ASSURED GUARANTY LTD
Form 10-Q
November 06, 2015
Table of Contents

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2015

Or

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

For the transition Period from to

Commission File No. 001-32141

ASSURED GUARANTY LTD.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

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

The number of registrant's Common Shares ($0.01 par value) outstanding as of November 3, 2015 was 141,324,493 (includes 62,145 unvested restricted shares).

Table of Contents

ASSURED GUARANTY LTD.

INDEX TO FORM 10-Q

		Page
PART I	Financial Information	1
Item 1.	Financial Statements:	1
	Consolidated Balance Sheets (unaudited) as of September 30, 2015 and December 31, 2014	1
	Consolidated Statements of Operations (unaudited) for the Three and Nine Months Ended September 30, 2015 and 2014	2
	Consolidated Statements of Comprehensive Income (unaudited) for the Three and Nine Months Ended September 30, 2015 and 2014	3
	Consolidated Statement of Shareholders' Equity (unaudited) for the Nine Months Ended September 30, 2015	4
	Consolidated Statements of Cash Flows (unaudited) for the Nine Months Ended September 30, 2015 and 2014	5
	Notes to Consolidated Financial Statements (unaudited)	6
	1. Business and Basis of Presentation	6
	2. Acquisition of Radian Asset Assurance Inc.	7
	3. Rating Actions	10
	4. Outstanding Exposure	11
	5. Financial Guaranty Insurance Premiums	21
	6. Expected Loss to be Paid	24
	7. Financial Guaranty Insurance Losses	50
	8. Fair Value Measurement	56
	9. Financial Guaranty Contracts Accounted for as Credit Derivatives	75
	10. Consolidated Variable Interest Entities	81
	11. Investments and Cash	84
	12. Insurance Company Regulatory Requirements	90
	13. Income Taxes	92
	14. Reinsurance and Other Monoline Exposures	94
	15. Commitments and Contingencies	98
	16. Long Term Debt and Credit Facilities	102
	17. Earnings Per Share	105
	18. Shareholders' Equity	106
	19. Subsidiary Information	110
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	118
	Forward Looking Statements	118
	Available Information	119
	Executive Summary	119
	Results of Operations	126
	Non-GAAP Financial Measures	139
	Insured Portfolio	143
	Liquidity and Capital Resources	156
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	170
Item 4.	Controls and Procedures	171
PART II	Other Information	172
Item 1.	Legal Proceedings	172

Item 1A.	Risk Factors	172
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	173
Item 6.	Exhibits	173

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
Assured Guaranty Ltd.

Consolidated Balance Sheets (unaudited)

(dollars in millions except per share and share amounts)

	As of September 30, 2015	As of December 31, 2014
Assets		
Investment portfolio:		
Fixed-maturity securities, available-for-sale, at fair value (amortized cost of $10,242 and $9,972)	$10,640	$10,491
Short-term investments, at fair value	522	767
Other invested assets	181	126
Total investment portfolio	11,343	11,384
Cash	66	75
Premiums receivable, net of commissions payable	676	729
Ceded unearned premium reserve	263	381
Deferred acquisition costs	118	121
Reinsurance recoverable on unpaid losses	89	78
Salvage and subrogation recoverable	135	151
Credit derivative assets	71	68
Deferred tax asset, net	426	260
Financial guaranty variable interest entities' assets, at fair value	1,547	1,402
Other assets	300	276
Total assets	$15,034	$14,925
Liabilities and shareholders' equity		
Unearned premium reserve	$4,112	$4,261
Loss and loss adjustment expense reserve	1,007	799
Reinsurance balances payable, net	61	107
Long-term debt	1,306	1,303
Credit derivative liabilities	918	963
Current income tax payable	—	5
Financial guaranty variable interest entities' liabilities with recourse, at fair value	1,315	1,277
Financial guaranty variable interest entities' liabilities without recourse, at fair value	167	142
Other liabilities	329	310
Total liabilities	9,215	9,167
Commitments and contingencies (See Note 15)		
Common stock ($0.01 par value, 500,000,000 shares authorized; 142,919,399 and 158,306,661 shares issued and outstanding)	1	2
Additional paid-in capital	1,474	1,887
Retained earnings	4,066	3,494
Accumulated other comprehensive income, net of tax of $113 and $159	273	370
Deferred equity compensation (320,193 and 320,193 shares)	5	5
Total shareholders' equity	5,819	5,758

Total liabilities and shareholders' equity	$15,034	$14,925

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

Table of Contents

Assured Guaranty Ltd.

Consolidated Statements of Operations (unaudited)

(dollars in millions except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues				
Net earned premiums	$213	$144	$574	$412
Net investment income	112	102	311	301
Net realized investment gains (losses):				
Other-than-temporary impairment losses	(18)	(17)	(34)	(47)
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	0	4	3	(9)
Net impairment loss	(18)	(21)	(37)	(38)
Other net realized investment gains (losses)	(9)	2	17	13
Net realized investment gains (losses)	(27)	(19)	(20)	(25)
Net change in fair value of credit derivatives:				
Realized gains (losses) and other settlements	6	(14)	35	20
Net unrealized gains (losses)	80	269	265	127
Net change in fair value of credit derivatives	86	255	300	147
Fair value gains (losses) on committed capital securities	(15)	4	10	(11)
Fair value gains (losses) on financial guaranty variable interest entities	2	50	0	232
Bargain purchase gain and settlement of pre-existing relationships	—	—	214	—
Other income (loss)	(3)	(11)	43	17
Total revenues	368	525	1,432	1,073
Expenses				
Loss and loss adjustment expenses	112	(44)	318	54
Amortization of deferred acquisition costs	5	4	15	12
Interest expense	25	27	76	67
Other operating expenses	54	50	176	165
Total expenses	196	37	585	298
Income (loss) before income taxes	172	488	847	775
Provision (benefit) for income taxes				
Current	41	36	78	75
Deferred	2	97	142	144
Total provision (benefit) for income taxes	43	133	220	219
Net income (loss)	$129	$355	$627	$556
Earnings per share:				
Basic	$0.88	$2.10	$4.16	$3.15
Diluted	$0.88	$2.09	$4.13	$3.13
Dividends per share	$0.12	$0.11	$0.36	$0.33

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

2

Table of Contents

Assured Guaranty Ltd.

Consolidated Statements of Comprehensive Income (unaudited)

(in millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income (loss)	$129	$355	$627	$556
Unrealized holding gains (losses) arising during the period on:				
Investments with no other-than-temporary impairment, net of tax provision (benefit) of $17, $4, $(36) and $74	41	(5)	(77)	164
Investments with other-than-temporary impairment, net of tax provision (benefit) of $(9), $1, $(12) and $(4)	(15)	1	(23)	(8)
Unrealized holding gains (losses) arising during the period, net of tax	26	(4)	(100)	156
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of $(6), $(5), $(4) and $(9)	(12)	(10)	(7)	(19)
Change in net unrealized gains on investments	38	6	(93)	175
Other, net of tax provision	(4)	(5)	(4)	(2)
Other comprehensive income (loss)	$34	$1	$(97)	$173
Comprehensive income (loss)	$163	$356	$530	$729

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

Table of Contents

Assured Guaranty Ltd.

Consolidated Statement of Shareholders' Equity (unaudited)

For the Nine Months Ended September 30, 2015

(dollars in millions, except share data)

	Common Shares Outstanding	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Deferred Equity Compensation	Total Shareholders' Equity
Balance at December 31, 2014	158,306,661	$ 2	$1,887	$3,494	$ 370	$ 5	$5,758
Net income	—	—	—	627	—	—	627
Dividends ($0.36 per share)	—	—	—	(55)	—	—	(55)
Common stock repurchases	(15,959,782)	(1)	(419)	—	—	—	(420)
Share-based compensation and other	572,520	0	6	—	—	—	6
Other comprehensive loss	—	—	—	—	(97)	—	(97)
Balance at September 30, 2015	142,919,399	$ 1	$1,474	$4,066	$ 273	$ 5	$5,819

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

Table of Contents

Assured Guaranty Ltd.

Consolidated Statements of Cash Flows (unaudited)

(in millions)

	Nine Months Ended September 30,	
	2015	2014
Net cash flows provided by (used in) operating activities	$(39)	$347
Investing activities		
Fixed-maturity securities:		
Purchases	(1,844)	(2,031)
Sales	1,719	951
Maturities	635	557
Net sales (purchases) of short-term investments	751	89
Net proceeds from paydowns on financial guaranty variable interest entities' assets	114	346
Acquisition of Radian Asset, net of cash acquired	(800)	—
Other	59	9
Net cash flows provided by (used in) investing activities	634	(79)
Financing activities		
Dividends paid	(55)	(58)
Repurchases of common stock	(420)	(438)
Share activity under option and incentive plans	(2)	(1)
Net paydowns of financial guaranty variable interest entities' liabilities	(122)	(348)
Proceeds from issuance of long-term debt	—	495
Repayment of long-term debt	(3)	(18)
Net cash flows provided by (used in) financing activities	(602)	(368)
Effect of foreign exchange rate changes	(2)	(2)
Increase (decrease) in cash	(9)	(102)
Cash at beginning of period	75	184
Cash at end of period	$66	$82
Supplemental cash flow information		
Cash paid (received) during the period for:		
Income taxes	$71	$68
Interest	$55	$45

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

Table of Contents

Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (unaudited)

September 30, 2015

1. Business and Basis of Presentation

Business

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

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

Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) and, in the opinion of management, reflect all adjustments that are of a normal recurring nature, necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated variable interest entities (“VIEs”) for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim consolidated financial statements are as of September 30, 2015 and cover the three-month period ended September 30, 2015 ("Third Quarter 2015"), the three-month period ended September 30, 2014 ("Third Quarter 2014"), the nine-month period ended September 30, 2015 ("Nine Months 2015") and the nine-month period ended September 30, 2014 ("Nine Months 2014"). Certain financial information that is normally included in annual financial statements prepared in accordance with GAAP, but

is not required for interim reporting purposes, has been condensed or omitted. The year-end balance sheet data was derived from audited financial statements.

The unaudited interim consolidated financial statements include the accounts of AGL, its direct and indirect subsidiaries (collectively, the "Subsidiaries"), and its consolidated VIEs. Intercompany accounts and transactions between and among all consolidated entities have been eliminated.

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements included in AGL's Annual Report on Form 10-K for the year ended December 31, 2014, filed with the U.S. Securities and Exchange Commission (the "SEC").

Table of Contents

The Company's principal insurance company subsidiaries are:

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

The Company’s organizational structure includes various holding companies, two of which - Assured Guaranty US Holdings Inc. (“AGUS”) and Assured Guaranty Municipal Holdings Inc. (“AGMH”) - have public debt outstanding. See Note 16, Long-Term Debt and Credit Facilities.

Future Application of Accounting Standards

Consolidation

In February 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis, which is intended to improve certain areas of consolidation guidance for legal entities such as limited partnerships, limited liability companies, and securitization structures. The ASU will be effective on January 1, 2016. Early adoption is permitted, including adoption in an interim period. The Company does not expect that ASU 2015-02 will have any material effect on its Consolidated Financial Statements.

Interest

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Topic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The ASU will be effective on January 1, 2016 and should be applied retrospectively. The adoption of this ASU will require the Company to reclassify its debt issuance costs from other assets to long-term debt on the Consolidated Balance Sheet. As of September 30, 2015, the debt issuance costs were approximately $5 million.

Investments

In May 2015, the FASB issued ASU No. 2015-07, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share, which removes the requirement to make certain disclosures and categorize within the fair value hierarchy, certain investments for which fair value is measured using the net asset value per share. The ASU will be effective on January 1, 2016 and should be applied retrospectively to all periods presented; earlier adoption is permitted. The Company has investments with a fair value of $45 million and $76 million, as of September 30, 2015 and December 31, 2014, respectively, that are carried at fair value using the net asset value per share subject to this ASU.

Short Duration Insurance Contracts

In May 2015, the FASB issued ASU 2015-09, Financial Services - Insurance (Topic 944) - Disclosures about Short-Duration Contracts. The primary objective of this ASU is to improve disclosures for insurance entities which issue short-duration contracts. As a financial guaranty insurance provider, ASU 2015-09 is not expected to have a material impact on the Company's financial statement disclosures. The ASU is effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016.

2. Acquisition of Radian Asset Assurance Inc.

On April 1, 2015 (“Acquisition Date”), AGC completed the acquisition (“Radian Asset Acquisition”) of all of the issued and outstanding capital stock of financial guaranty insurer Radian Asset Assurance Inc. (“Radian Asset”) for $804.5 million; the cash consideration was paid from AGC's available funds and from the proceeds of a $200 million loan from AGC’s direct parent, AGUS. AGC repaid the loan in full to AGUS on April 14, 2015. Radian Asset was merged with and into AGC, with AGC as the surviving company of the merger. The Radian Asset Acquisition added $13.6 billion to the Company's net par outstanding on April 1, 2015, and is consistent with one of the Company's key business strategies of supplementing its book of business through acquisitions.

Table of Contents

Radian Asset Acquisition was accounted for under the acquisition method of accounting which required that the assets and liabilities acquired be recorded at fair value. The Company was required to exercise significant judgment to determine the fair value of the assets it acquired and liabilities it assumed in the Radian Asset Acquisition. The most significant of these determinations related to the valuation of Radian Asset's financial guaranty insurance and credit derivative contracts. On an aggregate basis, Radian Asset’s contractual premiums for financial guaranty contracts were less than the premiums a market participant of similar credit quality would demand to acquire those contracts at the Acquisition Date, particularly for below-investment-grade transactions, resulting in a significant amount of the purchase price being allocated to these contracts. For information on the methodology the Company used to measure the fair value of assets it acquired and liabilities it assumed in the Radian Asset Acquisition, including financial guaranty insurance and credit derivative contracts, please refer to Note 8, Fair Value Measurement.

The fair value of the Company's stand-ready obligation for financial guaranty insurance contracts on the Acquisition Date is recorded in unearned premium reserve. At the Acquisition Date, the fair value of each financial guaranty insurance contract acquired was in excess of the expected losses for each contract and therefore no explicit loss reserves were recorded on the Acquisition Date. Instead, loss reserves and loss and loss adjustment expenses ("LAE") will be recorded when the expected losses for each contract exceeds the remaining unearned premium reserve, in accordance with the Company's accounting policy described in the Annual Report on Form 10-K. The expected losses acquired by the Company as part of the Radian Asset Acquisition are included in the description of expected losses to be paid under Note 6, Expected Losses to be Paid.

The excess of the fair value of net assets acquired over the consideration transferred was recorded as a bargain purchase gain in "bargain purchase gain and settlement of pre-existing relationships" in net income. In addition, the Company and Radian Asset had pre-existing reinsurance relationships, which were also effectively settled at fair value on the Acquisition Date. The gain on settlement of these pre-existing reinsurance relationships represents the net difference between the historical ceded balances that were recorded by AGM and the fair value of assumed balances acquired from Radian. The Company believes the bargain purchase resulted from the announced desire of Radian Guaranty Inc. to focus its business strategy on the mortgage and real estate markets and to monetize its investment in Radian Asset and thereby accelerate its ability to comply with the financial requirements of the final Private Mortgage Insurer Eligibility Requirements.

Table of Contents

The following table shows the net effect of the Radian Asset Acquisition at the Acquisition Date, including the effects of the settlement of pre-existing relationships.

	Fair Value of Net Assets Acquired, before Settlement of Pre-existing Relationships (in millions)	Net effect of Settlement of Pre-existing Relationships	Net Effect of Radian Asset Acquisition
Cash purchase price(1)	$804	$—	$804
Identifiable assets acquired:			
Investments	1,473	—	1,473
Cash	4	—	4
Ceded unearned premium reserve	(3)	(65)	(68)
Credit derivative assets	30	—	30
Deferred tax asset, net	263	(56)	207
Financial guaranty VIE assets	122	—	122
Other assets	86	(67)	19
Total assets	1,975	(188)	1,787
Liabilities assumed:			
Unearned premium reserves	697	(216)	481
Credit derivative liabilities	271	(26)	245
Financial guaranty VIE liabilities	118	—	118
Other liabilities	30	(49)	(19)
Total liabilities	1,116	(291)	825
Net asset effect of Radian Asset Acquisition	859	103	962
Bargain purchase gain and settlement of pre-existing relationships resulting from Radian Asset Acquisition, after-tax	55	103	158
Deferred tax	—	56	56
Bargain purchase gain and settlement of pre-existing relationships resulting from Radian Asset Acquisition, pre-tax	$55	$159	$214

(1) The cash purchase price of $804 million was the cash transferred for the acquisition which was allocated as follows: (1) $987 million for the purchase of net assets of $1,042 million, and (2) the settlement of pre-existing relationships between Radian and Assured Guaranty at a fair value of $(183) million.

Revenue and net income related to Radian Asset from the Acquisition Date through September 30, 2015 included in the consolidated statement of operations were approximately $348 million and $228 million, respectively. In the second quarter of 2015, the Company recorded transaction expenses related to the Radian Asset Acquisition in net income as part of other operating expenses. These expenses were primarily driven by the fees paid to the Company's legal and financial advisors and to the Company's independent auditor.

Radian Asset Acquisition-Related Expenses

	Nine Months 2015

	(in millions)
Professional services	$2
Financial advisory fees	10
Total	$12

Table of Contents

Unaudited Pro Forma Results of Operations

The following unaudited pro forma information presents the combined results of operations of Assured Guaranty and Radian Asset as if the acquisition had been completed on January 1, 2014, as required under GAAP. The pro forma accounts include the estimated historical results of the Company and Radian Asset and pro forma adjustments primarily comprising the earning of the unearned premium reserve and the expected losses that would be recognized in net income for each prior period presented, as well as the accounting for bargain purchase gain, settlement of pre-existing relationships and Radian acquisition related expenses, all net of tax at the applicable statutory rate.

The unaudited pro forma combined financial information is presented for illustrative purposes only and does not indicate the financial results of the combined company had the companies actually been combined as of January 1, 2014, nor is it indicative of the results of operations in future periods.

Pro Forma Unaudited Results of Operations

	Nine Months 2015	Nine Months 2014
	(in millions, except per share amounts)	
Pro forma revenues	$1,255	$1,542
Pro forma net income	493	958
Pro forma earnings per share:		
Basic	3.27	5.43
Diluted	3.25	5.40

3. Rating Actions

Rating Actions

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

In the last several years, Standard & Poor's Ratings Services ("S&P") and Moody's Investors Service, Inc. ("Moody's") have changed, multiple times, their financial strength ratings of AGL's insurance subsidiaries, or changed the outlook on such ratings. More recently, Kroll Bond Rating Agency ("KBRA") and A.M. Best Company, Inc. have assigned financial strength ratings to some of AGL's insurance subsidiaries. The rating agencies' most recent actions, proposals

and statements related to AGL's insurance subsidiaries are:

- On March 18, 2014, S&P upgraded the financial strength ratings of all of AGL's insurance subsidiaries to AA (stable outlook) from AA- (stable outlook); it most recently affirmed such ratings in a credit analysis issued on June 29, 2015.

- On July 2, 2014, Moody's affirmed the ratings of AGL's insurance subsidiaries, but changed to negative the outlook of the financial strength ratings of AGC and its subsidiary Assured Guaranty (UK) Ltd. ("AGUK"). Moody's adopted changes to its credit methodology for financial guaranty insurance companies on January 20, 2015 and, on February 18, 2015, Moody's published a credit opinion maintaining its existing ratings of AGL and its subsidiaries under that

Table of Contents

that new methodology. Effective April 8, 2015, at the Company's request, Moody’s withdrew the financial strength ratings it had assigned to Assured Guaranty Re Ltd. (“AG Re”) and Assured Guaranty Re Overseas Ltd. ("AGRO"). In an August 10, 2015 issuer comment, Moody's indicated that it was a "credit negative" for the Company that the Puerto Rico Public Finance Corporation (as to which the Company has no exposure) failed to make its full debt service payment due on August 1, 2015. However, in a summary opinion published on June 4, 2015, Moody’s noted that, despite adverse developments in Puerto Rico, Moody’s believed its current ratings on the financial guarantors remained well positioned.

- On June 22, 2013, KBRA assigned a financial strength rating of AA+ (stable outlook) to MAC, and affirmed that rating on August 3, 2015. On November 13, 2014, KBRA assigned a financial strength rating of AA+ (stable outlook) to AGM. On July 6, 2015, KBRA released a comment reviewing the approach it had taken to Puerto Rico exposures in its stress loss analysis of AGM, noting that its financial model showed AGM’s claims paying resources were sufficient to meet all requirements by a comfortable margin.

- On May 5, 2015, A.M. Best Company, Inc. assigned a financial strength rating of A+ (Stable) to AGRO.

There can be no assurance that any of the rating agencies will not take negative action on their financial strength ratings of AGL's insurance subsidiaries in the future.

For a discussion of the effects of rating actions on the Company, see the following:

- Note 7, Financial Guaranty Insurance Losses
- Note 9, Financial Guaranty Contracts Accounted for as Credit Derivatives
- Note 14, Reinsurance and Other Monoline Exposures
- Note 16, Long-Term Debt and Credit Facilities

4. Outstanding Exposure

The Company’s financial guaranty contracts are written in either insurance or credit derivative form, but collectively are considered financial guaranty contracts. The Company seeks to limit its exposure to losses by underwriting obligations that it views as investment grade at inception, although, as part of its loss mitigation strategy for existing troubled credits, it may underwrite new issuances that it views as below-investment-grade ("BIG"). The Company diversifies its insured portfolio across asset classes and, in the structured finance portfolio, requires rigorous subordination or collateralization requirements. Reinsurance is utilized in order to reduce net exposure to certain insured transactions.

Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the taxing powers of U.S. state or municipal governmental authorities, as well as tax-supported bonds, revenue bonds and other obligations supported by covenants from state or municipal governmental authorities or other municipal obligors to impose and collect fees and charges for public services or specific infrastructure projects. The Company also includes within public finance obligations those obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including utilities, toll roads, health care facilities and government office buildings.

Structured finance obligations insured by the Company are generally issued by special purpose entities, including VIEs, and backed by pools of assets having an ascertainable cash flow or market value or other specialized financial obligations. Some of these VIEs are consolidated as described in Note 10, Consolidated Variable Interest Entities. Unless otherwise specified, the outstanding par and Debt Service amounts presented in this note include outstanding

exposures on VIEs whether or not they are consolidated.

Surveillance Categories

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

Table of Contents

The Company monitors its investment grade credits to determine whether any need to be internally downgraded to BIG and refreshes its internal credit ratings on individual credits in quarterly, semi-annual or annual cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. The Company's credit ratings on assumed credits are based on the Company's reviews of low-rated credits or credits in volatile sectors, unless such information is not available, in which case, the ceding company's credit rating of the transactions are used. The Company models the performance of many of its structured finance transactions as part of its periodic internal credit rating review of them.

Credits identified as BIG are subjected to further review to determine the probability of a loss. See Note 6, Expected Loss to be Paid, for additional information. Surveillance personnel then assign each BIG transaction to the appropriate BIG surveillance category based upon whether a future loss is expected and whether a claim has been paid. For surveillance purposes, the Company calculates present value using a constant discount rate of 4.5% or 5% depending on the insurance subsidiary. (Risk-free rates are used for calculating the expected loss for financial statement measurement purposes.)

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

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

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

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

Components of Outstanding Exposure

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

The Company purchases securities that it has insured, and for which it has expected losses to be paid, in order to mitigate the economic effect of insured losses ("loss mitigation securities"). The Company excludes amounts attributable to loss mitigation securities (unless otherwise indicated) from par and Debt Service outstanding, because it manages such securities as investments and not insurance exposure.

Financial Guaranty
Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	September 30, 2015	December 31, 2014	September 30, 2015	December 31, 2014

	(in millions)			
Public finance	$532,771	$587,245	$509,645	$553,612
Structured finance	49,272	59,477	46,736	56,010
Total financial guaranty	$582,043	$646,722	$556,381	$609,622

In addition to the amounts shown in the table above, the Company's net mortgage guaranty insurance debt service was approximately $105 million as of September 30, 2015 and $127 million as of December 31, 2014, related to loans originated in Ireland. As of September 30, 2015, the Company also had exposure to €12 million of reinsurance contracts relating to Spanish housing cooperatives risk.

Table of Contents

Financial Guaranty Portfolio by Internal Rating
As of September 30, 2015

Rating Category	Public Finance U.S. Net Par Outstanding	%	Public Finance Non-U.S. Net Par Outstanding	%	Structured Finance U.S Net Par Outstanding	%	Structured Finance Non-U.S Net Par Outstanding	%	Total Net Par Outstanding	%
	(dollars in millions)									
AAA	$3,067	1.0 %	$702	2.4 %	$16,730 (3)	47.2 %	$3,028	49.7 %	$23,527	6.3 %
AA	73,224	24.3	2,416	8.0	8,624	24.3	322	5.3	84,586	22.7
A	168,963	56.2	6,906	22.9	2,279	6.5	332	5.4	178,480	48.0
BBB	45,998	15.3	18,565	61.7	1,744	4.9	1,850	30.4	68,157	18.3
BIG	9,480	3.2	1,514	5.0	6,058	17.1	559	9.2	17,611	4.7
Total net par outstanding (1)(2)	$300,732	100.0%	$30,103	100.0%	$35,435	100.0%	$6,091	100.0%	$372,361	100.0%

(1) Excludes $1.6 billion of loss mitigation securities insured and held by the Company as of September 30, 2015, which are primarily BIG.

(2) The September 30, 2015 amounts include $12.4 billion of net par acquired from Radian Asset.

(3) Includes $1,351 million net par in the form of CDS that was upgraded from BIG as of September 30, 2015, in anticipation of the termination of such CDS that occurred early in the fourth quarter of 2015. In the fourth quarter of 2015, the exposure will be removed.

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

Rating Category	Public Finance U.S. Net Par Outstanding	%	Public Finance Non-U.S. Net Par Outstanding	%	Structured Finance U.S Net Par Outstanding	%	Structured Finance Non-U.S Net Par Outstanding	%	Total Net Par Outstanding	%
	(dollars in millions)									
AAA	$4,082	1.3 %	$615	2.0 %	$20,037	48.7 %	$5,409	59.6 %	$30,143	7.5 %
AA	90,464	28.1	2,785	8.9	8,213	19.9	503	5.5	101,965	25.3
A	176,298	54.7	7,192	22.9	2,940	7.1	445	4.9	186,875	46.3
BBB	43,429	13.5	19,363	61.7	1,795	4.4	1,912	21.1	66,499	16.4
BIG	7,850	2.4	1,404	4.5	8,186	19.9	807	8.9	18,247	4.5
Total net par outstanding (1)	$322,123	100.0%	$31,359	100.0%	$41,171	100.0%	$9,076	100.0%	$403,729	100.0%

(1) Excludes $1.3 billion of loss mitigation securities insured and held by the Company as of December 31, 2014, which are primarily BIG.

In addition to amounts shown in the tables above, the Company had outstanding commitments to provide guaranties of $504 million for public finance obligations as of September 30, 2015. The expiration dates for the public finance commitments range between October 1, 2015 and February 25, 2017, with $357 million expiring prior to the date of this filing and an additional $23 million expiring prior to December 31, 2015. The commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty's request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.

Table of Contents

Components of BIG Portfolio

Components of BIG Net Par Outstanding
(Insurance and Credit Derivative Form)
As of September 30, 2015

	BIG Net Par Outstanding				Net Par
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding
			(in millions)		
U.S. public finance	$7,132	$2,212	$136	$9,480	$300,732
Non-U.S. public finance	913	601	—	1,514	30,103
Structured finance:					
First lien U.S. residential mortgage-backed securities ("RMBS"):					
Prime first lien	228	57	27	312	465
Alt-A first lien	106	77	638	821	2,189
Option ARM	48	8	95	151	308
Subprime	153	474	709	1,336	3,759
Second lien U.S. RMBS:					
Closed-end second lien	—	19	109	128	203
Home equity lines of credit (“HELOCs”)	609	36	737	1,382	1,476
Total U.S. RMBS	1,144	671	2,315	4,130	8,400
Triple-X life insurance transactions	—	—	216	216	2,750
Trust preferred securities (“TruPS”)	549	291	—	840	4,647
Student loans	—	80	85	165	1,823
Other structured finance	1,061	165	40	1,266	23,906
Total	$10,799	$4,020	$2,792	$17,611	$372,361

Table of Contents

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

	BIG Net Par Outstanding				Net Par Outstanding
	BIG 1	BIG 2	BIG 3	Total BIG	
			(in millions)		
U.S. public finance	$6,577	$1,156	$117	$7,850	$322,123
Non-U.S. public finance	1,402	2	—	1,404	31,359
Structured finance:					
First lien U.S. RMBS:					
Prime first lien	68	33	252	353	471
Alt-A first lien	585	531	725	1,841	2,532
Option ARM	47	18	118	183	407
Subprime	156	654	765	1,575	4,051
Second lien U.S. RMBS:					
Closed-end second lien	—	19	115	134	218
HELOCs	1,012	36	509	1,557	1,738
Total U.S. RMBS	1,868	1,291	2,484	5,643	9,417
Triple-X life insurance transactions	—	—	598	598	3,133
TruPS	997	—	336	1,333	4,326
Student loans	14	68	113	195	1,857
Other structured finance	1,007	172	45	1,224	31,514
Total	$11,865	$2,689	$3,693	$18,247	$403,729

BIG Net Par Outstanding
and Number of Risks
As of September 30, 2015

Description	Net Par Outstanding			Number of Risks(2)		
	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$9,552	$1,247	$10,799	239	13	252
Category 2	3,410	610	4,020	87	8	95
Category 3	2,620	172	2,792	125	12	137
Total BIG	$15,582	$2,029	$17,611	451	33	484

Table of Contents

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

Description	Net Par Outstanding			Number of Risks(2)		
	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$10,195	$1,670	$11,865	164	18	182
Category 2	2,135	554	2,689	75	14	89
Category 3	2,892	801	3,693	119	24	143
Total BIG	$15,222	$3,025	$18,247	358	56	414

(1) Includes net par outstanding for VIEs.

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

Exposure to Puerto Rico

The Company has insured exposure to general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating $5.1 billion net par as of September 30, 2015, all of which are rated BIG. In Nine Months 2015, the Company's Puerto Rico exposures increased due to (1) net par acquired in the Radian Asset Acquisition, which equals $385 million as of September 30, 2015, and (2) a commutation of previously ceded Puerto Rico exposures.

Puerto Rico has experienced significant general fund budget deficits in recent years. These deficits have been covered primarily with the net proceeds of bond issuances, interim financings provided by Government Development Bank for Puerto Rico (“GDB”) and, in some cases, one-time revenue measures or expense adjustment measures. In addition to high debt levels, Puerto Rico faces a challenging economic environment.

In June 2014, the Puerto Rico legislature passed the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act") in order to provide a legislative framework for certain public corporations experiencing severe financial stress to restructure their debt, including Puerto Rico Highway and Transportation Authority ("PRHTA") and Puerto Rico Electric Power Authority ("PREPA"). Subsequently, the Commonwealth stated PREPA might need to seek relief under the Recovery Act due to liquidity constraints. Investors in bonds issued by PREPA filed suit in the United States District Court for the District of Puerto Rico challenging the Recovery Act. On February 6, 2015, the U.S. District Court for the District of Puerto Rico ruled the Recovery Act is preempted by the U.S. Bankruptcy Code and is therefore void; on July 6, 2015, the U.S. Court of Appeals for the First Circuit upheld that ruling. In addition, the Commonwealth's Resident Commissioner has introduced a bill to the U.S. Congress that, if passed, would enable the Commonwealth to authorize one or more of its public corporations to restructure their debts under chapter 9 of the U.S. Bankruptcy Code if they were to become insolvent. The passage of the Recovery Act, its subsequent invalidation, and the introduction of legislation that would enable the Commonwealth to authorize chapter 9 protection for its public corporations have resulted in uncertainty among investors about the rights of creditors of the Commonwealth and its related authorities and public corporations.

On June 28, 2015, Governor García Padilla of Puerto Rico (the “Governor”) publicly stated that the Commonwealth’s public debt, considering the current level of economic activity, is unpayable and that a comprehensive debt restructuring may be necessary. On June 29, 2015 a report commissioned by the Commonwealth and authored by former World Bank Chief Economist and former Deputy Director of the International Monetary Fund Dr. Anne Krueger and economists Dr. Ranjit Teja and Dr. Andrew Wolfe and calling for debt restructuring of all Puerto Rico bonds was released ("Krueger Report"). The Governor recently formed a task force to prepare a five-year stability plan and start broad debt negotiation discussions.

Puerto Rico Public Finance Corporation (“PFC”), a subsidiary of the GDB, failed to make most of an approximately $58 million Debt Service payment on August 3, 2015 and to make subsequent Debt Service payments because the Commonwealth’s legislature did not appropriate funds for payment. The Company does not insure any obligations of the PFC.

Table of Contents

Also on August 3, 2015, the Commonwealth announced that it had temporarily suspended its monthly deposits to the general obligation redemption fund.

On September 9, 2015, the Working Group for the Fiscal and Economic Recovery of Puerto Rico ("Working Group") established by the Governor published its "Puerto Rico Fiscal and Economic Growth Plan" (the "FEGP"). The FEGP projects that the Commonwealth would face a cumulative financing gap of $27.8 billion from fiscal year 2016 to fiscal year 2020 without corrective action. Various stakeholders and analysts have publicly questioned the accuracy of the $27.8 billion gap projected by the Working Group. The FEGP recommends economic development, structural, fiscal and institutional reform measures that it projects would reduce that gap to $14.0 billion. The Working Group asserts that the Commonwealth's debt, including debt with a constitutional priority, is not sustainable. The FEGP includes a recommendation that the Commonwealth's advisors begin to work on a voluntary exchange offer to its creditors as part of the FEGP. The FEGP does not have the force of law and implementation of its recommendations would require actions by the governments of the Commonwealth and of the United States as well as the cooperation and agreement of various creditors.

On October 21, 2015, the U.S. Treasury Department proposed a four-point plan for Puerto Rico which, most significantly, would extend some form of bankruptcy protection not only to Puerto Rico's municipalities and instrumentalities but also the Commonwealth itself. The plan also calls for an independent fiscal oversight board. The Treasury Department's plan requires congressional action to be implemented.

There have been a number of other proposals, plans and legislative initiatives offered in Puerto Rico and in the United States aimed at addressing Puerto Rico's fiscal issues. The final shape of responses to Puerto Rico's distress eventually enacted or implemented by Puerto Rico or the United States, if any, and the impact of any such actions on obligations insured by the Company, is uncertain and may differ substantially from the recommendations of the FEGP, the four-point plan offered by the Treasury Department, or any other proposals or plans offered to date or in the future.

S&P, Moody's and Fitch Ratings have lowered the credit rating of the Commonwealth's bonds and on its public corporations several times over the past approximately two years, and the Commonwealth has disclosed its liquidity has been adversely affected by rating agency downgrades and by the limited market access for its debt, and also noted it has relied on short-term financings and interim loans from the GDB and other private lenders, which reliance has constrained its liquidity and increased its near-term refinancing risk.

PREPA

As of September 30, 2015, the Company had $744 million insured net par outstanding of PREPA obligations. In August 2014, PREPA entered into forbearance agreements with the GDB, its bank lenders, and bondholders and financial guaranty insurers (including AGM and AGC) that hold or guarantee more than 60% of PREPA's outstanding bonds, in order to address its near-term liquidity issues. Creditors, including AGM and AGC, agreed not to exercise available rights and remedies until March 31, 2015, and the bank lenders agreed to extend the maturity of two revolving lines of credit to the same date. PREPA agreed it would continue to make principal and interest payments on its outstanding bonds, and interest payments on its lines of credit. It also agreed it would develop a five year business plan and a recovery program in respect of its operations; a preliminary business plan was released in December 2014. Subsequently, most of the parties extended these forbearance agreements several times.

On July 1, 2015, PREPA made full payment of the $416 million of principal and interest due on its bonds, including bonds insured by AGM and AGC. However, that payment was conditioned on and facilitated by AGM and AGC agreeing, also on July 1, to purchase a portion of $131 million of interest-bearing bonds to help replenish certain of the operating funds PREPA used to make the $416 million of principal and interest payments. On July 31, 2015, AGM and AGC purchased $74 million aggregate principal amount of those bonds.

On September 2, 2015, PREPA announced that on September 1, 2015, it and an ad hoc group of uninsured bondholders (the "Ad Hoc Group") had reached an agreement on certain economic terms of a recovery plan, subject to

certain terms and conditions. On September 22, 2015, PREPA announced it and a group of fuel-line lenders had reached an agreement on the economic terms of a recovery plan, subject to certain terms and conditions. Neither AGM nor AGC are parties to either of those agreements. Other than AGM, AGC, National Public Finance Guarantee Corporation (“National”) and Syncora Guarantee Inc. (together the "Monolines"), parties to the original forbearance agreements continued to extend the forbearance agreements through November 5, 2015, when, according to a public announcement from PREPA, those other parties entered into a restructuring support agreement formalizing the previously announced agreements.

Table of Contents

PREPA continues to negotiate with the Monolines, including AGM and AGC. There can be no assurance that the negotiations will result in agreement or that the consensual recovery plan reportedly outlined in the recovery support agreement will be implemented. PREPA, during the pendency of the agreements, has suspended deposits into its Debt Service fund.

PRHTA

As of September 30, 2015, the Company had $909 million insured net par outstanding of PRHTA (Transportation revenue) bonds and $370 million net par of PRHTA (Highway revenue) bonds. In March 2015, legislation was passed in the Commonwealth that, among other things, provided for an increase in oil taxes that would benefit PRHTA, the transfer out of PRHTA of certain deficit-producing transit facilities, and a statutory lien on revenues at PRHTA, subject to certain conditions, including the issuance of at least $1.0 billion of bonds by the Puerto Rico Infrastructure Finance Authority ("PRIFA"). That legislative package would have supported proposals involving the GDB and PRIFA that contemplated PRIFA issuing up to $2.95 billion of bonds and a series of potential actions that would have, among other things, strengthened PRHTA. However, the Governor’s statement in late June 2015 that a comprehensive debt restructuring may be necessary has created uncertainty around this effort, and published reports suggest that there may not be a market for the debt issuance by PRIFA that was contemplated as part of a series of actions that would have strengthened PRHTA. In addition, because certain revenues supporting PRHTA are subject to a prior constitutional claim of the Commonwealth, the increased financial difficulties of the Commonwealth itself has increased the uncertainty regarding the full and timely receipt by PRHTA of such revenues.

Municipal Finance Agency

As of September 30, 2015, the Company had $387 million net par outstanding of bonds issued by the Puerto Rico Municipal Finance Agency (“MFA”) secured by a pledge of local property tax revenues. On October 13, 2015, the Company filed a motion to intervene in litigation between Centro de Recaudación de Ingresos Municipales (“CRIM”) and the GDB in which CRIM is seeking to ensure that the pledged tax revenues are, and will continue to be, available to support the MFA bonds. While the Company’s motion to intervene was denied, the GDB and CRIM have reported that they executed a new deed of trust that requires the GDB, as fiduciary, to keep the pledged tax revenues separate from any other GDB monies or accounts and that governs the manner in which the pledged revenues may be invested and dispersed.

Table of Contents

The following tables show the Company's insured exposure to general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations.

Puerto Rico
Gross Par and Gross Debt Service Outstanding

	Gross Par Outstanding		Gross Debt Service Outstanding	
	September 30, 2015	December 31, 2014	September 30, 2015	December 31, 2014
	(in millions)			
Previously Subject to the Voided Recovery Act (1)	$2,965	$3,058	$5,164	$5,326
Not Previously Subject to the Voided Recovery Act	2,833	2,977	4,520	4,748
Total	$5,798	$6,035	$9,684	$10,074

(1) On February 6, 2015, the U.S. District Court for the District of Puerto Rico ruled that the Recovery Act is preempted by the Federal Bankruptcy Code and is therefore void, and on July 6, 2015, the U.S. Court of Appeals for the First Circuit upheld that ruling.

Puerto Rico
Net Par Outstanding

	As of September 30, 2015		As of December 31, 2014	
	Total (1)	Internal Rating	Total	Internal Rating
	(in millions)			
Exposures Previously Subject to the Voided Recovery Act:				
PRHTA (Transportation revenue)	$909	CCC-	$844	BB-
PREPA	744	CC	772	B-
Puerto Rico Aqueduct and Sewer Authority	388	CCC	384	BB-
PRHTA (Highway revenue)	370	CCC	273	BB
Puerto Rico Convention Center District Authority	164	CCC-	174	BB-
Total	2,575		2,447	
Exposures Not Previously Subject to the Voided Recovery Act:				
Commonwealth of Puerto Rico - General Obligation Bonds	1,620	CCC	1,672	BB
MFA	387	CCC-	399	BB-
Puerto Rico Sales Tax Financing Corporation	269	CCC+	269	BBB
Puerto Rico Public Buildings Authority	188	CCC	100	BB
GDB	33	CCC	33	BB
PRIFA	18	CCC-	18	BB-
University of Puerto Rico	1	CCC-	1	BB-
Total	2,516		2,492	
Total net exposure to Puerto Rico	$5,091		$4,939	

(1)

As of September 30, 2015, the Company's Puerto Rico exposures increased due to (1) net par of $385 million acquired in the Radian Asset Acquisition, of which $21 million was of PREPA and $166 million of PRHTA, and (2) a commutation of previously ceded Puerto Rico exposures.

Table of Contents

The following table shows the scheduled amortization of the insured general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations. The Company guarantees payments of interest and principal when those amounts are scheduled to be paid and cannot be required to pay on an accelerated basis. In the event that obligors default on their obligations, the Company would only be required to pay the shortfall between the principal and interest due in any given period and the amount paid by the obligors.

