ASSURED GUARANTY LTD
Form 10-Q
May 09, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2014

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 May 7, 2014 was 179,629,028 (includes 47,747 unvested restricted shares).

Table of Contents

ASSURED GUARANTY LTD.

INDEX TO FORM 10-Q

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
Assured Guaranty Ltd.

Consolidated Balance Sheets (unaudited)

(dollars in millions except per share and share amounts)

	As of March 31, 2014	As of December 31, 2013
Assets		
Investment portfolio:		
Fixed-maturity securities, available-for-sale, at fair value (amortized cost of $9,729 and $9,488)	$10,094	$9,711
Short-term investments, at fair value	720	904
Other invested assets	134	170
Total investment portfolio	10,948	10,785
Cash	219	184
Premiums receivable, net of commissions payable	863	876
Ceded unearned premium reserve	454	452
Deferred acquisition costs	122	124
Reinsurance recoverable on unpaid losses	37	36
Salvage and subrogation recoverable	241	174
Credit derivative assets	78	94
Deferred tax asset, net	637	688
Financial guaranty variable interest entities' assets, at fair value	1,257	2,565
Other assets	250	309
Total assets	$15,106	$16,287
Liabilities and shareholders' equity		
Unearned premium reserve	$4,504	$4,595
Loss and loss adjustment expense reserve	636	592
Reinsurance balances payable, net	165	148
Long-term debt	812	816
Credit derivative liabilities	2,001	1,787
Current income tax payable	26	44
Financial guaranty variable interest entities' liabilities with recourse, at fair value	1,346	1,790
Financial guaranty variable interest entities' liabilities without recourse, at fair value	101	1,081
Other liabilities	306	319
Total liabilities	9,897	11,172
Commitments and contingencies (See Note 14)		
Common stock ($0.01 par value, 500,000,000 shares authorized; 181,158,708 and 182,177,866 shares issued and outstanding)	2	2
Additional paid-in capital	2,434	2,466
Retained earnings	2,504	2,482
Accumulated other comprehensive income, net of tax of $117 and $71	264	160
Deferred equity compensation (320,193 and 320,193 shares)	5	5
Total shareholders' equity	5,209	5,115

Total liabilities and shareholders' equity	$15,106	$16,287

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

Table of Contents

Assured Guaranty Ltd.

Consolidated Statements of Operations (unaudited)

(dollars in millions except per share amounts)

	Three Months Ended March 31,	
	2014	2013
Revenues		
Net earned premiums	$132	$248
Net investment income	103	94
Net realized investment gains (losses):		
Other-than-temporary impairment losses	(3)	(1)
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	2	4
Net impairment loss	(5)	(5)
Other net realized investment gains (losses)	7	33
Net realized investment gains (losses)	2	28
Net change in fair value of credit derivatives:		
Realized gains (losses) and other settlements	19	18
Net unrealized gains (losses)	(230)	(610)
Net change in fair value of credit derivatives	(211)	(592)
Fair value gains (losses) on committed capital securities	(9)	(10)
Fair value gains (losses) on financial guaranty variable interest entities	157	70
Other income (loss)	21	(14)
Total revenues	195	(176)
Expenses		
Loss and loss adjustment expenses	41	(48)
Amortization of deferred acquisition costs	5	3
Interest expense	20	21
Other operating expenses	60	60
Total expenses	126	36
Income (loss) before income taxes	69	(212)
Provision (benefit) for income taxes		
Current	21	55
Deferred	6	(123)
Total provision (benefit) for income taxes	27	(68)
Net income (loss)	$42	$(144)
Earnings per share:		
Basic	$0.23	$(0.74)
Diluted	$0.23	$(0.74)
Dividends per share	$0.11	$0.10

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

Table of Contents

Assured Guaranty Ltd.

Consolidated Statements of Comprehensive Income (unaudited)

(in millions)

	Three Months Ended March 31,	
	2014	2013
Net income (loss)	$42	$(144)
Unrealized holding gains (losses) arising during the period on:		
Investments with no other-than-temporary impairment, net of tax provision (benefit) of $41 and $(19)	94	(50)
Investments with other-than-temporary impairment, net of tax provision (benefit) of $3 and $(8)	8	(16)
Unrealized holding gains (losses) arising during the period, net of tax	102	(66)
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of $(1) and $(2)	(2)	(3)
Change in net unrealized gains on investments	104	(63)
Other, net of tax provision	0	(5)
Other comprehensive income (loss)	$104	$(68)
Comprehensive income (loss)	$146	$(212)

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

Table of Contents

Assured Guaranty Ltd.

Consolidated Statement of Shareholders' Equity (unaudited)

For the Three Months Ended March 31, 2014

(dollars in millions, except share data)

	Common Shares Outstanding	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Deferred Equity Compensation	Total Shareholders' Equity
Balance at December 31, 2013	182,177,866	$ 2	$2,466	$2,482	$ 160	$ 5	$5,115
Net income	—	—	—	42	—	—	42
Dividends ($0.11 per share)	—	—	—	(20)	—	—	(20)
Common stock repurchases	(1,350,443)	0	(35)	—	—	—	(35)
Share-based compensation and other	331,285	0	3	—	—	—	3
Other comprehensive income	—	—	—	—	104	—	104
Balance at March 31, 2014	181,158,708	$ 2	$2,434	$2,504	$ 264	$ 5	$5,209

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

Table of Contents

Assured Guaranty Ltd.

Consolidated Statements of Cash Flows (unaudited)

(in millions)

	Three Months Ended March 31,	
	2014	2013
Net cash flows provided by (used in) operating activities	$101	$(14)
Investing activities		
Fixed-maturity securities:		
Purchases	(517)	(510)
Sales	155	183
Maturities	148	283
Net sales (purchases) of short-term investments	184	88
Proceeds from paydowns on financial guaranty variable interest entities' assets	286	138
Other	19	55
Net cash flows provided by (used in) investing activities	275	237
Financing activities		
Dividends paid	(20)	(19)
Repurchases of common stock	(35)	(39)
Share activity under option and incentive plans	0	(2)
Paydowns of financial guaranty variable interest entities' liabilities	(281)	(167)
Repayment of long-term debt	(6)	(6)
Net cash flows provided by (used in) financing activities	(342)	(233)
Effect of exchange rate changes	1	(3)
Increase (decrease) in cash	35	(13)
Cash at beginning of period	184	138
Cash at end of period	$219	$125
Supplemental cash flow information		
Cash paid (received) during the period for:		
Income taxes	$37	$32
Interest	$8	$9

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

Table of Contents

Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (unaudited)

March 31, 2014

1. Business and Basis of Presentation

Business

Assured Guaranty Ltd. (“AGL” and, together with its subsidiaries, “Assured Guaranty” or the “Company”) is a Bermuda-based holding company that provides, through its operating subsidiaries, credit protection products to the United States (“U.S.”) and international public finance (including infrastructure) and structured finance markets. The Company applies its credit underwriting judgment, risk management skills and capital markets experience to offer financial guaranty insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments. If an obligor defaults on a scheduled payment due on an obligation, including a scheduled principal or interest payment (“Debt Service”), the Company is required under its unconditional and irrevocable financial guaranty to pay the amount of the shortfall to the holder of the obligation. Obligations insured by the Company include bonds issued by U.S. state or municipal governmental authorities; notes issued to finance international infrastructure projects; and asset-backed securities issued by special purpose entities. The Company markets its financial guaranty insurance directly to issuers and underwriters of public finance and structured finance securities as well as to investors in such obligations. The Company guarantees obligations issued principally in the U.S. and the United Kingdom ("U.K"). The Company also guarantees obligations issued in other countries and regions, including Australia and Western Europe.

In the past, the Company had sold credit protection by issuing policies that guaranteed payment obligations under credit derivatives, primarily credit default swaps ("CDS"). 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. The Company’s credit derivative transactions are governed by International Swaps and Derivative Association, Inc. (“ISDA”) documentation. The Company has not entered into any new CDS in order to sell credit protection since the beginning of 2009, when regulatory guidelines were issued that limited the terms under which such protection could be sold. The capital and margin requirements applicable under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) also contributed to the Company not entering into such new CDS since 2009. The Company actively pursues opportunities to terminate existing CDS, which have the effect of reducing future fair value volatility in income and/or reducing rating agency capital charges.

Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) and, in the opinion of management, reflect all adjustments that are of a normal recurring nature, necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated financial guaranty variable interest entities (“FG VIEs”) for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim consolidated financial statements are as of March 31, 2014 and cover the three-month period ended March 31, 2014 ("First Quarter 2014") and the three-month period ended March 31, 2013 ("First Quarter 2013"). Certain financial information that is

normally included in annual financial statements prepared in accordance with GAAP, but is not required for interim reporting purposes, has been condensed or omitted. The year-end balance sheet data was derived from audited financial statements.

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

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements included in AGL's Annual Report on Form 10-K for the year ended December 31, 2013, filed with the U.S. Securities and Exchange Commission (the "SEC").

Table of Contents

The Company's principal insurance company subsidiaries are:

- Assured Guaranty Municipal Corp. ("AGM"), domiciled in New York;
- Municipal Assurance Corp. ("MAC"), domiciled in New York;
- Assured Guaranty Corp. ("AGC"), domiciled in Maryland;
- Assured Guaranty (Europe) Ltd. ("AGE"), organized in the United Kingdom; and
- Assured Guaranty Re Ltd. (“AG Re”), domiciled in Bermuda.

The Company’s organizational structure includes various holding companies, two of which — Assured Guaranty US Holdings Inc. (“AGUS”) and Assured Guaranty Municipal Holdings Inc. (“AGMH”) — have public debt outstanding. See Note 15, Long Term Debt and Credit Facilities.

2. Rating Actions and Quarterly Developments

Rating Actions

On March 18, 2014, Standard & Poor's Ratings Services ("S&P") upgraded the financial strength ratings of all of AGL's insurance subsidiaries to AA (stable outlook) from AA- (stable outlook). The most recent rating action of Moody's Investors Service, Inc. ("Moody's") was on February 10, 2014, when it affirmed the financial strength ratings of AGM, AGC and AG Re, and affirmed the outlooks on AGM's and AGC's ratings at stable but changed the outlook on AG Re's rating to negative. Kroll Bond Rating Agency's most recent action was to assign a financial strength rating of AA+ (stable outlook) to MAC on July 22, 2013. In the last several years, S&P and Moody's have changed, multiple times, their financial strength ratings of the Company's insurance subsidiaries, or changed the outlook on such ratings. There can be no assurance that the rating agencies will not take negative action on the Company’s financial strength ratings in the future.

When a rating agency assigns a public rating to 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 the guaranty. Investors in products insured by AGL’s insurance company subsidiaries frequently rely on ratings published by nationally recognized statistical rating organizations (“NRSROs”) because such ratings influence the trading value of securities and form the basis for many institutions’ investment guidelines as well as individuals’ bond purchase decisions. Therefore, the Company manages its business with the goal of achieving high financial strength ratings. However, the methodologies and models used by NRSROs differ, presenting conflicting goals that may make it inefficient or impractical to reach the highest rating level. The methodologies and models are not fully transparent, contain subjective elements and data (such as assumptions about future market demand for the Company’s products) and change frequently. Ratings are subject to continuous review and revision or withdrawal at any time. If the financial strength ratings of one (or more) of the Company’s insurance subsidiaries were reduced below current levels, the Company expects it could have adverse effects on the impacted subsidiary's future business opportunities as well as the premiums the impacted subsidiary could charge for its insurance policies. For a discussion of other effects of rating actions on the Company, see the following:

- Note 5, Expected Loss to be Paid
- Note 8, Financial Guaranty Contracts Accounted for as Credit Derivatives
- Note 13, Reinsurance and Other Monoline Exposures
- Note 15, Long Term Debt and Credit Facilities (regarding the impact on the Company's insured leveraged lease transactions)

Quarterly Developments

- Repurchase of Common Shares: The Company repurchased approximately 1.4 million common shares in First Quarter 2014. See Note 17, Shareholders' Equity, for more information.

- Reinsurance: The Company entered into commutation agreements to reassume previously ceded business. See Note 13, Reinsurance and Other Monoline Exposures.

3. Outstanding Exposure

The Company’s financial guaranty contracts are written in either insurance or credit derivative form, but collectively are considered financial guaranty contracts. The Company seeks to limit its exposure to losses by underwriting obligations that are investment grade at inception, diversifying its insured portfolio and maintaining rigorous subordination or collateralization requirements on structured finance obligations. The Company also has utilized reinsurance by ceding business to third-party

Table of Contents

reinsurers. The Company provides financial guaranties with respect to debt obligations of special purpose entities, including variable interest entities ("VIEs"). Some of these VIEs are consolidated as described in Note 9, Consolidated Variable Interest Entities. The outstanding par and Debt Service amounts presented below include outstanding exposures on VIEs whether or not they are consolidated.

The Company has issued financial guaranty insurance policies on public finance obligations and structured finance obligations. Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the taxing powers of U.S. state or municipal governmental authorities, as well as tax-supported bonds, revenue bonds and other obligations supported by covenants from state or municipal governmental authorities or other municipal obligors to impose and collect fees and charges for public services or specific infrastructure projects. The Company also includes within public finance obligations those obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including utilities, toll roads, health care facilities and government office buildings. Structured finance obligations insured by the Company are generally issued by special purpose entities and backed by pools of assets having an ascertainable cash flow or market value or other specialized financial obligations.

Surveillance Categories

The Company segregates its insured portfolio into investment grade and below-investment-grade ("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 assessments of the likelihood of default and loss severity in the event of default. Internal credit ratings are expressed on a ratings scale similar to that used by the rating agencies and are generally reflective of an approach similar to that employed by the rating agencies, except that the Company's internal credit ratings focus on future performance rather than lifetime performance.

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 credit ratings on assumed credits are based on the Company’s reviews of low-rated credits or credits in volatile sectors, unless such information is not available, in which case, the ceding company’s credit rating of the transactions are used. The Company models the performance of many of its structured finance transactions as part of its periodic internal credit rating review of them. The Company models most assumed residential mortgage-backed security ("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, Expected Loss to be Paid, for additional information. Surveillance personnel then assign each BIG transaction to the appropriate BIG surveillance category based upon whether a future loss is expected and whether a claim has been paid. For surveillance purposes, the Company calculates present value using a constant discount rate of 5%. (A risk-free rate is used for calculating the expected loss for financial statement purposes.)

More extensive monitoring and intervention is employed for all BIG surveillance categories, with internal credit ratings reviewed quarterly. The Company expects “future losses” on a transaction when the Company believes there is at least a 50% chance that, on a present value basis, it will pay more claims over the future of that transaction than it will have reimbursed. The three BIG categories are:

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BIG Category 1: Below-investment-grade transactions showing sufficient deterioration to make future losses possible, but for which none are currently expected.

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

- BIG Category 3: Below-investment-grade transactions for which future losses are expected and on which claims (other than liquidity claims) have been paid.

Table of Contents

Components of Outstanding Exposure

Unless otherwise noted, ratings disclosed herein on the Company's insured portfolio reflect its internal ratings. The Company classifies those portions of risks benefiting from reimbursement obligations collateralized by eligible assets held in trust in acceptable reimbursement structures as the higher of 'AA' or their current internal rating.

Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	March 31, 2014	December 31, 2013	March 31, 2014	December 31, 2013
	(in millions)			
Public finance	$639,981	$650,924	$601,433	$610,011
Structured finance	81,195	86,456	75,535	80,524
Total financial guaranty	$721,176	$737,380	$676,968	$690,535

In addition to the amounts shown in the table above, the Company’s net mortgage guaranty insurance debt service was approximately $153 million as of March 31, 2014. The net mortgage guaranty insurance in force constitutes assumed excess of loss business written between 2004 and 2006 and comprises $145 million covering loans originated in Ireland and $8 million covering loans originated in the U.K.

Financial Guaranty Portfolio by Internal Rating
As of March 31, 2014

Rating Category	Public Finance U.S. Net Par Outstanding	%	Public Finance Non-U.S. Net Par Outstanding	%	Structured Finance U.S Net Par Outstanding	%	Structured Finance Non-U.S Net Par Outstanding	%	Total Net Par Outstanding	%
	(dollars in millions)									
AAA	$4,658	1.3 %	$1,020	2.9 %	$29,868	53.9 %	$8,856	68.2 %	$44,402	9.9 %
AA	104,577	30.2	427	1.2	9,396	17.0	570	4.4	114,970	25.6
A	187,433	54.1	9,595	27.6	2,340	4.2	661	5.1	200,029	44.4
BBB	40,783	11.8	22,173	63.7	3,496	6.3	1,829	14.1	68,281	15.2
BIG	8,977	2.6	1,611	4.6	10,293	18.6	1,062	8.2	21,943	4.9
Total net par outstanding (excluding loss mitigation bonds)	$346,428	100.0%	$34,826	100.0%	$55,393	100.0%	$12,978	100.0%	$449,625	100.0%
Loss Mitigation Bonds	32		—		1,204		—		1,236	
Net Par Outstanding (including loss mitigation	$346,460		$34,826		$56,597		$12,978		$450,861	

bonds)

9

Table of Contents

Financial Guaranty Portfolio by Internal Rating
As of December 31, 2013

Rating Category	Public Finance U.S. Net Par Outstanding (dollars in millions)	%	Public Finance Non-U.S. Net Par Outstanding	%	Structured Finance U.S Net Par Outstanding	%	Structured Finance Non-U.S Net Par Outstanding	%	Total Net Par Outstanding	%
AAA	$4,998	1.4 %	$1,016	3.0 %	$32,317	54.9 %	$9,684	69.1 %	$48,015	10.5 %
AA	107,503	30.5	422	1.2	9,431	16.0	577	4.1	117,933	25.7
A	192,841	54.8	9,453	27.9	2,580	4.4	742	5.3	205,616	44.8
BBB	37,745	10.7	21,499	63.2	3,815	6.4	1,946	13.9	65,005	14.1
BIG	9,094	2.6	1,608	4.7	10,764	18.3	1,072	7.6	22,538	4.9
Total net par outstanding (excluding loss mitigation bonds)	$352,181	100.0%	$33,998	100.0%	$58,907	100.0%	$14,021	100.0%	$459,107	100.0%
Loss Mitigation Bonds	32		—		1,163		—		1,195	
Net Par Outstanding (including loss mitigation bonds)	$352,213		$33,998		$60,070		$14,021		$460,302	

In accordance with the terms of certain credit derivative contracts, the referenced obligations in such contracts have been delivered to the Company and therefore are included in the investment portfolio. Such amounts are still included in the financial guaranty insured portfolio, and totaled $165 million and $195 million in gross par outstanding as of March 31, 2014 and December 31, 2013, respectively.

In addition to amounts shown in the tables above, the Company had outstanding commitments to provide guaranties of $577 million for structured finance and $330 million for public finance obligations at March 31, 2014. 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 April 15, 2014 and February 25, 2017, with $206 million expiring prior to December 31, 2014. The commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty’s request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.

