

ASSURED GUARANTY LTD
Form 10-Q
August 08, 2006

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2006

OR

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

transition Period from to

Commission File No. 001-32141

ASSURED GUARANTY LTD.

(Exact name of registrant as specified in its charter)

Bermuda
(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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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 August 1, 2006 was 73,230,687.

ASSURED GUARANTY LTD.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

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

	June 30, 2006	December 31, 2005
Assets		
Fixed maturity securities, at fair value (amortized cost: \$2,067,526 in 2006 and \$2,082,363 in 2005)	\$ 2,069,156	\$ 2,133,997
Short-term investments, at cost which approximates fair value	170,731	115,826
Total investments	2,239,887	2,249,823
Cash and cash equivalents	29,197	6,190
Accrued investment income	22,653	22,676
Deferred acquisition costs	205,307	193,442
Prepaid reinsurance premiums	12,442	12,478
Reinsurance recoverable on ceded losses	11,293	12,350
Premiums receivable	42,182	33,011
Goodwill	85,417	85,417
Unrealized gains on derivative financial instruments	52,338	53,037
Current income taxes receivable	7,644	3,005
Receivables for securities sold	9,650	984
Other assets	17,428	16,710
Total assets	\$ 2,735,438	\$ 2,689,123
Liabilities and shareholders equity		
Liabilities		
Unearned premium reserves	\$ 601,930	\$ 537,149
Reserves for losses and loss adjustment expenses	114,636	121,219
Profit commissions payable	29,616	52,993
Reinsurance balances payable	1,409	3,724
Deferred income taxes	24,328	26,629
Funds held by Company under reinsurance contracts	20,339	19,186
Unrealized losses on derivative financial instruments	6,211	12,652
Long-term debt	197,359	197,344
Liability for tax basis step-up adjustment	19,756	20,129
Payables for securities purchased	12,140	813
Other liabilities	24,936	35,772
Total liabilities	1,052,660	1,027,610
Commitments and contingencies		
Shareholders equity		
Common stock (\$0.01 par value, 500,000,000 shares authorized; 73,231,065 and 74,761,577 shares issued and outstanding in 2006 and 2005)	732	748
Additional paid-in capital	855,258	881,998
Unearned stock grant compensation		(14,756)
Retained earnings	821,826	747,691
Accumulated other comprehensive income	4,962	45,832
Total shareholders equity	1,682,778	1,661,513
Total liabilities and shareholders equity	\$ 2,735,438	\$ 2,689,123

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues				
Gross written premiums	\$ 111,484	\$ 40,470	\$ 166,868	\$ 118,567
Ceded premiums	(1,139)	(10,314)	(5,739)	(11,942)
Net written premiums	110,345	30,156	161,129	106,625
(Increase) decrease in net unearned premium reserves	(62,161)	18,108	(64,890)	(10,271)
Net earned premiums	48,184	48,264	96,239	96,354
Net investment income	27,255	23,668	53,493	46,800
Net realized investment (losses) gains	(1,005)	1,666	(2,011)	3,457
Unrealized gains (losses) on derivative financial instruments	5,713	(12,502)	5,742	(9,430)
Other income	23	(190)	23	93
Total revenues	80,170	60,906	153,486	137,274
Expenses				
Loss and loss adjustment expenses	(6,513)	(59,133)	(6,895)	(68,529)
Profit commission expense	1,697	3,345	3,005	4,332
Acquisition costs	11,308	11,713	22,093	21,929
Other operating expenses	15,615	14,487	32,765	28,995
Interest expense	3,367	3,410	6,742	6,706
Other expense	692	2,488	1,306	2,488
Total expenses	26,166	(23,690)	59,016	(4,079)
Income before provision for income taxes	54,004	84,596	94,470	141,353
Provision for income taxes				
Current	6,165	46,385	8,808	51,468
Deferred	3,325	(28,539)	6,266	(21,213)
Total provision for income taxes	9,490	17,846	15,074	30,255
Net income	44,514	66,750	79,396	111,098
Other comprehensive (loss) income, net of taxes				
Unrealized holding (losses) gains on fixed maturity securities arising during the year	(18,038)	22,127	(42,098)	1,489
Reclassification adjustment for realized losses (gains) included in net income	779	(1,245)	1,437	(2,746)
Change in net unrealized gains on fixed maturity securities	(17,259)	20,882	(40,661)	(1,257)
Cash flow hedge	(104)	(104)	(209)	(209)
Other comprehensive (loss) income, net of taxes	(17,363)	20,778	(40,870)	(1,466)
Comprehensive income	\$ 27,151	\$ 87,528	\$ 38,526	\$ 109,632
Earnings per share:				
Basic	\$ 0.60	\$ 0.90	\$ 1.08	\$ 1.50
Diluted	\$ 0.60	\$ 0.90	\$ 1.06	\$ 1.49
Dividends per share	\$ 0.035	\$ 0.03	\$ 0.07	\$ 0.06

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

Assured Guaranty Ltd.
Consolidated Statements of Shareholders' Equity
For Six Months Ended June 30, 2006
(in thousands of U.S. dollars except per share amounts)
(Unaudited)

	Common Stock	Additional Paid-in Capital	Unearned Stock Grant Compensation	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders Equity
Balance, December 31, 2005	\$ 748	\$ 881,998	\$ (14,756)	\$ 747,691	\$ 45,832	\$ 1,661,513
Net income				79,396		79,396
Dividends (\$0.07 per share)				(5,261)		(5,261)
Common stock repurchases	(7)	(17,183)				(17,190)
Shares cancelled to pay withholding taxes	(1)	(2,752)				(2,753)
Option exercises		443				443
Cash flow hedge, net of tax of \$(113)					(209)	(209)
Unrealized loss on fixed maturity securities, net of tax of \$(8,322)					(40,661)	(40,661)
Reclassification due to adoption of FAS 123R	(10)	(14,746)	14,756			
Share-based compensation and other	2	7,498				7,500
Balance, June 30, 2006	\$ 732	\$ 855,258	\$	\$ 821,826	\$ 4,962	\$ 1,682,778

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

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

	Six Months Ended June 30,	
	2006	2005
Operating activities		
Net income	\$ 79,396	\$ 111,098
Adjustments to reconcile net income to net cash flows provided by operating activities:		
Non-cash interest and operating expenses	7,825	3,349
Net amortization of premium on fixed maturity securities	2,916	3,460
Provision (benefit) for deferred income taxes	6,266	(21,213)
Net realized investment losses (gains)	2,011	(3,457)
Change in unrealized (gains) losses on derivative financial instruments	(5,742)	9,430
Change in deferred acquisition costs	(11,865)	(1,840)
Change in accrued investment income	23	476
Change in premiums receivable	(9,171)	12,312
Change in prepaid reinsurance premiums	36	1,401
Change in unearned premium reserves	64,781	8,880
Change in loss recovery receivable		(63,676)
Change in reserves for losses and loss adjustment expenses, net	(7,841)	(15,532)
Change in profit commissions payable	(23,377)	(16,250)
Change in funds held by Company under reinsurance contracts	1,153	3,003
Change in current income taxes	(4,639)	32,971
Tax benefit from employee stock options		4,059
Other	(10,410)	2,095
Net cash flows provided by operating activities	91,362	70,566
Investing activities		
Fixed maturity securities:		
Purchases	(434,471)	(513,987)
Sales	432,861	388,644
Maturities	14,295	13,000
(Purchases) sales of short-term investments, net	(55,019)	54,731
Net cash flows used in investing activities	(42,334)	(57,612)
Financing activities		
Repurchases of common stock	(17,190)	(19,014)
Dividends paid	(5,253)	(4,521)
Share activity under option and incentive plans	(2,310)	(1,276)
Repayment of notes assumed during formation transactions	(2,000)	
Net cash flows used in financing activities	(26,753)	(24,811)
Effect of exchange rate changes	732	(373)
Increase (decrease) in cash and cash equivalents	23,007	(12,230)
Cash and cash equivalents at beginning of period	6,190	16,978
Cash and cash equivalents at end of period	\$ 29,197	\$ 4,748
Supplementary cash flow information		

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Cash paid during the period for:				
Income taxes	\$	13,440	\$	14,609
Interest	\$	7,081	\$	7,000

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

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Assured Guaranty Ltd.
Notes to Consolidated Financial Statements
June 30, 2006
(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. 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 asset. 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 10.

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 coordinated 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), including, but not limited to, equity layer credit protection, trade credit reinsurance and title reinsurance. These lines of business make up the Company's other segment.

2. 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, consisting only of normal recurring adjustments, 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 June 30, 2006 (Second Quarter 2006) and the three-month period ended June 30, 2005 (Second Quarter 2005), and the six-month period ended June 30, 2006 (Six Months 2006) and the six-month period ended June 30, 2005 (Six Months 2005). Operating results for the three- and six-month periods ended June 30, 2006 and 2005 are not necessarily indicative of the results that may be expected for a full year. Certain items in the prior year unaudited interim consolidated financial statements have been reclassified to conform with the current period 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, 2005, filed with the Securities and Exchange Commission.

Certain of the Company's subsidiaries are subject to U.S. 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 derivative financial instruments. A discrete calculation of the provision is calculated for each interim period.

3. Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board (FASB) issued FAS No. 155, Accounting for Certain Hybrid Financial Instruments (FAS 155) which amends FAS No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133) and FAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 140), and addresses issues raised in FAS 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. The primary objectives of FAS 155 are: (i) with respect to FAS 133, to address the accounting for beneficial interests in securitized financial assets and (ii) with respect to FAS 140, eliminate a restriction on the passive derivative instruments that a qualifying special purpose entity may hold. FAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company is currently evaluating the implications of FAS 155 on its financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is assessing FIN 48 and has not determined the impact that the adoption of FIN 48 will have on its results of operations or financial position.

4. Analysis of premiums written, premiums earned and loss and loss adjustment expenses

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

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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 amounts were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
(in thousands of U.S. dollars)				
Premiums Written				
Direct	\$ 68,418	\$ 20,942	\$ 98,666	\$ 44,697
Assumed	43,066	19,528	68,202	73,870
Ceded	(1,139)	(10,314)	(5,739)	(11,942)
Net	\$ 110,345	\$ 30,156	\$ 161,129	\$ 106,625
Premiums Earned				
Direct	\$ 21,887	\$ 16,806	\$ 43,115	\$ 38,036
Assumed	28,475	42,248	59,003	71,660
Ceded	(2,178)	(10,790)	(5,879)	(13,342)
Net	\$ 48,184	\$ 48,264	\$ 96,239	\$ 96,354
Loss and Loss Adjustment Expenses				
Direct	\$ (12,644)	\$ 4,703	\$ (15,675)	\$ 2,636
Assumed	7,250	(71,385)	10,542	(80,574)
Ceded	(1,119)	7,549	(1,762)	9,409
Net	\$ (6,513)	\$ (59,133)	\$ (6,895)	\$ (68,529)

Net written premiums for Second Quarter 2006 and Six Months 2006 were \$110.3 million and \$161.1 million, respectively, compared with \$30.2 million and \$106.6 million for Second Quarter 2005 and Six Months 2005, respectively. The increase in direct written premiums for both periods is primarily attributable to several financial guaranty transactions written during Second Quarter 2006 in the United Kingdom (UK) with upfront premiums totaling \$41.0 million. Assumed written premiums increased in Second Quarter 2006 compared with Second Quarter 2005 due to more deals being written on an upfront basis during Second Quarter 2006 while Second Quarter 2005 was comprised of more installment based deals. Also contributing to the increase is a Second Quarter 2005 transaction whereby Financial Security Assurance Inc. (FSA) reassumed from Assured Guaranty Re Ltd. (AG Re) \$18.4 million of healthcare related business (FSA transaction).

