

ASSURED GUARANTY LTD
Form 10-Q
May 09, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2014

Or
 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

(State or other jurisdiction

of incorporation)

98-0429991

(I.R.S. employer

identification no.)

30 Woodbourne Avenue

Hamilton HM 08

Bermuda

(Address of principal executive 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 No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of registrant's Common Shares (\$0.01 par value) outstanding as of May 7, 2014 was 179,629,028 (includes 47,747 unvested restricted shares).

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Assured Guaranty Ltd.

Consolidated Balance Sheets (unaudited)

(dollars in millions except per share and share amounts)

	As of March 31, 2014	As of December 31, 2013
Assets		
Investment portfolio:		
Fixed-maturity securities, available-for-sale, at fair value (amortized cost of \$9,729 and \$9,488)	\$10,094	\$9,711
Short-term investments, at fair value	720	904
Other invested assets	134	170
Total investment portfolio	10,948	10,785
Cash	219	184
Premiums receivable, net of commissions payable	863	876
Ceded unearned premium reserve	454	452
Deferred acquisition costs	122	124
Reinsurance recoverable on unpaid losses	37	36
Salvage and subrogation recoverable	241	174
Credit derivative assets	78	94
Deferred tax asset, net	637	688
Financial guaranty variable interest entities' assets, at fair value	1,257	2,565
Other assets	250	309
Total assets	\$15,106	\$16,287
Liabilities and shareholders' equity		
Unearned premium reserve	\$4,504	\$4,595
Loss and loss adjustment expense reserve	636	592
Reinsurance balances payable, net	165	148
Long-term debt	812	816
Credit derivative liabilities	2,001	1,787
Current income tax payable	26	44
Financial guaranty variable interest entities' liabilities with recourse, at fair value	1,346	1,790
Financial guaranty variable interest entities' liabilities without recourse, at fair value	101	1,081
Other liabilities	306	319
Total liabilities	9,897	11,172
Commitments and contingencies (See Note 14)		
Common stock (\$0.01 par value, 500,000,000 shares authorized; 181,158,708 and 182,177,866 shares issued and outstanding)	2	2
Additional paid-in capital	2,434	2,466
Retained earnings	2,504	2,482
Accumulated other comprehensive income, net of tax of \$117 and \$71	264	160
Deferred equity compensation (320,193 and 320,193 shares)	5	5
Total shareholders' equity	5,209	5,115

Total liabilities and shareholders' equity	\$15,106	\$16,287
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The accompanying notes are an integral part of these consolidated financial statements.

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Assured Guaranty Ltd.

Consolidated Statements of Operations (unaudited)

(dollars in millions except per share amounts)

	Three Months Ended March 31,	
	2014	2013
Revenues		
Net earned premiums	\$132	\$248
Net investment income	103	94
Net realized investment gains (losses):		
Other-than-temporary impairment losses	(3	) (1
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	2	4
Net impairment loss	(5	) (5
Other net realized investment gains (losses)	7	33
Net realized investment gains (losses)	2	28
Net change in fair value of credit derivatives:		
Realized gains (losses) and other settlements	19	18
Net unrealized gains (losses)	(230	) (610
Net change in fair value of credit derivatives	(211	) (592
Fair value gains (losses) on committed capital securities	(9	) (10
Fair value gains (losses) on financial guaranty variable interest entities	157	70
Other income (loss)	21	(14
Total revenues	195	(176
Expenses		
Loss and loss adjustment expenses	41	(48
Amortization of deferred acquisition costs	5	3
Interest expense	20	21
Other operating expenses	60	60
Total expenses	126	36
Income (loss) before income taxes	69	(212
Provision (benefit) for income taxes		
Current	21	55
Deferred	6	(123
Total provision (benefit) for income taxes	27	(68
Net income (loss)	\$42	\$(144
Earnings per share:		
Basic	\$0.23	\$(0.74
Diluted	\$0.23	\$(0.74
Dividends per share	\$0.11	\$0.10

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

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Assured Guaranty Ltd.

Consolidated Statements of Comprehensive Income (unaudited)

(in millions)

	Three Months Ended March 31,	
	2014	2013
Net income (loss)	\$42	\$(144)
Unrealized holding gains (losses) arising during the period on:		
Investments with no other-than-temporary impairment, net of tax provision (benefit) of \$41 and \$(19)	94	(50)
Investments with other-than-temporary impairment, net of tax provision (benefit) of \$3 and \$(8)	8	(16)
Unrealized holding gains (losses) arising during the period, net of tax	102	(66)
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of \$(1) and \$(2)	(2)	(3)
Change in net unrealized gains on investments	104	(63)
Other, net of tax provision	0	(5)
Other comprehensive income (loss)	\$104	\$(68)
Comprehensive income (loss)	\$146	\$(212)

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

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Assured Guaranty Ltd.

Consolidated Statement of Shareholders' Equity (unaudited)

For the Three Months Ended March 31, 2014

(dollars in millions, except share data)

	Common Shares Outstanding	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Deferred Equity Compensation	Total Shareholders' Equity
Balance at December 31, 2013	182,177,866	\$ 2	\$2,466	\$2,482	\$ 160	\$ 5	\$5,115
Net income	—	—	—	42	—	—	42
Dividends (\$0.11 per share)	—	—	—	(20)	—	—	(20)
Common stock repurchases	(1,350,443)	0	(35)	—	—	—	(35)
Share-based compensation and other	331,285	0	3	—	—	—	3
Other comprehensive income	—	—	—	—	104	—	104
Balance at March 31, 2014	181,158,708	\$ 2	\$2,434	\$2,504	\$ 264	\$ 5	\$5,209

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

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Assured Guaranty Ltd.

Consolidated Statements of Cash Flows (unaudited)

(in millions)

	Three Months Ended March 31,	
	2014	2013
Net cash flows provided by (used in) operating activities	\$101	\$(14)
Investing activities		
Fixed-maturity securities:		
Purchases	(517)	(510)
Sales	155	183
Maturities	148	283
Net sales (purchases) of short-term investments	184	88
Proceeds from paydowns on financial guaranty variable interest entities' assets	286	138
Other	19	55
Net cash flows provided by (used in) investing activities	275	237
Financing activities		
Dividends paid	(20)	(19)
Repurchases of common stock	(35)	(39)
Share activity under option and incentive plans	0	(2)
Paydowns of financial guaranty variable interest entities' liabilities	(281)	(167)
Repayment of long-term debt	(6)	(6)
Net cash flows provided by (used in) financing activities	(342)	(233)
Effect of exchange rate changes	1	(3)
Increase (decrease) in cash	35	(13)
Cash at beginning of period	184	138
Cash at end of period	\$219	\$125
Supplemental cash flow information		
Cash paid (received) during the period for:		
Income taxes	\$37	\$32
Interest	\$8	\$9

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

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (unaudited)

March 31, 2014

1. Business and Basis of Presentation

Business

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

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

Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) and, in the opinion of management, reflect all adjustments that are of a normal recurring nature, necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated financial guaranty variable interest entities (“FG VIEs”) for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim consolidated financial statements are as of March 31, 2014 and cover the three-month period ended March 31, 2014 (“First Quarter 2014”) and the three-month period ended March 31, 2013 (“First Quarter 2013”). Certain financial information that is

normally included in annual financial statements prepared in accordance with GAAP, but is not required for interim reporting purposes, has been condensed or omitted. The year-end balance sheet data was derived from audited financial statements.

The unaudited interim consolidated financial statements include the accounts of AGL, its direct and indirect subsidiaries (collectively, the “Subsidiaries”) and its consolidated FG VIEs. Intercompany accounts and transactions between and among all consolidated entities have been eliminated. Certain prior year balances have been reclassified to conform to the current year’s presentation.