Table of Contents

Components of BIG Portfolio
Components of BIG Net Par Outstanding
(Insurance and Credit Derivative Form)
As of March 31, 2014

	BIG Net Par Outstanding				Net Par	BIG Net Par as a % of Total Net Par Outstanding	
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding		
			(in millions)				
First lien U.S. RMBS:							
Prime first lien	$77	$289	$29	$395	$528	0.1	%
Alt-A first lien	703	787	1,223	2,713	3,478	0.6	
Option ARM	66	59	440	565	877	0.1	
Subprime	227	860	769	1,856	5,921	0.4	
Second lien U.S. RMBS:							
Closed-end second lien	8	19	116	143	239	0.0	
Home equity lines of credit (“HELOCs”)	1,480	19	235	1,734	1,982	0.4	
Total U.S. RMBS	2,561	2,033	2,812	7,406	13,025	1.6	
Trust preferred securities (“TruPS”)	1,235	343	—	1,578	4,826	0.4	
Other structured finance	1,348	304	719	2,371	50,520	0.5	
U.S. public finance	8,117	419	441	8,977	346,428	2.0	
Non-U.S. public finance	989	622	—	1,611	34,826	0.4	
Total	$14,250	$3,721	$3,972	$21,943	$449,625	4.9	%

Components of BIG Net Par Outstanding
(Insurance and Credit Derivative Form)
As of December 31, 2013

	BIG Net Par Outstanding				Net Par	BIG Net Par as a % of Total Net Par Outstanding	
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding		
			(in millions)				
First lien U.S. RMBS:							
Prime first lien	$52	$321	$30	$403	$541	0.1	%
Alt-A first lien	656	1,137	935	2,728	3,590	0.6	
Option ARM	71	60	467	598	937	0.1	
Subprime	297	908	740	1,945	6,130	0.4	
Second lien U.S. RMBS:							
Closed-end second lien	8	20	118	146	244	0.0	
HELOCs	1,499	20	378	1,897	2,279	0.4	
Total U.S. RMBS	2,583	2,466	2,668	7,717	13,721	1.6	
TruPS	1,587	135	—	1,722	4,970	0.4	
Other structured finance	1,367	309	721	2,397	54,237	0.5	
U.S. public finance	8,205	440	449	9,094	352,181	2.0	
Non-U.S. public finance	1,009	599	—	1,608	33,998	0.4	

Total	$14,751	$3,949	$3,838	$22,538	$459,107	4.9	%

Table of Contents

BIG Net Par Outstanding
and Number of Risks
As of March 31, 2014

Description	Net Par Outstanding			Number of Risks(2)		
	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$12,242	$2,008	$14,250	193	24	217
Category 2	2,253	1,468	3,721	80	21	101
Category 3	2,872	1,100	3,972	109	27	136
Total BIG	$17,367	$4,576	$21,943	382	72	454

BIG Net Par Outstanding
and Number of Risks
As of December 31, 2013

Description	Net Par Outstanding			Number of Risks(2)		
	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$12,391	$2,360	$14,751	185	25	210
Category 2	2,323	1,626	3,949	80	21	101
Category 3	3,031	807	3,838	119	27	146
Total BIG	$17,745	$4,793	$22,538	384	73	457

(1) Includes net par outstanding for FG VIEs.

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

Direct Economic Exposure to the Selected European Countries

Several European countries continue to experience significant economic, fiscal and/or political strains such that the likelihood of default on obligations with a nexus to those countries may be higher than the Company anticipated when such factors did not exist. The European countries where the Company believes heightened uncertainties exist are: Hungary, Ireland, Italy, Portugal and Spain (collectively, the “Selected European Countries”). The Company is closely monitoring its exposures in the Selected European Countries where it believes heightened uncertainties exist. The Company’s economic exposure to the Selected European Countries (based on par for financial guaranty contracts and notional amount for financial guaranty contracts accounted for as derivatives) is shown in the following table, net of ceded reinsurance.

Table of Contents

Net Direct Economic Exposure to Selected European Countries(1)
As of March 31, 2014

	Hungary (2)	Ireland	Italy	Portugal (2)	Spain (2)	Total
Sovereign and sub-sovereign exposure:						
Non-infrastructure public finance (3)	$—	$—	$1,026	$98	$274	$1,398
Infrastructure finance	370	—	18	12	156	556
Sub-total	370	—	1,044	110	430	1,954
Non-sovereign exposure:						
Regulated utilities	—	—	235	—	—	235
RMBS	217	145	312	—	—	674
Sub-total	217	145	547	—	—	909
Total	$587	$145	$1,591	$110	$430	$2,863
Total BIG	$587	$—	$—	$110	$429	$1,126

(1) While the Company's exposures are shown in U.S. dollars, the obligations the Company insures are in various currencies, including U.S. dollars and Euros. Included in the table above is $145 million of reinsurance assumed on a 2004 - 2006 pool of Irish residential mortgages that is part of the Company's remaining legacy mortgage reinsurance business. One of the residential mortgage-backed securities included in the table above includes residential mortgages in both Italy and Germany, and only the portion of the transaction equal to the portion of the original mortgage pool in Italian mortgages is shown in the table.

(2) See Note 5, Expected Loss to be Paid.

(3) The exposure shown in the "Non-infrastructure public finance" category is from transactions backed by receivable payments from sub-sovereigns in Italy, Spain and Portugal. Sub-sovereign debt is debt issued by a governmental entity or government backed entity, or supported by such an entity, that is other than direct sovereign debt of the ultimate governing body of the country.

When the Company directly insures an obligation, it assigns the obligation to a geographic location or locations based on its view of the geographic location of the risk. For direct exposure this can be a relatively straight-forward determination as, for example, a debt issue supported by availability payments for a toll road in a particular country. The Company may also assign portions of a risk to more than one geographic location. The Company may also have direct exposures to the Selected European Countries in business assumed from unaffiliated monoline insurance companies. In the case of assumed business for direct exposures, the Company depends upon geographic information provided by the primary insurer.

The Company has excluded from the exposure tables above its indirect economic exposure to the Selected European Countries through policies it provides on (a) pooled corporate and (b) commercial receivables transactions. The Company considers economic exposure to a selected European Country to be indirect when the exposure relates to only a small portion of an insured transaction that otherwise is not related to a Selected European Country. The Company has reviewed transactions through which it believes it may have indirect exposure to the Selected European Countries that is material to the transaction and calculated total net indirect exposure to Selected European Counties in non-sovereign pooled corporate and non-sovereign commercial receivables to be $710 million and $89 million, respectively, based on the proportion of the insured par equal to the proportion of obligors identified as being domiciled in a Selected European Country.

13

Table of Contents

Exposure to Puerto Rico

The Company insures general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating $5.3 billion net par. The Company rates $5.1 billion net par of that amount BIG. The following table shows estimated amortization of the general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations insured and rated BIG by the Company. The Company guarantees payments of interest and principal when those amounts are scheduled to be paid and cannot be required to pay on an accelerated basis. The column labeled "Estimated BIG Net Debt Service Amortization" shows the total amount of principal and interest due in the period indicated and represents the maximum net amount the Company would be required to pay on BIG Puerto Rico exposures in a given period, assuming the obligors paid nothing on all of those obligations in that period.

Amortization Schedule of BIG Net Par Outstanding
and BIG Net Debt Service Outstanding of Puerto Rico
As of March 31, 2014

	Estimated BIG Net Par Amortization	Estimated BIG Net Debt Service Amortization
	(in millions)	
2014 (April 1 - June 30)	$—	$64
2014 (July 1 - September 30)	254	315
2014 (October 1 - December 31)	—	61
2015	364	601
2016	289	509
2017	208	415
2018	159	358
2019-2023	884	1,718
2024-2028	937	1,566
2029-2033	697	1,125
After 2033	1,281	1,574
Total	$5,073	$8,306

Recent announcements and actions by the Governor and his administration indicate officials of the Commonwealth are focused on measures to help Puerto Rico operate within its financial resources and maintain its access to the capital markets. All Puerto Rico credits insured by the Company are current on their debt service payments. Neither Puerto Rico nor its related authorities and public corporations are eligible debtors under Chapter 9 of the U.S. Bankruptcy Code. However, Puerto Rico faces high debt levels, a declining population and an economy that has been in recession since 2006. Puerto Rico has been operating with a structural budget deficit in recent years, and its two largest pension funds are significantly underfunded.

4. Financial Guaranty Insurance Premiums

The portfolio of outstanding exposures discussed in Note 3, Outstanding Exposure, includes financial guaranty contracts that meet the definition of insurance contracts as well as those that meet the definition of a derivative under GAAP. Amounts presented in this note relate only to financial guaranty insurance contracts. See Note 8, Financial Guaranty Contracts Accounted for as Credit Derivatives for amounts that relate to CDS.

14

Table of Contents

Net Earned Premiums

	First Quarter	
	2014	2013
	(in millions)	
Scheduled net earned premiums	$107	$128
Acceleration of net earned premiums	19	113
Accretion of discount on net premiums receivable	6	7
Net earned premiums(1)	$132	$248

(1) Excludes $17 million and $18 million for First Quarter 2014 and 2013, respectively, related to consolidated FG VIEs.

Components of Unearned Premium Reserve

	As of March 31, 2014			As of December 31, 2013		
	Gross	Ceded	Net(1)	Gross	Ceded	Net(1)
	(in millions)					
Deferred premium revenue:						
Financial guaranty insurance	$4,567	$472	$4,095	$4,647	$470	$4,177
Other	5	—	5	5	—	5
Deferred premium revenue	$4,572	$472	$4,100	$4,652	$470	$4,182
Contra-paid	(68)	(18)	(50)	(57)	(18)	(39)
Unearned premium reserve	$4,504	$454	$4,050	$4,595	$452	$4,143

(1) Excludes $137 million and $187 million of deferred premium revenue, and $49 million and $55 million of contra-paid related to FG VIEs as of March 31, 2014 and December 31, 2013, respectively.

Gross Premium Receivable,
Net of Commissions on Assumed Business
Roll Forward

	First Quarter	
	2014	2013
	(in millions)	
Beginning of period, December 31	$876	$1,005
Gross premium written, net of commissions on assumed business	33	17
Gross premiums received, net of commissions on assumed business	(53)	(53)
Adjustments:		
Changes in the expected term	(3)	1
Accretion of discount, net of commissions on assumed business	7	9
Foreign exchange translation	2	(23)
Other adjustments	1	0
End of period, March 31 (1)	$863	$956

(1) Excludes $18 million and $28 million as of March 31, 2014 and March 31, 2013, respectively, related to consolidated FG VIEs.

Gains or losses due to foreign exchange rate changes relate to installment premium receivables denominated in currencies other than the U.S. dollar. Approximately 49% and 48% of installment premiums at March 31, 2014 and December 31, 2013 respectively, are denominated in currencies other than the U.S. dollar, primarily the Euro and British Pound Sterling.

Table of Contents

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

Expected Collections of
Gross Premiums Receivable,
Net of Commissions on Assumed Business
(Undiscounted)

	As of March 31, 2014 (in millions)
2014 (April 1 - June 30)	$46
2014 (July 1 - September 30)	24
2014 (October 1 – December 31)	26
2015	95
2016	86
2017	79
2018	71
2019-2023	282
2024-2028	176
2029-2033	123
After 2033	130
Total(1)	$1,138

(1) Excludes expected cash collections on FG VIEs of $23 million.

Scheduled Net Earned Premiums

	As of March 31, 2014 (in millions)
2014 (April 1 - June 30)	$105
2014 (July 1 - September 30)	103
2014 (October 1–December 31)	99
2015	359
2016	335
2017	297
2018	271
2019 - 2023	1,058
2024 - 2028	676
2029 - 2033	412
After 2033	380
Total present value basis(1)	4,095
Discount	239
Total future value	$4,334

(1) Excludes scheduled net earned premiums on consolidated FG VIEs of $137 million.

16

Table of Contents

Selected Information for Policies Paid in Installments

	As of March 31, 2014	As of December 31, 2013
	(dollars in millions)	
Premiums receivable, net of commission payable	$863	$876
Gross deferred premium revenue	1,560	1,576
Weighted-average risk-free rate used to discount premiums	3.5 %	3.4 %
Weighted-average period of premiums receivable (in years)	9.4	9.4

5. Expected Loss to be Paid

The following table presents a roll forward of the present value of net expected loss to be paid for all contracts, whether accounted for as insurance, credit derivatives or FG VIEs, by sector, after the benefit for net expected recoveries for contractual breaches of representations and warranties ("R&W"). The Company used weighted average risk-free rates for U.S. dollar denominated obligations, which ranged from 0.0% to 3.97% as of March 31, 2014 and 0.0% to 4.44% as of December 31, 2013.

Net Expected Loss to be Paid
After Net Expected Recoveries for Breaches of R&W
Roll Forward by Sector
First Quarter 2014

	Net Expected Loss to be Paid as of December 31, 2013(2)	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of March 31, 2014(2)
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$21	$(3)	$—	$18
Alt-A first lien	304	8	(4)	308
Option ARM	(9)	(15)	(4)	(28)
Subprime	304	(7)	(2)	295
Total first lien	620	(17)	(10)	593
Second lien:				
Closed-end second lien	(11)	5	2	(4)
HELOCs	(116)	2	5	(109)
Total second lien	(127)	7	7	(113)
Total U.S. RMBS	493	(10)	(3)	480
TruPS	51	(19)	—	32
Other structured finance	120	19	(1)	138
U.S. public finance	264	23	(6)	281
Non-U.S public finance	57	—	—	57
Other insurance	(3)	(1)	—	(4)
Total	$982	$12	$(10)	$984

17

Table of Contents

Net Expected Loss to be Paid
After Net Expected Recoveries for Breaches of R&W
Roll Forward by Sector
First Quarter 2013

	Net Expected Loss to be Paid as of December 31, 2012 (in millions)	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of March 31, 2013
U.S. RMBS:				
First lien:				
Prime first lien	$6	$6	$(1)	$11
Alt-A first lien	315	9	(11)	313
Option ARM	(131)	(138)	(58)	(327)
Subprime	242	25	(4)	263
Total first lien	432	(98)	(74)	260
Second lien:				
Closed-end second lien	(39)	1	17	(21)
HELOCs	(111)	(3)	(8)	(122)
Total second lien	(150)	(2)	9	(143)
Total U.S. RMBS	282	(100)	(65)	117
TruPS	27	(3)	(1)	23
Other structured finance	312	(2)	(3)	307
U.S. public finance	7	7	(23)	(9)
Non-U.S public finance	52	10	—	62
Other insurance	(3)	(10)	—	(13)
Total	$677	$(98)	$(92)	$487

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

(2) Includes expected loss adjustment expenses ("LAE") to be paid for mitigating claim liabilities of $29 million as of March 31, 2014 and $34 million as of December 31, 2013. The Company paid $6 million and $13 million in LAE for First Quarter 2014 and 2013, respectively.

Table of Contents

Net Expected Recoveries from Breaches of R&W Rollforward
First Quarter 2014

	Future Net R&W Benefit as of December 31, 2013	R&W Development and Accretion of Discount During First Quarter 2014	R&W Recovered During First Quarter 2014(1)	Future Net R&W Benefit as of March 31, 2014
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$4	$ (1)	$—	$ 3
Alt-A first lien	274	3	(8)	269
Option ARM	173	9	(30)	152
Subprime	118	28	—	146
Total first lien	569	39	(38)	570
Second lien:				
Closed-end second lien	98	(3)	—	95
HELOC	45	12	(1)	56
Total second lien	143	9	(1)	151
Total	$712	$ 48	$(39)	$ 721

Net Expected Recoveries from Breaches of R&W Rollforward
First Quarter 2013

	Future Net R&W Benefit as of December 31, 2012	R&W Development and Accretion of Discount During First Quarter 2013	R&W Recovered During First Quarter 2013(1)	Future Net R&W Benefit as of March 31, 2013
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$4	$ —	$—	$ 4
Alt-A first lien	378	(8)	(8)	362
Option ARM	591	153	(54)	690
Subprime	109	4	—	113
Total first lien	1,082	149	(62)	1,169
Second lien:				
Closed-end second lien	138	(9)	(21)	108
HELOC	150	17	(6)	161
Total second lien	288	8	(27)	269
Total	$1,370	$ 157	$(89)	$ 1,438

(1) Gross amounts recovered were $41 million and $92 million for First Quarter 2014 and 2013, respectively.

19

Table of Contents

The following tables present the present value of net expected loss to be paid for all contracts by accounting model, by sector and after the benefit for estimated and contractual recoveries for breaches of R&W.

Net Expected Loss to be Paid
By Accounting Model
As of March 31, 2014

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$3	$—	$15	$18
Alt-A first lien	212	19	77	308
Option ARM	(38)	—	10	(28)
Subprime	140	80	75	295
Total first lien	317	99	177	593
Second lien:				
Closed-end second lien	(32)	26	2	(4)
HELOCs	(92)	(17)	—	(109)
Total second lien	(124)	9	2	(113)
Total U.S. RMBS	193	108	179	480
TruPS	2	—	30	32
Other structured finance	176	—	(38)	138
U.S. public finance	281	—	—	281
Non-U.S. public finance	56	—	1	57
Subtotal	$708	$108	$172	988
Other				(4)
Total				$984

Table of Contents

Net Expected Loss to be Paid
By Accounting Model
As of December 31, 2013

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$3	$—	$18	$21
Alt-A first lien	199	31	74	304
Option ARM	(18)	(2)	11	(9)
Subprime	149	81	74	304
Total first lien	333	110	177	620
Second Lien:				
Closed-end second lien	(34)	25	(2)	(11)
HELOCs	(41)	(75)	—	(116)
Total second lien	(75)	(50)	(2)	(127)
Total U.S. RMBS	258	60	175	493
TruPS	3	—	48	51
Other structured finance	161	—	(41)	120
U.S. public finance	264	—	—	264
Non-U.S. public finance	55	—	2	57
Subtotal	$741	$60	$184	985
Other				(3)
Total				$982

(1) Refer to Note 9, Consolidated Variable Interest Entities.

Table of Contents

The following tables present the net economic loss development for all contracts by accounting model, by sector and after the benefit for estimated and contractual recoveries for breaches of R&W.

Net Economic Loss Development
By Accounting Model
First Quarter 2014

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$—	$—	$(3)	$(3)
Alt-A first lien	19	(12)	1	8
Option ARM	(16)	1	—	(15)
Subprime	(8)	(2)	3	(7)
Total first lien	(5)	(13)	1	(17)
Second lien:				
Closed-end second lien	(1)	2	4	5
HELOCs	(56)	58	—	2
Total second lien	(57)	60	4	7
Total U.S. RMBS	(62)	47	5	(10)
TruPS	(1)	—	(18)	(19)
Other structured finance	17	—	2	19
U.S. public finance	23	—	—	23
Non-U.S. public finance	—	—	—	—
Subtotal	$(23)	$47	$(11)	13
Other				(1)
Total				$12

Table of Contents

Net Economic Loss Development
By Accounting Model
First Quarter 2013

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$—	$—	$6	$6
Alt-A first lien	5	(1)	5	9
Option ARM	(93)	(37)	(8)	(138)
Subprime	12	4	9	25
Total first lien	(76)	(34)	12	(98)
Second lien:				
Closed-end second lien	5	(3)	(1)	1
HELOCs	(7)	4	—	(3)
Total second lien	(2)	1	(1)	(2)
Total U.S. RMBS	(78)	(33)	11	(100)
TruPS	0	—	(3)	(3)
Other structured finance	(10)	—	8	(2)
U.S. public finance	7	—	—	7
Non-U.S. public finance	9	—	1	10
Subtotal	$(72)	$(33)	$17	(88)
Other				(10)
Total				$(98)

(1) Refer to Note 9, Consolidated Variable Interest Entities.

(2) Refer to Note 8, Financial Guaranty Contracts Accounted for as Credit Derivatives.

Approach to Projecting Losses in U.S. RMBS

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

The further behind a mortgage borrower falls in making payments, the more likely it is that he or she will default. The rate at which borrowers from a particular delinquency category (number of monthly payments behind) eventually default is referred to as the “liquidation rate.” The Company derives its liquidation rate assumptions 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

Table of Contents

delinquency categories before any defaults occur. The Company projects how many of the currently performing loans will default and when they will default, by first converting the projected near term defaults of delinquent borrowers derived from liquidation rates into a vector of conditional default rates ("CDR"), then projecting how the conditional default rates will develop over time. Loans that are defaulted pursuant to the conditional default rate after the near-term liquidation of currently delinquent loans represent defaults of currently performing loans and projected re-performing loans. A conditional default rate is the outstanding principal amount of defaulted loans liquidated in the current month divided by the remaining outstanding amount of the whole pool of loans (or “collateral pool balance”). The collateral pool balance decreases over time as a result of scheduled principal payments, partial and whole principal prepayments, and defaults.