The decrease in assumed written premiums for Six Months 2006 compared with Six Months 2005 is primarily due to a large excess of loss reinsurance transaction of \$16.3 million written during the three month period ended March 31, 2005 in our mortgage guaranty segment.

Ceded written and earned premiums have decreased in Second Quarter 2006 compared with Second Quarter 2005 and Six Months 2006 compared with Six Months 2005 due to the run-off and novation of our trade credit business, which is 100% retroceded to ACE.

Loss and loss adjustment expenses (LAE) were \$(6.5) million and \$(6.9) million for Second Quarter 2006 and Six Months 2006, respectively. The major component of these amounts is a \$10.1 million loss recovery from third party litigation settlements recorded during Second Quarter 2006 from our equity layer credit protection business, which was exited in connection with the IPO. This recovery was partially offset by increased loss reserves of \$5.4 million in our financial guaranty reinsurance segment, of which \$3.8 million related to a rating downgrade of a European infrastructure transaction and \$1.6 million related to the rating downgrade of various credits. In addition to these increases Six Months 2006 also contained a \$2.5 million case reserve addition due to a U.S. public infrastructure transaction.

Loss and loss adjustment expenses of \$(59.1) million in Second Quarter 2005 and \$(68.5) million in Six Months 2005, was the result of a third party settlement agreement that was reached during Second Quarter 2005, with two parties relating to a reinsurance claim incurred in 1998 and 1999, resulting in a recovery of \$63.7 million.

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Also in First Quarter 2005 the Company recovered \$6.8 million relating to this same reinsurance claim. In addition, during First Quarter 2005, the Company recovered \$1.1 million relating to its exited equity layer credit protection business. Loss recoveries for all periods presented are shown in the statements of operations and comprehensive income in loss and loss adjusted expenses.

Reinsurance recoverable on ceded losses and LAE as of June 30, 2006 and December 31, 2005 were \$11.3 million and \$12.4 million, respectively and are all related to our other segment. Of these amounts, \$11.1 million and \$12.3 million, respectively, relate to reinsurance agreements with ACE.

The following summarizes the Company's gross written premiums by significant client:

Gross Written Premiums by Client	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(\$ in millions)			
Financial Security Assurance Inc.(1)	\$ 18.2	\$ 10.4	\$ 25.7	\$ 32.6
Ambac Assurance Corporation	10.5	9.7	14.8	20.4
Financial Guaranty Insurance Company	9.5	3.3	12.9	5.6
MBIA Insurance Corporation	2.3	4.2	5.8	8.9

(1) Second Quarter 2005 and Six Months 2005 excludes \$18.4 million of reassumption premiums related to the Company's healthcare business.

Agreement with Financial Security Assurance Inc.

During Second Quarter 2005, Assured Guaranty Corp. (AGC) and AG Re, two of the Company's subsidiaries, entered into a reinsurance agreement with FSA pursuant to which substantially all of FSA's financial guaranty risks previously ceded to AGC (the Ceded Business) was assumed by AG Re. This agreement was effective as of January 1, 2005. In connection with the transaction, AGC transferred liabilities of \$169.0 million, consisting primarily of unearned premium reserves. All profit and loss related items associated with this transfer were eliminated in consolidation, with the exception of profit commission expense, certain other operating expenses, and provision for income taxes. Since this transaction transferred unearned premium reserve from AGC, a U.S. tax paying entity, to AG Re, a non-U.S. tax paying entity, the Company released a deferred tax liability related to differences between the book and tax carrying amounts of unearned premium reserves which resulted in a tax benefit. The total impact of all these items increased net income \$1.9 million for both Second Quarter 2005 and Six Months 2005. FSA has released AGC from all liabilities with respect to the Ceded Business. AG Re has assumed substantially all of AGC's liabilities with respect to the Ceded Business. FSA may receive a profit commission on the Ceded Business based on its future performance.

FSA has also reassumed from AG Re approximately \$12.0 million of unearned premium reserves, net of ceding commissions, of healthcare related business with an approximate par value of \$820.0 million.

5. Commitments and Contingencies

Lawsuits arise in the ordinary course of the Company's business. It is the opinion of the Company's management, based upon the information available, that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on the Company's financial position, results of operations or liquidity, although an adverse resolution of a number of these items could have a material adverse effect on the Company's results of operations or liquidity in a particular quarter or fiscal year.

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.

In April 2005, AGC received a Notice of Order to Preserve (Order) from the Office of the Commissioner of Insurance, State of Georgia (Commissioner). The Order was directed to ACE Limited, and all affiliates and requires the preservation of documents and other items related to finite insurance and a broad group of other insurance and reinsurance agreements. Also in April 2005, AGC, and numerous other insurers, received a subpoena from the Commissioner related to the initial phase of the Commissioner's investigation into finite-risk transactions. The subpoena requests information on AGC's assumed and ceded reinsurance contracts in force during 2004. AGC provided the required information in response to the subpoena in January of 2006 and has not been contacted further by the Commissioner.

During Second Quarter 2006, the Company's wholly owned subsidiary, Assured Guaranty Re Overseas Ltd. (AGRO), and a number of other parties, completed various settlements with defendants in the *In re: National Century Financial Enterprises Inc. Investment Litigation* now pending in the United States District Court for the Southern District of Ohio - Eastern District. AGRO received approximately \$10.1 million (pre-tax) in Second Quarter 2006, from the settlements. AGRO originally paid claims in 2003 of approximately \$41.7 million (pre-tax) related to National Century Financial Enterprises Inc. To date, including the settlements described above, the Company has recovered \$16.6 million (pre-tax). This is a partial settlement of the litigation, and the litigation will continue against other parties.

The Company is party to reinsurance agreements with all 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.

6. 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., 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 will be approximately 6.4%, taking into account the effect of a cash flow hedge executed by the Company in March 2004. The Company recorded interest expense of \$3.3 million, including \$0.2 million of amortized gain on the cash flow hedge, for both Second Quarter 2006 and Second Quarter 2005. The Company recorded interest expense of \$6.7 million, including \$0.3 million of amortized gain on the cash flow hedge, for both Six Months 2006 and Six Months 2005. These Senior Notes are fully and unconditionally guaranteed by Assured Guaranty Ltd.

Credit Facilities

\$300.0 million Credit Facility

On April 15, 2005, Assured Guaranty Ltd. and certain of its subsidiaries entered into a \$300.0 million three-year unsecured revolving credit facility (the "\$300.0 million credit facility") with a syndicate of banks, for which ABN AMRO Incorporated and Bank of America, N.A. acted as lead arrangers and KeyBank National Association (KeyBank) acted as syndication agent. Under the \$300.0 million credit facility, each of AGC, Assured Guaranty (UK) Ltd. (AG (UK)), a subsidiary of AGC organized under the laws of the United Kingdom, Assured Guaranty Ltd., AG Re and AGRO 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. Two letters of credit have been issued, both on behalf of AGRO, with an aggregate stated amount of approximately \$20.7 million.

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

At the closing of the \$300.0 million 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 and (iii) Assured Guaranty Overseas US Holdings Inc., as a Material Non-AGC Subsidiary (as defined in the related credit agreement), guaranteed the obligations of Assured Guaranty Ltd., AG Re and AGRO under such facility. Subsequently, AG Re and AGRO, as Material Non-AGC Subsidiaries, both guaranteed the obligations of the other and of Assured Guaranty Ltd. under such facility.

The \$300.0 million credit facility's financial covenants require that Assured Guaranty Ltd. (a) maintain a minimum net worth of \$1.2 billion, (b) maintain an interest coverage ratio of at least 2.5:1, and (c) maintain a maximum debt-to-capital ratio of 30%. In addition, the \$300.0 million credit facility requires that AGC: (x) maintain qualified statutory capital of at least 80% of its statutory capital as of the fiscal quarter prior to the closing date of the facility and (y) maintain a ratio of aggregate net par outstanding to qualified statutory capital of not more than 150:1. Furthermore, the \$300.0 million 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. 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 June 30, 2006 and December 31, 2005, Assured Guaranty was in compliance with all of those financial covenants.

As of June 30, 2006 and December 31, 2005, no amounts were outstanding under this facility nor have there been any borrowings under this facility.

Non-Recourse Credit Facility

AGC is also party to a non-recourse credit facility with a syndicate of banks which provides up to \$175.0 million specifically designed to provide rating agency-qualified capital to further support AGC's claims paying resources. The facility expires in December 2010. As of June 30, 2006 and December 31, 2005, no amounts were outstanding under this facility nor have there been any borrowings under this facility.

The Company's failure to comply with certain covenants under the Company's credit facilities could, subject to grace periods in the case of certain covenants, result in an event of default. This could require the Company to repay any outstanding borrowings in an accelerated manner.

Committed Capital Securities

On April 8, 2005, AGC entered into four separate agreements with four different unaffiliated custodial trusts pursuant to which AGC may, at its option, cause each of the custodial trusts to purchase up to \$50.0 million of

perpetual preferred stock of AGC. The custodial trusts were created as a vehicle for providing capital support to AGC by allowing AGC to obtain immediate access to new capital at its sole discretion at any time through the exercise of the put option. If the put options were exercised, AGC would receive \$200.0 million in return for the issuance of its own perpetual preferred stock, the proceeds of which may be used for any purpose including the payment of claims. The put options were not exercised as of June 30, 2006. Initially, all of the committed capital securities (the CCS Securities) were issued to a special purpose pass-through trust (the Pass-Through Trust). The Pass-Through Trust is a newly created statutory trust organized under the Delaware Statutory Trust Act formed for the purposes of (i) issuing \$200,000,000 of Pass-Through Trust Securities to qualified institutional buyers within the meaning of Rule 144A under the Securities Act of 1933, as amended, (ii) investing the proceeds from the sale of the Pass-Through Trust Securities in, and holding, the CCS Securities issued by the Custodial Trusts and (iii) entering into related agreements. Neither the Pass-Through Trust nor the Custodial Trusts are consolidated in Assured Guaranty Ltd.'s financial statements.

During Second Quarter 2006 and Six Months 2006, AGC incurred \$0.7 million and \$1.3 million, respectively, of put option premiums which are an on-going expense. During both Second Quarter 2005 and Six Months 2005, AGC incurred \$2.5 million which consists of \$2.0 million of investment banking fees associated with the committed capital securities and put option premiums which are an on-going expense. These expenses are presented in the Company's unaudited interim consolidated statements of operations and comprehensive income under other expense.

7. Share-Based Compensation

Effective January 1, 2006, the Company adopted FAS No. 123 (revised), Share-Based Payment (FAS 123R), which replaces FAS No. 123, Accounting for Stock-Based Compensation (FAS 123) and supersedes Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees (APB 25). FAS 123R requires all share-based compensation transactions with employees, including grants of employee stock options, to be recognized as compensation expense over the requisite service period based on their relative fair values.

Prior to the adoption of FAS 123R, the Company followed the guidance of APB 25 and did not record share-based compensation expense related to employee stock options in the statement of operations, since for all grants the exercise price was equal to the market value of the common stock on the grant date.

The Company elected to use the modified prospective transition method for implementing FAS 123R. Under this transition method, compensation expense includes: (a) compensation expense for all share-based payments granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FAS 123, and (b) compensation expense for all share-based payments granted on or after January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of FAS 123R. Because we elected to use the modified prospective transition method, results for prior periods have not been restated and new awards are valued and accounted for prospectively upon adoption.

