ASSURED GUARANTY LTD
Form 10-Q/A
November 14, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Mark One) **Amendment No. 1 to Form 10-Q**

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

For the Quarterly Period Ended June 30, 2011

or

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

For the transition Period from to

Commission File No. 001-32141

ASSURED GUARANTY LTD.

(Exact name of registrant as specified in its charter)

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

30 Woodbourne Avenue

Hamilton HM 08

Bermuda

(Address of principal executive offices)

(441) 279-5700

(Registrant s telephone number, including area code)

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

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

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

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

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

The number of registrant s Common Shares ($0.01 par value) outstanding as of November 4, 2011 was 182,228,965 (excludes 76,060 unvested restricted shares).

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Assured Guaranty Ltd.

Form 10-Q/A

Explanatory Note

This Amendment No. 1 on Form 10-Q/A (Form 10-Q/A) amends our quarterly report on Form 10-Q for the quarter ended June 30, 2011, which was originally filed on August 9, 2011 (Original Form 10-Q). This amendment is being filed to include restated financial statements as described in Note 2 to the consolidated financial statements contained in Item 1. Financial Statements, financial data and related disclosures. The Company is restating its previously issued consolidated financial statements as of and for the quarters ended June 30, 2011 and 2010 to reflect the Company s determination that it did not properly account for the elimination of intercompany activity between the Company s insurance subsidiaries and its consolidated financial guaranty variable interest entities. Included in this restatement is the correction of other immaterial errors which affected the quarters ended June 30, 2011 and 2010. The total effect of this restatement was a decrease to equity of $36.1 million and $65.3 million as of June 30, 2011 and December 31, 2010, respectively, an increase to net income of $15.1 million and $30.3 million for the three months and six months ended June 30, 2011, respectively, and a decrease to net income of $24.4 million and $12.9 million for the three months and six months ended June 30, 2010, respectively.

As a result of the errors discussed above, management has now determined that the Company had a material weakness in its internal control over financial reporting at June 30, 2011. A material weakness is a deficiency, or combination of control deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. For a discussion of management s consideration of the Company s disclosure controls and procedures and the material weakness identified, see Part I, Item 4, *Controls and Procedures* of this Form 10-Q/A.

In accordance with the rules of the Securities and Exchange Commission (the SEC), this Form 10-Q/A sets forth the complete text of the following items of the Original Form 10-Q as modified where necessary to reflect the restatement:

- Part I Item 1. Financial Statements;
- Part I Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations;
- Part I Item 4. Controls and Procedures; and
- Part II Item 6. Exhibits.

In accordance with rules of the SEC, this Form 10-Q/A also includes as exhibits certifications from our Chief Executive Officer and Chief Financial Officer dated as of the date of this filing.

Except for the items noted above, no other information included in the Original Form 10-Q is being amended by this Form 10-Q/A. This Form 10-Q/A continues to speak as of the date of the Original Form 10-Q and we have not updated the filing to reflect events occurring subsequently to the Original Form 10-Q date other than those associated with the restatement of the Company s financial statements and certain material events which are identified as to date. Accordingly, this Form 10-Q/A should be read in conjunction with the Company s filings with the SEC subsequent to the filing of the Original 10-Q, including any amendments to those filings.

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Assured Guaranty Ltd.

Consolidated Balance Sheets (Unaudited)

(dollars in thousands except per share and share amounts)

	June 30, 2011 (restated)	December 31, 2010 (restated)
Assets		
Investment portfolio:		
Fixed maturity securities, available-for-sale, at fair value (amortized cost of $9,596,052 and $9,274,718)	$ 9,864,203	$ 9,402,287
Short-term investments, at fair value	1,105,615	1,055,567
Other invested assets	252,082	283,032
Total investment portfolio	11,221,900	10,740,886
Cash	165,490	108,389
Premiums receivable, net of ceding commissions payable	1,059,461	1,167,587
Ceded unearned premium reserve	773,321	821,819
Deferred acquisition costs	232,311	239,805
Reinsurance recoverable on unpaid losses	26,025	22,255
Salvage and subrogation recoverable	307,147	1,032,369
Credit derivative assets	603,867	592,898
Deferred tax asset, net	1,031,438	1,259,125
Current income tax receivable	187,969	
Financial guaranty variable interest entities assets, at fair value	3,492,204	3,657,481
Other assets	198,692	199,305
Total assets	**$ 19,299,825**	**$ 19,841,919**
Liabilities and shareholders equity		
Unearned premium reserve	$ 6,315,362	$ 6,972,894
Loss and loss adjustment expense reserve	518,145	574,369
Reinsurance balances payable, net	175,875	274,431
Long-term debt	1,046,382	1,052,936
Credit derivative liabilities	2,791,473	2,462,831
Current income tax payable		93,020
Financial guaranty variable interest entities liabilities with recourse, at fair value	2,848,897	3,030,908
Financial guaranty variable interest entities liabilities without recourse, at fair value	1,282,463	1,337,214
Other liabilities	407,321	309,862
Total liabilities	**15,385,918**	**16,108,465**
Commitments and contingencies (See Note 13)		
Common stock ($0.01 par value, 500,000,000 shares authorized; 184,192,736 and 183,744,655 shares issued and outstanding in 2011 and 2010)	1,842	1,837
Additional paid-in capital	2,590,654	2,585,423
Retained earnings	1,113,820	1,032,445
Accumulated other comprehensive income, net of tax provision (benefit) of $66,293 and $18,341	205,591	111,749
Deferred equity compensation (181,818 shares)	2,000	2,000
Total shareholders equity	**3,913,907**	**3,733,454**
Total liabilities and shareholders equity	**$ 19,299,825**	**$ 19,841,919**

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

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Assured Guaranty Ltd.

Consolidated Statements of Operations (Unaudited)

(dollars in thousands except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011 (restated)	2010 (restated)	2011 (restated)	2010 (restated)
Revenues				
Net earned premiums	$ 230,068	$ 297,050	$ 484,045	$ 611,670
Net investment income	101,153	90,871	197,214	175,173
Net realized investment gains (losses):				
Other-than-temporary impairment losses	(26,818)	(17,412)	(33,765)	(18,529)
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	(15,240)		(17,609)	(661)
Other net realized investment gains (losses)	6,488	8,974	13,872	18,843
Net realized investment gains (losses)	(5,090)	(8,438)	(2,284)	975
Net change in fair value of credit derivatives:				
Realized gains and other settlements	(10,836)	38,353	24,591	65,056
Net unrealized gains (losses)	(54,059)	35,115	(325,695)	287,213
Net change in fair value of credit derivatives	(64,895)	73,468	(301,104)	352,269
Fair value gain (loss) on committed capital securities	569	12,593	1,095	11,318
Net change in fair value of financial guaranty variable interest entities	(174,286)	(27,392)	(54,685)	(36,305)
Other income	28,775	(13,396)	70,926	(26,325)
Total Revenues	**116,294**	**424,756**	**395,207**	**1,088,775**
Expenses				
Loss and loss adjustment expenses	123,913	85,770	98,333	196,622
Amortization of deferred acquisition costs	9,533	6,936	16,953	15,109
Assured Guaranty Municipal Holdings Inc. acquisition-related expenses		2,751		6,772
Interest expense	24,696	24,831	49,456	49,965
Other operating expenses	48,508	47,507	105,343	110,040
Total expenses	**206,650**	**167,795**	**270,085**	**378,508**
Income (loss) before income taxes	**(90,356)**	**256,961**	**125,122**	**710,267**
Provision (benefit) for income taxes				
Current	9,864	44,822	(187,735)	5,869
Deferred	(57,684)	33,004	214,781	191,803
Total provision (benefit) for income taxes	**(47,820)**	**77,826**	**27,046**	**197,672**
Net income (loss)	**$ (42,536)**	**$ 179,135**	**$ 98,076**	**$ 512,595**
Earnings per share:				
Basic	$ (0.23)	$ 0.97	$ 0.53	$ 2.78
Diluted	$ (0.23)	$ 0.95	$ 0.52	$ 2.70
Dividends per share	$ 0.045	$ 0.045	$ 0.090	$ 0.090

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

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Assured Guaranty Ltd.

Consolidated Statements of Comprehensive Income (Unaudited)

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011 (restated)	2010 (restated)	2011 (restated)	2010 (restated)
Net income (loss)	**$ (42,536)**	**$ 179,135**	**$ 98,076**	**$ 512,595**
Unrealized holding gains (losses) arising during the period, net of tax provision (benefit) of $56,071, $3,785, $45,634 and $(1,597)	114,809	48,183	89,264	57,397
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of $(1,743), $(4,206), $(1,571) and $(1,438)	(4,227)	(4,232)	(3,198)	2,413
Change in net unrealized gains on investments	119,036	52,415	92,462	54,984
Change in cumulative translation adjustment, net of tax provision (benefit) of $191, $(746), $860 and $(2,854)	346	(1,375)	1,589	(5,259)
Change in cash flow hedge, net of tax provision (benefit) of $(57), $(57), $(113) and $(113)	(104)	(104)	(209)	(209)
Other comprehensive income (loss)	119,278	50,936	93,842	49,516
Comprehensive income (loss)	**$ 76,742**	**$ 230,071**	**$ 191,918**	**$ 562,111**

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

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Assured Guaranty Ltd.

Consolidated Statement of Shareholders Equity (Unaudited)

For the Six Months Ended June 30, 2011

(dollars in thousands, except share data)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings (restated)	Accumulated Other Comprehensive Income (restated)	Deferred Equity Compensation	Total Shareholders Equity (restated)
Balance, December 31, 2010	**183,744,655**	**$ 1,837**	**$ 2,585,423**	**$ 1,032,445**	**$ 111,749**	**$ 2,000**	**$ 3,733,454**
Net income				98,076			98,076
Dividends ($0.09 per share)				(16,577)			(16,577)
Dividends on restricted stock units			124	(124)			
Share-based compensation and other	448,081	5	5,107				5,112
Change in cumulative translation adjustment					1,589		1,589
Change in cash flow hedge					(209)		(209)
Change in unrealized gains (losses) on:							
Investments with no other-than-temporary impairment					80,808		80,808
Investments with other-than-temporary impairment					8,456		8,456
Less: reclassification adjustment for gains (losses) included in net income (loss)					(3,198)		(3,198)
Balance, June 30, 2011	**184,192,736**	**$ 1,842**	**$ 2,590,654**	**$ 1,113,820**	**$ 205,591**	**$ 2,000**	**$ 3,913,907**

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

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Assured Guaranty Ltd.

Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Six Months Ended June 30,	
	2011 (restated)	**2010 (restated)**
Net cash flows provided by (used in) operating activities	**$ 631,946**	**$ (217,674)**
Investing activities		
Fixed maturity securities:		
Purchases	(1,349,745)	(1,166,379)
Sales	685,980	780,818
Maturities	325,750	488,552
Net sales (purchases) of short-term investments	(49,901)	248,780
Net proceeds from paydowns on financial guaranty variable interest entities assets	423,977	217,329
Other	8,696	8,317
Net cash flows provided by (used in) investing activities	**44,757**	**577,417**
Financing activities		
Dividends paid	(16,577)	(16,613)
Repurchases of common stock		(10,457)
Share activity under option and incentive plans	(2,652)	(2,233)
Net paydowns of financial guaranty variable interest entities liabilities	(593,294)	(259,367)
Repayment of long-term debt	(10,294)	(10,850)
Net cash flows provided by (used in) financing activities	**(622,817)**	**(299,520)**
Effect of foreign exchange rate changes	3,215	(3,090)
Increase (decrease) in cash	57,101	57,133
Cash at beginning of period	108,389	44,133
Cash at end of period	**$ 165,490**	**$ 101,266**
Supplemental cash flow information		
Cash paid (received) during the period for:		
Income taxes	$ 89,202	$ 136,645
Interest	$ 45,711	$ 46,261

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

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited)

June 30, 2011

1. Business and Basis of Presentation

Business

Assured Guaranty Ltd. (AGL and, together with its subsidiaries, Assured Guaranty or the Company) is a Bermuda-based holding company that provides, through its operating subsidiaries, credit protection products to the United States (U.S.) and international public finance, infrastructure and structured finance markets. The Company has applied its credit underwriting judgment, risk management skills and capital markets experience to develop insurance, reinsurance and credit derivative products that protect holders of debt instruments and other monetary obligations from defaults in scheduled payments, including scheduled interest and principal payments. The securities insured by the Company include tax-exempt and taxable obligations issued by U.S. state or municipal governmental authorities, utility districts or facilities; notes or bonds issued to finance international infrastructure projects; and asset-backed securities issued by special purpose entities. The Company markets its credit protection products directly to issuers and underwriters of public finance, infrastructure and structured finance securities as well as to investors in such debt obligations. The Company guarantees debt obligations issued in many countries, although its principal focus is on the U.S., Europe and Australia.