Amortization Schedule of Puerto Rico Net Par Outstanding
and Net Debt Service Outstanding
As of September 30, 2015

	Scheduled Net Par Amortization			Scheduled Net Debt Service Amortization		
	Previously Subject to the Voided Recovery Act	Not Previously Subject to the Voided Recovery Act	Total	Previously Subject to the Voided Recovery Act	Not Previously Subject to the Voided Recovery Act	Total
	(in millions)					
2015 (October 1 - December 31)	$0	$33	$33	$2	$34	$36
2016	98	204	302	229	330	559
2017	51	171	222	175	289	464
2018	56	123	179	178	232	410
2019	74	130	204	192	232	424
2020	87	183	270	202	280	482
2021	66	59	125	176	147	323
2022	47	68	115	153	152	305
2023	110	41	151	214	123	337
2024	89	85	174	188	164	352
2025-2029	619	395	1,014	1,032	723	1,755
2030-2034	506	474	980	788	713	1,501
2035 -2039	429	284	713	569	384	953
2040 -2044	97	266	363	171	297	468
2045 -2047	246	—	246	272	—	272
Total	$2,575	$2,516	$5,091	$4,541	$4,100	$8,641

Exposure to the Selected European Countries

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

20

Table of Contents

Net Direct Economic Exposure to Selected European Countries(1)
As of September 30, 2015

	Hungary	Italy	Portugal	Spain	Total
	(in millions)				
Sovereign and sub-sovereign exposure:					
Non-infrastructure public finance (2)	$—	$815	$89	$256	$1,160
Infrastructure finance	279	11	—	123	413
Total sovereign and sub-sovereign exposure	279	826	89	379	1,573
Non-sovereign exposure:					
Regulated utilities	—	218	—	—	218
RMBS and other structured finance	176	254	—	13	443
Total non-sovereign exposure	176	472	—	13	661
Total	$455	$1,298	$89	$392	$2,234
Total BIG (See Note 6)	$385	$—	$89	$392	$866

(1) While the Company's exposures are shown in U.S. dollars, the obligations the Company insures are in various currencies, primarily Euros. One of the residential mortgage-backed securities included in the table above includes residential mortgages in both Italy and Germany, and only the portion of the transaction equal to the portion of the original mortgage pool in Italian mortgages is shown in the table.

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

When the Company directly insures an obligation, it assigns the obligation to a geographic location or locations based on its view of the geographic location of the risk. The Company may also have direct exposures to the Selected European Countries in business assumed from unaffiliated monoline insurance companies, in which case the Company depends upon geographic information provided by the primary insurer.

The Company has excluded from the exposure tables above its indirect economic exposure to the Selected European Countries through policies it provides on pooled corporate and commercial receivables transactions. The Company calculates indirect exposure to a country by multiplying the par amount of a transaction insured by the Company times the percent of the relevant collateral pool reported as having a nexus to the country. On that basis, the Company has calculated exposure of $278 million to Selected European Countries (plus Greece) in transactions with $4.8 billion of net par outstanding. The indirect exposure to credits with a nexus to Greece is $8 million across several highly rated pooled corporate obligations with net par outstanding of $333 million.

5. Financial Guaranty Insurance Premiums

The portfolio of outstanding exposures discussed in Note 4, Outstanding Exposure, includes financial guaranty contracts that meet the definition of insurance contracts as well as those that meet the definition of a derivative under GAAP. Amounts presented in this note relate to financial guaranty insurance contracts, unless otherwise noted. See Note 9, Financial Guaranty Contracts Accounted for as Credit Derivatives for amounts that relate to CDS.

Table of Contents

Net Earned Premiums

	Third Quarter		Nine Months	
	2015	2014	2015	2014
	(in millions)			
Scheduled net earned premiums	$104	$105	$318	$318
Acceleration of net earned premiums	105	36	242	79
Accretion of discount on net premiums receivable	4	3	13	14
Financial guaranty insurance net earned premiums	213	144	573	411
Other	0	0	1	1
Net earned premiums(1)	$213	$144	$574	$412

(1) Excludes $6 million and $5 million for Third Quarter 2015 and 2014, respectively, and $16 million and $27 million for Nine Months 2015 and 2014, respectively, related to consolidated financial guaranty ("FG") VIEs.

Components of Unearned Premium Reserve

	As of September 30, 2015			As of December 31, 2014		
	Gross	Ceded	Net(1)	Gross	Ceded	Net(1)
	(in millions)					
Deferred premium revenue:						
Financial guaranty insurance	$4,126	$271	$3,855	$4,167	$387	$3,780
Other	0	—	0	0	—	0
Deferred premium revenue	$4,126	$271	$3,855	$4,167	$387	$3,780
Contra-paid (2)	(14)	(8)	(6)	94	(6)	100
Unearned premium reserve	$4,112	$263	$3,849	$4,261	$381	$3,880

(1) Excludes $120 million and $125 million of deferred premium revenue, and $35 million and $42 million of contra-paid related to FG VIEs as of September 30, 2015 and December 31, 2014, respectively.

(2) See Note 7, "Financial Guaranty Insurance Losses– Insurance Contracts' Loss Information" for an explanation of "contra-paid".

Table of Contents

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

	Nine Months	
	2015	2014
	(in millions)	
Beginning of period, December 31	$729	$876
Premiums receivable acquired in Radian Asset Acquisition on April 1, 2015	2	—
Gross premium written, net of commissions on assumed business	103	116
Gross premiums received, net of commissions on assumed business	(140)	(172)
Adjustments:		
Changes in the expected term	(11)	(21)
Accretion of discount, net of commissions on assumed business	15	17
Foreign exchange translation	(18)	(16)
Consolidation/deconsolidation of FG VIEs	(4)	1
End of period, September 30 (1)	$676	$801

(1) Excludes $23 million and $18 million as of September 30, 2015 and September 30, 2014, respectively, related to consolidated FG VIEs.

Foreign exchange translation relates to installment premium receivables denominated in currencies other than the U.S. dollar. Approximately 50% and 51% of installment premiums at September 30, 2015 and December 31, 2014, respectively, are denominated in currencies other than the U.S. dollar, primarily the Euro and British Pound Sterling.

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

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

	As of September 30, 2015
	(in millions)
2015 (October 1 – December 31)	$25
2016	77
2017	68
2018	61
2019	57
2020-2024	240
2025-2029	155
2030-2034	108
After 2034	99
Total(1)	$890

(1) Excludes expected cash collections on FG VIEs of $28 million.

23

Table of Contents

Scheduled Financial Guaranty Net Earned Premiums

	As of September 30, 2015 (in millions)
2015 (October 1 – December 31)	$99
2016	379
2017	331
2018	299
2019	272
2020-2024	1,066
2025-2029	678
2030-2034	405
After 2034	326
Net deferred premium revenue(1)	3,855
Future accretion	197
Total future net earned premiums	$4,052

(1) Excludes scheduled net earned premiums on consolidated FG VIEs of $120 million.

Selected Information for Financial Guaranty Policies Paid in Installments

	As of September 30, 2015	As of December 31, 2014
	(dollars in millions)	
Premiums receivable, net of commission payable	$676	$729
Gross deferred premium revenue	1,250	1,370
Weighted-average risk-free rate used to discount premiums	3.4 %	3.5 %
Weighted-average period of premiums receivable (in years)	9.3	9.4

6. Expected Loss to be Paid

Loss Estimation Process

The Company’s loss reserve committees estimate expected loss to be paid for all contracts. Surveillance personnel present analyses related to potential losses to the Company’s loss reserve committees for consideration in estimating the expected loss to be paid. Such analyses include the consideration of various scenarios with corresponding probabilities assigned to them. Depending upon the nature of the risk, the Company’s view of the potential size of any loss and the information available to the Company, that analysis may be based upon individually developed cash flow models, internal credit rating assessments and sector-driven loss severity assumptions or judgmental assessments. In the case of its assumed business, the Company may conduct its own analysis as just described or, depending on the Company’s view of the potential size of any loss and the information available to the Company, the Company may use loss estimates provided by ceding insurers. The Company monitors the performance of its transactions with expected losses and each quarter the Company’s loss reserve committees review and refresh their loss projection assumptions and scenarios and the probabilities they assign to those scenarios based on actual developments during the quarter and their view of future performance.

The financial guaranties issued by the Company insure the credit performance of the guaranteed obligations over an extended period of time, in some cases over 30 years, and in most circumstances, the Company has no right to cancel such financial guaranties. As a result, the Company's estimate of ultimate losses on a policy is subject to significant uncertainty over the life of the insured transaction. Credit performance can be adversely affected by economic, fiscal and financial market variability over the long duration of most contracts.

Table of Contents

The determination of expected loss to be paid is an inherently subjective process involving numerous estimates, assumptions and judgments by management, using both internal and external data sources with regard to frequency, severity of loss, economic projections, governmental actions, negotiations and other factors that affect credit performance. These estimates, assumptions and judgments, and the factors on which they are based, may change materially over a quarter, and as a result the Company's loss estimates may change materially over that same period. Changes over a quarter in the Company's loss estimates for structured finance transactions generally will be influenced by factors impacting the performance of the assets supporting those transactions. For example, changes over a quarter in the Company's loss estimates for its RMBS transactions may be influenced by such factors as the level and timing of loan defaults experienced; changes in housing prices; results from the Company's loss mitigation activities; and other variables. Similarly, changes over a quarter in the Company's loss estimates for municipal obligations supported by specified revenue streams, such as revenue bonds issued by toll road authorities, municipal utilities or airport authorities, generally will be influenced by factors impacting their revenue levels, such as changes in demand; changing demographics; and other economic factors, especially if the obligations do not benefit from financial support from other tax revenues or governmental authorities. On the other hand, changes over a quarter in the Company's loss estimates for its tax-supported public finance transactions generally will be influenced by factors impacting the public issuer's ability and willingness to pay, such as changes in the economy and population of the relevant area; changes in the issuer's ability or willingness to raise taxes, decrease spending or receive federal assistance; new legislation; rating agency downgrades that reduce the issuer's ability to refinance maturing obligations or issue new debt at a reasonable cost; changes in the priority or amount of pensions and other obligations owed to workers; developments in restructuring or settlement negotiations; and other political and economic factors.

The Company does not use traditional actuarial approaches to determine its estimates of expected losses. Actual losses will ultimately depend on future events or transaction performance and may be influenced by many interrelated factors that are difficult to predict. As a result, the Company's current projections of probable and estimable losses may be subject to considerable volatility and may not reflect the Company's ultimate claims paid.

The following tables present a roll forward of the present value of net expected loss to be paid for all contracts, whether accounted for as insurance, credit derivatives or FG VIEs, by sector, after the benefit for net expected recoveries for contractual breaches of representations and warranties ("R&W"). The Company used weighted average risk-free rates for U.S. dollar denominated obligations that ranged from 0.0% to 3.34% as of September 30, 2015 and 0.0% to 3.37% as of December 31, 2014.

Net Expected Loss to be Paid
After Net Expected Recoveries for Breaches of R&W
Roll Forward

	Third Quarter 2015	Nine Months 2015
	(in millions)	
Net expected loss to be paid, beginning of period	$1,510	$1,169
Net expected loss to be paid on Radian Asset portfolio as of April 1, 2015	—	190
Economic loss development due to:		
Accretion of discount	10	24
Changes in discount rates	11	(29)
Changes in timing and assumptions	(24)	191
Total economic loss development	(3)	186
Paid losses	(200)	(238)
Net expected loss to be paid, end of period	$1,307	$1,307

25

Table of Contents

Net Expected Loss to be Paid
After Net Expected Recoveries for Breaches of R&W
Roll Forward by Sector
Third Quarter 2015

	Net Expected Loss to be Paid (Recovered) as of June 30, 2015	Economic Loss Development	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of September 30, 2015 (2)
	(in millions)			
Public Finance:				
U.S. public finance	$613	$92	$(18)	$687
Non-U.S public finance	44	(1)	—	43
Public Finance	657	91	(18)	730
Structured Finance:				
U.S. RMBS:				
First lien:				
Prime first lien	1	0	(1)	0
Alt-A first lien	265	(111)	(108)	46
Option ARM	(18)	(4)	6	(16)
Subprime	273	26	(20)	279
Total first lien	521	(89)	(123)	309
Second lien:				
Closed-end second lien	9	0	2	11
HELOCs	(6)	13	8	15
Total second lien	3	13	10	26
Total U.S. RMBS	524	(76)	(113)	335
Triple-X life insurance transactions	165	1	(68)	98
TruPS	10	(5)	—	5
Student loans	58	(2)	0	56
Other structured finance	96	(12)	(1)	83
Structured Finance	853	(94)	(182)	577
Total	$1,510	$(3)	$(200)	$1,307

Table of Contents

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

	Net Expected Loss to be Paid (Recovered) as of June 30, 2014	Economic Loss Development	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of September 30, 2014
	(in millions)			
Public Finance:				
U.S. public finance	$339	$2	$(8)	$333
Non-U.S public finance	52	(1)	—	51
Public Finance	391	1	(8)	384
Structured Finance:				
U.S. RMBS:				
First lien:				
Prime first lien	11	(1)	—	10
Alt-A first lien	301	(18)	(35)	248
Option ARM	(51)	—	20	(31)
Subprime	341	(11)	(23)	307
Total first lien	602	(30)	(38)	534
Second lien:				
Closed-end second lien	(9)	2	2	(5)
HELOCs	(117)	(34)	3	(148)
Total second lien	(126)	(32)	5	(153)
Total U.S. RMBS	476	(62)	(33)	381
Triple-X life insurance transactions	90	3	(1)	92
TruPS	32	(5)	(1)	26
Student loans	58	6	—	64
Other structured finance	(12)	(6)	4	(14)
Structured Finance	644	(64)	(31)	549
Total	$1,035	$(63)	$(39)	$933

Table of Contents

Net Expected Loss to be Paid
After Net Expected Recoveries for Breaches of R&W
Roll Forward by Sector
Nine Months 2015

	Net Expected Loss to be Paid (Recovered) as of December 31, 2014 (2)	Net Expected Loss to be Paid (Recovered) on Radian Asset portfolio as of April 1, 2015	Economic Loss Development	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of September 30, 2015 (2)
	(in millions)				
Public Finance:					
U.S. public finance	$303	$81	$327	$(24)	$687
Non-U.S public finance	45	4	(6)	—	43
Public Finance	348	85	321	(24)	730
Structured Finance:					
U.S. RMBS:					
First lien:					
Prime first lien	4	—	(1)	(3)	0
Alt-A first lien	304	7	(132)	(133)	46
Option ARM	(16)	0	(3)	3	(16)
Subprime	303	(4)	19	(39)	279
Total first lien	595	3	(117)	(172)	309
Second lien:					
Closed-end second lien	8	—	(2)	5	11
HELOCs	(19)	1	15	18	15
Total second lien	(11)	1	13	23	26
Total U.S. RMBS	584	4	(104)	(149)	335
Triple-X life insurance transactions	161	—	8	(71)	98
TruPS	23	—	(18)	—	5
Student loans	68	—	(7)	(5)	56
Other structured finance	(15)	101	(14)	11	83
Structured Finance	821	105	(135)	(214)	577
Total	$1,169	$190	$186	$(238)	$1,307

Table of Contents

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

	Net Expected Loss to be Paid (Recovered) as of December 31, 2013 (in millions)	Economic Loss Development	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of September 30, 2014
Public Finance:				
U.S. public finance	$264	$107	$(38)	$333
Non-U.S public finance	57	(6)	—	51
Public Finance	321	101	(38)	384
Structured Finance:				
U.S. RMBS:				
First lien:				
Prime first lien	21	(11)	—	10
Alt-A first lien	304	(6)	(50)	248
Option ARM	(9)	(39)	17	(31)
Subprime	304	(12)	15	307
Total first lien	620	(68)	(18)	534
Second lien:				
Closed-end second lien	(11)	2	4	(5)
HELOCs	(116)	(65)	33	(148)
Total second lien	(127)	(63)	37	(153)
Total U.S. RMBS	493	(131)	19	381
Triple-X life insurance transactions	75	21	(4)	92
TruPS	51	(24)	(1)	26
Student loans	52	12	—	64
Other structured finance	(10)	(7)	3	(14)
Structured Finance	661	(129)	17	549
Total	$982	$(28)	$(21)	$933

(1) Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance recoverable on paid losses included in other assets. The Company paid $7 million and $6 million in LAE for Third Quarter 2015 and 2014, respectively, and $16 million and $20 million in LAE for Nine Months 2015 and 2014, respectively.

(2) Includes expected LAE to be paid of $13 million as of September 30, 2015 and $16 million as of December 31, 2014.

Table of Contents

Net Expected Recoveries from Breaches of R&W Rollforward
Third Quarter 2015

	Future Net R&W Benefit as of June 30, 2015	R&W Development and Accretion of Discount During Third Quarter 2015	R&W (Recovered) During Third Quarter 2015	Future Net R&W Benefit as of September 30, 2015 (1)
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$1	$ 0	$ 0	$ 1
Alt-A first lien	93	9	(2)	100
Option ARM	(33)	(5)	(20)	(58)
Subprime	81	(4)	(3)	74
Total first lien	142	0	(25)	117
Second lien:				
Closed-end second lien	83	(1)	(1)	81
HELOC	—	—	—	—
Total second lien	83	(1)	(1)	81
Total	$225	$ (1)	$ (26)	$ 198

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

	Future Net R&W Benefit as of June 30, 2014	R&W Development and Accretion of Discount During Third Quarter 2014	R&W (Recovered) During Third Quarter 2014	Future Net R&W Benefit as of September 30, 2014
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$3	$ 1	$ (1)	$ 3
Alt-A first lien	263	19	(79)	203
Option ARM	144	10	(76)	78
Subprime	99	5	(7)	97
Total first lien	509	35	(163)	381
Second lien:				
Closed-end second lien	93	(1)	(3)	89
HELOC	49	59	—	108
Total second lien	142	58	(3)	197
Total	$651	$ 93	$ (166)	$ 578

30

Table of Contents

Net Expected Recoveries from Breaches of R&W Rollforward
Nine Months 2015

	Future Net R&W Benefit as of December 31, 2014	Future Net R&W Benefit on Radian Asset portfolio as of April 1,2015	R&W Development and Accretion of Discount During 2015	R&W (Recovered) During 2015	Future Net R&W Benefit as of September 30, 2015 (1)
	(in millions)				
U.S. RMBS:					
First lien:					
Prime first lien	$2	$ —	$ (1)	$ 0	$ 1
Alt-A first lien	106	—	(1)	(5)	100
Option ARM	15	—	(19)	(54)	(58)
Subprime	109	1	(27)	(9)	74
Total first lien	232	1	(48)	(68)	117
Second lien:					
Closed-end second lien	85	1	0	(5)	81
HELOC	—	—	—	—	—
Total second lien	85	1	—	(5)	81
Total	$317	$ 2	$ (48)	$ (73)	$ 198

Net Expected Recoveries from Breaches of R&W Rollforward
Nine Months 2014

	Future Net R&W Benefit as of December 31, 2013	R&W Development and Accretion of Discount During 2014	R&W (Recovered) During 2014	Future Net R&W Benefit as of September 30, 2014
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$4	$ —	$ (1)	$ 3
Alt-A first lien	274	20	(91)	203
Option ARM	173	30	(125)	78
Subprime	118	34	(55)	97
Total first lien	569	84	(272)	381
Second lien:				
Closed-end second lien	98	(4)	(5)	89
HELOC	45	80	(17)	108
Total second lien	143	76	(22)	197
Total	$712	$ 160	$ (294)	$ 578

(1) See the section "Breaches of Representations and Warranties" below for eligible assets held in trust.

31

Table of Contents

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

Net Expected Loss to be Paid (Recovered)
By Accounting Model
As of September 30, 2015

	Financial Guaranty Insurance	FG VIEs(1) and Other	Credit Derivatives(2)	Total
	(in millions)			
Public Finance:				
U.S. public finance	$687	$—	$0	$687
Non-U.S. public finance	43	—	—	43
Public Finance	730	—	0	730
Structured Finance:				
U.S. RMBS:				
First lien:				
Prime first lien	2	—	(2)	0
Alt-A first lien	109	16	(79)	46
Option ARM	(17)	—	1	(16)
Subprime	159	63	57	279
Total first lien	253	79	(23)	309
Second lien:				
Closed-end second lien	(23)	30	4	11
HELOCs	7	8	—	15
Total second lien	(16)	38	4	26
Total U.S. RMBS	237	117	(19)	335
Triple-X life insurance transactions	88	—	10	98
TruPS	0	—	5	5
Student loans	56	—	—	56
Other structured finance	34	18	31	83
Structured Finance	415	135	27	577
Total	$1,145	$135	$27	$1,307

Table of Contents

Net Expected Loss to be Paid (Recovered)
By Accounting Model
As of December 31, 2014

	Financial Guaranty Insurance	FG VIEs(1) and Other	Credit Derivatives(2)	Total
	(in millions)			
Public Finance:				
U.S. public finance	$303	$—	$—	$303
Non-U.S. public finance	45	—	—	45
Public Finance	348	—	—	348
Structured Finance:				
U.S. RMBS:				
First lien:				
Prime first lien	2	—	2	4
Alt-A first lien	288	17	(1)	304
Option ARM	(15)	—	(1)	(16)
Subprime	163	71	69	303
Total first lien	438	88	69	595
Second lien:				
Closed-end second lien	(27)	31	4	8
HELOCs	(26)	7	—	(19)
Total second lien	(53)	38	4	(11)
Total U.S. RMBS	385	126	73	584
Triple-X life insurance transactions	153	—	8	161
TruPS	1	—	22	23
Student loans	68	—	—	68
Other structured finance	34	(4)	(45)	(15)
Structured Finance	641	122	58	821
Total	$989	$122	$58	$1,169

(1) Refer to Note 10, Consolidated Variable Interest Entities.

