

ASSURED GUARANTY LTD
Form 10-Q
May 11, 2009
Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2009

OR

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

transition Period from to

Commission File No. 001-32141

ASSURED GUARANTY LTD.

(Exact name of registrant as specified in its charter)

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Bermuda
(State or other jurisdiction of incorporation)

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

30 Woodbourne Avenue

Hamilton HM 08

Bermuda

(address of principal executive office)

(441) 299-9375

(Registrants telephone number, including area code)

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

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

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

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

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

The number of registrant's Common Shares (\$0.01 par value) outstanding as of May 1, 2009 was 90,990,867.

Table of Contents

ASSURED GUARANTY LTD.

INDEX TO FORM 10-Q

Page

PART I. FINANCIAL INFORMATION

<u>Item 1.</u>	<u>Financial Statements:</u>	
	<u>Consolidated Balance Sheets (unaudited) as of March 31, 2009 and December 31, 2008</u>	3
	<u>Consolidated Statements of Operations and Comprehensive Income (unaudited) for the Three Months Ended March 31, 2009 and 2008</u>	4
	<u>Consolidated Statements of Shareholders' Equity (unaudited) for the Three Months Ended March 31, 2009</u>	5
	<u>Consolidated Statements of Cash Flows (unaudited) for the Three Months Ended March 31, 2009 and 2008</u>	6
	<u>Notes to Consolidated Financial Statements (unaudited)</u>	7
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	57
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	108
<u>Item 4.</u>	<u>Controls and Procedures</u>	110

PART II. OTHER INFORMATION

<u>Item 1.</u>	<u>Legal Proceedings</u>	111
<u>Item 1A.</u>	<u>Risk Factors</u>	112
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	112
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	112
<u>Item 5.</u>	<u>Other Information</u>	114
<u>Item 6.</u>	<u>Exhibits</u>	114

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

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

(Unaudited)

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

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

Table of Contents

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

(Unaudited)

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

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

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

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

Table of Contents

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

(Unaudited)

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

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

Table of Contents

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

(Unaudited)

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

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Cash and cash equivalents at end of period	\$	19,328	\$	8,378
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Supplementary cash flow information

Cash (received)/paid during the period for:

Income taxes	\$	(14,514)	\$	500
Interest	\$		\$	

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

Table of Contents

**Assured Guaranty Ltd.
Notes to Consolidated Financial Statements**

March 31, 2009

(Unaudited)

1. Business and Organization

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

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

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

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

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

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

Table of Contents

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

Acquisition of Financial Security Assurance Holdings Ltd.

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

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

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

The Company expects to finance the cash portion of the acquisition with the proceeds of a public equity offering. The Company has received a backstop commitment (the WLR Backstop Commitment) from the WLR Funds, a related party, to fund the cash portion of the purchase price with the purchase of newly issued common shares. The Company entered into the WLR Backstop Commitment on November 13, 2008 with the WLR Funds. The WLR Backstop Commitment amended the Investment Agreement between the Company and the WLR Funds and provided to the Company the option to cause the WLR Funds to purchase from Assured Guaranty Ltd. or Assured Guaranty US Holdings Inc. a number of the Company's common shares equal to the quotient of (i) the aggregate dollar amount not to exceed \$361 million specified by the Company

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divided by (ii) the volume weighted average price of the Company's common share on the NYSE for the 20 NYSE trading days ending with the last NYSE trading day immediately preceding the date of the closing under the stock purchase agreement, with a floor of \$6.00 and a cap of \$8.50.

Table of Contents

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

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

2. Significant Accounting Policies

Basis of Presentation

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

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

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

Table of Contents**Adoption of FAS 163**

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

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

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

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

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

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- Unearned premium reserves increased to reflect the recording of the net present value of future installment premiums discounted at a risk-free rate and the change in the premium earnings methodology to the effective yield method prescribed by FAS 163. Prepaid reinsurance premiums increased correspondingly for those amounts ceded to reinsurers.
- Reserves for losses and loss adjustment expenses decreased to reflect the release of the Company's portfolio reserves on fundamentally sound credits. This was partially offset by an increase in case reserves, which are now calculated based on probability weighted cash flows discounted at a risk free rate instead of based on a single case best estimate reserve discounted based on the after-tax investment yield of the Company's investment portfolio (6%). Reinsurance recoverable on ceded losses decreased correspondingly. Salvage recoverable increased to reflect the change in discount

Table of Contents

rates.

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

Premium Revenue Recognition

Premiums are received either upfront or in installments.

Upon Adoption of FAS 163

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

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

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Table of Contents

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

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

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

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

The premiums receivable expected to be collected are:

(dollar in thousands)

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

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

(dollar in thousands)

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

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

Table of Contents

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

(dollar in thousands)

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

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

Prior to Adoption of FAS 163

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

Deferred Acquisition Costs

Acquisition costs incurred, other than those associated with financial guarantees written in credit derivative form, that vary with and are directly related to the production of new business are deferred in proportion to written premium and amortized in relation to earned premiums. These costs include direct and indirect expenses such as ceding commissions, brokerage expenses and the cost of underwriting and marketing personnel. Management uses its judgment in determining what types of costs should be deferred, as well as what percentage of these costs

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should be deferred. The Company annually conducts a study to determine which operating costs vary with, and are directly related to, the acquisition of new business and qualify for deferral. Ceding commissions received on premiums the Company cedes to other reinsurers reduce acquisition costs. Anticipated losses, loss adjustment expenses and the remaining costs of servicing the insured or reinsured business are considered in determining the recoverability of acquisition costs. Acquisition costs associated with credit derivative products are expensed as incurred. When an insured issue is retired early, as discussed above in the Premium Revenue Recognition section, the remaining related deferred acquisition cost is expensed at that time. Ceding commissions, calculated at their contractually defined

Table of Contents

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

Reserves for Losses and Loss Adjustment Expenses

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

Financial Guaranty Contracts Upon Adoption of FAS 163

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

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

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

Financial Guaranty Contracts Prior to Adoption of FAS 163

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

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

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

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

Table of Contents

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

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

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

Mortgage Guaranty and Other Lines of Business

Mortgage guaranty and other lines of business are not in the scope of FAS 163. Reserves for losses and loss adjustment expenses in the Company's mortgage guaranty line of business include case reserves and portfolio reserves. Case reserves are established when there is significant credit deterioration on specific insured obligations and the obligations are in default or default is probable, not necessarily upon non-payment of principal or interest by an insured. Case reserves represent the present value of expected future loss payments and loss adjustment expenses (LAE), net of estimated recoveries, but before considering ceded reinsurance. This reserving method is different from case reserves established by traditional property and casualty insurance companies, which establish case reserves upon notification of a claim and establish incurred but not reported (IBNR) reserves for the difference between actuarially estimated ultimate losses and recorded case reserves.

The Company also records portfolio reserves for mortgage guaranty line of business in a manner consistent with its financial guaranty business prior to the adoption of FAS 163. While other mortgage guaranty insurance companies do not record portfolio reserves, rather just case and IBNR reserves, the Company records portfolio reserves because the Company writes business on an excess of loss basis, while other industry participants write quota share or first layer loss business. The Company manages and underwrites this business in the same manner as its financial guaranty insurance and reinsurance business because they have similar characteristics as insured obligations of mortgage backed securities.

The Company also records IBNR reserves for its other line of business. IBNR is an estimate of losses for which the insured event has occurred but the claim has not yet been reported to the Company. In establishing IBNR, the Company uses traditional actuarial methods to estimate the reporting lag of such claims based on historical experience, claim reviews and information reported by ceding companies. The Company records IBNR for trade credit reinsurance within its other segment, which is 100% reinsured. The other segment represents lines of business that the Company exited or sold as part of the Company's IPO.

Due to the inherent uncertainties of estimating loss and LAE reserves, actual experience may differ from the estimates reflected in the Company's consolidated financial statements, and the differences may be material.

Reinsurance

In the ordinary course of business, the Company's insurance subsidiaries assume and retrocede business with other insurance and reinsurance companies. These agreements provide greater diversification of business and may minimize the net potential loss from large risks. Retrocessional contracts do not relieve the Company of its

Table of Contents

obligation to the reinsured. Reinsurance recoverable on ceded losses includes balances due from reinsurance companies for paid and unpaid losses and LAE that will be recovered from reinsurers, based on contracts in force, and is presented net of any provision for estimated uncollectible reinsurance. Any change in the provision for uncollectible reinsurance is included in loss and loss adjustment expenses. Prepaid reinsurance premiums represent the portion of premiums ceded to reinsurers relating to the unexpired terms of the reinsurance contracts in force.

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

Salvage Recoverable

When the Company becomes entitled to the underlying collateral (generally a future stream of cash flows or pool assets) of an insured credit under salvage and subrogation rights as a result of a claim payment or estimates recoveries from disputed claim payments on contractual grounds, it reduces the corresponding loss reserve for a particular financial guaranty insurance policy for the estimated salvage and subrogation, in accordance with FAS No. 60, *Accounting and Reporting by Insurance Enterprises*. If the expected salvage and subrogation exceeds the estimated loss reserve for a policy, such amounts are recorded as a salvage recoverable asset in the Company's balance sheets.

3. Recent Accounting Pronouncements

In December 2007, the FASB issued FAS No. 141 (revised), *Business Combinations* (FAS 141R). FAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. FAS 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. FAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim statements within those fiscal years. Early adoption is not permitted. Since FAS 141R applies prospectively to business combinations whose acquisition date is subsequent to the statement's adoption. The Company is applying the provisions of FAS 141R to account for its pending acquisition of FSAH. As of March 31, 2009, the Company had paid \$4.6 million related to the Company's pending acquisition of FSAH that the Company expensed in the first quarter 2009 in operating expenses.

In October 2008, the FASB issued FASB Staff Position (FSP) No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP 157-3). FSP 157-3 clarified the application of FAS 157, *Fair Value Measurements* (FAS 157), in a market that is not active. FSP 157-3 was effective when issued. It did not have an impact on the Company's current results of operations or financial position.

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The FASB adopted FSP FAS 133-1 and FIN 45-4, Disclosures About Credit Derivatives and Certain Guarantees (FSAP 133-1) and FAS 161, Disclosures about Derivative Instruments and Hedging Activities (FAS 161) to address concerns that current derivative disclosure requirements did not adequately address the potential adverse effects that these instruments can have on the financial performance and operations of an entity. Companies will be required to provide enhanced disclosures about their derivative activities to enable users to better understand: (1) how and why a company uses derivatives, (2) how it accounts for derivatives and related hedged items, and (3) how derivatives affect its financial statements. These should include the terms of the derivatives, collateral posting requirements and triggers, and other significant provisions that could be detrimental to earnings or liquidity. Management believes that the Company's current derivatives disclosures are in compliance with the requirements of FSP 133-1 and FAS 161.

Table of Contents

In April 2009, the FASB issued FSP FAS No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP 157-4). FSP 157-4 amends FAS 157 to provide additional guidance on estimating fair value when the volume and level of activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability. FSP 157-4 also provides additional guidance on circumstances that may indicate that a transaction is not orderly. FSP 157-4 supersedes FSP 157-3. FSP 157-4 amends FAS 157 to require additional disclosures about fair value measurements in annual and interim reporting periods. FSP 157-4 is effective for interim and annual reporting periods ending after June 15, 2009. Early adoption is permitted, but only for periods ending after March 15, 2009. FSP 157-4 must be applied prospectively and does not require disclosures for earlier periods presented for comparative purposes at initial adoption. The Company will adopt FSP 157-4 in its Form 10-Q for the period ended June 30, 2009. The Company is currently evaluating the impact, if any, FSP 157-4 will have on its financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP 107-1). FSP 107-1 extends the disclosure requirements of FAS No. 107, *Disclosures about Fair Value of Financial Instruments*, to interim financial statements of publicly traded companies. FSP 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP 107-1 does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, FSP 107-1 requires comparative disclosures only for periods ending after initial adoption. The Company will adopt FSP 107-1 in its Form 10-Q for the period ended June 30, 2009. The Company is currently evaluating the impact, if any, FSP 107-1 will have on its financial statements disclosures.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP 115-2). FSP 115-2 provides new guidance on the recognition and presentation of an other than temporary impairment (OTTI) for debt securities classified as available-for-sale and held-to-maturity and provides some new disclosure requirements for both debt and equity securities. FSP 115-2 mandates new disclosure requirements affect both debt and equity securities and extend the disclosure requirements (both new and existing) to interim periods. FSP 115-2 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP 115-2 is to be applied to existing and new investments held by an entity as of the beginning of the period in which it is adopted. The Company will adopt FSP 115-2 in its Form 10-Q for the period ended June 30, 2009. The Company is currently evaluating the impact, if any, FSP 115-2 will have on its financial statements.

4. Credit Derivatives

Financial guarantees written in credit derivative form issued by the Company, principally in the form of insured credit default swap (CDS) contracts, have been deemed to meet the definition of a derivative under FAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133), FAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (FAS 149) and FAS No. 155, *Accounting for Certain Hybrid Financial Instruments* (FAS 155). FAS 133 and FAS 149 require that an entity recognize all derivatives as either assets or liabilities in the consolidated balance sheets and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as a fair value, cash flow or foreign currency hedge. FAS 155 requires companies to recognize freestanding or embedded derivatives relating to beneficial interests in securitized financial instruments. This recognition was not required prior to January 1, 2007. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

Realized gains and other settlements on credit derivatives include credit derivative premiums received and receivable for credit protection the Company has sold under its insured CDS contracts as well as any contractual claim losses paid and payable related to insured credit events under these contracts, ceding commissions (expense) income and realized gains or losses related to their early termination. The Company almost always holds credit derivative contracts to maturity. However, in certain circumstances such as for the downgrade of AGC or AGRe, the CDS

counterparty may decide to terminate a credit derivative contract prior to maturity.

The following table disaggregates realized gains and other settlements on credit derivatives into its component

Table of Contents

parts for the periods ended March 31, 2009 and 2008 (dollars in thousands):

	Three Months Ended March 31,	
	2009	2008
Realized gains and other settlements on credit derivatives		
Net credit derivative premiums received and receivable	\$ 29,515	\$ 27,822
Net credit derivative losses (paid and payable) recovered and recoverable	(9,058)	14
Ceding commissions received/receivable (paid/payable), net	122	(219)
Total realized gains and other settlements on credit derivatives	\$ 20,579	\$ 27,617

Unrealized gains (losses) on credit derivatives represent the adjustments for changes in fair value that are recorded in each reporting period, under FAS 133. Changes in unrealized gains and losses on credit derivatives are reflected in the consolidated statements of operations and comprehensive income in unrealized gains (losses) on credit derivatives. Cumulative unrealized losses, determined on a contract by contract basis, are reflected as either net assets or net liabilities in the Company's balance sheets. Unrealized gains and losses resulting from changes in the fair value of credit derivatives occur because of changes in interest rates, credit spreads, the credit ratings of the referenced entities and the issuing Company's own credit rating and other market factors. The unrealized gains and losses on credit derivatives will reduce to zero as the exposure approaches its maturity date, unless there is a payment default on the exposure or early termination. Changes in the fair value of the Company's credit derivative contracts do not generally reflect actual claims or credit losses, and have no impact on the Company's claims paying resources, rating agency capital or regulatory capital positions.

The Company determines fair value of its credit derivative contracts primarily through modeling that uses various inputs such as credit spreads, based on observable market indices and on recent pricing for similar contracts, and expected contractual life to derive an estimate of the value of our contracts in our principal market (see Note 5). Credit spreads capture the impact of recovery rates and performance of underlying assets, among other factors, on these contracts. The Company's pricing model takes into account not only how credit spreads on risks that it assumes affects pricing, but how the Company's own credit spread affects the pricing of its deals. If credit spreads of the underlying obligations change, the fair value of the related credit derivative changes. Market liquidity could also impact valuations of the underlying obligations.

The impact of changes in credit spreads will vary based upon the volume, tenor, interest rates, and other market conditions at the time these fair values are determined. In addition, since each transaction has unique collateral and structure terms, the underlying change in fair value of each transaction may vary considerably. The fair value of credit derivative contracts also reflects the change in the Company's own credit cost based on the price to purchase credit protection on AGC. During First Quarter 2009, the Company incurred net pre-tax unrealized gains on credit derivative contracts of \$27.0 million. Of this amount, \$2,291.5 million was due to the widening of AGC's own credit spread from 1,775 basis points at December 31, 2008 to 3,847 basis points at March 31, 2009. As of March 31, 2009 the net credit liability includes a reduction in the liability of \$6,439.1 million associated with the widening of AGC's credit spread to 3,847 basis points. Management believes that the widening of AGC's credit spread is due to the correlation between AGC's risk profile and that experienced currently by the broader financial markets and increased demand for credit protection against AGC as the result of its direct segment financial guarantee volume as well as the overall lack of liquidity in the CDS market. Offsetting the gain attributable to the significant increase in AGC's credit spread were declines in fixed income security market prices primarily attributable to widening spreads in certain markets as a result of the continued deterioration in credit markets and some credit rating downgrades, rather than from delinquencies or defaults on securities guaranteed by the Company. The higher credit spreads in the fixed income security market are due to the recent lack of liquidity in the high yield collateralized debt obligation and collateralized loan obligation markets as well as continuing market concerns over the most recent vintages of subprime residential mortgage backed securities and commercial mortgage backed securities.

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During First Quarter 2008, the Company incurred net mark-to-market losses on credit derivative contracts of \$(259.6) million, pre-tax, related to high yield and investment grade corporate collateralized loan obligations (CLOs), as well as residential and commercial mortgage backed securities exposures. The unrealized loss on credit derivatives

Table of Contents

resulted largely from the decline in fixed income security market prices resulting from higher credit spreads, due to the lack of liquidity in the High Yield CDO and CLO market as well as market concerns over continued recent vintages of subprime residential mortgage backed securities, rather than from credit rating downgrades, delinquencies or defaults on securities guaranteed by the Company.

The total notional amount of credit derivative exposure outstanding as of March 31, 2009 and December 31, 2008 and included in the Company's financial guaranty exposure was \$73.3 billion and \$75.1 billion, respectively.

The components of the Company's unrealized gain (loss) on credit derivatives for the three months ended March 31, 2009 is:

Asset Type	As of March 31, 2009		Weighted Average Credit Rating(1)	First Quarter 2009	
	Net Par Outstanding (in billions)			Unrealized Gain (Loss) (in millions)	
Corporate collateralized loan obligations	\$	26.0	AAA	\$	(78.9)
Market value CDOs of corporate obligations		3.4	AAA		(7.0)
Trust preferred securities		6.0	A-		75.3
Total pooled corporate obligations		35.4	AA+		(10.5)
Commercial mortgage-backed securities		5.8	AAA		(31.2)
Residential mortgage-backed securities		19.6	AA-		(89.8)
Other		9.3	AA-		142.3
Total		70.0	AA		10.8
Reinsurance exposures written in CDS form		3.3	AA+		16.2
Grand Total	\$	73.3	AA	\$	27.0

(1) Based on the Company's internal rating, which is on a comparable scale to that of the nationally recognized rating agencies.