Financial guaranty insurance contracts provide an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest when due. Financial guaranty contracts accounted for as credit derivatives are generally structured such that the circumstances giving rise to the Company s obligation to make loss payments are similar to those for financial guaranty insurance contracts and only occurs upon one or more defined credit events such as failure to pay or bankruptcy, in each case, as defined within the transaction documents, with respect to one or more third party referenced securities or loans. Financial guaranty contracts accounted for as credit derivatives are primarily comprised of credit default swaps (CDS). In general, the Company structures credit derivative transactions such that the circumstances giving rise to the Company s obligation to make loss payments are similar to those for financial guaranty insurance contracts but are governed by International Swaps and Derivative Association, Inc. (ISDA) documentation.

The Company s business has evolved as a result of the recent crisis in the financial markets. For example, the Company is focused primarily on insuring public finance obligations in the primary and secondary markets. It is selectively underwriting certain structured finance transactions, but has not underwritten a new U.S. residential mortgage-backed security (RMBS) since 2008 and will not do so until underwriting standards improve significantly. See Note 4 for the Company s outstanding U.S. RMBS exposures. In addition, the Company ceased selling credit protection through CDS in the beginning of 2009 following the issuance of regulatory guidelines that limited the terms under which such protection could be sold. The potential capital or margin requirements that may apply under the Dodd-Frank Wall Street Reform and Consumer protection Act (the Dodd-Frank Act) also contributed to the decision of the Company not to sell new credit protection through CDS in the foreseeable future. Furthermore, the Company had historically entered into ceded reinsurance contracts in order to obtain greater business diversification and reduce the net potential loss from large risks. However, given the lack of viable third party financial guaranty insurers and

reinsurers, the Company has not entered into any new assumed or ceded reinsurance treaties since 2008, and has been reassuming previously ceded business from reinsurers whose ratings have declined to below-investment-grade (BIG) levels.

Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the issuers taxing powers, tax-supported bonds and revenue bonds and other obligations of states, their political subdivisions and other municipal issuers supported by the issuers or obligors covenant to impose and collect fees and charges for public services or specific projects. Public finance obligations include obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including government office buildings, toll roads, health-care facilities and utilities. Structured finance obligations insured by the Company are generally backed by pools of assets such as residential or commercial mortgage loans, consumer or trade receivables, securities or other assets having an ascertainable cash flow or market value and issued by special purpose entities; the Company will also insure other specialized financial obligations.

When a rating agency rates a financial obligation guaranteed by one of AGL s insurance company subsidiaries, it generally awards that obligation the same rating it has assigned to the financial strength of the AGL subsidiary that provides

Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

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

On January 24, 2011, Standard &Poor s Rating Services (S&P) released a publication entitled Request for Comment: Bond Insurance Criteria, in which it requested comments on proposed changes to its bond insurance ratings criteria. In the Request for Comment, S&P noted that it could lower its financial strength ratings on existing investment- grade bond insurers (which include the Company s insurance subsidiaries) by one or more rating categories if the proposed bond insurance ratings criteria are adopted, unless those bond insurers raise additional capital or reduce risk. The proposed ratings criteria contemplate the imposition of a leverage test that is based solely on the amount of par insured and does not take into account the bond insurer s unearned premium reserve as a claims-paying resource; changes to S&P s capital adequacy model, including significant increases in capital charges for both U.S. public finance obligations and structured finance obligations; and reductions in the single-risk limits for U.S. public finance obligations. This action by S&P has exacerbated uncertainty in the market over the Company s financial strength ratings and has a negative impact on the demand for the Company s insurance product. The Company has submitted comment letters to S&P discussing the modifications that it believes would be necessary to establish a supportable framework for determining the ratings of financial guaranty companies, and on April 21, 2011, S&P announced that it is in the process of analyzing the feedback received from market participants and revisiting its assumptions and analysis in light of the feedback. S&P also stated that it expects to publish the final criteria in the third quarter of 2011 and to publish updated ratings that reflect the application of the new criteria by September 30, 2011. If S&P were not to accept any of our comments and adopts the ratings criteria as proposed, the new criteria could have an adverse impact on the financial strength ratings of the Company s insurance subsidiaries if the Company were unable to reduce risk or raise capital on acceptable terms. Since S&P announced its proposed criteria, the Company has been pursuing strategies to improve its rating agency capital position. Such strategies include pursuing negotiated agreements with providers of representations and warranties in the insured U.S. RMBS portfolio, and agreeing to terminate credit default swap transactions and financial guaranties that carry high rating agency capital charges. See Notes 5, 7 and 12 for the potential impact of a rating downgrade on the insured portfolio. See Note 17 for subsequent events.

Unless otherwise noted, ratings on Assured Guaranty s insured portfolio reflect internal ratings. The Company s ratings scale is similar to that used by the NRSROs; however, the ratings in these financial statements may not be the same as those assigned by any such rating agency. The super senior category, which is not generally used by rating agencies, is used by the Company in instances where Assured Guaranty s AAA-rated exposure on its internal rating scale has additional credit enhancement due to either (1) the existence of another security rated AAA that is subordinated to Assured Guaranty s exposure or (2) Assured Guaranty s exposure benefiting from a different form of credit enhancement that would pay any claims first in the event that any of the exposures incurs a loss, and such credit enhancement, in management s opinion, causes Assured Guaranty s attachment point to be materially above the AAA attachment point.

Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and, in the opinion of management, reflect all adjustments that are of a normal recurring nature, necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated financial guaranty variable interest entities (FG VIEs) for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim consolidated financial statements cover the three-month period ended June 30, 2011 (Second Quarter 2011), the three-month period ended June 30, 2010 (Second Quarter 2010), the six-month period ended June 30, 2011 (Six Months 2011) and the six-month period ended June 30, 2010 (Six Months 2010).

These unaudited interim consolidated financial statements include the accounts of AGL and its direct and indirect subsidiaries (collectively, the Subsidiaries) and its consolidated FG VIEs. Intercompany accounts and transactions between and among AGL and its Subsidiaries have been eliminated, as well as transactions between the insurance company

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

subsidiaries and the consolidated FG VIEs. Certain prior year balances have been reclassified to conform to the current year s presentation.

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company s Annual Report on Form 10-K/A for the year ended December 31, 2010, filed with the U.S. Securities and Exchange Commission (the SEC).

AGL s principal insurance company subsidiaries are Assured Guaranty Corp. (AGC), domiciled in Maryland, Assured Guaranty Municipal Corp. (AGM), domiciled in New York, and Assured Guaranty Re Ltd. (AG Re), domiciled in Bermuda. In addition, the Company also has another U.S. and another Bermuda insurance company subsidiary that participates in a pooling agreement with AGM, two insurance subsidiaries organized in the United Kingdom, and a mortgage insurance company. The Company s organizational structure includes various holdings companies, two of which Assured Guaranty US Holdings Inc. (AGUS) and Assured Guaranty Municipal Holdings Inc. (AGMH) have public debt outstanding. See Note 14.

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income (ASU 2011-05), which eliminates the option to report other comprehensive income and its components in the statement of changes in stockholders equity and requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement or in two separate but consecutive statements. Upon adoption, the Company will expand the Consolidated Statements of Comprehensive Income to include the other comprehensive income items now presented in the Consolidated Statement of Shareholders Equity. This pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, which corresponds to the Company s first quarter of fiscal 2012. Early adoption of the new guidance is permitted and full retrospective application is required when the new guidance is adopted. The Company has not yet adopted this guidance.

Change in Accounting Policy

Prior to January 1, 2011, the Company managed its business and reported financial information for two principal financial guaranty segments: direct and reinsurance. There has been no market for financial guaranty reinsurance in the past two years and one is not expected to develop in the foreseeable future. The Company s reinsurance subsidiary, AG Re, now only writes new treaties with affiliates that are eliminated in consolidation. As a result, the chief operating decision maker now manages the operations of the Company at a consolidated level and no longer uses underwriting gain (loss) by segment as an operating metric. Therefore, segment financial information is no longer disclosed.

2. Restatement of Previously Issued Financial Statements

AGL, through its insurance subsidiaries, has provided financial guaranties with respect to debt obligations issued by special purpose entities, including FG VIEs. Assured Guaranty does not sponsor such FG VIEs nor does it act as the servicer or collateral manager for any FG VIE debt obligations that it insures. However, when Assured Guaranty provides such financial guaranties, it can obtain certain control rights through the transaction structure which make Assured Guaranty the primary beneficiary of the FG VIE. Assured Guaranty is required under GAAP to consolidate the FG VIE in its financial statements when it is the primary beneficiary. See Note 8. When such consolidation occurs, Assured Guaranty must eliminate the intercompany transactions between the relevant Assured Guaranty insurance subsidiary and the consolidated FG VIE. Assured Guaranty discovered errors in the elimination of such intercompany transactions, which resulted in the restatement of the consolidated financial statements for the three and six months ended June 30, 2011 and the year ended December 31, 2010.

In addition, the Company was required to correct certain unrelated, immaterial errors as part of the restatement which affected expected losses, the fair value of credit derivatives, and the classification of FG VIE assets and liabilities, which affected the years ended December 31, 2010 and 2009. While these immaterial errors were corrected at the time they were identified, these restated financial statements reflect the correction of such errors in period in which they arose.

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

The effect of the restatement on the balance sheet is shown in the tables below.

	As of June 30, 2011			
	As Previously Filed	(1) FG VIE Eliminations	(2) Other Adjustments	Restated
	(in millions)			
Assets				
Total investment portfolio	$ 11,186.7	$ 35.2	$	$ 11,221.9
Cash	159.2	6.3		165.5
Premiums receivable, net of ceding commissions payable	1,059.5			1,059.5
Ceded unearned premium reserve	773.3			773.3
Deferred acquisition costs	232.3			232.3
Reinsurance recoverable on unpaid losses	26.0			26.0
Salvage and subrogation recoverable	307.1			307.1
Credit derivative assets	603.9			603.9
Deferred tax asset, net	1,012.0	18.3	1.1	1,031.4
Current income tax receivable	188.0			188.0
Financial guaranty variable interest entities assets, at fair value	3,492.2			3,492.2
Other assets	198.7			198.7
Total assets	**$ 19,238.9**	**$ 59.8**	**$ 1.1**	**$ 19,299.8**
Liabilities and shareholders equity				
Unearned premium reserve	$ 6,315.4	$	$	$ 6,315.4
Loss and loss adjustment expense reserve	518.1			518.1
Reinsurance balances payable, net	175.9			175.9
Long-term debt	1,046.4			1,046.4
Credit derivative liabilities	2,788.2		3.2	2,791.4
Financial guaranty variable interest entities liabilities with recourse, at fair value	2,755.1	93.8		2,848.9
Financial guaranty variable interest entities liabilities without recourse, at fair value	1,282.5			1,282.5
Other liabilities	407.3			407.3
Total liabilities	**15,288.9**	**93.8**	**3.2**	**15,385.9**
Commitments and contingencies				
Common stock	1.8			1.8
Additional paid-in capital	2,590.7			2,590.7
Retained earnings	1,149.9	(34.0)	(2.1)	1,113.8
	205.6			205.6

Accumulated other comprehensive income, net of tax provision (benefit)								
Deferred equity compensation		2.0						2.0
Total shareholders equity		**3,950.0**		**(34.0)**		**(2.1)**		**3,913.9**
Total liabilities and shareholders equity	**$**	**19,238.9**	**$**	**59.8**	**$**	**1.1**	**$**	**19,299.8**

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

	As of December 31, 2010			
	As Previously Filed	(1) FG VIE Eliminations	(2) Other Adjustments	Restated
	(in millions)			
Assets				
Total investment portfolio	$ 10,729.9	$ 11.0	$	$ 10,740.9
Cash	107.2	1.2		108.4
Premiums receivable, net of ceding commissions payable	1,167.6			1,167.6
Ceded unearned premium reserve	821.8			821.8
Deferred acquisition costs	239.8			239.8
Reinsurance recoverable on unpaid losses	22.3			22.3
Salvage and subrogation recoverable	1,032.4			1,032.4
Credit derivative assets	592.9			592.9
Deferred tax asset, net	1,224.0	32.1	3.0	1,259.1
Financial guaranty variable interest entities assets, at fair value	4,334.4		(676.9)	3,657.5
Other assets	199.2			199.2
Total assets	**$ 20,471.5**	**$ 44.3**	**$ (673.9)**	**$ 19,841.9**
Liabilities and shareholders equity				
Unearned premium reserve	$ 6,972.9	$	$	$ 6,972.9
Loss and loss adjustment expense reserve	563.0		11.4	574.4
Reinsurance balances payable, net	274.4			274.4
Long-term debt	1,052.9			1,052.9
Credit derivative liabilities	2,465.5		(2.7)	2,462.8
Current income tax payable	93.0			93.0
Financial guaranty variable interest entities liabilities with recourse, at fair value	2,927.0	103.9		3,030.9
Financial guaranty variable interest entities liabilities without recourse, at fair value	2,014.1		(676.9)	1,337.2
Other liabilities	309.9			309.9
Total liabilities	**16,672.7**	**103.9**	**(668.2)**	**16,108.4**
Commitments and contingencies				
Common stock	1.8			1.8
Additional paid-in capital	2,585.4			2,585.4
Retained earnings	1,098.9	(60.7)	(5.7)	1,032.5
Accumulated other comprehensive income, net of tax provision (benefit)	110.7	1.1		111.8
Deferred equity compensation	2.0			2.0
Total shareholders equity	3,798.8	(59.6)	(5.7)	3,733.5
Total liabilities and shareholders equity	**$ 20,471.5**	**$ 44.3**	**$ (673.9)**	**$ 19,841.9**

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

The effect of the restatement on the consolidated statements of operations is shown in the tables below.

