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

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2009

OR

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

transition Period from to

Commission File No. 001-32141

ASSURED GUARANTY LTD.

(Exact name of registrant as specified in its charter)

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 office)

(441) 299-9375

(Registrants telephone number, including area code)

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

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

Large accelerated filer 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 1, 2009 was 90,990,867.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

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

(Unaudited)

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

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

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Assured Guaranty Ltd.
Consolidated Statements of Operations and Comprehensive Income
(in thousands of U.S. dollars except per share amounts)

(Unaudited)

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

Diluted	$	0.93	$	(2.09)
Dividends per share	$	0.045	$	0.045

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

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

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

(Unaudited)

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

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

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

(Unaudited)

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

Cash and cash equivalents at end of period	**$**	**19,328**	**$**	**8,378**
Supplementary cash flow information				
Cash (received)/paid during the period for:				
Income taxes	$	(14,514)	$	500
Interest	$		$	

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

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Assured Guaranty Ltd.
Notes to Consolidated Financial Statements

March 31, 2009

(Unaudited)

1. Business and Organization

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

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

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

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

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

	Moody s	**S&P**	**Fitch**
Assured Guaranty Corp.	Aa2(Excellent)	AAA(Extremely Strong)	AA(Very Strong)
Assured Guaranty Re Ltd.	Aa3(Excellent)	AA(Very Strong)	AA-(Very Strong)
Assured Guaranty Re Overseas Ltd.	Aa3(Excellent)	AA(Very Strong)	AA-(Very Strong)
Assured Guaranty Mortgage Insurance Company	Aa3(Excellent)	AA(Very Strong)	AA-(Very Strong)
Assured Guaranty (UK) Ltd	Aa2(Excellent)	AAA(Extremely Strong)	AA(Very Strong)

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

Acquisition of Financial Security Assurance Holdings Ltd.

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

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

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

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

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

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

2. Significant Accounting Policies

Basis of Presentation

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

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

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

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Adoption of FAS 163

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

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

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

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

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

- Unearned premium reserves increased to reflect the recording of the net present value of future installment premiums discounted at a risk-free rate and the change in the premium earnings methodology to the effective yield method prescribed by FAS 163. Prepaid reinsurance premiums increased correspondingly for those amounts ceded to reinsurers.

- Reserves for losses and loss adjustment expenses decreased to reflect the release of the Company s portfolio reserves on fundamentally sound credits. This was partially offset by an increase in case reserves, which are now calculated based on probability weighted cash flows discounted at a risk free rate instead of based on a single case best estimate reserve discounted based on the after-tax investment yield of the Company s investment portfolio (6%). Reinsurance recoverable on ceded losses decreased correspondingly. Salvage recoverable increased to reflect the change in discount

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rates.

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

Premium Revenue Recognition

Premiums are received either upfront or in installments.

Upon Adoption of FAS 163

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

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

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

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

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

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

The premiums receivable expected to be collected are:

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

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

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

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

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

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

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

Prior to Adoption of FAS 163

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

Deferred Acquisition Costs

Acquisition costs incurred, other than those associated with financial guarantees written in credit derivative form, that vary with and are directly related to the production of new business are deferred in proportion to written premium and amortized in relation to earned premiums. These costs include direct and indirect expenses such as ceding commissions, brokerage expenses and the cost of underwriting and marketing personnel. Management uses its judgment in determining what types of costs should be deferred, as well as what percentage of these costs should be deferred. The Company annually conducts a study to determine which operating costs vary with, and are directly related to, the acquisition of new business and qualify for deferral. Ceding commissions received on premiums the Company cedes to other reinsurers reduce acquisition costs. Anticipated losses, loss adjustment expenses and the remaining costs of servicing the insured or reinsured business are considered in determining the recoverability of acquisition costs. Acquisition costs associated with credit derivative products are expensed as incurred. When an insured issue is retired early, as discussed above in the Premium Revenue Recognition section, the remaining related deferred acquisition cost is expensed at that time. Ceding commissions, calculated at their contractually defined

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

Reserves for Losses and Loss Adjustment Expenses

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

Financial Guaranty Contracts Upon Adoption of FAS 163

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

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

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

Financial Guaranty Contracts Prior to Adoption of FAS 163

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

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

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

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

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