ASSURED GUARANTY LTD
Form 10-Q
August 09, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2011

or

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

For the transition Period from to
Commission File No. 001-32141

ASSURED GUARANTY LTD.

(Exact name of registrant as specified in its charter)

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

30 Woodbourne Avenue
Hamilton HM 08
Bermuda
(Address of principal executive offices)

(441) 279-5700
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý 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 ý 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 ý Accelerated filer o Non-accelerated filer o Smaller reporting company o
(Do not check if a smaller reporting company)

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

The number of registrant's Common Shares ($0.01 par value) outstanding as of July 31, 2011 was 184,217,299 (excludes 76,060 unvested restricted shares).

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Assured Guaranty Ltd.

Consolidated Balance Sheets (Unaudited)

(dollars in thousands except per share and share amounts)

	June 30, 2011	December 31, 2010
Assets		
Investment portfolio:		
Fixed maturity securities, available-for-sale, at fair value (amortized cost of $9,596,052 and $9,289,444)	$ 9,864,203	$ 9,415,315
Short-term investments, at fair value	1,070,401	1,031,578
Other invested assets	252,082	283,032
Total investment portfolio	11,186,686	10,729,925
Cash	159,170	107,179
Premiums receivable, net of ceding commissions payable	1,059,461	1,167,587
Ceded unearned premium reserve	773,321	821,819
Deferred acquisition costs	232,311	239,805
Reinsurance recoverable on unpaid losses	26,025	22,255
Salvage and subrogation recoverable	307,147	1,032,369
Credit derivative assets	603,867	592,898
Deferred tax asset, net	1,012,011	1,223,958
Current income tax receivable	187,969	
Financial guaranty variable interest entities' assets, at fair value	3,492,204	3,657,481
Other assets	198,692	199,308
Total assets	**$ 19,238,864**	**$ 19,794,584**
Liabilities and shareholders' equity		
Unearned premium reserve	$ 6,315,362	$ 6,972,894
Loss and loss adjustment expense reserve	518,145	562,955
Reinsurance balances payable, net	175,875	274,431
Long-term debt	1,046,382	1,052,936
Credit derivative liabilities	2,788,218	2,465,520
Current income tax payable		93,020
Financial guaranty variable interest entities' liabilities with recourse, at fair value	2,755,113	2,926,988
Financial guaranty variable interest entities' liabilities without recourse, at fair value	1,282,463	1,337,214
Other liabilities	407,321	309,862
Total liabilities	**15,288,879**	**15,995,820**
Commitments and contingencies (See Note 12)		
	1,842	1,837

Common stock ($0.01 par value, 500,000,000 shares authorized; 184,192,736 and 183,744,655 shares issued and outstanding in 2011 and 2010)		
Additional paid-in capital	2,590,654	2,585,423
Retained earnings	1,149,898	1,098,859
Accumulated other comprehensive income, net of tax provision (benefit) of $66,293 and $17,746	205,591	110,645
Deferred equity compensation (181,818 shares)	2,000	2,000
Total shareholders' equity	**3,949,985**	**3,798,764**
Total liabilities and shareholders' equity	**$ 19,238,864**	**$ 19,794,584**

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

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Assured Guaranty Ltd.

Consolidated Statements of Operations (Unaudited)

(dollars in thousands except per share amounts)

