ASSURED GUARANTY LTD
Form 10-Q
November 07, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2006

OR

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

transition Period from to

Commission File No. 001-32141

ASSURED GUARANTY LTD.

(Exact name of registrant as specified in its charter)

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 office)

(441) 299-9375
(Registrants telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES x NO o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

The number of registrant s Common Shares ($0.01 par value) outstanding as of November 1, 2006 was 73,147,882.

ASSURED GUARANTY LTD.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

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

	September 30, 2006	December 31, 2005
Assets		
Fixed maturity securities, at fair value (amortized cost: $2,163,089 in 2006 and $2,082,363 in 2005)	$ 2,210,011	$ 2,133,997
Short-term investments, at cost which approximates fair value	169,430	115,826
Total investments	**2,379,441**	**2,249,823**
Cash and cash equivalents	15,656	6,190
Accrued investment income	22,569	22,676
Deferred acquisition costs	210,184	193,442
Prepaid reinsurance premiums	8,956	12,478
Reinsurance recoverable on ceded losses	9,397	12,350
Premiums receivable	33,280	33,011
Goodwill	85,417	85,417
Unrealized gains on derivative financial instruments	51,135	53,037
Current income taxes receivable	6,853	3,005
Other assets	21,961	17,694
Total assets	**$ 2,844,849**	**$ 2,689,123**
Liabilities and shareholders equity		
Liabilities		
Unearned premium reserves	$ 619,737	$ 537,149
Reserves for losses and loss adjustment expenses	116,914	121,219
Profit commissions payable	30,979	52,993
Reinsurance balances payable	2,069	3,724
Deferred income taxes	44,855	26,629
Funds held by Company under reinsurance contracts	20,338	19,186
Unrealized losses on derivative financial instruments	6,599	12,652
Long-term debt	197,367	197,344
Liability for tax basis step-up adjustment	15,177	20,129
Other liabilities	33,923	36,585
Total liabilities	**1,087,958**	**1,027,610**
Commitments and contingencies		
Shareholders equity		
Common stock ($0.01 par value, 500,000,000 shares authorized; 73,144,785 and 74,761,577 shares issued and outstanding in 2006 and 2005)	731	748
Additional paid-in capital	856,243	881,998
Unearned stock grant compensation		(14,756)
Retained earnings	857,121	747,691
Accumulated other comprehensive income	42,796	45,832
Total shareholders equity	**1,756,891**	**1,661,513**
Total liabilities and shareholders equity	**$ 2,844,849**	**$ 2,689,123**

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

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

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Revenues				
Gross written premiums	$ 73,634	$ 75,567	$ 240,502	$ 194,134
Ceded premiums	(560)	(22,337)	(6,299)	(34,279)
Net written premiums	73,074	53,230	234,203	159,855
(Increase) decrease in net unearned premium reserves	(21,127)	1,315	(86,017)	(8,956)
Net earned premiums	**51,947**	**54,545**	**148,186**	**150,899**
Net investment income	28,472	24,378	81,965	71,178
Net realized investment gains (losses)	72	178	(1,939)	3,635
Unrealized (losses) gains on derivative financial instruments	(1,591)	286	4,151	(9,144)
Other income	1	147	24	240
Total revenues	**78,901**	**79,534**	**232,387**	**216,808**
Expenses				
Loss and loss adjustment expenses	888	(790)	(6,007)	(69,319)
Profit commission expense	1,649	2,037	4,654	6,369
Acquisition costs	11,348	13,004	33,441	34,933
Other operating expenses	16,495	14,961	49,260	43,956
Interest expense	3,364	3,440	10,106	10,146
Other expense	611	623	1,917	3,111
Total expenses	**34,355**	**33,275**	**93,371**	**29,196**
Income before provision for income taxes	44,546	46,259	139,016	187,612
Provision for income taxes				
Current	(2,873)	1,003	5,935	52,471
Deferred	9,517	6,071	15,783	(15,142)
Total provision for income taxes	**6,644**	**7,074**	**21,718**	**37,329**
Net income	**37,902**	**39,185**	**117,298**	**150,283**
Other comprehensive income (loss), net of taxes				
Unrealized holding gains (losses) on fixed maturity securities arising during the year	37,965	(24,339)	(4,133)	(22,850)
Reclassification adjustment for realized (gains) losses included in net income	(26)	(107)	1,411	(2,853)
Change in net unrealized gains on fixed maturity securities	37,939	(24,446)	(2,722)	(25,703)
Cash flow hedge	(105)	(105)	(314)	(314)
Other comprehensive income (loss), net of taxes	**37,834**	**(24,551)**	**(3,036)**	**(26,017)**
Comprehensive income	**$ 75,736**	**$ 14,634**	**$ 114,262**	**$ 124,266**
Earnings per share:				
Basic	$ 0.52	$ 0.53	$ 1.60	$ 2.03
Diluted	$ 0.51	$ 0.53	$ 1.57	$ 2.02
Dividends per share	$ 0.035	$ 0.03	$ 0.105	$ 0.09

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

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

	Common Stock	Additional Paid-in Capital	Unearned Stock Grant Compensation	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders Equity
Balance, December 31, 2005	**$ 748**	**$ 881,998**	**$ (14,756)**	**$ 747,691**	**$ 45,832**	**$ 1,661,513**
Net income				117,298		117,298
Dividends ($0.105 per share)				(7,868)		(7,868)
Common stock repurchases	(8)	(20,527)				(20,535)
Shares cancelled to pay withholding taxes	(1)	(2,891)				(2,892)
Stock option exercises		947				947
Tax benefit for stock options exercised		147				147
Shares issued under Employee Stock Purchase Plan		236				236
Reclassification due to adoption of FAS 123R	(10)	(14,746)	14,756			
Share-based compensation and other	2	11,079				11,081
Cash flow hedge, net of tax of $(169)					(314)	(314)
Unrealized loss on fixed maturity securities, net of tax of $(262)					(2,722)	(2,722)
Balance, September 30, 2006	**$ 731**	**$ 856,243**	**$**	**$ 857,121**	**$ 42,796**	**$ 1,756,891**