In order to derive collateral pool losses from the collateral pool defaults it has projected, the Company applies a loss severity. The loss severity is the amount of loss the transaction experiences on a defaulted loan after the application of net proceeds from the disposal of the underlying property. The Company projects loss severities by sector based on its experience to date. Further detail regarding the assumptions and variables the Company used to project collateral losses in its U.S. RMBS portfolio may be found below in the sections “U.S. First Lien RMBS Loss Projections: Alt-A First Lien, Option ARM, Subprime and Prime” and “U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second Lien” 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 Company is in the process of enforcing claims for breaches of R&W regarding the characteristics of the loans included in the collateral pools. The Company calculates a credit from the RMBS issuer for such recoveries where the R&W were provided by an entity the Company believes to be financially viable and where the Company already has access or believes it will attain access to the underlying mortgage loan files. Where the Company has an agreement with an R&W provider (e.g., the Bank of America Agreement, the Deutsche Bank Agreement or the UBS Agreement) or where it is in advanced discussions on a potential agreement, that credit is based on the agreement or potential agreement. Where the Company does not have an agreement with the R&W provider but the Company believes the R&W provider to be economically viable, the Company estimates what portion of its past and projected future claims it believes will be reimbursed by that provider. Further detail regarding how the Company calculates these credits may be found under “Breaches of Representations and Warranties” below.

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

The ultimate performance of the Company’s RMBS transactions remains highly uncertain, may differ from the Company's projections 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, results from the Company’s loss mitigation activities and other variables. The Company will continue to monitor the performance of its RMBS exposures and will adjust its RMBS loss projection assumptions and scenarios based on actual performance and management’s view of future performance.

First Quarter 2014 U.S. RMBS Loss Projections

The Company's RMBS loss projection methodology assumes that the housing and mortgage markets will continue improving. Each quarter the Company makes a judgment as to whether to change the assumptions it uses to make RMBS loss projections based on its observation during the quarter of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and, for first liens, loss severity) as well as the residential property market and economy in general. To the extent it observes changes, it makes a judgment as whether those changes are normal fluctuations or part of a trend. Based on such observations the Company chose to use the same general assumptions to project RMBS losses as of March 31, 2014 as it used as of December 31, 2013.

Table of Contents

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

The majority of projected losses in first lien RMBS transactions are expected to come from non-performing mortgage loans (those that have been modified in the previous 12 months or are delinquent or in foreclosure or that have been foreclosed and so the RMBS issuer owns the underlying real estate). Changes in the amount of non-performing loans from the amount projected in the previous period are one of the primary drivers of loss development in this portfolio. In order to determine the number of defaults resulting from these delinquent and foreclosed loans, the Company applies a liquidation rate assumption to loans in each of various non-performing categories. The Company arrived at its liquidation rates based on data purchased from a third party provider and assumptions about how delays in the foreclosure process and loan modifications may ultimately affect the rate at which loans are liquidated. The following table shows liquidation assumptions for various non-performing categories.

First Lien Liquidation Rates

	March 31, 2014	December 31, 2013
Current Loans Modified in Previous 12 Months		
Alt A and Prime	35%	35%
Option ARM	35	35
Subprime	35	35
30 – 59 Days Delinquent		
Alt A and Prime	50	50
Option ARM	50	50
Subprime	45	45
60 – 89 Days Delinquent		
Alt A and Prime	60	60
Option ARM	65	65
Subprime	50	50
90+ Days Delinquent		
Alt A and Prime	75	75
Option ARM	70	70
Subprime	60	60
Bankruptcy		
Alt A and Prime	60	60
Option ARM	60	60
Subprime	55	55
Foreclosure		
Alt A and Prime	85	85
Option ARM	80	80
Subprime	70	70
Real Estate Owned		
All	100	100

While the Company uses liquidation rates as described above to project defaults of non-performing loans (including current loans modified within the last 12 months), it projects defaults on presently current loans by applying a CDR trend. The start of that CDR trend is based on the defaults the Company projects will emerge from currently nonperforming loans. The total amount of expected defaults from the non-performing loans is translated into a constant CDR (i.e., the CDR plateau), which, if applied for each of the next 36 months, would be sufficient to produce

approximately the amount of defaults that were calculated to emerge from the various delinquency categories. The CDR thus calculated individually on the delinquent collateral pool for each RMBS is then used as the starting point for the CDR curve used to project defaults of the presently performing loans.

Table of Contents

In the base case, after the initial 36-month CDR plateau period, each transaction's CDR is projected to improve over 12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for 36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. Under the Company's methodology, defaults projected to occur in the first 36 months represent defaults that can be attributed to loans that were modified in the last 12 months or that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected CDR trend after the first 36 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 in the base case that these high levels generally will continue for another 18 months, except that in the case of subprime loans, the Company assumes the unprecedented 90% loss severity rate will continue for another nine months then drop to 80% for nine more months, in each case before following the ramp described below. The Company determines its initial loss severity based on actual recent experience. The Company's initial loss severity assumptions for March 31, 2014 were the same as it used for December 31, 2013. The Company then assumes that loss severities begin returning to levels consistent with underwriting assumptions beginning after the initial 18 month period declining to 40% in the base case over 2.5 years.

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

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

	As of March 31, 2014		As of December 31, 2013	
Alt-A First Lien				
Plateau CDR	2.3 %	– 18.4%	2.8 %	– 18.4%
Intermediate CDR	0.5 %	– 3.7%	0.6 %	– 3.7%
Period until intermediate CDR	48 months		48 months	
Final CDR	0.1 %	– 0.9%	0.1 %	– 0.9%
Initial loss severity	65%		65%	
Initial conditional prepayment rate ("CPR")	0.9 %	– 33.9%	0.0 %	– 34.2%
Final CPR	15%		15%	
Option ARM				
Plateau CDR	3.8 %	– 16.8%	4.9 %	– 16.8%
Intermediate CDR	0.8 %	– 3.4%	1.0 %	– 3.4%
Period until intermediate CDR	48 months		48 months	
Final CDR	0.2 %	– 0.8%	0.2 %	– 0.8%
Initial loss severity	65%		65%	
Initial CPR	0.8 %	– 12.2%	0.4 %	– 13.1%
Final CPR	15%		15%	
Subprime				
Plateau CDR	5.9 %	– 16.3%	5.6 %	– 16.2%
Intermediate CDR	1.2 %	– 3.3%	1.1 %	– 3.2%
Period until intermediate CDR	48 months		48 months	
Final CDR	0.3 %	– 0.8%	0.3 %	– 0.8%
Initial loss severity	90%		90%	

Initial CPR	0.0	%– 11.6%	0.0	%– 15.7%
Final CPR	15%		15%	

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

Table of Contents

The rate at which the principal amount of loans is voluntarily prepaid may impact both the amount of losses projected (since that amount is a function of the conditional default rate, the loss severity and the loan balance over time) as well as the amount of excess spread (the amount by which the interest paid by the borrowers on the underlying loan exceeds the amount of interest owed on the insured obligations). The assumption for the voluntarily CPR 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 CPR, which is assumed to be 15% in the base case. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. These assumptions are the same as those the Company used for December 31, 2013.

In estimating expected losses, the Company modeled and probability weighted sensitivities for first lien transactions by varying its assumptions of how fast a recovery is expected to occur. One of the variables used to model sensitivities was how quickly the conditional default rate returned to its modeled equilibrium, which was defined as 5% of the initial conditional default rate. The Company also stressed CPR and the speed of recovery of loss severity rates. The Company probability weighted a total of five scenarios (including its base case) as of March 31, 2014. The Company used a similar approach to establish its pessimistic and optimistic scenarios as of March 31, 2014 as it used as of December 31, 2013, increasing and decreasing the periods of stress from those used in the base case. In a somewhat more stressful environment than that of the base case, where the conditional default rate plateau was extended six months (to be 42 months long) before the same more gradual conditional default rate recovery and loss severities were assumed to recover over 4.5 rather than 2.5 years (and subprime loss severities were assumed to recover only to 60%), expected loss to be paid would increase from current projections by approximately $39 million for Alt-A first liens, $13 million for Option ARM, $93 million for subprime and $4 million for prime transactions.

In an even more stressful scenario where loss severities were assumed to rise and then recover over nine years and the initial ramp-down of the conditional default rate was assumed to occur over 15 months and other assumptions were the same as the other stress scenario, expected loss to be paid would increase from current projections by approximately $104 million for Alt-A first liens, $31 million for Option ARM, $138 million for subprime and $11 million for prime transactions. The Company also considered two scenarios where the recovery was faster than in its base case. In a scenario with a somewhat less stressful environment than the base case, where conditional default rate recovery was somewhat less gradual and the initial subprime loss severity rate was assumed to be 80% for 18 months and was assumed to recover to 40% over 2.5 years, expected loss to be paid would increase from current projections by approximately $1 million for Alt-A first lien and would decrease by $10 million for Option ARM, $25 million for subprime and $1 million for prime transactions. In an even less stressful scenario where the conditional default rate plateau was six months shorter (30 months, effectively assuming that liquidation rates would improve) and the conditional default rate recovery was more pronounced, (including an initial ramp-down of the conditional default rate over nine months), expected loss to be paid would decrease from current projections by approximately $36 million for Alt-A first lien, $28 million for Option ARM, $78 million for subprime and $4 million for prime transactions.

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

The Company believes the primary variable affecting its expected losses in second lien RMBS transactions is the amount and timing of future losses in the collateral pool supporting the transactions. Expected losses are also a function of the structure of the transaction; the voluntary prepayment rate (typically also referred to as CPR of the collateral); the interest rate environment; and assumptions about the draw rate and loss severity.

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

Table of Contents

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

HELOC key assumptions	As of March 31, 2014	As of December 31, 2013
Plateau CDR	1.9% – 7.3%	2.3% – 7.7%
Final CDR trended down to	0.4% – 3.2%	0.4% – 3.2%
Period until final CDR	34 months	34 months
Initial CPR	2.3% – 21.0%	2.7% – 21.5%
Final CPR	10%	10%
Loss severity	98%	98%

Closed-end second lien key assumptions	As of March 31, 2014	As of December 31, 2013
Plateau CDR	6.7% – 15.5%	7.3% – 15.1%
Final CDR trended down to	3.5% – 9.1%	3.5% – 9.1%
Period until final CDR	34 months	34 months
Initial CPR	2.9% – 12.8%	3.1% – 12.0%
Final CPR	10%	10%
Loss severity	98%	98%

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

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

As of March 31, 2014, for the base case scenario, the CDR (the "plateau CDR") was held constant for one month. Once the plateau period has ended, the CDR is assumed to gradually trend down in uniform increments to its final long-term steady state CDR. (The long-term steady state CDR is calculated as the constant CDR that would have yielded the amount of losses originally expected at underwriting.) In the base case scenario, the time over which the CDR trends down to its final CDR is 28 months. Therefore, the total stress period for second lien transactions is 34 months, comprising five months of delinquent data, a one month plateau period and 28 months of decrease to the steady state CDR. When a second lien loan defaults, there is generally a very low recovery. Based on current expectations of future performance, the Company assumes that it will only recover 2% of the collateral, the same as of December 31, 2013.

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected as well as the amount of excess spread. In the base case, the current CPR (based on experience of the most recent three quarters) is assumed to continue until the end of the plateau before gradually increasing to the final CPR over the same period the CDR decreases. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. The final CPR is assumed to be 10% for both HELOC and closed-end second lien transactions. This level is much higher than current rates for most transactions, but lower than the historical average, which reflects the Company's continued uncertainty about the projected performance of the borrowers in these transactions. This pattern is consistent with how the Company modeled the

Table of Contents

CPR at December 31, 2013. 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, the loss severity, and HELOC draw rates (the amount of new advances provided on existing HELOCs expressed as a percentage of current outstanding advances). These variables have been relatively stable over the past several quarters and in the relevant ranges have less impact on the projection results than the variables discussed above. However, in a number of HELOC transactions the servicers have been modifying poorly performing loans from floating to fixed rates, and rising interest rates would negatively impact the excess spread available from these modified loans to support the transactions. In a number of HELOC transactions the servicers have been modifying poorly performing loans from floating to fixed rates, and as a result, rising interest rates would negatively impact the available excess spread available from these modified loans. The Company incorporated these modifications in its assumptions.

In estimating expected losses, the Company modeled and probability weighted three possible CDR curves applicable to the period preceding the return to the long-term steady state CDR. The Company believes that the level of the elevated CDR and the length of time it will persist is the primary driver behind the likely amount of losses the collateral will suffer. The Company continues to evaluate the assumptions affecting its modeling results.

As of March 31, 2014, the Company's base case assumed a one month CDR plateau and a 28 month ramp-down (for a total stress period of 34 months). The Company also modeled a scenario with a longer period of elevated defaults and another with a shorter period of elevated defaults and weighted them the same as of December 31, 2013. Increasing the CDR plateau to four months and increasing the ramp-down by five months to 33 months (for a total stress period of 42 months) would increase the expected loss by approximately $24 million for HELOC transactions and $2 million for closed-end second lien transactions. On the other hand, keeping the CDR plateau at one month but decreasing the length of the CDR ramp-down to 18 months (for a total stress period of 24 months) would decrease the expected loss by approximately $22 million for HELOC transactions and $2 million for closed-end second lien transactions.

Breaches of Representations and Warranties

Generally, when mortgage loans are transferred into a securitization, the loan originator(s) and/or sponsor(s) provide R&W that the loans meet certain characteristics, and a breach of such R&W often requires that the loan be repurchased from the securitization. In many of the transactions the Company insures, it is in a position to enforce these R&W provisions. Soon after the Company observed the deterioration in the performance of its insured RMBS following the deterioration of the residential mortgage and property markets, the Company began using internal resources as well as third party forensic underwriting firms and legal firms to pursue breaches of R&W on a loan-by-loan basis. Where a provider of R&W refused to honor its repurchase obligations, the Company sometimes chose to initiate litigation. See "Recovery Litigation" below. The Company's success in pursuing these strategies permitted the Company to enter into agreements with R&W providers under which those providers made payments to the Company, agreed to make payments to the Company in the future, and / or repurchased loans from the transactions, all in return for releases of related liability by the Company. Such agreements provide the Company with many of the benefits of pursuing the R&W claims on a loan by loan basis or through litigation, but without the related expense and uncertainty. The Company continues to pursue these strategies against R&W providers with which it does not yet have agreements.

Using these strategies, through March 31, 2014 the Company has caused entities providing R&Ws to pay or agree to pay approximately $3.7 billion (gross of reinsurance) in respect of their R&W liabilities for transactions in which the Company has provided insurance.

	(in millions)
Agreement amounts already received	$2,716
Agreement amounts projected to be received in the future	402
Repurchase amounts paid into the relevant RMBS prior to settlement (1)	579
Total R&W payments, gross of reinsurance	$3,697

(1) These amounts were paid into the relevant RMBS transactions (rather than to the Company as in most settlements) and distributed in accordance with the priority of payments set out in the relevant transaction documents. Because the Company may insure only a portion of the capital structure of a transaction, such payments will not necessarily directly benefit the Company dollar-for-dollar, especially in first lien transactions.

Table of Contents

Based on this success, the Company has included in its net expected loss estimates as of March 31, 2014 an estimated net benefit related to breaches of R&W of $721 million, which includes $384 million from agreements with R&W providers and $337 million in transactions where the Company does not yet have such an agreement, all net of reinsurance.

Representations and Warranties Agreements (1)

	Agreement Date	Current Net Par Covered	Receipts to March 31, 2014 (net of reinsurance)	Estimated Future Receipts (net of reinsurance)	Eligible Assets Held in Trust (gross of reinsurance)
		(in millions)			
Bank of America - First Lien	April 2011	$1,023	$490	$195	$585
Bank of America - Second Lien	April 2011	1,335	968	NA	NA
Deutsche Bank	May 2012 and October 2013	1,649	235	100	142
UBS	May 2013	778	410	33	147
Others	Various	1,019	394	56	NA
Total		$5,804	$2,497	$384	$874

(1) This table relates to past and projected future recoveries under R&W and related agreements. Excluded from this table is the $337 million of future net recoveries the Company projects receiving from R&W counterparties in transactions with $1,379 million of net par outstanding as of March 31, 2014 not covered by current agreements. Also excluded from this table is $773 million of net par partially covered by agreements but for which the Company projects receiving additional amounts.

The Company's agreements with the counterparties specifically named in the table above required an initial payment to the Company to reimburse it for past claims as well as an obligation to reimburse it for a portion of future claims. The named counterparties placed eligible assets in trust to collateralize their future reimbursement obligations, and the amount of collateral they are required to post may be increased or decreased from time to time as determined by rating agency requirements. Reimbursement payments under these agreements are made either monthly or quarterly and have been made timely. With respect to the reimbursement for future claims:

- Bank of America. Under the Company's agreement with Bank of America Corporation and certain of its subsidiaries (“Bank of America”), Bank of America agreed to reimburse the Company for 80% of claims on the first lien transactions covered by the agreement that the Company pays in the future, until the aggregate lifetime collateral losses (not insurance losses or claims) on those transactions reach $6.6 billion. As of March 31, 2014 aggregate lifetime collateral losses on those transactions was $3.9 billion, and the Company was projecting in its base case that such collateral losses would eventually reach $5.1 billion.

- Deutsche Bank. Under the Company's May 2012 agreement with Deutsche Bank AG and certain of its affiliates (collectively, “Deutsche Bank”), Deutsche Bank agreed to reimburse the Company for certain claims it pays in the future on eight first and second lien transactions, including 80% of claims it pays on those transactions until the aggregate lifetime claims (before reimbursement) reach $319 million. As of March 31, 2014, the Company was projecting in its base case that such aggregate lifetime claims would remain below $319 million. In the event aggregate lifetime claims paid exceed $389 million, Deutsche Bank must reimburse Assured Guaranty for 85% of such claims paid (in excess of $389 million) until such claims paid reach $600 million.

The agreement also requires Deutsche Bank to reimburse AGC for future claims it pays on certain RMBS re-securitizations. The amount available for reimbursement of claim payments is based on a percentage of the losses that occur in certain uninsured tranches ("Uninsured Tranches") within the eight transactions described above: 60% of losses on the Uninsured Tranches (up to $141 million of losses), 60% of such losses (for losses between $161 million and $185 million), and 100% of such losses (for losses from $185 million to $248 million). Losses on the Uninsured Tranches from $141 million to $161 million and above $248 million are not included in the calculation of AGC's reimbursement amount for re-securitization claim payments. As of March 31, 2014, the Company was projecting in its base case that losses on the Uninsured Tranches would be $153 million. Pursuant to the CDS termination on October 10, 2013 described below, a portion of Deutsche Bank's reimbursement obligation was applied to the terminated CDS. After giving effect to application of the portion of the reimbursement obligation to the terminated

Table of Contents

CDS, as well as to reimbursements related to other covered RMBS re-securitizations, and based on the Company's base case projections for losses on the Uninsured Tranches, the Company expects that $24 million will be available to reimburse AGC for re-securitization claim payments on the remaining re-securitizations. Except for the reimbursement obligation based on losses occurring on the Uninsured Tranches and the termination agreed to described below, the agreement with Deutsche Bank does not cover transactions where the Company has provided protection to Deutsche Bank on RMBS transactions in CDS form.

On October 10, 2013, the Company and Deutsche Bank terminated one below investment grade transaction under which the Company had provided credit protection to Deutsche Bank through a CDS. The transaction had a net par outstanding of $294 million at the time of termination. In connection with the termination, Assured Guaranty agreed to release to Deutsche Bank $60 million of assets held in trust that was in excess of the amount of assets required to be held in trust for regulatory and rating agency capital relief.

- UBS. On May 6, 2013, the Company entered into an agreement with UBS Real Estate Securities Inc. and affiliates ("UBS") and a third party resolving the Company’s claims and liabilities related to specified RMBS transactions that were issued, underwritten or sponsored by UBS and insured by AGM or AGC under financial guaranty insurance policies. Under the agreement, UBS agreed to reimburse the Company for 85% of future losses on three first lien RMBS transactions.

The Company calculated an expected recovery of $337 million from breaches of R&W in transactions not covered by agreements with $1,379 million of net par outstanding as of March 31, 2014 and $773 million of net par partially covered by agreements but for which the Company projects receiving additional amounts. The Company did not incorporate any gain contingencies from potential litigation in its estimated repurchases. The amount the Company will ultimately recover related to such 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 not already covered by agreements, the Company considered the creditworthiness of the provider of the R&W, the number of breaches found on defaulted loans, the success rate in resolving these breaches across those transactions where material repurchases have been made and the potential amount of time until the recovery is realized. The calculation of expected recovery from breaches of such contractual R&W involved a variety of scenarios which ranged from the Company recovering substantially all of the losses it incurred due to violations of R&W to the Company realizing limited recoveries. These scenarios were probability weighted in order to determine the recovery incorporated into the Company's estimate of expected losses. This approach was used for both loans that had already defaulted and those assumed to default in the future. The Company adjusts the calculation of its expected recovery from breaches of R&W based on changing facts and circumstances with respect to each counterparty and transaction.

