies and only occurs as losses are realized on the underlying reference obligation. Nonetheless, credit derivative transactions are governed by International Swaps and Derivatives Association, Inc. ( ISDA ) documentation and operate differently from financial insurance guaranty policies. For example, our control rights with respect to a reference obligation under a credit derivative may be more limited than when we issue a financial guaranty policy on a direct primary basis. In addition, while our exposure under credit derivatives, like our exposure under financial guaranty policies, has been generally for as long as the reference obligation remains outstanding, unlike financial guaranty insurance policies, a credit derivative may be terminated for a breach of the ISDA documentation or other specific events. In some older credit derivative transactions, one such specified event is the failure of AGC to maintain specified financial strength ratings ranging from AA- to BBB.

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If a credit derivative is terminated, the Company could be required to make a mark-to-market payment as determined under the ISDA documentation. In some older credit derivative transactions, one such specified event is the failure of AGC to maintain specified financial strength ratings ranging from A or A2 to BBB- or Baa3. If a credit derivative is terminated the Company could be required to make a mark-to-market payment as determined under the ISDA documentation. For example, if AGC's ratings were downgraded to A- or A3, the CDS counterparties could terminate CDS covering \$847.8 million par insured. If AGC's ratings are downgraded to levels between BBB+ or Baa1 and BB+ or Ba1, the CDS counterparties could terminate the CDS covering \$10.9 billion par insured. Given current market conditions, the Company does not believe that it can accurately estimate the payments it would be required to make if AGC or AGRe were downgraded and the CDS counterparties terminated the CDS. These payments could have a material adverse effect on the Company's liquidity and financial condition. During May 2009 the Company entered into an agreement with a CDS counterparty, which had the right to terminate four CDS contracts if AGC was downgraded below AA- or Aa3. Under the agreement, the CDS counterparty's right to terminate the CDS contracts based on AGC's ratings was eliminated. In return, the Company agreed to post up to \$250 million in collateral to secure its payment obligations under the CDS contracts covering \$5.9 billion of par insured. The collateral posting would increase to up to \$300 million if AGC were downgraded to below AA- or A2. The posting of this collateral has no impact on the Company's net income or shareholders' equity under U.S. GAAP nor does it impact AGC's statutory surplus or net income.

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Under a limited number of credit derivative contracts, the Company is required to post eligible securities as collateral, generally cash or U.S. government or agency securities. The need to post collateral under these transactions is generally based on mark-to-market valuation in excess of contractual thresholds. The particular thresholds decline if the Company ratings decline. As of March 31, 2009 the Company had pre-IPO transactions with approximately \$1.8 billion of par subject to collateral posting due to changes in market value. Of this amount, as of March 31, 2009, the Company posted collateral totaling approximately \$177.9 million (including \$156.2 million for AGC) based on the unrealized mark-to-market loss position for transactions with two of its counterparties. Any amounts required to be posted as collateral in the future will depend on changes in the market values of these transactions. Additionally, in the event AGC were downgraded below A-, contractual thresholds would be eliminated and the amount of par that could be subject to collateral posting requirements would be \$2.3 billion. Based on market values as of March 31, 2009, such a downgrade would have resulted in AGC posting an additional \$113.7 million of collateral. The actual amounts posted would be based on market conditions at the time of the posting and would be based on the CDS contract's ISDA documentation. The actual amounts that would be required to be posted could be materially larger than the Company's estimate. As described above, in May 2009 AGC posted an additional \$250 million of collateral.

Unrealized gains and losses on credit derivatives are a function of changes in the estimated fair value of our credit derivative contracts. If credit spreads of the underlying obligations change, the fair value of the related credit derivative changes. Market liquidity could also impact valuations of the underlying obligations. As such, Assured Guaranty experiences mark-to-market gains or losses. We consider the impact of our own credit risk, in collaboration with credit spreads on risk that we assume through CDS contracts, in determining the fair value of our credit derivatives. We determine our own credit risk based on quoted CDS prices traded on the Company at each balance sheet date. The quoted price of CDS contracts traded on AGC at March 31, 2009 and December 31, 2008 was 3,847 basis points and 1,775 basis points, respectively. The price of CDS traded on the Company generally moves directionally the same as general market spreads. A widening of the CDS prices traded on the Company has an effect of offsetting unrealized losses that result from widening general market credit spreads. Thus, as the Company's credit spreads widen, the value of our CDS decreases. Conversely, as our own credit spread narrows, the value of our unrealized losses widens. However, an overall narrowing of spreads generally results in an unrealized gain on credit derivatives for us and a widening of spreads generally results in an unrealized loss for us.