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

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The Company's principal insurance company subsidiaries are:

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

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

2. Rating Actions and Quarterly Developments

Rating Actions

On March 18, 2014, Standard & Poor's Ratings Services ("S&P") upgraded the financial strength ratings of all of AGL's insurance subsidiaries to AA (stable outlook) from AA- (stable outlook). The most recent rating action of Moody's Investors Service, Inc. ("Moody's") was on February 10, 2014, when it affirmed the financial strength ratings of AGM, AGC and AG Re, and affirmed the outlooks on AGM's and AGC's ratings at stable but changed the outlook on AG Re's rating to negative. Kroll Bond Rating Agency's most recent action was to assign a financial strength rating of AA+ (stable outlook) to MAC on July 22, 2013. In the last several years, S&P and Moody's have changed, multiple times, their financial strength ratings of the Company's insurance subsidiaries, or changed the outlook on such ratings. There can be no assurance that the rating agencies will not take negative action on the Company's financial strength ratings in the future.

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

♣ Note 5, Expected Loss to be Paid

♣ Note 8, Financial Guaranty Contracts Accounted for as Credit Derivatives

♣ Note 13, Reinsurance and Other Monoline Exposures

♣ Note 15, Long Term Debt and Credit Facilities (regarding the impact on the Company's insured leveraged lease transactions)

Quarterly Developments

Repurchase of Common Shares: The Company repurchased approximately 1.4 million common shares in First Quarter 2014. See Note 17, Shareholders' Equity, for more information.

Reinsurance: The Company entered into commutation agreements to reassume previously ceded business. See Note 13, Reinsurance and Other Monoline Exposures.

3. Outstanding Exposure

The Company's financial guaranty contracts are written in either insurance or credit derivative form, but collectively are considered financial guaranty contracts. The Company seeks to limit its exposure to losses by underwriting obligations that are investment grade at inception, diversifying its insured portfolio and maintaining rigorous subordination or collateralization requirements on structured finance obligations. The Company also has utilized reinsurance by ceding business to third-party

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reinsurers. The Company provides financial guaranties with respect to debt obligations of special purpose entities, including variable interest entities ("VIEs"). Some of these VIEs are consolidated as described in Note 9, Consolidated Variable Interest Entities. The outstanding par and Debt Service amounts presented below include outstanding exposures on VIEs whether or not they are consolidated.

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

Surveillance Categories

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

The Company monitors its investment grade credits to determine whether any new credits need to be internally downgraded to BIG. The Company refreshes its internal credit ratings on individual credits in quarterly, semi-annual or annual cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. The Company's credit ratings on assumed credits are based on the Company's reviews of low-rated credits or credits in volatile sectors, unless such information is not available, in which case, the ceding company's credit rating of the transactions are used. The Company models the performance of many of its structured finance transactions as part of its periodic internal credit rating review of them. The Company models most assumed residential mortgage-backed security ("RMBS") credits with par above \$1 million, as well as certain RMBS credits below that amount.

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

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

-

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

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

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

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Components of Outstanding Exposure

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

Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	March 31, 2014	December 31, 2013	March 31, 2014	December 31, 2013
	(in millions)			
Public finance	\$639,981	\$650,924	\$601,433	\$610,011
Structured finance	81,195	86,456	75,535	80,524
Total financial guaranty	\$721,176	\$737,380	\$676,968	\$690,535

In addition to the amounts shown in the table above, the Company's net mortgage guaranty insurance debt service was approximately \$153 million as of March 31, 2014. The net mortgage guaranty insurance in force constitutes assumed excess of loss business written between 2004 and 2006 and comprises \$145 million covering loans originated in Ireland and \$8 million covering loans originated in the U.K.

Financial Guaranty Portfolio by Internal Rating
As of March 31, 2014

Rating Category	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S		Structured Finance Non-U.S		Total	
	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%
	(dollars in millions)									
AAA	\$4,658	1.3 %	\$1,020	2.9 %	\$29,868	53.9 %	\$8,856	68.2 %	\$44,402	9.9 %
AA	104,577	30.2	427	1.2	9,396	17.0	570	4.4	114,970	25.6
A	187,433	54.1	9,595	27.6	2,340	4.2	661	5.1	200,029	44.4
BBB	40,783	11.8	22,173	63.7	3,496	6.3	1,829	14.1	68,281	15.2
BIG	8,977	2.6	1,611	4.6	10,293	18.6	1,062	8.2	21,943	4.9
Total net par outstanding (excluding loss mitigation bonds)	\$346,428	100.0%	\$34,826	100.0%	\$55,393	100.0%	\$12,978	100.0%	\$449,625	100.0%
Loss Mitigation Bonds	32		—		1,204		—		1,236	
Net Par Outstanding (including loss mitigation)	\$346,460		\$34,826		\$56,597		\$12,978		\$450,861	

bonds)

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Financial Guaranty Portfolio by Internal Rating

As of December 31, 2013

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

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

In addition to amounts shown in the tables above, the Company had outstanding commitments to provide guaranties of \$577 million for structured finance and \$330 million for public finance obligations at March 31, 2014. The structured finance commitments include the unfunded component of pooled corporate and other transactions. Public finance commitments typically relate to primary and secondary public finance debt issuances. The expiration dates for the public finance commitments range between April 15, 2014 and February 25, 2017, with \$206 million expiring prior to December 31, 2014. The commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty's request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.

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Components of BIG Portfolio
 Components of BIG Net Par Outstanding
 (Insurance and Credit Derivative Form)
 As of March 31, 2014

	BIG Net Par Outstanding				Net Par Outstanding	BIG Net Par as a % of Total Net Par Outstanding	
	BIG 1	BIG 2	BIG 3 (in millions)	Total BIG			
First lien U.S. RMBS:							
Prime first lien	\$77	\$289	\$29	\$395	\$528	0.1	%
Alt-A first lien	703	787	1,223	2,713	3,478	0.6	
Option ARM	66	59	440	565	877	0.1	
Subprime	227	860	769	1,856	5,921	0.4	
Second lien U.S. RMBS:							
Closed-end second lien	8	19	116	143	239	0.0	
Home equity lines of credit ("HELOCs")	1,480	19	235	1,734	1,982	0.4	
Total U.S. RMBS	2,561	2,033	2,812	7,406	13,025	1.6	
Trust preferred securities ("TruPS")	1,235	343	—	1,578	4,826	0.4	
Other structured finance	1,348	304	719	2,371	50,520	0.5	
U.S. public finance	8,117	419	441	8,977	346,428	2.0	
Non-U.S. public finance	989	622	—	1,611	34,826	0.4	
Total	\$14,250	\$3,721	\$3,972	\$21,943	\$449,625	4.9	%

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

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

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Total	\$14,751	\$3,949	\$3,838	\$22,538	\$459,107	4.9	%
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Table of ContentsBIG Net Par Outstanding
and Number of Risks
As of March 31, 2014

Description	Net Par Outstanding			Number of Risks(2)		
	Financial Guaranty Insurance(1) (dollars in millions)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
BIG:						
Category 1	\$12,242	\$2,008	\$14,250	193	24	217
Category 2	2,253	1,468	3,721	80	21	101
Category 3	2,872	1,100	3,972	109	27	136
Total BIG	\$17,367	\$4,576	\$21,943	382	72	454

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

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

(1) Includes net par outstanding for FG VIEs.