Beginning January 1, 2006, upon adoption of FAS 123R, the Company recorded share-based compensation for the cost of stock options, restricted stock and the Company sponsored employee stock purchase plan. As a result of adopting FAS 123R on January 1, 2006, the Company's Second Quarter 2006 income before income taxes and net income are \$1.5 million and \$1.1 million lower, respectively, and for Six Months 2006 are \$3.2 million and \$2.5 million lower, respectively, than if it had continued to account for share-based compensation under APB 25. Basic and diluted earnings per share for Second Quarter 2006 and Six Months 2006 are \$0.01 and \$0.03 lower, respectively, than if the Company had continued to account for share-based compensation under APB 25.

Share-based compensation expense in Second Quarter 2006 and Six Months 2006 was \$3.1 million (\$2.5 million after tax) and \$6.3 million (\$5.2 million after tax), respectively. The effect on basic and diluted earnings per share for Second Quarter 2006 and Six Months 2006 was \$0.03 and \$0.07, respectively. Included in Second Quarter 2006 and Six Months 2006 expense was \$0.5 million and \$1.2 million, respectively, for stock award grants to retirement-eligible employees. FAS 123R requires these awards to be expensed over the period through the date the employee first becomes eligible to retire and is no longer required to provide service to earn part or all of the award, regardless of the employees intent of retirement. The amount of share-based compensation capitalized in Second

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Quarter 2006 and Six Months 2006 as deferred acquisition costs (DAC) was \$0.7 million and \$1.2 million, respectively. Share-based compensation expense in Second Quarter 2005 and Six Months 2005 was \$1.7 million (\$1.4 million after tax) and \$3.0 million (\$2.7 million after tax), respectively.

The following table presents pre-DAC and pre-tax, share-based compensation cost by share-based type:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
(in thousands of U.S. dollars)				
Share-Based Employee Cost				
<i>Restricted Stock</i>				
Recurring amortization	\$ 1,957	\$ 1,382	\$ 3,764	\$ 2,561
Accelerated amortization for retirement eligible employees	364		807	
Subtotal	2,321	1,382	4,571	2,561
<i>Stock Options</i>				
Recurring amortization	909		1,953	
Accelerated amortization for retirement eligible employees	150		355	
Subtotal	1,059		2,308	
<i>ESPP</i>	32		64	
Total Share-Based Employee Cost	3,412	1,382	6,943	2,561
Share-Based Directors Cost				
<i>Restricted Stock</i>	72	120	139	150
<i>Restricted Stock Units</i>	229	149	413	307
Total Share-Based Directors Cost	301	269	552	457
Total Share-Based Cost	\$ 3,713	\$ 1,651	7,495	\$ 3,018

For Second Quarter 2005 and Six Months 2005, had the compensation expense been determined in accordance with the fair value method recommended in FAS 123, the Company's net income and net income per share would have been adjusted to the pro forma amounts indicated below:

(in thousands of U.S. dollars, except per share amounts)	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net income as reported	\$ 66,750	\$ 111,098
Add: Stock-based compensation expense included in reported net income, net of income tax	1,445	2,653
Deduct: Compensation expense, in accordance with FAS 123, net of income tax	2,394	4,701
Pro forma net income	\$ 65,801	\$ 109,050
Basic Earnings Per Share:		
As reported	\$ 0.90	\$ 1.50
Pro forma	\$ 0.89	\$ 1.47
Diluted Earnings Per Share:		
As reported	\$ 0.90	\$ 1.49
Pro forma	\$ 0.89	\$ 1.46

Assured Guaranty Ltd. Share-Based Compensation Plans

As of April 27, 2004, the Company adopted the Assured Guaranty Ltd. 2004 Long-Term Incentive Plan (the Incentive Plan). The Incentive Plan authorizes the grant of incentive stock options, non-qualified stock options, stock appreciation rights, and full value awards that are based on the Company's common shares. The number of common shares that may be delivered under the Incentive Plan may not exceed 7,500,000. As of June 30, 2006, 2,682,432 common shares were available for grant under the Incentive Plan. In January 2005, the Company implemented the Stock Purchase Plan (Stock Purchase Plan) in accordance with Internal Revenue Code

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Section 423. The Company reserved for issuance and purchases under the Stock Purchase Plan 100,000 shares of its common stock. As of June 30, 2006, 80,512 common shares were available for grant under the Stock Purchase Plan. The Incentive Plan and the Stock Purchase Plan are described more fully in the Company's 2005 Annual Report on Form 10-K.

Stock Options

Nonqualified or incentive stock options may be granted to employees and directors of the Company. Stock options are generally granted once a year with exercise prices equal to the closing price on the date of grant. To date, the Company has only issued nonqualified stock options. All stock options granted to employees vest in equal annual installments over a three-year period and expire 10 years from the date of grant. None of our options have a performance or market condition. The following table summarizes stock option activity for the six months ended June 30, 2006:

Options	Options for Common Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (1) (in thousands)
Outstanding at December 31, 2005	2,457,302	\$ 18.05		
Granted	785,967	\$ 25.49		
Exercised	(24,774)	) \$ 17.91		
Forfeited	(52,996)	) \$ 19.99		
Outstanding at June 30, 2006	3,165,499	\$ 19.86	8.2	17,442
Vested and exercisable at June 30, 2006	1,348,481	\$ 17.95	7.5	\$ 9,999

(1) The aggregate intrinsic value was calculated based on the positive difference between the closing price of the Company's common stock on June 30, 2006 (i.e. \$25.37) and the weighted average exercise price of the underlying options.

The Company recorded \$1.1 million (\$0.8 million after tax) and \$2.3 million (\$1.8 million after tax) in share-based compensation related to stock options during Second Quarter 2006 and Six Months 2006, respectively. As of June 30, 2006 the total unrecognized compensation expense related to outstanding non-vested stock options was \$5.2 million, which will be adjusted in the future for the difference between estimated and actual forfeitures. The Company expects to recognize that expense over the weighted-average remaining service period of 1.6 years.

The weighted-average grant-date fair value of options granted were \$6.86 and \$5.08 for Second Quarter 2006 and Second Quarter 2005, respectively. The weighted-average grant-date fair value of options granted were \$6.71 and \$4.53 for Six Months 2006 and Six Months 2005, respectively. The fair value of options issued is estimated on the date of grant using the Black-Scholes option-pricing model, with the following weighted-average assumptions used for grants in 2006 and 2005:

	Three Months Ended June 30, 2006	2005	Six Months Ended June 30, 2006	2005
Dividend yield	0.6%	0.6%	0.5%	0.7%
Expected volatility	20.12%	20.92%	20.44%	20.82%
Risk free interest rate	5.1%	4.2%	4.6%	4.1%
Expected life	5 years	5 years	5 years	5 years
Forfeiture rate	6.0%	6.0%	6.0%	6.0%

These assumptions were based on the following:

- The expected dividend yield is based on the current expected annual dividend and company share price on the grant date,
- Expected volatility is estimated at the date of grant based on the historical share price volatility, calculated on a daily basis,

- The risk-free interest rate is the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term to the granted stock options,
- The expected life is based on the average expected term of our guideline companies, which are defined as similar entities, since the Company has insufficient expected life data,
- The forfeiture rate is based on the rate used by our guideline companies, since the Company has insufficient forfeiture data. Estimated forfeitures will be reassessed at each balance sheet date and may change based on new facts and circumstances.

For options granted before January 1, 2006, the Company amortizes the fair value on an accelerated basis. For options granted on or after January 1, 2006, the Company amortizes the fair value on a straight-line basis. All options are amortized over the requisite service periods of the awards, which are generally the vesting periods, with the exception of retirement-eligible employees. For retirement-eligible employees options are amortized over the period through the date the employee first becomes eligible to retire and is no longer required to provide service to earn part or all of the award. The Company may elect to use different assumptions under the Black-Scholes option valuation model in the future, which could materially affect the Company's net income or earnings per share.

The total intrinsic value of options exercised during Six Months 2006 was \$0.2 million. During Six Months 2006, \$0.4 million was received from the exercise of stock options and an immaterial related tax benefit was recorded.

Restricted Stock Awards

The Company has granted restricted stock awards to employees and directors of the Company. Restricted stock awards generally vest in equal annual installments over a four-year period. Restricted stock awards are amortized over the requisite service periods of the awards, which are generally the vesting periods, with the exception of retirement-eligible employees, discussed above. Prior to the adoption of FAS 123R, the Company presented restricted stock issuances on the balance sheet in common stock and additional paid-in capital with an offset in unearned stock grant compensation as a separate component of shareholders' equity. In accordance with the provisions of FAS 123R, on January 1, 2006, the Company reclassified the balance in unearned stock grant compensation to common stock and additional paid-in capital in shareholders' equity. The following table summarizes restricted stock award activity for the six months ended June 30, 2006:

Nonvested Shares	Number of Shares	Weighted Average Grant-Date Fair Value	
		\$	
Nonvested at December 31, 2005	1,021,124	\$	18.12
Granted	454,333	\$	25.49
Vested	(268,638)	\$	18.00
Forfeited	(30,336)	\$	19.54
Nonvested at June 30, 2006	1,176,483	\$	20.96

The Company recorded \$2.4 million (\$1.9 million after tax) and \$4.7 million (\$3.7 million after tax) in share-based compensation, related to restricted stock awards, during Second Quarter 2006 and Six Months 2006, respectively. Restricted stock awards are expensed on a straight-line basis over the vesting period. As of June 30, 2006 the total unrecognized compensation cost related to outstanding nonvested restricted stock awards was \$20.8 million, which the Company expects to recognize over the weighted-average remaining service period of 2.4 years.

Restricted Stock Units

The Company has granted restricted stock units to directors of the Company. Restricted stock units vest over a one-year period.

The following table summarizes restricted stock unit activity (excluding dividend equivalents) for the six months ended June 30, 2006:

Nonvested Stock Units	Number of Stock Units	Weighted Average Grant-Date Fair Value	
		\$	
Nonvested at December 31, 2005	36,301	\$	20.25
Granted	34,030	\$	24.39
Vested	(28,773)	\$	19.29
Forfeited		\$	
Nonvested at June 30, 2006	41,558	\$	24.30

The Company recorded \$0.2 million (\$0.2 million after tax) and \$0.4 million (\$0.4 million after tax) in share-based compensation during Second Quarter 2006 and Six Months 2006, respectively. The compensation for restricted stock units is expensed on a straight-line basis over the vesting period. As of June 30, 2006, the total unrecognized compensation cost related to outstanding nonvested restricted stock units was \$0.7 million, which the Company expects to recognize over the weighted-average remaining service period of 0.7 years.

Employee Stock Purchase Plan

Participation in the Stock Purchase Plan is available to all eligible employees. Maximum annual purchases by participants are limited to the number of whole shares that can be purchased by an amount equal to 10 percent of the participant's compensation or, if less, shares having a value of \$25,000. Participants may purchase shares at a purchase price equal to 85 percent of the lesser of the fair market value of the stock on the first day or the last day of the subscription period. The Company recorded \$32,000 (\$23,000 after tax) and \$64,000 (\$45,000 after tax) in share-based compensation during Second Quarter 2006 and Six Months 2006, respectively.