The Company uses the same RMBS projection scenarios and weightings to project its future R&W benefit as it uses to project RMBS losses on its portfolio. To the extent the Company increases its loss projections, the R&W benefit (whether pursuant to an R&W agreement or not) generally will also increase, subject to the agreement limits and thresholds described above. Similarly, to the extent the Company decreases its loss projections, the R&W benefit (whether pursuant to an R&W agreement or not) generally will also decrease, subject to the agreement limits and thresholds described above.

The Company accounts for the loss sharing obligations under the R&W agreements on financial guaranty insurance contracts as subrogation, offsetting the losses it projects by an R&W benefit from the relevant party for the applicable portion of the projected loss amount. 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. See Notes 7, Fair Value Measurement and 9, Consolidated Variable Interest Entities.

Table of Contents

U.S. RMBS Risks with R&W Benefit

	Number of Risks (1) as of		Debt Service as of	
	March 31, 2014	December 31, 2013	March 31, 2014	December 31, 2013
			(dollars in millions)	
Prime first lien	1	1	$36	$38
Alt-A first lien	20	19	2,791	2,856
Option ARM	10	9	589	641
Subprime	5	5	985	998
Closed-end second lien	4	4	155	158
HELOC	5	4	141	320
Total	45	42	$4,697	$5,011

(1) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making Debt Service payments. This table shows the full future Debt Service (not just the amount of Debt Service expected to be reimbursed) for risks with projected future R&W benefit, whether pursuant to an agreement or not.

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.

Components of R&W Development

	First Quarter	
	2014	2013
	(in millions)	
Change in recovery assumptions as the result of additional file review and recovery success	$10	$11
Estimated increase (decrease) in defaults that will result in additional (lower) breaches	0	1
Settlements and anticipated settlements	35	142
Accretion of discount on balance	3	3
Total	$48	$157

“XXX” Life Insurance Transactions

The Company’s $2.7 billion net par of XXX life insurance transactions as of March 31, 2014 include $598 million rated BIG. The BIG “XXX” life insurance reserve securitizations are based on discrete blocks of individual life insurance business. In each such transaction the monies raised by the sale of the bonds insured by the Company were used to capitalize a special purpose vehicle that provides reinsurance to a life insurer or reinsurer. The monies are invested at inception in accounts managed by third-party investment managers.

The BIG “XXX” life insurance transactions consist of two transactions, notes issued by each of Ballantyne Re p.l.c and Orkney Re II p.l.c. These transactions had material amounts of their assets invested in U.S. RMBS transactions. Based on its analysis of the information currently available, including estimates of future investment performance, and projected credit impairments on the invested assets and performance of the blocks of life insurance business at March 31, 2014, the Company’s projected net expected loss to be paid is $85 million. The overall increase of approximately $12 million in expected loss to be paid during First Quarter 2014 is due primarily to changes in lapse assumptions on the underlying life insurance policies in the Ballantyne Re p.l.c transaction and a decrease in the risk

free rates used to discount the losses.

Table of Contents

Student Loan Transactions

The Company has insured or reinsured $2.8 billion net par of student loan securitizations, of which $1.9 billion was issued by private issuers and classified as asset-backed and $0.9 billion was issued by public authorities and classified as public finance. Of these amounts, $204 million and $251 million, respectively, are rated BIG. The Company is projecting approximately $68 million of net expected loss to be paid in these portfolios. In general, the losses are due to: (i) the poor credit performance of private student loan collateral and high loss severities, or (ii) high interest rates on auction rate securities with respect to which the auctions have failed. The largest of these losses was approximately $28 million and related to a transaction backed by a pool of private student loans assumed by AG Re from another monoline insurer. The guaranteed bonds were issued as auction rate securities that now bear a high rate of interest due to the downgrade of the primary insurer’s financial strength rating. Further, the underlying loan collateral has performed below expectations. The overall increase of $4 million in net expected loss during First Quarter 2014 is primarily due to a decrease in the risk free rates used to discount the losses along with some deterioration in collateral performance.

Trust Preferred Securities Collateralized Debt Obligations

The Company has insured or reinsured $4.8 billion of net par (71% of which is in CDS form) of collateralized debt obligations (“CDOs”) backed by TruPS and similar debt instruments, or “TruPS CDOs.” Of the $4.8 billion, $1.6 billion is rated BIG. The underlying collateral in the TruPS CDOs consists of subordinated debt instruments such as TruPS issued by bank holding companies and similar instruments issued by insurance companies, real estate investment trusts (“REITs”) and other real estate related issuers.

The Company projects losses for TruPS CDOs by projecting the performance of the asset pools across several scenarios (which it weights) and applying the CDO structures to the resulting cash flows. At March 31, 2014, the Company has projected expected losses to be paid for TruPS CDOs of $32 million. The decrease of approximately $19 million in First Quarter 2014 was due primarily to improving collateral performance.

Selected U.S. Public Finance Transactions

The Company insures general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating $5.3 billion net par. The Company rates $5.1 billion net par of that amount BIG. Information regarding the Company's exposure to general obligations of Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations, please refer "Puerto Rico Exposure" in Note 3, Outstanding Exposure.

Many U.S. municipalities and related entities continue to be under increased pressure, and a few have filed for protection under the U.S. Bankruptcy Code, entered into state processes designed to help municipalities in fiscal distress or otherwise indicated they may consider not meeting their obligations to make timely payments on their debts. Given some of these developments, and the circumstances surrounding each instance, the ultimate outcome cannot be certain and may lead to an increase in defaults on some of the Company's insured public finance obligations. The Company will continue to analyze developments in each of these matters closely. The municipalities whose obligations the Company has insured that have filed for protection under Chapter 9 of the U.S Bankruptcy Code and have not been resolved are: Detroit, Michigan and Stockton, California.

The Company has net par exposure to the City of Detroit, Michigan of $2.1 billion as of March 31, 2014. On July 18, 2013, the City of Detroit filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. Most of the Company's net par exposure relates to $1.0 billion of sewer revenue bonds and $784 million of water revenue bonds, both of which the Company rates BBB. Both the sewer and water systems provide services to areas that extend beyond the

city limits, and the bonds are secured by a lien on "special revenues." The Company also has net par exposure of $146 million to the City's general obligation bonds (which are secured by a pledge of the unlimited tax, full faith, credit and resources of the City and the specific ad valorem taxes approved by the voters solely to pay debt service on the general obligation bonds) and $175 million of the City's Certificates of Participation (which are unsecured unconditional contractual obligations of the City), both of which the Company rates BIG. On April 9, 2014, the City and the Company reached a tentative settlement with respect to the treatment of the unlimited tax general obligation bonds insured by the Company. The agreement provides for the confirmation of both the secured status of such general obligation bonds and the existence of a valid lien on the City’s pledged property tax revenues, a finding that such revenues constitute “special revenues” under the U.S. Bankruptcy Code, and the provision of additional security for such general obligation bonds in the form of a statutory lien on, and intercept of, the City’s distributable state aid. After giving effect to post-petition payments made by Assured Guaranty on such general obligation bonds, the settlement results in a minimum ultimate recovery of approximately 74% on such general obligation bonds, with the ability to

Table of Contents

achieve a higher ultimate recovery rate over time if other debt creditors' recoveries reach certain specified thresholds. The settlement is subject to a number of conditions, including confirmation of a plan of adjustment. The City has filed a proposed plan of adjustment and disclosure statement with the Bankruptcy Court, amended most recently on April 16, 2014.

On June 28, 2012, the City of Stockton, California filed for bankruptcy protection under Chapter 9 of the U.S. Bankruptcy Code. The Company's net exposure to the City's general fund is $119 million, consisting of pension obligation bonds. The Company also had exposure to lease obligation bonds; as of March 31, 2014, the Company owned all of such bonds and held them in its investment portfolio. As of March 31, 2014, the Company had paid $32 million in net claims. On October 3, 2013, the Company reached a tentative settlement with the City regarding the treatment of the bonds insured by the Company in the City's proposed plan of adjustment. Under the terms of the settlement, the Company will receive title to an office building, the ground lease of which secures the lease revenue bonds, and will also be entitled to certain fixed payments and certain variable payments contingent on the City's revenue growth. The settlement is subject to a number of conditions, including a sales tax increase (which was approved by voters on November 5, 2013), confirmation of a plan of adjustment that implements the terms of the settlement and definitive documentation. Pursuant to an order of the Bankruptcy Court, the City held a vote of its creditors on its proposed plan of adjustment; all but one of the classes polled voted to accept the plan. The court proceeding to determine whether to confirm the plan of adjustment is expected to begin in May 2014. The Company expects the plan to be confirmed and implemented during 2014.
The Company has $337 million of net par exposure to the Louisville Arena Authority. The bond proceeds were used to construct the KFC Yum Center, home to the University of Louisville men's and women's basketball teams. Actual revenues available for Debt Service are well below original projections, and under the Company's internal rating scale, the transaction is BIG.

The Company projects that its total future expected net loss across its troubled U.S. public finance credits as of March 31, 2014 will be $281 million. As of December 31, 2013 the Company was projecting a net expected loss of $264 million across its troubled U.S. public finance credits. The net increase of $17 million in expected loss was primarily attributable to negative developments with respect to the City of Detroit offset, in part, by the modest reduction in exposure to Puerto Rico.

Certain Selected European Country Transactions

The Company insures and reinsures credits with sub-sovereign exposure to various Spanish and Portuguese issuers where a Spanish and Portuguese sovereign default may cause the regions also to default. The Company's gross exposure to these Spanish and Portuguese credits is €435 million and €92 million, respectively and exposure net of reinsurance for Spanish and Portuguese credits is €312 million and €80 million, respectively. The Company rates most of these issuers in the BB category due to the financial condition of Spain and Portugal and their dependence on the sovereign. The Company's Hungary exposure is to infrastructure bonds dependent on payments from Hungarian governmental entities and covered mortgage bonds issued by Hungarian banks. The Company's gross exposure to these Hungarian credits is $623 million and its exposure net of reinsurance is $587 million, all of which all is rated BIG. The Company estimated net expected losses of $51 million related to these Spanish, Portuguese and Hungarian credits, which is largely unchanged from the amount reported as of December 31, 2013.

Manufactured Housing

The Company insures or reinsures a total of $248 million net par of securities backed by manufactured housing loans, of which $175 million is rated BIG. The Company has expected loss to be paid of $27 million as of March 31, 2014, up from $26 million as of December 31, 2013, due primarily to the decrease in risk free rates used to discount losses.

Infrastructure Finance

The Company has insured exposure of approximately $3.0 billion to infrastructure transactions with refinancing risk as to which the Company may need to make claim payments that it did not anticipate paying when the policies were issued. Although the Company may not experience ultimate loss on a particular transaction, the aggregate amount of the claim payments may be substantial and reimbursement may not occur for an extended time, if at all. These transactions generally involve long-term infrastructure projects that were financed by bonds that mature prior to the expiration of the project concession. The Company expected the cash flows from these projects to be sufficient to repay all of the debt over the life of the project concession, but also expected the debt to be refinanced in the market at or prior to its maturity. Due to market conditions, the Company may have to pay a claim when the debt matures, and then recover its payment from cash flows produced by the project in the future. The Company generally projects that in most scenarios it will be fully reimbursed for

Table of Contents

such payments. However, the recovery of the payments is uncertain and may take from 10 to 35 years, depending on the transaction and the performance of the underlying collateral. The Company estimates total claims for the remaining two largest transactions with significant refinancing risk, assuming no refinancing, and based on certain performance assumptions could be $1.8 billion on a gross basis; such claims would be payable from 2017 through 2022.

Recovery Litigation

RMBS Transactions

As of the date of this filing, AGM and AGC have lawsuits pending against providers of representations and warranties in U.S. RMBS transactions insured by them, seeking damages. In all the lawsuits, AGM and AGC have alleged breaches of R&W in respect of the underlying loans in the transactions, and failure to cure or repurchase defective loans identified by AGM and AGC to such persons.

- Deutsche Bank: 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 on the ACE Securities Corp. Home Equity Loan Trust, Series 2006-GP1 second lien transaction.

- Credit Suisse: AGM and AGC have sued DLJ Mortgage Capital, Inc. (“DLJ”) and Credit Suisse Securities (USA) LLC (“Credit Suisse”) on first lien U.S. RMBS transactions insured by them. Although DLJ and Credit Suisse successfully dismissed certain causes of action and claims for relief asserted in the complaint, the primary causes of action against DLJ for breach of R&W and breach of its repurchase obligations remained. On May 6, 2014, the Appellate Division, First Department unanimously reversed certain aspects of the partial dismissal by the Supreme Court of the State of New York of certain claims for relief by holding as a matter of law that AGM’s and AGC’s remedies for breach of R&W are not limited to the repurchase remedy. AGM and AGC had filed an amended complaint against DLJ and Credit Suisse (and added Credit Suisse First Boston Mortgage Securities Corp. as a defendant), asserting claims of fraud and material misrepresentation in the inducement of an insurance contract, in addition to their existing breach of contract claims. The defendants have filed a motion to dismiss certain aspects of the fraud claim against DLJ and Credit Suisse, all of the claims against Credit Suisse First Boston Mortgage Securities Corp., and AGM and AGC’s claims for compensatory damages in the form of all claims paid and to be paid by AGM and AGC. The motion to dismiss is currently pending.

On March 26, 2013, AGM filed a lawsuit against RBS Securities Inc., RBS Financial Products Inc. and Financial Asset Securities Corp. (collectively, “RBS”) in the United States District Court for the Southern District of New York on the Soundview Home Loan Trust 2007-WMC1 transaction. The complaint alleges that RBS made fraudulent misrepresentations to AGM regarding the quality of the underlying mortgage loans in the transaction and that RBS's misrepresentations induced AGM into issuing a financial guaranty insurance policy in respect of the Class II-A-1 certificates issued in the transaction. On July 19, 2013, AGM amended its complaint to add a claim under Section 3105 of the New York Insurance Law. On March 17, 2014, the court denied RBS' motion to dismiss AGM's fraudulent misrepresentation claims but granted its motion to dismiss the insurance law claim.

“XXX” Life Insurance Transactions

In December 2008, Assured Guaranty (UK) Ltd. (“AGUK”) filed an action against J.P. Morgan Investment Management Inc. (“JPMIM”), the investment manager in the Orkney Re II transaction, in the Supreme Court of the State of New York alleging that JPMIM engaged in breaches of fiduciary duty, gross negligence and breaches of contract based upon its handling of the investments of Orkney Re II. After AGUK’s claims were dismissed with prejudice in January 2010, AGUK was successful in its subsequent motions and appeals and, as of December 2011, all

of AGUK’s claims for breaches of fiduciary duty, gross negligence and contract were reinstated in full. Separately, at the trial court level, discovery is ongoing.

Table of Contents

6. Financial Guaranty Insurance Losses

Insurance Contracts' Loss Information

The following table provides balance sheet information on loss and LAE reserves and salvage and subrogation recoverable, net of reinsurance.

Loss and LAE Reserve and Salvage and Subrogation Recoverable
Net of Reinsurance
Insurance Contracts

	As of March 31, 2014			As of December 31, 2013		
	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net Reserve (Recoverable)	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net Reserve (Recoverable)
	(in millions)					
U.S. RMBS:						
First lien:						
Prime first lien	$3	$—	$3	$3	$—	$3
Alt-A first lien	112	—	112	108	—	108
Option ARM	19	57	(38)	22	47	(25)
Subprime	135	1	134	143	2	141
First lien	269	58	211	276	49	227
Second lien:						
Closed-end second lien	5	43	(38)	5	45	(40)
HELOC	6	117	(111)	5	127	(122)
Second lien	11	160	(149)	10	172	(162)
Total U.S. RMBS	280	218	62	286	221	65
TruPS	1	—	1	2	—	2
Other structured finance	159	5	154	145	6	139
U.S. public finance	212	8	204	189	8	181
Non-U.S. public finance	36	—	36	35	—	35
Financial guaranty	688	231	457	657	235	422
Other	1	5	(4)	2	5	(3)
Subtotal	689	236	453	659	240	419
Effect of consolidating FG VIEs	(90)	(17)	(73)	(103)	(85)	(18)
Total (1)	$599	$219	$380	$556	$155	$401

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

Table of Contents

The following table reconciles the reported gross and ceded reserve and salvage and subrogation amount to the financial guaranty net reserves (salvage) in the financial guaranty BIG transaction loss summary tables.

Components of Net Reserves (Salvage)
Insurance Contracts

	As of March 31, 2014	As of December 31, 2013
	(in millions)	
Loss and LAE reserve	$636	$592
Reinsurance recoverable on unpaid losses	(37)	(36)
Loss and LAE reserve, net	599	556
Salvage and subrogation recoverable	(241)	(174)
Salvage and subrogation payable(1)	22	19
Salvage and subrogation recoverable, net	(219)	(155)
Subtotal	380	401
Other recoverables(2)	(17)	(15)
Net reserves (salvage)	363	386
Less: other (non-financial guaranty business)	(4)	(3)
Net reserves (salvage)	$367	$389

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

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

Balance Sheet Classification of
Net Expected Recoveries for Breaches of R&W
Insurance Contracts

	As of March 31, 2014			As of December 31, 2013		
	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet(1)	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet(1)
	(in millions)					
Salvage and subrogation recoverable, net	$126	$—	$ 126	$122	$(49)	$ 73
Loss and LAE reserve, net	378	(14)	364	363	(24)	339

(1) The remaining benefit for R&W is either recorded at fair value in FG VIE assets, or not recorded on the balance sheet until the total loss, net of R&W, exceeds unearned premium reserve.

The table below provides a reconciliation of net expected loss to be paid to net expected loss to be expensed. Expected loss to be paid differs from expected loss to be expensed due to: (1) the contra-paid which represent the payments that have been made but have not yet been expensed, (2) salvage and subrogation recoverable for transactions that are in a net recovery position where the Company has not yet received recoveries on claims previously paid (having the effect of reducing net expected loss to be paid by the amount of the previously paid claim and the expected recovery), but

will have no future income effect (because the previously paid claims and the corresponding recovery of those claims will offset in income in future periods), and (3) loss reserves that have already been established (and therefore expensed but not yet paid).

Table of Contents

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

	As of March 31, 2014 (in millions)
Net expected loss to be paid	$816
Less: net expected loss to be paid for FG VIEs	108
Total	708
Contra-paid, net	50
Salvage and subrogation recoverable, net of reinsurance	214
Loss and LAE reserve, net of reinsurance	(598)
Other recoveries (1)	17
Net expected loss to be expensed (2)	$391

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

(2) Excludes $84 million as of March 31, 2014, related to consolidated FG VIEs.

The following table provides a schedule of the expected timing of net expected losses to be expensed. The amount and timing of actual loss and LAE may differ from the estimates shown below due to factors such as refundings, accelerations, commutations, changes in expected lives and updates to loss estimates. This table excludes amounts related to FG VIEs, which are eliminated in consolidation.

Net Expected Loss to be Expensed
Insurance Contracts

	As of March 31, 2014 (in millions)
2014 (April 1– June 30)	$12
2014 (July 1– September 30)	11
2014 (October 1–December 31)	10
2015	42
2016	38
2017	31
2018	28
2019 - 2023	98
2024 - 2028	57
2029 - 2033	37
After 2033	27
Net expected loss to be expensed(1)	391
Discount	419
Total future value	$810

(1) Consolidation of FG VIEs resulted in reductions of $84 million in net expected loss to be expensed which is on a present value basis.

38

Table of Contents

The following table presents the loss and LAE recorded in the consolidated statements of operations by sector for insurance contracts. Amounts presented are net of reinsurance.