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

Direct Economic Exposure to the Selected European Countries

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

Table of ContentsNet Direct Economic Exposure to Selected European Countries(1)
As of March 31, 2014

	Hungary (2)	Ireland	Italy	Portugal (2)	Spain (2)	Total
Sovereign and sub-sovereign exposure:						
Non-infrastructure public finance (3)	\$—	\$—	\$1,026	\$98	\$274	\$1,398
Infrastructure finance	370	—	18	12	156	556
Sub-total	370	—	1,044	110	430	1,954
Non-sovereign exposure:						
Regulated utilities	—	—	235	—	—	235
RMBS	217	145	312	—	—	674
Sub-total	217	145	547	—	—	909
Total	\$587	\$145	\$1,591	\$110	\$430	\$2,863
Total BIG	\$587	\$—	\$—	\$110	\$429	\$1,126

(1) While the Company's exposures are shown in U.S. dollars, the obligations the Company insures are in various currencies, including U.S. dollars and Euros. Included in the table above is \$145 million of reinsurance assumed on a 2004 - 2006 pool of Irish residential mortgages that is part of the Company's remaining legacy mortgage reinsurance business. One of the residential mortgage-backed securities included in the table above includes residential mortgages in both Italy and Germany, and only the portion of the transaction equal to the portion of the original mortgage pool in Italian mortgages is shown in the table.

(2) See Note 5, Expected Loss to be Paid.

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

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

The Company has excluded from the exposure tables above its indirect economic exposure to the Selected European Countries through policies it provides on (a) pooled corporate and (b) commercial receivables transactions. The Company considers economic exposure to a selected European Country to be indirect when the exposure relates to only a small portion of an insured transaction that otherwise is not related to a Selected European Country. The Company has reviewed transactions through which it believes it may have indirect exposure to the Selected European Countries that is material to the transaction and calculated total net indirect exposure to Selected European Countries in non-sovereign pooled corporate and non-sovereign commercial receivables to be \$710 million and \$89 million, respectively, based on the proportion of the insured par equal to the proportion of obligors identified as being domiciled in a Selected European Country.

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Exposure to Puerto Rico

The Company insures general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating \$5.3 billion net par. The Company rates \$5.1 billion net par of that amount BIG. The following table shows estimated amortization of the general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations insured and rated BIG by the Company. The Company guarantees payments of interest and principal when those amounts are scheduled to be paid and cannot be required to pay on an accelerated basis. The column labeled “Estimated BIG Net Debt Service Amortization” shows the total amount of principal and interest due in the period indicated and represents the maximum net amount the Company would be required to pay on BIG Puerto Rico exposures in a given period, assuming the obligors paid nothing on all of those obligations in that period.

Amortization Schedule of BIG Net Par Outstanding
and BIG Net Debt Service Outstanding of Puerto Rico
As of March 31, 2014

	Estimated BIG Net Par Amortization (in millions)	Estimated BIG Net Debt Service Amortization
2014 (April 1 - June 30)	\$—	\$64
2014 (July 1 - September 30)	254	315
2014 (October 1 - December 31)	—	61
2015	364	601
2016	289	509
2017	208	415
2018	159	358
2019-2023	884	1,718
2024-2028	937	1,566
2029-2033	697	1,125
After 2033	1,281	1,574
Total	\$5,073	\$8,306

Recent announcements and actions by the Governor and his administration indicate officials of the Commonwealth are focused on measures to help Puerto Rico operate within its financial resources and maintain its access to the capital markets. All Puerto Rico credits insured by the Company are current on their debt service payments. Neither Puerto Rico nor its related authorities and public corporations are eligible debtors under Chapter 9 of the U.S. Bankruptcy Code. However, Puerto Rico faces high debt levels, a declining population and an economy that has been in recession since 2006. Puerto Rico has been operating with a structural budget deficit in recent years, and its two largest pension funds are significantly underfunded.

4. Financial Guaranty Insurance Premiums

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

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Net Earned Premiums

	First Quarter 2014	2013
	(in millions)	
Scheduled net earned premiums	\$107	\$128
Acceleration of net earned premiums	19	113
Accretion of discount on net premiums receivable	6	7
Net earned premiums(1)	\$132	\$248

(1) Excludes \$17 million and \$18 million for First Quarter 2014 and 2013, respectively, related to consolidated FG VIEs.

Components of Unearned Premium Reserve

	As of March 31, 2014			As of December 31, 2013		
	Gross	Ceded	Net(1)	Gross	Ceded	Net(1)
	(in millions)					
Deferred premium revenue:						
Financial guaranty insurance	\$4,567	\$472	\$4,095	\$4,647	\$470	\$4,177
Other	5	—	5	5	—	5
Deferred premium revenue	\$4,572	\$472	\$4,100	\$4,652	\$470	\$4,182
Contra-paid	(68	) (18	) (50	) (57	) (18	) (39
Unearned premium reserve	\$4,504	\$454	\$4,050	\$4,595	\$452	\$4,143

(1) Excludes \$137 million and \$187 million of deferred premium revenue, and \$49 million and \$55 million of contra-paid related to FG VIEs as of March 31, 2014 and December 31, 2013, respectively.

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

	First Quarter 2014	2013
	(in millions)	
Beginning of period, December 31	\$876	\$1,005
Gross premium written, net of commissions on assumed business	33	17
Gross premiums received, net of commissions on assumed business	(53	) (53
Adjustments:		
Changes in the expected term	(3	) 1
Accretion of discount, net of commissions on assumed business	7	9
Foreign exchange translation	2	(23
Other adjustments	1	0
End of period, March 31 (1)	\$863	\$956

(1) Excludes \$18 million and \$28 million as of March 31, 2014 and March 31, 2013, respectively, related to consolidated FG VIEs.

Gains or losses due to foreign exchange rate changes relate to installment premium receivables denominated in currencies other than the U.S. dollar. Approximately 49% and 48% of installment premiums at March 31, 2014 and December 31, 2013 respectively, are denominated in currencies other than the U.S. dollar, primarily the Euro and British Pound Sterling.

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

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

	As of March 31, 2014 (in millions)
2014 (April 1 - June 30)	\$46
2014 (July 1 - September 30)	24
2014 (October 1 – December 31)	26
2015	95
2016	86
2017	79
2018	71
2019-2023	282
2024-2028	176
2029-2033	123
After 2033	130
Total(1)	\$1,138

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

Scheduled Net Earned Premiums

	As of March 31, 2014 (in millions)
2014 (April 1 - June 30)	\$105
2014 (July 1 - September 30)	103
2014 (October 1–December 31)	99
2015	359
2016	335
2017	297
2018	271
2019 - 2023	1,058
2024 - 2028	676
2029 - 2033	412
After 2033	380
Total present value basis(1)	4,095
Discount	239
Total future value	\$4,334

(1)Excludes scheduled net earned premiums on consolidated FG VIEs of \$137 million.

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Selected Information for Policies Paid in Installments

	As of March 31, 2014	As of December 31, 2013		
	(dollars in millions)			
Premiums receivable, net of commission payable	\$863	\$876		
Gross deferred premium revenue	1,560	1,576		
Weighted-average risk-free rate used to discount premiums	3.5	% 3.4		%
Weighted-average period of premiums receivable (in years)	9.4	9.4		

5. Expected Loss to be Paid

The following table presents a roll forward of the present value of net expected loss to be paid for all contracts, whether accounted for as insurance, credit derivatives or FG VIEs, by sector, after the benefit for net expected recoveries for contractual breaches of representations and warranties ("R&W"). The Company used weighted average risk-free rates for U.S. dollar denominated obligations, which ranged from 0.0% to 3.97% as of March 31, 2014 and 0.0% to 4.44% as of December 31, 2013.

