

ASSURED GUARANTY LTD
Form 10-Q
November 16, 2009

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2009

or

**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
(State or other jurisdiction of incorporation)

98-0429991
(I.R.S. employer identification no.)

**30 Woodbourne Avenue
Hamilton HM 08
Bermuda**

(Address of principal executive 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 No

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a
smaller reporting company)

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

The number of registrant's Common Shares (\$0.01 par value) outstanding as of November 13, 2009 was 156,604,868 (excludes 396,997 unvested restricted shares).

**ASSURED GUARANTY LTD.
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ASSURED GUARANTY LTD.
CONSOLIDATED BALANCE SHEETS (unaudited)
(in thousands, except per share and share amounts)

| | September 30, 2009 | December 31, 2008 |
|---|-----------------------|----------------------|
| ASSETS | | |
| Investment portfolio, available-for-sale: | | |
| Fixed maturity securities, at fair value (amortized cost of \$8,151,058 and \$3,162,308) | \$ 8,448,099 | \$ 3,154,137 |
| Short-term investments (cost of \$1,492,479 and \$477,197) | 1,492,891 | 477,197 |
| Total investment portfolio | 9,940,990 | 3,631,334 |
| Assets acquired in refinancing transactions (includes \$32,943 at fair value) | 159,180 | |
| Cash | 260,484 | 12,305 |
| Premiums receivable, net | 1,504,043 | 15,743 |
| Ceded unearned premium reserve | 1,163,110 | 18,856 |
| Deferred acquisition costs | 243,609 | 288,616 |
| Reinsurance recoverable on paid and unpaid losses | 5,857 | 6,528 |
| Credit derivative assets | 462,298 | 146,959 |
| Committed capital securities, at fair value | 38,516 | 51,062 |
| Deferred tax asset, net | 1,093,608 | 129,118 |
| Goodwill | | 85,417 |
| Salvage recoverable | 184,447 | 80,207 |
| Financial guaranty variable interest entities' assets | 846,945 | |
| Other assets | 299,543 | 89,562 |
| TOTAL ASSETS | \$ 16,202,630 | \$ 4,555,707 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Unearned premium reserves | \$ 8,632,733 | \$ 1,233,714 |
| Loss and loss adjustment expense reserve | 218,739 | 196,798 |
| Long-term debt | 915,237 | 347,210 |
| Note payable to related party | 155,827 | |
| Credit derivative liabilities | 2,100,465 | 733,766 |
| Funds held under reinsurance contracts | 30,178 | 30,683 |
| Reinsurance balances payable, net | 179,258 | 17,957 |
| Financial guaranty variable interest entities' liabilities | 851,390 | |
| Other liabilities | 321,671 | 69,357 |
| TOTAL LIABILITIES | 13,405,498 | 2,629,485 |
| COMMITMENTS AND CONTINGENCIES | | |
| Common stock (\$0.01 par value, 500,000,000 shares authorized; 156,604,569 and 90,955,703 shares issued and outstanding in 2009 and 2008) | 1,566 | 910 |
| Additional paid-in capital | 2,010,759 | 1,284,370 |
| Retained earnings | 580,239 | 638,055 |
| Accumulated other comprehensive income (loss), net of deferred tax (benefit) provision of \$104,649 and \$(1,302) | 209,013 | 2,887 |
| TOTAL SHAREHOLDERS' EQUITY ATTRIBUTABLE TO ASSURED GUARANTY LTD. | 2,801,577 | 1,926,222 |
| Noncontrolling interest of financial guaranty variable interest entities | (4,445) | |

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| | | |
|--|---------------|--------------|
| TOTAL SHAREHOLDERS' EQUITY | 2,797,132 | 1,926,222 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 16,202,630 | \$ 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 (unaudited)
(in thousands, except per share amounts)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|--------------------|------------------------------------|-------------------|
| | 2009 | 2008 | 2009 | 2008 |
| REVENUES | | | | |
| Net earned premiums | \$ 329,970 | \$ 85,516 | \$ 557,050 | \$ 184,034 |
| Net investment income | 84,742 | 43,441 | 171,643 | 120,247 |
| Net realized investment gains (losses): | | | | |
| Other-than-temporary impairment (OTTI) losses | (13,321) | (18,273) | (68,233) | (18,536) |
| Less: portion of OTTI loss recognized in other comprehensive income | (5,287) | | (26,920) | |
| Other net realized investment gains (losses) | 1,937 | (1,758) | 13,218 | 585 |
| Net realized investment gains (losses) | (6,097) | (20,031) | (28,095) | (17,951) |
| Net change in fair value of credit derivatives | | | | |
| Realized gains and other settlements | 71,691 | 29,960 | 120,086 | 89,370 |
| Net unrealized gains (losses) | (205,336) | (116,247) | (432,638) | 332,634 |
| Net change in fair value of credit derivatives | (133,645) | (86,287) | (312,552) | 422,004 |
| Fair value gain (loss) on committed capital securities | (53,057) | 6,912 | (93,961) | 24,319 |
| Financial guaranty variable interest entities revenues | 4,881 | | 4,881 | |
| Other income | 58,758 | 259 | 60,152 | 437 |
| TOTAL REVENUES | 285,552 | 29,810 | 359,118 | 733,090 |
| EXPENSES | | | | |
| Loss and loss adjustment expenses | 133,325 | 82,542 | 251,109 | 175,805 |
| Amortization of deferred acquisition costs | 1,308 | 19,296 | 41,277 | 43,004 |
| Other operating expenses | 66,233 | 21,609 | 116,524 | 69,912 |
| Financial Security Assurance Holdings Ltd. (FSAH) acquisition-related expenses | 51,333 | | 80,179 | |
| Interest expense | 25,190 | 5,821 | 37,495 | 17,462 |
| Goodwill and settlement of pre-existing relationship | 23,341 | | 23,341 | |
| Financial guaranty variable interest entities expenses | 10,152 | | 10,152 | |
| Profit commission expense | 223 | (1,444) | 2,549 | 758 |
| Other expenses | 2,533 | 1,524 | 5,801 | 3,974 |
| TOTAL EXPENSES | 313,638 | 129,348 | 568,427 | 310,915 |
| INCOME (LOSS) BEFORE INCOME TAXES | (28,086) | (99,538) | (209,309) | 422,175 |
| (Benefit) provision for income taxes | | | | |
| Current | 67,116 | (13,092) | 68,817 | 4,233 |
| Deferred | (54,901) | (23,106) | (153,310) | 105,275 |
| Total (benefit) provision for income taxes | 12,215 | (36,198) | (84,493) | 109,508 |
| NET INCOME (LOSS) | (40,301) | (63,340) | (124,816) | 312,667 |
| Less: Noncontrolling interest of variable interest entities | (5,271) | | (5,271) | |
| NET INCOME (LOSS) ATTRIBUTABLE TO ASSURED GUARANTY LTD. | \$ (35,030) | \$ (63,340) | \$ (119,545) | \$ 312,667 |
| Earnings per share: | | | | |
| Basic | \$ (0.22) | \$ (0.69) | \$ (1.05) | \$ 3.56 |

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| | | | | | | | | |
|---------------------|----|--------|----|--------|----|--------|----|-------|
| Diluted | \$ | (0.22) | \$ | (0.69) | \$ | (1.05) | \$ | 3.54 |
| Dividends per share | \$ | 0.045 | \$ | 0.045 | \$ | 0.135 | \$ | 0.135 |

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 September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|---------------------|------------------------------------|-------------------|
| | 2009 | 2008 | 2009 | 2008 |
| NET (LOSS) INCOME | \$ (40,301) | \$ (63,340) | \$ (124,816) | \$ 312,667 |
| Unrealized holding gains (losses) on available-for-sale securities arising during the period, net of deferred income tax provision (benefit) of \$93,677, \$(24,267), \$106,279 and \$(40,312) | 210,007 | (104,137) | 259,972 | (150,323) |
| Less: reclassification adjustment for gains (losses) included in net income (loss), net of deferred income tax provision (benefit) of \$663, \$0, \$2,328 and \$0 | (5,961) | (17,146) | (30,150) | (15,857) |
| Less: unrealized losses on fixed income securities related to factors other than credit | 4,624 | | 24,592 | |
| Change in net unrealized gains on available-for-sale securities | 211,344 | (86,991) | 265,530 | (134,466) |
| Change in cumulative translation adjustment | 565 | (645) | (1,438) | (746) |
| Cash flow hedge | (105) | (105) | (314) | (314) |
| Other comprehensive income (loss) | 211,804 | (87,741) | 263,778 | (135,526) |
| COMPREHENSIVE INCOME (LOSS) | 171,503 | (151,081) | 138,962 | 177,141 |
| Less: Comprehensive income (loss) attributable to noncontrolling interest of variable interest entities | 48 | | 48 | |
| COMPREHENSIVE INCOME (LOSS) OF ASSURED GUARANTY LTD. | \$ 171,455 | \$ (151,081) | \$ 138,914 | \$ 177,141 |

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

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ASSURED GUARANTY LTD.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (unaudited)
FOR NINE MONTHS ENDED SEPTEMBER 30, 2009
(in thousands, except share data)

| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity Attributable to Assured Guaranty Ltd. | Noncontrolling Interest of Financial Guaranty Consolidated Variable Interest Entities | Total Shareholders' Equity |
|--|--------------------|-----------------|----------------------------------|----------------------|---|--|--|----------------------------------|
| | Shares | Amount | | | | | | |
| Balance, December 31, 2008 | 90,955,703 | \$ 910 | \$ 1,284,370 | \$ 638,055 | \$ 2,887 | \$ 1,926,222 | | \$ 1,926,222 |
| Cumulative effect of accounting change Adoption of ASC 944-20 effective January 1, 2009 | | | | 19,443 | | 19,443 | | 19,443 |
| Balance at the beginning of the year, adjusted | 90,955,703 | 910 | 1,284,370 | 657,498 | 2,887 | 1,945,665 | | 1,945,665 |
| Cumulative effect of accounting change Adoption of ASC 320-10-65-1 effective April 1, 2009 | | | | 57,652 | (57,652) | | | |
| Issuance of stock for acquisition of FSAH | 22,153,951 | 222 | 275,653 | | | 275,875 | | 275,875 |
| Consolidation of financial guaranty variable interest entities | | | | | | | 778 | 778 |
| Net income (loss) | | | | (119,545) | | (119,545) | (5,271) | (124,816) |
| Dividends (\$0.135 per share) | | | | (15,267) | | (15,267) | | (15,267) |
| Dividends on restricted stock units | | | 99 | (99) | | | | |
| Net proceeds from issuance of common stock | 44,275,000 | 443 | 447,642 | | | 448,085 | | 448,085 |
| Common stock repurchases | (1,010,050) | (10) | (3,666) | | | (3,676) | | (3,676) |
| Shares cancelled to pay withholding taxes | (110,149) | (1) | (1,044) | | | (1,045) | | (1,045) |
| Shares issued under Employees Stock Purchase Plan (ESPP) | 21,349 | 0 | 205 | | | 205 | | 205 |
| Share-based compensation and other | 318,765 | 2 | 7,500 | | | 7,502 | | 7,502 |
| Change in cash flow hedge, net of tax of \$(169) | | | | | (314) | (314) | | (314) |
| Change in cumulative translation adjustment | | | | | (1,438) | (1,438) | 48 | (1,390) |
| Net unrealized gains (losses) on fixed maturity securities, net of tax of \$101,897 | | | | | 265,530 | 265,530 | | 265,530 |
| Balance, September 30, 2009 | 156,604,569 | \$ 1,566 | \$ 2,010,759 | \$ 580,239 | \$ 209,013 | \$ 2,801,577 | \$ (4,445) | \$ 2,797,132 |

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)

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------|
| | 2009 | 2008 |
| Operating activities | | |
| Net (loss) income | \$ (124,816) | \$ 312,667 |
| Adjustments to reconcile net (loss) income to net cash flows provided by operating activities: | | |
| Non-cash interest and operating expenses | 11,756 | 13,647 |
| Net amortization of premium on fixed maturity securities | 9,212 | 2,400 |
| Accretion of discount on premium receivable | (22,428) | |
| (Benefit) provision for deferred income taxes | (153,310) | 105,275 |
| Net realized investment losses (gains) | 28,095 | 17,951 |
| Unrealized losses (gains) on credit derivatives | 432,638 | (332,634) |
| Fair value loss (gain) on committed capital securities | 93,961 | (24,319) |
| Goodwill and settlements of pre-existing relationship | 23,341 | |
| Other income | (26,881) | |
| Change in deferred acquisition costs | 29,998 | (32,823) |
| Change in premiums receivable | 56,087 | (24,064) |
| Change in ceded unearned premium reserves | 89,534 | (6,404) |
| Change in unearned premium reserves | (298,594) | 344,671 |
| Change in reserves for losses and loss adjustment expenses, net | (23,868) | 20,287 |
| Change in funds held by Company under reinsurance contracts | (505) | 4,136 |
| Change in current income taxes | 58,253 | (19,916) |
| Other | 111,106 | (10,953) |

| | | |
|--|----------------|----------------|
| Net cash flows provided by (used by) operating activities | 293,579 | 369,921 |
|--|----------------|----------------|

Investing activities

| | | |
|---|-------------|-------------|
| Fixed maturity securities: | | |
| Purchases | (1,301,684) | (1,196,917) |
| Sales | 1,258,372 | 401,854 |
| Maturities | 80,773 | 6,350 |
| (Purchases) sales of short-term investments, net | (220,825) | 185,690 |
| Cash paid to acquire FSAH, net of cash acquired | (458,998) | |
| Paydowns and proceeds from sales of assets acquired in refinancing transactions | 8,735 | |
| Other | (718) | |

| | | |
|---|------------------|------------------|
| Net cash flows provided by (used for) investing activities | (634,345) | (603,023) |
|---|------------------|------------------|

Financing activities

| | | |
|---|----------|----------|
| Net proceeds from issuance of common stock | 448,340 | 248,971 |
| Net proceeds from issuance of equity units | 167,972 | |
| Dividends paid | (15,267) | (11,892) |
| Repurchases of common stock | (3,676) | |
| Share activity under option and incentive plans | (840) | (3,664) |
| Tax benefit for stock options exercised | | 16 |
| Repayment of note payable | (8,331) | |

| | | |
|---|----------------|----------------|
| Net cash flows provided by (used for) financing activities | 588,198 | 233,431 |
|---|----------------|----------------|

| | | |
|---------------------------------|-----|-------|
| Effect of exchange rate changes | 747 | (513) |
|---------------------------------|-----|-------|

| | | |
|-----------------------------|---------|-------|
| Increase (decrease) in cash | 248,179 | (184) |
| Cash at beginning of period | 12,305 | 8,048 |

| | | |
|------------------------------|-------------------|-----------------|
| Cash at end of period | \$ 260,484 | \$ 7,864 |
|------------------------------|-------------------|-----------------|

Supplementary cash flow information

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Cash paid during the period for:

| | | | | |
|--------------|----|--------|----|--------|
| Income taxes | \$ | 6,603 | \$ | 20,700 |
| Interest | \$ | 22,980 | \$ | 11,800 |

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)

SEPTEMBER 30, 2009

1. BUSINESS AND ORGANIZATION

Assured Guaranty Ltd. ("AGL") is a Bermuda-based holding company which provides, through its operating subsidiaries, credit and credit enhancement products to the public finance, structured finance and mortgage markets. References to "Assured Guaranty" or the "Company" are to AGL together with its subsidiaries. Credit and credit enhancement products are financial guaranties or other types of financial credit support, including credit derivatives that improve the credit of underlying debt obligations. The Company issues credit and credit enhancement policies in both insurance and credit derivative form.

The insurance subsidiaries of AGL are Assured Guaranty Corp. ("AGC"), Assured Guaranty Re Ltd. ("AG Re"), Assured Guaranty Re Overseas Ltd. ("AGRO"), Assured Guaranty Mortgage Insurance Company ("AGMIC"), Assured Guaranty (UK) Ltd. ("AGUK") and, as of July 1, 2009, Assured Guaranty Municipal Corp., formerly known as Financial Security Assurance Inc. ("AGM"), FSA Insurance Company, Financial Security Assurance International Ltd., and Financial Security Assurance (U.K.) Ltd.

The Financial Security Assurance Inc. name change to Assured Guaranty Municipal Corp. became effective November 9, 2009.

On July 1, 2009 (the "Acquisition Date"), the Company acquired Financial Security Assurance Holdings Ltd. (together with its subsidiaries, "FSAH") and most of its subsidiaries, including AGM, from Dexia Holdings Inc. ("Dexia Holdings") (the "FSAH Acquisition"). The FSAH Acquisition excluded FSAH's subsidiaries that made up FSAH's financial products segment (the "Financial Products Companies"). The Financial Products Companies were sold to an affiliate of Dexia Holdings prior to the FSAH Acquisition. AGM is a New York domiciled financial guaranty insurance company and the principal operating subsidiary of FSAH. FSAH's financial guaranty insurance subsidiaries participated in the same markets and issued financial guaranty contracts similar to those of the Company.

Segments

The Company's financial results include four principal business segments: financial guaranty direct, financial guaranty reinsurance, mortgage guaranty and other. The financial guaranty segments include policies in both insurance and credit derivative form. These segments are further discussed in Note 17.

Financial Guaranty Direct and Reinsurance

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. Upon an issuer's default, the Company is required under the financial guaranty contract to pay the principal and interest when due in accordance with the underlying contract. 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. Under a reinsurance agreement, the reinsurer receives a premium and, in exchange, agrees to indemnify another insurer, called the ceding company, for part or all of the liability of the ceding company under one or more financial guaranty insurance policies that the ceding company has issued. A credit derivative is a financial instrument whose characteristics and value depend upon the characteristics and value of an

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

1. BUSINESS AND ORGANIZATION (Continued)

underlying security. The Company markets its products directly to and through financial institutions, serving the U.S. and international markets.

Prior to the FSAH Acquisition, AG Re assumed business from FSAH and it continues to do so. For periods prior to the FSAH Acquisition, the Company reported the business assumed from FSAH in the financial guaranty reinsurance segment, reflecting the separate organizational structures as of those reporting dates. As a result, prior period segment results are consistent with the amounts previously reported by segment. For periods subsequent to the FSAH Acquisition, the Company included all financial guaranty business written by FSAH in the financial guaranty direct segment and the FSAH business assumed by AG Re is eliminated from the financial guaranty reinsurance segment as an intercompany transaction.

Mortgage Guaranty

Mortgage guaranty insurance is a specialized class of credit insurance that provides protection to mortgage lending institutions against the default by borrowers on mortgage loans that, at the time of the advance, had a loan to value ratio 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.

Other

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 17.

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****1. BUSINESS AND ORGANIZATION (Continued)****Current Status of Ratings**

The Company's subsidiaries have been assigned the following insurance financial strength ratings as of November 16, 2009. These ratings are subject to continuous review:

Rating Agency Ratings and Outlooks

| | S&P | Fitch | Moody's |
|---|----------------------|----------------------|--------------------------|
| Assured Guaranty Corp. | AAA/Negative Outlook | AA-/Negative Outlook | Aa3/Review for Downgrade |
| Assured Guaranty Re Ltd. | AA/Stable | AA-/Negative Outlook | A1/Review for Downgrade |
| Assured Guaranty Re Overseas Ltd. | AA/Stable | AA-/Negative Outlook | A1/Review for Downgrade |
| Assured Guaranty Mortgage Insurance Company | AA/Stable | AA-/Negative Outlook | A1/Review for Downgrade |
| Assured Guaranty (UK) Ltd. | AAA/Negative Outlook | AA-/Negative Outlook | Aa3/Review for Downgrade |
| Assured Guaranty Municipal Corp. (formerly Financial Security Assurance Inc.) | AAA/Negative Outlook | AA/Negative Outlook | Aa3/Negative Outlook |
| FSA Insurance Company | AAA/Negative Outlook | AA/Negative Outlook | Aa3/Negative Outlook |
| Financial Security Assurance International Ltd. | AAA/Negative Outlook | AA/Negative Outlook | Aa3/Negative Outlook |
| Financial Security Assurance (U.K.) Ltd | AAA/Negative Outlook | AA/Negative Outlook | Aa3/Negative Outlook |

On November 12, 2009, Moody's Investors Service, Inc. ("Moody's") downgraded the insurance financial strength, debt and issuer ratings of AGL and certain of its subsidiaries. AGC and AGUK's insurance financial strength ratings were downgraded to Aa3 from Aa2 and AG Re, AGRO and AGMIC's insurance financial strength ratings were downgraded to A1 from Aa3. All of such ratings are on review for possible downgrade. Moody's stated that if the Company fully implemented certain capital strengthening initiatives, Moody's could conclude the rating review with a confirmation of the ratings of AGC and AGUK at the Aa3 level, with a negative outlook. Moody's further stated, however, that absent such initiatives, Moody's expected to lower such rating into the single-A range. Moody's stated that a key focus of its capital adequacy analysis was the evaluation of Assured Guaranty's exposure to mortgage-related losses. At the same time, Moody's affirmed the Aa3 insurance financial strength ratings of AGM and its affiliated insurance operating companies; all of such ratings have been assigned a negative outlook. There can be no assurance that Moody's will not take further action on the ratings of AGM and its affiliated insurance operating companies, or as to the ultimate conclusion of Moody's rating review of AGC, AGUK, or AG Re and its subsidiaries.

In response to Moody's rating action, the Company currently intends to implement a capital relief plan involving the cession of a portfolio of transactions to a third party reinsurer, intercompany capital support and approximately \$300 million of additional capital. The Company may not be able to implement the capital strengthening initiatives fully or at all, and its ratings may be downgraded by one or more of the rating agencies as a result. Even if such capital strengthening initiatives were available, the cost of the capital relief may be high and therefore result in increased expense to the Company or dilution to AGL's shareholders.

On October 12, 2009, Fitch Ratings, Inc. ("Fitch") downgraded the debt and insurer financial strength ratings of Assured Guaranty and its subsidiaries, as applicable, stating that its downgrade was based on its expectations of credit losses arising from the Company's residential mortgage securitization

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

1. BUSINESS AND ORGANIZATION (Continued)

exposures, as well as other areas of concern in the insured portfolio of AGC and AG Re, particularly their exposure to trust preferred CDOs. Fitch downgraded the insurer financial strength ratings of AGC and Assured Guaranty (UK) Ltd. ("AGUK") to "AA-" from "AA" and the insurer financial strength ratings of AGM, FSA Insurance Company, Financial Security Assurance International Ltd. and Financial Security Assurance (U.K.) Ltd to "AA" from "AA+." It also downgraded the debt ratings of AGUS to "A-" from "A," the senior debt ratings of FSAH to "A-" from "A+" and its subordinated debt ratings to "BBB+" from "A." It affirmed the insurer financial strength ratings of AG Re, AGRO and AGMIC at "AA-." All of the above ratings have been assigned a negative outlook. There is no assurance that Fitch will not take further action regarding the Company's ratings.

On July 1, 2009, Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("S&P") published a Research Update in which it affirmed its "AAA" counterparty credit and financial strength ratings on AGC and AGM. At the same time, S&P revised its outlook on AGC and AGUK to negative from stable and continued its negative outlook on AGM. S&P cited as a rationale for its actions the large single risk concentration exposure that the Company and AGM retain to Belgium and France related to the residual exposure to FSAH's financial products segment prior to the posting of collateral by Dexia S.A. ("Dexia"), a Belgian corporation, in October 2011, all in connection with the FSAH Acquisition. In addition, the outlook also reflected S&P's view that the change in the competitive dynamics of the industry with the potential entrance of new competitors, alternative forms of credit enhancement and limited insurance penetration in the U.S. public finance market could hurt the companies' business prospects. There can be no assurance that S&P will not take further action on the Company's ratings.

See Note 6 and Note 9 for more information regarding the impact of rating agency actions upon the credit derivative business and the reinsurance business of the Company.

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD.

On the Acquisition Date, the Company, through its wholly-owned subsidiary AGUS, purchased FSAH and, indirectly, its subsidiaries (excluding those involved in FSAH's financial products business) from Dexia Holdings, an indirect subsidiary of Dexia. The acquired companies are collectively referred to as the "Acquired Companies." The Financial Products Companies were sold to an affiliate of Dexia Holdings prior to the FSAH Acquisition. FSAH's former financial products segment had been in the business of borrowing funds through the issuance of guaranteed investment contracts ("GICs") and medium term notes ("MTNs") and reinvesting the proceeds in investments that met FSAH's investment criteria. The financial products business also included portions of FSAH's leveraged lease business. In connection with the FSAH Acquisition, Dexia Holdings agreed to assume the risks in respect of the GICs and MTNs, and the risks relating to the equity payment undertaking agreement in the leveraged lease business; AGM agreed to retain the risks relating to the debt and strip policy portions of such business. See Note 12.

The Company is indemnified against exposure to FSAH's former financial products segment through guarantees issued by Dexia and certain of its affiliates. In addition, the Company is protected from exposure to the GIC business of FSAH's former financial products segment through guaranties issued by the French and Belgian governments.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)

FSAH is now a wholly owned subsidiary of AGUS and the Company's financial statements subsequent to the Acquisition Date include the activities of FSAH.

The purchase price paid by the Company was \$546.0 million in cash and 22.3 million common shares of AGL with an Acquisition Date fair value of \$275.9 million, for a total purchase price of \$821.9 million.

At the closing of the FSAH Acquisition, Dexia Holdings, a Delaware corporation, owned approximately 14.0% of AGL's issued common shares. Dexia Holdings agreed that the voting rights with respect to all AGL's common shares issued pursuant to the purchase agreement providing for the sale of the FSAH shares owned by Dexia Holdings to Assured Guaranty will constitute less than 9.5% of the voting power of all issued and outstanding AGL common shares. Dexia Holdings transferred its common shares of AGL to Dexia, acting through its French branch, effective August 13, 2009.

The FSAH Acquisition was accounted for under the purchase method of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Accordingly, the purchase price was allocated to assets acquired and liabilities assumed based on their estimated fair value at the Acquisition Date. In many cases, determining the fair value of acquired assets and assumed liabilities required the Company to exercise significant judgment. The most significant of these determinations related to the valuation of the acquired financial guaranty direct and ceded contracts.

The fair value of the deferred premium revenue (which is a component of unearned premium reserve, as described below) is the estimated premium that a similarly rated hypothetical financial guarantor would demand to assume each policy. The methodology for determining such value takes into account the rating of the insured obligation expectation of loss and sector. As the fair value of the deferred premium revenue exceeded the Company's estimate of expected loss for each contract, no loss reserves were recorded at July 1, 2009.

Based on the Company's assumptions, the fair value of the Acquired Companies' deferred premium revenue on its insurance contracts at July 1, 2009 was \$7.3 billion, an amount approximately \$1.7 billion greater than the Acquired Companies' gross stand ready obligations at June 30, 2009. The stand-ready obligation as June 30, 2009 was comprised of \$3.8 billion in deferred premium revenue and \$1.8 billion of loss reserves. This indicates that the amounts of the Acquired Companies' contractual premiums were less than the premiums a market participant of similar credit quality would demand to assume those contracts at the Acquisition Date. The fair value of the Acquired Companies' deferred premium revenue on its ceded contracts at July 1, 2009 was an asset of \$1.7 billion. The fair value of the ceded contracts is in part derived from the fair value of the related insurance contracts with an adjustment for the credit quality of each reinsurer applied.

For FSAH's long-term debt, the fair value was based upon quoted market prices available from third-party brokers as of the Acquisition Date. The fair value of this debt was approximately \$0.3 billion lower than its carrying value immediately prior to the acquisition. This discount will be amortized into interest expense over the estimated remaining life of the debt.