Loss and LAE
Reported on the
Consolidated Statements of Operations

	First Quarter	
	2014	2013
Structured Finance:	(in millions)	
U.S. RMBS:		
First lien:		
Prime first lien	$0	$—
Alt-A first lien	7	9
Option ARM	(8)	(83)
Subprime	(8)	11
First lien	(9)	(63)
Second lien:		
Closed-end second lien	—	20
HELOC	8	3
Second lien	8	23
Total U.S. RMBS	(1)	(40)
TruPS	(1)	—
Other structured finance	16	(12)
Structured finance	14	(52)
Public Finance:		
U.S. public finance	26	(4)
Non-U.S. public finance	1	1
Public finance	27	(3)
Subtotal	41	(55)
Other	(1)	—
Loss and LAE insurance contracts before FG VIE consolidation	40	(55)
Effect of consolidating FG VIEs	1	7
Loss and LAE	$41	$(48)

Table of Contents

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

Financial Guaranty Insurance
BIG Transaction Loss Summary
As of March 31, 2014

	BIG Categories								
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating FG VIEs	Total
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	193	(74)	80	(23)	109	(32)	382	—	382
Remaining weighted-average contract period (in years)	10.2	7.9	8.3	5.6	10.0	8.5	10.4	—	10.4
Outstanding exposure:									
Principal	$14,981	$(2,739)	$2,412	$(159)	$2,980	$(108)	$17,367	$—	$17,367
Interest	7,836	(1,107)	1,139	(52)	1,197	(40)	8,973	—	8,973
Total(2)	$22,817	$(3,846)	$3,551	$(211)	$4,177	$(148)	$26,340	$—	$26,340
Expected cash outflows (inflows)	$1,901	$(528)	$727	$(33)	$1,695	$(59)	$3,703	$(358)	$3,345
Potential recoveries									
Undiscounted R&W	(174)	10	(108)	4	(374)	14	(628)	15	(613)
Other(3)	(1,780)	506	(255)	17	(302)	18	(1,796)	191	(1,605)
Total potential recoveries	(1,954)	516	(363)	21	(676)	32	(2,424)	206	(2,218)
Subtotal	(53)	(12)	364	(12)	1,019	(27)	1,279	(152)	1,127
Discount	13	1	(120)	3	(366)	6	(463)	44	(419)
Present value of expected cash flows	$(40)	$(11)	$244	$(9)	$653	$(21)	$816	$(108)	$708
Deferred premium revenue	$521	$(93)	$148	$(7)	$262	$(17)	$814	$(128)	$686
Reserves (salvage)(4)	$(137)	$5	$133	$(5)	$458	$(14)	$440	$(73)	$367

Table of Contents

Financial Guaranty Insurance
BIG Transaction Loss Summary
As of December 31, 2013

	BIG Categories								
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating FG VIEs	Total
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	185	(72)	80	(24)	119	(34)	384	—	384
Remaining weighted-average contract period (in years)	10.5	8.1	8.3	5.9	9.8	7.2	10.5	—	10.5
Outstanding exposure:									
Principal	$15,132	$(2,741)	$2,483	$(160)	$3,189	$(158)	$17,745	$—	$17,745
Interest	8,114	(1,144)	1,181	(53)	1,244	(52)	9,290	—	9,290
Total(2)	$23,246	$(3,885)	$3,664	$(213)	$4,433	$(210)	$27,035	$—	$27,035
Expected cash outflows (inflows)	$1,853	$(528)	$1,038	$(40)	$1,681	$(62)	$3,942	$(690)	$3,252
Potential recoveries									
Undiscounted R&W	(105)	1	(201)	8	(356)	13	(640)	72	(568)
Other(3)	(1,774)	513	(470)	19	(351)	19	(2,044)	507	(1,537)
Total potential recoveries	(1,879)	514	(671)	27	(707)	32	(2,684)	579	(2,105)
Subtotal	(26)	(14)	367	(13)	974	(30)	1,258	(111)	1,147
Discount	13	—	(126)	3	(352)	5	(457)	51	(406)
Present value of expected cash flows	$(13)	$(14)	$241	$(10)	$622	$(25)	$801	$(60)	$741
Deferred premium revenue	$517	$(90)	$163	$(7)	$303	$(27)	$859	$(178)	$681
Reserves (salvage)(4)	$(114)	$1	$117	$(4)	$420	$(13)	$407	$(18)	$389

(1) The ceded number of risks represents the number of risks for which the Company ceded a portion of its exposure.

(2) Includes BIG amounts related to FG VIEs.

(3) Includes excess spread and draws on HELOCs.

(4) See table “Components of net reserves (salvage).”

Ratings Impact on Financial Guaranty Business

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

For example, AGM has issued financial guaranty insurance policies in respect of the obligations of municipal obligors under interest rate swaps. Under the swaps, AGM insures periodic payments owed by the municipal obligors to the bank counterparties. Under certain of the swaps, AGM also insures termination payments that may be owed by the municipal obligors to the bank counterparties. If (i) AGM has been downgraded below the rating trigger set forth in a swap under which it has insured the termination payment, which rating trigger varies on a transaction by transaction basis; (ii) the municipal obligor has the right to cure by, but has failed in, posting collateral, replacing AGM or otherwise curing the downgrade of AGM; (iii) the transaction documents include as a condition that an event of default or termination event with respect to the municipal obligor has occurred, such as the rating of the municipal obligor being downgraded past a specified level, and such condition has been met; (iv) the bank counterparty has elected to terminate the swap; (v) a termination payment is payable by the municipal obligor; and (vi) the municipal obligor has failed to make the termination payment payable by it, then AGM would be required to pay the termination payment due by the municipal obligor, in an amount not to exceed the policy limit set forth in the financial guaranty insurance policy. At AGM's current financial strength ratings, if the conditions giving rise to the obligation of AGM to make a termination payment under the swap termination policies were all satisfied, then AGM could pay claims in an amount not exceeding approximately $104 million in respect of such termination payments. Taking into

Table of Contents

consideration whether the rating of the municipal obligor is below any applicable specified trigger, if the financial strength ratings of AGM were further downgraded below "A" by S&P or below "A2" by Moody's, and the conditions giving rise to the obligation of AGM to make a payment under the swap policies were all satisfied, then AGM could pay claims in an additional amount not exceeding approximately $290 million in respect of such termination payments.

As another example, with respect to variable rate demand obligations ("VRDOs") for which a bank has agreed to provide a liquidity facility, a downgrade of AGM or AGC may provide the bank with the right to give notice to bondholders that the bank will terminate the liquidity facility, causing the bondholders to tender their bonds to the bank. Bonds held by the bank accrue interest at a “bank bond rate” that is higher than the rate otherwise borne by the bond (typically the prime rate plus 2.00% — 3.00%, and capped at the lesser of 25% and the maximum legal limit). In the event the bank holds such bonds for longer than a specified period of time, usually 90-180 days, the bank has the right to demand accelerated repayment of bond principal, usually through payment of equal installments over a period of not less than five years. In the event that a municipal obligor is unable to pay interest accruing at the bank bond rate or to pay principal during the shortened amortization period, a claim could be submitted to AGM or AGC under its financial guaranty policy. As of March 31, 2014, AGM and AGC had insured approximately $7.0 billion net par of VRDOs, of which approximately $0.4 billion of net par constituted VRDOs issued by municipal obligors rated BBB- or lower pursuant to the Company’s internal rating. The specific terms relating to the rating levels that trigger the bank’s termination right, and whether it is triggered by a downgrade by one rating agency or a downgrade by all rating agencies then rating the insurer, vary depending on the transaction.

In addition, AGM may be required to pay claims in respect of AGMH’s former financial products business if Dexia SA and its affiliates, from which the Company had purchased AGMH and its subsidiaries, do not comply with their obligations following a downgrade of the financial strength rating of AGM. Most of the guaranteed investment contracts ("GICs") insured by AGM allow for the withdrawal of GIC funds in the event of a downgrade of AGM, unless the relevant GIC issuer posts collateral or otherwise enhances its credit. Most GICs insured by AGM allow for the termination of the GIC contract and a withdrawal of GIC funds at the option of the GIC holder in the event of a downgrade of AGM below a specified threshold, generally below A- by S&P or A3 by Moody’s, with no right of the GIC issuer to avoid such withdrawal by posting collateral or otherwise enhancing its credit. Each GIC contract stipulates the thresholds below which the GIC issuer must post eligible collateral, along with the types of securities eligible for posting and the collateralization percentage applicable to each security type. These collateralization percentages range from 100% of the GIC balance for cash posted as collateral to, typically, 108% for asset-backed securities. If the entire aggregate accreted GIC balance of approximately $2.6 billion as of March 31, 2014 were terminated, the assets of the GIC issuers (which had an aggregate accreted principal of approximately $3.9 billion and an aggregate market value of approximately $3.7 billion) would be sufficient to fund the withdrawal of the GIC funds.

7. Fair Value Measurement

The Company carries a significant portion of its assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e., exit price). The price represents the price available in the principal market for the asset or liability. If there is no principal market, then the price is based on a hypothetical market that maximizes the value received for an asset or minimizes the amount paid for a liability (i.e., the most advantageous market).

Fair value is based on quoted market prices, where available. If listed prices or quotes are not available, fair value is based on either internally developed models that primarily use, as inputs, market-based or independently sourced market parameters, including but not limited to yield curves, interest rates and debt prices or with the assistance of an independent third-party using a discounted cash flow approach and the third party’s proprietary pricing models. In

addition to market information, models also incorporate transaction details, such as maturity of the instrument and contractual features designed to reduce the Company's credit exposure, such as collateral rights as applicable.

Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, the Company's creditworthiness and constraints on liquidity. As markets and products develop and the pricing for certain products becomes more or less transparent, the Company may refine its methodologies and assumptions. During First Quarter 2014, no changes were made to the Company's valuation models that had or are expected to have, a material impact on the Company's consolidated balance sheets or statements of operations and comprehensive income.

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

Table of Contents

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

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

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

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

Transfers between Levels 1, 2 and 3 are recognized at the end of the period when the transfer occurs. The Company reviews the classification between Levels 1, 2 and 3 quarterly to determine whether a transfer is necessary. During the periods presented, there were no transfers between Level 1, 2 and 3.

Measured and Carried at Fair Value

Fixed-Maturity Securities and Short-term Investments

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

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

Prices determined based on models where at least one significant model assumption or input is unobservable, are considered to be Level 3 in the fair value hierarchy. As of March 31, 2014, the Company used models to price 38 fixed-maturity securities, which was 7.3% or $787 million of the Company's fixed-maturity securities and short-term investments at fair value. Certain Level 3 securities were priced with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach using the third-party's proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); home price depreciation/appreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the bond including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could materially change the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

Table of Contents

Other Invested Assets

Other invested assets include investments carried and measured at fair value on a recurring basis of $88 million, and include primarily short-term investments, fixed-maturity securities classified as trading and investments in two vehicles that invest in the global property catastrophe risk market.

Other Assets

Committed Capital Securities

The fair value of committed capital securities ("CCS"), which is recorded in “other assets” on the consolidated balance sheets, represents the difference between the present value of remaining expected put option premium payments under AGC’s CCS (the “AGC CCS”) and AGM’s Committed Preferred Trust Securities (the “AGM CPS”) agreements, and the estimated present value that the Company would hypothetically have to pay currently for a comparable security (see Note 15, Long Term Debt and Credit Facilities). The AGC CCS and AGM CPS are carried at fair value with changes in fair value recorded on the consolidated statement of operations. The estimated current cost of the Company’s CCS is based on several factors, including broker-dealer quotes for the outstanding securities, the U.S. dollar forward swap curve, London Interbank Offered Rate ("LIBOR") curve projections and the term the securities are estimated to remain outstanding.

Supplemental Executive Retirement Plans

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

Financial Guaranty Contracts Accounted for as Credit Derivatives

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

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

Due to the lack of quoted prices and other observable inputs for its instruments or for similar instruments, the Company determines the fair value of its credit derivative contracts primarily through internally developed, proprietary models that use both observable and unobservable market data inputs to derive an estimate of the fair value of the Company's contracts in its principal markets (see "Assumptions and Inputs"). There is no established

market where financial guaranty insured credit derivatives are actively traded, therefore, management has determined that the exit market for the Company's credit derivatives is a hypothetical one based on its entry market. Management has tracked the historical pricing of the Company's deals to establish historical price points in the hypothetical market that are used in the fair value calculation. These contracts are classified as Level 3 in the fair value hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation model, most importantly the Company's estimate of the value of the non-standard terms and conditions of its credit derivative contracts and of the Company's current credit standing.

The Company's models and the related assumptions are continuously reevaluated by management and enhanced, as appropriate, based upon improvements in modeling techniques and availability of more timely and relevant market information.

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining premiums the Company expects to receive or pay and the estimated present value of premiums that a financial guarantor of comparable credit-worthiness would hypothetically charge or pay for the same protection. The fair value of the Company's credit derivatives depends on a number of factors, including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of referenced entities, the Company's own credit risk and remaining

Table of Contents

contractual cash flows. The expected remaining contractual premium cash flows are the most readily observable inputs since they are based on the CDS contractual terms. Credit spreads capture the effect of recovery rates and performance of underlying assets of these contracts, among other factors. Consistent with previous years, market conditions at March 31, 2014 were such that market prices of the Company's CDS contracts were not available.

Management considers factors such as current prices charged for similar agreements, when available, performance of underlying assets, life of the instrument, and the nature and extent of activity in the financial guaranty credit derivative marketplace. The assumptions that management uses to determine the fair value may change in the future due to market conditions. Due to the inherent uncertainties of the assumptions used in the valuation models, actual experience may differ from the estimates reflected in the Company's consolidated financial statements and the differences may be material.

Assumptions and Inputs

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

· Gross spread.

· The allocation of gross spread among:

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

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

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

· The weighted average life which is based on Debt Service schedules.

The rates used to discount future expected premium cash flows ranged from 0.20% to 3.53% at March 31, 2014 and 0.21% to 3.88% at December 31, 2013.

The Company obtains gross spreads on its outstanding contracts from market data sources published by third parties (e.g., dealer spread tables for the collateral similar to assets within the Company's transactions), as well as collateral-specific spreads provided by trustees or obtained from market sources. If observable market credit spreads are not available or reliable for the underlying reference obligations, then market indices are used that most closely resemble the underlying reference obligations, considering asset class, credit quality rating and maturity of the underlying reference obligations. These indices are adjusted to reflect the non-standard terms of the Company's CDS contracts. Market sources determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. Management validates these quotes by cross-referencing quotes received from one market source against quotes received from another market source to ensure reasonableness. In addition, the Company compares the relative change in price quotes received from one quarter to another, with the relative change experienced by published market indices for a specific asset class. Collateral specific spreads obtained from third-party, independent market sources are un-published spread quotes from market participants or market traders who are not trustees. Management obtains this information as the result of direct communication with these sources as part of the valuation process.

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

Table of Contents

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

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

Information by Credit Spread Type (1)

	As of March 31, 2014		As of December 31, 2013	
Based on actual collateral specific spreads	6	%	6	%
Based on market indices	88	%	88	%
Provided by the CDS counterparty	6	%	6	%
Total	100	%	100	%

(1) Based on par.

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

The Company interpolates a curve based on the historical relationship between the premium the Company receives when a credit derivative is closed to the daily closing price of the market index related to the specific asset class and rating of the deal. This curve indicates expected credit spreads at each indicative level on the related market index. For transactions with unique terms or characteristics where no price quotes are available, management extrapolates credit spreads based on a similar transaction for which the Company has received a spread quote from one of the first three sources within the Company's spread hierarchy. This alternative transaction will be within the same asset class, have similar underlying assets, similar credit ratings, and similar time to maturity. The Company then calculates the percentage of relative spread change quarter over quarter for the alternative transaction. This percentage change is then applied to the historical credit spread of the transaction for which no price quote was received in order to calculate the transactions' current spread. Counterparties determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. These quotes are validated by cross-referencing quotes received from one market source with those quotes received from another market source to ensure reasonableness.

The premium the Company receives is referred to as the “net spread.” The Company’s pricing model takes into account not only how credit spreads on risks that it assumes affect pricing, but also how the Company’s own credit spread affects the pricing of its deals. The Company’s own credit risk is factored into the determination of net spread based on the impact of changes in the quoted market price for credit protection bought on the Company, as reflected by quoted market prices on CDS referencing AGC or AGM. For credit spreads on the Company’s name the Company obtains the quoted price of CDS contracts traded on AGC and AGM from market data sources published by third parties. The cost to acquire CDS protection referencing AGC or AGM affects the amount of spread on CDS deals that the Company retains and, hence, their fair value. As the cost to acquire CDS protection referencing AGC or AGM increases, the amount of premium the Company retains on a deal generally decreases. As the cost to acquire CDS protection referencing AGC or AGM decreases, the amount of premium the Company retains on a deal generally increases. In the Company’s valuation model, the premium the Company captures is not permitted to go below the minimum rate that the Company would currently charge to assume similar risks. This assumption can have the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts. Given the current market conditions and the Company’s own credit spreads, approximately 24% and 61%, based on number of deals, of the Company's CDS contracts are fair valued using this minimum premium as of March 31, 2014 and December 31, 2013,

Table of Contents

respectively. The change period over period is driven by AGM's and AGC's credit spreads narrowing as a result of the recent S&P upgrades. As a result of this, the cost to hedge AGC's and AGM's name has declined significantly causing more transactions to price above previously established floor levels. The Company corroborates the assumptions in its fair value model, including the portion of exposure to AGC and AGM hedged by its counterparties, with independent third parties each reporting period. The current level of AGC's and AGM's own credit spread has resulted in the bank or deal originator hedging a significant portion of its exposure to AGC and AGM. This reduces the amount of contractual cash flows AGC and AGM can capture as premium for selling its protection.

The amount of premium a financial guaranty insurance market participant can demand is inversely related to the cost of credit protection on the insurance company as measured by market credit spreads assuming all other assumptions remain constant. This is because the buyers of credit protection typically hedge a portion of their risk to the financial guarantor, due to the fact that the contractual terms of the Company's contracts typically do not require the posting of collateral by the guarantor. The extent of the hedge depends on the types of instruments insured and the current market conditions.

A fair value resulting in a credit derivative asset on protection sold is the result of contractual cash inflows on in-force deals in excess of what a hypothetical financial guarantor could receive if it sold protection on the same risk as of the reporting date. If the Company were able to freely exchange these contracts (i.e., assuming its contracts did not contain proscriptions on transfer and there was a viable exchange market), it would be able to realize a gain representing the difference between the higher contractual premiums to which it is entitled and the current market premiums for a similar contract. The Company determines the fair value of its CDS contracts by applying the difference between the current net spread and the contractual net spread for the remaining duration of each contract to the notional value of its CDS contracts.

Example

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

	Scenario 1			Scenario 2		
	bps	% of Total		bps	% of Total	
Original gross spread/cash bond price (in bps)	185			500		
Bank profit (in bps)	115	62	%	50	10	%
Hedge cost (in bps)	30	16	%	440	88	%
The premium the Company receives per annum (in bps)	40	22	%	10	2	%

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

In Scenario 2, the gross spread is 500 basis points. The bank or deal originator captures 50 basis points of the original gross spread and hedges 25% of its exposure to AGC, when the CDS spread on AGC was 1,760 basis points (1,760 basis points × 25% = 440 basis points). Under this scenario the Company would receive premium of 10 basis points, or 2% of the gross spread. Due to the increased cost to hedge AGC's name, the amount of profit the bank would expect to receive, and the premium the Company would expect to receive decline significantly.

In this example, the contractual cash flows (the Company premium received per annum above) exceed the amount a market participant would require the Company to pay in today's market to accept its obligations under the CDS contract, thus resulting in an asset. This credit derivative asset is equal to the difference in premium rates discounted at the corresponding LIBOR over the weighted average remaining life of the contract multiplied by the par outstanding at a given point in time.

Strengths and Weaknesses of Model

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

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

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

Table of Contents

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

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

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

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

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

- At March 31, 2014 and December 31, 2013, the markets for the inputs to the model were highly illiquid, which impacts their reliability.