Net Expected Loss to be Paid

After Net Expected Recoveries for Breaches of R&W

Roll Forward by Sector

First Quarter 2014

	Net Expected Loss to be Paid as of December 31, 2013(2) (in millions)	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of March 31, 2014(2)	
U.S. RMBS:					
First lien:					
Prime first lien	\$21	\$ (3)	\$ —	\$18	
Alt-A first lien	304	8	(4)	308	
Option ARM	(9)	(15)	(4)	(28))
Subprime	304	(7)	(2)	295)
Total first lien	620	(17)	(10)	593)
Second lien:					
Closed-end second lien	(11)	5	2	(4))
HELOCs	(116)	2	5	(109))
Total second lien	(127)	7	7	(113))
Total U.S. RMBS	493	(10)	(3)	480)
TruPS	51	(19)	—	32	
Other structured finance	120	19	(1)	138)
U.S. public finance	264	23	(6)	281)
Non-U.S. public finance	57	—	—	57	
Other insurance	(3)	(1)	—	(4))
Total	\$982	\$12	\$(10)	\$984)

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

	Net Expected Loss to be Paid as of December 31, 2012 (in millions)	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of March 31, 2013
U.S. RMBS:				
First lien:				
Prime first lien	\$6	\$6	\$(1)	) \$11
Alt-A first lien	315	9	(11)	) 313
Option ARM	(131)	) (138)	) (58)	) (327)
Subprime	242	25	(4)	) 263
Total first lien	432	(98)	) (74)	) 260
Second lien:				
Closed-end second lien	(39)	) 1	17	(21)
HELOCs	(111)	) (3)	) (8)	) (122)
Total second lien	(150)	) (2)	) 9	(143)
Total U.S. RMBS	282	(100)	) (65)	) 117
TruPS	27	(3)	) (1)	) 23
Other structured finance	312	(2)	) (3)	) 307
U.S. public finance	7	7	(23)	) (9)
Non-U.S public finance	52	10	—	62
Other insurance	(3)	) (10)	) —	(13)
Total	\$677	\$(98)	) \$(92)	) \$487

Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are (1) 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.

Includes expected loss adjustment expenses ("LAE") to be paid for mitigating claim liabilities of \$29 million as of (2) March 31, 2014 and \$34 million as of December 31, 2013. The Company paid \$6 million and \$13 million in LAE for First Quarter 2014 and 2013, respectively.

Table of ContentsNet Expected Recoveries from
Breaches of R&W Rollforward
First Quarter 2014

	Future Net R&W Benefit as of December 31, 2013	R&W Development and Accretion of Discount During First Quarter 2014	R&W Recovered During First Quarter 2014(1)	Future Net R&W Benefit as of March 31, 2014
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	\$4	\$ (1	) \$—	\$ 3
Alt-A first lien	274	3	(8	) 269
Option ARM	173	9	(30	) 152
Subprime	118	28	—	146
Total first lien	569	39	(38	) 570
Second lien:				
Closed-end second lien	98	(3	) —	95
HELOC	45	12	(1	) 56
Total second lien	143	9	(1	) 151
Total	\$712	\$ 48	\$(39	) \$ 721

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

	Future Net R&W Benefit as of December 31, 2012	R&W Development and Accretion of Discount During First Quarter 2013	R&W Recovered During First Quarter 2013(1)	Future Net R&W Benefit as of March 31, 2013
	(in millions)			
U.S. RMBS:				
First lien:				
Prime first lien	\$4	\$ —	\$—	\$ 4
Alt-A first lien	378	(8	) (8	) 362
Option ARM	591	153	(54	) 690
Subprime	109	4	—	113
Total first lien	1,082	149	(62	) 1,169
Second lien:				
Closed-end second lien	138	(9	) (21	) 108
HELOC	150	17	(6	) 161
Total second lien	288	8	(27	) 269
Total	\$1,370	\$ 157	\$(89	) \$ 1,438

(1)Gross amounts recovered were \$41 million and \$92 million for First Quarter 2014 and 2013, respectively.

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

Net Expected Loss to be Paid
By Accounting Model
As of March 31, 2014

	Financial Guaranty Insurance (in millions)	FG VIEs(1)	Credit Derivatives	Total
U.S. RMBS:				
First lien:				
Prime first lien	\$3	\$—	\$15	\$18
Alt-A first lien	212	19	77	308
Option ARM	(38	) —	10	(28
Subprime	140	80	75	295
Total first lien	317	99	177	593
Second lien:				
Closed-end second lien	(32	) 26	2	(4
HELOCs	(92	) (17	) —	(109
Total second lien	(124	) 9	2	(113
Total U.S. RMBS	193	108	179	480
TruPS	2	—	30	32
Other structured finance	176	—	(38	) 138
U.S. public finance	281	—	—	281
Non-U.S. public finance	56	—	1	57
Subtotal	\$708	\$108	\$172	988
Other				(4
Total				\$984

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

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

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

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

Net Economic Loss Development
By Accounting Model
First Quarter 2014

	Financial Guaranty Insurance (in millions)	FG VIEs(1)	Credit Derivatives(2)	Total
U.S. RMBS:				
First lien:				
Prime first lien	\$—	\$—	\$(3	) \$(3
Alt-A first lien	19	(12	) 1	8
Option ARM	(16	) 1	—	(15
Subprime	(8	) (2	) 3	(7
Total first lien	(5	) (13	) 1	(17
Second lien:				
Closed-end second lien	(1	) 2	4	5
HELOCs	(56	) 58	—	2
Total second lien	(57	) 60	4	7
Total U.S. RMBS	(62	) 47	5	(10
TruPS	(1	) —	(18	) (19
Other structured finance	17	—	2	19
U.S. public finance	23	—	—	23
Non-U.S. public finance	—	—	—	—
Subtotal	\$(23) \$47	\$(11) 13
Other				(1
Total				\$12

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Net Economic Loss Development
By Accounting Model
First Quarter 2013

	Financial Guaranty Insurance (in millions)	FG VIEs(1)	Credit Derivatives(2)	Total
U.S. RMBS:				
First lien:				
Prime first lien	\$—	\$—	\$6	\$6
Alt-A first lien	5	(1	) 5	9
Option ARM	(93	) (37	) (8	) (138
Subprime	12	4	9	25
Total first lien	(76	) (34	) 12	(98
Second lien:				
Closed-end second lien	5	(3	) (1	) 1
HELOCs	(7	) 4	—	(3
Total second lien	(2	) 1	(1	) (2
Total U.S. RMBS	(78	) (33	) 11	(100
TruPS	0	—	(3	) (3
Other structured finance	(10	) —	8	(2
U.S. public finance	7	—	—	7
Non-U.S. public finance	9	—	1	10
Subtotal	\$(72	) \$(33	) \$17	(88
Other				(10
Total				\$(98

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

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

Approach to Projecting Losses in U.S. RMBS

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

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

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

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

In order to derive collateral pool losses from the collateral pool defaults it has projected, the Company applies a loss severity. The loss severity is the amount of loss the transaction experiences on a defaulted loan after the application of net proceeds from the disposal of the underlying property. The Company projects loss severities by sector based on its experience to date. Further detail regarding the assumptions and variables the Company used to project collateral losses in its U.S. RMBS portfolio may be found below in the sections "U.S. First Lien RMBS Loss Projections: Alt-A First Lien, Option ARM, Subprime and Prime" and "U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second Lien" These variables are interrelated, difficult to predict and subject to considerable volatility. If actual experience differs from the Company's assumptions, the losses incurred could be materially different from the estimate. The Company continues to update its evaluation of these exposures as new information becomes available.

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

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

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

First Quarter 2014 U.S. RMBS Loss Projections

The Company's RMBS loss projection methodology assumes that the housing and mortgage markets will continue improving. Each quarter the Company makes a judgment as to whether to change the assumptions it uses to make RMBS loss projections based on its observation during the quarter of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and, for first liens, loss severity) as well as the residential property market and economy in general. To the extent it observes changes, it makes a judgment as to whether those changes are normal fluctuations or part of a trend. Based on such observations the Company chose to use the same general assumptions to project RMBS losses as of March 31, 2014 as it used as of December 31, 2013.