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

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

	Nine Months Ended September 30, 2006	2005
Operating activities		
Net income	$ 117,298	$ 150,283
Adjustments to reconcile net income to net cash flows provided by operating activities:		
Non-cash interest and operating expenses	11,600	5,138
Net amortization of premium on fixed maturity securities	4,333	5,206
Provision (benefit) for deferred income taxes	15,783	(15,142)
Net realized investment losses (gains)	1,939	(3,635)
Change in unrealized (gains) losses on derivative financial instruments	(4,151)	9,144
Change in deferred acquisition costs	(16,742)	(3,680)
Change in accrued investment income	107	(757)
Change in premiums receivable	(269)	7,450
Change in prepaid reinsurance premiums	3,522	2,310
Change in unearned premium reserves	82,588	6,654
Change in reserves for losses and loss adjustment expenses, net	(3,007)	(19,522)
Change in profit commissions payable	(22,014)	(14,368)
Change in funds held by Company under reinsurance contracts	1,152	4,357
Change in current income taxes	(3,848)	16,957
Tax benefit for stock options exercised		4,059
Change in liability for tax basis step-up adjustment	(4,952)	(559)
Other	(1,756)	11,279
Net cash flows provided by operating activities	**181,583**	**165,174**
Investing activities		
Fixed maturity securities:		
Purchases	(694,810)	(799,385)
Sales	591,517	525,278
Maturities	16,295	14,000
(Purchases) sales of short-term investments, net	(53,878)	113,023
Net cash flows used in investing activities	**(140,876)**	**(147,084)**
Financing activities		
Repurchases of common stock	(20,535)	(19,014)
Dividends paid	(7,858)	(6,768)
Share activity under option and incentive plans	(1,709)	(1,169)
Tax benefit for stock options exercised	147	
Repayment of notes assumed during formation transactions	(2,000)	
Net cash flows used in financing activities	**(31,955)**	**(26,951)**
Effect of exchange rate changes	714	(1,052)
Increase (decrease) in cash and cash equivalents	9,466	(9,913)
Cash and cash equivalents at beginning of period	6,190	16,978
Cash and cash equivalents at end of period	**$ 15,656**	**$ 7,065**
Supplementary cash flow information		

Cash paid during the period for:		
Income taxes	$ 10,840	$ 31,614
Interest	$ 7,081	$ 7,000

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

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Assured Guaranty Ltd.
Notes to Consolidated Financial Statements
September 30, 2006
(Unaudited)

1. Business and Organization

Assured Guaranty Ltd. (the Company) is a Bermuda-based holding company which provides, through its operating subsidiaries, credit enhancement products to the public finance, structured finance and mortgage markets. Credit enhancement products are financial guarantees or other types of support, including credit derivatives, that improve the credit of underlying debt obligations. Assured Guaranty Ltd. applies its credit expertise, risk management skills and capital markets experience to develop insurance, reinsurance and derivative products that meet the credit enhancement needs of its customers. Under a reinsurance agreement, the reinsurer, in consideration of a premium paid to it, agrees to indemnify another insurer, called the ceding company, for part or all of the liability of the ceding company under one or more insurance policies that the ceding company has issued. A derivative is a financial instrument whose characteristics and value depend upon the characteristics and value of an underlying asset. Assured Guaranty Ltd. markets its products directly to and through financial institutions, serving the U.S. and international markets. Assured Guaranty Ltd. s financial results include four principal business segments: financial guaranty direct, financial guaranty reinsurance, mortgage guaranty and other. These segments are further discussed in Note 12.

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

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

The Company has participated in several lines of business that are reflected in its historical financial statements but that the Company exited in connection with its 2004 initial public offering (IPO), including, but not limited to, equity layer credit protection, trade credit reinsurance and title reinsurance. These lines of business make up the Company s other segment.

2. Basis of Presentation

The unaudited interim consolidated financial statements, which include the accounts of the Company, have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and, in the opinion of management, reflect all adjustments, necessary for a fair presentation of the Company s financial condition, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim consolidated financial statements cover the three-month period ended September 30, 2006 (Third Quarter 2006) and the three-month period ended September 30, 2005 (Third Quarter 2005), and the nine-month period ended September 30, 2006 (Nine Months 2006) and the nine-month period ended September 30, 2005 (Nine Months 2005). Operating results for the three- and nine-month periods ended September 30, 2006 are not necessarily indicative of the results that may be expected for the full year. Certain items in the prior year unaudited interim consolidated financial statements have been reclassified to conform with the current period presentation. These unaudited interim consolidated financial statements should be read in conjunction with the Company s consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005, filed with the Securities and Exchange Commission.

Certain of the Company s subsidiaries are subject to U.S. income tax. The provision for income taxes is calculated in accordance with Statement of Financial Accounting Standards (FAS) FAS No. 109, Accounting for Income Taxes . The Company s provision for income taxes for interim financial periods is not based on an estimated annual effective rate due to the variability in changes in fair value of its derivative financial instruments. A discrete calculation of the provision is calculated for each interim period.

3. Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board (FASB) issued FAS No. 155, Accounting for Certain Hybrid Financial Instruments (FAS 155) which amends FAS No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133) and FAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 140), and addresses issues raised in FAS 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. The primary objectives of FAS 155 are: (i) with respect to FAS 133, to address the accounting for beneficial interests in securitized financial assets and (ii) with respect to FAS 140, eliminate a restriction on the passive derivative instruments that a qualifying special purpose entity may hold. FAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The adoption of FAS 155 is not expected to have a material impact on the Company s operating results or financial condition.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is assessing FIN 48 and is determining the impact that the adoption of FIN 48 will have on its results of operations or financial position.

In September 2006, the FASB issued FAS No. 157, Fair Value Measurements (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FAS 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, FAS 157 does not require any new fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company plans to adopt FAS 157 beginning in the first quarter of 2008. The Company is currently evaluating the impact, if any, the adoption of FAS 157 will have on its results of operations or financial position.

In October 2006, the FASB issued FAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R) (FAS 158). FAS 158 represents the completion of the first phase in the FASB s postretirement benefits accounting project. FAS 158 is effective for fiscal years ending after December 15, 2006, for public entities, and at the end of fiscal years ending after June 15, 2007, for all other entities. Since the Company has no defined benefit pension or other postretirement plans, FAS 158 will have no impact on the Company s results of operations or financial position.

