ASSURED GUARANTY LTD
Form 10-Q
August 02, 2018
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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, 2018
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, a smaller reporting company or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. 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 July 30, 2018 was 108,387,058 (includes 51,746 unvested restricted shares).

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Assured Guaranty Ltd.

Condensed Consolidated Balance Sheets (unaudited)

(dollars in millions except per share and share amounts)

	As of June 30, 2018	As of December 31, 2017
Assets		
Investment portfolio:		
Fixed-maturity securities, available-for-sale, at fair value (amortized cost of $9,957 and $10,187)	$10,225	$ 10,674
Short-term investments, at fair value	911	627
Other invested assets	102	94
Total investment portfolio	11,238	11,395
Cash	185	144
Premiums receivable, net of commissions payable	932	915
Ceded unearned premium reserve	66	119
Deferred acquisition costs	102	101
Salvage and subrogation recoverable	425	572
Financial guaranty variable interest entities’ assets, at fair value	627	700
Other assets	557	487
Total assets	$14,132	$ 14,433
Liabilities and shareholders’ equity		
Unearned premium reserve	$3,635	$ 3,475
Loss and loss adjustment expense reserve	1,327	1,444
Long-term debt	1,264	1,292
Credit derivative liabilities	258	271
Financial guaranty variable interest entities’ liabilities with recourse, at fair value	571	627
Financial guaranty variable interest entities’ liabilities without recourse, at fair value	108	130
Other liabilities	335	355
Total liabilities	7,498	7,594
Commitments and contingencies (see Note 14)		
Common stock ($0.01 par value, 500,000,000 shares authorized; 109,614,214 and 116,020,852 shares issued and outstanding)	1	1
Additional paid-in capital	321	573
Retained earnings	6,159	5,892
Accumulated other comprehensive income, net of tax of $49 and $89	152	372
Deferred equity compensation	1	1
Total shareholders’ equity	6,634	6,839
Total liabilities and shareholders’ equity	$14,132	$ 14,433

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

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Assured Guaranty Ltd.

Condensed Consolidated Statements of Operations (unaudited)

(dollars in millions except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues				
Net earned premiums	$136	$162	$281	$326
Net investment income	99	101	200	223
Net realized investment gains (losses):				
Other-than-temporary impairment losses	(4)	(2)	(15)	(3)
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	(1)	5	(4)	13
Net impairment loss	(3)	(7)	(11)	(16)
Other net realized investment gains (losses)	1	22	4	63
Net realized investment gains (losses)	(2)	15	(7)	47
Net change in fair value of credit derivatives:				
Realized gains (losses) and other settlements	1	5	3	20
Net unrealized gains (losses)	47	(11)	79	28
Net change in fair value of credit derivatives	48	(6)	82	48
Fair value gains (losses) on financial guaranty variable interest entities	2	12	6	22
Bargain purchase gain and settlement of pre-existing relationships	—	—	—	58
Commutation gains (losses)	(18)	—	(17)	73
Other income (loss)	(44)	24	(31)	38
Total revenues	221	308	514	835
Expenses				
Loss and loss adjustment expenses	44	72	26	131
Amortization of deferred acquisition costs	4	4	9	8
Interest expense	24	25	48	49
Other operating expenses	62	57	127	125
Total expenses	134	158	210	313
Income (loss) before income taxes	87	150	304	522
Provision (benefit) for income taxes				
Current	6	(5)	(31)	46
Deferred	6	2	63	6
Total provision (benefit) for income taxes	12	(3)	32	52
Net income (loss)	$75	$153	$272	$470
Earnings per share:				
Basic	$0.67	$1.26	$2.39	$3.81
Diluted	$0.67	$1.24	$2.37	$3.76
Dividends per share	$0.16	$0.1425	$0.32	$0.285

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

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Assured Guaranty Ltd.

Condensed Consolidated Statements of Comprehensive Income (unaudited)

(in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income (loss)	$75	$153	$272	$470
Unrealized holding gains (losses) arising during the period on:				
Investments with no other-than-temporary impairment, net of tax provision (benefit) of $(2), $30, $(31) and $53	(64)	62	(186)	106
Investments with other-than-temporary impairment, net of tax provision (benefit) of $1, $23, $(2) and $51	6	46	(5)	96
Unrealized holding gains (losses) arising during the period, net of tax	(58)	108	(191)	202
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of $0, $5, $(2) and $26	(1)	9	(4)	48
Change in net unrealized gains (losses) on investments	(57)	99	(187)	154
Net unrealized gains (losses) arising during the period on financial guaranty variable interest entities' liabilities with recourse attributable to changes in instrument-specific credit risk, net of tax provision (benefit) of $1 and $0 (see Note 1)	3	—	(1)	—
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of $0 and $(1)	(1)	—	(3)	—
Change in net unrealized gains (losses) on financial guaranty variable interest entities' liabilities with recourse	4	—	2	—
Other, net of tax provision	(9)	10	(3)	12
Other comprehensive income (loss)	(62)	$109	(188)	$166
Comprehensive income (loss)	$13	$262	$84	$636

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

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Assured Guaranty Ltd.

Condensed Consolidated Statement of Shareholders' Equity (unaudited)

For the Six Months Ended June 30, 2018

(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, 2017	116,020,852	$ 1	$ 573	$ 5,892	$ 372	$ 1	$ 6,839
Net income	—	—	—	272	—	—	272
Dividends ($0.32 per share)	—	—	—	(37)	—	—	(37)
Common stock repurchases	(6,951,126)	0	(250)	—	—	—	(250)
Share-based compensation and other	544,488	0	(2)	—	—	—	(2)
Other comprehensive loss	—	—	—	—	(188)	—	(188)
Effect of adoption of ASU 2016-01 (see Note 1)	—	—	—	32	(32)	—	—
Balance at June 30, 2018	109,614,214	$ 1	$ 321	$ 6,159	$ 152	$ 1	$ 6,634

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

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Assured Guaranty Ltd.

Condensed Consolidated Statements of Cash Flows (unaudited)

(in millions)

	Six Months Ended June 30,	
	2018	2017
Net cash flows provided by (used in) operating activities	$444	$198
Investing activities		
Fixed-maturity securities:		
Purchases	(879)	(1,143)
Sales	592	778
Maturities	533	462
Net sales (purchases) of short-term investments	(304)	20
Net proceeds from paydowns on financial guaranty variable interest entities' assets	60	81
Acquisition of MBIA UK Insurance Limited, net of cash acquired	—	95
Other	(16)	68
Net cash flows provided by (used in) investing activities	(14)	361
Financing activities		
Dividends paid	(37)	(36)
Repurchases of common stock	(250)	(351)
Repurchases of common stock to pay withholding taxes	(13)	(12)
Net paydowns of financial guaranty variable interest entities' liabilities	(61)	(86)
Paydown of long-term debt	(24)	(6)
Proceeds from option exercises	1	3
Net cash flows provided by (used in) financing activities	(384)	(488)
Effect of foreign exchange rate changes	(1)	3
Increase (decrease) in cash and restricted cash	45	74
Cash and restricted cash at beginning of period (see Note 10)	144	127
Cash and restricted cash at end of period (see Note 10)	$189	$201
Supplemental cash flow information		
Cash paid (received) during the period for:		
Income taxes	$39	$(7)
Interest	$57	$45

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

Assured Guaranty Ltd.

Notes to Condensed Consolidated Financial Statements (unaudited)

June 30, 2018

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 primarily to offer financial guaranty insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments. If an obligor defaults on a scheduled payment due on an obligation, including a scheduled principal or interest payment (debt service), the Company is required under its unconditional and irrevocable financial guaranty to pay the amount of the shortfall to the holder of the obligation. The Company markets its financial guaranty insurance directly to issuers and underwriters of public finance and structured finance securities as well as to investors in such obligations. The Company guarantees obligations issued principally in the U.S. and the United Kingdom (U.K.), and also guarantees obligations issued in other countries and regions, including Australia and Western Europe. The Company also provides other forms of insurance (non-financial guaranty insurance) that are in line with its risk profile and benefit from its underwriting experience.

In the past, the Company sold credit protection by issuing policies that guaranteed payment obligations under credit derivatives, primarily credit default swaps (CDS). 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 in the U.S. 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 also contributed to the Company not entering into such new CDS in the U.S. since 2009. The Company actively pursues opportunities to terminate existing CDS, which terminations have the effect of reducing future fair value volatility in income and/or reducing rating agency capital charges.

Basis of Presentation

The unaudited interim condensed 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 material adjustments that are of a normal recurring nature, necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated variable interest entities (VIEs) for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim condensed consolidated financial statements are as of June 30, 2018 and cover the three-month period ended June 30, 2018 (Second Quarter 2018), the three-month period ended June 30, 2017 (Second Quarter 2017), the six-month period ended June 30, 2018 (Six Months 2018) and the six-month period ended June 30, 2017 (Six Months 2017). 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 condensed consolidated financial statements include the accounts of AGL, its direct and indirect subsidiaries and its consolidated VIEs. Intercompany accounts and transactions between and among all consolidated entities have been eliminated. Certain prior year balances have been reclassified to conform to the current year's presentation.

These unaudited interim condensed 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, 2017, filed with the U.S. Securities and Exchange Commission (SEC).

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) plc (AGE), organized in the U.K.;
- Assured Guaranty Re Ltd. (AG Re), domiciled in Bermuda; and
- Assured Guaranty Re Overseas Ltd. (AGRO), 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 and Note 18, Subsidiary Information.

The Company is actively working to combine the operations of its European subsidiaries, AGE, Assured Guaranty (UK) plc (AGUK), Assured Guaranty (London) plc (AGLN) and CIFG Europe S.A. (CIFGE), through a multi-step transaction, which ultimately is expected to result in AGUK, AGLN and CIFGE transferring their insurance portfolios to and merging with and into AGE. Any such combination is subject to regulatory and court approvals. As a result, the Company cannot predict when, or if, such combination will be completed, and, if so, what conditions may be attached.

Adopted Accounting Standards

Financial Instruments

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-01, Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this ASU are intended to make targeted improvements to GAAP by addressing certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Amendments under this ASU apply to the Company's financial guaranty variable interest entities (FG VIE) liabilities, which the Company has historically elected to measure through the statement of operations under the fair value option, and to certain equity securities in the Company’s investment portfolio.

For FG VIEs' liabilities with recourse, the portion of the change in fair value caused by changes in instrument-specific credit risk (ISCR) (i.e. in the case of FG VIE liabilities, the Company's own credit risk) must now be separately presented in other comprehensive income (OCI) as opposed to the statement of operations. See Note 9, Consolidated Variable Interest Entities for additional information.

Amendments under this ASU also apply to equity securities, except those that are accounted for under the equity method of accounting or that resulted in consolidation of the investee by the Company. For equity securities accounted for at fair value, changes in fair value that previously were recorded in OCI, are recorded in other income in the condensed consolidated statements of operations effective January 1, 2018. Equity securities carried at cost as of December 31, 2017, are recorded at cost less impairment plus or minus the change resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. See Note 10, Investments and Cash for additional information.

Effective January 1, 2018, the Company adopted this ASU with a cumulative-effect adjustment to the statement of financial position as of January 1, 2018. This resulted in a reclassification of a $32 million loss, net of tax, from retained earnings to accumulated OCI (AOCI). See Note 17, Shareholders' Equity, for additional information.

Income Taxes

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory, which removed the prohibition against immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. Under the ASU, the selling (transferring) entity is required to recognize a current income tax expense or benefit upon transfer of the asset. Similarly, the purchasing (receiving) entity is required to recognize a deferred tax asset or deferred tax liability, as well as the related deferred tax benefit or expense, upon receipt of the asset. The ASU is applied on a modified retrospective basis (i.e. by recording a cumulative effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is adopted). The ASU was adopted on January 1, 2018 with no material effect on the condensed consolidated financial statements.

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Future Application of Accounting Standards

Premium Amortization on Purchased Callable Debt Securities

In March 2017, the FASB issued ASU 2017-08, Receivables-Nonrefundable Fees and Other Costs (Topic 310-20) - Premium Amortization on Purchased Callable Debt Securities. This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. This ASU has no effect on the accounting for purchased callable debt securities held at a discount. It is to be applied using a modified retrospective approach and the ASU is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2018. The Company does not expect this ASU to have a material effect on its condensed consolidated financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). Subsequent to the issuance of this ASU, Topic 842 was amended by various updates that clarified the impact and implementation of ASU 2016-02. Collectively, these updates will require lessees to present right-of-use assets and lease liabilities on the balance sheet. The Company currently accounts for its lease agreements, where the Company is the lessee, as operating leases and, therefore, does not record these leases on its condensed consolidated balance sheets. While the Company is still evaluating the impact of adopting Topic 842 on its condensed consolidated financial statements, including the practical expedients it may elect at adoption and the determination of the incremental borrowing rate, the analysis conducted to date indicates that there will be an increase in assets and liabilities on the Company’s condensed consolidated balance sheets as a result of the right-of-use assets and lease liabilities that will be recorded upon adoption, primarily related to Company’s office space leases. These updates will be applied using a modified retrospective approach and are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company intends to adopt these updates on January 1, 2019.

Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The amendments in this ASU are intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will be required to use forward-looking information to better inform their credit loss estimates as a result of the ASU. While many of the loss estimation techniques applied today will still be permitted, the inputs to those techniques will change to reflect the full amount of expected credit losses. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as credit quality and underwriting standards of an organization’s portfolio.