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

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

First Lien Liquidation Rates

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

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

approximately the amount of defaults that were calculated to emerge from the various delinquency categories. The CDR thus calculated individually on the delinquent collateral pool for each RMBS is then used as the starting point for the CDR curve used to project defaults of the presently performing loans.

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

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

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

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

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

Initial CPR	0.0	%– 11.6%	0.0	%– 15.7%
Final CPR	15%		15%	

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

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The rate at which the principal amount of loans is voluntarily prepaid may impact both the amount of losses projected (since that amount is a function of the conditional default rate, the loss severity and the loan balance over time) as 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 voluntarily CPR follows a similar pattern to that of the conditional default rate. The current level of voluntary prepayments is assumed to continue for the plateau period before gradually increasing over 12 months to the final CPR, which is assumed to be 15% in the base case. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. These assumptions are the same as those the Company used for December 31, 2013.

In estimating expected losses, the Company modeled and probability weighted sensitivities for first lien transactions by varying its assumptions of how fast a recovery is expected to occur. One of the variables used to model sensitivities was how quickly the conditional default rate returned to its modeled equilibrium, which was defined as 5% of the initial conditional default rate. The Company also stressed CPR and the speed of recovery of loss severity rates. The Company probability weighted a total of five scenarios (including its base case) as of March 31, 2014. The Company used a similar approach to establish its pessimistic and optimistic scenarios as of March 31, 2014 as it used as of December 31, 2013, increasing and decreasing the periods of stress from those used in the base case. In a somewhat more stressful environment than that of the base case, where the conditional default rate plateau was extended six months (to be 42 months long) before the same more gradual conditional default rate recovery and loss severities were assumed to recover over 4.5 rather than 2.5 years (and subprime loss severities were assumed to recover only to 60%), expected loss to be paid would increase from current projections by approximately \$39 million for Alt-A first liens, \$13 million for Option ARM, \$93 million for subprime and \$4 million for prime transactions.

In an even more stressful scenario where loss severities were assumed to rise and then recover over nine years and the initial ramp-down of the conditional default rate was assumed to occur over 15 months and other assumptions were the same as the other stress scenario, expected loss to be paid would increase from current projections by approximately \$104 million for Alt-A first liens, \$31 million for Option ARM, \$138 million for subprime and \$11 million for prime transactions. The Company also considered two scenarios where the recovery was faster than in its base case. In a scenario with a somewhat less stressful environment than the base case, where conditional default rate recovery was somewhat less gradual and the initial subprime loss severity rate was assumed to be 80% for 18 months and was assumed to recover to 40% over 2.5 years, expected loss to be paid would increase from current projections by approximately \$1 million for Alt-A first lien and would decrease by \$10 million for Option ARM, \$25 million for subprime and \$1 million for prime transactions. In an even less stressful scenario where the conditional default rate plateau was six months shorter (30 months, effectively assuming that liquidation rates would improve) and the conditional default rate recovery was more pronounced, (including an initial ramp-down of the conditional default rate over nine months), expected loss to be paid would decrease from current projections by approximately \$36 million for Alt-A first lien, \$28 million for Option ARM, \$78 million for subprime and \$4 million for prime transactions.

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

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

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

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Second Lien RMBS(1)

	As of March 31, 2014	As of December 31, 2013
HELOC key assumptions		
Plateau CDR	1.9 %– 7.3%	2.3 %– 7.7%
Final CDR trended down to	0.4 %– 3.2%	0.4 %– 3.2%
Period until final CDR	34 months	34 months
Initial CPR	2.3 %– 21.0%	2.7 %– 21.5%
Final CPR	10%	10%
Loss severity	98%	98%
Closed-end second lien key assumptions	As of March 31, 2014	As of December 31, 2013
Plateau CDR	6.7 %– 15.5%	7.3 %– 15.1%
Final CDR trended down to	3.5 %– 9.1%	3.5 %– 9.1%
Period until final CDR	34 months	34 months
Initial CPR	2.9 %– 12.8%	3.1 %– 12.0%
Final CPR	10%	10%
Loss severity	98%	98%

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

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

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

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

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CPR at December 31, 2013. To the extent that prepayments differ from projected levels it could materially change the Company's projected excess spread and losses.

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

In estimating expected losses, the Company modeled and probability weighted three possible CDR curves applicable to the period preceding the return to the long-term steady state CDR. The Company believes that the level of the elevated CDR and the length of time it will persist is the primary driver behind the likely amount of losses the collateral will suffer. The Company continues to evaluate the assumptions affecting its modeling results.

As of March 31, 2014, the Company's base case assumed a one month CDR plateau and a 28 month ramp-down (for a total stress period of 34 months). The Company also modeled a scenario with a longer period of elevated defaults and another with a shorter period of elevated defaults and weighted them the same as of December 31, 2013. Increasing the CDR plateau to four months and increasing the ramp-down by five months to 33 months (for a total stress period of 42 months) would increase the expected loss by approximately \$24 million for HELOC transactions and \$2 million for closed-end second lien transactions. On the other hand, keeping the CDR plateau at one month but decreasing the length of the CDR ramp-down to 18 months (for a total stress period of 24 months) would decrease the expected loss by approximately \$22 million for HELOC transactions and \$2 million for closed-end second lien transactions.

Breaches of Representations and Warranties

Generally, when mortgage loans are transferred into a securitization, the loan originator(s) and/or sponsor(s) provide R&W that the loans meet certain characteristics, and a breach of such R&W often requires that the loan be repurchased from the securitization. In many of the transactions the Company insures, it is in a position to enforce these R&W provisions. Soon after the Company observed the deterioration in the performance of its insured RMBS following the deterioration of the residential mortgage and property markets, the Company began using internal resources as well as third party forensic underwriting firms and legal firms to pursue breaches of R&W on a loan-by-loan basis. Where a provider of R&W refused to honor its repurchase obligations, the Company sometimes chose to initiate litigation. See "Recovery Litigation" below. The Company's success in pursuing these strategies permitted the Company to enter into agreements with R&W providers under which those providers made payments to the Company, agreed to make payments to the Company in the future, and / or repurchased loans from the transactions, all in return for releases of related liability by the Company. Such agreements provide the Company with many of the benefits of pursuing the R&W claims on a loan by loan basis or through litigation, but without the related expense and uncertainty. The Company continues to pursue these strategies against R&W providers with which it does not yet have agreements.

Using these strategies, through March 31, 2014 the Company has caused entities providing R&Ws to pay or agree to pay approximately \$3.7 billion (gross of reinsurance) in respect of their R&W liabilities for transactions in which the Company has provided insurance.

	(in millions)
Agreement amounts already received	\$2,716
Agreement amounts projected to be received in the future	402
Repurchase amounts paid into the relevant RMBS prior to settlement (1)	579
Total R&W payments, gross of reinsurance	\$3,697

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

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Based on this success, the Company has included in its net expected loss estimates as of March 31, 2014 an estimated net benefit related to breaches of R&W of \$721 million, which includes \$384 million from agreements with R&W providers and \$337 million in transactions where the Company does not yet have such an agreement, all net of reinsurance.

Representations and Warranties Agreements (1)

	Agreement Date	Current Net Par Covered	Receipts to March 31, 2014 (net of reinsurance)	Estimated Future Receipts (net of reinsurance)	Eligible Assets Held in Trust (gross of reinsurance)
	(in millions)				
Bank of America - First Lien	April 2011	\$1,023	\$490	\$195	\$585
Bank of America - Second Lien	April 2011	1,335	968	NA	NA
Deutsche Bank	May 2012 and October 2013	1,649	235	100	142
UBS	May 2013	778	410	33	147
Others	Various	1,019	394	56	NA
Total		\$5,804	\$2,497	\$384	\$874

This table relates to past and projected future recoveries under R&W and related agreements. Excluded from this table is the \$337 million of future net recoveries the Company projects receiving from R&W counterparties in (1) transactions with \$1,379 million of net par outstanding as of March 31, 2014 not covered by current agreements. Also excluded from this table is \$773 million of net par partially covered by agreements but for which the Company projects receiving additional amounts.