Corporate collateralized loan obligations, market value CDOs, and trust preferred securities, which comprise the Company's pooled corporate exposures, include all U.S. structured finance pooled corporate obligations and international pooled corporate obligations. Commercial mortgage backed securities are comprised of commercial U.S. structured finance and commercial international mortgage backed securities. Residential mortgage backed securities are comprised of prime and subprime U.S. mortgage backed and home equity securities, international residential mortgage backed and international home equity securities. Other includes all other U.S. and international asset classes, such as commercial receivables, and international infrastructure and pooled infrastructure securities.

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

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The Company's \$9.3 billion exposure to Other CDS contracts is also highly diversified. It includes \$3.7 billion of exposure to four pooled infrastructure transactions comprised of diversified pools of international infrastructure project transactions and loans to regulated utilities. These pools were all structured with underlying credit enhancement sufficient for the Company to attach at super senior AAA levels. The remaining \$5.6 billion of exposure in Other CDS contracts is comprised of numerous deals typically structured with significant underlying credit enhancement and spread across various asset classes, such as commercial receivables, infrastructure, regulated utilities and consumer receivables. Substantially all of this \$9.3 billion of exposure is rated investment grade and the weighted average credit rating is AA-.

The unrealized gain of \$142.3 million on Other CDS contracts for the three months ended March 31, 2009 is primarily attributable to the aforementioned change in AGC's credit spread. This increased hedge cost caused the

Table of Contents

implied spreads of several UK public finance infrastructure transactions and a film securitization transaction to narrow during the quarter as on offset.

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

The Company's exposure to the mortgage industry is discussed in Note 7.

The following table presents additional details about the Company's unrealized loss on pooled corporate obligation credit derivatives, which includes collateralized loan obligations, market value CDOs and trust preferred securities, by asset type as of March 31, 2009:

Asset Type	Original Subordination(2)	Current Subordination(2)	Net Par Outstanding (in billions)	Weighted Average Credit Rating(1)	First Quarter 2009 Unrealized Gain (Loss) (in millions)
High yield corporate obligations	35.9%	29.6%	\$ 22.8	AAA	\$ (77.4)
Trust preferred	46.7%	41.7%	6.0	A-	75.3
Market value CDOs of corporate obligations	38.4%	27.3%	3.4	AAA	(7.0)
Investment grade corporate obligations	28.7%	29.9%	2.3	AAA	1.6
Commercial real estate	49.1%	47.9%	0.8	AAA	(2.2)
CDO of CDOs (corporate obligations)	1.7%	5.4%	0.1	AAA	(0.9)
Total	37.7%	31.8%	\$ 35.4	AA+	\$ (10.5)

(1) Based on the Company's internal rating, which is on a comparable scale to that of the nationally recognized rating agencies.

(2) 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

The following table presents additional details about the Company's unrealized loss on credit derivatives associated with commercial mortgage-backed securities by vintage as of March 31, 2009:

Vintage	Original Subordination(2)	Current Subordination(2)	Net Par Outstanding (in billions)	Weighted Average Credit Rating(1)	First Quarter 2009 Unrealized Gain (Loss) (in millions)
2004 and Prior	19.8%	21.5%	\$ 0.3	AAA	\$ (0.6)
2005	27.8%	28.9%	3.4	AAA	(19.7)
2006	27.7%	28.5%	1.8	AAA	(9.6)

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2007	35.8%	35.9%	0.2	AAA	(1.4)
2008					
2009					
Total	27.7%	28.7%	5.8	AAA	\$ (31.2)

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Table of Contents

The following tables present additional details about the Company's unrealized loss on credit derivatives associated with residential mortgage-backed securities by vintage and asset type as of March 31, 2009:

Vintage	Original Subordination(2)	Current Subordination(2)	Net Par Outstanding (in billions)	Weighted Average Credit Rating(1)	First Quarter 2009 Unrealized Gain (Loss) (in millions)
2004 and Prior	5.2%	13.0%	\$ 0.4	A	\$ 4.6
2005	24.5%	51.6%	4.8	AA	1.3
2006	16.6%	23.5%	5.7	AA	1.2
2007	16.5%	18.7%	8.7	A	(96.9)
2008					
2009					
Total	18.2%	28.1%	\$ 19.6	AA-	\$ (89.8)

Asset Type	Original Subordination(2)	Current Subordination(2)	Net Par Outstanding (in billions)	Weighted Average Credit Rating(1)	First Quarter 2009 Unrealized Gain (Loss) (in millions)
Alt-A loans	20.3%	23.1%	\$ 6.3	A-	\$ (44.1)
Prime first lien	10.3%	12.6%	7.8	AA+	(48.7)
Subprime lien	26.9%	55.0%	5.6	AA-	3.0
Total	18.2%	28.1%	\$ 19.6	AA-	\$ (89.8)

In general, the Company structures credit derivative transactions such that the circumstances giving rise to our obligation to make payments is similar to that for financial guaranty policies and generally occurs as losses are realized on the underlying reference obligation. Nonetheless, credit derivative transactions are governed by International Swaps and Derivatives Association, Inc. (ISDA) documentation and operate differently from financial guaranty insurance policies. For example, our 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 policy on a direct primary basis. In addition, while the Company's exposure under credit derivatives, like the Company's exposure under financial guaranty insurance policies, is generally for as long as the reference obligation remains outstanding, unlike financial guaranty insurance policies, a credit derivative may be terminated due to the occurrence of an event of default set forth in the ISDA documentation or other specific termination events. In some older credit derivative transactions, one such specified termination event is the failure of AGC to maintain specified financial strength ratings ranging from A or A2 to BBB- or Baa3. If a credit derivative is terminated the Company could be required to make a mark-to-market payment as determined under the ISDA documentation. For example, if AGC's ratings were downgraded to A- or A3, the CDS counterparties could terminate CDS covering \$847.8 million par insured. If AGC's ratings are downgraded to levels between BBB+ or Baa1 and BB+ or Ba1, the CDS counterparties could terminate the CDS covering \$10.9 billion par insured. Given current market conditions, the Company does not believe that it can accurately estimate the payments it would be required to make if AGC or AGRe were downgraded and the CDS counterparties terminated the CDS. These payments could have a material adverse effect on the Company's liquidity and financial condition. During May 2009 the Company entered into an agreement with a CDS counterparty, which had the right to terminate four CDS contracts if AGC was downgraded below AA- or Aa3. Under the agreement, the CDS counterparty's right to terminate the CDS contracts based on AGC's ratings was eliminated. In return, the Company agreed to post up to \$250 million in collateral to secure its payment obligations under the CDS contracts covering \$5.9 billion of par insured. The collateral posting would increase to up to \$300 million if AGC were downgraded to below AA- or A2. The posting of this collateral has no impact on the Company's net income or shareholders' equity under U.S. GAAP nor does it impact AGC's statutory surplus or net income.

Under a limited number of credit derivative contracts, the Company is required to post eligible securities as collateral, generally cash or U.S. government or agency securities. The need to post collateral under these transactions is generally based on mark-to-market valuation in excess of contractual thresholds. The particular thresholds decline if the Company's ratings decline. As of March 31, 2009 the Company had pre-IPO

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transactions with approximately \$1.8 billion of par subject to collateral posting due to changes in market value. Of this amount, as of March 31, 2009, the Company posted collateral totaling approximately \$177.9 million (including \$156.2 million for AGC) based on the unrealized mark-to-market loss position for transactions with two of its counterparties. Any amounts required to be posted as collateral in the future will depend on changes in the market values of these transactions. Additionally, in the event AGC were downgraded below A-, contractual thresholds would be eliminated and the amount of par that could be subject to collateral posting requirements would be \$2.3 billion. Based on market values as of March 31, 2009, the Company estimates that such a downgrade would have resulted in AGC posting an additional \$113.7 million of collateral. The actual amounts posted would be based on market conditions at the time of the posting and would be based on the CDS contract's ISDA documentation. The actual amounts that would be required to be posted could be materially larger than the Company's estimate. As described above, in May 2009 AGC posted an additional \$250 million of collateral.

Table of Contents

As of March 31, 2009 and December 31, 2008, the Company considered the impact of its own credit risk, in combination with credit spreads on risk that it assumes through CDS contracts, in determining the fair value of its credit derivatives. The Company determines its own credit risk based on quoted CDS prices traded on the Company at each balance sheet date. The quoted price of CDS contracts traded on AGC at March 31, 2009 and December 31, 2008 was 3,847 basis points and 1,775 basis points, respectively. Historically, the price of CDS traded on AGC moves directionally the same as general market spreads. Generally, a widening of the CDS prices traded on AGC has an effect of offsetting unrealized losses that result from widening general market credit spreads, while a narrowing of the CDS prices traded on AGC has an effect of offsetting unrealized gains that result from narrowing general market credit spreads. An overall narrowing of spreads generally results in an unrealized gain on credit derivatives for the Company and an overall widening of spreads generally results in an unrealized loss for the Company. At March 31, 2009, the values of our CDS contracts before and after considering implications of our credit spreads were \$(6,959.5) million and \$(520.4) million, respectively. At December 31, 2008, the values of our CDS contracts before and after considering implications of our credit spreads were \$(4,686.8) million and \$(539.2) million, respectively. As noted above, our own credit spread widened from 180 basis points at December 31, 2007 to 1,775 basis points at December 31, 2008.

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 on the risks that it assumes at March 31, 2009:

(Dollars in millions)

Credit Spreads(1)		Estimated Net Fair Value (Pre-Tax)	Estimated Pre-Tax Change in Gain / (Loss)
March 31, 2009:			
100%	widening in spreads	\$ (1,603.8)	\$ (1,083.4)
50%	widening in spreads	(1,075.6)	(555.2)
25%	widening in spreads	(792.5)	(272.1)
10%	widening in spreads	(632.7)	(112.3)
	Base Scenario	(520.4)	
10%	narrowing in spreads	(457.2)	63.2
25%	narrowing in spreads	(366.0)	154.4
50%	narrowing in spreads	(233.0)	287.4

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

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

5. Fair Value of Financial Instruments

Background

Effective January 1, 2008, the Company adopted FAS No. 157, Fair Value Measurements (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 applies to other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements.

FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. The price shall represent that available in the principal market for the asset or liability. If there is no principal market, then the price is based on the market that maximizes the value received for an asset or minimizes the amount paid for a liability (i.e. the most advantageous market).

FAS 157 specifies a fair value hierarchy based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Company estimates of market assumptions. In accordance with FAS 157, the fair value hierarchy prioritizes model inputs into three broad levels as follows:

Table of Contents

- Level 1 Quoted prices for identical instruments in active markets.
- Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and observable inputs other than quoted prices, such as interest rates or yield curves and other inputs derived from or corroborated by observable market inputs.
- Level 3 Model derived valuations in which one or more significant inputs or significant value drivers are unobservable. This hierarchy requires the use of observable market data when available.

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

Effect on the Company's financial statements

FAS 157 applies to both amounts recorded in the Company's financial statements and to disclosures. Amounts recorded at fair value in the Company's financial statements on a recurring basis are fixed maturity securities available for sale, short-term investments, credit derivative assets and liabilities relating to the Company's CDS contracts and CCS Securities. The fair value of these items as of March 31, 2009 is summarized in the following table.

(Dollars in millions)	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Fixed maturity securities	\$ 3,176.2	\$	\$ 3,176.2	\$
Short-term investments	616.8	67.3	549.5	
Credit derivative assets	149.8			149.8
CCS Securities	70.7		70.7	
Total assets	\$ 4,013.5	\$ 67.3	\$ 3,796.4	\$ 149.8
Liabilities				
Credit derivative liabilities	\$ 706.8	\$	\$	\$ 706.8
Total liabilities	\$ 706.8	\$	\$	\$ 706.8

The fair value of these items as of December 31, 2008 is summarized in the following table.

(Dollars in millions)	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Fixed maturity securities	\$ 3,154.1	\$	\$ 3,154.1	\$

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Short-term investments	477.2		47.8		429.4		
Credit derivative assets	147.0						147.0
CCS Securities	51.1				51.1		
Total assets	\$ 3,829.4	\$	47.8	\$	3,634.6	\$	147.0
Liabilities							
Credit derivative liabilities	\$ 733.8	\$		\$		\$	733.8
Total liabilities	\$ 733.8	\$		\$		\$	733.8

Fixed Maturity Securities and Short-term Investments

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

Typical inputs used by these three pricing methods include, but are not limited to, reported trades, benchmark yields, issuer spreads, bids, offers, and/or estimated cash flows and prepayments speeds. Based on the typical trading volumes and the lack of quoted market prices for fixed maturities, third party pricing services will normally derive the security prices through recent reported trades for identical or similar securities making adjustments through the reporting date based upon available market observable information as outlined above. If there are no recent reported trades, the third party pricing services and brokers may use matrix or model processes to develop a security price where future cash flow expectations are developed based upon collateral performance and discounted at an estimated market rate. Included in the pricing of asset backed securities are estimates of the rate of future prepayments of principal over the remaining life of the securities. Such estimates are derived based on the characteristics of the underlying structure and prepayment speeds previously experienced at the interest rate levels projected for the underlying collateral. The Company does not make any internal adjustments to prices provided by its third party pricing service.

Table of Contents

The Company has analyzed the third party pricing services' valuation methodologies and related inputs, and has also evaluated the various types of securities in its investment portfolio to determine an appropriate FAS 157 fair value hierarchy level based upon trading activity and observability of market inputs. Based on this evaluation, each price was classified as Level 1, 2 or 3. Prices provided by third party pricing services with market observable inputs are classified as Level 2. Prices on the money fund portion of short-term investments are classified as Level 1. No investments were classified as Level 3 as of or for the three months ended March 31, 2009.

Committed Capital Securities (CCS Securities)

The fair value of CCS Securities represents the present value of remaining expected put option premium payments under the CCS Securities agreements and the value of such estimated payments based upon the quoted price for such premium payments as of March 31, 2009 (see Note 10). The \$70.7 million fair value asset for CCS Securities is included in the consolidated balance sheet. Changes in fair value of this asset are included in other income in the consolidated statement of operations and comprehensive income. The significant market inputs used are observable, therefore, the Company classified this fair value measurement as Level 2.

Level 3 Valuation Techniques

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. A brief description of the valuation techniques used for Level 3 assets and liabilities is provided below.

Credit Derivatives

The Company's credit derivatives consist of insured CDS contracts (see Note 4). As discussed in Note 4, the Company does not typically exit its credit derivative contracts, and there are no quoted prices for its instruments or for similar instruments. Observable inputs other than quoted market prices exist, however, these inputs reflect contracts that do not contain terms and conditions similar to the credit derivative contracts issued by the Company. Therefore, the valuation of credit derivative contracts requires the use of models that contain significant, unobservable inputs. Thus, we believe the credit derivative valuations are in Level 3 in the fair value hierarchy discussed above.

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining expected premiums the Company receives for the credit protection and the estimated present value of premiums that a comparable financial guarantor would hypothetically charge the Company for the same protection at the balance sheet date. The fair value of the Company's credit 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. Contractual cash flows, which are included in the Realized gains and other settlements on credit derivatives' fair value component of credit derivatives, are the most readily observable variables of the fair value of credit derivative contracts since they are based on contractual terms. These variables include (i) net premiums received and receivable on written credit derivative contracts, (ii) net premiums paid and payable on purchased contracts, (iii) losses paid and payable to credit derivative contract counterparties and (iv) losses recovered and recoverable on purchased contracts. The remaining key variables described above impact Unrealized gains (losses) on credit derivatives.

Market conditions at March 31, 2009 were such that market prices of the Company's CDS contracts were not generally available. Where market prices were not available, the Company used a combination of observable market data and valuation models, using various market indices, credit spreads, the Company's own credit risk, and estimated contractual payments to estimate the Unrealized gains (losses) on credit derivatives portion of the fair value of its credit derivatives. These models are primarily developed internally based on market conventions for similar transactions.

Management considers the non-standard terms of its credit derivative contracts in determining the fair value of these contracts. These terms differ from credit derivatives sold by companies outside the financial guaranty industry. The non-standard terms include the absence of collateral support agreements or immediate settlement provisions, relatively high attachment points and the fact that the Company does not exit derivatives it sells for

Table of Contents

credit protection purposes, except under specific circumstances such as exiting a line of business. Because of these terms and conditions, the fair value of the Company's credit derivatives may not reflect the same prices observed in an actively traded market of credit derivatives that do not contain terms and conditions similar to those observed in the financial guaranty market. These models and the related assumptions are continuously reevaluated by management and enhanced, as appropriate, based upon improvements in modeling techniques and availability of more timely market information.

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

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

Assumptions

The key assumptions of our internally developed model include:

- Gross spread is the difference between the yield of a security paid by an issuer on an insured versus uninsured basis or, in the case of a CDS transaction, the difference between the yield and an index such as LIBOR. Such pricing is well established by historical financial guarantee fees relative to capital market spreads as observed and executed in competitive markets, including in financial guarantee reinsurance and secondary market transactions.
- Gross spread on a financial guarantee written in CDS form is allocated among 1) profit the originator, usually an investment bank, realizes for putting the deal together and funding the transaction, 2) premiums paid to us for our credit protection provided and 3) the cost of CDS protection purchased on us by the originator to hedge their counterparty credit risk exposure to the Company. The premium the Company receives is referred to as the net spread. The Company's own credit risk is factored into the determination of net spread based on the impact of changes in the quoted market price for credit protection bought on the Company, as reflected by quoted market prices on CDS sold on Assured Guaranty Corp. The cost to acquire CDS protection sold on AGC affects the amount of spread on CDS deals that the Company captures and, hence, their fair value. As the cost to acquire CDS protection sold on AGC increases the amount of premium we capture on a deal generally decreases. As the cost to acquire CDS protection sold on AGC decreases the amount of premium we capture on a deal generally increases. In our model, the premium we capture is not permitted to go below the minimum rate that we would currently charge to assume similar risks. This has the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts.
- The Company determines the fair value of its CDS contracts by applying the net spread for the remaining duration of each contract to the notional value of its CDS contracts.
- Actual transactions are used to validate the model results and to explain the correlation between various market indices and indicative CDS market prices.

Inputs

The specific model inputs are listed below, including how we derive inputs for market credit spreads on the underlying transaction collateral.

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

Table of Contents

This is an observable input that the Company obtains for deals it has closed or bid on in the market place.