8. Earnings Per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(in thousands of U.S. dollars, except per share amounts)			
Net income as reported	\$ 44,514	\$ 66,750	\$ 79,396	\$ 111,098
Basic shares	73,633	73,813	73,695	74,134
Effect of dilutive securities:				
Stock awards	809	281	947	362
Diluted shares	74,442	74,094	74,642	74,496
Basic EPS	\$ 0.60	\$ 0.90	\$ 1.08	\$ 1.50
Diluted EPS	\$ 0.60	\$ 0.90	\$ 1.06	\$ 1.49

9. 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 will make a Section 338 (h)(10) election that will have 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 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 estimates that as of the IPO date, it will pay \$20.9 million to AFS and accordingly has 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 during 2004. During both Six Months 2006 and Six Months 2005 the Company paid AFS \$0.4 million.

10. 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 several lines of business in which the Company is no longer active, including, but not limited to equity layer credit protection, trade credit reinsurance and title reinsurance.

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. During 2006, the Company implemented a new operating expense methodology to more closely apply expenses to the individual operating segments. This new methodology was based on a comprehensive study and is based on departmental time estimates and headcount. 2005 amounts have been restated to show this new methodology on a comparative basis. Management uses underwriting gains as the primary measure of each segment's financial performance.

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

	Three Months Ended June 30, 2006					
	Financial Guaranty Direct	Financial Guaranty Reinsurance	Mortgage Guaranty	Other		Total
	(in millions of U.S. dollars)					
Gross written premiums	\$ 68.4	\$ 41.7	\$ 1.2	\$ 0.1		\$ 111.5
Net written premiums	67.8	41.3	1.2			110.3
Net earned premiums	21.2	23.1	3.7			48.2
Loss and loss adjustment expenses	(2.5)	5.7	0.4	(10.1)		(6.5)
Profit commission expense		1.0	0.7			1.7
Acquisition costs	2.3	8.5	0.3			11.3
Other operating expenses	12.0	3.4	0.3			15.6
Underwriting gain	\$ 9.4	\$ 4.6	\$ 2.0	\$ 10.1		\$ 26.1

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	Three Months Ended June 30, 2005									
	Financial Guaranty Direct		Financial Guaranty Reinsurance		Mortgage Guaranty		Other		Total	
	(in millions of U.S. dollars)									
Gross written premiums	\$	20.9	\$	8.2	\$	1.9	\$	9.5	\$	40.5
Net written premiums		20.4		8.0		1.9				30.2
Net earned premiums		16.0		27.2		5.1				48.3
Loss and loss adjustment expenses		5.0		(64.1)						(59.1)
Profit commission expense				2.3		1.0				3.3
Acquisition costs		1.6		9.5		0.6				11.7
Other operating expenses		9.5		4.7		0.3				14.5
Underwriting (loss) gain	\$	(0.1)	\$	74.8	\$	3.2	\$		\$	77.9

	Six Months Ended June 30, 2006									
	Financial Guaranty Direct		Financial Guaranty Reinsurance		Mortgage Guaranty		Other		Total	
	(in millions of U.S. dollars)									
Gross written premiums	\$	98.6	\$	60.5	\$	3.8	\$	3.9	\$	166.9
Net written premiums		97.5		59.8		3.8				161.1
Net earned premiums		41.9		46.4		7.9				96.2
Loss and loss adjustment expenses		(4.3)		8.5		0.2		(11.3)		(6.9)
Profit commission expense				1.4		1.6				3.0
Acquisition costs		4.2		17.2		0.6				22.1
Other operating expenses		25.4		6.8		0.6				32.8
Underwriting gain	\$	16.6	\$	12.6	\$	4.8	\$	11.3	\$	45.2

	Six Months Ended June 30, 2005									
	Financial Guaranty Direct		Financial Guaranty Reinsurance		Mortgage Guaranty		Other		Total	
	(in millions of U.S. dollars)									
Gross written premiums	\$	44.7	\$	42.2	\$	21.3	\$	10.4	\$	118.6
Net written premiums		43.5		42.0		21.3				106.6
Net earned premiums		36.4		50.2		9.7				96.4
Loss and loss adjustment expenses		3.5		(71.2)		0.2		(1.1)		(68.5)
Profit commission expense				2.3		2.0				4.3
Acquisition costs		3.1		17.6		1.1				21.9
Other operating expenses		20.9		7.5		0.6				29.0

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Underwriting gain	\$	8.9	\$	94.0	\$	5.8	\$	1.1	\$	109.9
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The following is a reconciliation of total underwriting gain to income before provision for income taxes for the periods ended:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(in millions of U.S. dollars)			
Total underwriting gain	\$ 26.1	\$ 77.9	\$ 45.2	\$ 109.9
Net investment income	27.3	23.7	53.5	46.8
Net realized investment (losses) gains	(1.0)	1.7	(2.0)	3.5
Unrealized gains (losses) on derivative financial instruments	5.7	(12.5)	5.7	(9.4)
Other income		(0.2)		0.1
Interest expense	(3.4)	(3.4)	(6.7)	(6.7)
Other expense	(0.7)	(2.5)	(1.3)	(2.5)
Income before provision for income taxes	\$ 54.0	\$ 84.6	\$ 94.5	\$ 141.4

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(in millions of U.S. dollars)			
Financial guaranty direct:				
Public finance	\$ 1.7	\$ 0.4	\$ 2.8	\$ 0.5
Structured finance	19.5	15.6	39.1	35.9
Total	21.2	16.0	41.9	36.4
Financial guaranty reinsurance:				
Public finance	14.4	12.7	30.0	23.7
Structured finance	8.7	14.5	16.4	26.5
Total	23.1	27.2	46.4	50.2
Mortgage guaranty:				
Mortgage guaranty	3.7	5.1	7.9	9.7
Total net earned premiums	\$ 48.2	\$ 48.3	\$ 96.2	\$ 96.4

The other segment had an underwriting gain of \$10.1 million for Second Quarter 2006 and \$11.3 million and \$1.1 million for Six Months 2006 and Six Months 2005, respectively, as the equity layer credit protection business recorded loss recoveries in both periods. During Second Quarter 2005 the other segment had no underwriting gain or loss.

11. 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 June 30, 2006 and December 31, 2005 and for the three and six months ended June 30, 2006 and 2005.

CONDENSED CONSOLIDATING BALANCE SHEET
AS OF JUNE 30, 2006
(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	\$ 683	\$ 1,175,922	\$ 1,092,479	\$	\$ 2,269,084
Investment in subsidiaries	1,690,407			(1,690,407))
Deferred acquisition costs		72,314	132,993		205,307
Reinsurance recoverable		8,358	4,495	(1,560)	) 11,293
Goodwill		85,417			85,417
Premiums receivable		17,963	43,246	(19,027)	) 42,182
Other	10,263	129,667	57,331	(75,106)	) 122,155
Total assets	\$ 1,701,353	\$ 1,489,641	\$ 1,330,544	\$ (1,786,100)	) \$ 2,735,438
Liabilities and shareholders equity					
Liabilities					
Unearned premium reserves	\$	\$ 236,644	\$ 409,978	\$ (44,692)	) \$ 601,930
Reserves for losses and loss adjustment expenses		58,766	57,430	(1,560)	) 114,636
Profit commissions payable		3,715	25,901		29,616
Deferred income taxes		31,796	(7,468)	)	24,328
Long-term debt		197,359			197,359
Other	18,575	75,193	40,464	(49,441)	) 84,791
Total liabilities	18,575	603,473	526,305	(95,693)	) 1,052,660
Total shareholders equity	1,682,778	886,168	804,239	(1,690,407)	) 1,682,778
Total liabilities and shareholders equity	\$ 1,701,353	\$ 1,489,641	\$ 1,330,544	\$ (1,786,100)	) \$ 2,735,438

CONDENSED CONSOLIDATING BALANCE SHEET
AS OF DECEMBER 31, 2005
(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	\$ 163	\$ 1,116,387	\$ 1,139,463	\$	\$ 2,256,013
Investment in subsidiaries	1,665,392			(1,665,392)	
Deferred acquisition costs		73,803	119,639		193,442
Reinsurance recoverable		11,410	4,108	(3,168)	12,350
Goodwill		85,417			85,417
Premiums receivable		17,168	17,278	(1,435)	33,011
Other	1,172	107,211	27,121	(26,614)	108,890
Total assets	\$ 1,666,727	\$ 1,411,396	\$ 1,307,609	\$ (1,696,609)	\$ 2,689,123
Liabilities and shareholders equity					
Liabilities					
Unearned premium reserves	\$	\$ 196,435	\$ 362,273	\$ (21,559)	\$ 537,149
Reserves for losses and loss adjustment expenses		63,491	60,896	(3,168)	121,219
Profit commissions payable		4,237	48,756		52,993
Deferred income taxes		35,997	(9,368)		26,629
Long-term debt		197,344			197,344
Other	5,214	55,384	38,168	(6,490)	92,276
Total liabilities	5,214	552,888	500,725	(31,217)	1,027,610
Total shareholders equity	1,661,513	858,508	806,884	(1,665,392)	1,661,513
Total liabilities and shareholders equity	\$ 1,666,727	\$ 1,411,396	\$ 1,307,609	\$ (1,696,609)	\$ 2,689,123

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
FOR THREE MONTHS ENDED JUNE 30, 2006
(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 premiums written	\$	\$ 43,701	\$ 66,644	\$	\$ 110,345
Net premiums earned		23,888	24,296		48,184
Net investment income	1	13,708	13,563	(17	) 27,255
Net realized investment losses		(216	) (789	)	(1,005
Unrealized gains on derivative financial instruments		4,135	1,578		5,713
Equity in earnings of subsidiaries	48,401			(48,401)
Other revenues			23		23
Total revenues	48,402	41,515	38,671	(48,418	) 80,170
Expenses					
Loss and loss adjustment expenses		3,353	(9,866	)	(6,513
Acquisition costs and other operating expenses	3,885	13,586	11,149		28,620
Other	3	4,055	1		4,059
Total expenses	3,888	20,994	1,284		26,166
Income before provision for income taxes	44,514	20,521	37,387	(48,418	) 54,004
Total provision for income taxes		4,399	5,091		9,490
Net income	\$ 44,514	\$ 16,122	\$ 32,296	\$ (48,418	) \$ 44,514

* - The net income in the consolidating adjustment column will not equal parent company equity in earnings of subsidiaries, due to the residual effects of the 2005 reinsurance agreement with FSA.

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CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
FOR THREE MONTHS ENDED JUNE 30, 2005
(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 premiums written	\$	\$ 16,769	\$ 13,387	\$	\$ 30,156
Net premiums earned		23,434	24,830		48,264
Net investment income		13,387	10,281		23,668
Net realized investment gains	1	844	949	(128)	1,666
Unrealized losses on derivative financial instruments		(8,619)	(3,883)		(12,502)
Equity in earnings of subsidiaries	70,331			(70,331)	
Other revenues			(190)		(190)
Total revenues	70,332	29,046	31,987	(70,459)	60,906
Expenses					
Loss and loss adjustment expenses		(2,227)	(56,906)		(59,133)
Acquisition costs and other operating expenses	3,535	15,105	9,373	1,532	29,545
Other	47	5,851			5,898
Total expenses	3,582	18,729	(47,533)	1,532	(23,690)
Income before provision for income taxes	66,750	10,317	79,520	(71,991)	84,596
Total provision for income taxes		813	22,711	(5,678)	17,846
Net income	\$ 66,750	\$ 9,504	\$ 56,809	\$ (66,313)	\$ 66,750

* - Due to the accounting for subsidiaries under common control, net income in the consolidating adjustment column will not equal parent company equity in earnings of subsidiaries, due to the FSA agreement discussed in Note 4.