(2) Refer to Note 9, Financial Guaranty Contracts Accounted for as Credit Derivatives.

Table of Contents

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

Net Economic Loss Development (Benefit)
By Accounting Model
Third Quarter 2015

	Financial Guaranty Insurance	FG VIEs(1) and Other	Credit Derivatives(2)	Total
	(in millions)			
Public Finance:				
U.S. public finance	$91	$—	$1	$92
Non-U.S. public finance	(1)	—	0	(1)
Public Finance	90	—	1	91
Structured Finance:				
U.S. RMBS:				
First lien:				
Prime first lien	0	—	0	0
Alt-A first lien	(44)	0	(67)	(111)
Option ARM	(2)	—	(2)	(4)
Subprime	16	7	3	26
Total first lien	(30)	7	(66)	(89)
Second lien:				
Closed-end second lien	(1)	1	0	0
HELOCs	12	1	—	13
Total second lien	11	2	0	13
Total U.S. RMBS	(19)	9	(66)	(76)
Triple-X life insurance transactions	(1)	—	2	1
TruPS	0	—	(5)	(5)
Student loans	(2)	—	—	(2)
Other structured finance	(1)	0	(11)	(12)
Structured Finance	(23)	9	(80)	(94)
Total	$67	$9	$(79)	$(3)

Table of Contents

Net Economic Loss Development (Benefit)
By Accounting Model
Third Quarter 2014

	Financial Guaranty Insurance	FG VIEs(1) and Other	Credit Derivatives(2)	Total
	(in millions)			
Public Finance:				
U.S. public finance	$2	$—	$—	$2
Non-U.S. public finance	(1)	—	—	(1)
Public Finance	1	—	—	1
Structured Finance:				
U.S. RMBS:				
First lien:				
Prime first lien	(1)	—	—	(1)
Alt-A first lien	6	(2)	(22)	(18)
Option ARM	7	—	(7)	—
Subprime	(21)	8	2	(11)
Total first lien	(9)	6	(27)	(30)
Second lien:				
Closed-end second lien	2	1	(1)	2
HELOCs	(48)	14	—	(34)
Total second lien	(46)	15	(1)	(32)
Total U.S. RMBS	(55)	21	(28)	(62)
Triple-X life insurance transactions	3	—	—	3
TruPS	(1)	—	(4)	(5)
Student loans	6	—	—	6
Other structured finance	(4)	—	(2)	(6)
Structured Finance	(51)	21	(34)	(64)
Total	$(50)	$21	$(34)	$(63)

Table of Contents

Net Economic Loss Development (Benefit)
By Accounting Model
Nine Months 2015

	Financial Guaranty Insurance	FG VIEs(1) and Other	Credit Derivatives(2)	Total
	(in millions)			
Public Finance:				
U.S. public finance	$332	$—	$(5)	$327
Non-U.S. public finance	(6)	—	0	(6)
Public Finance	326	—	(5)	321
Structured Finance:				
U.S. RMBS:				
First lien:				
Prime first lien	0	—	(1)	(1)
Alt-A first lien	(54)	(1)	(77)	(132)
Option ARM	(5)	—	2	(3)
Subprime	12	10	(3)	19
Total first lien	(47)	9	(79)	(117)
Second lien:				
Closed-end second lien	(2)	0	0	(2)
HELOCs	14	1	—	15
Total second lien	12	1	0	13
Total U.S. RMBS	(35)	10	(79)	(104)
Triple-X life insurance transactions	4	—	4	8
TruPS	(1)	—	(17)	(18)
Student loans	(7)	—	—	(7)
Other structured finance	(1)	0	(13)	(14)
Structured Finance	(40)	10	(105)	(135)
Total	$286	$10	$(110)	$186

Table of Contents

Net Economic Loss Development (Benefit)
By Accounting Model
Nine Months 2014

	Financial Guaranty Insurance	FG VIEs(1) and Other	Credit Derivatives(2)	Total
	(in millions)			
Public Finance:				
U.S. public finance	$107	$—	$—	$107
Non-U.S. public finance	(5)	—	(1)	(6)
Public Finance	102	—	(1)	101
Structured Finance:				
U.S. RMBS:				
First lien:				
Prime first lien	—	—	(11)	(11)
Alt-A first lien	32	(12)	(26)	(6)
Option ARM	(32)	1	(8)	(39)
Subprime	(25)	9	4	(12)
Total first lien	(25)	(2)	(41)	(68)
Second lien:				
Closed-end second lien	—	4	(2)	2
HELOCs	(138)	73	—	(65)
Total second lien	(138)	77	(2)	(63)
Total U.S. RMBS	(163)	75	(43)	(131)
Triple-X life insurance transactions	20	—	1	21
TruPS	(2)	—	(22)	(24)
Student loans	12	—	—	12
Other structured finance	(6)	(1)	—	(7)
Structured Finance	(139)	74	(64)	(129)
Total	$(37)	$74	$(65)	$(28)

(1) Refer to Note 10, Consolidated Variable Interest Entities.

(2) Refer to Note 9, Financial Guaranty Contracts Accounted for as Credit Derivatives.

Selected U.S. Public Finance Transactions

The Company insures general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating $5.1 billion net par as of September 30, 2015, all of which are BIG. For additional information regarding the Company's exposure to general obligations of Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations, please refer to "Exposure to Puerto Rico" in Note 4, Outstanding Exposure.

On February 25, 2015, a plan of adjustment resolving the bankruptcy filing of the City of Stockton, California under chapter 9 of the U.S. Bankruptcy Code became effective. As of September 30, 2015, the Company’s net exposure subject to the plan consists of $115 million of pension obligation bonds. As part of the plan settlement, the City will repay the pension obligation bonds from certain fixed payments and certain variable payments contingent on the City's revenue growth. The Company agreed as part of the plan to cancel its $40 million of the City’s lease revenue bonds in exchange for the irrevocable option to take title to the office building that served as collateral for the lease revenue

bonds. The Company also receives net rental payments from the office building. The Company no longer reflects the canceled lease revenue bonds as outstanding

Table of Contents

insured net par, but instead the financial statements reflect an investment in the office building and related lease revenue and expenses. As of September 30, 2015, the office building is carried at approximately $29 million and is reported as part of Other Assets.

The Company has $337 million of net par exposure to the Louisville Arena Authority. The bond proceeds were used to construct the KFC Yum Center, home to the University of Louisville men's and women's basketball teams. Actual revenues available for Debt Service are well below original projections, and under the Company's internal rating scale, the transaction is BIG.

In December 2014, the City of Detroit emerged from bankruptcy under chapter 9 of the U.S. Bankruptcy Code. The Company still expects to make debt service payments on the 15.5% of the City’s unlimited tax general obligation that were not exchanged as part of the related settlement. As of September 30, 2015, these bonds had a net debt service outstanding of $23 million.

As a result of the Radian Asset Acquisition, the Company has approximately $21 million of net par exposure as of September 30, 2015 to bonds issued by Parkway East Public Improvement District, which is located in Madison County, Mississippi. The bonds, which are rated BIG, are payable from special assessments on properties within the District, as well as amounts paid under a contribution agreement with the County in which the County covenants that it will provide funds in the event special assessments are not sufficient to make a debt service payment. The special assessments have not been sufficient to pay debt service in full. In earlier years, the County provided funding to cover the balance of the debt service requirement, but the County now claims that the District’s failure to reimburse it within the two years stipulated in the contribution agreement means that the County is not required to provide funding until it is reimbursed. A declaratory judgment action is pending against the District and the County to establish the Company's rights under the contribution agreement. See "Recovery Litigation" below.

The Company also has $15.4 billion of net par exposure to healthcare transactions. The BIG net par outstanding in this sector is $351 million, $301 million of which was acquired as part of the Radian Asset Acquisition.

The Company projects that its total net expected loss across its troubled U.S. public finance credits as of September 30, 2015, which incorporated the likelihood of the outcomes mentioned above, will be $687 million, compared with a net expected loss of $613 million as of June 30, 2015 and $303 million as of December 31, 2014. On April 1, 2015, the Radian Asset Acquisition added $81 million in net economic losses to be paid for U.S. public finance credits. Economic loss development in Third Quarter 2015 was $92 million, which was primarily attributable to Puerto Rico exposures. Economic loss development in Nine Months 2015 was $327 million, which was also primarily attributable to Puerto Rico exposures.

Certain Selected European Country Sub-Sovereign Transactions

The Company insures and reinsures credits with sub-sovereign exposure to various Spanish and Portuguese issuers where a Spanish and Portuguese sovereign default may cause the sub-sovereigns also to default. The Company's gross exposure to these Spanish and Portuguese credits is $474 million and $96 million, respectively, and exposure net of reinsurance for Spanish and Portuguese credits is $379 million and $89 million, respectively. The Company rates most of these issuers in the BB category due to the financial condition of Spain and Portugal and their dependence on the sovereign. The Company's Hungary exposure is to infrastructure bonds dependent on payments from Hungarian governmental entities. The Company's gross exposure to these Hungarian credits is $282 million and its exposure net of reinsurance is $279 million, all of which is rated BIG. The Company estimated net expected losses of $41 million related to these Spanish, Portuguese and Hungarian credits. The economic benefit of approximately $1 million during Third Quarter 2015 and $5 million during Nine Months 2015 was primarily related to changes in the exchange rate between the Euro and US Dollar.

38

Table of Contents

Infrastructure Finance

The Company has insured exposure of approximately $3.0 billion to infrastructure transactions with refinancing risk as to which the Company may need to make claim payments that it did not anticipate paying when the policies were issued. Although the Company may not experience ultimate loss on a particular transaction, the aggregate amount of the claim payments may be substantial and reimbursement may not occur for an extended time. These transactions generally involve long-term infrastructure projects that were financed by bonds that mature prior to the expiration of the project concession. The Company expects the cash flows from these projects to be sufficient to repay all of the debt over the life of the project concession, but also expects the debt to be refinanced in the market at or prior to its maturity. If the issuer is unable to refinance the debt due to market conditions, the Company may have to pay a claim when the debt matures, and then recover its payment from cash flows produced by the project in the future. The Company generally projects that in most scenarios it will be fully reimbursed for such payments. However, the recovery of the payments is uncertain and may take from 10 to 35 years, depending on the transaction and the performance of the underlying collateral. The Company estimates total claims for the two largest transactions with significant refinancing risk, assuming no refinancing, and based on certain performance assumptions, could be $2.0 billion on a gross basis; such claims would be payable from 2017 through 2022.

Approach to Projecting Losses in U.S. RMBS

The Company projects losses on its insured U.S. RMBS on a transaction-by-transaction basis by projecting the performance of the underlying pool of mortgages over time and then applying the structural features (i.e., payment priorities and tranching) of the RMBS and any R&W agreements to the projected performance of the collateral over time. The resulting projected claim payments or reimbursements are then discounted using risk-free rates.

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

Mortgage borrowers that are not more than one payment behind (generally considered performing borrowers) have demonstrated an ability and willingness to pay throughout the recession and mortgage crisis, and as a result are viewed as less likely to default than delinquent borrowers. Performing borrowers that eventually default will also need to progress through delinquency categories before any defaults occur. The Company projects how many of the currently performing loans will default and when they will default, by first converting the projected near term defaults of delinquent borrowers derived from liquidation rates into a vector of conditional default rates ("CDR"), then projecting how the conditional default rates will develop over time. Loans that are defaulted pursuant to the conditional default rate after the near-term liquidation of currently delinquent loans represent defaults of currently performing loans and projected re-performing loans. A conditional default rate is the outstanding principal amount of defaulted loans liquidated in the current month divided by the remaining outstanding amount of the whole pool of loans (or “collateral pool balance”). The collateral pool balance decreases over time as a result of scheduled principal payments, partial and whole principal prepayments, and defaults.

In order to derive collateral pool losses from the collateral pool defaults it has projected, the Company applies a loss severity. The loss severity is the amount of loss the transaction experiences on a defaulted loan after the application of net proceeds from the disposal of the underlying property. The Company projects loss severities by sector based on its experience to date. The Company continues to update its evaluation of these loss severities as new information becomes available.

The Company has been enforcing claims for breaches of R&W regarding the characteristics of the loans included in the collateral pools, and by reaching agreements with certain R&W providers in early October, has completed its pursuit of R&W claims. The Company calculates a credit for R&W recoveries to include in its cash flow projections based on agreements it has with R&W providers, which are described in more detail under "Breaches of Representations and Warranties" below.

In some instances, the terms of the Company's policy gives it the option to pay principal on an accelerated basis, thereby reducing the amount of guaranteed interest due in the future. The Company has at times exercised this option, which uses cash but reduces projected future losses.

The Company projects the overall future cash flow from a collateral pool by adjusting the payment stream from the principal and interest contractually due on the underlying mortgages for the collateral losses it projects as described above; assumed voluntary prepayments; and servicer advances. The Company then applies an individual model of the structure of the

Table of Contents

transaction to the projected future cash flow from that transaction's collateral pool to project the Company's future claims and claim reimbursements for that individual transaction. Finally, the projected claims and reimbursements are discounted using risk-free rates. The Company runs several sets of assumptions regarding mortgage collateral performance, or scenarios, and probability weights them.

The Company's RMBS loss projection methodology assumes that the housing and mortgage markets will continue improving. Each period the Company makes a judgment as to whether to change the assumptions it uses to make RMBS loss projections based on its observation during the period of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and loss severity) as well as the residential property market and economy in general, and, to the extent it observes changes, it makes a judgment as whether those changes are normal fluctuations or part of a trend.

Third Quarter and Nine Months 2015 U.S. RMBS Loss Projections

Based on its observation during the period of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and loss severity) as well as the residential property market and economy in general, the Company chose to use the same general assumptions to project RMBS losses as of September 30, 2015 as it used as of June 30, 2015, except that, for its first lien RMBS loss projections it again this quarter shortened by three months the period it is projecting it will take in the base case to reach the final CDR. For the Nine Months 2015, first lien RMBS projections reflect a shortening of the period it is projecting it will take in the base case to reach the final CDR by nine months as compared with December 31, 2014.

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

The majority of projected losses in first lien RMBS transactions are expected to come from non-performing mortgage loans (those that are or in the past twelve months have been two or more payments behind, have been modified, are in foreclosure, or have been foreclosed upon). Changes in the amount of non-performing loans from the amount projected in the previous period are one of the primary drivers of loss development in this portfolio. In order to determine the number of defaults resulting from these delinquent and foreclosed loans, the Company applies a liquidation rate assumption to loans in each of various non-performing categories. The Company arrived at its liquidation rates based on data purchased from a third party provider and assumptions about how delays in the foreclosure process and loan modifications may ultimately affect the rate at which loans are liquidated. Each year the Company reviews the most recent twenty-four months of this data and (if necessary) adjusts its liquidation rates based on its observations. The following table shows liquidation assumptions for various non-performing categories.

Table of Contents

First Lien Liquidation Rates

	September 30, 2015	June 30, 2015	December 31, 2014
Current Loans Modified in the Previous 12 Months			
Alt A and Prime	25%	25%	25%
Option ARM	25	25	25
Subprime	25	25	25
Current Loans Delinquent in the Previous 12 Months			
Alt A and Prime	25	25	25
Option ARM	25	25	25
Subprime	25	25	25
30 – 59 Days Delinquent			
Alt A and Prime	35	35	35
Option ARM	45	40	40
Subprime	50	35	35
60 – 89 Days Delinquent			
Alt A and Prime	45	50	50
Option ARM	55	55	55
Subprime	55	40	40
90+ Days Delinquent			
Alt A and Prime	55	60	60
Option ARM	65	65	65
Subprime	60	55	55
Bankruptcy			
Alt A and Prime	45	45	45
Option ARM	50	50	50
Subprime	40	40	40
Foreclosure			
Alt A and Prime	65	75	75
Option ARM	75	80	80
Subprime	70	70	70
Real Estate Owned			
All	100	100	100

While the Company uses liquidation rates as described above to project defaults of non-performing loans (including current loans modified or delinquent within the last 12 months), it projects defaults on presently current loans by applying a CDR trend. The start of that CDR trend is based on the defaults the Company projects will emerge from currently nonperforming, recently nonperforming and modified loans. The total amount of expected defaults from the non-performing loans is translated into a constant CDR (i.e., the CDR plateau), which, if applied for each of the next 36 months, would be sufficient to produce approximately the amount of defaults that were calculated to emerge from the various delinquency categories. The CDR thus calculated individually on the delinquent collateral pool for each RMBS is then used as the starting point for the CDR curve used to project defaults of the presently performing loans.

In the base case, after the initial 36-month CDR plateau period, each transaction’s CDR is projected to improve over 12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for 36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. In the base case, the Company assumes the final CDR will be reached 7.75 years after the initial 36-month CDR plateau period, which is three months shorter than assumed as of June 30, 2015 and nine months shorter than assumed at December 31, 2014. Under

the Company's methodology, defaults projected to occur in the first 36 months represent defaults that can be attributed to loans that were modified or delinquent in the last 12 months or that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected CDR trend after the first 36 month period represent defaults attributable to borrowers that are currently performing or are projected to reperform.

Table of Contents

Another important driver of loss projections is loss severity, which is the amount of loss the transaction incurs on a loan after the application of net proceeds from the disposal of the underlying property. Loss severities experienced in first lien transactions have reached historically high levels, and the Company is assuming in the base case that these high levels generally will continue for another 18 months. The Company determines its initial loss severity based on actual recent experience. The Company then assumes that loss severities begin returning to levels consistent with underwriting assumptions beginning after the initial 18 month period, declining to 40% in the base case over 2.5 years. Beginning for December 31, 2014, the Company differentiated the loss severity assumptions depending on the vintage of the transaction, as shown in the table below.

The following table shows the range as well as the average, weighted by outstanding net insured par, for key assumptions used in the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 first lien U.S. RMBS.

Table of Contents

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

	As of September 30, 2015		As of June 30, 2015		As of December 31, 2014	
	Range	Weighted Average	Range	Weighted Average	Range	Weighted Average
Alt-A First Lien						
Plateau CDR	2.4% - 15.4%	6.4%	1.7% – 13.3%	7.1%	2.0% – 13.4%	7.3%
Intermediate CDR	0.5% - 3.1%	1.3%	0.3% – 2.7%	1.4%	0.4% – 2.7%	1.5%
Period until intermediate CDR	48 months		48 months		48 months	
Final CDR	0.1% - 0.8%	0.3%	0.1% – 0.7%	0.3%	0.1% – 0.7%	0.3%
Initial loss severity:						
2005 and prior	60.0%		60.0%		60.0%	
2006	70.0%		70.0%		70.0%	
2007	65.0%		65.0%		65.0%	
Initial conditional prepayment rate ("CPR")	2.7% - 32.0%	8.9%	1.6% – 27.7%	8.5%	1.7% – 21.0%	7.7%
Final CPR(2)	15.0% - 32.0%	15.5%	15.0% – 27.7%	15.3%	15%	
Option ARM						
Plateau CDR	3.6% - 11.2%	8.5%	4.0% – 12.1%	9.2%	4.3% – 14.2%	10.6%
Intermediate CDR	0.7% - 2.2%	1.7%	0.8% – 2.4%	1.8%	0.9% – 2.8%	2.1%
Period until intermediate CDR	48 months		48 months		48 months	
Final CDR	0.2% - 0.6%	0.4%	0.2% – 0.6%	0.5%	0.2% – 0.7%	0.5%
Initial loss severity:						
2005 and prior	60.0%		60.0%		60.0%	
2006	70.0%		70.0%		70.0%	
2007	65.0%		65.0%		65.0%	
Initial CPR	2.2% - 7.8%	4.9%	1.6% – 12.3%	5.0%	1.1% – 11.8%	4.9%
Final CPR(2)	15%		15%		15%	
Subprime						
Plateau CDR	5.0% - 13.7%	10.0%	4.9% – 13.5%	9.7%	4.9% – 15.0%	10.6%
Intermediate CDR	1.0% - 2.7%	2.0%	1.0% – 2.7%	1.9%	1.0% – 3.0%	2.1%
Period until intermediate CDR	48 months		48 months		48 months	
Final CDR	0.3% - 0.7%	0.4%	0.2% – 0.7%	0.4%	0.2% – 0.7%	0.4%
Initial loss severity:						
2005 and prior	75.0%		75.0%		75.0%	
2006	90.0%		90.0%		90.0%	
2007	90.0%		90.0%		90.0%	
Initial CPR	0.0% - 9.3%	3.9%	0.0% – 8.7%	4.0%	0.0% – 10.5%	6.1%
Final CPR(2)	15%		15%		15%	

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

(2) For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant and the final CPR is not used.

The rate at which the principal amount of loans is voluntarily prepaid may impact both the amount of losses projected (since that amount is a function of the conditional default rate, the loss severity and the loan balance over time) as well as the amount of excess spread (the amount by which the interest paid by the borrowers on the underlying loan exceeds the amount of interest owed on the insured obligations). The assumption for the voluntary CPR follows a similar pattern to that of the

Table of Contents

conditional default rate. The current level of voluntary prepayments is assumed to continue for the plateau period before gradually increasing over 12 months to the final CPR, which is assumed to be 15% in the base case. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant and the final CPR is not used. These assumptions are the same as those the Company used for June 30, 2015 and December 31, 2014.