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

These contracts were classified as Level 3 in the fair value hierarchy because there is a reliance on at least one unobservable input deemed significant to the valuation model, most significantly the Company's estimate of the value of non-standard terms and conditions of its credit derivative contracts and amount of protection purchased on AGC or AGM's name.

Fair Value Option on FG VIEs' Assets and Liabilities

The Company elected the fair value option for all the FG VIEs' assets and liabilities. See Note 9, Consolidated Variable Interest Entities.

The FG VIEs that are consolidated by the Company issued securities collateralized by first lien and second lien RMBS as well as loans and receivables. The lowest level input that is significant to the fair value measurement of these assets and liabilities was a Level 3 input (i.e. unobservable), therefore management classified them as Level 3 in the fair value hierarchy. Prices are generally determined with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach and the third-party's proprietary pricing models. The models to price the FG VIEs' liabilities used, where appropriate, inputs such as estimated prepayment speeds; market values of the assets that collateralize the securities; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); yields implied by market prices for similar securities; house price depreciation/appreciation rates based on macroeconomic forecasts and, for those liabilities insured by the Company, the benefit from the Company's insurance policy guaranteeing the timely payment of principal and interest for the FG VIE tranches insured by the Company, taking into account the timing of the potential default and the Company's own credit rating. The third-party also utilizes an internal model to determine an appropriate yield at which to discount the cash flows of the security, by factoring in collateral types, weighted-average lives, and other structural attributes specific to the security being priced. The expected yield is further calibrated by utilizing algorithms designed to aggregate market color, received by the third-party, on comparable bonds.

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

The fair value of the Company's FG VIE liabilities is also generally sensitive to changes relating to estimated prepayment speeds; market values of the underlying assets; estimated default rates (determined on the basis of an analysis of collateral attributes such as: historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; and house price depreciation/

Table of Contents

appreciation rates based on macroeconomic forecasts. In addition, the Company's FG VIE liabilities with recourse are also sensitive to changes in the Company's implied credit worthiness. Significant changes to any of these inputs could materially change the timing of expected losses within the insured transaction which is a significant factor in determining the implied benefit from the Company's insurance policy guaranteeing the timely payment of principal and interest for the tranches of debt issued by the FG VIE that is insured by the Company. In general, extending the timing of expected loss payments by the Company into the future typically leads to a decrease in the value of the Company's insurance and a decrease in the fair value of the Company's FG VIE liabilities with recourse, while a shortening of the timing of expected loss payments by the Company typically leads to an increase in the value of the Company's insurance and an increase in the fair value of the Company's FG VIE liabilities with recourse.

Not Carried at Fair Value

Financial Guaranty Insurance Contracts

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

Long-Term Debt

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

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

Other Invested Assets

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

Other Assets and Other Liabilities

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

Table of Contents

Financial Instruments Carried at Fair Value

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

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of March 31, 2014

	Fair Value (in millions)	Fair Value Hierarchy Level 1	Level 2	Level 3
Assets:				
Investment portfolio, available-for-sale:				
Fixed-maturity securities				
Obligations of state and political subdivisions	$5,249	$—	$5,211	$38
U.S. government and agencies	701	—	701	—
Corporate securities	1,427	—	1,289	138
Mortgage-backed securities:				
RMBS	1,171	—	812	359
Commercial mortgage-backed securities ("CMBS")	670	—	670	—
Asset-backed securities	554	—	302	252
Foreign government securities	322	—	322	—
Total fixed-maturity securities	10,094	—	9,307	787
Short-term investments	720	438	282	—
Other invested assets (1)	94	—	40	54
Credit derivative assets	78	—	—	78
FG VIEs' assets, at fair value	1,257	—	—	1,257
Other assets	77	29	11	37
Total assets carried at fair value	$12,320	$467	$9,640	$2,213
Liabilities:				
Credit derivative liabilities	$2,001	$—	$—	$2,001
FG VIEs' liabilities with recourse, at fair value	1,346	—	—	1,346
FG VIEs' liabilities without recourse, at fair value	101	—	—	101
Total liabilities carried at fair value	$3,448	$—	$—	$3,448

Table of Contents

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of December 31, 2013

	Fair Value (in millions)	Fair Value Hierarchy Level 1	Level 2	Level 3
Assets:				
Investment portfolio, available-for-sale:				
Fixed-maturity securities				
Obligations of state and political subdivisions	$5,079	$—	$5,043	$36
U.S. government and agencies	700	—	700	—
Corporate securities	1,340	—	1,204	136
Mortgage-backed securities:				
RMBS	1,122	—	832	290
CMBS	549	—	549	—
Asset-backed securities	608	—	340	268
Foreign government securities	313	—	313	—
Total fixed-maturity securities	9,711	—	8,981	730
Short-term investments	904	506	398	—
Other invested assets (1)	127	—	119	8
Credit derivative assets	94	—	—	94
FG VIEs' assets, at fair value	2,565	—	—	2,565
Other assets	84	27	11	46
Total assets carried at fair value	$13,485	$533	$9,509	$3,443
Liabilities:				
Credit derivative liabilities	$1,787	$—	$—	$1,787
FG VIEs' liabilities with recourse, at fair value	1,790	—	—	1,790
FG VIEs' liabilities without recourse, at fair value	1,081	—	—	1,081
Total liabilities carried at fair value	$4,658	$—	$—	$4,658

(1) Includes Level 3 mortgage loans that are recorded at fair value on a non-recurring basis.

Table of Contents

Changes in Level 3 Fair Value Measurements

The table below presents a roll forward of the Company's Level 3 financial instruments carried at fair value on a recurring basis during First Quarter 2014 and 2013.

Fair Value Level 3 Rollforward
Recurring Basis
First Quarter 2014

	Fixed-Maturity Securities									
	Obligations of State and Political Subdivisions	Corporate Securities	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)									
Fair value as of December 31, 2013	$36	$136	$290	$268	$2	$2,565	$46	$(1,693)	$(1,790)	$(1,081)
Total pretax realized and unrealized gains/(losses) recorded in:(1)										
Net income (loss)	1 (2)	3 (2)	4 (2)	7 (2)	—	82 (3)	(9) (4)	(211) (6)	(72) (3)	(9) (3)
Other comprehensive income (loss)	1	4	14	8	1	—	—	—	—	—
Purchases	—	—	53	—	45 (8)	—	—	—	—	—
Settlements	—	(5)	(15)	(31)	0	(286)	—	(19)	269	12
FG VIE consolidations	—	—	—	—	—	—	—	—	—	—
FG VIE deconsolidations	—	—	13	—	—	(1,104)	—	—	247	977
Fair value as of March 31, 2014	$38	$138	$359	$252	$48	$1,257	$37	$(1,923)	$(1,346)	$(101)
Change in unrealized gains/(losses) related to financial instruments held as of March 31, 2014	$1	$4	$15	$7	$1	$25	$(9)	$(232)	$(28)	$(10)

52

Table of Contents

Fair Value Level 3 Rollforward
Recurring Basis
First Quarter 2013

	Fixed-Maturity Securities								
	Obligations of State and Political Subdivisions	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)								
Fair value as of December 31, 2012	$35	$219	$306	$1	$2,688	$36	$(1,793)	$(2,090)	$(1,051)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	1 (2)	5 (2)	4 (2)	0 (7)	215 (3)	(10) (4)	(592) (6)	(81) (3)	(74) (3)
Other comprehensive income (loss)	0	7	(22)	0	—	—	—	—	—
Purchases	—	3	—	—	—	—	—	—	—
Settlements	(1)	(11)	(2)	—	(138)	—	(8)	112	55
FG VIE consolidations	—	(2)	—	—	48	—	—	(12)	(37)
Fair value as of March 31, 2013	$35	$221	$286	$1	$2,813	$26	$(2,393)	$(2,071)	$(1,107)
Change in unrealized gains/(losses) related to financial instruments held as of March 31, 2013	$0	$9	$(22)	$0	$199	$(10)	$(611)	$(83)	$(94)

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

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

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

(4) Recorded in fair value gains (losses) on CCS.

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

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

(7) Reported in other income.

(8) Non cash transaction.

Table of Contents

Level 3 Fair Value Disclosures

Quantitative Information About Level 3 Fair Value Inputs
At March 31, 2014

Financial Instrument Description	Fair Value at March 31, 2014 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Assets:				
Fixed-maturity securities:				
Obligations of state and political subdivisions	$38	Discounted cash flow	Rate of inflation	1.0% - 3.0%
			Cash flow receipts	0.5% - 62.3%
			Yield	4.6% - 9.0%
			Collateral recovery period	4 months - 34 years
Corporate	138	Discounted cash flow	Yield	8.0%
RMBS	359	Discounted cash flow	CPR	0.3% - 15.8%
			CDR	4.1% - 25.8%
			Severity	48.1% - 101.8%
			Yield	2.6% - 8.7%
Asset-backed securities:				
Investor owned utility	119	Discounted cash flow	Liquidation value (in millions)	$177 - $274
			Years to liquidation	0 years - 3 years
			Collateral recovery period	9 months - 5 years
			Discount factor	7.0%
XXX life insurance transactions	133	Discounted cash flow	Yield	12.5%
Other invested assets	54	Discounted cash flow	Discount for lack of liquidity	10.0% - 20.0%
			Recovery on delinquent loans	20.0% - 60.0%
			Default rates	0.0% - 10.0%
			Loss severity	40.0% - 90.0%
			Prepayment speeds	6.0% - 15.0%
			Net asset value (per share)	$1,010 $1,020
FG VIEs' assets, at fair value	1,257	Discounted cash flow	CPR	0.3% - 11.8%
			CDR	3.0% - 25.8%
			Loss severity	38.1% - 102.0%
			Yield	3.5% - 12.0%

Table of Contents

Financial Instrument Description	Fair Value at March 31, 2014 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Other assets	37	Discounted cash flow	Quotes from third party pricing Term (years)	$53 - $57 5 years
Liabilities:				
Credit derivative liabilities, net	(1,923)	Discounted cash flow	Year 1 loss estimates Hedge cost (in bps) Bank profit (in bps) Internal floor (in bps) Internal credit rating	0.0% - 48.0% 13.8 - 305.0 1.0 - 1,435.5 7.0 - 100.0 AAA - CCC
FG VIEs' liabilities, at fair value	(1,447)	Discounted cash flow	CPR CDR Loss severity Yield	0.3% - 11.8% 3.0% - 25.8% 38.1% - 102.0% 3.5% - 12.0%

Table of Contents

Quantitative Information About Level 3 Fair Value Inputs
At December 31, 2013

Financial Instrument Description	Fair Value at December 31, 2013 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Assets:				
Fixed-maturity securities:				
Obligations of state and political subdivisions	$36	Discounted cash flow	Rate of inflation	1.0% - 3.0%
			Cash flow receipts	0.5% - 60.9%
			Discount rates	4.6% 9.0%
			Collateral recovery period	1 month - 10 years
Corporate securities	136	Discounted cash flow	Yield	8.3%
RMBS	290	Discounted cash flow	CPR	1.0% - 15.8%
			CDR	5.0% - 25.8%
			Severity	48.1% - 102.5%
			Yield	2.5% - 9.4%
Asset-backed securities:				
Investor owned utility	141	Discounted cash flow	Liquidation value (in millions)	$195 - $245
			Years to liquidation	0 years - 3 years
			Collateral recovery period	12 months 6 years
			Discount factor	15.3%
XXX life insurance transactions	127	Discounted cash flow	Yield	12.5%
Other invested assets	8	Discounted cash flow	Discount for lack of liquidity	10.0% - 20.0%
			Recovery on delinquent loans	20.0% - 60.0%
			Default rates	1.0% - 10.0%
			Loss severity	40.0% - 90.0%
			Prepayment speeds	6.0% - 15.0%
FG VIEs' assets, at fair value	2,565	Discounted cash flow	CPR	0.3% - 11.8%
			CDR	3.0% - 25.8%
			Loss severity	37.5% - 102.0%
			Yield	3.5% - 10.2%

Table of Contents

Financial Instrument Description	Fair Value at December 31, 2013 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Other assets	46	Discounted cash flow	Quotes from third party pricing Term (years)	$47 - $53 5 years
Liabilities:				
Credit derivative liabilities, net	(1,693)	Discounted cash flow	Year 1 loss estimates Hedge cost (in bps) Bank profit (in bps) Internal floor (in bps) Internal credit rating	0.0% - 48.0% 46.3 - 525.0 1.0 - 1,418.5 7.0 - 100.0 AAA - BIG
FG VIEs' liabilities, at fair value	(2,871)	Discounted cash flow	CPR CDR Loss severity Yield	0.3% - 11.8% 3.0% - 25.8% 37.5% - 102.0% 3.5% - 10.2%

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

Fair Value of Financial Instruments

	As of March 31, 2014		As of December 31, 2013	
	Carrying Amount (in millions)	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Fixed-maturity securities	$10,094	$10,094	$9,711	$9,711
Short-term investments	720	720	904	904
Other invested assets	113	116	147	155
Credit derivative assets	78	78	94	94
FG VIEs' assets, at fair value	1,257	1,257	2,565	2,565
Other assets	181	181	179	179
Liabilities:				
Financial guaranty insurance contracts(1)	3,693	5,644	3,783	5,128
Long-term debt	812	1,050	816	970
Credit derivative liabilities	2,001	2,001	1,787	1,787
FG VIEs' liabilities with recourse, at fair value	1,346	1,346	1,790	1,790
FG VIEs' liabilities without recourse, at fair value	101	101	1,081	1,081
Other liabilities	62	62	36	36

(1) Carrying amount includes the assets and liabilities related to financial guaranty insurance contract premiums, losses, and salvage and subrogation and other recoverables net of reinsurance.

8. Financial Guaranty Contracts Accounted for as Credit Derivatives

Credit Derivatives

The Company has a portfolio of financial guaranty contracts that meet the definition of a derivative in accordance with GAAP (primarily CDS).

Credit derivative transactions are governed by ISDA documentation and have different characteristics from financial guaranty insurance contracts. For example, the Company's control rights with respect to a reference obligation under a credit

Table of Contents

derivative may be more limited than when the Company issues a financial guaranty insurance contract. In addition, there are more circumstances under which the Company may be obligated to make payments. Similar to a financial guaranty insurance contract, the Company would be obligated to pay if the obligor failed to make a scheduled payment of principal or interest in full. However, the Company may also be required to pay if the obligor became bankrupt or if the reference obligation were restructured if, after negotiation, those credit events are specified in the documentation for the credit derivative transactions. Furthermore, the Company may be required to make a payment due to an event that is unrelated to the performance of the obligation referenced in the credit derivative. If events of default or termination events specified in the credit derivative documentation were to occur, the non-defaulting or the non-affected party, which may be either the Company or the counterparty, depending upon the circumstances, may decide to terminate a credit derivative prior to maturity. In that case, the Company may be required to make a termination payment to its swap counterparty upon such termination. The Company may not unilaterally terminate a CDS contract; however, the Company on occasion has mutually agreed with various counterparties to terminate certain CDS transactions.

Credit Derivative Net Par Outstanding by Sector

The estimated remaining weighted average life of credit derivatives was 4.0 years at March 31, 2014 and 4.1 years at December 31, 2013. The components of the Company's credit derivative net par outstanding are presented below.

Credit Derivatives
Subordination and Ratings

Asset Type	As of March 31, 2014				As of December 31, 2013			
	Net Par Outstanding	Original Subordination(a)	Current Subordination(b)	Weighted Average Credit Rating(c)	Net Par Outstanding	Original Subordination(a)	Current Subordination(b)	Weighted Average Credit Rating(c)
	(dollars in millions)							
Pooled corporate obligations:								
Collateralized loan obligation/collateral bond obligations	$17,634	32.4%	36.1%	AAA	$19,323	32.4%	34.0%	AAA
Synthetic investment grade pooled corporate	9,759	21.6	20.3	AAA	9,754	21.6	20.0	AAA
Synthetic high yield pooled corporate	2,690	47.2	41.3	AAA	2,690	47.2	41.1	AAA
TruPS CDOs	3,436	45.4	33.7	BB	3,554	45.5	32.9	BB+
Market value CDOs of corporate obligations	1,807	23.6	30.6	AAA	2,000	24.4	30.5	AAA
Total pooled corporate obligations	35,326	31.4	31.6	AAA	37,321	31.5	30.6	AAA
U.S. RMBS:								
Option ARM and Alt-A first lien	2,520	19.1	7.6	BB-	2,609	19.2	8.6	BB-
Subprime first lien	2,837	30.6	51.3	AA-	2,930	30.5	51.9	AA-
Prime first lien	258	10.9	1.8	CCC	264	10.9	3.2	CCC
Closed-end second lien and HELOCs	22	—	—	B-	23	—	—	B+

Total U.S. RMBS	5,637	24.4	29.2	BBB	5,826	24.4	30.1	BBB
CMBS	2,822	33.5	42.5	AAA	3,744	33.5	42.5	AAA
Other	7,533	—	—	A-	7,591	—	—	A-
Total	$51,318			AA+	$54,482			AA+

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

Except for TruPS CDOs, the Company's exposure to pooled corporate obligations is highly diversified in terms of obligors and industries. Most pooled corporate transactions are structured to limit exposure to any given obligor and industry. The majority of the Company's pooled corporate exposure consists of collateralized loan obligation ("CLO") or synthetic

Table of Contents

pooled corporate obligations. Most of these CLOs have an average obligor size of less than 1% of the total transaction and typically restrict the maximum exposure to any one industry to approximately 10%. The Company's exposure also benefits from embedded credit enhancement in the transactions which allows a transaction to sustain a certain level of losses in the underlying collateral, further insulating the Company from industry specific concentrations of credit risk on these deals.

The Company's TruPS CDO asset pools are generally less diversified by obligors and industries than the typical CLO asset pool. Also, the underlying collateral in TruPS CDOs consists primarily of subordinated debt instruments such as TruPS issued by bank holding companies and similar instruments issued by insurance companies, REITs and other real estate related issuers while CLOs typically contain primarily senior secured obligations. However, to mitigate these risks TruPS CDOs were typically structured with higher levels of embedded credit enhancement than typical CLOs.

The Company's exposure to "Other" CDS contracts is also highly diversified. It includes $2.5 billion of exposure to two pooled infrastructure transactions comprising diversified pools of international infrastructure project transactions and loans to regulated utilities. These pools were all structured with underlying credit enhancement sufficient for the Company to attach at AAA levels at origination. The remaining $5.0 billion of exposure in "Other" CDS contracts comprises numerous deals across various asset classes, such as commercial receivables, international RMBS, infrastructure, regulated utilities and consumer receivables. Of the total net par outstanding in the "Other" sector, $0.5 billion is rated BIG.

Distribution of Credit Derivative Net Par Outstanding by Internal Rating

Ratings	As of March 31, 2014 Net Par Outstanding (dollars in millions)	% of Total		As of December 31, 2013 Net Par Outstanding	% of Total	
AAA	$35,157	68.5	%	$38,244	70.2	%
AA	3,660	7.1		3,648	6.7	
A	3,621	7.1		3,636	6.7	
BBB	4,304	8.4		4,161	7.6	
BIG	4,576	8.9		4,793	8.8	
Credit derivative net par outstanding	$51,318	100.0	%	$54,482	100.0	%

Fair Value of Credit Derivatives

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

	First Quarter 2014 (in millions)	2013
Realized gains on credit derivatives (1)	$20	$28
Net credit derivative losses (paid and payable) recovered and recoverable	(1)	(10)
Realized gains (losses) and other settlements on credit derivatives	19	18
Net change in unrealized gains (losses) on credit derivatives (2)	(230)	(610)
Net change in fair value of credit derivatives	$(211)	$(592)

(1)

Includes accelerations due to terminations of CDS contracts of $0.2 million and $1 million related to net par of $1.1 billion and $1.1 billion for First Quarter 2014 and First Quarter 2013, respectively.

(2) Except for net estimated credit impairments (i.e., net expected loss to be paid as discussed in Note 5), the unrealized gains and losses on credit derivatives are expected to reduce to zero as the exposure approaches its maturity date. With considerable volatility continuing in the market, unrealized gains (losses) on credit derivatives may fluctuate significantly in future periods.