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

Bank of America. Under the Company's agreement with Bank of America Corporation and certain of its subsidiaries ("Bank of America"), Bank of America agreed to reimburse the Company for 80% of claims on the first lien transactions covered by the agreement that the Company pays in the future, until the aggregate lifetime collateral losses (not insurance losses or claims) on those transactions reach \$6.6 billion. As of March 31, 2014 aggregate lifetime collateral losses on those transactions was \$3.9 billion, and the Company was projecting in its base case that such collateral losses would eventually reach \$5.1 billion.

Deutsche Bank. Under the Company's May 2012 agreement with Deutsche Bank AG and certain of its affiliates (collectively, "Deutsche Bank"), Deutsche Bank agreed to reimburse the Company for certain claims it pays in the future on eight first and second lien transactions, including 80% of claims it pays on those transactions until the aggregate lifetime claims (before reimbursement) reach \$319 million. As of March 31, 2014, the Company was projecting in its base case that such aggregate lifetime claims would remain below \$319 million. In the event aggregate lifetime claims paid exceed \$389 million, Deutsche Bank must reimburse Assured Guaranty for 85% of such claims paid (in excess of \$389 million) until such claims paid reach \$600 million.

The agreement also requires Deutsche Bank to reimburse AGC for future claims it pays on certain RMBS re-securitizations. The amount available for reimbursement of claim payments is based on a percentage of the losses that occur in certain uninsured tranches (“Uninsured Tranches”) within the eight transactions described above: 60% of losses on the Uninsured Tranches (up to \$141 million of losses), 60% of such losses (for losses between \$141 million and \$185 million), and 100% of such losses (for losses from \$185 million to \$248 million). Losses on the Uninsured Tranches from \$141 million to \$185 million and above \$248 million are not included in the calculation of AGC's reimbursement amount for re-securitization claim payments. As of March 31, 2014, the Company was projecting in its base case that losses on the Uninsured Tranches would be \$153 million. Pursuant to the CDS termination on October 10, 2013 described below, a portion of Deutsche Bank's reimbursement obligation was applied to the terminated CDS. After giving effect to application of the portion of the reimbursement obligation to the terminated

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CDS, as well as to reimbursements related to other covered RMBS re-securitizations, and based on the Company's base case projections for losses on the Uninsured Tranches, the Company expects that \$24 million will be available to reimburse AGC for re-securitization claim payments on the remaining re-securitizations. Except for the reimbursement obligation based on losses occurring on the Uninsured Tranches and the termination agreed to described below, the agreement with Deutsche Bank does not cover transactions where the Company has provided protection to Deutsche Bank on RMBS transactions in CDS form.

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

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

The Company calculated an expected recovery of \$337 million from breaches of R&W in transactions not covered by agreements with \$1,379 million of net par outstanding as of March 31, 2014 and \$773 million of net par partially covered by agreements but for which the Company projects receiving additional amounts. The Company did not incorporate any gain contingencies from potential litigation in its estimated repurchases. The amount the Company will ultimately recover related to such contractual R&W is uncertain and subject to a number of factors including the counterparty's ability to pay, the number and loss amount of loans determined to have breached R&W and, potentially, negotiated settlements or litigation recoveries. As such, the Company's estimate of recoveries is uncertain and actual amounts realized may differ significantly from these estimates. In arriving at the expected recovery from breaches of R&W not already covered by agreements, the Company considered the creditworthiness of the provider of the R&W, the number of breaches found on defaulted loans, the success rate in resolving these breaches across those transactions where material repurchases have been made and the potential amount of time until the recovery is realized. The calculation of expected recovery from breaches of such contractual R&W involved a variety of scenarios which ranged from the Company recovering substantially all of the losses it incurred due to violations of R&W to the Company realizing limited recoveries. These scenarios were probability weighted in order to determine the recovery incorporated into the Company's estimate of expected losses. This approach was used for both loans that had already defaulted and those assumed to default in the future. The Company adjusts the calculation of its expected recovery from breaches of R&W based on changing facts and circumstances with respect to each counterparty and transaction.

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

The Company accounts for the loss sharing obligations under the R&W agreements on financial guaranty insurance contracts as subrogation, offsetting the losses it projects by an R&W benefit from the relevant party for the applicable portion of the projected loss amount. Proceeds projected to be reimbursed to the Company on transactions where the Company has already paid claims are viewed as a recovery on paid losses. For transactions where the Company has not already paid claims, projected recoveries reduce projected loss estimates. In either case, projected recoveries have

no effect on the amount of the Company's exposure. See Notes 7, Fair Value Measurement and 9, Consolidated Variable Interest Entities.

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U.S. RMBS Risks with R&W Benefit

	Number of Risks (1) as of		Debt Service as of	
	March 31, 2014	December 31, 2013	March 31, 2014	December 31, 2013
			(dollars in millions)	
Prime first lien	1	1	\$36	\$38
Alt-A first lien	20	19	2,791	2,856
Option ARM	10	9	589	641
Subprime	5	5	985	998
Closed-end second lien	4	4	155	158
HELOC	5	4	141	320
Total	45	42	\$4,697	\$5,011

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

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

Components of R&W Development

	First Quarter 2014	2013
	(in millions)	
Change in recovery assumptions as the result of additional file review and recovery success	\$10	\$11
Estimated increase (decrease) in defaults that will result in additional (lower) breaches	0	1
Settlements and anticipated settlements	35	142
Accretion of discount on balance	3	3
Total	\$48	\$157

“XXX” Life Insurance Transactions

The Company’s \$2.7 billion net par of XXX life insurance transactions as of March 31, 2014 include \$598 million rated BIG. The BIG “XXX” life insurance reserve securitizations are based on discrete blocks of individual life insurance business. In each such transaction the monies raised by the sale of the bonds insured by the Company were used to capitalize a special purpose vehicle that provides reinsurance to a life insurer or reinsurer. The monies are invested at inception in accounts managed by third-party investment managers.

The BIG “XXX” life insurance transactions consist of two transactions, notes issued by each of Ballantyne Re p.l.c and Orkney Re II p.l.c. These transactions had material amounts of their assets invested in U.S. RMBS transactions. Based on its analysis of the information currently available, including estimates of future investment performance, and projected credit impairments on the invested assets and performance of the blocks of life insurance business at March 31, 2014, the Company’s projected net expected loss to be paid is \$85 million. The overall increase of approximately \$12 million in expected loss to be paid during First Quarter 2014 is due primarily to changes in lapse assumptions on the underlying life insurance policies in the Ballantyne Re p.l.c transaction and a decrease in the risk

free rates used to discount the losses.

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Student Loan Transactions

The Company has insured or reinsured \$2.8 billion net par of student loan securitizations, of which \$1.9 billion was issued by private issuers and classified as asset-backed and \$0.9 billion was issued by public authorities and classified as public finance. Of these amounts, \$204 million and \$251 million, respectively, are rated BIG. The Company is projecting approximately \$68 million of net expected loss to be paid in these portfolios. In general, the losses are due to: (i) the poor credit performance of private student loan collateral and high loss severities, or (ii) high interest rates on auction rate securities with respect to which the auctions have failed. The largest of these losses was approximately \$28 million and related to a transaction backed by a pool of private student loans assumed by AG Re from another monoline insurer. The guaranteed bonds were issued as auction rate securities that now bear a high rate of interest due to the downgrade of the primary insurer's financial strength rating. Further, the underlying loan collateral has performed below expectations. The overall increase of \$4 million in net expected loss during First Quarter 2014 is primarily due to a decrease in the risk free rates used to discount the losses along with some deterioration in collateral performance.