Additionally, in accordance with GAAP, other purchase accounting adjustments included (1) the write off of the Acquired Companies' deferred acquisition cost and (2) the consolidation of certain

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)

financial guaranty variable interest entities ("VIEs") in which the combined variable interest of the Acquired Companies and AG Re was determined to be the primary beneficiary.

The following table represents the allocation of the purchase price to the net assets of the Acquired Companies. The bargain purchase gain results from the difference between the purchase price and the net assets fair value estimates.

| | July 1, 2009 (in thousands) |
|--|--------------------------------|
| Purchase price: | |
| Cash | \$ 545,997 |
| Fair value of common stock issued (based upon June 30, 2009 closing price of AGO common stock) | 275,875 |
| Total purchase price | 821,872 |
| Identifiable assets acquired: | |
| Investments | 5,950,061 |
| Cash | 86,999 |
| Premiums receivable, net | 854,140 |
| Ceded unearned premium reserve | 1,727,673 |
| Deferred tax asset, net | 888,117 |
| Financial guaranty variable interest entities assets | 1,879,446 |
| Other assets | 662,496 |
| Total assets | 12,048,932 |
| Liabilities assumed: | |
| Unearned premium reserves | 7,286,393 |
| Long-term debt | 396,160 |
| Note payable to related party | 164,443 |
| Credit derivative liabilities | 920,018 |
| Financial guaranty variable interest entities liabilities | 1,878,586 |
| Other liabilities | 348,906 |
| Total liabilities | 10,994,506 |
| Net assets resulting from acquisition | 1,054,426 |
| Bargain purchase gain resulting from the FSAH Acquisition | \$ 232,554 |

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The bargain purchase gain was recorded within "Goodwill and settlement of pre-existing relationship" in the Company's consolidated statements of operations in the three-month period ended September 30, 2009 ("Third Quarter 2009"). The bargain purchase results from the unprecedented credit crisis, which resulted in a significant decline in FSAH's franchise value due to material insured losses, ratings downgrades and significant losses at FSAH's parent company, which resulted in government intervention in its affairs and resulting motivation to sell FSAH, and the absence of potential purchasers of FSAH due to the financial crisis. The initial difference between the purchase price of \$822 million and FSAH's recorded net assets of \$2.1 billion was reduced significantly by the

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)**

recognition of additional liabilities related to FSAH's insured portfolio on a fair value basis as required by purchase accounting. The Company and FSAH had a pre-existing reinsurance relationship before the acquisition. Under GAAP, this pre-existing relationship must be effectively settled at fair value. The loss relating to this pre-existing relationship results from the effective settlement of reinsurance contracts at fair value and the write-off of previously recorded assets and liabilities relating to this relationship recorded in the Company's historical accounts. The loss related to the contract settlement results from contractual premiums that were less than the Company's estimate of what a market participant would demand currently, estimated in a manner similar to how the value of the Acquired Companies insurance policies were valued, as described above.

A summary of goodwill and settlements of pre-existing relationship included in the consolidated statement of operations follows:

| | Nine months ended September 30, 2009 (in thousands) | |
|--|--|-----------|
| Goodwill impairment associated with reinsurance assumed line of business | \$ | 85,417 |
| Gain on bargain purchase of FSAH | | (232,554) |
| Settlement of pre-existing relationship in conjunction with the FSAH Acquisition | | 170,478 |
| Goodwill and settlement of pre-existing relationship | \$ | 23,341 |

Application of Financial Guaranty Insurance Accounting (ASC 944-20) to the FSAH Acquisition

Under GAAP, acquisition accounting requires that the fair value of each of the financial guaranty contracts in FSAH's insured portfolio be recorded on the Company's balance sheet. The fair value of FSAH's direct contracts was recorded on the line items "premium receivable" and "unearned premium reserve" and the fair value of its ceded contracts was recorded within "other liabilities" and "ceded unearned premium reserves" on the balance sheet. In accordance with Accounting Standards Codification ("ASC") 805-10, "Business Combinations" (Statement of Financial Accounting Standards ("FAS") No. 141 (revised), "Business Combinations") and ASC 944-20, "Financial Services-Insurance"

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)

(FAS No. 163, "Accounting for Financial Guaranty Insurance Contracts"), management recorded the FSAH financial guaranty insurance and reinsurance contracts as follows:

Financial Guaranty Contracts Acquired in FSAH Acquisition

| | FSAH Carrying Value As of June 30, 2009 | Acquisition Accounting Adjustment(1) | Assured Guaranty Carrying Value As of July 1, 2009(2) |
|---|---|--|---|
| | (in thousands) | | |
| Premiums receivable, net | \$ 854,140 | \$ | \$ 854,140 |
| Ceded unearned premium reserve | 1,299,224 | 418,449 | 1,727,673 |
| Reinsurance recoverable on paid and unpaid losses | 279,915 | (279,915) | |
| Reinsurance balances payable, net of commissions | 249,564 | | 249,564 |
| Unearned premium reserve | 3,778,676 | 3,507,717 | 7,286,393 |
| Loss and loss adjustment expense reserves | 1,821,309 | (1,821,309) | |
| Deferred acquisition costs | 289,290 | (289,290) | |

- (1) Represents the adjustments required to record the Acquired Companies' balances at fair value. The fair value adjustment to unearned premium reserve takes into account ratings, estimated economic losses and current pricing.
- (2) Represents the carrying value of the Acquired Companies' financial guaranty contracts, before intercompany eliminations primarily between AG Re and the Acquired Companies.

On July 1, 2009, premiums receivable and reinsurance balances payable were recorded at FSAH historical value (i.e. the carrying amount on the FSAH balance sheet at June 30, 2009, the date prior to the FSAH Acquisition) in the Company's consolidated balance sheet. Gross and ceded unearned premium reserve represents the stand ready obligation under ASC 944-20. The carrying value recorded on July 1, 2009 takes into account the total fair value of each financial guaranty contract, including expected losses, on a contract by contract basis, less premiums receivable or premiums payable.

Incurred losses are recognized in the consolidated statements of operations line item "loss and loss adjustment expenses" at the time that they exceed deferred premium revenue on a contract by contract basis. When a claim payment is made, it is recorded as a contra deferred premium revenue liability and becomes recognized in the income statement only when the sum of such claim payments and the present value of future expected losses exceeds deferred premium revenue. The new carrying value of gross and ceded unearned premium reserves therefore includes expected losses previously recognized in FSAH's financial statements prior to its acquisition by the Company. Such unearned premium reserves amounts will be earned through the "net earned premiums" line item on the consolidated statements of operations.

In accordance with GAAP, losses are recognized when they exceed deferred premium revenue on a contract by contract basis. Deferred premium revenue for the Acquired Companies includes fair value adjustments as noted in the table above, which incorporate, among other factors, estimates of expected loss at the Acquisition Date. As a result of the significant fair value adjustments, deferred premium revenue of the Acquired Companies exceeded its expected losses as of the Acquisition Date. Accordingly, no loss reserves were recorded on the Acquisition Date.

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)**

The unearned premium reserve related to AGM is comprised of the following components:

Unearned Premium Reserve

| | July 1, 2009 | | September 30, 2009 |
|---------------------------------|---------------------|-----------|--------------------|
| | (in thousands) | | |
| Deferred premium revenue | \$ 5,654,020 | \$ | 5,391,707 |
| Claim payments | | | (250,539) |
| Unearned premium reserve | \$ 5,654,020 | \$ | 5,141,168 |

Claim payments relate to claims paid on policies for which the Company has a continuing obligation to provide insurance and for which there is no loss reserve because deferred premium revenue exceeds expected losses.

Goodwill Impairment Analysis

In accordance with GAAP, the Company does not amortize goodwill, but instead is required to perform an impairment test annually or more frequently should circumstances warrant. The impairment test evaluates goodwill for recoverability by comparing the fair value of the Company's direct and reinsurance lines of business to their carrying value. If fair value is greater than carrying value then goodwill is deemed to be recoverable and there is no impairment. If fair value is less than carrying value then goodwill is deemed to be impaired and written down to an amount such that the fair value of the reporting unit is equal to the carrying value, but not less than \$0. As part of the impairment test of goodwill, there are inherent assumptions and estimates used by management in developing discounted future cash flows related to the Company's direct and reinsurance lines of business that are subject to change based on future events.

The Company reassessed the recoverability of goodwill in the Third Quarter 2009 subsequent to the FSAH Acquisition, which provided the Company's largest assumed book of business prior to the acquisition. As a result of the FSAH Acquisition, which significantly diminished the Company's potential near future market for assuming reinsurance, combined with the continued credit crisis, which has adversely affected the fair value of the Company's in-force policies, management determined that the full carrying value of \$85.4 million of goodwill on its books prior to the FSAH Acquisition should be written off in the Third Quarter 2009. This charge does not have any adverse effect on the Company's debt agreements or its overall compliance with the covenants of its debt agreements.

Pro Forma Condensed Combined Statement of Operations

The following unaudited pro forma information presents the combined results of operations of Assured Guaranty and the Acquired Companies for the nine months ended September 30, 2009 ("Nine Months 2009") as if the FSAH Acquisition had been completed on January 1, 2009. The pro forma information is presented for illustrative purposes and are not intended to represent or be indicative of the actual results of operations of the combined company that would have been achieved had the FSAH Acquisition occurred at the beginning of each period presented, nor are they intended to represent or be indicative of future results of operations. The pro forma results of operations shown

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)

below are not comparable due to new accounting requirements for financial guaranty contracts effective January 1, 2009.

Pro Forma Unaudited Results of Operations

| | Nine Months 2009 | | | Nine Months 2008 | | |
|---|------------------------------------|---|-----------------------|------------------------------------|---|-----------------------|
| | Assured Guaranty As Reported | Pro Forma Adjustments for Acquisition | Pro Forma Combined | Assured Guaranty As Reported | Pro Forma Adjustments for Acquisition | Pro Forma Combined |
| (in thousands) | | | | | | |
| REVENUES | | | | | | |
| Net earned premiums | \$ 557,050 | \$ 574,445 | \$ 1,131,495 | \$ 184,034 | \$ 436,738 | \$ 620,772 |
| Net investment income | 171,643 | 96,831 | 268,474 | 120,247 | 160,093 | 280,340 |
| Net realized investment gains (losses): | (28,096) | (9,687) | (37,783) | (17,951) | (1,727) | (19,678) |
| Net change in fair value of credit derivatives | | | | | | |
| Realized gains and other settlements | 120,086 | 59,963 | 180,049 | 89,370 | 98,764 | 188,134 |
| Net unrealized gains (losses) | (432,637) | 626,935 | 194,298 | 332,634 | (467,904) | (135,270) |
| Net change in fair value of credit derivatives | (312,551) | 686,898 | 374,347 | 422,004 | (369,140) | 52,864 |
| Financial guaranty variable interest entities revenues | 4,881 | | 4,881 | | | |
| Fair value gain (loss) on committed capital securities | (93,961) | 6,655 | (87,306) | | 70,704 | 70,704 |
| Income from assets acquired in financing transactions | 1,619 | 3,833 | 5,452 | | 8,385 | 8,385 |
| Other income | 58,533 | 59,045 | 117,578 | 24,756 | 6,406 | 31,162 |
| TOTAL REVENUES | 359,118 | 1,418,020 | 1,777,138 | 733,090 | 311,459 | 1,044,549 |
| EXPENSES | | | | | | |
| Loss and loss adjustment expenses | 251,109 | 44,272 | 295,381 | 175,805 | 1,482,367 | 1,658,172 |
| Amortization of deferred acquisition costs | 41,277 | (10,339) | 30,938 | 43,004 | 53,119 | 96,123 |
| Other operating expenses | 122,325 | 60,147 | 182,472 | 73,886 | 44,874 | 118,760 |
| FSAH acquisition-related expenses | 80,179 | (80,179) | | | | |
| Interest expense | 37,495 | 31,886 | 69,381 | 17,462 | 49,242 | 66,704 |
| Goodwill and settlement of pre-existing relationship | 23,341 | 62,076 | 85,417 | | | |
| Financial guaranty variable interest entities expenses | 10,152 | | 10,152 | | | |
| Profit commission expense | 2,549 | (1,289) | 1,260 | 758 | (90) | 668 |
| Other expenses | | | | | | |
| TOTAL EXPENSES | 568,427 | 106,574 | 675,001 | 310,915 | 1,629,512 | 1,940,427 |

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| | | | | | | |
|--|---------------------|-------------------|-------------------|-------------------|---------------------|---------------------|
| INCOME (LOSS) BEFORE | | | | | | |
| INCOME TAXES | (209,309) | 1,311,446 | 1,102,137 | 422,175 | (1,318,053) | (895,878) |
| (Benefit) provision for income taxes | (84,493) | 533,415 | 448,922 | 109,508 | (517,275) | (407,767) |
| NET INCOME (LOSS) | (124,816) | 778,031 | 653,215 | 312,667 | (800,778) | (488,111) |
| Less: Noncontrolling interest of variable interest entities | (5,271) | | (5,271) | | | |
| NET INCOME (LOSS) ATTRIBUTABLE TO ASSURED GUARANTY LTD. | \$ (119,545) | \$ 778,031 | \$ 658,486 | \$ 312,667 | \$ (800,778) | \$ (488,111) |
| Net (loss) earnings per basic share | | | 4.20 | | | (3.59) |

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****2. ACQUISITION OF FINANCIAL SECURITY ASSURANCE HOLDINGS LTD. (Continued)****Common Share and Equity Units Offerings**

On June 24, 2009, AGL completed the sale of 44,275,000 of its common shares (including 5,775,000 common shares allocable to the underwriters pursuant to the overallotment option) at a price of \$11.00 per share. Concurrent with the common share offering, AGL along with AGUS sold 3,450,000 equity units (including 450,000 equity units allocable to the underwriters) at a stated amount of \$50 per unit. The equity units initially consist of a forward purchase contract and a 5% undivided beneficial ownership interest in \$1,000 principal amount 8.50% senior notes due 2014 issued by AGUS ("8.50% Senior Notes"). Under the purchase contract, holders are required to purchase AGL's common shares no later than June 1, 2012. The threshold appreciation price of the equity units is \$12.93, which represents a premium of 17.5% over the public offering price in the common share offering. The 8.50% Senior Notes are fully and unconditionally guaranteed by AGL. The net proceeds after underwriting expenses and offering costs for these two offerings totaled approximately \$616.5 million. Of that amount, \$170.8 million related to the equity unit offering, \$168.0 million of which was recognized as long-term debt and \$2.8 million as additional paid-in-capital in shareholders' equity in the consolidated balance sheets. Offering costs totaled approximately \$43.5 million and were recorded within "Additional paid-in capital" in the consolidated balance sheets. For a description of the 8.50% Senior Notes, see Note 12.

In conjunction with the FSAH Acquisition, on November 13, 2008, the Company entered into an amendment (the "Amendment") to the investment agreement dated as of February 28, 2008 (the "Investment Agreement") between AGL and investment funds affiliated with WL Ross Group, L.P. ("WLR Funds"). The Amendment provided a back up funding commitment to finance the FSAH Acquisition. Pursuant to pre-emptive rights set forth in the Investment Agreement, WLR Funds purchased 3,850,000 common shares of the Company in the Company's June 2009 public common share offering at \$11.00 per common share, the public offering price in the public offering. The WLR Funds own approximately 10.2% of the outstanding common stock of AGL as of the date of this filing. WLR Funds is an affiliate of Wilbur L. Ross, Jr., who is one of AGL's directors.

FSAH Acquisition-Related Expenses

Expenses related to the FSAH Acquisition are summarized below.

| | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2009 |
|-----------------------|--|---|
| | (in thousands) | |
| Severance costs | \$ 37,147 | \$ 37,147 |
| Professional services | 13,624 | 27,739 |
| Office consolidation | 562 | 15,293 |
| Total | \$ 51,333 | \$ 80,179 |

The Company expects to incur additional FSAH Acquisition-related expenses, although such costs are expected to be less than the amount incurred during the first nine months of 2009. As of September 30, 2009, FSAH Acquisition-related expenses included \$13.7 million in accrued expenses, not yet paid.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

3. BASIS OF PRESENTATION

The unaudited interim consolidated financial statements have been prepared in conformity with GAAP and, in the opinion of management, reflect all adjustments which are of a normal recurring nature, in addition to adjustments required by acquisition accounting, 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 Third Quarter 2009, the three-month period ended September 30, 2008 ("Third Quarter 2008"), Nine Months 2009 and the nine-month period ended September 30, 2008 ("Nine Months 2008"). Operating results for the three- and nine-month periods ended September 30, 2009 and 2008 are not necessarily indicative of the results that may be expected for a full year. The 2009 financial statements include the effects of the Company's common share and equity units offering that took place on June 24, 2009 and the effects of the FSAH Acquisition, which was effective July 1, 2009.

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 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.

Volatility and disruption in the global financial markets including 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. 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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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

3. BASIS OF PRESENTATION (Continued)

Subsequent Events

The Company has performed an evaluation of events that have occurred subsequent to September 30, 2009 and through November 16, 2009 (the date of filing of this quarterly report on Form 10-Q). There have been no material subsequent events that occurred during such period that would require disclosure in the consolidated financial statements as of or for the three and nine months ending September 30, 2009.

Update for Significant Accounting Policies

Adoption of ASC 944-20

Effective January 1, 2009, the Company adopted ASC 944-20. ASC 944-20 changed the premium revenue recognition and loss reserving methodology for non-derivative financial guaranty contracts. See Note 5 for a detailed description of, and the disclosures required by, ASC 944-20 for premiums and losses on financial guaranty insurance contracts.

Update for Significant Accounting Policies as a Result of FSAH Acquisition

Foreign Currency Translation

Assets, liabilities, revenues and expenses denominated in non-U.S. currencies are translated into U.S. dollars using applicable exchange rates. Gains and losses relating to translating functional currency financial statements for U.S. reporting are included in "other comprehensive income" within shareholders' equity. Gains and losses relating to nonfunctional currency transactions, including non-U.S. operations where the functional currency is the U.S. dollar, are reported in "other income" in the consolidated statement of operations, except for unrealized gains and losses on available-for-sale securities which are recorded in "accumulated other comprehensive income" unless the unrealized loss on a security is deemed to be an other than temporary impairment ("OTTI").

Financial Guaranty Variable Interest Entities and Noncontrolling Interest

The Company consolidates VIEs for which it determines that it is the primary beneficiary. In determining whether the Company is the primary beneficiary, a number of factors are considered, including the structure of the entity and the risks it was created to pass along to variable interest holders, the extent of credit risk absorbed by the Company through its insurance contract, the extent to which credit protection provided by other variable interest holders reduces this exposure and the exposure that the Company cedes to third party reinsurers. See Note 13 for more information regarding the Company's consolidated VIEs.

The Company adopted ASC 810-10, "Consolidation" (FAS No. 160, "Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51") and presented noncontrolling interest in the consolidated financial statements.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

3. BASIS OF PRESENTATION (Continued)

Long-Term Debt and Notes Payable to Related Party

In accordance with acquisition accounting, long-term debt and notes payable to a related party were recorded at fair value on July 1, 2009. The fair-value adjustment is accreted through income over the term of the debt outstanding.

Cash and Short-Term Investments

Cash includes demand deposits.

Short-term investments, which are those investments with a maturity of less than one year at time of purchase, are carried at fair value. Amounts deposited in money market funds and investments with a maturity at time of purchase of three months or less are included in short-term investments.

4. RECENT ACCOUNTING PRONOUNCEMENTS

In August 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update No. 2009-05, "Fair Value Measurements and Disclosures Measuring Liabilities at Fair Value" ("ASU 2009-05"). The update provides clarification for circumstances in which a quoted price in an active market for an identical liability is not available. ASU 2009-05 is effective for the first reporting period beginning after August 2009. The adoption of ASU 2009-05 did not have a material impact on the Company's financial statements.

In June 2009, the FASB issued ASC 105, "Generally Accepted Accounting Principles" (FAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162"). This statement modifies the GAAP hierarchy by establishing only two levels of GAAP, authoritative and non-authoritative accounting literature. Effective July 2009, the FASB Accounting Standards Codification, also known collectively as the "Codification," is considered the single source of authoritative U.S. accounting and reporting standards, except for additional authoritative rules and interpretive releases issued by the Securities and Exchange Commission ("SEC"). Non-authoritative guidance and literature would include, among other things, FASB Concepts Statements, American Institute of Certified Public Accountants Issue Papers and Technical Practice Aids and accounting textbooks. The Codification was developed to organize GAAP pronouncements by topic so that users can more easily access authoritative accounting guidance. It is organized by topic, subtopic, section, and paragraph, each of which is identified by a numerical designation. Technical references to GAAP included in these Notes to Consolidated Financial Statements are provided under the new FASB ASC structure with the prior terminology included parenthetically when first used.

In June 2009, the FASB issued FAS No. 167, "Amendments to FASB Interpretation No. 46(R)" ("FAS 167"). FAS 167 changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. FAS 167 will require a company to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to that involvement. FAS 167 will become effective for the Company's fiscal year beginning January 1, 2010. The Company is currently evaluating the effect, if any, the adoption of FAS 167 will have on its consolidated financial statements.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

4. RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

In September 2008, the FASB issued ASC 815-10-65-2, "Derivatives and Hedging" (Staff Position ("FSP") FAS 133-1 and FASB Interpretation No. ("FIN") 45-4, "Disclosures About Credit Derivatives and Certain Guarantees") and ASC 815-10, "Derivatives and Hedging" (FAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities") to address concerns that current derivative disclosure requirements did not adequately address the potential adverse effects that these instruments can have on the financial performance and operations of an entity. Companies are required to provide enhanced disclosures about their derivative activities to enable users to better understand: (1) how and why a company uses derivatives, (2) how it accounts for derivatives and related hedged items, and (3) how derivatives affect its financial statements. These should include the terms of the derivatives, collateral posting requirements, triggers, and other significant provisions that could be detrimental to earnings or liquidity. Management believes that the Company's current derivatives disclosures are in compliance with the requirements of ASC 815-10-65-2 and ASC 815-10.

In December 2007, the FASB issued ASC 805-10. ASC 805-10 establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. ASC 805-10 also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. The Company applied the provisions of ASC 805-10 to account for the FSAH Acquisition. See Note 2.

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS

Effective January 1, 2009, the Company adopted ASC 944-20. ASC 944-20 clarifies the methodology to be used for financial guaranty premium revenue recognition and claim liability measurement, and expands the disclosures about the insurance enterprise's risk management activities. ASC 944-20 has been applied to all existing financial guaranty insurance and reinsurance contracts written by the Company except for financial guaranty contracts considered derivatives under ASC 815-10-65-2. The accounting changes prescribed by the statement were recognized by the Company as a cumulative effect adjustment to retained earnings as of January 1, 2009. As a result of the adoption of ASC 944-20 as well as the FSAH Acquisition, premium earnings and loss and loss adjustment expenses are not comparable between 2008 and 2009.

Premium Revenue Recognition

Upon Adoption of ASC 944-20

The Company recognizes a liability for unearned premium reserve at the inception of a financial guaranty contract equal to the present value of the premiums due or expected to be collected over the period of the contract or, for those contracts acquired under a business combination, at management's estimate of the contract fair value as of the date of the acquisition.

If the premium is a single premium received at the inception of the financial guaranty contract, the Company measures the unearned premium reserve as the amount received.

For premiums received in installments, the Company measures the unearned premium reserve as the present value of premiums due or expected to be collected over the life of the contracts. The term

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

of the financial guaranty contract that is used as the basis for the calculation of the present value of premiums due or expected to be collected is either (a) the contractual term or (b) the expected term. The contractual term is used unless the obligations underlying the financial guaranty contract represent homogeneous pools of assets for which prepayments are contractually prepayable, the amount of prepayments are probable, and the timing and amount of prepayments can be reasonably estimated. 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 reserve is equal to 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 guaranty insurance contract as revenue over the contractual period or expected 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 reserve occurs. The amount of insurance protection provided is a function of the insured principal amount outstanding. Accordingly, the proportionate share of premium revenue recognized in a given reporting period is a constant rate calculated based on the relationship between the insured principal amount outstanding in the 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, the financial guaranty insurance contract on the retired financial obligation is extinguished. The Company immediately recognizes any nonrefundable unearned premium reserve related to that contract as premium revenue and any associated acquisition costs previously deferred as an expense. Upon the FSAH Acquisition, the Company revised its assumptions used in calculating premium earnings to conform all entities within the consolidated group.

Premium revenue and the related amortization of deferred acquisition costs are accelerated when the Company is legally released from its financial guaranty insurance contract.

Prior to Adoption of ASC 944-20

Prior to January 1, 2009, 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, thereby matching revenue recognition with the underlying risk. The premiums were allocated in accordance with the principal amortization schedule of the related bond issuance and were earned ratably over the amortization period. When an insured issuance 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. On contracts where premiums were paid in installments, only the currently due installment was recorded in the financial statements.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

Summary of Consolidated Financial Guaranty Contracts

The following tables provide information for financial guaranty insurance contracts where premiums are received on an installment basis as of and for the nine months ended September 30, 2009:

Selected Information for Policies Paid in Installments

| | September 30, 2009 |
|---|------------------------|
| | (dollars in thousands) |
| Premiums receivable, net (end of period) | \$ 1,493,178 |
| Deferred premium revenue (end of period) | \$ 4,606,623 |
| Accretion of discount on premium receivable | \$ 24,350 |
| Weighted-average risk-free rate to discount premiums | 3.2% |
| Weighted-average period of premiums receivable (in years) | 10.3 |

Expected Collections of Premiums

| (dollars in thousands) | | |
|------------------------|---------------|-----------|
| 2009 (October 1 | December 31) | \$ 98,732 |
| 2010 (January 1 | March 31) | 42,816 |
| 2010 (April 1 | June 30) | 41,598 |
| 2010 (July 1 | September 30) | 38,164 |
| 2010 (October 1 | December 31) | 36,454 |
| 2011 | | 137,556 |
| 2012 | | 124,896 |
| 2013 | | 113,735 |
| 2014 | 2018 | 457,260 |
| 2019 | 2023 | 326,793 |
| 2024 | 2028 | 242,453 |
| 2029 | 2033 | 172,070 |
| 2034 | 2038 | 88,236 |
| 2039 | 2043 | 36,711 |
| 2044 | 2048 | 15,799 |
| 2049 | 2053 | 4,708 |
| 2054 | 2056 | 2,435 |

Total premiums receivable, net \$ 1,980,416

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

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

Gross Premium Receivable Rollforward(1)

| | (in thousands) |
|---|----------------|
| Premium receivable at January 1 | \$ 737,181 |
| Premiums written, net | 376,799 |
| Accretion of premium receivable discount | 10,812 |
| Premium payments received | (371,900) |
| Premium receivable, net at June 30 | 752,892 |
| Premiums receivable purchased in FSAH Acquisition on July 1, 2009 including intercompany eliminations | 800,944 |
| Premiums receivable, net as of July 1, 2009 | 1,553,836 |
| Premium written, net | 148,493 |
| Premium payments received | (217,702) |
| Adjustments to the premium receivable: | |
| Changes in the expected term of financial guaranty insurance contracts | (21,093) |
| Accretion of the premium receivable discount | 12,640 |
| Foreign exchange rate changes | 27,869 |
| Premium receivable, net at September 30 | \$ 1,504,043 |

- (1) The "accretion of premium receivable discount" is included in earned premium in the Company's consolidated statements of operations. The above amounts are presented net of applicable ceding commissions on assumed business.

The following table presents the components of net premiums earned.