The impact of changes in credit spreads will vary based upon the volume, tenor, interest rates, and other market conditions at the time these fair values are determined. In addition, since each transaction has unique collateral and structure terms, the underlying change in fair value of each transaction may vary considerably. The fair value of credit derivatives also reflects the change in our own credit cost based on the price to purchase credit protection on AGC. During the three months ended March 31, 2009, we incurred net pre-tax unrealized gains on credit derivative contracts of \$27.0 million. The First Quarter 2009 gain includes a gain of \$6,439.1 million associated with the change in AGC's credit spread, which widened substantially from 1,775 basis points at December 31, 2008 to 3,847 basis points at March 31, 2009. Management believes that the widening of AGC's credit spread is due to the correlation between AGC's risk profile and that experienced currently by the broader financial markets. Offsetting the gain attributable to the significant increase in AGC's credit spread were declines in fixed income security market prices primarily attributable to widening spreads in certain markets as a result of the continued deterioration in credit markets and some credit rating downgrades, rather than from delinquencies or defaults on securities guaranteed by the Company. The higher credit spreads in the fixed income security market are due to the recent lack of liquidity in the high yield collateralized debt obligation and collateralized loan obligation markets as well as continuing market concerns over the most recent vintages of subprime residential mortgage backed securities.

The total notional amount of credit derivative exposure outstanding as of March 31, 2009 and December 31, 2008 and included in our financial guaranty exposure was \$73.3 billion and \$75.1 billion, respectively.

We generally hold these credit derivative contracts to maturity. The unrealized gains and losses on derivative financial instruments will reduce to zero as the exposure approaches its maturity date, unless there is a payment default on the exposure.

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The following table summarizes the estimated change in fair values on the net balance of Assured Guaranty's credit derivative positions assuming immediate parallel shifts in credit spreads at March 31, 2009:

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(Dollars in millions)

| Credit Spreads         |                      | Estimated Net<br>Fair Value (Pre-Tax) | Estimated Pre-Tax<br>Change in Gain / (Loss) |
|------------------------|----------------------|---------------------------------------|--|
| <b>March 31, 2009:</b> |                      |                                       |  |
| 100%                   | widening in spreads  | \$ (1,603.8)                          | \$ (1,083.4)                                 |
| 50%                    | widening in spreads  | (1,075.6)                             | (555.2)                                      |
| 25%                    | widening in spreads  | (792.5)                               | (272.1)                                      |
| 10%                    | widening in spreads  | (632.7)                               | (112.3)                                      |
|                        | Base Scenario        | (520.4)                               |  |
| 10%                    | narrowing in spreads | (457.2)                               | 63.2   |
| 25%                    | narrowing in spreads | (366.0)                               | 154.4  |
| 50%                    | narrowing in spreads | (233.0)                               | 287.4  |

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures.* Assured Guaranty Ltd. s management, with the participation of Assured Guaranty Ltd. s Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of Assured Guaranty Ltd. s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this report. Based on this evaluation, Assured Guaranty Ltd. s Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, Assured Guaranty Ltd. s disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by Assured Guaranty Ltd. (including its consolidated subsidiaries) in the reports that it files or submits under the Exchange Act.

There has been no change in the Company s internal controls over financial reporting during the Company s quarter ended March 31, 2009, that has materially affected, or is reasonably likely to materially affect, the Company s internal controls over financial reporting.



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**PART II OTHER INFORMATION**

**Item 1 Legal Proceedings**

*Litigation*

Effective January 1, 2004, Assured Guaranty Mortgage Insurance Company ( AGMIC ) reinsured a private mortgage insurer (the Reinsured ) under a Mortgage Insurance Stop Loss Excess of Loss Reinsurance Agreement (the Agreement ). Under the Agreement, AGMIC agreed to cover the Reinsured 's aggregate mortgage guaranty insurance losses in excess of a \$25 million retention and subject to a \$95 million limit. Coverage under the Agreement was triggered only when the Reinsured 's: (1) combined loss ratio exceeded 100%; and (2) risk to capital ratio exceeded 25 to 1, according to insurance statutory accounting. In April 2008, AGMIC notified the Reinsured it was terminating the Agreement because of its breach of the terms of the Agreement. The Reinsured has notified AGMIC that it considers the Agreement to remain in effect and that the two coverage triggers under the Agreement apply as of April 1, 2008. By letter dated May 5, 2008, the Reinsured demanded arbitration against AGMIC seeking a declaration that the Agreement remains in effect and alleged compensatory and other damages. The arbitration hearing took place before a three person panel in December 2008 and January 2009. Post hearing briefing and oral arguments were completed on February 26, 2009, and the arbitration panel could render its decision at any time.

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 could have a material adverse effect on the Company 's results of operations in a particular quarter or fiscal year.