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
FOR SIX MONTHS ENDED JUNE 30, 2006
(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 premiums written	\$	\$ 68,818	\$ 92,311	\$	\$ 161,129
Net premiums earned		50,617	45,622		96,239
Net investment income	1	26,537	26,984	(29)	53,493
Net realized investment losses		(1,362)	(649)		(2,011)
Unrealized gains on derivative financial instruments		4,855	887		5,742
Equity in earnings of subsidiaries	86,743			(86,743)	
Other revenues			23		23
Total revenues	86,744	80,647	72,867	(86,772)	153,486
Expenses					
Loss and loss adjustment expenses		5,398	(12,293)		(6,895)
Acquisition costs and other operating expenses	7,335	28,880	21,648		57,863
Other	13	8,033	2		8,048
Total expenses	7,348	42,311	9,357		59,016
Income before provision for income taxes	79,396	38,336	63,510	(86,772)	94,470
Total provision for income taxes		7,904	7,150	20	15,074
Net income	\$ 79,396	\$ 30,432	\$ 56,360	\$ (86,792)	\$ 79,396

* - The net income in the consolidating adjustment column will not equal parent company equity in earnings of subsidiaries, due to the residual effects of the 2005 reinsurance agreement with FSA.

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
FOR SIX MONTHS ENDED JUNE 30, 2005
(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 premiums written	\$	\$ 42,698	\$ 63,927	\$	\$ 106,625
Net premiums earned		54,521	41,833		96,354
Net investment income		26,667	20,133		46,800
Net realized investment gains	1	1,006	2,578	(128)	3,457
Unrealized losses on derivative financial instruments		(3,696)	(5,734)		(9,430)
Equity in earnings of subsidiaries	118,275			(118,275)	
Other revenues			93		93
Total revenues	118,276	78,498	58,903	(118,403)	137,274
Expenses					
Loss and loss adjustment expenses		(4,055)	(64,474)		(68,529)
Acquisition costs and other operating expenses	7,131	31,736	14,857	1,532	55,256
Other	47	9,177	(30)		9,194
Total expenses	7,178	36,858	(49,647)	1,532	(4,079)
Income before provision for income taxes	111,098	41,640	108,550	(119,935)	141,353
Total provision for income taxes		9,018	26,915	(5,678)	30,255
Net income	\$ 111,098	\$ 32,622	\$ 81,635	\$ (114,257)	\$ 111,098

* - Due to the accounting for subsidiaries under common control, net income in the consolidating adjustment column will not equal parent company equity in earnings of subsidiaries, due to the FSA agreement discussed in Note 4.

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
 FOR SIX MONTHS ENDED JUNE 30, 2006
 (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)
Net cash flows provided by (used in) operating activities	\$ 27,273	\$ 78,158	\$ (14,069)	\$	\$ 91,362
Cash flows from investing activities					
Fixed maturity securities:					
Purchases		(237,714)	(196,757)		(434,471)
Sales		221,902	210,959		432,861
Maturities		6,864	7,431		14,295
Purchases of short-term investments, net	(520)	(46,075)	(8,424)		(55,019)
Net cash flows (used in) provided by investing activities	(520)	(55,023)	13,209		(42,334)
Cash flows from financing activities					
Repurchases of common stock	(17,190)				(17,190)
Dividends paid	(5,253)				(5,253)
Share activity under option and incentive plans	(2,310)				(2,310)
Repayment of notes assumed during formation transactions	(2,000)				(2,000)
Net cash flows used in financing activities	(26,753)				(26,753)
Effect of exchange rate changes		623	109		732
Increase (decrease) in cash and cash equivalents		23,758	(751)		23,007
Cash and cash equivalents at beginning of period		2,923	3,267		6,190
Cash and cash equivalents at end of period	\$	\$ 26,681	\$ 2,516	\$	\$ 29,197

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
FOR SIX MONTHS ENDED JUNE 30, 2005
(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)
Net cash flows provided by (used in) operating activities	\$ 24,825	\$ (53,645)	\$ 99,386	\$	\$ 70,566
Cash flows from investing activities					
Fixed maturity securities:					
Purchases		(196,830)	(317,157)		(513,987)
Sales		198,350	190,294		388,644
Maturities		9,000	4,000		13,000
Sales (purchases) of short-term investments, net	(14)	32,987	21,758		54,731
Net cash flows (used in) provided by investing activities	(14)	43,507	(101,105)		(57,612)
Cash flows from financing activities					
Repurchases of common stock	(19,014)				(19,014)
Dividends paid	(4,521)				(4,521)
Share activity under options and incentive plans	(1,276)				(1,276)
Net cash flows used in financing activities	(24,811)				(24,811)
Effect of exchange rate changes		(198)	(175)		(373)
Decrease in cash and cash equivalents		(10,336)	(1,894)		(12,230)
Cash and cash equivalents at beginning of period		12,096	4,882		16,978
Cash and cash equivalents at end of period	\$	\$ 1,760	\$ 2,988	\$	\$ 4,748

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) our inability to execute our business strategy; (3) reduction in the amount of reinsurance ceded by one or more of our principal ceding companies; (4) contract cancellations; (5) developments in the world's financial and capital markets that adversely affect our loss experience, the demand for our products or our investment returns; (6) more severe or frequent losses associated with our insurance products; (7) changes in regulation or tax laws applicable to us, our subsidiaries or customers; (8) governmental action; (9) natural catastrophes; (10) dependence on customers; (11) decreased demand for our insurance or reinsurance products or increased competition in our markets; (12) loss of key personnel; (13) technological developments; (14) the effects of mergers, acquisitions and divestitures; (15) changes in accounting policies or practices; (16) changes in general economic conditions, including interest rates and other factors; (17) other risks and uncertainties that have not been identified at this time; and (18) 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 financial results include four principal business segments: financial guaranty direct, financial guaranty reinsurance, mortgage guaranty and other. The other segment consists of a number of businesses that we exited in connection with our 2004 initial public offering (IPO).

We derive our revenues principally from premiums from our insurance, reinsurance and credit derivative businesses, net investment income, net realized gains and losses from our investment portfolio and unrealized gains and losses on derivative financial instruments. Our premiums are a function of the amount and type of contracts we write as well as prevailing market prices. We receive premiums 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.

Unrealized gains and losses on derivative financial instruments are a function of changes in the estimated fair value of our credit derivative contracts. We expect these unrealized gains and losses to fluctuate primarily based on changes in credit spreads and the credit quality of the referenced entities. We generally hold these derivative contracts to maturity. Where we hold a derivative contract to maturity, the cumulative unrealized gains and losses will net to zero if we incur no credit losses on that contract.

Our expenses consist primarily of losses and loss adjustment expenses (LAE), profit commission expense, acquisition costs, operating expenses, interest expense 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. Prior to the IPO, the majority of the risks we underwrote were investment grade, however some risks accepted were below investment grade. 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, 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. 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, valuation of derivative financial instruments, valuation of investments, other than temporary impairments of investments, premium revenue recognition, deferred acquisition costs and deferred income taxes. 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.

Reserves for Losses and Loss Adjustment Expenses

Reserves for losses and loss adjustment expenses for non-derivative transactions in our financial guaranty direct, financial guaranty assumed reinsurance and mortgage guaranty business include case reserves and portfolio reserves. See the Valuation of Derivative Financial Instruments for more information on our derivative transactions. 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 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. Financial guaranty insurance and assumed reinsurance case reserves and related salvage and subrogation, if any, are discounted at 6%, which is the approximate taxable equivalent yield on our investment portfolio in all periods presented.

We record portfolio reserves in our financial guaranty direct, financial guaranty assumed reinsurance and mortgage guaranty business. Portfolio reserves are established with respect to the portion of our business for which case reserves have not been established. Portfolio reserves are not established for quota share mortgage insurance contract types, all of which are in run-off, rather IBNR reserves have been established for these contracts.

Portfolio reserves are not established based on a specific event, rather they are calculated by aggregating the portfolio reserve calculated for each individual transaction. Individual transaction reserves are 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 is defined as the frequency of loss multiplied by the severity of loss, where the frequency is defined as the probability of default for each individual issue. The earning factor is inception to date earned premium divided by the estimated ultimate written premium for each transaction. The probability of default is estimated from historical rating agency data and is based on the transaction's credit rating, industry sector and

time until maturity. The severity is defined as the complement of historical recovery/salvage rates gathered by the rating agencies of defaulting issues and is based on the industry sector.

Portfolio reserves are recorded gross of reinsurance. To date our reinsurance programs have been made up of excess of loss contracts. We have not ceded any amounts under these contracts, as our recorded portfolio reserves have not exceeded our contractual retentions.

The Company records an incurred loss that is reflected in the statement of operations upon the establishment of portfolio reserves. When we initially record a case reserve, we reclassify 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 is recorded as a charge in our statement of operations. It would be a remote occurrence when the case reserve is not greater than the reclassified portfolio reserve. Any subsequent change in portfolio reserves or the initial case reserves is recorded quarterly as a charge or credit in our statement of operations in the period such estimates change. Due to the inherent uncertainties of estimating loss and LAE reserves, actual experience may differ from the estimates reflected in our unaudited interim consolidated financial statements, and the differences may be material.

The chart below demonstrates the portfolio reserve's sensitivity to frequency and severity assumptions. The change in these estimates represent management's estimate of reasonably possible material changes and are based upon our analysis of historical experience. Portfolio reserves were recalculated with changes made to the default and severity assumptions. In all scenarios, the starting point used to test the portfolio reserve's sensitivity to the changes in the frequency and severity assumptions was the weighted average frequency and severity by rating and asset class of our insured portfolio. Overall the weighted average default frequency was 0.86 % and the weighted average severity was 19.1 % at June 30, 2006. For example, in the first scenario where the frequency was increased by 5.0%, each transaction's contribution to the portfolio reserve was recalculated by adding 0.04 % (i.e. 5.0% multiplied by 0.86 %) to the individual transaction's default frequency.

(in thousands of U.S. dollars)	Portfolio Reserve	Reserve Increase	Percentage Change	
Portfolio reserve as of June 30, 2006	\$ 64,676	\$		
5% Frequency Increase	68,931	4,255	6.58	%
10% Frequency Increase	72,831	8,155	12.61	%
5% Severity Increase	68,291	3,615	5.59	%
10% Severity Increase	71,551	6,875	10.63	%
5% Frequency and Severity Increase	72,399	7,723	11.94	%

In addition to analyzing the sensitivity of our portfolio reserves to possible changes in frequency and severity, we have also performed a sensitivity analysis on our financial guaranty and mortgage guaranty case reserves. Case reserves may change from our original estimate due to changes in severity factors. An actuarial analysis of the historical development of our case reserves shows that it is reasonably possible that our case reserves could develop by as much as ten percent. This analysis was performed by separately evaluating the historical development by comparing the initial case reserve established to the subsequent development in that case reserve, excluding the effects of discounting, for each sector in which we currently have significant case reserves, and estimating the possible future development. Based on this analysis, it is reasonably possible that our current financial guaranty and mortgage guaranty case reserves of \$31.2 million could reasonably increase by approximately \$3.0 million to \$4.0 million in the future. This would cause an increase in incurred losses on our statement of operations and comprehensive income.

A sensitivity analysis is not appropriate for our other segment reserves and our mortgage guaranty IBNR, since the amounts are fully reserved or reinsured.