	Three Months Ended June 30, 2011			
	As Previously Filed	(1) FG VIE Eliminations	(2) Other Adjustments	Restated
	(in millions except per share amounts)			
Revenues				
Net earned premiums	$ 230.0	$	$	$ 230.0
Net investment income	100.8	0.3		101.1
Net realized investment gains (losses)	(5.1)			(5.1)
Net change in fair value of credit derivatives	(59.4)		(5.4)	(64.8)
Fair value gain (loss) on committed capital securities	0.6			0.6
Net change in financial guaranty variable interest entities	(193.7)	19.4		(174.3)
Other income	28.8			28.8
Total revenues	102.0	19.7	(5.4)	116.3
Expenses				
Loss and loss adjustment expenses	132.9	2.7	(11.7)	123.9
Interest and other operating expenses	82.7			82.7
Total expenses	215.6	2.7	(11.7)	206.6
Income (loss) before income taxes	(113.6)	17.0	6.3	(90.3)
Provision (benefit) for income taxes				
Current	9.9			9.9
Deferred	(65.8)	6.0	2.2	(57.6)
Total provision (benefit) for income taxes	(55.9)	6.0	2.2	(47.7)
Net income (loss)	**$ (57.7)**	**$ 11.0**	**$ 4.1**	**$ (42.6)**
Earnings per share:				
Basic	$ (0.31)			$ (0.23)
Diluted	$ (0.31)			$ (0.23)

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

	Three Months Ended June 30, 2010			
	As Previously Filed	(1) FG VIE Eliminations	(2) Other Adjustments	Restated
	(in millions except per share amounts)			
Revenues				
Net earned premiums	$ 292.1	$ 4.9	$	$ 297.0
Net investment income	90.9			90.9
Net realized investment gains (losses)	(8.4)			(8.4)
Net change in fair value of credit derivatives	73.5			73.5
Fair value gain (loss) on committed capital securities	12.6			12.6
Net change in financial guaranty variable interest entities	0.5	(27.9)		(27.4)
Other income	(13.5)			(13.5)
Total revenues	447.7	(23.0)		424.7
Expenses				
Loss and loss adjustment expenses	71.2	14.3	0.2	85.7
Interest and other operating expenses	82.0			82.0
Total expenses	153.2	14.3	0.2	167.7
Income (loss) before income taxes	294.5	(37.3)	(0.2)	257.0
Provision (benefit) for income taxes				
Current	44.9			44.9
Deferred	46.1	(13.1)		33.0
Total provision (benefit) for income taxes	91.0	(13.1)		77.9
Net income (loss)	**$ 203.5**	**$ (24.2)**	**$ (0.2)**	**$ 179.1**
Earnings per share:				
Basic	$ 1.10			$ 0.97
Diluted	$ 1.08			$ 0.95

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

	Six Months Ended June 30, 2011			
	As Previously Filed	(1) FG VIE Eliminations	(2) Other Adjustments	Restated
	(in millions except per share amounts)			
Revenues				
Net earned premiums	$ 484.0	$	$	$ 484.0
Net investment income	197.2			197.2
Net realized investment gains (losses)	(2.3)			(2.3)
Net change in fair value of credit derivatives	(295.1)		(5.9)	(301.0)
Fair value gain (loss) on committed capital securities	1.1			1.1
Net change in financial guaranty variable interest entities	(99.8)	45.1		(54.7)
Other income	71.0			71.0
Total revenues	356.1	45.1	(5.9)	395.3
Expenses				
Loss and loss adjustment expenses	105.9	3.9	(11.4)	98.4
Interest and other operating expenses	171.7			171.7
Total expenses	277.6	3.9	(11.4)	270.1
Income (loss) before income taxes	78.5	41.2	5.5	125.2
Provision (benefit) for income taxes				
Current	(187.7)			(187.7)
Deferred	198.5	14.5	1.9	214.9
Total provision (benefit) for income taxes	10.8	14.5	1.9	27.2
Net income (loss)	**$ 67.7**	**$ 26.7**	**$ 3.6**	**$ 98.0**
Earnings per share:				
Basic	$ 0.37			$ 0.53
Diluted	$ 0.36			$ 0.52

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

	Six Months Ended June 30, 2010			
	As Previously Filed	(1) FG VIE Eliminations	(2) Other Adjustments	Restated
	(in millions except per share amounts)			
Revenues				
Net earned premiums	$ 611.7	$	$	$ 611.7
Net investment income	175.2			175.2
Net realized investment gains (losses)	1.0			1.0
Net change in fair value of credit derivatives	352.3			352.3
Fair value gain (loss) on committed capital securities	11.3			11.3
Net change in financial guaranty variable interest entities	(10.1)	(26.2)		(36.3)
Other income	(26.4)			(26.4)
Total revenues	1,115.0	(26.2)		1,088.8
Expenses				
Loss and loss adjustment expenses	201.7	0.1	(5.2)	196.6
Interest and other operating expenses	181.9			181.9
Total expenses	383.6	0.1	(5.2)	378.5
Income (loss) before income taxes	731.4	(26.3)	5.2	710.3
Provision (benefit) for income taxes				
Current	5.9			5.9
Deferred	200.0	(9.2)	1.0	191.8
Total provision (benefit) for income taxes	205.9	(9.2)	1.0	197.7
Net income (loss)	**$ 525.5**	**$ (17.1)**	**$ 4.2**	**$ 512.6**
Earnings per share:				
Basic	$ 2.85			$ 2.78
Diluted	$ 2.77			$ 2.70

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

The effect of the restatement on the consolidated statements of comprehensive income is shown in the tables below.

	Three Months Ended June 30, 2011			
	As Previously Filed	(1) FG VIE Eliminations	(2) Other Adjustments	Restated
	(in millions)			
Net income (loss)	**$ (57.7)**	**$ 11.0**	**$ 4.1**	**$ (42.6)**
Unrealized holding gains (losses) arising during the period	115.6	(0.8)		114.8
Less: reclassification adjustment for gains (losses)	(4.2)			(4.2)
Change in net unrealized gains on investments	119.8	(0.8)		119.0
Change in cumulative translation adjustment	0.4			0.4
Change in cash flow hedge	(0.1)			(0.1)
Other comprehensive income(loss)	120.1	(0.8)		119.3
Comprehensive income (loss)	**$ 62.4**	**$ 10.2**	**$ 4.1**	**$ 76.7**

	Three Months Ended June 30, 2010			
	As Previously Filed	(1) FG VIE Eliminations	(2) Other Adjustments	Restated
	(in millions)			
Net income (loss)	**$ 203.5**	**$ (24.2)**	**$ (0.2)**	**$ 179.1**
Unrealized holding gains (losses) arising during the period	48.2			48.2
Less: reclassification adjustment for gains (losses)	(4.2)			(4.2)
Change in net unrealized gains on investments	52.4			52.4
Change in cumulative translation adjustment	(1.4)			(1.4)
Change in cash flow hedge	(0.1)			(0.1)
Other comprehensive income(loss)	50.9			50.9
Comprehensive income (loss)	**$ 254.4**	**$ (24.2)**	**$ (0.2)**	**$ 230.0**

	Six Months Ended June 30, 2011			
	As Previously Filed	(1) FG VIE Eliminations	(2) Other Adjustments	Restated

	(in millions)			
Net income (loss)	**$ 67.7**	**$ 26.7**	**$ 3.6**	**$ 98.0**
Unrealized holding gains (losses) arising during the period	90.4	(1.1)		89.3
Less: reclassification adjustment for gains (losses)	(3.2)			(3.2)
Change in net unrealized gains on investments	93.6	(1.1)		92.5
Change in cumulative translation adjustment	1.6			1.6
Change in cash flow hedge	(0.2)			(0.2)
Other comprehensive income(loss)	95.0	(1.1)		93.9
Comprehensive income (loss)	**$ 162.7**	**$ 25.6**	**$ 3.6**	**$ 191.9**

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

	Six Months Ended June 30, 2010			
	As Previously Filed	(1) FG VIE Eliminations	(2) Other Adjustments	Restated
		(in millions)		
Net income (loss)	**$ 525.5**	**$ (17.1)**	**$ 4.2**	**512.6**
Unrealized holding gains (losses) arising during the period	57.4			57.4
Less: reclassification adjustment for gains (losses)	2.4			2.4
Change in net unrealized gains on investments	55.0			55.0
Change in cumulative translation adjustment	(5.3)			(5.3)
Change in cash flow hedge	(0.2)			(0.2)
Other comprehensive income(loss)	49.5			49.5
Comprehensive income (loss)	**$ 575.0**	**$ (17.1)**	**$ 4.2**	**562.1**

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

The effect of the restatement on the consolidated statements of cash flows is shown in the tables below.

	Six Months Ended June 30, 2011 (1)		
	As Previously Filed	FG VIE Eliminations	Restated
Net cash flows provided by (used in) operating activities	**$ 614.4**	**$ 17.5**	**$ 631.9**
Investing activities			
Fixed maturity securities:			
Purchases	(1,349.7)		(1,349.7)
Sales	686.0		686.0
Maturities	326.9	(1.2)	325.7
Net sales (purchases) of short-term investments	(38.7)	(11.2)	(49.9)
Net proceeds from paydowns on financial guaranty variable interest entities assets	424.0		424.0
Other	8.7		8.7
Net cash flows provided by (used in) investing activities	**57.2**	**(12.4)**	**44.8**
Financing activities			
Dividends paid	(16.6)		(16.6)
Share activity under option and incentive plans	(2.6)		(2.6)
Net paydowns of financial guarantyvariable interest entities liabilities	(593.3)		(593.3)
Repayment of long-term debt	(10.3)		(10.3)
Net cash flows provided by (used in) financing activities	**(622.8)**		**(622.8)**
Effect of exchange rate changes	3.2		3.2
Increase (decrease) in cash	52.0	5.1	57.1
Cash at beginning of period	107.2	1.2	108.4
Cash at end of period	**$ 159.2**	**$ 6.3**	**$ 165.5**

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

	Six Months Ended June 30, 2010 (1)		
	As Previously Filed	FG VIE Eliminations	Restated
Net cash flows provided by (used in) operating activities	**$ (249.5)**	**$ 31.9**	**$ (217.6)**
Investing activities			
Fixed maturity securities:			
Purchases	(1,166.3)		(1,166.3)
Sales	780.8		780.8
Maturities	488.6		488.6
Net sales (purchases) of short-term investments	276.6	(27.9)	248.7
Net proceeds from paydowns on financial guarantyvariable interest entities assets	217.3		217.3
Other	8.3		8.3
Net cash flows provided by (used in) investing activities	**605.3**	**(27.9)**	**577.4**
Financing activities			
Dividends paid	(16.6)		(16.6)
Share repurchases	(10.5)		(10.5)
Share activity under option and incentive plans	(2.3)		(2.3)
Net paydowns of financial guaranty variable interest entities liabilities	(259.4)		(259.4)
Repayment of long-term debt	(10.8)		(10.8)
Net cash flows provided by (used in) financing activities	**(299.6)**		**(299.6)**
Effect of exchange rate changes	(3.1)		(3.1)
Increase (decrease) in cash	53.1	4.0	57.1
Cash at beginning of period	44.1		44.1
Cash at end of period	**$ 97.2**	**$ 4.0**	**$ 101.2**

(1) Represents adjustments related to the correction of FG VIE intercompany eliminations.

(2) Represents other adjustments of immaterial errors. These corrections related to (a) errors in expected losses that had previously been corrected by the Company in the period such errors were identified, but which are now being recorded in the period in which they arose, (b) an error related to one credit derivative contract that resulted from the use of an incorrect par outstanding balance in the pricing model and (c) the correction of an error related to the classification of FG VIE assets and liabilities that resulted from a misinterpretation of a trustee report.

The Company also revised certain disclosures in Note 16 as part of the restatement of these financial statements.

3. Business Changes, Risks, Uncertainties and Accounting Developments

Summarized below are updates of the most significant events since year-end 2010 that have had, or may have in the future, a material effect on the financial position, results of operations or business prospects of the Company.