4. Significant Accounting Policies

The Company has disclosed its significant accounting policies in Note 2: Significant Accounting Policies in the Notes to Consolidated Financial Statements included in the Company s Form 10-K for the year ended December 31, 2005. The following significant accounting policy provides an update to that included under the same caption in the Company s Form 10-K.

Premium Revenue Recognition

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

Due to the customary lag (ranging from 30 to 90 days) in reporting premium data by some of the ceding companies, the Company must estimate the ultimate written and earned premiums to be received from a ceding company as of each balance sheet date for the reinsurance business. Actual written premiums reported in the consolidated statements of operations and comprehensive income are based upon reports received by ceding companies supplemented by the Company s own estimates of premium for which ceding company reports have not yet been received. Differences between such estimates and actual amounts are recorded in the period in which the actual amounts are determined.

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

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

In the event that any or all of the reinsurers are unable to meet their obligations, the Company would be liable for such defaulted amounts. Direct, assumed, and ceded amounts were as follows:

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
	(in thousands of U.S. dollars)			
Premiums Written				
Direct	$ 41,880	$ 24,891	$ 140,546	$ 69,588
Assumed	31,754	50,676	99,956	124,546
Ceded	(560)	(22,337)	(6,299)	(34,279)
Net	$ 73,074	$ 53,230	$ 234,203	$ 159,855
Premiums Earned				
Direct	$ 22,166	$ 19,085	$ 65,281	$ 57,121
Assumed	33,715	58,714	92,718	130,374
Ceded	(3,934)	(23,254)	(9,813)	(36,596)
Net	$ 51,947	$ 54,545	$ 148,186	$ 150,899
Loss and Loss Adjustment Expenses				
Direct	$ (1,299)	$ (5,127)	$ (16,974)	$ (2,491)
Assumed	1,581	8,694	12,123	(71,880)
Ceded	606	(4,357)	(1,156)	5,052
Net	$ 888	$ (790)	$ (6,007)	$ (69,319)

The increase in direct written premiums for both periods is primarily attributable to upfront gross written premiums from our international and U.S. public finance business. Third Quarter 2006 and Nine Months 2006 include upfront gross written premiums of $13.3 million and $53.0 million from our international business. Third Quarter 2005 and Nine Months 2005 did not include any such premiums. Our U.S. public finance business contributed $8.2 million in Third Quarter 2006 and $22.7 million Nine Months 2006 compared with $6.3 million and $13.0 million for the same periods last year.

Assumed written premiums decreased in Third Quarter 2006 compared with Third Quarter 2005 and Nine Months 2006 compared with Nine Months 2005 as both Third Quarter 2005 and Nine Months 2005 include $21.0 million and $25.8 million, respectively, of assumed written premium for a pre-IPO reinsurance agreement with a subsidiary of ACE Limited (ACE), our former parent, under which we provided reinsurance to CGA Group Ltd. (CGA) and retroceded 100% of this exposure to the ACE subsidiary. This transaction is included in our other segment results. Excluding this transaction, assumed written premiums increased in Third Quarter 2006 when compared with Third Quarter 2005 due to increased facultative business and Nine Months 2006 remained relatively flat when compared with Nine Months 2005. Assumed written premiums from treaty business have remained relatively flat, though one cedant relationship was terminated effective July 1, 2004 and a second cedant relationship was terminated effective July 1, 2006, partially offset by increased gross written premium from another client. Additionally, Nine Months 2005 includes $16.3 million of assumed written premium due to a large excess of loss reinsurance transaction written in our mortgage guaranty segment. Nine Months 2005 also includes $(18.4) million from a transaction whereby Financial Security Assurance Inc. (FSA) reassumed from Assured Guaranty Re Ltd. (AG Re) healthcare related business (FSA transaction).

Ceded premiums written and ceded premiums earned for Third Quarter 2005 and Nine Months 2005 include $21.0 million and $25.8 million from the pre-IPO reinsurance agreement discussed above.

Loss and loss adjustment expenses (LAE) were $0.9 million and $(6.0) million for Third Quarter 2006 and Nine Months 2006, respectively, compared with $(0.8) million in Third Quarter 2005 and $(69.3) million in Nine Months 2005. Included in direct loss and LAE for Third Quarter 2006 are $(0.3) million in loss recoveries on two deals and $(1.0) million of loss recoveries from third party litigation settlements related to the equity layer credit protection business, which was exited in connection with the IPO. Third Quarter 2005 includes a reduction to loss

reserves of $(4.0) million caused by changes in credit quality and from continued runoff from maturing collateralized debt obligation (CDO) exposures and $(1.3) million of loss recoveries from third party litigation settlements related to the exited equity layer credit protection business.

Assumed loss and LAE for Third Quarter 2006 includes additions to portfolio reserves of $3.0 million primarily due to management updating its loss reserving data to include the most current rating agency default frequency statistics as well as ratings migration. This is part of our normal portfolio reserve process which we perform during the third quarter of every year. The increase in portfolio reserves was partially offset by a $(1.1) million LAE recovery. Assumed loss and LAE for Third Quarter 2005 includes an increase to loss reserves of $4.3 million due to credit deteriorations and development of existing exposure, as well as management updating its rating agency default statistics used in the portfolio loss reserving process. In addition, both assumed and ceded loss and LAE amounts include $4.4 million primarily from the pre-IPO reinsurance agreement with a subsidiary of ACE under which we provided reinsurance to CGA and retroceded 100% of this exposure to the ACE subsidiary. This transaction is included in our other segment results.

Direct loss and LAE for Nine Months 2006 includes $(12.3) million in loss recoveries from third party litigation settlements relating to our exited equity layer credit protection business. In addition to Third Quarter 2005 amounts, assumed loss and LAE includes loss reserve increases of $7.9 million related to the rating downgrade of various credits. The major component of Nine Months 2005 is $(71.0) million in assumed loss and LAE resulting from loss recoveries from a third party settlement agreement that was reached during Second Quarter 2005, with two parties relating to a reinsurance claim incurred in 1998 and 1999.