In addition, the ASU amends the accounting for credit losses on available-for-sale securities and purchased financial assets with credit deterioration. The ASU also eliminates the concept of “other than temporary” from the impairment model for certain available-for-sale securities. Accordingly, the ASU states that an entity must use an allowance approach, must limit the allowance to an amount by which the security’s fair value is less than its amortized cost basis, may not consider the length of time fair value has been less than amortized cost, and may not consider recoveries in fair value after the balance sheet date when assessing whether a credit loss exists. For purchased financial assets with credit deterioration, the ASU requires an entity’s method for measuring credit losses to be consistent with its method for measuring expected losses for originated and purchased non-credit-deteriorated assets.

The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For reinsurance recoverables, premiums receivable and debt instruments such as loans and held to maturity securities, entities will be required to record a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is adopted. The changes to the impairment model for available-for-sale securities and changes to purchased financial assets with credit deterioration are to be applied prospectively. The Company is evaluating the effect that this ASU will have on its condensed consolidated financial statements.

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2. Assumption of Insured Portfolio and Business Combinations

Reinsurance of Syncora Guarantee Inc.'s Insured Portfolio

On June 1, 2018, AGC closed a reinsurance transaction with Syncora Guarantee Inc. (SGI) (SGI Transaction) under which AGC assumed, generally on a 100% quota share basis, substantially all of SGI's insured portfolio. The SGI Transaction also included the commutation of a book of business previously ceded to SGI by AGM . The net par value of exposures reinsured and commuted totaled approximately $12 billion (including CDS net par of approximately $1.5 billion). The reinsured portfolio consists predominantly of public finance and infrastructure obligations that meet AGC's underwriting criteria. As consideration, SGI paid $363 million and assigned to Assured Guaranty financial guaranty future insurance installment premiums of $45 million, and future credit derivative installments of approximately $17 million. The assumed portfolio from SGI includes below-investment-grade (BIG) contracts with expected losses to be paid of $131 million (present value basis using risk free rates), which will be expensed over the expected terms of those contracts as unearned premium reserve amortizes. In connection with the SGI Transaction, the Company incurred and expensed $4 million in fees to professional advisors. The effect of the SGI Transaction on the insurance and credit derivative balances as of June 1, 2018 is summarized below:

Effect of SGI Transaction

	Commutation	Assumed	Total
	(in millions)		
Cash	$20	$ 343	$363
Premiums receivable/payable, net of commissions	$16	$ 45	$61
Unearned premium reserve, net	(56)	(319)	(375)
Credit derivative liability, net	—	(68)	(68)
Other	2	(1)	1
Impact to net assets (liabilities)	$(38)	$ (343)	$(381)
Commutation loss	$18	$ —	$18

Additionally, beginning on June 1, 2018, on behalf of SGI, AGC began providing certain administrative services on the assumed portfolio, including surveillance, risk management, and claims processing.

MBIA UK Insurance Limited

AGC completed its acquisition of MBIA UK Insurance Limited (MBIA UK), the U.K. operating subsidiary of MBIA Insurance Corporation (MBIA) (the MBIA UK Acquisition) on January 10, 2017 (the MBIA UK Acquisition Date). As consideration for the outstanding shares of MBIA UK plus $23 million in cash, AGC exchanged all its holdings of notes issued in the Zohar II 2005-1 transaction (Zohar II Notes), which were insured by MBIA. AGC's Zohar II Notes had total outstanding principal of approximately $347 million and fair value of $334 million as of the MBIA UK Acquisition Date. The MBIA UK Acquisition added approximately $12 billion of net par insured on January 10, 2017. In connection with the MBIA UK Acquisition in the first quarter of 2017, the Company recognized a $56 million bargain purchase gain and a $2 million gain on settlement of pre-existing relationships.

MBIA UK was renamed Assured Guaranty (London) Ltd. and on June 1, 2017, was re-registered as a public limited company. Further, as part of a multi-step transaction, which ultimately is expected to result in AGUK, AGLN and CIFGE transferring their insurance portfolios to and merging with and into AGE, AGLN was sold by AGC to AGM and then contributed by AGM to AGE on June 26, 2017. See Note 1, Business and Basis of Presentation for additional

information on the Company's European subsidiaries combination.

For additional information on the acquisition of MBIA UK, including the purchase price and the allocation of the purchase price to net assets acquired and the resulting bargain purchase gain and the gain on settlement of pre-existing relationships, see Note 2, Acquisitions, in Part II, Item 8. “Financial Statements and Supplementary Data” of AGL’s Annual Report on Form 10-K for the year ended December 31, 2017.

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3. Ratings

The financial strength ratings (or similar ratings) for the Company's insurance companies, along with the date of the most recent rating action (or confirmation) by the rating agency, are shown in the table below. Ratings are subject to continuous rating agency review and revision or withdrawal at any time. In addition, the Company periodically assesses the value of each rating assigned to each of its companies, and as a result of such assessment may request that a rating agency add or drop a rating from certain of its companies.

	S&P Global Ratings, a division of Standard & Poor's Financial Services LLC	Kroll Bond Rating Agency	Moody's Investors Service, Inc.	A.M. Best Company, Inc.
AGM	AA (stable) (6/26/18)	AA+ (stable) (1/23/18)	A2 (stable) (5/7/18)	—
AGC	AA (stable) (6/26/18)	AA (stable) (12/1/17)	(1)	—
MAC	AA (stable) (6/26/18)	AA+ (stable) (7/12/18)	—	—
AG Re	AA (stable) (6/26/18)	—	—	—
AGRO	AA (stable) (6/26/18)	—	—	A+ (stable) (7/13/18)
AGE	AA (stable) (6/26/18)	—	A2 (stable) (5/7/18)	—
AGUK	AA (stable) (6/26/18)	—	(1)	—
AGLN	BB (positive) (6/26/18)	—	(2)	—
CIFGE	—	—	—	—

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(1) AGC requested that Moody's Investors Service, Inc. (Moody's) withdraw its financial strength ratings of AGC and AGUK in January 2017, but Moody's denied that request. Moody's continues to rate AGC A3 (stable) and AGUK A3; Moody's put AGUK on review for upgrade on June 27, 2017, following its transfer to AGM.

(2) Assured Guaranty did not request that Moody's rate AGLN. Moody's continues to rate AGLN, and upgraded its rating to Baa2 (stable) on January 13, 2017, following its acquisition by AGC, and then to Baa1 on review for further upgrade on June 27, 2017, following its transfer to AGM.

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

For a discussion of the effects of rating actions on the Company, see Note 6, Contracts Accounted for as Insurance, and Note 13, Reinsurance and Other Monoline Exposures.

4. Outstanding Exposure

The Company primarily writes financial guaranty contracts in insurance form. Until 2009, the Company also wrote some of its financial guaranty contracts in credit derivative form, and has acquired or reinsured portfolios both before and after 2009 that include financial guaranty contracts in credit derivative form. Whether written as an insurance contract or as a credit derivative, the Company considers these financial guaranty contracts. The Company also writes a relatively small amount of non-financial guaranty insurance. The Company seeks to limit its exposure to losses by underwriting obligations that it views as investment grade at inception, although on occasion it may underwrite new issuances that it views as BIG, typically as part of its loss mitigation strategy for existing troubled exposures. The Company also seeks to acquire portfolios of insurance from financial guarantors that are no longer writing new

business by acquiring such companies, providing reinsurance on a portfolio of insurance or reassuming a portfolio of reinsurance it had previously ceded; in such instances, it evaluates the risk characteristics of the target portfolio, which may include some BIG exposures, as a whole in the context of the proposed transaction. The Company diversifies its insured portfolio across asset classes and, in the structured finance portfolio, typically requires rigorous subordination or collateralization requirements. Reinsurance may be used in order to reduce net exposure to certain insured transactions.

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

purposes, including utilities, toll roads, health care facilities and government office buildings. The Company also includes within public finance similar obligations issued by territorial and non-U.S. sovereign and sub-sovereign issuers and governmental authorities.

Structured finance obligations insured by the Company are generally issued by special purpose entities, including VIEs, and backed by pools of assets having an ascertainable cash flow or market value or other specialized financial obligations. Some of these VIEs are consolidated as described in Note 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 also provides non-financial guaranty insurance and reinsurance on transactions without special purpose entities but with similar risk profiles to its structured finance exposures written in financial guaranty form.

Surveillance Categories

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

The Company monitors its insured portfolio and refreshes its internal credit ratings on individual exposures in quarterly, semi-annual or annual cycles based on the Company’s view of the exposure’s quality, loss potential, volatility and sector. Ratings on exposures in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. For assumed exposures, the Company may use the ceding company’s credit ratings of transactions where it is impractical for it to assign its own rating. The Company provides surveillance for exposures assumed from SGI, so for those exposures assigns its own rating.

Exposures 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. The Company uses a tax-equivalent yield, which reflects long-term trends in interest rates, to calculate the present value of projected payments and recoveries and determine whether a future loss is expected in order to assign the appropriate BIG surveillance category to a transaction. On the other hand, the Company uses risk-free rates, which are determined each quarter to calculate the expected loss for financial statement measurement purposes.

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

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.

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Financial Guaranty Exposure

The Company purchases securities that it has insured, and for which it has expected losses to be paid, in order to mitigate the economic effect of insured losses (loss mitigation securities). The Company excludes amounts attributable to loss mitigation securities from par and debt service outstanding, which amounts are included in the investment portfolio, because it manages such securities as investments and not insurance exposure. As of June 30, 2018 and December 31, 2017, the Company excluded $1.9 billion and $2.0 billion, respectively, of net par attributable to loss mitigation securities (which are mostly BIG), and other loss mitigation strategies. The following table presents the gross and net debt service for financial guaranty contracts.

Financial Guaranty
Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
	(in millions)			
Public finance	$382,564	$ 393,010	$378,746	$ 386,092
Structured finance	14,655	15,482	14,251	15,026
Total financial guaranty	$397,219	$ 408,492	$392,997	$ 401,118

In addition to amounts shown in the tables above, the Company had outstanding commitments to provide guaranties of $25 million as of the date of this filing. 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.

Financial Guaranty Portfolio by Internal Rating
As of June 30, 2018

	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S		Structured Finance Non-U.S		Total	
Rating Category	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%
	(dollars in millions)									
AAA	$520	0.3 %	$2,429	5.3 %	$1,778	16.5 %	$282	22.8 %	$5,009	1.9 %
AA	26,408	13.1	201	0.4	3,688	34.3	66	5.3	30,363	11.8
A	113,915	56.8	14,260	31.4	1,306	12.1	198	16.0	129,679	50.3
BBB	53,221	26.6	27,419	60.4	888	8.3	587	47.6	82,115	31.9
BIG	6,314	3.2	1,133	2.5	3,089	28.8	102	8.3	10,638	4.1
Total net par outstanding	$200,378	100.0%	$45,442	100.0%	$10,749	100.0 %	$1,235	100.0 %	$257,804	100.0%

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Financial Guaranty Portfolio by Internal Rating
As of December 31, 2017

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	$877	0.4 %	$2,541	5.9 %	$1,655	14.7 %	$319	22.5 %	$5,392	2.1 %
AA	30,016	14.3	205	0.5	3,915	34.9	76	5.4	34,212	12.9
A	118,620	56.7	13,936	32.5	1,630	14.5	210	14.9	134,396	50.7
BBB	52,739	25.2	24,509	57.1	763	6.8	703	49.7	78,714	29.7
BIG	7,140	3.4	1,731	4.0	3,261	29.1	106	7.5	12,238	4.6
Total net par outstanding	$209,392	100.0%	$42,922	100.0%	$11,224	100.0 %	$1,414	100.0 %	$264,952	100.0%

Components of BIG Portfolio

Financial Guaranty Portfolio
Components of BIG Net Par Outstanding
As of June 30, 2018

	BIG Net Par Outstanding				Net Par
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding
			(in millions)		
Public finance:					
U.S. public finance	$1,557	$390	$ 4,367	$ 6,314	$ 200,378
Non-U.S. public finance	871	262	—	1,133	45,442
Public finance	2,428	652	4,367	7,447	245,820
Structured finance:					
U.S. Residential mortgage-backed securities (RMBS)	182	375	2,115	2,672	4,763
Triple-X life insurance transactions	—	—	85	85	1,191
Trust preferred securities (TruPS)	97	—	—	97	1,183
Other structured finance	183	85	69	337	4,847
Structured finance	462	460	2,269	3,191	11,984
Total	$2,890	$1,112	$ 6,636	$ 10,638	$ 257,804

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Financial Guaranty Portfolio
Components of BIG Net Par Outstanding
As of December 31, 2017

	BIG Net Par Outstanding				Net Par
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding
			(in millions)		
Public finance:					
U.S. public finance	$2,368	$663	$ 4,109	$ 7,140	$ 209,392
Non-U.S. public finance	1,455	276	—	1,731	42,922
Public finance	3,823	939	4,109	8,871	252,314
Structured finance:					
U.S. RMBS	374	304	2,083	2,761	4,818
Triple-X life insurance transactions	—	—	85	85	1,199
TruPS	161	—	—	161	1,349
Other structured finance	170	118	72	360	5,272
Structured finance	705	422	2,240	3,367	12,638
Total	$4,528	$1,361	$ 6,349	$ 12,238	$ 264,952

Financial Guaranty Portfolio
BIG Net Par Outstanding
and Number of Risks
As of June 30, 2018

	Net Par Outstanding			Number of Risks(2)		
Description	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$2,734	$ 156	$2,890	138	5	143
Category 2	1,096	16	1,112	44	3	47
Category 3	6,555	81	6,636	150	10	160
Total BIG	$10,385	$ 253	$10,638	332	18	350

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Financial Guaranty Portfolio
BIG Net Par Outstanding
and Number of Risks
As of December 31, 2017

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	$4,301	$ 227	$4,528	139	7	146
Category 2	1,344	17	1,361	46	3	49
Category 3	6,255	94	6,349	150	9	159
Total BIG	$11,900	$ 338	$12,238	335	19	354

(1) Includes net par outstanding for VIEs.

