ASSURED GUARANTY LTD
Form 10-Q
August 08, 2014
Table of Contents

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

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2014

Or

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

For the transition Period from to

Commission File No. 001-32141

ASSURED GUARANTY LTD.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

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

The number of registrant's Common Shares ($0.01 par value) outstanding as of August 1, 2014 was 169,208,597 (includes 47,747 unvested restricted shares).

Table of Contents

ASSURED GUARANTY LTD.

INDEX TO FORM 10-Q

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
Assured Guaranty Ltd.

Consolidated Balance Sheets (unaudited)

(dollars in millions except per share and share amounts)

	As of June 30, 2014	As of December 31, 2013
Assets		
Investment portfolio:		
Fixed-maturity securities, available-for-sale, at fair value (amortized cost of $10,078 and $9,488)	$10,530	$9,711
Short-term investments, at fair value	979	904
Other invested assets	126	170
Total investment portfolio	11,635	10,785
Cash	106	184
Premiums receivable, net of commissions payable	849	876
Ceded unearned premium reserve	440	452
Deferred acquisition costs	122	124
Reinsurance recoverable on unpaid losses	59	36
Salvage and subrogation recoverable	273	174
Credit derivative assets	80	94
Deferred tax asset, net	571	688
Financial guaranty variable interest entities' assets, at fair value	1,284	2,565
Other assets	271	309
Total assets	$15,690	$16,287
Liabilities and shareholders' equity		
Unearned premium reserve	$4,391	$4,595
Loss and loss adjustment expense reserve	775	592
Reinsurance balances payable, net	178	148
Long-term debt	1,311	816
Credit derivative liabilities	1,917	1,787
Current income tax payable	12	44
Financial guaranty variable interest entities' liabilities with recourse, at fair value	1,366	1,790
Financial guaranty variable interest entities' liabilities without recourse, at fair value	124	1,081
Other liabilities	374	319
Total liabilities	10,448	11,172
Commitments and contingencies (See Note 14)		
Common stock ($0.01 par value, 500,000,000 shares authorized; 174,155,033 and 182,177,866 shares issued and outstanding)	2	2
Additional paid-in capital	2,260	2,466
Retained earnings	2,643	2,482
Accumulated other comprehensive income, net of tax of $143 and $71	332	160
Deferred equity compensation (320,193 and 320,193 shares)	5	5
Total shareholders' equity	5,242	5,115

Total liabilities and shareholders' equity	$15,690	$16,287

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

Table of Contents

Assured Guaranty Ltd.

Consolidated Statements of Operations (unaudited)

(dollars in millions except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenues				
Net earned premiums	$136	$163	$268	$411
Net investment income	96	93	199	187
Net realized investment gains (losses):				
Other-than-temporary impairment losses	(27)	(16)	(30)	(17)
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	(15)	(9)	(13)	(5)
Net impairment loss	(12)	(7)	(17)	(12)
Other net realized investment gains (losses)	4	9	11	42
Net realized investment gains (losses)	(8)	2	(6)	30
Net change in fair value of credit derivatives:				
Realized gains (losses) and other settlements	15	(86)	34	(68)
Net unrealized gains (losses)	88	160	(142)	(450)
Net change in fair value of credit derivatives	103	74	(108)	(518)
Fair value gains (losses) on committed capital securities	(6)	(3)	(15)	(13)
Fair value gains (losses) on financial guaranty variable interest entities	25	143	182	213
Other income (loss)	7	(7)	28	(21)
Total revenues	353	465	548	289
Expenses				
Loss and loss adjustment expenses	57	62	98	14
Amortization of deferred acquisition costs	3	1	8	4
Interest expense	20	21	40	42
Other operating expenses	55	52	115	112
Total expenses	135	136	261	172
Income (loss) before income taxes	218	329	287	117
Provision (benefit) for income taxes				
Current	18	3	39	58
Deferred	41	107	47	(16)
Total provision (benefit) for income taxes	59	110	86	42
Net income (loss)	$159	$219	$201	$75
Earnings per share:				
Basic	$0.89	$1.17	$1.12	$0.39
Diluted	$0.89	$1.16	$1.11	$0.39
Dividends per share	$0.11	$0.10	$0.22	$0.20

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

2

Table of Contents

Assured Guaranty Ltd.

Consolidated Statements of Comprehensive Income (unaudited)

(in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income (loss)	$159	$219	$201	$75
Unrealized holding gains (losses) arising during the period on:				
Investments with no other-than-temporary impairment, net of tax provision (benefit) of $29, $(79), $70 and $(98)	75	(219)	169	(269)
Investments with other-than-temporary impairment, net of tax provision (benefit) of $(8), $(7), $(5) and $(15)	(17)	(16)	(9)	(32)
Unrealized holding gains (losses) arising during the period, net of tax	58	(235)	160	(301)
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of $(3), $0, $(4) and $(2)	(7)	2	(9)	(1)
Change in net unrealized gains on investments	65	(237)	169	(300)
Other, net of tax provision	3	(1)	3	(6)
Other comprehensive income (loss)	$68	$(238)	$172	$(306)
Comprehensive income (loss)	$227	$(19)	$373	$(231)

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

Table of Contents

Assured Guaranty Ltd.

Consolidated Statement of Shareholders' Equity (unaudited)

For the Six Months Ended June 30, 2014

(dollars in millions, except share data)

	Common Shares Outstanding	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Deferred Equity Compensation	Total Shareholders' Equity
Balance at December 31, 2013	182,177,866	$ 2	$2,466	$2,482	$ 160	$ 5	$5,115
Net income	—	—	—	201	—	—	201
Dividends ($0.22 per share)	—	—	—	(40)	—	—	(40)
Common stock repurchases	(8,402,285)	0	(212)	—	—	—	(212)
Share-based compensation and other	379,452	0	6	—	—	—	6
Other comprehensive income	—	—	—	—	172	—	172
Balance at June 30, 2014	174,155,033	$ 2	$2,260	$2,643	$ 332	$ 5	$5,242

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

Table of Contents

Assured Guaranty Ltd.

Consolidated Statements of Cash Flows (unaudited)

(in millions)

	Six Months Ended June 30,	
	2014	2013
Net cash flows provided by (used in) operating activities	$222	$122
Investing activities		
Fixed-maturity securities:		
Purchases	(1,357)	(987)
Sales	444	632
Maturities	397	446
Net sales (purchases) of short-term investments	(51)	(126)
Proceeds from paydowns on financial guaranty variable interest entities' assets	315	440
Other	23	67
Net cash flows provided by (used in) investing activities	(229)	472
Financing activities		
Dividends paid	(40)	(38)
Repurchases of common stock	(212)	(244)
Share activity under option and incentive plans	1	(1)
Paydowns of financial guaranty variable interest entities' liabilities	(311)	(289)
Proceeds from issuance of long-term debt	496	—
Repayment of long-term debt	(7)	(13)
Net cash flows provided by (used in) financing activities	(73)	(585)
Effect of exchange rate changes	2	(4)
Increase (decrease) in cash	(78)	5
Cash at beginning of period	184	138
Cash at end of period	$106	$143
Supplemental cash flow information		
Cash paid (received) during the period for:		
Income taxes	$68	$69
Interest	$36	$38

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

Table of Contents

Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (unaudited)

June 30, 2014

1. Business and Basis of Presentation

Business

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

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

Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) and, in the opinion of management, reflect all adjustments that are of a normal recurring nature, necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated financial guaranty variable interest entities (“FG VIEs”) for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim consolidated financial statements are as of June 30, 2014 and cover the three-month period ended June 30, 2014 ("Second Quarter 2014"), the three-month period ended June 30, 2013 ("Second Quarter 2013"), six-month period ended June 30, 2014 ("Six

Months 2014") and the six-month period ended June 30, 2013 ("Six Months 2013"). Certain financial information that is normally included in annual financial statements prepared in accordance with GAAP, but is not required for interim reporting purposes, has been condensed or omitted. The year-end balance sheet data was derived from audited financial statements.

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

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements included in AGL’s Annual Report on Form 10-K for the year ended December 31, 2013, filed with the U.S. Securities and Exchange Commission (the “SEC”).

Table of Contents

The Company's principal insurance company subsidiaries are:

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

The Company’s organizational structure includes various holding companies, two of which — Assured Guaranty US Holdings Inc. (“AGUS”) and Assured Guaranty Municipal Holdings Inc. (“AGMH”) — have public debt outstanding. See Note 15, Long Term Debt and Credit Facilities.

2. Rating Actions and Other Developments

Rating Actions

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

In the last several years, S&P and Moody's have changed, multiple times, their financial strength ratings of the Company's insurance subsidiaries, or changed the outlook on such ratings.

- On March 18, 2014, Standard & Poor's Ratings Services ("S&P") upgraded the financial strength ratings of all of AGL's insurance subsidiaries to AA (stable outlook) from AA- (stable outlook); it affirmed such ratings in a credit analysis issued on July 2, 2014.

The most recent rating action of Moody's Investors Service, Inc. ("Moody's") was on July 2, 2014, when it affirmed

- the ratings of AGL and its subsidiaries, but changed to negative the outlook of the financial strength ratings of AGC and its subsidiary Assured Guaranty (UK) Ltd. ("AGUK").

On July 15, 2014, Moody’s issued a “Request for Comment” on proposed changes to its credit rating methodology for financial guaranty insurance companies. While Moody’s noted that if changes to the credit rating methodology were

- adopted as proposed, Moody's does not expect to change outstanding ratings that it has assigned, there can be no assurance that the proposed changes will be adopted as proposed or that, even if they are, Moody’s would not change its ratings on AGM, AGC or AG Re.

The most recent rating action of Kroll Bond Rating Agency was on August 4, 2014, when it affirmed MAC's AA+

- (stable outlook) financial strength rating.

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

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

- Note 6, Financial Guaranty Insurance Losses
- Note 8, Financial Guaranty Contracts Accounted for as Credit Derivatives
- Note 13, Reinsurance and Other Monoline Exposures
- Note 15, Long Term Debt and Credit Facilities (regarding the impact on the Company's insured leveraged lease transactions)

Table of Contents

Other Developments

- Repurchase of Common Shares: The Company repurchased 7.1 million and 8.4 million common shares in Second Quarter 2014 and Six Months 2014, respectively. See Note 17, Shareholders' Equity, for more information.

- Issuance of long-term debt: The Company issued $500 million in long-term debt. See Note 15, Long-Term Debt and Credit Facilities, for more information.

3. Outstanding Exposure

The Company’s financial guaranty contracts are written in either insurance or credit derivative form, but collectively are considered financial guaranty contracts. The Company seeks to limit its exposure to losses by underwriting obligations that are investment grade at inception, diversifying its insured portfolio and maintaining rigorous subordination or collateralization requirements on structured finance obligations. The Company also has utilized reinsurance by ceding business to third-party reinsurers. The Company provides financial guaranties with respect to debt obligations of special purpose entities, including variable interest entities ("VIEs"). Some of these VIEs are consolidated as described in Note 9, Consolidated Variable Interest Entities. Unless otherwise specified, the outstanding par and Debt Service amounts presented in this note include outstanding exposures on VIEs whether or not they are consolidated.

The Company has issued financial guaranty insurance policies on public finance obligations and structured finance obligations. Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the taxing powers of U.S. state or municipal governmental authorities, as well as tax-supported bonds, revenue bonds and other obligations supported by covenants from state or municipal governmental authorities or other municipal obligors to impose and collect fees and charges for public services or specific infrastructure projects. The Company also includes within public finance obligations those obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including utilities, toll roads, health care facilities and government office buildings. Structured finance obligations insured by the Company are generally issued by special purpose entities and backed by pools of assets having an ascertainable cash flow or market value or other specialized financial obligations.

Surveillance Categories

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

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

transactions are used. The Company models the performance of many of its structured finance transactions as part of its periodic internal credit rating review of them. The Company models most assumed residential mortgage-backed security ("RMBS") credits with par above $1 million, as well as certain RMBS credits below that amount.

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

More extensive monitoring and intervention is employed for all BIG surveillance categories, with internal credit ratings reviewed quarterly. The Company expects “future losses” on a transaction when the Company believes there is at least a

Table of Contents

50% chance that, on a present value basis, it will pay more claims over the future of that transaction than it will have reimbursed. The three BIG categories are:

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

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

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

Components of Outstanding Exposure

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

Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013
	(in millions)			
Public finance	$627,173	$650,924	$589,294	$610,011
Structured finance	78,092	86,456	72,710	80,524
Total financial guaranty	$705,265	$737,380	$662,004	$690,535

In addition to the amounts shown in the table above, the Company’s net mortgage guaranty insurance debt service was approximately $152 million as of June 30, 2014. The net mortgage guaranty insurance in force constitutes assumed excess of loss business written between 2004 and 2006 and comprises $144 million covering loans originated in Ireland and $8 million covering loans originated in the U.K.