- **Credit spreads on risks assumed** These are obtained from market data sources published by third parties (e.g. dealer spread tables for the collateral similar to assets within our transactions) as well as collateral-specific spreads provided by trustees or obtained from market sources. If observable market credit spreads are not available or reliable for the underlying reference obligations, then market indices are used that most closely resembles the underlying reference obligations, considering asset class, credit quality rating and maturity of the underlying reference obligations. As discussed previously, these indices are adjusted to reflect the non-standard terms of the Company's CDS contracts. As of March 31, 2009, the Company obtained approximately 20% of its credit spread data, based on notional par outstanding, from sources published by third parties, while 80% was obtained from market sources or similar market indices. Market sources determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. Management validates these quotes by cross-referencing quotes received from one market source against quotes received from another market source to ensure reasonableness. In addition, we compare the relative change in price quotes received from one quarter to another, with the relative change experienced by published market indices for a specific asset class. Collateral specific spreads obtained from third-party, independent market sources are un-published spread quotes from market participants and or market traders whom are not trustees. Management obtains this information as the result of direct communication with these sources as part of the valuation process.
- **Credit spreads on the Company's name** The Company obtains the quoted price of CDS contracts traded on AGC from market data sources published by third parties.

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

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

In Scenario 1, the gross spread is 185bps. The bank or deal originator captures 115bps of the original gross spread and hedges 10% of its exposure to AGC, when the CDS spread on AGC was 300bps ($300\text{bps} \times 10\% = 30\text{bps}$). Under this scenario AGC received premium of 40bps, or 22% of the gross spread.

In Scenario 2, the gross spread is 500bps. The bank or deal originator captures 50bps of the original gross spread and hedges 25% of its exposure to AGC, when the CDS spread on AGC was 1,760bps ($1,760\text{bps} \times 25\% = 440\text{bps}$). Under this scenario AGC would receive premium of 10bps, or 2% of the gross spread.

In this example, the contractual cash flows (the AGC premium above) exceed the amount a market participant would require AGC to pay in today's market to accept its obligations under the credit default swap contract, thus resulting in an asset. This credit derivative asset is equal to the difference in premium rate discounted at a risk adjusted rate over the weighted average remaining life of the contract. The expected future cash flows for the Company's credit derivatives were discounted at rates ranging from 1.0% to 23.0% over LIBOR at March 31, 2009, with over 95% of the transactions ranging from 1.0% to 6.0% over LIBOR.

The Company corroborates the assumptions in its fair value model, including the amount of exposure to the Company hedged by its counterparties, with independent third parties each reporting period. Recent increases in the CDS spread on AGC have resulted in the bank or deal originator hedging a greater portion of its exposure to AGC. This has the effect of reducing the amount of contractual cash flows AGC can capture for selling our protection.

The amount of premium a financial guaranty insurance market participant can demand is inversely related to the cost of credit protection on the insurance company as measured by market credit spreads. This is because the buyers of credit protection typically hedge a portion of their risk to the financial guarantor, due to the fact that

Table of Contents

contractual terms of financial guaranty insurance contracts typically do not require the posting of collateral by the guarantor. The widening of a financial guarantor's own credit spread increases the cost to buy credit protection on the guarantor, thereby, reducing the amount of premium the guarantor can capture out of the gross spread on the deal. The extent of the hedge depends on the types of instruments insured and the current market conditions.

A credit derivative asset under FAS 157 is the result of contractual cash flows on in-force deals in excess of what a hypothetical financial guarantor could receive if it sold protection on the same risk as of the current reporting date. If the Company were able to freely exchange these contracts (i.e., assuming its contracts did not contain proscriptions on transfer and there was a viable exchange market), it would be able to realize an asset representing the difference between the higher contractual premiums to which it is entitled and the current market premiums for a similar contract.

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

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

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

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

As of March 31, 2009, the Company obtained approximately 8% of its credit spread information, based on notional par outstanding, from actual collateral specific credit spreads, while 80% was based on market indices and 12% was based on spreads provided by the CDS counterparty. The Company interpolates a curve based on the historical relationship between premium the Company receives when a financial guarantee written in CDS form closes to the daily closing price of the market index related to the specific asset class and rating of the deal. This curve indicates expected credit spreads at each indicative level on the related market index. For specific transactions where no price quotes are available and

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credit spreads need to be extrapolated, an alternative transaction for which the Company has received a spread quote from one of the first three sources within the Company's spread hierarchy is chosen. This alternative transaction will be within the same asset class, have similar underlying assets, similar credit ratings, and similar time to maturity. The Company then calculates the percentage of relative spread change quarter over quarter for the alternative transaction. This percentage change is then applied to the historical credit spread of the transaction for which no price quote was received in order to calculate the transactions current spread. Counterparties determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. These quotes are validated by cross-referencing quotes received from one market source with those quotes received from another market source to ensure reasonableness. In addition, management compares the relative change experienced on published market indices for a specific asset class for reasonableness and accuracy.

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

Table of Contents

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

- The model takes account of transaction structure and the key drivers of market value. The transaction structure includes par insured, weighted average life, level of subordination and composition of collateral.
- The model maximizes the use of market-driven inputs whenever they are available. The key inputs to the model are market-based spreads for the collateral, and the credit rating of referenced entities. These are viewed by us to be the key parameters that affect fair value of the transaction.
- The Company is able to use actual transactions to validate its model results and to explain the correlation between various market indices and indicative CDS market prices.
- The model is a well-documented, consistent approach to valuing positions that minimizes subjectivity. The Company has developed a hierarchy for market-based spread inputs that helps mitigate the degree of subjectivity during periods of high illiquidity.

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

- There is no exit market or actual exit transactions. Thus our exit market is a hypothetical one based on our entry market.
- There is a very limited market in which to verify the fair values developed by the Company's model.
- At March 31, 2009, the markets for the inputs to the model were highly illiquid, which impacts their reliability. However, the Company employs various procedures to corroborate the reasonableness of quotes received and calculated by our internal valuation model, including comparing to other quotes received on similarly structured transactions, observed spreads on structured products with comparable underlying assets and, on a selective basis when possible, through second independent quotes on the same reference obligation.
- Due to the non-standard terms under which the Company enters into derivative contracts, the fair value of its credit derivatives may not reflect the same prices observed in an actively traded market of credit derivatives that do not contain terms and conditions similar to those observed in the financial guaranty market.

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

The net par outstanding of the Company's credit derivative contracts was \$73.3 billion and \$75.1 billion at March 31, 2009 and December 31, 2008, respectively. The estimated remaining average life of these contracts at March 31, 2009 was 7.9 years.

As required by FAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. As of March 31, 2009, these contracts are classified as Level 3 in the FAS 157 hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation model, most significantly the Company's estimate of the value of the non-standard terms and conditions of its credit derivative contracts and of the Company's current credit standing.

The table below presents a reconciliation of the Company's credit derivatives whose fair value included significant unobservable inputs (Level 3) during the three months ended March 31, 2009 and 2008.

Table of Contents

(Dollars in millions)	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	First Quarter 2009 Credit Derivative Liability (Asset), net	First Quarter 2008 Credit Derivative Liability (Asset), net
Beginning Balance	\$ 586,807	\$ 617,644
Total gains or losses realized and unrealized		
Unrealized (gains) losses on credit derivatives	(26,982)	259,621
Realized gains and other settlements on credit derivatives	(20,579)	(27,617)
Current period net effect of purchases, settlements and other activity included in unrealized portion of beginning balance	17,724	31,989
Transfers in and/or out of Level 3		
Ending Balance	\$ 556,970	\$ 881,637
Gains and losses (realized and unrealized) included in earnings for the period are reported as follows:		
Total realized and unrealized (gains) losses included in earnings for the period	\$ (47,561)	\$ 232,004
Change in unrealized (gains) losses on credit derivatives still held at the reporting date	\$ (27,182)	\$ 262,462

6. Investments

The following table summarizes the Company's aggregate investment portfolio as of March 31, 2009:

	Amortized Cost	Gross Unrealized Gains (in thousands of U.S. dollars)	Gross Unrealized Losses	Estimated Fair Value
<i>Fixed maturity securities</i>				
U.S. government and agencies	\$ 426,058	\$ 36,575	\$ (23)	\$ 462,610
Obligations of state and political subdivisions	1,245,811	34,310	(32,102)	1,248,019
Corporate securities	278,772	3,984	(20,522)	262,234
Mortgage-backed securities	1,089,288	28,968	(50,109)	1,068,147
Asset-backed securities	70,880	249	(2,006)	69,123
Foreign government securities	61,617	4,428		66,045
Preferred stock				
Total fixed maturity securities	3,172,426	108,514	(104,762)	3,176,178
Short-term investments	616,834			616,834
Total investments	\$ 3,789,260	\$ 108,514	\$ (104,762)	\$ 3,793,012

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Table of Contents

The following table summarizes the Company's aggregate investment portfolio as of December 31, 2008:

	Amortized Cost	Gross Unrealized Gains (in thousands of U.S. dollars)	Gross Unrealized Losses	Estimated Fair Value
<i>Fixed maturity securities</i>				
U.S. government and agencies	\$ 426,592	\$ 49,370	\$ (36)	\$ 475,926
Obligations of state and political subdivisions	1,235,942	33,196	(51,427)	1,217,711
Corporate securities	274,237	5,793	(11,793)	268,237
Mortgage-backed securities	1,081,879	21,772	(51,817)	1,051,834
Asset-backed securities	80,710		(7,144)	73,566
Foreign government securities	50,323	4,173		54,496
Preferred stock	12,625		(258)	12,367
Total fixed maturity securities	3,162,308	114,304	(122,475)	3,154,137
Short-term investments	477,197			477,197
Total investments	\$ 3,639,505	\$ 114,304	\$ (122,475)	\$ 3,631,334

Approximately 28% and 29% of the Company's total investment portfolio as of March 31, 2009 and December 31, 2008, respectively, was composed of mortgage backed securities, including collateralized mortgage obligations and commercial mortgage backed securities. As of March 31, 2009 and December 31, 2008, respectively, approximately 70% and 69% of the Company's total mortgage backed securities were government agency obligations. As of both March 31, 2009 and December 31, 2008, the weighted average credit quality of the Company's entire investment portfolio was AA+. The Company's portfolio is comprised primarily of high-quality, liquid instruments. The Company continues to receive sufficient information to value its investments and has not had to modify its approach due to the current market conditions.

Under agreements with its cedants and in accordance with statutory requirements, the Company maintains fixed maturity securities in trust accounts of \$1,269.2 million and \$1,233.4 million as of March 31, 2009 and December 31, 2008, respectively, for the benefit of reinsured companies and for the protection of policyholders, generally in states in which the Company or its subsidiaries, as applicable, are not licensed or accredited.

Under certain derivative contracts, the Company is required to post eligible securities as collateral, generally cash or U.S. government or agency securities. The need to post collateral under these transactions is generally based on mark-to-market valuation in excess of contractual thresholds. The fair market value of the Company's pledged securities totaled \$177.9 million and \$157.7 million as of March 31, 2009 and December 31, 2008, respectively.

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

- a decline in the market value of a security by 20% or more below amortized cost for a continuous period of at least six months;
- a decline in the market value of a security for a continuous period of 12 months;

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- recent credit downgrades of the applicable security or the issuer by rating agencies;
- the financial condition of the applicable issuer;
- whether loss of investment principal is anticipated;
- whether scheduled interest payments are past due; and
- whether the Company has the ability and intent to hold the security for a sufficient period of time to allow for anticipated recoveries in fair value.

If the Company believes a decline in the value of a particular investment is temporary, the decline is recorded as an unrealized loss on the balance sheet in accumulated other comprehensive income in shareholders' equity. If the Company believes the decline is other than temporary, the Company will write down the carrying value of the investment and record a realized loss in its consolidated statements of operations and comprehensive income. In periods subsequent to the recognition of an other-than-temporary impairment, the impaired security is accounted for as if it had been purchased on the measurement date of the impairment. Accordingly, the discount (or reduced premium) based on the new cost basis is accreted into net investment income in future periods based upon

Table of Contents

the amount and timing of expected future cash flows of the security, if the recoverable value of the investment based upon those cash flows is greater than the carrying value of the investment after the impairment.

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

As part of its other than temporary impairment review process, management considers the nature of the investment, the cause for the impairment (interest or credit related), the severity (both as a percentage of book value and absolute dollars) and duration of the impairment, the severity of the impairment regardless of duration, and any other available evidence, such as discussions with investment advisors, volatility of the securities fair value and recent news reports when performing its assessment.

As of March 31, 2009, the Company's gross unrealized loss position stood at \$104.8 million compared to \$122.5 million at December 31, 2008. The \$17.7 million decrease in gross unrealized losses was primarily attributable to municipal securities, \$19.3 million, mortgage and asset backed securities, \$6.9 million, and partially offset by an increase in gross unrealized losses in corporate securities, \$8.8 million. The decrease in gross unrealized losses during the three months ended March 31, 2009 was related to the recovery of liquidity in the financial markets.

As of March 31, 2009, the Company had 85 securities in an unrealized loss position for greater than 12 months, representing a gross unrealized loss of \$55.8 million. Of these securities, 28 securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of March 31, 2009 was \$39.0 million. This unrealized loss is primarily attributable to the market illiquidity and volatility in the U.S. economy mentioned above and not specific to individual issuer credit. Except as noted below, the Company has recognized no other than temporary impairment losses and has the ability and intent to hold these securities until a recovery in value.

The Company recognized \$18.5 million of other than temporary impairment losses substantially related to mortgage backed and corporate securities for the three months ended March 31, 2009 primarily due to the fact that it does not have the intent to hold these securities until there is a recovery in their value. The Company continues to monitor the value of these investments. Future events may result in further impairment of the Company's investments. The Company had no write downs of investments for other than temporary impairment losses for the three months ended March 31, 2008.

Table of Contents

The following table summarizes the unrealized losses in our investment portfolio by type of security and the length of time such securities have been in a continuous unrealized loss position as of the dates indicated:

Length of Time in Continuous Unrealized Loss Position	As of March 31, 2009		As of December 31, 2008	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
	(\$ in millions)			
Municipal securities				
0-6 months	\$ 148.1	\$ (2.6)	\$ 168.8	\$ (5.8)
7-12 months	174.8	(5.8)	310.6	(22.9)
Greater than 12 months	295.8	(23.7)	137.9	(22.7)
	618.7	(32.1)	617.3	(51.4)
Corporate securities				
0-6 months	66.9	(7.6)	23.7	(1.7)
7-12 months	71.8	(9.0)	81.9	(8.5)
Greater than 12 months	20.1	(4.0)	14.2	(1.6)
	158.8	(20.6)	119.8	(11.8)
U.S. Government obligations				
0-6 months	8.0			
7-12 months			8.0	
Greater than 12 months				
	8.0		8.0	
Mortgage and asset-backed securities				
0-6 months	68.8	(12.0)	143.6	(15.5)
7-12 months	126.4	(12.0)	111.0	(36.2)
Greater than 12 months	113.1	(28.1)	74.4	(7.3)
	308.3	(52.1)	329.0	(59.0)
Preferred stocks				
0-6 months			12.4	(0.3)
7-12 months				
Greater than 12 months				
			12.4	(0.3)
Total	\$ 1,093.8	\$ (104.8)	\$ 1,086.5	\$ (122.5)

Table of Contents

The following table summarizes the unrealized losses in our investment portfolio by type of security and remaining time to maturity as of the dates indicated:

Remaining Time to Maturity	As of March 31, 2009		As of December 31, 2008	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
	(\$ in millions)			
Municipal securities				
Due in one year or less	\$	\$	\$	\$
Due after one year through five years			5.4	
Due after five years through ten years	43.0	(1.6)	42.4	(2.6)
Due after ten years	575.7	(30.5)	569.5	(48.8)
	618.7	(32.1)	617.3	(51.4)
Corporate securities				
Due in one year or less	4.5		0.8	
Due after one year through five years	28.9	(2.8)	23.9	(1.2)
Due after five years through ten years	104.6	(11.5)	72.6	(6.6)
Due after ten years	20.8	(6.3)	22.5	(4.0)
	158.8	(20.6)	119.8	(11.8)
U.S. Government obligations				
Due in one year or less	8.0		8.0	
Due after one year through five years				
Due after five years through ten years				
Due after ten years	8.0		8.0	
Mortgage and asset-backed securities	308.3	(52.1)	329.0	(59.0)
Preferred stocks			12.4	(0.3)
Total	\$ 1,093.8	\$ (104.8)	\$ 1,086.5	\$ (122.5)

Table of Contents

The following table summarizes, for all securities sold at a loss through March 31, 2009 and 2008, the fair value and realized loss by length of time such securities were in a continuous unrealized loss position prior to the date of sale:

Length of Time in Continuous Unrealized Loss Prior to Sale	Three Months Ended March 31,				
	2009				2008
	Estimated Fair Value	Gross Realized Losses	Estimated Fair Value	Gross Realized Losses	
	(\$ in millions)				
Municipal securities					
0-6 months	\$	\$	\$	2.5	\$ (0.3)
7-12 months					
Greater than 12 months	3.7	(1.7)			
	3.7	(1.7)	2.5		(0.3)
Corporate securities					
0-6 months	1.1	(0.4)	0.4		
7-12 months	7.3	(6.9)	2.1		
Greater than 12 months	0.8	(0.2)			
	9.2	(7.5)	2.5		
U.S. Government securities					
0-6 months					
7-12 months					
Greater than 12 months					
Mortgage and asset-backed securities					
0-6 months	0.1	(0.1)	4.9		(0.1)
7-12 months	7.6	(3.4)	1.2		
Greater than 12 months	23.3	(12.2)	1.2		
	31.0	(15.7)	7.3		(0.1)
Preferred stock					
0-6 months	11.2	(1.5)			
7-12 months					
Greater than 12 months					
	11.2	(1.5)			
Total	\$ 55.1	\$ (26.4)	\$ 12.3	\$	(0.4)

7. Significant Risk Management Activities

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

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Risk Management and Surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio, including exposures in both the Direct and Reinsurance segments. The primary objective of the surveillance process is to monitor trends and changes in transaction credit quality, detect any deterioration in credit quality, and recommend to management such remedial actions as may be necessary or appropriate. All transactions in the insured portfolio are risk rated, and surveillance personnel are responsible for

Table of Contents

adjusting those ratings to reflect changes in transaction credit quality. Surveillance personnel are also responsible for managing work-out and loss situations when necessary. For transactions where a loss is considered probable, surveillance personnel present analysis related to potential loss situations to a Reserve Committee. The Reserve Committee is made up of the Chief Executive Officer, Chief Financial Officer, Chief Actuary, General Counsel and Chief Accounting Officer. The Reserve Committee considers the information provided by surveillance personnel when setting reserves.

Direct Businesses

We conduct surveillance procedures to track risk aggregations and monitor performance of each risk. The review cycle and scope vary based upon transaction type and credit quality. In general, the review process includes the collection and analysis of information from various sources, including trustee and servicer reports, financial statements and reports, general industry or sector news and analyses, and rating agency reports. For Public Finance risks, the surveillance process includes monitoring general economic trends, developments with respect to state and municipal finances, and the financial situation of the issuers. For Structured Finance transactions, the surveillance process can include monitoring transaction performance data and cash flows, compliance with transaction terms and conditions, and evaluation of servicer or collateral manager performance and financial condition. Additionally, the Company uses various quantitative tools and models to assess transaction performance and identify situations where there may have been a change in credit quality. For all transactions, surveillance activities may include discussions with or site visits to issuers, servicers or other parties to a transaction.