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

Exposure to Puerto Rico

The Company has insured exposure to general obligation bonds of the Commonwealth of Puerto Rico (Puerto Rico or the Commonwealth) and various obligations of its related authorities and public corporations aggregating $5.0 billion net par as of June 30, 2018, all of which was rated BIG. Puerto Rico experienced significant general fund budget deficits and a challenging economic environment since at least the financial crisis. Beginning on January 1, 2016, a number of Puerto Rico exposures have defaulted on bond payments, and the Company has now paid claims on all of its Puerto Rico exposures except for Puerto Rico Aqueduct and Sewer Authority (PRASA), Municipal Finance Agency (MFA) and University of Puerto Rico (U of PR).

On November 30, 2015 and December 8, 2015, the former governor of Puerto Rico (Former Governor) issued executive orders (Clawback Orders) directing the Puerto Rico Department of Treasury and the Puerto Rico Tourism Company to "claw back" certain taxes pledged to secure the payment of bonds issued by the Puerto Rico Highways and Transportation Authority (PRHTA), Puerto Rico Infrastructure Financing Authority (PRIFA), and Puerto Rico Convention Center District Authority (PRCCDA). The Puerto Rico exposures insured by the Company subject to clawback are shown in the table “Puerto Rico Net Par Outstanding”.

On June 30, 2016, the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) was signed into law by the President of the United States. PROMESA established a seven-member financial oversight board (Oversight Board) with authority to require that balanced budgets and fiscal plans be adopted and implemented by Puerto Rico. PROMESA provides a legal framework under which the debt of the Commonwealth and its related authorities and public corporations may be voluntarily restructured, and grants the Oversight Board the sole authority to file restructuring petitions in a federal court to restructure the debt of the Commonwealth and its related authorities and public corporations if voluntary negotiations fail, provided that any such restructuring must be in accordance with an Oversight Board approved fiscal plan that respects the liens and priorities provided under Puerto Rico law.

In May and July 2017, the Oversight Board filed petitions under Title III of PROMESA with the United States District Court for the District of Puerto Rico (Federal District Court for Puerto Rico) for the Commonwealth, the Puerto Rico Sales Tax Financing Corporation (COFINA), PRHTA, and Puerto Rico Electric Power Authority (PREPA). Title III of PROMESA provides for a process analogous to a voluntary bankruptcy process under chapter 9 of the United States Bankruptcy Code (Bankruptcy Code).

Judge Laura Taylor Swain of the Southern District of New York was selected by Chief Justice John Roberts of the United States Supreme Court to preside over any legal proceedings under PROMESA. Judge Swain has selected a team of five federal judges to act as mediators for certain issues and disputes.

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On September 20, 2017, Hurricane Maria made landfall in Puerto Rico as a Category 4 hurricane on the Saffir-Simpson scale, causing loss of life and widespread devastation in the Commonwealth. Damage to the Commonwealth’s infrastructure, including the power grid, water system and transportation system, was extensive, and rebuilding and economic recovery are expected to take years.

In December 2017, legislation known as the 2017 Tax Cuts and Jobs Act (Tax Act) was enacted. Many of the provisions under the Tax Act are geared toward increasing production in the U.S. and discouraging companies from having operations or intangibles off-shore. Since Puerto Rico is considered a foreign territory under the U.S. tax system, the Tax Act may have adverse consequences to Puerto Rico’s economy. However, the Company is unable to predict the impact of the Tax Act on Puerto Rico.

On June 7, 2018, the court-appointed agents for COFINA and the Commonwealth filed with the Federal District Court for Puerto Rico an agreement in principle to resolve a dispute between the Commonwealth and COFINA regarding ownership of the 5.5% Sales and Use Taxes (SUT). The agreement in principle, which requires, among other things, that future challenges to it be barred by the court or made illegal, provides that, beginning July 1, 2018, SUT would be paid first to COFINA until it has received 53.65% of the pledged sales tax base amount (PSTBA) and that the remaining 46.35% of the PSTBA would be paid to the Commonwealth thereafter. The agreement in principle does not address the proportion of the amount to be paid to COFINA that would be paid to the senior versus the junior creditors, nor does it address the restructuring of COFINA.

On June 29, 2018, the Oversight Board certified a revised version of the fiscal plan for the Commonwealth as developed by the Oversight Board. The revised certified Commonwealth fiscal plan (which the Company believes covers its general obligations as well as obligations of certain of its other authorities and public corporations) indicates a primary budget surplus of $6.7 billion that would be available for debt service over the six-year forecast period (as compared to contractual debt service of approximately $15.5 billion over the same period). The certified PRHTA fiscal plan projects very limited capacity to pay debt service over the six-year forecast period, as the Commonwealth anticipates continuing to retain approximately three-fourths of PRHTA's total revenues. The certified PREPA fiscal plan indicates that no funds will be available for legacy debt service payments over the six-year forecast period unless rates are adjusted. Additionally, in June 2018, the Commonwealth enacted a law that would enable the partial privatization of PREPA. The certified PRASA fiscal plan projects cash flows available for debt service equal to approximately 56% of aggregate debt service during the six-year projection period, based on projection assumptions (including receipt of certain federal funding). The Company does not believe the certified fiscal plans for the Commonwealth, PRHTA, PREPA or PRASA comply with certain mandatory requirements of PROMESA.

On July 30, 2018, the Oversight Board and the Governor announced that they had reached a tentative agreement with a certain group of PREPA bondholders regarding approximately $3 billion of PREPA’s outstanding debt. Bondholders would be able to exchange their debt for new securitization debt maturing in 40 years at 67% of par, plus growth bonds tied to the recovery of Puerto Rico at 10% of par. The Company and certain other creditors of PREPA have not agreed to the terms of that tentative agreement.

The Company believes that a number of the actions taken by the Commonwealth, the Oversight Board and others with respect to obligations the Company insures are illegal or unconstitutional or both, and has taken legal action, and may take additional legal action in the future, to enforce its rights with respect to these matters. See “Puerto Rico Recovery Litigation” below.

Litigation and mediation related to the Commonwealth’s debt were delayed by Hurricane Maria. The final form and timing of responses to Puerto Rico’s financial distress and the devastation of Hurricane Maria eventually taken by the federal government or implemented under the auspices of PROMESA and the Oversight Board or otherwise, and the final impact, after resolution of legal challenges, of any such responses on obligations insured by the Company, are

uncertain.

The Company groups its Puerto Rico exposure into three categories:

- Constitutionally Guaranteed. The Company includes in this category public debt benefiting from Article VI of the Constitution of the Commonwealth, which expressly provides that interest and principal payments on the public debt are to be paid before other disbursements are made.

- Public Corporations – Certain Revenues Potentially Subject to Clawback. The Company includes in this category the debt of public corporations for which applicable law permits the Commonwealth to claw back, subject to certain conditions and for the payment of public debt, at least a portion of the revenues supporting the bonds the Company insures. As a constitutional condition to clawback, available Commonwealth revenues for any fiscal

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year must be insufficient to pay Commonwealth debt service before the payment of any appropriations for that year. The Company believes that this condition has not been satisfied to date, and accordingly that the Commonwealth has not to date been entitled to claw back revenues supporting debt insured by the Company. Prior to the enactment of PROMESA, the Company sued various Puerto Rico governmental officials in the Federal District Court for Puerto Rico asserting that Puerto Rico's attempt to “claw back” pledged taxes is unconstitutional, and demanding declaratory and injunctive relief. See "Puerto Rico Recovery Litigation" below.

- Other Public Corporations. The Company includes in this category the debt of public corporations that are supported by revenues it does not believe are subject to clawback.

Constitutionally Guaranteed

General Obligation. As of June 30, 2018, the Company had $1,419 million insured net par outstanding of the general obligations of Puerto Rico, which are supported by the good faith, credit and taxing power of the Commonwealth. Despite the requirements of Article VI of its Constitution, the Commonwealth defaulted on the debt service payment due on July 1, 2016, and the Company has been making claim payments on these bonds since that date. As noted above, the Oversight Board filed a petition under Title III of PROMESA with respect to the Commonwealth.

Puerto Rico Public Buildings Authority (PBA). As of June 30, 2018, the Company had $141 million insured net par outstanding of PBA bonds, which are supported by a pledge of the rents due under leases of government facilities to departments, agencies, instrumentalities and municipalities of the Commonwealth, and that benefit from a Commonwealth guaranty supported by a pledge of the Commonwealth’s good faith, credit and taxing power. Despite the requirements of Article VI of its Constitution, the PBA defaulted on most of the debt service payment due on July 1, 2016, and the Company has been making claim payments on these bonds since then.

Public Corporations - Certain Revenues Potentially Subject to Clawback

PRHTA. As of June 30, 2018, the Company had $882 million insured net par outstanding of PRHTA (transportation revenue) bonds and $495 million insured net par outstanding of PRHTA (highways revenue) bonds. The transportation revenue bonds are secured by a subordinate gross lien on gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls, plus a first lien on up to $120 million annually of taxes on crude oil, unfinished oil and derivative products. The highways revenue bonds are secured by a gross lien on gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls. The non-toll revenues consisting of excise taxes and fees collected by the Commonwealth on behalf of PRHTA and its bondholders that are statutorily allocated to PRHTA and its bondholders are potentially subject to clawback. Despite the presence of funds in relevant debt service reserve accounts that the Company believes should have been employed to fund debt service, PRHTA defaulted on the full July 1, 2017 insured debt service payment, and the Company has been making claim payments on these bonds since that date. As noted above, the Oversight Board filed a petition under Title III of PROMESA with respect to PRHTA.

PRCCDA. As of June 30, 2018, the Company had $152 million insured net par outstanding of PRCCDA bonds, which are secured by certain hotel tax revenues. These revenues are sensitive to the level of economic activity in the area and are potentially subject to clawback. There were sufficient funds in the PRCCDA bond accounts to make only partial payments on the July 1, 2017 PRCCDA bond payments guaranteed by the Company, and the Company has been making claim payments on these bonds since that date.

PRIFA. As of June 30, 2018, the Company had $18 million insured net par outstanding of PRIFA bonds, which are secured primarily by the return to Puerto Rico of federal excise taxes paid on rum. These revenues are potentially subject to the clawback. The Company has been making claim payments on the PRIFA bonds since January 2016.

Other Public Corporations

PREPA. As of June 30, 2018, the Company had $853 million insured net par outstanding of PREPA obligations, which are secured by a lien on the revenues of the electric system.

On December 24, 2015, AGM and AGC entered into a Restructuring Support Agreement (RSA) with PREPA, an ad hoc group of uninsured bondholders and a group of fuel-line lenders that, subject to certain conditions, would have resulted in, among other things, modernization of the utility and a restructuring of current debt.

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The Oversight Board did not certify the RSA under Title VI of PROMESA as the Company believes was required by PROMESA, but rather, on July 2, 2017, commenced proceedings for PREPA under Title III of PROMESA. The Company has been making claim payments on these bonds since July 1, 2017.

PRASA. As of June 30, 2018, the Company had $373 million of insured net par outstanding of PRASA bonds, which are secured by a lien on the gross revenues of the water and sewer system. On September 15, 2015, PRASA entered into a settlement with the U.S. Department of Justice and the U.S. Environmental Protection Agency that requires it to spend $1.6 billion to upgrade and improve its sewer system island-wide. The PRASA bond accounts contained sufficient funds to make the PRASA bond payments due through the date of this filing that were guaranteed by the Company, and those payments were made in full.

MFA. As of June 30, 2018, the Company had $360 million net par outstanding of bonds issued by MFA secured by a lien on local property tax revenues. The MFA bond accounts contained sufficient funds to make the MFA bond payments due through the date of this filing that were guaranteed by the Company, and those payments were made in full.

COFINA. As of June 30, 2018, the Company had $273 million insured net par outstanding of junior COFINA bonds, which are secured primarily by a second lien on certain sales and use taxes. As noted above, the Oversight Board filed a petition on behalf of COFINA under Title III of PROMESA. COFINA bond debt service payments were not made on August 1, 2017, and the Company made its first claim payments on these bonds. The Company has continued to make claim payments on these bonds.

U of PR. As of June 30, 2018, the Company had $1 million insured net par outstanding of U of PR bonds, which are general obligations of the university and are secured by a subordinate lien on the proceeds, profits and other income of the university, subject to a senior pledge and lien for the benefit of outstanding university system revenue bonds. As of the date of this filing, all debt service payments on U of PR bonds insured by the Company have been made.

Puerto Rico Recovery Litigation

The Company believes that a number of the actions taken by the Commonwealth, the Oversight Board and others with respect to obligations it insures are illegal or unconstitutional or both, and has taken legal action, and may take additional legal action in the future, to enforce its rights with respect to these matters.