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Revenues				
Net earned premiums	$ 230,068	$ 292,110	$ 484,045	$ 611,670
Net investment income	100,827	90,871	197,214	175,173
Net realized investment gains (losses):				
Other-than-temporary impairment losses	(26,818)	(17,412)	(33,765)	(18,529)
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	(15,240)		(17,609)	(661)
Other net realized investment gains (losses)	6,488	8,974	13,872	18,843
Net realized investment gains (losses)	(5,090)	(8,438)	(2,284)	975
Net change in fair value of credit derivatives:				
Realized gains and other settlements	(10,836)	38,353	24,591	65,056
Net unrealized gains (losses)	(48,625)	35,115	(319,751)	287,213
Net change in fair value of credit derivatives	(59,461)	73,468	(295,160)	352,269
Fair value gain (loss) on committed capital securities	569	12,593	1,095	11,318
Net change in fair value of financial guaranty variable interest entities	(193,676)	477	(99,771)	(10,113)
Other income	28,775	(13,396)	70,926	(26,325)
Total Revenues	**102,012**	**447,685**	**356,065**	**1,114,967**
Expenses				
Loss and loss adjustment expenses	132,908	71,156	105,861	201,657
Amortization of deferred acquisition costs	9,533	6,936	16,953	15,109
Assured Guaranty Municipal Holdings Inc. acquisition-related expenses		2,751		6,772
Interest expense	24,696	24,831	49,456	49,965
Other operating expenses	48,508	47,507	105,343	110,040
Total expenses	215,645	153,181	277,613	383,543
Income (loss) before income taxes	**(113,633)**	**294,504**	**78,452**	**731,424**
Provision (benefit) for income taxes				
Current	9,864	44,822	(187,735)	5,869
Deferred	(65,830)	46,144	198,447	200,042
Total provision (benefit) for income taxes	**(55,966)**	**90,966**	**10,712**	**205,911**
Net income (loss)	**$ (57,667)**	**$ 203,538**	**$ 67,740**	**$ 525,513**
Earnings per share:				
Basic	$ (0.31)	$ 1.10	$ 0.37	$ 2.85
Diluted	$ (0.31)	$ 1.08	$ 0.36	$ 2.77
Dividends per share	$ 0.045	$ 0.045	$ 0.090	$ 0.090

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

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Assured Guaranty Ltd.

Consolidated Statements of Comprehensive Income (Unaudited)

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	**2010**	**2011**	**2010**
Net income (loss)	**$ (57,667)**	**$ 203,538**	**$ 67,740**	**$ 525,513**
Unrealized holding gains (losses) arising during the period, net of tax provision (benefit) of $56,487, $3,785, $46,229 and $(1,597)	115,580	48,183	90,368	57,397
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of $(1,743), $(4,206), $(1,571) and $(1,438)	(4,227)	(4,232)	(3,198)	2,413
Change in net unrealized gains on investments	119,807	52,415	93,566	54,984
Change in cumulative translation adjustment, net of tax provision (benefit) of $191, $(746), $860 and $(2,854)	346	(1,375)	1,589	(5,259)
Change in cash flow hedge, net of tax provision (benefit) of $(57), $(57), $(113) and $(113)	(104)	(104)	(209)	(209)
Other comprehensive income (loss)	120,049	50,936	94,946	49,516
Comprehensive income (loss)	**$ 62,382**	**$ 254,474**	**$ 162,686**	**$ 575,029**

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

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Assured Guaranty Ltd.

Consolidated Statement of Shareholders' Equity (Unaudited)

For the Six Months Ended June 30, 2011

(dollars in thousands, except share data)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Deferred Equity Compensation	Total Shareholders' Equity
	Shares	Amount					
Balance, December 31, 2010	**183,744,655**	**$ 1,837**	**$ 2,585,423**	**$ 1,098,859**	**$ 110,645**	**$ 2,000**	**$ 3,798,764**
Net income				67,740			67,740
Dividends ($0.09 per share)				(16,577)			(16,577)
Dividends on restricted stock units			124	(124)			
Common stock repurchases							
Share-based compensation and other	448,081	5	5,107				5,112
Change in cumulative translation adjustment					1,589		1,589
Change in cash flow hedge					(209)		(209)
Change in unrealized gains (losses) on:							
Investments with no other-than-temporary impairment					81,912		81,912
Investments with other-than-temporary impairment					8,456		8,456
Less: reclassification adjustment for gains (losses) included in net income (loss)					(3,198)		(3,198)
Balance, June 30, 2011	**184,192,736**	**$ 1,842**	**$ 2,590,654**	**$ 1,149,898**	**$ 205,591**	**$ 2,000**	**$ 3,949,985**

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

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Assured Guaranty Ltd.

Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Net cash flows provided by (used in) operating activities	**$ 614,434**	**$ (249,589)**
Investing activities		
Fixed maturity securities:		
Purchases	(1,349,745)	(1,166,379)
Sales	685,980	780,818
Maturities	326,927	488,552
Net sales (purchases) of short-term investments	(38,676)	276,641
Net proceeds from paydowns on financial guaranty variable interest entities' assets	423,977	217,329
Other	8,696	8,317
Net cash flows provided by (used in) investing activities	**57,159**	**605,278**
Financing activities		
Dividends paid	(16,577)	(16,613)
Repurchases of common stock		(10,457)
Share activity under option and incentive plans	(2,652)	(2,233)
Net paydowns of financial guaranty variable interest entities' liabilities	(593,294)	(259,367)
Repayment of long-term debt	(10,294)	(10,850)
Net cash flows provided by (used in) financing activities	**(622,817)**	**(299,520)**
Effect of foreign exchange rate changes	3,215	(3,090)
Increase (decrease) in cash	51,991	53,079
Cash at beginning of period	107,179	44,133

Cash at end of period	**$**	**159,170**	**$**	**97,212**
Supplemental cash flow information				
Cash paid (received) during the period for:				
Income taxes	$	89,202	$	136,645
Interest	$	45,711	$	45,266

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

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited)

June 30, 2011

1. Business and Basis of Presentation

Business

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

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

The Company's business has evolved as a result of the recent crisis in the financial markets. For example, the Company is focused primarily on insuring public finance obligations in the primary and secondary markets. It is selectively underwriting certain structured finance transactions, but has not underwritten a new U.S. residential mortgage-backed security ("RMBS") since 2008 and will not do so until underwriting standards improve significantly. See Note 3 for the Company's outstanding U.S. RMBS exposures. In addition, the Company ceased selling credit protection through CDS in the beginning of 2009 following the issuance of regulatory guidelines that limited the terms under which such protection could be sold. The potential capital or margin requirements that may apply under the Dodd-Frank Wall Street Reform and Consumer protection Act (the "Dodd-Frank Act") also contributed to the decision of the Company not to sell new credit protection through CDS in the foreseeable future. Furthermore, the Company had historically entered into ceded reinsurance contracts in order to obtain greater business diversification and reduce the net potential loss from large risks. However, given the lack of viable third party financial guaranty insurers and reinsurers, the Company has not entered into any new assumed or ceded reinsurance treaties since 2008, and has been reassuming previously ceded business from reinsurers whose ratings have declined to below-investment-grade ("BIG") levels.

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

1. Business and Basis of Presentation (Continued)

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

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

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

Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

1. Business and Basis of Presentation (Continued)

to reduce risk or raise capital on acceptable terms. Since S&P announced its proposed criteria, the Company has been pursuing strategies to improve its rating agency capital position. Such strategies include pursuing negotiated agreements with providers of representations and warranties in the insured U.S. RMBS portfolio, and agreeing to terminate credit default swap transactions and financial guaranties that carry high rating agency capital charges. See Notes 4 and 6 for the potential impact of a rating downgrade on the insured portfolio.

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

Basis of Presentation

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

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

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

AGL's principal insurance company subsidiaries are Assured Guaranty Corp. ("AGC"), domiciled in Maryland, Assured Guaranty Municipal Corp. ("AGM"), domiciled in New York, and Assured

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

1. Business and Basis of Presentation (Continued)

Guaranty Re Ltd. ("AG Re"), domiciled in Bermuda. In addition, the Company also has another U.S. and another Bermuda insurance company subsidiary that participates in a pooling agreement with AGM, two insurance subsidiaries organized in the United Kingdom, and a mortgage insurance company. The Company's organizational structure includes various holdings companies, two of which Assured Guaranty US Holdings Inc. ("AGUS") and Assured Guaranty Municipal Holdings Inc. ("AGMH") have public debt outstanding. See Note 13.

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

Change in Accounting Policy

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

2. Business Changes, Risks, Uncertainties and Accounting Developments

Summarized below are updates of the most significant events since the filing of the 2010 Annual Report on Form 10-K, that have had, or may have in the future, a material effect on the financial position, results of operations or business prospects of the Company.