Financial Guaranty Portfolio by Internal Rating
As of June 30, 2014

Rating Category	Public Finance U.S. Net Par Outstanding	%	Public Finance Non-U.S. Net Par Outstanding	%	Structured Finance U.S Net Par Outstanding	%	Structured Finance Non-U.S Net Par Outstanding	%	Total Net Par Outstanding	%
	(dollars in millions)									
AAA	$4,239	1.3 %	$1,031	2.9 %	$26,709	51.9 %	$7,597	64.5 %	$39,576	9.0 %
AA	100,089	29.5	432	1.2	8,963	17.4	567	4.8	110,051	25.2
A	184,593	54.5	9,803	27.7	2,395	4.7	610	5.2	197,401	45.1
BBB	41,174	12.1	22,529	63.6	3,331	6.5	1,939	16.5	68,973	15.8
BIG	8,861	2.6	1,613	4.6	10,044	19.5	1,057	9.0	21,575	4.9
	$338,956	100.0%	$35,408	100.0%	$51,442	100.0%	$11,770	100.0%	$437,576	100.0%

Total net par outstanding (excluding loss mitigation bonds)					
Loss Mitigation Bonds	29	—	1,187	—	1,216
Net Par Outstanding (including loss mitigation bonds)	$338,985	$35,408	$52,629	$11,770	$438,792

Table of Contents

Financial Guaranty Portfolio by Internal Rating
As of December 31, 2013

Rating Category	Public Finance U.S. Net Par Outstanding	%	Public Finance Non-U.S. Net Par Outstanding	%	Structured Finance U.S Net Par Outstanding	%	Structured Finance Non-U.S Net Par Outstanding	%	Total Net Par Outstanding	%
	(dollars in millions)									
AAA	$4,998	1.4 %	$1,016	3.0 %	$32,317	54.9 %	$9,684	69.1 %	$48,015	10.5 %
AA	107,503	30.5	422	1.2	9,431	16.0	577	4.1	117,933	25.7
A	192,841	54.8	9,453	27.9	2,580	4.4	742	5.3	205,616	44.8
BBB	37,745	10.7	21,499	63.2	3,815	6.4	1,946	13.9	65,005	14.1
BIG	9,094	2.6	1,608	4.7	10,764	18.3	1,072	7.6	22,538	4.9
Total net par outstanding (excluding loss mitigation bonds)	$352,181	100.0%	$33,998	100.0%	$58,907	100.0%	$14,021	100.0%	$459,107	100.0%
Loss Mitigation Bonds	32		—		1,163		—		1,195	
Net Par Outstanding (including loss mitigation bonds)	$352,213		$33,998		$60,070		$14,021		$460,302	

In accordance with the terms of certain credit derivative contracts, the referenced obligations in such contracts have been delivered to the Company and therefore are included in the investment portfolio. Such amounts are still included in the financial guaranty insured portfolio (excluding loss mitigation bonds), and totaled $165 million and $195 million in gross par outstanding as of June 30, 2014 and December 31, 2013, respectively.

In addition to amounts shown in the tables above, the Company had outstanding commitments to provide guaranties of $451 million for structured finance and $424 million for public finance obligations at June 30, 2014. The structured finance commitments include the unfunded component of pooled corporate and other transactions. Public finance commitments typically relate to primary and secondary public finance debt issuances. The expiration dates for the public finance commitments range between July 1, 2014 and February 25, 2017, with $300 million expiring prior to December 31, 2014. The commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty’s request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.

Table of Contents

Components of BIG Portfolio
Components of BIG Net Par Outstanding
(Insurance and Credit Derivative Form)
As of June 30, 2014

	BIG Net Par Outstanding				Net Par	BIG Net Par as a % of Total Net Par Outstanding	
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding		
			(in millions)				
First lien U.S. RMBS:							
Prime first lien	$51	$301	$29	$381	$509	0.1	%
Alt-A first lien	681	729	1,211	2,621	3,369	0.6	
Option ARM	95	20	433	548	833	0.1	
Subprime	223	829	772	1,824	5,736	0.4	
Second lien U.S. RMBS:							
Closed-end second lien	33	20	87	140	232	0.0	
Home equity lines of credit (“HELOCs”)	1,402	18	251	1,671	1,901	0.4	
Total U.S. RMBS	2,485	1,917	2,783	7,185	12,580	1.6	
Trust preferred securities (“TruPS”)	1,217	—	344	1,561	4,724	0.4	
Other structured finance	1,341	298	716	2,355	45,908	0.5	
U.S. public finance	7,170	1,269	422	8,861	338,956	2.0	
Non-U.S. public finance	1,611	2	—	1,613	35,408	0.4	
Total	$13,824	$3,486	$4,265	$21,575	$437,576	4.9	%

Components of BIG Net Par Outstanding
(Insurance and Credit Derivative Form)
As of December 31, 2013

	BIG Net Par Outstanding				Net Par	BIG Net Par as a % of Total Net Par Outstanding	
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding		
			(in millions)				
First lien U.S. RMBS:							
Prime first lien	$52	$321	$30	$403	$541	0.1	%
Alt-A first lien	656	1,137	935	2,728	3,590	0.6	
Option ARM	71	60	467	598	937	0.1	
Subprime	297	908	740	1,945	6,130	0.4	
Second lien U.S. RMBS:							
Closed-end second lien	8	20	118	146	244	0.0	
HELOCs	1,499	20	378	1,897	2,279	0.4	
Total U.S. RMBS	2,583	2,466	2,668	7,717	13,721	1.6	
TruPS	1,587	135	—	1,722	4,970	0.4	
Other structured finance	1,367	309	721	2,397	54,237	0.5	
U.S. public finance	8,205	440	449	9,094	352,181	2.0	
Non-U.S. public finance	1,009	599	—	1,608	33,998	0.4	

Total	$14,751	$3,949	$3,838	$22,538	$459,107	4.9	%

Table of Contents

BIG Net Par Outstanding
and Number of Risks
As of June 30, 2014

Description	Net Par Outstanding			Number of Risks(2)		
	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$11,613	$2,211	$13,824	184	29	213
Category 2	2,608	878	3,486	84	18	102
Category 3	2,883	1,382	4,265	113	27	140
Total BIG	$17,104	$4,471	$21,575	381	74	455

BIG Net Par Outstanding
and Number of Risks
As of December 31, 2013

Description	Net Par Outstanding			Number of Risks(2)		
	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$12,391	$2,360	$14,751	185	25	210
Category 2	2,323	1,626	3,949	80	21	101
Category 3	3,031	807	3,838	119	27	146
Total BIG	$17,745	$4,793	$22,538	384	73	457

(1) Includes net par outstanding for FG VIEs.

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

Direct Economic Exposure to the Selected European Countries

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

Table of Contents

Net Direct Economic Exposure to Selected European Countries(1)
As of June 30, 2014

	Hungary	Ireland	Italy	Portugal	Spain	Total
Sovereign and sub-sovereign exposure:						
Non-infrastructure public finance (2)	$—	$—	$1,007	$95	$272	$1,374
Infrastructure finance	369	—	16	11	155	551
Sub-total	369	—	1,023	106	427	1,925
Non-sovereign exposure:						
Regulated utilities	—	—	242	—	—	242
RMBS	214	144	308	—	—	666
Sub-total	214	144	550	—	—	908
Total	$583	$144	$1,573	$106	$427	$2,833
Total BIG (See Note 5)	$583	$—	$—	$106	$427	$1,116

(1) While the Company's exposures are shown in U.S. dollars, the obligations the Company insures are in various currencies, including U.S. dollars and Euros. Included in the table above is $144 million of reinsurance assumed on a 2004 - 2006 pool of Irish residential mortgages that is part of the Company's remaining legacy mortgage reinsurance business. One of the residential mortgage-backed securities included in the table above includes residential mortgages in both Italy and Germany, and only the portion of the transaction equal to the portion of the original mortgage pool in Italian mortgages is shown in the table.

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

When the Company directly insures an obligation, it assigns the obligation to a geographic location or locations based on its view of the geographic location of the risk. For direct exposure this can be a relatively straight-forward determination as, for example, a debt issue supported by availability payments for a toll road in a particular country. The Company may also assign portions of a risk to more than one geographic location. The Company may also have direct exposures to the Selected European Countries in business assumed from unaffiliated monoline insurance companies. In the case of assumed business for direct exposures, the Company depends upon geographic information provided by the primary insurer.

The Company has excluded from the exposure tables above its indirect economic exposure to the Selected European Countries through policies it provides on pooled corporate and commercial receivables transactions. The Company considers economic exposure to a selected European Country to be indirect when the exposure relates to only a small portion of an insured transaction that otherwise is not related to a Selected European Country. Total net indirect exposure to Selected European Counties in non-sovereign pooled corporate and non-sovereign commercial receivables is $595 million and $84 million, respectively, based on the proportion of the insured par equal to the proportion of obligors identified as being domiciled in a Selected European Country.

Exposure to Puerto Rico

The Company insures general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating $5.2 billion net par. The Company rates $5.0 billion net par of

that amount BIG.

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

Table of Contents

In June 2014, the Puerto Rico legislature passed the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act") in order to provide a legislative framework for certain public corporations experiencing severe financial stress to restructure their debt. In its Quarterly Report dated as of July 17, 2014, the Commonwealth stated the Puerto Rico Electric Power Authority (“PREPA”) may need to seek relief under the Recovery Act due to liquidity constraints. In the same report, the Commonwealth disclosed PREPA utilized approximately $42 million on deposit in its reserve account in order to pay debt service due on its bonds on July 1, 2014. Investors in bonds issued by PREPA have filed suit in the United States District Court for the District of Puerto Rico asserting the Recovery Act violates the U.S. Constitution.

Following the enactment of the Recovery Act, S&P, Moody’s and Fitch Ratings lowered the credit rating of the Commonwealth’s bonds and the ratings on certain of Puerto Rico’s public corporations. The Commonwealth disclosed its liquidity has been adversely affected by rating agency downgrades and by the limited market access for its debt. The Commonwealth noted it has relied on short-term financings and interim loans from the GDB and other private lenders, which reliance has constrained its liquidity and increased its near-term refinancing risk. The Commonwealth has also noted it is committed to addressing its fiscal and economic challenges and to repaying the general obligation debt of the Commonwealth and the debt of GDB and the public corporations that are not eligible to seek relief under the Recovery Act.

Puerto Rico
Gross Par and Gross Debt Service Outstanding
As of June 30, 2014

	Gross Par Outstanding	Gross Debt Service Outstanding
	(in millions)	
Subject to the terms of the Recovery Act	$3,195	$5,472
Not subject to the terms of the Recovery Act	3,220	5,000
Total	$6,415	$10,472

Table of Contents

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

Puerto Rico
Net Par Outstanding

	As of June 30, 2014		As of December 31, 2013	
	Total (1)	Internal Rating	Total	Internal Rating
	(in millions)			
Exposures subject to the terms of the Recovery Act:				
Puerto Rico Highways and Transportation Authority (Transportation revenue)	$872	BB-	$872	BB-
PREPA	819	B-	860	BB-
Puerto Rico Aqueduct and Sewer Authority	384	BB-	384	BB-
Puerto Rico Highways and Transportation Authority (Highway revenue)	302	BB	302	BB
Puerto Rico Convention Center District Authority	185	BB-	185	BB-
Puerto Rico Public Finance Corporation	—	-	44	B
Total	2,562		2,647	
Exposures not subject to the terms of the Recovery Act:				
Commonwealth of Puerto Rico - General Obligation Bonds	1,766	BB	1,885	BB
Puerto Rico Municipal Finance Authority	450	BB-	450	BB-
Puerto Rico Sales Tax Financing Corporation	268	BBB	268	A-
Puerto Rico Public Buildings Authority	124	BB	139	BB
GDB	33	BB	33	BB
Puerto Rico Infrastructure Financing Authority	18	BB-	18	BB-
University of Puerto Rico	1	BB-	1	BB-
Total	2,660		2,794	
Total net exposure to Puerto Rico	$5,222		$5,441	

(1) In July 2014, various Puerto Rico issuers made payment on $215 million of par scheduled to be paid; of that amount, $46 million of par was paid by PREPA.

Table of Contents

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

Amortization Schedule of Puerto Rico BIG Net Par Outstanding
and BIG Net Debt Service Outstanding
As of June 30, 2014

	Scheduled BIG Net Par Amortization			Scheduled BIG Net Debt Service Amortization			
	Subject to the Terms of the Recovery Act	Not Subject to the Terms of the Recovery Act	Total	Subject to the Terms of the Recovery Act	Not Subject to the Terms of the Recovery Act	Total	
	(in millions)						
2014 (July 1 - December 31)	$93	$161	$254	$155	$217	$372	(1)
2015	126	205	331	246	316	562	
2016	105	184	289	220	284	504	
2017	41	167	208	152	259	411	
2018	48	111	159	157	195	352	
2019	61	128	189	167	206	373	
2020	73	182	255	175	252	427	
2021	51	58	109	149	123	272	
2022	43	67	110	139	128	267	
2023	102	40	142	195	98	293	
2024-2028	581	351	932	971	589	1,560	
2029-2033	375	320	695	641	483	1,124	
2034 -2038	461	405	866	603	449	1,052	
2039 -2043	156	13	169	230	15	245	
2044 -2047	246	—	246	278	—	278	
Total	$2,562	$2,392	$4,954	$4,478	$3,614	$8,092	

(1) In July 2014, various Puerto Rico issuers made scheduled par payments of $215 million plus interest. Of that amount $46 million of par related to PREPA.

4. Financial Guaranty Insurance Premiums

The portfolio of outstanding exposures discussed in Note 3, Outstanding Exposure, includes financial guaranty contracts that meet the definition of insurance contracts as well as those that meet the definition of a derivative under GAAP. Amounts presented in this note relate only to financial guaranty insurance contracts. See Note 8, Financial Guaranty Contracts Accounted for as Credit Derivatives for amounts that relate to CDS.

Table of Contents

Net Earned Premiums

	Second Quarter		Six Months	
	2014	2013	2014	2013
	(in millions)			
Scheduled net earned premiums	$106	$113	$213	$241
Acceleration of net earned premiums	24	46	43	159
Accretion of discount on net premiums receivable	5	3	11	10
Financial guaranty insurance net earned premiums	135	162	267	410
Other	1	1	1	1
Net earned premiums(1)	$136	$163	$268	$411

(1) Excludes $5 million and $15 million for Second Quarter 2014 and 2013, respectively, and $22 million and $33 million for Six Months 2014 and 2013, respectively, related to consolidated FG VIEs.

Components of Unearned Premium Reserve

	As of June 30, 2014			As of December 31, 2013		
	Gross	Ceded	Net(1)	Gross	Ceded	Net(1)
	(in millions)					
Deferred premium revenue:						
Financial guaranty insurance	$4,435	$451	$3,984	$4,647	$470	$4,177
Other	5	—	5	5	—	5
Deferred premium revenue	$4,440	$451	$3,989	$4,652	$470	$4,182
Contra-paid	(49)	(11)	(38)	(57)	(18)	(39)
Unearned premium reserve	$4,391	$440	$3,951	$4,595	$452	$4,143

(1) Excludes $132 million and $187 million of deferred premium revenue, and $47 million and $55 million of contra-paid related to FG VIEs as of June 30, 2014 and December 31, 2013, respectively.