On January 7, 2016, AGM, AGC and Ambac Assurance Corporation commenced an action for declaratory judgment and injunctive relief in the Federal District Court for Puerto Rico to invalidate the executive orders issued by the Former Governor on November 30, 2015 and December 8, 2015 directing that the Secretary of the Treasury of the Commonwealth of Puerto Rico and the Puerto Rico Tourism Company claw back certain taxes and revenues pledged to secure the payment of bonds issued by the PRHTA, the PRCCDA and the PRIFA. The Commonwealth defendants filed a motion to dismiss the action for lack of subject matter jurisdiction, which the court denied on October 4, 2016. On October 14, 2016, the Commonwealth defendants filed a notice of PROMESA automatic stay. While the PROMESA automatic stay expired on May 1, 2017, on May 17, 2017, the court stayed the action under Title III of PROMESA.

On May 16, 2017, The Bank of New York Mellon, as trustee for the bonds issued by COFINA, filed an adversary complaint for interpleader and declaratory relief with the Federal District Court for Puerto Rico to resolve competing and conflicting demands made by various groups of COFINA bondholders, insurers of certain COFINA Bonds and COFINA, regarding funds held by the trustee for certain COFINA bond debt service payments scheduled to occur on and after June 1, 2017. On May 19, 2017, an order to show cause was entered permitting AGM to intervene in this matter.

On June 3, 2017, AGC and AGM filed an adversary complaint in the Federal District Court for Puerto Rico seeking (i) a judgment declaring that the application of pledged special revenues to the payment of the PRHTA Bonds is not subject to the PROMESA Title III automatic stay and that the Commonwealth has violated the special revenue protections provided to the PRHTA Bonds under the Bankruptcy Code; (ii) an injunction enjoining the Commonwealth from taking or causing to be taken any action that would further violate the special revenue protections provided to the PRHTA Bonds under the Bankruptcy Code; and (iii) an injunction ordering the Commonwealth to remit the pledged special revenues securing the PRHTA Bonds in accordance with the terms of the special revenue provisions set forth in the Bankruptcy Code. On January 30, 2018, the district court rendered an opinion dismissing the complaint and holding, among other things, that (x) even though the special revenue provisions of the Bankruptcy Code protect a lien on pledged special revenues, those provisions do not mandate the turnover of pledged special revenues to the payment of bonds and (y) actions to enforce liens on pledged special revenues remain stayed. AGC and AGM are appealing the district court's decision to the United States Court of Appeals for the First Circuit.

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On June 26, 2017, AGM and AGC filed a complaint in the Federal District Court for Puerto Rico seeking (i) a declaratory judgment that the PREPA RSA is a “Preexisting Voluntary Agreement” under Section 104 of PROMESA and the Oversight Board’s failure to certify the PREPA RSA is an unlawful application of Section 601 of PROMESA; (ii) an injunction enjoining the Oversight Board from unlawfully applying Section 601 of PROMESA and ordering it to certify the PREPA RSA; and (iii) a writ of mandamus requiring the Oversight Board to comply with its duties under PROMESA and certify the PREPA RSA. On July 21, 2017, in light of its PREPA Title III petition on July 2, 2017, the Oversight Board filed a notice of stay under PROMESA.

On July 18, 2017, AGM and AGC filed in the Federal District Court for Puerto Rico a motion for relief from the automatic stay in the PREPA Title III bankruptcy proceeding and a form of complaint seeking the appointment of a receiver for PREPA. That motion was denied on September 14, 2017. AGM and AGC are appealing the trial court's decision with the United States Court of Appeals for the First Circuit.

On May 23, 2018, AGM and AGC filed an adversary complaint in the Federal District Court for Puerto Rico seeking a judgment declaring that (i) the Oversight Board lacked authority to develop or approve the new fiscal plan for Puerto Rico which it certified on April 19, 2018 (Revised Fiscal Plan); (ii) the Revised Fiscal Plan and the Fiscal Plan Compliance Law (Compliance Law) enacted by the Commonwealth to implement the original Commonwealth fiscal plan violate various sections of PROMESA; (iii) the Revised Fiscal Plan, the Compliance Law and various moratorium laws and executive orders enacted by the Commonwealth to prevent the payment of debt service (a) are unconstitutional and void because they violate the Contracts, Takings and Due Process Clauses of the U.S. Constitution and (b) are preempted by various sections of PROMESA; and (iv) no Title III plan of adjustment based on the Revised Fiscal Plan can be confirmed under PROMESA.

On July 23, 2018, AGC and AGM filed an adversary complaint in the Federal District Court for Puerto Rico seeking a judgment (i) declaring the members of the Oversight Board are officers of the U.S. whose appointments were unlawful under the Appointments Clause of the U.S. Constitution; (ii) declaring void ab initio the unlawful actions taken by the Oversight Board to date, including (x) development of the Commonwealth's Fiscal Plan, (y) development of PRHTA's Fiscal Plan, and (z) filing of the Title III cases on behalf of the Commonwealth and PRHTA; and (iii) enjoining the Oversight Board from taking any further action until the Oversight Board members have been lawfully appointed in conformity with the Appointments Clause of the U.S. Constitution. The Title III court recently dismissed a similar lawsuit filed by another party in the Commonwealth’s Title III case; AGC and AGM expect to participate in the appellate phase of the various Appointments Clause lawsuits.

Puerto Rico Par and Debt Service Schedules

All Puerto Rico exposures are internally rated BIG. The following tables show the Company’s insured exposure to general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations.

Puerto Rico
Gross Par and Gross Debt Service Outstanding

	Gross Par Outstanding		Gross Debt Service Outstanding	
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
	(in millions)			
Exposure to Puerto Rico	$5,187	$ 5,186	$8,383	$ 8,514

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Puerto Rico
Net Par Outstanding

	As of June 30, 2018	As of December 31, 2017
	(in millions)	
Commonwealth Constitutionally Guaranteed		
Commonwealth of Puerto Rico - General Obligation Bonds (1)	$1,419	$ 1,419
PBA	141	141
Public Corporations - Certain Revenues Potentially Subject to Clawback		
PRHTA (Transportation revenue) (1)	882	882
PRHTA (Highways revenue) (1)	495	495
PRCCDA	152	152
PRIFA	18	18
Other Public Corporations		
PREPA (1)	853	853
PRASA	373	373
MFA	360	360
COFINA (1)	273	272
U of PR	1	1
Total net exposure to Puerto Rico	$4,967	$ 4,966

(1) As of the date of this filing, the Oversight Board has certified a filing under Title III of PROMESA for these exposures.

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

Amortization Schedule of Puerto Rico Net Par Outstanding
and Net Debt Service Outstanding
As of June 30, 2018

	Scheduled Net Par Amortization	Scheduled Net Debt Service Amortization
	(in millions)	
2018 (July 1 - September 30)	$200	$ 322
2018 (October 1 - December 31)	0	3
Subtotal 2018	200	325
2019	223	464
2020	285	516
2021	148	364
2022	137	345
2023-2027	1,229	2,128
2028-2032	812	1,437
2033-2037	1,217	1,572
2038-2042	453	602
2043-2047	263	316
Total	$4,967	$ 8,069

Exposure to the U.S. Virgin Islands

As of June 30, 2018, the Company had $498 million insured net par outstanding to the U.S. Virgin Islands and its related authorities (USVI), of which it rated $224 million BIG. The $274 million USVI net par the Company rated investment grade was comprised primarily of bonds secured by a lien on matching fund revenues related to excise taxes on products produced in the USVI and exported to the U.S., primarily rum. The $224 million BIG USVI net par comprised (a) Public Finance Authority bonds secured by a gross receipts tax and the general obligation, full faith and credit pledge of the USVI and (b) bonds of the Virgin Islands Water and Power Authority secured by a net revenue pledge of the electric system.

Hurricane Irma caused significant damage in St. John and St. Thomas, while Hurricane Maria made landfall on St. Croix as a Category 4 hurricane on the Saffir-Simpson scale, causing loss of life and substantial damage to St. Croix's businesses and infrastructure, including the power grid. The USVI is benefiting from the federal response to the 2017 hurricanes and has made its debt service payments to date.

Non-Financial Guaranty Exposure

The Company also provides non-financial guaranty insurance and reinsurance on transactions with similar risk profiles to its structured finance exposures written in financial guaranty form. All non-financial guaranty exposures

shown in the table below are rated investment grade internally.

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Non-Financial Guaranty Exposure

	As of June 30, 2018		As of December 31, 2017	
	Gross Exposure	Net Exposure	Gross Exposure	Net Exposure
	(in millions)			
Capital relief triple-X life reinsurance (1)	$ 849	$ 738	$ 773	$ 675
Aircraft residual value insurance policies	340	218	201	140

(1) The capital relief triple-X life reinsurance net exposure is expected to increase to approximately $1.0 billion prior to September 30, 2036.

5. Expected Loss to be Paid

This note provides information regarding expected claim payments to be made under all contracts in the insured portfolio.

Loss Estimation Process

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

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

The determination of expected loss to be paid is an inherently subjective process involving numerous estimates, assumptions and judgments by management, using both internal and external data sources with regard to frequency, severity of loss, economic projections, governmental actions, negotiations and other factors that affect credit performance. These estimates, assumptions and judgments, and the factors on which they are based, may change materially over a reporting period, and as a result the Company’s loss estimates may change materially over that same period.

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

volatility and may not reflect the Company's ultimate claims paid. For information on the Company's loss estimation process, see Note 5, Expected Loss to be Paid, of Part II, Item 8, Financial Statements and Supplementary Data in AGL's Annual Report on Form 10-K for the year ended December 31, 2017.

In some instances, the terms of the Company's policy gives it the option to pay principal losses that have been recognized in the transaction but which it is not yet required to pay, thereby reducing the amount of guaranteed interest due in the future. The Company has sometimes exercised this option, which uses cash but reduces projected future losses.

The following tables present a roll forward of net expected loss to be paid for all contracts. The Company used risk-free rates for U.S. dollar denominated obligations that ranged from 0.0% to 3.03% with a weighted average of 2.85% as of June 30, 2018 and 0.00% to 2.78% with a weighted average of 2.38% as of December 31, 2017. Expected losses to be paid for

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transactions denominated in currencies other than the U.S. dollar represented approximately 2.9% and 3.7% of the total as of June 30, 2018 and December 31, 2017, respectively.

Net Expected Loss to be Paid
Roll Forward

	Second Quarter		Six Months	
	2018	2017	2018	2017
	(in millions)			
Net expected loss to be paid, beginning of period	$1,298	$1,244	$1,303	$1,198
Net expected loss to be paid on the SGI portfolio as of June 1, 2018 (see Note 2)	131	—	131	—
Net expected loss to be paid on the MBIA UK portfolio as of January 10, 2017	—	—	—	21
Economic loss development (benefit) due to:				
Accretion of discount	9	8	17	16
Changes in discount rates	0	23	(6)	34
Changes in timing and assumptions	10	16	(16)	44
Total economic loss development (benefit)	19	47	(5)	94
Net (paid) recovered losses	(16)	6	3	(16)
Net expected loss to be paid, end of period	$1,432	$1,297	$1,432	$1,297

Net Expected Loss to be Paid
Roll Forward by Sector
Second Quarter 2018

	Net Expected Loss to be Paid (Recovered) as of March 31, 2018	Net Expected Loss to be Paid on SGI Portfolio as of June 1, 2018	Economic Loss Development / (Benefit)	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of June 30, 2018 (2)
	(in millions)				
Public finance:					
U.S. public finance	$1,007	$ 0	$ 56	$ (22)	$ 1,041
Non-U.S. public finance	43	1	(3)	0	41
Public finance	1,050	1	53	(22)	1,082
Structured finance:					
U.S. RMBS	219	130	(28)	5	326
Other structured finance	29	—	(6)	1	24
Structured finance	248	130	(34)	6	350
Total	$1,298	$ 131	$ 19	$ (16)	$ 1,432

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Net Expected Loss to be Paid
Roll Forward by Sector
Second Quarter 2017

	Net Expected Loss to be Paid (Recovered) as of March 31, 2017	Economic Loss Development / (Benefit)	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of June 30, 2017
	(in millions)			
Public finance:				
U.S. public finance	$970	$ 78	$ (4)	$ 1,044
Non-U.S. public finance	41	1	0	42
Public finance	1,011	79	(4)	1,086
Structured finance:				
U.S. RMBS	197	(29)	14	182
Other structured finance	36	(3)	(4)	29
Structured finance	233	(32)	10	211
Total	$1,244	$ 47	$ 6	$ 1,297

Net Expected Loss to be Paid
Roll Forward by Sector
Six Months 2018

	Net Expected Loss to be Paid (Recovered) as of December 31, 2017 (2)	Net Expected Loss to be Paid on SGI Portfolio as of June 1, 2018	Economic Loss Development / (Benefit)	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of June 30, 2018 (2)
	(in millions)				
Public finance:					
U.S. public finance	$1,157	$ 0	$ 17	$ (133)	$ 1,041
Non-U.S. public finance	46	1	(6)	0	41
Public finance	1,203	1	11	(133)	1,082
Structured finance:					
U.S. RMBS	73	130	(12)	135	326
Other structured finance	27	—	(4)	1	24
Structured finance	100	130	(16)	136	350
Total	$1,303	$ 131	$ (5)	$ 3	$ 1,432

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Net Expected Loss to be Paid
Roll Forward by Sector
Six Months 2017

	Net Expected Loss to be Paid (Recovered) as of December 31, 2016	Net Expected Loss to be Paid on MBIA UK as of January 10, 2017	Economic Loss Development / (Benefit)	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of June 30, 2017
	(in millions)				
Public finance:					
U.S. public finance	$871	$ —	$ 202	$ (29)	$ 1,044
Non-U.S. public finance	33	13	(4)	0	42
Public finance	904	13	198	(29)	1,086
Structured finance:					
U.S. RMBS	206	—	(51)	27	182
Other structured finance	88	8	(53)	(14)	29
Structured finance	294	8	(104)	13	211
Total	$1,198	$ 21	$ 94	$ (16)	$ 1,297

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(1) Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance recoverable on paid losses included in other assets. The Company paid $6 million and $7 million in loss adjustment expenses (LAE) for Second Quarter 2018 and 2017, respectively, and $11 million and $9 million in LAE for Six Months 2018 and 2017, respectively.