Reinsurance Businesses

For transactions in the Company's Reinsurance segment, the primary insurers are responsible for conducting ongoing surveillance, and our surveillance personnel monitor the activities of the primary insurers through a variety of means, such as review of surveillance reports provided by the primary insurers, and meetings and discussions with their analysts. Our surveillance personnel take steps to ensure that the primary insurer is managing risk pursuant to the terms of the applicable reinsurance agreement. To this end, we conduct periodic reviews of ceding companies' surveillance activities and capabilities. That process may include the review of the primary insurer's underwriting, surveillance, and claim files for certain transactions. In the event of credit deterioration of a particular exposure, more frequent reviews of the ceding company's risk mitigation activities are conducted. Our surveillance personnel also monitor general news and information, industry trends, and rating agency reports to help focus surveillance activities on sectors or credits of particular concern. For certain exposures, we also will undertake an independent analysis and remodeling of the transaction.

Below Investment Grade Credits

The Company's surveillance department is responsible for monitoring our portfolio of credits and maintains a list of below investment grade (BIG) credits. The BIG credits are divided into three categories:

- Category 1 (below investment grade credit with no expected losses);
- Category 2 (below investment grade credit with a loss reserve established prior to an event of default);

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- Category 3 (below investment grade credit with a loss reserve established and where an event of default has occurred or is imminent).

The BIG credit list includes all credits rated lower than BBB- where there is a material amount of exposure (generally greater than \$10.0 million) or a material risk of the Company incurring a loss greater than \$0.5 million. Credit ratings are based on the Company's internal assessment of the likelihood of default. The Company's internal credit ratings are generally in line or lower than those of the ratings agencies.

As part of our surveillance process, we continually monitor all of our investment grade credits to determine whether they have suffered any credit impairments. Our quarterly procedures included qualitative and quantitative analysis on all of our insured credits to ensure that all potential BIG credits have been identified. Credits we identified through this process as having future credit impairments are subjected to further review by surveillance personnel to ensure that they have an appropriate ratings assigned to them.

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Table of Contents

The following table provides financial guaranty net par outstanding by BIG category as of March 31, 2009 (dollars in millions):

	BIG Credits			
	Category 1	Category 2	Category 3	Total
Number of policies	82	175	120	377
Remaining weighted-average contract period (in years)	16.9	12.1	7.4	11.5
Insured contractual payments outstanding:				
Principal	\$ 1,641.8	\$ 1,226.4	\$ 2,287.8	\$ 5,155.9
Interest	1,139.7	629.0	684.5	2,453.2
Total	\$ 2,781.5	\$ 1,855.4	\$ 2,972.3	\$ 7,609.1
Gross reserves for loss and loss adjustment expenses				
	\$ 2.8	\$ 99.4	\$ 192.9	\$ 295.1
Less:				
Gross potential recoveries			120.5	120.5
Discount, net	1.0	44.1	40.0	85.1
Net reserves for loss and loss adjustment expenses	\$ 1.8	\$ 55.3	\$ 32.4	\$ 89.5
Unearned premium reserves	\$ 1.8	\$ 9.9	\$ 14.5	\$ 26.2
Net reserves for loss and loss adjustment expenses reported in the balance sheet				
	\$	\$ 45.4	\$ 17.9	\$ 63.2
Reinsurance recoverable	\$	\$	\$ (3.9)	\$ (3.9)

The Company's loss adjustment expense reserves for mitigating claim liabilities were \$1.7 million as of March 31, 2009.

In accordance with FAS 163, the above table includes financial guaranty contracts written in insurance form. It does not include financial guaranty contracts written in CDS form, mortgage guaranty insurance or the Company's other lines of insurance.

The Company used weighted-average risk free discount rate of 2.4% to discount reserves for loss and loss adjustment expenses.

Overview of Significant Risk Management Activities

The Company insures various types of residential mortgage backed securitizations (RMBS). Such transactions may include obligations backed by closed-end first mortgage loans and closed and open-end second mortgage loans or home equity loans on one-to-four family residential

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properties, including condominiums and cooperative apartments. An RMBS transaction where the underlying collateral is comprised of revolving home equity lines of credit is generally referred to as a HELOC transaction. In general, the collateral supporting HELOC securitizations are second lien loans made to prime borrowers. As of March 31, 2009, the Company had net par outstanding of \$1.6 billion related to HELOC securitizations, of which \$1.2 billion were written in the Company's financial guaranty direct segment. As of March 31, 2009, the Company had net par outstanding of \$1.4 billion for transactions with Countrywide, of which \$1.1 billion were written in the Company's financial guaranty direct segment (direct Countrywide transactions or Countrywide 2005-J and Countrywide 2007-D). As of December 31, 2008, the Company had net par outstanding of \$1.7 billion related to HELOC securitizations, of which \$1.5 billion were transactions with Countrywide.

Table of Contents

The performance of our HELOC exposures deteriorated during 2007 and 2008 and the first three months of 2009 and transactions, particularly those originated in the period from 2005 through 2007, continue to perform below our original underwriting expectations. In accordance with its standard practice, during the three months ended March 31, 2009, we evaluated the most currently available information, including trends in delinquencies and charge-offs on the underlying loans, draw rates on the lines of credit, and the servicer's ability to fulfill its contractual obligations including its obligation to fund additional draws. The key assumptions used in our analysis of potential case loss reserves on the direct Countrywide transactions are presented in the following table:

Key Variables

Constant payment rate (CPR)	3-month average, 5.63% as of March 31, 2009
Constant default rate (CDR)	6-month average CDR of approximately 18.19% used for our initial default projections, ramping down to a steady state CDR of 1.0%
Draw rate	3-month average, 1.2% as of March 31, 2009
Excess spread	250 bps per annum
Repurchases of Ineligible loans by Countrywide	\$79.0 million; or approximately 3.3% of original pool balance of \$2.4 billion
Loss Severity	100%

In recent periods, CDR, CPR, Draw Rates and delinquency percentages have fluctuated within ranges that we believe make it appropriate to use rolling averages to project future performance. Accordingly, the Company is using modeling assumptions that are based upon or which approximate recent actual historical performance to project future performance and potential losses. In the first quarter 2009, consistent with FAS 163, the Company modeled and probability weighted a variety of potential time periods over which an elevated CDR may potentially occur. Further, the Company also incorporated in its loss reserve estimates the possibility that in some of those scenarios the prepayment rates increase after the stressed CDR period, leading to lower recoveries through excess spread. The Company continues to model sensitivities around the results booked using a variety of CDR rates and stress periods as well as other modeling approaches including roll rates and hybrid roll rate/CDR methods.

As a result of this modeling and analysis, the Company incurred loss and loss adjustment expenses of \$(4.9) million for its direct Countrywide transactions during First Quarter 2009. The Company's cumulative incurred loss and loss adjustment expenses on the direct Countrywide transactions as of March 31, 2009 were \$93.3 million (\$73.0 million after-tax). During First Quarter 2009, the Company paid losses and loss adjustment expenses for its direct Countrywide transactions of \$35.5 million compared to \$22.6 million paid during First Quarter 2008. The Company's cumulative paid losses and loss adjustment expenses for its direct Countrywide transactions are \$205.5 million as of March 31, 2009. The Company expects to recover a significant amount of these paid losses through excess spread from future cash flows as well as funding of future draws and recoverables from breaches of representations and warranties with respect to the underlying collateral. The recoverable that reduces these losses in the amount of \$112.2 million is included in salvage recoverable on the balance sheet as of March 31, 2009.

For the three months ended March 31, 2009, the Company incurred loss and loss adjustment expenses of \$18.7 million for its HELOC exposures. Of this amount, \$(0.1) million related to the Company's financial guaranty direct segment, including \$(4.9) million of incurred loss and loss adjustment expenses for the direct Countrywide transactions. The remaining \$18.7 million of incurred loss and loss adjustment expenses related to the Company's assumed HELOC exposures in its financial guaranty reinsurance segment.

The ultimate performance of the Company's HELOC transactions will depend on many factors, such as the level and timing of loan defaults, interest proceeds generated by the securitized loans, repayment speeds and changes in home prices, as well as the levels of credit support built into each transaction. Other factors also may have a material impact upon the ultimate performance of each transaction, including the ability of the seller and servicer to fulfill all of their contractual obligations including its obligation to fund future draws on lines of credit as well as the amount of benefit received from put-backs of ineligible loans to Countrywide. The variables affecting transaction performance are interrelated,

difficult to predict and subject to considerable volatility. If actual results differ materially from any of our

Table of Contents

assumptions, the losses incurred could be materially different from our estimate. We continue to update our evaluation of these exposures as new information becomes available.

A summary of the Company's exposure to these two transactions and their actual performance statistics through March 31, 2009 are as follows:

(\$ in millions)

	Countrywide 2005J		Countrywide 2007D	
Original principal balance	\$	1,500	\$	900
Remaining principal balance	\$	492.5	\$	580.9
Cumulative losses (% of original principal balance)(1)		12.1%		17.2%
Total delinquencies (% of current balance)(2)		19.4%		17.3%
Average initial FICO score of borrowers(3)		709		712
Interest margin over prime(4)		2.0%		1.8%
Revolving period(5)		10		10
Repayment period(6)		15		15
Average draw rate(7)		1.1%		1.5%
Average constant payment rate(8)		5.0%		6.3%
Excess spread(9)		321 bps		292 bps
Expected collateral loss(10)		20.2%		34.1%

-
- (1) Cumulative collateral losses expressed as a percentage of the original deal balance.
- (2) Total delinquencies (includes bankruptcies, foreclosures and real estate owned by Countrywide) as a percentage of the current deal balance.
- (3) Fair Isaacs and Company score is a measurement designed to indicate the credit quality of a borrower.
- (4) Floating rate charged to borrowers above the prime rate.
- (5) Time period (usually 5-10 years) in which the borrower may draw funds from their HELOC.
- (6) Time period (usually 10-20years) in which the borrower must repay the funds withdrawn from the HELOC.
- (7) Represents the three-month average draw rate as of March 2009.
- (8) Represents the three-month average constant payment rate as of March 2009.
- (9) Excess spread during March 2009.
- (10) Calculated using a weighted average basis.

Another type of RMBS transaction is generally referred to as Subprime RMBS. The collateral supporting such transactions is comprised of first-lien residential mortgage loans made to subprime borrowers. A subprime borrower is one considered to be a higher risk credit based on credit scores or other risk characteristics. As of March 31, 2009, we had net par outstanding of \$6.5 billion related to Subprime RMBS securitizations, of which \$612 million is classified by us as Below Investment Grade risk. Of the total U.S. Subprime RMBS exposure of \$6.5 billion, \$6.0 billion is from transactions issued in the period from 2005 through 2007 and written in our direct financial guaranty segment. As of March 31, 2009, we had case reserves of \$10.0 million related to our \$6.5 billion U.S. Subprime RMBS exposure, of which \$1.8 million were related to our \$6.0 billion exposure in the direct financial guaranty segment for transactions issued from 2005 through 2007.

The problems affecting the subprime mortgage market have been widely reported, with rising delinquencies, defaults and foreclosures negatively impacting the performance of Subprime RMBS transactions. Those concerns relate primarily to Subprime RMBS issued in the period from 2005 through 2007. The \$6.0 billion exposure that we have to such transactions in our direct financial guaranty segment benefits from various structural protections, including credit enhancement that on average currently equals approximately 54.6% of the remaining principal balance of the transactions.

We also have exposure of \$415 million to Closed-End Second (CES) RMBS transactions, of which \$405 million is in the direct segment. As with other types of RMBS, we have seen significant deterioration in the performance of our CES transactions. On two transactions, which had exposure of \$304 million, as of March 31, 2009 we have seen a significant increase in delinquencies and collateral losses, which resulted in erosion of the Company's credit enhancement and the payment of claims totaling \$26.4 million. Based on the Company's analysis of these transaction and their projected collateral losses, the Company had case reserves of \$38.1 million as of March 31, 2009.

Another type of RMBS transaction is generally referred to as Alt-A RMBS. The collateral supporting such transactions is comprised of first-lien residential mortgage loans made to prime quality borrowers that lack certain

Table of Contents

ancillary characteristics that would make them prime. Included in this category is Alt-A Option ARMs, which include transactions where 66% or more of the collateral is comprised of mortgage loans that have the potential to negatively amortize. As of March 31, 2009, the Company had net par outstanding of \$7.7 billion related to Alt-A RMBS securitizations. Of that amount, \$7.4 billion is from transactions issued in the period from 2005 through 2007 and written in the Company's financial guaranty direct segment. As of March 31, 2009, the Company had case reserves of \$12.5 million for ALT-A and \$11.4 million for Option-ARM related to its \$7.7 billion Alt-A/Option ARM RMBS exposure, in the financial guaranty direct and reinsurance segments, respectively.

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

The Company has exposure on two life insurance reserve securitization transactions based on two discrete blocks of individual life insurance business reinsured by Scottish Re (U.S.) Inc. (Scottish Re). The two transactions relate to Ballantyne Re p.l.c. (Ballantyne) (gross exposure of \$500 million) and Orkney Re II, p.l.c. (Orkney II) (gross exposure of \$423 million). Under both transactions, monies raised through the issuance of the insured notes support present and future U.S. statutory life insurance reserve requirements. The monies were invested at inception of each transaction in accounts managed by a large, well-known investment manager. However, those investment accounts have incurred substantial mark-to-market losses since mid-year 2007, principally as a result of their exposure to subprime and Alt-A RMBS transactions. Largely as a result of these mark-to-market losses both we and the rating agencies have downgraded our exposure to both Ballantyne and Orkney II to below investment grade. As regards the Ballantyne transaction, the Company is working with the directing guarantor, who has insured exposure of \$900 million, to remediate the risk. On the Orkney Re II transaction, the Company, as directing financial guarantor, is taking remedial action.

Some credit losses have been realized on the securities in the Ballantyne and Orkney Re II portfolios and significant additional credit losses are expected to occur. Performance of the underlying blocks of life insurance business thus far generally has been in accordance with expectations. The combination of cash flows from the investment accounts and the treaty settlements currently is sufficient to cover interest payments due on the notes that we insure. Adverse treaty performance and/or a rise in credit losses on the invested assets are expected to lead to interest shortfalls. Additionally, the transactions also contain features linked to the market values of the invested assets, reserve funding requirements on the underlying blocks of life insurance business, and minimum capital requirements for the transactions themselves that may trigger a shut off of interest payments to the insured notes and thereby result in claim payments by the Company.

Another key risk is that the occurrence of certain events may result in a situation where either Ballantyne and/or Orkney Re II are required to sell assets and potentially realize substantial investment losses and for Assured Guaranty Ltd. to incur corresponding insured losses ahead of the scheduled final maturity date. For example, cedants to Scottish Re may have the right to recapture blocks of life insurance business which Scottish Re has ceded to Orkney Re II. Such recaptures could require Orkney Re II to sell assets and realize investment losses. In the Ballantyne transaction, further declines in the market value of the invested assets and/or an increase in the reserve funding requirements could lead to a similar mandatory realization of investment losses and for Assured Guaranty Ltd. to incur corresponding insured losses ahead of the scheduled final maturity date.

In order for the Company to incur an ultimate net loss on these transactions, adverse experience on the underlying block of life insurance policies and/or credit losses in the investment portfolio would need to exceed the level of credit enhancement built into the transaction structures. Based on its analysis of the information currently available, including estimates of future investment performance, projected credit impairments on the invested assets and performance of the blocks of life insurance business, at March 31, 2009, the Company's case reserve is now \$43.0 million for the Ballantyne transaction. The Company has not established a case loss reserve for the Orkney Re II transaction.

On December 19, 2008, the Company sued J.P. Morgan Investment Management Inc. (JPMIM), the

Table of Contents

investment manager in the Orkney II transaction, in New York Supreme Court alleging that JPMIM engaged in breaches of fiduciary duty, gross negligence and breaches of contract based upon its handling of the investments of Orkney Re II. JPMIM has filed a motion to dismiss Assured's complaint, which has been opposed by Assured. The Court has not yet acted on the motion to dismiss.

The Company has exposure to a public finance transaction for sewer service in Jefferson County, Alabama through several reinsurance treaties. The Company's total exposure to this transaction is approximately \$455 million as of March 31, 2009. The Company has made debt service payments during the year and expects to make additional payments in the near term. Through our cedants, the Company is currently in discussions with the bond issuer to structure a solution, which may result in some or all of these payments being recoverable. The Company incurred cumulative loss and loss adjustment expenses of \$19.3 million as of March 31, 2009.

8. Analysis Of Premiums Written, Premiums Earned And Loss And Loss Adjustment Expenses

The Company enters into reinsurance agreements with non-affiliated companies to limit its exposure to risk on an on-going basis. In the event that any or all of the reinsurers are unable to meet their obligations, the Company would be liable for such defaulted amounts. Direct, assumed, and ceded premium and loss and loss adjustment expense amounts for three months ended March 31, 2009 and 2008 were as follows:

	Three Months Ended March 31,	
	2009	2008
	(in thousands of U.S. dollars)	
Premiums Written		
Direct	\$ 140,080	\$ 146,409
Assumed	94,678	29,393
Ceded	38	(6,110)
Net	\$ 234,796	\$ 169,692
Premiums Earned		
Direct	\$ 106,463	\$ 17,967
Assumed	46,928	30,927
Ceded	(4,945)	(2,061)
Net	\$ 148,446	\$ 46,833
Loss and Loss Adjustment Expenses		
Direct	\$ 15,066	\$ 35,915
Assumed	67,228	19,028
Ceded	(2,540)	195
Net	\$ 79,754	\$ 55,138

Net premiums written for First Quarter 2009 were \$234.8 million compared with \$169.7 million for First Quarter 2008. The \$65.1 million increase is mainly attributable to the Company's direct premiums written resulting from the expansion of the Company's financial guaranty direct segment, particularly in the U.S. public finance market. First Quarter 2009 included upfront direct premiums written of \$112.9 million from the

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Company's U.S. public finance business compared with \$121.6 million in First Quarter 2008.

Net premiums earned for First Quarter 2009 were \$148.4 million compared with \$46.8 million for First Quarter 2008. The \$101.6 million increase is partially attributable to the Company's direct earned premiums which increased \$88.5 million in First Quarter 2009, compared with First Quarter 2008. This increase is principally attributable to accelerated premiums earned of \$73.6 million resulting from early contract terminations in the financial guaranty direct segment and to the continued growth of the Company's in-force book of business. First Quarter 2009 earned premiums include \$5.3 million related to the accretion of discount on future financial guaranty installment premiums as the result of the implementation of FAS 163 effective January 1, 2009. The First Quarter 2009 and First Quarter 2008 did not have any earned premiums from public finance refundings in the financial guaranty direct segment but did have \$16.7 million and \$2.4 million in the financial guaranty reinsurance segment

Table of Contents

for these periods. Public finance refundings reflect the unscheduled pre-payment or refundings of underlying municipal bonds. Also contributing to the Company's increase in net premiums earned was the financial guaranty reinsurance segment, which increased \$18.4 million compared to the same period last year. This increase was mainly due to the portfolio assumed from Ambac Assurance Corp. (Ambac) during December 2007. Offsetting these increases was a decrease of \$1.1 million in net premiums earned in the mortgage segment due to run-off.