Net Premiums Earned

| | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2009 |
|---|--|---|
| | (in thousands) | |
| Net earned premiums | \$ 300,973 | \$ 406,912 |
| Acceleration of premium earnings | 17,374 | 127,710 |
| Accretion of discount on premium receivable | 11,623 | 22,428 |
| Total net earned premiums and accretion | \$ 329,970 | \$ 557,050 |

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In the Company's assumed 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. A portion of the premiums must be estimated because some of the Company's ceding companies report premium data between 30 and 90 days after the end of the reporting period. Earned premium reported

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)**

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.

The following table provides a schedule of how the Company's premiums and losses are expected to run off in the consolidated statement of operations.

Runoff of Deferred Premium Revenue, Net

| | Deferred Premium Revenue | Expected Losses | Deferred Premium Revenue in Excess of Expected Losses |
|--------------------------------|---|----------------------------|--|
| | (in thousands) | | |
| 2009 (October 1 - December 31) | \$ 304,034 | \$ 16,573 | \$ 287,461 |
| 2010 (January 1 - March 31) | 284,117 | 26,572 | 257,545 |
| 2010 (April 1 - June 30) | 272,488 | 45,558 | 226,930 |
| 2010 (July 1 - September 30) | 256,776 | 44,581 | 212,195 |
| 2010 (October 1 - December 31) | 240,575 | 41,713 | 198,862 |
| 2011 | 809,059 | 116,795 | 692,264 |
| 2012 | 670,813 | 120,265 | 550,548 |
| 2013 | 570,663 | 119,163 | 451,500 |
| 2014 - 2018 | 1,894,073 | 354,485 | 1,539,588 |
| 2019 - 2023 | 1,019,119 | 86,082 | 933,037 |
| 2024 - 2028 | 642,081 | 40,791 | 601,290 |
| After 2028 | 742,838 | 53,082 | 689,756 |
| Total | \$ 7,706,636 | \$ 1,065,660 | \$ 6,640,976 |

Deferred Acquisition Costs

Acquisition costs incurred on financial guaranty insurance contracts that vary with and are directly related to the production of new business are deferred and then 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. Expected 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 financial guaranty contracts accounted for as credit derivatives are expensed as incurred. When an insured issue is retired early, the remaining related deferred acquisition cost is expensed at that time. Ceding commissions associated with future installment premiums on assumed and ceded business are calculated at their contractually defined rate and recorded in deferred acquisition costs consistent with

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

the adoption of ASC 944-20. There is a corresponding offset to premium receivable. No deferred acquisition costs are recorded in connection with policies acquired as part of a business combination.

Reserves for Losses and Loss Adjustment Expenses

Financial Guaranty Contracts Upon Adoption of ASC 944-20

The Company recognizes a reserve for losses and loss adjustment expenses on a financial guaranty insurance contract when expected loss exceeds the deferred 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 reserve represents the insurance enterprise's stand-ready obligation under a financial guaranty 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 reserve, the Company recognizes a reserve for losses and loss adjustment expenses for the amount of expected loss in excess of unearned premium reserve.

The expected loss 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 (the contract or expected period, 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 possible outcomes. The Company estimates the expected net cash outflows using management's assumptions about the likelihood of possible outcomes based on all information available to it. Those assumptions consider the 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. 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.

When a claim payment is made on a contract it reduces loss reserves or, to the extent loss reserve are not recorded, it reduces unearned premium reserve.

The deferred premium revenue represents the amount that will be recorded through earned premiums in the consolidated statements of operations over the terms of the relevant financial guaranty contracts. Accumulated claim payments do not reduce the amount of earned premium to be recognized over the life of a given contract; instead, such losses are recorded in "loss and loss adjustment expenses" on the consolidated statements of operations beginning in the reporting period that "total losses" (i.e. the sum of cumulative claim payments, plus estimated expected future losses), exceeds deferred premium revenue. The amount recorded in "loss and loss adjustment expense" in a given reporting period is the excess of total losses over deferred premium revenue on a contract by contract basis.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

Financial Guaranty Contracts Prior to Adoption of ASC 944-20

Prior to January 1, 2009, reserves for losses for non-derivative transactions in the Company's financial guaranty contracts 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 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 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. Instead, they were calculated by aggregating the portfolio reserve calculated for each individual transaction. Individual transaction reserves were calculated on a quarterly basis by multiplying the par in-force by the product of the ultimate loss and earning factors without regard to discounting. The ultimate loss factor was defined as the frequency of loss multiplied by the severity of loss, where the frequency was defined as the probability of default for each individual issue. The earning factor was inception to date earned premium divided by the estimated ultimate written premium for each transaction. The probability of default was estimated from rating agency data and was based on the transaction's credit rating, industry sector and time until maturity. The severity was defined as the complement of recovery/salvage rates gathered by the rating agencies of defaulting issues and was based on the industry sector.

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

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

Reinsurance

In the ordinary course of business, the Company's insurance subsidiaries assume and cede business with other insurance and reinsurance companies. These agreements provide greater diversification of

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

business and may reduce the net potential loss from large risks. Ceded contracts do not relieve the Company of its obligations. Reinsurance recoverable on ceded losses include balances due from reinsurance companies for paid and unpaid losses and loss adjustment expenses that will be recovered from reinsurers, based on contracts in force, and is presented net of any provision for estimated uncollectible reinsurance. However, the reinsurance receivable on ceded losses that were acquired in the FSAH Acquisition is recorded at fair value as a component of ceded unearned premium reserve at July 1, 2009. Any change in the provision for uncollectible reinsurance is included in loss and loss adjustment expenses. Ceded reinsurance premiums represent the portion of premiums ceded to reinsurers.

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

Salvage Recoverable

When the Company becomes entitled to the underlying collateral (generally a future stream of cash flows or pool assets) of an insured credit under salvage and subrogation rights as a result of a claim payment or estimates recoveries from disputed claim payments on contractual grounds, it reduces the corresponding loss reserve for a particular financial guaranty insurance policy for the estimated salvage and subrogation. If the expected salvage and subrogation exceeds the estimated loss reserve for a policy, such amounts are recorded as a salvage recoverable asset in the Company's balances sheets.

Significant Risk Management Activities

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

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

Risk Management and Surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio, including exposures in both the financial guaranty direct and financial guaranty reinsurance segments. The primary objective of the surveillance process is to monitor trends and changes in transaction credit quality, detect any deterioration in credit quality, and recommend to management such remedial actions as may be necessary or appropriate. All transactions in the insured portfolio are assigned internal credit ratings, and surveillance personnel are responsible for recommending adjustments to those ratings to reflect changes in transaction credit quality. Surveillance personnel are also responsible for managing work-out and loss situations when necessary.

The Company segregates its insured portfolio of investment grade and below investment grade ("BIG") risks into 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 credits include all credits internally rated lower than BBB-. The Company's internal credit ratings are based on the Company's internal assessment of the likelihood of default. The Company's 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. Quarterly procedures include qualitative and quantitative analysis on the Company's insured portfolio to identify potential new BIG credits. The Company refreshes its internal credit ratings on individual credit in cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits and in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. Credits identified through this process as BIG are subjected to further review by surveillance personnel to determine whether a loss is probable. For transactions where a loss is considered probable, surveillance personnel present analysis related to potential loss situations to a reserve committee. There is a reserve committee for AGC and AGM made up of the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, General Counsel, Chief Accounting Officer, Chief Surveillance Officer and Chief Actuary which establishes reserves for those entities. There is also a reserve committee of AGL made up of the Chief Executive Officer, Chief Financial Officer, General Counsel and Chief Accounting Officer of that company, as well as the Chief Actuary of AGC and AGM, which establishes reserves for the Company. The reserve committees consider the information provided by surveillance personnel when setting reserves.

Below Investment Grade Surveillance Categories

Within the BIG category, the Company assigns each credit to one of three surveillance categories:

BIG Category 1: BIG transactions showing sufficient deterioration to make material losses possible, but for which no losses have been incurred. Non-investment grade transactions on which liquidity claims have been paid are in this category. Intense monitoring and intervention is employed, with internal credit ratings reviewed quarterly.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

BIG Category 2: BIG transactions for which expected losses have been established but for which no unreimbursed claims have yet been paid. Intense monitoring and intervention is employed, with internal credit ratings reviewed quarterly.

BIG Category 3: BIG transactions for which expected losses have been established and on which unreimbursed claims have been paid. Transactions remain in this category when claims have been paid and only a recoverable remains. Intense monitoring and intervention is employed, with internal credit ratings reviewed quarterly.

The following table provides information on financial guaranty insurance and reinsurance contracts categorized BIG as of September 30, 2009:

| | BIG Categories | | | |
|--|-----------------------|-------------|------------|-------------|
| | BIG 1 | BIG 2 | BIG 3 | Total |
| | (dollars in millions) | | | |
| Number of policies | 231 | 189 | 121 | 541 |
| Remaining weighted-average contract period (in years) | 8.6 | 9.6 | 6.7 | 8.6 |
| Insured contractual payments outstanding: | | | | |
| Principal | \$ 6,313.7 | \$ 7,266.1 | \$ 3,967.8 | \$ 17,547.6 |
| Interest | 1,865.3 | 2,832.4 | 1,034.0 | 5,731.7 |
| Total | \$ 8,179.0 | \$ 10,098.5 | \$ 5,001.8 | \$ 23,279.3 |
| Gross expected cash outflows for loss and loss adjustment expenses | 18.4 | 2,229.8 | 588.9 | \$ 2,837.1 |
| Less: | | | | |
| Gross potential recoveries | 18.2 | 588.5 | 601.4 | 1,208.1 |
| Discount, net | 0.0 | 638.9 | (59.1) | 579.8 |
| Present value of expected cash flows for loss and loss adjustment expenses | 0.2 | 1,002.4 | 46.6 | 1,049.2 |
| Unearned premium reserves | \$ 104.3 | \$ 1,608.6 | 605.4 | 2,318.3 |
| Gross reserves (salvage) for loss and loss adjustment | \$ | \$ 141.3 | \$ (112.3) | \$ 29.0 |

expenses reported in
the balance sheet

| | | | | | | |
|--------------------------------------|----|-----|----|-------|----|-------|
| Reinsurance recoverable (payable) | \$ | 1.2 | \$ | (4.4) | \$ | (3.2) |
|--------------------------------------|----|-----|----|-------|----|-------|

The Company's loss adjustment expense reserves for mitigating claim liabilities were \$1.6 million as of September 30, 2009.

The Company used a weighted-average risk free discount rate of approximately 2.3% to discount reserves for loss and loss adjustment expenses.

Overview of Significant Risk Management Activities

Since the onset of the credit crisis in the fall of 2007 and the ensuing sharp recession, the Company has been intensely involved in risk management activities. Its most significant activities have

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

centered on the residential mortgage sector, where the crisis began, but it is also active in other areas experiencing stress. Residential mortgage loans are loans secured by mortgages on one to four family homes. RMBS may be broadly divided into two categories: (1) first lien transactions, which are generally comprised of loans with mortgages that are senior to any other mortgages on the same property, and (2) second lien transactions, which are comprised of loans with mortgages that are often not senior to other mortgages, but rather are second in priority. Both first lien RMBS and second lien RMBS sometimes include a portion of loan collateral with a different priority than the majority of the collateral.

Second Lien RMBS: HELOCs and CES

The Company insures two types of second lien RMBS, those secured by home equity lines of credit ("HELOCs") and those secured by closed-end second mortgages ("CES"). HELOCs are revolving lines of credit generally secured by a second lien on a one to four family home. A mortgage for a fixed amount secured by a second lien on a one-to-four family home is generally referred to as a CES. The Company has material exposure to second lien mortgage loans originated and serviced by a number of parties, but the Company's most significant second lien exposure is to HELOCs originated and serviced by Countrywide.

As of September 30, 2009, the Company had insured \$6.3 billion in net par of HELOC transactions, of which \$6.1 billion was in the financial guaranty direct segment. Of the total, \$4.8 billion was rated BIG by the Company as of September 30, 2009, with \$4.5 billion in net par rated BIG 2 or BIG 3. As of September 30, 2009 the Company had a gross salvage asset related to HELOC policies of \$148.5 million, prior to reinsurance or netting of unearned premium as required by GAAP, and a net salvage asset of \$145.2 million.

As of September 30, 2009, the Company had insured \$1.3 billion in net par of CES transactions, of which \$1.2 billion was in the financial guaranty direct segment. Of the \$1.3 billion, \$1.2 billion was rated either BIG 2 or BIG 3 by the Company as of September 30, 2009. As of September 30, 2009 the Company had gross expected loss, prior to reinsurance or netting of unearned premium, in this sector of \$254.3 million, and gross reserves of \$30.5 million.

The performance of the Company's HELOC and CES exposures deteriorated during 2007 and 2008 and the first nine months of 2009 and transactions, particularly those originated in the period from 2005 through 2007, continue to perform below the Company's original underwriting expectations. In accordance with the Company's standard practices, during Third Quarter 2009 and Nine Months 2009, the Company evaluated the most current available information as part of its loss reserving process, including trends in delinquencies and charge-offs on the underlying loans and its success in requiring providers of representations and warranties to purchase ineligible loans out of these transactions.

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)**

The following table shows the Company's key assumptions used in its loss reserves for these types of policies as of September 30, 2009 and December 31, 2008:

| HELOC Key Variables | September 30, | | December 31, | |
|---|----------------------|-------|---------------------|------|
| | 2009 | | 2008 | |
| Plateau Conditional Default Rate (CDR) | 10.6% | 39.7% | 19 | 21% |
| Final CDR | 0.5% | 3.2% | 1% | |
| Expected Period until Final CDR | 21 months | | 15 months | |
| Initial Conditional Prepayment Rate (CPR) | 0.4% | 16.0% | 7.0% | 8.0% |
| Final CPR | 10% | | 7.0% | 8.0% |
| Loss Severity | 95% | | 100% | |
| Future Repurchase of Ineligible Loans | \$724.8 million | | \$49 million | |
| Initial Draw Rate | 0.3% | 4.0% | 1.0% | 2.0% |

| Closed-End Second Liens Key Variables | September 30, | | December 31, | |
|--|----------------------|-------|---------------------|-------|
| | 2009 | | 2008 | |
| Plateau CDR | 21.3% | 42.6% | 34.0% | 36.0% |
| Final CDR | 3.3% | 8.1% | 3.4% | 3.6% |
| Expected Period until Final CDR achieved | 21 months | | 24 months | |
| Initial CPR | 0.6% | 4.9% | 7% | |
| Final CPR | 10% | | 7% | |
| Loss Severity | 95% | | 100% | |
| Future Repurchase of Ineligible Loans | \$79.5 million | | | |

The primary driver of the adverse development the Company has experienced related to its HELOC and CES exposure is the result of much higher total pool delinquencies than had been experienced historically. In order to project future defaults in each pool, a conditional default rate ("CDR") is applied each reporting period to various delinquency categories to calculate the projected losses to the pool. During the Third Quarter 2009, the Company modified its calculation methodology for HELOC transactions from an approach that used an average of the prior six months' CDR to an approach that projects future CDR based on currently delinquent loans. This change was made due to the continued volatility in mortgage backed transactions. Management believes that this refinement in approach should prove to be more responsive to changes in CDR rates than the prior methodology. Under this methodology, current representative roll rates are used to estimate losses in the first five months from loans that are currently delinquent and then the CDR of the fifth month is held constant for a period of time. Taken together, the first five months of losses plus the period of time for which the CDR is held constant represent the stress period. Once the stress period has elapsed, the CDR is assumed to gradually trend down to its final CDR. In the base case as of September 30, 2009, the total time between the current period's CDR and the long-term assumed CDR used to project losses was 21 months. At the end of this period, the long-term steady CDRs modeled were between 0.5% and 3.2% for HELOC transactions and between 3.3% and 8.1% for CES transactions. The Company continued to assume an extended stress period based on transaction performance and the continued weakened overall economic environment.

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

The assumption for the Conditional Prepayment Rate ("CPR"), which represents voluntary prepayments, follows a similar pattern to that of the CDR. The current CPR is assumed to continue for the stress period before gradually increasing to the final CPR, which is assumed to be 10% for both HELOC and CES transactions. This level is much higher than current rates but lower than the historical average, which reflects the Company's continued uncertainty about performance of the borrowers in these transactions. For HELOC transactions, the draw rate is assumed to decline from the current level to the final draw rate over a period of 4 months. The final draw rates were assumed to be between 0.2% and 2.0%.

In the Third Quarter 2009 and Nine Months 2009, the Company modeled and probability weighted three potential time periods over which an elevated CDR may potentially occur, one of which assumed a three month shorter period of elevated CDR and another of which assumed a three month longer period of elevated CDR than the most heavily weighted scenario described in the table above. Given that draw rates have been reduced to levels below the historical average and that loss severities in these products have been higher than anticipated at inception, the Company believes that the level of the elevated CDR and the length of time it will persist is the primary driver behind the likely amount of losses the collateral will suffer (before considering the effects of repurchases of ineligible loans). The Company continues to evaluate all of the assumptions informing its modeling results.

Performance of the collateral underlying certain securitizations has substantially differed from the Company's original expectations. Employing several loan file diligence firms and law firms as well as internal resources, as of September 30, 2009 the Company had performed a detailed review of over 18,500 files, representing nearly \$1.5 billion in outstanding par of defaulted second lien loans underlying insured transactions, and identified a material number of defaulted loans that breach representations and warranties regarding the characteristics of the loans. The Company continues to review new files as new loans default and as new loan files are made available to it. Following negotiation with the sellers and originators of the breaching loans, as of mid-October 2009 the Company had reached agreement to have \$128.9 million of the second lien loans repurchased. The Company has included in its loss estimates for second liens as of September 30, 2009 an estimated benefit from repurchases of \$804.3 million, of which \$380.8 million is either netted from the Company's GAAP loss reserves or included in salvage recoverable, with the balance pertaining to policies whose calculated loss reserve is less than its unearned premium reserve, principally as a result of the effects of purchase accounting on AGM's financial guaranty policies. The Company recognized a benefit related from repurchases of \$189.2 million in the Third Quarter 2009. The amount the Company ultimately recovers related to contractual representations and warranties is uncertain and subject to a number of factors including the counterparty's ability to pay, the number and amount of loans determined to have breached representations and warranties and, potentially, negotiated settlements or litigation. As such, the Company's estimate of recoveries is uncertain and actual amounts realized may differ significantly from these estimates.

The ultimate performance of the Company's HELOC and CES transactions will depend on many factors, such as the level and timing of loan defaults, interest proceeds generated by the securitized loans, prepayment speeds and changes in home prices, as well as the levels of credit support built into each transaction. The ability and willingness of providers of representations and warranties to repurchase ineligible loans from the transactions will also have a material effect on the Company's

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

ultimate loss on these transactions. Finally, other factors also may have a material impact upon the ultimate performance of each transaction, including the ability of the seller and servicer to fulfill all of their contractual obligations including any obligation to fund future draws on lines of credit. The variables affecting transaction performance are interrelated, difficult to predict and subject to considerable volatility. If actual results differ materially from any of 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.

First Lien RMBS: Subprime, Alt-A, Option ARM and Prime

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

The problems affecting the subprime mortgage market have been widely reported, with rising delinquencies, defaults and foreclosures negatively impacting the performance of Subprime RMBS transactions. Those concerns relate primarily to Subprime RMBS issued in the period from 2005 through 2007. As of September 30, 2009, the Company had insured \$5.0 billion in net par of Subprime RMBS transactions, of which \$4.9 billion was in the financial guaranty direct segment. These transactions benefit from various structural protections, including credit enhancement that in the direct portfolio for the vintages 2005 through 2008 currently averages approximately 32.1% of the remaining insured balance. Of the total Subprime RMBS, \$1.9 billion was rated BIG by the Company as of September 30, 2009, with \$0.7 billion in net par rated BIG 2 or BIG 3. As of September 30, 2009 the Company had gross reserves, prior to reinsurance or netting of unearned premium, in this sector of \$52.7 million, and net reserves of \$20.9 million.

As has been reported, the problems affecting the subprime mortgage market are affecting Option ARM RMBS transactions, with rising delinquencies, defaults and foreclosures negatively impacting their performance. Those concerns relate primarily to Option ARM RMBS issued in the period from 2005 through 2007. As of September 30, 2009, the Company had insured \$2.9 billion in net par of Option ARM RMBS transactions, all of which was in the financial guaranty direct segment. These transactions benefit from various structural protections, including credit enhancement that in the direct portfolio for the vintages 2005 through 2007 currently averages approximately 9.8% of the remaining insured balance. Of the Company's \$2.9 billion total Option ARM RMBS net insured par, \$2.8 billion was rated BIG by the Company as of September 30, 2009, with \$2.0 billion in net par rated BIG 2 or BIG 3. As of September 30, 2009 the Company had gross reserves, prior to reinsurance or netting of unearned premium, in this sector of \$446.7 million, and net reserves of \$19.1 million.

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SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

As has also been reported, the problems affecting the subprime mortgage market are now affecting Alt-A RMBS transactions, with rising delinquencies, defaults and foreclosures negatively impacting their performance. Those concerns relate primarily to Alt-A RMBS issued in the period from 2005 through 2007. As of September 30, 2009, the Company had insured \$2.5 billion in net par of Alt-A RMBS transactions, all of which was in the financial guaranty direct segment. These transactions benefit from various structural protections, including credit enhancement that in the direct portfolio for the vintages 2005 through 2007 currently averages approximately 7.6% of the remaining insured balance. Of the total Alt-A RMBS, \$1.7 billion was rated BIG by the Company as of September 30, 2009, with \$1.6 billion in net par rated BIG 2 or BIG 3. As of September 30, 2009 the Company had gross reserves, prior to reinsurance or netting of unearned premium, in this sector of \$214.6 million, and net reserves of \$20.4 million.

The performance of the Company's first lien RMBS exposures deteriorated during 2007 and 2008 and the first nine months of 2009 and transactions, particularly those originated in the period from 2005 through 2007, continue to perform below the Company's original underwriting expectations. Most of the projected losses in the First Lien RMBS transactions are expected to come from mortgage loans that are currently delinquent, so an increase in delinquent loans beyond those expected last quarter is one of the primary drivers of loss development in this portfolio. Like many market participants, the Company applies a liquidation rate assumption to loans in various delinquency categories to determine what proportion of loans in those categories will eventually default.

The following table shows the Company's liquidation assumptions for various delinquency categories as of September 30, 2009 and December 31, 2008:

| | September 30, 2009 | December 31, 2008 |
|-----------------------|-----------------------|----------------------|
| 30 59 Days Delinquent | | |
| Subprime | 45% | 48% |
| Option ARM | 50 | 47 |
| Alt-A | 50 | 42 |
| 60 89 Days Delinquent | | |
| Subprime | 65 | 70 |
| Option ARM | 65 | 71 |
| Alt-A | 65 | 66 |
| 90 BK | | |
| Subprime | 70 | 90 |
| Option ARM | 75 | 91 |
| Alt-A | 75 | 84 |
| Foreclosure | | |
| Subprime | 85 | 100 |
| Option ARM | 85 | 100 |
| Alt-A | 85 | 100 |
| REO | | |
| Subprime | 100 | 100 |
| Option ARM | 100 | 100 |
| Alt-A | 100 | 100 |

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

Another important driver of loss projections in this area is loss severities, i.e. 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 historical highs, and the Company has been revising its assumptions to match experience. The Company is assuming that loss severities begin returning to more normal levels beginning in October 2010, reducing over two or four years to either 40% or 20 points (i.e. from 60% to 40%) below their initial levels, depending on the scenario.

The following table shows the Company's initial loss severity assumptions as of September 30, 2009 and December 31, 2008:

| | September 30, 2009 | December 31, 2008 |
|------------|-----------------------|----------------------|
| Subprime | 70% | 70% |
| Option ARM | 60 | 54 |
| Alt-A | 65 | 54 |

The primary driver of the adverse development related to first lien exposure, as was the case with the Company's second lien transactions, is the result of the continued increase in delinquent mortgages. During the Third Quarter 2009, the Company modified its method of predicting losses from one where losses for both current and delinquent loans were projected using liquidation rates to a method where only the loss related to delinquent loans is calculated using liquidation rates, while losses from current loans are determined by applying a CDR trend. The Company made this change so that its methodology would be more responsive in reacting to the volatility in delinquency data. For delinquent loans, a liquidation rate is applied to loans in various stages of delinquency to determine the portion of loans in each delinquency category that will eventually default. Then, for each transaction, management calculates the constant CDR that, over the next 24 months, would be sufficient to produce the amount of losses that were calculated to emerge from the various delinquency categories. That CDR plateau is extended another three months, for a total of 27 months, in some scenarios. Each transaction's CDR is calculated to improve over 12 months to an intermediate CDR based upon its CDR plateau, then trail off to its final CDR. The intermediate CDRs modeled were between 0.5% and 7.6% for Alt-A first lien transactions, between 3.2% to 6.3% for Option ARM transactions and between 3.1% and 7.6% for Subprime transactions. The defaults resulting from the CDR after the 24 month represent the defaults that can be attributed to borrowers that are currently performing.

The assumption for the CPR follows a similar pattern to that of the CDR. The current level of voluntary prepayments is assumed to continue for the stress period before gradually increasing over 12 months to the final CPR, which is assumed to be either 10% or 15% depending on the scenario run. In the Third Quarter 2009 and Nine Months 2009, consistent with ASC 944-20, the Company modeled and probability weighted four different scenarios with differing CDR curve shapes, loss severity development assumptions and voluntary prepayment assumptions.

The performance of the collateral underlying certain of these securitizations has substantially differed from the Company's original expectations. As with the second lien policies, as of September 30, 2009 the Company had performed a detailed review of over 2,500 files representing over \$1.1 billion in outstanding par of defaulted first lien loans underlying insured transactions, and a material number of defaulted loans that breach representations and warranties regarding the

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5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

characteristics of the loans. The Company continues to review new files as new loans default and as new loan files are made available to it. Following negotiation with the sellers and originators of the breaching loans, as of mid-October 2009 the Company had reached agreement to have \$17.2 million of first lien loans repurchased. The Company has included in its loss estimates for first lien an estimated benefit from repurchases of \$310.7 million, of which \$66.2 million is netted from the Company's GAAP loss reserves, with the balance pertaining to policies whose calculated loss reserve is less than its deferred premium revenue, principally as a result of the effects of purchase accounting on AGM's financial guaranty policies. The amount the Company ultimately recovers related to contractual representations and warranties is uncertain and subject to a number of factors including the counterparty's ability to pay, the number and amount of loans determined to have breached representations and warranties and, potentially, negotiated settlements or litigation. As such, the Company's estimate of recoveries is uncertain and actual amounts realized may differ significantly from these estimates.

The Company also insures one direct nominally prime RMBS transaction rated BIG with a net outstanding par at September 30, 2009 of \$52 million, which it models as an Alt-A transaction and on which it has established case reserves of \$2.3 million. Finally, the Company insures Net Interest Margin ("NIM") securities with a net par outstanding as of September 30, 2009 of \$103 million. While these securities are backed by First Lien RMBS, the Company no longer expects to receive any cash flow on the underlying First Lien RMBS and has, therefore, fully reserved for these transactions, with the exception of expected payments of \$119.3 million from third parties to cover principal and interest on the NIMs.

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

"XXX" Life Insurance Transactions

The Company has insured \$2.2 billion of net par in "XXX" life insurance reserve securitization transactions based on discrete blocks of individual life insurance business. In these transactions the monies raised by the sale of the bonds insured by the Company are used to capitalize a special purpose vehicle that provides reinsurance to a life insurer or reinsurer. The monies are invested at inception in accounts managed by third-party investment managers. In order for the Company to incur an ultimate net loss on these transactions, adverse experience on the underlying block of life insurance policies and/or credit losses in the investment portfolio would need to exceed the level of credit enhancement built into the transaction structures.