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

	Six Months	
	2014	2013
	(in millions)	
Beginning of period, December 31	$876	$1,005
Gross premium written, net of commissions on assumed business	61	32
Gross premiums received, net of commissions on assumed business	(97)	(109)
Adjustments:		
Changes in the expected term	(13)	1
Accretion of discount, net of commissions on assumed business	12	13
Foreign exchange translation	9	(27)
Other adjustments	1	0

End of period, June 30 (1)	$849	$915

(1) Excludes $18 million and $20 million as of June 30, 2014 and June 30, 2013, respectively, related to consolidated FG VIEs.

Table of Contents

Gains or losses due to foreign exchange rate changes relate to installment premium receivables denominated in currencies other than the U.S. dollar. Approximately 50% and 48% of installment premiums at June 30, 2014 and December 31, 2013 respectively, are denominated in currencies other than the U.S. dollar, primarily the Euro and British Pound Sterling.

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

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

	As of June 30, 2014 (in millions)
2014 (July 1 - September 30)	$38
2014 (October 1 – December 31)	30
2015	99
2016	86
2017	79
2018	72
2019-2023	283
2024-2028	177
2029-2033	124
After 2033	132
Total(1)	$1,120

(1) Excludes expected cash collections on FG VIEs of $23 million.

Scheduled Net Earned Premiums

	As of June 30, 2014 (in millions)
2014 (July 1 - September 30)	$103
2014 (October 1–December 31)	99
2015	360
2016	334
2017	296
2018	270
2019 - 2023	1,054
2024 - 2028	675
2029 - 2033	412
After 2033	381
Total present value basis(1)	3,984
Discount	235
Total future value	$4,219

(1) Excludes scheduled net earned premiums on consolidated FG VIEs of $132 million.

Table of Contents

Selected Information for Policies Paid in Installments

	As of June 30, 2014	As of December 31, 2013
	(dollars in millions)	
Premiums receivable, net of commission payable	$849	$876
Gross deferred premium revenue	1,501	1,576
Weighted-average risk-free rate used to discount premiums	3.4 %	3.4 %
Weighted-average period of premiums receivable (in years)	9.4	9.4

5. Expected Loss to be Paid

The following table presents a roll forward of the present value of net expected loss to be paid for all contracts, whether accounted for as insurance, credit derivatives or FG VIEs, by sector, after the benefit for net expected recoveries for contractual breaches of representations and warranties ("R&W"). The Company used weighted average risk-free rates for U.S. dollar denominated obligations that ranged from 0.0% to 3.78% as of June 30, 2014 and 0.0% to 4.44% as of December 31, 2013.

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

	Net Expected Loss to be Paid as of March 31, 2014 (in millions)	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of June 30, 2014(2)
U.S. RMBS:				
First lien:				
Prime first lien	$18	$(7)	$—	$11
Alt-A first lien	308	4	(11)	301
Option ARM	(28)	(24)	1	(51)
Subprime	295	6	40	341
Total first lien	593	(21)	30	602
Second lien:				
Closed-end second lien	(4)	(5)	—	(9)
HELOCs	(109)	(33)	25	(117)
Total second lien	(113)	(38)	25	(126)
Total U.S. RMBS	480	(59)	55	476
TruPS	32	0	—	32
Other structured finance	138	5	(3)	140
U.S. public finance	281	82	(24)	339
Non-U.S public finance	57	(5)	—	52
Other insurance	(4)	—	—	(4)
Total	$984	$23	$28	$1,035

Table of Contents

Net Expected Loss to be Paid
After Net Expected Recoveries for Breaches of R&W
Roll Forward by Sector
Second Quarter 2013

	Net Expected Loss to be Paid as of March 31, 2013 (in millions)	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of June 30, 2013
U.S. RMBS:				
First lien:				
Prime first lien	$11	$7	$—	$18
Alt-A first lien	313	(7)	(18)	288
Option ARM	(327)	21	286	(20)
Subprime	263	23	(12)	274
Total first lien	260	44	256	560
Second lien:				
Closed-end second lien	(21)	6	1	(14)
HELOCs	(122)	(31)	56	(97)
Total second lien	(143)	(25)	57	(111)
Total U.S. RMBS	117	19	313	449
TruPS	23	1	9	33
Other structured finance	307	(24)	(125)	158
U.S. public finance	(9)	87	(7)	71
Non-U.S public finance	62	4	—	66
Other insurance	(13)	—	10	(3)
Total	$487	$87	$200	$774

Table of Contents

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

	Net Expected Loss to be Paid as of December 31, 2013(2)	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of June 30, 2014(2)
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$21	$(10)	$—	$11
Alt-A first lien	304	12	(15)	301
Option ARM	(9)	(39)	(3)	(51)
Subprime	304	(1)	38	341
Total first lien	620	(38)	20	602
Second lien:				
Closed-end second lien	(11)	—	2	(9)
HELOCs	(116)	(31)	30	(117)
Total second lien	(127)	(31)	32	(126)
Total U.S. RMBS	493	(69)	52	476
TruPS	51	(19)	—	32
Other structured finance	120	24	(4)	140
U.S. public finance	264	105	(30)	339
Non-U.S public finance	57	(5)	—	52
Other insurance	(3)	(1)	—	(4)
Total	$982	$35	$18	$1,035

Table of Contents

Net Expected Loss to be Paid
After Net Expected Recoveries for Breaches of R&W
Roll Forward by Sector
Six Months 2013

	Net Expected Loss to be Paid as of December 31, 2012 (in millions)	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of June 30, 2013
U.S. RMBS:				
First lien:				
Prime first lien	$6	$13	$(1)	$18
Alt-A first lien	315	2	(29)	288
Option ARM	(131)	(117)	228	(20)
Subprime	242	48	(16)	274
Total first lien	432	(54)	182	560
Second lien:				
Closed-end second lien	(39)	7	18	(14)
HELOCs	(111)	(34)	48	(97)
Total second lien	(150)	(27)	66	(111)
Total U.S. RMBS	282	(81)	248	449
TruPS	27	(2)	8	33
Other structured finance	312	(26)	(128)	158
U.S. public finance	7	94	(30)	71
Non-U.S public finance	52	14	—	66
Other insurance	(3)	(10)	10	(3)
Total	$677	$(11)	$108	$774

(1) Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance recoverable on paid losses included in other assets.

(2) Includes expected loss adjustment expenses ("LAE") to be paid of $33 million as of June 30, 2014 and $34 million as of December 31, 2013. The Company paid $8 million and $16 million in LAE for Second Quarter 2014 and 2013, respectively, and $14 million and $29 million in LAE for Six Months 2014 and 2013, respectively.

Table of Contents

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

	Future Net R&W Benefit as of March 31, 2014	R&W Development and Accretion of Discount During Second Quarter 2014	R&W (Recovered) During Second Quarter 2014	Future Net R&W Benefit as of June 30, 2014(1)
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$3	$ —	$ —	$ 3
Alt-A first lien	269	(2)	(4)	263
Option ARM	152	11	(19)	144
Subprime	146	1	(48)	99
Total first lien	570	10	(71)	509
Second lien:				
Closed-end second lien	95	—	(2)	93
HELOC	56	9	(16)	49
Total second lien	151	9	(18)	142
Total	$721	$ 19	$ (89)	$ 651

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

Net Expected Recoveries from Breaches of R&W Rollforward
Second Quarter 2013

	Future Net R&W Benefit as of March 31, 2013	R&W Development and Accretion of Discount During Second Quarter 2013	R&W (Recovered) During Second Quarter 2013	Future Net R&W Benefit as of June 30, 2013
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$4	$ —	$ —	$ 4
Alt-A first lien	362	(5)	(9)	348
Option ARM	690	13	(410)	293
Subprime	113	(5)	—	108
Total first lien	1,169	3	(419)	753
Second lien:				
Closed-end second lien	108	(3)	(3)	102
HELOC	161	51	(103)	109
Total second lien	269	48	(106)	211
Total	$1,438	$ 51	$ (525)	$ 964

Table of Contents

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

	Future Net R&W Benefit as of December 31, 2013 (in millions)	R&W Development and Accretion of Discount During 2014	R&W (Recovered) During 2014	Future Net R&W Benefit as of June 30, 2014(1)
U.S. RMBS:				
First lien:				
Prime first lien	$4	$ (1)	$ —	$ 3
Alt-A first lien	274	1	(12)	263
Option ARM	173	20	(49)	144
Subprime	118	29	(48)	99
Total first lien	569	49	(109)	509
Second lien:				
Closed-end second lien	98	(3)	(2)	93
HELOC	45	21	(17)	49
Total second lien	143	18	(19)	142
Total	$712	$ 67	$ (128)	$ 651

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

Net Expected Recoveries from Breaches of R&W Rollforward
Six Months 2013

	Future Net R&W Benefit as of December 31, 2012 (in millions)	R&W Development and Accretion of Discount During 2013	R&W (Recovered) During 2013	Future Net R&W Benefit as of June 30, 2013
U.S. RMBS:				
First lien:				
Prime first lien	$4	$ —	$ —	$ 4
Alt-A first lien	378	(13)	(17)	348
Option ARM	591	166	(464)	293
Subprime	109	(1)	—	108
Total first lien	1,082	152	(481)	753
Second lien:				
Closed-end second lien	138	(12)	(24)	102
HELOC	150	68	(109)	109
Total second lien	288	56	(133)	211
Total	$1,370	$ 208	$ (614)	$ 964

24

Table of Contents

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

Net Expected Loss to be Paid
By Accounting Model
As of June 30, 2014

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$3	$—	$8	$11
Alt-A first lien	211	21	69	301
Option ARM	(60)	—	9	(51)
Subprime	191	76	74	341
Total first lien	345	97	160	602
Second lien:				
Closed-end second lien	(31)	27	(5)	(9)
HELOCs	(101)	(16)	—	(117)
Total second lien	(132)	11	(5)	(126)
Total U.S. RMBS	213	108	155	476
TruPS	2	—	30	32
Other structured finance	179	—	(39)	140
U.S. public finance	339	—	—	339
Non-U.S. public finance	51	—	1	52
Subtotal	$784	$108	$147	1,039
Other				(4)
Total				$1,035

Table of Contents

Net Expected Loss to be Paid
By Accounting Model
As of December 31, 2013

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$3	$—	$18	$21
Alt-A first lien	199	31	74	304
Option ARM	(18)	(2)	11	(9)
Subprime	149	81	74	304
Total first lien	333	110	177	620
Second lien:				
Closed-end second lien	(34)	25	(2)	(11)
HELOCs	(41)	(75)	—	(116)
Total second lien	(75)	(50)	(2)	(127)
Total U.S. RMBS	258	60	175	493
TruPS	3	—	48	51
Other structured finance	161	—	(41)	120
U.S. public finance	264	—	—	264
Non-U.S. public finance	55	—	2	57
Subtotal	$741	$60	$184	985
Other				(3)
Total				$982

(1) Refer to Note 9, Consolidated Variable Interest Entities.

Table of Contents

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

Net Economic Loss Development
By Accounting Model
Second Quarter 2014

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$1	$—	$(8)	$(7)
Alt-A first lien	7	2	(5)	4
Option ARM	(23)	—	(1)	(24)
Subprime	4	3	(1)	6
Total first lien	(11)	5	(15)	(21)
Second lien:				
Closed-end second lien	(1)	1	(5)	(5)
HELOCs	(34)	1	—	(33)
Total second lien	(35)	2	(5)	(38)
Total U.S. RMBS	(46)	7	(20)	(59)
TruPS	—	—	—	—
Other structured finance	4	—	1	5
U.S. public finance	82	—	—	82
Non-U.S. public finance	(4)	—	(1)	(5)
Subtotal	$36	$7	$(20)	23
Other				—
Total				$23

Table of Contents

Net Economic Loss Development
By Accounting Model
Second Quarter 2013

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$(1)	$—	$8	$7
Alt-A first lien	(12)	1	4	(7)
Option ARM	15	4	2	21
Subprime	3	16	4	23
Total first lien	5	21	18	44
Second lien:				
Closed-end second lien	(7)	2	11	6
HELOCs	(10)	(22)	1	(31)
Total second lien	(17)	(20)	12	(25)
Total U.S. RMBS	(12)	1	30	19
TruPS	0	—	1	1
Other structured finance	(9)	—	(15)	(24)
U.S. public finance	87	—	—	87
Non-U.S. public finance	4	—	—	4
Subtotal	$70	$1	$16	87
Other				—
Total				$87

28

Table of Contents

Net Economic Loss Development
By Accounting Model
Six Months 2014

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$1	$—	$(11)	$(10)
Alt-A first lien	26	(10)	(4)	12
Option ARM	(39)	1	(1)	(39)
Subprime	(4)	1	2	(1)
Total first lien	(16)	(8)	(14)	(38)
Second lien:				
Closed-end second lien	(2)	3	(1)	—
HELOCs	(90)	59	—	(31)
Total second lien	(92)	62	(1)	(31)
Total U.S. RMBS	(108)	54	(15)	(69)
TruPS	(1)	—	(18)	(19)
Other structured finance	21	—	3	24
U.S. public finance	105	—	—	105
Non-U.S. public finance	(4)	—	(1)	(5)
Subtotal	$13	$54	$(31)	36
Other				(1)
Total				$35

Table of Contents

Net Economic Loss Development
By Accounting Model
Six Months 2013

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	$(1)	$—	$14	$13
Alt-A first lien	(7)	—	9	2
Option ARM	(78)	(33)	(6)	(117)
Subprime	15	20	13	48
Total first lien	(71)	(13)	30	(54)
Second lien:				
Closed-end second lien	(2)	(1)	10	7
HELOCs	(17)	(18)	1	(34)
Total second lien	(19)	(19)	11	(27)
Total U.S. RMBS	(90)	(32)	41	(81)
TruPS	0	—	(2)	(2)
Other structured finance	(19)	—	(7)	(26)
U.S. public finance	94	—	—	94
Non-U.S. public finance	13	—	1	14
Subtotal	$(2)	$(32)	$33	(1)
Other				(10)
Total				$(11)

(1) Refer to Note 9, Consolidated Variable Interest Entities.

(2) Refer to Note 8, Financial Guaranty Contracts Accounted for as Credit Derivatives.