Recoveries for Breaches of Representations and Warranties

On April 14, 2011, Assured Guaranty reached a comprehensive agreement with Bank of America Corporation and its subsidiaries, including Countrywide Financial Corporation and its subsidiaries (collectively, "Bank of America"), regarding their liabilities with respect to 29 RMBS transactions insured by Assured Guaranty, including claims relating to reimbursement for breaches of R&W and historical loan servicing issues ("Bank of America Agreement"). Of the 29 RMBS transactions, eight are second lien transactions and 21 are first lien transactions. The Bank of America Agreement covers Bank of America-sponsored securitizations that AGM or AGC has insured, as well as certain other

Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

2. Business Changes, Risks, Uncertainties and Accounting Developments (Continued)

securitizations containing concentrations of Countrywide-originated loans that AGM or AGC has insured. The transactions covered by the Bank of America Agreement have a gross par outstanding of $4.7 billion ($4.4 billion net par outstanding) as of June 30, 2011, or 28% of Assured Guaranty's total BIG RMBS net par outstanding.

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

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

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

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

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

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

3. Outstanding Exposure

The Company's insurance policies and credit derivative contracts are written in different forms, but collectively are considered financial guaranty contracts. They typically guarantee the scheduled payments of principal and interest ("Debt Service") on public finance and structured finance obligations. The Company seeks to limit its exposure to losses by underwriting obligations that are investment grade at inception, diversifying its portfolio and maintaining rigorous subordination or collateralization requirements on structured finance obligations. The Company also has utilized reinsurance by ceding business to third party reinsurers. The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. Based on accounting standards in effect during any given reporting period, some of these VIEs are consolidated as described in Note 7. The outstanding par and Debt Service amounts presented below include outstanding exposures on VIEs, whether or not they are consolidated.

Debt Service Outstanding

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

Financial Guaranty Net Par Outstanding by Internal Rating

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

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

3. Outstanding Exposure (Continued)

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

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

Surveillance Categories

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

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

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

3. Outstanding Exposure (Continued)

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

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

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

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

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

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

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

3. Outstanding Exposure (Continued)

Financial Guaranty Exposures
(Insurance and Credit Derivative Form)

June 30, 2011

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

December 31, 2010

	BIG Net Par Outstanding					BIG Net Par as a % of Net Par Outstanding
	BIG 1	BIG 2	BIG 3	Total BIG	Net Par Outstanding	

	(in millions)					
First lien U.S. RMBS:						
Prime first lien	$ 82	$ 542	$	$ 624	$ 849	0.1%
Alt-A first lien	976	3,108	573	4,657	6,134	0.8
Option ARM	33	2,186	640	2,859	3,214	0.5
Subprime (including net interest margin securities)	729	2,248	106	3,083	9,039	0.4
Second lien U.S. RMBS:						
Closed-end second lien	63	444	624	1,131	1,164	0.2
HELOCs	369		3,632	4,001	4,730	0.6
Total U.S. RMBS	2,252	8,528	5,575	16,355	25,130	2.6
Other structured finance	2,758	292	2,447	5,497	124,262	0.9
Public finance	3,752	283	919	4,954	467,739	0.8
Total	$ 8,762	$ 9,103	$ 8,941	$ 26,806	$ 617,131	4.3%

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

June 30, 2011

3. Outstanding Exposure (Continued)

By Category Below-Investment-Grade Credits

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

	As of December 31, 2010					
	Net Par Outstanding			Number of Risks(3)		
Description	Financial Guaranty Insurance(1)	Credit Derivative(2)	Total	Financial Guaranty Insurance(1)	Credit Derivative(2)	Total
	(dollars in millions)					
BIG:						
Category 1	$ 5,521	$ 3,241	$ 8,762	120	31	151
Category 2	5,646	3,457	9,103	97	50	147
Category 3	7,281	1,660	8,941	115	13	128
Total BIG	$ 18,448	$ 8,358	$ 26,806	332	94	426

(1) Represents contracts accounted for as financial guaranty insurance. See Note 4.

(2) Represents contracts accounted for as credit derivatives and carried at fair value on the consolidated balance sheets. See Note 6.

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

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4. Financial Guaranty Insurance Contracts

The portfolio of outstanding exposures discussed in Note 3 includes financial guaranty contracts that meet the definition of insurance contracts under ASC 944 as well as those that meet the definition of derivative contracts under ASC 815. Amounts presented in this Note relate to financial guaranty insurance contracts. Tables presented herein also present reconciliations to financial statement line items for other less significant types of insurance.

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

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

Net Earned Premiums