The Company's \$2.2 billion in net par of XXX Life Insurance transactions includes \$1.8 billion in the financial guaranty direct segment. Of the total, \$882.5 million was rated BIG by the Company as of September 30, 2009, and corresponded to two transactions, classified as BIG 2 and BIG 3. These two XXX transactions had material amounts of their assets invested in US RMBS transactions.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

5. ACCOUNTING FOR FINANCIAL GUARANTY INSURANCE AND REINSURANCE CONTRACTS (Continued)

Based on its analysis of the information currently available, including estimates of future investment performance provided by the current investment manager, projected credit impairments on the invested assets and performance of the blocks of life insurance business at September 30, 2009, the Company's gross reserve, prior to reinsurance or netting of unearned premium, for its two BIG XXX insurance transactions was \$60.6 million and its net reserve was \$43.2 million.

On December 19, 2008, the Company sued J.P. Morgan Investment Management Inc. ("JPMIM"), the investment manager in one of the transactions, which relates to Orkney Re II, p.l.c. ("Orkney Re II"), in New York Supreme Court alleging that JPMIM engaged in breaches of fiduciary duty, gross negligence and breaches of contract based upon its handling of the investments of Orkney Re II. On May 13, 2009, the Company filed a First Amended Complaint, additionally asserting the same claims in the name of Orkney Re II. JPMIM has filed a motion to dismiss the First Amended Complaint. The court has not yet acted upon the motion.

Public Finance Transactions

The Company has exposure to a public finance transaction for sewer service in Jefferson County, Alabama. The Company's total exposure to this transaction is approximately \$597.8 million of net par, of which \$238.9 million is in the financial guaranty direct segment. The Company has made debt service payments during the year and expects to make additional payments in the near term. The Company is continuing its risk remediation efforts for this exposure.

Other Sectors and Transactions

The Company continues to closely monitor other sectors and individual transactions it feels warrant the additional attention, including, as of September 30, 2009, its commercial mortgage exposure of \$0.7 billion of net par, of which \$0.3 billion was in the financial guaranty direct segment; its Trust Preferred Securities Collateralized Debt Obligations exposure of \$1.2 billion, all of which was in the financial guaranty direct segment; and its U.S. health care exposure of \$22.1 billion of net par, of which \$19.6 billion was in the financial guaranty direct segment.

6. CREDIT DERIVATIVES

Certain financial guaranties written in credit derivative form, principally in the form of insured credit default swap ("CDS") contracts, have been deemed to meet the definition of a derivative under GAAP, which requires that an entity recognize all derivatives as either assets or liabilities in the consolidated balance sheet and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as a fair value, cash flow or foreign currency hedge. GAAP requires companies to recognize freestanding or embedded derivatives relating to beneficial interests in securitized financial instruments. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****6. CREDIT DERIVATIVES (Continued)**

In general, the Company structures credit derivative transactions such that the circumstances giving rise to the Company's obligation to make loss payments is similar to that for financial guaranty insurance policies and only occurs as losses are realized on the underlying reference obligation. Nonetheless, credit derivative transactions are governed by International Swaps and Derivatives Association, Inc. ("ISDA") documentation and operate differently from financial guaranty insurance policies. For example, the Company's control rights with respect to a reference obligation under a credit derivative may be more limited than when the Company issues a financial guaranty policy on a direct primary basis. In addition, while the Company's exposure under credit derivatives, like the Company's exposure under financial guaranty policies, has been generally for as long as the reference obligation remains outstanding, unlike financial guaranty insurance policies, a credit derivative may be terminated for a breach of the ISDA documentation or other specific events. 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. The Company may be required to make a termination payment to its swap counterparty upon such termination.

Some of the Company's CDS have rating triggers that allow certain CDS counterparties to terminate in the case of downgrades. If certain of its credit derivative contracts were terminated the Company could be required to make a termination payment as determined under the relevant documentation, although under certain documents, the Company may have the right to cure the termination event by posting collateral, assigning its rights and obligations in respect of the transactions to a third party or seeking a third party guaranty of the obligations of the Company. As of September 30, 2009, if AGC's ratings were downgraded to levels between BBB or Baa2 and BB+ or Ba1, certain CDS counterparties could terminate certain CDS contracts covering approximately \$7.3 billion par insured, compared to approximately \$7.7 billion as of June 30, 2009. As of September 30, 2009, if AGRO's ratings were downgraded to BBB- or Baa3, certain CDS counterparties could terminate certain CDS contracts covering approximately \$3.1 million par insured. As of September 30, 2009, AG Re had no CDS exposure subject to termination based on its rating. The Company does not believe that it can accurately estimate the termination payments it could be required to make if, as a result of any such downgrade, a CDS counterparty terminated its CDS contracts with the Company. These payments could have a material adverse effect on the Company's liquidity and financial condition.

Under a limited number of other CDS contracts, the Company may be required to post eligible securities as collateral generally cash or U.S. government or agency securities. This requirement is based generally on a mark-to-market valuation in excess of contractual thresholds that decline if the Company's ratings decline. As of September 30, 2009, the Company had posted approximately \$570.6 million of collateral in respect of approximately \$19.8 billion of par insured. Upon the downgrade of AGC by Moody's on November 12, 2009, certain of the thresholds set out in the CDS contracts were eliminated, and as of November 16, 2009, the amount of par that the Company has subject to collateral posting requirements is approximately \$20.38 billion. Accordingly, the Company may be required to post incremental collateral in addition to the \$570.6 million already being posted. Amounts required to be posted as collateral in the future will depend the market values of the transactions subject to the collateral posting, which market values change from time to time.

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****6. CREDIT DERIVATIVES (Continued)**

As of November 16, 2009, if AGC were further downgraded, additional contractual thresholds would be eliminated and the amount of par that the Company would have subject to collateral posting requirements would increase to approximately \$20.41 billion in the case of a downgrade below AA- or Aa3 to A+ or A1, and approximately \$20.49 billion in the case of a downgrade below A- or A3 to BBB+ or Baa1 or below. In each case, the actual amounts required to be posted would be based on market conditions at the time of the posting and the applicable CDS contracts. Any such amounts posted could have a material adverse effect on the Company's liquidity.

As of September 30, 2009, AGM had no CDS exposure subject to termination based on its rating, or subject to collateral posting.

"Realized gains and other settlements" on credit derivatives include credit derivative premiums received and receivable for credit protection the Company has sold under its insured CDS contracts, premiums paid and payable for credit protection the Company has purchased as well as any contractual claim losses paid and payable and received and receivable related to insured credit events under these contracts, ceding commissions (expense) income and realized gains or losses related to their early termination.

The following table disaggregates realized gains and other settlements on credit derivatives into its component parts for the Third Quarter and Nine Months 2009 and 2008:

Realized Gains and Other Settlements on Credit Derivatives

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|------------------|--|------------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (in thousands) | | | |
| Realized gains and other settlements on credit derivatives | | | | |
| Net credit derivative premiums received and receivable | \$ 57,447 | \$ 30,545 | \$ 114,915 | \$ 89,853 |
| Net credit derivative losses (paid and payable) recovered and recoverable | 14,270 | 30 | 5,227 | 410 |
| Ceding commissions received/receivable (paid/payable), net | (26) | (615) | (56) | (893) |
| Total realized gains and other settlements on credit derivatives | \$ 71,691 | \$ 29,960 | \$ 120,086 | \$ 89,370 |

"Net unrealized gains (losses)" on credit derivatives represent the adjustments for changes in fair value that are recorded in each reporting period, under ASC 815-10. Changes in unrealized gains and losses on credit derivatives are reflected in the consolidated statements of operations in "net unrealized gains (losses)" on credit derivatives. Cumulative unrealized losses, determined on a contract by contract basis, are reflected as either net assets or net liabilities in the Company's balance sheets. Unrealized gains and losses resulting from changes in the fair value of credit derivatives occur because of changes in interest rates, credit spreads, the credit ratings of the referenced entities and the issuing company's own credit rating and other market factors. The unrealized gains and losses on credit derivatives will reduce to zero as the exposure approaches its maturity date, unless there is a payment default on the exposure or early termination. If unrealized losses on credit derivatives reduce the Company's

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

6. CREDIT DERIVATIVES (Continued)

consolidated net worth to less than 75% of the consolidated net worth of the Company as of the quarter ended June 30, 2009, the Company would be in violation of its financial covenants in its 2006 credit facility. See Note 12.

The Company determines the fair value of its credit derivative contracts primarily through modeling that uses various inputs to derive an estimate of the value of the Company's contracts in principal markets. See Note 7. Inputs include expected contractual life and credit spreads, based on observable market indices and on recent pricing for similar contracts. Credit spreads capture the impact of recovery rates and performance of underlying assets, among other factors, on these contracts. The Company's pricing model takes into account not only how credit spreads on risks that it assumes affect pricing, but also how the Company's own credit spread affects the pricing of its deals. If credit spreads of the underlying obligations change, the fair value of the related credit derivative changes. Market liquidity could also impact valuations of the underlying obligations.

The impact of changes in credit spreads will vary based upon the volume, tenor, interest rates, and other market conditions at the time these fair values are determined. In addition, since each transaction has unique collateral and structure terms, the underlying change in fair value of each transaction may vary considerably. The fair value of credit derivative contracts also reflects the change in the Company's own credit cost, based on the price to purchase credit protection on AGC and AGM. During Third Quarter 2009 and Nine Months 2009, the Company incurred net pre-tax unrealized losses on credit derivatives of \$205.3 million and \$432.6 million, respectively. As of September 30, 2009 the net credit liability included a reduction in the liability of \$6,716.1 million representing AGC's and AGM's credit value adjustment, which was based on the market cost of AGC's and AGM's credit protection of 825 and 660 basis points, respectively. Management believes that the trading level of AGC's and AGM's credit spread was due to the correlation between AGC's and AGM's risk profile and that experienced currently by the broader financial markets and increased demand for credit protection against AGC and AGM as the result of its financial guaranty direct segment financial guarantee 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 declines in fixed income security market prices primarily attributable to widening spreads in certain markets as a result of the continued deterioration in credit markets and some credit rating downgrades. The higher credit spreads in the fixed income security market were primarily due to continuing market concerns over the most recent vintages of Subprime RMBS and trust-preferred securities.

During Third Quarter and Nine Months 2008, the Company incurred net pre-tax unrealized losses of \$116.2 million and unrealized gains of \$332.6 million on credit derivatives, respectively. The Third Quarter 2008 loss included a gain of \$668.0 million associated with the change in AGC's credit spread, which widened substantially from 900 basis points at June 30, 2008 to 1,255 basis points at September 30, 2008.

The total notional amount of credit derivative exposure outstanding as of September 30, 2009 and December 31, 2008 and included in the Company's financial guaranty exposure was \$123.4 billion and \$75.1 billion, respectively.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

6. CREDIT DERIVATIVES (Continued)

The components of the Company's unrealized gain (loss) on credit derivatives as of and for the three and nine months ended September 30, 2009 are:

| Asset Type | As of September 30, 2009 | | Third | Nine Months |
|--|---|---|--|-----------------------------------|
| | Net Par Outstanding (in billions) | Weighted Average Credit Rating(1) | Quarter 2009 Unrealized Gain (Loss) (in millions) | 2009 Unrealized Gain (Loss) |
| Financial Guaranty Direct: | | | | |
| Pooled corporate obligations: | | | | |
| High yield corporates | \$ 60.7 | AAA | \$ 47.9 | \$ (28.0) |
| Trust preferred securities | 6.1 | BBB- | (32.3) | (32.6) |
| Market value CDOs of corporate obligations | 5.5 | AAA | (0.8) | (8.1) |
| Investment grade corporates | 14.8 | AAA*(2) | (21.6) | (18.7) |
| CDO of CDOs (corporate) | | | 6.6 | 6.3 |
| Total pooled corporate obligations | 87.1 | AAA | (0.2) | (81.1) |
| U.S. RMBS: | | | | |
| Prime first lien | 3.1 | A+ | (31.3) | (70.0) |
| Alt-A first lien | 6.2 | BB+ | (41.8) | (287.6) |
| Subprime lien | 5.5 | A+ | (1.5) | 2.2 |
| Total U.S. RMBS | 14.8 | A- | (74.6) | (355.4) |
| Commercial mortgage-backed securities | 7.3 | AAA | 0.1 | (31.9) |
| Other | 12.6 | AA- | (102.2) | 52.3 |
| Total Financial Guaranty Direct | 121.8 | AA+ | (176.9) | (416.1) |
| Financial Guaranty Reinsurance | 1.6 | AA+ | (28.4) | (16.5) |
| Total | \$ 123.4 | AA+ | \$ (205.3) | \$ (432.6) |

(1) Based on the Company's internal rating, which is on a ratings scale similar to that used by the nationally recognized rating agencies.

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

Corporate collateralized loan obligations ("CLOs"), synthetic pooled corporate obligations, market value CDOs, and trust preferred securities ("TRUPS"), which comprise the Company's pooled corporate exposures, include all U.S. structured finance pooled corporate obligations and international pooled corporate obligations. RMBS are comprised of prime and Subprime U.S. mortgage-backed and home equity securities, international RMBS and international home equity securities. Commercial

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

6. CREDIT DERIVATIVES (Continued)

mortgage-backed securities are comprised of commercial U.S. structured finance and commercial international mortgage backed securities. "Other" includes all other U.S. and international asset classes, such as commercial receivables, and international infrastructure and pooled infrastructure securities.

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

The Company's \$12.6 billion exposure to "Other" CDS contracts is also highly diversified. It includes \$4.3 billion of exposure to four pooled infrastructure transactions comprised of diversified pools of international infrastructure project transactions and loans to regulated utilities. These pools were all structured with underlying credit enhancement sufficient for the Company to attach at super senior AAA levels. The remaining \$8.3 billion of exposure in "Other" CDS contracts is comprised of numerous deals typically structured with significant underlying credit enhancement and spread across various asset classes, such as commercial receivables, infrastructure, regulated utilities and consumer receivables. Substantially all of this \$12.6 billion of exposure is rated investment grade and the weighted average credit rating is AA-.

The unrealized loss of \$102.2 million in Third Quarter 2009 and unrealized gain of \$52.3 million in Nine Months 2009 on "Other" CDS contracts is primarily attributable to implied spread widening during Third Quarter 2009 on a U.S. infrastructure transaction, a XXX life insurance securitization and a film securitization transaction.

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

The Company's exposure to the mortgage industry is discussed in Note 5.

As of September 30, 2009 and December 31, 2008, the Company considered the impact of its own credit risk, in combination with credit spreads on risk that it assumes through CDS contracts, in determining the fair value of its credit derivatives. The Company determines its own credit risk based on quoted CDS prices traded on the Company at each balance sheet date. The quoted price of CDS contracts traded on AGC at September 30, 2009 and December 31, 2008 was 825 basis points and 1,775 basis points, respectively. The quoted price of CDS contracts traded on AGM at September 30, 2009 and December 31, 2008 was 660 basis points and 1,420 basis points, respectively. Historically, the price of CDS traded on AGC and AGM moves directionally the same as general market spreads. Generally, a widening of the CDS prices traded on AGC and AGM has an effect of offsetting unrealized losses that result from widening general market credit spreads, while a narrowing of the CDS prices traded on AGC and AGM has an effect of offsetting unrealized gains that result from narrowing general market credit spreads. An overall narrowing of spreads generally results in an unrealized gain on credit derivatives for the Company and an overall widening of spreads generally results in an unrealized loss

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

6. CREDIT DERIVATIVES (Continued)

for the Company. At September 30, 2009, the values of the Company's CDS contracts before and after considering implications of the Company's credit spreads were negative \$7,991.9 million and negative \$1,275.8 million, respectively. At December 31, 2008, the values of the Company's CDS contracts before and after considering implications of the Company's credit spreads were negative \$4,686.8 million and negative \$539.2 million, respectively.

The following table presents additional details about the Company's unrealized loss on pooled corporate obligation credit derivatives by asset type, as of September 30, 2009:

| Asset Type | Original Subordination(1) | Current Subordination(1) | Net Par Outstanding (in billions) | Weighted Average Credit Rating(2) | Third Quarter 2009 Unrealized Gain (Loss) (in millions) | Nine Months 2009 Unrealized Gain (Loss) (in millions) |
|--|---------------------------|--------------------------|-----------------------------------|-----------------------------------|---|---|
| High yield corporate obligations | 32.5% | 28.0% | \$ 60.7 | AAA | \$ 47.9 | \$ (28.0) |
| Trust preferred securities | 46.6 | 38.0 | 6.1 | BBB- | (32.3) | (32.6) |
| Market value CDOs of corporate obligations | 32.1 | 39.3 | 5.5 | AAA | (0.8) | (8.1) |
| Investment grade corporate obligations | 19.2 | 17.8 | 14.8 | AAA*(3) | (21.6) | (18.7) |
| CDO of CDOs (corporate obligations) | | | | | 6.6 | 6.3 |
| Total | 31.2% | 27.7% | \$ 87.1 | AAA | \$ (0.2) | \$ (81.1) |

(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.

(2) Based on the Company's internal rating, which is on a ratings scale similar to that used by the nationally recognized rating agencies.

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

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

6. CREDIT DERIVATIVES (Continued)

The following table presents additional details about the Company's unrealized gain (loss) on credit derivatives associated with commercial mortgage-backed securities by vintage as of September 30, 2009:

| Vintage | Original Subordination(1) | Current Subordination(1) | Net Par Outstanding (in billions) | Weighted Average Credit Rating(2) | Third Quarter 2009 Unrealized Gain (Loss) (in millions) | Nine Months 2009 Unrealized Gain (Loss) (in millions) |
|----------------|---------------------------|--------------------------|-----------------------------------|-----------------------------------|---|---|
| 2004 and Prior | 26.1% | 37.7% | \$ 0.9 | AAA | \$ (0.3) | \$ (0.6) |
| 2005 | 27.2 | 25.8 | 3.7 | AAA | 0.2 | (18.6) |
| 2006 | 29.7 | 28.7 | 2.0 | AAA | 0.2 | (10.1) |
| 2007 | 46.6 | 44.8 | 0.7 | AAA | (0.0) | (2.6) |
| 2008 | | | | | | |
| 2009 | | | | | | |
| Total | 29.6% | 29.9% | \$ 7.3 | AAA | \$ 0.1 | \$ (31.9) |

(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.

(2) Based on the Company's internal rating, which is on a ratings scale similar to that used by the nationally recognized rating agencies.

The following tables present additional details about the Company's unrealized loss on credit derivatives associated with RMBS by vintage and asset type as of September 30, 2009:

| Vintage | Original Subordination(1) | Current Subordination(1) | Net Par Outstanding (in billions) | Weighted Average Credit Rating(2) | Third Quarter 2009 Unrealized Gain (Loss) (in millions) | Nine Months 2009 Unrealized Gain (Loss) (in millions) |
|----------------|---------------------------|--------------------------|-----------------------------------|-----------------------------------|---|---|
| 2004 and Prior | 5.6% | 16.0% | \$ 0.8 | AA+ | \$ (0.1) | \$ 32.9 |
| 2005 | 26.4 | 56.1 | 3.8 | AA- | (1.4) | (1.3) |
| 2006 | 18.4 | 25.2 | 3.6 | A+ | (19.0) | (19.6) |
| 2007 | 18.5 | 19.5 | 6.6 | BB+ | (54.1) | (367.4) |
| 2008 | | | | | | |
| 2009 | | | | | | |
| Total | 20.3% | 30.8% | \$ 14.8 | A- | \$ (74.6) | \$ (355.4) |

- (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.
- (2) Based on the Company's internal rating, which is on a ratings scale similar to that used by the nationally recognized rating agencies.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

6. CREDIT DERIVATIVES (Continued)

| Asset Type | Original Subordination(1) | Current Subordination(1) | Net Par Outstanding (in billions) | Weighted Average Credit Rating(2) | Third Quarter 2009 Unrealized Gain (Loss) (in millions) | Nine Months 2009 Unrealized Gain (Loss) (in millions) |
|------------------|---------------------------|--------------------------|-----------------------------------|-----------------------------------|---|---|
| Alt-A loans | 20.3% | 22.1% | \$ 6.2 | BB+ | \$ (41.8) | \$ (287.6) |
| Prime first lien | 9.1 | 12.2 | 3.1 | A+ | (31.3) | (70.0) |
| Subprime lien | 27.5 | 53.0 | 5.5 | A+ | (1.5) | 2.2 |
| Total | 20.3% | 30.8% | \$ 14.8 | A- | \$ (74.6) | \$ (355.4) |

(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.

(2) Based on the Company's internal rating, which is on a ratings scale similar to that used by the nationally recognized rating agencies.

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 at September 30, 2009:

| Credit Spreads(1) | Estimated Net Fair Value (Pre-Tax) | Estimated Pre-Tax Change in Gain/(Loss) |
|----------------------------|------------------------------------|---|
| | (in millions) | |
| September 30, 2009: | | |
| 100% widening in spreads | \$ (3,734.5) | \$ (2,458.7) |
| 50% widening in spreads | (2,506.1) | (1,230.3) |
| 25% widening in spreads | (1,891.9) | (616.1) |
| 10% widening in spreads | (1,524.2) | (248.4) |
| Base Scenario | (1,275.8) | |
| 10% narrowing in spreads | (1,095.8) | 180.0 |
| 25% narrowing in spreads | (826.2) | 449.6 |
| 50% narrowing in spreads | (380.6) | 895.2 |

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

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

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount and estimated fair value of financial instruments are presented in the following table:

| | As of September 30, 2009 | | As of December 31, 2008 | |
|---|--------------------------|----------------------|-------------------------|----------------------|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| | (in thousands) | | | |
| Assets: | | | | |
| Fixed maturity securities | \$ 8,448,099 | \$ 8,448,099 | \$ 3,154,137 | \$ 3,154,137 |
| Cash and short-term investments | 1,753,375 | 1,753,375 | 489,502 | 489,502 |
| Credit derivative assets | 462,298 | 462,298 | 146,959 | 146,959 |
| Assets acquired in refinancing transactions | 159,180 | 163,824 | | |
| Committed capital securities, at fair value | 38,516 | 38,516 | | |
| Financial guaranty variable interest entities assets | 706,611 | 706,611 | | |
| Other assets | 19,536 | 19,536 | | |
| Liabilities: | | | | |
| Financial guaranty insurance contracts(1) | 7,677,316 | 8,715,390 | 1,233,714 | 1,785,769 |
| Long-term debt: | | | | |
| 7.0% Senior Notes | 197,471 | 129,780 | 197,443 | 105,560 |
| 8.50% Senior Notes | 169,923 | 142,313 | | |
| Series A Enhanced Junior Subordinated Debentures | 149,789 | 93,750 | 149,767 | 37,500 |
| 6 ⁷ / ₈ % QUIBS | 66,571 | 66,400 | | |
| 6.25% Notes | 133,658 | 138,000 | | |
| 5.60% Notes | 52,407 | 54,000 | | |
| Junior Subordinated Debentures | 145,418 | 181,500 | | |
| Note payable to related party | 155,827 | 157,657 | | |
| Credit derivative liabilities | 2,100,465 | 2,100,465 | 733,766 | 733,766 |
| Financial guaranty variable interest entities liabilities | 841,719 | 841,719 | | |
| Off-Balance Sheet Instruments: | | | | |
| Financial guaranty contracts future installment premiums | | | | 463,407 |

- (1) Includes the balance sheet amounts related to financial guaranty insurance contract premiums and losses, net of reinsurance.

Background

Effective January 1, 2008, the Company adopted ASC 820-10. ASC 820-10 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. ASC 820-10 applies to other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements.

ASC 820-10 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. The price 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 the market that maximizes the value received for an asset or minimizes the amount paid for a liability (i.e. the most advantageous market).

ASC 820-10 specifies a fair value hierarchy based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

obtained from independent sources, while unobservable inputs reflect Company estimates of market assumptions. In accordance with ASC 820-10, the fair value hierarchy prioritizes model inputs into three broad levels as follows:

Level 1 Quoted prices for identical instruments in active markets.

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

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

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

Financial Instruments Carried at Fair Value on a Recurring Basis

The measurement provision of ASC 820-10 applies to both amounts recorded in the Company's financial statements and to disclosures. Amounts recorded at fair value in the Company's financial statements on a recurring basis are included in the tables below. The fair value of these items as of September 30, 2009 is summarized in the following table.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Fair Value Hierarchy of Financial Instruments
Recurring Basis
As of September 30, 2009

| | Fair Value | Fair Value Measurements Using | | |
|---|--------------------|---|--|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| (in millions) | | | | |
| Assets | | | | |
| Investment portfolio, available-for-sale: | | | | |
| Fixed maturity securities: | | | | |
| U.S. government and agencies | \$ 988.9 | \$ | \$ 988.9 | \$ |
| Obligations of state and political subdivisions | 5,239.6 | | 5,239.6 | |
| Corporate securities | 370.3 | | 370.3 | |
| Mortgage-backed securities: | | | | |
| Residential mortgage-backed securities | 1,196.3 | | 1,196.3 | |
| Commercial mortgage-backed securities | 246.9 | | 246.9 | |
| Asset-backed securities | 54.8 | | 54.8 | |
| Foreign government securities | 351.3 | | 351.3 | |
| Short-term investments | 1,492.9 | 471.1 | 1,018.8 | |
| Cash | 260.5 | 260.5 | | |
| Credit derivative assets | 462.3 | | | 462.3 |
| Committed capital securities, at fair value | 38.5 | | 38.5 | |
| Other assets: | | | | |
| Equity securities | 2.5 | 2.5 | | |
| DCP and SERP(1) | 17.1 | 17.1 | | |
| Total assets | \$ 10,754.8 | \$ 754.2 | \$ 9,505.4 | \$ 495.2 |
| Liabilities | | | | |
| Credit derivative liabilities | \$ 2,100.5 | \$ | \$ | 2,100.5 |
| Total liabilities | \$ 2,100.5 | \$ | \$ | 2,100.5 |

- (1) Represents assets that economically defease the Company's liability for deferred compensation plans ("DCP") and supplemental executive retirement plans ("SERP").

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Fair Value Hierarchy of Financial Instruments
Recurring Basis
As of December 31, 2008(1)

| | Fair Value | Fair Value Measurements Using | | |
|--|------------|---|--|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| (in millions) | | | | |
| Investment portfolio, available-for-sale: | | | | |
| Fixed maturity securities: | | | | |
| U.S. government and agencies | \$ 475.9 | \$ | \$ 475.9 | \$ |
| Obligations of state and political subdivisions | 1,217.7 | | 1,217.7 | |
| Corporate securities | 268.2 | | 268.2 | |
| Mortgage-backed securities: | | | | |
| Residential mortgage-backed securities | 830.3 | | 830.3 | |
| Commercial mortgage-backed securities | 221.5 | | 221.5 | |
| Asset-backed securities | 73.6 | | 73.6 | |
| Foreign government securities | 54.5 | | 54.5 | |
| Preferred stock | 12.4 | | 12.4 | |
| Short-term investments | 477.2 | 47.8 | 429.4 | |
| Cash | 12.3 | 12.3 | | |
| Credit derivative assets | 147.0 | | | 147.0 |
| Committed capital securities, at fair value | 51.1 | | 51.1 | |
| Total assets | \$ 3,841.7 | \$ 60.1 | \$ 3,634.6 | \$ 147.0 |
| Liabilities | | | | |
| Credit derivative liabilities | \$ 733.8 | \$ | \$ | \$ 733.8 |
| Total liabilities | \$ 733.8 | \$ | \$ | \$ 733.8 |

(1) Reclassified to conform to the current period's presentation.