Approach to Projecting Losses in U.S. RMBS

The Company projects losses on its insured U.S. RMBS on a transaction-by-transaction basis by projecting the performance of the underlying pool of mortgages over time and then applying the structural features (i.e., payment priorities and tranching) of the RMBS to the projected performance of the collateral over time. The resulting projected claim payments or reimbursements are then discounted using risk-free rates. For transactions where the Company projects it will receive recoveries from providers of R&W, it projects the amount of recoveries and either establishes a recovery for claims already paid or reduces its projected claim payments accordingly.

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

Mortgage borrowers that are not more than one payment behind (generally considered performing borrowers) have demonstrated an ability and willingness to pay throughout the recession and mortgage crisis, and as a result are viewed as less likely to default than delinquent borrowers. Performing borrowers that eventually default will also need to progress through

Table of Contents

delinquency categories before any defaults occur. The Company projects how many of the currently performing loans will default and when they will default, by first converting the projected near term defaults of delinquent borrowers derived from liquidation rates into a vector of conditional default rates ("CDR"), then projecting how the conditional default rates will develop over time. Loans that are defaulted pursuant to the conditional default rate after the near-term liquidation of currently delinquent loans represent defaults of currently performing loans and projected re-performing loans. A conditional default rate is the outstanding principal amount of defaulted loans liquidated in the current month divided by the remaining outstanding amount of the whole pool of loans (or “collateral pool balance”). The collateral pool balance decreases over time as a result of scheduled principal payments, partial and whole principal prepayments, and defaults.

In order to derive collateral pool losses from the collateral pool defaults it has projected, the Company applies a loss severity. The loss severity is the amount of loss the transaction experiences on a defaulted loan after the application of net proceeds from the disposal of the underlying property. The Company projects loss severities by sector based on its experience to date. The assumptions and variables the Company used to project collateral losses in its U.S. RMBS portfolio are interrelated, difficult to predict and subject to considerable volatility. If actual experience differs from the Company’s assumptions, the losses incurred could be materially different from the estimate. The Company continues to update its evaluation of these exposures as new information becomes available.

The Company is in the process of enforcing claims for breaches of R&W regarding the characteristics of the loans included in the collateral pools. The Company calculates a credit from the RMBS issuer for such recoveries where the R&W were provided by an entity the Company believes to be financially viable and where the Company already has access. Where the Company has an agreement with an R&W provider (e.g., the Bank of America Agreement, the Deutsche Bank Agreement or the UBS Agreement) or where it is in advanced discussions on a potential agreement, that credit is based on the agreement or potential agreement. Where the Company does not have an agreement with the R&W provider but the Company believes the R&W provider to be economically viable, the Company estimates what portion of its past and projected future claims it believes will be reimbursed by that provider.

The Company projects the overall future cash flow from a collateral pool by adjusting the payment stream from the principal and interest contractually due on the underlying mortgages for the collateral losses it projects as described above; assumed voluntary prepayments; and servicer advances. The Company then applies an individual model of the structure of the transaction to the projected future cash flow from that transaction’s collateral pool to project the Company’s future claims and claim reimbursements for that individual transaction. Finally, the projected claims and reimbursements are discounted using risk-free rates. As noted above, the Company runs several sets of assumptions regarding mortgage collateral performance, or scenarios, and probability weights them.

The ultimate performance of the Company’s RMBS transactions remains highly uncertain, may differ from the Company's projections and may be subject to considerable volatility due to the influence of many factors, including the level and timing of loan defaults, changes in housing prices, results from the Company’s loss mitigation activities and other variables. The Company will continue to monitor the performance of its RMBS exposures and will adjust its RMBS loss projection assumptions and scenarios based on actual performance and management’s view of future performance.

Second Quarter 2014 U.S. RMBS Loss Projections

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

whether those changes are normal fluctuations or part of a trend. Based on such observations, the Company chose to use the same general assumptions to project RMBS losses as of June 30, 2014 as it used as of March 31, 2014 and December 31, 2013.

Table of Contents

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

The majority of projected losses in first lien RMBS transactions are expected to come from non-performing mortgage loans (those that have been modified in the previous 12 months or are delinquent or in foreclosure or that have been foreclosed and so the RMBS issuer owns the underlying real estate). Changes in the amount of non-performing loans from the amount projected in the previous period are one of the primary drivers of loss development in this portfolio. In order to determine the number of defaults resulting from these delinquent and foreclosed loans, the Company applies a liquidation rate assumption to loans in each of various non-performing categories. The Company arrived at its liquidation rates based on data purchased from a third party provider and assumptions about how delays in the foreclosure process and loan modifications may ultimately affect the rate at which loans are liquidated. The following table shows liquidation assumptions for various non-performing categories.

First Lien Liquidation Rates

	June 30, 2014	March 31, 2014	December 31, 2013
Current Loans Modified in Previous 12 Months			
Alt A and Prime	35%	35%	35%
Option ARM	35	35	35
Subprime	35	35	35
30 – 59 Days Delinquent			
Alt A and Prime	50	50	50
Option ARM	50	50	50
Subprime	45	45	45
60 – 89 Days Delinquent			
Alt A and Prime	60	60	60
Option ARM	65	65	65
Subprime	50	50	50
90+ Days Delinquent			
Alt A and Prime	75	75	75
Option ARM	70	70	70
Subprime	60	60	60
Bankruptcy			
Alt A and Prime	60	60	60
Option ARM	60	60	60
Subprime	55	55	55
Foreclosure			
Alt A and Prime	85	85	85
Option ARM	80	80	80
Subprime	70	70	70
Real Estate Owned			
All	100	100	100

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

CDR thus calculated individually on the delinquent collateral pool for each RMBS is then used as the starting point for the CDR curve used to project defaults of the presently performing loans.

In the base case, after the initial 36-month CDR plateau period, each transaction's CDR is projected to improve over 12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for

Table of Contents

36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. Under the Company's methodology, defaults projected to occur in the first 36 months represent defaults that can be attributed to loans that were modified in the last 12 months or that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected CDR trend after the first 36 month period represent defaults attributable to borrowers that are currently performing.

Another important driver of loss projections is loss severity, which is the amount of loss the transaction incurs on a loan after the application of net proceeds from the disposal of the underlying property. Loss severities experienced in first lien transactions have reached historic high levels, and the Company is assuming in the base case that these high levels generally will continue for another 18 months, except that in the case of subprime loans, the Company assumes the 90% loss severity rate will continue for another nine months then drop to 80% for nine more months, in each case before following the ramp described below. The Company determines its initial loss severity based on actual recent experience. The Company's initial loss severity assumptions for June 30, 2014 were the same as it used for March 31, 2014 and December 31, 2013. The Company then assumes that loss severities begin returning to levels consistent with underwriting assumptions beginning after the initial 18 month period declining to 40% in the base case over 2.5 years.

The following table shows the range of key assumptions used in the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 first lien U.S. RMBS.

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

	As of June 30, 2014	As of March 31, 2014	As of December 31, 2013
Alt-A First Lien			
Plateau CDR	2.9% – 16.8%	2.3% – 18.4%	2.8% – 18.4%
Intermediate CDR	0.6% – 3.4%	0.5% – 3.7%	0.6% – 3.7%
Period until intermediate CDR	48 months	48 months	48 months
Final CDR	0.1% – 0.8%	0.1% – 0.9%	0.1% – 0.9%
Initial loss severity	65%	65%	65%
Initial conditional prepayment rate ("CPR")	1.0% – 23.2%	0.9% – 33.9%	0.0% – 34.2%
Final CPR	15%	15%	15%
Option ARM			
Plateau CDR	5.0% – 15.8%	3.8% – 16.8%	4.9% – 16.8%
Intermediate CDR	1.0% – 3.2%	0.8% – 3.4%	1.0% – 3.4%
Period until intermediate CDR	48 months	48 months	48 months
Final CDR	0.2% – 0.8%	0.2% – 0.8%	0.2% – 0.8%
Initial loss severity	65%	65%	65%
Initial CPR	0.9% – 9.0%	0.8% – 12.2%	0.4% – 13.1%
Final CPR	15%	15%	15%
Subprime			
Plateau CDR	5.7% – 16.5%	5.9% – 16.3%	5.6% – 16.2%
Intermediate CDR	1.1% – 3.3%	1.2% – 3.3%	1.1% – 3.2%
Period until intermediate CDR	48 months	48 months	48 months
Final CDR	0.3% – 0.8%	0.3% – 0.8%	0.3% – 0.8%
Initial loss severity	90%	90%	90%
Initial CPR	0.0% – 13.7%	0.0% – 11.6%	0.0% – 15.7%
Final CPR	15%	15%	15%

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

The rate at which the principal amount of loans is voluntarily prepaid may impact both the amount of losses projected (since that amount is a function of the conditional default rate, the loss severity and the loan balance over time) as

Table of Contents

well as the amount of excess spread (the amount by which the interest paid by the borrowers on the underlying loan exceeds the amount of interest owed on the insured obligations). The assumption for the voluntary CPR follows a similar pattern to that of the conditional default rate. The current level of voluntary prepayments is assumed to continue for the plateau period before gradually increasing over 12 months to the final CPR, which is assumed to be 15% in the base case. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. These assumptions are the same as those the Company used for March 31, 2014 and December 31, 2013.

In estimating expected losses, the Company modeled and probability weighted sensitivities for first lien transactions by varying its assumptions of how fast a recovery is expected to occur. One of the variables used to model sensitivities was how quickly the conditional default rate returned to its modeled equilibrium, which was defined as 5% of the initial conditional default rate. The Company also stressed CPR and the speed of recovery of loss severity rates. The Company probability weighted a total of five scenarios (including its base case) as of June 30, 2014. The Company used a similar approach to establish its pessimistic and optimistic scenarios as of June 30, 2014 as it used as of March 31, 2014 and December 31, 2013, increasing and decreasing the periods of stress from those used in the base case. In a somewhat more stressful environment than that of the base case, where the conditional default rate plateau was extended six months (to be 42 months long) before the same more gradual conditional default rate recovery and loss severities were assumed to recover over 4.5 rather than 2.5 years (and subprime loss severities were assumed to recover only to 60%), expected loss to be paid would increase from current projections by approximately $40 million for Alt-A first liens, $11 million for Option ARM, $88 million for subprime and $4 million for prime transactions. In an even more stressful scenario where loss severities were assumed to rise and then recover over nine years and the initial ramp-down of the conditional default rate was assumed to occur over 15 months and other assumptions were the same as the other stress scenario, expected loss to be paid would increase from current projections by approximately $102 million for Alt-A first liens, $29 million for Option ARM, $130 million for subprime and $11 million for prime transactions.

The Company also considered two scenarios where the recovery was faster than in its base case. In a scenario with a somewhat less stressful environment than the base case, where conditional default rate recovery was somewhat less gradual and the initial subprime loss severity rate was assumed to be 80% for 18 months and was assumed to recover to 40% over 2.5 years, expected loss to be paid would increase from current projections by approximately $1 million for Alt-A first lien and would decrease by $11 million for Option ARM, $26 million for subprime and $1 million for prime transactions. In an even less stressful scenario where the conditional default rate plateau was six months shorter (30 months, effectively assuming that liquidation rates would improve) and the conditional default rate recovery was more pronounced, (including an initial ramp-down of the conditional default rate over nine months), expected loss to be paid would decrease from current projections by approximately $35 million for Alt-A first lien, $29 million for Option ARM, $77 million for subprime and $5 million for prime transactions.

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

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

The following table shows the range of key assumptions for the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 second lien U.S. RMBS.

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

HELOC key assumptions	As of June 30, 2014	As of March 31, 2014	As of December 31, 2013
Plateau CDR	2.2% – 9.6%	1.9% – 7.3%	2.3% – 7.7%
Final CDR trended down to	0.5% – 3.2%	0.4% – 3.2%	0.4% – 3.2%
Period until final CDR	34 months	34 months	34 months
Initial CPR	2.4% – 19.4%	2.3% – 21.0%	2.7% – 21.5%
Final CPR	10%	10%	10%
Loss severity	98%	98%	98%

Table of Contents

Closed-end second lien key assumptions	As of June 30, 2014	As of March 31, 2014	As of December 31, 2013
Plateau CDR	4.8% – 14.9%	6.7% – 15.5%	7.3% – 15.1%
Final CDR trended down to	3.5% – 9.1%	3.5% – 9.1%	3.5% – 9.1%
Period until final CDR	34 months	34 months	34 months
Initial CPR	2.6% – 10.4%	2.9% – 12.8%	3.1% – 12.0%
Final CPR	10%	10%	10%
Loss severity	98%	98%	98%

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

In second lien transactions the projection of near-term defaults from currently delinquent loans is relatively straightforward because loans in second lien transactions are generally "charged off" (treated as defaulted) by the securitization's servicer once the loan is 180 days past due. Most second lien transactions report the amount of loans in five monthly delinquency categories (i.e., 30-59 days past due, 60-89 days past due, 90-119 days past due, 120-149 days past due and 150-179 days past due). The Company estimates the amount of loans that will default over the next five months by calculating current representative liquidation rates (the percent of loans in a given delinquency status that are assumed to ultimately default) from selected representative transactions and then applying an average of the preceding twelve months' liquidation rates to the amount of loans in the delinquency categories. The amount of loans projected to default in the first through fifth months is expressed as a CDR. The first four months' CDR is calculated by applying the liquidation rates to the current period past due balances (i.e., the 150-179 day balance is liquidated in the first projected month, the 120-149 day balance is liquidated in the second projected month, the 90-119 day balance is liquidated in the third projected month and the 60-89 day balance is liquidated in the fourth projected month). For the fifth month the CDR is calculated using the average 30-59 day past due balances for the prior three months, adjusted as necessary to reflect one-time service events. The fifth month CDR is then used as the basis for the plateau period that follows the embedded five months of losses.