Loss and loss adjustment expenses (LAE) were \$79.8 million and \$55.1 million for First Quarter 2009 and First Quarter 2008, respectively. First Quarter 2009 included a decrease in loss and loss adjustment expenses in the financial guaranty direct segment of \$24.2 million offset by an increase of \$17.6 million in the financial guaranty reinsurance segment and \$31.2 million in the mortgage segment, as a result of a loss reserve estimate related to a contract under dispute.

To limit its exposure on assumed risks, the Company entered into certain proportional and non-proportional retrocessional agreements with other insurance companies, primarily subsidiaries of ACE Limited (ACE), the Company's former parent, to cede a portion of the risk underwritten by the Company, prior to the IPO. In addition, the Company enters into reinsurance agreements with non-affiliated companies to limit its exposure to risk on an on-going basis.

Reinsurance recoverable on ceded losses and LAE as of March 31, 2009 and December 31, 2008 were \$7.8 million and \$6.5 million, respectively and are mainly related to the Company's other segment. In the event that any or all of the reinsurers are unable to meet their obligations, the Company would be liable for such defaulted amounts.

Agreement with CIFG Assurance North America, Inc.

AGC entered into an agreement with CIFG Assurance North America, Inc. (CIFG) to assume a diversified portfolio of financial guaranty contracts totaling approximately \$13.3 billion of net par outstanding. The Company closed the transaction in January 2009 and received \$75.6 million (\$85.7 million of upfront premiums net of ceding commissions) and will receive approximately \$12.2 million of future installments premiums.

9. Commitments and Contingencies

Litigation

Effective January 1, 2004, Assured Guaranty Mortgage Insurance Company (AGMIC) reinsured a private mortgage insurer (the Reinsured) under a Mortgage Insurance Stop Loss Excess of Loss Reinsurance Agreement (the Agreement). Under the Agreement, AGMIC agreed to cover the Reinsured's aggregate mortgage guaranty insurance losses in excess of a \$25 million retention and subject to a \$95 million limit.

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Coverage under the Agreement was triggered only when the Reinsured s: (1) combined loss ratio exceeded 100%; and (2) risk to capital ratio exceeded 25 to 1, according to insurance statutory accounting. In April 2008, AGMIC notified the Reinsured it was terminating the Agreement because of the Reinsured s breach of the terms of the Agreement. The Reinsured notified AGMIC that it considers the Agreement to remain in effect and that the two coverage triggers under the Agreement apply as of April 1, 2008. By letter dated May 5, 2008, the Reinsured demanded arbitration against AGMIC seeking a declaration that the Agreement remains in effect and alleged compensatory and other damages. The arbitration hearing took place before a three person panel in December 2008 and January 2009. Post hearing briefing and oral arguments was completed on February 26, 2009, and the arbitration panel could render its decision at any time.

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

Real Estate Leases

The Company and its subsidiaries are party to various lease agreements. In June 2008, the Company s subsidiary, Assured Guaranty Corp., entered into a new five-year lease agreement for New York office space. Future

Table of Contents

minimum annual payments of \$5.3 million for the first twelve month period and \$5.7 million for subsequent twelve month periods commenced October 1, 2008 and are subject to escalation in building operating costs and real estate taxes.

Reinsurance

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

The Company is party to reinsurance agreements with most of the major monoline primary financial guaranty insurance companies. The Company's facultative and treaty agreements are generally subject to termination (i) upon written notice (ranging from 90 to 120 days) prior to the specified deadline for renewal, (ii) at the option of the primary insurer if the Company fails to maintain certain financial, regulatory and rating agency criteria which are equivalent to or more stringent than those the Company is otherwise required to maintain for its own compliance with state mandated insurance laws and to maintain a specified financial strength rating for the particular insurance subsidiary or (iii) upon certain changes of control of the Company. Upon termination under the conditions set forth in (ii) and (iii) above, the Company may be required (under some of its reinsurance agreements) to return to the primary insurer all statutory unearned premiums, less ceding commissions, attributable to reinsurance ceded pursuant to such agreements after which the Company would be released from liability with respect to the ceded business. Upon the occurrence of the conditions set forth in (ii) above, whether or not an agreement is terminated, the Company may be required to obtain a letter of credit or alternative form of security to collateralize its obligation to perform under such agreement or it may be obligated to increase the level of ceding commission paid.

10. Long-Term Debt and Credit Facilities

The Company's unaudited interim consolidated financial statements include long-term debt used to fund the Company's insurance operations, and related interest expense, as described below.

Senior Notes

On May 18, 2004, Assured Guaranty US Holdings Inc. (AGUS), a subsidiary of the Company, issued \$200.0 million of 7.0% Senior Notes due 2034 for net proceeds of \$197.3 million. The proceeds of the offering were used to repay substantially all of a \$200.0 million promissory note issued to a subsidiary of ACE in April 2004 as part of the IPO related formation transactions. The coupon on the Senior Notes is 7.0%, however, the effective rate is approximately 6.4%, taking into account the effect of a cash flow hedge executed by the Company in March 2004, the term of which matches that of the Senior Notes. The Company recorded interest expense of \$3.3 million, including \$0.2 million of amortized gain on the cash flow hedge, for both First Quarter 2009 and First Quarter 2008. These Senior Notes are fully and unconditionally guaranteed by Assured Guaranty Ltd.

Series A Enhanced Junior Subordinated Debentures

On December 20, 2006, AGUS issued \$150.0 million of Series A Enhanced Junior Subordinated Debentures (the "Debentures") due 2066 for net proceeds of \$149.7 million. The proceeds of the offering were used to repurchase 5,692,599 of Assured Guaranty Ltd.'s common shares from ACE Bermuda Insurance Ltd., a subsidiary of ACE. The Debentures pay a fixed 6.40% rate of interest until December 15, 2016, and thereafter pay a floating rate of interest, reset quarterly, at a rate equal to 3 month LIBOR plus a margin equal to 2.38%. AGUS may elect at one or more times to defer payment of interest for one or more consecutive periods for up to ten years. Any unpaid interest bears interest at the then applicable rate. AGUS may not defer interest past the maturity date. The Company recorded interest expense of \$2.5 million in both First Quarter 2009 and First Quarter 2008. These Debentures are guaranteed on a junior subordinated basis by Assured Guaranty Ltd.

Table of Contents

Credit Facilities

2006 Credit Facility

On November 6, 2006, Assured Guaranty Ltd. and certain of its subsidiaries entered into a \$300.0 million five-year unsecured revolving credit facility (the 2006 credit facility) with a syndicate of banks. Under the \$300.0 million credit facility, each of Assured Guaranty Corp. (AGC), Assured Guaranty (UK) Ltd. (AG (UK)), Assured Guaranty Re Ltd. (AG Re), Assured Guaranty Re Overseas Ltd. (AGRO) and Assured Guaranty Ltd. are entitled to request the banks to make loans to such borrower or to request that letters of credit be issued for the account of such borrower.

Of the \$300.0 million available to be borrowed, no more than \$100.0 million may be borrowed by Assured Guaranty Ltd., AG Re or AGRO, individually or in the aggregate, and no more than \$20.0 million may be borrowed by AG (UK). The stated amount of all outstanding letters of credit and the amount of all unpaid drawings in respect of all letters of credit cannot, in the aggregate, exceed \$100.0 million.

The 2006 credit facility also provides that Assured Guaranty Ltd. may request that the commitment of the banks be increased an additional \$100.0 million up to a maximum aggregate amount of \$400.0 million. Any such incremental commitment increase is subject to certain conditions provided in the agreement and must be for at least \$25.0 million.

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

At the closing of the 2006 credit facility, (i) AGC guaranteed the obligations of AG (UK) under such facility, (ii) Assured Guaranty Ltd. guaranteed the obligations of AG Re and AGRO under such facility and agreed that, if the Company Consolidated Assets (as defined in the related credit agreement) of AGC and its subsidiaries were to fall below \$1.2 billion, it would, within 15 days, guarantee the obligations of AGC and AG (UK) under such facility, (iii) Assured Guaranty Overseas US Holdings Inc., guaranteed the obligations of Assured Guaranty Ltd., AG Re and AGRO under such facility and (iv) each of AG Re and AGRO guarantees the other as well as Assured Guaranty Ltd.

The 2006 credit facility's financial covenants require that Assured Guaranty Ltd. (a) maintain a minimum net worth of seventy-five percent (75%) of the Consolidated Net Worth of Assured Guaranty Ltd. as of the most recent fiscal quarter of Assured Guaranty Ltd. prior to November 6, 2006 and (b) maintain a maximum debt-to-capital ratio of 30%. In addition, the 2006 credit facility requires that AGC maintain qualified statutory capital of at least 75% of its statutory capital as of the fiscal quarter prior to November 6, 2006. Furthermore, the 2006 credit facility contains restrictions on Assured Guaranty Ltd. and its subsidiaries, including, among other things, in respect of their ability to incur debt, permit liens, become liable in respect of guaranties, make loans or investments, pay dividends or make distributions, dissolve or become party to a merger, consolidation or acquisition, dispose of assets or enter into affiliate transactions. Most of these restrictions are subject to certain minimum thresholds and exceptions. The 2006 credit facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representation or warranty, bankruptcy or insolvency proceedings, change of control and cross-default to other debt agreements. A default by one borrower will give rise to a right of the lenders to terminate the facility and accelerate all amounts then outstanding. As of March 31, 2009 and December 31, 2008, Assured Guaranty was in compliance with all of those financial covenants.

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As of March 31, 2009 and December 31, 2008, no amounts were outstanding under this facility nor have there been any borrowings under this facility.

Letters of credit totaling approximately \$2.9 million remained outstanding as of March 31, 2009 and December 31, 2008, respectively, discussed in Note 9.

Table of Contents

Non-Recourse Credit Facilities

AG Re Credit Facility

On July 31, 2007 AG Re entered into a non-recourse credit facility (AG Re Credit Facility) with a syndicate of banks which provides up to \$200.0 million to satisfy certain reinsurance agreements and obligations. The AG Re Credit Facility expires in July 2014.

The AG Re Credit Facility does not contain any financial covenants. The AG Re Credit Facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, failure to comply with covenants, material inaccuracy of representation or warranty, bankruptcy or insolvency proceedings, change of control and cross default to other debt agreements. If any such event of default were triggered, AG Re could be required to repay potential outstanding borrowings in an accelerated manner.

AG Re's obligations to make payments of principal and interest on loans under the AG Re Credit Facility, whether at maturity, upon acceleration or otherwise, are limited recourse obligations of AG Re and are payable solely from the collateral securing the AG Re Credit Facility, including recoveries with respect to certain insured obligations in a designated portfolio, premiums with respect to defaulted insured obligations in that portfolio, certain designated reserves and other designated collateral.

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

Committed Capital Securities

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

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

During First Quarter 2009 and First Quarter 2008, AGC incurred \$1.4 million and \$0.7 million, respectively, of put option premiums which are an on-going expense. The increase in First Quarter 2009 compared with First Quarter 2008 was due to the increase in annualized rates from One-Month LIBOR plus 110 basis points to One-Month LIBOR plus 250 basis points as a result of the failed auction process in April 2008. These expenses are presented in the Company's unaudited interim consolidated statements of operations and comprehensive income under other expense.

The CCS securities had a fair value of \$70.7 million (see Note 5) and \$51.1 million as of March 31, 2009 and December 31, 2008, respectively, and a change in fair value during First Quarter 2009 and First Quarter 2008 of \$19.7 million and \$8.5 million, respectively, which are recorded in the unaudited interim consolidated statements of operations and comprehensive income in other income.

Table of Contents

11. Employee Benefit Plans

Share-Based Compensation

Share-based compensation expense in First Quarter 2009 and First Quarter 2008 was \$3.8 million (\$3.1 million after tax) and \$6.4 million (\$5.4 million after tax), respectively. The effect on basic and diluted earnings per share for First Quarter 2009 and First Quarter 2008 was \$0.03 and \$0.07, respectively. First Quarter 2009 and First Quarter 2008 expense included \$2.0 million (\$1.8 million after tax) and \$3.9 million (\$3.5 million after tax), respectively, related to accelerated vesting for stock award grants to retirement-eligible employees.

Performance Retention Plan

The Company recognized approximately \$5.2 million (\$4.4 million after-tax) and \$5.5 million (\$4.6 million after-tax) of expense for performance retention awards in First Quarter 2009 and First Quarter 2008, respectively. Included in First Quarter 2009 and First Quarter 2008 amounts were \$4.3 million and \$4.6 million, respectively, of accelerated expense related to retirement eligible employees.

12. Earnings Per Share

Effective January 1, 2009, the Company adopted FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP). The FSP clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends or dividend equivalents before vesting should be considered participating securities. Restricted stock awards granted prior to February 2008 are considered participating securities as they received non-forfeitable rights to dividends at the same rate as common stock. As participating securities, the Company is required to include these instruments in the calculation of basic earnings per share (EPS), and needs to calculate basic EPS using the two-class method described in FAS No. 128, *Earnings per Share*.

Prior to adoption of the FSP, restricted stock was included in our dilutive EPS calculation using the treasury stock method. The two-class method of computing EPS is an earnings allocation formula that determines EPS for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Basic EPS is then calculated by dividing net (loss) income available to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted EPS adjusts basic (loss) earnings per share for the effects of restricted stock, stock options and other potentially dilutive financial instruments (dilutive securities), only in the periods in which such effect is dilutive. The dilutive effect of the dilutive securities is reflected in diluted EPS by application of the more dilutive of (1) the treasury stock method or (2) the two-class method assuming nonvested shares are not converted into common shares. The FSP requires the presentation of basic and diluted EPS for each class of common stock. The Company has a single class of common stock. Therefore, the following EPS amounts only pertain to common stock. Pursuant to the FSP, all prior period EPS data were adjusted retrospectively. The impact of adopting the FSP increased previously reported basic EPS by \$0.02 and previously reported diluted EPS by \$0.02 for the three months ended March 31, 2008.

Table of Contents

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

	Three Months Ended March 31,	
	2009	2008
	(in thousands of U.S. dollars except per share amounts)	
Net income (loss)	\$ 85,489	\$ (169,209)
Less: Distributed and undistributed income (loss) available to nonvested shareholders	501	(2,131)
Distributed and undistributed income (loss) available to common shareholders	\$ 84,988	\$ (167,078)
Basic shares	90,811	80,044
Effect of dilutive securities:		
Options and restricted stock awards	364	
Diluted shares	91,175	80,044
Basic EPS	\$ 0.94	\$ (2.09)
Diluted EPS	\$ 0.93	\$ (2.09)

Potentially dilutive securities representing approximately 4.8 million and 5.4 million shares of common stock for the three months ended March 31, 2009 and 2008, respectively, were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive.

13. Income Taxes

As of both March 31, 2009 and December 31, 2008, Assured Guaranty Re Overseas Ltd. (AGRO) had a stand alone NOL of \$47.9 million, which is available to offset its future U.S. taxable income. The Company has \$27.2 million of this NOL available through 2017 and \$20.7 million available through 2023. AGRO's stand alone NOL is not permitted to offset the income of any other members of AGRO's consolidated group due to certain tax regulations. Assured Guaranty Mortgage Insurance Company (AGMIC) is a member of the same consolidated tax group as AGRO. In First Quarter 2009 AGMIC had a projected NOL of \$9.6 million which would be available through 2020.

Under applicable accounting rules, the Company is required to establish a valuation allowance for NOLs that are more likely than not to expire before being utilized. Management has assessed the likelihood of realization of all of its deferred tax assets. Based on this analysis, management believes it is more likely than not that \$20.0 million of AGRO's \$47.9 million NOL will not be utilized before it expires and has established a \$7.0 million valuation allowance related to the NOL deferred tax asset. In addition, management believes it is more likely than not that AGMIC's NOL will not be utilized before it expires and has established a \$3.4 million valuation allowance related to the NOL deferred tax asset. Management believes that all other deferred income taxes are more-likely-than-not to be realized. The valuation allowance is subject to considerable judgment, is reviewed quarterly and will be adjusted to the extent actual taxable income differs from estimates of future taxable income that may be used to realize NOLs or capital losses.

Liability For Tax Basis Step-Up Adjustment

In connection with the IPO, the Company and ACE Financial Services Inc. (AFS), a subsidiary of ACE, entered into a tax allocation agreement, whereby the Company and AFS made a Section 338 (h)(10) election that has the effect of increasing the tax basis of certain affected subsidiaries tangible and intangible assets to fair value. Future tax benefits that the Company derives from the election will be payable to AFS when realized by the Company.

As a result of the election, the Company has adjusted its net deferred tax liability to reflect the new tax basis of the Company s affected assets. The additional basis is expected to result in increased future income tax deductions and, accordingly, may reduce income taxes otherwise payable by the Company. Any tax benefit realized by the Company will be paid to AFS. Such tax benefits will generally be calculated by comparing the Company s

Table of Contents

affected subsidiaries' actual taxes to the taxes that would have been owed by those subsidiaries had the increase in basis not occurred. After a 15 year period, to the extent there remains an unrealized tax benefit, the Company and AFS will negotiate a settlement of the unrealized benefit based on the expected realization at that time.

The Company initially recorded a \$49.0 million reduction of its existing deferred tax liability, based on an estimate of the ultimate resolution of the Section 338(h)(10) election. Under the tax allocation agreement, the Company estimated that, as of the IPO date, it was obligated to pay \$20.9 million to AFS and accordingly established this amount as a liability. The initial difference, which is attributable to the change in the tax basis of certain liabilities for which there is no associated step-up in the tax basis of its assets and no amounts due to AFS, resulted in an increase to additional paid-in capital of \$28.1 million. As of March 31, 2009 and December 31, 2008, the liability for tax basis step-up adjustment, which is included in the Company's balance sheets in "Other liabilities," was \$9.0 million and \$9.1 million, respectively. The Company has paid ACE and correspondingly reduced its liability by \$0.2 million and \$0.2 million in First Quarter 2009 and First Quarter 2008, respectively.

Tax Treatment of CDS

The Company treats the guaranty it provides on CDS as insurance contracts for tax purposes and as such a taxable loss does not occur until the Company expects to make a loss payment to the buyer of credit protection based upon the occurrence of one or more specified credit events with respect to the contractually referenced obligation or entity. The Company holds its CDS to maturity, at which time any unrealized mark to market loss would revert to zero absent any credit related losses. As of March 31, 2009, the Company did not anticipate any significant credit related losses on its credit default swaps and, therefore, no resultant tax deductions.