We also record IBNR reserves for our mortgage guaranty and other segments. 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 mortgage guaranty quota-share

reinsurance contracts, all of which are in run-off, within our mortgage guaranty segment. We also record IBNR for title reinsurance, auto residual value reinsurance and trade credit reinsurance within our other segment. The other segment represents lines of business we have exited or sold prior to the IPO.

For all other mortgage guaranty transactions we record portfolio reserves in a manner consistent with our financial guaranty business. While other mortgage guaranty insurance companies do not record portfolio reserves, rather just case 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.

Statement of Financial Accounting Standards (FAS) No. 60, Accounting and Reporting by Insurance Enterprises (FAS 60) is the authoritative guidance for an insurance enterprise. FAS 60 prescribes differing reserving methodologies depending on whether a contract fits within its definition of a short-duration contract or a long-duration contract. Financial guaranty contracts have elements of long-duration insurance contracts in that they are irrevocable and extend over a period that may exceed 30 years or more, but for regulatory purposes are reported as property and liability insurance, which are normally considered short-duration contracts. The short-duration and long-duration classifications have different methods of accounting for premium revenue and contract liability recognition. Additionally, the accounting for deferred acquisition costs (DAC) could be different under the two methods.

We believe the guidance of FAS 60 does not expressly address the distinctive characteristics of financial guaranty insurance, so we also apply the analogous guidance of Emerging Issues Task Force (EITF) Issue No. 85-20, Recognition of Fees for Guaranteeing a Loan (EITF 85-20), which provides guidance relating to the recognition of fees for guaranteeing a loan, which has similarities to financial guaranty insurance contracts. Under the guidance in EITF 85-20, the guarantor should assess the probability of loss on an ongoing basis to determine if a liability should be recognized under FAS No. 5, Accounting for Contingencies (FAS 5). FAS 5 requires that a loss be recognized where it is probable that one or more future events will occur confirming that a liability has been incurred at the date of the financial statements and the amount of loss can be reasonably estimated.

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

	June 30, 2006	December 31, 2005
	(in millions of U.S. dollars)	
<i>By segment:</i>		
Financial guaranty direct	\$ 6.6	\$ 13.1
Financial guaranty reinsurance	86.2	86.3
Mortgage guaranty	7.0	7.0
Other	14.8	14.8
Total	\$ 114.6	\$ 121.2

	June 30, 2006	December 31, 2005
	(in millions of U.S. dollars)	
<i>By type of reserve:</i>		
Case	\$ 38.4	\$ 45.9
IBNR	11.6	11.6
Portfolio	64.6	63.7
Total	\$ 114.6	\$ 121.2

	As of June 30, 2006									
	Financial Guaranty Direct	Financial Guaranty Reinsurance	Mortgage Guaranty	Other	Total					
	(in millions of U.S. dollars)									
<i>By segment and type of reserve:</i>										
Case	\$	30.9	\$	0.3	\$	7.2	\$	38.4		
IBNR				4.0		7.6		11.6		
Portfolio	6.6	55.3	2.7					64.6		
Total	\$	6.6	\$	86.2	\$	7.0	\$	14.8	\$	114.6

	As of December 31, 2005									
	Financial Guaranty Direct	Financial Guaranty Reinsurance	Mortgage Guaranty	Other	Total					
	(in millions of U.S. dollars)									
<i>By segment and type of reserve:</i>										
Case	\$	4.5	\$	33.8	\$	0.3	\$	7.3	\$	45.9
IBNR				4.1		7.5		11.6		
Portfolio	8.6	52.5	2.6					63.7		
Total	\$	13.1	\$	86.3	\$	7.0	\$	14.8	\$	121.2

The following table sets forth the financial guaranty in-force portfolio by underlying rating:

Ratings(1)	As of June 30, 2006			As of December 31, 2005				
	Net par outstanding	% of Net par outstanding		Net par outstanding	% of Net par outstanding			
	(in billions of U.S. dollars)							
AAA	\$	43.7	37.8	%	\$	34.5	33.7	%
AA	21.0	18.2	%	20.0	19.5	%		
A	32.2	27.8	%	30.3	29.5	%		
BBB	17.3	14.9	%	16.4	16.0	%		
Below investment grade	1.4	1.3	%	1.3	1.3	%		
Total exposures	\$	115.6	100.0	%	\$	102.5	100.0	%

(1) These ratings represent the Company's internal assessment of the underlying credit quality of the insured obligations. Our scale is comparable to that of the nationally recognized rating agencies.

Our surveillance department is responsible for monitoring our portfolio of credits and maintains a list of closely monitored credits. The closely monitored credits are 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 include all below investment grade (BIG) exposures 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. The closely monitored credits also include investment grade (IG) risks where credit quality is deteriorating and where, in the view of the Company, there is significant potential that the risk quality will fall below investment grade. The closely monitored credits include approximately 97% of our BIG exposure, and the remaining BIG exposure of \$38.6 million is distributed across 76 different credits, as of June 30, 2006. As of December 31, 2005, the closely monitored credits include approximately 96% of our BIG exposure, and the remaining BIG exposure of \$55.2 million is distributed across 103 different credits. Other than those excluded BIG credits, credits that are not included in the closely monitored credit list are categorized as fundamentally sound risks.

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The following table provides financial guaranty net par outstanding by credit monitoring category as of June 30, 2006 and December 31, 2005:

Description:	As of June 30, 2006				
	Net Par Outstanding	% of Net Par Outstanding	# of Credits in Category	Case Reserves	
	(\$ in millions)				
Fundamentally sound risk(1)	\$ 114,102	98.7	%		
Closely monitored:					
Category 1	874	0.8	%	38	\$
Category 2	370	0.4	%	19	
Category 3	201	0.2	%	17	17
Category 4	25			12	15
Sub total	1,470	1.3	%	86	32
Other below investment grade risk	39			76	
Total	\$ 115,611	100.0	%		\$ 32

(1) As of June 30, 2006, Category 1 contains 3 credits with net par outstanding of \$59.6 million and Category 2 contains 6 credits with net par outstanding of \$49.4 million related to Hurricane Katrina.

Description:	As of December 31, 2005				
	Net Par Outstanding	% of Net Par Outstanding	# of Credits in Category	Case Reserves	
	(\$ in millions)				
Fundamentally sound risk(1)	\$ 100,951	98.6	%		
Closely monitored:					
Category 1	872	0.9	%	36	\$
Category 2	433	0.4	%	22	
Category 3	131	0.1	%	15	16
Category 4	23			11	15
Sub total	1,459	1.4	%	84	31
Other below investment grade risk	55			103	
Total	\$ 102,465	100.0	%		\$ 31

(1) As of December 31, 2005, Category 1 contains 4 credits with net par outstanding of \$44.8 million and Category 2 contains 7 credits with net par outstanding of \$80.6 million related to Hurricane Katrina.

The following table summarizes movements in CMC exposure by risk category:

Net Par Outstanding	Category 1	Category 2	Category 3	Category 4	Total CMC
	(\$ in millions)				
Balance, December 31, 2005	\$ 872	\$ 433	\$ 131	\$ 23	\$ 1,459
Less: Amortization	111	(20)	17		108
Add: Additions from:					
First time on CMC	140	3	16		159
Upgrades	37	16			53
Downgrades		24	89	2	115
Less: Deletions from:					
Upgrades	40	37	16		93
Downgrades	24	89	2		115
Net Change	2	(63)	70	2	11
Balance, June 30, 2006	\$ 874	\$ 370	\$ 201	\$ 25	\$ 1,470

Industry Methodology

The Company is aware that there are certain differences regarding the measurement of portfolio loss liabilities among companies in the financial guaranty industry. In January and February 2005, the Securities and Exchange Commission (SEC) staff had discussions concerning these differences with a number of industry participants. Based on those discussions, in June 2005, the Financial Accounting Standards Board (FASB) staff decided additional guidance is necessary regarding financial guaranty contracts. When the FASB staff reaches a conclusion on this issue, which is expected during the third quarter of 2006, the Company and the rest of the financial guaranty industry may be required to change some aspects of their loss reserving policies, but the Company cannot currently assess how the FASB or SEC staffs ultimate resolution of this issue will impact our reserving policy or other balances, i.e., premiums and DAC. Until the issue is resolved, the Company intends to continue to apply its existing policy with respect to the establishment of both case and portfolio reserves.

Valuation of Derivative Financial Instruments

The Company follows FAS No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133) and FAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities (FAS 149), which establishes accounting and reporting standards for derivative instruments. FAS 133 and FAS 149 require recognition of all derivatives on the balance sheet at fair value.

We issue credit derivative financial instruments, which prior to 2004 included a few index-based derivative financial instruments, that we view as an extension of our financial guaranty business but which do not qualify for the financial guaranty insurance scope exception under FAS 133 and FAS 149 and therefore are reported at fair value, with changes in fair value included in our earnings.

Since we view these derivative contracts as an extension of our financial guaranty business, we believe that the most meaningful presentation of these derivatives is to reflect revenue as earned premium, to record estimates of losses and LAE on specific credit events as incurred and to record changes in fair value as incurred. Reserves for losses and LAE are established on a similar basis as our insurance policies. Other changes in fair value are included in unrealized gains and losses on derivative financial instruments. We generally hold 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, we may decide to terminate a derivative contract prior to maturity. Where we hold a derivative contract to maturity, the cumulative unrealized gains and losses will net to zero if we incur no credit losses on that contract. However, in the event that we terminate a derivative contract prior to maturity the unrealized gain or loss will be realized through premiums earned and losses incurred.

The fair value of these instruments depends on a number of factors including credit spreads, changes in interest rates, recovery rates and the credit ratings of referenced entities. Where available, we use quoted market

prices to determine the fair value of these credit derivatives. If the quoted prices are not available, particularly for senior layer CDOs and equity layer credit protection, the fair value is estimated using valuation models for each type of credit protection. These models may be developed by third parties, such as rating agencies, or developed internally based on market conventions for similar transactions, depending on the circumstances. 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. The majority of our single name credit derivatives were valued using third-party market quotes. These exposures were substantially liquidated in the first quarter of 2005 as we are no longer involved in the single name credit derivatives business. Our exposures to CDOs are typically valued using a combination of rating agency models and internally developed models.

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 derivative instruments is affected by current market conditions. Management considers factors such as current prices charged for similar agreements, performance of underlying assets, and our ability to obtain reinsurance for our insured obligations. Due to the inherent uncertainties of the assumptions used in the valuation models to determine the fair value of these derivative products, actual experience may differ from the estimates reflected in our unaudited interim consolidated financial statements, and the differences may be material.

During the first quarter 2005 review of its valuation models, management identified a limitation in its valuation models highlighted by the then widening credit spread environment. Management adjusted its valuation models for this limitation in the first quarter 2005 resulting in an adjustment to unrealized gains on derivative financial instruments of \$4.3 million, net of income taxes. Management continues to perform additional analysis, as necessary, to address market anomalies and their effect on its valuation models.

The fair value adjustment recognized in our statements of operations for the three months ended June 30, 2006 (Second Quarter 2006) was a \$5.7 million gain compared with a \$12.5 million loss for the three months ended June 30, 2005 (Second Quarter 2005). The fair value adjustment recognized in our statements of operations for Six Months ended June 30, 2006 (Six Months 2006) was a \$5.7 million gain compared with a \$9.4 million loss for Six Months ended June 30, 2005 (Six Months 2005). The change in fair value is related to many factors but primarily due to narrowing in credit spreads.

Valuation of Investments

As of June 30, 2006 and December 31, 2005, we had total investments of \$2.2 billion. The fair values of all of our investments are calculated from independent market quotations.