For the base case scenario, the CDR (the "plateau CDR") was held constant for one month. Once the plateau period has ended, the CDR is assumed to gradually trend down in uniform increments to its final long-term steady state CDR. (The long-term steady state CDR is calculated as the constant CDR that would have yielded the amount of losses originally expected at underwriting.) In the base case scenario, the time over which the CDR trends down to its final CDR is 28 months. Therefore, the total stress period for second lien transactions is 34 months, comprising five months of delinquent data, a one month plateau period and 28 months of decrease to the steady state CDR, the same as of March 31, 2014 and December 31, 2013. When a second lien loan defaults, there is generally a very low recovery. Based on current expectations of future performance, the Company assumes that it will only recover 2% of the collateral, the same as of March 31, 2014 and December 31, 2013.

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected as well as the amount of excess spread. In the base case, the current CPR (based on experience of the most recent three quarters) is assumed to continue until the end of the plateau before gradually increasing to the final CPR over the same period the CDR decreases. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. The final CPR is assumed to be 10% for both HELOC and closed-end second lien transactions. This level is much higher than current rates for most transactions, but lower than the historical average, which reflects the Company's continued uncertainty about the projected performance of the borrowers in these transactions. This pattern is consistent with how the Company modeled the CPR at March 31, 2014 and December 31, 2013. To the extent that prepayments differ from projected levels it could materially change the Company's projected excess spread and losses.

The Company uses a number of other variables in its second lien loss projections, including the spread between relevant interest rate indices, the loss severity, and HELOC draw rates (the amount of new advances provided on existing HELOCs expressed as a percentage of current outstanding advances). These variables have been relatively stable over the past several quarters and in the relevant ranges have less impact on the projection results than the variables discussed above. However, in a number of HELOC transactions the servicers have been modifying poorly performing loans from floating to fixed rates, and, as a result, rising interest rates would negatively impact the excess spread available from these modified loans to support the transactions. The Company incorporated these modifications in its assumptions.

In estimating expected losses, the Company modeled and probability weighted three possible CDR curves applicable to the period preceding the return to the long-term steady state CDR using the same approaches and weightings as it did as of

Table of Contents

March 31, 2014 and December 31, 2013. The Company believes that the level of the elevated CDR and the length of time it will persist is the primary driver behind the likely amount of losses the collateral will suffer. The Company continues to evaluate the assumptions affecting its modeling results.

The Company's base case assumed a one month CDR plateau and a 28 month ramp-down (for a total stress period of 34 months). The Company also modeled a scenario with a longer period of elevated defaults and another with a shorter period of elevated defaults. Increasing the CDR plateau to four months and increasing the ramp-down by five months to 33 months (for a total stress period of 42 months) would increase the expected loss by approximately $19 million for HELOC transactions and $1 million for closed-end second lien transactions. On the other hand, keeping the CDR plateau at one month but decreasing the length of the CDR ramp-down to 18 months (for a total stress period of 24 months) would decrease the expected loss by approximately $19 million for HELOC transactions and $1 million for closed-end second lien transactions.

Breaches of Representations and Warranties

Generally, when mortgage loans are transferred into a securitization, the loan originator(s) and/or sponsor(s) provide R&W that the loans meet certain characteristics, and a breach of such R&W often requires that the loan be repurchased from the securitization. In many of the transactions the Company insures, it is in a position to enforce these R&W provisions. The Company has pursued breaches of R&W on a loan-by-loan basis or in cases where a provider of R&W refused to honor its repurchase obligations, the Company sometimes chose to initiate litigation. See "Recovery Litigation" below. The Company's success in pursuing these strategies permitted the Company to enter into agreements with R&W providers under which those providers made payments to the Company, agreed to make payments to the Company in the future, and / or repurchased loans from the transactions, all in return for releases of related liability by the Company. Such agreements provide the Company with many of the benefits of pursuing the R&W claims on a loan by loan basis or through litigation, but without the related expense and uncertainty. The Company continues to pursue these strategies against R&W providers with which it does not yet have agreements.

Through June 30, 2014 the Company has caused entities providing R&Ws to pay or agree to pay approximately $3.8 billion (gross of reinsurance) in respect of their R&W liabilities for transactions in which the Company has provided insurance.

R&W Payments (Gross of Reinsurance)
As of June 30, 2014

	(in millions)
Agreement amounts already received	$2,811
Agreement amounts projected to be received in the future	388
Repurchase amounts paid into the relevant RMBS prior to settlement (1)	579
Total R&W payments, gross of reinsurance	$3,778

(1) These amounts were paid into the relevant RMBS transactions (rather than to the Company as in most settlements) and distributed in accordance with the priority of payments set out in the relevant transaction documents. Because the Company may insure only a portion of the capital structure of a transaction, such payments will not necessarily directly benefit the Company dollar-for-dollar, especially in first lien transactions.

Based on this success, the Company has included in its net expected loss estimates as of June 30, 2014 an estimated net benefit related to breaches of R&W of $651 million, which includes $377 million from agreements with R&W providers and $274 million in transactions where the Company does not yet have such an agreement, all net of reinsurance.

36

Table of Contents

Representations and Warranties Agreements (1)

	Agreement Date	Current Net Par Covered	Receipts to June 30, 2014 (net of reinsurance)	Estimated Future Receipts (net of reinsurance)	Eligible Assets Held in Trust (gross of reinsurance)
	(in millions)				
Bank of America - First Lien	April 2011	$999	$500	$220	$593
Bank of America - Second Lien	April 2011	1,292	968	NA	NA
Deutsche Bank	May 2012 and October 2013	1,582	245	96	139
UBS	May 2013	754	420	18	129
Others	Various	1,153	453	43	NA
Total		$5,780	$2,586	$377	$861

(1) This table relates to past and projected future recoveries under R&W and related agreements. Excluded from this table is the $274 million of future net recoveries the Company projects receiving from R&W counterparties in transactions with $1,174 million of net par outstanding as of June 30, 2014 not covered by current agreements.

The Company's agreements with the counterparties specifically named in the table above required an initial payment to the Company to reimburse it for past claims as well as an obligation to reimburse it for a portion of future claims. The named counterparties placed eligible assets in trust to collateralize their future reimbursement obligations, and the amount of collateral they are required to post may be increased or decreased from time to time as determined by rating agency requirements. Reimbursement payments under these agreements are made either monthly or quarterly and have been made timely. With respect to the reimbursement for future claims:

- Bank of America. Under the Company's agreement with Bank of America Corporation and certain of its subsidiaries (“Bank of America”), Bank of America agreed to reimburse the Company for 80% of claims on the first lien transactions covered by the agreement that the Company pays in the future, until the aggregate lifetime collateral losses (not insurance losses or claims) on those transactions reach $6.6 billion. As of June 30, 2014 aggregate lifetime collateral losses on those transactions was $4.0 billion, and the Company was projecting in its base case that such collateral losses would eventually reach $5.1 billion.

- Deutsche Bank. Under the Company's May 2012 agreement with Deutsche Bank AG and certain of its affiliates (collectively, “Deutsche Bank”), Deutsche Bank agreed to reimburse the Company for certain claims it pays in the future on eight first and second lien transactions, including 80% of claims it pays on those transactions until the aggregate lifetime claims (before reimbursement) reach $319 million. As of June 30, 2014, the Company was projecting in its base case that such aggregate lifetime claims would remain below $319 million. In the event aggregate lifetime claims paid exceed $389 million, Deutsche Bank must reimburse Assured Guaranty for 85% of such claims paid (in excess of $389 million) until such claims paid reach $600 million.

The agreement also requires Deutsche Bank to reimburse AGC for future claims it pays on certain RMBS re-securitizations. The amount available for reimbursement of claim payments is based on a percentage of the losses that occur in certain uninsured tranches (“Uninsured Tranches”) within the eight transactions described above: 60% of losses on the Uninsured Tranches (up to $141 million of losses), 60% of such losses (for losses between $161 million and $185 million), and 100% of such losses (for losses from $185 million to $248 million). Losses on the Uninsured Tranches from $141 million to $161 million and above $248 million are not included in the calculation of AGC's reimbursement amount for re-securitization claim payments. As of June 30, 2014, the Company was projecting in its base case that losses on the Uninsured Tranches would be $153 million. Pursuant to the CDS termination on October

10, 2013 described below, a portion of Deutsche Bank's reimbursement obligation was applied to the terminated CDS. After giving effect to application of the portion of the reimbursement obligation to the terminated CDS, as well as to reimbursements related to other covered RMBS re-securitizations, and based on the Company's base case projections for losses on the Uninsured Tranches, the Company expects that $21 million will be available to reimburse AGC for re-securitization claim payments on the remaining re-securitizations. Except for the reimbursement obligation based on losses occurring on the Uninsured Tranches and the termination agreed to described below, the agreement with Deutsche Bank does not cover transactions where the Company has provided protection to Deutsche Bank on RMBS transactions in CDS form.

Table of Contents

On October 10, 2013, the Company and Deutsche Bank terminated one below investment grade transaction under which the Company had provided credit protection to Deutsche Bank through a CDS. The transaction had a net par outstanding of $294 million at the time of termination. In connection with the termination, Assured Guaranty agreed to release to Deutsche Bank $60 million of assets held in trust that was in excess of the amount of assets required to be held in trust for regulatory and rating agency capital relief.

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

In addition to the agreements mentioned above, the Company entered into several other agreements with other R&W counterparties over the past several years. The results of those settlements have been included in the changes in the benefit for R&W in the appropriate reporting periods.

The Company calculated an expected recovery of $274 million from breaches of R&W in transactions not covered by agreements with $1,174 million of net par outstanding as of June 30, 2014. The Company did not incorporate any gain contingencies from potential litigation in its estimated repurchases. The amount the Company will ultimately recover related to such contractual R&W is uncertain and subject to a number of factors including the counterparty's ability to pay, the number and loss amount of loans determined to have breached R&W and, potentially, negotiated settlements or litigation recoveries. As such, the Company's estimate of recoveries is uncertain and actual amounts realized may differ significantly from these estimates. In arriving at the expected recovery from breaches of R&W not already covered by agreements, the Company considered the creditworthiness of the provider of the R&W, the number of breaches found on defaulted loans, the success rate in resolving these breaches across those transactions where material repurchases have been made and the potential amount of time until the recovery is realized. The calculation of expected recovery from breaches of such contractual R&W involved a variety of scenarios which ranged from the Company recovering substantially all of the losses it incurred due to violations of R&W to the Company realizing limited recoveries. These scenarios were probability weighted in order to determine the recovery incorporated into the Company's estimate of expected losses. This approach was used for both loans that had already defaulted and those assumed to default in the future. The Company adjusts the calculation of its expected recovery from breaches of R&W based on changing facts and circumstances with respect to each counterparty and transaction.

The Company uses the same RMBS projection scenarios and weightings to project its future R&W benefit as it uses to project RMBS losses on its portfolio. To the extent the Company increases its loss projections, the R&W benefit (whether pursuant to an R&W agreement or not) generally will also increase, subject to the agreement limits and thresholds described above. Similarly, to the extent the Company decreases its loss projections, the R&W benefit (whether pursuant to an R&W agreement or not) generally will also decrease, subject to the agreement limits and thresholds described above.

Table of Contents

U.S. RMBS Risks with R&W Benefit

	Number of Risks (1) as of		Debt Service as of	
	June 30, 2014	December 31, 2013	June 30, 2014	December 31, 2013
			(dollars in millions)	
Prime first lien	1	1	$35	$38
Alt-A first lien	23	19	2,739	2,856
Option ARM	10	9	553	641
Subprime	4	5	668	998
Closed-end second lien	4	4	149	158
HELOC	2	4	70	320
Total	44	42	$4,214	$5,011

(1) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making Debt Service payments. This table shows the full future Debt Service (not just the amount of Debt Service expected to be reimbursed) for risks with projected future R&W benefit, whether pursuant to an agreement or not.

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

Components of R&W Development

	Second Quarter		Six Months	
	2014	2013	2014	2013
	(in millions)			
Inclusion or removal of deals with breaches of R&W during period	$—	$6	$—	$6
Change in recovery assumptions as the result of recovery success	17	6	27	17
Estimated increase (decrease) in defaults that will result in additional (lower) breaches	(11)	(4)	(11)	(3)
Settlements and anticipated settlements	10	38	45	180
Accretion of discount on balance	3	5	6	8
Total	$19	$51	$67	$208

“XXX” Life Insurance Transactions

The Company’s $2.7 billion net par of XXX life insurance transactions as of June 30, 2014 includes $598 million rated BIG. The BIG “XXX” life insurance reserve securitizations are based on discrete blocks of individual life insurance business. In each such transaction the monies raised by the sale of the bonds insured by the Company were used to capitalize a special purpose vehicle that provides reinsurance to a life insurer or reinsurer. The monies are invested at inception in accounts managed by third-party investment managers.

The BIG “XXX” life insurance transactions consist of two transactions, notes issued by each of Ballantyne Re p.l.c and Orkney Re II p.l.c. These transactions had material amounts of their assets invested in U.S. RMBS. Based on its analysis of the information currently available, including estimates of future investment performance, and projected credit impairments on the invested assets and performance of the blocks of life insurance business at June 30, 2014, the Company’s projected net expected loss to be paid is $87 million. The economic loss development during Second

Quarter 2014 was approximately $3 million, which was due primarily to a decrease in the risk free rates used to discount the long dated losses. The economic loss development during Six Months 2014 was approximately $16 million, which was due primarily to changes in lapse assumptions on the underlying life insurance policies of one of the XXX transactions and a decrease in the risk free rates used to discount the losses.

Table of Contents

Trust Preferred Securities Collateralized Debt Obligations

The Company has insured or reinsured $4.7 billion of net par (71% of which is in CDS form) of collateralized debt obligations ("CDOs") backed by TruPS and similar debt instruments, or "TruPS CDOs." Of the $4.7 billion, $1.6 billion is rated BIG. The underlying collateral in the TruPS CDOs consists of subordinated debt instruments such as TruPS issued by bank holding companies and similar instruments issued by insurance companies, real estate investment trusts ("REITs") and other real estate related issuers.

The Company projects losses for TruPS CDOs by projecting the performance of the asset pools across several scenarios (which it weights) and applying the CDO structures to the resulting cash flows. At June 30, 2014, the Company has projected expected losses to be paid for TruPS CDOs of $32 million. There was not any significant economic loss development during Second Quarter 2014 on the Company's TruPS insured portfolio. During Six Months 2014, there was positive economic development of approximately $19 million, which was due primarily to improving collateral performance during the first quarter of 2014.