Reinsurance recoverable on ceded losses and LAE as of September 30, 2006 and December 31, 2005 were $9.4 million and $12.4 million, respectively and are all related to our other segment. Of these amounts, $9.3 million and $12.3 million, respectively, relate to reinsurance agreements with ACE.

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

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
Gross Written Premiums by Client	**2006**	**2005**	**2006**	**2005**
	($ in millions)			
Financial Security Assurance Inc.(1)	$ 15.8	$ 13.4	$ 41.5	$ 38.3
Ambac Assurance Corporation(2)	5.0	6.9	19.8	26.0
Financial Guaranty Insurance Company	4.3	2.0	17.2	7.6
MBIA Insurance Corporation	3.3	4.6	9.1	13.5
CGA Group Ltd.		21.0		25.8

(1) Nine Months 2005 does not include $18.4 million of reassumed premiums related to the Company s healthcare business.

(2) On April 20, 2005, Ambac provided notice of a non-renewal of the quota share treaty on a run-off basis, effective July 1, 2006.

Agreement with Financial Security Assurance Inc.

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

FSA has released AGC from all liabilities with respect to the Ceded Business. AG Re has assumed substantially all of AGC s

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liabilities with respect to the Ceded Business. FSA may receive a profit commission on the Ceded Business based on its future performance.

FSA has also reassumed from AG Re during Second Quarter 2005, approximately $12.4 million of unearned premium reserves, net of ceding commissions, of healthcare related business with an approximate par value of $820.0 million.

6. Commitments and Contingencies

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

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

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

During 2006, the Company s wholly owned subsidiary, Assured Guaranty Re Overseas Ltd. (AGRO), and a number of other parties, completed various settlements with defendants in the *In re: National Century Financial Enterprises Inc. Investment Litigation* now pending in the United States District Court for the Southern District of Ohio - Eastern District. AGRO received approximately $12.3 million (pre-tax) in the Nine Months 2006, from the settlements. AGRO originally paid claims in 2003 of approximately $41.7 million (pre-tax) related to National Century Financial Enterprises Inc. To date, including the settlements described above, the Company has recovered $17.6 million (pre-tax), representing a partial settlement of the litigation. The litigation will continue against other parties.

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

7. Long-Term Debt and Credit Facilities

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

Senior Notes

On May 18, 2004, Assured Guaranty US Holdings Inc., a subsidiary of the Company, issued $200.0 million of 7.0% Senior Notes due 2034 for net proceeds of $197.3 million. The proceeds of the offering were used to repay substantially all of a $200.0 million promissory note issued to a subsidiary of ACE in April 2004 as part of the IPO related formation transactions. The coupon on the Senior Notes is 7.0%, however, the effective rate will be approximately 6.4%, taking into account the effect of a cash flow hedge executed by the Company in March 2004. The Company recorded interest expense of $3.3 million, including $0.2 million of amortized gain on the cash flow hedge, for both Third Quarter 2006 and Third Quarter 2005. The Company recorded interest expense of $10.0 million, including $0.5 million of amortized gain on the cash flow hedge, for both Nine Months 2006 and Nine Months 2005. These Senior Notes are fully and unconditionally guaranteed by Assured Guaranty Ltd.

Credit Facilities

$300.0 million Credit Facility

On April 15, 2005, Assured Guaranty Ltd. and certain of its subsidiaries entered into a $300.0 million three-year unsecured revolving credit facility (the $300.0 million credit facility) with a syndicate of banks, for which ABN AMRO Incorporated and Bank of America, N.A. acted as lead arrangers and KeyBank National Association (KeyBank) acted as syndication agent. Under the $300.0 million credit facility, each of AGC, Assured Guaranty (UK) Ltd. (AG (UK)), a subsidiary of AGC organized under the laws of the United Kingdom, Assured Guaranty Ltd., AG Re and AGRO are entitled to request the banks to make loans to such borrower or to request that letters of credit be issued for the account of such borrower. As of September 30, 2006 and December 31, 2005, two letters of credit have been issued, both on behalf of AGRO, with an aggregate stated amount of approximately $19.2 million and $20.7 million, respectively.

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

At the closing of the $300.0 million credit facility, (i) AGC guaranteed the obligations of AG (UK) under such facility, (ii) Assured Guaranty Ltd. guaranteed the obligations of AG Re and AGRO under such facility and agreed that, if the Company Consolidated Assets (as defined in the related credit agreement) of AGC and its subsidiaries were to fall below $1.2 billion, it would, within 15 days, guarantee the obligations of AGC and AG (UK) under such facility and (iii) Assured Guaranty Overseas US Holdings Inc., as a Material Non-AGC Subsidiary (as defined in the related credit agreement), guaranteed the obligations of Assured Guaranty Ltd., AG Re and AGRO under such facility. Subsequently, AG Re and AGRO, as Material Non-AGC Subsidiaries, both guaranteed the obligations of the other and of Assured Guaranty Ltd. under such facility.

The $300.0 million credit facility s financial covenants require that Assured Guaranty Ltd. (a) maintain a minimum net worth of $1.2 billion, (b) maintain an interest coverage ratio of at least 2.5:1, and (c) maintain a maximum debt-to-capital ratio of 30%. In addition, the $300.0 million credit facility requires that AGC: (x) maintain qualified statutory capital of at least 80% of its statutory capital as of the fiscal quarter prior to the closing date of the facility and (y) maintain a ratio of aggregate net par outstanding to qualified statutory capital of not more than 150:1. Furthermore, the $300.0 million credit facility contains restrictions on Assured Guaranty Ltd. and its subsidiaries, including, among other things, in respect of their ability to incur debt, permit liens, become liable in respect of guaranties, make loans or investments, pay dividends or make distributions, dissolve or become party to a merger, consolidation or acquisition, dispose of assets or enter into affiliate transactions. Most of these restrictions are subject to certain minimum thresholds and exceptions. A default by one borrower will give rise to a right of the lenders to terminate the facility and accelerate all amounts then outstanding. As of September 30, 2006 and December 31, 2005, Assured Guaranty was in compliance with all of those financial covenants.