Fixed Maturity Securities and Short-term Investments

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

The Company's third-party investment manager obtains prices from pricing services, index providers or broker-dealers. From time to time a pricing source may be updated to improve consistency of coverage and/or accuracy of prices.

Generally one price is obtained for each security. Where multiple prices are obtained, the investment manager maintains a hierarchy by asset class to prioritize the pricing source to be used. The investment manager performs daily and monthly controls to ensure completeness and

accuracy of security prices, such as reviewing missing price or stale price data and day-over-day variance reports by asset class. The investment manager maintains a valuation oversight committee that is required to approve all changes in pricing practices and policies.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Fixed maturity securities are valued by broker-dealers, pricing services or index providers using standard market conventions. The market conventions utilize market quotations, market transactions in comparable instruments, and various relationships between instruments such as yield to maturity, dollar prices and spread prices in determining value. Generally, all of the Company's fixed maturity securities are priced using matrix pricing. The Company used no model processes to price its fixed maturity securities as of September 30, 2009.

Broker-dealer quotations obtained to price securities are generally considered to be indicative and are nonactionable (i.e. non-binding).

The Company is provided with a pricing chart, which for each asset class provides the pricing source, pricing methodology and recommended ASC 820-10 fair value level. The Company reviews the pricing source of each security each reporting period to determine the method of pricing and appropriateness of ASC 820-10 fair value level. The Company considers securities prices from pricing services, index providers or broker-dealers to be Level 2 in the ASC 820-10 fair value hierarchy. Prices determined based upon model processes are considered to be Level 3 in the ASC 820-10 fair value hierarchy. No investments were classified as Level 3 as of or for the three- and nine-month periods ended September 30, 2009.

The Company did not make any internal adjustments to prices provided by its third party pricing service.

Committed Capital Securities

The fair value of committed capital securities ("CCS Securities") represents the present value of remaining expected put option premium payments under the CCS Securities agreements and the value of such estimated payments based upon the quoted price for such premium payments as of September 30, 2009 (see Note 12). The \$38.5 million fair value asset for CCS Securities is included in the consolidated balance sheet. Changes in fair value of this asset are included in the consolidated statement of operations. The significant market inputs used are observable, therefore, the Company classified this fair value measurement as Level 2.

Credit Derivatives

The Company's credit derivatives consist primarily of insured CDS contracts, as well as NIM securitization and interest rate swaps (see Note 6). The Company does not typically exit its credit derivative contracts, and there are no quoted prices for its instruments or for similar instruments. Observable inputs other than quoted market prices exist; however, these inputs reflect contracts that do not contain terms and conditions similar to the credit derivative contracts issued by the Company. Therefore, the valuation of credit derivative contracts requires the use of models that contain significant, unobservable inputs. The Company accordingly believes the credit derivative valuations are in Level 3 in the fair value hierarchy discussed above.

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining expected premiums the Company receives for the credit protection and the estimated present value of premiums that a comparable financial guarantor would hypothetically charge the Company for the same protection at the balance sheet date. The fair value of the Company's credit

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

derivatives depends on a number of factors, including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of referenced entities, the Company's own credit risk and remaining contractual cash flows.

Market conditions at September 30, 2009 were such that market prices of the Company's CDS contracts were not generally available. Where market prices were not available, the Company used a combination of observable market data and valuation models, using various market indices, credit spreads, the Company's own credit risk, and estimated contractual payments to estimate the "Unrealized gains (losses) on credit derivatives" portion of the fair value of its credit derivatives. These models are primarily developed internally based on market conventions for similar transactions.

Management considers the non-standard terms of its credit derivative contracts in determining the fair value of these contracts. These terms differ from credit derivatives sold by companies outside the financial guaranty industry. The non-standard terms include the absence of collateral support agreements or immediate settlement provisions, relatively high attachment points and the fact that the Company does not exit derivatives it sells for credit protection purposes, except under specific circumstances such as novations upon exiting a line of business. Because of these terms and conditions, the fair value of the Company's credit derivatives may not reflect the same prices observed in an actively traded market of credit derivatives that do not contain terms and conditions similar to those observed in the financial guaranty market. These models and the related assumptions are continuously reevaluated by management and enhanced, as appropriate, based upon improvements in modeling techniques and availability of more timely market information.

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

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.

The key assumptions of the Company's internally developed model include the following:

Gross spread is the difference between the yield of a security paid by an issuer on an insured versus uninsured basis or, in the case of a CDS transaction, the difference between the yield and an index such as the London Interbank Offered Rate ("LIBOR"). Such pricing is well established by historical financial guaranty fees relative to capital market spreads as observed and executed in competitive markets, including in financial guaranty reinsurance and secondary market transactions.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Gross spread on a financial guaranty written in CDS form is allocated among:

1. the profit the originator, usually an investment bank, realizes for putting the deal together and funding the transaction;
2. premiums paid to the Company for the Company's credit protection provided; and
3. the cost of CDS protection purchased on the Company by the originator to hedge their counterparty credit risk exposure to the Company.

The premium the Company receives is referred to as the "net spread." The Company's own credit risk is factored into the determination of net spread based on the impact of changes in the quoted market price for credit protection bought on the Company, as reflected by quoted market prices on CDS sold on AGC. The cost to acquire CDS protection sold on AGC affects the amount of spread on CDS deals that the Company captures and, hence, their fair value. As the cost to acquire CDS protection sold on AGC increases, the amount of premium the Company captures on a deal generally decreases. As the cost to acquire CDS protection sold on AGC decreases, the amount of premium the Company captures on a deal generally increases. In the Company's 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 has the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts.

The Company determines the fair value of its CDS contracts by applying the net spread for the remaining duration of each contract to the notional value of its CDS contracts.

Actual transactions are used to validate the model results and to explain the correlation between various market indices and indicative CDS market prices.

The Company's specific model inputs are gross spread, credit spreads on risks assumed and credit spreads on the Company's name.

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

The Company obtains credit spreads on risks assumed 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 resembles the underlying reference obligations, considering asset class, credit quality rating and maturity of the underlying reference obligations. As discussed previously, these indices are adjusted to reflect the non-standard terms of the Company's CDS contracts. As of September 30, 2009, the Company obtained approximately 9% of its credit spread

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

data, based on notional par outstanding, from sources published by third parties, while 91% was obtained from market sources or similar market indices. Market sources determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. Management validates these quotes by cross-referencing quotes received from one market source against quotes received from another market source to ensure reasonableness. In addition, 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 and or market traders whom are not trustees. Management obtains this information as the result of direct communication with these sources as part of the valuation process.

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.

Example

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

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

In Scenario 1, the gross spread is 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 \times 10% = 30 basis points). Under this scenario AGC received 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 \times 25% = 440 basis points). Under this scenario AGC would receive premium of 10 basis points, or 2% of the gross spread.

In this example, the contractual cash flows (the AGC premium above) exceed the amount a market participant would require AGC to pay in today's market to accept its obligations under the CDS contract, thus resulting in an asset. This credit derivative asset is equal to the difference in premium rate discounted at the corresponding London Inter-Bank Offer Rate ("LIBOR") over the weighted average remaining life of the contract. The expected future cash flows for the Company's credit derivatives were discounted at rates ranging from 0.5% to 4% at September 30, 2009.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The Company corroborates the assumptions in its fair value model, including the amount of exposure to AGC hedged by its counterparties, with independent third parties each reporting period. Recent increases in the CDS spread on AGC have resulted in the bank or deal originator hedging a greater portion of its exposure to AGC. This has the effect of reducing the amount of contractual cash flows AGC can capture for selling 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. This is because the buyers of credit protection typically hedge a portion of their risk to the financial guarantor, due to the fact that contractual terms of financial guaranty insurance contracts typically do not require the posting of collateral by the guarantor. The widening of a financial guarantor's own credit spread increases the cost to buy credit protection on the guarantor, thereby reducing the amount of premium the guarantor can capture out of the gross spread on the deal. The extent of the hedge depends on the types of instruments insured and the current market conditions.

A credit derivative asset under ASC 820-10 is the result of contractual cash flows on in-force deals in excess of what a hypothetical financial guarantor could receive if it sold protection on the same risk as of the current reporting date. If the Company were able to freely exchange these contracts (i.e., assuming its contracts did not contain proscriptions on transfer and there was a viable exchange market), it would be able to realize an asset representing the difference between the higher contractual premiums to which it is entitled and the current market premiums for a similar contract.

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

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

Actual collateral specific credit spreads (if up-to-date and reliable market-based spreads are available, they are used).

Credit spreads are interpolated based upon market indices or deals priced or closed during a specific quarter within a specific asset class and specific rating.

Credit spreads provided by the counterparty of the CDS.

Credit spreads are extrapolated based upon transactions of similar asset classes, similar ratings, and similar time to maturity.

Over time the data inputs can change as new sources become available or existing sources are discontinued or are no longer considered to be the most appropriate. It is the Company's objective to move to higher levels on the hierarchy whenever possible, but it is sometimes necessary to move to

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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.

As of September 30, 2009, the Company obtained approximately 5% of its credit spread information, based on notional par outstanding, from actual collateral specific credit spreads, while 91% was based on market indices and 4% was based on spreads provided by the CDS counterparty. The Company interpolates a curve based on the historical relationship between premium the Company receives when a financial guaranty written in CDS form closes to the daily closing price of the market index related to the specific asset class and rating of the deal. This curve indicates expected credit spreads at each indicative level on the related market index. For specific transactions where no price quotes are available and credit spreads need to be extrapolated, an alternative transaction for which the Company has received a spread quote from one of the first three sources within the Company's spread hierarchy is chosen. This alternative transaction will be within the same asset class, have similar underlying assets, similar credit ratings, and similar time to maturity. The Company then calculates the percentage of relative spread change quarter over quarter for the alternative transaction. This percentage change is then applied to the historical credit spread of the transaction for which no price quote was received in order to calculate the transactions current spread. Counterparties determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. These quotes are validated by cross-referencing quotes received from one market source with those quotes received from another market source to ensure reasonableness. In addition, management compares the relative change experienced on published market indices for a specific asset class for reasonableness and accuracy.

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

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

The Company is able to use actual transactions to validate its model results and to explain the correlation between various market indices and indicative CDS market prices.

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

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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 verify the fair values developed by the Company's model.

At September 30, 2009, the markets for the inputs to the model were highly illiquid, which impacts their reliability. However, the Company employs various procedures to corroborate the reasonableness of quotes received and calculated by the Company's internal valuation model, including comparing to other quotes received on similarly structured transactions, observed spreads on structured products with comparable underlying assets and, on a selective basis when possible, through second independent quotes on the same reference obligation.

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

Limitations on Model

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

The net par outstanding of the Company's credit derivative contracts was \$123.4 billion and \$75.1 billion at September 30, 2009 and December 31, 2008, respectively. The estimated remaining average life of these contracts at September 30, 2009 was 6.1 years.

As required by ASC 820-10, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. As of September 30, 2009, these contracts are classified as Level 3 in the ASC 820-10 hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation model, most significantly the Company's estimate of the value of the non-standard terms and conditions of its credit derivative contracts and of the Company's current credit standing.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Financial Instruments Carried at Fair Value on a Non-recurring Basis

Assets Acquired in Refinancing Transactions

Mortgage loans included in assets acquired in refinancing transactions are accounted for at fair value when lower than cost.

Level 3 Instruments

The table below presents a reconciliation of the Company's financial instruments whose fair value included significant unobservable inputs (Level 3) during the Third Quarter 2009.

Fair Value Level 3 Rollforward

| | Three Months Ended September 30, 2009 | | |
|--|---|---|-----------------------------------|
| | Assets Acquired in Refinancing Transactions | Credit Derivative Asset (Liability), Net (in thousands) | Total Net Assets (Liabilities) |
| Beginning Balance, June 30, 2009 | \$ | \$ (811,402) | \$ (811,402) |
| FSAH Acquisition | 33,810 | (622,828) | (589,018) |
| Adjusted beginning balance | 33,810 | (1,434,230) | (1,400,420) |
| Total gains or losses realized and unrealized: | | | |
| Unrealized gains (losses) on credit derivatives | | (205,336) | (205,336) |
| Realized gains and other settlements on credit derivatives | | 71,691 | 71,691 |
| Other income | (637) | | (637) |
| Current period net effect of purchases, settlements and other activity included in unrealized portion of beginning balance | (230) | (70,292) | (70,522) |
| Transfers in and/or out of Level 3 | | | |
| Ending Balance, September 30, 2009 | \$ 32,943 | \$ (1,638,167) | \$ (1,605,224) |
| Gains and losses (realized and unrealized) included in earnings for the period are reported as follows: | | | |
| Total realized and unrealized gains (losses) included in earnings for the period | | \$ (133,645) | \$ (133,645) |
| Change in unrealized gains (losses) on credit derivatives still held at the reporting date | | \$ (184,190) | \$ (184,190) |

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The table below presents a reconciliation of the Company's financial instruments whose fair value included significant unobservable inputs (Level 3) during the Nine Months 2009.

| | Nine Months Ended September 30, 2009 | | |
|---|---|---|-----------------------------------|
| | Assets Acquired in Refinancing Transactions | Credit Derivative Asset (Liability), Net (in thousands) | Total Net Assets (Liabilities) |
| Beginning Balance | \$ | \$ (586,807) | \$ (586,807) |
| FSAH Acquisition | 33,810 | (622,828) | (589,018) |
| Adjusted beginning balance | 33,810 | (1,209,635) | (1,175,825) |
| Total gains or losses realized and unrealized: | | | |
| Unrealized gains (losses) on credit derivatives | | (432,638) | (432,638) |
| Realized gains and other settlements on credit derivatives | | 120,086 | 120,086 |
| Other income | (637) | | (637) |
| Current period net effect of purchases, settlements and other activity included in unrealized portion of beginning balance | (230) | (115,980) | (116,210) |
| Transfers in and/or out of Level 3 | | | |
| Ending Balance, September 30, 2009 | \$ 32,943 | \$ (1,638,167) | \$ (1,605,224) |
| Gains and losses (realized and unrealized) included in earnings for the period are reported as follows: | | | |
| Total realized and unrealized gains (losses) included in earnings for the period | | \$ (312,552) | \$ (312,552) |
| Change in unrealized gains (losses) on credit derivatives still held at the reporting date | | \$ (439,735) | \$ (439,735) |

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The table below presents a reconciliation of the Company's credit derivatives whose fair value included significant unobservable inputs (Level 3) during Third Quarter and Nine Months 2008.

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) | |
|--|---|--|
| | Three Months Ended September 30, 2008 Credit Derivative (Liability) Asset, Net | Nine Months Ended September 30, 2008 Credit Derivative (Liability) Asset, Net |
| | (in thousands) | |
| Beginning Balance | \$ (165,943) | \$ (617,644) |
| Total gains or losses realized and unrealized | | |
| Unrealized gains (losses) on credit derivatives | (116,247) | 332,634 |
| Realized gains and other settlements on credit derivatives | 29,960 | 89,370 |
| Current period net effect of purchases, settlements and other activity included in unrealized portion of beginning balance | (33,733) | (90,323) |
| Transfers in and/or out of Level 3 | | |
| Ending Balance | \$ (285,963) | \$ (285,963) |

Gains and losses (realized and unrealized) included in earnings for the period are reported as follows:

| | | |
|--|------------|--------------|
| Total realized and unrealized gains (losses) included in earnings for the period | \$ 86,287 | \$ (422,004) |
| Change in unrealized gains (losses) on credit derivatives still held at the reporting date | \$ 116,838 | \$ (325,729) |

Unearned Premium Reserves

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

Long Term Debt and Notes Payable to Related Party

The Company's long term debt is valued by broker-dealers using third party independent pricing sources and standard market conventions. The market conventions utilize market quotations, market transactions in comparable instruments, and various relationships between instruments, such as yield to maturity. The Company classified this fair value measurement as Level 3.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

For a description of the Company's long term debt, see Note 12.

The fair value of the note payable to related party was determined by calculating the present value of the expected cash flows. The Company classified this fair value measurement as Level 3.

Financial Guaranty Variable Interest Entities Assets and Liabilities

The fair values of VIE assets and VIE liabilities are determined using prices provided by broker-dealers or valuation models that use market-based inputs, including contractual terms and yield curves. These fair values do not consider the Company's own credit risk, as this risk is borne by the underlying VIE assets that serve to collateralize the VIE liabilities. The most significant market inputs used are unobservable and, therefore, the Company classified these fair value measurements as Level 3.

Future Installment Premiums

As described in Note 5, with the adoption of ASC 944-20 effective January 1, 2009, future installment premiums are included in the unearned premium reserves for contracts written in financial guaranty form. See "Unearned Premium Reserves" section above for additional information.

Prior to adoption of ASC 944-20, future installment premiums were not recorded in the Company's financial statements. The fair value of the Company's installment premiums was derived by calculating the present value of the estimated future cash flow stream for financial guaranty installment premiums discounted at 6.0%. The significant inputs used to fair value this item were observable. The Company accordingly classified this fair value measurement as Level 2.

8. INVESTMENT PORTFOLIO

As of the Acquisition Date, the investment portfolio includes assets acquired in the FSAH Acquisition with a fair value of \$5.8 billion, which is the Company's cost basis. The difference between fair value at the Acquisition Date and par value will be amortized through net investment income over the estimated lives of each security. The weighted average life of these securities is 4.8 years. In Third Quarter 2009 net investment income included approximately \$13.8 million in amortization of premium

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

8. INVESTMENT PORTFOLIO (Continued)

| Investments Category | Amortized Cost | As of December 31, 2008(1) | | Estimated Fair Value |
|---|---------------------|------------------------------|-------------------------------|-------------------------|
| | | Gross Unrealized Gains | Gross Unrealized Losses | |
| (in thousands) | | | | |
| <i>Fixed maturity securities</i> | | | | |
| U.S. government and agencies | \$ 426,592 | \$ 49,370 | \$ (36) | \$ 475,926 |
| Obligations of state and political subdivisions | 1,235,942 | 33,196 | (51,427) | 1,217,711 |
| Corporate securities | 274,237 | 5,793 | (11,793) | 268,237 |
| Mortgage-backed securities: | | | | |
| Residential mortgage-backed securities | 829,091 | 21,717 | (20,470) | 830,338 |
| Commercial mortgage-backed securities | 252,788 | 55 | (31,347) | 221,496 |
| Asset-backed securities | 80,710 | | (7,144) | 73,566 |
| Foreign government securities | 50,323 | 4,173 | | 54,496 |
| Preferred stock | 12,625 | | (258) | 12,367 |
| Total fixed maturity securities | 3,162,308 | 114,304 | (122,475) | 3,154,137 |
| Short-term investments | 477,197 | | | 477,197 |
| Total investments | \$ 3,639,505 | \$ 114,304 | \$ (122,475) | \$ 3,631,334 |

(1)

Reclassified to conform to the current period's presentation.

Approximately 15% and 29% of the Company's total investment portfolio as of September 30, 2009 and December 31, 2008, respectively, was composed of mortgage backed securities, including collateralized mortgage obligations and commercial mortgage backed securities. As of September 30, 2009 and December 31, 2008, respectively, approximately 82% and 69% of the Company's total mortgage backed securities were government agency obligations. As of September 30, 2009 and December 31, 2008, respectively, the weighted average credit quality of the Company's entire investment portfolio was AA and AA+. These ratings are represented by the lower of the Moody's and S&P classifications. The Company's portfolio is comprised primarily of high-quality, liquid instruments. The Company continues to receive sufficient information to value its investments and has not had to modify its valuation approach due to the current market conditions.

The amortized cost and estimated fair value of available-for-sale fixed maturity securities as of September 30, 2009 are shown below, by contractual maturity. 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.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

8. INVESTMENT PORTFOLIO (Continued)

Distribution of Fixed-Income Securities in Investment Portfolio
by Contractual Maturity

| | Amortized Cost | Estimated Fair Value |
|--|-------------------|-------------------------|
| | (in thousands) | |
| Due within one year | \$ 256,575 | \$ 257,894 |
| Due after one year through five years | 1,507,759 | 1,535,386 |
| Due after five years through ten years | 1,365,797 | 1,425,988 |
| Due after ten years | 3,581,140 | 3,785,663 |
| Mortgage-backed securities: | | |
| Residential mortgage-backed securities | 1,184,107 | 1,196,300 |
| Commercial mortgage-backed securities | 255,680 | 246,868 |
| Total | \$ 8,151,058 | \$ 8,448,099 |

Proceeds from the sale of available-for-sale fixed maturity securities were \$1,258.4 million and \$401.9 million for the Nine Months 2009 and 2008, respectively.

Net Realized Investment Gains (Losses)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-------------|------------------------------------|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (in thousands) | | | |
| Gains on investment portfolio | \$ 5,752 | \$ 1,365 | \$ 25,340 | \$ 4,639 |
| Losses on investment portfolio | (4,033) | (3,123) | (12,340) | (4,054) |
| Assets acquired in refinancing transactions | 218 | | 218 | |
| Other than temporary impairments | (8,034) | (18,273) | (41,313) | (18,536) |
| Net realized investment (losses) gains | \$ (6,097) | \$ (20,031) | \$ (28,095) | \$ (17,951) |

Net Investment Income

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------------------|-------------------------------------|-----------|------------------------------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (in thousands) | | | |
| Income from fixed maturity securities | \$ 88,162 | \$ 42,022 | \$ 175,468 | \$ 111,949 |
| Income from short-term investments | (1,506) | 2,201 | 6 | 10,431 |
| Gross investment income | 86,656 | 44,223 | 175,474 | 122,380 |
| Less: investment expenses | 1,914 | 782 | 3,831 | 2,133 |

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| | | | | | | | | |
|-----------------------|----|--------|----|--------|----|---------|----|---------|
| Net investment income | \$ | 84,742 | \$ | 43,441 | \$ | 171,643 | \$ | 120,247 |
|-----------------------|----|--------|----|--------|----|---------|----|---------|

Under agreements with its cedants and in accordance with statutory requirements, the Company maintains fixed maturity securities in trust accounts of \$2,666.2 million and \$1,233.4 million as of

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

8. INVESTMENT PORTFOLIO (Continued)

September 30, 2009 and December 31, 2008, respectively, for the benefit of reinsured companies and for the protection of policyholders, generally in states in which the Company or its subsidiaries, as applicable, are not licensed or accredited.

Under certain derivative contracts, the Company is required to post eligible securities as collateral, generally cash or U.S. government or agency securities. The need to post collateral under these transactions is generally based on mark-to-market valuation in excess of contractual thresholds. The fair market value of the Company's pledged securities totaled \$570.6 million and \$157.7 million as of September 30, 2009 and December 31, 2008, respectively.

The Company is not exposed to significant concentrations of credit risk within its investment portfolio.

No material investments of the Company were non-income producing for the Third Quarter and Nine Months 2009 and 2008.

Other-Than Temporary Impairment Methodology

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

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

a decline in the market value of a security for a continuous period of 12 months;

recent credit downgrades of the applicable security or the issuer by rating agencies;

the financial condition of the applicable issuer;

whether loss of investment principal is anticipated;

whether scheduled interest payments are past due; and

whether the Company has the intent to sell a security prior to its recovery in fair value.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss on the balance sheet in "accumulated other comprehensive income" in shareholders' equity.

As discussed in more detail below, prior to April 1, 2009, the reviews for impairment of investments were conducted pursuant to FSP No. 115-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" and accordingly, any unrealized loss identified as other than temporary was recorded directly in the consolidated statement of income. As of April 1, 2009, the Company adopted ASC 320-10-65-1. Accordingly, any credit-related impairment related to debt securities the Company does not plan to sell and is more-likely-than-not to be required to sell is recognized in the consolidated statement of income, with the non-credit-related impairment

recognized in other comprehensive income ("OCI"). For other impaired debt securities, where the Company has the intent to sell the security or where the entire impairment is deemed by the Company to be credit-related, the entire impairment is recognized in the consolidated statement of income.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

8. INVESTMENT PORTFOLIO (Continued)

Effective with the adoption of ASC 320-10-65-1 the Company recognizes an OTTI loss in earnings for a debt security in an unrealized loss position when either:

- (a) the Company has the intent to sell the debt security; or
- (b) it is more likely than not the Company will be required to sell the debt security before its anticipated recovery.

For all debt securities in unrealized loss positions that do not meet either of these two criteria, the Company analyzes the ability to recover the amortized cost by comparing the net present value of projected future cash flows with the amortized cost of the security. If the net present value is less than the amortized cost of the investment, an OTTI loss is recorded. The net present value is calculated by discounting the Company's best estimate of projected future cash flows at the effective interest rate implicit in the debt security prior to impairment. The Company's estimates of projected future cash flows are driven by assumptions regarding probability of default and estimates regarding timing and amount of recoveries associated with a default. The Company develops these estimates using information based on historical experience, credit analysis of an investment, as mentioned above, and market observable data, such as industry analyst reports and forecasts, sector credit ratings and other data relevant to the collectability of the security. For mortgage-backed and asset-backed securities, cash flow estimates also include prepayment assumptions and other assumptions regarding the underlying collateral including default rates, recoveries and changes in value. The determination of the assumptions used in these projections requires the use of significant management judgment.

Prior to adoption of ASC 320-10-65-1 on April 1, 2009, if the Company believed the decline was "other than temporary," the Company would write down the carrying value of the investment and record a realized loss in its consolidated statement of operations equal to the total difference between amortized cost and fair value at the impairment measurement date.

In periods subsequent to the recognition of an OTTI loss, the impaired debt security is accounted for as if it had been purchased on the measurement date of the impairment. Accordingly, the discount (or reduced premium) based on the new cost basis is accreted into net investment income in future periods based upon the amount and timing of expected future cash flows of the security, if the recoverable value of the investment based upon those cash flows is greater than the carrying value of the investment after the impairment.

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

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****8. INVESTMENT PORTFOLIO (Continued)**

The following tables present a three- and nine-month roll-forward of the credit loss component of the amortized cost of fixed maturity securities that the Company has written down for OTTI where the portion related to other factors was recognized in OCI.

| | Three Months Ended September 30, 2009 | |
|---|--|--------|
| | (in thousands) | |
| Balance, beginning of period | \$ | 15,415 |
| Additions for credit losses on securities for which an OTTI was not previously recognized | | |
| Additions for credit losses on securities for which an OTTI was previously recognized | | 4,619 |
| Balance, end of period | \$ | 20,034 |

| | Nine Months Ended September 30, 2009 | |
|---|---|--------|
| | (in thousands) | |
| Balance, beginning of period(1) | \$ | 582 |
| Additions for credit losses on securities for which an OTTI was not previously recognized | | 13,657 |
| Additions for credit losses on securities for which an OTTI was previously recognized | | 5,795 |
| Balance, end of period | \$ | 20,034 |

(1) The Company adopted ASC 320-10-65-1 on April 1, 2009.