Trust Preferred Securities Collateralized Debt Obligations

The Company has insured or reinsured \$4.8 billion of net par (71% of which is in CDS form) of collateralized debt obligations ("CDOs") backed by TruPS and similar debt instruments, or "TruPS CDOs." Of the \$4.8 billion, \$1.6 billion is rated BIG. The underlying collateral in the TruPS CDOs consists of subordinated debt instruments such as TruPS issued by bank holding companies and similar instruments issued by insurance companies, real estate investment trusts ("REITs") and other real estate related issuers.

The Company projects losses for TruPS CDOs by projecting the performance of the asset pools across several scenarios (which it weights) and applying the CDO structures to the resulting cash flows. At March 31, 2014, the Company has projected expected losses to be paid for TruPS CDOs of \$32 million. The decrease of approximately \$19 million in First Quarter 2014 was due primarily to improving collateral performance.

Selected U.S. Public Finance Transactions

The Company insures general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating \$5.3 billion net par. The Company rates \$5.1 billion net par of that amount BIG. Information regarding the Company's exposure to general obligations of Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations, please refer "Puerto Rico Exposure" in Note 3, Outstanding Exposure.

Many U.S. municipalities and related entities continue to be under increased pressure, and a few have filed for protection under the U.S. Bankruptcy Code, entered into state processes designed to help municipalities in fiscal distress or otherwise indicated they may consider not meeting their obligations to make timely payments on their debts. Given some of these developments, and the circumstances surrounding each instance, the ultimate outcome cannot be certain and may lead to an increase in defaults on some of the Company's insured public finance obligations. The Company will continue to analyze developments in each of these matters closely. The municipalities whose obligations the Company has insured that have filed for protection under Chapter 9 of the U.S. Bankruptcy Code and have not been resolved are: Detroit, Michigan and Stockton, California.

The Company has net par exposure to the City of Detroit, Michigan of \$2.1 billion as of March 31, 2014. On July 18, 2013, the City of Detroit filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. Most of the Company's net par exposure relates to \$1.0 billion of sewer revenue bonds and \$784 million of water revenue bonds, both of which the Company rates BBB. Both the sewer and water systems provide services to areas that extend beyond the

city limits, and the bonds are secured by a lien on "special revenues." The Company also has net par exposure of \$146 million to the City's general obligation bonds (which are secured by a pledge of the unlimited tax, full faith, credit and resources of the City and the specific ad valorem taxes approved by the voters solely to pay debt service on the general obligation bonds) and \$175 million of the City's Certificates of Participation (which are unsecured unconditional contractual obligations of the City), both of which the Company rates BIG. On April 9, 2014, the City and the Company reached a tentative settlement with respect to the treatment of the unlimited tax general obligation bonds insured by the Company. The agreement provides for the confirmation of both the secured status of such general obligation bonds and the existence of a valid lien on the City's pledged property tax revenues, a finding that such revenues constitute "special revenues" under the U.S. Bankruptcy Code, and the provision of additional security for such general obligation bonds in the form of a statutory lien on, and intercept of, the City's distributable state aid. After giving effect to post-petition payments made by Assured Guaranty on such general obligation bonds, the settlement results in a minimum ultimate recovery of approximately 74% on such general obligation bonds, with the ability to

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achieve a higher ultimate recovery rate over time if other debt creditors' recoveries reach certain specified thresholds. The settlement is subject to a number of conditions, including confirmation of a plan of adjustment. The City has filed a proposed plan of adjustment and disclosure statement with the Bankruptcy Court, amended most recently on April 16, 2014.

On June 28, 2012, the City of Stockton, California filed for bankruptcy protection under Chapter 9 of the U.S. Bankruptcy Code. The Company's net exposure to the City's general fund is \$119 million, consisting of pension obligation bonds. The Company also had exposure to lease obligation bonds; as of March 31, 2014, the Company owned all of such bonds and held them in its investment portfolio. As of March 31, 2014, the Company had paid \$32 million in net claims. On October 3, 2013, the Company reached a tentative settlement with the City regarding the treatment of the bonds insured by the Company in the City's proposed plan of adjustment. Under the terms of the settlement, the Company will receive title to an office building, the ground lease of which secures the lease revenue bonds, and will also be entitled to certain fixed payments and certain variable payments contingent on the City's revenue growth. The settlement is subject to a number of conditions, including a sales tax increase (which was approved by voters on November 5, 2013), confirmation of a plan of adjustment that implements the terms of the settlement and definitive documentation. Pursuant to an order of the Bankruptcy Court, the City held a vote of its creditors on its proposed plan of adjustment; all but one of the classes polled voted to accept the plan. The court proceeding to determine whether to confirm the plan of adjustment is expected to begin in May 2014. The Company expects the plan to be confirmed and implemented during 2014.

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

The Company projects that its total future expected net loss across its troubled U.S. public finance credits as of March 31, 2014 will be \$281 million. As of December 31, 2013 the Company was projecting a net expected loss of \$264 million across its troubled U.S. public finance credits. The net increase of \$17 million in expected loss was primarily attributable to negative developments with respect to the City of Detroit offset, in part, by the modest reduction in exposure to Puerto Rico.

Certain Selected European Country Transactions

The Company insures and reinsures credits with sub-sovereign exposure to various Spanish and Portuguese issuers where a Spanish and Portuguese sovereign default may cause the regions also to default. The Company's gross exposure to these Spanish and Portuguese credits is €435 million and €92 million, respectively and exposure net of reinsurance for Spanish and Portuguese credits is €312 million and €80 million, respectively. The Company rates most of these issuers in the BB category due to the financial condition of Spain and Portugal and their dependence on the sovereign. The Company's Hungary exposure is to infrastructure bonds dependent on payments from Hungarian governmental entities and covered mortgage bonds issued by Hungarian banks. The Company's gross exposure to these Hungarian credits is \$623 million and its exposure net of reinsurance is \$587 million, all of which all is rated BIG. The Company estimated net expected losses of \$51 million related to these Spanish, Portuguese and Hungarian credits, which is largely unchanged from the amount reported as of December 31, 2013.

Manufactured Housing

The Company insures or reinsures a total of \$248 million net par of securities backed by manufactured housing loans, of which \$175 million is rated BIG. The Company has expected loss to be paid of \$27 million as of March 31, 2014, up from \$26 million as of December 31, 2013, due primarily to the decrease in risk free rates used to discount losses.

Infrastructure Finance

The Company has insured exposure of approximately \$3.0 billion to infrastructure transactions with refinancing risk as to which the Company may need to make claim payments that it did not anticipate paying when the policies were issued. Although the Company may not experience ultimate loss on a particular transaction, the aggregate amount of the claim payments may be substantial and reimbursement may not occur for an extended time, if at all. These transactions generally involve long-term infrastructure projects that were financed by bonds that mature prior to the expiration of the project concession. The Company expected the cash flows from these projects to be sufficient to repay all of the debt over the life of the project concession, but also expected the debt to be refinanced in the market at or prior to its maturity. Due to market conditions, the Company may have to pay a claim when the debt matures, and then recover its payment from cash flows produced by the project in the future. The Company generally projects that in most scenarios it will be fully reimbursed for

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such payments. However, the recovery of the payments is uncertain and may take from 10 to 35 years, depending on the transaction and the performance of the underlying collateral. The Company estimates total claims for the remaining two largest transactions with significant refinancing risk, assuming no refinancing, and based on certain performance assumptions could be \$1.8 billion on a gross basis; such claims would be payable from 2017 through 2022.