Recoveries for Breaches of Representations and Warranties

On April 14, 2011, Assured Guaranty reached a comprehensive agreement with Bank of America Corporation and its subsidiaries, including Countrywide Financial Corporation and its subsidiaries (collectively, Bank of America), regarding their liabilities with respect to 29 RMBS transactions insured by Assured Guaranty, including claims relating to reimbursement for breaches of representations and warranties (R&W) and historical loan servicing issues (Bank of America Agreement). Of the 29 RMBS transactions, eight are second lien transactions and 21 are first lien transactions. The Bank of America Agreement covers Bank of America-sponsored securitizations that AGM or AGC has insured, as well as certain other securitizations containing concentrations of Countrywide-originated loans that AGM or AGC has insured. The transactions covered by the Bank of America Agreement have a gross par outstanding of $4.7 billion ($4.4 billion net par outstanding) as of June 30, 2011, or 28% of Assured Guaranty s total BIG RMBS net par outstanding.

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

Bank of America paid $928.1 million in Second Quarter 2011 in respect of covered second lien transactions and is obligated to pay another $171.9 million by March 2012. In consideration of the $1.1 billion, the Company has agreed to release its claims for the repurchase of mortgage loans underlying the eight second lien transactions (i.e., Assured Guaranty will retain the risk of future insured losses without further offset for R&W claims against Bank of America).

In addition, Bank of America will reimburse Assured Guaranty 80% of claims Assured Guaranty pays on the 21 first lien transactions, until aggregate collateral losses on such RMBS transactions reach $6.6 billion. The Company accounts for the 80% loss sharing agreement with Bank of America as subrogation. As the Company calculates expected losses for these 21 first lien transactions, such expected losses will be offset by an R&W benefit from Bank of America for 80% of these amounts. As of June 30, 2011, Bank of America had placed $1.0 billion of eligible assets in trust in order to collateralize the reimbursement obligation relating to the first lien transactions. The amount of assets required to be posted may increase or decrease from time to time, as determined by rating agency requirements.

Although the Bank of America Agreement was executed in Second Quarter 2011, it provided additional evidence about the estimates inherent in the loss estimation process at March 31, 2011, and therefore, the March 31, 2011 loss estimates incorporated updated assumptions and estimates reflecting the terms of the Bank of America Agreement. The benefit for R&W in 2011 reflects higher expected recoveries across all transactions as a result of the Bank of America Agreement. For transactions covered under the agreement, the R&W benefit has been updated to reflect amounts collected and expected to be collected under the terms of the Bank of America Agreement. For transactions with other sponsors of U.S. RMBS, against which the Company is pursuing R&W claims, the Company has increased the benefit for R&W in 2011 to reflect the probability that actual recovery rates may be higher than originally expected in the three-months period ended March 31, 2011 (First Quarter 2011). For transactions involving R&W providers other than Bank of America, the Company has continued to review additional loan files and has found breach rates consistent with those in the Bank of America transactions.

As a result of the 80% loss sharing arrangement, the Company increased its estimate of expected R&W recoveries during First Quarter 2011 for the transactions covered under the Bank of America Agreement by $411.2 million, resulting in an increase to pre-tax income of approximately $220 million. Changes in gross expected loss on these first lien transactions will result in a corresponding benefit for R&W equal to 80% of such development, up to $6.6 billion of collateral losses.

The Company believes the Bank of America Agreement was a significant step in the effort to recover U.S. RMBS losses the Company experienced resulting from breaches of R&W. The Company is continuing to pursue other representation and warranty providers for U.S. RMBS transactions it has insured. See Recovery Litigation for a discussion of the litigation proceedings the Company has initiated against other R&W providers.

4. Outstanding Exposure

The Company s insurance policies and credit derivative contracts are written in different forms, but collectively are considered financial guaranty contracts. They typically guarantee the scheduled payments of principal and interest (Debt Service) on public finance and structured finance obligations. The Company seeks to limit its exposure to losses by underwriting obligations that are investment grade at inception, diversifying its portfolio and maintaining rigorous subordination or collateralization requirements on structured finance obligations. The Company also has utilized reinsurance by ceding business to third party reinsurers. The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. Based on accounting standards in effect during any given reporting period, some of these VIEs are consolidated as described in Note 8. The outstanding par and Debt Service amounts presented below include outstanding exposures on VIEs, whether or not they are consolidated.

Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	June 30, 2011	December 31, 2010	June 30, 2011	December 31, 2010
	(in millions)			
Public finance	$ 826,907	$ 851,634	$ 739,493	$ 760,167
Structured finance	157,646	178,348	147,275	166,976
Total	$ 984,553	$ 1,029,982	$ 886,768	$ 927,143

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

Financial Guaranty Net Par Outstanding by Internal Rating

	As of June 30, 2011									
	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S		Structured Finance Non-U.S		Total	
Rating Category	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%
					(dollars in millions)					
Super senior	$	%	$ 1,507	3.7%	$ 19,957	19.2%	$ 7,683	26.8%	$ 29,147	5.0%
AAA	5,078	1.2	1,379	3.3	38,175	36.7	12,722	44.3	57,354	9.8
AA	151,571	36.7	1,145	2.8	14,236	13.7	1,606	5.6	168,558	28.7
A	211,736	51.2	12,517	30.4	5,721	5.5	1,610	5.6	231,584	39.4
BBB	41,939	10.2	22,318	54.1	5,248	5.0	3,273	11.3	72,778	12.4
BIG	2,950	0.7	2,360	5.7	20,641	19.9	1,824	6.4	27,775	4.7
Total net par outstanding	$ 413,274	100.0%	$ 41,226	100.0%	$ 103,978	100.0%	$ 28,718	100.0%	$ 587,196	100.0%

	As of December 31, 2010									
	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S		Structured Finance Non-U.S		Total	
Rating Category	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%
					(dollars in millions)					
Super senior	$	%	$ 1,420	3.5%	$ 21,837	18.4%	$ 7,882	25.7%	$ 31,139	5.0%
AAA	5,784	1.4	1,378	3.4	45,067	37.9	13,573	44.3	65,802	10.7
AA	161,906	37.9	1,330	3.3	17,355	14.6	1,969	6.4	182,560	29.6
A	214,199	50.2	12,482	30.6	6,396	5.4	1,873	6.1	234,950	38.1
BBB	41,948	9.8	22,338	54.8	7,543	6.4	4,045	13.2	75,874	12.3
BIG	3,159	0.7	1,795	4.4	20,558	17.3	1,294	4.3	26,806	4.3
Total net par outstanding	$ 426,996	100.0%	$ 40,743	100.0%	$ 118,756	100.0%	$ 30,636	100.0%	$ 617,131	100.0%

In addition to amounts shown in the tables above, the Company had outstanding commitments to provide guaranties of $3.9 billion for structured finance and $1.7 billion for public finance commitments at June 30, 2011. The structured finance commitments include the unfunded component of pooled corporate and other transactions. Public finance commitments typically relate to primary and secondary public finance debt issuances. The expiration dates for the public finance commitments range between July 1, 2011 and February 1, 2019, with $1.3 billion expiring prior to December 31, 2011. All the commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be cancelled at the counterparty s request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.

Surveillance Categories

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

The Company monitors its investment grade credits to determine whether any new credits need to be internally downgraded to BIG. The Company refreshes its internal credit ratings on individual credits in quarterly, semi-annual or annual cycles based on the Company s view of the credit s quality, loss potential, volatility and sector. Ratings on credits in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. The Company s insured credit ratings on assumed credits are based on the Company s independent reviews of low-rated credits or credits in volatile sectors, unless such information is not available, in which case, the ceding company s credit rating of the transactions are used. For example, the Company models all assumed RMBS credits with par above $1 million, as well as certain RMBS credits below that amount.

Credits identified as BIG are subjected to further review to determine the probability of a loss (see Note 5 Loss estimation process). Surveillance personnel then assign each BIG transaction to the appropriate BIG surveillance category based upon whether a lifetime loss is expected and whether a claim has been paid. The Company expects lifetime losses on

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a transaction when the Company believes there is more than a 50% chance that, on a present value basis, it will pay more claims over the life of that transaction than it will ultimately have been reimbursed. For surveillance purposes, the Company calculates present value using a constant discount rate of 5%. (A risk-free rate is used for recording of reserves for financial statement purposes.) A liquidity claim is a claim that the Company expects to be reimbursed within one year.

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

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

- BIG Category 2: Below-investment-grade transactions for which lifetime losses are expected but for which no claims (other than liquidity claims) have yet been paid.

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

Included in the BIG first lien RMBS exposures below is $1.9 billion of net par outstanding related to transactions covered by the Bank of America Agreement, which represents 17% of the U.S. RMBS first lien net par outstanding as of June 30, 2011. Under the Bank of America Agreement, 80% of first lien claims paid by Assured Guaranty will be reimbursed, until such time as losses on the collateral underlying the RMBS on which Assured Guaranty is paying claims reach $6.6 billion.

Financial Guaranty Exposures

(Insurance and Credit Derivative Form)

	June 30, 2011					
	BIG Net Par Outstanding					BIG Net Par as a % of Net Par Outstanding
	BIG 1	BIG 2	BIG 3	Total BIG	Net Par Outstanding	
	(in millions)					
First lien U.S. RMBS:						
Prime first lien	$ 26	$ 582	$	$ 608	$ 786	0.1%
Alt-A first lien	1,127	2,397	1,487	5,011	5,731	0.9
Option ARM	0	1,302	1,260	2,562	2,809	0.4
Subprime (including net interest margin securities)	334	2,468	212	3,014	8,572	0.5
Second lien U.S. RMBS:						
Closed-end second lien	153	438	467	1,058	1,087	0.2
Home equity lines of credit (HELOCs)	470		3,134	3,604	4,281	0.6
Total U.S. RMBS	2,110	7,187	6,560	15,857	23,266	2.7
Other structured finance	3,756	424	2,428	6,608	109,430	1.1
Public finance	4,241	204	865	5,310	454,500	0.9
Total	$ 10,107	$ 7,815	$ 9,853	$ 27,775	$ 587,196	4.7%

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	December 31, 2010					
	BIG Net Par Outstanding					
	BIG 1 (restated)	BIG 2 (restated)	BIG 3 (in millions)	Total BIG	Net Par Outstanding	BIG Net Par as a % of Net Par Outstanding
First lien U.S. RMBS:						
Prime first lien	$ 82	$ 542	$	$ 624	$ 849	0.1%
Alt-A first lien	976	3,108	573	4,657	6,134	0.8
Option ARM	33	2,186	640	2,859	3,214	0.5
Subprime (including net interest margin securities)	729	2,248	106	3,083	9,039	0.4
Second lien U.S. RMBS:						
Closed-end second lien	63	444	624	1,131	1,164	0.2
HELOCs	369		3,632	4,001	4,730	0.6
Total U.S. RMBS	2,252	8,528	5,575	16,355	25,130	2.6
Other structured finance	2,687	363	2,447	5,497	124,262	0.9
Public finance	3,752	283	919	4,954	467,739	0.8
Total	$ 8,691	$ 9,174	$ 8,941	$ 26,806	$ 617,131	4.3%

By Category Below-Investment-Grade Credits

	As of June 30, 2011					
	Net Par Outstanding			Number of Risks(3)		
Description	Financial Guaranty Insurance(1)	Credit Derivative(2)	Total (dollars in millions)	Financial Guaranty Insurance(1)	Credit Derivative(2)	Total
BIG:						
Category 1	$ 6,877	$ 3,230	$ 10,107	151	30	181
Category 2	5,038	2,777	7,815	84	44	128
Category 3	7,424	2,429	9,853	129	23	152
Total BIG	$ 19,339	$ 8,436	$ 27,775	364	97	461

	As of December 31, 2010					
	Net Par Outstanding			Number of Risks(3)		
Description	Financial Guaranty Insurance(1)	Credit Derivative(2)	Total (dollars in millions)	Financial Guaranty Insurance(1)	Credit Derivative(2)	Total

	(restated)		(restated)			(restated)
BIG:						
Category 1	$ 5,450	$ 3,241	$ 8,691	119	31	150
Category 2	5,717	3,457	9,174	98	50	148
Category 3	7,281	1,660	8,941	115	12	127
Total BIG	$ 18,448	$ 8,358	$ 26,806	332	93	425

(1) Represents contracts accounted for as financial guaranty insurance. See Note 5.

(2) Represents contracts accounted for as credit derivatives and carried at fair value on the consolidated balance sheets. See Note 7.

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

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5. Financial Guaranty Insurance Contracts

The portfolio of outstanding exposures discussed in Note 4 includes financial guaranty contracts that meet the definition of insurance contracts under ASC 944 as well as those that meet the definition of derivative contracts under ASC 815. Amounts presented in this Note relate to financial guaranty insurance contracts. Tables presented herein also present reconciliations to financial statement line items for other less significant types of insurance.