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

As of March 31, 2009 and December 31, 2008 the deferred tax assets associated with CDS were \$124.0 million and \$116.5 million, respectively. The Company came to the conclusion that it is more likely than not that its deferred tax asset related to CDS will be fully realized after weighing all positive and negative evidence available as required under FAS 109. The evidence that was considered included the following:

Negative Evidence

- Although the Company believes that income or losses for these credit default swaps are properly characterized for tax purposes as ordinary, the federal tax treatment is an unsettled area of tax law as described above.
- Changes in the fair value of CDS have resulted in significant swings in the Company's net income in recent periods. Changes in the fair value of CDS in future periods could result in the U.S. consolidated tax group having a pre-tax loss under GAAP. Although not recognized for tax, this loss could result in a cumulative three year pre-tax loss, which is considered significant negative evidence for the recoverability of a

deferred tax asset under FAS 109.

- For the three year period ended March 31, 2009 the US consolidated tax group had a pre-tax loss under GAAP of \$103.9 million.

Positive Evidence

- The mark to market loss on CDS is not considered a tax event, and therefore no taxable loss has occurred.
- The Company is in a cumulative net gain position related to the taxable activity on CDS contracts.
- The Company has no significant anticipated loss payments under its existing CDS contracts.
- After analysis of the current tax law on CDS the Company believes it is more likely than not that the CDS will be treated as ordinary income or loss for tax purposes.
- Assuming a hypothetical loss were triggered for the amount of deferred tax asset (DTA), there would be enough taxable income through carryback and future income to offset it as follows:

Table of Contents

- The amortization of the tax-basis unearned premium reserve of \$599.6 million as of March 31, 2009 as well as the collection of future installment premiums of contracts already written we believe will result in significant taxable income in the future.
- The Company has the ability to carryback losses two years which would offset over \$22.8 million of losses as of March 31, 2009.
- Although the Company has a significant tax exempt portfolio, this can be converted to taxable securities as permitted as a tax planning strategy under FAS 109.
- The mark-to-market loss is reflective of market valuations and will change from quarter to quarter. It is not indicative of the Company's ability to enter new business. The Company writes and continues to write new business which will increase the amortization of unearned premium and investment portfolio resulting in expected taxable income in future periods.

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

14. Segment Reporting

The Company has four principal business segments: (1) financial guaranty direct, which includes transactions whereby the Company provides an unconditional and irrevocable guaranty that indemnifies the holder of a financial obligation against non-payment of principal and interest when due, and could take the form of a credit derivative; (2) financial guaranty reinsurance, which includes agreements whereby the Company is a reinsurer and agrees to indemnify a primary insurance company against part or all of the loss which the latter may sustain under a policy it has issued; (3) mortgage guaranty, which includes mortgage guaranty insurance and reinsurance whereby the Company provides protection against the default of borrowers on mortgage loans; and (4) other, which includes lines of business in which the Company is no longer active.

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

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

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Table of Contents

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

	Three Months Ended March 31, 2009				Total
	Financial Guaranty Direct	Financial Guaranty Reinsurance	Mortgage Guaranty	Other	
	(in millions of U.S. dollars)				
Net earned premiums	\$ 101.5	\$ 46.2	\$ 0.8	\$	\$ 148.4
Realized gain and other settlements on credit derivatives	20.0	0.6			20.6
Loss and loss adjustment expenses	11.7	36.8	31.2		79.8
Incurred losses (gains) on credit derivatives	(7.3)	(0.7)			(8.1)
Total loss and loss adjustment expenses	4.4	36.1	31.2		71.7
Profit commission expense		0.2	0.1		0.3
Acquisition costs	6.2	17.1	0.1		23.4
Other operating expenses	24.0	7.6	0.7		32.3
Underwriting gain (loss)	\$ 87.0	\$ (14.2)	\$ (31.3)	\$	\$ 41.5

	Three Months Ended March 31, 2008				Total
	Financial Guaranty Direct	Financial Guaranty Reinsurance	Mortgage Guaranty	Other	
	(in millions of U.S. dollars)				
Net earned premiums	\$ 17.3	\$ 27.8	\$ 1.9	\$	\$ 46.8
Realized gain and other settlements on credit derivatives	27.3	0.3			27.6
Loss and loss adjustment expenses (recoveries)	35.9	19.2			55.1
Incurred losses on credit derivatives	3.2				3.2
Total loss and loss adjustment expenses (recoveries)	39.1	19.2			58.3
Profit commission expense		1.1	0.1		1.2
Acquisition costs	3.0	8.8	0.1		11.9
Other operating expenses	21.3	6.4	0.9		28.6
Underwriting (loss) gain	\$ (18.9)	\$ (7.3)	\$ 0.8	\$	\$ (25.4)

The following is a reconciliation of total underwriting (loss) gain to (loss) income before provision for income taxes for the periods ended:

	Three Months Ended March 31,	
	2009	2008
	(in millions of U.S. dollars)	
Total underwriting gain (loss)	\$ 41.5	\$ (25.4)
Net investment income	43.6	36.6

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Net realized investment (losses) gains	(17.1)	0.6
Unrealized gains (losses) on credit derivatives, excluding incurred losses on credit derivatives	18.8	(256.4)
Other income	20.6	8.5
Interest expense	(5.8)	(5.8)
Other expense	(1.4)	(0.7)
Income (loss) before provision for income taxes	\$ 100.1	\$ (242.8)

Table of Contents

The following table provides the lines of businesses from which each of the Company's segments derive their net earned premiums:

	Three Months Ended	
	March 31,	
	2009	2008
	(in millions of U.S. dollars)	
Financial guaranty direct:		
Public finance	\$ 85.5	\$ 4.1
Structured finance	16.0	13.2
Total	101.5	17.3
Financial guaranty reinsurance:		
Public finance	34.8	18.6
Structured finance	11.4	9.2
Total	46.2	27.8
Mortgage guaranty:		
Mortgage guaranty	0.8	1.9
Total net earned premiums	148.4	46.8
Net credit derivative premiums received and receivable	29.5	27.8
Total net earned premiums and credit derivative premiums received and receivable	\$ 178.0	\$ 74.7

The other segment had an underwriting gain of \$0 million for both First Quarter 2009 and First Quarter 2008.

Table of Contents**15. Subsidiary Information**

The following tables present the unaudited condensed consolidated financial information for Assured Guaranty Ltd., Assured Guaranty US Holdings Inc., of which AGC is a subsidiary and other subsidiaries of Assured Guaranty Ltd. as of March 31, 2009 and December 31, 2008 and for the three months ended March 31, 2009 and 2008.

CONDENSED CONSOLIDATING BALANCE SHEET

AS OF MARCH 31, 2009

(in thousands of U. S. dollars)

	Assured Guaranty Ltd. (Parent Company)	Assured Guaranty US Holdings Inc.	AG Re and Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)
Assets					
Total investments and cash	\$ 4,419	\$ 1,799,467	\$ 2,008,454	\$	\$ 3,812,340
Investment in subsidiaries	2,003,499			(2,003,499)	
Deferred acquisition costs		55,804	326,721		382,525
Reinsurance recoverable		21,407	2,472	(16,116)	7,763
Goodwill		85,417			85,417
Credit derivative assets		121,321	28,477		149,798
Premiums receivable		419,250	475,303	(146,139)	748,414
Deferred tax asset		101,595	15,965		117,560
Other	22,598	584,873	62,075	(385,035)	284,511
Total assets	\$ 2,030,516	\$ 3,189,134	\$ 2,919,467	\$ (2,550,789)	\$ 5,588,328
Liabilities and shareholders equity					
Liabilities					
Unearned premium reserves	\$	\$ 1,202,038	\$ 1,291,100	\$ (339,826)	\$ 2,153,312
Reserves for losses and loss adjustment expenses		143,633	122,799	(43,877)	222,555
Profit commissions payable		3,971	3,780		7,751
Credit derivative liabilities		497,401	209,367		706,768
Senior Notes		197,452			197,452
Series A Enhanced Junior Subordinated Debentures		149,774			149,774
Other	4,923	234,145	49,642	(163,587)	125,123
Total liabilities	4,923	2,428,414	1,676,688	(547,290)	3,562,735
Total shareholders equity	2,025,593	760,720	1,242,779	(2,003,499)	2,025,593
Total liabilities and shareholders equity	\$ 2,030,516	\$ 3,189,134	\$ 2,919,467	\$ (2,550,789)	\$ 5,588,328

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Table of Contents

CONDENSED CONSOLIDATING BALANCE SHEET

AS OF DECEMBER 31, 2008

(in thousands of U. S. dollars)

	Assured Guaranty Ltd. (Parent Company)	Assured Guaranty US Holdings Inc.	AG Re and Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)
Assets					
Total investments and cash	\$ 188	\$ 1,651,761	\$ 1,991,690	\$	\$ 3,643,639
Investment in subsidiaries	1,901,108			(1,901,108)	
Deferred acquisition costs		78,987	209,629		288,616
Reinsurance recoverable		22,014	3,474	(18,960)	6,528
Goodwill		85,417			85,417
Credit derivative assets		125,082	21,877		146,959
Premiums receivable		6,659	23,559	(14,475)	15,743
Deferred tax asset		109,565	19,553		129,118
Other	29,427	383,272	49,502	(222,514)	239,687
Total assets	\$ 1,930,723	\$ 2,462,757	\$ 2,319,284	\$ (2,157,057)	\$ 4,555,707
Liabilities and shareholders equity					
Liabilities					
Unearned premium reserves	\$	\$ 707,957	\$ 713,948	\$ (188,191)	\$ 1,233,714
Reserves for losses and loss adjustment expenses		133,710	90,752	(27,664)	196,798
Profit commissions payable		3,971	4,613		8,584
Credit derivative liabilities		481,253	252,513		733,766
Senior Notes		197,443			197,443
Series A Enhanced Junior Subordinated Debentures		149,767			149,767
Other	4,501	82,024	62,982	(40,094)	109,413
Total liabilities	4,501	1,756,125	1,124,808	(255,949)	2,629,485
Total shareholders equity	1,926,222	706,632	1,194,476	(1,901,108)	1,926,222
Total liabilities and shareholders equity	\$ 1,930,723	\$ 2,462,757	\$ 2,319,284	\$ (2,157,057)	\$ 4,555,707

Table of Contents

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

FOR THE THREE MONTHS ENDED MARCH 31, 2009

(in thousands of U. S. dollars)

	Assured Guaranty Ltd. (Parent Company)	Assured Guaranty US Holdings Inc.	AG Re and Other Subsidiaries	Consolidating Adjustments*	Assured Guaranty Ltd. (Consolidated)
Revenues					
Net earned premiums	\$	\$ 67,725	\$ 80,721	\$	\$ 148,446
Net investment income	1	19,313	24,367	(80)	43,601
Net realized investment gains (losses)		238	(17,348)		(17,110)
Change in fair value of credit derivatives					
Realized gain and other settlements on credit derivatives		24,363	(3,763)	(21)	20,579
Unrealized losses on credit derivatives		(23,147)	50,108	21	26,982
Net change in fair value of credit derivatives		1,216	46,345		47,561
Equity in earnings of subsidiaries	96,726			(96,726)	
Other income		20,809		(241)	20,568
Total revenues	96,727	109,301	134,085	(97,047)	243,066
Expenses					
Loss and loss adjustment expenses		21,382	58,372		79,754
Acquisition costs and other operating expenses	11,238	16,238	28,518		55,994
Other		7,221			7,221
Total expenses	11,238	44,841	86,890		142,969
(Loss) income before (benefit) provision for income taxes	85,489	64,460	47,195	(97,047)	100,097
Total (benefit) provision for income taxes		18,781	(4,173)		14,608
Net (loss) income	\$ 85,489	\$ 45,679	\$ 51,368	\$ (97,047)	\$ 85,489

* Due to the accounting for subsidiaries under common control, net income in the consolidating adjustment column does not equal parent company equity in earnings of subsidiaries, due to 1) recognition of income by Assured Guaranty US Holdings Inc. for dividends received from Assured Guaranty Ltd. and 2) the residual effects of the FSA agreement.

Table of Contents

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

FOR THE THREE MONTHS ENDED MARCH 31, 2008

(in thousands of U. S. dollars)

	Assured Guaranty Ltd. (Parent Company)	Assured Guaranty US Holdings Inc.	AG Re and Other Subsidiaries	Consolidating Adjustments*	Assured Guaranty Ltd. (Consolidated)
Revenues					
Net earned premiums	\$	\$ 16,034	\$ 30,799	\$	\$ 46,833
Net investment income	7	16,250	20,313	4	36,574
Net realized investment gains (losses)		667	(40)		627
Change in fair value of credit derivatives					
Realized gain and other settlements on credit derivatives		21,881	5,736		27,617
Unrealized losses on credit derivatives		(216,387)	(43,234)		(259,621)
Net change in fair value of credit derivatives		(194,506)	(37,498)		(232,004)
Equity in earnings of subsidiaries	(160,678)			160,678	
Other income		8,777		(241)	8,536
Total revenues	(160,671)	(152,778)	13,574	160,441	(139,434)
Expenses					
Loss and loss adjustment expenses		23,525	31,613		55,138
Acquisition costs and other operating expenses	8,538	19,782	13,381		41,701
Other		6,556			6,556
Total expenses	8,538	49,863	44,994		103,395
(Loss) income before (benefit) provision for income taxes	(169,209)	(202,641)	(31,420)	160,441	(242,829)
Total (benefit) provision for income taxes		(74,340)	720		(73,620)
Net (loss) income	\$ (169,209)	\$ (128,301)	\$ (32,140)	\$ 160,441	\$ (169,209)

* Due to the accounting for subsidiaries under common control, net income in the consolidating adjustment column does not equal parent company equity in earnings of subsidiaries, due to 1) recognition of income by Assured Guaranty US Holdings Inc. for dividends received from Assured Guaranty Ltd. and 2) the residual effects of the FSA agreement.

Table of Contents

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2009

(in thousands of U. S. dollars)

	Assured Guaranty Ltd. (Parent Company)	Assured Guaranty US Holdings Inc.	AG Re and Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)
Dividends received	\$ 16,576	\$ 241	\$	\$ (16,817)	\$
Other operating activities	(3,364)	123,162	47,219		167,017
Net cash flows provided by (used in) operating activities	13,212	123,403	47,219	(16,817)	167,017
Cash flows from investing activities					
Fixed maturity securities:					
Purchases		(140,300)	(148,919)		(289,219)
Sales		135,380	138,880		274,260
Maturities			3,500		3,500
Purchases of short-term investments, net	(4,231)	(111,330)	(24,061)		(139,622)
Net cash flows used in investing activities	(4,231)	(116,250)	(30,600)		(151,081)
Cash flows from financing activities					
Dividends paid	(4,363)		(16,576)	16,817	(4,122)
Repurchases of common stock	(3,676)				(3,676)
Share activity under option and incentive plans	(942)				(942)
Net cash flows used in financing activities	(8,981)		(16,576)	16,817	(8,740)
Effect of exchange rate changes		(142)	(31)		(173)
Increase in cash and cash equivalents		7,011	12		7,023
Cash and cash equivalents at beginning of period		10,226	2,079		12,305
Cash and cash equivalents at end of period	\$	\$ 17,237	\$ 2,091	\$	\$ 19,328

Table of Contents

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2008

(in thousands of U. S. dollars)

	Assured Guaranty Ltd. (Parent Company)	Assured Guaranty US Holdings Inc.	AG Re and Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)
Dividends received	\$	\$ 241	\$	\$ (241)	\$
Other operating activities	10,272	114,214	24,559		149,045
Net cash flows provided by (used in) operating activities	10,272	114,455	24,559	(241)	149,045
Cash flows from investing activities					
Fixed maturity securities:					
Purchases		(77,831)	(248,373)		(326,204)
Sales		59,039	59,353		118,392
Maturities			3,250		3,250
(Purchases) sales of short-term investments, net	(3,693)	(95,814)	161,649		62,142
Net cash flows used in investing activities	(3,693)	(114,606)	(24,121)		(142,420)
Cash flows from financing activities					
Dividends paid	(3,888)			241	(3,647)
Share activity under option and incentive plans	(2,262)				(2,262)
Offering costs	(429)				(429)
Net cash flows used in financing activities	(6,579)			241	(6,338)
Effect of exchange rate changes		29	14		43
(Decrease) increase in cash and cash equivalents		(122)	452		330
Cash and cash equivalents at beginning of period		5,688	2,360		8,048
Cash and cash equivalents at end of period	\$	\$ 5,566	\$ 2,812	\$	\$ 8,378

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This Form 10-Q contains information that includes or is based upon forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements give Assured Guaranty Ltd. (hereafter Assured Guaranty, we, our or the Company) expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts and relate to future operating or financial performance.

Any or all of Assured Guaranty's forward-looking statements herein may turn out to be wrong and are based on current expectations and the current economic environment. Assured Guaranty's actual results may vary materially. Among factors that could cause actual results to differ materially are: (1) downgrades of the financial strength ratings assigned by the major rating agencies to any of our insurance subsidiaries at any time, which has occurred in the past; (2) downgrades of the transactions we insure; (3) our inability to execute our business strategy; (4) reduction in the amount of reinsurance facultative cessions or portfolio opportunities available to us; (5) contract cancellations; (6) developments in the world's financial and capital markets that adversely affect our loss experience, the demand for our products, our access to capital, our unrealized (losses) gains on derivative financial instruments or our investment returns; (7) more severe or frequent losses associated with our insurance products, or changes in our assumptions used to estimate loss reserves and unrealized (losses) gains on derivative financial instruments; (8) changes in regulation or tax laws applicable to us, our subsidiaries or customers; (9) governmental actions; (10) natural or man-made catastrophes; (11) dependence on customers; (12) decreased demand for our insurance or reinsurance products or increased competition in our markets; (13) loss of key personnel; (14) technological developments; (15) the effects of mergers, acquisitions and divestitures; (16) changes in accounting policies or practices; (17) changes in the credit markets, segments thereof or general economic conditions, including the overall level of activity in the economy or particular sectors, interest rates, credit spreads and other factors; (18) other risks and uncertainties that have not been identified at this time; and (19) management's response to these factors. Assured Guaranty is not obligated to publicly correct or update any forward-looking statement if we later become aware that it is not likely to be achieved, except as required by law. You are advised, however, to consult any further disclosures we make on related subjects in our periodic reports filed with the Securities and Exchange Commission.

Executive Summary

Assured Guaranty Ltd. is a Bermuda based holding company which provides, through its operating subsidiaries, credit enhancement products to the public finance, structured finance and mortgage markets. We apply our credit expertise, risk management skills and capital markets experience to develop insurance, reinsurance and credit derivative products that meet the credit enhancement needs of our customers. We market our products directly and through financial institutions. We serve the U.S. and international markets.