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. The amounts, if any, the Company will recover in these proceedings are uncertain, although recoveries in any one or more of these proceedings during any quarter or fiscal year could be material to the Company 's results of operations in that particular quarter or fiscal year.

*Reinsurance*

The Company is party to reinsurance agreements with most of the major monoline primary financial guaranty insurance companies. The Company 's facultative and treaty agreements are generally subject to termination (i) upon written notice (ranging from 90 to 120 days) prior to the specified deadline for renewal, (ii) at the option of the primary insurer if the Company fails to maintain certain financial, regulatory and rating agency criteria which 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 (iii) upon certain changes of control of the Company. Upon termination under the conditions set forth in (ii) and (iii) above, the Company may be required (under some of its reinsurance agreements) to return to the primary insurer all statutory unearned premiums, less ceding commissions, attributable to reinsurance ceded pursuant to such agreements after which the Company would be released from liability with respect to the ceded business. Upon the occurrence of the conditions set forth in (ii) 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.

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**Item 1A Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008, which could materially affect our business, financial condition or future results.

On May 4, 2009, Fitch, Inc. (Fitch) downgraded Assured's debt and financial strength ratings based on Fitch's concerns related to their downgrade of mortgage related and trust preferred securities collateralized debt obligations (TruPS CDO's) in Assured's insured portfolio. Both Standard & Poor's, a division of The McGraw-Hill Companies, Inc. (S&P) and Moody's Investors Service, Inc. (Moody's) are also in the process of reviewing their stress loss estimates for our portfolio. These reviews could lead S&P or Moody's to change their view of Assured and its subsidiaries and downgrade or revise the financial strength or financial enhancement ratings of Assured and its subsidiaries without notice and at any time. There can be no assurance that Fitch will not take further action on our ratings. A downgrade of the financial strength or financial enhancement ratings of Assured or any of its insurance subsidiaries would adversely affect our business prospects and consequently, our results of operations and financial condition. See Item 1A, Risk Factors, of our Form 10-K for the fiscal year ended December 31, 2008 for a more complete description of the risks related to our financial strength ratings and other risks related to Assured.

**Item 2 Unregistered Sales of Equity Securities and Use of Proceeds**



**Issuer's Purchases of Equity Securities**

The following table reflects purchases made by the Company during the three months ended March 31, 2009:

| Period                   | (a) Total Number of Shares Purchased | (b) Average Price Paid Per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Program | (d) Maximum Number of Shares that May Yet Be Purchased Under the Program |
|--------------------------|--------------------------------------|----------------------------------|--|--|
| January 1 - January 31   | 154(1)                               | \$ 7.72                          | 154  | 1,717,400  |
| February 1 - February 28 | 103,338(1)                           | \$ 7.52                          | 103,338  | 1,717,400  |
| March 1 - March 31       | 1,010,050                            | \$ 3.64                          | 1,010,050  | 707,350  |
| <b>Total</b>             | <b>1,113,542</b>                     | <b>\$ 4.00</b>                   | <b>1,113,542</b>   |  |

(1) These shares were repurchased from employees in connection with the payment of withholding taxes due in connection with the vesting of restricted stock awards.

For the restricted stock units granted, the number of shares issued on the date the restricted stock units vest is net of the statutory withholding requirements that the Company pays on behalf of its employees. These withheld shares are not included in the common stock repurchase table above. During the three months ended March 31, 2009 we withheld approximately 25 thousand shares to satisfy \$0.2 million of employee tax obligations.

**Item 4 - Submission of Matters to a Vote of Security Holders**

At the Special General Meeting held on March 16, 2009, the following matters were submitted to, and approved by, shareholders of the Company:

1. Approval of the issuance of Common Shares to Dexia Holdings, Inc. (or its designated affiliate) in connection with the Company's acquisition of Financial Security Assurance Holdings Ltd:

|          |            |
|----------|------------|
| For:     | 81,042,801 |
| Against: | 25,940     |
| Abstain: | 5,885      |

2. Approval of the issuance of Common Shares to WLR Recovery Fund IV, L.P. and/or its affiliates in connection with the financing of the Company's acquisition of Financial Security Assurance Holdings Ltd:

|      |            |
|------|------------|
| For: | 81,040,246 |
|------|------------|

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Against: 29,345  
Abstain: 5,035

At the Annual General Meeting held on May 7, 2009, the following matters were submitted to, and approved by, shareholders of the Company:

1.01 Election of Stephen A Cozen as a Class II Director for a term expiring in 2012:

For: 79,995,805  
Withheld: 902,331

1.02 Election of Donald H. Layton as a Class II Director for a term expiring in 2012:

For: 63,607,494  
Withheld: 17,290,652

1.03 Election of Wilbur L. Ross, Jr. as a Class II Director for a term expiring in 2012:

For: 75,648,421  
Withheld: 5,249,724

1.04 Election of Walter A. Scott as a Class II Director for a term expiring in 2012:

For: 80,082,321  
Withheld: 815,825

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2. Amendment of 2004 Long-Term Incentive Plan:

|          |            |
|----------|------------|
| For:     | 68,379,622 |
| Against: | 7,278,984  |
| Abstain: | 11,115     |

3. Amendment of Employee Stock Purchase Plan:

|          |            |
|----------|------------|
| For:     | 75,196,743 |
| Against: | 463,536    |
| Abstain: | 10,302     |

4. Ratification of selection of PricewaterhouseCoopers LLP as the Company's auditors for the year ending December 31, 2009:

|          |            |
|----------|------------|
| For:     | 80,670,071 |
| Against: | 214,477    |
| Abstain: | 13,595     |

5. Subsidiary Matters

5.1 Authorizing the Company to vote for directors of Assured Guaranty Re Ltd. for terms expiring in 2010:

(1) Howard Albert

|           |            |
|-----------|------------|
| For:      | 79,921,801 |
| Withheld: | 976,326    |

(2) Robert A. Bailenson

|           |            |
|-----------|------------|
| For:      | 79,921,986 |
| Withheld: | 976,160    |

(3) Gary Burnet

|      |            |
|------|------------|
| For: | 79,917,688 |
|------|------------|

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Withheld: 980,457

(4) Dominic J. Frederico

For: 80,019,168

Withheld: 878,977

(5) James M. Michener

For: 80,019,257

Withheld: 878,889

(6) Robert B. Mills

For: 80,019,235

Withheld: 878,911

(7) David Penchoff

For: 79,921,755

Withheld: 976,391

(8) Andrew Pickering

For: 79,618,752

Withheld: 979,395

5.2 Authorizing the Company to vote for the appointment of PricewaterhouseCoopers LLP as the auditors of Assured Guaranty Re Ltd. for the year ending December 31, 2009:

For: 80,845,084

Against: 47,499

Abstain: 13,422



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**Item 5 Other Information**

On May 7, 2009, the Company's shareholders approved the Assured Guaranty Ltd. 2004 Long-Term Incentive Plan (as amended and restated as of May 7, 2009) (the "LTIP") and the Assured Guaranty Ltd. Stock Purchase Plan (Effective as of November 4, 2004 and as amended through the First Amendment) (the "ESPP"). As a result, an additional 3,470,000 shares are now available for awards under the LTIP and an additional 250,000 shares are available for purchase under the ESPP. More complete descriptions of the LTIP and the ESPP are contained in Company's Proxy Statement dated March 25, 2009, as filed with the Securities and Exchange Commission, under the headings "Proposal No. 2: Approval of the Assured Guaranty Ltd. 2004 Long-Term Incentive Plan as Amended and Restated as of May 7, 2009" and "Proposal No.3: Approval of the Assured Guaranty Ltd. Employee Stock Purchase Plan as Amended by the First Amendment," which are hereby incorporated herein by reference. For the full text of the LTIP, see Exhibit 10.1 hereto, which is hereby incorporated herein by reference. For the full text of the ESPP, see Exhibit 10.2 hereto, which is hereby incorporated herein by reference.

**Item 6 - Exhibits**

See Exhibit Index for a list of exhibits filed with this report.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

Assured Guaranty Ltd. (Registrant)

Dated: May 11, 2009

By:

/S/ Robert B. Mills

Robert B. Mills  
Chief Financial Officer (Principal  
Financial Officer  
and Duly Authorized Officer)

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**EXHIBIT INDEX**

| <b>Exhibit Number</b> | <b>Description</b>   |
|-----------------------|--|
| 10.1                  | Assured Guaranty Ltd. 2004 Long-Term Incentive Plan (as amended and restated as of May 7, 2009)*   |
| 10.2                  | Assured Guaranty Ltd. Employee Stock Purchase Plan (Effective as of November 4, 2004 and as amended through the First Amendment)*                                      |
| 10.3                  | Director Compensation Summary*   |
| 31.1                  | Certification of CEO Pursuant to Exchange Act Rules 13A-14 and 15D-14, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                            |
| 31.2                  | Certification of CFO Pursuant to Exchange Act Rules 13A-14 and 15D-14, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                            |
| 32.1                  | Certification of CEO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 32.2                  | Certification of CFO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 99.1                  | Assured Guaranty Corp. s Consolidated Unaudited Financial Statements as of March 31, 2009 and December 31, 2008 and for the Three Months Ended March 31, 2009 and 2008 |

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\* Management contract or compensatory plan

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