In October 2010, the FASB adopted Accounting Standards Update (Update) No. 2010-26. The Update specifies that certain costs incurred in the successful acquisition of new and renewal insurance contracts should be capitalized. These costs include incremental direct costs of contract acquisition that result directly from, and are essential to, the contract transaction and would not have been incurred by the insurance entity had the contract transaction not occurred. Costs incurred by the insurer for soliciting potential customers, market research, training, administration, unsuccessful acquisition efforts, and product development as well as all overhead type costs should be charged to expense as incurred. The Update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. Retrospective application to all prior periods presented upon the date of adoption is permitted, but not required. The Company is currently evaluating the impact the amendment in the Update will have on its consolidated financial statements in 2012.

The following tables present net earned premiums, premium receivable activity, expected collections of future premiums and expected future earnings on the existing book of business. The tables below provide the expected timing of premium revenue recognition, before accretion, and the expected timing of loss and loss adjustment expenses (LAE) recognition, before accretion. Actual collections may differ from expected collections in the tables below due to factors such as foreign exchange rate fluctuations, counterparty collectability issues, and changes in expected lives. The amount and timing of actual premium earnings and loss expense may differ from the estimates shown below due to factors such as refundings, accelerations, future commutations, changes in expected lives and updates to loss estimates.

Net Earned Premiums

	Second Quarter		Six Months	
	2011	2010	2011	2010
		(in millions)		
		(restated)		
Scheduled net earned premiums	$ 202.7	$ 271.7	$ 417.6	$ 558.3
Acceleration of premium earnings(1)	21.0	15.4	50.6	30.8

Accretion of discount on net premiums receivable		5.8		9.2		14.8		21.3
Total financial guaranty		229.5		296.3		483.0		610.4
Other		0.5		0.7		1.0		1.3
Total net earned premiums(2)	$	230.0	$	297.0	$	484.0	$	611.7

(1) Reflects the unscheduled refundings of underlying insured obligations.

(2) Excludes $18.3 million and $10.7 million in Second Quarter 2011 and 2010, respectively, and $37.4 million and $21.6 million for the Six Months 2011 and 2010, respectively, in net earned premium related to consolidated FG VIEs.

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Gross Premium Receivable, Net of Ceding Commissions Roll Forward

	Six Months 2011	Six Months 2010
	(in millions)	
Balance beginning of period	$ 1,167.6	$ 1,418.2
Change in accounting(1)		(19.0)
Balance beginning of the period, adjusted	1,167.6	1,399.2
Premium written, net	102.9	178.7
Premium payments received, net	(151.7)	(234.3)
Adjustments to the premium receivable:		
Changes in the expected term of financial guaranty insurance contracts	(91.1)	8.2
Accretion of discount	16.4	23.7
Foreign exchange translation	22.8	(65.9)
Other adjustments	(7.4)	1.7
Balance, end of period	$ 1,059.5	$ 1,311.3

(1) Represents elimination of premium receivable at January 1, 2010 related to consolidated FG VIEs upon the adoption of the new accounting guidance.

Gains or losses due to foreign exchange rate changes relate to installment premium receivables denominated in currencies other than the U.S. dollar. Approximately 51% and 42% of installment premiums at June 30, 2011 and December 31, 2010, respectively, are denominated in currencies other than the U.S. dollar, primarily in euro and British Pound Sterling.

For premiums received in installments, premium receivable is the present value of premiums due or expected to be collected over the life of the contract. Installment premiums typically relate to structured finance transactions, where the insurance premium rate is determined at the inception of the contract but the insured par is subject to prepayment throughout the life of the deal. Premium receipts are typically made from insured deal cash flows that are senior to payments made to the holders of the insured securities. When there are significant changes to expected premium collections, an adjustment is recorded to premiums receivable with a corresponding adjustment to deferred premium revenue. When these installment premiums are related to assumed reinsurance amounts, the Company also assesses the credit quality and liquidity of the company that the premiums are assumed from as well as the impact of any potential regulatory constraints to determine the collectability of such amounts.

Expected Collections of Gross Premiums Receivable,

Net of Ceding Commissions

	June 30, 2011(1) (in millions)
Gross premium collections expected:	
2011 (July 1 - September 30)	$ 54.5
2011 (October 1 - December 31)	63.6
2012	117.5
2013	103.0
2014	91.1
2015	81.4
2016 - 2020	326.3
2021 - 2025	229.3
2026 - 2030	167.7
After 2030	213.9
Total gross expected collections(2)	$ 1,448.3

(1) Represents undiscounted amounts expected to be collected.

(2) Total gross expected collections exclude $31.7 million related to FG VIEs at June 30, 2011.

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The unearned premium reserve comprises deferred premium revenue and the contra-paid as presented in the table below.

Net Unearned Premium Reserve

	As of June 30, 2011			As of December 31, 2010		
	Gross	Ceded	Net(1)	Gross	Ceded	Net(1)
	(in millions)					
Deferred premium revenue	$ 6,412.6	$ 791.1	$ 5,621.5	$ 7,108.6	$ 846.6	$ 6,262.0
Contra-paid	(106.7)	(18.1)	(88.6)	(146.1)	(24.8)	(121.3)
Total financial guaranty	6,305.9	773.0	5,532.9	6,962.5	821.8	6,140.7
Other	9.5	0.3	9.2	10.4		10.4
Total	$ 6,315.4	$ 773.3	$ 5,542.1	$ 6,972.9	$ 821.8	$ 6,151.1

(1) Net unearned premium reserve excludes $306.7 million and $193.2 million related to FG VIEs as of June 30, 2011 and December 31, 2010, respectively.

Net deferred premium revenue will be recognized as net earned premiums over the period of the contract in proportion to the amount of insurance protection provided. Amounts expected to be recognized in net earned premiums differ significantly from expected cash collections due primarily to amounts in deferred premium revenue representing cash already collected on policies paid upfront and fair value adjustments recorded in connection with the acquisition of AGMH on July 1, 2009 (AGMH Acquisition).

The following table provides a schedule of the expected timing of the income statement recognition of financial guaranty insurance net deferred premium revenue and present value of net expected losses to be expensed, pretax. This table excludes amounts related to consolidated FG VIEs.

Expected Timing of Financial Guaranty Insurance

Premium and Loss Recognition

	As of June 30, 2011		
	Scheduled Net Earned Premium	Net Expected Loss to be Expensed(1)	Net
		(in millions)	
2011 (July 1 - September 30)	$ 180.1	$ 51.1	$ 129.0
2011 (October 1 - December 31)	167.8	40.4	127.4
2012	574.7	109.2	465.5
2013	480.5	64.5	416.0
2014	424.1	47.3	376.8
2015	374.9	37.6	337.3
2016 - 2020	1,408.3	121.5	1,286.8
2021 - 2025	886.0	65.9	820.1
2026 - 2030	543.2	33.2	510.0
After 2030	581.9	18.4	563.5
Total present value basis(2)(3)	5,621.5	589.1	5,032.4
Discount	341.4	442.1	(100.7)
Total future value	$ 5,962.9	$ 1,031.2	$ 4,931.7

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(1) These amounts reflect the Company s estimate as of June 30, 2011 of expected losses to be expensed and are not included in loss and LAE reserve because loss and LAE is only recorded for the amount by which net expected loss to be expensed exceeds deferred premium revenue, determined on a contract-by-contract basis.

(2) Balances represent discounted amounts.

(3) Consolidation of FG VIEs resulted in reductions of $444.5 million in future scheduled amortization of deferred premium revenue and $260.3 million in net present value of expected loss to be expensed.

Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

Selected Information for Policies Paid in Installments

	As of June 30, 2011	As of December 31, 2010
	(dollars in millions)	
Premiums receivable, net of ceding commission payable	$ 1,059.5	$ 1,167.6
Gross deferred premium revenue	2,384.4	2,933.6
Weighted average risk-free rate used to discount premiums	3.6%	3.5%
Weighted average period of premiums receivable (in years)	10.1	10.1

Loss Estimation Process

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

The following table presents a roll forward of the present value of net expected loss to be paid for financial guaranty insurance contracts by sector. Expected loss to be paid is the estimate of the present value of future claim payments, net of reinsurance and net of salvage and subrogation that includes the present value benefit of estimated recoveries for breaches of R&W.

Financial Guaranty Insurance

Present Value of Net Expected Loss to be Paid

Roll Forward by Sector(1)

	Net Expected Loss to be Paid as of December 31, 2010 (restated)	Economic Loss Development(2) (restated)	(Paid) Recovered Losses	Net Expected Loss to be Paid as of June 30, 2011
		(in millions)		
U.S. RMBS:				
First lien:				
Prime first lien	$ 1.4	$ 1.8	$	$ 3.2
Alt-A first lien	184.4	21.8	(38.6)	167.6
Option ARM	523.7	(88.4)	(168.4)	266.9
Subprime	200.4	(23.2)	(15.7)	161.5
Total first lien	909.9	(88.0)	(222.7)	599.2
Second lien:				
Closed-end second lien	56.6	(109.6)	(41.7)	(94.7)
HELOCs	(805.7)	104.7	662.7	(38.3)
Total second lien	(749.1)	(4.9)	621.0	(133.0)
Total U.S. RMBS	160.8	(92.9)	398.3	466.2
Other structured finance	159.1	24.5	(3.0)	180.6
Public finance	88.9	(13.5)	(9.2)	66.2
Total	$ 408.8	$ (81.9)	$ 386.1	$ 713.0

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	Net Expected Loss to be Paid as of December 31, 2009 (restated)	Economic Loss Development(2) (restated)	(Paid) Recovered Losses	Net Expected Loss to be Paid as of June 30, 2010 (restated)
		(in millions)		
U.S. RMBS:				
First lien:				
Prime first lien	$	$ 0.4	$	$ 0.4
Alt-A first lien	204.4	15.4	(29.0)	190.8
Option ARM	545.2	75.1	(49.1)	571.2
Subprime	77.5	69.3	(2.3)	144.5
Total first lien	827.1	160.2	(80.4)	906.9
Second lien:				
Closed-end second lien	199.3	(40.4)	(39.9)	119.0
HELOCs	(206.6)	28.7	(315.8)	(493.7)
Total second lien	(7.3)	(11.7)	(355.7)	(374.7)
Total U.S. RMBS	819.8	148.5	(436.1)	532.2
Other structured finance	115.7	36.0	(5.6)	146.1
Public finance	130.9	(8.1)	(34.2)	88.6
Total	$ 1,066.4	$ 176.4	$ (475.9)	$ 766.9

(1) Amounts include all expected payments whether or not the insured transaction VIE is consolidated. Amounts exclude reserves for mortgage business of $2.1 million as of June 30, 2011 and $2.1 million as of December 31, 2010.

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

Expected LAE for mitigating claim liabilities were $15.9 million and $17.2 million as of June 30, 2011 and December 31, 2010, respectively. The Company used weighted average risk-free rates ranging from 0% to 5.0% and 0% to 5.34% to discount expected loss to be paid as of June 30, 2011 and December 31, 2010, respectively.

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

already been established (and therefore, expensed but not yet paid).

Reconciliation of Present Value of Net Expected Loss to be Paid

and Present Value of Net Expected Loss to be Expensed

	As of June 30, 2011	As of December 31, 2010
	(in millions)	
		(restated)
Net expected loss to be paid	$ 713.0	$ 408.8
Less: net expected loss to be paid for FG VIEs	(5.6)	49.2
Total	718.6	359.6
Contra-paid, net	88.6	121.3
Salvage and subrogation recoverable, net(1)	271.9	903.0
Loss and LAE reserve, net(2)	(490.0)	(550.0)
Net expected loss to be expensed(3)	$ 589.1	$ 833.9

(1) June 30, 2011 amount consists of gross salvage and subrogation amounts of $307.1 million net of ceded amounts of $35.2 million which is recorded in reinsurance balances payable. The December 31, 2010 amount consists of gross

Assured Guaranty Ltd.

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salvage and subrogation amounts of $1,032.4 million net of ceded amounts of $129.4 million which is recorded in reinsurance balances payable.

(2) Represents loss and LAE reserves, net of reinsurance recoverable on unpaid losses, excluding $2.1 million in reserves for other runoff lines of business as of June 30, 2011 and December 31, 2010.

(3) Excludes $260.3 million and $211.9 million as of June 30, 2011 and December 31, 2010, respectively, related to consolidated FG VIEs.

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

The Company projects losses in U.S. RMBS on a transaction-by-transaction basis by projecting the performance of the underlying pool of mortgages over time and then applying the structural features (i.e., payment priorities and tranching) of the RMBS to the projected performance of the collateral over time. The resulting projected claim payments or reimbursements are then discounted to a present value using a risk-free rate. For transactions, other than those covered under Bank of America Agreement, where the Company projects it will receive recoveries from providers of R&W, the projected amount of recoveries is included in the projected cash flows from the collateral. The Company runs, and probability-weights, several sets of assumptions (referred to as scenarios) regarding potential mortgage collateral performance.