Manufactured Housing

The Company insures or reinsures a total of $239 million net par of securities backed by manufactured housing loans, of which $169 million is rated BIG. The Company has expected loss to be paid of $26 million as of June 30, 2014. The economic loss development during both the Second Quarter 2014 and Six Months 2014 was approximately $1 million.

Student Loan Transactions

The Company has insured or reinsured $2.7 billion net par of student loan securitizations, of which $1.9 billion was issued by private issuers and classified as asset-backed and $0.8 billion was issued by public authorities and classified as public finance. Of these amounts, $201 million and $248 million, respectively, are rated BIG. The Company is projecting approximately $73 million of net expected loss to be paid in these portfolios. In general, the losses are due to: (i) the poor credit performance of private student loan collateral and high loss severities, or (ii) high interest rates on auction rate securities with respect to which the auctions have failed. The largest of these losses was approximately $32 million and related to a transaction backed by a pool of private student loans assumed by AG Re from another monoline insurer. The guaranteed bonds were issued as auction rate securities that now bear a high rate of interest due to the downgrade of the primary insurer's financial strength rating. Further, the underlying loan collateral has performed below expectations. The economic loss development during Second Quarter 2014 was approximately $5 million, which is primarily due to a decrease in the risk free rates used to discount the losses along with an increase in the assumed commutation price in the primary insurer commutation scenarios run as part of the Company's loss calculations. The economic loss development during Six Months 2014 was approximately $8 million, which, in addition to the second quarter effects mentioned above, was also due to a decrease during the first quarter 2014 in the risk free rates used to discount the losses along with some deterioration in collateral performance during the first quarter 2014.

Selected U.S. Public Finance Transactions

Many U.S. municipalities and related entities continue to be under increased pressure, and a few have filed for protection under the U.S. Bankruptcy Code, entered into state processes designed to help municipalities in fiscal distress or otherwise indicated they may consider not meeting their obligations to make timely payments on their debts. Given some of these developments, and the circumstances surrounding each instance, the ultimate outcome cannot be certain and may lead to an increase in defaults on some of the Company's insured public finance

obligations. The Company will continue to analyze developments in each of these matters closely. The municipalities whose obligations the Company has insured that have filed for protection under Chapter 9 of the U.S Bankruptcy Code and have not been resolved are: Detroit, Michigan and Stockton, California.

The Company insures general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating $5.2 billion net par. The Company rates $5.0 billion net par of that amount BIG. For additional information regarding the Company's exposure to general obligations of Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations, please refer to "Puerto Rico Exposure" in Note 3, Outstanding Exposure.

Table of Contents

The Company has net par exposure to the City of Detroit, Michigan of $2.1 billion as of June 30, 2014. On July 18, 2013, the City of Detroit filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. The City has filed a proposed plan of adjustment and disclosure statement with the Bankruptcy Court.

Most of the Company's net par exposure relates to $1.0 billion of sewer revenue bonds and $784 million of water revenue bonds, both of which the Company rates BBB. Both the sewer and water systems provide services to areas that extend beyond the city limits, and the bonds are secured by a lien on "special revenues." On August 7, 2014, the City announced tender offers for approximately $5.2 billion of outstanding sewer and water revenue bonds. Under the terms of the tender offer, bondholders who wish to participate must advise the City of their intention to sell bonds to the City by August 21, 2014, and the City expects to advise bondholders on August 22, 2014 whether the offers are accepted and if the City intends to repurchase the bonds. If the City completes the purchase of bonds subject to the tender offer, on the closing date of such purchase, it will file an amended plan of adjustment with the Bankruptcy Court that would amend the provisions contained in the current plan of adjustment that impair certain classes of the bonds, including those provisions which provide for the impairment of interest rates and call protection on such bonds. Under such amended plan of adjustment, all bonds that are not purchased pursuant to the tender offer would be unimpaired.

- The Company has net par exposure of $128 million to the City's general obligation bonds, which are secured by a pledge of the unlimited tax, full faith, credit and resources of the City and the specific ad valorem taxes approved by the voters solely to pay debt service on the general obligation bonds. The Company rates this exposure BIG. On April 9, 2014, the City and the Company reached a tentative settlement with respect to the treatment of the unlimited tax general obligation bonds insured by the Company. The agreement provides for the confirmation of both the secured status of such general obligation bonds and the existence of a valid lien on the City’s pledged property tax revenues, a finding that such revenues constitute “special revenues” under the U.S. Bankruptcy Code, and the provision of additional security for such general obligation bonds in the form of a statutory lien on, and intercept of, the City’s distributable state aid. After giving effect to post-petition payments made by Assured Guaranty on such general obligation bonds, the settlement results in a minimum ultimate recovery of approximately 74% on such general obligation bonds, with the ability to achieve a higher ultimate recovery rate over time if other debt creditors’ recoveries reach certain specified thresholds. The settlement is subject to a number of conditions, including confirmation of a plan of adjustment.

- The Company has net par exposure of $175 million to the City's Certificates of Participation, which are unsecured unconditional contractual obligations of the City. The Company rates this exposure BIG.

On June 28, 2012, the City of Stockton, California filed for bankruptcy protection under Chapter 9 of the U.S. Bankruptcy Code. The Company's net exposure to the City's general fund is $119 million, consisting of pension obligation bonds. The Company also had exposure to lease revenue bonds; as of June 30, 2014, the Company owned all of such bonds and held them in its investment portfolio. On October 3, 2013, the Company reached a tentative settlement with the City regarding the treatment of the bonds insured by the Company in the City's proposed plan of adjustment. Under the terms of the settlement, the Company will continue to receive net revenues from an office building and an option to take title to that building, and will be entitled to certain fixed payments and certain variable payments contingent on the City's revenue growth. The settlement is subject to a number of conditions, including a sales tax increase (which was approved by voters on November 5, 2013), confirmation of a plan of adjustment that implements the terms of the settlement and definitive documentation. Pursuant to an order of the Bankruptcy Court, the City held a vote of its creditors on its proposed plan of adjustment; all but one of the classes polled voted to accept the plan. The court proceeding to determine whether to confirm the plan of adjustment began in May 2014 and is scheduled to continue through October 2014. The Company expects the plan to be confirmed and implemented at the end of 2014.

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

The Company projects that its total future expected net loss across its troubled U.S. public finance credits as of June 30, 2014 will be $339 million, compared with a net expected loss of $281 million as of March 31, 2014 and $264 million as of December 31, 2013. Economic loss development in Second Quarter 2014 was $82 million, which was primarily attributable to certain Puerto Rico exposures. Economic loss development in Six Months 2014 was approximately $105 million, which was also primarily attributable to Puerto Rico in addition to development on Detroit exposures.

Table of Contents

Certain Selected European Country Transactions

The Company insures and reinsures credits with sub-sovereign exposure to various Spanish and Portuguese issuers where a Spanish and Portuguese sovereign default may cause the regions also to default. The Company's gross exposure to these Spanish and Portuguese credits is €435 million and €88 million, respectively and exposure net of reinsurance for Spanish and Portuguese credits is €312 million and €77 million, respectively. The Company rates most of these issuers in the BB category due to the financial condition of Spain and Portugal and their dependence on the sovereign. The Company's Hungary exposure is to infrastructure bonds dependent on payments from Hungarian governmental entities and covered mortgage bonds issued by Hungarian banks. The Company's gross exposure to these Hungarian credits is $618 million and its exposure net of reinsurance is $583 million, all of which all is rated BIG. The Company estimated net expected losses of $50 million related to these Spanish, Portuguese and Hungarian credits. The economic loss development during both the Second Quarter 2014 and Six Months 2014 was approximately $1 million.

Infrastructure Finance

The Company has insured exposure of approximately $3.1 billion to infrastructure transactions with refinancing risk as to which the Company may need to make claim payments that it did not anticipate paying when the policies were issued. Although the Company may not experience ultimate loss on a particular transaction, the aggregate amount of the claim payments may be substantial and reimbursement may not occur for an extended time, if at all. These transactions generally involve long-term infrastructure projects that were financed by bonds that mature prior to the expiration of the project concession. The Company expected the cash flows from these projects to be sufficient to repay all of the debt over the life of the project concession, but also expected the debt to be refinanced in the market at or prior to its maturity. If the issuer is unable to refinance the debt due to market conditions, the Company may have to pay a claim when the debt matures, and then recover its payment from cash flows produced by the project in the future. The Company generally projects that in most scenarios it will be fully reimbursed for such payments. However, the recovery of the payments is uncertain and may take from 10 to 35 years, depending on the transaction and the performance of the underlying collateral. The Company estimates total claims for the two largest transactions with significant refinancing risk, assuming no refinancing, and based on certain performance assumptions could be $1.8 billion on a gross basis; such claims would be payable from 2017 through 2022.

Recovery Litigation

RMBS Transactions

As of the date of this filing, AGM and AGC have lawsuits pending against providers of representations and warranties in U.S. RMBS transactions insured by them, seeking damages. In all the lawsuits, AGM and AGC have alleged breaches of R&W in respect of the underlying loans in the transactions, and failure to cure or repurchase defective loans identified by AGM and AGC to such persons.

- Deutsche Bank: AGM has sued Deutsche Bank AG affiliates DB Structured Products, Inc. and ACE Securities Corp. in the Supreme Court of the State of New York on the ACE Securities Corp. Home Equity Loan Trust, Series 2006-GP1 second lien transaction.

- Credit Suisse: AGM and AGC have sued DLJ Mortgage Capital, Inc. (“DLJ”) and Credit Suisse Securities (USA) LLC (“Credit Suisse”) on first lien U.S. RMBS transactions insured by them. On May 6, 2014, the Appellate Division, First Department unanimously reversed certain aspects of the partial dismissal by the Supreme Court of the State of New York of certain claims for relief by holding as a matter of law that AGM’s and AGC’s remedies for breach of R&W are not limited to the repurchase remedy. AGM and AGC filed an amended complaint against DLJ and Credit Suisse (and

added Credit Suisse First Boston Mortgage Securities Corp. as a defendant), asserting claims of fraud and material misrepresentation in the inducement of an insurance contract, in addition to their existing breach of contract claims.

On July 3, 2014, the Supreme Court of the State of New York issued decisions in both cases that the court noted were intended to be read together. In the Deutsche Bank action, Deutsche Bank had filed a motion to dismiss certain of AGM's claims as well as a motion for partial summary judgment against AGM. The decision provides that AGM continues to have claims for a breach of contract cause of action, which the court deems to consist of a claim for recovery of the portion of AGM's paid claims attributable to all loans that breached R&W, not solely for claims attributable to loans that AGM had demanded that Deutsche Bank repurchase prior to the litigation. The court also held that sampling and expert evidence could be used to calculate damages, and that AGM could recover its reasonable litigation costs and expenses. In the Credit Suisse action, the court granted the defendants' motion to dismiss certain of AGM's and AGC's fraud claims and all of the claims against Credit

Table of Contents

Suisse First Boston Mortgage Securities Corp., along with the remaining fraud claims and claims of material misrepresentation in the inducement of an insurance contract. On July 10, 2014, AGM and AGC filed a notice of appeal of the court's dismissal action. AGM and AGC continue to have claims for breach of R&W and breach of DLJ's repurchase obligations.

On March 26, 2013, AGM filed a lawsuit against RBS Securities Inc., RBS Financial Products Inc. and Financial Asset Securities Corp. (collectively, "RBS") in the United States District Court for the Southern District of New York on the Soundview Home Loan Trust 2007-WMC1 transaction. The complaint alleges that RBS made fraudulent misrepresentations to AGM regarding the quality of the underlying mortgage loans in the transaction and that RBS's misrepresentations induced AGM into issuing a financial guaranty insurance policy in respect of the Class II-A-1 certificates issued in the transaction. On July 19, 2013, AGM amended its complaint to add a claim under Section 3105 of the New York Insurance Law. On March 17, 2014, the court denied RBS' motion to dismiss AGM's fraudulent misrepresentation claims but granted its motion to dismiss the insurance law claim.

"XXX" Life Insurance Transactions

In December 2008, AGUK filed an action against J.P. Morgan Investment Management Inc. ("JPMIM"), the investment manager in the Orkney Re II transaction, in the Supreme Court of the State of New York alleging that JPMIM engaged in breaches of fiduciary duty, gross negligence and breaches of contract based upon its handling of the investments of Orkney Re II. After AGUK's claims were dismissed with prejudice in January 2010, AGUK was successful in its subsequent motions and appeals and, as of December 2011, all of AGUK's claims for breaches of fiduciary duty, gross negligence and contract were reinstated in full. Separately, at the trial court level, discovery is ongoing.

Table of Contents

6. Financial Guaranty Insurance Losses

Insurance Contracts' Loss Information

The following table provides balance sheet information on loss and LAE reserves and salvage and subrogation recoverable, net of reinsurance.

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

	As of June 30, 2014			As of December 31, 2013		
	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net Reserve (Recoverable)	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net Reserve (Recoverable)
	(in millions)					
U.S. RMBS:						
First lien:						
Prime first lien	$3	$—	$3	$3	$—	$3
Alt-A first lien	121	—	121	108	—	108
Option ARM	18	80	(62)	22	47	(25)
Subprime	186	2	184	143	2	141
First lien	328	82	246	276	49	227
Second lien:						
Closed-end second lien	4	43	(39)	5	45	(40)
HELOC	3	127	(124)	5	127	(122)
Second lien	7	170	(163)	10	172	(162)
Total U.S. RMBS	335	252	83	286	221	65
TruPS	0	—	0	2	—	2
Other structured finance	162	4	158	145	6	139
U.S. public finance	272	7	265	189	8	181
Non-U.S. public finance	34	—	34	35	—	35
Financial guaranty	803	263	540	657	235	422
Other	2	6	(4)	2	5	(3)
Subtotal	805	269	536	659	240	419
Effect of consolidating FG VIEs	(89)	(16)	(73)	(103)	(85)	(18)
Total (1)	$716	$253	$463	$556	$155	$401

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

Table of Contents

The following table reconciles the reported gross and ceded reserve and salvage and subrogation amount to the financial guaranty net reserves (salvage) in the financial guaranty BIG transaction loss summary tables.