Table of Contents

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

Asset Type	First Quarter 2014	2013
	(in millions)	
Pooled corporate obligations	$(58)	$(105)
U.S. RMBS	(140)	(457)
CMBS	0	(3)
Other	(32)	(45)
Total (1)	$(230)	$(610)

(1) "Other" includes all other U.S. and international asset classes, such as commercial receivables, international infrastructure, international RMBS securities, and pooled infrastructure securities.

During First Quarter 2014, unrealized fair value losses were generated primarily in the U.S. RMBS prime first lien, Alt-A, Option ARM and subprime sectors, as well as pooled corporate obligations, due to wider implied net spreads. The wider implied net spreads were primarily a result of the decreased cost to buy protection in AGC's name as the market cost of AGC's credit protection decreased significantly during the period. These transactions were pricing at or above their floor levels (or the minimum rate at which the Company would consider assuming these risks based on historical experience); therefore when the cost of purchasing CDS protection on AGC, which management refers to as the CDS spread on AGC, decreased, the implied spreads that the Company would expect to receive on these transactions increased. The cost of AGM's credit protection also decreased during First Quarter 2014 generating unrealized fair value losses on a XXX life insurance securitization transaction, due to wider implied net spreads. This did not have a significant impact on the remainder of AGM's portfolio, as a significant portion of AGM's policies continue to price at floor levels.

During First Quarter 2013, unrealized fair value losses were generated primarily in the U.S. RMBS sectors, as well as pooled corporate obligations, due to wider implied net spreads. The wider implied net spreads were primarily a result of the decreased cost to buy protection in AGC's name as the market cost of AGC's credit protection decreased significantly during the period. These transactions were pricing at or above their floor levels. To calculate the fair value of the CDS contracts, the Company matches the tenor of the CDS contracts in the Company's portfolio to the tenor of the CDS spread purchased in AGC's name. The cost of AGM's 5 Year and 1 Year credit protection also decreased during First Quarter 2013, but did not lead to significant fair value losses, as a significant portion of AGM policies continue to price at floor levels. First Quarter 2013 changes in fair value of credit derivatives in the Other category included a $20 million loss for guaranteed interest rate swaps identified during the quarter.

The impact of changes in credit spreads will vary based upon the volume, tenor, interest rates, and other market conditions at the time these fair values are determined. In addition, since each transaction has unique collateral and structural terms, the underlying change in fair value of each transaction may vary considerably. The fair value of credit derivative contracts also reflects the change in the Company's own credit cost based on the price to purchase credit protection on AGC and AGM. The Company determines its own credit risk based on quoted CDS prices traded on the Company at each balance sheet date.

Five-Year CDS Spread
on AGC and AGM
Quoted price of CDS contract (in basis points)

	As of March 31, 2014	As of December 31, 2013	As of March 31, 2013	As of December 31, 2012
AGC	291	460	397	678
AGM	305	525	380	536

Table of Contents

One-Year CDS Spread
on AGC and AGM
Quoted price of CDS contract (in basis points)

	As of March 31, 2014	As of December 31, 2013	As of March 31, 2013	As of December 31, 2012
AGC	55	185	59	270
AGM	70	220	60	257

Fair Value of Credit Derivatives
and Effect of AGC and AGM
Credit Spreads

	As of March 31, 2014	As of December 31, 2013
	(in millions)	
Fair value of credit derivatives before effect of AGC and AGM credit spreads	$(3,095)	$(3,442)
Plus: Effect of AGC and AGM credit spreads	1,172	1,749
Net fair value of credit derivatives	$(1,923)	$(1,693)

The fair value of CDS contracts at March 31, 2014, before considering the implications of AGC's and AGM's credit spreads, is a direct result of continued wide credit spreads in the fixed income security markets and ratings downgrades. The asset classes that remain most affected are 2005-2007 vintages of prime first lien, Alt-A, Option ARM, subprime RMBS deals as well as trust-preferred and pooled corporate securities. Comparing March 31, 2014 with December 31, 2013, there was a narrowing of spreads primarily related to Alt-A first lien, Option ARM, and subprime RMBS transactions, as well as the Company's pooled corporate obligations. This narrowing of spreads combined with the runoff of par outstanding and termination of securities, resulted in a gain of approximately $347 million, before taking into account AGC's or AGM's credit spreads.

Management believes that the trading level of AGC's and AGM's credit spreads over the past several years has been due to the correlation between AGC's and AGM's risk profile and the current risk profile of the broader financial markets and to increased demand for credit protection against AGC and AGM as the result of its financial guaranty volume, as well as the overall lack of liquidity in the CDS market. Offsetting the benefit attributable to AGC's and AGM's credit spread were higher credit spreads in the fixed income security markets. The higher credit spreads in the fixed income security market are due to the lack of liquidity in the high yield CDO, TruPS CDO, and CLO markets as well as continuing market concerns over the 2005-2007 vintages of RMBS.

Table of Contents

The following table presents the fair value and the present value of expected claim payments or recoveries (i.e. net expected loss to be paid as described in Note 5) for contracts accounted for as derivatives.

Net Fair Value and Expected Losses In Excess of Premiums
of Credit Derivatives by Sector

	Fair Value of Credit Derivative Asset (Liability), net		Present Value of Expected Claim (Payments) Recoveries In Excess of Premiums (1)	
Asset Type	As of March 31, 2014	As of December 31, 2013	As of March 31, 2014	As of December 31, 2013
	(in millions)			
Pooled corporate obligations	$(89)	$(30)	$(20)	$(35)
U.S. RMBS	(1,448)	(1,308)	(154)	(147)
CMBS	(2)	(2)	—	—
Other	(384)	(353)	40	43
Total	$(1,923)	$(1,693)	$(134)	$(139)

(1) Represents the expected claim payments (recoveries) in excess of the present value of future installment fees to be received of $39 million as of March 31, 2014 and $45 million as of December 31, 2013. Includes R&W benefit of $175 million as of March 31, 2014 and $180 million as of December 31, 2013.

Ratings Sensitivities of Credit Derivative Contracts

Within the Company’s insured CDS portfolio, the transaction documentation for approximately $1.6 billion in CDS gross par insured as of March 31, 2014 provides that a downgrade of AGC's financial strength rating below BBB- or Baa3 would constitute a termination event that would allow the relevant CDS counterparty to terminate the affected transactions. As of December 31, 2013 such amount was $1.7 billion. If the CDS counterparty elected to terminate the affected transactions, AGC could be required to make a termination payment (or may be entitled to receive a termination payment from the CDS counterparty). The Company does not believe that it can accurately estimate the termination payments AGC could be required to make if, as a result of any such downgrade, a CDS counterparty terminated the affected transactions. These payments could have a material adverse effect on the Company’s liquidity and financial condition.

The transaction documentation for approximately $9.8 billion in CDS gross par insured as of March 31, 2014 requires AGC and Assured Guaranty Re Overseas Ltd. ("AGRO") to post eligible collateral to secure its obligations to make payments under such contracts. Eligible collateral is generally cash or U.S. government or agency securities; eligible collateral other than cash is valued at a discount to the face amount. For approximately $9.5 billion of such contracts, AGC has negotiated caps such that the posting requirement cannot exceed a certain fixed amount, regardless of the mark-to-market valuation of the exposure or the financial strength ratings of AGC. For such contracts, AGC need not post on a cash basis more than $665 million, although the value of the collateral posted may exceed such fixed amount depending on the advance rate agreed with the counterparty for the particular type of collateral posted. For the remaining approximately $341 million of such contracts, AGC or AGRO could be required from time to time to post additional collateral without such cap based on movements in the mark-to-market valuation of the underlying exposure. As of March 31, 2014, the Company was posting approximately $669 million to secure obligations under its CDS exposure, of which approximately $54 million related to such $341 million of notional. As of December 31, 2013, the Company was posting approximately $677 million, of which approximately $62 million related to $347 million of notional where AGC or AGRO could be required to post additional collateral based on movements in the

mark-to-market valuation of the underlying exposure.

Table of Contents

Sensitivity to Changes in Credit Spread

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

Effect of Changes in Credit Spread
As of March 31, 2014

Credit Spreads(1)	Estimated Net Fair Value (Pre-Tax) (in millions)	Estimated Change in Gain/(Loss) (Pre-Tax)
100% widening in spreads	$(3,936)	$(2,013)
50% widening in spreads	(2,929)	(1,006)
25% widening in spreads	(2,426)	(503)
10% widening in spreads	(2,124)	(201)
Base Scenario	(1,923)	—
10% narrowing in spreads	(1,737)	186
25% narrowing in spreads	(1,457)	466
50% narrowing in spreads	(991)	932

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

9. Consolidated Variable Interest Entities

The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. AGC and AGM do not sponsor any VIEs when underwriting third party financial guaranty insurance or credit derivative transactions, nor has either of them acted as the servicer or collateral manager for any VIE obligations that it insures. The transaction structure generally provides certain financial protections to the Company. This financial protection can take several forms, the most common of which are overcollateralization, first loss protection (or subordination) and excess spread. In the case of overcollateralization (i.e., the principal amount of the securitized assets exceeds the principal amount of the structured finance obligations guaranteed by the Company), the structure allows defaults of the securitized assets before a default is experienced on the structured finance obligation guaranteed by the Company. In the case of first loss, the financial guaranty insurance policy only covers a senior layer of losses experienced by multiple obligations issued by special purpose entities, including VIEs. The first loss exposure with respect to the assets is either retained by the seller or sold off in the form of equity or mezzanine debt to other investors. In the case of excess spread, the financial assets contributed to special purpose entities, including VIEs, generate cash flows that are in excess of the interest payments on the debt issued by the special purpose entity. Such excess spread is typically distributed through the transaction's cash flow waterfall and may be used to create additional credit enhancement, applied to redeem debt issued by the special purpose entities, including VIEs (thereby, creating additional overcollateralization), or distributed to equity or other investors in the transaction.

AGC and AGM are not primarily liable for the debt obligations issued by the VIEs they insure and would only be required to make payments on these insured debt obligations in the event that the issuer of such debt obligations defaults on any principal or interest due. AGL's and its Subsidiaries' creditors do not have any rights with regard to the collateral supporting the debt issued by the FG VIEs. Proceeds from sales, maturities, prepayments and interest from such underlying collateral may only be used to pay Debt Service on VIE liabilities. Net fair value gains and losses on

FG VIEs are expected to reverse to zero at maturity of the VIE debt, except for net premiums received and net claims paid by AGC or AGM under the financial guaranty insurance contract. The Company’s estimate of expected loss to be paid for FG VIEs is included in Note 5, Expected Loss to be Paid.

As part of the terms of its financial guaranty contracts, the Company obtains certain protective rights with respect to the VIE that are triggered by the occurrence of certain events, such as failure to be in compliance with a covenant due to poor deal performance or a deterioration in a servicer or collateral manager's financial condition. At deal inception, the Company typically is not deemed to control a VIE; however, once a trigger event occurs, the Company's control of the VIE typically increases. The Company continuously evaluates its power to direct the activities that most significantly impact the economic performance of VIEs that have debt obligations insured by the Company and, accordingly, where the Company is obligated to

Table of Contents

absorb VIE losses or receive benefits that could potentially be significant to the VIE. The Company obtains protective rights under its insurance contracts that give the Company additional controls over a VIE if there is either deterioration of deal performance or in the financial health of the deal servicer. The Company is deemed to be the control party for certain VIEs under GAAP, typically when its protective rights give it the power to both terminate and replace the deal servicer, which are characteristics specific to the Company's financial guaranty contracts. If the protective rights that could make the Company the control party have not been triggered, then the VIE is not consolidated. If the Company is deemed no longer to have those protective rights, the transaction is deconsolidated. As of March 31, 2014 and December 31, 2013, the Company had issued financial guaranty contracts for approximately 950 and 1,000 VIEs, respectively, that it did not consolidate.

Consolidated FG VIEs

Number of FG VIE's Consolidated

	As of March 31, 2014	As of December 31, 2013
Beginning of the period	40	33
Consolidated (1)	—	11
Deconsolidated (1)	(7)	(3)
Matured	(2)	(1)
End of the period	31	40

(1) Net gain on deconsolidation was $120 million in First Quarter 2014, and a net loss on consolidation and deconsolidation was $7 million in 2013, and recorded in “fair value gains (losses) on FG VIEs” in the consolidated statement of operations.

The total unpaid principal balance for the FG VIEs’ assets that were over 90 days or more past due was approximately $201 million at March 31, 2014 and $750 million at December 31, 2013. The aggregate unpaid principal of the FG VIEs’ assets was approximately $1,159 million greater than the aggregate fair value at March 31, 2014, excluding the effect of R&W settlements. The aggregate unpaid principal of the FG VIEs’ assets was approximately $1,940 million greater than the aggregate fair value at December 31, 2013, excluding the effect of R&W settlements. The change in the instrument-specific credit risk of the FG VIEs’ assets that was recorded in the consolidated statements of operations for First Quarter 2014 and First Quarter 2013 were gains of $58 million and $71 million, respectively.

The unpaid principal for FG VIE liabilities with recourse was $1,783 million and $2,316 million as of March 31, 2014 and December 31, 2013, respectively. FG VIE liabilities with recourse will mature at various dates ranging from 2025 to 2038. The aggregate unpaid principal balance was approximately $954 million greater than the aggregate fair value of the FG VIEs’ liabilities as of March 31, 2014. The aggregate unpaid principal balance was approximately $1,611 million greater than the aggregate fair value of the FG VIEs' liabilities as of December 31, 2013.

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

Table of Contents

Consolidated FG VIEs
By Type of Collateral

	As of March 31, 2014		As of December 31, 2013	
	Assets	Liabilities	Assets	Liabilities
	(in millions)			
With recourse:				
First lien	$505	$599	$630	$791
Second lien	256	387	460	640
Other	360	360	359	359
Total with recourse	1,121	1,346	1,449	1,790
Without recourse	136	101	1,116	1,081
Total	$1,257	$1,447	$2,565	$2,871

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

Effect of Consolidating FG VIEs on Net Income,
Cash Flows From Operating Activities and Shareholders' Equity

	First Quarter	
	2014	2013
	(in millions)	
Net earned premiums	$(17)	$(18)
Net investment income	(3)	(3)
Net realized investment gains (losses)	0	1
Fair value gains (losses) on FG VIEs	157	70
Other income	(2)	—
Loss and LAE	(1)	(7)
Effect on net income before tax provision	134	43
Less: tax provision (benefit)	47	15
Effect on net income (loss)	$87	$28
Effect on cash flows from operating activities	$(8)	$21

	As of March 31, 2014	As of December 31, 2013
	(in millions)	
Effect on shareholders' equity (decrease) increase	$(87)	$(172)

Fair value gains (losses) on FG VIEs represent the net change in fair value on the consolidated FG VIEs' assets and liabilities. During First Quarter 2014, the Company recorded a pre-tax net fair value gain of consolidated FG VIEs of $157 million. The primary driver of this gain, $120 million, was a result of the deconsolidation of seven VIEs. There

was an additional gain of $37 million resulting from the Company exercising its option to accelerate two second lien RMBS VIEs. These two VIEs were treated as maturities during the period.

Table of Contents

For First Quarter 2013, the Company recorded a pre-tax fair value gain on FG VIEs of $70 million. The majority of this gain, approximately $64 million, was the result of a R&W benefit on two Flagstar policies recognized during the quarter. There was also price appreciation across all of the Company's FG VIE assets and liabilities as a result of the overall financial market continuing to improve in First Quarter 2013. The most significant price appreciation occurred in several HELOC transactions where the price appreciation was slightly greater on the FG VIE assets than on the FG VIE liabilities. This was a result of improved performance in the underlying collateral of these securities during the period.

Non-Consolidated VIEs

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

10. Investments and Cash

Net Investment Income and Realized Gains (Losses)

Net investment income is a function of the yield that the Company earns on invested assets and the size of the portfolio. The investment yield is a function of market interest rates at the time of investment as well as the type, credit quality and maturity of the invested assets. Accrued investment income on fixed-maturity securities, short-term investments and assets acquired in refinancing transactions was $95 million and $93 million as of March 31, 2014 and December 31, 2013, respectively.

Net Investment Income

	First Quarter	
	2014	2013
	(in millions)	
Income from fixed-maturity securities managed by third parties	$80	$79
Income from internally managed securities:		
Fixed maturities	20	16
Other invested assets	5	1
Gross investment income	105	96
Investment expenses	(2)	(2)
Net investment income	$103	$94

Net Realized Investment Gains (Losses)

	First Quarter	
	2014	2013
	(in millions)	
Gross realized gains on available-for-sale securities	$4	$6
Gross realized gains on other assets in investment portfolio	5	33
Gross realized losses on available-for-sale securities	(2)	(4)
Gross realized losses on other assets in investment portfolio	0	(2)
Other-than-temporary impairment	(5)	(5)
Net realized investment gains (losses)	$2	$28

66

Table of Contents

The following table presents the roll-forward of the credit losses of fixed-maturity securities for which the Company has recognized an other-than-temporary-impairment and where the portion of the fair value adjustment related to other factors was recognized in other comprehensive income ("OCI").

Roll Forward of Credit Losses
in the Investment Portfolio

	First Quarter	
	2014	2013
	(in millions)	
Balance, beginning of period	$80	$64
Additions for credit losses on securities for which an other-than-temporary-impairment was not previously recognized	1	1
Additions for credit losses on securities for which an other-than-temporary-impairment was previously recognized	4	4
Balance, end of period	$85	$69

Investment Portfolio

Fixed-Maturity Securities and Short-Term Investments
by Security Type
As of March 31, 2014

Investment Category	Percent of Total(1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI(2) Gain (Loss) on Securities with Other-Than-Temporary Impairment	Weighted Average Credit Quality(3)
	(dollars in millions)						
Fixed-maturity securities:							
Obligations of state and political subdivisions	48 %	$4,982	$281	$(14)	$5,249	$ 7	AA
U.S. government and agencies	7	674	32	(5)	701	—	AA+
Corporate securities	13	1,382	55	(10)	1,427	0	A
Mortgage-backed securities(4):	0						
RMBS	11	1,182	44	(55)	1,171	(31)	A
CMBS	6	656	16	(2)	670	—	AAA
Asset-backed securities	5	544	13	(3)	554	3	BBB+
Foreign government securities	3	309	14	(1)	322	—	AA+
Total fixed-maturity securities	93	9,729	455	(90)	10,094	(21)	AA-
Short-term investments	7	720	0	0	720	—	AAA
	100 %	$10,449	$455	$(90)	$10,814	$ (21)	AA-

Total investment
portfolio

Table of Contents

Fixed-Maturity Securities and Short-Term Investments
by Security Type
As of December 31, 2013

Investment Category	Percent of Total(1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI Gain (Loss) on Securities with Other-Than-Temporary Impairment	Weighted Average Credit Quality(3)
		(dollars in millions)					
Fixed-maturity securities:							
Obligations of state and political subdivisions	47 %	$4,899	$219	$(39)	$5,079	$ 4	AA
U.S. government and agencies	7	674	32	(6)	700	—	AA+
Corporate securities	13	1,314	44	(18)	1,340	0	A
Mortgage-backed securities(4):							
RMBS	11	1,160	34	(72)	1,122	(43)	A
CMBS	5	536	17	(4)	549	—	AAA
Asset-backed securities	6	605	10	(7)	608	2	BBB+
Foreign government securities	3	300	14	(1)	313	—	AA+
Total fixed-maturity securities	91	9,488	370	(147)	9,711	(37)	AA-
Short-term investments	9	904	0	0	904	—	AAA
Total investment portfolio	100 %	$10,392	$370	$(147)	$10,615	$ (37)	AA-

(1) Based on amortized cost.

(2) Accumulated OCI ("AOCI"). See also Note 17, Shareholders' Equity.

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

(4) Government-agency obligations were approximately 45% of mortgage backed securities as of March 31, 2014 and 50% as of December 31, 2013 based on fair value.

The Company's investment portfolio in tax-exempt and taxable municipal securities includes issuances by a wide number of municipal authorities across the U.S. and its territories. Securities rated lower than A-/A3 by S&P or Moody's are not eligible to be purchased for the Company's portfolio unless acquired for loss mitigation or risk management strategies.