As of June 30, 2006, approximately 92% of our investments were long-term fixed maturity securities, and our portfolio had an average duration of 4.3 years, compared with 95% and 4.4 years as of December 31, 2005. Changes in interest rates affect the value of our fixed maturity portfolio. As interest rates fall, the fair value of fixed maturity securities increases and as interest rates rise, the fair value of fixed maturity securities decreases.

Other than Temporary Impairments

We have a formal review process for all securities in our investment portfolio, including a review for impairment losses. Factors considered when assessing impairment include:

- a decline in the market value of a security by 20% or more below amortized cost for a continuous period of at least six months;
- a decline in the market value of a security for a continuous period of 12 months;
- recent credit downgrades of the applicable security or the issuer by rating agencies;
- the financial condition of the applicable issuer;

- whether scheduled interest payments are past due; and
- whether we have the ability and intent to hold the security for a sufficient period of time to allow for anticipated recoveries in fair value.

If we believe a decline in the value of a particular investment is temporary, we record the decline as an unrealized loss on our balance sheet in accumulated other comprehensive income in shareholders' equity. If we believe the decline is other than temporary, we write down the carrying value of the investment and record a realized loss in our statement of operations. Our assessment of a decline in value includes management's current assessment of the factors noted above. If that assessment changes in the future, we may ultimately record a loss after having originally concluded that the decline in value was temporary.

The Company had no write downs of investments for other than temporary impairment losses for the three- and six-month periods ended June 30, 2006 and 2005.

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	As of June 30, 2006		As of December 31, 2005	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
	(\$ in millions)			
Municipal securities				
0-6 months	\$ 187.8	\$ (3.3)	\$ 103.2	\$ (0.9)
7-12 months	48.0	(1.7)	11.9	(0.3)
Greater than 12 months	21.2	(1.0)	13.1	(0.4)
	257.0	(6.0)	128.2	(1.6)
Corporate securities				
0-6 months	30.8	(0.5)	21.4	(0.4)
7-12 months	20.8	(0.9)	13.4	(0.2)
Greater than 12 months	27.8	(1.2)	16.8	(0.7)
	79.4	(2.6)	51.6	(1.3)
U.S. Government obligations				
0-6 months	93.8	(2.8)	160.5	(0.8)
7-12 months	68.0	(2.0)	8.7	(0.2)
Greater than 12 months	18.6	(0.7)	13.2	(0.4)
	180.4	(5.5)	182.4	(1.4)
Mortgage and asset-backed securities				
0-6 months	222.3	(4.2)	318.8	(4.7)
7-12 months	261.1	(11.1)	136.8	(2.6)
Greater than 12 months	188.2	(9.5)	89.7	(2.9)
	671.6	(24.8)	545.3	(10.2)
Total	\$ 1,188.4	\$ (38.9)	\$ 907.5	\$ (14.5)

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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 June 30, 2006		As of December 31, 2005	
	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	1.0		0.3	
Due after five years through ten years	52.6	(1.9)	60.1	(1.2)
Due after ten years	203.4	(4.1)	67.8	(0.4)
	257.0	(6.0)	128.2	(1.6)
Corporate securities				
Due in one year or less	6.8			
Due after one year through five years	57.2	(1.6)	44.3	(1.0)
Due after five years through ten years	5.7	(0.2)	4.2	
Due after ten years	9.7	(0.8)	3.1	(0.3)
	79.4	(2.6)	51.6	(1.3)
U.S. Government obligations				
Due in one year or less	2.4		57.8	(0.2)
Due after one year through five years	18.4	(0.3)	39.5	(0.3)
Due after five years through ten years	66.6	(1.6)	45.2	(0.6)
Due after ten years	93.0	(3.6)	39.9	(0.3)
	180.4	(5.5)	182.4	(1.4)
Mortgage and asset-backed securities	671.6	(24.8)	545.3	(10.2)
Total	\$ 1,188.4	\$ (38.9)	\$ 907.5	\$ (14.5)

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The following table summarizes, for all securities sold at a loss through June 30, 2006 and 2005, 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 June 30,			
	2006		2005	
	Estimated Fair Value	Gross Realized Losses	Estimated Fair Value	Gross Realized Losses
	(\$ in millions)			
Municipal securities				
0-6 months	\$ 12.8	\$ (0.1)	\$ 20.7	\$
7-12 months	6.0	(0.1)		
Greater than 12 months	3.3	(0.1)		
	22.1	(0.3)	20.7	
Corporate securities				
0-6 months			5.3	
7-12 months			5.4	(0.1)
Greater than 12 months	1.9	(0.1)	8.4	(0.3)
	1.9	(0.1)	19.1	(0.4)
U.S. Government securities				
0-6 months	32.2	(0.6)	9.9	(0.1)
7-12 months	46.4	(0.3)		
Greater than 12 months				
	78.6	(0.9)	9.9	(0.1)
Mortgage and asset-backed securities				
0-6 months	3.8	(0.1)	6.8	
7-12 months	9.1	(0.1)		
Greater than 12 months				
	12.9	(0.2)	6.8	
Total	\$ 115.5	\$ (1.5)	\$ 56.5	\$ (0.5)

Length of Time in Continuous Unrealized Loss Prior to Sale	Six Months Ended June 30,			
	2006		2005	
	Estimated Fair Value	Gross Realized Losses	Estimated Fair Value	Gross Realized Losses
	(\$ in millions)			
Municipal securities				
0-6 months	\$ 18.2	\$ (0.1)	\$ 20.7	\$
7-12 months	19.0	(0.4)	5.5	(0.1)
Greater than 12 months	3.3	(0.1)		
	40.5	(0.6)	26.2	(0.1)
Corporate securities				
0-6 months			5.3	
7-12 months			5.4	(0.1)
Greater than 12 months	1.9	(0.1)	8.4	(0.3)
	1.9	(0.1)	19.1	(0.4)
U.S. Government securities				
0-6 months	117.5	(1.9)	20.3	(0.1)
7-12 months	76.5	(0.7)	4.9	(0.1)
Greater than 12 months				
	194.0	(2.6)	25.2	(0.2)
Mortgage and asset-backed securities				
0-6 months	31.0	(0.2)	17.0	(0.3)
7-12 months	9.1	(0.1)	1.8	
Greater than 12 months			3.3	(0.2)
	40.1	(0.3)	22.1	(0.5)
Total	\$ 276.5	\$ (3.6)	\$ 92.6	\$ (1.2)

Premium Revenue Recognition

Premiums are received either upfront or in installments. Upfront premiums are earned in proportion to the expiration of the related risk. Each installment premium is earned ratably over its installment period, generally one year or less. For the financial guaranty direct and financial guaranty reinsurance segments, earned premiums related to upfront premiums are greater in the earlier periods of an upfront transaction when there is a higher amount of risk outstanding. The premiums are allocated in accordance with the principal amortization schedule of the related bond issue and are earned ratably over the amortization period. When an insured issue is retired early, is called by the issuer, or is in substance paid in advance through a refunding accomplished by placing U.S. Government securities in escrow, the remaining unearned premium reserve is earned at that time. Unearned premium reserves represent the portion of premiums written that are applicable to the unexpired amount at risk of insured bonds.

In our reinsurance businesses, we estimate 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 our ceding companies report premium data anywhere from 30 to 90 days after the end of the relevant period. Written premiums reported in our statement of operations are based upon reports received from ceding companies supplemented by our own estimates of premium for which ceding company reports have not yet been received. As of June 30, 2006 and December 31, 2005, the assumed premium estimate and related ceding commissions included in our unaudited interim consolidated financial statements were \$23.1 million and \$7.2 million and \$14.3 million and \$4.5 million, respectively. Key assumptions used to arrive at management's best estimate of assumed premiums are premium amounts reported historically and informal communications with ceding companies. Differences between such estimates and actual amounts are recorded in the period in which the actual amounts are determined. Historically, the differences have not been material. We do not record a provision for doubtful accounts related to our assumed premium estimate. Historically there have not been any material issues related to the collectibility of assumed premium. No provision for doubtful accounts related to our premium receivable was recorded for 2006 or 2005.

Deferred Acquisition Costs

Acquisition costs incurred, other than those associated with credit derivative products, that vary with and are directly related to the production of new business are deferred 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. As of June 30, 2006 and December 31, 2005, we had deferred acquisition costs of \$205.3 million and \$193.4 million, respectively. Ceding commissions paid to primary insurers are the largest component of deferred acquisition costs, constituting 70.0% and 72.6% of total deferred acquisition costs as of June 30, 2006 and December 31, 2005, respectively. Management uses its judgment in determining what types of costs should be deferred, as well as what percentage of these costs should be deferred. We annually conduct 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 we cede to other reinsurers reduce acquisition costs. Anticipated losses, LAE 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 in the Premium Revenue Recognition section of these Critical Accounting Estimates, the remaining related deferred acquisition cost is expensed at that time.

Deferred Income Taxes

As of June 30, 2006 and December 31, 2005, we had a net deferred income tax liability of \$24.3 million and \$26.6 million, respectively. Certain of our subsidiaries are subject to U.S. income tax. Deferred income tax assets and liabilities are established for the temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities using enacted rates in effect for the year in which the differences are expected to reverse. Such temporary differences relate principally to deferred acquisition costs, reserves for losses and LAE, unearned premium reserves, net operating loss carryforwards (NOLs), unrealized gains and losses on investments and derivative financial instruments and statutory contingency reserves. A valuation allowance is recorded to reduce a deferred tax asset to the amount that in management's opinion is more likely than not to be realized.

As of June 30, 2006, Assured Guaranty Re Overseas Ltd. (AGRO) had a stand-alone NOL of \$54.0 million, which is available to offset its future U.S. taxable income. AGRO has \$33.3 million of this NOL

available through 2017 and \$20.7 million available through 2023. AGRO's stand-alone NOL is not permitted to offset income of any other members of AGRO's consolidated group due to certain tax regulations. Under applicable accounting rules, we are required to establish a valuation allowance for NOLs that we believe are more likely than not to expire before utilized. Management believes it is more likely than not that \$20.0 million of AGRO's \$54.0 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 has established a valuation allowance for deferred tax assets attributable to unrealized losses of AGRO in the amount of \$1.7 million which are unlikely 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.

Accounting for Share-Based Compensation

Prior to January 1, 2006, we accounted for our share-based employee compensation plans under the measurement and recognition provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB) and related Interpretations, as permitted by FAS No. 123, *Accounting for Stock-Based Compensation* (FAS 123). During the three- and six- month periods ended June 30, 2005, we recorded no share-based employee compensation expense for options granted under the Assured Guaranty Ltd. 2004 Long-Term Incentive Plan (the Incentive Plan) as all options granted under that plan had exercise prices equal to the fair market value of our common stock on the date of grant. Also, during the three- and six-month periods ended June 30, 2005, we recorded no compensation expense in connection with the Assured Guaranty Ltd. Employee Stock Purchase Plan (the Stock Purchase Plan) as the purchase price of the stock was not less than 85% of the lower of the fair market value of our common stock at the beginning of each offering period or at the end of each purchase period. In accordance with FAS 123 and FAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (FAS 148) we disclosed our net income and earnings per share as if we had applied the fair value-based method in measuring compensation expense for our share-based incentive programs.

Effective January 1, 2006, we adopted the fair value recognition provisions of FAS No. 123 (revised), *Share-Based Payment* (FAS 123R) using the modified prospective transition method. Under that transition method, compensation expense includes: (a) compensation expense for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FAS 123, and (b) compensation expense for all share-based payments granted on or after January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of FAS 123R.