(2) Includes expected LAE to be paid of $17 million as of June 30, 2018 and $23 million as of December 31, 2017.

The following table presents the present value of net expected loss to be paid and the net economic loss development for all contracts by accounting model.

Net Expected Loss to be Paid (Recovered) and
Net Economic Loss Development (Benefit)
By Accounting Model

	Net Expected Loss to be Paid (Recovered)		Net Economic Loss Development (Benefit)			
	As of June 30, 2018	As of December 31, 2017	Second Quarter 2018	Second Quarter 2017	Six Months 2018	Six Months 2017
	(in millions)					
Financial guaranty insurance	$1,350	$ 1,226	$23	$ 55	$ (10)	$ 121
FG VIEs (1) and other	87	91	(6)	0	(4)	(4)
Credit derivatives (2)	(5)	(14)	2	(8)	9	(23)

Total	$1,432	$ 1,303	$19	$ 47	$ (5)	$ 94

(1) See Note 9, Consolidated Variable Interest Entities.

(2) See Note 8, Contracts Accounted for as Credit Derivatives.

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Selected U.S. Public Finance Transactions

The Company insured general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating $5.0 billion net par as of June 30, 2018, all of which was BIG. For additional information regarding the Company's exposure to general obligations of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations, see "Exposure to Puerto Rico" in Note 4, Outstanding Exposure.

As of June 30, 2018, the Company had insured $341 million net par outstanding of general obligation bonds issued by the City of Hartford, Connecticut, most of which was rated BIG at December 31, 2017. In the first quarter of 2018, the State of Connecticut entered into a contract assistance agreement with the City of Hartford under which the state will pay the debt service costs of the City’s general obligation bonds, including those insured by the Company. As a result, the Company reduced the corresponding expected losses as of March 31, 2018 and upgraded this exposure to investment grade.

The Company had approximately $18 million of net par exposure as of June 30, 2018 to bonds issued by Parkway East Public Improvement District (District), which is located in Madison County, Mississippi (the County). The bonds, which are rated BIG, are payable from special assessments on properties within the District, as well as amounts paid under a contribution agreement with the County in which the County covenants that it will provide funds in the event special assessments are not sufficient to make a debt service payment. The special assessments have not been sufficient to pay debt service in full. In earlier years, the County provided funding to cover the balance of the debt service requirement, but subsequently claimed the District’s failure to reimburse it within the two years stipulated in the contribution agreement means that the County is not required to provide funding until it is reimbursed. See “Recovery Litigation” at the end of this note for the settlement agreement reached between the County, the District and AGC with respect to the County's obligations.

On February 25, 2015, a plan of adjustment resolving the bankruptcy filing of the City of Stockton, California under chapter 9 of the U.S. Bankruptcy Code became effective. As of June 30, 2018, the Company’s net par subject to the plan consisted of $113 million of pension obligation bonds. As part of the plan of adjustment, the City will repay any claims paid on the pension obligation bonds from certain fixed payments and certain variable payments contingent on the City’s revenue growth.

The Company projected that its total net expected loss across its troubled U.S. public finance exposures as of June 30, 2018 including those mentioned above, would be $1,041 million, compared with a net expected loss of $1,157 million as of December 31, 2017. The economic loss development in Second Quarter 2018 was $56 million, which was primarily attributable to Puerto Rico exposures. The economic loss development for Six Months 2018 was $17 million, which was primarily attributable to Puerto Rico exposures, partially offset by a benefit related to the State of Connecticut's agreement to pay the debt service costs of certain bonds of the City of Hartford, including the bonds insured by the Company.

Selected Non - U.S. Public Finance Transactions

The Company insures and reinsures transactions with sub-sovereign exposure to various Spanish and Portuguese issuers where a Spanish and Portuguese sovereign default may cause the sub-sovereigns also to default. The Company's exposure net of reinsurance to these Spanish and Portuguese exposures is $446 million and $72 million, respectively. The Company rates all of these exposures BIG due to the financial condition of Spain and Portugal and their dependence on the sovereign. The Company's Hungary exposure is to infrastructure bonds dependent on payments from Hungarian governmental entities. The Company's exposure, net of reinsurance, to these Hungarian exposures is $197 million, all of which is rated BIG.

The Company also insures an obligation backed by the availability and toll revenues of a major arterial road into a city in the U.K. with $212 million of net par outstanding as of June 30, 2018. This transaction has been underperforming due to higher costs compared with expectations at underwriting. In the first quarter of 2018, the Company changed its traffic assumptions for this road, resulting in a benefit.

These transactions, together with other non-U.S. public finance insured obligations, had expected loss to be paid of $41 million as of June 30, 2018, compared with $46 million as of December 31, 2017. The economic benefit of approximately $3 million for Second Quarter 2018 was attributable mainly to changes in foreign exchange rates. The economic benefit of approximately $6 million during Six Months 2018 was attributable mainly to the U.K. arterial road mentioned above and changes in foreign exchange rates.

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U.S. RMBS Loss Projections

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

Based on its observation during the period of the performance of its insured transactions (including delinquencies, liquidation rates and loss severities) as well as the residential property market and economy in general, the Company chose to make the changes to the assumptions it uses to project RMBS losses shown in the tables of assumptions in the sections below.

The following table presents the net economic loss development (benefit).

Net Economic Loss Development (Benefit)

	Second Quarter		Six Months	
	2018	2017	2018	2017
	(in millions)			
First lien U.S. RMBS	$(7)	$(14)	$17	$(23)
Second lien U.S. RMBS	(21)	(15)	(29)	(28)

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

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

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First Lien Liquidation Rates

	June 30, 2018	March 31, 2018	December 31, 2017
Delinquent/Modified in the Previous 12 Months			
Alt A and Prime	20%	20%	20%
Option ARM	20	20	20
Subprime	20	20	20
30 – 59 Days Delinquent			
Alt A and Prime	30	30	30
Option ARM	35	35	35
Subprime	40	45	40
60 – 89 Days Delinquent			
Alt A and Prime	35	40	40
Option ARM	45	45	50
Subprime	50	50	50
90+ Days Delinquent			
Alt A and Prime	40	45	55
Option ARM	55	55	60
Subprime	55	55	55
Bankruptcy			
Alt A and Prime	45	45	45
Option ARM	50	50	50
Subprime	40	40	40
Foreclosure			
Alt A and Prime	55	55	65
Option ARM	65	65	70
Subprime	65	65	65
Real Estate Owned			
All	100	100	100

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

In the most heavily weighted scenario (the base case), after the initial 36-month CDR plateau period, each transaction's CDR is projected to improve over 12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for 36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. In the base case, the Company assumes the final CDR will be reached 5 years after the initial 36-month CDR plateau period. Under the Company's methodology, defaults projected to occur in the first 36 months represent defaults that can be attributed to loans that were modified or delinquent in the last 12 months or that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected CDR trend after the first 36 month period

represent defaults attributable to borrowers that are currently performing or are projected to reperform.

Another important driver of loss projections is loss severity, which is the amount of loss the transaction incurs on a loan after the application of net proceeds from the disposal of the underlying property. Loss severities experienced in first lien transactions have reached historically high levels, and the Company is assuming in the base case that these high levels

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generally will continue for another 18 months. The Company determines its initial loss severity based on actual recent experience. Each quarter the Company reviews available data and (if necessary) adjusts its severities based on its observations. 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 as well as the average, weighted by outstanding net insured par, for key assumptions used in the calculation of expected loss to be paid for individual transactions for vintage 2004 - 2008 first lien U.S. RMBS.

Key Assumptions in Base Case Expected Loss Estimates
First Lien RMBS

	As of June 30, 2018		As of March 31, 2018		As of December 31, 2017	
	Range	Weighted Average	Range	Weighted Average	Range	Weighted Average
Alt-A First Lien						
Plateau CDR	0.7%-12.2%	4.7%	1.4%-9.2%	4.7%	1.3%-9.8%	5.2%
Final CDR	0.0%-0.6%	0.2%	0.1%-0.5%	0.2%	0.1%-0.5%	0.3%
Initial loss severity:						
2005 and prior	60%		60%		60%	
2006	80%		80%		80%	
2007+	70%		70%		70%	
Option ARM						
Plateau CDR	2.1%-8.5%	5.9%	1.4%-7.8%	5.8%	2.5%-7.0%	5.9%
Final CDR	0.1%-0.4%	0.3%	0.1%-0.4%	0.3%	0.1%-0.3%	0.3%
Initial loss severity:						
2005 and prior	60%		60%		60%	
2006	70%		70%		70%	
2007+	75%		75%		75%	
Subprime						
Plateau CDR	3.2%-18.4%	6.9%	4.2%-11.8%	7.7%	3.5%-13.1%	7.8%
Final CDR	0.2%-0.9%	0.3%	0.2%-0.6%	0.4%	0.2%-0.7%	0.4%
Initial loss severity:						
2005 and prior	80%		80%		80%	
2006	85%		85%		90%	
2007+	95%		95%		95%	

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 CDR, the loss severity and the loan balance over time) as well as the amount of excess spread (the amount by which the interest paid by the borrowers on the underlying loan exceeds the amount of interest owed on the insured obligations). The assumption for the voluntary conditional prepayment rate (CPR) follows a similar pattern to that of the CDR. The current level of voluntary prepayments is assumed to continue for the plateau period before gradually increasing over 12 months to the final CPR, which is assumed to be 15% in the base case. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant and the final

CPR is not used. These CPR assumptions are the same as those the Company used for March 31, 2018 and December 31, 2017.

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 CDR returned to its modeled equilibrium, which was defined as 5% of the initial CDR. The Company also stressed CPR and the speed of recovery of loss severity rates. The Company probability weighted a total of five scenarios as of June 30, 2018 and December 31, 2017.

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Total expected loss to be paid on all first lien U.S. RMBS was $248 million and $123 million as of June 30, 2018 and December 31, 2017, respectively. The reinsurance of the SGI portfolio added $113 million of net expected loss to first lien U.S. RMBS on June 1, 2018. The Company used a similar approach to establish its pessimistic and optimistic scenarios as of June 30, 2018 as it used as of March 31, 2018 and December 31, 2017, increasing and decreasing the periods of stress from those used in the base case.

In the Company's most stressful scenario where loss severities were assumed to rise and then recover over nine years and the initial ramp-down of the CDR was assumed to occur over 15 months, expected loss to be paid would increase from current projections by approximately $64 million for all first lien U.S. RMBS transactions.

In the Company's least stressful scenario where the CDR plateau was six months shorter (30 months, effectively assuming that liquidation rates would improve) and the CDR recovery was more pronounced (including an initial ramp-down of the CDR over nine months), expected loss to be paid would decrease from current projections by approximately $38 million for all first lien U.S. RMBS transactions.

U.S. Second Lien RMBS Loss Projections

Second lien RMBS transactions include both home equity lines of credit (HELOC) and closed end second lien mortgages. 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 loss severity.

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. The Company estimates the amount of loans that will default over the next six months by calculating current representative liquidation rates. Similar to first liens, the Company then calculates a CDR for six months, which is the period over which the currently delinquent collateral is expected to be liquidated. That CDR is then used as the basis for the plateau CDR period that follows the embedded plateau losses.

For the base case scenario, the CDR (the plateau CDR) was held constant for six months. Once the plateau period has ended, the CDR is assumed to gradually trend down in uniform increments to its final long-term steady state CDR. (The long-term steady state CDR is calculated as the constant CDR that would have yielded the amount of losses originally expected at underwriting.) In the base case scenario, the time over which the CDR trends down to its final CDR is 28 months. Therefore, the total stress period for second lien transactions is 34 months, comprising six months of delinquent loan liquidations, followed by 28 months of decrease to the steady state CDR, the same as of March 31, 2018 and December 31, 2017.

HELOC loans generally permit the borrower to pay only interest for an initial period (often ten years) and, after that period, require the borrower to make both the monthly interest payment and a monthly principal payment. This causes the borrower's total monthly payment to increase, sometimes substantially, at the end of the initial interest-only period. In the prior periods, as the HELOC loans underlying the Company's insured HELOC transactions reached their principal amortization period, the Company incorporated an assumption that a percentage of loans reaching their principal amortization periods would default around the time of the payment increase.

Most of the HELOC loans underlying the Company's insured HELOC transactions are now past their interest only reset date, although a significant number of HELOC loans were modified to extend the interest only period for another five years. As a result, in 2017, the Company eliminated the CDR increase that was applied when such loans reached

their principal amortization period. In addition, based on the average performance history, starting in third quarter 2017, the Company applied a CDR floor of 2.5% for the future steady state CDR on all its HELOC transactions.

When a second lien loan defaults, there is generally a very low recovery. The Company assumed as of June 30, 2018 that it will generally recover only 2% of future defaulting collateral at the time of charge-off, with additional amounts of post charge-off recoveries assumed to come in over time. This is the same assumption used as of March 31, 2018 and December 31, 2017.