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

Mortgage borrowers that are not more than one payment behind (generally considered performing borrowers) have demonstrated an ability and willingness to pay throughout the recession and mortgage crisis, and as a result are viewed as less likely to default than delinquent borrowers. Performing borrowers that eventually default will also need to progress through delinquency categories before any defaults occur. The Company projects how many of the currently performing loans will default, and when, by first converting the projected near-term defaults of delinquent borrowers derived from liquidation rates into a vector of conditional default rates, then projecting how the conditional default rates will develop

over time. Loans that are defaulted pursuant to the conditional default rate after the liquidation of currently delinquent loans represent defaults of currently performing loans. A conditional default rate is the outstanding principal amount of defaulted loans liquidated in the current month divided by the remaining outstanding amount of the whole pool of loans (or collateral pool balance). The collateral pool balance decreases over time as a result of scheduled principal payments, partial and whole principal repayments, and defaults.

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

The Company is in the process of enforcing claims for breaches of R&W regarding the characteristics of the loans included in the collateral pools. The Company calculates a credit to the RMBS issuer for such recoveries where the R&W were provided by an entity the Company believes to be financially viable and where the Company already has access or believes it will attain access to the underlying mortgage loan files. In second lien RMBS transactions this credit is based on a percentage of actual repurchase rates achieved, while in first lien RMBS transactions, other than those covered under the Bank of America Agreement, this credit is estimated by reducing collateral losses projected by the Company to reflect a percentage of the recoveries the Company believes it will achieve, which factor is derived based on the number of breaches identified to date and incorporated scenarios based on the amounts the Company was able to negotiate under the Bank of America Agreement. The first lien approach is different from the second lien approach because the Company s first lien transactions have multiple tranches and a more complicated method is required to correctly allocate credit to each tranche. In each case, the credit is a function of the projected lifetime collateral losses in the collateral pool, so an increase in projected collateral losses increases the R&W credit calculated by the Company for the RMBS issuer. Further detail regarding how the Company calculates these credits may be found under *Breaches of Representations and Warranties* below.

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

Second Quarter-End 2011 U.S. RMBS Loss Projections

In both Second Quarter 2011 and First Quarter 2011, the Company chose to use loss projection curves with the same shape as that used in the fourth quarter of 2010, including retaining the initial plateau period it had used in the fourth quarter of 2010. The Company s RMBS projection methodology assumes that the housing and mortgage markets will eventually recover but are doing so at a slower than expected pace.

The scenarios used to project RMBS collateral losses in Second Quarter 2011 were essentially the same as those used in the First Quarter 2011, except that (as noted above), based on its observation of the continued elevated levels of early stage delinquencies, the Company adjusted its loss projection curves to reflect its view that the recovery would be longer than it had anticipated in the First Quarter 2011. The scenarios used in Second Quarter 2011 were also the same as those employed at year-end 2010, with the following exceptions: (i) the initial plateau periods were again retained; (ii) an increase in the expected period for reaching the final conditional default rate for second lien transactions from that used in the fourth quarter of 2010 was established for the First Quarter 2011 and retained in the Second Quarter 2011; (iii) the initial Alt-A first lien and Option ARM loss severities were increased from 60% at year-end 2010 to 65% in both the First and Second Quarters 2011; and (iv) the Company s probability weightings from the fourth quarter of 2010 were adjusted in First Quarter 2011 to reflect changes to each of its second lien scenarios and such adjustments were retained in the Second Quarter 2011.

The Company also used generally the same methodology to project the credit received by the RMBS issuers for recoveries in R&W in Second Quarter 2011 as it used for the First Quarter 2011 and at year-end 2010. The primary difference relates to the execution of the Bank of America Agreement and the inclusion of the terms of the agreement as a potential scenario in transactions not covered by the Bank of America Agreement in both the First and Second Quarters 2011 that were not included at year-end 2010. During the First Quarter 2011, the Company added R&W credits for two second lien transactions where the Company concluded it had the right to obtain loan files that it had not previously concluded were accessible. The Company also added R&W credits for ten first lien transactions where either it concluded it had the right to obtain loan files that it had not previously concluded were accessible or it anticipates receiving a benefit due to the Bank of America Agreement. See Bank of America Agreement in Note 3. During the Second Quarter the Company did not calculate an R&W benefit for any credit for which it had not previously calculated an R&W benefit.

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

The Company insures two types of second lien RMBS: those secured by HELOCs and those secured by closed-end second lien mortgages. HELOCs are revolving lines of credit generally secured by a second lien on a one-to-four family home. A mortgage for a fixed amount secured by a second lien on a one-to-four family home is generally referred to as a closed-end second lien. Both first lien RMBS and second lien RMBS sometimes include a portion of loan collateral with a different priority than the majority of the collateral. The Company has material exposure to second lien mortgage loans originated and serviced by a number of parties, but the Company s most significant second lien exposure is to HELOCs originated and serviced by Countrywide, a subsidiary of Bank of America. See Breaches of Representations and Warranties.

The delinquency performance of HELOC and closed-end second lien exposures included in transactions insured by the Company began to deteriorate in 2007, and such transactions, particularly those originated in the period from 2005 through 2007, continue to perform below the Company s original underwriting expectations. While insured securities benefit from structural protections within the transactions designed to absorb collateral losses in excess of previous historically high levels, in many second lien RMBS projected losses now exceed those structural protections.

The Company believes the primary variables affecting its expected losses in second lien RMBS transactions are the amount and timing of future losses in the collateral pool supporting the transactions and the amount of loans repurchased for breaches of R&W. Expected losses are also a function of the structure of the transaction; the voluntary prepayment rate (typically also referred to as conditional prepayment rate of the collateral); the interest rate environment; and assumptions

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about the draw rate and loss severity. These variables are interrelated, difficult to predict and subject to considerable volatility. If actual experience differs from the Company s assumptions, the losses incurred could be materially different from the estimate. The Company continues to update its evaluation of these exposures as new information becomes available.

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

Assumptions in Base Case Expected Loss Estimates

Second Lien RMBS(1)

HELOC Key Variables	As of June 30, 2011	As of March 31, 2011	As of December 31, 2010
Plateau conditional default rate	4.6 - 34.6%	4.7 - 21.4%	4.2 - 22.1%
Final conditional default rate trended down to	0.4 - 3.2%	0.4 - 3.2%	0.4 - 3.2%
Expected period until final conditional default rate	36 months	36 months	24 months
Initial conditional prepayment rate	0.9 - 15.5%	0.9 - 12.6%	3.3 - 17.5%
Final conditional prepayment rate	10%	10%	10%
Loss severity	98%	98%	98%
Initial draw rate	0.0 - 8.6%	0.0 - 5.2%	0.0 - 6.8%

Closed-End Second Lien Key Variables	As of June 30, 2011	As of March 31, 2011	As of December 31, 2010
Plateau conditional default rate	4.8 - 22.8%	7.2 - 28.9%	7.3 - 27.1%
Final conditional default rate trended down to	2.9 - 8.1%	2.9 - 8.1%	2.9 - 8.1%
Expected period until final conditional default rate achieved	36 months	36 months	24 months
Initial conditional prepayment rate	1.4 - 12.0%	0.9 - 12.7%	1.3 - 9.7%
Final conditional prepayment rate	10%	10%	10%
Loss severity	98%	98%	98%

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

In second lien transactions the projection of near-term defaults from currently delinquent loans is relatively straightforward because loans in second lien transactions are generally charged off (treated as defaulted) by the securitization s servicer once the loan is 180 days past due. Most second lien transactions report the amount of loans in five monthly delinquency categories (i.e., 30-59 days past due, 60-89 days past due, 90-119 days past due, 120-149 days past due and 150-179 days past due). The Company estimates the amount of loans that will default over the next five months by calculating current representative liquidation rates (the percent of loans in a given delinquency status that are assumed to ultimately default) from selected representative transactions and then applying an average of the preceding 12 months liquidation rates to the amount of loans in the delinquency categories. The amount of loans projected to default in the first through fifth months is expressed as a conditional default rate. The first four months conditional default rate is calculated by applying the liquidation rates to the current-period past-due balances (i.e., the 150-179 day balance is liquidated in the first projected month, the 120-149 day balance is liquidated in the second projected month, the 90-119 day balance is liquidated in the third projected month and the 60-89 day balance is liquidated in the fourth projected month). For the fifth month the conditional default rate is calculated using the average 30-59 day past due balances for the prior three months. An average of the third, fourth and fifth month conditional default rates is then used as the basis for the plateau period that follows the embedded five months of losses.

In Six Months 2011 in the base scenario, the conditional default rate (the plateau conditional default rate) was held constant for one month. Once the plateau period has ended, the conditional default rate is assumed to gradually trend down in uniform increments to its final long-term steady state conditional default rate. In the base scenario, the time over which the conditional default rate trends down to its final conditional default rate is 30 months (compared with 18 months at year-end 2010). Therefore, the total stress period for second lien transactions would be 36 months, comprising five months of delinquent data, a one-month plateau period and 30 months of decrease to the steady state conditional default rate. This is 12 months longer than the 24 months of total stress period used at year-end 2010. The long-term steady state conditional default rates are calculated as the constant conditional default rates that would have yielded the amount of losses originally expected at underwriting. When a second lien loan defaults, there is generally very low recovery. Based on current expectations of future performance, the Company assumes that it will only recover 2% of the collateral.

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The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected (which is a function of the conditional default rate and the loan balance over time) as well as the amount of excess spread (which is the excess of the interest paid by the borrowers on the underlying loan over the amount of interest and expenses owed on the insured obligations). In the base case, the current conditional prepayment rate is assumed to continue until the end of the plateau before gradually increasing to the final conditional prepayment rate over the same period the conditional default rate decreases. For transactions where the initial conditional prepayment rate is higher than the final conditional prepayment rate, the initial conditional prepayment rate is held constant. The final conditional prepayment rate is assumed to be 10% for both HELOC and closed-end second lien transactions. This level is much higher than current rates, but lower than the historical average, which reflects the Company s continued uncertainty about performance of the borrowers in these transactions. This pattern is consistent with how the Company modeled the conditional prepayment rate at year-end 2010 and in the First Quarter 2011. To the extent that prepayments differ from projected levels it could materially change the Company s projected excess spread and losses.

The Company uses a number of other variables in its second lien loss projections, including the spread between relevant interest rate indices, and HELOC draw rates (the amount of new advances provided on existing HELOCs expressed as a percentage of current outstanding advances). For HELOC transactions, the draw rate is assumed to decline from the current level to a final draw rate over a period of three months. The final draw rates were assumed to range from 0.0% to 4.3%.

In estimating expected losses, the Company modeled and probability-weighted three possible conditional default rate curves applicable to the period preceding the return to the long-term steady state conditional default rate. Given that draw rates have been reduced to levels below the historical average and that loss severities in these products have been higher than anticipated at inception, the Company believes that the level of the elevated conditional default rate and the length of time it will persist is the primary driver behind the likely amount of losses the collateral will suffer (before considering the effects of repurchases of ineligible loans). The Company continues to evaluate the assumptions affecting its modeling results.

At June 30, 2011, the Company s base case assumed a one-month conditional default rate plateau and a 30-month ramp-down (for a total stress period of 36 months). Increasing the conditional default rate plateau to four months and keeping the ramp-down at 30-months (for a total stress period of 39 months) would increase the expected loss by approximately $72.1 million for HELOC transactions and $7.9 million for closed-end second lien transactions. On the other hand, keeping the conditional default rate plateau at one month but decreasing the length of the conditional default rate ramp-down to a 24 month assumption (for a total stress period of 30 months) would decrease the expected loss by approximately $66.7 million for HELOC transactions and $3.0 million for closed-end second lien transactions.

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

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

The performance of the Company s first lien RMBS exposures began to deteriorate in 2007, and such transactions, particularly those originated in the period from 2005 through 2007, continue to perform below the Company s original underwriting expectations. The Company currently projects first lien collateral losses many times those expected at the time of underwriting. While insured securities benefited from structural protections within the transactions designed to absorb some of the collateral losses, in many first lien RMBS transactions, projected losses exceed those structural protections.

The majority of projected losses in first lien RMBS transactions are expected to come from non-performing mortgage loans (those that are delinquent or in foreclosure or where the loan has been foreclosed and the RMBS issuer owns the underlying real estate). An increase in non-performing loans beyond that projected in the previous period is one of the primary drivers of loss development in this portfolio. In order to determine the number of defaults resulting from these delinquent and foreclosed loans, the Company applies a liquidation rate assumption to loans in each of various delinquency

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categories. The Company arrived at its liquidation rates based on data in loan performance and assumptions about how delays in the foreclosure process may ultimately affect the rate at which loans are liquidated. The liquidation rate is a standard industry measure that is used to estimate the number of loans in a given aging category that will default within a specified time period. The Company projects these liquidations to occur over two years.