The majority of the investment portfolio is managed by four outside managers. The Company has established detailed guidelines regarding credit quality, exposure to a particular sector and exposure to a particular obligor within a sector.

Table of Contents

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

Fixed-Maturity Securities
Gross Unrealized Loss by Length of Time
As of March 31, 2014

	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(dollars in millions)					
Obligations of state and political subdivisions	$458	$(14)	$13	$0	$471	$(14)
U.S. government and agencies	175	(5)	—	—	175	(5)
Corporate securities	307	(9)	10	(1)	317	(10)
Mortgage-backed securities:						
RMBS	317	(13)	155	(42)	472	(55)
CMBS	93	(2)	—	—	93	(2)
Asset-backed securities	21	0	44	(3)	65	(3)
Foreign government securities	59	(1)	—	—	59	(1)
Total	$1,430	$(44)	$222	$(46)	$1,652	$(90)
Number of securities		307		30		337
Number of securities with other-than-temporary impairment		3		11		14

Fixed-Maturity Securities
Gross Unrealized Loss by Length of Time
As of December 31, 2013

	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(dollars in millions)					
Obligations of state and political subdivisions	$781	$(39)	$5	$0	$786	$(39)
U.S. government and agencies	173	(6)	—	—	173	(6)
Corporate securities	401	(18)	3	0	404	(18)
Mortgage-backed securities:						
RMBS	414	(21)	186	(51)	600	(72)
CMBS	121	(4)	—	—	121	(4)
Asset-backed securities	196	(2)	42	(5)	238	(7)
Foreign government securities	54	(1)	1	0	55	(1)

Total	$2,140	$(91)	$237	$(56)	$2,377	$(147)
Number of securities		425		33		458
Number of securities with other-than-temporary impairment		13		11		24

Of the securities in an unrealized loss position for 12 months or more as of March 31, 2014, nine securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of March 31, 2014 was $38 million. The Company has determined that the unrealized losses recorded as of March 31, 2014 are yield related and not the result of other-than-temporary-impairment.

Table of Contents

The amortized cost and estimated fair value of available-for-sale fixed maturity securities by contractual maturity as of March 31, 2014 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Distribution of Fixed-Maturity Securities
by Contractual Maturity
As of March 31, 2014

	Amortized Cost	Estimated Fair Value
	(in millions)	
Due within one year	$301	$304
Due after one year through five years	1,767	1,843
Due after five years through 10 years	2,375	2,481
Due after 10 years	3,448	3,625
Mortgage-backed securities:		
RMBS	1,182	1,171
CMBS	656	670
Total	$9,729	$10,094

Under agreements with its cedants and in accordance with statutory requirements, the Company maintains fixed maturity securities and cash in trust accounts for the benefit of reinsured companies, which amounted to $397 million and $377 million as of March 31, 2014 and December 31, 2013, respectively, based on fair value. In addition, to fulfill state licensing requirements the Company has placed on deposit eligible securities of $19 million and $19 million as of March 31, 2014 and December 31, 2013, respectively, based on fair value.

The fair value of the Company’s pledged securities under credit derivative contracts totaled $669 million and $677 million as of March 31, 2014 and December 31, 2013, respectively.

No material investments of the Company were non-income producing for First Quarter 2014 and 2013, respectively.

Internally Managed Portfolio

The investment portfolio tables shown above include both assets managed externally and internally. In the table below, more detailed information is provided for the component of the total investment portfolio that is internally managed (excluding short-term investments). The internally managed portfolio, as defined below, represents approximately 9% and 9% of the investment portfolio, on a fair value basis as of March 31, 2014 and December 31, 2013, respectively. The internally managed portfolio consists primarily of the Company's investments in securities for (i) loss mitigation purposes, (ii) other risk management purposes and (iii) where the Company believes a particular security presents an attractive investment opportunity (the "trading portfolio").

One of the Company's strategies for mitigating losses has been to purchase securities it has insured that have expected losses, at discounted prices (assets purchased for loss mitigation purposes). In addition, the Company holds other invested assets that were obtained or purchased as part of negotiated settlements with insured counterparties or under the terms of our financial guaranties (other risk management assets).

Additional detail about the types and amounts of securities acquired by the Company for loss mitigation, other risk management and in the trading portfolio is set forth in the table below.

70

Table of Contents

Internally Managed Portfolio
Carrying Value

	As of March 31, 2014 (in millions)	As of December 31, 2013
Assets purchased for loss mitigation purposes:		
Fixed maturity securities:		
Obligations of state and political subdivisions	$30	$28
RMBS	277	284
Asset-backed securities	133	127
Other invested assets	46	47
Other risk management assets:		
Fixed maturity securities	401	322
Other	83	35
Trading portfolio (other invested assets)	4	88
Total	$974	$931

11. Insurance Company Regulatory Requirements

Dividend Restrictions and Capital Requirements

Under New York insurance law, AGM may only pay dividends out of "earned surplus", which is the portion of a company's surplus that represents the net earnings, gains or profits (after deduction of all losses) that have not been distributed to shareholders as dividends or transferred to stated capital or capital surplus, or applied to other purposes permitted by law, but does not include unrealized appreciation of assets. AGM may pay dividends without the prior approval of the NYSDFS that, together with all dividends declared or distributed by it during the preceding 12 months, does not exceed the lesser of 10% of its policyholders' surplus (as of the last annual or quarterly statement filed with the New York Superintendent of Financial Services ("New York Superintendent")) or 100% of its adjusted net investment income during that period. The aggregate amount available for AGM to distribute as dividends in 2014 without regulatory approval is estimated to be approximately $175 million. AGM did not distribute any dividends in First Quarter 2014.

Under Maryland insurance law, AGC may, with prior notice to the Maryland Insurance Commissioner, pay an ordinary dividend that, together with all dividends paid in the prior 12 months, does not exceed 10% of its policyholders' surplus (as of the prior December 31) or 100% of its adjusted net investment income during that period. The aggregate amount available for AGC to distribute as ordinary dividends in 2014 will be approximately $69 million. AGC did not distribute any dividends in First Quarter 2014.

MAC is subject to the same dividend limitations described above for AGM. The Company does not currently anticipate that MAC will distribute any dividends.

As of March 31, 2014, AG Re had unencumbered assets of $201 million. AG Re maintains unencumbered assets for general corporate purposes, including the payment of dividends and for placing assets in trust for the benefit of cedants to reflect declines in the market value of previously posted assets or additional ceded reserves. Accordingly, the amount of unencumbered assets will fluctuate during a given quarter based upon factors including the market value of previously posted assets and additional ceded reserves, if any. AG Re is an insurance company registered and

licensed under the Insurance Act 1978 of Bermuda, amendments thereto and related regulations. Based on regulatory capital requirements, AG Re currently has $600 million in excess capital and surplus. As a Class 3B insurer, AG Re is restricted from paying dividends or distributing capital by the following regulatory requirements:

- Dividends shall not exceed outstanding statutory surplus which is $276 million.

- Dividends on an annual basis shall not exceed 25% of its total statutory capital and statutory surplus (as set out in its previous year's financial statements) which is $280 million unless it files (at least seven days before payment of such

Table of Contents

dividends) with the Bermuda Monetary Authority an affidavit stating that it will continue to meet the required margins.

- Capital distributions on an annual basis shall not exceed 15% of its total statutory capital (as set out in its previous year's financial statements) which is $127 million, unless approval is granted by the Bermuda Monetary Authority.

- Dividends are limited by requirements that the subject company must at all times (i) maintain the minimum solvency margin and the Company's applicable enhanced capital requirements required under the Insurance Act of 1978 and (ii) have relevant assets in an amount at least equal to 75% of relevant liabilities, both as defined under the Insurance Act of 1978.

U.K. company law prohibits each of AGE and AGUK from declaring a dividend to its shareholders unless it has "profits available for distribution." The determination of whether a company has profits available for distribution is based on its accumulated realized profits less its accumulated realized losses. While the U.K. insurance regulatory laws impose no statutory restrictions on a general insurer's ability to declare a dividend, the Prudential Regulation Authority's capital requirements may in practice act as a restriction on dividends. The Company does not expect AGE or AGUK to distribute any dividends at this time.

Dividends and Surplus Notes
By Insurance Company Subsidiaries

	First Quarter	
	2014	2013
	(in millions)	
Dividends paid by AG Re to AGL	$62	$40
Repayment of surplus note by AGM to AGMH	25	25

12. Income Taxes

Overview

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

In November 2013, AGL became tax resident in the U.K. although it will remain a Bermuda-based company and its administrative and head office functions will continue to be carried on in Bermuda. As a company that is not incorporated in the U.K., AGL currently intends to manage the affairs of AGL in such a way as to establish and maintain its status as a company that is tax resident in the U.K. As a U.K. tax resident company, AGL is required to file a corporation tax return with Her Majesty's Revenue & Customs ("HMRC"). AGL is subject to U.K. corporation tax in respect of its worldwide profits (both income and capital gains), subject to any applicable exemptions. The main rate of corporation tax is 23% currently; such rate fell 21% as of April 1, 2014 and will fall to 20% as of April 1, 2015. AGL has also registered in the U.K. to report its Value Added Tax ("VAT") liability. The current rate of VAT is 20%. Assured Guaranty does not expect that becoming U.K. tax resident will result in any material change in the group's overall tax charge. Assured Guaranty expects that the dividends AGL receives from its direct subsidiaries will

be exempt from U.K. corporation tax due to the exemption in section 931D of the U.K. Corporation Tax Act 2009. In addition, any dividends paid by AGL to its shareholders should not be subject to any withholding tax in the U.K. The U.K. government implemented a new tax regime for “controlled foreign companies” (“CFC regime”) effective January 1, 2013. Assured Guaranty does not expect any profits of non-U.K. resident members of the group to be taxed under the CFC regime and has obtained a clearance from HMRC confirming this on the basis of current facts.

For the periods beginning on July 1, 2009 and forward, AGMH files a consolidated federal income tax return with AGUS, AGC, AG Financial Products Inc. ("AGFP") and AG Analytics Inc. (“AGUS consolidated tax group”). Beginning on

Table of Contents

May 12, 2012, MAC also joined the the AGUS consolidated tax group. Assured Guaranty Overseas US Holdings Inc. and its subsidiaries AGRO and AG Intermediary Inc., file their own consolidated federal income tax return.

Provision for Income Taxes

The Company's provision for income taxes for interim financial periods is not based on an estimated annual effective rate due, for example, to the variability in fair value of its credit derivatives, which prevents the Company from projecting a reliable estimated annual effective tax rate and pretax income for the full year 2014. A discrete calculation of the provision is calculated for each interim period.

The effective tax rates reflect the proportion of income recognized by each of the Company’s operating subsidiaries, with U.S. subsidiaries taxed at the U.S. marginal corporate income tax rate of 35%, U.K. subsidiaries taxed at the U.K. blended marginal corporate tax rate of 21.5% unless subject to U.S. tax by election or as a U.S. controlled foreign corporation, and no taxes for the Company’s Bermuda subsidiaries unless subject to U.S. tax by election or as a U.S. controlled foreign corporation. For periods subsequent to April 1, 2014, the U.K. corporation tax rate has been reduced to 21%, for the period April 1, 2013 to April 1, 2014 the U.K. corporation tax rate was 23% resulting in a blended tax rate of 21.5% in 2014, and prior to April 1, 2013, the U.K. corporation tax rate was 24% resulting in a blended tax rate of 23.25% in 2013. The Company’s overall corporate effective tax rate fluctuates based on the distribution of income across jurisdictions.

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

Effective Tax Rate Reconciliation

	First Quarter	
	2014	2013
	(in millions)	
Expected tax provision (benefit) at statutory rates in taxable jurisdictions	$38	$(48)
Tax-exempt interest	(14)	(14)
Change in liability for uncertain tax positions	1	(8)
Other	2	2
Total provision (benefit) for income taxes	$27	$(68)
Effective tax rate	38.8%	31.8%

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

The following table presents pretax income and revenue by jurisdiction.

Pretax Income (Loss) by Tax Jurisdiction

	First Quarter	
	2014	2013
	(in millions)	

United States	$113	$(134)
Bermuda	(37)	(78)
U.K.	(7)	0
Total	$69	$(212)

Table of Contents

Revenue by Tax Jurisdiction

	First Quarter	
	2014	2013
	(in millions)	
United States	$195	$(127)
Bermuda	1	(49)
U.K.	(1)	0
Total	$195	$(176)

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

Valuation Allowance

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

Audits

AGUS has open tax years with the U.S. Internal Revenue Service (“IRS”) for 2009 forward and is currently under audit for the 2009-2012 tax years. The IRS concluded its field work with respect to tax years 2006 through 2008 without adjustment. On February 20, 2013 the IRS notified AGUS that the Joint Committee on Taxation completed its review of the 2006 through 2008 tax years and has accepted the results of the IRS examination without exception. Assured Guaranty Oversees US Holdings Inc. has open tax years of 2009 forward. AGMH and subsidiaries have separate open tax years with the IRS of January 1, 2009 through the July 1, 2009 when they joined the AGUS consolidated group. The IRS concluded its field work with respect to tax year 2008 for AGMH and subsidiaries while members of the Dexia Holdings Inc. consolidated tax group without adjustment. The Company is indemnified by Dexia SA and Dexia Crédit Local S.A. for any potential liability associated with this audit of any periods prior to the Company's acquisition of AGMH on July 1, 2009. The Company's U.K. subsidiaries are not currently under examination and have open tax years of 2011 forward.

Uncertain Tax Positions

The Company's policy is to recognize interest and penalties related to uncertain tax positions in income tax expense and has accrued $0.3 million for First Quarter 2014 and $1 million for 2013. For First Quarter 2013, an amount of $9 million was released following the closing of an IRS audit. As of March 31, 2014 and December 31, 2013, the Company has accrued $3 million and $3 million of interest, respectively.

The total amount of unrecognized tax benefits as of March 31, 2014 and December 31, 2013, that would affect the effective tax rate, if recognized, was $21 million and $20 million, respectively.

13. Reinsurance and Other Monoline Exposures

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

historically entered into ceded reinsurance contracts in order to obtain greater business diversification and reduce the net potential loss from large risks.

Assumed and Ceded Business

The Company assumes business from other monoline financial guaranty companies. Under these relationships, the Company assumes a portion of the ceding company's insured risk in exchange for a premium. The Company may be exposed to risk in this portfolio in that the Company may be required to pay losses without a corresponding premium in circumstances

Table of Contents

where the ceding company is experiencing financial distress and is unable to pay premiums. The Company's facultative and treaty agreements are generally subject to termination at the option of the ceding company:

- if the Company fails to meet certain financial and regulatory criteria and to maintain a specified minimum financial strength rating, or
- upon certain changes of control of the Company.

Upon termination under these conditions, the Company may be required (under some of its reinsurance agreements) to return to the ceding company unearned premiums (net of ceding commissions) and loss reserves calculated on a statutory basis of accounting, attributable to reinsurance assumed pursuant to such agreements after which the Company would be released from liability with respect to the Assumed Business.

Upon the occurrence of the conditions set forth in the first bullet above, whether or not an agreement is terminated, the Company may be required to obtain a letter of credit or alternative form of security to collateralize its obligation to perform under such agreement or it may be obligated to increase the level of ceding commission paid.

The downgrade of the financial strength ratings of AG Re or of AGC gives certain reinsurance counterparties the right to recapture ceded business, which would lead to a reduction in the Company's unearned premium reserve and related earnings on such reserve. With respect to a significant portion of the Company's in-force financial guaranty assumed business, based on AG Re's and AGC's current ratings and subject to the terms of each reinsurance agreement, the third party ceding company may have the right to recapture assumed business ceded to AG Re and/or AGC, and in connection therewith, to receive payment from the assuming reinsurer of an amount equal to the reinsurer's statutory unearned premium (net of ceding commissions) and statutory loss reserves (if any) associated with that business, plus, in certain cases, an additional ceding commission. As of March 31, 2014, if each third party company ceding business to AG Re and/or AGC had a right to recapture such business, and chose to exercise such right, the aggregate amounts that AG Re and AGC could be required to pay to all such companies would be approximately $283 million and $57 million, respectively.

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

In First Quarter 2014, the Company entered into commutation agreements to reassume previously ceded business consisting of approximately $856 million par of almost exclusively U.S. public finance and European (predominantly UK) utility and infrastructure exposures outstanding as of February 28, 2014. For such reassumptions, the Company received the statutory unearned premium outstanding as of the commutation dates plus, in one case, a commutation premium. There were no commutations in First Quarter 2013.

The following table presents the components of premiums and losses reported in the consolidated statement of operations and the contribution of the Company's Assumed and Ceded Businesses.

75

Table of Contents

Effect of Reinsurance on Statement of Operations

	First Quarter	
	2014	2013
	(in millions)	
Premiums Written:		
Direct	$31	$19
Assumed(1)	(1)	(2)
Ceded	(24)	(2)
Net	$6	$15
Premiums Earned:		
Direct	$140	$267
Assumed	11	13
Ceded	(19)	(32)
Net	$132	$248
Loss and LAE:		
Direct	$34	$(27)
Assumed	6	(14)
Ceded	1	(7)
Net	$41	$(48)

(1) Negative assumed premiums written were due to changes in expected Debt Service schedules.

Reinsurer Exposure

In addition to assumed and ceded reinsurance arrangements, the Company may also have exposure to some financial guaranty reinsurers (i.e., monolines) in other areas. Second-to-pay insured par outstanding represents transactions the Company has insured that were previously insured by other monolines. The Company underwrites such transactions based on the underlying insured obligation without regard to the primary insurer. Another area of exposure is in the investment portfolio where the Company holds fixed-maturity securities that are wrapped by monolines and whose value may decline based on the rating of the monoline. At March 31, 2014, based on fair value, the Company had fixed-maturity securities in its investment portfolio consisting of $435 million insured by National Public Finance Guarantee Corporation, $455 million insured by Ambac Assurance Corporation ("Ambac") and $29 million insured by other guarantors.

Table of Contents

Exposure by Reinsurer

Reinsurer	Ratings at May 5, 2014		Par Outstanding As of March 31, 2014		
	Moody's Reinsurer Rating	S&P Reinsurer Rating	Ceded Par Outstanding(1)	Second-to-Pay Insured Par Outstanding	Assumed Par Outstanding
	(dollars in millions)				
American Overseas Reinsurance Company Limited (f/k/a Ram Re)	WR (2)	WR	$8,113	$—	$30
Tokio Marine & Nichido Fire Insurance Co., Ltd.	Aa3 (3)	AA- (3)	6,273	—	—
Radian Asset Assurance Inc.	Ba1	B+	4,696	24	987
Syncora Guarantee Inc.	WR	WR	4,192	1,769	161
Mitsui Sumitomo Insurance Co. Ltd.	A1	A+ (3)	2,139	—	—
ACA Financial Guaranty Corp.	NR (5)	WR	809	3	8
Federal Insurance Company	Aa2	AA	382	—	—
Swiss Reinsurance Co.	Aa3	AA-	347	—	—
Security Life of Denver Insurance Company	A3	A-	239	—	—
Ambac (4)	WR	WR	85	6,013	17,578
CIFG Assurance North America Inc.	WR	WR	—	114	4,883
MBIA Inc.	(4)	(4)	—	10,208	7,221
Financial Guaranty Insurance Co.	WR	WR	—	2,273	1,237
Other	Various	Various	251	2,114	45
Total			$27,526	$22,518	$32,150

(1) Includes $3,038 million in ceded par outstanding related to insured credit derivatives.

(2) Represents "Withdrawn Rating."

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

(4) MBIA Inc. includes various subsidiaries which are rated AA- and B by S&P and Baa1, B1 and B3 by Moody's. Ambac includes policies in their general and segregated account.

(5) Represents "Not Rated."

Table of Contents

Amounts Due (To) From Reinsurers
As of March 31, 2014

	Assumed Premium, net of Commissions	Ceded Premium, net of Commissions	Assumed Expected Loss and LAE	Ceded Expected Loss and LAE
	(in millions)			
American Overseas Reinsurance Company Limited	$—	$(9)	$—	$7
Tokio Marine & Nichido Fire Insurance Co., Ltd.	—	(18)		