In estimating expected losses, the Company modeled and probability weighted sensitivities for first lien transactions by varying its assumptions of how fast a recovery is expected to occur. One of the variables used to model sensitivities was how quickly the conditional default rate returned to its modeled equilibrium, which was defined as 5% of the initial conditional default rate. The Company also stressed CPR and the speed of recovery of loss severity rates. The Company probability weighted a total of five scenarios (including its base case) as of September 30, 2015. The Company used a similar approach to establish its pessimistic and optimistic scenarios as of September 30, 2015 as it used as of June 30, 2015 and December 31, 2014, increasing and decreasing the periods of stress from those used in the base case.

In a somewhat more stressful environment than that of the base case, where the conditional default rate plateau was extended six months (to be 42 months long) before the same more gradual conditional default rate recovery and loss severities were assumed to recover over 4.5 rather than 2.5 years (and subprime loss severities were assumed to recover only to 60% and Option ARM and Alt A loss severities to only 45%), expected loss to be paid would increase from current projections by approximately $13 million for Alt-A first liens, $5 million for Option ARM, $49 million for subprime and $1 million for prime transactions.

In an even more stressful scenario where loss severities were assumed to rise and then recover over nine years and the initial ramp-down of the conditional default rate was assumed to occur over 15 months and other assumptions were the same as the other stress scenario, expected loss to be paid would increase from current projections by approximately $33 million for Alt-A first liens, $12 million for Option ARM, $69 million for subprime and $4 million for prime transactions.

In a scenario with a somewhat less stressful environment than the base case, where conditional default rate recovery was somewhat less gradual, expected loss to be paid would decrease from current projections by approximately $1 million for Alt-A first liens, $14 million for Option ARM, $8 million for subprime and $40 thousand for prime transactions.

In an even less stressful scenario where the conditional default rate plateau was six months shorter (30 months, effectively assuming that liquidation rates would improve) and the conditional default rate recovery was more pronounced, (including an initial ramp-down of the conditional default rate over nine months), expected loss to be paid would decrease from current projections by approximately $13 million for Alt-A first liens, $22 million for Option ARM, $36 million for subprime and $0.2 million for prime transactions.

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

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

The following table shows the range as well as the average, weighted by outstanding net insured par, for key assumptions for the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 second lien U.S. RMBS.

44

Table of Contents

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

HELOC key assumptions	As of September 30, 2015		As of June 30, 2015		As of December 31, 2014	
	Range	Weighted Average	Range	Weighted Average	Range	Weighted Average
Plateau CDR	6.0% – 24.0%	9.5%	5.3% – 23.3%	8.9%	2.8% – 6.8%	4.1%
Final CDR trended down to	0.5% – 3.2%	1.2%	0.5% – 3.2%	1.2%	0.5% – 3.2%	1.2%
Period until final CDR	34 months		34 months		34 months	
Initial CPR	9.8%	9.8%	9.3%	9.3%	6.9% – 21.8%	11.0%
Final CPR(2)	10.0% – 15.0%	13.3%	10.0% – 15.0%	13.25%	15.0% – 21.8%	15.5%
Loss severity	90.0% – 98.0%	90.3%	90.0% – 98.0%	90.5%	90.0% – 98.0%	90.4%

Closed-end second lien key assumptions	As of September 30, 2015		As of June 30, 2015		As of December 31, 2014	
	Range	Weighted Average	Range	Weighted Average	Range	Weighted Average
Plateau CDR	6.0% – 19.7%	10.2%	6.0% – 21.4%	10.8%	5.5% – 12.5%	7.2%
Final CDR trended down to	3.5% – 9.2%	4.8%	3.5% – 9.2%	4.8%	3.5% – 9.1%	4.9%
Period until final CDR	34 months		34 months		34 months	
Initial CPR	5.7% – 15.1%	9%	5.3% – 13.4%	8.6%	2.8% – 13.9%	9.9%
Final CPR(2)	15.0% – 15.1%	15%	15%		15%	
Loss severity	98%		98%		98%	

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

(2) For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant and the final CPR is not used.

In second lien transactions the projection of near-term defaults from currently delinquent loans is relatively straightforward because loans in second lien transactions are generally "charged off" (treated as defaulted) by the securitization's servicer once the loan is 180 days past due. Most second lien transactions report the amount of loans in five monthly delinquency categories (i.e., 30-59 days past due, 60-89 days past due, 90-119 days past due, 120-149 days past due and 150-179 days past due). The Company estimates the amount of loans that will default over the next five months by calculating current representative liquidation rates. A liquidation rate is the percent of loans in a given cohort (in this instance, delinquency category) that ultimately default. Similar to first liens, the Company then calculates a CDR for six months, which is the period over which the currently delinquent collateral is expected to be liquidated. That CDR is then used as the basis for the plateau period that follows the embedded five months of losses. Liquidation rates assumed as of September 30, 2015, were from 10% to 100%.

For the base case scenario, the CDR (the "plateau CDR") was held constant for six months. Once the plateau period has ended, the CDR is assumed to gradually trend down in uniform increments to its final long-term steady state CDR. (The long-term steady state CDR is calculated as the constant CDR that would have yielded the amount of losses originally expected at underwriting.) In the base case scenario, the time over which the CDR trends down to its final CDR is 28 months. Therefore, the total stress period for second lien transactions is 34 months, comprising five months of delinquent data, a one month plateau period and 28 months of decrease to the steady state CDR, the same as of

June 30, 2015 and December 31, 2014.

HELOC loans generally permit the borrower to pay only interest for an initial period (often ten years) and, after that period, require the borrower to make both the monthly interest payment and a monthly principal payment, and so increase the borrower's aggregate monthly payment. Some of the HELOC loans underlying the Company's insured HELOC transactions have reached their principal amortization period. The Company has observed that the increase in monthly payments occurring when a loan reaches its principal amortization period, even if mitigated by borrower relief offered by the servicer, is associated with increased borrower defaults. Thus, most of the Company's HELOC projections incorporate an assumption that a percentage of loans reaching their amortization periods will default around the time of the payment increase. These projected defaults are in addition to those generated using the CDR curve as described above. This assumption is similar to the one used

Table of Contents

at June 30, 2015 and December 31, 2014. For September 30, 2015 the Company used the approach it had refined for June 30, 2015 to calculate the number of additional delinquencies as a function of the number of modified loans in the transaction and the final steady state CDR. Under this refined approach, transactions that have worse than average expected experience will have higher defaults and transactions where borrowers are receiving modifications so that they will not default when their interest only period ends will have higher losses.

When a second lien loan defaults, there is generally a very low recovery. The Company had assumed as of September 30, 2015 that it will generally recover only 10% or less of the collateral defaulting in the future and declining additional amounts on post-default receipts on previously defaulted collateral. This is the same as at June 30, 2015 and December 31, 2014.

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected as well as the amount of excess spread. In the base case, an average CPR (based on experience of the most recent three quarters) is assumed to continue until the end of the plateau before gradually increasing to the final CPR over the same period the CDR decreases. The final CPR is assumed to be 15% for both HELOC and closed-end second lien transactions, which is lower than the historical average but reflects the Company's continued uncertainty about the projected performance of the borrowers in these transactions. This pattern is generally consistent with how the Company modeled the CPR at June 30, 2015 and December 31, 2014. To the extent that prepayments differ from projected levels it could materially change the Company's projected excess spread and losses.

The Company uses a number of other variables in its second lien loss projections, including the spread between relevant interest rate indices. These variables have been relatively stable and in the relevant ranges have less impact on the projection results than the variables discussed above. However, in a number of HELOC transactions the servicers have been modifying poorly performing loans from floating to fixed rates, and, as a result, rising interest rates would negatively impact the excess spread available from these modified loans to support the transactions. The Company incorporated these modifications in its assumptions.

In estimating expected losses, the Company modeled and probability weighted five possible CDR curves applicable to the period preceding the return to the long-term steady state CDR. The Company used five scenarios at June 30, 2015 and three scenarios at December 31, 2014. The Company believes that the level of the elevated CDR and the length of time it will persist, the ultimate prepayment rate, and the amount of additional defaults because of the expiry of the interest only period, are the primary drivers behind the likely amount of losses the collateral will suffer. The Company continues to evaluate the assumptions affecting its modeling results.

The Company's base case assumed a six month CDR plateau and a 28 month ramp-down (for a total stress period of 34 months). The Company also modeled a scenario with a longer period of elevated defaults and another with a shorter period of elevated defaults. Increasing the CDR plateau to eight months and increasing the ramp-down by three months to 31 months (for a total stress period of 39 months), and doubling the defaults relating to the end of the interest only period would increase the expected loss by approximately $37 million for HELOC transactions and $1 million for closed-end second lien transactions. On the other hand, reducing the CDR plateau to four months and decreasing the length of the CDR ramp-down to 25 months (for a total stress period of 29 months), and lowering the ultimate prepayment rate to 10% would decrease the expected loss by approximately $36 million for HELOC transactions and $0.6 million for closed-end second lien transactions.

Breaches of Representations and Warranties

Generally, when mortgage loans are transferred into a securitization, the loan originator(s) and/or sponsor(s) provide R&W that the loans meet certain characteristics, and a breach of such R&W often requires that the loan be repurchased from the securitization. The Company has pursued such breaches of R&W on a loan-by-loan basis or in

cases where a provider of R&W refused to honor its repurchase obligations, the Company sometimes chose to initiate litigation. The Company's success in pursuing these strategies permitted the Company to enter into agreements with R&W providers under which those providers made payments to the Company, agreed to make payments to the Company in the future, and / or repurchased loans from the transactions, all in return for releases of related liability by the Company. In some instances, the entity providing the R&W (or an affiliate of that entity) also benefited from credit protection sold by the Company through a CDS, and the Company entered into an agreement terminating the CDS protection it provided (and so avoiding future losses on that transaction), again in return for releases of related liability by the Company and in certain instances other consideration.

Through October 31, 2015, the Company has caused entities providing R&Ws to pay, or agree to pay, or to terminate or agree to terminate insurance protection on future projected losses of, approximately $4.2 billion (gross of reinsurance) in respect of their R&W liabilities for transactions in which the Company has provided insurance. The Company has included in

Table of Contents

its net expected loss estimates as of September 30, 2015 an estimated net benefit of $198 million (net of reinsurance), all of which is projected to be received pursuant to existing agreements with R&W providers. The Company is no longer actively pursuing R&W providers where it does not have such an agreement. Most of the amount projected to be received pursuant to existing agreements with R&W providers benefits from eligible assets placed in trusts to collateralize the R&W provider's future reimbursement obligation, with the amount of such collateral subject to increase or decrease from time to time as determined by rating agency requirements. Currently the Company has agreements with three counterparties where a future reimbursement obligation is collateralized by eligible assets held in trust:

- Bank of America. Under the Company's agreement with Bank of America Corporation and certain of its subsidiaries ("Bank of America"), Bank of America agreed to reimburse the Company for 80% of claims on the first lien transactions covered by the agreement that the Company pays in the future, until the aggregate lifetime collateral losses (not insurance losses or claims) on those transactions reach $6.6 billion. As of September 30, 2015 aggregate lifetime collateral losses on those transactions was $4.3 billion, and the Company was projecting in its base case that such collateral losses would eventually reach $5.2 billion. Bank of America's reimbursement obligation is secured by $551 million of collateral held in trust for the Company's benefit.

- Deutsche Bank. Under the Company's May 2012 agreement with Deutsche Bank AG and certain of its affiliates (collectively, "Deutsche Bank"), Deutsche Bank agreed to reimburse the Company for certain claims it pays in the future on eight first and second lien transactions, including 80% of claims it pays on those transactions until the aggregate lifetime claims (before reimbursement) reach $319 million. As of September 30, 2015, the Company was projecting in its base case that such aggregate lifetime claims would remain below $319 million. In the event aggregate lifetime claims paid exceed $389 million, Deutsche Bank must reimburse the Company for 85% of such claims paid (in excess of $389 million) until such claims paid reach $600 million. Deutsche Bank's reimbursement obligation is secured by $71 million of collateral held in trust for the Company's benefit.

When the agreement was first signed, Deutsche Bank was also required to reimburse AGC for future claims AGC paid on certain RMBS resecuritizations. These and other RMBS transactions with respect to which AGC had provided credit protection to Deutsche Bank through a CDS have since been terminated, while Deutsche Bank's reimbursement obligation described above remains in place.

- UBS. On May 6, 2013, the Company entered into an agreement with UBS Real Estate Securities Inc. and affiliates ("UBS") and a third party resolving the Company's claims and liabilities related to specified RMBS transactions that were issued, underwritten or sponsored by UBS and insured by AGM or AGC under financial guaranty insurance policies. Under the agreement, UBS agreed to reimburse the Company for 85% of future losses on three first lien RMBS transactions, and such reimbursement obligation is secured by $62 million of collateral held in trust for the Company's benefit.

The Company uses the same RMBS projection scenarios and weightings to project its future R&W benefit as it uses to project RMBS losses on its portfolio. To the extent the Company increases its loss projections, the R&W benefit generally will also increase, subject to the agreement limits and thresholds described above. Similarly, to the extent the Company decreases its loss projections, the R&W benefit generally will also decrease, subject to the agreement limits and thresholds described above.

The number of risks subject to R&W recovery is 28, with related net debt service of $1.9 billion as of September 30, 2015 compared to 29 with related net debt service of $2.1 billion as of December 31, 2014. A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making debt service payments. Included in these September 30 amounts is one risk with related net debt service of $568 million as of September 30, 2015 that was terminated early in the fourth quarter of 2015. The Company's RMBS projection

scenarios include the projected net benefit of those fourth quarter terminations, which have already occurred.

Table of Contents

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

Components of R&W Development

	Third Quarter		Nine Months	
	2015	2014	2015	2014
	(in millions)			
Estimated increase (decrease) in defaults that will result in additional (lower) breaches	$(16)	$(4)	$(65)	$(15)
Inclusion or removal of deals with breaches of R&W during period	—	—	0	—
Change in recovery assumptions	—	4	—	31
Settlements and anticipated settlements	14	90	14	96
Accretion of discount on balance	1	3	3	48
Total	$(1)	$93	$(48)	$160

Triple-X Life Insurance Transactions

The Company had $2.8 billion of net par exposure to Triple-X life insurance transactions as of September 30, 2015. Two of these transactions, with $216 million of net par outstanding, are rated BIG. The Triple-X life insurance transactions are based on discrete blocks of individual life insurance business. In older vintage Triple-X transactions, which include the two BIG-rated transactions, the monies raised by the sale of the notes insured by the Company were used to capitalize a special purpose vehicle that provides reinsurance to a life insurer or reinsurer. The monies are invested at inception in accounts managed by third-party investment managers. In the case of the two BIG-rated transactions, material amounts of their assets were invested in U.S. RMBS. Based on its analysis of the information currently available, including estimates of future investment performance, and projected credit impairments on the invested assets and performance of the blocks of life insurance business at September 30, 2015, the Company’s projected net expected loss to be paid is $98 million. The economic loss development during Third Quarter 2015 was $1 million, which was due primarily to additional loss adjustment expenses. The economic loss development during Nine Months 2015 was $8 million, which was due primarily to changes in the risk free rates used to discount the losses and life insurance projections earlier in the year.

In the case of one of the BIG-rated transactions, AGM had guaranteed a CDS that referenced the entire issued and outstanding amount of its Series A-1 Notes, which AGUK guarantees. On July 9, 2015, in consideration of a cash payment by AGM, the swap counterparty delivered to AGM all of the Series A-1 Notes, and the parties terminated the CDS. AGUK continues to guarantee the Series A-1 Notes. However, consistent with the Company's practice of excluding from its par and Debt Service outstanding amounts attributable to loss mitigation securities it has purchased because it manages such securities as investments and not insurance exposure, the Company excluded from its consolidated net par outstanding as of September 30, 2015 the $382.5 million net par of such notes.

TruPS

The Company has insured or reinsured $4.6 billion of net par (78% of which is in CDS form) of collateralized debt obligations (“CDOs”) backed by TruPS and similar debt instruments, or “TruPS CDOs.” Of the $4.6 billion, $0.8 billion is rated BIG. The underlying collateral in the TruPS CDOs consists of subordinated debt instruments such as TruPS issued by bank holding companies and similar instruments issued by insurance companies, real estate investment

trusts (“REITs”) and other real estate related issuers.

The Company projects losses for TruPS CDOs by projecting the performance of the asset pools across several scenarios (which it weighs) and applying the CDO structures to the resulting cash flows. At September 30, 2015, the Company has projected expected losses to be paid for TruPS CDOs of $5 million. During Third Quarter 2015, there was a decrease in economic loss development of $5 million, which was due primarily to improving collateral performance and collateral redemptions during the quarter. During Nine Months 2015, there was a decrease in economic loss development of $18 million, which was due primarily to improving collateral performance and collateral redemptions during the period.

Table of Contents

Student Loan Transactions

The Company has insured or reinsured $1.8 billion net par of student loan securitizations issued by private issuers and that it classifies as structured finance. Of this amount, $165 million is rated BIG. The Company is projecting approximately $56 million of net expected loss to be paid on these transactions. In general, the losses are due to: (i) the poor credit performance of private student loan collateral and high loss severities, or (ii) high interest rates on auction rate securities with respect to which the auctions have failed. The economic benefit during Third Quarter 2015 was $2 million, which was due primarily to lower delinquencies in the loan portfolio. The economic benefit during Nine Months 2015 was $7 million, which was driven primarily by a partial commutation by the underlying insurer during the first quarter.

Other structured finance

The Company's other structured finance include $1.3 billion net par rated BIG, including a distressed collateralized loan obligation ("CLO") transaction, transactions backed by manufactured housing loans and quota share surety reinsurance contracts on Spanish housing cooperatives. As of April 1, 2015, the Radian Asset Acquisition added $101 million in net economic losses for other structured finance credits. The Company has expected loss to be paid of $83 million as of September 30, 2015. The economic benefit during Third Quarter 2015 was $12 million and for Nine Months 2015 was a benefit of $14 million, which were attributable primarily to a commercial mortgage-backed security ("CMBS"), which was terminated in October 2015.

The transaction in this area most sensitive to changes in losses in the future is the distressed CLO transaction. In its most pessimistic scenario, where the primary insurer defaults (the Company's contract is a second-to-pay policy), the expected loss could increase by $120 million. In its most optimistic scenario, where the primary insurer pays the full claim, the Company would have no expected losses.

Recovery Litigation

RMBS Transactions

In November 2014, AGM and its affiliate AGC reached a confidential settlement with DLJ Mortgage Capital, Inc., Credit Suisse First Boston Mortgage Securities Corp. and Credit Suisse Securities (USA) LLC to resolve a lawsuit relating to six first lien U.S. RMBS transactions. AGM and AGC sought damages for alleged breaches of representations and warranties in respect of the underlying loans in these transactions, and failure to cure or repurchase defective loans identified by AGM and AGC. On November 25, 2014, the parties filed a joint stipulation discontinuing the lawsuit with prejudice. However, on November 20, 2014, U.S. Bank National Association, as trustee for the transactions, had filed a motion to intervene as a plaintiff in the lawsuit. On November 26, 2014, the trustee submitted a letter stating that the joint stipulation is ineffective and that the lawsuit may be discontinued only by court order, and requesting an opportunity to review and potentially oppose the settlement. On March 5, 2015 the Court denied the motion to intervene.

Triple-X Life Insurance Transactions

In December 2008, AGUK filed an action in the Supreme Court of the State of New York against J.P. Morgan Investment Management Inc. (“JPMIM”), the investment manager for a triple-X life insurance transaction, Orkney Re II plc ("Orkney"), involving securities guaranteed by AGUK. The action alleges that JPMIM engaged in breaches of fiduciary duty, gross negligence and breaches of contract based upon its handling of the Orkney investments. After AGUK’s claims were dismissed with prejudice in January 2010, AGUK was successful in its subsequent motions and appeals and, as of December 2011, all of AGUK’s claims for breaches of fiduciary duty, gross negligence and contract

were reinstated in full. Discovery is ongoing.

Public Finance Transactions

On November 1, 2013, Radian Asset commenced a declaratory judgment action in the U.S. District Court for the Southern District of Mississippi against Madison County, Mississippi and the Parkway East Public Improvement District to establish its rights under a contribution agreement from the County supporting certain special assessment bonds issued by the District and insured by Radian Asset (now AGC). As of September 30, 2015, $21 million of such bonds were outstanding. The County maintains that its payment obligation is limited to two years of annual debt service, while AGC contends no such limitation applies. On April 20, 2015, the Court issued an order addressing AGC's and the County's cross-motions for partial summary judgment, and denied the County's motion for summary judgment that its payment obligation lasts only two years. On May 1, 2015, AGC paid its first claim on the insured bonds. Discovery is ongoing.

Table of Contents

7. Financial Guaranty Insurance Losses

Insurance Contracts' Loss Information

The following table provides balance sheet information on loss and LAE reserves and salvage and subrogation recoverable, net of reinsurance. The Company used weighted average risk-free rates for U.S. dollar denominated financial guaranty insurance obligations that ranged from 0.0% to 3.34% as of September 30, 2015 and 0.0% to 2.95% as of December 31, 2014. Financial guaranty insurance expected LAE reserve was $10 million as of September 30, 2015 and $12 million as of December 31, 2014.