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

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

Aaa (Exceptional) is the highest ranking, which Assured Guaranty Corp. (AGC) and Assured Guaranty (UK) Ltd. achieved in July 2007, and Aa2 (Excellent) is the third highest ranking of 21 ratings categories used by Moody's Investors Service (Moody's). A AAA (Extremely Strong) rating is the highest ranking and AA (Very Strong) is the third highest ranking of the 21 ratings categories used by Standard & Poor's Inc. (S&P). AAA (Extremely Strong) is the highest ranking and AA (Very Strong) is the third highest ranking of the 24 ratings categories used by Fitch

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Ratings (Fitch). An insurance financial strength rating is an opinion with respect to an insurer 's ability to pay under its insurance policies and contracts in accordance with their terms. The opinion is not specific to any particular policy or contract. Insurance financial strength ratings do not refer to an insurer 's

Table of Contents

ability to meet non insurance obligations and are not a recommendation to purchase or discontinue any policy or contract issued by an insurer or to buy, hold, or sell any security issued by an insurer, including our common shares.

On November 21, 2008, Moody's downgraded the insurance financial strength ratings of Assured Guaranty Corp. (AGC) and its wholly owned subsidiary, Assured Guaranty (UK) Ltd., to Aa2 from Aaa and also downgraded the insurance financial strength ratings of Assured Guaranty Re Ltd. (AG Re) and its affiliated insurance operating companies to Aa3 from Aa2. In the same rating action, Moody's downgraded the senior unsecured rating of Assured Guaranty US Holdings Inc. and the issuer rating of the ultimate holding company, Assured Guaranty Ltd. to A2 from Aa3.

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

If the ratings of any of our insurance subsidiaries were reduced below current levels, we expect it would have an adverse effect on our subsidiary's competitive position and its prospects for future business opportunities. A downgrade may also reduce the value of the reinsurance we offer, which may no longer be of sufficient economic value for our customers to continue to cede to our subsidiaries at economically viable rates.

With respect to a significant portion of our in-force financial guaranty reinsurance business, in the event that AG Re were downgraded from Aa3 to A1, subject to the terms of each reinsurance agreement, the ceding company may have the right to recapture business ceded to AG Re and assets representing substantially all of the statutory unearned premium and loss reserves (if any) associated with that business. As of March 31, 2009, the statutory unearned premium, which represents deferred revenue to the Company, subject to recapture is approximately \$170 million. If this entire amount was recaptured, it would result in a corresponding one-time reduction to net income of approximately \$15 million. With respect to one of AG Re's ceding companies, the right to recapture business can only be exercised if AG Re were downgraded to the A category by more than one rating agency, or below A2 or A by any one rating agency. As of March 31, 2009, the statutory unearned premium subject to recapture by this ceding company is approximately \$358 million. If this entire amount were recaptured, it would result in a corresponding one-time reduction to net income of approximately \$42 million. Alternatively, the ceding company can increase the commissions it charges AG Re for cessions. Any such increase may be retroactive to the date of the cession. As of March 31, 2009, the potential increase in ceding commissions would result in a one-time reduction to net income of approximately \$40 million. The effect on net income under these scenarios is exclusive of any capital gains or losses that may be realized.

If a credit derivative is terminated, the Company could be required to make a mark-to-market payment as determined under the ISDA documentation. In some older credit derivative transactions, one such specified event is the failure of AGC to maintain specified financial strength ratings ranging from A or A2 to BBB- or Baa3. If a credit derivative is terminated the Company could be required to make a mark-to-market payment as determined under the ISDA documentation. For example, if AGC's ratings were downgraded to A- or A3, the CDS counterparties could terminate CDS covering \$847.8 million par insured. If AGC's ratings are downgraded to levels between BBB+ or Baa1 and BB+ or Ba1, the CDS counterparties could terminate the CDS covering \$10.9 billion par insured. Given current market conditions, the Company does not believe that it can accurately estimate the payments it would be required to make if AGC or AGRe were downgraded and the CDS counterparties terminated the CDS. These payments could have a material adverse effect on the Company's liquidity and financial condition. During May 2009 the Company entered into an agreement with a CDS counterparty, which had the right to terminate four CDS contracts if AGC was downgraded below AA- or Aa3. Under the agreement, the CDS counterparty's right to terminate the CDS contracts based

on AGC's ratings was eliminated. In return, the Company agreed to post up to \$250 million in collateral to secure its payment obligations under the CDS contracts covering \$5.9 billion of par insured. The collateral posting would increase to up to \$300 million if AGC were downgraded to below AA- or A2. The posting of this collateral has no impact on the Company's net income or shareholders' equity under U.S. GAAP nor does it impact AGC's statutory surplus or net income.

Under a limited number of credit derivative contracts, the Company is required to post eligible securities as collateral, generally cash or U.S. government or agency securities. The need to post collateral under these transactions is generally based on mark-to-market valuation in excess of contractual thresholds. The particular thresholds decline if the Company's ratings decline. As of March 31, 2009 the Company had pre-IPO transactions with approximately \$1.8 billion of par subject to collateral posting due to changes in market value. Of this amount, as of March 31, 2009, the Company posted collateral totaling approximately \$177.9 million (including \$156.2 million for AGC) based on the unrealized mark-to-market loss position for transactions with two of its counterparties. Any amounts required to be posted as collateral in the future will depend on changes in the market.

Table of Contents

values of these transactions. Additionally, in the event AGC were downgraded below A-, contractual thresholds would be eliminated and the amount of par that could be subject to collateral posting requirements would be \$2.3 billion. Based on market values as of March 31, 2009, the Company estimates that such a downgrade would have resulted in AGC posting an additional \$113.7 million of collateral. The actual amounts posted would be based on market conditions at the time of the posting and would be based on the CDS contract's ISDA documentation. The actual amounts that would be required to be posted could be materially larger than the Company's estimate. As described above, in May 2009 AGC posted an additional \$250 million of collateral.

The Company's financial strength ratings assigned by S&P were affirmed on June 18, 2008. Management is uncertain what, if any, impact Fitch and Moody's ratings actions will have on the Company's financial strength ratings from S&P.

On April 8, 2008, investment funds managed by WL Ross & Co. LLC (WL Ross) purchased 10,651,896 shares of the Company's common equity at a price of \$23.47 per share, resulting in proceeds to the Company of \$250.0 million. The Company contributed \$150.0 million of these proceeds to its subsidiary, Assured Guaranty Re Ltd. In addition, the Company contributed \$100.0 million of these proceeds to its subsidiary, Assured Guaranty US Holdings Inc., which in turn contributed the same amount to its subsidiary, AGC. The commitment to purchase these shares was previously announced on February 29, 2008. In addition, Wilbur L. Ross, Jr., President and Chief Executive Officer of WL Ross, has been elected as a Director of the Company with a term expiring at the Company's 2012 annual general meeting of shareholders.

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

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

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

The Company expects to finance the cash portion of the acquisition with the proceeds of a public equity offering. The Company has received a backstop commitment (the WLR Backstop Commitment) from the WLR Funds, a related party, to fund the cash portion of the purchase price with the purchase of newly issued common shares. The Company entered into the WLR Backstop Commitment on November 13, 2008 with the WLR Funds. The WLR Backstop Commitment amended the Investment Agreement between the Company and the WLR Funds

Table of Contents

and provided to the Company the option to cause the WLR Funds to purchase from Assured Guaranty Ltd. or Assured Guaranty US Holdings Inc. a number of the Company's common shares equal to the quotient of (i) the aggregate dollar amount not to exceed \$361 million specified by the Company divided by (ii) the volume weighted average price of the Company's common share on the NYSE for the 20 NYSE trading days ending with the last NYSE trading day immediately preceding the date of the closing under the stock purchase agreement, with a floor of \$6.00 and a cap of \$8.50.

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

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

In January 2009, AGC finalized an agreement with CIFG Assurance North America, Inc. (CIFG) to assume a diversified portfolio of financial guaranty contracts totaling approximately \$13.3 billion of net par outstanding. AGC received \$75.6 million, which included \$85.7 million of upfront premiums net of ceding commissions and approximately \$12.2 million of future installments related to this transaction.

We regularly evaluate potential acquisitions of other companies, lines of business and portfolios of risks and hold discussions with potential third parties regarding such transactions. As a general rule, we publicly announce such transactions only after a definitive agreement has been reached.

The financial guaranty industry, along with many other financial institutions, continues to be threatened by deterioration of the credit performance of securities collateralized by U.S. residential mortgages. There is significant uncertainty surrounding general economic factors, including interest rates and housing prices, which may adversely affect our loss experience on these securities. The Company continues to monitor these exposures and update our loss estimates as new information is received. Additionally, scrutiny from state and federal regulatory agencies could result in changes that limit our business.

Our financial results include four principal business segments: financial guaranty direct, financial guaranty reinsurance, mortgage guaranty and other. The other segment represents lines of business that we exited or sold as part of our 2004 initial public offering (IPO).

We derive our revenues principally from premiums from our insurance and reinsurance businesses, unrealized gains and losses and realized gains and other settlements on credit derivatives, net investment income, and net realized gains and losses from our investment portfolio. Our premiums and realized gains and other settlement on credit derivatives are a function of the amount and type of contracts we write as well as prevailing market prices. We receive payments on an upfront basis when the policy is issued or the contract is executed and/or on an installment basis over the life of the applicable transaction.

Investment income is a function of invested assets and the yield that we earn on those assets. 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 our invested assets. In addition, we could realize capital losses on securities in our investment portfolio from other than temporary declines in market value as a result of changing market conditions, including changes in market interest rates, and changes in the credit quality of our invested assets.

Table of Contents

Realized gains and other settlements on credit derivatives include credit derivative premiums received and receivable for credit protection the Company has sold under its credit default swaps (CDS), any contractual claim losses paid and payable related to insured credit events under these contracts, realized gains or losses related to their early termination and ceding commissions (expense) income. The Company generally holds credit derivative contracts to maturity. However, in certain circumstances such as for risk management purposes or as a result of a decision to exit a line of business, the Company may decide to terminate a derivative contract prior to maturity.

Unrealized gains (losses) on credit derivatives represent the adjustments for changes in fair value that are recorded in each reporting period under Statement of Financial Accounting Standards (FAS) No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133). Changes in unrealized gains and losses on credit derivatives are reflected in the consolidated statements of operations and comprehensive income in unrealized gains (losses) on credit derivatives. Cumulative unrealized gains (losses), determined on a contract by contract basis, are reflected as either net assets or net liabilities in the Company s balance sheets. Unrealized gains and losses resulting from changes in the fair value of credit derivatives occur because of changes in interest rates, credit spreads, the credit ratings of the referenced entities, the Company s credit rating and other market factors. The unrealized gains (losses) on credit derivatives will reduce to zero as the exposure approaches its maturity date, unless there is a payment default on the exposure. Changes in the fair value of the Company s credit derivatives do not reflect actual claims or credit losses, and have no impact on the Company s claims paying resources, rating agency capital or regulatory capital positions.

In the three months ended March 31, 2009 and 2008 the Company also recorded a fair value gain of \$19.7 million and \$8.5 million, pre-tax, respectively, related to Assured Guaranty Corp. s committed capital securities.

Our expenses consist primarily of losses and loss adjustment expenses (LAE), profit commission expense, acquisition costs, operating expenses, interest expense, put-option premium expense associated with our committed capital securities (the CCS Securities) and income taxes. Losses and LAE are a function of the amount and types of business we write. Losses and LAE are based upon estimates of the ultimate aggregate losses inherent in the portfolio. The risks we take have a low expected frequency of loss and are investment grade at the time we accept the risk. Profit commission expense represents payments made to ceding companies generally based on the profitability of the business reinsured by us. Acquisition costs are related to the production of new business. Certain acquisition costs that vary with and are directly attributable to the production of new business are deferred and recognized over the period in which the related premiums are earned. Operating expenses consist primarily of salaries and other employee related costs, including share based compensation, various outside service providers, rent and related costs and other expenses related to maintaining a holding company structure. These costs do not vary with the amount of premiums written. Interest expense is a function of outstanding debt and the contractual interest rate related to that debt. Put-option premium expense, which is included in other expenses on the Consolidated Statements of Operations and Comprehensive Income, is a function of the outstanding amount of the CCS Securities and the applicable distribution rate. Income taxes are a function of our profitability and the applicable tax rate in the various jurisdictions in which we do business.

Critical Accounting Estimates

Our unaudited interim consolidated financial statements include amounts that, either by their nature or due to requirements of accounting principles generally accepted in the United States of America (GAAP), are determined using estimates and assumptions. The actual amounts realized could ultimately be materially different from the amounts currently provided for in our unaudited interim consolidated financial statements. We believe the items requiring the most inherently subjective and complex estimates to be reserves for losses and LAE, fair value of credit derivatives, fair value of committed capital securities, valuation of investments, other than temporary impairments of investments, premium revenue recognition, deferred acquisition costs, deferred income taxes and accounting for share based compensation. An understanding of our accounting policies for these items is of critical importance to understanding our unaudited interim consolidated financial statements. The following discussion provides more information regarding the estimates and assumptions used for these items and should be read in conjunction

with the notes to our unaudited interim consolidated financial statements.

Table of Contents

Reserves for Losses and Loss Adjustment Expenses

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

Financial Guaranty Contracts Upon Adoption of FAS 163

The Company, subsequent to the adoption of FAS No. 163, Accounting for Financial Guarantee Insurance Contracts (FAS 163) on January 1, 2009, recognizes a reserve for losses and loss adjustment expenses on a financial guarantee insurance contract when the Company expects that a claim loss will exceed the unearned premium revenue for that contract based on the present value of expected net cash outflows to be paid under the insurance contract. The unearned premium revenue represents the insurance enterprise's stand-ready obligation under a financial guarantee insurance contract at initial recognition. Subsequently, if the likelihood of a default (insured event) increases so that the present value of the expected net cash outflows expected to be paid under the insurance contract exceeds the unearned premium revenue, the Company recognizes a reserve for losses and loss adjustment expenses in addition to the unearned premium revenue.

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

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

It is possible that our estimated loss and loss adjustment expense reserves recorded in our March 31, 2009 financial statements could experience significant adverse development which could lead to material amounts of incurred loss and loss adjustment expenses in future reporting periods as a result of continued deterioration in housing prices; the effects of a weakened economy marked by growing unemployment and wage pressures and/or continued illiquidity of the mortgage market. The company believes that the maximum probable development on its loss reserve for structured finance credits is \$306 million. This amount reflects stressed loss assumptions that the Company used in modeling all of its material below investment grade credits. These scenarios were modeled by increasing defaults probabilities, default severities and expected recoveries to reflect the company's view of the maximum probable deterioration likely to occur on these transactions.

Financial Guaranty Contracts Prior to Adoption of FAS 163

Reserves for losses and loss adjustment expenses for non-derivative transactions in our financial guaranty direct and financial guaranty assumed reinsurance included case reserves and portfolio reserves. See the Fair Value of Credit Derivatives of the Critical Accounting Estimates section for more information on our derivative transactions. Case reserves were established when there was significant credit deterioration on specific insured obligations and the obligations were in default or default was probable, not necessarily upon non-payment of principal or interest by an insured. Case reserves represented the present value of expected future loss payments and LAE, net of estimated recoveries, but before considering ceded reinsurance. This reserving method was different from case reserves established by traditional property and casualty insurance companies, which establish case reserves upon notification of a claim and establish incurred but not reported (IBNR) reserves for the difference between actuarially estimated ultimate losses and recorded case reserves. Financial guaranty insurance and assumed reinsurance case reserves and related salvage and subrogation, if any, were discounted at the taxable equivalent yield on our investment portfolio, which was approximately 6%, during 2008.

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

Portfolio reserves were not established based on a specific event, rather they are calculated by aggregating the portfolio reserve calculated for each individual transaction. Individual transaction reserves were calculated on a quarterly basis by multiplying the par in-force by the product of the ultimate loss and earning factors without regard to discounting. The ultimate loss factor was defined as the frequency of loss multiplied by the severity of loss, where the frequency was defined as the probability of default for each individual issue. The earning factor was inception to

Table of Contents

date earned premium divided by the estimated ultimate written premium for each transaction. The probability of default was estimated from rating agency data and was based on the transaction's credit rating, industry sector and time until maturity. The severity was defined as the complement of recovery/salvage rates gathered by the rating agencies of defaulting issues and was based on the industry sector.

Portfolio reserves were recorded gross of reinsurance. We did not cede any amounts under these reinsurance contracts, as our recorded portfolio reserves did not exceed our contractual retentions, required by said contracts.

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

The weighted average default frequencies and severities of the Company's portfolio reserves as of December 31, 2008 were as follows (Effective January 1, 2009, upon the adoption of FAS 163, the Company no longer maintains portfolio reserves.):

	Average Default Frequency	Average Default Severity
December 31, 2008	1.08%	23.87%

The Company incorporates default frequency and severity by asset class into its portfolio loss reserve models. Average default frequency and severity are based on information published by rating agencies. The increase in average default frequency shown in 2008 is reflective of downgrades within the Company's direct insured portfolio, including HELOC exposures. Rating agencies update default frequency and severity information on a periodic basis, as warranted by changes in observable data.

Table of Contents

Mortgage Guaranty and Other Lines of Business

Reserves for losses and loss adjustment expenses in our mortgage guaranty line of business include case reserves and portfolio reserves. Case reserves are established when there is significant credit deterioration on specific insured obligations and the obligations are in default or default is probable, not necessarily upon non-payment of principal or interest by an insured. Case reserves represent the present value of expected future loss payments and loss adjustment expenses (LAE), net of estimated recoveries, but before considering ceded reinsurance. This reserving method is different from case reserves established by traditional property and casualty insurance companies, which establish case reserves upon notification of a claim and establish incurred but not reported (IBNR) reserves for the difference between actuarially estimated ultimate losses and recorded case reserves.

We also record portfolio reserves for our mortgage guaranty line of business in a manner consistent with our financial guaranty business prior to the adoption of FAS 163. While other mortgage guaranty insurance companies do not record portfolio reserves, rather just case reserves and IBNR reserves, we record portfolio reserves because we write business on an excess of loss basis, while other industry participants write quota share or first layer loss business. We manage and underwrite this business in the same manner as our financial guaranty insurance and reinsurance business because they have similar characteristics as insured obligations of mortgage backed securities.

We also record IBNR reserves for our other lines of business. IBNR is an estimate of losses for which the insured event has occurred but the claim has not yet been reported to us. In establishing IBNR, we use traditional actuarial methods to estimate the reporting lag of such claims based on historical experience, claim reviews and information reported by ceding companies. We record IBNR for trade credit reinsurance within our other segment, which is 100% reinsured. The other segment represents lines of business that we exited or sold as part of the Company's IPO.

Due to the inherent uncertainties of estimating loss and LAE reserves, actual experience may differ from the estimates reflected in our consolidated financial statements and the differences may be material.

Home Equity Line of Credit (HELOC) Transactions

Specifically with respect to reserves related to our U.S. home equity line of credit (HELOC) and other U.S. residential mortgage exposures, there exists significant uncertainty as to the ultimate performance of these transactions. As of March 31, 2009, the Company had net par outstanding of \$1.6 billion related to HELOC securitizations, of which \$1.4 billion are transactions with Countrywide and \$1.1 billion were written in the Company's financial guaranty direct segment (direct Countrywide transactions or Countrywide 2005 J and Countrywide 2007 D).