Components of Net Reserves (Salvage)
Insurance Contracts

	As of June 30, 2014	As of December 31, 2013
	(in millions)	
Loss and LAE reserve	$775	$592
Reinsurance recoverable on unpaid losses	(59)	(36)
Loss and LAE reserve, net	716	556
Salvage and subrogation recoverable	(273)	(174)
Salvage and subrogation payable(1)	20	19
Salvage and subrogation recoverable, net	(253)	(155)
Subtotal	463	401
Other recoverables(2)	(15)	(15)
Net reserves (salvage)	448	386
Less: other (non-financial guaranty business)	(4)	(3)
Net reserves (salvage)	$452	$389

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

(2) R&W recoverables recorded in other assets on the consolidated balance sheet.

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

	As of June 30, 2014			As of December 31, 2013		
	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet(1)	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet(1)
	(in millions)					
Salvage and subrogation recoverable, net	$132	$—	$ 132	$122	$(49)	$ 73
Loss and LAE reserve, net	317	(13)	304	363	(24)	339

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

The table below provides a reconciliation of net expected loss to be paid to net expected loss to be expensed. Expected loss to be paid differs from expected loss to be expensed due to: (1) the contra-paid which represent the payments that have been made but have not yet been expensed, (2) salvage and subrogation recoverable for transactions that are in a net recovery position where the Company has not yet received recoveries on claims previously paid (having the effect of reducing net expected loss to be paid by the amount of the previously paid claim and the expected recovery), but

will have no future income effect (because the previously paid claims and the corresponding recovery of those claims will offset in income in future periods), and (3) loss reserves that have already been established (and therefore expensed but not yet paid).

Table of Contents

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

	As of June 30, 2014 (in millions)
Net expected loss to be paid	$892
Less: net expected loss to be paid for FG VIEs	108
Total	784
Contra-paid, net	38
Salvage and subrogation recoverable, net of reinsurance	247
Loss and LAE reserve, net of reinsurance	(714)
Other recoveries (1)	15
Net expected loss to be expensed (Present value) (2)	$370

(1) R&W recoverables recorded in other assets on the consolidated balance sheet.

(2) Excludes $82 million as of June 30, 2014, related to consolidated FG VIEs.

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

Net Expected Loss to be Expensed
Insurance Contracts

	As of June 30, 2014 (in millions)
2014 (July 1– September 30)	$10
2014 (October 1–December 31)	10
2015	39
2016	36
2017	30
2018	27
2019 - 2023	96
2024 - 2028	57
2029 - 2033	37
After 2033	28
Net expected loss to be expensed (Present value) (1)	370
Discount	435
Total future value	$805

(1) Consolidation of FG VIEs resulted in reductions of $82 million in net expected loss to be expensed on a present value basis.

Table of Contents

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

Loss and LAE
Reported on the
Consolidated Statements of Operations

	Second Quarter		Six Months	
	2014	2013	2014	2013
			(in millions)	
Structured Finance:				
U.S. RMBS:				
First lien:				
Prime first lien	$0	$0	$0	$0
Alt-A first lien	10	(9)	17	0
Option ARM	(22)	22	(30)	(61)
Subprime	10	23	2	34
First lien	(2)	36	(11)	(27)
Second lien:				
Closed-end second lien	(1)	(1)	(1)	19
HELOC	(18)	(19)	(10)	(16)
Second lien	(19)	(20)	(11)	3
Total U.S. RMBS	(21)	16	(22)	(24)
TruPS	0	(1)	(1)	(1)
Other structured finance	4	(9)	20	(21)
Structured finance	(17)	6	(3)	(46)
Public Finance:				
U.S. public finance	83	78	109	74
Non-U.S. public finance	(1)	—	0	1
Public finance	82	78	109	75
Subtotal	65	84	106	29
Other	0	—	(1)	—
Loss and LAE on insurance contracts before FG VIE consolidation	65	84	105	29
Effect of consolidating FG VIEs	(8)	(22)	(7)	(15)
Loss and LAE	$57	$62	$98	$14

Table of Contents

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

Financial Guaranty Insurance
BIG Transaction Loss Summary
As of June 30, 2014

	BIG Categories								
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating FG VIEs	Total
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	184	(71)	84	(21)	113	(35)	381	—	381
Remaining weighted-average contract period (in years)	9.9	7.4	9.6	9.0	9.9	7.6	10.3	—	10.3
Outstanding exposure:									
Principal	$14,049	$(2,436)	$2,918	$(310)	$3,020	$(137)	$17,104	$—	$17,104
Interest	7,204	(942)	1,473	(134)	1,204	(48)	8,757	—	8,757
Total(2)	$21,253	$(3,378)	$4,391	$(444)	$4,224	$(185)	$25,861	$—	$25,861
Expected cash outflows (inflows)	$1,812	$(502)	$752	$(55)	$1,738	$(71)	$3,674	$(354)	$3,320
Potential recoveries									
Undiscounted R&W	(159)	3	(81)	3	(336)	13	(557)	14	(543)
Other(3)	(1,773)	489	(175)	5	(319)	26	(1,747)	189	(1,558)
Total potential recoveries	(1,932)	492	(256)	8	(655)	39	(2,304)	203	(2,101)
Subtotal	(120)	(10)	496	(47)	1,083	(32)	1,370	(151)	1,219
Discount	20	(1)	(138)	10	(378)	9	(478)	43	(435)
Present value of expected cash flows	$(100)	$(11)	$358	$(37)	$705	$(23)	$892	$(108)	$784
Deferred premium revenue	$482	$(82)	$143	$(7)	$270	$(23)	$783	$(124)	$659
Reserves (salvage)(4)	$(185)	$3	$247	$(31)	$502	$(11)	$525	$(73)	$452

Table of Contents

Financial Guaranty Insurance
BIG Transaction Loss Summary
As of December 31, 2013

	BIG Categories								
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating FG VIEs	Total
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	185	(72)	80	(24)	119	(34)	384	—	384
Remaining weighted-average contract period (in years)	10.5	8.1	8.3	5.9	9.8	7.2	10.5	—	10.5
Outstanding exposure:									
Principal	$15,132	$(2,741)	$2,483	$(160)	$3,189	$(158)	$17,745	$—	$17,745
Interest	8,114	(1,144)	1,181	(53)	1,244	(52)	9,290	—	9,290
Total(2)	$23,246	$(3,885)	$3,664	$(213)	$4,433	$(210)	$27,035	$—	$27,035
Expected cash outflows (inflows)	$1,853	$(528)	$1,038	$(40)	$1,681	$(62)	$3,942	$(690)	$3,252
Potential recoveries									
Undiscounted R&W	(105)	1	(201)	8	(356)	13	(640)	72	(568)
Other(3)	(1,774)	513	(470)	19	(351)	19	(2,044)	507	(1,537)
Total potential recoveries	(1,879)	514	(671)	27	(707)	32	(2,684)	579	(2,105)
Subtotal	(26)	(14)	367	(13)	974	(30)	1,258	(111)	1,147
Discount	13	—	(126)	3	(352)	5	(457)	51	(406)
Present value of expected cash flows	$(13)	$(14)	$241	$(10)	$622	$(25)	$801	$(60)	$741
Deferred premium revenue	$517	$(90)	$163	$(7)	$303	$(27)	$859	$(178)	$681
Reserves (salvage)(4)	$(114)	$1	$117	$(4)	$420	$(13)	$407	$(18)	$389

(1) The ceded number of risks represents the number of risks for which the Company ceded a portion of its exposure.

(2) Includes BIG amounts related to FG VIEs.

(3) Includes excess spread and draws on HELOCs.

(4) See table “Components of net reserves (salvage).”

Ratings Impact on Financial Guaranty Business

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

For example, AGM has issued financial guaranty insurance policies in respect of the obligations of municipal obligors under interest rate swaps. Under the swaps, AGM insures periodic payments owed by the municipal obligors to the bank counterparties. Under certain of the swaps, AGM also insures termination payments that may be owed by the municipal obligors to the bank counterparties. If (i) AGM has been downgraded below the rating trigger set forth in a swap under which it has insured the termination payment, which rating trigger varies on a transaction by transaction basis; (ii) the municipal obligor has the right to cure by, but has failed in, posting collateral, replacing AGM or otherwise curing the downgrade of AGM; (iii) the transaction documents include as a condition that an event of default or termination event with respect to the municipal obligor has occurred, such as the rating of the municipal obligor being downgraded past a specified level, and such condition has been met; (iv) the bank counterparty has elected to terminate the swap; (v) a termination payment is payable by the municipal obligor; and (vi) the municipal obligor has failed to make the termination payment payable by it, then AGM would be required to pay the termination payment due by the municipal obligor, in an amount not to exceed the policy limit set forth in the financial guaranty insurance policy. At AGM's current financial strength ratings, if the conditions giving rise to the obligation of AGM to make a termination payment under the swap termination policies were all satisfied, then AGM could pay claims in an amount not exceeding approximately $104 million in respect of such termination payments. Taking into

Table of Contents

consideration whether the rating of the municipal obligor is below any applicable specified trigger, if the financial strength ratings of AGM were further downgraded below "A" by S&P or below "A2" by Moody's, and the conditions giving rise to the obligation of AGM to make a payment under the swap policies were all satisfied, then AGM could pay claims in an additional amount not exceeding approximately $286 million in respect of such termination payments.

As another example, with respect to variable rate demand obligations ("VRDOs") for which a bank has agreed to provide a liquidity facility, a downgrade of AGM or AGC may provide the bank with the right to give notice to bondholders that the bank will terminate the liquidity facility, causing the bondholders to tender their bonds to the bank. Bonds held by the bank accrue interest at a “bank bond rate” that is higher than the rate otherwise borne by the bond (typically the prime rate plus 2.00% — 3.00%, and capped at the lesser of 25% and the maximum legal limit). In the event the bank holds such bonds for longer than a specified period of time, usually 90-180 days, the bank has the right to demand accelerated repayment of bond principal, usually through payment of equal installments over a period of not less than five years. In the event that a municipal obligor is unable to pay interest accruing at the bank bond rate or to pay principal during the shortened amortization period, a claim could be submitted to AGM or AGC under its financial guaranty policy. As of June 30, 2014, AGM and AGC had insured approximately $6.6 billion net par of VRDOs, of which approximately $0.3 billion of net par constituted VRDOs issued by municipal obligors rated BBB- or lower pursuant to the Company’s internal rating. The specific terms relating to the rating levels that trigger the bank’s termination right, and whether it is triggered by a downgrade by one rating agency or a downgrade by all rating agencies then rating the insurer, vary depending on the transaction.

In addition, AGM may be required to pay claims in respect of AGMH’s former financial products business if Dexia SA and its affiliates, from which the Company had purchased AGMH and its subsidiaries, do not comply with their obligations following a downgrade of the financial strength rating of AGM. Most of the guaranteed investment contracts ("GICs") insured by AGM allow the GIC holder to terminate the GIC and withdraw the funds in the event of a downgrade of AGM below A3 or A-, with no right of the GIC issuer to avoid such withdrawal by posting collateral or otherwise enhancing its credit. Each GIC contract stipulates the thresholds below which the GIC issuer must post eligible collateral, along with the types of securities eligible for posting and the collateralization percentage applicable to each security type. These collateralization percentages range from 100% of the GIC balance for cash posted as collateral to, typically, 108% for asset-backed securities. If the entire aggregate accreted GIC balance of approximately $2.5 billion as of June 30, 2014 were terminated, the assets of the GIC issuers (which had an aggregate accreted principal of approximately $3.8 billion and an aggregate market value of approximately $3.7 billion) would be sufficient to fund the withdrawal of the GIC funds.

7. Fair Value Measurement

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

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

Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, the Company's creditworthiness and constraints on liquidity. As markets and products develop and the pricing for certain products becomes more or less transparent, the Company may refine its methodologies and assumptions. During Six Months 2014, no changes were made to the Company's valuation models that had or are expected to have, a material impact on the Company's consolidated balance sheets or statements of operations and comprehensive income.

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

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

Table of Contents

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

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

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

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

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

Measured and Carried at Fair Value

Fixed-Maturity Securities and Short-term Investments

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

Short-term investments, that are traded in active markets, are classified within Level 1 in the fair value hierarchy and are based on quoted market prices. Securities such as discount notes are classified within Level 2 because these securities are typically not actively traded due to their approaching maturity and, as such, their cost approximates fair value.

Prices determined based on models where at least one significant model assumption or input is unobservable, are considered to be Level 3 in the fair value hierarchy. As of June 30, 2014, the Company used models to price 38

fixed-maturity securities, which was 6.5% or $748 million of the Company's fixed-maturity securities and short-term investments at fair value. Certain Level 3 securities were priced with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach using the third-party's proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); home price depreciation/appreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the bond including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could materially change the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

Table of Contents

Other Invested Assets

Other invested assets include investments carried and measured at fair value on a recurring basis of $82 million, and include primarily fixed-maturity securities classified as trading and investments in two vehicles that invest in the global property catastrophe risk market.

Other Assets

Committed Capital Securities

The fair value of committed capital securities ("CCS"), which is recorded in “other assets” on the consolidated balance sheets, represents the difference between the present value of remaining expected put option premium payments under AGC’s CCS (the “AGC CCS”) and AGM’s Committed Preferred Trust Securities (the “AGM CPS”) agreements, and the estimated present value that the Company would hypothetically have to pay currently for a comparable security (see Note 15, Long Term Debt and Credit Facilities). The AGC CCS and AGM CPS are carried at fair value with changes in fair value recorded on the consolidated statement of operations. The estimated current cost of the Company’s CCS is based on several factors, including broker-dealer quotes for the outstanding securities, the U.S. dollar forward swap curve, London Interbank Offered Rate ("LIBOR") curve projections and the term the securities are estimated to remain outstanding.