As of September 30, 2009, amounts, net of tax, in accumulated other comprehensive income included a loss of \$14.1 million for securities for which the Company had recognized OTTI and a gain of \$228.9 million for securities for which the Company had not recognized OTTI. As of December 31, 2008, substantially all of accumulated other comprehensive income related to unrealized gains and losses on securities.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

8. INVESTMENT PORTFOLIO (Continued)

The following tables summarize, for all securities in an unrealized loss position as of September 30, 2009 and December 31, 2008, the aggregate fair value and gross unrealized loss by length of time the amounts have continuously been in an unrealized loss position.

| | As of September 30, 2009 | | | | | |
|---|--------------------------|-----------------|-------------------|-----------------|------------|-----------------|
| | Less than 12 months | | 12 months or more | | Total | |
| | Fair value | Unrealized loss | Fair value | Unrealized loss | Fair value | Unrealized loss |
| | (in millions) | | | | | |
| U.S. government and agencies | \$ 52.4 | \$ (0.4) | \$ | \$ | \$ 52.4 | \$ (0.4) |
| Obligations of state and political subdivisions | 33.8 | (0.1) | 60.6 | (1.2) | 94.4 | (1.3) |
| Corporate securities | 3.4 | (0.9) | 27.7 | (0.6) | 31.1 | (1.5) |
| Mortgage-backed securities: | | | | | | |
| Residential mortgage-backed securities | 97.9 | (18.7) | 30.4 | (3.8) | 128.3 | (22.5) |
| Commercial mortgage-backed securities | 52.8 | (3.0) | 79.1 | (8.9) | 131.9 | (11.9) |
| Asset-backed securities | 9.1 | (16.5) | 1.9 | | 11.0 | (16.5) |
| Foreign government securities | 262.3 | (4.2) | | | 262.3 | (4.2) |
| Preferred stock | | | | | | |
| Total | \$ 511.7 | \$ (43.8) | \$ 199.7 | \$ (14.5) | \$ 711.4 | \$ (58.3) |

| | As of December 31, 2008(1) | | | | | |
|---|----------------------------|-----------------|-------------------|-----------------|------------|-----------------|
| | Less than 12 months | | 12 months or more | | Total | |
| | Fair value | Unrealized loss | Fair value | Unrealized loss | Fair value | Unrealized loss |
| | (in millions) | | | | | |
| U.S. government and agencies | \$ 8.0 | \$ | \$ | \$ | \$ 8.0 | \$ |
| Obligations of state and political subdivisions | 479.4 | (28.7) | 137.9 | (22.7) | 617.3 | (51.4) |
| Corporate securities | 105.6 | (10.2) | 14.2 | (1.6) | 119.8 | (11.8) |
| Mortgage-backed securities: | | | | | | |
| Residential mortgage-backed securities | 46.4 | (17.7) | 38.2 | (2.8) | 84.6 | (20.5) |
| Commercial mortgage-backed securities | 135.0 | (26.8) | 36.2 | (4.5) | 171.2 | (31.3) |
| Asset-backed securities | 73.2 | (7.2) | | | 73.2 | (7.2) |
| Foreign government securities | | | | | | |
| Preferred stock | 12.4 | (0.3) | | | 12.4 | (0.3) |
| Total | \$ 860.0 | \$ (90.9) | \$ 226.5 | \$ (31.6) | \$ 1,086.5 | \$ (122.5) |

- (1) Reclassified to conform to the current period presentation.

The above unrealized loss balances are comprised of 108 and 218 fixed maturity securities as of September 30, 2009 and December 31, 2008, respectively. As of September 30, 2009, the Company's

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

8. INVESTMENT PORTFOLIO (Continued)

gross unrealized loss position stood at \$58.3 million compared to \$122.5 million at December 31, 2008. The \$64.2 million decrease in gross unrealized losses was primarily due to the reduction of unrealized losses attributable to municipal securities of \$50.1 million, and, to a lesser extent, \$19.4 million attributable to commercial mortgage-backed securities and \$10.3 million of losses attributable to corporate bonds. The decrease in unrealized losses was partially offset by a \$9.3 million increase in gross unrealized losses in asset-backed securities. The decrease in gross unrealized losses during the Nine Months 2009 was related to the recovery of liquidity in the financial markets, offset in part by a \$62.2 million transition adjustment for adoption of ASC 320-10-65-1.

As of September 30, 2009, the Company had 44 securities in an unrealized loss position for greater than 12 months, representing a gross unrealized loss of \$14.5 million. Of these securities, 12 securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of September 30, 2009 was \$9.3 million. This unrealized loss is primarily attributable to the market illiquidity and volatility in the U.S. economy and not specific to individual issuer credit. Except as noted below, the Company has recognized no OTTI losses.

The Company recognized \$8.0 million and \$41.3 million of OTTI losses substantially related to mortgage-backed and corporate securities for the Third Quarter and Nine Months 2009, respectively. The 2009 OTTI represents the credit component of the changes in unrealized losses for impaired securities. The Company continues to monitor the value of these investments. Future events may result in further impairment of the Company's investments. The Company recognized \$18.3 million and \$18.5 million of other than temporary impairment losses related to corporate securities for the Third Quarter and Nine Months 2008, respectively.

9. REINSURANCE

The Company enters into ceded reinsurance agreements with non-affiliated companies to limit its exposure to risk on an on-going basis. In the event that any of the reinsurers are unable to meet their obligations, the Company would be liable for such defaulted amounts.

With respect to a significant portion of the Company's in-force financial guaranty reinsurance business, due to the downgrade of AG Re to A1, subject to the terms of each reinsurance agreement, the ceding company may have the right to recapture business ceded to AG Re and assets representing substantially all of the statutory unearned premium and loss reserves (if any) associated with that business. As of September 30, 2009, the statutory unearned premium, which represents deferred revenue to the Company, subject to recapture was approximately \$156 million. If this entire amount were recaptured, it would result in a corresponding one-time reduction to net income of approximately \$9 million.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

9. REINSURANCE (Continued)

Direct, assumed, and ceded premium and loss and loss adjustment expense amounts for Third Quarter and Nine Months 2009 and 2008 were as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------|-------------------------------------|------------|------------------------------------|------------|
| | 2009 | 2008(1) | 2009(1) | 2008(1) |
| | (in thousands) | | | |
| Premiums | | | | |
| Written | | | | |
| Direct | \$ 131,501 | \$ 71,326 | \$ 409,141 | \$ 415,501 |
| Assumed | (7,286)(2) | 41,489 | 90,896 | 118,892 |
| Ceded | (7,718) | (1,328) | (6,741) | (12,545) |
| Net | \$ 116,497 | \$ 111,487 | \$ 493,296 | \$ 521,848 |
| Premiums | | | | |
| Earned | | | | |
| Direct | \$ 362,805 | \$ 27,793 | \$ 500,151 | \$ 67,441 |
| Assumed | 15,366 | 59,769 | 109,674 | 122,686 |
| Ceded | (48,201) | (2,046) | (52,775) | (6,093) |
| Net | \$ 329,970 | \$ 85,516 | \$ 557,050 | \$ 184,034 |
| Loss and Loss | | | | |
| Adjustment | | | | |
| Expenses | | | | |
| Direct | \$ 99,980 | \$ 67,392 | \$ 143,978 | \$ 131,523 |
| Assumed | 36,200 | 13,453 | 109,987 | 42,319 |
| Ceded | (2,855) | 1,697 | (2,856) | 1,963 |
| Net | \$ 133,325 | \$ 82,542 | \$ 251,109 | \$ 175,805 |

- (1) Amounts assumed by AG Re and AGC from FSAH in periods prior to the FSAH Acquisition are included in the assumed premiums written, premiums earned and loss and loss adjustment expenses amounts above reflecting the separate organizational structures in effect at the time.
- (2) Includes the effects of conforming accounting policies and methodologies as a result of the FSAH Acquisition.

The insured financial guaranty portfolio of the Acquired Companies uses ceded reinsurance to a greater extent than Assured Guaranty has historically used. While certain ceded portfolios have been re-assumed, the Company still has significant ceded reinsurance with third parties.

The Company's reinsurance contracts generally allow the Company to recapture ceded business after certain triggering events, such as reinsurer downgrades. Included in the table below is \$12,212 million in ceded par outstanding related to insured credit derivatives.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

9. REINSURANCE (Continued)

Ceded Par Outstanding by Reinsurer and Ratings

| Reinsurer | Ratings at November 16, 2009 | | Ceded Par Outstanding (dollars in millions) | Ceded Par Outstanding as a % of Total |
|--|--------------------------------|----------------------------|---|--|
| | Moody's Reinsurer Rating | S&P Reinsurer Rating | | |
| Tokio Marine and Nichido Fire Insurance Co., Ltd. | Aa2(1) | AA(1) | \$ 31,000 | 34.8% |
| Radian Asset Assurance Inc. | Ba1 | BBB- | 24,305 | 27.3 |
| RAM Reinsurance Co. Ltd. | WR(2) | WR(2) | 14,723 | 16.5 |
| Syncora Guarantee Inc | Ca | R(3) | 4,290 | 4.8 |
| Swiss Reinsurance Company. | A1 | A+ | 4,045 | 4.5 |
| R.V.I. Guaranty Co., Ltd. | WR(2) | BBB | 4,136 | 4.7 |
| Mitsui Sumitomo Insurance Co. Ltd. | Aa3 | AA | 2,516 | 2.8 |
| Other | Various | Various | 3,991 | 4.6 |
| Total | | | \$ 89,006 | 100.0% |

- (1) The Company has structural collateral agreements satisfying the triple-A credit requirement of S&P and/or Moody's.
- (2) Represents "Withdrawn Rating."
- (3) Represents "Regulatory Action. Placed under an order of rehabilitation and liquidation."

In accordance with statutory accounting requirements and U.S. insurance laws and regulations, in order for the Company to receive credit for liabilities ceded to reinsurers domiciled outside of the U.S., such reinsurers must secure their liabilities to the Company. Except for R.V.I. Guaranty Co., Ltd., which does not secure its ceded contingency reserves, all of the unauthorized reinsurers in the table above post collateral for the benefit of the Company in an amount at least equal to the sum of their ceded unearned premiums reserve, loss reserves and contingency reserves calculated on a statutory basis of accounting. In the case of CIFG Assurance North America Inc., included in "Other," and Radian Asset Assurance Inc., which are authorized reinsurers and, therefore, are not required to post security, their collateral equals or exceeds their ceded statutory loss reserves. Collateral may be in the form of letters of credit or trust accounts. The total collateral posted by all reinsurers as of September 30, 2009 exceeds \$1.2 billion.

10. COMMITMENTS AND CONTINGENCIES

Leases

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AGL and its subsidiaries are party to various lease agreements. In June 2008, the Company entered into a new five-year lease agreement for New York office space. Future minimum annual payments of \$5.3 million for the first twelve month period and \$5.7 million for subsequent twelve month periods commenced October 1, 2008 and are subject to escalation in building operating costs and real estate taxes. As a result of the FSAH Acquisition, during Second Quarter 2009 the Company decided not to occupy the office space described above and subleased it to two tenants for total minimum annual payments of approximately \$3.7 million until October 2013. The Company wrote off related leasehold improvements and recorded a pre-tax loss on the sublease of \$11.7 million in Second Quarter 2009, which is included in "FSAH acquisition-related expenses" and "other liabilities" in the unaudited consolidated statements of operations and balance sheets, respectively.

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****10. COMMITMENTS AND CONTINGENCIES (Continued)**

The Company leases space in New York City through June 2024. In addition, AGL and its subsidiaries lease additional office space under non-cancelable operating leases in various locations. Lease payments for the remainder of 2009, each of the next four calendar years ending December 31, and thereafter are as follows:

Future Minimum Rental Payments

| Year | (in thousands) |
|--------------------|-----------------------|
| 2009 (4th Quarter) | \$ 3,530 |
| 2010 | 11,491 |
| 2011 | 10,987 |
| 2012 | 10,992 |
| 2013 | 10,360 |
| Thereafter | 97,539 |
| Total | \$ 144,899 |

Rent expense was \$2.3 million for the Third Quarter 2009 and \$7.5 million for Nine Months 2009.

Legal Proceedings*Litigation*

In the ordinary course of their respective businesses, certain of the Company's subsidiaries assert claims in legal proceedings against third parties to recover losses paid in prior periods. The amounts, if any, the Company will recover in these proceedings are uncertain, although recoveries, or failure to obtain recoveries, in any one or more of these proceedings during any quarter or fiscal year could be material to the Company's results of operations in that particular quarter or fiscal year.

It is the opinion of the Company's management, based upon the information available, that the expected outcome of litigation against the Company, individually or in the aggregate, will not have a material adverse effect on the Company's financial position or liquidity, although an adverse resolution of litigation against the Company could have a material adverse effect on the Company's results of operations in a particular quarter or fiscal year.

Proceedings Related to FSAH's Former Financial Products Business

The following is a description of legal proceedings involving FSAH's former financial products business. Although the Company did not acquire FSAH's former financial products business, which included FSAH's former GIC business, medium-term note business and the portions of the leveraged lease businesses, certain legal proceedings relating to those businesses are against entities which the Company did acquire. Pursuant to an indemnification agreement entered into among AGM, Dexia Crédit Local ("DCL") and Dexia in connection with the FSAH Acquisition, each of DCL and Dexia, jointly and severally, has agreed to indemnify AGM and its affiliates against liability arising out of the proceedings described under this "Proceedings Related to FSAH's Former Financial Products Business" heading.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

10. COMMITMENTS AND CONTINGENCIES (Continued)

FSAH and AGM have received subpoenas duces tecum and interrogatories or civil investigative demands from the Attorney General of the States of Connecticut, Florida, Illinois, Missouri, New York, Texas and West Virginia relating to their investigations of alleged bid rigging of municipal GICs. FSAH has satisfied or is in the process of satisfying such requests. FSAH may receive additional inquiries from these or other regulators and expects to provide additional information to such regulators regarding their inquiries in the future.

In November 2006, (i) FSAH received a subpoena from the Antitrust Division of the Department of Justice ("DOJ") issued in connection with an ongoing criminal investigation of bid rigging of awards of municipal GICs and other municipal derivatives and (ii) AGM received a subpoena from the SEC related to an ongoing industry-wide investigation concerning the bidding of municipal GICs and other municipal derivatives. Pursuant to the subpoenas FSAH has furnished to the DOJ and SEC records and other information with respect to FSAH's municipal GIC business. On February 4, 2008, FSAH received a "Wells Notice" from the staff of the Philadelphia Regional Office of the SEC relating to the foregoing matter. The Wells Notice indicates that the SEC staff is considering recommending that the SEC authorize the staff to bring a civil injunctive action and/or institute administrative proceedings against FSAH, alleging violations of Section 10(b) of the Securities Exchange Act of 1934, as amended and Rule 10b-5 thereunder and Section 17(a) of the Securities Act of 1933, as amended. The ultimate loss that may arise from these investigations remains uncertain.

During 2008 nine putative class action lawsuits were filed in federal court alleging federal antitrust violations in the municipal derivatives industry, seeking damages and alleging, among other things, a conspiracy to fix the pricing of, and manipulate bids for, municipal derivatives, including GICs. These cases have been coordinated and consolidated for pretrial proceedings in the U.S. District Court for the Southern District of New York as *MDL 1950, In re Municipal Derivatives Antitrust Litigation*, Case No. 1:08-cv-2516 ("MDL 1950"). Five of these cases named both FSAH and AGM: (a) *Hinds County, Mississippi v. Wachovia Bank, N.A.* (filed on or about March 13, 2008); (b) *Fairfax County, Virginia v. Wachovia Bank, N.A.* (filed on or about March 12, 2008); (c) *Central Bucks School District, Pennsylvania v. Wachovia Bank N.A.* (filed on or about June 4, 2008); (d) *Mayor & City Counsel of Baltimore, Maryland v. Wachovia Bank N.A.* (filed on or about July 3, 2008); and (e) *Washington County, Tennessee v. Wachovia Bank N.A.* (filed on or about July 14, 2008). Four of the cases named only FSAH and also alleged that the defendants violated California state antitrust law and common law by engaging in illegal bid-rigging and market allocation, thereby depriving the cities of competition in the awarding of GICs and ultimately resulting in the cities paying higher fees for these products: (a) *City of Oakland, California, v. AIG Financial Products Corp.* (filed on or about April 23, 2008); (b) *County of Alameda, California v. AIG Financial Products Corp.* (filed on or about July 8, 2008); (c) *City of Fresno, California v. AIG Financial Products Corp.* (filed on or about July 17, 2008); and (d) *Fresno County Financing Authority v. AIG Financial Products Corp.* (filed on or about December 24, 2008).

In April 2009, the MDL 1950 court granted the defendants' motion to dismiss on the federal claims, but granted leave for the plaintiffs to file a second amended complaint. On June 18, 2009, interim lead plaintiffs' counsel filed a Second Consolidated Amended Class Action Complaint. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees and other costs. The Company cannot reasonably estimate the possible loss or range of loss that may arise

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

10. COMMITMENTS AND CONTINGENCIES (Continued)

from these lawsuits; although the Second Consolidated Amended Class Action Complaint currently describes some of FSAH's and AGM's activities, it does not name those entities as defendants.

FSAH and AGM also were named in five non-class action lawsuits originally filed in the California Superior Courts alleging violations of California law related to the municipal derivatives industry:

- (a) *City of Los Angeles v. Bank of America, N.A.* (filed on or about July 23, 2008 in the Superior Court of the State of California in and for the County of Los Angeles, Case No. BC 394944, removed to the U.S. District Court for the Central District of California ("C.D. Cal.") as Case No. 2:08-cv-5574, transferred to S.D.N.Y. as Case No. 1:08-cv-10351);
- (b) *City of Stockton v. Bank of America, N.A.* (filed on or about July 23, 2008 in the Superior Court of the State of California in and for the County of San Francisco, Case No. CGC-08-477851, removed to the N.D. Cal. as Case No. 3:08-cv-4060, transferred to S.D.N.Y. as Case No. 1:08-cv-10350);
- (c) *County of San Diego v. Bank of America, N.A.* (filed on or about August 28, 2008 in the Superior Court of the State of California in and for the County of Los Angeles, Case No. SC 99566, removed to C.D. Cal. as Case No. 2:08-cv-6283, transferred to S.D.N.Y. as Case No. 1:09-cv-1195);
- (d) *County of San Mateo v. Bank of America, N.A.* (filed on or about October 7, 2008 in the Superior Court of the State of California in and for the County of San Francisco, Case No. CGC-08-480664, removed to N.D. Cal. as Case No. 3:08-cv-4751, transferred to S.D.N.Y. as Case No. 1:09-cv-1196); and
- (e) *County of Contra Costa v. Bank of America, N.A.* (filed on or about October 8, 2008 in the Superior Court of the State of California in and for the County of San Francisco, Case No. CGC-08-480733, removed to N.D. Cal. as Case No. 3:08-cv-4752, transferred to S.D.N.Y. as Case No. 1:09-cv-1197).

These cases have been transferred to the S.D.N.Y. and consolidated with *MDL 1950* for pretrial proceedings. Amended complaints in these actions were filed on September 15, 2009 naming AGM and AGUS, among other defendants. Responses to the amended complaints, which also include a federal antitrust claim, have yet to be filed. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss or range of loss that may arise from these lawsuits.

Proceedings Relating to the Company's Financial Guaranty Business

The Company has received subpoenas duces tecum and interrogatories from the State of Connecticut Attorney General and the Attorney General of the State of California related to antitrust concerns associated with the methodologies used by rating agencies for determining the credit rating of municipal debt, including a proposal by Moody's to assign corporate equivalent ratings to municipal obligations, and the Company's communications with rating agencies. The Company has satisfied or is in the process of satisfying such requests. It may receive additional inquiries from these or other regulators and expects to provide additional information to such regulators regarding their inquiries in the future.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

10. COMMITMENTS AND CONTINGENCIES (Continued)

AGM and various other financial guarantors were named in three complaints filed in the Superior Court, San Francisco County in December 2008 and January 2009: (a) *City of Los Angeles, acting by and through the Department of Water and Power v. Ambac Financial Group et. al* (filed on or about December 31, 2008), Case No. CG-08-483689; (b) *Sacramento Municipal Utility District v. Ambac Financial Group et. al* (filed on or about December 31, 2008), Case No. CGC-08-483691; and (c) *City of Sacramento v. Ambac Financial Group Inc. et. al* (filed on or about January 6, 2009), Case No. CGC-09-483862. On or about August 31, 2009, plaintiffs in these cases filed amended complaints against AGC and AGM. At the same time, AGC and AGM were named in the following complaints, five of which were amended complaints and three of which were new complaints: (a) *City of Los Angeles v. Ambac Financial Group, Inc. et al.*, Case No. CGC-08-394943; (b) *City of Oakland v. Ambac Financial Group, Inc. et al.*, Case No. CGC-08-479241; (c) *City of Riverside v. Ambac Financial Group, Inc. et al.*, Case No. CGC-09-492059; (d) *City of Stockton v. Ambac Financial Group, Inc. et al.*, Case No. CGC-08-477848; (e) *County of Alameda v. Ambac Financial Group, Inc. et al.*, Case No. CGC-08-481447; (f) *County of Contra Costa v. Ambac Financial Group, Inc. et al*, Case No. CGC-09-492055; (g) *County of San Mateo v. Ambac Financial Group, Inc. et al.*, Case No. CGC-080481223; and (h) *Los Angeles World Airports v. Ambac Financial Group, Inc. et al.*, Case No. CGC-09-492057.

These complaints allege (i) participation in a conspiracy in violation of California's antitrust laws to maintain a dual credit rating scale that misstated the credit default risk of municipal bond issuers and created market demand for municipal bond insurance, (ii) participation in risky financial transactions in other lines of business that damaged each bond insurer's financial condition (thereby undermining the value of each of their guaranties), and (iii) a failure to adequately disclose the impact of those transactions on their financial condition. These latter allegations form the predicate for five separate causes of action against AGC: breach of contract, breach of the covenant of good faith and fair dealing, fraud, negligence, and negligent misrepresentation. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss or range of loss that may arise from these lawsuits.

In August 2008 a number of financial institutions and other parties, including AGM, were named as defendants in a civil action brought in the circuit court of Jefferson County, Alabama relating to the County's problems meeting its debt obligations on its \$3.2 billion sewer debt: *Charles E. Wilson vs. JPMorgan Chase & Co et al* (filed on or about August 8, 2008 in the Circuit Court of Jefferson County, Alabama), Case No. 01-CV-2008-901907.00, a putative class action. The action was brought on behalf of rate payers, tax payers and citizens residing in Jefferson County, and alleges conspiracy and fraud in connection with the issuance of the County's debt. The complaint in this lawsuit seeks unspecified monetary damages, interest, attorneys' fees and other costs. The Company cannot reasonably estimate the possible loss or range of loss that may arise from this lawsuit.

Reinsurance

The Company is party to reinsurance agreements with other monoline financial guaranty insurance companies. The Company's facultative and treaty agreements are generally subject to termination:

- (a) upon written notice (ranging from 90 to 120 days) prior to the specified deadline for renewal,

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

10. COMMITMENTS AND CONTINGENCIES (Continued)

- (b) at the option of the primary insurer if the Company fails to maintain certain financial, regulatory and rating agency criteria which are equivalent to or more stringent than those the Company is otherwise required to maintain for its own compliance with state mandated insurance laws and to maintain a specified financial strength rating for the particular insurance subsidiary, or
- (c) upon certain changes of control of the Company.

Upon termination under the conditions set forth in (b) and (c) above, the Company may be required (under some of its reinsurance agreements) to return to the primary insurer all statutory unearned premiums, less ceding commissions, attributable to reinsurance ceded pursuant to such agreements after which the Company would be released from liability with respect to the ceded business. Upon the occurrence of the conditions set forth in (b) 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. See Note 9.

11. DIVIDENDS AND CAPITAL REQUIREMENTS

Each operating company's ability to pay dividends depends, among other things, upon their financial condition, results of operations, cash requirements and compliance with rating agency requirements, and is also subject to restrictions contained in the insurance laws and related regulations of their state of domicile and other states.

AGC is a Maryland domiciled insurance company and a subsidiary of the Company. Under Maryland's 1993 revised insurance law, AGC may pay dividends out of earned surplus in any twelve-month period in an aggregate amount not exceeding the lesser of (a) 10% of policyholders' surplus or (b) net investment income (at the preceding December 31) without prior approval of the Maryland Commissioner of Insurance. The amount available for distribution from AGC during 2009 with notice to, but without prior approval of, the Maryland Commissioner of Insurance under the Maryland insurance law is approximately \$37.8 million. For the Third Quarter 2009 and 2008, AGC declared and paid \$6.1 million and \$0 million, respectively, in dividends to AGUS. For the Nine Months 2009 and 2008, AGC declared and paid \$16.8 million and \$7.3 million, respectively, in dividends to AGUS. Under Maryland insurance regulations, AGC is required at all times to maintain a minimum surplus of \$750,000.

AGM is a New York domiciled insurance company and a subsidiary of the Company. Under the insurance laws of the State of New York and related requirements, AGM may pay dividends out of earned surplus, provided that, together with all dividends declared or distributed by AGM during the preceding 12 months, the dividends do not exceed the lesser of (a) 10% of policyholders' surplus as of its last statement filed with the Superintendent of Insurance of the State of New York (the "New York Superintendent") or (b) adjusted net investment income during this period. Based on AGM's statutory statements for the first nine months of 2009, the maximum amount available for payment of dividends by AGM without regulatory approval over the 12 months following September 30, 2009 was approximately \$112.0 million. Furthermore, in connection with the FSAH Acquisition, the Company has committed to the New York Insurance Department that AGM will not pay any dividends for a period

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****11. DIVIDENDS AND CAPITAL REQUIREMENTS (Continued)**

of two years from the Acquisition Date without the written approval of the New York Insurance Department. AGM paid \$10.0 million in dividends during the first quarter of 2009 and \$10.0 million in dividends during the Third Quarter 2008. Under New York insurance regulations, AGM is required at all times to maintain a minimum surplus of \$66.5 million.

12. LONG-TERM DEBT, NOTE PAYABLE TO RELATED PARTY AND CREDIT FACILITIES

The carrying value of long-term debt was as follows:

| | As of | |
|--|--------------------|-------------------|
| | September 30, 2009 | December 31, 2008 |
| | (in millions) | |
| AGUS: | | |
| 7.0% Senior Notes | \$ 197,471 | \$ 197,443 |
| 8.50% Senior Notes | 169,923 | |
| Series A Enhanced Junior Subordinated Debentures | 149,789 | 149,767 |
| FSAH: | | |
| 6 ⁷ / ₈ % QUIBS | 66,571 | |
| 5.60% Notes | 52,407 | |
| 6.25% Notes | 133,658 | |
| Junior Subordinated Debentures | 145,418 | |
| | | |
| Total long-term debt | 915,237 | 347,210 |
| Note Payable to Related Party | 155,827 | |
| | | |
| Total | \$ 1,071,064 | \$ 347,210 |

The Company's unaudited interim consolidated financial statements include long-term debt and related interest expense, which was used to fund the Company's insurance operations and the FSAH Acquisition on July 1, 2009, as described below.

7.0% Senior Notes

On May 18, 2004, AGUS issued \$200.0 million of 7.0% senior notes due 2034 ("7.0% Senior Notes") for net proceeds of \$197.3 million. The proceeds of the offering were used to repay substantially all of a \$200.0 million promissory note issued to a subsidiary of ACE Limited ("ACE") in April 2004 as part of the IPO-related formation transactions. Although the coupon on the Senior Notes is 7.0%, the effective rate is approximately 6.4%, taking into account the effect of a cash flow hedge executed by the Company in March 2004. The 7.0% Senior Notes are fully and unconditionally guaranteed by AGL.