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected as well as the amount of excess spread. In the base case, an average CPR (based on experience of the past year) is assumed to continue until the end of the plateau before gradually increasing to the final CPR over the same period the CDR decreases. The final CPR is assumed to be 15% for second lien transactions (in the base case), which is lower than the historical average but reflects

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the Company’s continued uncertainty about the projected performance of the borrowers in these transactions. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant and the final CPR is not used. This pattern is generally consistent with how the Company modeled the CPR as of March 31, 2018 and December 31, 2017. To the extent that prepayments differ from projected levels it could materially change the Company’s projected excess spread and losses.

In estimating expected losses, the Company modeled and probability weighted five scenarios, each with a different CDR curve applicable to the period preceding the return to the long-term steady state CDR. The Company believes that the level of the elevated CDR and the length of time it will persist and the ultimate prepayment rate are the primary drivers behind the likely amount of losses the collateral will suffer.

The Company continues to evaluate the assumptions affecting its modeling results. The Company believes the most important driver of its projected second lien RMBS losses is the performance of its HELOC transactions. Total expected loss to be paid on all second lien U.S. RMBS was $78 million as of June 30, 2018 and total expected recovery on all second lien U.S. RMBS was $50 million as of December 31, 2017, respectively. This change was due primarily to cash received in 2018 from a favorable settlement of R&W litigation reached in late December 2017 and the additional $17 million of net expected loss on second lien U.S. RMBS from reinsurance of the SGI portfolio on June 1, 2018.

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

Key Assumptions in Base Case Expected Loss Estimates
HELOCs

	As of June 30, 2018		As of March 31, 2018		As of December 31, 2017	
	Range	Weighted Average	Range	Weighted Average	Range	Weighted Average
Plateau CDR	4.8%-28.5%	11.1%	2.5%-18.4%	10.6%	2.7%-19.9%	11.4%
Final CDR trended down to	2.5%-3.2%	2.5%	2.5%-3.2%	2.5%	2.5%-3.2%	2.5%
Liquidation rates:						
Delinquent/Modified in the Previous 12 Months	20%		20%		20%	
30 – 59 Days Delinquent	40		40		45	
60 – 89 Days Delinquent	55		60		60	
90+ Days Delinquent	75		75		75	
Bankruptcy	55		55		55	
Foreclosure	65		65		70	
Real Estate Owned	100		100		100	
Loss severity	98%		98%		98%	

The Company’s base case assumed a six month CDR plateau and a 28 month ramp-down (for a total stress period of 34 months). The Company also modeled a scenario with a longer period of elevated defaults and another with a shorter period of elevated defaults. Increasing the CDR plateau to eight months and increasing the ramp-down by three months to 31 months (for a total stress period of 39 months) would increase the expected loss by approximately $11 million for HELOC transactions. On the other hand, reducing the CDR plateau to four months and decreasing the

length of the CDR ramp-down to 25 months (for a total stress period of 29 months), and lowering the ultimate prepayment rate to 10% would decrease the expected loss by approximately $12 million for HELOC transactions.

Breaches of Representations and Warranties

As of June 30, 2018, the Company had a net R&W receivable of $17 million from R&W counterparties, compared to a net R&W receivable of $117 million as of December 31, 2017. The decrease was due primarily to cash received in 2018 from a favorable settlement of R&W litigation reached in late December 2017.

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Other Structured Finance

The Company had $1.2 billion of net par exposure to financial guaranty triple-X life insurance transactions as of June 30, 2018, of which $85 million in net par was rated BIG. The triple-X life insurance transactions are based on discrete blocks of individual life insurance business. In older vintage triple-X life insurance transactions, which include the BIG-rated transactions, the amounts raised by the sale of the notes insured by the Company were used to capitalize a special purpose vehicle that provides reinsurance to a life insurer or reinsurer. The amounts have been invested since inception in accounts managed by third-party investment managers. In the case of the BIG-rated transactions, material amounts of their assets were invested in U.S. RMBS.

The Company has insured or reinsured $1.2 billion net par of student loan securitizations issued by private issuers that are classified as structured finance. Of this amount, $112 million is rated BIG. In general, the projected 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 Company projected that its total net expected loss across its troubled non-RMBS structured finance exposures as of June 30, 2018 including those mentioned above was $24 million and is primarily attributable to structured student loans. The economic benefit during Second Quarter 2018 and Six Months 2018 was $6 million and $4 million, respectively, primarily attributable to certain assumed student loan transactions.

Recovery Litigation

In the ordinary course of their respective businesses, certain of AGL's subsidiaries assert claims in legal proceedings against third parties to recover losses paid in prior periods or prevent losses in the future.

Public Finance Transactions

The Company has asserted claims in a number of legal proceedings in connection with its exposure to Puerto Rico. See Note 4, Outstanding Exposure, for a discussion of the Company's exposure to Puerto Rico and related recovery litigation being pursued by the Company.

On November 1, 2013, Radian Asset Assurance Inc. (Radian Asset) commenced a declaratory judgment action in the U.S. District Court for the Southern District of Mississippi against Madison County, Mississippi (the County) and the Parkway East Public Improvement District (District) to establish its rights under a contribution agreement from the County supporting certain special assessment bonds issued by the District and insured by Radian Asset (now AGC). As of June 30, 2018, $18 million of such bonds were outstanding. The County maintained that its payment obligation is limited to two years of annual debt service, while AGC contended the County’s obligations under the contribution agreement continue so long as the bonds remain outstanding. On April 27, 2016, the district court granted AGC's motion for summary judgment, agreeing with AGC's interpretation of the County's obligations. The County appealed the district court’s summary judgment ruling to the United States Court of Appeals for the Fifth Circuit, and on May 31, 2017, the appellate court reversed the district court’s ruling and remanded the matter to the district court. In March 2018, the County, the District, and AGC executed a settlement agreement which formalizes the procedures related to the disposition of assessments and of the properties that have defaulted, and on May 11, 2018, the district court dismissed the case. The settlement agreement also provides for the County owned property to be conveyed to the District, which, to the extent practicable, is obligated to lease, sell or otherwise dispose of the property to maximize pledged revenues. Any such actions will require AGC’s consent.

RMBS Transactions

On November 26, 2012, CIFG Assurance North America Inc. (CIFGNA) filed a complaint in the Supreme Court of the State of New York against JP Morgan Securities LLC (JP Morgan) for material misrepresentation in the inducement of insurance and common law fraud, alleging that JP Morgan fraudulently induced CIFGNA to insure $400 million of securities issued by ACA ABS CDO 2006-2 Ltd. and $325 million of securities issued by Libertas Preferred Funding II, Ltd. On June 26, 2015, the court dismissed with prejudice CIFGNA’s material misrepresentation in the inducement of insurance claim and dismissed without prejudice CIFGNA’s common law fraud claim. On September 24, 2015, the court denied CIFGNA’s motion to amend but allowed CIFGNA to re-plead a cause of action for common law fraud. On November 20, 2015, CIFGNA filed a motion for leave to amend its complaint to re-plead common law fraud. On April 29, 2016, CIFGNA filed an appeal to reverse the court’s decision dismissing CIFGNA’s material misrepresentation in the inducement of insurance claim. On November 29, 2016, the Appellate Division of the Supreme Court of the State of New York ruled that the court’s decision

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dismissing with prejudice CIFGNA's material misrepresentation in the inducement of insurance claim should be modified to grant CIFGNA leave to re-plead such claim. On February 27, 2017, AGC (as successor to CIFGNA) filed an amended complaint which includes a claim for material misrepresentation in the inducement of insurance.

6. Contracts Accounted for as Insurance

Premiums

The portfolio of outstanding exposures discussed in Note 4, Outstanding Exposure, includes contracts that meet the definition of insurance contracts, contracts that meet the definition of a derivative, and contracts that are accounted for as consolidated FG VIEs. Amounts presented in this note relate only to insurance contracts. See Note 8, Contracts Accounted for as Credit Derivatives for amounts that relate to CDS and Note 9, Consolidated Variable Interest Entities for amounts that relate to FG VIEs.

Net Earned Premiums

	Second Quarter		Six Months	
	2018	2017	2018	2017
	(in millions)			
Scheduled net earned premiums	$92	$97	$180	$200
Accelerations:				
Refundings	38	49	84	105
Terminations	1	10	7	12
Total Accelerations	39	59	91	117
Accretion of discount on net premiums receivable	4	5	8	8
Financial guaranty insurance net earned premiums	135	161	279	325
Non-financial guaranty net earned premiums	1	1	2	1
Net earned premiums (1)	$136	$162	$281	$326

(1) Excludes $3 million and $4 million for Second Quarter 2018 and 2017, respectively, and $6 million and $8 million for Six Months 2018 and 2017, respectively, related to consolidated FG VIEs.

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

	Six Months	
	2018	2017
	(in millions)	
December 31,	$915	$576
Less: Non-financial guaranty insurance premium receivable	1	0
FG insurance premiums receivable	914	576
Premiums receivable from acquisitions (see Note 2)	—	270
Gross written premiums on new business, net of commissions (2)	459	179
Gross premiums received, net of commissions (3)	(415)	(159)
Adjustments:		
Changes in the expected term	(3)	0
Accretion of discount, net of commissions on assumed business	0	9
Foreign exchange translation	(14)	35
Cancellation of assumed reinsurance	(10)	—
FG insurance premium receivable (1)	931	910
Non-financial guaranty insurance premium receivable	1	6
June 30,	$932	$916

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(1) Excludes $9 million and $10 million as of June 30, 2018 and June 30, 2017, respectively, related to consolidated FG VIEs.

(2) For transactions where the Company replaces a previous Assured Guaranty financial guaranty contract, gross premiums written represents only the incremental gross premium written in excess of the original gross premiums written. Includes $330 million related to the SGI reinsured portfolio. See Note 2, Assumption of Insured Portfolio and Business Combinations.

(3) Includes $275 million of cash received related to the SGI reinsured portfolio.

Approximately 72%, 72% and 69% of installment premiums at June 30, 2018, December 31, 2017 and June 30, 2017, respectively, are denominated in currencies other than the U.S. dollar, primarily the euro and 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.

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

	As of June 30, 2018 (in millions)
2018 (July 1 - September 30)	$ 31
2018 (October 1 - December 31)	26
2019	88
2020	100
2021	82
2022	74
2023-2027	301
2028-2032	199
2033-2037	109
After 2037	105
Total(1)	$ 1,115

(1) Excludes expected cash collections on FG VIEs of $12 million.

Scheduled Financial Guaranty Insurance Net Earned Premiums

	As of June 30, 2018 (in millions)
2018 (July 1 - September 30)	$ 95
2018 (October 1 - December 31)	92
Subtotal 2018	187
2019	331
2020	301
2021	273
2022	247
2023-2027	962
2028-2032	636
2033-2037	374
After 2037	312
Net deferred premium revenue(1)	3,623
Future accretion	182
Total future net earned premiums	$ 3,805

(1) Excludes scheduled net earned premiums on consolidated FG VIEs of $70 million and non-financial guaranty business net earned premium of $13 million.

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Selected Information for Financial Guaranty Insurance
Policies Paid in Installments

	As of June 30, 2018	As of December 31, 2017
	(dollars in millions)	
Premiums receivable, net of commission payable	$ 932	$ 914
Gross deferred premium revenue	1,351	1,205
Weighted-average risk-free rate used to discount premiums	2.3 %	2.3 %
Weighted-average period of premiums receivable (in years)	9.0	9.2

Financial Guaranty Insurance Losses

Insurance Contracts' Loss Information

The following table provides information on net reserve (salvage), comprised of loss and LAE reserves and salvage and subrogation recoverable, both net of reinsurance. The Company used risk-free rates for U.S. dollar denominated financial guaranty insurance obligations that ranged from 0.0% to 3.03% with a weighted average of 2.85% as of June 30, 2018 and 0.0% to 2.78% with a weighted average of 2.39% as of December 31, 2017.

Net Reserve (Salvage)

	As of June 30, 2018	As of December 31, 2017
	(in millions)	
Public finance:		
U.S. public finance	$811	$ 901
Non-U.S. public finance	19	21
Public finance	830	922
Structured finance:		
U.S. RMBS	76	(59)
Other structured finance	30	40
Structured finance	106	(19)
Subtotal	936	903
Other payable (recoverable)	(4)	(4)
Subtotal	932	899
Elimination of losses attributable to FG VIEs	(55)	(55)
Total	$877	$ 844

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Components of Net Reserves (Salvage)

	As of June 30, 2018	As of December 31, 2017
	(in millions)	
Loss and LAE reserve	$1,327	$ 1,444
Reinsurance recoverable on unpaid losses (1)	(38)	(44)
Loss and LAE reserve, net	1,289	1,400
Salvage and subrogation recoverable	(425)	(572)
Salvage and subrogation payable(2)	17	20
Other payable (recoverable) (1)	(4)	(4)
Salvage and subrogation recoverable, net, and other recoverable	(412)	(556)
Net reserves (salvage)	$877	$ 844

(1) Recorded as a component of other assets in condensed consolidated balance sheets.

(2) Recorded as a component of other liabilities in condensed consolidated balance sheets.

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: (i) the contra-paid which represent the claim payments made and recoveries received that have not yet been recognized in the statement of operations, (ii) 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 (and therefore recognized in income but not yet received), and (iii) loss reserves that have already been established (and therefore expensed but not yet paid).