Supplemental Executive Retirement Plans

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

Financial Guaranty Contracts Accounted for as Credit Derivatives

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

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

Due to the lack of quoted prices and other observable inputs for its instruments or for similar instruments, the Company determines the fair value of its credit derivative contracts primarily through internally developed, proprietary models that use both observable and unobservable market data inputs to derive an estimate of the fair value of the Company's contracts in its principal markets (see "Assumptions and Inputs"). There is no established

market where financial guaranty insured credit derivatives are actively traded, therefore, management has determined that the exit market for the Company's credit derivatives is a hypothetical one based on its entry market. Management has tracked the historical pricing of the Company's deals to establish historical price points in the hypothetical market that are used in the fair value calculation. These contracts are classified as Level 3 in the fair value hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation model, most importantly the Company's estimate of the value of the non-standard terms and conditions of its credit derivative contracts and of the Company's current credit standing.

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

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining premiums the Company expects to receive or pay and the estimated present value of premiums that a financial guarantor of comparable credit-worthiness would hypothetically charge or pay at the reporting date for the same protection. The fair value of the Company's credit derivatives depends on a number of factors, including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of referenced entities, the Company's own credit risk

Table of Contents

and remaining contractual cash flows. The expected remaining contractual premium cash flows are the most readily observable inputs since they are based on the CDS contractual terms. Credit spreads capture the effect of recovery rates and performance of underlying assets of these contracts, among other factors. Consistent with previous years, market conditions at June 30, 2014 were such that market prices of the Company's CDS contracts were not available.

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

Assumptions and Inputs

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

•Gross spread.

•The allocation of gross spread among:

•the profit the originator, usually an investment bank, realizes for putting the deal together and funding the transaction ("bank profit");

•premiums paid to the Company for the Company's credit protection provided ("net spread"); and

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

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

The rates used to discount future expected premium cash flows ranged from 0.20% to 3.32% at June 30, 2014 and 0.21% to 3.88% at December 31, 2013.

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

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

Table of Contents

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

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

Information by Credit Spread Type (1)

	As of June 30, 2014		As of December 31, 2013	
Based on actual collateral specific spreads	7	%	6	%
Based on market indices	86	%	88	%
Provided by the CDS counterparty	7	%	6	%
Total	100	%	100	%

(1) Based on par.

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

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

The premium the Company receives is referred to as the “net spread.” The Company’s pricing model takes into account not only how credit spreads on risks that it assumes affect pricing, but also how the Company’s own credit spread affects the pricing of its deals. The Company’s own credit risk is factored into the determination of net spread based on the impact of changes in the quoted market price for credit protection bought on the Company, as reflected by quoted market prices on CDS referencing AGC or AGM. For credit spreads on the Company’s name the Company obtains the quoted price of CDS contracts traded on AGC and AGM from market data sources published by third parties. The cost to acquire CDS protection referencing AGC or AGM affects the amount of spread on CDS deals that the Company retains and, hence, their fair value. As the cost to acquire CDS protection referencing AGC or AGM increases, the amount of premium the Company retains on a deal generally decreases. As the cost to acquire CDS protection referencing AGC or AGM decreases, the amount of premium the Company retains on a deal generally increases. In the Company’s valuation model, the premium the Company captures is not permitted to go below the minimum rate that the Company would currently charge to assume similar risks. This assumption can have the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts. Given the current market conditions and the Company’s own credit spreads, approximately 28% , 24% and 61%, based on number of deals, of the Company's CDS contracts are fair valued using this minimum premium as of June 30, 2014, March 31, 2014 and December 31,

Table of Contents

2013, respectively. The percentage of deals that price using the minimum premiums has declined since December 31, 2013 due to AGM's and AGC's credit spreads narrowing as a result of the S&P upgrades in March 2014. As a result of this, the cost to hedge AGC's and AGM's name has declined significantly causing more transactions to price above previously established floor levels. The Company corroborates the assumptions in its fair value model, including the portion of exposure to AGC and AGM hedged by its counterparties, with independent third parties each reporting period. The current level of AGC's and AGM's own credit spread has resulted in the bank or deal originator hedging a significant portion of its exposure to AGC and AGM. This reduces the amount of contractual cash flows AGC and AGM can capture as premium for selling its protection.

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

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

Example

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

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

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

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

to receive, and the premium the Company would expect to receive decline significantly.

In this example, the contractual cash flows (the Company premium received per annum above) exceed the amount a market participant would require the Company to pay in today's market to accept its obligations under the CDS contract, thus resulting in an asset. This credit derivative asset is equal to the difference in premium rates discounted at the corresponding LIBOR over the weighted average remaining life of the contract multiplied by the par outstanding as of the reporting period.

Strengths and Weaknesses of Model

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

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

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

Table of Contents

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

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

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

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

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

- At June 30, 2014 and December 31, 2013, the markets for the inputs to the model were highly illiquid, which impacts their reliability.

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

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

Fair Value Option on FG VIEs' Assets and Liabilities

The Company elected the fair value option for all the FG VIEs' assets and liabilities. See Note 9, Consolidated Variable Interest Entities.

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

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

The fair value of the Company's FG VIE liabilities is also generally sensitive to changes relating to estimated prepayment speeds; market values of the underlying assets; estimated default rates (determined on the basis of an analysis of collateral attributes such as: historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; and house price depreciation/

Table of Contents

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

Not Carried at Fair Value

Financial Guaranty Insurance Contracts

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

Long-Term Debt

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

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

Other Invested Assets

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

Other Assets and Other Liabilities

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

57

Table of Contents

Financial Instruments Carried at Fair Value

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

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of June 30, 2014

	Fair Value (in millions)	Fair Value Hierarchy Level 1	Level 2	Level 3
Assets:				
Investment portfolio, available-for-sale:				
Fixed-maturity securities				
Obligations of state and political subdivisions	$5,500	$—	$5,462	$38
U.S. government and agencies	853	—	853	—
Corporate securities	1,413	—	1,307	106
Mortgage-backed securities:				
RMBS	1,171	—	821	350
Commercial mortgage-backed securities ("CMBS")	712	—	712	—
Asset-backed securities	548	—	294	254
Foreign government securities	333	—	333	—
Total fixed-maturity securities	10,530	—	9,782	748
Short-term investments	979	583	396	—
Other invested assets (1)	89	—	33	56
Credit derivative assets	80	—	—	80
FG VIEs' assets, at fair value	1,284	—	—	1,284
Other assets	73	25	17	31
Total assets carried at fair value	$13,035	$608	$10,228	$2,199
Liabilities:				
Credit derivative liabilities	$1,917	$—	$—	$1,917
FG VIEs' liabilities with recourse, at fair value	1,366	—	—	1,366
FG VIEs' liabilities without recourse, at fair value	124	—	—	124
Total liabilities carried at fair value	$3,407	$—	$—	$3,407

Table of Contents

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of December 31, 2013

	Fair Value (in millions)	Fair Value Hierarchy Level 1	Level 2	Level 3
Assets:				
Investment portfolio, available-for-sale:				
Fixed-maturity securities				
Obligations of state and political subdivisions	$5,079	$—	$5,043	$36
U.S. government and agencies	700	—	700	—
Corporate securities	1,340	—	1,204	136
Mortgage-backed securities:				
RMBS	1,122	—	832	290
CMBS	549	—	549	—
Asset-backed securities	608	—	340	268
Foreign government securities	313	—	313	—
Total fixed-maturity securities	9,711	—	8,981	730
Short-term investments	904	506	398	—
Other invested assets (1)	127	—	119	8
Credit derivative assets	94	—	—	94
FG VIEs' assets, at fair value	2,565	—	—	2,565
Other assets	84	27	11	46
Total assets carried at fair value	$13,485	$533	$9,509	$3,443
Liabilities:				
Credit derivative liabilities	$1,787	$—	$—	$1,787
FG VIEs' liabilities with recourse, at fair value	1,790	—	—	1,790
FG VIEs' liabilities without recourse, at fair value	1,081	—	—	1,081
Total liabilities carried at fair value	$4,658	$—	$—	$4,658

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

Table of Contents

Changes in Level 3 Fair Value Measurements

The table below presents a roll forward of the Company's Level 3 financial instruments carried at fair value on a recurring basis during Second Quarter 2014 and 2013 and Six Months 2014 and 2013.

Fair Value Level 3 Rollforward
Recurring Basis
Second Quarter 2014

	Fixed-Maturity Securities									
	Obligations of State and Political Subdivisions	Corporate Securities	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)									
Fair value as of March 31, 2014	$38	$138	$359	$252	$48	$1,257	$37	$(1,923)	$(1,346)	$(101)
Total pretax realized and unrealized gains/(losses) recorded in:(1)										
Net income (loss)	1 (2)	(7) (2)	6 (2)	3 (2)	—	35 (3)	(6) (4)	103 (6)	(25) (3)	(27) (3)
Other comprehensive income (loss)	0	(25)	0	0	1	—	—	—	—	—
Purchases	—	—	—	—	—	—	—	—	—	—
Settlements	(1)	—	(15)	(1)	0	(29)	—	(17)	30	—
FG VIE consolidations	—	—	—	—	—	46	—	—	(25)	(21)
FG VIE deconsolidations	—	—	—	—	—	(25)	—	—	—	25
Fair value as of June 30, 2014	$38	$106	$350	$254	$49	$1,284	$31	$(1,837)	$(1,366)	$(124)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2014	$0	$(25)	$0	$0	$1	$40	$(6)	$88	$(24)	$4

60

Table of Contents

Fair Value Level 3 Rollforward
Recurring Basis
Second Quarter 2013

	Fixed-Maturity Securities								
	Obligations of State and Political Subdivisions	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)								
Fair value as of March 31, 2013	$35	$221	$286	$1	$2,813	$26	$(2,393)	$(2,071)	$(1,107)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	—	(2) 6	(2) 5	(2) (1)	(7) 341	(3) (3)	(4) 74	(6) (82)	(3) (118) (3)
Other comprehensive income (loss)	1	(3)	—	2	—	—	—	—	—
Purchases	—	67	11	—	—	—	—	—	—
Settlements	—	(15)	(2)	—	(302)	—	71	78	44
FG VIE consolidations	—	—	—	—	—	—	—	—	—
FG VIE deconsolidations	—	—	—	—	(178)	—	—	135	47
Fair value as of June 30, 2013	$36	$276	$300	$2	$2,674	$23	$(2,248)	$(1,940)	$(1,134)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2013	$1	$(3)	$1	$2	$231	$(3)	$294	$(82)	$(132)

Table of Contents

Fair Value Level 3 Rollforward
Recurring Basis
Six Months 2014

	Fixed-Maturity Securities									
	Obligations of State and Political Subdivisions	Corporate Securities	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)									
Fair value as of December 31, 2013	$36	$136	$290	$268	$2	$2,565	$46	$(1,693)	$(1,790)	$(1,081)
Total pretax realized and unrealized gains/(losses) recorded in:(1)										
Net income (loss)	2 (2)	(4) (2)	10 (2)	10 (2)	—	117 (3)	(15) (4)	(108) (6)	(97) (3)	(36) (3)
Other comprehensive income (loss)	1	(21)	14	8	2	—	—	—	—	—
Purchases	—	—	53	—	45	—	—	—	—	—
Settlements	(1)	(5)	(30)	(32)	0	(315)	—	(36)	299	12
FG VIE consolidations	—	—	—	—	—	46	—	—	(25)	(21)
FG VIE deconsolidations	—	—	13	—	—	(1,129)	—	—	247	1,002
Fair value as of June 30, 2014	$38	$106	$350	$254	$49	$1,284	$31	$(1,837)	$(1,366)	$(124)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2014	$1	$(21)	$15	$7	$2	$65	$(15)	$(144)	$(53)	$(5)

Table of Contents

Fair Value Level 3 Rollforward
Recurring Basis
Six Months 2013

	Fixed-Maturity Securities								
	Obligations of State and Political Subdivisions	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)								
Fair value as of December 31, 2012	$35	$219	$306	$1	$2,688	$36	$(1,793)	$(2,090)	$(1,051)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	1 (2)	11 (2)	9 (2)	(1) (7)	556 (3)	(13) (4)	(518) (6)	(163) (3)	(192) (3)
Other comprehensive income (loss)	1	4	(22)	2	—	—	—	—	—
Purchases	—	70	11	—	—	—	—	—	—
Settlements	(1)	(28)	(4)	—	(440)	—	63	190	99
FG VIE consolidations	—	—	—	—	48	—	—	(12)	(37)
FG VIE deconsolidations	—	—	—	—	(178)	—	—	135	47
Fair value as of June 30, 2013	$36	$276	$300	$2	$2,674	$23	$(2,248)	$(1,940)	$(1,134)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2013	$1	$5	$(21)	$2	$430	$(13)	$(317)	$(165)	$(226)

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

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

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

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

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

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

(7) Reported in other income.

Table of Contents

Level 3 Fair Value Disclosures

Quantitative Information About Level 3 Fair Value Inputs
At June 30, 2014

Financial Instrument Description	Fair Value at June 30, 2014 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Assets:				
Fixed maturity securities:				
Obligations of state and political subdivisions	$38	Discounted cash flow	Rate of inflation	1.0% - 3.0%
			Cash flow receipts	0.5% - 61.3%
			Yield	4.6% - 9.0%
			Collateral recovery period	1 month - 34 years
Corporate securities	106	Discounted cash flow	Yield	11.5%
RMBS	350	Discounted cash flow	CPR	0.3% - 16.4%
			CDR	3.2% - 18.0%
			Severity	40.0% - 108.9%
			Yield	2.2% - 8.3%
Asset-backed securities:				
Investor owned utility	121	Discounted cash flow	Liquidation value (in millions)	$178 - $284
			Years to liquidation	0 years - 2.5 years
			Collateral recovery period	6 months - 5.5 years
			Discount factor	7.0%
XXX life insurance transactions	133	Discounted cash flow	Yield	12.0%
Other invested assets	56	Discounted cash flow	Discount for lack of liquidity	10.0% - 20.0%
			Recovery on delinquent loans	20.0% - 60.0%
			Default rates	0.0% - 10.0%
			Loss severity	40.0% - 90.0%
			Prepayment speeds	5.0% - 15.0%
			Net asset value (per share)	$1,029 - $1,038