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

Non-Recourse Credit Facility

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

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

Committed Capital Securities

On April 8, 2005, AGC entered into four separate agreements with four different unaffiliated custodial trusts pursuant to which AGC may, at its option, cause each of the custodial trusts to purchase up to $50.0 million of perpetual preferred stock of AGC. The custodial trusts were created to provide capital support to AGC by allowing AGC to obtain immediate access to new capital at its sole discretion at any time through the exercise of the put option. If the put options were exercised, AGC would receive $200.0 million in return for the issuance of its own perpetual preferred stock, the proceeds of which may be used for any purpose including the payment of claims. The put options were not exercised as of September 30, 2006. Initially, all of the committed capital securities (the CCS Securities) were issued to a special purpose pass-through trust (the Pass-Through Trust). The Pass-Through Trust is a newly created statutory trust organized under the Delaware Statutory Trust Act formed for the purposes of (i) issuing $200,000,000 of Pass-Through Trust Securities to qualified institutional buyers within the meaning of Rule 144A under the Securities Act of 1933, as amended, (ii) investing the proceeds from the sale of the Pass-Through Trust Securities in, and holding, the CCS Securities issued by the Custodial Trusts and (iii) entering into related agreements. Neither the Pass-Through Trust nor the Custodial Trusts are consolidated in Assured Guaranty Ltd. s financial statements.

During Third Quarter 2006 and Nine Months 2006, AGC incurred $0.6 million and $1.9 million, respectively, of put option premiums which are an on-going expense. During Third Quarter 2005 and Nine Months 2005, the Company incurred $0.6 million and $3.1 million, respectively. Nine Months 2005 expense consists of $2.0 million of investment banking fees associated with the committed capital securities and put option premiums which are an on-going expense. These expenses are presented in the Company s unaudited interim consolidated statements of operations and comprehensive income under other expense.

8. Share-Based Compensation

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

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

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

Beginning January 1, 2006, upon adoption of FAS 123R, the Company recorded share-based compensation for the cost of stock options, restricted stock and the Company sponsored employee stock purchase plan. As a result of adopting FAS 123R on January 1, 2006, the Company s Third Quarter 2006 income before income taxes and net income are $1.4 million and $1.1 million lower, respectively, and for Nine Months 2006 are $4.5 million and $3.6 million lower, respectively, than if it had continued to account for share-based compensation under APB 25. Basic and diluted earnings per share for Third Quarter 2006 and Nine Months 2006 are $0.01 and $0.05 lower, respectively, than if the Company had continued to account for share-based compensation under APB 25.

Share-based compensation expense in Third Quarter 2006 and Nine Months 2006 was $3.0 million ($2.5 million after tax) and $9.3 million ($7.7 million after tax), respectively. The effect on basic and diluted earnings per share for Third Quarter 2006 and Nine Months 2006 was $0.03 and $0.10, respectively. Included in Third Quarter 2006 and Nine Months 2006 expense was $0.5 million and $1.7 million, respectively, for stock award grants to retirement-eligible employees. FAS 123R requires these awards to be expensed over the period through the date the employee first becomes eligible to retire and is no longer required to provide service to earn part or all of the award, regardless of the employees intent of retirement. The amount of share-based compensation capitalized in Third Quarter 2006 and Nine Months 2006 as deferred acquisition costs (DAC) was $0.5 million and $1.8 million, respectively. Share-based compensation expense in Third Quarter 2005 and Nine Months 2005 was $1.6 million ($1.4 million after tax) and $4.7 million ($4.1 million after tax), respectively.

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

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(in thousands of U.S. dollars)	**2006**	**2005**	**2006**	**2005**
Share-Based Employee Cost				
Restricted Stock				
Recurring amortization	$ 1,913	$ 1,410	$ 5,677	$ 3,971
Accelerated amortization for retirement eligible employees	364		1,171	
Subtotal	2,277	1,410	6,848	3,971
Stock Options				
Recurring amortization	823		2,776	
Accelerated amortization for retirement eligible employees	150		505	
Subtotal	973		3,281	
ESPP	30		94	
Total Share-Based Employee Cost	**3,280**	**1,410**	**10,223**	**3,971**
Share-Based Directors Cost				
Restricted Stock	75	61	214	211
Restricted Stock Units	223	171	636	478
Total Share-Based Directors Cost	**298**	**232**	**850**	**689**
Total Share-Based Cost	**$ 3,578**	**$ 1,642**	**$ 11,073**	**$ 4,660**

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

(in thousands of U.S. dollars, except per share amounts)	Three Months Ended September 30, 2005		Nine Months Ended September 30, 2005	
Net income as reported	$	39,185	$	150,283
Add: Stock-based compensation expense included in reported net income, net of income tax	1,426		4,079	
Deduct: Compensation expense, in accordance with FAS 123, net of income tax	2,243		6,944	
Pro forma net income	$	38,368	$	147,418
Basic Earnings Per Share:				
As reported	$	0.53	$	2.03
Pro forma	$	0.52	$	1.99
Diluted Earnings Per Share:				
As reported	$	0.53	$	2.02
Pro forma	$	0.52	$	1.98

Assured Guaranty Ltd. Share-Based Compensation Plans

As of April 27, 2004, the Company adopted the Assured Guaranty Ltd. 2004 Long-Term Incentive Plan (the Incentive Plan). The Incentive Plan authorizes the grant of incentive stock options, non-qualified stock options, stock appreciation rights, and full value awards that are based on the Company s common shares. The number of common shares that may be delivered under the Incentive Plan may not exceed 7,500,000. As of September 30, 2006, 2,740,977 common shares were available for grant under the Incentive Plan. In January 2005, the Company implemented the Stock Purchase Plan (Stock Purchase Plan) in accordance with Internal Revenue Code Section 423. The Company reserved for issuance and purchases under the Stock Purchase Plan 100,000 shares of its common stock. As of September 30, 2006, 69,563 common shares were available for grant under the Stock Purchase Plan. The Incentive Plan and the Stock Purchase Plan are described more fully in the Company s 2005 Annual Report on Form 10-K.

Stock Options

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

Options	Options for Common Shares		Weighted Average Exercise Price		Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value(1)	
						(in thousands)	
Outstanding at December 31, 2005	2,457,302		$	18.05			
Granted	790,967		$	25.49			
Exercised	(53,111	)	$	17.84			
Forfeited	(91,994	)	$	20.51			
Outstanding at September 30, 2006	3,103,164		$	19.87	8.0	$	18,805
Vested and exercisable at September 30, 2006	1,353,813		$	18.00	7.3	$	10,731

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(1) The aggregate intrinsic value was calculated based on the positive difference between the closing price of the Company s common stock on September 30, 2006 (i.e. $25.93) and the weighted average exercise price of the underlying options.