As a result of adopting FAS 123R on January 1, 2006, the Company's Second Quarter 2006 income before income taxes and net income are \$1.5 million and \$1.1 million lower, respectively, and for Six Months 2006 are \$3.2 million and \$2.5 million lower, respectively, than if it had continued to account for share-based compensation under APB 25. Basic and diluted earnings per share for Second Quarter 2006 and Six Months 2006 are \$0.01 and \$0.03 lower, respectively, than if the Company had continued to account for share-based compensation under APB 25. In addition, the Company capitalized \$1.2 million in Six Months 2006 of share-based compensation as deferred acquisition costs (DAC). Because we elected to use the modified prospective transition method, results for prior periods have not been restated.

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The following table presents pre-DAC and pre-tax, share-based compensation cost by share-based expense type:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
(in thousands of U.S. dollars)				
Share-Based Employee Cost				
<i>Restricted Stock</i>				
Recurring amortization	\$ 1,957	\$ 1,382	\$ 3,764	\$ 2,561
Accelerated amortization for retirement eligible employees	364		807	
Subtotal	2,321	1,382	4,571	2,561
<i>Stock Options</i>				
Recurring amortization	909		1,953	
Accelerated amortization for retirement eligible employees	150		355	
Subtotal	1,059		2,308	
<i>ESPP</i>	32		64	
Total Share-Based Employee Cost	3,412	1,382	6,943	2,561
Share-Based Directors Cost				
<i>Restricted Stock</i>	72	120	139	150
<i>Restricted Stock Units</i>	229	149	413	307
Total Share-Based Directors Cost	301	269	552	457
Total Share-Based Cost	\$ 3,713	\$ 1,651	7,495	\$ 3,018

At June 30, 2006, there was \$26.9 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under all equity compensation plans. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures. We expect to recognize that cost over a weighted average period of 1.9 years. As a result of the adoption of FAS 123R, the income tax effects of compensatory stock options are included in the computation of the income tax expense (benefit), and deferred tax assets and liabilities, subject to certain prospective adjustments to shareholders' equity for the differences between the income tax effects of expenses recognized in the results of operations and the related amounts deducted for income tax purposes. Prior to the adoption of FAS 123R, the tax benefits relating to the income tax deductions for compensatory stock options were recorded directly to shareholders' equity.

The weighted-average grant-date fair value of options granted were \$6.86 and \$5.08 for Second Quarter 2006 and Second Quarter 2005, respectively. The weighted-average grant-date fair value of options granted were \$6.71 and \$4.53 for Six Months 2006 and Six Months 2005, respectively. The fair value of options issued is estimated on the date of grant using the Black-Scholes option-pricing model, with the following weighted-average assumptions used for grants in 2006 and 2005:

	Three Months Ended June 30,		Six Months Ended June 30,					
	2006	2005	2006	2005				
Dividend yield	0.6	%	0.6	%	0.5	%	0.7	%
Expected volatility	20.12	%	20.92	%	20.44	%	20.82	%
Risk free interest rate	5.1	%	4.2	%	4.6	%	4.1	%
Expected life	5 years		5 years		5 years		5 years	
Forfeiture rate	6.0	%	6.0	%	6.0	%	6.0	%

These assumptions were based on the following:

- The expected dividend yield is based on the current expected annual dividend and share price on the grant date,

- Expected volatility is estimated at the date of grant based on the historical share price volatility, calculated on a daily basis,

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- The risk-free interest rate is the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term to the granted stock options,
- The expected life is based on the average expected term of our guideline companies, which are defined as similar entities, since the Company has insufficient expected life data,
- The forfeiture rate is based on the rate used by our guideline companies, since the Company has insufficient forfeiture data. Estimated forfeitures will be reassessed at each balance sheet date and may change based on new facts and circumstances.

For options granted before January 1, 2006, the Company amortizes the fair value on an accelerated basis. For options granted on or after January 1, 2006, the Company amortizes the fair value on a straight-line basis. All options are amortized over the requisite service periods of the awards, which are generally the vesting periods. Stock options are generally granted once a year with exercise prices equal to the closing price on the date of grant. The Company may elect to use different assumptions under the Black-Scholes option valuation model in the future, which could materially affect the Company's net income or earnings per share.

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Consolidated Results of Operations (1)

The following table presents summary consolidated results of operations data for the three and six months ended June 30, 2006 and 2005.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(\$ in millions)			
Revenues:				
Gross written premiums	\$ 111.5	\$ 40.5	\$ 166.9	\$ 118.6
Net written premiums	110.3	30.2	161.1	106.6
Net earned premiums	48.2	48.3	96.2	96.4
Net investment income	27.3	23.7	53.5	46.8
Net realized investment (losses) gains	(1.0)	1.7	(2.0)	3.5
Unrealized gains (losses) on derivative financial instruments	5.7	(12.5)	5.7	(9.4)
Other income		(0.2)		0.1
Total revenues	80.2	60.9	153.5	137.3
Expenses:				
Loss and loss adjustment expenses	(6.5)	(59.1)	(6.9)	(68.5)
Profit commission expense	1.7	3.3	3.0	4.3
Acquisition costs	11.3	11.7	22.1	21.9
Operating expenses	15.6	14.5	32.8	29.0
Interest expense	3.4	3.4	6.7	6.7
Other expenses	0.7	2.5	1.3	2.5
Total expenses	26.2	(23.7)	59.0	(4.1)
Income before provision for income taxes	54.0	84.6	94.5	141.4
Provision for income taxes	9.5	17.8	15.1	30.3
Net income	\$ 44.5	\$ 66.8	\$ 79.4	\$ 111.1
Underwriting gain (loss) by segment (2):				
Financial guaranty direct	\$ 9.4	\$ (0.1)	\$ 16.6	\$ 8.9
Financial guaranty reinsurance	4.6	74.8	12.6	94.0
Mortgage guaranty	2.0	3.2	4.8	5.8
Other	10.1		11.3	1.1
Total	\$ 26.1	\$ 77.9	\$ 45.2	\$ 109.9

(1) Some amounts may not foot due to rounding.

(2) Prior year segment amounts have been adjusted to reflect current year operating expense allocations for comparability purposes.

We organize our business around four principal business segments: financial guaranty direct, financial guaranty reinsurance, mortgage guaranty and other. There are a number of lines of business that we exited as part of our IPO in April 2004, which are included in the other segment. However, the results of these businesses are reflected in our consolidated financial statements. These businesses include equity layer credit protection, trade credit reinsurance, title reinsurance and auto residual value reinsurance. These unaudited interim consolidated financial statements cover the Second Quarter 2006, Second Quarter 2005, Six Months 2006 and Six Months 2005.

Net Income

Net income was \$44.5 million for Second Quarter 2006, a decrease of \$22.3 million compared with \$66.8 million for Second Quarter 2005. The decrease is primarily attributable to a \$63.7 million loss recovery in Second Quarter 2005 resulting from reinsurance of financial guaranty policies that insured certain investments in securities issued by entities related to Commercial Financial Services, Inc. (CFS). Offsetting the decrease are

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unrealized gains on derivative financial instruments of \$5.7 million in Second Quarter 2006 compared with a loss of \$12.5 million in Second Quarter 2005. Further offsetting the decrease was an \$8.3 million reduction in our income tax provision which was \$9.5 million in Second Quarter 2006, compared with \$17.8 million in Second Quarter 2005. The Second Quarter 2005 included \$22.3 million of income tax expense related to the \$63.7 million loss recovery mentioned above. Differences in our income tax expense are primarily attributable to the relative distribution of income across our taxable and non-taxable jurisdictions. Net income was \$79.4 million for Six Months 2006, compared with \$111.1 million for Six Months 2005. The decrease of \$31.7 million in 2006 compared with 2005 is primarily due to the same reasons mentioned above.

Gross Written Premiums

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Gross Written Premiums	(\$ in millions)			
Financial guaranty direct	\$ 68.4	\$ 20.9	\$ 98.6	\$ 44.7
Financial guaranty reinsurance	41.7	8.2	60.5	42.2
Mortgage guaranty	1.2	1.9	3.8	21.3
Total financial guaranty gross written premiums	111.4	31.0	163.0	108.2
Other	0.1	9.5	3.9	10.4
Total gross written premiums	\$ 111.5	\$ 40.5	\$ 166.9	\$ 118.6

Gross written premiums for Second Quarter 2006 were \$111.5 million compared with \$40.5 million for Second Quarter 2005. Gross written premiums from our financial guaranty direct operations increased \$47.5 million in Second Quarter 2006 compared with Second Quarter 2005. The increase is primarily attributable to several financial guaranty transactions written during Second Quarter 2006 in the United Kingdom (UK) with upfront premiums totaling \$41.0 million. Our financial guaranty reinsurance segment increased \$33.5 million in Second Quarter 2006 compared with Second Quarter 2005 due to increased upfront treaty and facultative assumed premiums in Second Quarter 2006, where as Second Quarter 2005 had more installment treaty and facultative assumed premiums. In addition, Financial Security Assurance Inc. (FSA) reassumed from Assured Guaranty Re Ltd. (AG Re) \$18.4 million of healthcare related business (FSA transaction) in Second Quarter 2005.

Gross written premiums for Six Months 2006 were \$166.9 million, compared with \$118.6 million for Six Months 2005. This increase is primarily due to the same reasons mentioned above. However, gross written premiums for Six Months 2006 in our mortgage guaranty segment decreased \$17.5 million compared with Six Months 2005, primarily attributable to a single transaction executed in First Quarter 2005 which contributed \$16.3 million to gross written premiums.

Net Earned Premiums

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Net Earned Premiums	(\$ in millions)			
Financial guaranty direct	\$ 21.2	\$ 16.0	\$ 41.9	\$ 36.4
Financial guaranty reinsurance	23.1	27.2	46.4	50.2
Mortgage guaranty	3.7	5.1	7.9	9.7
Total financial guaranty net earned premiums	48.2	48.3	96.2	96.4
Other				
Total net earned premiums	\$ 48.2	\$ 48.3	\$ 96.2	\$ 96.4

Net earned premiums for Second Quarter 2006 were \$48.2 million compared with \$48.3 million for Second Quarter 2005. Financial guaranty direct segment net earned premium was \$21.2 million for Second Quarter 2006

an increase of \$5.2 million compared with Second Quarter 2005. The increase reflects the continued execution of our direct business strategy and increased market share.

Net earned premiums for Six Months 2006 were \$96.2 million, compared with \$96.4 million for Six Months 2005. Included in Six Months 2005 financial guaranty direct net earned premiums is \$4.4 million of single name corporate CDS net earned premiums, primarily due to a novation of the business which generated \$2.4 million of net earned premiums. Six Months 2006 included only \$0.6 million, of net earned premiums from this line of business.

Net Investment Income

Net investment income was \$27.3 million for Second Quarter 2006, compared with \$23.7 million for Second Quarter 2005. The \$3.6 million increase is attributable to increasing investment yields during the year, combined with increased invested assets due to positive operating cash flows.

Net investment income was \$53.5 million for Six Months 2006, compared with \$46.8 million for Six Months 2005. Pre-tax book yields were 5.1% and 4.7% for the periods ended June 30, 2006 and 2005, respectively. The \$6.7 million increase for Six Months 2006 compared with Six Months 2005 is primarily due to the same reasons mentioned above.

Net Realized Investment (Losses)Gains