The following table shows liquidation assumptions for various delinquency categories.

First Lien Liquidation Rates

	June 30, 2011	March 31, 2011	December 31, 2010
30 - 59 Days Delinquent			
Alt-A first lien	50%	50%	50%
Option ARM	50	50	50
Subprime	45	45	45
60 - 89 Days Delinquent			
Alt-A first lien	65	65	65
Option ARM	65	65	65
Subprime	65	65	65
90 - Bankruptcy			
Alt-A first lien	75	75	75
Option ARM	75	75	75
Subprime	70	70	70
Foreclosure			
Alt-A first lien	85	85	85
Option ARM	85	85	85
Subprime	85	85	85
Real Estate Owned			
Alt-A first lien	100	100	100
Option ARM	100	100	100
Subprime	100	100	100

While the Company uses liquidation rates as described above to project defaults of non-performing loans, it projects defaults on presently current loans by applying a conditional default rate trend. The start of that conditional default rate trend is based on the defaults the Company projects will emerge from currently nonperforming loans. The total amount of expected defaults from the non-performing loans is translated into

a constant conditional default rate (*i.e.*, the conditional default rate plateau), which, if applied for each of the next 24 months, would be sufficient to produce approximately the amount of defaults that were calculated to emerge from the various delinquency categories. The conditional default rate thus calculated individually on the collateral pool for each RMBS is then used as the starting point for the conditional default rate curve used to project defaults of the presently performing loans.

In the base case, each transaction s conditional default rate is projected to improve over 12 months to an intermediate conditional default rate (calculated as 15% of its conditional default rate plateau); that intermediate conditional default rate is held constant for 36 months and then trails off in steps to a final conditional default rate of 5% of the conditional default rate plateau. Under the Company s methodology, defaults projected to occur in the first 24 months represent defaults that can be attributed to loans that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected conditional default rate trend after the first 24 month period represent defaults attributable to borrowers that are currently performing.

Another important driver of loss projections is loss severity, which is the amount of loss the transaction incurs on a loan after the application of net proceeds from the disposal of the underlying property. Loss severities experienced in first lien transactions have reached historic high levels, and the Company is assuming that these historic high levels will continue for another year. The Company determines its initial loss severity based on actual recent experience. The Company then assumes that loss severities begin returning to levels consistent with underwriting assumptions beginning in June 2012 and, in the base scenario, decline over two years to 40%.

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

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Key Assumptions in Base Case Expected Loss Estimates of First Lien RMBS Transactions

	As of June 30, 2011	As of March 31, 2011	As of December 31, 2010
Alt-A First Lien			
Plateau conditional default rate	2.9 - 36.6%	2.7 - 40.2%	2.6 - 42.2%
Intermediate conditional default rate	0.4 - 5.5%	0.4 - 6.0%	0.4 - 6.3%
Final conditional default rate	0.1 - 1.8%	0.1 - 2.0%	0.1 - 2.1%
Initial loss severity	65%	65%	60%
Initial conditional prepayment rate	0.0 - 28.3%	0.4 - 40.5%	0.0 - 36.5%
Final conditional prepayment rate	10%	10%	10%
Option ARM			
Plateau conditional default rate	13.1 - 32.1%	12.3 - 33.2%	11.7 - 32.7%
Intermediate conditional default rate	2.0 - 4.8%	1.8 - 5.0%	1.8 - 4.9%
Final conditional default rate	0.7 - 1.6%	0.6 - 1.7%	0.6 - 1.6%
Initial loss severity	65%	65%	60%
Initial conditional prepayment rate	0.0 - 7.2%	0.0 - 24.5%	0.0 - 17.7%
Final conditional prepayment rate	10%	10%	10%
Subprime			
Plateau conditional default rate	7.7 - 34.2%	8.0 - 34.3%	9.0 - 34.6%
Intermediate conditional default rate	1.2 - 5.1%	1.2 - 5.1%	1.3 - 5.2%
Final conditional default rate	0.4 - 1.7%	0.4 - 1.7%	0.4 - 1.7%
Initial loss severity	80%	80%	80%
Initial conditional prepayment rate	0.0 - 9.3%	0.0 - 13.3%	0.0 - 13.5%
Final conditional prepayment rate	10%	10%	10%

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected (since that amount is a function of the conditional default rate and the loan balance over time) as well as the amount of excess spread (the amount by which the interest paid by the borrowers on the underlying loan exceeds the amount of interest owed on the insured obligations). The assumption for the conditional prepayment rate follows a similar pattern to that of the conditional default rate. The current level of voluntary prepayments is assumed to continue for the plateau period before gradually increasing over 12 months to the final conditional prepayment rate, which is assumed to be either 10% or 15% depending on the scenario run. For transactions where the initial conditional prepayment rate is higher than the final conditional prepayment rate, the initial conditional prepayment rate is held constant.

The ultimate performance of the Company s first lien RMBS transactions remains highly uncertain and may be subject to considerable volatility due to the influence of many factors, including the level and timing of loan defaults, changes in housing prices and other variables. The

Company will continue to monitor the performance of its RMBS exposures and will adjust the loss projections for those transactions based on actual performance and management s estimates of future performance.

In estimating expected losses, the Company modeled and probability-weighted sensitivities for first lien transactions by varying its assumptions of how fast recovery is expected to occur. The primary variable when modeling sensitivities was how quickly the conditional default rate returned to its modeled equilibrium, which was defined as 5% of the current conditional default rate. The Company also stressed conditional prepayment rates and the speed of recovery of loss severity rates. In a somewhat more stressful environment than that of the base case, where the conditional default rate recovery was more gradual and the final conditional prepayment rate was 15% rather than 10%, expected loss to be paid would increase by approximately $8.1 million for Alt-A first lien, $55.8 million for Option ARM, $13.8 million for subprime and $0.2 million for prime transactions. In an even more stressful scenario where the conditional default rate plateau was extended three months (to be 27 months long) before the same more gradual conditional default rate recovery and loss severities were assumed to recover over four rather than two years (and subprime loss severities were assumed to recover only to 60%), expected loss to be paid would increase by approximately $39.5 million for Alt-A first lien, $140.7 million for Option ARM, $149.0 million for subprime and $1.5 million for prime transactions. The Company also considered a scenario where the recovery was faster than in its base case. In this scenario, where the conditional default rate plateau was three months shorter (21 months, effectively assuming that liquidation rates would improve) and the conditional default rate recovery was more pronounced, expected loss to be paid would decrease by approximately $22.4 million for Alt-A first lien, $76.8 million for Option ARM, $29.7 million for subprime and $0.9 million for prime transactions.

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Breaches of Representations and Warranties

The Company is pursuing reimbursements for breaches of R&W regarding loan characteristics. Performance of the collateral underlying certain first and second lien securitizations has substantially differed from the Company s original expectations. The Company has employed several loan file diligence firms and law firms as well as devoted internal resources to review the mortgage files surrounding many of the defaulted loans. The Company s success in these efforts resulted in two negotiated agreements, to date, in respect of the Company s R&W claims, including on April 14, 2011 with Bank of America as described under Bank of America Agreement in Note 3. Additionally, for the RMBS transactions as to which the Company had not settled its claims for breaches of R&W as of June 30, 2011, the Company had performed a detailed review of approximately 13,900 second lien and 16,200 first lien defaulted loan files, representing approximately $959 million in second lien and $4,587 million in first lien outstanding par of defaulted loans underlying insured transactions. The Company identified approximately 12,300 second lien transaction loan files and approximately 14,700 first lien transaction loan files that breached one or more R&W regarding the characteristics of the loans, such as misrepresentation of income or employment of the borrower, occupancy, undisclosed debt and non-compliance with underwriting guidelines at loan origination. The Company continues to review new files as new loans default and as new loan files are made available to it. The Company generally obtains the loan files from the originators or servicers (including master servicers). In some cases, the Company requests loan files via the trustee, which then requests the loan files from the originators and/or servicers. On second lien loans, the Company requests loan files for all charged-off loans. On first lien loans, the Company requests loan files for all severely (60+ days) delinquent loans and all liquidated loans. Recently, the Company started requesting loan files for all the loans (both performing and non-performing) in certain deals to limit the number of requests for additional loan files as the transactions season and loans charge-off, become 60+ days delinquent or are liquidated. (The Company takes no repurchase credit for R&W breaches on loans that are expected to continue to perform.) In addition to Bank of America, as of June 30, 2011, the Company had reached agreement with other R&W providers for the repurchase of $38.4 million of second lien and $47.5 million of first lien mortgage loans. The $38.4 million for second lien loans represents the calculated repurchase price for 466 loans, and the $47.5 million for first lien represents the calculated repurchase price for 142 loans. The repurchase proceeds are paid to the RMBS transactions and distributed in accordance with the payment priorities set out in the transaction agreements, so the proceeds are not necessarily allocated to the Company on a dollar-for-dollar basis. Proceeds projected to be reimbursed to the Company on transactions where the Company has already paid claims are viewed as a recovery on paid losses. For transactions where the Company has not already paid claims, projected recoveries reduce projected loss estimates. In either case, projected recoveries have no effect on the amount of the Company s exposure. These amounts reflect payments made pursuant to the negotiated transaction agreements and not payments made pursuant to legal settlements. See Recovery Litigation below for a description of the related legal proceedings the Company has commenced.

The Company has included in its net expected loss estimates as of June 30, 2011 an estimated benefit from loan repurchases related to breaches of R&W of $1.5 billion, which includes amounts with Bank of America. The amount of benefit recorded as a reduction of expected losses was calculated by extrapolating each transaction s breach rate on defaulted loans to projected defaults and, in the case of transactions subject to Bank of America Agreement, the estimated impact of that agreement on the relevant transactions. See Bank of America Agreement in Note 3. The Company did not incorporate any gain contingencies or damages paid from potential litigation in its estimated repurchases. The amount the Company will ultimately recover related to contractual R&W is uncertain and subject to a number of factors including the counterparty s ability to pay, the number and loss amount of loans determined to have breached R&W and, potentially, negotiated settlements or litigation recoveries. As such, the Company s estimate of recoveries is uncertain and actual amounts realized may differ significantly from these estimates. In arriving at the expected recovery from breaches of R&W, the Company considered the creditworthiness of the provider of the R&W, the number of

breaches found on defaulted loans, the success rate in resolving these breaches with the provider of the R&W and the potential amount of time until the recovery is realized.

The calculation of expected recovery from breaches of R&W involved a variety of scenarios, which ranged from the Company recovering substantially all of the losses it incurred due to violations of R&W to the Company realizing very limited recoveries. The Company did not include any recoveries related to breaches of R&W in amounts greater than the losses it expected to pay under any given cash flow scenario. These scenarios were probability-weighted in order to determine the recovery incorporated into the Company s estimate of expected losses. This approach was used for both loans that had already defaulted and those assumed to default in the future. In all cases, recoveries were limited to amounts paid or expected to be paid by the Company.

The following table shows the balance sheet classification of estimated R&W benefits:

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Balance Sheet Classification of R&W Benefit

	As of June 30, 2011			As of December 31, 2010		
	Benefit for R&W	Effect of Consolidating FG VIEs	Reported on Balance Sheet	Benefit for R&W	Effect of Consolidating FG VIEs	Reported on Balance Sheet
	(in billions)					
Salvage and subrogation recoverable	$ 0.4	$ (0.2)	$ 0.2	$ 0.9	$ (0.1)	$ 0.8
Loss and LAE reserve	0.9	(0.1)	0.8	0.5	(0.1)	0.4
Unearned premium reserve	0.2		0.2	0.2		0.2
Total	$ 1.5	$ (0.3)	$ 1.2	$ 1.6	$ (0.2)	$ 1.4

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

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

Net of Reinsurance

	Future Net R&W Benefit at December 31, 2010	R&W Development and Accretion of Discount During Six Months 2011	R&W Recovered During Six Months 2011(1)	Future Net R&W Benefit at June 30, 2011(2)
	(in millions)			
Prime first lien	$ 1.1	$ 1.8	$	$ 2.9
Alt-A first lien	81.0	46.6		127.6
Option ARM	309.3	449.2	(47.3)	711.2
Subprime	26.8	54.7		81.5
Closed-end second lien	178.2	61.5		239.7
HELOC	1,004.1	157.1	(850.8)	310.4
Total	$ 1,600.5	$ 770.9	$ (898.1)	$ 1,473.3

	Future Net R&W Benefit at December 31, 2009	R&W Development and Accretion of Discount During Six Months 2010	R&W Recovered During Six Months 2010(1)	Future Net R&W Benefit at June 30, 2010
		(in millions)		
Prime first lien	$	$ 0.8	$	$ 0.8
Alt-A first lien	64.2	15.0		79.2
Option ARM	203.7	52.4	(13.3)	242.8
Subprime				
Closed-end second lien	76.5	46.5		123.0
HELOC	828.7	97.2	(50.9)	875.0
Total	$ 1,173.1	$ 211.9	$ (64.2)	$ 1,320.8

(1) Gross amounts recovered are $1,015.0 million and $72.0 million for Six Months 2011 and 2010, respectively.