The Company recorded $1.0 million ($0.8 million after tax) and $3.3 million ($2.5 million after tax) in share-based compensation related to stock options during Third Quarter 2006 and Nine Months 2006, respectively. As of September 30, 2006 the total unrecognized compensation expense related to outstanding non-vested stock options was $4.2 million, which will be adjusted in the future for the difference between estimated and actual forfeitures. The Company expects to recognize that expense over the weighted-average remaining service period of 1.3 years.

The weighted-average grant-date fair value of options granted were $6.65 and $5.92 for Third Quarter 2006 and Third Quarter 2005, respectively. The weighted-average grant-date fair value of options granted were $6.71 and $4.63 for Nine Months 2006 and Nine Months 2005, respectively. The fair value of options issued is estimated on the date of grant using the Black-Scholes option-pricing model, with the following weighted-average assumptions used for grants in 2006 and 2005:

	Three Months Ended September 30,				**Nine Months Ended September 30,**			
	2006		**2005**		**2006**		**2005**	
Dividend yield	0.6	%	0.5	%	0.5	%	0.7	%
Expected volatility	19.82	%	20.60	%	20.43	%	20.80	%
Risk free interest rate	4.9	%	4.2	%	4.6	%	4.1	%
Expected life	5 years		5 years		5 years		5 years	
Forfeiture rate	6.0	%	6.0	%	6.0	%	6.0	%

These assumptions were based on the following:

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

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

The total intrinsic value of options exercised during Nine Months 2006 was $0.4 million. During Nine Months 2006, $0.9 million was received from the exercise of stock options and $0.1 million related tax benefit was recorded as financing cash flow in the statement of cash flows. During Nine Months 2005, the Company recorded $4.1 million in benefits for tax deductions in excess of recognized compensation expense, which was reported as operating cash flow in the statement of cash flows. The Company has a policy of issuing new shares to satisfy stock option exercises.

Restricted Stock Awards

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

Nonvested Shares	Number of Shares		Weighted Average Grant-Date Fair Value	
Nonvested at December 31, 2005	1,021,124		$	18.12
Granted	457,033		$	25.48
Vested	(283,138	)	$	18.06
Forfeited	(52,061	)	$	20.04
Nonvested at September 30, 2006	1,142,958		$	20.99

The Company recorded $2.4 million ($1.9 million after tax) and $7.1 million ($5.6 million after tax) in share-based compensation, related to restricted stock awards, during Third Quarter 2006 and Nine Months 2006, respectively. Restricted stock awards are expensed on a straight-line basis over the vesting period. As of September 30, 2006 the total unrecognized compensation cost related to outstanding nonvested restricted stock awards was $18.0 million, which the Company expects to recognize over the weighted-average remaining service period of 2.2 years.

Restricted Stock Units

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

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

Nonvested Stock Units	Number of Stock Units		Weighted Average Grant-Date Fair Value	
Nonvested at December 31, 2005	36,301		$	20.25
Granted	34,030		$	24.39
Vested	(36,301	)	$	20.25
Forfeited				
Nonvested at September 30, 2006	34,030		$	24.39

The Company recorded $0.2 million ($0.2 million after tax) and $0.6 million ($0.6 million after tax) in share-based compensation during Third Quarter 2006 and Nine Months 2006, respectively. The compensation for restricted stock units is expensed on a straight-line basis over the vesting period. As of September 30, 2006, the total unrecognized compensation cost related to outstanding nonvested restricted stock units was $0.5 million, which the Company expects to recognize over the weighted-average remaining service period of 0.6 years.

Employee Stock Purchase Plan

Participation in the Stock Purchase Plan is available to all eligible employees. Maximum annual purchases by participants are limited to the number of whole shares that can be purchased by an amount equal to 10 percent of the participant s compensation or, if less, shares having a value of $25,000. Participants may purchase shares at a purchase price equal to 85 percent of the lesser of the fair market value of the stock on the first day or the last day of the subscription period. The Company recorded $30,000 ($22,000 after tax) and $94,000 ($67,000 after tax) in share-based compensation during Third Quarter 2006 and Nine Months 2006, respectively.

9. Earnings Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
	(in thousands of U.S. dollars, except per share amounts)			
Net income as reported	$ 37,902	$ 39,185	$ 117,298	$ 150,283
Basic shares	73,187	73,868	73,523	74,044
Effect of dilutive securities:				
Stock awards	982	583	960	436
Diluted shares	74,169	74,451	74,483	74,480
Basic EPS	$ 0.52	$ 0.53	$ 1.60	$ 2.03
Diluted EPS	$ 0.51	$ 0.53	$ 1.57	$ 2.02

10. Liability For Tax Basis Step-Up Adjustment

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

As a result of the election, the Company has adjusted its net deferred tax liability, to reflect the new tax basis of the Company s affected assets. The additional basis is expected to result in increased future income tax deductions and, accordingly, may reduce income taxes otherwise payable by the Company. Any tax benefit realized by the Company will be paid to AFS. Such tax benefits will generally be calculated by comparing the Company s affected subsidiaries actual taxes to the taxes that would have been owed by those subsidiaries had the increase in basis not occurred. After a 15-year period, to the extent there remains an unrealized tax benefit, the Company and AFS will negotiate a settlement of the unrealized benefit based on the expected realization at that time.

The Company initially recorded a $49.0 million reduction of its existing deferred tax liability, based on an estimate of the ultimate resolution of the Section 338(h)(10) election. Under the tax allocation agreement, the Company estimated as of the IPO date, that it was obligated to pay $20.9 million to AFS and accordingly established this amount as a liability. The initial difference, which is attributable to the change in the tax basis of certain liabilities for which there is no associated step-up in the tax basis of its assets and no amounts due to AFS, resulted in an increase to additional paid-in capital of $28.1 million during 2004. The Company has paid ACE and correspondingly reduced its liability, $5.0 million and $0.6 million for Nine Months 2006 and Nine Months 2005, respectively.