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

	As of September 30, 2015			As of December 31, 2014		
	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net Reserve (Recoverable)	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net Reserve (Recoverable)
	(in millions)					
Public Finance:						
U.S. public finance	$525	$11	$514	$243	$8	$235
Non-U.S. public finance	30	—	30	30	—	30
Public Finance	555	11	544	273	8	265
Structured Finance:						
U.S. RMBS:						
First lien:						
Prime first lien	2	—	2	2	—	2
Alt-A first lien	43	—	43	87	—	87
Option ARM	18	34	(16)	28	40	(12)
Subprime	176	22	154	166	8	158
First lien	239	56	183	283	48	235
Second lien:						
Closed-end second lien	4	35	(31)	4	39	(35)
HELOCs	13	30	(17)	3	39	(36)
Second lien	17	65	(48)	7	78	(71)
Total U.S. RMBS	256	121	135	290	126	164
Triple-X life insurance transactions	80	—	80	140	—	140
TruPS	—	—	—	0	—	0
Student loans	53	—	53	64	—	64
Other structured finance	47	—	47	34	8	26
Structured Finance	436	121	315	528	134	394
Subtotal	991	132	859	801	142	659
Other recoverables	—	5	(5)	—	13	(13)
Subtotal	991	137	854	801	155	646
Effect of consolidating FG VIEs	(73)	(1)	(72)	(80)	(1)	(79)
Total (1)	$918	$136	$782	$721	$154	$567

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

Table of Contents

Components of Net Reserves (Salvage)

	As of September 30, 2015	As of December 31, 2014
	(in millions)	
Loss and LAE reserve	$1,007	$799
Reinsurance recoverable on unpaid losses	(89)	(78)
Loss and LAE reserve, net	918	721
Salvage and subrogation recoverable	(135)	(151)
Salvage and subrogation payable(1)	4	10
Other recoverables	(5)	(13)
Salvage and subrogation recoverable, net and other recoverable	(136)	(154)
Net reserves (salvage)	$782	$567

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

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

	As of September 30, 2015			As of December 31, 2014		
	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet(1)	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet(1)
	(in millions)					
Salvage and subrogation recoverable, net	$(19)	$—	$ (19)	$20	$—	$ 20
Loss and LAE reserve, net	119	(7)	112	185	(8)	177

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

Table of Contents

The table below provides a reconciliation of net expected loss to be paid to net expected loss to be expensed. Expected loss to be paid differs from expected loss to be expensed due to: (1) the contra-paid which represent the claim payments made and recoveries received that have not yet been recognized in the statement of operations, (2) salvage and subrogation recoverable for transactions that are in a net recovery position where the Company has not yet received recoveries on claims previously paid (having the effect of reducing net expected loss to be paid by the amount of the previously paid claim and the expected recovery), but will have no future income effect (because the previously paid claims and the corresponding recovery of those claims will offset in income in future periods), and (3) loss reserves that have already been established (and therefore expensed but not yet paid).

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

	As of September 30, 2015 (in millions)
Net expected loss to be paid	$1,280
Less: net expected loss to be paid for FG VIEs and other	135
Total	1,145
Contra-paid, net	6
Salvage and subrogation recoverable, net of reinsurance	131
Loss and LAE reserve, net of reinsurance	(899)
Other recoveries	4
Net expected loss to be expensed (present value) (1)	$387

(1) Excludes $79 million as of September 30, 2015, related to consolidated FG VIEs.

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

Net Expected Loss to be Expensed
Financial Guaranty Insurance Contracts

	As of September 30, 2015 (in millions)
2015 (October 1 – December 31)	$7
Subtotal 2015	7
2016	38
2017	31
2018	29
2019	28
2020-2024	104
2025-2029	75
2030-2034	51
After 2034	24

Net expected loss to be expensed	387
Discount	406
Total expected future loss and LAE	$793

Table of Contents

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

Loss and LAE
Reported on the
Consolidated Statements of Operations

	Third Quarter		Nine Months	
	2015	2014	2015	2014
	(in millions)			
Public Finance:				
U.S. public finance	$89	$3	$298	$112
Non-U.S. public finance	(2)	(1)	4	(1)
Public finance	87	2	302	111
Structured Finance:				
U.S. RMBS:				
First lien:				
Prime first lien	0	0	(1)	0
Alt-A first lien	(15)	4	(26)	21
Option ARM	(4)	9	(5)	(21)
Subprime	31	(7)	32	(5)
First lien	12	6	0	(5)
Second lien:				
Closed-end second lien	1	1	0	0
HELOCs	18	(45)	29	(55)
Second lien	19	(44)	29	(55)
Total U.S. RMBS	31	(38)	29	(60)
Triple-X life insurance transactions	7	3	14	20
TruPS	—	0	(1)	(1)
Student loans	(2)	6	(7)	12
Other structured finance	(1)	(3)	(2)	(7)
Structured finance	35	(32)	33	(36)
Loss and LAE on insurance contracts before FG VIE consolidation	122	(30)	335	75
Effect of consolidating FG VIEs	(10)	(14)	(17)	(21)
Loss and LAE	$112	$(44)	$318	$54

Table of Contents

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

Financial Guaranty Insurance
BIG Transaction Loss Summary
As of September 30, 2015

	BIG Categories								
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating FG VIEs	Total
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	239	(50)	87	(13)	125	(41)	451	—	451
Remaining weighted-average contract period (in years)	9.9	6.8	11.0	9.2	8.0	6.2	10.2	—	10.2
Outstanding exposure:									
Principal	$11,001	$(1,449)	$3,673	$(263)	$2,780	$(160)	$15,582	$—	$15,582
Interest	5,676	(509)	2,102	(118)	926	(34)	8,043	—	8,043
Total(2)	$16,677	$(1,958)	$5,775	$(381)	$3,706	$(194)	$23,625	$—	$23,625
Expected cash outflows (inflows)	$1,809	$(566)	$1,110	$(67)	$1,402	$(44)	$3,644	$(333)	$3,311
Potential recoveries									
Undiscounted R&W	42	(1)	(49)	1	(94)	5	(96)	8	(88)
Other(3)	(1,663)	514	(258)	11	(467)	18	(1,845)	173	(1,672)
Total potential recoveries	(1,621)	513	(307)	12	(561)	23	(1,941)	181	(1,760)
Subtotal	188	(53)	803	(55)	841	(21)	1,703	(152)	1,551
Discount	(21)	8	(194)	10	(158)	(86)	(441)	35	(406)
Present value of expected cash flows	$167	$(45)	$609	$(45)	$683	$(107)	$1,262	$(117)	$1,145
Deferred premium revenue	$510	$(47)	$144	$(4)	$333	$(26)	$910	$(103)	$807
Reserves (salvage)	$30	$(36)	$502	$(42)	$389	$(7)	$836	$(72)	$764

Table of Contents

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

	BIG Categories								
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating FG VIEs	Total
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	164	(59)	75	(15)	119	(38)	358	—	358
Remaining weighted-average contract period (in years)	9.9	7.4	10.1	8.9	9.6	6.9	10.3	—	10.3
Outstanding exposure:									
Principal	$12,358	$(2,163)	$2,421	$(286)	$3,067	$(175)	$15,222	$—	$15,222
Interest	6,350	(838)	1,274	(121)	1,034	(48)	7,651	—	7,651
Total(2)	$18,708	$(3,001)	$3,695	$(407)	$4,101	$(223)	$22,873	$—	$22,873
Expected cash outflows (inflows)	$1,762	$(626)	$763	$(77)	$1,716	$(75)	$3,463	$(345)	$3,118
Potential recoveries									
Undiscounted R&W	(39)	0	(48)	2	(171)	9	(247)	8	(239)
Other(3)	(1,687)	608	(206)	5	(404)	30	(1,654)	177	(1,477)
Total potential recoveries	(1,726)	608	(254)	7	(575)	39	(1,901)	185	(1,716)
Subtotal	36	(18)	509	(70)	1,141	(36)	1,562	(160)	1,402
Discount	3	0	(117)	11	(353)	9	(447)	34	(413)
Present value of expected cash flows	$39	$(18)	$392	$(59)	$788	$(27)	$1,115	$(126)	$989
Deferred premium revenue	$378	$(70)	$119	$(6)	$312	$(33)	$700	$(116)	$584
Reserves (salvage)	$(42)	$(5)	$278	$(53)	$482	$(10)	$650	$(79)	$571

(1) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making Debt Service payments. The ceded number of risks represents the number of risks for which the Company ceded a portion of its exposure.

(2) Includes BIG amounts related to FG VIEs.

(3) Includes excess spread and draws on HELOCs.

Ratings Impact on Financial Guaranty Business

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

For example, AGM has issued financial guaranty insurance policies in respect of the obligations of municipal obligors under interest rate swaps. AGM insures periodic payments owed by the municipal obligors to the bank counterparties. In certain cases, AGM also insures termination payments that may be owed by the municipal obligors to the bank counterparties. If (i) AGM has been downgraded below the rating trigger set forth in a swap under which it has insured the termination payment, which rating trigger varies on a transaction by transaction basis; (ii) the municipal obligor has the right to cure by, but has failed in, posting collateral, replacing AGM or otherwise curing the downgrade of AGM; (iii) the transaction documents include as a condition that an event of default or termination event with respect to the municipal obligor has occurred, such as the rating of the municipal obligor being downgraded past a specified level, and such condition has been met; (iv) the bank counterparty has elected to terminate the swap; (v) a termination payment is payable by the municipal obligor; and (vi) the municipal obligor has failed to make the termination payment payable by it, then AGM would be required to pay the termination payment due by the municipal obligor, in an amount not to exceed the policy limit set forth in the financial guaranty insurance policy. At AGM's current financial strength ratings, if the conditions giving rise to the obligation of AGM to make a termination payment under the swap termination policies were all satisfied, then AGM could pay claims in an amount not exceeding approximately $157 million in respect of such termination payments. Taking into consideration whether the

Table of Contents

rating of the municipal obligor is below any applicable specified trigger, if the financial strength ratings of AGM were further downgraded below "A" by S&P or below "A2" by Moody's, and the conditions giving rise to the obligation of AGM to make a payment under the swap policies were all satisfied, then AGM could pay claims in an additional amount not exceeding approximately $399 million in respect of such termination payments.

As another example, with respect to variable rate demand obligations ("VRDOs") for which a bank has agreed to provide a liquidity facility, a downgrade of AGM or AGC may provide the bank with the right to give notice to bondholders that the bank will terminate the liquidity facility, causing the bondholders to tender their bonds to the bank. Bonds held by the bank accrue interest at a “bank bond rate” that is higher than the rate otherwise borne by the bond (typically the prime rate plus 2.00% — 3.00%, and capped at the lesser of 25% and the maximum legal limit). In the event the bank holds such bonds for longer than a specified period of time, usually 90-180 days, the bank has the right to demand accelerated repayment of bond principal, usually through payment of equal installments over a period of not less than five years. In the event that a municipal obligor is unable to pay interest accruing at the bank bond rate or to pay principal during the shortened amortization period, a claim could be submitted to AGM or AGC under its financial guaranty policy. As of September 30, 2015, AGM and AGC had insured approximately $5.8 billion net par of VRDOs, of which approximately $0.3 billion of net par constituted VRDOs issued by municipal obligors rated BBB- or lower pursuant to the Company’s internal rating. The specific terms relating to the rating levels that trigger the bank’s termination right, and whether it is triggered by a downgrade by one rating agency or a downgrade by all rating agencies then rating the insurer, vary depending on the transaction.

In addition, AGM may be required to pay claims in respect of AGMH’s former financial products business if Dexia SA and its affiliates, from which the Company had purchased AGMH and its subsidiaries, do not comply with their obligations following a downgrade of the financial strength rating of AGM. Most of the guaranteed investment contracts ("GICs") insured by AGM allow the GIC holder to terminate the GIC and withdraw the funds in the event of a downgrade of AGM below A3 or A-, with no right of the GIC issuer to avoid such withdrawal by posting collateral or otherwise enhancing its credit. Each GIC contract stipulates the thresholds below which the GIC issuer must post eligible collateral, along with the types of securities eligible for posting and the collateralization percentage applicable to each security type. These collateralization percentages range from 100% of the GIC balance for cash posted as collateral to, typically, 108% for asset-backed securities. If the entire aggregate accreted GIC balance of approximately $1.9 billion as of September 30, 2015 were terminated, the assets of the GIC issuers (which had an aggregate market value which exceed the liabilities by $0.9 billion) would be sufficient to fund the withdrawal of the GIC funds.

8. Fair Value Measurement

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

Fair value is based on quoted market prices, where available. If listed prices or quotes are not available, fair value is based on either internally developed models that primarily use, as inputs, market-based or independently sourced market parameters, including but not limited to yield curves, interest rates and debt prices or with the assistance of an independent third-party using a discounted cash flow approach and the third party’s proprietary pricing models. In addition to market information, models also incorporate transaction details, such as maturity of the instrument and contractual features designed to reduce the Company’s credit exposure, such as collateral rights as applicable.

Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, the Company's creditworthiness and constraints on liquidity. As markets and products develop and the pricing for certain products becomes more or less transparent, the Company may refine its methodologies and assumptions. During Nine Months 2015, no changes were made to the Company's valuation models that had or are expected to have, a material impact on the Company's consolidated balance sheets or statements of operations and comprehensive income.

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

The fair value hierarchy is determined based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable

Table of Contents

inputs reflect Company estimates of market assumptions. The fair value hierarchy prioritizes model inputs into three broad levels as follows, with Level 1 being the highest and Level 3 the lowest. An asset or liability's categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation.

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

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

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

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

Measured and Carried at Fair Value

Fixed-Maturity Securities and Short-Term Investments

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

Short-term investments, that are traded in active markets, are classified within Level 1 in the fair value hierarchy and are based on quoted market prices. Securities such as discount notes are classified within Level 2 because these securities are typically not actively traded due to their approaching maturity and, as such, their cost approximates fair value. Short term securities that were obtained as part of loss mitigation efforts and whose prices were determined based on models, where at least one significant model assumption or input is unobservable, are considered to be Level 3 in the fair value hierarchy.

Annually, the Company reviews each pricing service's procedures, controls and models used in the valuations of the Company's investment portfolio, as well as the competency of the pricing service's key personnel. In addition, on a quarterly basis, the Company holds a meeting of the internal valuation committee (comprised of individuals within the Company with market, valuation, accounting, and/or finance experience) that reviews and approves prices and assumptions used by the pricing services.

For Level 1 and 2 securities, the Company, on a quarterly basis, reviews internally developed analytic packages that highlight, at a CUSIP level, price changes from the previous quarter to the current quarter. Where unexpected price movements are noted for a specific CUSIP, the Company formally challenges the price provided, and reviews all key inputs utilized in the third party's pricing model, and compares such information to management's own market information.

Table of Contents

For Level 3 securities, the Company, on a quarterly basis:

- reviews methodologies, any model updates and inputs and compares such information to management's own market information and, where applicable, the internal models,
- reviews internally developed analytic packages that highlight, at a CUSIP level, price changes from the previous quarter to the current quarter, and evaluates, documents, and resolves any significant pricing differences with the assistance of the third party pricing source, and
- compares prices received from different third party pricing sources, and evaluates, documents the rationale for, and resolves any significant pricing differences.

Prices determined based on models where at least one significant model assumption or input is unobservable, are considered to be Level 3 in the fair value hierarchy. As of September 30, 2015, the Company used models to price 35 fixed-maturity securities and short-term investments (which were purchased or obtained for loss mitigation or other risk management purposes), which was 8.4% or $933 million of the Company's fixed-maturity securities and short-term investments at fair value. Certain Level 3 securities were priced with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach using the third-party's proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); home price depreciation/appreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the bond including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could materially change the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

Other Invested Assets

As of September 30, 2015 and December 31, 2014, other invested assets include investments carried and measured at fair value on a recurring basis of $54 million and $95 million, respectively, and include primarily an investment in the global property catastrophe risk market and an investment in a fund that invests primarily in senior loans and bonds. Both of these investments were classified as Level 3. Other invested assets also include fixed-maturity securities classified as trading carried as Level 2.

Other Assets

Committed Capital Securities

The fair value of committed capital securities ("CCS"), which is recorded in other assets on the consolidated balance sheets, represents the difference between the present value of remaining expected put option premium payments under AGC's CCS (the "AGC CCS") and AGM's Committed Preferred Trust Securities (the "AGM CPS") agreements, and the estimated present value that the Company would hypothetically have to pay currently for a comparable security (see Note 16, Long Term Debt and Credit Facilities). The AGC CCS and AGM CPS are carried at fair value with changes in fair value recorded in the consolidated statement of operations. The estimated current cost of the Company's CCS is based on several factors, including broker-dealer quotes for the outstanding securities, AGM and AGC CDS spreads, the U.S. dollar forward swap curve, London Interbank Offered Rate ("LIBOR") curve projections and the term the securities are estimated to remain outstanding.

Supplemental Executive Retirement Plans

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

Table of Contents

Financial Guaranty Contracts Accounted for as Credit Derivatives

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

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

Due to the lack of quoted prices and other observable inputs for its instruments or for similar instruments, the Company determines the fair value of its credit derivative contracts primarily through internally developed, proprietary models that use both observable and unobservable market data inputs to derive an estimate of the fair value of the Company's contracts in its principal markets (see "Assumptions and Inputs"). There is no established market where financial guaranty insured credit derivatives are actively traded, therefore, management has determined that the exit market for the Company's credit derivatives is a hypothetical one based on its entry market. Management has tracked the historical pricing of the Company's deals to establish historical price points in the hypothetical market that are used in the fair value calculation. These contracts are classified as Level 3 in the fair value hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation model, most importantly the Company's estimate of the value of the non-standard terms and conditions of its credit derivative contracts and of the Company's current credit standing.

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

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining premiums the Company expects to receive or pay and the estimated present value of premiums that a financial guarantor of comparable credit-worthiness would hypothetically charge or pay at the reporting date for the same protection. The fair value of the Company's credit derivatives depends on a number of factors, including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of referenced entities, the Company's own credit risk and remaining contractual cash flows. The expected remaining contractual premium cash flows are the most readily observable inputs since they are based on the CDS contractual terms. Credit spreads capture the effect of recovery rates and performance of underlying assets of these contracts, among other factors. Consistent with previous years, market conditions at September 30, 2015 were such that market prices of the Company's CDS contracts were not available.

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

differences may be material.

Assumptions and Inputs

The various inputs and assumptions that are key to the establishment of the Company's fair value for CDS contracts are as follows:

•Gross spread.

•The allocation of gross spread among:
the profit the originator, usually an investment bank, realizes for putting the deal together and funding the transaction ("bank profit");
premiums paid to the Company for the Company's credit protection provided ("net spread"); and

Table of Contents

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

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

The rates used to discount future expected premium cash flows ranged from 0.20% to 2.47% at September 30, 2015 and 0.26% to 2.70% at December 31, 2014.

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

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

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

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

•Deals priced or closed during a specific quarter within a specific asset class and specific rating. No transactions closed during the periods presented.

•Credit spreads interpolated based upon market indices.

•Credit spreads provided by the counterparty of the CDS.

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

Information by Credit Spread Type (1)

	As of September 30,	As of December 31,

	2015		2014	
Based on actual collateral specific spreads	12	%	9	%
Based on market indices	76	%	82	%
Provided by the CDS counterparty	12	%	9	%
Total	100	%	100	%

(1) Based on par.

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

Table of Contents

assessment that the higher priority inputs are no longer considered to be representative of market spreads for a given type of collateral. This can happen, for example, if transaction volume changes such that a previously used spread index is no longer viewed as being reflective of current market levels.

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

The premium the Company receives is referred to as the "net spread." The Company's pricing model takes into account not only how credit spreads on risks that it assumes affect pricing, but also how the Company's own credit spread affects the pricing of its deals. The Company's own credit risk is factored into the determination of net spread based on the impact of changes in the quoted market price for credit protection bought on the Company, as reflected by quoted market prices on CDS referencing AGC or AGM. For credit spreads on the Company's name the Company obtains the quoted price of CDS contracts traded on AGC and AGM from market data sources published by third parties. The cost to acquire CDS protection referencing AGC or AGM affects the amount of spread on CDS deals that the Company retains and, hence, their fair value. As the cost to acquire CDS protection referencing AGC or AGM increases, the amount of premium the Company retains on a deal generally decreases. As the cost to acquire CDS protection referencing AGC or AGM decreases, the amount of premium the Company retains on a deal generally increases. In the Company's valuation model, the premium the Company captures is not permitted to go below the minimum rate that the Company would currently charge to assume similar risks. This assumption can have the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts. Given the current market conditions and the Company's own credit spreads, approximately 16%, 17% and 21% based on number of deals, of the Company's CDS contracts are fair valued using this minimum premium as of September 30, 2015, June 30, 2015 and December 31, 2014, respectively. The percentage of deals that price using the minimum premiums fluctuates due to changes in AGM's and AGC's credit spreads. In general when AGM's and AGC's credit spreads narrow, the cost to hedge AGM's and AGC's name declines and more transactions price above previously established floor levels. Meanwhile, when AGM's and AGC's credit spreads widen, the cost to hedge AGM's and AGC's name increases causing more transactions to price at previously established floor levels. The Company corroborates the assumptions in its fair value model, including the portion of exposure to AGC and AGM hedged by its counterparties, with independent third parties each reporting period. The current level of AGC's and AGM's own credit spread has resulted in the bank or deal originator hedging a significant portion of its exposure to AGC and AGM. This reduces the amount of contractual cash flows AGC and AGM can capture as premium for selling its protection.