The performance of our HELOC exposures deteriorated during 2007 and 2008 and the first three months of 2009 and transactions, particularly those originated in the period from 2005 through 2007, continue to perform below our original underwriting expectations. In accordance with our standard practice, during the three months ended March 31, 2009, we evaluated the most currently available information, including trends in delinquencies and charge-offs on the underlying loans, draw rates on the lines of credit, and the servicer's ability to fulfill its contractual obligations including its obligation to fund additional draws. In recent periods, Constant Default Rate (CDR), Constant Payment Rate (CPR), Draw Rates and delinquency percentages have fluctuated within ranges that we believe make it appropriate to use rolling averages to project future performance. Accordingly, the Company is using modeling assumptions that are based upon or which approximate recent actual historical

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performance to project future performance and potential losses. In the first quarter 2009, consistent with FAS 163, the Company modeled and probability weighted a variety of potential time periods over which an elevated CDR may potentially occur. Further, the Company also incorporated in its loss reserve estimates the possibility that in some of those scenarios the prepayment rates increase after the stressed CDR period, leading to lower recoveries through excess spread. The Company continues to model sensitivities around the results booked using a variety of CDR rates and stress periods as well as other modeling

Table of Contents

approaches including roll rates and hybrid roll rate/CDR methods. As a result of this modeling and analysis, the Company incurred loss and loss adjustment expenses of \$(4.9) million for its direct Countrywide transactions during the three months ended March 31, 2009. The Company's cumulative incurred loss and loss adjustment expenses on the direct Countrywide transactions as of March 31, 2009 was \$93.3 million (\$73.0 million after-tax). During 2009, the Company paid losses and loss adjustment expenses for its direct Countrywide transactions of \$35.5 million. The Company's cumulative paid losses and loss adjustment expenses for its direct Countrywide transactions are \$205.5 million as of March 31, 2009, of which we expect to recover \$112.2 million from the receipt of excess spread from future cash flows as well as funding of future draws and recoverables from breaches of representations and warranties with respect to the underlying collateral. This amount of \$112.2 million is included in salvage recoverable on the balance sheet as of March 31, 2009.

Credit support for HELOC transactions comes primarily from two sources. In the first instance, excess spread is used to build a certain amount of credit enhancement and absorb losses. Over the past 12 months, excess spread (the difference between the interest collections on the collateral and the interest paid on the insured notes) has averaged approximately 270 basis points per annum. Additionally, for the transactions serviced by Countrywide, the servicer is required to fund additional draws on the HELOC loans following the occurrence of a Rapid Amortization Event. Among other things, such an event is triggered when claim payments by us exceed a certain threshold. Prior to the occurrence of a Rapid Amortization Event, during the transactions' revolving period, new draws on the HELOC loans are funded first from principal collections. As such, during the revolving period no additional credit enhancement is created by the additional draws, and the speed at which our exposure amortizes is reduced to the extent of such additional draws, since principal collections are used to fund those draws rather than pay down the insured notes. Subsequent to the occurrence of a Rapid Amortization Event, new draws are funded by Countrywide and all principal collections are used to pay down the insured notes. Any draws funded by Countrywide are subordinate to us in the cash flow waterfall and hence represent additional credit enhancement available to absorb losses before we have to make a claim payment. Additionally, since all principal collections are used to pay down the insured notes, rather than fund additional draws, our exposure begins to amortize more quickly. A Rapid Amortization Event occurred for Countrywide 2007 D in April 2008 and for Countrywide 2005 J in May 2008.

We have modeled our HELOC exposures under a number of different scenarios, taking into account the multiple variables and structural features that materially affect transaction performance and potential losses to us. The key variables include the speed or rate at which borrowers make payments on their loans, as measured by the CPR(1), the default rate, as measured by the CDR(2), excess spread, and the amount of loans that are already delinquent more than 30 days. We also take into account the pool factor (the percentage of the original principal balance that remains outstanding), and the timing of the remaining cash flows. Additionally, it should be noted that our contractual rights allow us to retroactively claim that loans included in the insured pool were inappropriately included in the pool by the seller, and to put these loans back to the seller such that we would not be responsible for losses related to these loans. Such actions would benefit us by reducing potential losses. We have included in our loss model an estimated benefit for loans we expect Countrywide will repurchase.

The ultimate performance of the Company's HELOC transactions will depend on many factors, such as the level and timing of loan defaults, interest proceeds generated by the securitized loans, repayment speeds and changes in home prices, as well as the levels of credit support built into each transaction. Other factors also may have a material impact upon the ultimate performance of each transaction, including the ability of the seller and servicer to fulfill all of their contractual obligations including its obligation to fund future draws on lines of credit, as well as the amount of benefit received from repurchases of ineligible loans by Countrywide. The variables affecting transaction performance are interrelated, difficult to predict and subject to considerable volatility. Consequently, the range of potential outcomes is wide and subject to significant uncertainty. We continue to update our evaluation of these exposures as new information becomes available.

(1) The CPR is the annualized rate at which the portfolio amortizes, so that a 15% CPR implies that 15% of the collateral will be retired over a one-year period.

(2) The CDR is the annualized default rate, so that a 1.0% CDR implies that 1.0% of the remaining collateral will default each year.

Table of Contents

The key assumptions used in our analysis of potential case loss reserves on the direct Countrywide transactions are presented in the following table:

Key Variables	
Constant payment rate (CPR)	3-month average, 5 6.3% as of March 31, 2009
Constant default rate (CDR)	6-month average CDR of approximately 18 19% used for our initial default projections, ramping down to a steady state CDR of 1.0%
Draw rate	3-month average, 1 2% as of March 31, 2009
Excess spread	250 bps per annum
Repurchases of Ineligible loans by Countrywide	\$79.0 million; or approximately 3.3% of original pool balance of \$2.4 billion
Loss Severity	100%

Subprime, Alt-A and Closed End Second RMBS Transactions

Another type of RMBS transaction is generally referred to as Subprime RMBS. The collateral supporting such transactions is comprised of first-lien residential mortgage loans made to subprime borrowers. A subprime borrower is one considered to be a higher risk credit based on credit scores or other risk characteristics. As of March 31, 2009, we had net par outstanding of \$6.5 billion related to Subprime RMBS securitizations, of which \$612 million is classified by us as Below Investment Grade risk. Of the total U.S. Subprime RMBS exposure of \$6.5 billion, \$6.0 billion is from transactions issued in the period from 2005 through 2007 and written in our direct financial guaranty segment. As of March 31, 2009, we had case reserves of \$10.0 million related to our \$6.5 billion U.S. Subprime RMBS exposure, of which \$1.8 million were portfolio reserves related to our \$6.0 billion exposure in the direct financial guaranty segment for transactions issued from 2005 through 2007.

The problems affecting the subprime mortgage market have been widely reported, with rising delinquencies, defaults and foreclosures negatively impacting the performance of Subprime RMBS transactions. Those concerns relate primarily to Subprime RMBS issued in the period from 2005 through 2007. The \$6.0 billion exposure that we have to such transactions in our direct financial guaranty segment benefits from various structural protections, including credit enhancement that on average currently equals approximately 54.6% of the remaining principal balance of the transactions.

We also have exposure of \$415 million to Closed-End Second (CES) RMBS transactions, of which \$405 million is in the direct segment. As with other types of RMBS, we have seen significant deterioration in the performance of our CES transactions. On two transactions, which had exposure of \$304 million, as of March 31, 2009 we have seen a significant increase in delinquencies and collateral losses, which resulted in erosion of the Company's credit enhancement and the payment of claims totaling \$26.4 million. Based on the Company's analysis of these transaction and their projected collateral losses, the Company had case reserves of \$38.1 million as of March 31, 2009 in its direct segment.

Another type of RMBS transaction is generally referred to as Alt-A RMBS. The collateral supporting such transactions is comprised of first-lien residential mortgage loans made to prime quality borrowers that lack certain ancillary characteristics that would make them prime. Included in this category is Alt-A Option ARMs, which include transactions where 66% or more of the collateral is comprised of mortgage loans that have the potential to negatively amortize. As of March 31, 2009, the Company had net par outstanding of \$7.7 billion related to Alt-A RMBS securitizations. Of that amount, \$7.4 billion is from transactions issued in the period from 2005 through 2007 and written in the Company's financial guaranty direct segment. As of March 31, 2008, the Company had case reserves of \$12.5 million for Alt-A and \$11.4 million for the Option-ARM related to its \$7.7 billion Alt-A/Option-ARM RMBS exposure, in the financial guaranty direct and reinsurance segments,

respectively.

Table of Contents

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

Life Insurance Securitizations

The Company has exposure on two life insurance reserve securitization transactions based on two discrete blocks of individual life insurance business reinsured by Scottish Re (U.S.) Inc. (Scottish Re). The two transactions relate to Ballantyne Re p.l.c. (Ballantyne) (gross exposure of \$500 million) and Orkney Re II, p.l.c. (Orkney II) (gross exposure of \$423 million). Under both transactions, monies raised through the issuance of the insured notes support present and future U.S. statutory life insurance reserve requirements. The monies were invested at inception of each transaction in accounts managed by a large, well-known investment manager. However, those investment accounts have incurred substantial mark-to-market losses since mid-year 2007, principally as a result of their exposure to subprime and Alt-A RMBS transactions. Largely as a result of these mark-to-market losses both we and the rating agencies have downgraded our exposure to both Ballantyne and Orkney II to below investment grade. As regards the Ballantyne transaction, the Company is working with the directing guarantor, who has insured exposure of \$900 million, to remediate the risk. On the Orkney Re II transaction, the Company, as directing financial guarantor, is taking remedial action.

Some credit losses have been realized on the securities in the Ballantyne and Orkney Re II portfolios and significant additional credit losses are expected to occur. Performance of the underlying blocks of life insurance business thus far generally has been in accordance with expectations. The combination of cash flows from the investment accounts and the treaty settlements currently is sufficient to cover interest payments due on the notes that we insure. Adverse treaty performance and/or a rise in credit losses on the invested assets are expected to lead to interest shortfalls. Additionally, the transactions also contain features linked to the market values of the invested assets, reserve funding requirements on the underlying blocks of life insurance business, and minimum capital requirements for the transactions themselves that may trigger a shut off of interest payments to the insured notes and thereby result in claim payments by the Company.

Another key risk is that the occurrence of certain events may result in a situation where either Ballantyne and/or Orkney Re II are required to sell assets and potentially realize substantial investment losses and for Assured Guaranty Ltd. to incur corresponding insured losses ahead of the scheduled final maturity date. For example, cedants to Scottish Re may have the right to recapture blocks of life insurance business which Scottish Re has ceded to Orkney Re II. Such recaptures could require Orkney Re II to sell assets and realize investment losses. In the Ballantyne transaction, further declines in the market value of the invested assets and/or an increase in the reserve funding requirements could lead to a similar mandatory realization of investment losses and for Assured Guaranty Ltd. to incur corresponding insured losses ahead of the scheduled final maturity date.

In order for the Company to incur an ultimate net loss on these transactions, adverse experience on the underlying block of life insurance policies and/or credit losses in the investment portfolio would need to exceed the level of credit enhancement built into the transaction structures. Based on its analysis of the information currently available, including estimates of future investment performance, projected credit impairments on the invested assets and performance of the blocks of life insurance business, at March 31, 2009, the Company's case reserve is \$43.0 million for the Ballantyne transaction. This case reserve reflects expected losses resulting primarily from the deterioration in the investment portfolio as discussed above. At this time we do not expect the shut off triggers or recaptures by cedants discussed above to occur. Should these events occur our losses could be significantly greater than our case reserve. The Company has not established a case loss reserve for the Orkney Re II transaction.

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On December 19, 2008, the Company sued J.P. Morgan Investment Management Inc. (JPMIM), the investment manager in the Orkney II transaction, in New York Supreme Court alleging that JPMIM engaged in breaches of fiduciary duty, gross negligence and breaches of contract based upon its handling of the investments of Orkney Re II. JPMIM requested and was given an extension of time to answer until the end of February.

The Company has exposure to a public finance transaction for sewer service in Jefferson County, Alabama through several reinsurance treaties. The Company's total exposure to this transaction is approximately \$455 million as of March 31, 2009. The Company has made debt service payments during the year and expects to make additional

Table of Contents

payments in the near term. Through our cedants, the Company is currently in discussions with the bond issuer to structure a solution, which may result in some or all of these payments being recoverable. The Company incurred cumulative loss and loss adjustment expenses of \$19.3 million as of March 31, 2009.

A sensitivity analysis is not appropriate for our other segment reserves, since the amounts are 100% reinsured.

The following tables summarize our reserves for losses and LAE by segment and type of reserve as of the dates presented. For an explanation of changes in these reserves see Consolidated Results of Operations.

	As of March 31, 2009					Total
	Financial Guaranty Direct	Financial Guaranty Reinsurance	Mortgage Guaranty	Other		
	(in millions of U.S. dollars)					
<i>Financial Guaranty Insurance Reserves by segment and type(1):</i>						
Case	\$ 110.3	\$ 73.4	\$ 30.1	\$ 1.2	\$	215.0
IBNR and portfolio	N/A	N/A	1.9	5.6		7.5
Total financial guaranty insurance loss and LAE reserves	110.3	73.4	32.0	6.8		222.6
<i>Credit Derivative Reserves by segment and type(2):</i>						
Case	40.8	4.8				45.6
Total credit derivative loss and LAE reserves	40.8	4.8				45.6
Total loss and LAE reserves, including credit derivatives(3)	\$ 151.1	\$ 78.2	\$ 32.0	\$ 6.8	\$	268.2

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Table of Contents

	As of December 31, 2008					Total
	Financial Guaranty Direct	Financial Guaranty Reinsurance	Mortgage Guaranty	Other	(in millions of U.S. dollars)	
<i>Financial Guaranty Insurance Reserves by segment and type(1):</i>						
Case	\$ 64.2	\$ 55.7	\$ 0.1	\$ 1.5	\$	121.5
IBNR				3.0		3.0
Portfolio reserves associated with fundamentally sound credits	11.8	35.5	2.5			49.8
Portfolio reserves associated with CMC credits	15.8	6.7				22.5
Total financial guaranty insurance loss and LAE reserves	91.8	97.9	2.6	4.5		196.8
<i>Credit Derivative Reserves by segment and type(2):</i>						
Case	7.2	5.5				12.7
Credit derivative portfolio reserves associated with fundamentally sound credits	15.7					15.7
Credit derivative portfolio reserves associated with CMC credits	23.4					23.4
Total credit derivative loss and LAE reserves	46.3	5.5				51.8
Total loss and LAE reserves, including credit derivatives(3)	\$ 138.1	\$ 103.4	\$ 2.6	\$ 4.5	\$	248.6

(1) Included in Reserves for losses and loss adjustment expenses on the Balance Sheet.

(2) Included in Credit derivative liabilities/assets on the Balance Sheet.

(3) Total does not add due to rounding.

N/A = Not applicable

The following table sets forth the financial guaranty insurance policy and CDS contract in-force portfolio by underlying rating:

Ratings(1)	As of March 31, 2009		As of December 31, 2008	
	Net par outstanding	% of Net par outstanding	Net par outstanding	% of Net par outstanding
Super senior	\$ 29.6	12.5%	\$ 32.4	14.5%
AAA	33.1	13.9%	40.7	18.3%

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AA		50.5	21.3%	47.7	21.4%
A		80.2	33.8%	66.0	29.6%
BBB		34.4	14.5%	29.4	13.2%
Below investment grade		9.4	4.0%	6.6	3.0%
Total exposures(2)	\$	237.2	100.0%	\$ 222.7	100.0%

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

(2) Total does not add due to rounding.

Table of Contents

The change in ratings above is mainly related to the Company's U.S. RMBS exposures.

Our surveillance department is responsible for monitoring our portfolio of credits and maintains a list of below investment grade (BIG) credits. This list includes credits written in both financial guarantee insurance policy and CDS contract form. The BIG credits are divided into three categories: Category 1 (below investment grade credit with no expected losses); Category 2 (below investment grade credit with a loss reserve established prior to an event of default); Category 3 (below investment grade credit with a loss reserve established and where an event of default has occurred or is imminent).

The BIG credit list includes all credits rated lower than BBB- where there is a material amount of exposure (generally greater than \$10.0 million) or a material risk of the Company incurring a loss greater than \$0.5 million. Credit ratings are based on the Company's internal assessment of the likelihood of default. The Company's internal credit ratings are generally in line or lower than those of the ratings agencies.

As part of our surveillance process, we continually monitor all of our investment grade credits to determine whether they have suffered any credit impairments. Our quarterly procedures included qualitative and quantitative analysis on all of our insured credits to ensure that all potential BIG credits have been identified. Credits we identified through this process as having future credit impairments are subjected to further review by surveillance personnel to ensure that they have an appropriate ratings assigned to them.

The following table provides financial guaranty insurance policy and CDS contract net par outstanding by credit monitoring category as of March 31, 2009:

Description:	Net Par Outstanding	As of March 31, 2009		Case Reserves(2)
		% of Net Par Outstanding (\$ in millions)	# of Policies in Category	
Category 1	\$ 3,733	39.8%	117	\$
Category 2	3,363	35.8%	222	83.9
Category 3	2,295	24.4%	125	145.5
BIG total(1)	\$ 9,391	100.0%	464	\$ 229.3

(1) Total does not add due to rounding.

(2) Includes case reserves on credit derivatives of \$45.6 million at March 31, 2009, which balances are included in credit derivative liabilities in the Company's consolidated balance sheets.

During the first quarter 2009, we added net par of approximately \$1.7 billion related to U.S. RMBS, \$0.8 billion related trust preferred collateralized debt obligations and \$0.4 billion related to U.S. municipal obligations to our BIG list.

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Prior to 2009, our surveillance department maintained a list of closely monitored credits (CMC). The closely monitored credits were divided into four categories: Category 1 (low priority; fundamentally sound, greater than normal risk); Category 2 (medium priority; weakening credit profile, may result in loss); Category 3 (high priority; claim/default probable, case reserve established); Category 4 (claim paid, case reserve established for future payments). The closely monitored credits included all below investment grade (BIG) exposures where there was a material amount of exposure (generally greater than \$10.0 million) or a material risk of the Company incurring a loss greater than \$0.5 million. The closely monitored credits also included investment grade (IG) risks where credit quality was deteriorating and where, in the view of the Company, there was significant potential that the risk quality would fall below investment grade. As of December 31, 2008, the closely monitored credits included approximately 99% of our BIG exposure, and the remaining BIG exposure of \$92.3 million was distributed across 89 different credits. Other than those excluded BIG credits, credits that were not included in the closely monitored credit list were categorized as fundamentally sound risks.

Table of Contents

The following table provides financial guaranty insurance policy and CDS contract net par outstanding by credit monitoring category as of December 31, 2008:

Description:	Net Par Outstanding	As of December 31, 2008		Case Reserves(2)
		% of Net Par Outstanding (\$ in millions)	# of Credits in Category	
Fundamentally sound risk	\$ 215,987	97.0%		
Closely monitored: Category 1	2,967			