11. Variable Interest Entities and Special Purpose Entities

Assured Guaranty provides financial guarantees in respect of debt obligations of special purpose entities, including variable interest entities (VIE s). Assured Guaranty s variable interest exists through this financial guaranty insurance or credit derivative contract. The transaction structure generally provides certain financial protections to Assured Guaranty. This financial protection can take several forms, the most common are over-collateralization, first loss protection (or subordination) and excess spread. In the case of over-collateralization (i.e. the principal amount of the securitized assets exceeds the principal amount of the structured finance obligations guaranteed by Assured Guaranty), the structure allows defaults of the securitized assets before a default is experienced on the structured finance obligation guaranteed by Assured Guaranty. In the case of first loss, the financial guaranty insurance policy only covers a senior layer of losses of multiple obligations issued by special purpose entities, including VIE s. The first loss exposure with respect to the assets is either retained by the seller or sold off in the form of equity or mezzanine debt to other investors. In the case of excess spread, the financial assets contributed to special purpose entities, including VIE s, generate interest cash flows that are in excess of the interest payments on the debt issued by the special purpose entity. Such excess spread is typically distributed through the transaction s cash flow waterfall and may be used to create additional credit enhancement, applied to redeem debt issued by the special purpose entity (thereby creating additional over-collateralization), or distributed to equity or other investors in the transaction.

There are two different accounting frameworks applicable to special purpose entities (SPE); the qualifying SPE (QSPE) framework under FAS 140; and the VIE framework under Financial Interpretation (FIN) 46R Consolidation of Variable Interest Entities . The applicable framework depends on the nature of the entity and Assured Guaranty s relation to that entity. The QSPE framework is applicable when an entity transfers (sells) financial assets to a SPE meeting certain criteria as defined in FAS 140. These criteria are designed to ensure that the activities of the entity are essentially predetermined in their entirety at the inception of the vehicle; decision making is limited and restricted to certain events, and that the transferor of the financial assets cannot exercise control over the entity and the assets therein. Entities meeting these criteria are not consolidated by the transferor or other counterparty, as long as the entity does not have the unilateral ability to liquidate or to cause it to no longer meet the QSPE criteria. SPE s meeting all of FAS 140 s criteria for a QSPE are not within the scope of FIN 46 and as such, need not be assessed for consolidation. When the SPE does not meet the QSPE criteria, consolidation is assessed pursuant to FIN 46R. Under FIN 46R, a VIE is defined as an entity that is not assessed for consolidation by determining which party maintains a controlling financial interest. As such, a VIE (i) lacks enough equity investment at risk to permit the entity to finance its activities without additional subordinated financial support from other parties, (ii) its equity owners lack the right to make significant decisions affecting the entity s operations, and (iii) its equity owners do not have an obligation to absorb or the right to receive the entity s losses or returns. FIN 46R requires a variable interest holder (e.g., an investor in the entity or a financial guarantor) to consolidate that VIE if that holder will absorb a majority of the expected losses of the VIE, receive a majority of the residual returns of the VIE, or both. Assured Guaranty determines whether it is the primary beneficiary of a VIE by first performing a qualitative analysis of the VIE that includes, among other factors, its capital structure, contractual terms, which variable interests create or absorb variability, related party relationships and the design of the VIE. When qualitative analysis is not conclusive Assured Guaranty performs a quantitative analysis. To date the results of the qualitative and quantitative analyses have indicated that Assured Guaranty does not have a majority of the variability and as a result these VIE s are not consolidated in Assured Guaranty s financial statements.

Qualifying Special Purpose Entities:

During the third quarter of 2006, Assured Guaranty issued a financial guaranty on financial assets that were transferred into a special purpose entity for which the business purpose of that entity was to provide a financial guarantee client with funding for their debt obligation. This entity met the characteristics of a QSPE in accordance with FAS 140. QSPEs are not subject to the requirements of FIN 46R and accordingly are not consolidated in Assured Guaranty s financial statements. QSPEs are legal entities that are demonstrably distinct from Assured Guaranty, and neither Assured Guaranty, nor its affiliates or its agents can unilaterally dissolve the QSPE. The QSPE s permitted activities are contractually limited to purchasing assets, issuing notes to fund such purchase, and related administrative services. Pursuant to the terms of Assured Guaranty s insurance policy, insurance premiums are paid to Assured Guaranty by the QSPE and are earned in a manner consistent with other insurance policies, over the risk period. Any losses incurred would be included in Assured Guaranty s Consolidated Statements of Operations.

12. Segment Reporting

The Company has four principal business segments: (1) financial guaranty direct, which includes transactions whereby the Company provides an unconditional and irrevocable guaranty that indemnifies the holder of a financial obligation against non-payment of principal and interest when due, and could take the form of a credit derivative; (2) financial guaranty reinsurance, which includes agreements whereby the Company is a reinsurer and agrees to indemnify a primary insurance company against part or all of the loss which the latter may sustain under a policy it has issued; (3) mortgage guaranty, which includes mortgage guaranty insurance and reinsurance whereby the Company provides protection against the default of borrowers on mortgage loans; and (4) other, which includes several lines of business in which the Company is no longer active, including, but not limited to equity layer credit protection, trade credit reinsurance and title reinsurance.

The Company does not segregate assets and liabilities at a segment level since management reviews and controls these assets and liabilities on a consolidated basis. The Company allocates operating expenses to each segment based on a comprehensive cost study. During 2006, the Company implemented a new operating expense allocation methodology to more closely allocate expenses to the individual operating segments. This new methodology was based on a comprehensive study and is based on departmental time estimates and headcount. 2005 amounts have been reclassified to show this new methodology on a comparative basis. Management uses underwriting gains as the primary measure of each segment s financial performance.