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

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

Table of Contents

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. The assumptions used in these examples are hypothetical amounts. Scenario 1 represents the market conditions in effect on the transaction date and Scenario 2 represents market conditions at a subsequent reporting date.

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

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

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

In this example, the contractual cash flows (the Company premium received per annum above) exceed the amount a market participant would require the Company to pay in today's market to accept its obligations under the CDS contract, thus resulting in an asset.

Strengths and Weaknesses of Model

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

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

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

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

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

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

-

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

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

- At September 30, 2015 and December 31, 2014, the markets for the inputs to the model were highly illiquid, which impacts their reliability.

Table of Contents

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

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

Fair Value Option on FG VIEs' Assets and Liabilities

The Company elected the fair value option for all the FG VIEs' assets and liabilities. See Note 10, Consolidated Variable Interest Entities.

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

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

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

63

Table of Contents

Not Carried at Fair Value

Financial Guaranty Insurance Contracts

For financial guaranty insurance contracts that are acquired in a business combination, the Company measures each contract at fair value on the date of acquisition, and then follows insurance accounting guidance on a recurring basis thereafter. On a quarterly basis, the Company also discloses the fair value of its outstanding financial guaranty insurance contracts. In both cases, fair value is based on management's estimate of what a similarly rated financial guaranty insurance company would demand to acquire the Company's in-force book of financial guaranty insurance business. It is based on a variety of factors that may include pricing assumptions management has observed for portfolio transfers, commutations, and acquisitions that have occurred in the financial guaranty market, as well as prices observed in the credit derivative market with an adjustment for illiquidity so that the terms would be similar to a financial guaranty insurance contract, and includes adjustments to the carrying value of unearned premium reserve for stressed losses, ceding commissions and return on capital. The significant inputs were not readily observable. The Company accordingly classified this fair value measurement as Level 3.

Long-Term Debt

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

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

Other Invested Assets

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

Other Assets and Other Liabilities

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

Table of Contents

Financial Instruments Carried at Fair Value

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

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of September 30, 2015

		Fair Value Hierarchy		
	Fair Value (in millions)	Level 1	Level 2	Level 3
Assets:				
Investment portfolio, available-for-sale:				
Fixed-maturity securities				
Obligations of state and political subdivisions	$5,958	$—	$5,950	$8
U.S. government and agencies	477	—	477	—
Corporate securities	1,436	—	1,357	79
Mortgage-backed securities:				
RMBS	1,371	—	1,010	361
CMBS	511	—	511	—
Asset-backed securities	590	—	155	435
Foreign government securities	297	—	297	—
Total fixed-maturity securities	10,640	—	9,757	883
Short-term investments	522	406	66	50
Other invested assets (1)	59	—	6	53
Credit derivative assets	71	—	—	71
FG VIEs' assets, at fair value (2)	1,541	—	—	1,541
Other assets	90	24	21	45
Total assets carried at fair value	$12,923	$430	$9,850	$2,643
Liabilities:				
Credit derivative liabilities	$918	$—	$—	$918
FG VIEs' liabilities with recourse, at fair value	1,315	—	—	1,315
FG VIEs' liabilities without recourse, at fair value	167	—	—	167
Total liabilities carried at fair value	$2,400	$—	$—	$2,400

Table of Contents

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

	Fair Value (in millions)	Fair Value Hierarchy Level 1	Level 2	Level 3
Assets:				
Investment portfolio, available-for-sale:				
Fixed-maturity securities				
Obligations of state and political subdivisions	$5,795	$—	$5,757	$38
U.S. government and agencies	665	—	665	—
Corporate securities	1,368	—	1,289	79
Mortgage-backed securities:				
RMBS	1,285	—	860	425
CMBS	659	—	659	—
Asset-backed securities	417	—	189	228
Foreign government securities	302	—	302	—
Total fixed-maturity securities	10,491	—	9,721	770
Short-term investments	767	359	408	—
Other invested assets (1)	100	0	17	83
Credit derivative assets	68	—	—	68
FG VIEs' assets, at fair value (2)	1,398	—	—	1,398
Other assets	78	26	17	35
Total assets carried at fair value	$12,902	$385	$10,163	$2,354
Liabilities:				
Credit derivative liabilities	$963	$—	$—	$963
FG VIEs' liabilities with recourse, at fair value	1,277	—	—	1,277
FG VIEs' liabilities without recourse, at fair value	142	—	—	142
Total liabilities carried at fair value	$2,382	$—	$—	$2,382

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

(2) Excludes restricted cash.

Table of Contents

Changes in Level 3 Fair Value Measurements

The table below presents a roll forward of the Company's Level 3 financial instruments carried at fair value on a recurring basis during Third Quarter 2015 and 2014, and Nine Months 2015 and 2014.

Fair Value Level 3 Rollforward
Recurring Basis
Third Quarter 2015

	Fixed-Maturity Securities	Short-Term Investments	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)							
Fair value as of June 30, 2015	$655	$—	$78	$1,596	$60	$(926)	$(1,361)	$(171)
Total pretax realized and unrealized gains/(losses) recorded in: (1)								
Net income (loss)	(3)(2)	8(2)	4(2)	(11)(3)	(15)(4)	86(6)	6(3)	0(3)
Other comprehensive income (loss)	(10)	(4)	(4)	—	—	—	—	—
Purchases	250	52(7)	—	—	—	—	—	—
Settlements	(9)	(6)	(30)	(44)	—	(7)	40	4
FG VIE consolidations	—	—	—	—	—	—	—	—
FG VIE deconsolidations	—	—	—	—	—	—	—	—
Fair value as of September 30, 2015	$883	$50	$48	$1,541	$45	$(847)	$(1,315)	$(167)
Change in unrealized gains/(losses) related to financial instruments held as of September 30, 2015	$(10)	$(4)	$0	$3	$(15)	$(19)	$7	$(1)

Table of Contents

Fair Value Level 3 Rollforward
Recurring Basis
Third Quarter 2014

	Fixed-Maturity Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)						
Fair value as of June 30, 2014	$748	$49	$1,284	$31	$(1,837)	$(1,366)	$(124)
Total pretax realized and unrealized gains/(losses) recorded in: (1)							
Net income (loss)	(4)(2)	—(2)	43(3)	4(4)	255(6)	7(3)	(13)(3)
Other comprehensive income (loss)	25	2	—	—	—	—	—
Purchases	159	25	—	—	—	—	—
Settlements	(15)	0	(31)	—	14	33	4
FG VIE consolidations	—	—	—	—	—	—	—
FG VIE deconsolidations	—	—	—	—	—	—	—
Fair value as of September 30, 2014	$913	$76	$1,296	$35	$(1,568)	$(1,326)	$(133)
Change in unrealized gains/(losses) related to financial instruments held as of September 30, 2014	$25	$2	$55	$4	$98	$6	$(5)

Table of Contents

Fair Value Level 3 Rollforward
Recurring Basis
Nine Months 2015

	Fixed-Maturity Securities	Short-Term Investments	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)							
Fair value as of December 31, 2014	$770	$ —	$78	$1,398	$35	$(895)	$(1,277)	$(142)
Radian Asset Acquisition	4	—	2	122	—	(215)	(114)	(4)
Total pretax realized and unrealized gains/(losses) recorded in: (1)								
Net income (loss)	17 (2)	8 (2)	8 (2)	31 (3)	10 (4)	300 (6)	94 (3)	(30) (3)
Other comprehensive income (loss)	(9)	(4)	(6)	—	—	—	—	—
Purchases	260	52 (7)	—	—	—	—	—	—
Settlements	(158) (7)	(6)	(34)	(114)	—	(37)	113	9
FG VIE consolidations	(1)	—	—	104	—	—	(131)	—
FG VIE deconsolidations	—	—	—	—	—	—	—	—
Fair value as of September 30, 2015	$883	$ 50	$48	$1,541	$45	$(847)	$(1,315)	$(167)
Change in unrealized gains/(losses) related to financial instruments held as of September 30, 2015	$(4)	$ (4)	$(2)	$68	$10	$166	$(5)	$(19)

Table of Contents

Fair Value Level 3 Rollforward
Recurring Basis
Nine Months 2014

	Fixed-Maturity Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)						
Fair value as of December 31, 2013	$730	$2	$2,565	$46	$(1,693)	$(1,790)	$(1,081)
Total pretax realized and unrealized gains/(losses) recorded in: (1)							
Net income (loss)	14 (2)	—	160 (3)	(11) (4)	147 (6)	(90) (3)	(49) (3)
Other comprehensive income (loss)	27	4	—	—	—	—	—
Purchases	212	70 (7)	—	—	—	—	—
Settlements	(83)	0	(346)	—	(22)	332	16
FG VIE consolidations	—	—	46	—	—	(25)	(21)
FG VIE deconsolidations	13	—	(1,129)	—	—	247	1,002
Fair value as of September 30, 2014	$913	$76	$1,296	$35	$(1,568)	$(1,326)	$(133)
Change in unrealized gains/(losses) related to financial instruments held as of September 30, 2014	$25	$4	$120	$(11)	$(47)	$(46)	$(10)

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

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

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

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

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

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

(7) Includes a non-cash transaction.

70

Table of Contents

Level 3 Fair Value Disclosures

Quantitative Information About Level 3 Fair Value Inputs
At September 30, 2015

Financial Instrument Description (1)	Fair Value at September 30, 2015 (in millions)	Significant Unobservable Inputs	Range	Weighted Average as a Percentage of Current Par Outstanding
Assets:				
Fixed-maturity securities (2):				
Corporate securities	$79	Yield	20.6%	
RMBS	361	CPR	0.3% - 8.2%	2.6%
		CDR	2.6% - 11.9%	5.9%
		Loss severity	60.0% - 100.0%	75.6%
		Yield	4.3% - 7.8%	5.7%
Asset-backed securities:				
Investor owned utility	99	Cash flow receipts	100.0%	
		Collateral recovery period	3.3 years	
		Discount factor	7.0%	
Triple-X life insurance transactions	336	Yield	3.0% - 7.0%	4.5%
Short-term investments	50	Yield	15.0%	
Other invested assets (3)	45	Net asset value (per share)	$906 - $1,113	$998
FG VIEs' assets, at fair value	1,541	CPR	0.3% - 12.0%	3.6%
		CDR	1.0% - 22.0%	4.8%
		Loss severity	40.0% - 100.0%	81.7%
		Yield	1.5% - 17.3%	6.3%
Other assets	45	Quotes from third party pricing	$48 - $53	$51
		Term (years)	5 years	

Table of Contents

Financial Instrument Description (1)	Fair Value at September 30, 2015 (in millions)	Significant Unobservable Inputs	Range		Weighted Average as a Percentage of Current Par Outstanding
Liabilities:					
Credit derivative liabilities, net	(847)	Year 1 loss estimates	0.0	% - 100.0%	4.0%
		Hedge cost (in bps)	26.0	- 252.8	64.0
		Bank profit (in bps)	3.8	- 1,170.4	148.9
		Internal floor (in bps)	7.0	- 100.0	25.6
		Internal credit rating	AAA	- CCC	AA
FG VIEs' liabilities, at fair value	(1,482)	CPR	0.3	% - 12.0%	3.6%
		CDR	1.0	% - 22.0%	4.8%
		Loss severity	40.0	% - 100.0%	81.7%
		Yield	1.5	% - 17.3%	5.4%

(1) Discounted cash flow is used as valuation technique for all financial instruments.

(2) Excludes obligations of state and political subdivisions investments with fair value of $8 million.

(3) Excludes several investments with fair value of $8 million.

Table of Contents

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

Financial Instrument Description (1)	Fair Value at December 31, 2014 (in millions)	Significant Unobservable Inputs	Range		Weighted Average as a Percentage of Current Par Outstanding
Assets:					
Fixed-maturity securities:					
Obligations of state and political subdivisions	$38	Rate of inflation	1.0	% - 3.0%	2.0%
		Cash flow receipts	0.5	% - 74.3%	63.0%
		Discount rates	4.6	% - 8.0%	7.3%
		Collateral recovery period	1 month	- 34 years	28 years
Corporate securities	79	Yield	17.8%		
RMBS	425	CPR	0.3	% - 8.1%	3.3%
		CDR	2.7	% - 10.6%	5.3%
		Loss severity	52.6	% - 100.0%	75.2%
		Yield	4.7	% - 11.7%	6.4%
Asset-backed securities:					
Investor owned utility	95	Cash flow receipts	100%		
		Collateral recovery period	4 years		
		Discount factor	7.0%		
Triple-X life insurance transactions	133	Yield	7.3%		
Other invested assets	83	Discount for lack of liquidity	20.0%		
		Recovery on delinquent loans	40.0%		
		Default rates	0.0	% - 7.0%	5.8%
		Loss severity	40.0	% - 75.0%	68.3%
		Prepayment speeds	5.0	% - 15.0%	12.3%
		Net asset value (per share)	$965	- $1,159	$1,082
FG VIEs' assets, at fair value	1,398	CPR	0.3	% - 11.0%	3.3%
		CDR	1.6	% - 11.8%	5.1%
		Loss severity	40.0	% - 100.0%	82.2%
		Yield	2.7	% - 17.7%	7.9%

Table of Contents

Financial Instrument Description (1)	Fair Value at December 31, 2014 (in millions)	Significant Unobservable Inputs	Range		Weighted Average as a Percentage of Current Par Outstanding
Other assets	35	Quotes from third party pricing	$52	- $61	$57
		Term (years)	5 years		
Liabilities:					
Credit derivative liabilities, net	(895)	Year 1 loss estimates	0.0%	- 93.0%	2.1%
		Hedge cost (in bps)	20.0	- 243.8	61.5
		Bank profit (in bps)	1.0	- 994.4	127.0
		Internal floor (in bps)	7.0	- 100.0	15.9
		Internal credit rating	AAA	- CCC	AA+
FG VIEs' liabilities, at fair value	(1,419)	CPR	0.3%	- 11.0%	3.3%
		CDR	1.6%	- 11.8%	5.1%
		Loss severity	40.0%	- 100.0%	82.2%
		Yield	2.7%	- 17.7%	5.8%

(1) Discounted cash flow is used as valuation technique for all financial instruments.

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

Fair Value of Financial Instruments

	As of September 30, 2015		As of December 31, 2014	
	Carrying Amount (in millions)	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Fixed-maturity securities	$10,640	$10,640	$10,491	$10,491
Short-term investments	522	522	767	767
Other invested assets	153	155	108	110
Credit derivative assets	71	71	68	68
FG VIEs' assets, at fair value	1,541	1,541	1,398	1,398
Other assets	194	194	184	184
Liabilities:				
Financial guaranty insurance contracts(1)	4,019	8,807	3,823	6,205
Long-term debt	1,306	1,513	1,303	1,603
Credit derivative liabilities	918	918	963	963
FG VIEs' liabilities with recourse, at fair value	1,315	1,315	1,277	1,277
FG VIEs' liabilities without recourse, at fair value	167	167	142	142
Other liabilities	65	65	27	27

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

Table of Contents

9. Financial Guaranty Contracts Accounted for as Credit Derivatives

Credit Derivatives

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

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

Table of Contents

Credit Derivative Net Par Outstanding by Sector

The estimated remaining weighted average life of credit derivatives was 5.3 years at September 30, 2015 and 4.7 years at December 31, 2014. The components of the Company's credit derivative net par outstanding are presented below.

Credit Derivatives
Subordination and Ratings

Asset Type	As of September 30, 2015			As of December 31, 2014			
	Net Par Outstanding	Original Subordination(a)	Current Subordination(a)	Weighted Average Credit Rating	Net Par Outstanding	Original Subordination(a)	Current Subordination(a)	Weighted Average Credit Rating
	(dollars in millions)							
Pooled corporate obligations:								
Collateralized loan obligation/collateral bond obligations	$7,299	31.1 %	39.6 %	AAA	$11,688	32.0 %	36.9 %	AAA
Synthetic investment grade pooled corporate	7,119	21.7	19.4	AAA	7,640	22.6	20.6	AAA
TruPS CDOs	3,604	45.7	41.6	BBB+	3,119	45.3	35.8	BBB-
Market value CDOs of corporate obligations	1,113	17.0	10.5	AAA	1,174	19.1	20.7	AAA
Total pooled corporate obligations	19,135	29.5	30.8	AAA	23,621	30.1	30.7	AAA
U.S. RMBS:								
Option ARM and Alt-A first lien	1,186	15.7	10.5	AAA	1,378	16.3	10.7	BB+
Subprime first lien	1,215	27.2	41.8	AA	1,366	31.1	50.5	A
Prime first lien	183	10.9	0.0	BB	223	10.9	0.0	B
Closed-end second lien	17	—	—	CCC	19	—	—	CCC
Total U.S. RMBS	2,601	22.6	29.6	AA	2,986	24.8	33.9	BBB
CMBS	1,127	28.4	35.8	AAA	1,952	35.3	43.6	AAA
Other	6,770	—	—	A	6,437	—	—	A
Total(2)	$29,633			AA	$34,996			AA+

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

(2) The September 30, 2015 total amount includes $4.3 billion net par outstanding of credit derivatives acquired from Radian Asset.

Except for TruPS CDOs, the Company's exposure to pooled corporate obligations is highly diversified in terms of obligors and industries. Most pooled corporate transactions are structured to limit exposure to any given obligor and industry. The majority of the Company's pooled corporate exposure consists of CLO or synthetic pooled corporate obligations. Most of these CLOs have an average obligor size of less than 1% of the total transaction and typically restrict the maximum exposure to any one industry to approximately 10%. The Company's exposure also benefits from embedded credit enhancement in the transactions which allows a transaction to sustain a certain level of losses in the

underlying collateral, further insulating the Company from industry specific concentrations of credit risk on these deals.

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

Table of Contents

The Company's exposure to "Other" CDS contracts is also highly diversified. It includes $1.9 billion of exposure to one pooled infrastructure transaction comprising diversified pools of international infrastructure project transactions and loans to regulated utilities. These pools were all structured with underlying credit enhancement sufficient for the Company to attach at AAA levels at origination. The remaining $4.9 billion of exposure in "Other" CDS contracts comprises numerous deals across various asset classes, such as commercial receivables, international RMBS, infrastructure, regulated utilities and consumer receivables.

Distribution of Credit Derivative Net Par Outstanding by Internal Rating

Ratings	As of September 30, 2015 Net Par Outstanding	% of Total	As of December 31, 2014 Net Par Outstanding	% of Total
	(dollars in millions)			
AAA	$17,080	57.7 %	$21,817	62.3 %
AA	5,785	19.5	5,398	15.4
A	2,065	7.0	1,982	5.7
BBB	2,674	9.0	2,774	8.0
BIG(1)	2,029	6.8	3,025	8.6
Credit derivative net par outstanding	$29,633	100.0 %	$34,996	100.0 %

(1) The September 30, 2015 BIG amount includes $489 million net par outstanding of credit derivatives acquired from Radian Asset.

Fair Value of Credit Derivatives

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

	Third Quarter		Nine Months	
	2015	2014	2015	2014
	(in millions)			
Realized gains on credit derivatives (1)	$14	$17	$52	$58
Net credit derivative losses (paid and payable) recovered and recoverable and other settlements	(8)	(31)	(17)	(38)
Realized gains (losses) and other settlements on credit derivatives	6	(14)	35	20
Net change in unrealized gains (losses) on credit derivatives:				
Pooled corporate obligations	(24)	4	0	10
U.S. RMBS	11	252	148	117
CMBS	(3)	0	1	2
Other	96	13	116	(2)
Net change in unrealized gains (losses) on credit derivatives	80	269	265	127
Net change in fair value of credit derivatives (2)	$86	$255	$300	$147

(1) Includes realized gain due to terminations of CDS contracts. CDS terminations in Nine Months 2015 also included a payment received from the resolution of a dispute related to a termination of CDS in 2008.

(2)

On October 9, 2015, the Company reached a settlement agreement with a CDS counterparty to terminate five Alt-A first lien CDS transactions. This termination agreement will generate a net fair value gain of approximately $293 million in the Company’s fourth quarter 2015 financial statements. In addition, on October 13, 2015, the Company terminated a CMBS transaction with a CDS counterparty and this termination agreement will generate a net fair value gain of approximately $34 million in the Company's fourth quarter 2015 financial statements.

Table of Contents

Net Par and Realized Gain
from Terminations of CDS Contracts

	Third Quarter		Nine Months	
	2015	2014	2015	2014
	(in millions)			
Net par of terminated CDS contracts	$405	$1,631	$969	$2,931
Realized gain due to termination of CDS contracts	0.3	(0.1)	12.9	0.6

During Third Quarter 2015, unrealized fair value gains were driven primarily by the termination of a Triple-X life-securitization transaction in the Other sector. These unrealized gains were partially offset by wider implied net spreads in the Company's pooled corporate CLO sector. The wider implied net spreads were primarily a result of the decreased cost to buy protection in AGC's and AGM's name, particularly for the one year and five year CDS spreads, as the market cost of AGC's and AGM's credit protection decreased during the period. These transactions were pricing at or above their floor levels (or the minimum rate at which the Company would consider assuming these risks based on historical experience); therefore when the cost of purchasing CDS protection on AGC and AGM, which management refers to as the CDS spread on AGC and AGM, decreased the implied spreads that the Company would expect to receive on these transactions increased.