Recovery Litigation

RMBS Transactions

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

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

Credit Suisse: AGM and AGC have sued DLJ Mortgage Capital, Inc. (“DLJ”) and Credit Suisse Securities (USA) LLC (“Credit Suisse”) on first lien U.S. RMBS transactions insured by them. Although DLJ and Credit Suisse successfully dismissed certain causes of action and claims for relief asserted in the complaint, the primary causes of action against DLJ for breach of R&W and breach of its repurchase obligations remained. On May 6, 2014, the Appellate Division, First Department unanimously reversed certain aspects of the partial dismissal by the Supreme Court of the State of New York of certain claims for relief by holding as a matter of law that AGM’s and AGC’s remedies for breach of R&W are not limited to the repurchase remedy. AGM and AGC had filed an amended complaint against DLJ and Credit Suisse (and added Credit Suisse First Boston Mortgage Securities Corp. as a defendant), asserting claims of fraud and material misrepresentation in the inducement of an insurance contract, in addition to their existing breach of contract claims. The defendants have filed a motion to dismiss certain aspects of the fraud claim against DLJ and Credit Suisse, all of the claims against Credit Suisse First Boston Mortgage Securities Corp., and AGM and AGC’s claims for compensatory damages in the form of all claims paid and to be paid by AGM and AGC. The motion to dismiss is currently pending.

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

“XXX” Life Insurance Transactions

In December 2008, Assured Guaranty (UK) Ltd. (“AGUK”) filed an action against J.P. Morgan Investment Management Inc. (“JPMIM”), the investment manager in the Orkney Re II transaction, in the Supreme Court of the State of New York alleging that JPMIM engaged in breaches of fiduciary duty, gross negligence and breaches of contract based upon its handling of the investments of Orkney Re II. After AGUK’s claims were dismissed with prejudice in January 2010, AGUK was successful in its subsequent motions and appeals and, as of December 2011, all

of AGUK's claims for breaches of fiduciary duty, gross negligence and contract were reinstated in full. Separately, at the trial court level, discovery is ongoing.

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6. Financial Guaranty Insurance Losses

Insurance Contracts' Loss Information

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

Loss and LAE Reserve and Salvage and Subrogation Recoverable

Net of Reinsurance

Insurance Contracts

	As of March 31, 2014			As of December 31, 2013			
	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net Reserve (Recoverable)	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net Reserve (Recoverable)	
	(in millions)						
U.S. RMBS:							
First lien:							
Prime first lien	\$3	\$—	\$3	\$3	\$—	\$3	
Alt-A first lien	112	—	112	108	—	108	
Option ARM	19	57	(38) 22	47	(25)
Subprime	135	1	134	143	2	141	
First lien	269	58	211	276	49	227	
Second lien:							
Closed-end second lien	5	43	(38) 5	45	(40)
HELOC	6	117	(111) 5	127	(122)
Second lien	11	160	(149) 10	172	(162)
Total U.S. RMBS	280	218	62	286	221	65	
TruPS	1	—	1	2	—	2	
Other structured finance	159	5	154	145	6	139	
U.S. public finance	212	8	204	189	8	181	
Non-U.S. public finance	36	—	36	35	—	35	
Financial guaranty	688	231	457	657	235	422	
Other	1	5	(4) 2	5	(3)
Subtotal	689	236	453	659	240	419	
Effect of consolidating FG VIEs	(90) (17) (73) (103) (85) (18)
Total (1)	\$599	\$219	\$380	\$556	\$155	\$401	

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

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

Components of Net Reserves (Salvage)

Insurance Contracts

	As of March 31, 2014	As of December 31, 2013
	(in millions)	
Loss and LAE reserve	\$636	\$592
Reinsurance recoverable on unpaid losses	(37	) (36
Loss and LAE reserve, net	599	556
Salvage and subrogation recoverable	(241	) (174
Salvage and subrogation payable(1)	22	19
Salvage and subrogation recoverable, net	(219	) (155
Subtotal	380	401
Other recoverables(2)	(17	) (15
Net reserves (salvage)	363	386
Less: other (non-financial guaranty business)	(4	) (3
Net reserves (salvage)	\$367	\$389

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

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

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

	As of March 31, 2014			As of December 31, 2013		
	For all Financial Guaranty Insurance Contracts (in millions)	Effect of Consolidating FG VIEs	Reported on Balance Sheet(1)	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet(1)
Salvage and subrogation recoverable, net	\$126	\$—	\$ 126	\$122	\$(49	) \$ 73
Loss and LAE reserve, net	378	(14	) 364	363	(24	) 339

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

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

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

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Net Expected Loss to be Expensed
Financial Guaranty Insurance Contracts

	As of March 31, 2014 (in millions)
Net expected loss to be paid	\$816
Less: net expected loss to be paid for FG VIEs	108
Total	708
Contra-paid, net	50
Salvage and subrogation recoverable, net of reinsurance	214
Loss and LAE reserve, net of reinsurance	(598)
Other recoveries (1)	17
Net expected loss to be expensed (2)	\$391

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

(2) Excludes \$84 million as of March 31, 2014, related to consolidated FG VIEs.

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

Net Expected Loss to be Expensed
Insurance Contracts

	As of March 31, 2014 (in millions)
2014 (April 1– June 30)	\$12
2014 (July 1– September 30)	11
2014 (October 1–December 31)	10
2015	42
2016	38
2017	31
2018	28
2019 - 2023	98
2024 - 2028	57
2029 - 2033	37
After 2033	27
Net expected loss to be expensed(1)	391
Discount	419
Total future value	\$810

(1) Consolidation of FG VIEs resulted in reductions of \$84 million in net expected loss to be expensed which is on a present value basis.

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

Loss and LAE
Reported on the

Consolidated Statements of Operations

	First Quarter	
	2014	2013
	(in millions)	
Structured Finance:		
U.S. RMBS:		
First lien:		
Prime first lien	\$0	\$—
Alt-A first lien	7	9
Option ARM	(8	) (83
Subprime	(8	) 11
First lien	(9	) (63
Second lien:		
Closed-end second lien	—	20
HELOC	8	3
Second lien	8	23
Total U.S. RMBS	(1	) (40
TruPS	(1) —
Other structured finance	16	(12
Structured finance	14	(52
Public Finance:		
U.S. public finance	26	(4
Non-U.S. public finance	1	1
Public finance	27	(3
Subtotal	41	(55
Other	(1) —
Loss and LAE insurance contracts before FG VIE consolidation	40	(55
Effect of consolidating FG VIEs	1	7
Loss and LAE	\$41	\$(48

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

Financial Guaranty Insurance
BIG Transaction Loss Summary
As of March 31, 2014

	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)	193	(74)	80	(23)	109	(32)	382	—	382
Remaining weighted-average contract period (in years)	10.2	7.9	8.3	5.6	10.0	8.5	10.4	—	10.4
Outstanding exposure:									
Principal	\$14,981	\$(2,739)	\$2,412	\$(159)	\$2,980	\$(108)	\$17,367	\$—	\$17,367
Interest	7,836	(1,107)	1,139	(52)	1,197	(40)	8,973	—	8,973
Total(2)	\$22,817	\$(3,846)	\$3,551	\$(211)	\$4,177	\$(148)	\$26,340	\$—	\$26,340
Expected cash outflows (inflows)	\$1,901	\$(528)	\$727	\$(33)	\$1,695	\$(59)	\$3,703	\$(358)	\$3,345
Potential recoveries									
Undiscounted R&W	(174)	10	(108)	4	(374)	14	(628)	15	(613)
Other(3)	(1,780)	506	(255)	17	(302)	18	(1,796)	191	(1,605)
Total potential recoveries	(1,954)	516	(363)	21	(676)	32	(2,424)	206	(2,218)
Subtotal	(53)	(12)	364	(12)	1,019	(27)	1,279	(152)	1,127
Discount	13	1	(120)	3	(366)	6	(463)	44	(419)
Present value of expected cash flows	\$(40)	\$(11)	\$244	\$(9)	\$				