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

	As of June 30, 2018
	(in millions)
Net expected loss to be paid - financial guaranty insurance (1)	$ 1,350
Contra-paid, net	66
Salvage and subrogation recoverable, net of reinsurance	408
Loss and LAE reserve - financial guaranty insurance contracts, net of reinsurance	(1,288)
Other recoverable (payable)	4
Net expected loss to be expensed (present value) (2)	$ 540

(1) See "Net Expected Loss to be Paid (Recovered) by Accounting Model" table in Note 5, Expected Loss to be Paid.

(2) Excludes $46 million as of June 30, 2018, related to consolidated FG VIEs.

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

Net Expected Loss to be Expensed
Financial Guaranty Insurance Contracts

	As of June 30, 2018 (in millions)
2018 (July 1 – September 30)	$ 9
2018 (October 1 – December 31)	9
Subtotal 2018	18
2019	40
2020	43
2021	44
2022	41
2023-2027	169
2028-2032	111
2033-2037	61
After 2037	13
Net expected loss to be expensed	540
Future accretion	170
Total expected future loss and LAE	$ 710

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

Loss and LAE
Reported on the
Condensed Consolidated Statements of Operations

	Loss (Benefit)			
	Second Quarter		Six Months	
	2018	2017	2018	2017
	(in millions)			
Public finance:				
U.S. public finance	$62	$79	$34	$191
Non-U.S. public finance	(1)	0	(2)	(3)
Public finance	61	79	32	188
Structured finance:				
U.S. RMBS	(15)	(1)	7	(10)
Other structured finance	(5)	(4)	(10)	(43)
Structured finance	(20)	(5)	(3)	(53)
Loss and LAE on insurance contracts before FG VIE consolidation	41	74	29	135
Gain (loss) related to FG VIE consolidation	3	(2)	(3)	(4)
Loss and LAE	$44	$72	$26	$131

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

Financial Guaranty Insurance
BIG Transaction Loss Summary
As of June 30, 2018

	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)	138	(11)	44	(1)	150	(7)	332	—	332
Remaining weighted-average contract period (in years)	7.9	6.6	12.2	2.4	9.9	9.2	9.7	—	9.7
Outstanding exposure:									
Principal	$2,822	$(88)	$1,102	$ (6)	$6,720	$(165)	$10,385	$ —	$10,385
Interest	1,204	(35)	649	(1)	3,301	(76)	5,042	—	5,042
Total(2)	$4,026	$(123)	$1,751	$ (7)	$10,021	$(241)	$15,427	$ —	$15,427
Expected cash outflows (inflows)	$93	$(5)	$314	$ (1)	$4,316	$(89)	$4,628	$ (300)	$4,328
Potential recoveries(3)	(427)	19	(112)	0	(2,537)	60	(2,997)	189	(2,808)
Subtotal	(334)	14	202	(1)	1,779	(29)	1,631	(111)	1,520
Discount	84	(5)	(57)	0	(214)	(3)	(195)	25	(170)
	$(250)	$9	$145	$ (1)	$1,565	$(32)	$1,436	$ (86)	$1,350

Present value of expected cash flows								
Deferred premium revenue	$88	$(4)	$171	$ 0	$599	$(2)	$852	$ (68)	$784
Reserves (salvage)	$(279)	$10	$52	$ (1)	$1,179	$(30)	$931	$ (55)	$876

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Financial Guaranty Insurance
BIG Transaction Loss Summary
As of December 31, 2017

	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)	139	(22)	46	(3)	150	(41)	335	—	335
Remaining weighted-average contract period (in years)	8.9	7.3	14.0	2.9	9.6	9.3	9.9	—	9.9
Outstanding exposure:									
Principal	$4,397	$(96)	$1,352	$(8)	$6,445	$(190)	$11,900	$ —	$11,900
Interest	2,110	(42)	1,002	(1)	3,098	(86)	6,081	—	6,081
Total(2)	$6,507	$(138)	$2,354	$(9)	$9,543	$(276)	$17,981	$ —	$17,981
Expected cash outflows (inflows)	$186	$(5)	$492	$(1)	$3,785	$(104)	$4,353	$ (307)	$4,046
Potential recoveries(3)	(595)	20	(145)	0	(2,273)	67	(2,926)	194	(2,732)
Subtotal	(409)	15	347	(1)	1,512	(37)	1,427	(113)	1,314
Discount	66	(4)	(93)	0	(78)	(2)	(111)	23	(88)
Present value of expected cash flows	$(343)	$11	$254	$(1)	$1,434	$(39)	$1,316	$ (90)	$1,226
Deferred premium revenue	$112	$(5)	$129	$0	$540	$(6)	$770	$ (74)	$696
Reserves (salvage)	$(380)	$11	$202	$(1)	$1,100	$(34)	$898	$ (55)	$843

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

(2) Includes BIG amounts related to FG VIEs.

(3) Includes excess spread and R&W receivables and payables.

Ratings Impact on Financial Guaranty Business

A downgrade of one of AGL’s insurance subsidiaries may result in increased claims under financial guaranties issued by the Company if counterparties exercise contractual rights triggered by the downgrade against insured obligors, and the insured obligors are unable to pay.

Since the filing with the SEC of AGL’s Annual Report on Form 10-K for the year ended December 31, 2017, there have been no material changes to (i) the Company's potential termination payments under interest rate swaps, (ii) the variable rate demand obligations exposure, and (iii) the potential payment obligations under guaranteed investment contracts and availability of sufficient eligible and liquid assets to AGMH's former subsidiary, FSA Asset Management LLC, to satisfy any expected withdrawal and collateral posting obligations. See Note 6, Contracts Accounted for as Insurance, in Part II, Item 8. “Financial Statements and Supplementary Data” of AGL’s Annual Report on Form 10-K for the year ended December 31, 2017 for additional information.

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).

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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 2018, no changes were made to the Company's valuation models that had or are expected to have, a material impact on the Company's condensed consolidated balance sheets or statements of operations and comprehensive income.

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

The categorization within 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 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's or liability's categorization 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 and Level 2. There were no transfers into or out of Level 3 during Second Quarter 2018 or Six Months 2018. There was a transfer of a fixed-maturity security from Level 2 into Level 3 during Second Quarter 2017 and Six Month 2017 because starting Second Quarter 2017 the price of the security included a significant unobservable assumption. There was a transfer of a fixed-maturity security from Level 3 into Level 2 during Second Quarter 2017 and Six Months 2017.

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 take into account: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, industry and economic events 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.

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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. The valuation of fixed-maturity investments is more subjective when markets are less liquid due to the lack of market based inputs.

Short-term investments, that are traded in active markets, are classified within Level 1 in the fair value hierarchy and their value is 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.

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

The Company, on a quarterly basis:

- reviews methodologies for Level 3 securities, any model updates and inputs for Level 3 securities, and compares such information to management's own market information and, where applicable, the internal models,

- reviews internally developed analytic packages for all securities that highlight, at a CUSIP level, price changes from the previous quarter to the current quarter, and evaluates, documents, and resolves any significant pricing differences with the assistance of the third party pricing source, and

- compares prices received from different third party pricing sources for Level 3, and evaluates, documents the rationale for, and resolves any significant pricing differences for Level 3.

As of June 30, 2018, the Company used models to price 107 securities (primarily securities that were purchased or obtained for loss mitigation or other risk management purposes), which were 12% or $1,363 million of the Company's fixed-maturity securities and short-term investments at fair value. Most 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 appreciation/depreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the bond including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could materially change the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

Other Invested Assets

As of June 30, 2018 and December 31, 2017, other invested assets included investments carried and measured at fair value on a recurring basis of $44 million and $48 million, respectively, and included primarily preferred stock investments in the global property catastrophe risk market and in a fund that invested primarily in senior loans and bonds. Fair values for the preferred stock investments are based on their respective net asset value (NAV) per share or equivalent. Included in the amounts above are other equity investments that were carried at their fair value of $2 million as of June 30, 2018 and December 31, 2017. These equity investments were classified as Level 3.

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Other Assets

Committed Capital Securities

The fair value of committed capital securities (CCS), which is recorded in "other assets" on the condensed consolidated balance sheets, represents the difference between the present value of remaining expected put option premium payments under 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 in other income in the condensed consolidated statement of operations. The estimated current cost of the Company's CCS is based on several factors, including AGM and AGC CDS spreads, London Interbank Offered Rate (LIBOR) curve projections, the Company's publicly traded debt 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 NAV of the funds if a published daily value is not available (Level 2). The NAV's are based on observable information.

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 following is a description of the fair value methodology applied to the Company's insured CDS that are accounted for as credit derivatives, which constitute the vast majority of the net credit derivative liability in the condensed consolidated balance sheets. The Company did 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 such contracts; however, the Company has mutually agreed with various counterparties to terminate certain CDS transactions. In transactions where the counterparty does not have the right to terminate, such transactions are generally terminated for an amount that approximates the present value of future premiums or for a negotiated amount, rather than 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 generally 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, 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. 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 transactions 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 how the Company’s own credit spread affects the pricing of its transactions.

The fair value of the Company’s credit derivative contracts represents the difference between the present value of remaining premiums the Company expects to receive or pay and the estimated present value of premiums that a financial guarantor of comparable credit-worthiness would hypothetically charge or pay at the reporting date for the same protection. The fair value of the Company’s credit derivatives depends on a number of factors, including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of referenced entities, the Company’s own credit risk and remaining contractual cash flows. The expected remaining contractual premium cash flows are the most readily observable inputs since they are based on the CDS contractual terms. Credit spreads capture the effect of recovery rates and performance of underlying assets of these contracts, among other factors. Consistent with previous years, market conditions at June 30, 2018 were such that market prices of the Company’s CDS contracts were not available.

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Assumptions and Inputs

The various inputs and assumptions that are key to the establishment of the Company's fair value for CDS contracts are as follows: the gross spread, the allocation of gross spread among the bank profit, net spread and hedge cost, and the weighted average life which is based on debt service schedules. 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. The bank profit represents the profit the originator, usually an investment bank, realizes for structuring and funding the transaction; the net spread represents the premiums paid to the Company for the Company's credit protection provided; and the hedge cost represents the cost of CDS protection purchased by the originator to hedge its counterparty credit risk exposure to the Company.

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

The following spread hierarchy is utilized in determining which source of gross spread to use. 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.

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

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

- Credit spreads interpolated based upon market indices adjusted to reflect the non-standard terms of the Company's CDS contracts.

- 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, 2018	As of December 31, 2017
Based on actual collateral specific spreads	20 %	14 %
Based on market indices	34 %	48 %
Provided by the CDS counterparty	46 %	38 %

Total	100 %	100 %

(1) Based on par.

The rates used to discount future expected premium cash flows ranged from 2.41% to 2.94% at June 30, 2018 and 1.72% to 2.55% at December 31, 2017.

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 transaction. 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 transaction's current spread.

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 transactions. 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 transactions 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 transaction generally decreases.

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 0%, 18% and 16%, based on fair value, of the Company's CDS contracts were fair valued using this minimum premium as of June 30, 2018, March 31, 2018 and December 31, 2017, respectively. The percentage of transactions that price using the minimum premiums fluctuates due to changes in AGC's credit spreads. In general when AGC's credit spreads narrow, the cost to hedge AGC's name declines and more transactions price above previously established floor levels. Meanwhile, when AGC's credit spreads widen, the cost to hedge AGC's name increases causing more transactions to price at previously established floor levels. Due to the low volume of CDS contracts remaining in AGM's portfolio, changes in AGM's credit spreads do not significantly affect the overall percentage of transactions fair valued using the minimum premium. 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 transaction 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 credit derivative liability on protection sold is the result of contractual cash inflows on in-force transactions that are less than 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 realize a loss representing the difference between the lower contractual premiums to which it is entitled and the current market premiums for a similar contract. The Company determines the fair value of its CDS contracts by applying the difference between the current net spread and the contractual net spread for the remaining duration of each contract to the notional value of its CDS contracts and taking the present value of such amounts discounted at the corresponding LIBOR over the weighted average remaining life of the contract.

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 model maximizes the use of market-driven inputs whenever they are available.
- The model is a consistent approach to valuing positions.

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

- There is no exit market or any 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.

- The markets for the inputs to the model are 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.

Fair Value Option on FG VIEs’ Assets and Liabilities

The Company elected the fair value option for all the FG VIEs’ assets and liabilities and classifies them as Level 3 in the fair value hierarchy as the lowest level input that is significant to their fair value is unobservable. The prices are generally determined with the assistance of an independent third-party, based on a discounted cash flow approach. Interest income and interest expense are derived from the trustee reports and also included in “fair value gains (losses) on FG VIEs.” The FG VIEs issued securities collateralized by first lien and second lien RMBS as well as loans and receivables.

The fair value of the Company’s FG VIEs’ 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); yields 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 VIEs’ assets and the implied collateral losses within the transaction. In general, the fair value of the FG VIEs’ assets 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 VIEs’ assets, while a decrease in collateral losses typically leads to an increase in the fair value of FG VIEs’ assets.

The third-party 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 independent third-party, on comparable bonds.

The models to price the FG VIEs’ liabilities used, where appropriate, the same inputs used in determining fair value of FG VIEs’ assets 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 Company's own credit risk.

Significant changes to any of the inputs described above 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 VIEs’ 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 VIEs' liabilities with recourse.