During Nine Months 2015, unrealized fair value gains were generated primarily in the U.S. RMBS prime first lien and Option ARM and subprime sectors, due to tighter implied net spreads. The tighter implied net spreads were primarily a result of the increased cost to buy protection in AGC's and AGM's name, particularly for the one year CDS spread, as the market cost of AGC's and AGM's credit protection increased during the period. These transactions were pricing at or above their floor levels, therefore when the cost of purchasing CDS protection on AGC and AGM increased, the implied spreads that the Company would expect to receive on these transactions decreased. The unrealized fair value gains in the other sector were a result of the termination of a Triple-X life-securitization transaction, referenced above. In addition, during Nine Months 2015 there was a refinement in methodology to address an instance in a U.S. RMBS transaction where the Company now expects recoveries. This refinement resulted in approximately $49 million in fair value gains in Nine Months 2015.

During Third Quarter 2014, unrealized fair value gains were generated primarily in the U.S. RMBS prime first lien and Option ARM and subprime sectors. This is due primarily to a significant unrealized fair value gain in the Option ARM sector as a result of the termination of a resecuritization transaction during the period. In addition, there were unrealized fair value gains due to tighter implied net spreads. The tighter implied net spreads were primarily a result of the increased cost to buy protection in AGC's name, as the market cost of AGC's credit protection increased during the period, with the change in the one year CDS spread having the largest impact. These transactions were pricing at or above their floor levels; therefore when the cost of purchasing CDS protection on AGC, which management refers to as the CDS spread on AGC, increased, the implied spreads that the Company would expect to receive on these transactions decreased. The cost of AGM's credit protection did not change significantly during Third Quarter 2014, and did not lead to significant changes in the fair value of the Company's CDS policies.

During Nine Months 2014, unrealized fair value gains were generated primarily in the U.S. RMBS Option ARM sector due to the termination of a resecuritization transaction. The unrealized fair value gains were partially offset by unrealized fair value losses resulting from wider implied net spreads in the prime first lien and Option ARM sectors. The wider implied net spreads were primarily a result of the decreased cost to buy protection in AGC's name as the market cost of AGC's credit protection decreased significantly during the period. These transactions were pricing above their floor levels; therefore when the cost of purchasing CDS protection on AGC decreased, the implied spreads that the Company would expect to receive on these transactions increased. The cost of AGM's credit protection also decreased during Nine Months 2014, but did not lead to significant fair value losses, as the majority of AGM policies

continue to price at floor levels.

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

Table of Contents

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

	As of September 30, 2015	As of June 30, 2015	As of December 31, 2014	As of September 30, 2014	As of June 30, 2014	As of December 31, 2013
AGC	331	390	323	345	327	460
AGM	337	410	325	344	346	525

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

	As of September 30, 2015	As of June 30, 2015	As of December 31, 2014	As of September 30, 2014	As of June 30, 2014	As of December 31, 2013
AGC	112	120	80	125	85	185
AGM	104	125	85	120	115	220

Fair Value of Credit Derivatives Assets (Liabilities)
and Effect of AGC and AGM
Credit Spreads

	As of September 30, 2015	As of December 31, 2014
	(in millions)	
Fair value of credit derivatives before effect of AGC and AGM credit spreads	$(1,973)	$(2,029)
Plus: Effect of AGC and AGM credit spreads	1,126	1,134
Net fair value of credit derivatives (1)	$(847)	$(895)

(1) September 30, 2015 amount includes $174 million of net fair value loss of credit derivatives acquired from Radian Asset.

The fair value of CDS contracts at September 30, 2015, before considering the implications of AGC's and AGM's credit spreads, is a direct result of continued wide credit spreads in the fixed income security markets and ratings downgrades. The asset classes that remain most affected are 2005-2007 vintages of prime first lien, Alt-A, Option ARM, subprime RMBS deals as well as TruPS and pooled corporate securities. Comparing September 30, 2015 with December 31, 2014, there was a narrowing of spreads primarily related to the Company's pooled corporate obligations which resulted in a mark to market benefit. This benefit was partially offset by the Company's acquisition of Radian Asset Assurance's CDS portfolio which increased the Company's mark to market liability. This narrowing of spreads combined with the acquisition of Radian Asset, resulted in a gain of approximately $56 million, before taking into account AGC's or AGM's credit spreads.

Management believes that the trading level of AGC's and AGM's credit spreads over the past several years has been due to the correlation between AGC's and AGM's risk profile and the current risk profile of the broader financial

markets and to increased demand for credit protection against AGC and AGM as the result of its financial guaranty volume, as well as the overall lack of liquidity in the CDS market. Offsetting the benefit attributable to AGC's and AGM's credit spread were higher credit spreads in the fixed income security markets. The higher credit spreads in the fixed income security market are due to the lack of liquidity in the high yield CDO, TruPS CDO, and CLO markets as well as continuing market concerns over the 2005-2007 vintages of RMBS.

Table of Contents

The following table presents the fair value and the present value of expected claim payments or recoveries (i.e. net expected loss to be paid as described in Note 6) for contracts accounted for as derivatives.

Net Fair Value and Expected Losses
of Credit Derivatives by Sector

	Fair Value of Credit Derivative Asset (Liability), net		Expected Loss to be (Paid) Recovered (1)	
Asset Type	As of September 30, 2015	As of December 31, 2014	As of September 30, 2015	As of December 31, 2014
	(in millions)			
Pooled corporate obligations	$(231)	$(49)	$(67)	$(23)
U.S. RMBS	(346)	(494)	19	(73)
CMBS	(40)	0	(7)	—
Other	(230)	(352)	28	38
Total	$(847)	$(895)	$(27)	$(58)

(1) Includes R&W benefit of $82 million as of September 30, 2015 and $86 million as of December 31, 2014.

Ratings Sensitivities of Credit Derivative Contracts

Within the Company's insured CDS portfolio, the transaction documentation for approximately $4.9 billion in CDS gross par insured as of September 30, 2015 requires AGC to post eligible collateral to secure its obligations to make payments under such contracts. Eligible collateral is generally cash or U.S. government or agency securities; eligible collateral other than cash is valued at a discount to the face amount.

- For approximately $4.7 billion of such contracts, AGC has negotiated caps such that the posting requirement cannot exceed a certain fixed amount, regardless of the mark-to-market valuation of the exposure or the financial strength ratings of AGC. For such contracts, AGC need not post on a cash basis more than $575 million, although the value of the collateral posted may exceed such fixed amount depending on the advance rate agreed with the counterparty for the particular type of collateral posted.

- For the remaining approximately $235 million of such contracts, AGC could be required from time to time to post additional collateral without such cap based on movements in the mark-to-market valuation of the underlying exposure.

As of September 30, 2015, the Company posted approximately $333 million to secure obligations under its CDS exposure, of which approximately $20 million related to such $235 million of notional. As of December 31, 2014, the Company posted approximately $376 million, of which approximately $25 million related to $242 million of notional where AGC or AGRO could be required to post additional collateral based on movements in the mark-to-market valuation of the underlying exposure.

Table of Contents

Sensitivity to Changes in Credit Spread

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

Effect of Changes in Credit Spread
As of September 30, 2015

Credit Spreads(1)	Estimated Net Fair Value (Pre-Tax) (in millions)	Estimated Change in Gain/(Loss) (Pre-Tax)
100% widening in spreads	$(1,723)	$(876)
50% widening in spreads	(1,285)	(438)
25% widening in spreads	(1,067)	(220)
10% widening in spreads	(935)	(88)
Base Scenario	(847)	—
10% narrowing in spreads	(765)	82
25% narrowing in spreads	(643)	204
50% narrowing in spreads	(441)	406

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

10. Consolidated Variable Interest Entities

Consolidated FG VIEs

The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. Assured Guaranty does not act as the servicer or collateral manager for any VIE obligations insured by its companies. The transaction structure generally provides certain financial protections to the Company. This financial protection can take several forms, the most common of which are overcollateralization, first loss protection (or subordination) and excess spread. In the case of overcollateralization (i.e., the principal amount of the securitized assets exceeds the principal amount of the structured finance obligations guaranteed by the Company), the structure allows defaults of the securitized assets before a default is experienced on the structured finance obligation guaranteed by the Company. In the case of first loss, the financial guaranty insurance policy only covers a senior layer of losses experienced by multiple obligations issued by special purpose entities, including VIEs. The first loss exposure with respect to the assets is either retained by the seller or sold off in the form of equity or mezzanine debt to other investors. In the case of excess spread, the financial assets contributed to special purpose entities, including VIEs, generate cash flows that are in excess of the interest payments on the debt issued by the special purpose entity. Such excess spread is typically distributed through the transaction's cash flow waterfall and may be used to create additional credit enhancement, applied to redeem debt issued by the special purpose entities, including VIEs (thereby, creating additional overcollateralization), or distributed to equity or other investors in the transaction.

Assured Guaranty is not primarily liable for the debt obligations issued by the VIEs it insures and would only be required to make payments on those insured debt obligations in the event that the issuer of such debt obligations defaults on any principal or interest due and only for the amount of the shortfall. AGL's and its Subsidiaries' creditors do not have any rights with regard to the collateral supporting the debt issued by the FG VIEs. Proceeds from sales,

maturities, prepayments and interest from such underlying collateral may only be used to pay Debt Service on VIE liabilities. Net fair value gains and losses on FG VIEs are expected to reverse to zero at maturity of the VIE debt, except for net premiums received and net claims paid by Assured Guaranty under the financial guaranty insurance contract. The Company’s estimate of expected loss to be paid for FG VIEs is included in Note 6, Expected Loss to be Paid.

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

Table of Contents

performance of VIEs that have debt obligations insured by the Company and, accordingly, where the Company is obligated to absorb VIE losses or receive benefits that could potentially be significant to the VIE. The Company obtains protective rights under its insurance contracts that give the Company additional controls over a VIE if there is either deterioration of deal performance or in the financial health of the deal servicer. The Company is deemed to be the control party for certain VIEs under GAAP, typically when its protective rights give it the power to both terminate and replace the deal servicer, which are characteristics specific to the Company's financial guaranty contracts. If the protective rights that could make the Company the control party have not been triggered, then the VIE is not consolidated. If the Company is deemed no longer to have those protective rights, the transaction is deconsolidated.

Number of FG VIEs Consolidated

	Nine Months	
	2015	2014
Beginning of the period, December 31	32	40
Radian Asset Acquisition	4	—
Consolidated (1)	1	1
Deconsolidated (1)	—	(8)
Matured	—	(2)
End of the period, September 30	37	31

(1) Net loss on consolidation was $26 million in Nine Months 2015, and net gain on deconsolidation was $120 million in Nine Months 2014, and recorded in “fair value gains (losses) on FG VIEs” in the consolidated statement of operations.

The total unpaid principal balance for the FG VIEs’ assets that were over 90 days or more past due was approximately $198 million at September 30, 2015 and $183 million at December 31, 2014. The aggregate unpaid principal of the FG VIEs’ assets was approximately $923 million greater than the aggregate fair value at September 30, 2015, excluding the effect of R&W settlements and restricted cash. The aggregate unpaid principal of the FG VIEs’ assets was approximately $941 million greater than the aggregate fair value at December 31, 2014, excluding the effect of R&W settlements and restricted cash.

The change in the instrument-specific credit risk of the FG VIEs’ assets held as of September 30, 2015 that was recorded in the consolidated statements of operations for Third Quarter 2015 and Nine Months 2015 were gains of $56 million and $25 million, respectively. The change in the instrument-specific credit risk of the FG VIEs’ assets held as of September 30, 2014 that was recorded in the consolidated statements of operations for Third Quarter 2014 and Nine Months 2014 were gains of $86 million and $140 million, respectively. To calculate the instrument specific credit risk, the changes in the fair value of the FG VIE assets are allocated between those changes that are due to the instrument specific credit risk and those are due to other factors, including interest rates. The instrument specific credit risk amount is determined by using expected contractual cash flows versus current expected cash flows discounted at original contractual rate. The net present value is calculated by discounting the expected cash flows of the underlying security, excluding the Company’s financial guaranty insurance, at the relevant effective interest rate.

The unpaid principal for FG VIE liabilities with recourse was $2,045 million and $1,912 million as of September 30, 2015 and December 31, 2014, respectively. FG VIE liabilities with recourse will mature at various dates ranging from 2025 to 2046. The aggregate unpaid principal balance of the FG VIE liabilities with and without recourse was approximately $981 million greater than the aggregate fair value of the FG VIEs’ liabilities as of September 30, 2015. The aggregate unpaid principal balance was approximately $916 million greater than the aggregate fair value of the FG VIEs' liabilities as of December 31, 2014.

82

Table of Contents

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

Consolidated FG VIEs
By Type of Collateral

	As of September 30, 2015 (1)		As of December 31, 2014	
	Assets	Liabilities	Assets	Liabilities
	(in millions)			
With recourse:				
U.S. RMBS first lien	$713	$572	$632	$581
U.S. RMBS second lien	208	295	238	327
Other	448	448	369	369
Total with recourse	1,369	1,315	1,239	1,277
Without recourse	178	167	163	142
Total	$1,547	$1,482	$1,402	$1,419

(1) The September 30, 2015 amounts include $115 million of FG VIE assets and $111 million of FG VIE liabilities acquired from Radian Asset.

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

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

	Third Quarter		Nine Months	
	2015	2014	2015	2014
	(in millions)			
Net earned premiums	$(6)	$(5)	$(16)	$(27)
Net investment income	(3)	(2)	(9)	(8)
Net realized investment gains (losses)	6	0	9	(5)
Fair value gains (losses) on FG VIEs	2	50	0	232
Bargain purchase gain	—	—	2	—
Other income (loss)	0	0	0	(2)
Loss and LAE	11	14	18	21
Effect on income before tax	10	57	4	211
Less: tax provision (benefit)	4	20	1	74
Effect on net income (loss)	$6	$37	$3	$137
Effect on cash flows from operating activities	$11	$18	$44	$57

	As of September 30,	As of December 31,

	2015	2014
	(in millions)	
Effect on shareholders' equity (decrease) increase	$(38)	$(44)

Table of Contents

Fair value gains (losses) on FG VIEs represent the net change in fair value on the consolidated FG VIEs' assets and liabilities. During Third Quarter 2015, the Company recorded a pre-tax net fair value gain on consolidated FG VIEs of $2 million. The primary driver of the gain was mark-to-market gains due to price appreciation on the FG VIE assets during the quarter resulting from improvements in the underlying collateral. During Nine Months 2015, the Company recorded a pre-tax net fair value loss on consolidated FG VIEs of less than $1 million. The primary driver of the loss was a pre-tax loss of $26 million on the consolidation of one new FG VIE which was mostly offset by net mark-to-market gains due to price appreciation on the FG VIE assets resulting from improvements in the underlying collateral.

During Third Quarter 2014, the Company recorded a pre-tax net fair value gain on consolidated FG VIEs of $50 million. This gain was primarily driven by price appreciation on the Company's FG VIE assets relating to HELOC transactions and principal payments. During Nine Months 2014 the Company recorded a pre-tax net fair value gain of consolidated FG VIEs of $232 million. The primary driver of this gain, $120 million, was a result of the deconsolidation of seven VIEs in first quarter 2014. There was an additional gain of $37 million resulting from the Company exercising its option to accelerate two second lien RMBS VIEs. These two VIEs were treated as maturities during the period.

Other Consolidated VIEs

In certain instances where the Company consolidates a VIE that was established as part of a loss mitigation negotiation settlement agreement that results in the termination of the original insured financial guaranty insurance or credit derivative contract the Company classifies the assets and liabilities of those VIEs in the line items that most accurately reflect the nature of the items, as opposed to within the FG VIE assets and FG VIE liabilities.

Non-Consolidated VIEs

As of September 30, 2015 and December 31, 2014, the Company had financial guaranty contracts outstanding for approximately 840 and 930 VIEs, respectively, that it did not consolidate. To date, the Company's analyses have indicated that it does not have a controlling financial interest in any other VIEs and, as a result, they are not consolidated in the consolidated financial statements. The Company's exposure provided through its financial guaranties with respect to debt obligations of special purpose entities is included within net par outstanding in Note 4, Outstanding Exposure.

11. Investments and Cash

Net Investment Income and Realized Gains (Losses)

Net investment income is a function of the yield that the Company earns on invested assets and the size of the portfolio. The investment yield is a function of market interest rates at the time of investment as well as the type, credit quality and maturity of the invested assets. Accrued investment income was $103 million and $98 million as of September 30, 2015 and December 31, 2014, respectively.

Net Investment Income

Third Quarter		Nine Months	
2015	2014	2015	2014
(in millions)			
$85	$83	$252	$244

Income from fixed-maturity securities managed by third parties				
Income from internally managed securities:				
Fixed maturities	15	15	44	52
Other	14	6	21	11
Gross investment income	114	104	317	307
Investment expenses	(2)	(2)	(6)	(6)
Net investment income	$112	$102	$311	$301

Table of Contents

Net Realized Investment Gains (Losses)

	Third Quarter		Nine Months	
	2015	2014	2015	2014
	(in millions)			
Gross realized gains on available-for-sale securities	$3	$3	$35	$10
Gross realized gains on other assets in investment portfolio	0	1	3	8
Gross realized losses on available-for-sale securities	(3)	(1)	(10)	(4)
Gross realized losses on other assets in investment portfolio	(9)	(1)	(11)	(1)
Other-than-temporary impairment	(18)	(21)	(37)	(38)
Net realized investment gains (losses)	$(27)	$(19)	$(20)	$(25)

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

Roll Forward of Credit Losses
in the Investment Portfolio

	Third Quarter		Nine Months	
	2015	2014	2015	2014
	(in millions)			
Balance, beginning of period	$104	$84	$124	$80
Additions for credit losses on securities for which an other-than-temporary-impairment was not previously recognized	2	3	2	29
Reductions for securities sold and other settlement during the period	—	—	(28)	(12)
Additions for credit losses on securities for which an other-than-temporary-impairment was previously recognized	0	17	8	7
Balance, end of period	$106	$104	$106	$104

Table of Contents

Investment Portfolio

Fixed-Maturity Securities and Short-Term Investments
by Security Type
As of September 30, 2015

Investment Category	Percent of Total(1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI(2) Gain (Loss) on Securities with Other-Than-Temporary Impairment	Weighted Average Credit Rating(3)
		(dollars in millions)					
Fixed-maturity securities:							
Obligations of state and political subdivisions	53 %	$5,668	$308	$(18)	$5,958	$ 3	AA
U.S. government and agencies	4	449	28	0	477	0	AA+
Corporate securities	13	1,403	45	(12)	1,436	(3)	A
Mortgage-backed securities(4):	0						
RMBS	13	1,349	38	(16)	1,371	(2)	A
CMBS	4	492	19	0	511	—	AAA
Asset-backed securities	5	584	6	0	590	4	BB-
Foreign government securities	3	297	6	(6)	297	—	AA+
Total fixed-maturity securities	95	10,242	450	(52)	10,640	2	AA-
Short-term investments	5	526	0	(4)	522	—	AA
Total investment portfolio	100 %	$10,768	$450	$(56)	$11,162	$ 2	AA-

Table of Contents

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

Investment Category	Percent of Total(1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI Gain (Loss) on Securities with Other-Than-Temporary Impairment	Weighted Average Credit Rating(3)
		(dollars in millions)					
Fixed-maturity securities:							
Obligations of state and political subdivisions	50 %	$5,416	$380	$(1)	$5,795	$ 7	AA
U.S. government and agencies	6	635	31	(1)	665	—	AA+
Corporate securities	12	1,320	53	(5)	1,368	(2)	A
Mortgage-backed securities(4):							
RMBS	12	1,255	51	(21)	1,285	0	A-
CMBS	6	639	20	0	659	—	AAA
Asset-backed securities	4	411	9	(3)	417	3	BBB-
Foreign government securities	3	296	8	(2)	302	—	AA+
Total fixed-maturity securities	93	9,972	552	(33)	10,491	8	AA-
Short-term investments	7	767	0	0	767	0	AA+
Total investment portfolio	100 %	$10,739	$552	$(33)	$11,258	$ 8	AA-

(1) Based on amortized cost.

(2) Accumulated OCI. See also Note 18, Shareholders' Equity.

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

(4) Government-agency obligations were approximately 55% of mortgage backed securities as of September 30, 2015 and 44% as of December 31, 2014 based on fair value.

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

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

87

Table of Contents

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

Fixed-Maturity Securities
Gross Unrealized Loss by Length of Time
As of September 30, 2015

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(dollars in millions)					
Obligations of state and political subdivisions	$587	$(18)	$4	$0	$591	$(18)
U.S. government and agencies	31	0	—	—	31	0
Corporate securities	373	(8)	99	(4)	472	(12)
Mortgage-backed securities:						
RMBS	315	(2)	91	(14)	406	(16)
CMBS	24	0	2	0	26	0
Asset-backed securities	2	0	—	—	2	0
Foreign government securities	97	(3)	54	(3)	151	(6)
Total	$1,429	$(31)	$250	$(21)	$1,679	$(52)
Number of securities (1)		342		37		372
Number of securities with other-than-temporary impairment		5		4		9

Table of Contents

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

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(dollars in millions)					
Obligations of state and political subdivisions						