(2) Includes R&W benefit of $588.9 million attributable to transactions covered by the Bank of America Agreement.

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

as of June 30, 2011 and December 31, 2010

	Number of Risks(1) as of		Outstanding Principal and Interest as of	
	June 30, 2011	December 31, 2010	June 30, 2011	December 31, 2010
		(dollars in millions)		
Prime first lien	1	1	$ 54.5	$ 57.1
Alt-A first lien	20	17	1,826.7	1,882.8
Option ARM	11	10	1,914.8	1,909.8
Subprime	4	1	982.7	228.7
Closed-end second lien	4	4	396.3	444.9
HELOC	15	13	3,844.9	2,969.8
Total	55	46	$ 9,019.9	$ 7,493.1

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

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

	Second Quarter		Six Months	
	2011	2010	2011	2010
		(in millions)		
Inclusion of new deals with breaches of R&W during period	$	$	$ 107.1	$ 62.4
Change in recovery assumptions as the result of additional file review and recovery success		35.5	198.4	65.3
Estimated increase(decrease) in defaults that will result in additional breaches	(5.8)	18.4	34.0	82.1
Results of Bank of America Agreement	95.6		429.7	
Accretion of discount on balance	1.1	2.0	1.7	2.1
Total	$ 90.9	$ 55.9	$ 770.9	$ 211.9

The $90.9 million and $770.9 million R&W development and accretion of discount during Second Quarter 2011 and Six Months 2011, respectively, in the table above resulted in large part from the Bank of America Agreement executed on April 14, 2011 related to the Company s R&W claims and described under Bank of America Agreement in Note 3. The benefit of the Bank of America Agreement is included in the R&W credit for the transactions directly affected by the agreement. In addition, the Bank of America Agreement caused the Company to increase the probability of successful pursuit of R&W claims against other providers where the Company believed those providers were breaching at a similar rate. The remainder of the development primarily relates to additional projected defaults. The Company assumes that recoveries on HELOC and closed-end second lien loans that were not subject to the Bank of America Agreement will occur in two to four years from the balance sheet date depending on the scenarios and that recoveries on Alt-A first lien, Option ARM and subprime loans will occur as claims are paid over the life of the transactions. Recoveries on second lien transactions subject to the Bank of America Agreement will be paid in full by March 31, 2012.

As of June 30, 2011, cumulative collateral losses on the 21 first lien RMBS transactions were approximately $1.6 billion. The Company estimates that cumulative projected collateral losses for these first lien transactions will be $4.84 billion, which will result in estimated gross expected losses to the Company of $630.9 million before considering R&W recoveries from Bank of America, and $126.8 million after considering such R&W recoveries. As of June 30, 2011, the Company had been reimbursed $14.9 million in respect of the covered first lien transactions under the Bank of America Agreement.

Student Loan Transactions

The Company has insured or reinsured $2.9 billion net par of student loan securitizations, $1.5 billion issued by private issuers and classified as asset-backed and $1.4 billion issued by public authorities and classified as public finance. Of these amounts, $242.3 million and $531.9 million, respectively, are rated BIG. The Company is projecting approximately $60.7 million and $12.6 million, respectively, of expected loss to be paid in these portfolios. In general the losses are due to: (i) the poor credit performance of private student loan collateral; (ii) high interest rates on auction rate securities with respect

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to which the auctions have failed or (iii) high interest rates on variable rate demand obligations (VRDO) that have been put to the liquidity provider by the holder and are therefore bearing high bank bond interest rates. The largest of these losses was approximately $32.8 million and related to a transaction backed by a pool of private student loans ceded to AG Re by another monoline insurer. The guaranteed bonds were issued as auction rate securities that now bear a high rate of interest due to the primary insurer s downgrade. Further, the underlying loan collateral has performed below expectations.

XXX Life Insurance Transactions

The Company has insured $2.0 billion of net par in XXX life insurance reserve securitizations based on discrete blocks of individual life insurance business. In each such transaction the monies raised by the sale of the bonds insured by the Company were used to capitalize a special purpose vehicle that provides reinsurance to a life insurer or reinsurer. The monies are invested at inception in accounts managed by third party investment managers. 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. In particular, such credit losses in the investment portfolio could be realized in the event that circumstances arise resulting in the early liquidation of assets at a time when their market value is less than their intrinsic value.

The Company s $2.0 billion net par of XXX life insurance transactions includes, as of June 30, 2011, a total of $882.5 million rated BIG, consisting of Class A-2 Floating Rate Notes issued by Ballantyne Re p.l.c and Series A-1 Floating Rate Notes issued by Orkney Re II p.l.c (Orkney Re II). The Ballantyne Re and Orkney Re II XXX transactions had material amounts of their assets invested in U.S. RMBS transactions. Based on its analysis of the information currently available, including estimates of future investment performance provided by the current investment manager, and projected credit impairments on the invested assets and performance of the blocks of life insurance business at June 30, 2011, the Company s gross expected loss, prior to reinsurance or netting of unearned premium, for its two BIG XXX insurance transactions was $72.9 million. The Company s net loss and LAE reserve was $61.2 million.

Other Notable Loss or Claim Transactions

The preceding pages describe the asset classes in the financial guaranty portfolio that encompass most of the Company s projected losses. The Company also projects losses on a number of other transactions, the most significant of which are described in the following paragraphs.

The Company has projected expected loss to be paid of $31.1 million on its total net par outstanding of $495.8 million on Jefferson County Alabama Sewer Authority exposure. This estimate is based primarily on the Company s view of how much debt the Authority should be able to support under certain probability-weighted scenarios. See Note 17.

The Company has projected expected loss to be paid of $6.5 million on a transaction backed by revenues generated by telephone directory yellow pages in various jurisdictions with a net par of $110.7 million and guaranteed by Ambac Assurance Corporation (Ambac). This estimate is based primarily on the Company s view of how quickly yellow pages revenues are likely to decline in the future.

The Company has projected expected loss to be paid of $14.5 million on one transaction from 2000 backed by manufactured housing loans with a net par of $67.1 million. The Company insures a total of $358.8 million net par of securities backed by manufactured housing loans, a total of $240.5 million rated BIG.

The Company has $165.0 million of net par exposure to the city of Harrisburg, Pennsylvania, of which $93.1 million is BIG. The Company has paid $4.5 million in net claims to date, and expects a full recovery.

Recovery Litigation

As of August 9, 2011, the Company had filed lawsuits with regard to six second lien U.S. RMBS transactions insured by AGM or AGC, alleging breaches of R&W both in respect of the underlying loans in the transactions and the accuracy of the information provided to AGM and AGC, and failure to cure or repurchase defective loans identified by AGM and AGC to such persons. These transactions consist of the ACE Securities Corp. Home Equity Loan Trust, Series 2006-GP1, the ACE Securities Corp. Home Equity Loan Trust, Series 2007-SL2 and the ACE Securities Corp. Home Equity Loan Trust, Series 2007-SL3 transactions (in each of which AGC or AGM has sued Deutsche Bank AG affiliates DB Structured Products, Inc. and ACE Securities Corp. in the Supreme Court of the State of New York), the SACO I Trust 2005-GP1 transaction (in which AGC has sued JPMorgan Chase & Co. s affiliate EMC Mortgage Corporation in the United States

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District Court for the Southern District of New York) and the Flagstar Home Equity Loan Trust, Series 2005-1 and Series 2006-2 transactions (in which AGM has sued Flagstar Bank, FSB, Flagstar Capital Markets Corporation and Flagstar ABS, LLC in the United States District Court for the Southern District of New York). In these lawsuits, AGM and AGC seek for the R&W provider to repurchase the defective loans and to indemnify or reimburse AGM or AGC for its losses.

AGM has also filed a lawsuit in the Superior Court of the State of California, County of Los Angeles, against UBS Securities LLC and Deutsche Bank Securities, Inc., as underwriters, as well as several named and unnamed control persons of IndyMac Bank, FSB and related IndyMac entities, with regard to two U.S. RMBS transactions that AGM had insured, seeking damages for alleged violations of state securities laws and breach of contract, among other claims. One of these transactions (referred to as IndyMac Home Equity Loan Trust 2007-H1) is a second lien transaction and the other (referred to as IndyMac IMSC Mortgage Loan Trust 2007-HOA-1) is a first lien transaction.

In December 2008, Assured Guaranty (UK) Ltd. (AGUK) sued J.P. Morgan Investment Management Inc. (JPMIM), the investment manager in the Orkney Re II transaction, in the Supreme Court of the State of New York alleging that JPMIM engaged in breaches of fiduciary duty, gross negligence and breaches of contract based upon its handling of the investments of Orkney Re II. In January 2010, the court ruled against AGUK on a motion to dismiss filed by JPMIM, dismissing the AGUK s claims for breaches of fiduciary duty and gross negligence on the ground that such claims are preempted by the Martin Act, which is New York s blue sky law, such that only the New York Attorney General has the authority to sue JPMIM. AGUK appealed and, in November 2010, the Appellate Division (First Department) issued a ruling, ordering the court s order to be modified to reinstate AGUK s claims for breach of fiduciary duty and gross negligence and certain of its claims for breach of contract, in each case for claims accruing on or after June 26, 2007. In December 2010, JPMIM filed a motion for permission to appeal to the Court of Appeals on the Martin Act issue; that motion was granted in February 2011. Separately, at the trial court level, a preliminary conference order related to discovery was entered in February 2011 and discovery has commenced. See Note 17.

In June 2010, AGM sued JPMorgan Chase Bank, N.A. and JPMorgan Securities, Inc. (together, JPMorgan), the underwriter of debt issued by Jefferson County, in the Supreme Court of the State of New York alleging that JPMorgan induced AGM to issue its insurance policies in respect of such debt through material and fraudulent misrepresentations and omissions, including concealing that it had secured its position as underwriter and swap provider through bribes to Jefferson County commissioners and others. In December 2010, the court denied JPMorgan s motion to dismiss. AGM is continuing its risk remediation efforts for the Jefferson County exposure.

In September 2010, AGM, together with TD Bank, National Association and Manufacturers and Traders Trust Company, filed a complaint in the Court of Common Pleas in the Supreme Court of Pennsylvania against The Harrisburg Authority, The City of Harrisburg, Pennsylvania (the City), and the Treasurer of the City in connection with certain Resource Recovery Facility bonds and notes issued by the Harrisburg Authority, alleging, among other claims, breach of contract by both the Harrisburg Authority and the City, and seeking remedies including an order compelling the Harrisburg Authority to pay all unpaid and past due principal and interest and to charge and collect sufficient rates, rental and

other charges adequate to carry out its pledge of revenues and receipts; an order compelling the City to budget for, impose and collect taxes and revenues sufficient to satisfy its obligations; and the appointment of a receiver for the Harrisburg Authority. See Note 17.

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Net Loss Summary

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

Loss and LAE Reserve, Net of Reinsurance and Salvage and Subrogation Recoverable

	As of June 30, 2011			As of December 31, 2010		
	Loss and LAE Reserve(1)	**Salvage and Subrogation Recoverable(2)**	**Net**	**Loss and LAE Reserve(1)**	**Salvage and Subrogation Recoverable(2)**	**Net**
			(in millions)			
				(restated)		**(restated)**
U.S. RMBS:						
First lien:						
Prime first lien	$ 2.5	$	$ 2.5	$ 1.2	$	1.2
Alt-A first lien	46.5	5.5	41.0	39.2	2.6	36.6
Option ARM	136.1	106.3	29.8	223.3	63.0	160.3
Subprime	87.4	0.1	87.3	108.3	0.1	108.2
Total first lien	272.5	111.9	160.6	372.0	65.7	306.3
Second lien:						
Closed-end second lien	9.3	129.6	(120.3)	7.7	50.3	(42.6)
HELOC	59.8	182.9	(123.1)	7.1	843.4	(836.3)
Total second lien	69.1	312.5	(243.4)	14.8	893.7	(878.9)
Total U.S. RMBS	341.6	424.4	(82.8)	386.8	959.4	(572.6)
Other structured finance	149.2	2.5	146.7	131.1	1.4	129.7
Public finance	64.0	37.9	26.1	81.6	34.4	47.2
Total financial guaranty	554.8	464.8	90.0	599.5	995.2	(395.7)
Other	2.1		2.1	2.1		2.1
Subtotal	556.9	464.8	92.1	601.6	995.2	(393.6)
Effect of consolidating FG VIEs	(64.8)	(192.9)	128.1	(49.5)	(92.2)	42.7
Total(1)	$ 492.1	$ 271.9				