8.50% Senior Notes

On June 24, 2009, AGL issued 3,450,000 equity units for net proceeds of approximately \$166.8 million in a registered public offering. The net proceeds of the offering were used to pay a portion of the consideration for the FSAH Acquisition. Each equity unit consists of (i) a forward

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

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12. LONG-TERM DEBT, NOTE PAYABLE TO RELATED PARTY AND CREDIT FACILITIES (Continued)

purchase contract and (ii) a 1/20th, or 5%, undivided beneficial ownership interest in \$1,000 principal amount 8.50% senior notes due 2014 issued by AGUS and guaranteed by AGL. Under the purchase contract, holders are required to purchase, and AGL is required to issue, between 3.8685 and 4.5455 of AGL common shares for \$50 no later than June 1, 2012. The actual number of shares purchased will be based on the average closing price of the common shares over a 20-trading day period ending three trading days prior to June 1, 2012. More specifically, if the average closing price per share for the relevant period (the "Applicable Market Value") is equal to or exceeds \$12.93, the settlement rate will be 3.8685 shares. If the Applicable Market Value is less than or equal to \$11.00, the settlement rate will be 4.5455 shares, and if it is between \$11.00 and \$12.93, the settlement rate will be equal to the quotient of \$50.00 and the Applicable Market Value.

The notes are pledged by the holders of the equity units to a collateral agent to secure their obligations under the purchase contracts. Interest on the notes is payable, initially, quarterly at the rate of 8.50% per year. The notes are subject to a mandatory remarketing on a date chosen by AGUS between December 1, 2011 and May 1, 2012 (or, if not remarketed during such period, during a designated three business day period in May 2012). In the remarketing, the interest rate on the notes will be reset and certain other terms of the notes may be modified in order to generate sufficient remarketing proceeds to satisfy the equity unit holders' obligations under the purchase contract and to pay fees payable to the remarketing agent. In the remarketing, AGUS may elect to extend the stated maturity of the notes to any date not later than June 1, 2039, add to, modify or remove altogether AGUS' redemption rights on the notes; provided that there will be at least two years between the reset effective date and any modified redemption date; and interest deferral provisions to the notes. If the notes are not successfully remarketed, the interest rate on the notes will not be reset and holders of all notes will have the right to put their notes to the Company on the purchase contract settlement date at a put price equal to \$1,000 per note (\$50 per equity unit) plus accrued and unpaid interest. This put right will be automatically exercised unless such holders (a) notify the Company of their intent to settle their obligations under the purchase contracts in cash, and (b) deliver \$50 in cash per purchase contract, by the applicable dates specified by the purchase contracts. Unless an equity unit holder has settled the related purchase contract with separate cash on or prior to the purchase contract settlement date, the holder will be deemed to have elected to apply a portion of the proceeds of the put price equal to the principal amount of the notes against the holder's obligations under the related purchase contracts, thereby satisfying such obligations in full, and AGL will deliver its common shares to such holder pursuant to the related purchase contracts. Any remaining amount of the put price following satisfaction of the purchase contract will be paid to such equity unit holder.

The notes are redeemable at AGUS' option, in whole but not in part, upon the occurrence and continuation of a tax event or an accounting event (as such terms are defined in the terms of the notes) at any time prior to the earlier of the date of a successful remarketing and the purchase contract settlement date at the redemption price described below. The aggregate redemption amount for the notes is equal to an amount that would permit the collateral agent to purchase a portfolio of U.S. Treasury securities sufficient to pay the principal amount of the notes and all scheduled interest payment dates that occur after the special event redemption date to, and including the purchase contract settlement date; provided that the aggregate redemption amount may not be less than the principal amount of the notes. Following any special event redemption of the notes, the redemption

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

12. LONG-TERM DEBT, NOTE PAYABLE TO RELATED PARTY AND CREDIT FACILITIES (Continued)

price for the notes will be paid to the collateral agent who will purchase a portfolio of Treasury securities (which will be held by the collateral agent to secure the obligations of the equity units holders under the purchase contract) and remit any remaining proceeds to the holders. Other than in connection with a special event, the notes may not be redeemed by AGUS prior to June 1, 2014.

Series A Enhanced Junior Subordinated Debentures

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

Debt Issued by FSAH

AGL fully and unconditionally guarantees the following three series of FSAH debt obligations:

- (a) *\$100.0 million face amount of 6⁷/₈% Quarterly Income Bond Securities ("QUIBS") due December 15, 2101.* On December 19, 2001, FSAH issued \$100.0 million face amount of 6⁷/₈% QUIBS due December 15, 2101, which are callable without premium or penalty on or after December 19, 2006. A portion of the proceeds were used to pay a dividend to the shareholders of FSAH. On the Acquisition Date, the fair value of these bonds was \$66.5 million, representing a discount of \$33.5 million, which will be amortized over the term of the debt.
- (b) *\$230.0 million face amount of 6.25% Notes due November 1, 2102.* On November 26, 2002, FSAH issued \$230.0 million face amount of 6.25% Notes due November 1, 2102, which are callable without premium or penalty in whole or in part at any time on or after November 26, 2007. A portion of the proceeds were used to redeem in whole FSAH's \$130.0 million principal amount of 7.375% Senior Quarterly Income Debt Securities ("QUIDS") due September 30, 2097. On July 1, 2009, the date of the FSAH Acquisition, the fair value of these bonds was \$133.4 million, representing a discount of \$96.6 million, which will be amortized over the term of the debt.
- (c) *\$100.0 million face amount of 5.60% Notes due July 15, 2103.* On July 31, 2003, FSAH issued \$100.0 million face amount of 5.60% Notes due July 15, 2103, which are callable without premium or penalty in whole or in part at any time on or after July 31, 2008. The proceeds were used to redeem in whole FSAH's \$100.0 million principal amount of 6.950% Senior QUIDS due November 1, 2098. On July 1, 2009, the date of the FSAH Acquisition, the fair value of these bonds was \$52.3 million, representing a discount of \$47.7 million, which will be amortized over the term of the debt.

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12. LONG-TERM DEBT, NOTE PAYABLE TO RELATED PARTY AND CREDIT FACILITIES (Continued)

AGL also guarantees, on a junior subordinated basis, the \$300 million of FSAH's outstanding Junior Subordinated Debentures.

On November 22, 2006, FSAH issued \$300.0 million face amount of Junior Subordinated Debentures with a scheduled maturity date of December 15, 2036 and a final repayment date of December 15, 2066. The final repayment date of December 15, 2066 may be automatically extended up to four times in five-year increments provided certain conditions are met. The debentures are redeemable, in whole or in part, at any time prior to December 15, 2036 at their principal amount plus accrued and unpaid interest to the date of redemption or, if greater, the make-whole redemption price. Interest on the debentures will accrue from November 22, 2006 to December 15, 2036 at the annual rate of 6.40%. If any amount of the debentures remains outstanding after December 15, 2036, then the principal amount of the outstanding debentures will bear interest at a floating interest rate equal to one-month LIBOR plus 2.215% until repaid. FSAH may elect at one or more times to defer payment of interest on the debentures for one or more consecutive interest periods that do not exceed ten years. In connection with the completion of this offering, FSAH entered into a replacement capital covenant for the benefit of persons that buy, hold or sell a specified series of FSAH long-term indebtedness ranking senior to the debentures. Under the covenant, the debentures will not be repaid, redeemed, repurchased or defeased by FSAH or any of its subsidiaries on or before the date that is 20 years prior to the final repayment date, except to the extent that FSAH has received proceeds from the sale of replacement capital securities. The proceeds from this offering were used to pay a dividend to the shareholders of FSAH. On the Acquisition Date, the fair value of these bonds was \$144.0 million, representing a discount of \$156.0 million, which will be amortized over the term of the debt.

Note Payable to Related Party

Note Payable to Related Party represents debt issued by AGM to the Financial Products Companies, which were transferred to Dexia prior to the FSAH Acquisition. AGM borrowed funds from its then consolidated financial products subsidiaries to finance the purchase of the underlying obligations of AGM-insured obligations which had breached triggers allowing AGM to exercise its right to accelerate payment of a claim in order to mitigate loss. The assets purchased are classified as assets acquired in refinancing transactions. The term of the note payable matches the terms of the assets. On the Acquisition Date, the fair value of this note was \$164.4 million, representing a premium of \$9.5 million, which will be amortized over the term of the debt.

The Company recorded \$2.3 million of interest expense on the note payable for the Third Quarter 2009.

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12. LONG-TERM DEBT, NOTE PAYABLE TO RELATED PARTY AND CREDIT FACILITIES (Continued)

Principal payments due under these notes for the remainder of 2009, each of the next four calendar years ending December 31, and thereafter are as follows:

Expected Maturity Schedule of Note Payable to Related Party

| Expected Withdrawal Date | Principal Amount (in thousands) |
|--------------------------|---------------------------------------|
| 2009 | \$ 2,279 |
| 2010 | 7,695 |
| 2011 | 6,075 |
| 2012 | 24,778 |
| 2013 | 26,504 |
| Thereafter | 88,496 |
| Total | \$ 155,827 |

Interest Expense

The Company recorded interest expense of \$25.2 million and \$37.5 million for Third Quarter 2009 and Nine Months 2009, respectively, compared to \$5.8 million and \$17.5 million for Third Quarter 2008 and Nine Months 2008, respectively. The increase in both periods is primarily due to \$13.4 million of interest expense related to FSAH debt, \$3.6 million of interest expense related to the 8.50% Senior Notes and \$2.3 million of interest expense on note payable to related party. The Company acquired long-term debt with a face value of \$730 million as part of the FSAH Acquisition. See Note 2. This debt was recorded on the Company's books at its Acquisition Date fair value of approximately \$396 million. The discount on this debt will be amortized as part of interest expense over the estimated remaining life of the applicable debt. During Third Quarter 2009, the Company recognized interest expense of approximately \$1.9 million related to this amortization.

The following table shows the component of interest expense for Third Quarter 2009.

| | Third Quarter 2009 | | |
|---|--------------------|---------------------------------------|------------------------------|
| | Coupon Interest | Amortization/ Accretion & Other | Total Interest Expense |
| | (in millions) | | |
| 7.0% Senior Notes(1) | \$ 3.5 | \$ (0.1) | \$ 3.4 |
| 8.50% Senior Notes(1) | 3.7 | (0.1) | 3.6 |
| Series A Enhanced Junior Subordinated Debentures(1) | 2.4 | 0.1 | 2.5 |
| 6 ⁷ / ₈ % QUIBS(2) | 1.7 | 0.1 | 1.8 |
| 6.25% Notes(2) | 3.6 | 0.3 | 3.9 |
| 5.60% Notes (2) Junior Subordinated Debentures (2) | 4.8 | 1.4 | 6.2 |

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12. LONG-TERM DEBT, NOTE PAYABLE TO RELATED PARTY AND CREDIT FACILITIES (Continued)

| | Third Quarter 2009 | | |
|----------------------------------|--------------------|--|------------------------------|
| | Coupon Interest | Amortization/ Accretion & Other (in millions) | Total Interest Expense |
| Note Payable to Related Party | 2.6 | (0.3) | 2.3 |
| Total | \$ 23.7 | \$ 1.5 | \$ 25.2 |

(1) Issued by AGUS.

(2) Issued by FSAH.

Credit Facilities**2006 Credit Facility**

On November 6, 2006, AGL and certain of its subsidiaries entered into a \$300.0 million five-year unsecured revolving credit facility (the "2006 Credit Facility") with a syndicate of banks. Under the 2006 Credit Facility, each of AGC, AGUK, AG Re, AGRO and AGL are entitled to request the banks to make loans to such borrower or to request that letters of credit be issued for the account of such borrower. Of the \$300.0 million available to be borrowed, no more than \$100.0 million may be borrowed by AGL, AG Re or AGRO, individually or in the aggregate, and no more than \$20.0 million may be borrowed by AGUK. The stated amount of all outstanding letters of credit and the amount of all unpaid drawings in respect of all letters of credit cannot, in the aggregate, exceed \$100.0 million. The 2006 Credit Facility also provides that Assured Guaranty may request that the commitment of the banks be increased an additional \$100.0 million up to a maximum aggregate amount of \$400.0 million. Any such incremental commitment increase is subject to certain conditions provided in the agreement and must be for at least \$25.0 million.

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

At the closing of the 2006 Credit Facility, AGC guaranteed the obligations of AGUK under the facility and AGL guaranteed the obligations of AG Re and AGRO under the facility and agreed that, if the Company consolidated assets (as defined in the related credit agreement) of AGC and its subsidiaries were to fall below \$1.2 billion, it would, within 15 days, guarantee the obligations of AGC and AGUK under the facility. At the same time, Assured Guaranty Overseas US Holdings Inc. ("AGOUS") guaranteed the obligations of AGL, AG Re and AGRO under the facility, and each of AG Re and AGRO guaranteed the other as well as AGL.

The 2006 Credit Facility's financial covenants require that AGL:

- (a) maintain a minimum net worth of 75% of the Consolidated Net Worth of Assured Guaranty as of the quarter ended June 30, 2009; and

- (b) maintain a maximum debt-to-capital ratio of 30%.

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12. LONG-TERM DEBT, NOTE PAYABLE TO RELATED PARTY AND CREDIT FACILITIES (Continued)

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

As of September 30, 2009 and December 31, 2008, no amounts were outstanding under this facility. There have not been any borrowings under the 2006 Credit Facility.

Letters of credit totaling approximately \$2.9 million and \$2.9 million remained outstanding as of September 30, 2009 and December 31, 2008, respectively. The Company obtained the letters of credit in connection with entering into a lease for new office space in 2008, which space was subsequently sublet. See Note 10.

2009 Strip Coverage Liquidity Agreement

In connection with the FSAH Acquisition, AGM agreed to retain the risks relating to the debt and strip policy portions of the leveraged lease business. The liquidity risk to AGM related to the strip policy portion of the leveraged lease business is mitigated by the strip coverage facility described below.

In a leveraged lease transaction, a tax-exempt entity (such as a transit agency) transfers tax benefits to a tax-paying entity by transferring ownership of a depreciable asset, such as subway cars. The tax-exempt entity then leases the asset back from its new owner.

If the lease is terminated early, the tax-exempt entity must make an early termination payment to the lessor. A portion of this early termination payment is funded from monies that were pre-funded and invested at the closing of the leveraged lease transaction (along with earnings on those invested funds); the tax-exempt entity is obligated to pay the remaining, unfunded portion of this early termination payment (known as the "strip coverage") from its own sources. AGM issued financial guaranty insurance policies (known as "strip policies") that guaranteed the payment of these unfunded strip coverage amounts to the lessor, in the event that a tax-exempt entity defaulted on its obligation to pay this portion of its early termination payment. AGM can then seek reimbursement of its strip policy payments from the tax-exempt entity, and can also sell the transferred depreciable asset and reimburse itself from the sale proceeds.

On July 1, 2009, AGM and DCL, acting through its New York Branch ("DCL (NY)"), entered into a credit facility (the "Strip Coverage Facility"). DCL is a subsidiary of Dexia. Under the Strip Coverage Facility, DCL (NY) agreed to make loans to AGM to finance all draws made by lessors on

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12. LONG-TERM DEBT, NOTE PAYABLE TO RELATED PARTY AND CREDIT FACILITIES (Continued)

AGM strip policies that were outstanding as of November 13, 2008, up to the commitment amount. The commitment amount of the Strip Coverage Facility was \$1 billion at closing of the FSAH Acquisition but is scheduled to amortize over time; it may also be reduced in 2014 to \$750 million, if AGM does not have a specified consolidated net worth at that time.

Fundings under this facility are subject to certain conditions precedent, and their repayment is collateralized by a security interest that AGM granted to DCL (NY) in amounts that AGM recovers from the tax-exempt entity, or from asset sale proceeds following its payment of strip policy claims. The Strip Coverage Facility will terminate upon the earliest to occur of an AGM change of control, the reduction of the commitment amount to \$0, and January 31, 2042.

The Strip Coverage Facility's financial covenants require that AGM and its subsidiaries maintain a maximum debt-to-capital ratio of 30% and maintain a minimum net worth of (a) 75% of consolidated net worth as of the quarter ended June 30, 2009, plus (b) 25% of the aggregate consolidated net income (or loss) for the period beginning July 1, 2009 and ending on June 30, 2014 or, if the commitment amount has been reduced to \$750 million as described above, zero.

The Strip Coverage Facility contains restrictions on AGM, including, among other things, in respect of its ability to incur debt, permit liens, pay dividends or make distributions, dissolve or become party to a merger or consolidation. Most of these restrictions are subject to exceptions. The Strip Coverage Facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, bankruptcy or insolvency proceedings and cross-default to other debt agreements.

As of September 30, 2009 no amounts were outstanding under this facility, nor have there been any borrowings during the life of this facility.

Limited Recourse Credit Facilities

AG Re Credit Facility

On July 31, 2007, AG Re entered into a limited recourse credit facility ("AG Re Credit Facility") with a syndicate of banks which provides up to \$200.0 million for the payment of losses in respect of the covered portfolio. The AG Re Credit Facility expires in July 2014. The facility can be utilized after AG Re has incurred, during the term of the facility, cumulative municipal losses (net of any recoveries) in excess of the greater of \$260 million or the average annual debt service of the covered portfolio multiplied by 4.5%. The obligation to repay loans under this agreement is a limited recourse obligation payable solely from, and collateralized by, a pledge of recoveries realized on defaulted insured obligations in the covered portfolio, including certain installment premiums and other collateral.

As of September 30, 2009 and December 31, 2008, no amounts were outstanding under this facility nor have there been any borrowings during the life of this facility.

AGM Credit Facility

On April 30, 2005, AGM entered into a limited recourse credit facility ("AGM Credit Facility") with a syndicate of international banks which provides up to \$297.5 million for the payment of losses in

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ASSURED GUARANTY LTD.

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12. LONG-TERM DEBT, NOTE PAYABLE TO RELATED PARTY AND CREDIT FACILITIES (Continued)

respect of the covered portfolio. The AGM Credit Facility expires April 30, 2015. The facility can be utilized after AGM has incurred, during the term of the facility, cumulative municipal losses (net of any recoveries) in excess of the greater of \$297.5 million or the average annual debt service of the covered portfolio multiplied by 5.0%. The obligation to repay loans under this agreement is a limited recourse obligation payable solely from, and collateralized by, a pledge of recoveries realized on defaulted insured obligations in the covered portfolio, including certain installment premiums and other collateral. The ratings downgrade of AGM by Moody's to Aa3 in November, 2008 resulted in an increase to the commitment fee.

As of September 30, 2009 and December 31, 2008, no amounts were outstanding under this facility nor have there been any borrowings during the life of this facility.

Committed Capital Securities

AGC CCS Securities

On April 8, 2005, AGC entered into four separate agreements with four different unaffiliated custodial trusts pursuant to which AGC may, at its option, cause each of the custodial trusts to purchase up to \$50.0 million of perpetual preferred stock of AGC. The custodial trusts were created as a vehicle for providing capital support to AGC by allowing AGC to obtain immediate access to new capital at its sole discretion at any time through the exercise of the put option. If the put options were exercised, AGC would receive \$200.0 million in return for the issuance of its own perpetual preferred stock, the proceeds of which may be used for any purpose, including the payment of claims. The put options were not exercised during 2009 or 2008. Initially, all of AGC's committed capital securities (the "AGC CCS Securities") were issued to a special purpose pass-through trust (the "Pass-Through Trust"). The Pass-Through Trust was dissolved in April 2008 and the AGC CCS Securities were distributed to the holders of the Pass-Through Trust's securities. Neither the Pass-Through Trust nor the custodial trusts are consolidated in the Company's financial statements.

Income distributions on the Pass-Through Trust Securities and AGC CCS Securities were equal to an annualized rate of One-Month LIBOR plus 110 basis points for all periods ending on or prior to April 8, 2008. Following dissolution of the Pass-Through Trust, distributions on the AGC CCS Securities are determined pursuant to an auction process. On April 7, 2008 this auction process failed, thereby increasing the annualized rate on the AGC CCS Securities to One-Month LIBOR plus 250 basis points. Distributions on the AGC preferred stock will be determined pursuant to the same process.

During Third Quarter 2009 and Third Quarter 2008, AGC incurred \$1.3 million and \$1.5 million, respectively, of put option premiums, which are an on-going expense. During Nine Months 2009 and Nine Months 2008, AGC incurred \$4.6 million and \$4.0 million, respectively, of put option premiums, which are an on-going expense. The increase in Nine Months 2009 compared to the respective periods in 2008 was due to the increase in annualized rates from One-Month LIBOR plus 110 basis points to One-Month LIBOR plus 250 basis points as a result of the failed auction process in April 2008. These expenses are presented in the Company's unaudited interim consolidated statements of operations under "other expenses."

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****12. LONG-TERM DEBT, NOTE PAYABLE TO RELATED PARTY AND CREDIT FACILITIES (Continued)**

The AGC CCS Securities had a fair value of \$8.9 million (see Note 7) and \$51.1 million as of September 30, 2009 and December 31, 2008, respectively, and a reduction in fair value during Third Quarter 2009 and Nine Months 2009 of \$1.2 million and \$42.1 million, respectively, which are recorded in the consolidated balance sheets in "committed capital securities, at fair value" and the unaudited interim consolidated statements of operations in "fair value gain (loss) on committed capital securities," respectively. The change in fair value during Third Quarter 2008 and Nine Months 2008 was \$6.9 million and \$24.3 million, respectively.

AGM CPS Securities

In June 2003, \$200.0 million of AGM Committed Preferred Trust Securities (the "AGM CPS Securities"), money market committed preferred trust securities, were issued by trusts created for the primary purpose of issuing the AGM CPS Securities, investing the proceeds in high-quality commercial paper and selling put options to AGM, allowing AGM to issue the trusts non-cumulative redeemable perpetual preferred stock (the "AGM Preferred Stock") of AGM in exchange for cash. There are four trusts, each with an initial aggregate face amount of \$50 million. These trusts hold auctions every 28 days, at which time investors submit bid orders to purchase AGM CPS Securities. If AGM were to exercise a put option, the applicable trust would transfer the portion of the proceeds attributable to principal received upon maturity of its assets, net of expenses, to AGM in exchange for AGM Preferred Stock. AGM pays a floating put premium to the trusts, which represents the difference between the commercial paper yield and the winning auction rate (plus all fees and expenses of the trust). If an auction does not attract sufficient clearing bids, however, the auction rate is subject to a maximum rate of 200 basis points above LIBOR for the next succeeding distribution period. Beginning in August 2007, the AGM CPS Securities required the maximum rate for each of the relevant trusts. AGM continues to have the ability to exercise its put option and cause the related trusts to purchase AGM Preferred Stock. The trusts are vehicles for providing AGM access to new capital at its sole discretion through the exercise of the put options. The Company does not consider itself to be the primary beneficiary of the trusts because it does not retain the majority of the residual benefits or expected losses.

During Third Quarter 2009, AGM incurred \$1.2 million of put option premiums related to its AGM CPS Securities.

The AGM CPS Securities had a fair value of \$29.6 million and \$100.0 million as of September 30, 2009 and December 31, 2008, respectively. The Company recorded a \$51.8 million decrease in fair value during Third Quarter 2009. The AGM CPS Securities are recorded in the consolidated balance sheets in "committed capital securities, at fair value."

13. OUTSTANDING EXPOSURE

The Company's insurance policies typically guarantee the scheduled payments of principal and interest on public finance and structured finance (including credit derivatives in the insured portfolio) obligations. The gross amount of financial guaranties in force (principal and interest) was \$1,108.7 billion at September 30, 2009 and \$354.9 billion at December 31, 2008. The net amount of financial guaranties in force was \$967.4 billion at September 30, 2009 and \$348.8 billion at December 31, 2008.

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****13. OUTSTANDING EXPOSURE (Continued)**

The Company seeks to limit its exposure to losses from writing financial guarantees by underwriting investment-grade obligations, diversifying its portfolio and maintaining rigorous collateral requirements on structured finance obligations, as well as through reinsurance.

Actual maturities could differ from contractual maturities because borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties. The expected maturities for structured finance obligations are, in general, considerably shorter than the contractual maturities for such obligations. For structured finance obligations, the full par outstanding for each insured risk is shown in the maturity category that corresponds to the final legal maturity of such risk:

Contractual Terms to Maturity of Net Par Outstanding of Insured Obligations

| Terms to Maturity | September 30, 2009 | |
|--------------------|--------------------|-----------------------|
| | Public Finance | Structured Finance |
| | (in millions) | |
| 0 to 5 years | \$ 85,206 | \$ 36,809 |
| 5 to 10 years | 94,689 | 43,314 |
| 10 to 15 years | 88,297 | 28,505 |
| 15 to 20 years | 72,605 | 1,958 |
| 20 years and above | 127,315 | 67,932 |
| Total | \$ 468,112 | \$ 178,518 |

Contractual Terms to Maturity of Ceded Par Outstanding of Insured Obligations

| Terms to Maturity | September 30, 2009 | |
|--------------------|--------------------|-----------------------|
| | Public Finance | Structured Finance |
| | (in millions) | |
| 0 to 5 years | \$ 11,533 | \$ 4,175 |
| 5 to 10 years | 14,009 | 6,007 |
| 10 to 15 years | 13,479 | 2,819 |
| 15 to 20 years | 12,452 | 62 |
| 20 years and above | 21,396 | 3,074 |
| Total | \$ 72,869 | \$ 16,137 |

ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

13. OUTSTANDING EXPOSURE (Continued)

The par outstanding of insured obligations in the public finance insured portfolio includes the following amounts by type of issue:

Summary of Public Finance Insured Portfolio

| Types of Issues | Gross Par Outstanding | | Ceded Par Outstanding | | Net Par Outstanding | |
|----------------------------------|-----------------------|-------------------|-----------------------|-------------------|---------------------|-------------------|
| | September 30, 2009 | December 31, 2008 | September 30, 2009 | December 31, 2008 | September 30, 2009 | December 31, 2008 |
| | (in millions) | | | | | |
| U.S.: | | | | | | |
| General obligation | \$ 201,860 | \$ 27,082 | \$ 23,426 | \$ 35 | \$ 178,434 | \$ 27,047 |
| Tax backed | 95,672 | 25,922 | 12,082 | 60 | 83,590 | 25,862 |
| Municipal utilities | 78,428 | 15,734 | 8,465 | 130 | 69,963 | 15,604 |
| Transportation | 43,268 | 12,708 | 7,326 | 61 | 35,942 | 12,647 |
| Healthcare | 28,885 | 12,002 | 6,786 | 324 | 22,099 | 11,678 |
| Higher education | 16,292 | 5,341 | 1,302 | 11 | 14,990 | 5,330 |
| Housing | 9,859 | 1,981 | 1,169 | | 8,690 | 1,981 |
| Infrastructure finance | 4,236 | 822 | 954 | 16 | 3,282 | 806 |
| Investor-owned utilities | 1,852 | 2,159 | 3 | 3 | 1,849 | 2,156 |
| Other public finance U.S. | 6,200 | 4,225 | 154 | 14 | 6,046 | 4,210 |
| Total public finance U.S. | 486,552 | 107,976 | 61,667 | 654 | 424,885 | 107,322 |
| Non-U.S.: | | | | | | |
| Infrastructure finance | 19,491 | 5,072 | 3,433 | 21 | 16,058 | 5,051 |
| Regulated utilities | 19,062 | 7,756 | 5,147 | 241 | 13,915 | 7,515 |
| Pooled infrastructure | 4,666 | 4,514 | 277 | 259 | 4,389 | 4,255 |
| Other public finance non-U.S. | 11,210 | 1,680 | 2,345 | | 8,865 | 1,680 |
| Total public finance non-U.S. | 54,429 | 19,022 | 11,202 | 521 | 43,227 | 18,501 |
| Total public finance obligations | \$ 540,981 | \$ 126,998 | \$ 72,869 | \$ 1,175 | \$ 468,112 | \$ 125,823 |

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

13. OUTSTANDING EXPOSURE (Continued)

The par outstanding of insured obligations in the structured finance insured portfolio includes the following amounts by type of collateral:

Summary of Structured Finance Insured Portfolio

| Types of Collateral | Gross Par Outstanding | | Ceded Par Outstanding | | Net Par Outstanding | |
|---|-----------------------|-------------------|-----------------------|-------------------|---------------------|-------------------|
| | September 30, 2009 | December 31, 2008 | September 30, 2009 | December 31, 2008 | September 30, 2009 | December 31, 2008 |
| | (in millions) | | | | | |
| U.S.: | | | | | | |
| Pooled corporate obligations | \$ 84,039 | \$ 36,511 | \$ 8,473 | \$ 1,831 | \$ 75,566 | \$ 34,680 |
| Residential mortgage-backed and home equity | 32,082 | 18,758 | 1,925 | 365 | 30,157 | 18,393 |
| Financial products | 10,914 | | | | 10,914 | |
| Consumer receivables | 9,982 | 5,223 | 497 | 65 | 9,485 | 5,158 |
| Commercial mortgage-backed securities | 7,508 | 5,876 | 53 | | 7,455 | 5,876 |
| Commercial receivables | 2,944 | 4,956 | 3 | 11 | 2,941 | 4,945 |
| Structured credit | 2,872 | 3,361 | 136 | 87 | 2,736 | 3,274 |
| Insurance securitizations | 1,731 | 1,648 | 80 | 55 | 1,651 | 1,593 |
| Other structured finance U.S. | 2,535 | 454 | 1,257 | | 1,278 | 454 |
| Total structured finance U.S. | 154,607 | 76,787 | 12,424 | 2,414 | 142,183 | 74,373 |
| Non-U.S.: | | | | | | |
| Pooled corporate obligations | 27,381 | 8,791 | 3,001 | 408 | 24,380 | 8,383 |
| Residential mortgage-backed and home equity | 5,702 | 8,593 | 384 | 344 | 5,318 | 8,249 |
| Structured credit | 2,455 | 437 | 223 | | 2,232 | 437 |
| Commercial receivables | 1,935 | 1,751 | 37 | 38 | 1,898 | 1,713 |
| Insurance securitizations | 1,010 | 954 | 15 | | 995 | 954 |
| Commercial mortgage-backed securities | 772 | 795 | | | 772 | 795 |
| Other structured finance non-U.S. | 793 | 2,058 | 53 | 63 | 740 | 1,995 |
| Total structured finance non-U.S. | 40,048 | 23,379 | 3,713 | 853 | 36,335 | 22,526 |
| Total structured finance obligations | \$ 194,655 | \$ 100,166 | \$ 16,137 | \$ 3,267 | \$ 178,518 | \$ 96,899 |

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

13. OUTSTANDING EXPOSURE (Continued)

The Company seeks to maintain a diversified portfolio of insured public finance obligations designed to spread its risk across a number of geographic areas. The following table sets forth those states in which municipalities located therein issued an aggregate of 2% or more of the Company's net par amount outstanding of insured public finance securities:

Public Finance Insured Portfolio by Location of Exposure

| | Number of Risks | September 30, 2009 | | |
|---|--------------------|----------------------------------|--|------------------------------------|
| | | Net Par Amount Outstanding | Percent of Total Net Par Amount Outstanding | Ceded Par Amount Outstanding |
| (dollars in millions) | | | | |
| U.S.: | | | | |
| California | 1,752 | \$ 59,822 | 9.3% | \$ 9,181 |
| New York | 1,230 | 35,457 | 5.5 | 6,217 |
| Texas | 1,372 | 30,778 | 4.8 | 3,167 |
| Pennsylvania | 1,277 | 28,952 | 4.5 | 3,214 |
| Florida | 595 | 25,468 | 3.9 | 3,323 |
| Illinois | 1,080 | 25,320 | 3.9 | 4,452 |
| New Jersey | 879 | 18,662 | 2.9 | 4,236 |
| Michigan | 832 | 17,133 | 2.6 | 1,770 |
| Washington | 440 | 13,422 | 2.1 | 2,707 |
| Massachusetts | 395 | 13,347 | 2.1 | 2,989 |
| Other states | 6,378 | 156,524 | 24.2 | 20,411 |
| Structured finance (multiple states) | 1,498 | 142,183 | 21.9 | 12,424 |
| Total U.S. | 17,728 | 567,068 | 87.7 | 74,091 |
| Non-U.S.: | | | | |
| United Kingdom | 286 | 31,553 | 4.9 | 6,663 |
| Australia | 65 | 8,795 | 1.4 | 1,731 |
| Canada | 74 | 5,052 | 0.8 | 816 |
| France | 40 | 2,595 | 0.4 | 944 |
| Italy | 26 | 2,582 | 0.4 | 841 |
| Other | 500 | 28,985 | 4.4 | 3,920 |
| Total non-U.S. | 991 | 79,562 | 12.3 | 14,915 |
| Total | 18,719 | \$ 646,630 | 100.0% | \$ 89,006 |

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****13. OUTSTANDING EXPOSURE (Continued)**

The following table sets forth the net financial guaranty par outstanding by underwriting rating:

| Ratings(1) | September 30, 2009 | | December 31, 2008 | |
|---------------------------|---------------------|--------------------------|---------------------|--------------------------|
| | Net Par Outstanding | % of Net Par Outstanding | Net Par Outstanding | % of Net Par Outstanding |
| (dollars in millions) | | | | |
| Super senior | \$ 45,795 | 7.1% | \$ 32,352 | 14.5% |
| AAA | 62,872 | 9.7 | 40,733 | 18.3 |
| AA | 198,760 | 30.7 | 47,685 | 21.4 |
| A | 231,500 | 35.8 | 65,991 | 29.6 |
| BBB | 83,675 | 12.9 | 29,361 | 13.2 |
| Below investment grade | 24,028 | 3.8 | 6,600 | 3.0 |
| Total exposures(2) | \$ 646,630 | 100.0% | \$ 222,722 | 100.0% |

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

(2) Totals may not add due to rounding.

As part of its financial guaranty business, the Company enters into CDS transactions. In such transactions, the buyer of protection pays the seller of protection a periodic fee in fixed basis points on a notional amount. In return, the seller makes a contingent payment to the buyer if one or more defined credit events occurs with respect to one or more third party referenced securities or loans. A credit event may be a nonpayment event such as a failure to pay, bankruptcy, or restructuring, as negotiated by the parties to the CDS transaction. The total notional amount of insured CDS exposure outstanding as of September 30, 2009 and December 31, 2008 and included in the Company's financial guaranty exposure in the tables above was \$123.4 billion and \$75.1 billion, respectively. See Note 6.

As of September 30, 2009 and December 31, 2008, the Company's net mortgage guaranty insurance in force (representing the current principal balance of all mortgage loans currently reinsured) was approximately \$0.4 billion and \$0.4 billion, respectively, and net risk in force was approximately \$0.4 billion and \$0.4 billion, respectively. These amounts are not included in the above table.

Variable Interest Entities

The Company provides financial guaranties with respect to debt obligations of special purpose entities ("SPEs"), including VIEs. The Company's variable interest in such entities exists through financial guaranty insurance or credit derivative contracts. The transaction structure generally provides certain financial protections to the Company. This financial protection can take several forms, the most

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

13. OUTSTANDING EXPOSURE (Continued)

common of which are over-collateralization, first loss protection (or subordination) and excess spread. In the case of over-collateralization (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 of multiple obligations issued by SPEs, 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 SPEs, including VIEs, generate interest 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 SPE (thereby, creating additional over-collateralization), or distributed to equity or other investors in the transaction.

There are two different accounting frameworks applicable to SPEs; the qualifying SPE ("QSPE") framework under ASC 860-10, "Transfers and Servicing" (FAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities"); and the VIE framework under ASC 810-10. The applicable framework depends on the nature of the entity and the Company's relation to that entity.

The QSPE framework is applicable when an entity transfers or sells financial assets to an SPE meeting certain criteria as defined in ASC 860-10. These criteria are designed to ensure that the activities of the entity are essentially predetermined in their entirety at the inception of the vehicle; decision making is limited and restricted to certain events, and that the transferor of the financial assets cannot exercise control over the entity and the assets therein. Entities meeting these criteria are not consolidated by the transferor or other counterparty, as long as the entity does not have the unilateral ability to liquidate or to cause it to no longer meet the QSPE criteria. SPEs meeting all of ASC 860-10's criteria for a QSPE are not within the scope of ASC 810-10 and, as a result do not need to be assessed for consolidation.

When the SPE does not meet the QSPE criteria, consolidation is assessed pursuant to ASC 810-10. Under ASC 810-10, a VIE is defined as an entity that is not assessed for consolidation by determining which party maintains a controlling financial interest. As a result, a VIE

- (a) lacks enough equity investment at risk to permit the entity to finance its activities without additional subordinated financial support from other parties,
- (b) its equity owners lack the right to make significant decisions affecting the entity's operations, and
- (c) its equity owners do not have an obligation to absorb or the right to receive the entity's losses or returns. ASC 810-10 requires a variable interest holder (e.g., an investor in the entity or a financial guarantor) to consolidate that VIE if that holder will absorb a majority of the expected losses of the VIE, receive a majority of the residual returns of the VIE, or both.

The Company determines whether it is the primary beneficiary (i.e., the variable interest holder required to consolidate the VIE) of a VIE by first performing a qualitative analysis of the VIE that

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****13. OUTSTANDING EXPOSURE (Continued)**

includes, among other factors, its capital structure, contractual terms, which variable interests create or absorb variability, related party relationships and the design of the VIE. The Company performs a quantitative analysis when qualitative analysis is not conclusive.

Qualifying Special Purpose Entities

The Company has issued financial guaranties on financial assets that were transferred into SPEs for which the business purpose of those SPEs was to provide financial guaranty clients with funding for their debt obligations. These entities met the characteristics of a QSPE in accordance with ASC 860-10. QSPEs are not subject to the requirements of ASC 810-10 and, accordingly, are not consolidated in the Company's financial statements. The Company's QSPEs are legal entities that are demonstrably distinct from the Company, and neither the Company, nor its affiliates or its agents, can unilaterally dissolve the QSPE. The permitted activities of these QSPEs are contractually limited to purchasing assets, issuing notes to fund such purchases and related administrative services. Pursuant to the terms of the Company's insurance policies, insurance premiums are paid to the Company by the QSPEs and are earned in a manner consistent with other insurance policies (i.e., over the risk period). Any losses incurred would be included in the Company's consolidated statements of operations.

Consolidated VIEs

As of September 30, 2009, the Company consolidated four VIEs that have debt obligations insured by the Company. The Company determined that it is the primary beneficiary of the aforementioned VIEs based on its assessment of potential exposure to expected losses from insured obligations issued by or insured assets held by the VIEs. The Company is not primarily liable for the debt obligations issued by the VIEs and would only be required to make payments on these debt obligations in the event that the issuer of such debt obligations defaults on any principal or interest due. The Company's creditors do not have any rights with regard to the assets of the VIEs.

The table below shows the carrying value of the consolidated VIE assets, liabilities and noncontrolling interest in the Company's consolidated financial statements, segregated by the types of assets held by VIEs that collateralize their respective debt obligations:

Consolidated VIEs

| | September 30, 2009 | | |
|-------------------------------------|---------------------------|-----------------------|--|
| | Total Assets | Total Debt | Total Noncontrolling Interest |
| | (in thousands) | | |
| Italian healthcare receivables | \$ 218,393 | \$ 223,470 | \$ (5,077) |
| Japanese consumer loans | 229,429 | 228,995 | 434 |
| Japanese credit card loans | 281,243 | 281,071 | 172 |
| Northern Irish gas pipeline tariffs | 117,880 | 117,854 | 26 |
| Total | \$ 846,945 | \$ 851,390 | \$ (4,445) |

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

13. OUTSTANDING EXPOSURE (Continued)

The financial reports of the four consolidated VIEs are prepared by outside parties and are not available within the time constraints that the Company requires to ensure the financial accuracy of the operating results. As such, the financial results of the four VIEs are consolidated on a one quarter lag.

Non-Consolidated VIEs

To date, the results of qualitative and quantitative analyses have indicated that the Company does not have a majority of the variability in any of these VIEs and, as a result, none of these VIEs are consolidated in the Company's consolidated financial statements. The Company's exposure provided through its financial guaranties with respect to debt obligations of non-consolidated SPEs is included within net par in force in this note.

14. EMPLOYEE BENEFIT PLANS

Share-Based Compensation

Share-based compensation expense in Third Quarter 2009 and Third Quarter 2008 was \$0.7 million (\$0.5 million after tax) and \$1.8 million (\$1.4 million after tax), respectively. Share-based compensation expense in Nine Months 2009 and Nine Months 2008 was \$6.0 million (\$4.8 million after tax) and \$10.2 million (\$8.3 million after tax), respectively. The effect on basic and diluted earnings per share for Third Quarter 2009 and Nine Months 2009 was \$0.00 and \$0.04, respectively. The effect on both basic and diluted earnings per share for Third Quarter 2008 and Nine Months 2008 was \$0.02. Third Quarter 2009 and Nine Months 2009 expense included expenses of \$(0.3) million \$(0.2) million after tax) and \$1.7 million (\$1.5 million after tax), respectively, related to accelerated vesting for stock award grants to retirement-eligible employees. Third Quarter 2008 and Nine Months 2008 expense included expenses of \$(0.2) million \$(0.2) million after tax) and \$3.5 million (\$3.1 million after tax), respectively, related to accelerated vesting for stock award grants to retirement-eligible employees.

Performance Retention Plan

The Company recognized approximately \$0.9 million (\$0.6 million after tax) and \$(0.3) million (\$(0.3) million after tax) of expense for performance retention awards in Third Quarter 2009 and Third Quarter 2008, respectively. The Company recognized approximately \$7.1 million (\$5.7 million after tax) and \$6.0 million (\$4.9 million after tax) of expense for performance retention awards in Nine Months 2009 and Nine Months 2008, respectively. Included in Third Quarter 2009 and Nine Months 2009 amounts were \$0 million and \$4.3 million, respectively, of accelerated expense related to retirement-eligible employees. Included in Third Quarter 2008 and Nine Months 2008 amounts were \$(0.7) million and \$3.9 million, respectively, of accelerated expense related to retirement-eligible employees.

15. EARNINGS PER SHARE

Effective January 1, 2009, the Company adopted ASC 260-10, "Earnings Per Share" (FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities"). ASC 260-10 clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends or dividend equivalents before vesting should be considered participating securities. Restricted stock awards granted prior to February 2008 are considered

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

15. EARNINGS PER SHARE (Continued)

participating securities as they received non-forfeitable rights to dividends at the same rate as common stock. As participating securities, the Company is required to include these instruments in the calculation of basic earnings per share ("EPS"), and needs to calculate basic EPS using the two-class method described in ASC 260-10 (FAS No. 128, "Earnings per Share"). Prior to adoption of ASC 260-10, restricted stock was included in the Company's dilutive EPS calculation using the treasury stock method.

The two-class method of computing EPS is an earnings allocation formula that determines EPS for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Basic EPS is then calculated by dividing net (loss) income available to common shareholders of Assured Guaranty and subsidiaries by the weighted-average number of common shares outstanding during the period. Diluted EPS adjusts basic (loss) earnings per share for the effects of restricted stock, stock options, equity units and other potentially dilutive financial instruments ("dilutive securities"), only in the periods in which such effect is dilutive. The dilutive effect of the dilutive securities is reflected in diluted EPS by application of the more dilutive of (1) the treasury stock method or (2) the two-class method assuming nonvested shares are not converted into common shares. ASC 260-10 requires the presentation of basic and diluted EPS for each class of common stock. The Company has a single class of common stock. Therefore, the following EPS amounts only pertain to common stock. Pursuant to ASC 260-10, all prior period EPS data were adjusted retrospectively. The impact of adopting the FSP increased both previously reported basic and diluted EPS by \$0.01 for the Third Quarter 2008, and decreased previously reported basic and diluted EPS by \$0.03 and \$0.01, respectively, for the Nine Months 2008.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

15. EARNINGS PER SHARE (Continued)

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-------------|------------------------------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| (in thousands of U.S. dollars, except per share amounts) | | | | |
| Basic earnings per share: | | | | |
| Net (loss) income of AGL and subsidiaries | \$ (35,030) | \$ (63,340) | \$ (119,545) | \$ 312,667 |
| Less: Distributed and undistributed income (loss) available to nonvested shareholders | (99) | (494) | (506) | 2,971 |
| Distributed and undistributed income (loss) available to common shareholders of AGL and subsidiaries | \$ (34,931) | \$ (62,846) | \$ (119,039) | \$ 309,696 |
| Basic shares | 156,335 | 90,930 | 113,641 | 86,977 |
| Basic EPS | \$ (0.22) | \$ (0.69) | \$ (1.05) | \$ 3.56 |
| Diluted earnings per share: | | | | |
| Distributed and undistributed income (loss) available to common shareholders of AGL and subsidiaries | \$ (34,931) | \$ (62,846) | \$ (119,039) | \$ 309,696 |
| Plus: Re-allocation of undistributed income (loss) available to nonvested shareholders of AGL and subsidiaries | | | | 16 |
| Distributed and undistributed income (loss) available to common shareholders of AGL and subsidiaries | \$ (34,931) | \$ (62,846) | \$ (119,039) | \$ 309,712 |
| Basic shares | 156,335 | 90,930 | 113,641 | 86,977 |
| Effect of dilutive securities: | | | | |
| Options and restricted stock awards | | | | 508 |
| Equity units | | | | |
| Diluted shares | 156,535 | 90,930 | 113,641 | 87,485 |
| Diluted EPS | \$ (0.22) | \$ (0.69) | \$ (1.05) | \$ 3.54 |

Potentially dilutive securities representing approximately 9.3 million and 5.4 million shares of common stock for the Third Quarter 2009 and 2008, respectively, and 9.2 million and 2.4 million shares of common stock for the Nine Months 2009 and 2008, respectively, were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive.

16. INCOME TAXES

The Company and its Bermuda Subsidiaries 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, the Company and its Bermuda Subsidiaries will be exempt from taxation in Bermuda until March 28, 2016.

Table of Contents**ASSURED GUARANTY LTD.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)****SEPTEMBER 30, 2009****16. INCOME TAXES (Continued)**

The Company's U.S. subsidiaries are subject to income taxes imposed by U.S. authorities and file U.S. tax returns.

In conjunction with the FSAH Acquisition on July 1, 2009, FSAH has joined the consolidated federal tax group of AGUS, AGC, and AG Financial Products Inc. ("AGFP"). For the periods beginning on July 1, 2009 and forward FSAH will file a consolidated federal income tax return with AGUS, AGC, and AGFP ("AGUS consolidated tax group"). In addition a new tax sharing agreement was entered into effective July 1, 2009 whereby each company in the AGUS consolidated tax group will pay or receive its proportionate share of taxable expense or benefit as if it filed on a separate return basis. AGOUS and its subsidiaries AGRO, AGMIC and AG Intermediary Inc., have historically filed a consolidated federal income tax return. AGRO, a Bermuda domiciled company, has elected under Section 953(d) of the Internal Revenue Code to be taxed as a U.S. domestic corporation. Each company, as a member of its respective consolidated tax return group, has paid its proportionate share of the consolidated federal tax burden for its group as if each company filed on a separate return basis with current period credit for net losses.

The following table provides the Company's income tax (benefit) provision and effective tax rates:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|--------------------|--|-------------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (dollars in thousands) | | | |
| Current tax (benefit) provision | \$ 67,116 | \$ (13,092) | \$ 68,817 | \$ 4,233 |
| Deferred tax provision (benefit) | (54,901) | (23,106) | (153,310) | 105,275 |
| Provision (benefit) for income taxes | \$ 12,215 | \$ (36,198) | \$ (84,493) | \$ 109,508 |
| Effective tax rate benefit (expense) | (43.5)% | 36.4% | 40.4% | (25.9)% |

Reconciliation of the difference between the provision for income taxes and the expected tax provision at statutory rates in taxable jurisdictions was as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|--------------------|--|-------------------|
| | 2009 | 2008 | 2009 | 2008 |
| | (in thousands) | | | |
| Expected tax provision at statutory rates in taxable jurisdictions | \$ 67,857 | \$ (31,546) | \$ (18,415) | \$ 122,417 |
| Tax-exempt interest | (14,055) | (4,288) | (22,359) | (11,935) |
| Goodwill | (51,499) | | (51,498) | |
| Change in FIN 48 liability | 5,488 | 2,306 | 5,488 | 2,306 |
| Other | 4,424 | (2,670) | 2,291 | (3,280) |
| Total provision for income taxes | \$ 12,215 | \$ (36,198) | \$ (84,493) | \$ 109,508 |

The deferred tax asset of the Company increased in the Third Quarter 2009 due to the FSAH Acquisition. The acquired deferred tax asset of FSAH was \$363.4 million as of July 1, 2009 and primarily included deferred tax assets related to temporary differences for loss reserves, unearned

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

16. INCOME TAXES (Continued)

premium reserves and the mark to market of CDS contracts. In addition, there was a deferred tax asset recorded in conjunction with purchase accounting for FSAH under GAAP. This asset primarily included temporary differences related to purchase accounting for unearned premium reserves, loss reserves, and the mark-to-market of FSAH public debt.

As of September 30, 2009 and December 31, 2008, AGRO had a standalone net operating loss ("NOL") of \$49.4 million and \$47.9 million, respectively, which is available to offset its future U.S. taxable income. The Company has \$28.7 million of this NOL available through 2017 and \$20.7 million available through 2023. AGRO's stand alone NOL is not permitted to offset the income of any other members of AGRO's consolidated group due to certain tax regulations. AGMIC is a member of the same consolidated tax group as AGRO.

Under applicable accounting rules, the Company is required to establish a valuation allowance for NOLs that are more likely than not to expire before being utilized. Management has assessed the likelihood of realization of all of its deferred tax assets. Based on this analysis, management believes it is more likely than not that \$20.0 million of AGRO's \$49.4 million NOL will not be utilized before it expires and has established a \$7.0 million valuation allowance related to the NOL deferred tax asset. Management believes that all other deferred income taxes are more-likely-than-not to be realized. The valuation allowance is subject to considerable judgment, is reviewed quarterly and will be adjusted to the extent actual taxable income differs from estimates of future taxable income that may be used to realize NOLs or capital losses.

Tax Treatment of CDS

The Company treats the guaranty it provides on CDS as insurance contracts for tax purposes and as such a taxable loss does not occur until the Company expects to make a loss payment to the buyer of credit protection based upon the occurrence of one or more specified credit events with respect to the contractually referenced obligation or entity. The Company holds its CDS to maturity, at which time any unrealized mark to market loss would revert to zero absent any credit related losses.

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

As of September 30, 2009 and December 31, 2008 the deferred tax assets associated with CDS were \$401.7 million and \$116.5 million, respectively. The Company came to the conclusion that it is more likely than not that its deferred tax asset related to CDS will be fully realized after weighing all

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

16. INCOME TAXES (Continued)

positive and negative evidence available as required under ASC 744-10. The evidence that was considered included the following:

Negative Evidence

Although the Company believes that income or losses for these CDSs are properly characterized for tax purposes as ordinary, the federal tax treatment is an unsettled area of tax law, as noted above.

Changes in the fair value of CDS have resulted in significant swings in the Company's net income in recent periods. Changes in the fair value of CDS in future periods could result in the U.S. consolidated tax group having a pre-tax loss under GAAP. Although not recognized for tax, this loss could result in a cumulative three year pre-tax loss, which is considered significant negative evidence for the recoverability of a deferred tax asset under ASC 744-10.

For the three year period ended September 30, 2009 the Company's U.S. consolidated tax group had a pre-tax loss under GAAP of \$337.6 million.

Positive Evidence

The mark-to-market loss on CDS is not considered a tax event, and therefore no taxable loss has occurred.

After analysis of the current tax law on CDS the Company believes it is more likely than not that the CDS will be treated as ordinary income or loss for tax purposes.

Assuming a hypothetical loss were triggered for the amount of deferred tax asset, there would be enough taxable income through future income to offset it as follows:

- (a) The amortization of the tax-basis unearned premium reserve of \$2,891.3 million as of September 30, 2009 as well as the collection of future installment premiums of contracts already written the Company believes will result in significant taxable income in the future.
- (b) Although the Company has a significant tax exempt portfolio, this can be converted to taxable securities as permitted as a tax planning strategy under ASC 744-10.
- (c) The mark-to-market loss is reflective of market valuations and will change from quarter to quarter. It is not indicative of the Company's ability to enter new business. The Company writes and continues to write new business which will increase the amortization of unearned premium and investment portfolio resulting in expected taxable income in future periods.

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

On November 6, 2009 the U.S. enacted new tax legislation that, among other things, extends the period over which companies may carry back net operating losses to recover previously paid income taxes. Under GAAP, the effects of changes in tax law are recorded in the period in which the law is enacted. The Company is currently reviewing the new legislation and will reflect the implications on its financial position and results of operations, if any, in its year-end financial statements.

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

17. SEGMENT REPORTING

The Company has four principal business segments:

- (1) financial guaranty direct, which includes transactions whereby the Company provides an unconditional and irrevocable guaranty that indemnifies the holder of a financial obligation against non-payment of principal and interest when due, and may take the form of a credit derivative. This segment includes the results of operations for FSAH as of the Acquisition Date forward, including business these entities have ceded to AG Re, which was included in the Company's financial guaranty reinsurance business prior to the Acquisition Date;
- (2) financial guaranty reinsurance, which includes agreements whereby the Company is a reinsurer and agrees to indemnify a primary insurance company against part or all of the loss which the latter may sustain under a policy it has issued;
- (3) mortgage guaranty, which includes mortgage guaranty insurance and reinsurance whereby the Company provides protection against the default of borrowers on mortgage loans; and
- (4) other, which includes lines of business in which the Company is no longer active.

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

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

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ASSURED GUARANTY LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (Continued)

SEPTEMBER 30, 2009

17. SEGMENT REPORTING (Continued)

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

Underwriting Gain (Loss) by Segment

| | Three Months Ended September 30, 2009 | | | | |
|---|---------------------------------------|--------------------------------------|----------------------|-------|----------|
| | Financial Guaranty Direct | Financial Guaranty Reinsurance | Mortgage Guaranty | Other | Total |
| | (in millions) | | | | |
| Net earned premiums | \$ 314.7 | \$ 14.6 | \$ 0.7 | \$ | \$ 330.0 |
| Realized gains on credit derivatives(1) | 57.0 | 0.3 | | | 57.3 |
| Other income | 34.6 | 21.5 | | | 56.1 |
| Loss and loss adjustment (expenses) recoveries | (97.2) | (35.9) | (0.2) | | (133.3) |
| Incurred losses on credit derivatives(2) | (142.4) | 0.2 | | | (142.2) |
| Total loss and loss adjustment (expenses) recoveries and incurred losses on credit derivatives | (239.6) | (35.7) | (0.2) | | (275.5) |
| Profit commission expense | | | (0.2) | | (0.2) |
| Amortization of deferred acquisition costs | (3.0) | 1.8 | (0.1) | | (1.3) |
| Other operating expenses | (59.1) | (6.3) | (0.8) | | (66.2) |
| Underwriting gain (loss) | \$ 104.6 | \$ (3.8) | \$ (0.6) | \$ | \$ 100.2 |

| | Three Months Ended September 30, 2008 | | | | |
|---|---------------------------------------|--------------------------------------|----------------------|-------|---------|
| | Financial Guaranty Direct | Financial Guaranty Reinsurance | Mortgage Guaranty | Other | Total |
| | (in millions) | | | | |
| Net earned premiums | \$ 26.9 | \$ 57.4 | \$ 1.2 | \$ | \$ 85.5 |
| Realized gains on credit derivatives(1) | 28.6 | | | | |