Not Carried at Fair Value

The following financial instruments are not carried at fair value:

- As of June 30, 2018, Other Invested Assets included equity securities of $49 million that were accounted for under the equity method and equity securities of $4 million that were accounted at cost less any impairment, plus or minus the change resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.
- Other Assets and Other Liabilities, which consist predominantly of accrued interest, receivables for securities sold and payables for securities purchased, the carrying values of which approximate fair value.

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- Financial Guaranty Insurance Contracts (classified as Level 3 for fair value disclosure).

- Long-Term Debt (primarily classified as Level 2 for fair value disclosure).

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, 2018

		Fair Value Hierarchy		
	Fair Value	Level 1	Level 2	Level 3
	(in millions)			
Assets:				
Investment portfolio, available-for-sale(1):				
Fixed-maturity securities				
Obligations of state and political subdivisions	$5,289	$—	$5,197	$92
U.S. government and agencies	283	—	283	—
Corporate securities	1,983	—	1,920	63
Mortgage-backed securities:				
RMBS	844	—	533	311
Commercial mortgage-backed securities (CMBS)	546	—	546	—
Asset-backed securities	968	—	71	897
Non-U.S. government securities	312	—	312	—
Total fixed-maturity securities	10,225	—	8,862	1,363
Short-term investments	911	549	362	—
Other invested assets (2)	7	—	0	7
FG VIEs’ assets, at fair value (3)	627	—	—	627
Other assets(3)	124	25	40	59
Total assets carried at fair value	$11,894	$574	$9,264	$2,056
Liabilities:				
Credit derivative liabilities (3)	$258	$—	$—	$258
FG VIEs’ liabilities with recourse, at fair value (4)	571	—	—	571
FG VIEs’ liabilities without recourse, at fair value (3)	108	—	—	108
Total liabilities carried at fair value	$937	$—	$—	$937

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Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of December 31, 2017

		Fair Value Hierarchy		
	Fair Value	Level 1	Level 2	Level 3
	(in millions)			
Assets:				
Investment portfolio, available-for-sale(1):				
Fixed-maturity securities				
Obligations of state and political subdivisions	$5,760	$—	$5,684	$76
U.S. government and agencies	285	—	285	—
Corporate securities	2,018	—	1,951	67
Mortgage-backed securities:				
RMBS	861	—	527	334
CMBS	549	—	549	—
Asset-backed securities	896	—	109	787
Non-U.S. government securities	305	—	305	—
Total fixed-maturity securities	10,674	—	9,410	1,264
Short-term investments	627	464	162	1
Other invested assets (2)	7	—	0	7
FG VIEs' assets, at fair value (3)	700	—	—	700
Other assets(3)	123	25	36	62
Total assets carried at fair value	$12,131	$489	$9,608	$2,034
Liabilities:				
Credit derivative liabilities (3)	$271	$—	$—	$271
FG VIEs' liabilities with recourse, at fair value (3)	627	—	—	627
FG VIEs' liabilities without recourse, at fair value (3)	130	—	—	130
Total liabilities carried at fair value	$1,028	$—	$—	$1,028

(1) Change in fair value is included in OCI.

(2) Excludes investments of $41 million and $45 million as of June 30, 2018 and December 31, 2017, respectively, measured using NAV per share with fair value recorded in the condensed consolidated statements of operations. Includes Level 3 mortgage loans that are recorded at fair value on a non-recurring basis.

(3) Change in fair value is included in net income.

(4) Change in fair value attributable to ISCR is recorded in OCI with the remainder of the change in fair value recorded in net income.

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Changes in Level 3 Fair Value Measurements

The tables below present a roll forward of the Company’s Level 3 financial instruments carried at fair value on a recurring basis during Second Quarter 2018 and 2017 and Six Months 2018 and 2017.

Fair Value Level 3 Rollforward
Recurring Basis
Second Quarter 2018

	Fixed-Maturity Securities								
	Obligations of State and Political Subdivisions	Corporate Securities	RMBS	Asset-Backed Securities	FG VIEs’ Assets at Fair Value	Other (7)	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, 2018	$ 83	$ 62	$ 314	$ 809	$ 651	$ 62	$ (236)	$ (598)	$ (110)
Total pretax realized and unrealized gains/(losses) recorded in: (1)									
Net income (loss)	1 (2)	1 (2)	6 (2)	14 (2)	3 (3)	(1) (4)	48 (6)	(4) (3)	1 (3)
Other comprehensive income (loss)	8	0	(3)	6	—	0	—	4	—
Purchases	—	—	9	91	—	—	—	—	—
Issuances	—	—	—	—	—	—	(68) (9)	—	—
Settlements	—	—	(15)	(23)	(27)	—	(1)	27	1
Fair value as of June 30, 2018	$ 92	$ 63	$ 311	$ 897	$ 627	$ 61	$ (257)	$ (571)	$ (108)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2018	$ 8	$ 0	$ (2)	$ 6	$ 6 (3)	$ (1) (4)	$ 46 (6)	$ 2 (3)	$ 1 (3)

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Fair Value Level 3 Rollforward
Recurring Basis
Second Quarter 2017

	Fixed-Maturity Securities								
	Obligations of State and Political Subdivisions	Corporate Securities	RMBS	Asset-Backed Securities	FG VIEs' Assets at Fair Value	Other (8)	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, 2017	$42	$ 62	$402	$ 602	$ 781	$ 63	$ (350)	$ (721)	$ (134)
Total pretax realized and unrealized gains/(losses) recorded in: (1)									
Net income (loss)	1 (2)	1 (2)	20 (2)	11 (2)	11 (3)	2 (4)	(6) (6)	(2) (3)	(1) (3)
Other comprehensive income (loss)	(7)	0	(1)	51	—	0	—	—	—
Purchases	—	—	2	4	—	—	—	—	—
Settlements	—	—	(66)	(7)	(35)	—	(5)	34	4
Transfers into Level 3	55	—	—	—	—	—	—	—	—
Transfers out of Level 3	—	—	—	(5)	—	—	—	—	—
Fair value as of June 30, 2017	$91	$ 63	$357	$ 656	$ 757	$ 65	$ (361)	$ (689)	$ (131)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2017	$9	$ 0	$13	$ 51	$ 19 (3)	$ 2 (4)	$ (13) (6)	$ (2) (3)	$ (1) (3)

Fair Value Level 3 Rollforward
Recurring Basis
Six Months 2018

	Fixed-Maturity Securities								
	Obligations of State and Political Subdivisions	Corporate Securities	RMBS	Asset-Backed Securities	FG VIEs' Assets at Fair Value	Other (7)	Credit Derivative Asset (Liability), net (5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)								
	$76	$ 67	$334	$ 787	$ 700	$64	$ (269)	$ (627)	$ (130)

Fair value as of December 31, 2017									
Total pretax realized and unrealized gains/(losses) recorded in: (1)									
Net income (loss)	2 (2)	(4) (2)	13 (2)	29 (2)	4 (3)	(2) (4)	82 (6)	(4) (3)	2 (3)
Other comprehensive income (loss)	11	0	(10)	9	—	0	—	2	—
Purchases	4	—	9	100	—	—	—	—	—
Issuances	—	—	—	—	—	—	(68) (9)	—	—
Settlements	(1)	—	(35)	(28)	(60)	(1)	(2)	57	4
FG VIE deconsolidations	—	—	—	—	(17)	—	—	1	16
Fair value as of June 30, 2018	92	63	311	897	627	61	(257)	(571)	(108)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2018	11	0	(8)	10	10 (3)	(2) (4)	73 (6)	(1) (3)	1 (3)

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Fair Value Level 3 Rollforward
Recurring Basis
Six Months 2017

	Fixed-Maturity Securities								
	Obligations of State and Political Subdivisions	Corporate Securities	RMBS	Asset-Backed Securities	FG VIEs' Assets at Fair Value	Other (8)	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, 2016	$ 39	$ 60	$ 365	$ 805	$ 876	$ 65	$ (389)	$ (807)	$ (151)
MBIA UK Acquisition	—	—	—	7	—	—	—	—	—
Total pretax realized and unrealized gains/(losses) recorded in: (1)									
Net income (loss)	2 (2)	3 (2)	18 (2)	85 (2)	28 (3)	0 (4)	48 (6)	(11) (3)	(3) (3)
Other comprehensive income (loss)	(3)	0	26	58	—	0	—	—	—
Purchases	—	—	29	56	—	—	—	—	—
Settlements	(2)	—	(81)	(355)	(81)	—	(20)	78	8
FG VIE consolidations	—	—	—	—	21	—	—	—	(21)
FG VIE deconsolidations	—	—	—	—	(87)	—	—	51	36
Transfers into Level 3	55	—	—	—	—	—	—	—	—
Fair value as of June 30, 2017	$ 91	$ 63	$ 357	$ 656	$ 757	$ 65	$ (361)	$ (689)	$ (131)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2017	$ 13	$ 0	$ 26	$ 124	$ 40 (3)	$ 0 (4)	$ 12 (6)	$ (9) (3)	$ (3) (3)

(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 net investment income and other income.

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

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

(7) Included short-term investments, CCS and other invested assets.

(8) Included CCS and other invested assets.

(9) Relates to SGI Transaction. See Note 2, Assumption of Insured Portfolio and Business Combinations.

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Level 3 Fair Value Disclosures

Quantitative Information About Level 3 Fair Value Inputs
At June 30, 2018

Financial Instrument Description (1)	Fair Value at June 30, 2018 (in millions)	Significant Unobservable Inputs	Range	Weighted Average as a Percentage of Current Par Outstanding
Assets (2):				
Fixed-maturity securities:				
Obligations of state and political subdivisions	$ 92	Yield	4.5 %-42.6%	11.8%
Corporate securities	63	Yield	25.2%	
RMBS	311	CPR CDR Loss severity Yield	2.1 %-17.8% 1.5 %-7.1% 40.0 %-125.0% 5.1 %-7.9%	6.4% 5.4% 82.3% 6.0%
Asset-backed securities:				
Triple-X life insurance transactions	643	Yield	6.5 %-6.6%	6.6%
Collateralized loan obligations (CLO) /TruPS	199	Yield	3.2 %-4.9%	4.0%
Others	55	Yield	11.3%	
FG VIEs' assets, at fair value	627	CPR CDR Loss severity Yield	1.3 %-17.8% 1.3 %-23.2% 60.0 %-100.0% 4.1 %-10.1%	9.4% 5.7% 79.8% 6.7%
Other assets	58	Implied Yield Term (years)	5.7 %-6.3% 10 years	6.0%
Liabilities:				
Credit derivative liabilities, net	(257)	Year 1 loss estimates Hedge cost (in bps) Bank profit (in bps) Internal floor (in bps) Internal credit rating	0.0 %-43.0% 5.3 -78.8 8.3 -495.0 8.8 -30.0 AAA -CCC	2.0% 22.2 75.7 10.1 AA-
FG VIEs' liabilities, at fair value	(679)	CPR CDR Loss severity Yield	1.3 %-17.8% 1.3 %-23.2% 60.0 %-100.0% 3.8 %-10.1%	9.4% 5.7% 79.8% 5.4%

(1) Discounted cash flow is used as the primary valuation technique for all financial instruments listed in this table.

(2) Excluded several investments recorded in other invested assets with fair value of $7 million.

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Quantitative Information About Level 3 Fair Value Inputs
At December 31, 2017

Financial Instrument Description (1)	Fair Value at December 31, 2017 (in millions)	Significant Unobservable Inputs	Range	Weighted Average as a Percentage of Current Par Outstanding
Assets (2):				
Fixed-maturity securities:				
Obligations of state and political subdivisions	$ 76	Yield	4.5 %-40.8%	12.5%
Corporate securities	67	Yield	22.5%	
RMBS	334	CPR	1.3 %-17.4%	6.4%
		CDR	1.5 %-9.2%	5.9%
		Loss severity	40.0 %-125.0%	82.5%
		Yield	4.0 %-7.5%	5.6%
Asset-backed securities:				
Triple-X life insurance transactions	613	Yield	6.2 %-6.4%	6.3%
CLO/TruPS	116	Yield	2.6 %-4.6%	3.3%
Others	58	Yield	10.7%	
FG VIEs' assets, at fair value	700	CPR	3.0 %-14.9%	9.5%
		CDR	1.3 %-21.7%	5.4%
		Loss severity	60.0 %-100.0%	79.6%
		Yield	3.7 %-10.0%	6.2%
Other assets	60	Implied Yield	5.2 %-5.9%	5.5%
		Term (years)	10 years	
Liabilities:				
Credit derivative liabilities, net	(269)	Year 1 loss estimates	0.0 %-42.0%	3.3%
		Hedge cost (in bps)	17.6 -122.6	48.1
		Bank profit (in bps)	6.0 -852.5	107.5
		Internal floor (in bps)	8.0 -30.0	21.8
		Internal credit rating	AAA -CCC	AA-
FG VIEs' liabilities, at fair value	(757)	CPR	3.0 %-14.9%	9.5%
		CDR	1.3 %-21.7%	5.4%
		Loss severity	60.0 %-100.0%	79.6%
		Yield	3.4 %-10.0%	4.9%

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(1) Discounted cash flow is used as the primary valuation technique for all financial instruments listed in this table.

(2) Excluded short-term investments with fair value of $1 million and several investments recorded in other invested assets with fair value of $7 million.

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

Fair Value of Financial Instruments

	As of June 30, 2018		As of December 31, 2017	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in millions)			
Assets:				
Fixed-maturity securities	$10,225	$ 10,225	$10,674	$ 10,674
Short-term investments	911	911		