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

	Three Months Ended September 30, 2006				
	Financial Guaranty Direct	Financial Guaranty Reinsurance	Mortgage Guaranty	Other	Total
	(in millions of U.S. dollars)				
Gross written premiums	$ 41.9	$ 29.7	$ 1.9	$ 0.1	$ 73.6
Net written premiums	41.5	29.7	1.9		73.1
Net earned premiums	21.8	25.4	4.9		51.9
Loss and loss adjustment expenses	(0.3)	1.8	0.4	(1.0)	0.9
Profit commission expense		0.7	0.9		1.6
Acquisition costs	2.1	8.9	0.3		11.3
Other operating expenses	12.2	3.9	0.4		16.5
Underwriting gain	$ 7.7	$ 10.1	$ 2.9	$ 1.0	$ 21.6

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	Three Months Ended September 30, 2005				
	Financial Guaranty Direct	Financial Guaranty Reinsurance	Mortgage Guaranty	Other	Total
	(in millions of U.S. dollars)				
Gross written premiums	$ 24.9	$ 27.3	$ 1.7	$ 21.6	$ 75.6
Net written premiums	24.2	27.3	1.7		53.2
Net earned premiums	18.3	32.0	4.3		54.5
Loss and loss adjustment expenses	(4.0)	4.3	0.3	(1.3)	(0.8)
Profit commission expense		1.1	0.9		2.0
Acquisition costs	1.6	11.0	0.4		13.0
Other operating expenses	11.9	2.9	0.3		15.0
Underwriting gain	$ 8.8	$ 12.8	$ 2.4	$ 1.3	$ 25.3

	Nine Months Ended September 30, 2006				
	Financial Guaranty Direct	Financial Guaranty Reinsurance	Mortgage Guaranty	Other	Total
	(in millions of U.S. dollars)				
Gross written premiums	$ 140.5	$ 90.2	$ 5.7	$ 4.0	$ 240.5
Net written premiums	139.0	89.5	5.7		234.2
Net earned premiums	63.7	71.8	12.7		148.2
Loss and loss adjustment expenses	(4.6)	10.3	0.6	(12.3)	(6.0)
Profit commission expense		2.2	2.5		4.7
Acquisition costs	6.4	26.1	0.9		33.4
Other operating expenses	37.6	10.7	1.0		49.3
Underwriting gain	$ 24.3	$ 22.6	$ 7.7	$ 12.3	$ 66.8

	Nine Months Ended September 30, 2005				
	Financial Guaranty Direct	Financial Guaranty Reinsurance	Mortgage Guaranty	Other	Total
	(in millions of U.S. dollars)				
Gross written premiums	$ 69.6	$ 69.5	$ 23.0	$ 32.0	$ 194.1
Net written premiums	67.6	69.2	23.0		159.9
Net earned premiums	54.7	82.2	14.0		150.9
Loss and loss adjustment expenses	(0.5)	(66.9)	0.5	(2.4)	(69.3)
Profit commission expense		3.4	2.9		6.4
Acquisition costs	4.7	28.6	1.5		34.9
Other operating expenses	32.8	10.4	0.9		44.0
Underwriting gain	$ 17.7	$ 106.8	$ 8.2	$ 2.4	$ 134.9

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

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
	(in millions of U.S. dollars)			
Total underwriting gain	$ 21.6	$ 25.3	$ 66.8	$ 134.9
Net investment income	28.5	24.4	82.0	71.2
Net realized investment gains (losses)	0.1	0.2	(1.9)	3.6
Unrealized (losses) gains on derivative financial instruments	(1.6)	0.3	4.2	(9.1)
Other income		0.1		0.2
Interest expense	(3.4)	(3.4)	(10.1)	(10.1)
Other expense	(0.6)	(0.6)	(1.9)	(3.1)
Income before provision for income taxes	$ 44.5	$ 46.3	$ 139.0	$ 187.6

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

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
	(in millions of U.S. dollars)			
Financial guaranty direct:				
Public finance	$ 2.6	$ 0.7	$ 5.4	$ 1.3
Structured finance	19.2	17.6	58.3	53.4
Total	21.8	18.3	63.7	54.7
Financial guaranty reinsurance:				
Public finance	16.9	21.1	46.9	44.8
Structured finance	8.5	10.9	24.9	37.4
Total	25.4	32.0	71.8	82.2
Mortgage guaranty:				
Mortgage guaranty	4.9	4.3	12.7	14.0
Total net earned premiums	**$ 51.9**	**$ 54.5**	**$ 148.2**	**$ 150.9**

The other segment had an underwriting gain of $1.0 million and $1.3 million for Third Quarter 2006 and Third Quarter 2005, respectively, and $12.3 million and $2.4 million for Nine Months 2006 and Nine Months 2005, respectively, as the equity layer credit protection business recorded loss recoveries in both periods.

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13. Subsidiary Information

The following tables present the unaudited condensed consolidated financial information for Assured Guaranty Ltd., Assured Guaranty US Holdings Inc., of which AGC is a subsidiary and other subsidiaries of Assured Guaranty Ltd. as of September 30, 2006 and December 31, 2005 and for the three and nine months ended September 30, 2006 and 2005.

CONDENSED CONSOLIDATING BALANCE SHEET
AS OF SEPTEMBER 30, 2006
(in thousands of U.S. dollars)

	Assured Guaranty Ltd. (Parent Company)	Assured Guaranty US Holdings Inc.	AG Re and Other Subsidiaries	Consolidating Adjustments	Assured Guaranty Ltd. (Consolidated)
Assets					
Total investments and cash	$ 658	$ 1,223,581	$ 1,170,858	$	$ 2,395,097
Investment in subsidiaries	1,770,387			(1,770,387)	
Deferred acquisition costs		72,494	137,690		210,184
Reinsurance recoverable		7,352	4,009	(1,964)	9,397
Goodwill		85,417			85,417
Premiums receivable		18,236	25,119	(10,075)	33,280
Other	6,251	125,680	60,015	(80,472)	111,474
Total assets	$ 1,777,296	$ 1,532,760	$ 1,397,691	$ (1,862,898)	$ 2,844,849
Liabilities and shareholders equity					
Liabilities					
Unearned premium reserves	$	$ 250,557	$ 421,471	$ (52,291)	$ 619,737
Reserves for losses and loss adjustment expenses		60,008	58,870	(1,964)	116,914
Profit commissions payable		3,715	27,264		30,979
Deferred income taxes		46,196	(1,341)		44,855
Long-term debt		197,367			197,367
Other	20,405	56,221	39,736	(38,256)	78,106
Total liabilities	20,405	614,064	546,000	(92,511)	1,087,958
Total shareholders equity					